

## WISCONSIN PUBLIC POWER INC.

Notes to Financial Statements

December 31, 2005 and 2004

### (1) Summary of Significant Accounting Policies

#### (a) *Organization and Operations*

Wisconsin Public Power Inc. (WPPI) is a municipal electric company and political subdivision of the State of Wisconsin, formed in 1980. The purpose and function of WPPI is to provide an adequate, economical, and reliable wholesale supply of electricity to its members for distribution by the members' electric utilities to their retail customers. WPPI is owned by its member municipalities, which govern its policies. WPPI had 40 members as of December 31, 2005.

WPPI sells power to its members under power sales contracts that remain in effect until December 31, 2037. Under the contracts, WPPI has agreed to sell and deliver to each member, and each member has agreed to take and pay for its electric power requirements, with certain exceptions related to existing member-owned hydroelectric facilities and other specified generation. Also, from time to time, WPPI sells capacity and energy at market prices to other entities.

In addition to its power supply program, WPPI offers various services to members that are intended to enable members to operate their electric systems more efficiently. The services include rate analyses, rate comparisons, computer network support, large-customer billing, equipment testing, joint purchasing of equipment and supplies, joint arrangements for disposal of hazardous waste, and various energy- and customer-related programs.

WPPI supplies the power requirements of its members from a mix of resources, including an undivided 20% ownership in the 535 MW Boswell Unit 4 coal-fired steam unit near Grand Rapids, Minnesota; two 84 MW combustion turbine units near Fond du Lac, Wisconsin; a 54 MW combustion turbine in Kaukauna; member generation under contract to WPPI; and power purchases from other entities. Minnesota Power owns the remaining interest in Boswell Unit 4 and is the operating agent responsible for operation and maintenance of the unit. WPPI's undivided ownership interest in Boswell Unit 4 is included in capital assets. WPPI pays 20% of the total cost to operate and maintain Boswell Unit 4. South Fond du Lac Units 1 and 4 are two of the four combustion turbine units located on a site owned by Alliant Energy (Alliant). Alliant owns the other two units on the site and operates and maintains the units owned by WPPI. WPPI compensates Alliant for these services. Construction was completed on the Kaukauna combustion turbine in 2004. WPPI owns the unit, and Kaukauna Utilities operates it. WPPI compensates Kaukauna Utilities for operating and maintaining the combustion turbine. The member generation under contract to WPPI consists of a number of small generating units, totaling approximately 37 MW of capacity. The remainder of WPPI's power requirements is purchased from other entities.

#### (b) *Basis of Presentation/Chart of Accounts*

The financial statements are prepared on the accrual basis of accounting, in conformity with U.S. generally accepted accounting principles, including the application of Statement of Financial Accounting Standards (SFAS) No. 71, *Accounting for the Effects of Certain Types of Regulation*, as the statement relates to the deferral of revenues and expenses to future periods in which the revenues are earned or the expenses are recovered through the rate-making process. WPPI uses the Uniform System of Accounts prescribed by the Federal Energy Regulatory Commission (FERC).

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WPPI complies with all applicable pronouncements of the Governmental Accounting Standards Board (GASB). In accordance with GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*. WPPI also complies with the pronouncements of the Financial Accounting Standards Board that do not conflict with GASB pronouncements.

**(c) *Use of Estimates in the Preparation of Financial Statements***

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**(d) *Capital Assets***

Additions to and replacements of capital assets are recorded at original cost, including allowance for borrowed funds if acquired with tax-exempt debt. Depreciation is recorded using the straight-line method using service lives of 2 to 35 years.

**(e) *Restricted Cash and Investments***

WPPI's bond resolution requires the segregation of bond proceeds and prescribes the application of WPPI's revenues. Amounts classified as restricted cash and investments on the balance sheets represent cash and investments whose use is restricted by the bond resolution.

**(f) *Unamortized Bond Issuance Costs***

Bond issuance costs are amortized over the repayment period of the related issues using a method that approximates the effective-interest method.

**(g) *Future Recoverable Costs***

Revenues from members include amounts to pay bond principal and interest. For financial reporting purposes, WPPI recognizes depreciation and amortization pertaining to fixed assets and other assets financed by bond principal. As allowed through the application of the provisions of SFAS No. 71, future recoverable costs represent the difference between depreciation and amortization of assets financed with bond proceeds and the related principal recovered in rates in the present period. These costs will be recovered in future periods when the principal amounts exceed the related depreciation and amortization.

**(h) *Other Deferred Charges***

Other deferred charges primarily represent costs associated with the buyout of WPPI's obligations under capacity purchase agreements with two of its members. As allowed through the application of SFAS No. 71, such effects have been deferred and are being amortized for rate-making purposes over the original terms of the capacity purchase agreements, which expire in 2007 and 2009, respectively.

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**(i) Cash Equivalents**

For purposes of the statements of cash flows, cash equivalents are cash and investments having an initial maturity of three months or less when purchased.

**(j) Power Sales Accounts Receivable**

Power sales accounts receivable, representing power sales to members for the period between the last billing date and the end of the period, are accrued in the period sold.

**(k) Inventories**

Inventories include fuel and repair parts. They are charged to plant or operation and maintenance expense at average cost when used. Inventories are valued at the lower of average cost or fair value.

**(l) Rates**

Rates are reviewed and adopted by WPPI's board of directors annually. Under the bond resolution, WPPI's rates are expected to yield net revenues for an annual period equal to at least 1.10 times the aggregate debt service for that period. Rates are not subject to state or federal regulation.

Beginning in 2004, in December of each year the board of directors determines how to distribute the margin above 110%. As allowed through the application of the provisions of SFAS No. 71, the margin may be deposited in the Rate Stabilization Fund and is also reported as deferred credits on the accompanying balance sheet to be distributed in future years as revenues in the statement of revenues, expenses, and changes in net assets to cover costs that otherwise would be recovered through its rates to members. For the years ended December 31, 2005 and 2004, \$628,831, and \$449,840, respectively, was deferred and added to the Rate Stabilization Fund. In 2004, \$3,016,600 of the Rate Stabilization Fund was used to curb the impact of major outages and recognized as revenue.

**(m) Taxes**

WPPI is exempt from federal, Wisconsin, and Minnesota income taxes as a political subdivision of the State of Wisconsin. Tax expense includes Minnesota property taxes, Wisconsin payments-in-lieu-of-ad valorem taxes, payroll-related taxes, and emission fees.

**(n) Vacation and Sick Leave**

Under terms of employment, employees are granted one day of sick leave per month. Employees are paid annually for any sick leave accrued in excess of 1,080 hours. Accrued sick leave is not paid to employees when they leave employment.

Employees are allowed to accumulate up to five days of vacation pay. Employees are paid annually for any accrued vacation in excess of five days. In extraordinary circumstances, the chief executive officer may allow an employee to accumulate additional vacation pay. Accrued vacation is not considered material; therefore, no liability is recorded.

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**(o) *Operating Revenues and Expenses***

Operating revenues result from exchange transactions associated with the principal activity of WPPI, the sale of electricity. Reported operating revenues are affected by the contributions to or distributions from the rate stabilization account. Operating expenses are defined as expenses directly related to, or incurred in support of, the provision of electricity and other services to the members. All other expenses are classified as nonoperating expenses.

**(p) *Fair Value of Financial Instruments***

The carrying amount of WPPI's cash and cash equivalents, receivables, and accounts payable approximates fair value because of the short maturities of these instruments. Investments are carried at fair value based on quoted market prices. The fair value of WPPI's long-term debt is estimated by discounting future cash flows using interest rates that approximate those that could currently be obtained by WPPI. The fair value of long-term debt as of December 31, 2005 and 2004 is approximately \$413 million and \$190 million, respectively.

**(q) *Reclassifications***

Certain 2004 financial statement amounts have been reclassified to conform with the 2005 presentation.

**(r) *New Accounting Pronouncements***

In March 2003, the Governmental Accounting Standards Board (GASB) issued Statement No. 40, *Deposit and Investment Risk Disclosures – an amendment of GASB Statement No. 3*. WPPI implemented Statement No. 40 during the year ended December 31, 2005. As a result of implementing this statement, WPPI revised the deposit and investment risks disclosures in note 2 to include disclosure of credit risk, concentration of credit risk, and interest rate risk.

In November 2003, the GASB issued Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. This Statement establishes accounting and financial reporting standards for impairment of capital assets. WPPI will implement Statement No. 42 beginning with the year ending December 31, 2006. WPPI is currently evaluating the impact of adopting Statement No. 42.

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**(2) Deposits and Investments**

WPPI's bond resolution requires the segregation of bond proceeds and establishment of various funds, and prescribes the application of WPPI's revenues. Also, it defines what type of securities WPPI may invest in. Funds consist principally of cash, money market funds, repurchase agreements, investments in the LGIP, treasury notes, agencies, treasury strips, and corporate bonds. The fund's purposes and balances are summarized below:

<b>Fund</b>	<b>Held by</b>	<b>Purpose</b>
Construction	Trustee	To provide for the acquisition and construction of the power supply system.
Debt Service	Trustee	To accumulate principal and interest associated with each bond series.
Debt Service Reserve	Trustee	To establish a reserve equal to the largest principal and interest payment that would have to be made in any one year during the remaining life of the bonds.
Revenue	WPPI	To accumulate revenues and to provide for the payment of expenses and for disposition of revenues to various funds.
Renewal & Replacement	WPPI	To provide a reserve to be applied to the payment of the costs of renewals, replacements, and repairs to the power supply system.
Self-Insurance	WPPI	To provide a reserve to be applied to the payment of claims and losses arising from hazards and risks to the extent that the insurance required to be maintained does not cover such claims or losses.
Rate Stabilization	WPPI	To accumulate revenues which will be used to reduce rates in a future period.
Decommissioning	WPPI	To accumulate funds to pay for the eventual costs of decommissioning, retirement, or disposal of major facilities.

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	<u>2005</u>	<u>2004</u>
Restricted cash and investments:		
Noncurrent:		
Debt service reserve accounts	\$ 16,938,383	8,130,135
Renewal & Replacement Fund	5,895,010	2,260,369
Self-Insurance Fund	3,084,255	2,078,805
Rate Stabilization Fund	35,425,534	33,736,915
Decommissioning	2,290,767	2,139,509
Construction Fund	134,992,319	—
Debt Service Funds	25,344,883	—
Total noncurrent	<u>223,971,151</u>	<u>48,345,733</u>
Current:		
Construction Fund	33,900,980	1,096,213
Debt Service Funds	17,390,555	4,854,553
Total current	<u>51,291,535</u>	<u>5,950,766</u>
Total restricted cash and investments	<u>275,262,686</u>	<u>54,296,499</u>
Unrestricted cash and investments:		
Noncurrent:		
Investments	657,941	6,557,361
Investment in ATC	32,257,900	26,975,087
	<u>32,915,841</u>	<u>33,532,448</u>
Current cash and investments:		
Petty cash	300	300
Revenue Fund	18,160,397	15,085,538
	<u>18,160,697</u>	<u>15,085,838</u>
Total unrestricted cash and investments	<u>51,076,538</u>	<u>48,618,286</u>
Total cash and investments	<u>\$ 326,339,224</u>	<u>102,914,785</u>

WPPI's investments are potentially subject to various risks, including the following:

- **Custodial credit risk** – The risk that in the event of a failure of the counterparty to an investment transaction (typically a brokerage firm or financial institution), the government would not be able to recover the value of the investment or collateral securities.
- **Credit risk** – The risk than an issuer or other counterparty to an investment will not fulfill its obligations.

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**Concentration risk** – Investing 5% or more of WPPI’s portfolio in the securities of a single issuer. This disclosure excludes U.S. Government Securities that are explicitly guaranteed by the U.S. government.

- **Interest rate risk** – The risk of potential variability in the fair value of fixed rate investments resulting from changes in interest rates (the longer the period for which an interest rate is fixed, the greater the risk). The weighted average maturity of the money market mutual funds is 60 days.

As of December 31, 2005, WPPI owned a portfolio of 58 individual investments consisting of 52 U.S. Government Agency securities and 6 corporate bonds. Fifty-one securities had maturities of three years or less. Seven securities were mortgage-backed securities that have monthly maturities, with final maturities ranging from 7.86 years to 18.16 years.

WPPI has a guaranteed investment contract with Morgan Stanley & Co. Inc. for capitalized interest bond proceeds for the 2005 A Debt Service Fund in the amount of \$21,583,805 as of December 31, 2005. Tranches of the funds are withdrawn semi annually in December and June of each year to make debt service payments. The final tranche of the investment is scheduled for withdrawal in June 2009.

WPPI has a guaranteed investment contract with Citigroup Global Markets Inc. for project bond proceeds for the 2005 A Construction Fund in the amount of \$102,916,623 as of December 31, 2005. Tranches of the funds are withdrawn monthly to make project payments. The final tranche of the investment is scheduled for withdrawal in December 2010.

WPPI has a guaranteed investment contract with Citigroup Global Markets Inc. for capitalized interest bond proceeds for the 2005 B Debt Service Fund in the amount of \$13,717,083 as of December 31, 2005. Tranches of the funds are withdrawn weekly to make debt service payments. The final tranche of the investment is scheduled for withdrawal in June 2010.

WPPI has a guaranteed investment contract with JP Morgan Chase Bank N.A. for project bond proceeds for the 2005 B Construction Fund in the amount of \$60,387,630 as of December 31, 2005. Tranches of the funds are withdrawn monthly to make project payments. The final tranche of the investment is scheduled for withdrawal in July 2010.

WPPI has an internal investment policy that stipulates its guidelines to help ensure safety of principal, liquidity, and diversification of its investment portfolio. Generally, permitted investments include U.S. government obligations, state and local government and corporate obligations rated in either of the two highest whole rating categories by a nationally recognized rating agency, guaranteed investment contracts, and money market mutual funds.

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Cash and investments are summarized as follows as of December 31, 2005 and 2004:

	<u>2005</u>	<u>2004</u>
U.S. government securities	\$ 43,250,249	46,122,338
Money market mutual fund	48,190,397	26,231,980
Guaranteed investment contracts	198,605,140	—
Corporate bonds	2,690,607	2,479,144
Mutual funds	652,624	1,061,961
	<u>293,389,017</u>	<u>75,895,423</u>
Investment in ATC	32,257,900	26,975,087
Deposits – cash	692,307	44,275
Total cash and investments	<u>\$ 326,339,224</u>	<u>102,914,785</u>

Deposits and investments in each bank are insured by the Federal Deposit Insurance Corporation (FDIC) in the amount of \$100,000 for interest-bearing accounts and \$100,000 for noninterest-bearing accounts. Deposits and investments are also insured for \$400,000 by the State Deposit Guarantee Fund (SDGF). However, due to the relatively small size of the SDGF in relation to the total deposits covered and other legal implications, recovery of material principal losses of the pool may not be significant to the utility.

Investments are stated at fair value, based on quoted market prices. Adjustments necessary to record investments at fair value are recorded in the statements of revenues, expenses, and changes in net assets.

### (3) Investment in American Transmission Company

During 2000, WPPI purchased an equity interest in ATC Management Inc. and American Transmission Company LLC (collectively ATC). ATC is a for-profit, transmission-only company. It owns, plans, maintains, monitors, and operates electric transmission assets in portions of Wisconsin, Michigan, and Illinois. ATC began operations on January 1, 2001. At December 31, 2005 and 2004, WPPI's equity interest in ATC was approximately 5.2%. WPPI's investment in ATC qualifies for the equity method of accounting.

Under the terms of the ownership agreement with ATC, WPPI has the right, but not the obligation, to purchase additional member units in ATC as may from time to time arise in order to maintain its initial percentage interest in ATC, as well as participate in voluntary additional capital calls. At December 31, 2005, WPPI had outstanding commitments to fund ATC of approximately \$2,478,000. The amount was paid in January 2006.

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Condensed financial data of ATC for 2005 and 2004 follows:

	<u>2005</u>	<u>2004</u>
	(In millions)	
Operating statement data:		
Revenues	\$ 296.0	262.5
Operating expenses	(166.6)	(157.7)
Other income	3.5	3.0
Net interest expense	(36.5)	(29.9)
Earnings before tax	<u>\$ 96.4</u>	<u>77.9</u>
Balance sheet data:		
Current assets	\$ 29.2	30.2
Noncurrent assets	<u>1,516.1</u>	<u>1,228.6</u>
Total assets	<u>\$ 1,545.3</u>	<u>1,258.8</u>
Current liabilities	\$ 140.5	192.3
Long-term debt	648.7	448.5
Other noncurrent liabilities	105.3	81.3
Members' equity	<u>650.8</u>	<u>536.7</u>
Total liabilities and members' equity	<u>\$ 1,545.3</u>	<u>1,258.8</u>

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**(4) Capital Assets**

Capital asset activity for the years ended December 31, 2005 and 2004 was as follows:

<b>2005</b>	<b>Beginning balance</b>	<b>Additions</b>	<b>Transfers</b>	<b>Retirements</b>	<b>Ending balance</b>
Nondepreciable assets:					
Land	\$ 88,883	—	—	—	88,883
Construction work in progress	57,804	29,576,534	(939,965)	—	28,694,373
Total nondepreciable assets	146,687	29,576,534	(939,965)	—	28,783,256
Depreciable assets:					
Utility plant	208,828,773	50,250	939,965	(895,875)	208,923,113
Total depreciable assets	208,828,773	50,250	939,965	(895,875)	208,923,113
Accumulated depreciation and amortization	(79,247,568)	(6,641,731)	—	557,710	(85,331,589)
Depreciable assets, net	129,581,205	(6,591,481)	939,965	(338,165)	123,591,524
Capital assets, net	\$ 129,727,892	22,985,053	—	(338,165)	152,374,780
<b>2004</b>	<b>Beginning balance</b>	<b>Additions</b>	<b>Transfers</b>	<b>Retirements</b>	<b>Ending balance</b>
Nondepreciable assets:					
Land	\$ 88,883	—	—	—	88,883
Construction work in progress	18,130,457	15,900,333	(33,972,986)	—	57,804
Total nondepreciable assets	18,219,340	15,900,333	(33,972,986)	—	146,687
Depreciable assets:					
Utility plant	184,136,120	510,239	33,972,986	(9,790,572)	208,828,773
Total depreciable assets	184,136,120	510,239	33,972,986	(9,790,572)	208,828,773
Accumulated depreciation and amortization	(74,529,912)	(5,998,809)	—	1,281,153	(79,247,568)
Depreciable assets, net	109,606,208	(5,488,570)	33,972,986	(8,509,419)	129,581,205
Capital assets, net	\$ 127,825,548	10,411,763	—	(8,509,419)	129,727,892

In 2004, the combustion turbine gas generator project sited at Kaukauna, Wisconsin was completed. Capitalized interest of \$344,461 was included as a part of the cost of the project in 2004. The project was financed by internal funds and proceeds of the Series 2003A bond issue.

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During 2004, WPPI repaired damages sustained at two of its generating facilities, Boswell Unit 4 and South Fond du Lac Unit 1. The costs of repair are included in capital asset additions. A corresponding reduction in capital assets equal to the cost of the repairs has also been included in capital asset retirements to adjust capital assets for the effects of these events.

Construction work in progress at December 31, 2005 consists primarily of the 8.33% interest in two 615 MW supercritical coal-fired generating units under construction in Oak Creek, Wisconsin. Capitalized interest of \$489,809 was included as part of the cost of the project in 2005. The project was financed by the proceeds of the Series 2005A and 2005B bond issues.

**(5) Long-Term Debt**

The following Power Supply System Revenue Bonds were issued to finance WPPI's acquisition and construction of utility plants:

	<u>2005</u>	<u>2004</u>
Revenue bonds:		
2003 Series A 3.00% to 5.25%		
Due July 1, 2004–2033	\$ 76,930,000	80,630,000
2003 Series B variable rate bonds		
Due July 1, 2004–2021	65,100,000	65,500,000
2003 Series C variable rate bonds		
Due July 1, 2004–2023	36,425,000	37,925,000
2005 Series A 4.625% to 5.00%		
Due July 1, 2001–2038	143,020,000	—
2005 Series B variable rate bonds		
Due July 1, 2012–2038	93,900,000	—
	<u>415,375,000</u>	<u>184,055,000</u>
Less current maturities	8,585,000	5,600,000
Unamortized discount, net	13,223,283	20,181,268
	<u>\$ 393,566,717</u>	<u>158,273,732</u>

The Power Supply System Revenue Bonds are secured by all funds and revenues of WPPI derived from the ownership and operation of its power supply system.

The unamortized discount/premium, which includes the unamortized difference between the reacquisition price and the net carrying amount of refunded debt issues, is amortized over the terms of the related bond issues using a method that approximates the effective-interest method.

During 2005, \$143,020,000 of the Power Supply System Revenue Bonds, Series 2005A, and \$93,900,000 Power Supply System Revenue Bonds, Series 2005B were issued to purchase an 8.33% interest in two 615 MW supercritical coal-fired generating units under construction in Oak Creek, Wisconsin.

A total of \$32,855,000 of defeased debt remained outstanding at December 31, 2005 from advance refundings entered into by WPPI.

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Long-term liability activities for the years ended December 31, 2005 and 2004 were as follows:

<u>Long-term liabilities as of December 31, 2005</u>	<u>Beginning balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending balance</u>
Long-term revenue bonds	\$ 184,055,000	236,920,000	(5,600,000)	415,375,000
Less:				
Current maturities	5,600,000	8,585,000	(5,600,000)	8,585,000
Unamortized discount, net	<u>20,181,268</u>	<u>(5,229,623)</u>	<u>(1,728,362)</u>	<u>13,223,283</u>
Long-term revenue bonds, net	\$ <u>158,273,732</u>	<u>233,564,623</u>	<u>1,728,362</u>	<u>393,566,717</u>
Deferred credits and other liabilities:				
Operating reserves and accrued liabilities	\$ 9,081,927	1,564,899	(900,693)	9,746,133
Rate stabilization	35,127,846	628,831	—	35,756,677
Asset retirement obligation	1,806,068	90,303	—	1,896,371
Fair value of interest rate swap agreements	<u>280,985</u>	<u>945,856</u>	<u>—</u>	<u>1,226,841</u>
Total deferred credits and other liabilities	\$ <u>46,296,826</u>	<u>3,229,889</u>	<u>(900,693)</u>	<u>48,626,022</u>
<u>Long-term liabilities as of December 31, 2004</u>	<u>Beginning balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending balance</u>
Long-term revenue bonds	\$ 192,040,000	—	(7,985,000)	184,055,000
Less:				
Current maturities	7,985,000	—	(2,385,000)	5,600,000
Unamortized discount, net	<u>22,020,433</u>	<u>—</u>	<u>(1,839,165)</u>	<u>20,181,268</u>
Long-term revenue bonds, net	\$ <u>162,034,567</u>	<u>—</u>	<u>(3,760,835)</u>	<u>158,273,732</u>
Deferred credits and other liabilities:				
Operating reserves and accrued liabilities	\$ 14,769,507	5,029,058	(10,716,638)	9,081,927
Rate stabilization	37,694,606	449,840	(3,016,600)	35,127,846
Asset retirement obligation	1,720,065	86,003	—	1,806,068
Fair value of interest rate swap agreements	<u>—</u>	<u>280,985</u>	<u>—</u>	<u>280,985</u>
Total deferred credits and other liabilities	\$ <u>54,184,178</u>	<u>5,845,886</u>	<u>(13,733,238)</u>	<u>46,296,826</u>

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Debt service payments on the outstanding bonds and the interest rate swap agreements (see note 6) are as follows:

<u>Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2006	\$ 8,585,000	15,458,601	24,043,601
2007	6,085,000	17,336,075	23,421,075
2008	9,325,000	17,251,289	26,576,289
2009	6,755,000	16,648,919	23,403,919
2010	9,220,000	16,450,770	25,670,770
2011–2015	71,625,000	73,617,754	145,242,754
2016–2020	99,655,000	55,713,684	155,368,684
2021–2025	56,495,000	39,989,135	96,484,135
2026–2030	58,440,000	27,901,174	86,341,174
2031–2033	89,190,000	14,584,686	103,774,686
	<u>\$ 415,375,000</u>	<u>294,952,087</u>	<u>710,327,087</u>

#### (6) Interest Rate Swap Agreements

During 2005, WPPI entered into an interest rate swap agreement with JP Morgan Chase Bank N.A. and during 2003, WPPI entered into two interest rate swap agreements with Bear Stearns Capital Markets Inc. Interest rate swaps involve the contractual exchange of fixed- and floating-rate interest payment obligations based on a notional principal amount. WPPI entered into the interest rate swap agreements to achieve lower interest rates than would have been achieved by issuing traditional fixed rate debt. The interest rate swap agreement dated October 17, 2005 has a notional amount of \$93,900,000. The interest rate swap agreement dated February 6, 2003 has a notional amount of \$65,100,000. The interest rate swap agreement dated May 30, 2003 has a notional amount of \$36,425,000. WPPI is a receiver of floating-rate interest and a payer of a fixed-rate interest on all agreements. The fixed rates of interest were 3.5%, 3.355%, and 2.805%, respectively. As of December 31, 2005, the interest rate swaps had a combined negative fair value of \$1,226,841.

#### (7) Available Financing

During 2005, WPPI entered into a revolving line of credit agreement with a financial institution, which permits borrowings of up to \$10,000,000 and expires on May 31, 2006. Interest accrued on the unpaid principal amount outstanding at a rate per annum equal to the applicable British Bankers' Association LIBOR rate for deposits in U.S. dollars and the prime rate minus 175 points. The interest rate was 5.37% at December 31, 2005. At December 31, 2005, there was \$6,500,000 outstanding on the line of credit.

#### (8) Significant Members

Two significant members of WPPI accounted for \$63,780,091 and \$49,489,096 or approximately 20.9% and 22.5% of total sales revenues for the years ended December 31, 2005 and 2004, respectively.

**WISCONSIN PUBLIC POWER INC.**

Notes to Financial Statements

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**(9) Employee Benefits**

**(a) Retirement Plan**

WPPI has a Simplified Employee Pension-Individual Retirement Account (SEP-IRA) covering all of its employees funded through contributions by WPPI to an investment firm. The total contributions to the plan for the years ended December 31, 2005 and 2004 were \$564,623 and \$546,206, respectively.

**(b) Retention Plan**

In 1999, WPPI established an employee retention plan. The plan will make payments to specific employees after three, five, and eight years of continuing employment. Plan benefit expenses of \$105,227 and \$189,601 were accrued during 2005 and 2004, respectively. Total plan expenses in years one through eight of the program are expected to be approximately \$1.83 million.

**(10) Commitments**

WPPI has various long-term capacity and energy purchase contracts with various power suppliers. Capacity purchases for 2005 and 2004 totaled approximately 643 and 650 MW, respectively. WPPI does not own any transmission facilities and takes service for all of its transmission requirements under contracts and tariffs approved by FERC.

During 2005, WPPI entered into a series of agreements that establish WPPI's rights to an 8.33% interest in two 615 megawatt supercritical coal-fired generating units (the Project). Except under the limited circumstances as specifically provided within the agreements, WPPI may not terminate its participation or withdraw from the Project. Absent these circumstances or events, WPPI's financial obligation for its participation is approximately \$205 million. As of December 31, 2005, WPPI has paid approximately \$24.4 million of this commitment, with the remainder expected to be requested through 2010.

**(11) Risk Management**

WPPI is exposed to various risks of loss related to torts; theft of, damage to, or destruction of assets; errors and omissions; workers' compensation; and healthcare of its employees. The generating plants are covered by insurance, including property and boiler and machinery policies, with deductibles. Deductibles equal 200,000 per occurrence on Boswell Unit 4, \$1.5 million per occurrence for the South Fond du Lac units, and \$500,000 per occurrence on the Kaukauna combustion turbine. Other risks are covered through the purchase of commercial insurance, with minimal deductibles.

WPPI maintains assets in the Self-Insurance Fund described in note 2 to be applied to the payment of claims and losses arising from hazards and risks to the extent that insurance does not cover such claims or losses. In December 2003, South Fond du Lac Unit 1 was damaged as a result of a mechanical failure. Costs of repair not covered by insurance are expected to be paid from the Self-Insurance Fund. Additions to the self-insurance liability in 2005 and 2004 pertain to this event.

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Following is the activity for the self-insurance liability for the years ended December 31, 2005 and 2004:

	<u>2005</u>	<u>2004</u>
Self-insurance liability, beginning of year	\$ 2,875,017	3,567,011
Additions, representing interest	117,246	58,006
Additions	—	950,000
Usage	—	(1,700,000)
Self-insurance liability, end of year	\$ <u>2,992,263</u>	<u>2,875,017</u>