# CITY OF CLEVELAND, OHIO

## DEPARTMENT OF PUBLIC UTILITIES
## DIVISION OF CLEVELAND PUBLIC POWER

**REPORT ON AUDITS OF FINANCIAL STATEMENTS**
**For the years ended December 31, 2006 and 2005**

# CITY OF CLEVELAND, OHIO

## DEPARTMENT OF PUBLIC UTILITIES
## DIVISION OF CLEVELAND PUBLIC POWER

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Mary Taylor, CPA
Auditor of State

# INDEPENDENT ACCOUNTANTS' REPORT

Division of Cleveland Public Power
Department of Public Utilities
City of Cleveland
Cuyahoga County
601 Lakeside Avenue
Cleveland, Ohio 44114

To the Honorable Frank G. Jackson, Mayor, Members of Council, and the Audit Committee:

We have audited the accompanying basic financial statements of the Division of Cleveland Public Power, Department of Public Utilities, City of Cleveland, Cuyahoga County, Ohio, (the Division) as of and for the years ended December 31, 2006 and December 31, 2005, as listed in the table of contents. These financial statements are the responsibility of the Division's management. Our responsibility is to express opinions on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to reasonably assure 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 audits provide a reasonable basis for our opinions.

As described in Note A, the financial statements present only the Division and do not purport to, and do not, present fairly the financial position of the City of Cleveland as of December 31, 2006 and December 31, 2005, and the respective changes in its financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Division of Cleveland Public Power, Department of Public Utilities, City of Cleveland, Cuyahoga County, Ohio, as of December 31, 2006 and December 31, 2005, and the respective changes in financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

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Management's Discussion and Analysis is not a required part of the basic financial statements but is supplementary information the accounting principles generally accepted in the United States of America requires. 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.

Mary Taylor

Mary Taylor, CPA
Auditor of State

June 29, 2007

# CITY OF CLEVELAND, OHIO
## DEPARTMENT OF PUBLIC UTILITIES
## DIVISION OF CLEVELAND PUBLIC POWER

## MANAGEMENT'S DISCUSSION AND ANALYSIS

## GENERAL

As management of the City of Cleveland's (the "City") Department of Public Utilities, Division of Cleveland Public Power (the "Division"), we offer readers of the Division's financial statements this narrative overview and analysis of the financial activities of the Division for the years ended December 31, 2006 and 2005. Please read this information in conjunction with the Division's financial statements and footnotes that begin on page 13.

The Division was created in 1906 and charged with the responsibility of the distribution of electricity and related electric service to customers within its service areas. The Division operates a municipal electric system that is the largest in the State of Ohio and the thirty-seventh largest in the United States. The Division serves an area that is bound by the city limits of the City and presently serves over 78,000 customers.

The Division is one of the very few municipal electric companies in the United States that competes with an investor-owned utility, in this case First Energy Corporation's Cleveland Electric Illuminating Co. (CEI).

According to the 2000 census reports, the City's population is approximately 478,000 people. There are approximately 224,000 residential dwelling units and 11,000 commercial units. The Division has distribution facilities in about 60% of the geographical area of the City, primarily on the east side.

The Division obtains most of its power and energy requirements through short and long-term agreements with various regional utilities and other power suppliers through CEI interconnections. The balance of the Division's energy power and energy requirements are satisfied from combustion turbine generating units and various arrangements for the exchange of short-term power and energy. The Division anticipates that it will continue to rely on wholesale purchases of power and energy to meet its customer's needs for the foreseeable future.

## COMPARISON OF CURRENT YEARS' AND PRIOR YEARS' DATA

## FINANCIAL HIGHLIGHTS

- The assets of the Division exceeded its liabilities (net assets) by \$186,575,000, \$178,867,000 and \$179,981,000 at December 31, 2006, 2005 and 2004, respectively. Of these amounts, \$72,461,000, \$71,938,000 and \$84,716,000 are unrestricted net assets at December 31, 2006, 2005 and 2004, respectively, that may be used to meet the Division's ongoing obligations to customers and creditors.

- The Division's total net assets increased by \$7,708,000, decreased by \$1,114,000 and increased by \$5,313,000 during 2006, 2005 and 2004, respectively. Purchased power decreased by 10.7% decreasing total operating expenses by 7.5% for 2006. In addition, investment income increased by 55.5% whereas interest expense and amortization of bond issuance costs and discounts decreased by 11.6% and 16.4%, respectively due to the bond refinancing transaction in August 2006.

- During 2006, the Division had an increase in capital assets, net of accumulated depreciation of \$5,361,000. The principal capital expenditures in 2006 were for defective pole replacements, replacing and upgrading distribution feeders, work on the Euclid Corridor Transportation Project and the expansion of the Ridge Road substation.

## FINANCIAL HIGHLIGHTS (Continued)

- The Division's total long-term bonded debt decreased by $12,255,000 and $9,710,000 for the years ended December 31, 2006 and 2005, respectively. These decreases are attributed to scheduled debt service payments to bondholders. The Division also refinanced some outstanding bonds in 2006.

- In 2005, the Division was impacted by the introduction of SECA (Seams Elimination Cost Adjustment), which was mandated by the FERC (Federal Energy Regulatory Commission). See Footnote L. The Division paid SECA charges to Midwest Independent System Operator (MISO) of $2,733,000 and $8,072,000 in 2006 and 2005, respectively. The last payment made was for March 2006.

## OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to the Division's basic financial statements. The accompanying financial statements present financial information for the City's Division of Cleveland Public Power Fund, in which the City accounts for the operations of the Department of Public Utilities, Division of Cleveland Public Power. A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The City, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

The Division of Cleveland Public Power Fund is considered an enterprise fund because the operations of the Division are similar to a private sector business enterprise. Accordingly, in accounting for the activities of the Division, the economic resources measurement focus and accrual basis of accounting is used. This is similar to businesses in the private sector.

The basic financial statements of the Division can be found on pages 13 – 18 of this report. The notes to the financial statements provide additional information that is essential to a full understanding of the data provided in the basic financial statements. The notes to the financial statements can be found on pages 19 - 34 of this report.

**MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)**

## CONDENSED BALANCE SHEET INFORMATION

Provided below is condensed balance sheet information for the Division as of December 31, 2006, 2005 and 2004.

| | 2006 | 2005 | 2004 |
|---|---|---|---|
| | | (In thousands) | |
| Assets: | | | |
| Capital assets, net of accumulated depreciation | $ 309,122 | $ 303,761 | $ 296,094 |
| Restricted assets | 21,079 | 30,933 | 37,282 |
| Unamortized bond issuance costs | 2,590 | 1,737 | 1,952 |
| Current assets | 71,135 | 67,647 | 75,739 |
| Total assets | 403,926 | 404,078 | 411,067 |
| Net Assets and Liabilities: | | | |
| Net assets: | | | |
| Invested in capital assets, net of related debt | 109,695 | 95,977 | 80,572 |
| Restricted for capital projects | 1,461 | 4,534 | 8,816 |
| Restricted for debt service | 2,958 | 6,418 | 5,877 |
| Unrestricted | 72,461 | 71,938 | 84,716 |
| Total net assets | 186,575 | 178,867 | 179,981 |
| Liabilities: | | | |
| Long-term obligations | 192,193 | 197,692 | 205,812 |
| Current liabilities | 25,158 | 27,519 | 25,274 |
| Total liabilities | 217,351 | 225,211 | 231,086 |
| Total net assets and liabilities | $ 403,926 | $ 404,078 | $ 411,067 |

***Restricted assets****:* The Division's restricted assets decreased by $9,854,000 and $6,349,000 in 2006 and 2005, respectively, primarily due to purchases of capital assets and increased spending on capital projects.

***Current assets:*** The Division's current assets increased by $3,488,000 and decreased by $8,092,000 in 2006 and 2005, respectively. The increase in 2006 is mainly due to the following:

- The increase in current cash and cash equivalent of $5,675,000 from increased collection.
- The decrease in net accounts receivable of $1,383,000 in 2006 is due to increased collection activity and the receipt of a $1,220,000 SECA refund from American Electric Power offset by a $2.5 million receivable for a SECA reimbursement.

## CONDENSED BALANCE SHEET INFORMATION (Continued)

- Due from Other City Divisions decreased by $198,000 in 2006 primarily due to more efficient billings and payments between City-user divisions.

- Net materials and supplies increased by $701,000 in 2006 due to cost increases and the increase in stores on hand for future use.

***Capital assets:*** The Division's investment in capital assets as of December 31, 2006 amounted to $309,122,000 (net of accumulated depreciation). The total increase in the Division's investment in net capital assets for the current year was $5,361,000. A summary of the activity in the Division's capital assets during the year ended December 31, 2006 is as follows:

| | Balance January 1, 2006 | Additions | Reductions | Balance December 31, 2006 |
|---|---|---|---|---|
| | (In thousands) | | | |
| Land | $ 4,863 | $ | $ | $ 4,863 |
| Land improvements | 2,759 | | | 2,759 |
| Utility plant | 403,120 | 5,513 | | 408,633 |
| Buildings, structures and improvements | 42,278 | | | 42,278 |
| Furniture, fixtures, equipment and vehicles | 42,904 | 1,782 | (1,804) | 42,882 |
| Construction in progress | 8,181 | 21,174 | (5,635) | 23,720 |
| Total | 504,105 | 28,469 | (7,439) | 525,135 |
| Less: Accumulated depreciation | (200,344) | (16,713) | 1,044 | (216,013) |
| Capital assets, net | $ 303,761 | $ 11,756 | $ (6,395) | $ 309,122 |

A summary of the activity in the Division's capital assets during the year ended December 31, 2005 is as follows:

| | Balance January 1, 2005 | Additions | Reductions | Balance December 31, 2005 |
|---|---|---|---|---|
| | (In thousands) | | | |
| Land | $ 4,863 | $ | $ | $ 4,863 |
| Land improvements | 2,519 | 240 | | 2,759 |
| Utility plant | 361,901 | 41,219 | | 403,120 |
| Buildings, structures and improvements | 41,752 | 526 | | 42,278 |
| Furniture, fixtures, equipment and vehicles | 41,025 | 2,090 | (211) | 42,904 |
| Construction in progress | 28,176 | 24,166 | (44,161) | 8,181 |
| Total | 480,236 | 68,241 | (44,372) | 504,105 |
| Less: Accumulated depreciation | (184,142) | (16,412) | 210 | (200,344) |
| Capital assets, net | $ 296,094 | $ 51,829 | $ (44,162) | $ 303,761 |

## CONDENSED BALANCE SHEET INFORMATION (Continued)

The principal capital expenditures during 2006 included the following:

- Pole replacements - $6,784,000
- Related engineering and overhead expense capitalized - $3,491,000
- Ridge Road Substation construction - $1,200,000
- Vehicles purchased - $581,000
- New customer service connections - $547,000
- Distribution Engineering services - $1,020,000
- Distribution Feeders 2004 - $600,000
- Distribution Feeders 2005 - $899,000
- Euclid Corridor Electrical Work - $1,853,000

Additional information on the Division's capital assets, including commitments made for future capital expenditures, can be found in Notes A and D to the basic financial statements.

***Liabilities:***

***Current liabilities*** decreased by $2,361,000 in 2006 mainly due to the $2,980,000 decrease in the current portion of long-term debt, the $211,000 decrease in payables from restricted assets and the $100,000 decrease in accrued interest payable offset by normal increases in current liabilities.

***Long-term debt:*** The long-term obligation decrease of $5,499,000 in 2006 is attributed to scheduled debt service payments offset by a new refinancing bond issue expected to reduce interest cost.

At December 31, 2006, the Division had total debt outstanding of $228,390,000. All bonds are backed by the revenues generated by the Division.

The Division issued revenue bonds in the public capital markets in the late 1980's and early 1990's to finance a substantial expansion to its service territory. The Division also issued bonds in mid 2006 to refinance its long term debt. This debt is being retired in accordance with repayment schedules through 2024.

## CONDENSED BALANCE SHEET INFORMATION (Continued)

The activity in the Division's debt obligations outstanding during the year ended December 31, 2006 is summarized below (excluding unamortized discounts, premiums and losses on debt refundings):

| | Balance January 1, 2006 | Debt Issued | Debt Refunded | Debt Retired | Balance December 31, 2006 |
|---|---|---|---|---|---|
| | | | (In thousands) | | |
| Mortgage Revenue Bonds: | | | | | |
| Mortgage Revenue Bonds 1994 A | $ 48,335 | $ | $ (14,460) | $ | $ 33,875 |
| Mortgage Revenue Bonds 1996 | 120,190 | | (114,655) | (805) | 4,730 |
| Mortgage Revenue Bonds 1998 | 38,655 | | | (7,510) | 31,145 |
| Mortgage Revenue Bonds 2001 | 33,465 | | | (2,710) | 30,755 |
| Mortgage Revenue Bonds 2006 A-1 | | 95,265 | | | 95,265 |
| Mortgage Revenue Bonds 2006 A-2 | | 12,295 | | | 12,295 |
| Mortgage Revenue Bonds 2006 B | | 20,325 | | | 20,325 |
| Total | $ 240,645 | $ 127,885 | $ (129,115) | $ (11,025) | $ 228,390 |

The activity in the Division's debt obligations outstanding during the year ended December 31, 2005 is summarized below (excluding unamortized discounts, premiums and losses on debt refundings):

| | Balance January 1, 2005 | Debt Issued | Debt Refunded | Debt Retired | Balance December 31, 2005 |
|---|---|---|---|---|---|
| | | | (In thousands) | | |
| Mortgage Revenue Bonds: | | | | | |
| Mortgage Revenue Bonds 1994 A | $ 48,335 | $ | $ | $ | $ 48,335 |
| Mortgage Revenue Bonds 1996 | 120,955 | | | (765) | 120,190 |
| Mortgage Revenue Bonds 1998 | 44,760 | | | (6,105) | 38,655 |
| Mortgage Revenue Bonds 2001 | 36,305 | | | (2,840) | 33,465 |
| Total | $ 250,355 | $ | $ | $ (9,710) | $ 240,645 |

The bond ratings for the Division's outstanding revenue bonds are as follows:

| Moody's Investors Service | Standard & Poor's |
|---|---|
| A2 | A- |

The ratio of net revenue available for debt service to debt service requirements (revenue bond coverage) is a useful indicator of the Division's debt position to management, customers and creditors. The Division's revenue bond coverage for 2006, 2005 and 2004 was 179%, 178%, and 166%, respectively.

Additional information on the Division's long-term debt can be found in Note B to the basic financial statements on pages 22 - 26.

## CONDENSED BALANCE SHEET INFORMATION (Continued)

***Net Assets:*** Net assets serve as a useful indicator of a government's financial position. In the case of the Division, assets exceeded liabilities by $186,575,000, $178,867,000 and $179,981,000 at December 31, 2006, 2005 and 2004, respectively.

A large portion of the Division's net assets, $109,695,000 (59%) and $95,977,000 (54%) at December 31, 2006 and 2005, respectively, reflects its investment in capital assets (e.g., land, buildings, utility plant, furniture, fixtures, vehicles and equipment), net of accumulated depreciation, less any related, still-outstanding debt used to acquire those assets. The Division uses these capital assets to provide services to its customers. Consequently, these assets are not available for future spending.

Although the Division's investment in capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other resources, since the capital assets themselves cannot be used to liquidate these liabilities.

An additional portion of the Division's net assets of $4,419,000 (2%) and $10,952,000 (6%) at December 31, 2006 and 2005, respectively, represents resources that are subject to external restrictions. These funds are set aside for the payment of revenue bonds or represent unspent bond proceeds relating to capital projects. The remaining balance of unrestricted net assets, $72,461,000 (39%) and $71,938,000 (40%) at December 31, 2006 and 2005, respectively, may be used to meet the Division's ongoing obligations to customers and creditors.

## CONDENSED STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS INFORMATION

The Division's operations during 2006 increased its net assets by $7,708,000 as compared to a decrease in net assets of $1,114,000 in 2005. Provided below are key elements of the Division's results of operations as of and for the years ended December 31, 2006, 2005 and 2004:

| | 2006 | 2005 | 2004 |
|---|---|---|---|
| | | (In thousands) | |
| Operating revenues | $ 146,347 | $ 150,263 | $ 141,143 |
| Operating expenses | 131,655 | 142,336 | 124,562 |
| Operating income | 14,692 | 7,927 | 16,581 |
| Non-Operating Revenue (Expense): | | | |
| Investment income | 2,929 | 1,883 | 1,005 |
| Interest expense | (9,096) | (10,289) | (10,915) |
| Amortization of bond issuance costs and discount | (1,775) | (2,124) | (2,123) |
| Workers compensation refund | 10 | 8 | 12 |
| Gain on disposal of capital assets | 2 | 2 | 6 |
| Other | 946 | 1,079 | 679 |
| Total non-operating revenue (expense), net | (6,984) | (9,441) | (11,336) |
| Income (loss) before other contributions | 7,708 | (1,514) | 5,245 |
| Capital and other contributions | | 400 | 68 |
| Increase (Decrease) in net assets | 7,708 | (1,114) | 5,313 |
| Net assets, beginning of year | 178,867 | 179,981 | 174,668 |
| Net assets, end of year | $ 186,575 | $ 178,867 | $ 179,981 |

- In 2006, operating revenues decreased by $3,916,000 largely related to a 4% decrease in kilowatt-hours sold due to a cooler than normal summer. However, there has been a significant improvement in collections as cash receipts for 2006 increased by $2,729,000 over 2005. Much of the improvement could be attributed to collection policy changes, such as lowering the dollar threshold for delinquent customers, and requiring full payment for restoring electric service for customers that have been disconnected for non-payment.

- In 2005, operating revenues increased by $9,120,000 largely related to a 5% increase in kilowatt-hours sold.

- In 2006, operating expenses decreased by $10,681,000 primarily due to a $9,600,000 decrease in purchased power costs and a decrease of $1,486,000 in maintenance expense.

**CONDENSED STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS INFORMATION (Continued)**

- In 2005, operating expenses increased by $17,774,000 primarily due to a $14,738,000 increase in purchased power costs, which included $8,072,000 in SECA payments, an increase of $1,125,000 in depreciation expense and an increase in health care costs.

**FACTORS EXPECTED TO IMPACT THE DIVISION'S FUTURE FINANCIAL POSITION OR RESULTS OF OPERATIONS**

In 2006, the Division with the assistance of an external consultant, undertook a strategic planning initiative that will develop improved business processes and practices for meeting the challenges that will result from the planned change in 2009 to market rates for Ohio electric utilities pursuant to Ohio Amended Substitute Senate Bill 3 ("SB 3").

The Division is focusing its marketing efforts on those sections of the City that were part of its earlier system expansion to increase the density of customers served. As the Division competes with CEI in these areas, density is measured as the number of the Division's customers on a given street versus the total customers available on that street. Additional customers can be added with little extra expense.

The Division purchases most of its power requirements via medium and long-term contracts in the power markets. The actual costs of these power purchases are passed through to its customers via an Energy Adjustment Charge on its bills. As power costs rise, sales revenue will also increase commensurately. This will not impact the Division financially unless actual power costs push the Division's billing rates significantly above those of its competition.

In February 2000, Cleveland City Council approved a change in the method of calculating the Energy Adjustment Charge that resulted in an increase to customers of about 4%, the proceeds of which were used for debt reduction and pole replacements from the passage of the charge to November 30, 2005. The increase is scheduled to end December 31, 2008. Effective December 1, 2005, the proceeds of the increase, which is approximately $4,000,000 annually, are no longer earmarked for a specific purpose, but the Division maintains a fund with about $15,457,000 of historic receipts that remains earmarked by City Council for debt reduction and pole replacements.

In August 2006 the Division sold $127,885,000 in bonds to refinance $129,115,000 of older bonds. This is expected to reduce interest costs.

The Division is moving forward with a plan to construct a fourth interconnection with CEI. When completed, the Division will be able to deliver additional power to its customers. The project is currently estimated to cost $5 million.

**ADDITIONAL INFORMATION**

This financial report is designed to provide a general overview of the Division's finances. Questions concerning any of the information provided in this report or requests for additional information should be addressed to the Office of the Finance Director, City Hall, Room 104, 601 Lakeside Avenue, Cleveland, Ohio 44114.

# BASIC FINANCIAL STATEMENTS

# CITY OF CLEVELAND, OHIO

## DEPARTMENT OF PUBLIC UTILITIES
## DIVISION OF CLEVELAND PUBLIC POWER
## BALANCE SHEETS
## December 31, 2006 and 2005

| | (*In thousands*) 2006 | 2005 |
|---|---|---|
| **ASSETS** | | |
| **CAPITAL ASSETS** | | |
| Land | $ 4,863 | $ 4,863 |
| Land improvements | 2,759 | 2,759 |
| Utility plant | 408,633 | 403,120 |
| Buildings, structures and improvements | 42,278 | 42,278 |
| Furniture, fixtures, equipment and vehicles | 42,882 | 42,904 |
| | 501,415 | 495,924 |
| Less: Accumulated depreciation | (216,013) | (200,344) |
| | 285,402 | 295,580 |
| Construction in progress | 23,720 | 8,181 |
| **CAPITAL ASSETS, NET** | 309,122 | 303,761 |
| **RESTRICTED ASSETS** | | |
| Cash and cash equivalents | 7,903 | 14,919 |
| Investments | 13,162 | 15,975 |
| Accrued interest receivable | 14 | 39 |
| **TOTAL RESTRICTED ASSETS** | 21,079 | 30,933 |
| **UNAMORTIZED BOND ISSUANCE COSTS** | 2,590 | 1,737 |
| **CURRENT ASSETS** | | |
| Cash and cash equivalents | 10,442 | 4,767 |
| Restricted cash and cash equivalents | 1,272 | 1,483 |
| Investments | 28,383 | 29,302 |
| Receivables: | | |
| Accounts receivable - net of allowance for doubtful accounts of $1,338,000 in 2006 and $3,794,000 in 2005 | 19,782 | 21,165 |
| Unbilled revenue | 1,943 | 2,171 |
| Due from other City of Cleveland departments, divisions or funds | 2,532 | 2,730 |
| Accrued interest receivable | 318 | 267 |
| Materials and supplies - at average cost, net of allowance for obsolescence of $749,000 in 2006 and 2005 | 6,409 | 5,708 |
| Prepaid expenses | 54 | 54 |
| **TOTAL CURRENT ASSETS** | 71,135 | 67,647 |
| **TOTAL ASSETS** | $ 403,926 | $ 404,078 |

(Continued)

# CITY OF CLEVELAND, OHIO

## DEPARTMENT OF PUBLIC UTILITIES
## DIVISION OF CLEVELAND PUBLIC POWER
## BALANCE SHEETS
## December 31, 2006 and 2005

| | (*In thousands*) 2006 | 2005 |
|---|---|---|
| **NET ASSETS AND LIABILITIES** | | |
| **NET ASSETS** | | |
| Invested in capital assets, net of related debt | $ 109,695 | $ 95,977 |
| Restricted for capital projects | 1,461 | 4,534 |
| Restricted for debt service | 2,958 | 6,418 |
| Unrestricted | 72,461 | 71,938 |
| **TOTAL NET ASSETS** | 186,575 | 178,867 |
| **LIABILITIES** | | |
| **LONG-TERM OBLIGATIONS-excluding amounts due within one year:** | | |
| Revenue bonds | 191,383 | 196,759 |
| Accrued wages and benefits | 810 | 933 |
| **TOTAL LONG-TERM OBLIGATIONS** | 192,193 | 197,692 |
| **CURRENT LIABILITIES** | | |
| Current portion of long-term debt, due within one year | 8,045 | 11,025 |
| Accounts payable | 8,459 | 7,979 |
| Current payable from restricted assets | 1,272 | 1,483 |
| Due to other City of Cleveland departments, divisions or funds | 1,064 | 907 |
| Accrued interest payable | 1,084 | 1,184 |
| Current portion of accrued wages and benefits | 3,789 | 3,554 |
| Other accrued expenses | 445 | 435 |
| Customer deposits and other liabilities | 1,000 | 952 |
| **TOTAL CURRENT LIABILITIES** | 25,158 | 27,519 |
| **TOTAL LIABILITIES** | 217,351 | 225,211 |
| **TOTAL NET ASSETS AND LIABILITIES** | $ 403,926 | $ 404,078 |

See notes to financial statements. (Concluded)

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# CITY OF CLEVELAND, OHIO

## DEPARTMENT OF PUBLIC UTILITIES
## DIVISION OF CLEVELAND PUBLIC POWER
## STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
## For the Years Ended December 31, 2006 and 2005

| | *(In thousands)* | |
|---|---|---|
| | **2006** | **2005** |
| **OPERATING REVENUES** | | |
| Charges for services | $ 146,347 | $ 150,263 |
| **TOTAL OPERATING REVENUES** | 146,347 | 150,263 |
| **OPERATING EXPENSES** | | |
| Purchased power | 79,746 | 89,346 |
| Operations | 17,934 | 17,830 |
| Maintenance | 17,262 | 18,748 |
| Depreciation | 16,713 | 16,412 |
| **TOTAL OPERATING EXPENSES** | 131,655 | 142,336 |
| **OPERATING INCOME** | 14,692 | 7,927 |
| **NON-OPERATING REVENUE (EXPENSE)** | | |
| Investment income | 2,929 | 1,883 |
| Interest expense | (9,096) | (10,289) |
| Amortization of bond issuance costs and discounts | (1,775) | (2,124) |
| Workers compensation refund | 10 | 8 |
| Gain on disposal of capital assets | 2 | 2 |
| Other | 946 | 1,079 |
| **TOTAL NON-OPERATING REVENUE (EXPENSE), NET** | (6,984) | (9,441) |
| **INCOME (LOSS) BEFORE OTHER CONTRIBUTIONS** | 7,708 | (1,514) |
| Capital and other contributions | | 400 |
| **INCREASE (DECREASE) IN NET ASSETS** | 7,708 | (1,114) |
| **NET ASSETS, BEGINNING OF YEAR** | 178,867 | 179,981 |
| **NET ASSETS, END OF YEAR** | $ 186,575 | $ 178,867 |

See notes to financial statements.

## CITY OF CLEVELAND, OHIO

### DEPARTMENT OF PUBLIC UTILITIES
### DIVISION OF CLEVELAND PUBLIC POWER
### STATEMENTS OF CASH FLOWS
### For the Years Ended December 31, 2006 and 2005

| | *(In thousands)* 2006 | 2005 |
|---|---|---|
| **CASH FLOWS FROM OPERATING ACTIVITIES** | | |
| Cash received from customers | $ 152,881 | $ 150,152 |
| Cash payments to suppliers for goods or services | (6,774) | (5,813) |
| Cash payments to employees for services | (25,469) | (24,901) |
| Cash payments for purchased power | (82,080) | (90,140) |
| Electric excise tax payments to agency fund | (5,237) | (5,428) |
| **NET CASH PROVIDED BY OPERATING ACTIVITIES** | 33,321 | 23,870 |
| **CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES** | | |
| Grants | | 400 |
| Workers compensation refund | 10 | 8 |
| **NET CASH PROVIDED BY NONCAPITAL FINANCING ACTIVITIES** | 10 | 408 |
| **CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES** | | |
| Proceeds from sale of revenue bonds | 131,644 | |
| Acquisition and construction of capital assets | (23,006) | (21,591) |
| Principal paid on long-term debt | (11,025) | (4,920) |
| Interest paid on long-term debt | (8,144) | (9,813) |
| Cash paid to escrow agent for refunding | (131,110) | (4,910) |
| **NET CASH USED FOR CAPITAL AND RELATED FINANCING ACTIVITIES** | (41,641) | (41,234) |
| **CASH FLOWS FROM INVESTING ACTIVITIES** | | |
| Purchase of investment securities | (23,309) | (13,594) |
| Proceeds from sale and maturity of investment securities | 27,041 | 31,979 |
| Interest received on investments | 3,026 | 2,103 |
| **NET CASH PROVIDED BY INVESTING ACTIVITIES** | 6,758 | 20,488 |
| **NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS** | (1,552) | 3,532 |
| **CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR** | 21,169 | 17,637 |
| **CASH AND CASH EQUIVALENTS, END OF YEAR** | $ 19,617 | $ 21,169 |

(Continued)

# CITY OF CLEVELAND, OHIO

## DEPARTMENT OF PUBLIC UTILITIES
## DIVISION OF CLEVELAND PUBLIC POWER
## STATEMENTS OF CASH FLOWS

**For the Years Ended December 31, 2006 and 2005**

| | *(In thousands)* 2006 | 2005 |
|---|---|---|
| **RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES** | | |
| **OPERATING INCOME** | $ 14,692 | $ 7,927 |
| Adjustments to reconcile operating income to net cash provided by operating activities: | | |
| Depreciation | 16,713 | 16,412 |
| Changes in assets and liabilities: | | |
| Accounts receivable, net | 1,383 | (2,989) |
| Unbilled revenue | 228 | (207) |
| Due from other City of Cleveland departments, divisions or funds | 198 | 2,370 |
| Materials and supplies, net | (700) | 365 |
| Accounts payable | 480 | 316 |
| Due to other City of Cleveland departments, divisions or funds | 157 | (69) |
| Accrued wages and benefits | 112 | 325 |
| Other accrued expenses | 10 | 37 |
| Customer deposits and other liabilities | 48 | (617) |
| **TOTAL ADJUSTMENTS** | 18,629 | 15,943 |
| **NET CASH PROVIDED BY OPERATING ACTIVITIES** | $ 33,321 | $ 23,870 |

See notes to financial statements. (Concluded)

# NOTES TO FINANCIAL STATEMENTS
## For the Years Ended December 31, 2006 and 2005

### NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Division of Cleveland Public Power (Division) is reported as an enterprise fund of the City of Cleveland's (City) Department of Public Utilities and is a part of the City's primary government. The Division was created for the purpose of supplying electrical services to customers within the City. The following is a summary of the more significant accounting policies.

***Reporting Model and Basis of Accounting:*** The accounting policies and financial reporting practices of the Division comply with accounting principles generally accepted in the United States of America applicable to governmental units. Effective January 1, 2005, the Division implemented GASB Statement No. 40, *Deposit and Investment Risk Disclosures*. In November 2003, the GASB issued Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, which is effective for the year ended December 31, 2005. The Division has determined that GASB Statement No. 42 has no impact on its financial statements as of December 31, 2005. In May 2004, the GASB issued Statement No. 44, *Economic Condition Reporting: The Statistical Section*, which is effective for the year ended December 31, 2006. The Division has determined that GASB Statement No. 44 has no impact on its financial statements as of December 31, 2006. In June 2005, the GASB issued Statement No. 47, *Accounting for Termination Benefits*, which is effective for the year ended December 31, 2006. The Division has determined that GASB Statement No. 47 has no impact on its financial statements as of December 31, 2006.

The Division's net assets are accounted for in the accompanying balance sheet and the net assets are divided into the following categories:

- Amount invested in capital assets, net of related debt.
- Amount restricted for capital projects.
- Amount restricted for debt service.
- Remaining unrestricted amount.

In addition, certain additional financial information regarding the Division is included in these footnotes. The implementation of the new GASB statements did not result in a change in the Division's beginning net asset/equity balance as previously reported.

***Basis of Accounting:*** The Division's financial statements are prepared under the accrual basis of accounting. Under this method, revenues are recognized when earned and measurable and expenses are recognized as incurred. Under GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Activities*, all Proprietary Funds will continue to follow Financial Accounting Standards Board (FASB) standards issued on or before November 30, 1989. However, from that date forward, Proprietary Funds will have the option of either 1) choosing not to apply future FASB standards (including amendments of earlier pronouncements), or 2) continuing to follow new FASB pronouncements (unless they conflict with GASB pronouncements). The Division has chosen not to apply future FASB standards.

## NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

***Revenues:*** Revenues are derived primarily from sales of electricity to residential, commercial and industrial customers based upon actual consumption. Electricity rates are authorized by City Council and billings are made on a cyclical basis. Estimates for services between the end of the various cycles and the end of the year are recorded as unbilled revenue.

***Statement of Cash Flows:*** The Division utilizes the direct method of reporting for the statement of cash flows as defined by the GASB Statement No. 9, *Reporting Cash Flows of Proprietary and Non-expendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting*. In a statement of cash flows, cash receipts and cash payments are classified according to operating, non-capital financing, capital and related financing, and investment activities.

***Cash and Cash Equivalents:*** Cash and cash equivalents represent cash on hand and cash deposits maintained by the City Treasurer on behalf of the Division. Cash equivalents are defined as highly liquid investments with maturity of three months or less when purchased and include certificates of deposit, U.S. Treasury Bills, State Treasury Asset Reserve of Ohio (STAROhio) and repurchase agreements. The City's policy is to enter into repurchase agreements with local commercial banks and to obtain confirmation of securities pledged.

***Investments:*** The Division follows the provisions of GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and External Investment Pools*, which requires governmental entities to report certain investments at fair value in the balance sheet and recognize the corresponding change in the fair value of investments in the year in which the change occurred. The fair value is based on quoted market prices.

The City has invested funds in STAROhio during fiscal year 2006 and 2005. STAROhio is an investment pool managed by the State Treasurer's Office, which allows governments within the State to pool their funds for investment purposes. STAROhio is not registered with the SEC as an investment company, but does operate in a manner consistent with Rule 2a7 of the Investment Company Act of 1940. Investments in STAROhio are valued at STAROhio's share price, which is the price the investment could be sold for on December 31, 2006 and 2005.

***Restricted Assets:*** Proceeds from debt and amounts set aside in various fund accounts for payment of revenue bonds are classified as restricted assets since their use is limited by the bond indentures.

***Capital Assets and Depreciation:*** Capital assets are stated on the basis of historical cost, or, if contributed, at fair market value as of the date received. Depreciation is computed by allocating the cost of capital assets over the estimated useful lives of the assets using the straight-line method. A capital asset is defined as a tangible item with a useful life in excess of one year and an individual cost of more than $5,000 for furniture, fixtures, equipment, and vehicles, and $10,000 for all other assets. When capital assets are disposed, the cost and related accumulated depreciation are removed from the accounts with gains or losses on disposition being reflected in operations. The estimated useful lives are as follows:

| | |
|---|---|
| Utility plant | 10 to 50 years |
| Land improvements | 42 to 48 years |
| Buildings, structures and improvements | 10 to 47 years |
| Furniture, fixtures, equipment, and vehicles | 5 to 40 years |

## NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The Division's policy is to capitalize interest on construction projects up to the point in time that the project is substantially completed. Capitalized interest is included in the cost of the assets and is depreciated on the straight-line basis over the estimated useful lives of such assets. The Division applies Statement of Financial Accounting Standards No. 62, *Capitalization of Interest Cost in Situations Involving Certain Tax-Exempt Borrowings and Certain Gifts and Grants,* for its revenue bonds. This statement requires capitalization of interest cost of eligible borrowings less interest earned on investment of the related bond proceeds from the date of borrowing until the assets constructed from the bond proceeds are ready for their intended use.

For 2006 and 2005, total interest costs incurred amounted to $9,534,000 and $10,889,000 respectively, of which $344,000 and $429,000, respectively, was capitalized, net of interest income of $94,000 in 2006 and $171,000 in 2005.

***Bond Issuance Costs, Discounts and Unamortized Losses on Debt Refundings:*** Bond issuance costs are initially recorded as deferred expenses and unamortized original issuance discounts are netted against long-term debt. Both are amortized over the lives of the related bonds. Unamortized losses on debt refundings are netted against long-term debt and are amortized over the shorter of the remaining life of the defeased bond or the newly issued bond.

***Compensated Absences:*** The Division accrues for compensated absences such as vacation, sick leave and compensatory time using the termination payment method specified under GASB Statement No. 16, *Accounting for Compensated Absences*. These amounts are recorded as accrued wages and benefits in the accompanying balance sheets. The portion of the compensated absence liability that is not expected to be paid out within one year is reported as a long-term liability.

Normally, all vacation time is to be taken in the year available. The Division allows employees to carryover up to 80 hours of vacation from one year to the next with proper approval. Sick days not taken may be accumulated until retirement. An employee is paid one-third of accumulated sick leave upon retirement, calculated at the three-year average base salary rate, with the balance being forfeited.

## NOTE B - LONG-TERM DEBT

Long-term debt outstanding at December 31, 2006 and 2005 is as follows:

| | Interest Rate | Original Issuance | 2006 | 2005 |
|---|---|---|---|---|
| | | | (In thousands) | |
| **Mortgage Revenue Bonds:** | | | | |
| Series 1994, zero coupon bonds due through 2013 | | $ 219,105 | $ 33,875 | $ 48,335 |
| Series 1996, due through 2011 | 5.25%-6.00% | 123,720 | 4,730 | 120,190 |
| Series 1998, due through 2017 | 4.00%-5.25% | 44,840 | 31,145 | 38,655 |
| Series 2001, due through 2016 | 3.55%-5.50% | 41,925 | 30,755 | 33,465 |
| Series 2006 A-1, due through 2024 | 4.25%-5.00% | 95,265 | 95,265 | |
| Series 2006 A-2, due through 2017 | 5% | 12,295 | 12,295 | |
| Series 2006 B, due through 2024 | Auction Rates | 20,325 | 20,325 | |
| | | $ 557,475 | $ 228,390 | $ 240,645 |
| Less: | | | | |
| Unamortized discount-zero coupon bonds | | | (7,221) | (14,322) |
| Unamortized premium-current interest bonds (net) | | | 4,148 | (4,723) |
| Unamortized loss on debt refunding | | | (25,889) | (13,816) |
| Current portion | | | (8,045) | (11,025) |
| Total Long-Term Debt | | | $ 191,383 | $ 196,759 |

***Summary:*** Changes in long-term obligations for the year ended December 31, 2006 are as follows:

| | Balance January 1, 2006 | Increase | Decrease | Balance December 31, 2006 | Due Within One Year |
|---|---|---|---|---|---|
| | | | (In thousands) | | |
| **Mortgage Revenue Bonds:** | | | | | |
| Series 1994, zero coupon bonds due through 2013 | $ 48,335 | $ | $ (14,460) | $ 33,875 | $ 965 |
| Series 1996, due through 2011 | 120,190 | | (115,460) | 4,730 | 850 |
| Series 1998, due through 2017 | 38,655 | | (7,510) | 31,145 | 3,430 |
| Series 2001, due through 2016 | 33,465 | | (2,710) | 30,755 | 2,800 |
| Series 2006 A-1, due through 2024 | | 95,265 | | 95,265 | |
| Series 2006 A-2, due through 2017 | | 12,295 | | 12,295 | |
| Series 2006 B, due through 2024 | | 20,325 | | 20,325 | |
| Total revenue bonds | 240,645 | 127,885 | (140,140) | 228,390 | 8,045 |
| Accrued wages and benefits | 4,487 | 112 | | 4,599 | 3,789 |
| Total | $ 245,132 | $ 127,997 | $ (140,140) | $ 232,989 | $ 11,834 |

## NOTES TO FINANCIAL STATEMENTS (Continued)
## For the Years Ended December 31, 2006 and 2005

### NOTE B - LONG-TERM DEBT (Continued)

***Summary:*** Changes in long-term obligations for the year ended December 31, 2005 are as follows:

| | Balance January 1, 2005 | Increase | Decrease | Balance December 31, 2005 | Due Within One Year |
|---|---|---|---|---|---|
| | | | (In thousands) | | |
| **Mortgage Revenue Bonds:** | | | | | |
| Series 1994, zero coupon bonds due through 2013 | $ 48,335 | $ | $ | $ 48,335 | $ |
| Series 1996, due through 2024 | 120,955 | | (765) | 120,190 | 805 |
| Series 1998, due through 2017 | 44,760 | | (6,105) | 38,655 | 7,510 |
| Series 2001, due through 2016 | 36,305 | | (2,840) | 33,465 | 2,710 |
| Total revenue bonds | 250,355 | | (9,710) | 240,645 | 11,025 |
| Accrued wages and benefits | 4,162 | 325 | | 4,487 | 3,554 |
| Total | $ 254,517 | $ 325 | $ (9,710) | $ 245,132 | $ 14,579 |

Minimum principal and interest payments on long-term debt are as follows:

| | Principal | Interest | Total |
|---|---|---|---|
| | | (In thousands) | |
| 2007 | $ 8,045 | $ 9,626 | $ 17,671 |
| 2008 | 8,335 | 9,336 | 17,671 |
| 2009 | 8,530 | 9,150 | 17,680 |
| 2010 | 8,725 | 8,950 | 17,675 |
| 2011 | 11,210 | 8,731 | 19,941 |
| 2012-2016 | 59,540 | 39,147 | 98,687 |
| 2017-2021 | 72,285 | 24,101 | 96,386 |
| 2022-2024 | 51,720 | 5,251 | 56,971 |
| Total | $ 228,390 | $ 114,292 | $ 342,682 |

## NOTE B – LONG-TERM DEBT (Continued)

On August 17, 2006, the Division issued $95,265,000 of Public Power System Refunding Revenue Bonds, Series 2006A-1, $12,295,000 of Public Power System Refunding Revenue Bonds, Series 2006A-2 and $20,325,000 Public Power System Refunding Revenue Variable Rate Bonds, Series 2006B. The Bonds were issued to refund $114,655,000 of Public Power System First Mortgage Revenue Refunding Bonds, Series 1996, Sub-Series 1 and $14,460,000 of Public Power System First Mortgage Revenue Bonds, Series 1994A. Net proceeds of the bonds, including related premium, in the total amount of $131,110,000 will be used to pay the principal, interest and premium on the refunded bonds. As a result, the refunded bonds are considered to be defeased and the liability for these bonds has been removed from long term debt. The Division completed the refunding to reduce its debt service payments over the next ten years and to obtain an economic gain (the difference between the present values of the old and new debt service payments) of approximately $5.4 million. The Series 2006B Bonds were issued as variable rate debt (auction rate securities). The Division entered into a basis swap on a portion of the Series 2006A-1 Bonds at the time of issuance of the bonds.

*Interest Rate Swap Transaction*: Simultaneously with the issuance of the Division's $95,265,000 Series 2006A-1 Public Power System Refunding Revenue Bonds on August 17, 2006, the Division entered into a floating-to-floating rate basis swap agreement on an initial notional amount of $70,455,000 which is equal to a portion of the total declining balance of the Series 2006A-1 Bonds. Lehman Brothers Special Financing, Inc. is the counterparty on the transaction. Under the swap agreement for the Series 2006A-1 Bonds, the Division will pay the counterparty a floating rate based on the USD-BMA Municipal Swap Index. The counterparty is also a floating rate payor, paying the Division 67% of one month LIBOR plus a spread of 46.25 basis points. Net payments are exchanged quarterly on each February 15, May 15, August 15 and November 15. The obligation of the Division to make periodic payments (but not any termination payment) is secured by a pledge of and lien on the net revenues of the Public Power System on a parity with the pledge and lien securing the payment of debt service on the bonds.

***Objective***: The Division entered into the swap in order to maximize the savings associated with the refunding of the bonds. The actual overall savings to be realized by the Public Power System will depend upon the net payments received under the swap agreement.

***Basis Risk***: By entering into a swap based upon the 30 day LIBOR rate of interest, the Division has undertaken basis risk associated with a change in tax rates and structure. While the average relationship between LIBOR (taxable) and BMA (tax-exempt) interest rates has been 67%, this relationship may not continue to apply. If the payment received from the counterparty is less than the amount paid to the counterparty, the Division must make up the difference in addition to paying the fixed rate resulting from the swap. In addition, a reduction in federal income tax rates would increase the percentage relationship between BMA and LIBOR and would potentially increase the cost of financing.

***Counterparty Risk***: The Division selected a highly rated counterparty in order to minimize this risk. Lehman Brothers Special Financing, Inc. is rated A1 by Moody's Investors Service and A+ by Standard & Poors. However, over the long term it is possible that the credit strength of Lehman Brothers could change and this event could trigger a termination payment on the part of the Division.

## NOTE B - LONG-TERM DEBT (Continued)

***Termination Risk***: The swap agreement may be terminated prior to its stated termination date under certain circumstances. Upon termination, a payment may be owed by the Division to Lehman Brothers or by Lehman Brothers to the Division, depending upon the prevailing economic circumstances at the time of the termination.

***Fair Value***: The fair value of the swap at December 31, 2006 as reported by Lehman Brothers totaled $538,708, which would be payable by Lehman Brothers to the Division.

During September 2005, the Division utilized incremental charges to defease certain Mortgage Revenue Bonds that were due November 15, 2005 by placing $4,790,000 relating to principal and $120,000 relating to interest in an irrevocable trust to provide for the debt service payments. Accordingly, the trust account assets and the liability for the defeased bonds are not included in the Division's financial statements. As a result of the Series 2006 advance refunding, there was $14,460,000 Series 1994A defeased debt outstanding at December 31, 2006.

Mortgage Revenue Bonds are payable from the revenues derived from operations of the public power system, after the payment of all operating and maintenance expenses (net revenues). The bonds are collateralized by a pledge of and lien on such net revenues plus a first mortgage lien upon all property of the public power system, including any improvements, additions, replacements, and extensions thereto.

The indenture requires that, at all times, the Division will charge rates and fees for the products and services of the public power system. Revenues will be at least sufficient to provide funds for the payment in each year of the necessary operating and maintenance expenses of the power system and in an amount equal to 1.25 times the payments of principal and interest on the revenue bonds then outstanding and due in that year. As of December 31, 2006 and 2005, the Division was in compliance with the terms and requirements of the bond indenture. The indenture establishes the following fund accounts for the application of revenues:

***Revenue Fund*****:** All revenues will be deposited into this fund and will be used for payment of current operating expenses and deposits into other funds.

***Debt Service Fund*****:** Monthly deposits will be made from the revenue fund to cover succeeding principal and interest payments as they become due on the Mortgage Revenue Bonds.

***Debt Service Reserve Fund*****:** Deposits will be made to this fund if the amount in the debt service fund at any time is less than the debt service reserve requirement. However, the Division has elected, pursuant to provisions of the indenture governing the Division's bonds, to satisfy the bond reserve requirement with a surety bond in an aggregate amount at least equal to the bond reserve requirement.

***Renewal and Replacement Fund*****:** The balance in this fund is maintained at $1,000,000 and is to be applied against the cost of repair or replacement of capital assets in order to maintain the system.

## NOTE B - LONG-TERM DEBT (Continued)

***Construction Fund*:** The proceeds from Series 1994 and Series 1991 bonds of $79,386,000 and $12,050,000, respectively, were deposited into this fund to be used, along with earnings from investments of amounts held therein, for the payment of capital costs. As of December 31, 2006 and 2005, the Division had $4,439,000 and $8,434,000, respectively, of outstanding commitments for future constructions that will be funded by available bond proceeds and operating revenue. Capital costs include all costs of additions, extensions, renewals, replacements, alterations, betterments and any other capital improvements to the system. Amounts held in this fund are subject to a lien in favor of bondholders and may be used to pay principal of outstanding bonds to the extent that amounts in all other funds are insufficient. No payment needs to be made into a fund if the amounts in such fund are equal to the required fund balance, if any.

Amounts held in trust may be invested by the City Treasurer or the Trustee in permitted investments. However, the use of funds is limited by the bond indenture and, accordingly, the amounts are classified as restricted assets in the financial statements.

## NOTE C - DEPOSITS AND INVESTMENTS

***Deposits:*** At December 31, 2006 and 2005, the Division's carrying amount of deposits totaled $2,484,000 and $1,158,000, respectively, and the Division's bank balances totaled $2,697,000 and $1,395,000, respectively. The differences represent normal reconciling items. These amounts were insured or collateralized with securities held by the City or by its agent in the City's name.

Custodial credit risk for deposits is the risk that in the event of bank failure, the Division will not be able to recover deposits or collateral for securities that are in possession of an outside party. At year end, the Division's deposits were fully insured or collateralized. All deposits are collateralized with eligible securities pledged and deposited either with the City or with a qualified trustee by the financial institution as security for repayment of all public monies deposited in the financial institution whose market value at all times is equal to at least 110% of the carrying value of the deposits being secured.

***Investments:*** The City's investment policies are governed by state statutes and City ordinances which authorize the City to invest in obligations of the U.S. Treasury, agencies and instrumentalities; bonds and other State obligations; certificates of deposit; U.S. Government Money Market Mutual Funds; STAROhio; guaranteed investment contracts; and repurchase transactions. Such repurchase transactions must be purchased from financial institutions or registered broker/dealers. Repurchase transactions are not to exceed a period of one year and confirmation of securities pledged must be obtained.

Under City policy, investments are limited to repurchase agreements, U.S. Government securities, certificates of deposit, investments in certain money market mutual funds, and STAROhio. Generally, investments are recorded in segregated accounts by way of book entry through the banks' commercial or trust department and are kept at the Federal Reserve Bank in the depository institutions' separate custodial account for the City, apart from the assets of the depository institution. Ohio statute prohibits the use of Reverse Repurchase Agreements.

## NOTE C - DEPOSITS AND INVESTMENTS (Continued)

Investment securities are exposed to various risks such as interest rate, market and credit. Market values of securities fluctuate based on the magnitude of changing market conditions; significant changes in market conditions could materially affect the portfolio value.

***Interest rate risk***: As a means of limiting its exposure to fair value losses caused by rising interest rates, the Division invests primarily in short-term investments maturing within five years from the date of purchase. The intent is to avoid the need to sell securities prior to maturity. Investment maturities are disclosed in the table on the following page.

***Custodial Credit Risk***: For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the Division will not be able to recover the value of the investments or collateral securities that are in the possession of an outside party.

***Credit Risk***: The Division's investments as of December 31, 2006 and 2005 include U.S. Agencies, Victory Federal Money Market Funds, Allegiant Government Money Market Funds, STAROhio and mutual funds. The Division maintains the highest ratings for its investments. Investments in FHLMC, FNMA, FFCB and FHLB agency securities are rated AAA by Standard & Poor's. Investments in the Victory Money Market Fund, Allegiant Government Money Market Fund and STAROhio carry a rating of AAAm, which is the highest money market fund rating given by Standard & Poor's.

Ohio law requires that STAROhio maintain the highest rating provided by at least one nationally recognized standard rating service. The Division has no investment policy that would further limit its investment choices.

***Concentration of Credit Risk***: The Division places a limitation on the amount it may invest in any one issuer to help minimize the concentration of credit risk. The Division had the following investments at December 31, 2006 and 2005, which include those classified as cash and cash equivalents in the balance sheet in accordance with the provisions of GASB Statement No. 9 since they have a maturity of three months or less:

**NOTES TO FINANCIAL STATEMENTS (Continued)**
**For the Years Ended December 31, 2006 and 2005**

**NOTE C - DEPOSITS AND INVESTMENTS (Continued)**

| Type of Investment | 2006 Fair Value | 2006 Cost | 2005 Fair Value | 2005 Cost | Investment Maturities: Less than One Year | Investment Maturities: 1 - 5 Years | Investment Maturities: 5 Years or More |
|---|---|---|---|---|---|---|---|
| | | | | (In thousands) | | | |
| U.S. Agency Obligations | $ 40,373 | $ 40,547 | $ 43,415 | $ 44,104 | $ 23,398 | $ 16,975 | $ |
| U.S. Treasury Bills | 1,171 | 1,171 | 1,861 | 1,861 | 1,171 | | |
| Repurchase Agreements | 5,819 | 5,819 | 1,550 | 1,550 | 5,819 | | |
| STAROhio | 8,400 | 8,400 | 8,342 | 8,342 | 8,400 | | |
| Investment in Mutual Funds | 2,915 | 2,915 | 10,120 | 10,120 | 2,915 | | |
| Total Investments | 58,678 | 58,852 | 65,288 | 65,977 | 41,703 | 16,975 | - |
| Total Deposits | 2,484 | 2,484 | 1,158 | 1,158 | 2,484 | | |
| Total Deposits and Investments | $ 61,162 | $ 61,336 | $ 66,446 | $ 67,135 | $ 44,187 | $ 16,975 | $ - |

As of December 31, 2006, the investments in U.S. Agency Obligations, repurchase agreements and STAROhio are approximately 69%, 10% and 14%, respectively, of the Division's total investments. As of December 31, 2005, the investments in U.S. Agency Obligations, STAROhio and mutual funds are approximately 66%, 13% and 16%, respectively, of the Division's total investments.

**NOTES TO FINANCIAL STATEMENTS (Continued)**
**For the Years Ended December 31, 2006 and 2005**

## NOTE D - CAPITAL ASSETS

***Capital Asset Activity:*** Capital asset activity for the year ended December 31, 2006 was as follows:

| | Balance January 1, 2006 | Additions | Reductions | Balance December 31, 2006 |
|---|---|---|---|---|
| | | (In thousands) | | |
| Capital assets, not being depreciated: | | | | |
| Land | $ 4,863 | $ | $ | $ 4,863 |
| Construction in progress | 8,181 | 21,174 | (5,635) | 23,720 |
| Total capital assets, not being depreciated | 13,044 | 21,174 | (5,635) | 28,583 |
| Capital assets, being depreciated: | | | | |
| Land improvements | 2,759 | | | 2,759 |
| Utility plant | 403,120 | 5,513 | | 408,633 |
| Buildings, structures and improvements | 42,278 | | | 42,278 |
| Furniture, fixtures, equipment and vehicles | 42,904 | 1,782 | (1,804) | 42,882 |
| Total capital assets, being depreciated | 491,061 | 7,295 | (1,804) | 496,552 |
| Less: Accumulated depreciation | (200,344) | (16,713) | 1,044 | (216,013) |
| Total capital assets being depreciated, net | 290,717 | (9,418) | (760) | 280,539 |
| Capital assets, net | $ 303,761 | $ 11,756 | $ (6,395) | $ 309,122 |

***Capital Asset Activity:*** Capital asset activity for the year ended December 31, 2005 was as follows:

| | Balance January 1, 2005 | Additions | Reductions | Balance December 31, 2005 |
|---|---|---|---|---|
| | | (In thousands) | | |
| Capital assets, not being depreciated: | | | | |
| Land | $ 4,863 | $ | $ | $ 4,863 |
| Construction in progress | 28,176 | 24,166 | (44,161) | 8,181 |
| Total capital assets, not being depreciated | 33,039 | 24,166 | (44,161) | 13,044 |
| Capital assets, being depreciated: | | | | |
| Land improvements | 2,519 | 240 | | 2,759 |
| Utility plant | 361,901 | 41,219 | | 403,120 |
| Buildings, structures and improvements | 41,752 | 526 | | 42,278 |
| Furniture, fixtures, vehicles and equipment | 41,025 | 2,090 | (211) | 42,904 |
| Total capital assets, being depreciated | 447,197 | 44,075 | (211) | 491,061 |
| Less: Accumulated depreciation | (184,142) | (16,412) | 210 | (200,344) |
| Total capital assets being depreciated, net | 263,055 | 27,663 | (1) | 290,717 |
| Capital assets, net | $ 296,094 | $ 51,829 | $ (44,162) | $ 303,761 |

## NOTE D - CAPITAL ASSETS (Continued)

***Commitments:*** The Division has outstanding commitments of approximately $30,131,000 and $8,790,000 for future capital expenditures at December 31, 2006 and 2005, respectively. It is anticipated that these commitments will be financed from the Division's cash balances; however, at the discretion of the Division, additional long-term debt may be issued in the future to finance a portion of the costs.

## NOTE E - EMPLOYEES RETIREMENT PLAN

All full-time employees participate in the Ohio Public Employees Retirement System (OPERS). OPERS administers three separate pension plans as described below:

1) The Traditional Pension Plan (TP) – a cost-sharing, multiple-employer defined benefit pension plan.
2) The Member-Directed Plan (MD) – a defined contribution plan in which the member invests both member and employer contributions (employer contributions vest over five years at 20% per year). Under the Member-Directed Plan members accumulate retirement assets equal to the value of member and (vested) employer contributions plus any investment earnings.
3) The Combined Plan (CO) – a cost-sharing, multiple-employer defined benefit pension plan. Under the Combined Plan, employer contributions are invested by OPERS to provide a formula retirement benefit similar in nature to the Traditional Pension Plan benefit. Member contributions, the investment of which is self-directed by the members, accumulate retirement assets in a manner similar to the Member-Directed Plan.

OPERS provides retirement, disability, survivor and death benefits and annual cost-of-living adjustments to members of the Traditional Pension and Combined Plans. Members of the Member-Directed Plan do not qualify for ancillary benefits. Authority to establish and amend benefits is provided by state statute per Chapter 145 of the Ohio Revised Code. OPERS issues a stand-alone financial report. Interested parties may obtain a copy by making a written request to OPERS, 277 East Town Street, Columbus, Ohio 43215-4642 or by calling (614) 222-5601 or 1-800-222-7377.

The Ohio Revised Code provides statutory authority for member and employer contributions. Member and employer contribution rates were consistent across all three plans (TP, MD and CO). Member contribution rates were 9.0% in 2006 and 8.5% in 2005 and 2004 and employer contribution rates were 13.70% of covered payroll in 2006 and 13.55% of covered payroll in 2005 and 2004. The Division's required employer contributions to OPERS for the pension portion of all the plans for the years ending December 31, 2006, 2005 and 2004 were approximately $1,747,000, $1,776,000 and $1,815,000 each year, respectively. The required payments due in 2006, 2005 and 2004 have been made.

## NOTE F - OTHER POST-EMPLOYMENT BENEFITS

Ohio Public Employees Retirement System: Ohio Public Employees Retirement System (OPERS) administers three separate pension plans: The Traditional Pension Plan (TP) – a cost-sharing, multiple-employer defined benefit pension plan; the Member-Directed Plan (MD) – a defined contribution plan; and the Combined Plan (CO) – a cost-sharing, multiple-employer defined benefit pension plan that has elements of both a defined benefit and defined contribution plan. OPERS provides retirement, disability and survivor benefits as well as postretirement health care coverage to qualifying members of both the Traditional Pension and the Combined Plans. Members of the Member-Directed Plan do not qualify for ancillary benefits, including postemployment health care coverage. In order to qualify for postretirement health care coverage, age and service retirees under the Traditional Pension and Combined Plans must have 10 or more years of qualifying Ohio service credit. Health care coverage for disability benefit recipients and qualified survivor benefit recipients is available. The health care coverage provided by OPERS is considered to be an Other Postemployment Benefit (OPEB) as described in GASB Statement No. 12.

A portion of each employer's contribution to OPERS is set aside for the funding of postretirement health care. The Ohio Revised Code provides statutory authority for employer contributions. The Division's contribution rate was 13.70% of covered payroll in 2006 and 13.55% of covered payroll in 2005 and 2004, and 4.50% was used to fund health care for the year in 2006 and 4.00% was used to fund health care for the year in 2005 and 2004. The Ohio Revised Code provides the statutory authority requiring public employers to fund postretirement health care through their contributions to OPERS. The assumptions and calculations below were based on OPERS' latest actuarial review performed as of December 31, 2005. The individual entry age actuarial cost method of valuation is used in determining the present value of OPEB. The difference between assumed and actual experience (actuarial gains and losses) becomes part of the unfunded actuarial accrued liability. All investments are carried at market value. For actuarial valuation purposes, a smoothed market approach is used. Under this approach, assets are adjusted to reflect 25% of unrealized market appreciation or depreciation on investment assets annually, not to exceed a 12% corridor. The investment assumption rate for 2005 was 6.50%. An annual increase of 4.00%, compounded annually, is the base portion of the individual pay increase assumption. This assumes no change in the number of active employees. Additionally, annual pay increases, over and above the 4.00% base increase, were assumed to range from 0.50% to 6.30%.

Health care costs were assumed to increase at the projected wage inflation rate plus an additional factor ranging from .50% to 6% for the next 9 years. In subsequent years (10 and beyond) health care costs were assumed to increase at 4% (the projected wage inflation rate). OPEBs are advance-funded on an actuarially determined basis. The Traditional Pension and Combined Plans had 369,214 active contributing participants as of December 31, 2006. The number of active contributing participants for both plans used in December 31,2005, actuarial valuation was 358,804. The employer contribution rate of 13.70 % is the actuarially determined contribution requirements for OPERS. The Division's actual contributions for 2006 which were to fund postemployment benefits were approximately $854,000. $11.1 billion represents the actuarial value of OPERS' net assets available for OPEB at December 31, 2005. Based on the actuarial cost method used, the actuarial valuation as of December 31, 2005, reported the actuarial accrued liability and the unfunded actuarial accrued liability for OPEB at $31.3 billion and $20.2 billion, respectively.

## NOTE F – OTHER POST-EMPLOYMENT BENEFITS (Continued)

The Health Care Preservation Plan (HCPP) adopted by the OPERS Retirement Board on September 9, 2004, will be effective January 1, 2007. OPERS took additional actions to improve the solvency of the Health Care Fund in 2005 by creating a separate investment pool for health care assets. Member and employer contribution rates increased as of January 1, 2006, and January 1, 2007, which will allow additional funds to be allocated to the health care plan.

## NOTE G - CONTINGENT LIABILITIES AND RISK MANAGEMENT

***Contingent Liabilities:*** Various claims are pending against the City involving the Division for personal injuries, property damage and other matters. The City is responsible for the lawsuits. The City's management is of the opinion that ultimate settlement of such claims will not result in a material adverse effect on the Division's financial position, results of operations or cash flows.

***Risk Management:*** The Division is exposed to various risks of loss related to torts; thefts of, damage to and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Division carries insurance to cover particular liabilities and property protection. Otherwise, the Division is generally self-insured. No material losses, including incurred but not reported losses, occurred in 2006 or 2005. There were no significant decreases in any insurance coverage in 2006. In addition, there were no insurance settlements in excess of insurance coverage during the past three years.

The City provides the choice of four separate health insurance plans for its employees. These plans are provided by two different insurers through commercial insurance. Operating funds are charged a monthly rate per employee, by type of coverage. The City participates in the State of Ohio's workers' compensation retrospective rating program.

In accordance with GASB Statement No. 10, claims liabilities are reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. Liabilities include an amount for claims that have been incurred but not reported. The result of the process to estimate the claims liability is not an exact amount as it depends on many complex factors, such as inflation, changes in legal doctrines, and damage awards. Accordingly, claims are re-evaluated periodically to consider the effects of inflation, recent claim settlement trends (including frequency and amount of pay-outs), and other economic and social factors. The estimate of the claims liability also includes amounts for incremental claim adjustment expenses related to specific claims and other claim adjustment expenses, regardless of whether allocated to specific claims. Estimated recoveries, for example from salvage or subrogation, are another component of the claims liability estimate. Claims liability for the Division is reported as accounts payable on the balance sheet and is immaterial.

## NOTE H - RELATED PARTY TRANSACTIONS

***Revenues and Accounts Receivable:*** The Division provides services to the City, including its various departments and divisions. The usual and customary rates are charged to all City departments and divisions.

***Operating Expenses:*** The Division is provided various intra-city services. Charges are based on actual use or on a reasonable pro rata basis. The more significant costs for the years ended December 31, 2006 and 2005 are as follows:

| | 2006 | 2005 |
|---|---|---|
| | (In thousands) | |
| City Administration | $ 703 | $ 1,524 |
| Telephone Exchange | 570 | 488 |
| Division of Water | 434 | 357 |
| Utilities Administration and Fiscal Control | 654 | 545 |
| Motor Vehicle Maintenance | 449 | 483 |

## NOTE I - CUYAHOGA COUNTY REAL PROPERTY TAXES

The Division is required by ordinance to keep records of the estimated property taxes which would be payable to Cuyahoga County were it subject to such taxes. The estimated property taxes for the Division, based on book value of real estate at the current tax rates, would have been approximately $1,206,000 and $1,355,000 for the years ended December 31, 2006 and 2005, respectively.

## NOTE J - KILOWATT PER HOUR TAX

In May 2001, the Division started billing electric deregulation kilowatt-hour tax according to the laws of the State of Ohio. The Division billed $5,233,000 and $5,122,000 for this tax in 2006 and in 2005 respectively, of which $13,164 and $13,031 was remitted to the State. All except the State of Ohio’s portion belongs to the General Fund of the City. In March 2006, City Council passed ordinance 2068-05, which allocates 100% of the City’s share of the tax in 2006 to the General Fund of the City.

## NOTE K – INCREMENTAL CHARGES

In 2000, 2002 and 2003 Cleveland City Council passed ordinances 910-98, 1886-02 and 2088-03, respectively to allow the Division to add an incremental charge for excess fuel, power production and purchased power cost.

## NOTE K – INCREMENTAL CHARGES (Continued)

The proceeds of the incremental charges shall be applied to the repayment of any bond obligations of the Division and the replacement of utility poles treated with copper naphthenate in the Division's distribution system.

The incremental charges were originally scheduled to end November 30, 2005, but have been extended by recent legislation to December 31, 2008. Effective December 1, 2005, the proceeds of the incremental charges are no longer earmarked for a specific purpose. The incremental charges billed were $4,761,000 and $4,922,000 in 2006 and 2005, respectively.

## NOTE L – SEAMS ELIMINATION COST ADJUSTMENT (SECA) PAYMENTS

Between December 2004 and March 2006, the Division was required by the Federal Energy Regulatory Commission ("FERC") to pay SECA payments amounting to $10.8 million. The payments arose from a transmission restructuring effort aimed at reducing transmission costs by allowing users such as Cleveland Public Power to pay a single rate for transmission across a regional system consisting of multiple utilities. These payments, made subject to refund and the outcome of litigation proceedings, were intended as a temporary replacement for revenues previously received by transmission owners in neighboring regional systems for transmission access across their systems.

Through December 31, 2006, the Division received $2.2 million as reimbursements for SECA payments. In addition, the Division has recorded a $2.5 million receivable from a settlement awaiting final approval by FERC. The Division is also pursuing two additional reimbursements of approximately $1 million. The remaining SECA payment of approximately $5.1 million is eligible for pass through to the customers of the Division in future years.

Mary Taylor, CPA
Auditor of State

**CITY OF CLEVELAND – CLEVELAND PUBLIC POWER**

**CUYAHOGA COUNTY**

**CLERK'S CERTIFICATION**

**This is a true and correct copy of the report which is required to be filed in the Office of the Auditor of State pursuant to Section 117.26, Revised Code, and which is filed in Columbus, Ohio.**

Susan Babbitt

**CLERK OF THE BUREAU**

**CERTIFIED**
**JULY 31, 2007**

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