

WISCONSIN PUBLIC POWER INC.

Notes to Financial Statements

December 31, 2007 and 2006

(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. In addition, WPPI provides wholesale electricity to seven municipal utilities and one electric cooperative located in Michigan and Iowa. While not legal members of WPPI, the non-member purchasers ("Non-Member Purchasers") receive service from WPPI under long term power supply contracts ("Long Term Contracts") that are substantially identical to the member's Long Term Contracts. Including Non-Member Purchasers, WPPI served 48 customer-owned electric utilities as of December 31, 2007, with service to a 49th commencing January 1, 2009.

WPPI sells power to its members and non-member purchasers 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 and non-member purchasers that are intended to enable members and non-member purchasers 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 and non-member purchasers 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 and non-member purchasers 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 is purchased from other entities.

WISCONSIN PUBLIC POWER INC.

Notes to Financial Statements

December 31, 2007 and 2006

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

The financial statements are prepared on the accrual basis of accounting, in conformity with U. S. generally accepted accounting principles, including the application of Statement of Financial Accounting Standards (SFAS) No. 71, *Accounting for the 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).

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

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

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

(d) *Capital Assets*

Additions to and replacements of capital assets are recorded at original cost, including allowance for borrowed funds if acquired with tax-exempt debt. Depreciation is recorded using the straight-line method using service lives of 2 to 35 years. It is WPPI's capitalization policy to capitalize all long-lived assets with an initial cost greater than \$2,500.

(e) *Deposits and Investments*

Investments of WPPI's funds are restricted by Section 66.0825 of the Wisconsin Statutes which states that notwithstanding the provision of any other law, WPPI may invest in any funds in obligations, securities and other investments that the company deems proper. Investments are stated at fair value to comply with accounting standards.

(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 sheets represent cash and investments whose use is restricted by the bond resolution.

It is WPPI's practice to use restricted funds on hand, when applicable, 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.

WISCONSIN PUBLIC POWER INC.

Notes to Financial Statements

December 31, 2007 and 2006

(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.

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 or loss on the interest rate swaps is recorded under non-operating revenues (expenses) and the deferral of the gain or loss is recorded under future costs to be (returned) recovered. The deferrals are found on the statement of net assets under deferred costs and deferred credits.

(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 expired in 2007 and will expire in 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. Due to the membership relationship and the high degree of collectibility, no allowance for uncollectible accounts is necessary.

(l) Inventories

Inventories include fuel and repair spare 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.

WISCONSIN PUBLIC POWER INC.

Notes to Financial Statements

December 31, 2007 and 2006

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 statement of net assets 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 year ended December 31, 2007 no revenue was deferred, however, \$1,652,000 was used and replenished. In 2006, \$800,643 was added to the Rate Stabilization Fund from member contributions.

(n) Purchased Power

WPPI has purchased power contracts of varying longer-term duration with a number of suppliers to meet the members' power requirements. WPPI currently purchases a total of approximately 650 MW from Wisconsin Electric Power Company ("WEPCO"), Wisconsin Power and Light ("WPL"), Wisconsin Public Service Corporation ("WPS"), and Constellation Energy Commodities Group, Inc. ("Constellation").

WEPCO – Power Sales Agreement. WPPI purchases firm partial requirements service from WEPCO under a Third Revised Power Sales Agreement dated April, 1, 2005 (the "WEPCO Power Sales Agreement"). The initial term of the WEPCO Power Sales Agreement ends April 30, 2025. WPPI pays FERC approved formula based average embedded cost rates under the WEPCO Power Sales Agreement. WPPI has committed to purchase 250 MW through the contract year beginning June 1, 2008, 230 MW for the contract year beginning June 1, 2009 and 180 MW for the contract year beginning June 1, 2010. Subject to the restriction that WPPI's nomination may only be reduced by a maximum of 50 MW from the prior year's nomination, WPPI is not obligated to purchase a minimum amount of power under the Agreement. WPPI is permitted to schedule energy up to the nominated demand at any time, but is not required to take any energy.

WPL – Power Supply Agreement. WPPI purchased 166 MW under the First Revised Power Supply Agreement for the contract year beginning June 1, 2007, and 61 MW in 2007 under all-requirements contracts that were assigned to WPPI. WPPI and WPL entered into a Second Revised Power Supply Agreement ("PSA") on February 4, 2008 that replaced the previous First Revised Power Supply Agreement and the all requirements contracts. The initial term of the Second Revised PSA expires May 31, 2017. Firm partial requirements service purchased under the Second Revised PSA is provided under WPL's partial requirements tariff (PR-1 tariff) filed with FERC. For the contract year commencing on June 1, 2008, WPPI is purchasing a total of 215 MW under the Second Revised PSA. WPPI's nominations are subject to certain minimums and maximums and can change on an annual basis. WPPI nominations can change (up or down) by 25 MW per year. The minimum capacity nomination is 155 MW through May 2014 and then decreases 10 MW per year through May 2017.

Constellation – Kendall County. WPPI purchases, pursuant to the Long-Term Capacity and Energy Purchase Contract with Constellation, approximately 85 MW of capacity and associated energy from the Kendall County Generating Facility Unit 3 ("Kendall County Unit 3"). The Kendall County Generating Facility ("Facility") is a 275 MW gas-fired combined-cycle plant located near Joliet, Illinois, which went into service in 2002. The Facility is owned and operated by LSP-Kendall Energy LLC, a wholly owned subsidiary of LS Power who has been acquired by Dynegy. Constellation has purchased the rights to all of the output of Kendall County Unit 3 through September 16, 2017 at which time the contract terminates.

WISCONSIN PUBLIC POWER INC.

Notes to Financial Statements

December 31, 2007 and 2006

WPS Long-Term Power Sale and Purchase Agreement. WPPI has a Long-Term Purchase Agreement with WPS that began May 1, 2006. WPPI pays formula based average embedded cost rates under the Agreement. In 2007, WPPI purchased 50 MW from WPS. The purchase will increase to 100 MW on June 1, 2008 and 150 MW on June 1, 2009. The initial term for a 100 MW portion of the contract runs through May 31, 2021 with another 50 MW portion having an initial term running through May 31, 2029. Either party may reduce each of the transactions under the agreement at the end of the initial term or anytime thereafter by giving the other party three years' notice.

(o) 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-accrued in prior years. In 2006 WPPI reduced that accrual by \$831,386 which reduced tax expense and other current liabilities.

(p) 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 Vice President of Customer Services and Administration may allow an employee to accumulate additional vacation in excess of five days. Accrued vacation is not considered material; therefore, no liability is recorded.

(q) 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.

(r) 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.

WISCONSIN PUBLIC POWER INC.

Notes to Financial Statements

December 31, 2007 and 2006

(s) Operating Reserves and Other Liabilities

The operating reserves and other liabilities are comprised of the following:

	<u>2007</u>	<u>2006</u>
Self insurance provision	\$ 3,405,129	\$ 3,265,794
Regulatory credit for long-term maintenance	7,339,746	6,220,217
Arbitrage rebate liability	1,372,507	859,690
Other	<u>590,623</u>	<u>1,138,918</u>
Totals	<u>\$ 12,708,005</u>	<u>\$ 11,484,619</u>

(t) New Accounting Pronouncements

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 implemented Statement No. 45 beginning with the year ending December 31, 2007.

(u) Cumulative Effect of Change in Accounting Principle

The 2006 cumulative effect of change in accounting principle represents the amounts expensed in prior years to mark to market the interest rate swaps. 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.

Prior to 2007 WPPI had been accruing a liability for other post employment benefits (OPEB) under FASB 106. In 2007 WPPI implemented GASB 45 and set the beginning OPEB liability to zero. The 2007 cumulative effect of change in accounting principle was \$463,007.

WISCONSIN PUBLIC POWER INC.

Notes to Financial Statements

December 31, 2007 and 2006

(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 fund's 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 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, 2007 and 2006

	<u>2007</u>	<u>2006</u>
Current		
Cash and investments		
Petty Cash	\$ 20	\$ 20
Investments	100,000	-
Working Capital	<u>27,437,176</u>	<u>22,808,796</u>
Total current	<u>27,537,196</u>	<u>22,808,816</u>
Restricted cash and investments		
Construction Funds	48,892,996	54,881,090
Debt Service Funds	<u>19,840,531</u>	<u>18,663,669</u>
Total current	<u>68,733,527</u>	<u>73,544,759</u>
Total current	<u>96,270,723</u>	<u>96,353,575</u>
Noncurrent		
Restricted investments		
Debt Service Reserve Funds	16,146,474	17,557,808
Renewal and Replacement Fund	15,414,453	11,985,666
Self-Insurance Fund	3,418,385	3,256,495
Rate Stabilization Fund	36,256,383	36,024,873
Decommissioning	2,591,150	2,368,591
Construction Funds	50,102,857	87,677,636
Debt Service Funds	<u>5,981,870</u>	<u>15,573,950</u>
Total noncurrent	129,911,572	174,445,019
Investments	553,868	675,801
Investment in ATC	<u>49,785,744</u>	<u>43,269,461</u>
Total Noncurrent	<u>180,251,184</u>	<u>218,390,281</u>
Total cash and investments	<u>\$ 276,521,907</u>	<u>\$ 314,743,856</u>

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.

WISCONSIN PUBLIC POWER INC.

Notes to Financial Statements

December 31, 2007 and 2006

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.

At December 31, 2007 WPPI had \$706,832 in bank balances (\$274,277 book balances) that were uninsured and uncollateralized deposits. At December 31, 2006 WPPI had \$1,375,882 in bank balances (\$929,594 in book balances) that were uninsured and uncollateralized deposits. In 2007, WPPI entered into a brokerage agreement with J.P. Morgan Futures to facilitate financial energy transactions through the Intercontinental Exchange. This account is not insured by the FDIC. The balance in the account on December 31, 2007 was \$250,088. All investments held as of December 31, 2007 and December 31, 2006 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, 2007 and December 31, 2006 WPPI's investments were rated as follows:

	Standard & Poor's	Moody's	2007 Amount	2006 Amount
U.S. government and agency securities	AAA	Aaa	\$ 37,235,386	\$ 49,798,701
Money market mutual fund	AAAm	Aaa	73,057,588	52,747,874
Corporate Bonds	AAA	Aaa	498,950	1,000,000
Corporate Bonds	AA+	Aa1	525,430	1,025,318
Corporate Bonds	AA	Aa1	499,375	
Corporate Bonds	AA	Aa2		979,850
Corporate Bonds	AA	Aa3	500,000	
Corporate Bonds	AA-	Aa1	506,882	
Corporate Bonds	AA-	Aa3	2,533,854	1,490,255
Corporate Bonds	A+	Aa3		483,750
Corporate Bonds	A	Aa3	492,140	

WISCONSIN PUBLIC POWER INC.

Notes to Financial Statements

December 31, 2007 and 2006

• **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 2007 and 2006:

	2007	2006
Citigroup Global Markets Inc. Guaranteed Investment Contract	\$68,360,874	\$97,776,385
JPMorgan Chase Bank N.A. Guaranteed Investment Contract	\$33,024,165	\$49,851,646
Morgan Stanley & Co. Guaranteed Investment Contract	\$8,766,561	\$15,124,034

• **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).

As of December 31, 2007, WPPI’s investments were classified by maturity as follows:

	Fair Value	Maturity in Years		
		Less than 1	1-5	Over 5
U.S. government & agency securities	37,235,386	7,272,456	25,014,033	4,948,897
Money market mutual funds	73,057,588	73,057,588	-	-
Certificate of deposit	330,000	100,000	230,000	-
Guaranteed investment contracts	110,151,601	54,066,873	56,084,728	-
Corporate bonds	5,556,631	2,002,214	3,554,417	-
Mutual Funds	323,868	-	323,868	-
	226,655,074	136,499,131	85,207,046	4,948,897

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

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

WISCONSIN PUBLIC POWER INC.

Notes to Financial Statements

December 31, 2007 and 2006

(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, 2007 and 2006, 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 2007, WPPI had outstanding commitments to fund ATC of approximately \$455,734. The amount was paid in January 2008.

Condensed financial data of ATC for 2007 and 2006 follows:

	2007	2006
	(In millions)	(In millions)
Operating statement data:		
Revenues	\$ 408.0	\$ 340.7
Operating expenses	(198.1)	(179.4)
Other income	-	2.0
Net interest expense	(55.8)	(41.4)
Earnings before tax	\$ 154.1	\$ 121.9
Balance sheet data:		
Current assets	\$ 48.3	\$ 33.5
Noncurrent assets	2,189.0	1,853.7
Total assets	\$ 2,237.3	\$ 1,887.2
Current liabilities	\$ 317.1	\$ 305.3
Long-term debt	899.1	648.9
Other noncurrent liabilities	108.5	125.7
Members' equity	912.6	807.3
Total liabilities and members' equity	\$ 2,237.3	\$ 1,887.2

WISCONSIN PUBLIC POWER INC.

Notes to Financial Statements

December 31, 2007 and 2006

(4) Capital Assets

Capital asset activity for the years ended December 31, 2007 and 2006 was as follows:

2007	Beginning balance	Additions	Transfers	Retirements	Ending balance
Nondepreciable assets:					
Land	\$ 242,008	\$ -	\$ -	\$ -	\$ 242,008
Construction work in progress	63,063,956	62,763,317	(2,769,872)	-	123,057,401
Total nondepreciable assets	63,305,964	62,763,317	(2,769,872)	-	123,299,409
Depreciable assets:					
Utility plant	210,133,168	323,019	1,670,513	(891,142)	211,235,558
Total depreciable assets	210,133,168	323,019	1,670,513	(891,142)	211,235,558
Accumulated depreciation and amortization	(91,388,605)	(6,778,266)	-	1,129,186	(97,037,685)
Depreciable assets, net	118,744,563	(6,455,247)	1,670,513	238,044	114,197,873
Capital assets, net	<u>\$ 182,050,527</u>	<u>\$ 56,308,070</u>	<u>\$ (1,099,359)</u>	<u>\$ 238,044</u>	<u>\$ 237,497,282</u>
2006	Beginning balance	Additions	Transfers	Retirements	Ending balance
Nondepreciable assets:					
Land	\$ 242,008	\$ -	\$ -	\$ -	\$ 242,008
Construction work in progress	28,694,373	35,940,598	(1,571,015)	-	63,063,956
Total nondepreciable assets	28,936,381	35,940,598	(1,571,015)	-	63,305,964
Depreciable assets:					
Utility plant	208,769,988	203,335	1,571,015	(411,170)	210,133,168
Total depreciable assets	208,769,988	203,335	1,571,015	(411,170)	210,133,168
Accumulated depreciation and amortization	(85,331,589)	(6,736,109)	-	679,093	(91,388,605)
Depreciable assets, net	123,438,399	(6,532,774)	1,571,015	267,923	118,744,563
Capital assets, net	<u>\$ 152,374,780</u>	<u>\$ 29,407,824</u>	<u>\$ -</u>	<u>\$ 267,923</u>	<u>\$ 182,050,527</u>

Construction work in progress at December 31, 2007 and 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 \$10,139,463 and \$3,960,348 for the years ended December 31, 2007 and 2006, 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, 2007 and 2006

(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.

	2007	2006
Balance 1/1	1,991,190	1,896,371
Liabilities Incurred	-	-
Liabilities Settled	-	-
Accretion	99,559	94,819
Cash Flow Revisions	-	-
Balance 12/31	<u>2,090,749</u>	<u>1,991,190</u>

WISCONSIN PUBLIC POWER INC.

Notes to Financial Statements

December 31, 2007 and 2006

(6) Long-term Debt

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

The

	<u>2007</u>	<u>2006</u>
Revenue bonds:		
2003 Series A 4.00% to 5.25%		
Due July 1, 2006-2033	\$ 66,010,000	\$ 70,195,000
2003 Series B variable rate bonds		
Due July 1, 2006-2021	64,500,000	64,800,000
2003 Series C variable rate bonds		
Due July 1, 2006-2023	33,275,000	34,875,000
2005 Series A 4.625% to 5.00%		
Due July 1, 2011 -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	400,705,000	406,790,000
Less: Current maturities	(9,325,000)	(6,085,000)
Unamortized discount/premium, net	<u>(10,148,119)</u>	<u>(11,680,077)</u>
	<u>\$ 381,231,881</u>	<u>\$ 389,024,923</u>

The terms outstanding for WPPI's variable rate issues, including the interest rate swaps discussed in (7) below, are the following:

	Fixed Rate Paid	Var Rate Received	Rate paid to Bondholders
2003 Series B Variable Rate Bonds	3.355%	67% of 1 month LIBOR	35 day auction rate
2003 Series C Variable Rate Bonds	2.805%	67% of 1 month LIBOR	35 day auction rate
2005 Series B Variable Rate Bonds	3.500%	68% of weekly LIBOR	7 day auction rate

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

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

WISCONSIN PUBLIC POWER INC.

Notes to Financial Statements

December 31, 2007 and 2006

Long-term liability activities for the years ended December 31, 2007 and 2006 were as follows:

Long-term liabilities as of December 31, 2007	Beginning balance	Additions	Reductions	Ending balance
Long-term revenue bonds	\$ 406,790,000	\$ -	\$ (6,085,000)	\$ 400,705,000
Less:				
Current maturities	6,085,000	9,325,000	(6,085,000)	9,325,000
Unamortized discount/premium, net	11,680,077	-	(1,531,958)	10,148,119
Long-term revenue bonds, net	<u>\$ 389,024,923</u>	<u>\$(9,325,000)</u>	<u>\$ 1,531,958</u>	<u>\$ 381,231,881</u>
Deferred credits and other liabilities:				
Operating reserves and accrued liabilities	\$ 11,484,619	\$ 2,303,811	\$ (1,080,425)	\$ 12,708,005
Rate stabilization	36,557,320	1,652,000	(1,653,335)	36,555,985
Asset retirement obligation	1,991,190	99,559	-	2,090,749
Fair value of interest rate swap agreements	-	3,941,135	-	3,941,135
Regulatory liability	1,677,053	-	(1,677,053)	-
Total deferred credits and other liabilities	<u>\$ 51,710,182</u>	<u>\$ 7,996,505</u>	<u>\$(4,410,813)</u>	<u>\$ 55,295,874</u>
Long-term liabilities as of December 31, 2006	Beginning balance	Additions	Reductions	Ending balance
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	13,223,283	-	(1,543,206)	11,680,077
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	\$ 3,336,977	\$ (1,598,491)	\$ 11,484,619
Rate stabilization	35,756,677	800,643	-	36,557,320
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	-	1,677,053	-	1,677,053
Total deferred credits and other liabilities	<u>\$ 48,626,022</u>	<u>\$ 5,909,492</u>	<u>\$(2,825,332)</u>	<u>\$ 51,710,182</u>

WISCONSIN PUBLIC POWER INC.

Notes to Financial Statements

December 31, 2007 and 2006

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

Year	Principal	Interest	Total
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	12,395,000	15,305,828	27,700,828
2013-2017	86,295,000	66,902,422	153,197,422
2018-2022	86,405,000	48,654,653	135,059,653
2023-2027	54,220,000	35,247,737	89,467,737
2028-2032	63,760,000	22,513,272	86,273,272
2033-2037	61,955,000	7,288,589	69,243,589
Total	\$ 400,705,000	\$ 262,157,413	\$ 662,862,413

(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. As of December 31, 2007, the interest rate swaps had a negative fair value of \$3,941,135. As of December 31, 2006, the interest rate swaps had a positive value of \$1,677,053. Details of the agreements are shown below:

<u>Notional Amount</u>	<u>Purchase Date</u>	<u>Maturity Date</u>
\$64,500,000	4/23/03	7/1/21
33,275,000	6/19/03	7/1/23
93,900,000	10/18/05	7/1/37

(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, 2007, there were no outstanding amounts on the line of credit.

WISCONSIN PUBLIC POWER INC.

Notes to Financial Statements

December 31, 2007 and 2006

(9) Significant Members

On a combined basis, two significant members of WPPI accounted for \$72,398,604 and \$61,341,693 or approximately 21.4% and 22.0% of total sales revenues for the years ended December 31, 2007 and 2006, 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. The total contributions to the plan for the years ended December 31, 2007 and 2006 were \$651,008 and \$602,544, respectively.

(b) Retention Plan

In 1999, WPPI established an initial employee retention plan. In 2007 and 2006, additional amounts were 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 \$165,984 and \$153,874 were accrued during 2007 and 2006, respectively.

(c) Defined Benefit Plan

On January 1, 2007 WPPI adopted the Defined Benefit Plan of Wisconsin Public Power Inc. It is a single-employer plan where the employer (WPPI) contributes funds to the plan. In addition, a trust was formed to control and manage the plan's assets. WPPI is the plan administrator and does not charge the plan for services.

Senior executives are covered by the plan. Currently, there are three active plan participants and no retired participants.

Participants are 100% vested in their accrued benefit at all times. The contributions accrue monthly interest at .5%. Participants are generally eligible for payment of the accrued benefit on the January 2 following the participant's normal retirement date subject to the provisions for early retirement, disability benefits and death benefits. Benefits are paid in the form of a straight life annuity or an optional form of benefit payment. WPPI's Executive Committee approves changes to the plan and defines the amount of plan contributions.

The plan and an amendment to the plan defined the dollar contributions for each participant. An initial deposit of \$625,320 was made to the trust from the retention plan and from 2006 net earnings. The other deposit to the trust of \$256,526 was made from 2007 net earnings. Total funding of the plan as of December 31, 2007 was \$881,846 and will fund payment of benefits under the plan.

Financial statements for the WPPI Defined Benefit Trust are found after WPPI's financial statements. Accounting for the defined benefit plan is done on an accrual basis. The trust's fair value of the investments is determined by the published value of the mutual funds on December 31, 2007. The measurement date used to determine the pension benefit obligations was December 31, 2007. The discount rate and expected return on assets was 6.0%. A thirty year amortization period is used with a level dollar amortization method.

WISCONSIN PUBLIC POWER INC.

Notes to Financial Statements

December 31, 2007 and 2006

The projected unit credit cost method was used for this valuation. The objective under this method is to expense each participant's benefits under the plan as they accrue. The total pension to which each participant is expected to become entitled at retirement is broken down into units, each associated with a year of past or future service. The projected benefit obligation is calculated at the initial application date and each subsequent measurement date as the present value of benefits credited with respect to service before that date.

The service cost is the actuarial present value of those benefits which are expected to be credited with respect to service during the current year, beginning on the valuation date.

In years following the initial application, a plan amendment may change the amount of projected benefit obligation. The amount of change is a prior service cost, and is to be amortized (recognized) in equal annual installments of principal over the average future service, at date of plan amendment, of plan participants expected to receive benefits.

In years following initial application, gains or losses may arise from the following sources:

- A change in the projected benefit obligation resulting from a change in actuarial assumptions.
- Actual return on assets differing from expected return on assets.
- Difference in the projected benefit obligation at year-end (from expected value) due to other plan experience different from assumed.

The investment policies employ an approach that uses a mix of equity and debt mutual funds to attain a return of at least 6%. The policy states that no more than 50% of the funds shall be invested in any type of equity investments with no more than 15% of the fund in non-domestic equities. The investments are monitored monthly and reallocated quarterly.

The pension plan asset allocations by asset category are shown below.

Asset Category	Percent at December 31, 2007
Equity Securities	38.9%
Debt Securities	31.6%
Real Estate	0.0%
Other	29.5%
Total	100.0%

Pension plan expenses were \$884,077 for 2007. The following table presents the unfunded actuarial accrued liability, the annual required contribution (ARC), and the net pension obligation (NPO).

WISCONSIN PUBLIC POWER INC.

Notes to Financial Statements

December 31, 2007 and 2006

		December 31, 2007
Actuarial Present Value of Total Projected Benefits	\$	907,592
Actuarial Value of Assets		919,550
Unfunded Actuarial Accrued Liability	\$	(11,958)
Percent Funded		101.32%
Determination of Annual Required Contribution		
Normal Cost for Benefits	\$	881,846
Amortization of Unfunded Actuarial Liability		2,231
Annual Required Contribution (ARC)	\$	884,077
Net Pension Obligation		
Annual Required Contribution (ARC)	\$	884,077
Contributions Made		(881,846)
Increase in Net Pension Obligation	\$	2,231
Net Pension Obligation -Beginning of Year	\$	-
Net Pension Obligation -End of Year	\$	2,231

(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. An amendment to the plan provides health insurance premium payments for life for two employees. At December 31, 2007 there were 83 active participants, no retired participants, and no benefit payments. The plan is unfunded. WPPI is the plan administrator and does not charge the plan for services. WPPI's Executive Committee approves changes to the plan and defines the amount of plan contributions.

Other postemployment benefit (OPEB) expenses were \$148,676 for 2007. WPPI's annual OPEB expense is calculated based on the annual required contribution of the employer (ARC), an amount actuarially determined in accordance with parameters of GASB Statement No. 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years. The following table shows the components of the annual OPEB cost for the year, the amount actually contributed to plan, and changes in the net OPEB obligation to the plan.

WISCONSIN PUBLIC POWER INC.

Notes to Financial Statements

December 31, 2007 and 2006

	December 31, 2007
Actuarial Accrued Liability	\$ 880,108
Present Value of Future Normal Costs	1,330,502
Actuarial Present Value of Total Projected Benefits	2,210,610
Actuarial Accrued Liability	880,108
Actuarial Value of Assets	-
Unfunded Actuarial Accrued Liability (UAAL)	\$ 880,108
Funded Ratio	0.00%
Covered Payroll	\$ 6,224,721
UAAL as a percentage of Covered Payroll	14.14%
Determination of Annual Required Contribution	
Normal Cost for Benefits	\$ 102,478
Amortization of Unfunded Actuarial Liability	46,198
Annual Required Contribution (ARC)	\$ 148,676
Net OPEB Obligation	
Annual Required Contribution	\$ 148,676
Contributions Made	-
Increase in Net Pension Obligation	\$ 148,676
Net OPEB Obligation -Beginning of Year	\$ -
Net OPEB Obligation -End of Year	\$ 148,676

Actuarial valuations of an ongoing plan involve estimates for the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future.

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan is understood by the employer and plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing benefit costs between the employer and plan members to that point. The methods and assumptions used include techniques that are designed to reduce short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

WISCONSIN PUBLIC POWER INC.

Notes to Financial Statements

December 31, 2007 and 2006

The actuarial valuation date used to determine the OPEB obligations was December 31, 2007. In the actuarial valuation, the projected unit credit actuarial cost method was used. The actuarial assumptions include a 4.5 percent discount rate and an annual healthcare cost trend rate of 12 percent initially, reduced by decrements to an ultimate rate of 4 percent after 8 years. A thirty year amortization period is used with a level dollar amortization method.

(e) *Voluntary Employee Separation Benefits*

In 2007 two voluntary separation agreements were signed by employees. The agreements include payouts in 2008 – 2010. The present value of these payouts is included in the financials statements in the following administration and general and tax accounts.

Salaries	\$	338,822
Taxes		8,801
SEP-IRA		13,542
Health Insurance Benefits		22,374
	\$	<u>383,539</u>

(11) **Commitments**

WPPI has various long-term capacity and energy purchase contracts with various power suppliers. Capacity purchases for 2007 and 2006 totaled approximately 709 and 681 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.

WPPI participates in the Midwest Independent System Operator (MISO) energy market. MISO may routinely true-up expenses and revenues for up to 105 days. Under special circumstances, MISO has true-up revenue and expenses for as long as 826 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.

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, 2007, WPPI has paid approximately \$109.9 million of this commitment, with the remainder expected to be requested through 2010.

As of December 31, 2007, the water intake discharge ("WPDES") permit issued for the Project was the subject of a request for permit modification before the Wisconsin Department of Natural Resources after the Dane County Circuit Court remanded the DNR's original permit decision in part based upon a decision by the Federal Court of Appeals for the Second Circuit finding certain EPA rules upon which the DNR relied to be invalid. The Administrative Law Judge ("ALJ") to whom the Dane County Circuit Court remanded the case, ruled that the DNR must reissue or modify the permit to reflect "best technology available" to comply with the standards applicable to new facilities. The ALJ did not vacate the permit. In the event that the WPDES permit is invalidated or it is determined that the Project water intake and discharge systems are not best technology available, 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.

WISCONSIN PUBLIC POWER INC.

Notes to Financial Statements

December 31, 2007 and 2006

On December 26, 2007 PJM released a statement that they have initiated steps to further prevent future defaults related to Financial Transmission Rights after recent payment defaults by two market participants. The estimated default for the November through May invoice was \$84.5 million at the time of the statement. Under the PJM Operating agreements, defaults are allocated 10% pro rata per member up to \$10,000 and 90% based on each member's gross dollar activity.

WPL has informed WPPI that WPPI has scheduled more energy than allowed under the existing Power Supply Agreement, with overscheduling occurrence going back to 2004. The value of overscheduled energy has not been agreed upon by WPPI and WPL. However, we estimate the total impact to WPPI to be less than \$600K. It is likely this issue will be resolved in 2008.

WPPI has purchased power contracts with Wisconsin Electric Power Company (WEPCO), Wisconsin Public Service Corporation (WPS) and Wisconsin Power and Light (WPL) that provide WPPI system average cost power under formula rates. The capacity charges for each calendar year are true-up in the following year. The exact timing and mechanics of the true-up varies by purchase. WPPI does not attempt to make an estimate of the true-up under these purchases and will recognize the actual amount of the true-up in the following year.

(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 2007.

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 liability for the years ended December 31, 2007 and 2006.

	<u>2007</u>	<u>2006</u>
Self-insurance liability, beginning of year	\$ 3,265,793	\$ 2,992,263
Additions, representing interest	139,335	273,530
Additions	-	-
Usage	-	-
Self-insurance liability, end of year	<u>\$ 3,405,128</u>	<u>\$ 3,265,793</u>