

WISCONSIN PUBLIC POWER, INC.

FINANCIAL STATEMENTS

Including Independent Auditors' Report

December 31, 2006 and 2005

WISCONSIN PUBLIC POWER, INC.

TABLE OF CONTENTS

December 31, 2006 and 2005

Independent Auditors' Report	1
Management Discussion and Analysis	2 – 19
Financial Statements	
Statement of Net Assets	20 – 21
Statement of Revenues, Expenses and Changes in Net Assets	22
Statement of Cash Flows	23 – 24
Notes to Financial Statements	25 – 40



Virchow Krause & company

INDEPENDENT AUDITORS' REPORT

To the Board of Directors
Wisconsin Public Power Inc.
Sun Prairie, Wisconsin

We have audited the accompanying statement of net assets of Wisconsin Public Power Inc. as of December 31, 2006, and related statement of revenues, expenses and changes in net assets and statement of cash flows for the year then ended as noted in the table of contents. These financial statements are the responsibility of the Wisconsin Public Power Inc.'s management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of Wisconsin Public Power Inc. as of and for the year ended December 31, 2005 were audited by other auditors whose report, dated February 24, 2006, expressed an unqualified opinion on those financial statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, based on our audit, the financial statements referred to above present fairly, in all material respects, the financial position of Wisconsin Public Power Inc. as of December 31, 2006, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The management discussion and analysis information enclosed in this report is not a required part of the financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

In 2006, Wisconsin Public Power Inc. had a change in accounting principle relative to implementing Statement of Financial Accounting Standard 71 – "Accounting for Certain Types of Regulation" relative to accounting for unrealized gains and losses on investments as discussed in Note 1.

Virchow, Krause & Company, LLP

Madison, Wisconsin
March 16, 2007

Virchow, Krause & Company, LLP

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MANAGEMENT DISCUSSION AND ANALYSIS

WISCONSIN PUBLIC POWER INC.

Management Discussion and Analysis

December 31, 2006 and 2005

Financial Statement Overview

This discussion and analysis provides an overview of the financial performance of Wisconsin Public Power Inc. (WPPI) for the years ended December 31, 2006 and December 31, 2005. The information presented should be read in conjunction with WPPI's financial statements and the accompanying notes.

WPPI follows the Uniform System of Accounts prescribed by the Federal Energy Regulatory Commission. The financial statements are prepared on the accrual basis of accounting in accordance with U.S. generally accepted accounting principles.

WPPI's financial statements include the Statement of Net Assets, the Statement of Revenues, Expenses, and Changes in Net Assets, and the Statement of Cash Flows. The Statement of Net Assets provides information about the nature and amount of assets and obligations (liabilities) of WPPI as of the end of the year. The Statement of Revenues, Expenses, and Changes in Net Assets reports revenues and expenses for the current year. The Statement of Cash Flows reports cash receipts, cash payments, and net changes in cash resulting from operating, noncapital financing, investing, and capital and related financing activities.

Financial Changes in 2006 From 2005

The following table summarizes the financial position of WPPI as of December 31, 2006 and 2005:

Condensed Statement of Net Assets

Assets	2006	2005	Dollar change	Percentage change
Current assets	\$ 127,654,044	\$ 102,961,808	\$ 24,692,236	24.0%
Noncurrent assets	218,672,191	256,907,013	(38,234,822)	-14.9%
Deferred costs	30,870,133	29,974,277	895,856	3.0%
Capital assets, net of accumulated depreciation	182,050,527	152,374,780	29,675,747	19.5%
Total assets	<u>\$ 559,246,895</u>	<u>\$ 542,217,878</u>	<u>\$ 17,029,017</u>	3.1%
Liabilities and Net Assets				
Current liabilities	\$ 34,413,191	\$ 42,282,486	\$ (7,869,295)	-18.6%
Deferred credits and other liabilities	51,710,182	48,626,022	3,084,160	6.3%
Long-term debt	389,024,923	393,566,716	(4,541,793)	-1.2%
Total liabilities	<u>475,148,296</u>	<u>484,475,224</u>	<u>(9,326,928)</u>	-1.9%
Net assets				
Invested in capital assets, net of related debt	(64,967,255)	(75,014,998)	10,047,743	-13.4%
Restricted	109,501,473	107,860,039	1,641,434	1.5%
Unrestricted	39,564,381	24,897,613	14,666,768	58.9%
Total net assets	<u>84,098,599</u>	<u>57,742,654</u>	<u>26,355,945</u>	45.6%
Total liabilities and net assets	<u>\$ 559,246,895</u>	<u>\$ 542,217,878</u>	<u>\$ 17,029,017</u>	3.1%

WISCONSIN PUBLIC POWER INC.

Management Discussion and Analysis

December 31, 2006 and 2005

The condensed Statement of Net Assets in this discussion and analysis is discussed in more detail in the following sections. All amounts have been rounded to the nearest \$0.1 million.

Total Assets

Total assets increased by \$17.0 million due primarily to WPPI receiving one-time revenues of \$15.4 million from refunds related to the sale of the Kewaunee Nuclear Power Plant by two of WPPI's suppliers and a rate case settlement with Alliant Energy.

Current Assets

Current assets increased \$24.7 million, from \$103.0 million in 2005 to \$127.7 million in 2006. This change is primarily due to the net of the following factors:

Cash and investments increased \$4.6 million, from \$18.2 million in 2005 to \$22.8 million in 2006, partially as a result of the receipt of the refunds and rate case settlement mentioned above, offset by use of funds in 2006 to pay in full the \$6.5 million balance on WPPI's outstanding line of credit.

Restricted cash and investments increased \$22.3 million, from \$51.2 million in 2005 to \$73.5 million in 2006, primarily due to reclassification of construction funds for the Elm Road Units 1 and 2 ("Elm Road") from noncurrent assets to current assets in anticipation of construction obligations in 2007.

Power sales accounts receivable decreased \$6.1 million, from \$27.6 million in 2005 to \$21.5 million in 2006. The decrease is attributable to lower sales during December 2006, which resulted from lower costs of purchased power.

Restricted interest receivable increased \$2.6 million, from \$1.5 million in 2005 to \$4.1 million in 2006, primarily reflecting interest earnings through December 31, 2006 on the proceeds of the Series 2005 A and B bonds issued in November 2005 and held for the full year of 2006.

Inventories increased by \$0.2 million, from \$3.4 million in 2005 to \$3.6 million in 2006, as a result of fuel stock increases at Boswell 4.

Prepayments increased \$0.7 million, rising from \$0.4 million in 2005 to \$1.1 million in 2006, primarily as a result of contributions to a WPPI defined benefit plan becoming effective in 2007.

Other changes to current assets had a cumulative effect of increasing current assets \$0.4 million in 2006.

Noncurrent Assets

Noncurrent assets decreased by \$38.2 million, from \$256.9 million in 2005 to \$218.7 million in 2006. The change in noncurrent assets is primarily due to the net of the following factors:

Noncurrent restricted cash and investments decreased \$49.5 million, from \$223.9 million in 2005 to \$174.4 million in 2006. Fifty-seven million was transferred from long-term to current assets for construction and debt service obligations for 2007. The Renewals and Replacements Fund increased by \$6.1 million from \$5.9 million in 2005 to \$12.0 million in 2006. The Debt Service Fund, Self Insurance Fund, Rate Stabilization Fund and Decommissioning Fund collectively increased \$1.4 million in 2006.

WISCONSIN PUBLIC POWER INC.

Management Discussion and Analysis

December 31, 2006 and 2005

Investment in the American Transmission Company (ATC) increased \$11.0 million, from \$32.3 million in 2005 to \$43.3 million in 2006. This results from \$9.4 million in capital contributions by WPPI during 2006 and \$1.6 million in earnings remaining invested in ATC.

Other changes to noncurrent assets had a cumulative effect of increasing noncurrent assets \$0.3 million in 2006.

Deferred Costs

Deferred costs increased \$0.9 million, from \$30.0 million in 2005 to \$30.9 million in 2006. This was primarily due to the mark-to-market gain of \$1.7 million on WPPI's floating-to-fixed swap transactions with Bear Stearns and JP Morgan in connection with WPPI's Series 2003 B and C and Series 2005 B revenue bonds ("Swaps"). Other deferred costs were reduced \$0.8 million due primarily to scheduled amortization of the Kaukauna and Menasha capacity buyout contracts.

Capital Assets

Capital assets, net of accumulated depreciation, increased \$29.7 million, from \$152.4 million in 2005 to \$182.1 million in 2006. The change in capital assets is primarily due to the net of the following factors:

Construction work in progress increased by \$34.4 million, from \$28.7 million in 2005 to \$63.1 million in 2006, primarily related to the construction work in progress on Elm Road. Excluding construction work in progress, capital assets net of accumulated depreciation decreased by \$4.7 million in 2006, resulting from \$1.4 million in plant additions and \$6.1 million in normal depreciation.

Total Liabilities

Total liabilities decreased by \$9.3 million due primarily to WPPI's line of credit balance of \$6.5 million being paid in full in 2006, and a reduction in net long-term debt of \$7.0 million during 2006. These decreases were partially offset by other liabilities that are discussed in more detail below.

Current Liabilities

Current liabilities decreased \$7.9 million, from \$42.3 million in 2005 to \$34.4 million in 2006. The decrease is primarily due to the net of the following factors:

Accrued interest increased by \$2.1 million, from \$3.4 million in 2005 to \$5.5 million in 2006 because the Series 2005 A and B bonds were outstanding all of 2006.

The line of credit balance of \$6.5 million in 2005 was paid in full in 2006.

Current maturities of long-term debt decreased \$2.5 million, from \$8.6 million in 2005 to \$6.1 million in 2006.

Other current liabilities decreased by \$1.0 million, from \$1.1 million in 2005 to \$0.1 million in 2006. The majority of the decrease is attributable to the reduction in Minnesota property taxes.

WISCONSIN PUBLIC POWER INC.

Management Discussion and Analysis

December 31, 2006 and 2005

Deferred Credits and Other Liabilities

Deferred credits and other liabilities increased by \$3.1 million, from \$48.6 million in 2005 to \$51.7 million in 2006. The change is primarily due to the net of the following factors:

Operating reserves and other liabilities increased by \$1.7 million, from \$9.7 million in 2005 to \$11.4 million in 2006. The provision for long-term maintenance in the Renewals and Replacements Fund increased \$0.4 million, from \$5.8 million in 2005 to \$6.2 million in 2006, as a result of deposits during 2006. The arbitrage rebate provision for the 2005 bond issues increased by \$0.8 million in 2006. Other reserves increased by \$0.5 million in 2006.

The Rate Stabilization Fund increased \$0.8 million, from \$35.8 million in 2005 to \$36.6 million in 2006 due to deposits from new WPPI members.

The fair value of the Swaps of \$1.2 million in 2005 was written off in 2006 due to WPPI's implementation of Regulatory Asset & Liability Accounting. Pursuant to these accounting standards, a regulatory liability of \$1.7 million was established in 2006 to defer the gain in fair value of WPPI's Swaps accounted for as a Deferred Cost in 2006.

The Asset Retirement Obligation for retirement of the Boswell 4 ash ponds, also known as the Decommissioning Fund, increased \$0.1 million, from \$1.9 million in 2005 to \$2.0 million in 2006 due to accrual of accretion expense.

Long -Term Debt

Revenue bonds net of unamortized premium decreased by \$4.5 million, from \$393.5 million in 2005 to \$389.0 million in 2006, due to the reclassification of long-term debt to current maturities, amortizations of premiums and amortizations of losses on reacquired debt.

Net Assets

Total net assets increased \$26.4 million, from \$57.7 million in 2005 to \$84.1 million in 2006. The increase was a result of the increase in net assets during 2006 from continuing operations, including the aforementioned \$15.4 million in one-time revenues from refunds related to the sale of the Kewaunee Nuclear Power Plant by two of WPPI's suppliers and a refund from an Alliant Energy rate case, \$6.3 million in net earnings to provide 145% coverage of debt service from operations, and \$4.6 million in additional investment earnings from WPPI's portfolio of investment securities and its investment in ATC.

WISCONSIN PUBLIC POWER INC.

Management Discussion and Analysis

December 31, 2006 and 2005

The following table summarizes the changes in financial position for WPPI for the years ended December 31, 2006 and 2005:

Condensed Statements of Revenues, Expenses, and Changes in Net Assets for the Periods Ended December 31, 2006 and 2005

	<u>2006</u>	<u>2005</u>	<u>Dollar change</u>	<u>Percentage change</u>
Operating revenues	\$ 294,716,783	\$ 306,111,928	\$ (11,395,145)	-3.7%
Operating expenses	<u>272,552,743</u>	<u>296,977,487</u>	<u>(24,424,744)</u>	-8.2%
Operating income	22,164,040	9,134,441	13,029,599	142.6%
Net investment income, and equity in earnings of ATC, and unrealized gain(loss) on interest rate swaps	20,341,296	7,846,430	12,494,866	159.2%
Interest expense and debt-related expenses	(16,226,796)	(10,920,999)	(5,305,797)	48.6%
Other nonoperating expenses	<u>(32,759)</u>	<u>(81,129)</u>	<u>48,370</u>	-59.6%
Change in net assets before future recoverable costs	26,245,781	5,978,743	20,267,038	339.0%
Future costs to be (returned) recovered	(1,116,678)	650,611	(1,767,289)	-271.6%
Cumulative effect of change in acctg principle	<u>1,226,841</u>	—	<u>1,226,841</u>	N/A
Change in net assets	26,355,944	6,629,354	19,726,590	297.6%
Net assets, beginning of year	<u>57,742,654</u>	<u>51,113,300</u>	<u>6,629,354</u>	13.0%
Net assets, end of year	<u>\$ 84,098,598</u>	<u>\$ 57,742,654</u>	<u>\$ 26,355,944</u>	45.6%

Operating Revenues

Included in operating revenues are sales to members, sales to others, and other income. All amounts have been rounded to the nearest \$0.1 million.

Total operating revenues decreased \$11.4 million, or -3.7%, from \$306.1 million in 2005 to \$294.7 million in 2006. Purchased power costs moderated somewhat in 2006 from their rise in 2005 which in turn reduced operating revenues from members.

Sales to members decreased \$2.3 million or -0.9%, from \$254.0 million in 2005 to \$251.7 million in 2006. Megawatt hour (MWh) sales to members (including new members beginning service in 2006) increased 83,311 MWh or 1.7%, from 4,941,385 MWh in 2005 to a total of 5,024,696 MWh in 2006. Without sales to new members of 90,421 MWh, WPPI's megawatt hour sales to members would have decreased slightly in 2006.

WISCONSIN PUBLIC POWER INC.

Management Discussion and Analysis

December 31, 2006 and 2005

Sales to others decreased \$24.7 million, or 48.3%, from \$51.2 million in 2005 to \$26.5 million in 2006. Revenue associated with the Midwest Independent System Operator (MISO) Day 2 Market was \$8.7 million lower. Revenue from WPPI's power sales to Wisconsin Power and Light under the Combustion Turbine Agreements was \$8.4 million lower in 2006 due to MISO dispatching the units less frequently. The remaining \$7.6 million decrease in sales in 2006 is a cumulative effect of fewer power sales to various other companies.

Other income increased \$15.6 million driven primarily by the receipt of \$15.4 million in one time refund revenues as described above.

Operating Expenses

Total operating expenses decreased \$24.4 million, or 8.2%, from \$297.0 million in 2005 to \$272.6 million in 2006. The decrease in operating expenses was driven primarily by lower purchased power expense.

Purchased power expense, which includes purchased power and transmission expenses, decreased \$14.3 million, or -5.8%, from \$245.9 million in 2005 to \$231.6 million in 2006. Excluding transmission expenses, purchased power expenses decreased \$17.1 million, or -7.7%, from \$221.8 million in 2005 to \$204.7 million in 2006, primarily due to lower fuel adjustment clause charges from WPPI's power suppliers. Transmission expenses increased \$2.8 million, or 11.7%, from \$24.0 million in 2005 to \$26.8 million in 2006, primarily due to an increase in network service rates.

Fuel expense decreased \$10.5 million, from \$25.1 million in 2005 to \$14.6 million in 2006. The decrease is attributable to a decrease in megawatt production from WPPI generation units in 2006. Boswell 4 produced 744,197 MWh in 2006 versus 798,177 MWh in 2005 because of a scheduled outage for duty cycle maintenance. South Fond du Lac Units 1 and 4 produced a combined 21,551 MWh in 2006 versus a combined 79,344 MWh in 2005. The Island Street Peaking Plant produced 24,661 MWh in 2006 versus 37,094 MWh in 2005. The lower production at both South Fond du Lac Units 1 and 4 and the Island Street Peaking Plant are a result of MISO dispatching the units less frequently in 2006 compared to 2005.

Administrative and general expense increased \$1.1 million, or 9.4%, from \$11.8 million in 2005 to \$12.9 million in 2006. The primary factors driving the increase were the costs of additional energy conservation incentives, growth in number of employees, and salary and benefits adjustments.

Tax expense decreased \$0.9 million, from \$2.6 million in 2005 to \$1.7 million in 2006, because of a decrease in the accrual for property tax for Boswell 4.

Other operating expenses increased by \$0.2 million in 2006.

Nonoperating Revenues (Expenses)

Investment income increased \$7.6 million, from \$4.1 million in 2005 to \$11.7 million in 2006. The majority of the increase was from interest earnings on the unspent portion of the Series 2005 A and B bond proceeds held in the construction and debt service funds for a full year.

Equity in earnings of ATC increased \$1.5 million, from \$5.1 million in 2005 to \$6.6 million in 2006. WPPI maintains an ownership share of approximately 5.4% in ATC. ATC earnings increased in 2006 due to higher earnings at ATC as more new transmission projects were placed into rate base.

WISCONSIN PUBLIC POWER INC.

Management Discussion and Analysis

December 31, 2006 and 2005

Unrealized gain (loss) on the Swaps increased \$2.6 million, from a loss of \$0.9 million in 2005 to a gain of \$1.7 million in 2006. The unrealized gain is the net result of mark-to-market calculations for WPPI's Swaps.

Net increase (decrease) in fair value of investments increased \$0.8 million, from negative \$0.4 million in 2005 to \$0.4 million in 2006. WPPI has an investment policy of purchasing highly rated fixed income investments and holding them to maturity. The investment portfolio is structured in a ladder format to have investments of varying maturity dates.

Interest expense increased \$5.3 million, from \$9.0 million in 2005 to \$14.3 million in 2006. The increase was due to a full year of interest expense on WPPI's Series 2005 A and B bonds.

Future Costs to Be (Returned) Recovered

Future costs to be returned or recovered decreased \$1.8 million, from \$0.7 million in 2005 to negative \$1.1 million in 2006. Future recoverable costs, as allowed under Statement of Financial Accounting Standards No. 71 – "Accounting for Certain Types of Regulation" is a calculation designed to ensure that revenues are properly recognized in periods consistent with rate-making strategies and that ratepayers are not charged for both depreciation on an asset and principal payments on the bonds issued to acquire the asset in the same year. As previously discussed, in 2006, due to the adoption of Financial Accounting Standard 71 for regulatory asset and liability accounting, a cost to be returned in the amount of \$1.7 million was recognized as the offsetting entry to the \$1.7 million gain for marking WPPI's Series 2003 B and C and Series 2005 B swap transactions to market value.

Cumulative Effect of Change in Accounting Principle

As noted above, WPPI adopted the principle of regulatory asset and liability accounting in accordance with SFAS No. 71 to record unrealized gains and losses from the annual mark to market calculations on the interest rate swaps. In 2006, \$1.2 million that was expensed in prior years was included in income.

Change in Net Assets

Change in net assets increased by \$19.7 million, from \$6.6 million in 2005 to \$26.3 million in 2006. The change is the net result of revenues and other income minus expenses and other costs as described in the sections above.

Total net assets at the end of 2006 were \$84.1 million, up from \$57.7 million at the end of 2005.

WISCONSIN PUBLIC POWER INC.

Management Discussion and Analysis

December 31, 2006 and 2005

Financial Changes in 2005 From 2004

The following table summarizes the financial position of WPPI as of December 31, 2005 and 2004:

Condensed Balance Sheets

Assets	2005	2004	Dollar change	Percentage change
Current assets	\$ 102,961,808	\$ 44,639,286	\$ 58,322,522	130.7%
Noncurrent assets	256,907,013	82,119,841	174,787,172	212.8%
Deferred costs	29,974,277	27,171,118	2,803,159	10.3%
Capital assets, net of accumulated depreciation	<u>152,374,780</u>	<u>129,727,892</u>	<u>22,646,888</u>	17.5%
Total assets	<u>\$ 542,217,878</u>	<u>\$ 283,658,137</u>	<u>\$ 258,559,741</u>	91.2%
Liabilities and Net Assets				
Current liabilities	\$ 42,282,486	\$ 27,974,279	\$ 14,308,207	51.1%
Other deferred credits and liabilities	12,869,345	11,168,980	1,700,365	15.2%
Long-term debt	393,566,716	158,273,732	235,292,984	148.7%
Rate stabilization	<u>35,756,677</u>	<u>35,127,846</u>	<u>628,831</u>	1.8%
Total liabilities	<u>484,475,224</u>	<u>232,544,837</u>	<u>251,930,387</u>	108.3%
Net assets				
Invested in capital assets, net of related debt	(75,014,998)	(35,639,020)	(39,375,978)	110.5%
Restricted	107,860,039	53,218,725	54,641,314	102.7%
Unrestricted	<u>24,897,613</u>	<u>33,533,595</u>	<u>(8,635,982)</u>	-25.8%
Total net assets	<u>57,742,654</u>	<u>51,113,300</u>	<u>6,629,354</u>	13.0%
Total liabilities and net assets	<u>\$ 542,217,878</u>	<u>\$ 283,658,137</u>	<u>\$ 258,559,741</u>	91.2%

Total Assets

Total assets increased by approximately \$258.6 million due primarily to WPPI issuing \$236.92 million in bonds, including a premium of approximately \$5.2 million, for total proceeds of approximately \$242.1 million, to fund the acquisition of an approximately 51 MW share in each of Elm Road Generating Station Units 1 and 2 that are being constructed in Oak Creek, Wisconsin. Construction started in mid-2005 and is expected to continue through mid-2009 for Unit 1 and mid-2010 for Unit 2. WPPI has budgeted \$210.5 million for estimated construction costs and contingencies, which will be funded by bond proceeds of approximately \$193.4 million and interest earnings on the bond proceeds of approximately \$17.1 million. The remainder of the bonds were issued to cover capitalized interest of approximately \$37.0 million, a debt service reserve of approximately \$8.2 million, and costs of issuance of approximately \$3.5 million.

Each line item that is part of the condensed balance sheets in this audit is discussed in more detail in the following sections. All amounts have been rounded to the nearest \$0.1 million.

WISCONSIN PUBLIC POWER INC.

Management Discussion and Analysis

December 31, 2006 and 2005

Current Assets

Cash and investments increased approximately \$3.1 million, from approximately \$15.1 million in 2004 to approximately \$18.2 million in 2005. The total included \$6.5 million from WPPI's line of credit with Chase Bank.

Restricted cash and investments increased approximately \$45.3 million, from approximately \$6.0 million in 2004 to approximately \$51.3 million in 2005. The increase was attributable to cash from bond proceeds for construction funds expected to be used within 12 months of December 31, 2005 of approximately \$32.8 million, and capitalized interest due within 12 months of December 31, 2005 of approximately \$12.5 million.

Power sales accounts receivable increased approximately \$9.8 million, from approximately \$17.8 million in 2004 to approximately \$27.6 million in 2005. The increase was attributable to the higher cost of purchased power during December 2005 which was reflected on member invoices.

Other receivables decreased by approximately \$2.1 million, from slightly less than \$2.5 million in 2004 to approximately \$0.3 million in 2005. The decrease is a result of receivables from Members who joined in 2001 and 2002 being paid off in an amount of approximately \$0.7 million, and a decrease of approximately \$1.6 million in miscellaneous receivables consisting primarily of approximately \$1.4 million from Alliant Energy for overhaul costs of South Fond du Lac Combustion Turbine 4 and the remainder in numerous other smaller items.

Unrestricted interest receivable decreased by approximately \$0.1 million, from approximately \$0.4 million in 2004 to approximately \$0.3 million in 2005, primarily as a result of interest on the 2003 A B and C Debt Service Reserve Funds, which goes to the Revenue Fund, not being received by year end 2004, but being received as the close of business in 2005.

Restricted interest receivable increased approximately \$1.5 million, from just over \$0.0 million in 2004 to approximately \$1.5 million in 2005, primarily reflecting the reinvestment of interest earnings through December 31, 2005 on the 2005 A & B funds, which is restricted to those funds.

Inventories increased by approximately \$0.8 million, from approximately \$2.6 million in 2004 to approximately \$3.4 million in 2005 as a result of fuel stock increases at Boswell 4 and the Island Street Peaking Plant.

Prepayments increased less than \$0.1 million, rising from just over \$0.3 million in 2004 to just under \$0.4 million in 2005 primarily as a result of just over \$70,000 in January 2006 health insurance premiums paid in December 2005.

Noncurrent Assets

Total noncurrent assets increased by approximately \$174.8 million, from approximately \$82.1 million in 2004 to approximately \$256.9 million in 2005, consisting of an increase of approximately \$175.6 million in non-current cash and investments, a decrease of less than \$0.1 million in interest receivable, a decrease of approximately \$5.9 million in investments held, an increase of approximately \$5.3 million in the investment in the American Transmission Company, and a decrease of approximately \$0.2 million in Rate Stabilization Contributions receivable from members, as discussed in the following paragraphs.

WISCONSIN PUBLIC POWER INC.

Management Discussion and Analysis

December 31, 2006 and 2005

Noncurrent restricted cash and investments increased from approximately \$48.3 million in 2004 to approximately \$223.9 million in 2005, or a total of \$175.6 million, primarily due to the issue of the series 2005 A and 2005 B bonds. Changes in the composition of noncurrent restricted cash and investments detailed in Footnote 2 are discussed in the paragraphs that follow.

Cash and investments in the Renewal and Replacement Fund increased by approximately \$3.6 million from approximately \$2.3 million in 2004 to approximately \$5.9 million in 2005 as a result of deposits made during 2005 for Boswell 4, the South Fond du Lac units, and the Island Street Peaking Plant.

Cash and investments in the Self Insurance Fund increased by approximately \$1.0 million from approximately \$2.1 million in 2004 to approximately \$3.1 million in 2005 due to deposits to the Self Insurance Fund out of 2004 net earnings that occurred in 2005, and from interest earnings that are retained in the fund.

Cash and investments in the Rate Stabilization Fund increased by approximately \$1.7 million, from approximately \$33.7 million in 2004 to approximately \$35.4 million in 2005. The increase in cash was a result of deposits made for new Members of approximately \$0.6 million, plus continuing deposits of approximately \$0.8 million from Members joined WPPI several years prior who opted to make Rate Stabilization Fund deposits on a schedule, and a deposit of approximately \$0.4 million from year end 2004 deferrals of net income. The increases were offset slightly by mark to market calculations on investments held in the Rate Stabilization Fund which decreased the fund by approximately \$0.2 million, resulting in the net increase, after rounding, of approximately \$1.7 million in 2005.

Cash and investments in the Decommissioning Fund increased by approximately \$0.2 million, including approximately \$0.1 million deposited from member revenues and \$0.1 million deposited from interest earnings. These deposits brought the balance to approximately \$2.3 million in 2005 from approximately \$2.1 million in 2004.

Noncurrent Construction Fund cash and investments increased by approximately \$135.0 million, from \$0.0 in 2004 to approximately \$135.0 million in 2005. These funds came from bond proceeds for the Elm Road Generating Station project.

Noncurrent Debt Service Funds cash and investments increased by approximately \$25.3 million, from \$0.0 in 2004 to approximately \$25.3 million in 2005. These funds came from bond proceeds for the Elm Road Generating Station project.

Noncurrent Debt Service Reserve Funds cash and investments increased by approximately \$8.8 million, from approximately \$8.1 million in 2004 to approximately \$16.9 million in 2005. These funds came from approximately \$8.2 million bond proceeds for the Elm Road Generating Station project and approximately \$0.6 million in interest earnings on the 2003 Series A, B and C, and 2005 Series A and B Debt Service Reserve Funds.

Noncurrent unrestricted investments decreased by approximately \$5.9 million, from approximately \$6.6 million in 2004 to approximately \$0.7 million in 2005, as a result of investments being held closer to maturity, which reclassifies them from the non current investment category to the current assets category.

WISCONSIN PUBLIC POWER INC.

Management Discussion and Analysis

December 31, 2006 and 2005

Investment in the American Transmission Company increased by approximately \$5.3 million, from approximately \$27.0 million in 2004 to approximately \$32.3 million in 2005. The increase came from approximately \$4.1 million in capital contributions by WPPI during 2005, with the remainder of approximately \$1.2 million representing 2005 earnings allocations that were retained by ATC and increased WPPI's ownership.

Noncurrent receivables from Members decreased by approximately \$0.2 million, from approximately \$0.2 million to just above \$0. The decrease was attributable to Plymouth Utilities making its final payments to the Rate Stabilization Fund as a new Member. Payments to the fund due from Oconto Falls, Prairie du Sac and Reedsburg were moved to current receivables because they will be collected in 2006.

Deferred Costs

Unamortized bond issuance costs increased approximately \$3.3 million, from approximately \$2.6 million in 2004 to approximately \$5.9 million in 2005 as a result of approximately \$3.5 million in unamortized costs from the 2005 A and B bond issues, less approximately \$0.2 million in 2003 A B and C costs that were amortized in 2005.

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, as allowed through the application of provisions under SFAS No. 71. Future recoverable costs increased by approximately \$0.7 million during 2005.

Other deferred charges decreased by approximately \$1.1 million, from approximately \$4.2 million in 2005 to approximately \$3.1 million in 2004, primarily as the result of amortizing approximately \$0.8 million for termination of a power purchase agreement with Menasha Utilities that started being amortized in 2005 on a 55 month amortization schedule, \$0.2 million in amortization for a capacity buyout agreement with Kaukauna Utilities that started in 2002 and is being amortized over 60 months.

Capital Assets

Capital assets net of accumulated depreciation increased by approximately \$22.6 million. Within this category, electric plant and equipment increased a net of \$0.1 million from approximately \$208.9 million in 2004 to \$209.0 million in 2005. The increase was attributable primarily to the purchase of a van to WPPI's second metering technician with a vehicle and metering equipment for WPPI metering points.

Accumulated depreciation and amortization increased from approximately \$79.2 million in 2004 to approximately \$85.3 million in 2005, or approximately \$6.1 million. Major components of this increase include approximately \$2.6 million in accumulated depreciation for Boswell 4, approximately \$1.1 million in accumulated depreciation for South Fond du Lac 1, approximately \$1.2 million in accumulated depreciation for South Fond du Lac 4, approximately \$0.8 million in accumulated depreciation for the Island Street Peaking Plant, approximately \$0.1 million in accumulated depreciation for the Worthington Wind Turbines, and approximately \$0.4 million in accumulated depreciation for computer equipment.

WISCONSIN PUBLIC POWER INC.

Management Discussion and Analysis

December 31, 2006 and 2005

Construction work in progress increased by approximately \$28.6 million, from approximately \$0.1 million in 2004 to approximately \$28.7 million in 2005. Approximately \$28.1 million of the increase was construction work in progress on Elm Road Generating Station Units 1 and 2, approximately \$0.5 million of the increase was costs of preliminary work on the Prairie State Generating Project, and approximately \$0.1 million of the increase was construction work in progress on Boswell 4.

Total Liabilities

Total liabilities increased by approximately \$251.9 million due primarily to WPPI issuing \$236.92 million in bonds to fund the acquisition of an approximately 51 MW share in each of Elm Road Generating Station Units 1 and 2. WPPI has budgeted \$210.5 million for estimated construction costs and contingencies, which will be funded by bond proceeds of approximately \$193.4 million and interest earnings on the bond proceeds of approximately \$17.1 million. The remainder of the bonds were issued to cover capitalized interest of approximately \$37.0 million, a debt service reserve of approximately \$8.2 million, and costs of issuance of approximately \$3.5 million. Each line item that is part of the condensed balance sheets is discussed in more detail in the following sections.

Current Liabilities

Current maturities of long term debt increased approximately \$3.0 million, from approximately \$5.6 million in 2004 to approximately \$8.6 million in 2005. Increases in the account reflected reclassification of approximately \$8.6 million in 2003 Series A, B and C maturities from long term debt to short term debt, and retirement of approximately \$5.6 million in 2003 Series A, B and C maturities.

Interest accrued increased by approximately \$1.1 million, from approximately \$2.3 million in 2004 to approximately \$3.4 million in 2005. This amount increased by approximately \$1.5 million for interest expense for 2005 Series A&B, offset by a decrease of approximately \$0.4 million for interest expense due on 2003 Series A, B and C.

The line of credit balance outstanding increased by \$6.5 million, from \$0.0 million in 2004 to \$6.5 million in 2005. WPPI established a \$5.0 million line of credit in June 2004 with Chase Bank, and increased it to \$10.0 million in March 2005.

Accounts Payable increased by approximately \$6.5 million, from approximately \$16.2 million in 2004 to approximately \$22.3 million in 2005. The increase was attributable to the higher purchased power expense in the second half of 2005. WPPI also accrued approximately \$0.3 million for the Prairie State Energy Campus project for payment required with the Initial Interest Acquisition Notice which was issued on December 30, 2005.

Other current liabilities decreased by approximately \$2.7 million, from approximately \$3.9 million in 2004 to approximately \$1.1 million in 2005. The majority of the decrease was due to the payment in 2005 of \$2.5 million to Menasha Utilities for the buyout of an output contract, and a lowering of the SEP-IRA Retirement Plan contribution liability of approximately \$0.2 million due to a shift in 2005 to monthly deposits from bi-annual deposits.

WISCONSIN PUBLIC POWER INC.

Management Discussion and Analysis

December 31, 2006 and 2005

Other Deferred Credits and Liabilities

Operating reserves and accrued liabilities increased approximately \$0.7 million, from approximately \$9.1 million in 2004 to approximately \$9.7 million in 2005. Increases included Renewal and Replacement Fund deposits for South Fond du Lac 1 of approximately \$0.7 million, South Fond du Lac 4 of approximately \$0.4 million, and the Self Insurance Fund of approximately \$0.1 million, and Post Retirement Obligation and other miscellaneous accruals of approximately \$0.2 million. Decreases included use of approximately \$0.5 million in the Renewal and Replacement Fund for Boswell 4 for repairs during 2005, and Employee Retention Plan Fund payments.

The fair value of interest rate swap agreements decreased approximately \$0.9 million, from approximately negative \$0.3 million to approximately negative \$1.2 million as a result of a combination of swap value changes and recording of the 2005 B swap. The 2003 B swap increased in market value by approximately \$0.6 million, from approximately negative \$1.2 million in 2004 to approximately negative \$0.6 million in 2005. The 2003 C swap increased in market value by approximately \$0.3 million, from approximately \$0.9 million in 2004 to approximately \$1.2 million in 2005. The 2005 B swap was recorded at an initial value of approximately negative \$1.9 million on December 31, 2005. The value of the swaps to WPPI reflects changes in interest rates. If interest rates rise, the swaps will generally gain value, and if interest rates fall, the swaps will generally lose value.

The asset retirement obligation, which is the accrual of funds for retirement of the ash ponds at Boswell 4, increased approximately \$0.1 million as a result of monthly deferrals to the fund from ongoing revenue, plus interest earnings on the funds which remain in the fund.

Long-Term Debt

Revenue bonds net of unamortized premium increased by approximately \$235.3 million, from approximately \$158.3 million in 2004 to \$393.6 million in 2005. This increase included approximately \$236.9 million in new long term debt for 2005 Series A and B, and approximately \$5.2 million for unamortized premium for Series 2005 A and B, amortization of the loss on reacquired debt for 2003 Series A, B and C of approximately \$1.3 million, the amortization of the loss on reacquired debt for 1993 Series A and B of approximately \$1.3 million. Decreases in the account included approximately \$0.9 million for amortization of the premium on Series 2003 A and the reclassification of approximately \$8.6 million in 2003 Series A, B and C principal to short term debt.

Rate Stabilization Fund

The Rate Stabilization Fund increased by approximately \$0.6 million, from approximately \$35.1 million in 2004 to approximately \$35.8 million in 2005, due to payments from new Members.

WISCONSIN PUBLIC POWER INC.

Management Discussion and Analysis

December 31, 2006 and 2005

Net Assets

Net Assets invested in capital assets, net of related debt decreased by approximately \$46.5 million, from approximately negative \$35.6 million in 2004 to approximately negative \$82.1 million in 2005. The change was a result of an a decrease in net electric plant and equipment of approximately \$6.0 million, a decrease in the amount of the fair value of interest swaps of approximately \$0.9 million, and an increase in long term debt of approximately \$236.1 million, offset by an increase in construction work in progress of approximately \$28.7 million and an increase in funds available for construction of approximately \$167.8 million.

Restricted net assets increased by approximately \$54.6 million, from approximately \$53.2 million in 2004 to approximately \$107.9 in 2005. The change was a result of an increase in total non current restricted cash and investments of approximately \$175.6 million, an increase in restricted interest receivable of approximately \$1.5 million, and an increase in current restricted cash and investments of approximately \$45.3 million, less an increase for construction funds of approximately \$167.8 million, which must be subtracted because it is used to calculate net assets invested in capital assets, net of related debt.

Unrestricted net assets decreased by approximately \$1.5 million, from approximately \$33.5 million in 2004 to approximately \$32.0 million in 2005. This amount is the remainder of retained earnings after computing the value of net assets invested in capital assets, net of related debt and restricted net assets.

Total net assets increased by approximately \$6.6 million, from approximately \$51.1 million in 2004 to approximately \$57.7 million in 2005. The increase was a result of the change in net assets during 2005 from continuing operations. The change in net assets is described in further detail in the discussion of the Condensed Statements of Revenues, Expenses and Changes in Net Assets for 2005 and 2004.

WISCONSIN PUBLIC POWER INC.

Management Discussion and Analysis

December 31, 2006 and 2005

The following table summarizes the changes in financial position for WPPI for the years ended December 31, 2005 and 2004:

Condensed Statements of Revenues, Expenses, and Changes in Net Assets for the Periods Ended December 31, 2005 and 2004

	<u>2005</u>	<u>2004</u>	<u>Dollar change</u>	<u>Percentage change</u>
Operating revenues	\$ 306,111,928	\$ 223,028,979	\$ 83,082,949	37.3%
Operating expenses	<u>296,977,487</u>	<u>214,692,925</u>	<u>82,284,562</u>	38.3%
Operating income	9,134,441	8,336,054	798,387	9.6%
Net investment income, and equity in earnings of ATC, and unrealized gain(loss) on interest rate swaps	7,846,430	5,344,627	2,501,803	46.8%
Interest expense and debt-related expenses	(10,920,999)	(9,989,948)	(931,051)	9.3%
Other nonoperating expenses	<u>(81,129)</u>	<u>(147,092)</u>	<u>65,963</u>	-44.8%
Change in net assets before future recoverable costs	5,978,743	3,543,641	2,435,102	68.7%
Future recoverable costs	<u>650,610</u>	<u>556,359</u>	<u>94,251</u>	16.9%
Change in net assets	6,629,353	4,100,000	2,529,353	61.7%
Net assets, beginning of year	<u>51,113,300</u>	<u>47,013,300</u>	<u>4,100,000</u>	8.7%
Net assets, end of year	<u>\$ 57,742,653</u>	<u>\$ 51,113,300</u>	<u>\$ 6,629,353</u>	13.0%

Operating Revenues

2005 was a year which saw rapidly rising purchased power costs, particularly in the second half of the year. As WPPI purchased more expensive power to meet member demand, revenues increased correspondingly with those costs as WPPI billed members for the cost of purchased power. Total operating revenues increased approximately \$83.1 million, or approximately 37.3%, from approximately \$223.0 million in 2004 to approximately \$306.1 million in 2005.

Included in operating revenues are sales to member, sales to others, and other income. All amounts have been rounded to the nearest \$0.1 million.

Sales to members increased approximately \$57.5 million or approximately 29.2%, from approximately \$196.4 in 2004 million to approximately \$254.0 million in 2005. Megawatt hour sales to members increased approximately 7.8%, from 4,585,942 in 2004 to a total of 4,941,385 in 2005. New Members Juneau, New Glarus and Mt. Horeb accounted for approximately 2.0% of the megawatt hour increase, with the remaining 5.8% increase in megawatt hours attributable to requirements from existing members. Approximately \$42.0 million, or approximately 21.3%, of the increased revenue was attributable to billing for higher purchased power costs to serve members.

WISCONSIN PUBLIC POWER INC.

Management Discussion and Analysis

December 31, 2006 and 2005

There was no Rate Stabilization Fund use in 2005, whereas approximately \$3.0 million was utilized in 2004 to offset in part the cost of replacement power purchased during an unplanned outage at Boswell 4.

Sales to others increased approximately \$28.4 million, or approximately 124.8%, from approximately \$22.8 million in 2004 to approximately \$51.2 million in 2005. Sales of generation into the Midwest Independent System Operator Day 2 Market totaled approximately \$27.0 million, and accounted for the bulk of the increase. These sales occurred after the start of the Day 2 Market on April 1, 2005. Total sales to other customers accounted for the remaining approximately \$1.8 million increase in sales to others.

Other income increased approximately \$0.1 million driven primarily by an increase in revenue from the Worthington Wind Turbines of approximately \$0.1 million.

Operating Expenses

Total operating expenses increased approximately \$82.3 million, or approximately 38.3%, from approximately \$214.7 million in 2004 to approximately \$297.0 million in 2005. The increase in operating expenses was driven primarily by the higher purchased power costs.

Purchased power expense, which includes purchased power and transmission expenses, increased approximately \$64.7 million, or approximately 35.7%, from approximately \$181.2 million in 2004 to approximately \$245.9 million in 2005. The purchased power expense portion of this line item increased approximately \$61.6 million, or approximately 38.4%, from approximately \$160.2 million in 2004 to approximately \$221.8 million in 2005, primarily due to higher fuel prices. The transmission expense portion of this line item increased by approximately \$3.1 million, or approximately 15.0%, from approximately \$20.9 million in 2004 to approximately \$24.0 million in 2005, primarily due to an increase in rates.

Fuel expense increased approximately \$16.6 million, from approximately \$8.5 million in 2004 to approximately \$25.1 million in 2005. Part of the increase was attributable to WPPI's Boswell 4 and South Fond du Lac Units 1 and 4 returning to normal levels of operation in 2005, after experiencing unplanned outages that necessitated major repairs in 2004. Fuel expense was approximately \$18.0 million in 2003, which was a more typical year of operations. The additional increase in 2005 over the 2004 and 2003 levels was attributable to higher costs for natural gas.

Other power production expense decreased by approximately \$0.3 million, or approximately 6.0%, from approximately \$5.3 million in 2004 to approximately \$4.9 million in 2005. The reduction reflected lower maintenance costs at Boswell 4 and South Fond du Lac Units 1 and 4 due to the extensive maintenance performed in 2004.

Administrative and general expense increased by approximately \$0.5 million, or approximately 4.2%, from approximately \$11.3 million in 2004 to approximately \$11.8 million in 2005. Salary and benefits made up approximately 59% of all administrative and general expense. Those categories increased by approximately 7.3% in 2005 over 2004 due to an increase of 2 staff members, increases in salaries, and health insurance premium increases of approximately 19.5%.

WISCONSIN PUBLIC POWER INC.

Management Discussion and Analysis

December 31, 2006 and 2005

Depreciation and amortization expense increased approximately \$0.6 million, from approximately \$6.0 million in 2004 to approximately \$6.6 million in 2005. The increase was due primarily to the Island Street Peaking Plant being in operation for all of 2005 - the plant was operational as a new plant for May through December of 2004. Island Street depreciation increased approximately \$0.4 million. Boswell 4 had an increase of approximately \$0.1 million, and other WPPI generation units accounted for the remaining approximately \$0.1 million increase.

Tax expense increased approximately \$0.1 million, from approximately \$2.5 million in 2004 to approximately \$2.6 million in 2005. The increase was a result of the Island Street Peaking Plant being in operation for all 12 months of 2005, after being operational as a new plant for only a partial year in 2004.

Nonoperating Revenues (Expenses)

Investment income increased approximately \$1.9 million, from approximately \$2.2 million in 2004 to approximately \$4.1 million in 2005. The majority of the increase was from the reinvestment of the 2005 A and B bond proceeds for the last two months of 2005. Reinvestment of bond proceeds increased investment income approximately \$1.6 million in 2005. The investment income from the bond proceeds is being used to fund the construction of Elm Road Generating Station Units 1 and 2, and pay for a portion of capitalized interest during construction of the units, as outlined in the plan of finance for the units. The remaining approximately \$0.3 million in increased investment income was attributable to WPPI investment activities. WPPI maintains a laddered portfolio of investments to maximize interest earnings. A portion of the total investments is scheduled to mature each year. In 2005, WPPI was able to reinvest the proceeds from matured investments at higher interest rates than those funds had previously been invested in, which generated additional investment income over the investment income in 2004.

Equity in earnings of ATC (American Transmission Company) increased by approximately \$0.8 million, from approximately \$4.2 million in 2004 to approximately \$5.1 million in 2005. WPPI maintains an ownership share of approximately 5.2%. WPPI's equity in the earnings of ATC increased in 2005 as a result of higher earnings at ATC during 2005 compared with 2004.

Unrealized loss on interest rate swap agreement increased by approximately \$0.1 million, from approximately \$0.8 million in 2004 to approximately \$0.9 million in 2005. The unrealized loss is the net result of mark to market calculations for WPPI's three floating to fixed rate swaps.

WPPI's 2003B transaction, which had an original notional amount of \$65.7 million, had a notional amount of \$65.1 million at the end of 2005. The fair value of this swap increased approximately \$0.6 million, from approximately negative \$1.2 million in 2004 to approximately negative \$0.6 million in 2005.

WPPI's 2003C transaction, which had an original notional amount of \$39.35 million, had a notional amount of \$37.925 million at the end of 2005. The fair value of this swap increased approximately \$0.3 million, from approximately \$0.9 million in 2004 to approximately \$1.2 million in 2005.

WPPI's 2005B transaction, which had an original notional amount of \$93.9 million, had a notional amount of \$93.9 million at the end of 2005. The fair value of this swap was recorded for the first time in 2005 at approximately negative \$1.9 million.

The net result of marking the three swap transactions to market as of December 31, 2005 was the recognition of an unrealized loss of approximately \$0.9 million in 2005.

WISCONSIN PUBLIC POWER INC.

Management Discussion and Analysis

December 31, 2006 and 2005

Net decrease in fair value of investments increased by approximately \$0.1 million, from approximately negative \$0.3 million in 2004 to approximately negative \$0.4 million in 2005. WPPI has an investment policy of purchasing highly rated investments and holding them to maturity. The investment portfolio is structured in a ladder format to have investments of varying maturity dates.

Interest expense increased approximately \$1.1 million, from approximately \$7.9 million in 2004 to approximately \$9.0 million in 2005. The increase was due to interest expense of approximately \$1.8 million on WPPI's Series 2005 A and B bonds, which were issued on November 2, 2005 to fund the Elm Road Generating Station construction project. This amount was offset by a slight decline in interest expense on WPPI's Series 2003 A, B and C issues due to scheduled retirement of bond principal, and approximately \$0.5 million in allowance for funds used during construction attributable to the Elm Road Generation Station construction. The amount is calculated by taking capitalized interest less interest earnings on the capitalized interest funds. The difference is recorded as income and an asset. The asset is then amortized over the life of the project that generated it. This helps to moderate rates, because the net cost of the capitalized interest is spread over the life of the project.

Amortization of debt related costs decreased by approximately \$0.1 million, from approximately \$2.1 million in 2004 to approximately \$2.0 million in 2005. The decrease was in accordance with amortization schedules for the Series 2003 A, B and C debt related costs.

Future Recoverable Costs

Future recoverable costs increased approximately \$0.1 million, from approximately \$0.6 million in 2004 to approximately \$0.7 million in 2005. Future recoverable costs is a calculation designed to ensure that rate payers are not charged for both depreciation on an asset and principal payments on the bonds issued to acquire the asset in the same year. The calculation ensures that the combination of interest payments, principal payments, and depreciation expense are levelized over the life of an asset. In that manner, rates to pay for the asset are relatively level from year to year. In the early years of an asset, the calculation will result in an addition to income and assets. As principal is retired, the calculation will result in a reduction to income and a reduction in the accrued asset. WPPI added new debt service accruals in 2005 for the 2005A and 2005B bonds, resulting in an increase in future recoverable costs of approximately \$0.1 million.

Change in Net Assets

Change in net assets increased by approximately \$2.5 million, from \$4.1 million in 2004 to approximately \$6.6 million in 2005. The change is the net result of revenues and other income minus expenses and other costs as described in the sections above.

Total net assets at the end of 2005 were approximately \$57.7 million, up from approximately \$51.1 million at the end of 2004.

WISCONSIN PUBLIC POWER INC.

Statement of Net Assets December 31, 2006 and 2005

	2006	2005	Memorandum Only Net Change
Assets			
Current assets:			
Cash and investments	\$ 22,808,817	\$ 18,160,698	\$ 4,648,119
Restricted cash and investments	73,544,759	51,291,534	22,253,225
Receivables:			
Power sales	21,519,253	27,596,797	(6,077,544)
Other	524,047	348,944	175,103
Unrestricted Interest	552,134	319,436	232,698
Restricted Interest	4,070,421	1,490,653	2,579,768
Total receivables	26,665,855	29,755,830	(3,089,975)
Inventories	3,566,733	3,387,184	179,549
Prepayments	1,067,880	366,562	701,318
Total current assets	127,654,044	102,961,808	24,692,236
Noncurrent assets:			
Restricted cash and investments	174,445,019	223,971,151	(49,526,132)
Investments	675,801	657,941	17,860
Investment in ATC	43,269,461	32,257,900	11,011,561
Receivables from members	281,910	20,021	261,889
Total non-current assets	218,672,191	256,907,013	(38,234,822)
Deferred costs:			
Unamortized bond issuance costs	5,533,415	5,868,639	(335,224)
Future recoverable costs	21,542,177	20,981,802	560,375
Fair value of interest rate swap	1,677,053	-	1,677,053
Other	2,117,488	3,123,836	(1,006,348)
Total deferred costs	30,870,133	29,974,277	895,856
Capital assets:			
Property, plant and equipment	210,286,293	208,923,113	1,363,180
Accumulated depreciation and amortization	(91,388,605)	(85,331,589)	(6,057,016)
Electric plant and equipment, net	118,897,688	123,591,524	(4,693,836)
Land	88,883	88,883	
Construction work in progress	63,063,956	28,694,373	34,369,583
Total capital assets	182,050,527	152,374,780	29,675,747
Total assets	\$ 559,246,895	\$ 542,217,878	\$ 17,029,017

See accompanying notes to financial statements and independent auditors' report.

WISCONSIN PUBLIC POWER INC.

Statement of Net Assets December 31, 2006 and 2005

	2006	2005	Memorandum Only Net Change
Liabilities and Net Assets			
Current liabilities			
Liabilities payable from restricted assets:			
Accounts payable	\$ 22,705,805	\$ 22,669,026	\$ 36,779
Accrued interest	5,533,233	3,399,420	2,133,813
Line of credit	-	6,500,000	(6,500,000)
Current maturities of long-term debt	6,085,000	8,585,000	(2,500,000)
Other current liabilities	89,153	1,129,040	(1,039,887)
Total current liabilities	34,413,191	42,282,486	(7,869,295)
Deferred credits and other liabilities			
Operating reserves and other liabilities	11,484,619	9,746,133	1,738,486
Rate stabilization	36,557,320	35,756,677	800,643
Fair value of interest rate swap agreement	-	1,226,841	(1,226,841)
Regulatory liability	1,677,053	-	1,677,053
Asset retirement obligation	1,991,190	1,896,371	94,819
Total deferred credits & other liabilities	51,710,182	48,626,022	3,084,160
Long-term debt:			
Revenue bonds (net of unamortized premium)	389,024,923	393,566,716	(4,541,793)
Total liabilities	475,148,296	484,475,224	(9,326,928)
Net assets:			
Invested in capital assets, net of related debt	(64,967,255)	(75,014,998)	10,047,743
Restricted for debt compliance, decommissioning, self insurance and replacements	109,501,473	107,860,039	1,641,434
Unrestricted	39,564,381	24,897,613	14,666,768
Total net assets	84,098,599	57,742,654	26,355,945
Total net assets and liabilities	\$ 559,246,895	\$ 542,217,878	\$ 17,029,017

See accompanying notes to financial statements and independent auditors' report.

WISCONSIN PUBLIC POWER INC.

Statement of Revenue, Expenses, and Changes in Net Assets
Years Ended December 31, 2006 and 2005

	<u>2006</u>	<u>2005</u>
Operating revenues:		
Sales to members	\$ 251,657,355	\$ 253,960,043
Sales to others	26,507,436	51,226,690
Other income	16,551,992	925,195
Total operating revenues	<u>294,716,783</u>	<u>306,111,928</u>
Operating expenses:		
Purchased power	231,584,408	245,870,163
Fuel expense	14,630,152	25,081,903
Other power production	5,021,453	4,945,772
Administration and general	12,923,724	11,815,072
Depreciation and amortization	6,736,109	6,641,731
Taxes	1,656,897	2,622,846
Total operating expenses	<u>272,552,743</u>	<u>296,977,487</u>
Operating income	22,164,040	9,134,441
Nonoperating revenues (expenses):		
Investment income	11,704,102	4,140,803
Equity in earnings of ATC	6,565,662	5,061,484
Unrealized (loss) gain on interest rate swap investments	1,677,053	(945,856)
Net (decrease) increase in fair value of investments	394,479	(410,001)
Interest expense	(14,348,365)	(8,950,930)
Amortization of debt-related costs	(1,878,431)	(1,970,069)
Other	(33,750)	(34,625)
Loss disposal of assets	991	(46,504)
Total non-operating expenses, net	<u>4,081,741</u>	<u>(3,155,698)</u>
Change in net assets before future recoverable costs and cumulative effect of change in accounting principle	26,245,781	5,978,743
Future costs to be (returned) recovered	<u>(1,116,678)</u>	<u>650,611</u>
Change in net assets before cumulative effect of change in accounting principle	25,129,103	6,629,354
Cumulative Effect of Change in Accounting Principle	<u>1,226,841</u>	<u>-</u>
Change in net assets	26,355,944	6,629,354
Beginning year net assets	<u>57,742,654</u>	<u>51,113,300</u>
End of year net assets	<u>\$ 84,098,598</u>	<u>\$ 57,742,654</u>

See accompanying notes to financial statements and independent auditors' report.

WISCONSIN PUBLIC POWER INC.

Statement of Cash Flows
Years Ended December 31, 2006 and 2005

	2006	2005
Cash flows from operating activities		
Cash receipts from members and others	\$ 301,144,944	\$ 299,302,372
Cash payments for purchased power	(231,569,072)	(243,235,657)
Cash payments for fuel	(14,515,840)	(25,171,824)
Cash payments for operations and maintenance	(3,826,017)	(4,506,138)
Cash payments for payroll and ad valorem taxes	(2,490,377)	(2,619,890)
Cash payments to employees	(5,513,725)	(5,261,750)
Cash payments for administrative and general	(7,783,433)	(7,303,423)
Net cash provided by operating activities	35,446,480	11,203,690
Cash flows from noncapital financing activities		
Cash payments for other nonoperating expenses (lobbying)	(33,750)	(34,625)
Cash flows from investing activities		
Investments purchased	(62,590,405)	(244,016,037)
Investment in ATC	(9,405,938)	(4,100,592)
Investments sold	95,763,613	56,025,022
Investment income	10,032,286	2,882,185
Cash distributions received from ATC	4,960,039	3,879,264
Cash receipts from notes	-	5,488
Net cash provided by (used in) investing activities	38,759,595	(185,324,670)
Cash flows from capital and related financing activities		
Acquisition and construction of capital assets	(33,223,003)	(26,462,390)
Bond issuance costs paid	-	(3,520,954)
Bond premium proceeds	-	5,229,624
Proceeds from issuance of new debt	-	236,920,000
Proceeds from line of credit	(6,500,000)	6,500,000
Principal paid	(8,585,000)	(5,600,000)
Interest paid	(15,685,091)	(8,367,534)
Net cash provided by (used in) capital & related fin activities	(63,993,094)	204,698,746
Increase in cash and cash equivalents	10,179,231	30,543,141
Cash and cash equivalents, beginning of year	66,652,314	36,109,173
Cash and cash equivalents, end of year	\$ 76,831,545	\$ 66,652,314

See accompanying notes to financial statements and independent auditors' report.

WISCONSIN PUBLIC POWER INC.

Statement of Cash Flows Years Ended December 31, 2006 and 2005

	2006	2005
Reconciliation of operating income to net cash flows from operating activities		
Operating income	\$ 22,164,040	\$ 9,134,441
Noncash item included in operating income:		
Depreciation and amortization	6,736,109	6,641,731
Changes in assets and liabilities:		
Receivables	5,641,527	(7,502,656)
Inventories	(179,549)	(800,664)
Prepayments	(701,318)	(32,705)
Accounts payable and other current liabilities	(876,211)	1,247,964
Deferred credits & other liabilities	1,656,508	1,510,205
Other deferred charges	1,005,374	1,005,374
	\$ 35,446,480	\$ 11,203,690
 Reconciliation of cash and cash equivalents to the balance sheet:		
Current Assets		
Cash and Investments	\$ 22,808,817	\$ 18,160,698
Restricted Cash and Investments	73,544,759	51,291,534
Non-current Assets		
Cash and Investments	174,445,019	223,971,151
Investments	675,801	657,941
Total Cash and Investments	271,474,396	294,081,324
Less: Long Term Investments	194,642,851	227,429,010
Total Cash and Cash Equivalents	\$ 76,831,545	\$ 66,652,314

Non-Cash Activity:

During 2006 and 2005 WPPI recognized \$1,355,280 and \$1,012,297 of equity earnings in ATC.

During 2006 and 2005 WPPI recognized \$90,486 and \$83,845 of accretion of long term investments.

See accompanying notes to financial statements and independent auditors' report.

NOTES TO FINANCIAL STATEMENTS

WISCONSIN PUBLIC POWER INC.

Notes to Financial Statements

December 31, 2006 and 2005

(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 served 46 customer-owned electric utilities as of December 31, 2006. In 2007, Gladstone Power & Light and Alger Delta Cooperative Electric Association joined WPPI.

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, a small percentage of WPPI's operating revenue comes from sales of capacity and energy to other entities including sales in the MISO market.

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 twin pac combustion turbine generator unit in Kaukauna; member generation under contract to WPPI; and power purchases from other entities including the Midwest Independent System Operator (MISO) energy market. 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 owns the other two units on the site and operates and maintains the units owned by WPPI. WPPI compensates Alliant for these services. WPPI owns the combustion turbine located in Kaukauna 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 52 MW of capacity. The remainder of WPPI's power requirements are purchased from other entities.

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

The financial statements are prepared on the economic resources measurement focus 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 Effect 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).

WISCONSIN PUBLIC POWER INC.

Notes to Financial Statements

December 31, 2006 and 2005

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.

WPPI participates in the Midwest Independent System Operator (MISO) energy market. MISO may true-up expenses and revenues for up to 546 days. WPPI accrues items that are known at the time of closing, but since there is such a large window of true-ups, actual results may differ from the 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) *Deposits and Investments*

Investments of WPPI's funds are restricted by Section §66.0825 of the Wisconsin Statutes which states that notwithstanding the provisions of any other law, WPPI may invest in any funds in obligations, securities and other investments that the company deems proper.

(f) *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 sheet represent cash and investments whose use is restricted by the bond resolution.

It is WPPI's practice to use restricted funds on hand, when available, before using unrestricted funds.

(g) *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.

(h) *Future Costs to be (Returned) Recovered*

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.

WISCONSIN PUBLIC POWER INC.

Notes to Financial Statements

December 31, 2006 and 2005

In 2006 WPPI adopted the principles of regulatory asset and liability accounting in accordance with SFAS No. 71, to record the unrealized gains or losses from the annual mark to market calculations on interest rate swaps. The gain on interest rate swaps was recorded under non-operating revenues (expenses) and the deferral of the gain was recorded under future costs to be (returned) recovered. The deferrals are found on the balance sheet under deferred costs and deferred credits.

The cumulative effect of change in accounting principle represents the amounts expensed in prior years to mark to market the interest rate swaps.

(i) 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.

(j) Cash Equivalents

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

(k) 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.

(l) 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.

(m) Rates

Rates are reviewed and adopted by WPPI's Board of Directors annually. Under WPPI's 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, 2006 and 2005, \$800,643 and \$628,831, respectively, was deferred and added to the Rate Stabilization Fund.

(n) 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.

The Minnesota property taxes were over-estimated in prior years. In 2006, WPPI made an estimate true-up amounting to \$831,386 which reduced tax expense and other current liabilities.

WISCONSIN PUBLIC POWER INC.

Notes to Financial Statements

December 31, 2006 and 2005

(o) *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 960 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 in excess of five days. Accrued vacation is not considered material; therefore, no liability is recorded.

(p) *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 Fund. 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.

(q) *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.

(r) *New Accounting Pronouncements*

In March 2003, the Government 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 implemented Statement No. 42 beginning with the year ending December 31, 2006.

In June of 2004, the GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Post Employment Benefits Other Than Pensions*. This Statement establishes accounting and financial reporting standards for post employment benefits other than pensions. WPPI will implement Statement No. 42 beginning with the year ending December 31, 2007. WPPI is currently evaluating the impact of adopting Statement No. 45.

WISCONSIN PUBLIC POWER INC.

Notes to Financial Statements

December 31, 2006 and 2005

(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 Local Government Investment Pool, treasury notes, agencies, treasury strips, and corporate bonds. The funds' purposes and balances are summarized below:

<u>Fund</u>	<u>Held by</u>	<u>Purpose</u>
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 half of 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.
Renewals & Replacements	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.

WISCONSIN PUBLIC POWER INC.

Notes to Financial Statements

December 31, 2006 and 2005

	2006	2005
Restricted cash and investments:		
Noncurrent:		
Debt Service Reserve Accounts	\$ 17,557,808	\$ 16,938,383
Renewals & Replacements Fund	11,985,667	5,895,010
Self-Insurance Fund	3,256,495	3,084,255
Rate Stabilization Fund	36,024,873	35,425,534
Decommissioning	2,368,591	2,290,767
Construction Fund	87,677,635	134,992,319
Debt Service Funds	15,573,950	25,344,883
Total noncurrent	174,445,019	223,971,151
Current:		
Construction Fund	54,881,090	33,900,980
Debt Service Funds	18,663,669	17,390,555
Total current	73,544,759	51,291,535
Total restricted cash and investments	247,989,778	275,262,686
Unrestricted cash and investments:		
Noncurrent:		
Investments	675,801	657,941
Investment in ATC	43,269,461	32,257,900
	43,945,262	32,915,841
Current cash and investments:		
Petty cash	20	300
Revenue Fund	22,808,797	18,160,397
	22,808,817	18,160,697
Total cash and investments	\$ 314,743,857	\$ 326,339,224

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.

WPPI has an internal investment policy that stipulates its guidelines to help ensure safety of principal, liquidity, and diversification of its investment portfolio. Generally, investments permitted by the policy within the limits of WPPI's bond resolution 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, or a portfolio of such investments in money market funds or mutual funds, and investments in ATC.

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.

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 non-interest-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 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 WPPI.

WISCONSIN PUBLIC POWER INC.

Notes to Financial Statements

December 31, 2006 and 2005

At December 31, 2006 WPPI had \$1,375,882 in bank balances (\$929,594 book balances) that were uninsured and uncollateralized deposits. At December 31, 2005 WPPI had \$915,948 in bank balances (\$592,007 in book balances) that were uninsured and uncollateralized deposits. All investments held as of December 31, 2006 and December 31, 2005 were held in trust on behalf of WPPI in WPPI's name and therefore not subject to custodial credit risk.

- **Credit risk** – The risk that an issuer or other counterparty to an investment will not fulfill its obligations. WPPI makes certain investments in Guaranteed Investment Contracts. These investments are unrated. As of December 31, 2006 WPPI's other investments were rated as follows:

	Standard & Poor's	Moody's	Amount
U.S. government securities	AAA	Aaa	49,798,701
Money market mutual fund	AAAm	Aaa	52,747,874
Corporate Bonds	AAA	Aaa	1,000,000
Corporate Bonds	AA+	Aa1	1,025,318
Corporate Bonds	AA	Aa2	979,850
Corporate Bonds	AA-	Aa3	1,490,255
Corporate Bonds	A+	Aa3	483,750

As of December 31, 2005 WPPI's investments were rated as follows

	Standard & Poor's	Moody's	Amount
U.S. government securities	AAA	Aaa	43,250,249
Money market mutual fund	AAAm	Aaa	48,190,397
Corporate Bonds	AAA	Aaa	971,940
Corporate Bonds	AA-	Aa1	492,365
Corporate Bonds	AA	Aa2	484,880
Corporate Bonds	AA-	Aa3	491,440
Corporate Bonds	A-	A1	249,982

- **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. WPPI has guaranteed investment contracts (repurchase agreements) with three entities for construction and capitalized interest funds. Although the contracts are with each entity, there are underlying securities supporting each contract.

The following investments exceeded the 5% threshold in 2006 and 2005:

	2006	2005
CitiGroup Guaranteed Investment Contract	\$ 99,776,385	\$ 102,916,623
JP Morgan Guaranteed Investment Contract	\$ 49,851,646	\$ 60,387,630
Morgan Stanley Guaranteed Investment Contract	\$ 15,124,034	\$ 21,583,805

- **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).

WISCONSIN PUBLIC POWER INC.

Notes to Financial Statements

December 31, 2006 and 2005

As of December 31, 2006, WPPI's investments were classified by maturity as follows:

	Maturity in Years			Fair Value
	Less than 1	1-5	Over 5	
U.S. government securities	27,696,481	16,065,522	6,036,698	49,798,701
Money market mutual fund	52,747,874	-	-	52,747,874
Certificates of deposit	200,000	100,000	-	300,000
Guaranteed Investment Contracts	59,500,480	103,251,585	-	162,752,065
Corporate bonds	1,499,563	3,479,610	-	4,979,173
Mutual funds	20,000	350,872	-	370,872
	141,664,398	123,247,589	6,036,698	270,948,685

As of December 31, 2005, WPPI's investments were classified by maturity as follows:

	Maturity in Years			Fair Value
	Less than 1	1-5	Over 5	
U.S. government securities	13,450,547	23,245,341	6,554,361	43,250,249
Money market mutual fund	48,190,397	-	-	48,190,397
Certificates of deposit	-	-	-	-
Guaranteed Investment Contracts	38,267,939	160,337,202	-	198,605,140
Corporate bonds	249,982	2,440,625	-	2,690,607
Mutual funds	102,000	550,624	-	652,624
	100,260,865	186,573,792	6,554,361	293,389,017

(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, 2006 and 2005, WPPI's equity interest in ATC was approximately 5.5%. 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 2006, WPPI had outstanding commitments to fund ATC of approximately \$1,088,843. The amount was paid in January 2007.

WISCONSIN PUBLIC POWER INC.

Notes to Financial Statements

December 31, 2006 and 2005

Condensed financial data of ATC for 2006 and 2005 follows:

	<u>2006</u>	<u>2005</u>
	(In millions)	(In millions)
Operating statement data:		
Revenues	\$ 340.7	\$ 296.0
Operating expenses	(179.4)	(166.6)
Other income	2.0	3.5
Net interest expense	(41.4)	(36.5)
Earnings before tax	<u>\$ 121.9</u>	<u>\$ 96.4</u>
Balance sheet data:		
Current assets	\$ 33.5	\$ 29.2
Noncurrent assets	1,853.7	1,516.1
Total assets	<u>\$ 1,887.2</u>	<u>\$ 1,545.3</u>
Current liabilities	\$ 305.3	\$ 140.5
Long-term debt	648.9	648.7
Other noncurrent liabilities	125.7	105.3
Members' equity	807.3	650.8
Total liabilities and members' equity	<u>\$ 1,887.2</u>	<u>\$ 1,545.3</u>

WISCONSIN PUBLIC POWER INC.

Notes to Financial Statements

December 31, 2006 and 2005

(4) Capital Assets

Capital asset activity for the years ended December 31, 2006 and 2005 was as follows:

2006	Beginning balance	Additions	Transfers	Retirements	Ending balance
Nondepreciable assets:					
Land	\$ 88,883	\$ —	\$ —	\$ —	\$ 88,883
Construction work in progress	28,694,373	35,940,599	(1,571,015)	—	63,063,957
Total nondepreciable assets	28,783,256	35,940,599	(1,571,015)	—	63,152,840
Depreciable assets:					
Utility plant	208,923,113	203,335	1,571,015	(411,170)	210,286,293
Total depreciable assets	208,923,113	203,335	1,571,015	(411,170)	210,286,293
Accumulated depreciation and amortization	(85,331,589)	(6,736,109)	—	679,093	(91,388,605)
Depreciable assets, net	123,591,524	(6,532,774)	1,571,015	267,923	118,897,688
Capital assets, net	\$ 152,374,780	\$ 29,407,825	\$ —	\$ 267,923	\$ 182,050,528
2005	Beginning balance	Additions	Transfers	Retirements	Ending balance
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

Construction work in progress at December 31, 2006 consists primarily of the 8.33% interest in two 615 MW supercritical coal-fired generating units under construction in Oak Creek, Wisconsin. Capitalized interest included in the cost of the project was \$3,960,348 and \$489,809 for the years ended December 31, 2006 and 2005, respectively. The project was financed by the proceeds of the Series 2005A and 2005B bond issues.

WISCONSIN PUBLIC POWER INC.

Notes to Financial Statements

December 31, 2006 and 2005

(5) Asset Retirement Obligations

WPPI adopted Statement of Financial Accounting Standards No. 143 – *Accounting for Asset Retirement Obligations* (SFAS 143) in 2003. This statement addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. SFAS No. 143 requires an enterprise to record the fair value of an asset retirement obligation as a liability in the period in which it incurs a legal obligation associated with the retirement of a tangible long-lived asset. Adoption of this statement in 2003 resulted in an increase in net capital assets of \$576,824, an increase in accrued liabilities of \$263,987 and a change in net assets of \$312,837.

The scope of SFAS 143 includes future asset retirement obligations for the closure of ash ponds and scrubber ponds at the Boswell plant site. WPPI used information from Minnesota Power to estimate the cash flows to determine the obligation.

The following table presents the details of WPPI’s asset retirement obligations.

	2006	2005
Balance 1/1	1,896,971	1,806,068
Liabilities Incurred	-	-
Liabilities Settled	-	-
Accretion	94,219	90,903
Cash Flow Revisions	-	-
Balance 12/31	<u>1,991,190</u>	<u>1,896,971</u>

(6) Long-term Debt

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

	<u>2006</u>	<u>2005</u>
Revenue bonds:		
2003 Series A 3.00% to 5.25%		
Due July 1, 2005-2033	\$ 70,195,000	\$ 76,930,000
2003 Series B variable rate bonds		
Due July 1, 2005-2021	64,800,000	65,100,000
2003 Series C variable rate bonds		
Due July 1, 2005-2023	34,875,000	36,425,000
2005 Series A 4.625% to 5.00%		
Due July 1, 2005 -2037	143,020,000	143,020,000
2005 Series B variable rate bonds		
Due July 1, 2012-2037	<u>93,900,000</u>	<u>93,900,000</u>
Total bonds outstanding	406,790,000	415,375,000
Less: Current maturities	(6,085,000)	(8,585,000)
Unamortized discount/premium, net	<u>(11,680,077)</u>	<u>(13,223,283)</u>
	<u>\$ 389,024,923</u>	<u>\$ 393,566,717</u>

WISCONSIN PUBLIC POWER INC.

Notes to Financial Statements

December 31, 2006 and 2005

The terms outstanding for WPPI's variable rate issues are the following:

	<u>Fixed Rate Paid</u>	<u>Variable Rate Received</u>	<u>Rate Paid to Bond Holders</u>
2003 Series B Variable Rate Bonds	3.355%	67% of 1 month LIBOR	35 day auction rate
2003 Series C Variable Rate Bonds	2.8050%	67% of 1 month LIBOR	35 day auction rate
2005 Series B Variable Rate Bonds	3.500%	68% of 1 week LIBOR	7 day auction rate

The Power Supply System Revenue Bonds are generally secured by the 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.

No defeased debt remained outstanding at December 31, 2006 from advance refundings entered into by WPPI.

Long-term liability activities for the years ended December 31, 2006 and 2005 were as follows:

<u>Long-term liabilities as of December 31, 2006</u>	<u>Beginning balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending balance</u>
Long-term revenue bonds	\$ 415,375,000	\$ —	\$ (8,585,000)	\$ 406,790,000
Less:				
Current maturities	8,585,000	6,085,000	(8,585,000)	6,085,000
Unamortized discount/premium, net	<u>13,223,283</u>	<u>—</u>	<u>(1,543,206)</u>	<u>11,680,077</u>
Long-term revenue bonds, net	<u>\$ 393,566,717</u>	<u>\$ (6,085,000)</u>	<u>\$ 1,543,206</u>	<u>\$ 389,024,923</u>
Deferred credits and other liabilities:				
Operating reserves and accrued liabilities	\$ 9,746,133	\$ 2,477,287	\$ (2,458,180)	\$ 9,765,240
Rate stabilization	35,756,677	800,642	—	36,557,319
Asset retirement obligation	1,896,371	94,819	—	1,991,190
Fair value of interest rate swap agreements	1,226,841	—	(1,226,841)	—
Regulatory liability	<u>—</u>	<u>1,677,053</u>	<u>—</u>	<u>1,677,053</u>
Total deferred credits and other liabilities	<u>\$ 48,626,022</u>	<u>\$ 5,049,801</u>	<u>\$ (3,685,021)</u>	<u>\$ 49,990,802</u>

WISCONSIN PUBLIC POWER INC.

Notes to Financial Statements

December 31, 2006 and 2005

Long-term liabilities as of December 31, 2005	Beginning balance	Additions	Reductions	Ending balance
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/premium, 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>

Debt service payments on the outstanding bonds and the interest rate swap agreements (see note 7) are as follows:

Year	Principal	Interest	Total
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	10,375,000	15,893,934	26,268,934
2012-2016	79,585,000	70,265,331	149,850,331
2017-2021	93,935,000	52,140,359	146,075,359
2022-2026	54,490,000	37,595,213	92,085,213
2027-2031	61,235,000	25,292,545	86,527,545
2032-2037	<u>75,785,000</u>	<u>10,619,053</u>	<u>86,404,053</u>
	\$ <u>406,790,000</u>	\$ <u>279,493,488</u>	\$ <u>686,283,488</u>

(7) Interest Rate Swap Agreement

During 2005, WPPI entered into an interest rate swap agreement with JP Morgan and during 2003, WPPI entered into two interest rate swap agreements with Bear Stearns. 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 manage interest rate risk caused by fluctuations in interest rates. 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 both agreements. The fixed rates of interest were 3.5%, 3.355 % and 2.805%, respectively. As of December 31, 2006, the interest rate swaps had a positive fair value of \$1,677,053.

WISCONSIN PUBLIC POWER INC.

Notes to Financial Statements

December 31, 2006 and 2005

(8) Available Financing

During 2006, WPPI entered into a revolving line of credit agreement with Chase Bank, which permits borrowings of up to \$25,000,000 and expires on April 30, 2009. 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 plus 90 basis points. At December 31, 2006, there were no outstanding amounts on the line of credit.

Line of credit activities for the year ended December 31, 2006, is as follows:

	<u>Balance</u> <u>1/1</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance</u> <u>12/31</u>
Line of credit	\$ 6,500,000	\$ —	\$ (6,500,000)	\$ —

(9) Significant Members

Two significant members of WPPI accounted for \$61,341,693 and \$63,780,091 or approximately 22.0% and 22.5% of total sales revenues for the years ended December 31, 2006 and 2005, respectively.

(10) 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, 2006 and 2005 were \$602,544 and \$564,623, respectively.

(b) Retention Plan

In 1999, WPPI established an initial employee retention plan. In 2006, an additional amount was added to the plan that will extend payments out until 2011. The plan will make payments to specific employees after completing the defined years of continuing employment. Plan benefit expenses of \$153,874 and \$105,227 were accrued during 2006 and 2005, respectively.

(c) Defined Benefit Plan

Effective January 1, 2007 WPPI adopted a Defined Benefit Plan for several employees. The initial deposit was made from the retention plan and an additional amount from 2006 net earnings.

(d) Post Employment Medical Insurance

WPPI provides post employment medical insurance benefits. An employee who reaches age 60 and has ten years of service with WPPI qualifies for the benefit. For each full year worked past ten, the employee receives one year of benefit credit. An employee can earn up to a maximum of five years of benefit credits. For each year of benefit credit, WPPI will reimburse the employee for a portion of the cost of medical insurance. Full-time employees qualify for 50% reimbursement and part-time employees will receive a pro rata portion. At December 31, 2006 there were no participants and no benefit payments. The plan is unfunded. Post employment expenses of \$155,989 and \$129,200 were accrued during 2006 and 2005, respectively.

WISCONSIN PUBLIC POWER INC.

Notes to Financial Statements

December 31, 2006 and 2005

	2006			2005		
	Benefit Obligation	Accrued Benefit	Unrecognized Transition Obligation	Benefit Obligation	Accrued Benefit	Unrecognized Transition Obligation
Balance 1/1	672,005	307,018	364,987	337,789	177,819	159,970
Service Cost	88,759	88,759	0	70,831	70,831	0
Interest Cost	36,916	36,916	0	31,333	31,333	0
Actuarial Gain/Loss	(31,306)	0	(31,306)	232,052	0	232,052
Amort of transition	0	30,314	(30,314)	0	27,036	(27,036)
Annual Expense	94,369	155,989	(61,620)	334,216	129,200	205,017
Benefit Payments	0	0	0	0	0	0
Balance 12/31	766,374	463,007	303,367	672,005	307,018	364,987

The estimated benefits to be paid in the next ten years are shown below.

Year 1	\$8,029
Year 2	15,777
Year 3	26,376
Year 4	43,627
Year 5	53,052
Year 6-10	284,753

The measurement dates used to determine the postretirement benefit measurements are December 31, 2006 and December 31, 2005. The assumed health care cost trend rate for 2006 and 2005 was 12% with the trend rates declining to 4% in 2015. The weighed-average discount rate used in 2006 was 5.5%. The effect of a one-percentage-point change in the trend rate is shown below.

	1% Increase	1% Decrease
Service and Interest Cost	21,527	17,869
Accumulated Postretirement Benefit Obligation	99,579	78,181

(11) Commitments

WPPI has various long-term capacity and energy purchase contracts with various power suppliers. Capacity purchases for 2006 and 2005 totaled approximately 681 and 643 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, 2006, WPPI has paid approximately \$56.7 million of this commitment, with the remainder expected to be requested through 2010.

WISCONSIN PUBLIC POWER INC.

Notes to Financial Statements

December 31, 2006 and 2005

As of December 31, 2006, the water intake discharge (“WPDES”) permit issued for the Project was subject to judicial review in Dane County Circuit Court. In the event that the WPDES permit was to be invalidated, the project may incur additional costs relating to water intake and discharge systems, and WPPI would incur additional financial obligations as part of the project.

(12) 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 health care 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. There has been no significant reduction in insurance coverages in 2006.

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.

Following is the activity for the Self-Insurance Reserve for the years ended December 31, 2006 and 2005

	<u>2006</u>	<u>2005</u>
Self-Insurance Reserve, beginning of year	\$ 2,992,263	\$ 2,875,017
Additions, representing interest	273,530	117,246
Additions		
Usage		
Self-Insurance Reserve, end of year	<u>\$ 3,265,793</u>	<u>\$ 2,992,263</u>