

2006



**LCEC**

PEOPLE. POWER. POSSIBILITIES.

# Financial Statements

## Management's Report

The management of Lee County Electric Cooperative, Inc. (LCEC) has prepared – and is responsible for – the integrity and objectivity of the financial statements and related information included in this report. The financial statements have been prepared in conformity with accounting principles generally accepted in the United States.

To ensure the integrity of our financial statements, LCEC maintains a system of internal accounting controls. These controls have been put in place to ensure that LCEC's assets are properly safeguarded and the books and records reflect only those transactions that have been duly authorized. LCEC's controls are evaluated on an ongoing basis by both management and our internal auditors.

Based on the statements above, it is management's assertion that the financial statements do not omit or improperly include untrue statements of a material fact or include statements of a misleading nature.

Pamela M. May



Executive Vice President and CEO

Donald E. Schleicher



Director of Finance/Accounting &  
Chief Financial Officer

## LEE COUNTY ELECTRIC COOPERATIVE, INC.

## BALANCE SHEETS

ASSETS	December 31,	
	2006	2005
Utility plant, at historical cost		
Electric plant in service (Note 3)	\$ 593,353,813	\$ 531,080,177
Less accumulated depreciation	<u>(194,383,761)</u>	<u>(169,230,576)</u>
	398,970,052	361,849,601
Construction work in progress	<u>97,254,708</u>	<u>60,014,523</u>
	496,224,760	421,864,124
Investments (Note 4)	<u>34,542,084</u>	<u>31,051,573</u>
Current assets:		
Cash and cash equivalents	32,546	30,301
Receivables, less allowance for doubtful accounts of approximately \$550,000 and \$528,000	38,769,539	39,453,745
Materials and supplies, at average cost	9,408,659	7,741,803
Prepaid expenses and other current assets	<u>663,351</u>	<u>14,646,978</u>
Total current assets	<u>48,874,095</u>	<u>61,872,827</u>
Other assets:		
Deferred charges	660,064	797,748
Total other assets	<u>660,064</u>	<u>797,748</u>
	<u>\$ 580,301,003</u>	<u>\$ 515,586,272</u>
<b>MEMBERS' EQUITIES AND LIABILITIES</b>		
Members' equities:		
Memberships	\$ 769,846	\$ 736,062
Patronage capital	248,288,791	234,700,244
Other equities	21,911	21,911
Accumulated other comprehensive loss	<u>(2,678,240)</u>	<u>(3,045,321)</u>
	246,402,308	232,412,896
Long-term debt (Note 6)	<u>180,727,892</u>	<u>138,130,965</u>
Current liabilities:		
Current maturities of long-term debt (Note 6)	7,403,073	3,663,552
Lines of credit (Note 6)	68,382,000	53,831,385
Accounts payable (Note 10)	34,636,892	46,471,113
Customer deposits	7,835,816	6,930,148
Accrued taxes	2,497,140	2,123,644
Other current liabilities	<u>6,016,909</u>	<u>3,660,963</u>
Total current liabilities	<u>126,771,830</u>	<u>116,680,805</u>
Non-Current liabilities:		
Unamortized gain on refinancing (Note 7)	9,580,824	10,651,931
Patronage capital payable - long term	7,069,005	6,468,669
Accrued pension liability (Note 8)	2,080,094	4,832,390
Other post-retirement benefits (Note 8)	2,651,975	2,825,865
Deferred Credits	<u>5,017,075</u>	<u>3,582,751</u>
Total non-current liabilities	<u>26,398,973</u>	<u>28,361,606</u>
	<u>\$ 580,301,003</u>	<u>\$ 515,586,272</u>

LEE COUNTY ELECTRIC COOPERATIVE, INC.

STATEMENTS OF REVENUE, EXPENSES, AND CHANGES IN PATRONAGE CAPITAL

	For the years ended December 31,	
	2006	2005
Operating revenue and patronage capital	\$ 357,659,774	\$ 301,731,100
Operating expenses:		
Cost of power	261,580,160	218,865,811
Transmission expense	1,373,742	817,029
Distribution expense, operation	4,306,158	4,544,990
Distribution expense, maintenance	9,845,072	9,302,110
Customer accounts expense	7,532,065	6,608,529
Customer service and information expense	1,692,754	1,530,051
Administrative and general expense	12,300,195	13,254,729
Depreciation	25,935,335	23,022,947
Taxes other than income	7,352,006	7,277,696
	<u>331,917,487</u>	<u>285,223,892</u>
Operating margins	25,742,287	16,507,208
Interest expense	(14,126,252)	(9,451,767)
Amortization of gain / (loss) on refinancing	1,071,107	841,299
Other (loss) / income	432,316	376,570
Patronage capital from associated organizations	<u>5,180,751</u>	<u>2,669,310</u>
Net margins	18,300,209	10,942,620
Patronage capital at beginning of year	234,700,244	232,504,970
Distribution of patronage capital paid and payable	<u>(4,711,662)</u>	<u>(8,747,346)</u>
Patronage capital at end of year	<u>\$ 248,288,791</u>	<u>\$ 234,700,244</u>

STATEMENTS OF COMPREHENSIVE INCOME

	For the years ended December 31,	
	2006	2005
Net margins	\$ 18,300,209	\$ 10,942,620
Other comprehensive gain / (loss):		
Minimum pension liability adjustment	<u>367,081</u>	<u>(742,818)</u>
Comprehensive income	<u>\$ 18,667,290</u>	<u>\$ 10,199,802</u>

STATEMENTS OF CHANGES OF COMPREHENSIVE INCOME

	For the years ended December 31,	
	2006	2005
Accumulated other comprehensive loss – beginning balance	\$ (3,045,321)	\$ (2,302,503)
Minimum pension liability adjustment	<u>367,081</u>	<u>(742,818)</u>
Accumulated other comprehensive loss – ending balance	<u>\$ (2,678,240)</u>	<u>\$ (3,045,321)</u>

## LEE COUNTY ELECTRIC COOPERATIVE, INC.

## STATEMENTS OF CASH FLOWS

	December 31,	
	2006	2005
Cash flows from operating activities:		
Net margins	\$ 18,300,209	\$ 10,942,620
Adjustments to reconcile net margins to net cash provided by operating activities:		
Patronage capital credits from associated organizations	(5,180,751)	(2,669,310)
Provision for pension benefits	(2,335,623)	942,073
Provision for other post-retirement benefits	73,000	21,000
(Gain)/loss on disposition of property	(91,433)	(42,785)
Provision for bad debts	146,035	447,671
Depreciation and amortization	24,870,892	22,206,645
(Increase)/decrease in:		
Receivables net	538,172	(1,586,239)
Materials and supplies	(1,666,856)	(1,013,138)
Prepaid expenses and other current assets	13,983,626	(8,240,883)
Deferred charges	137,685	388,530
Increase/(decrease) in:		
Accounts payable	(11,834,221)	17,689,477
Customer deposits	905,668	1,187,532
Accrued taxes	373,496	(144,935)
Other liabilities	3,493,788	1,281,557
Total adjustments	<u>23,413,478</u>	<u>30,467,195</u>
Net cash provided by operating activities	<u>41,713,687</u>	<u>41,409,815</u>
Cash flows from investing activities:		
Capital expenditures	(100,302,635)	(80,273,385)
Proceeds from sale of property	91,433	42,785
Payments received on notes receivable	-	190,387
Return of capital from associated organizations	<u>1,690,240</u>	<u>667,429</u>
Net cash used for investing activities	<u>(98,520,962)</u>	<u>(79,372,784)</u>
Cash flows from financing activities:		
Memberships issued, net of terminations	33,784	37,396
Distribution of patronage capital	(4,111,326)	(7,825,441)
Lines of credit proceeds/(repayments), net	14,550,615	(1,220,145)
Issuance of long-term debt	50,000,000	50,000,000
Repayment of long-term debt	(3,663,553)	(2,776,069)
Prepayment penalty due to early retirement of debt	<u>-</u>	<u>(252,703)</u>
Net cash provided for financing activities	<u>56,809,520</u>	<u>37,963,038</u>
Net change in cash and cash equivalents	2,245	69
Cash and cash equivalents at beginning of year	<u>30,301</u>	<u>30,232</u>
Cash and cash equivalents at end of year	<u>\$ 32,546</u>	<u>\$ 30,301</u>
Supplemental disclosure of cash flow information:		
Cash paid for interest	<u>\$ 14,277,697</u>	<u>\$ 8,597,860</u>

LEE COUNTY ELECTRIC COOPERATIVE, INC.  
NOTES TO FINANCIAL STATEMENTS

Note 1. LCEC:

Lee County Electric Cooperative, Inc. (a Florida Corporation) (LCEC) is a nonprofit organization engaged principally in the transmission, distribution and sale of electricity in various sections of Southwest Florida. LCEC's Board of Trustees has ratemaking authority, while the Florida Public Service Commission has authority to review LCEC's rate structure.

Note 2. Summary of Significant Accounting Policies:

Revenues - LCEC uses the accrual method of accounting for operating revenue under which LCEC accrues estimated unbilled revenues, including amounts resulting from a power cost adjustment (PCA), for services provided to month-end. The PCA is based upon power costs projected by LCEC. Any over or under-recovery of power costs are refunded or billed to customers in subsequent billings and are included in other current liabilities or other current assets. At December 31, 2006, LCEC had a cumulative over-recovery of power costs of approximately \$2,300,000. At December 31, 2005, LCEC had a cumulative under-recovery of power costs of approximately \$14,200,000.

Utility Plant - LCEC records its utility plant at cost of construction, which includes labor, materials and indirect charges such as engineering, supervision and transportation. At December 31, 2006 and December 31, 2005 there was no interest capitalized for projects under construction, as its effect was determined to be immaterial. Nonrefundable payments received from customers and developers for extension of services are accounted for as a reduction of utility plant cost. Depreciation expense is computed based on the estimated remaining service lives using the composite method.

The depreciation rates for transmission and distribution plant averaged 2.75 percent and 3.82 percent respectively for 2006 and 2005. General plant is depreciated under the straight-line method over the estimated useful lives that vary from three years to thirty-eight years. Software is amortized under the straight-line method over the estimated useful lives that vary from three years to five years.

Inventory - LCEC uses the weighted average method of inventory valuation.

Regulatory Accounting - LCEC prepares its financial statements in accordance with the provisions of Statement of Financial Accounting Standards No. 71 — "Accounting for the Effects of Certain Types of Regulation" (SFAS 71). In general, SFAS 71 recognizes that accounting for rate-regulated enterprises should reflect the relationship of costs and revenues introduced by rate regulation. As a result, a regulated utility may defer recognition of a cost (a regulatory asset) or recognize an obligation (a regulatory liability) if it is probable that through the rate making process there will be a corresponding increase or decrease in future revenues. Accordingly, LCEC has recognized certain regulatory assets and regulatory liabilities in the accompanying balance sheets. In the event operations are no longer subject to the provisions of SFAS 71 as a result of a change in regulation or the effects of competition, LCEC would be required to recognize the effects of any regulatory change in assets or liabilities in its statement of revenues and expenses.

Investments - Investments in capital term certificates are considered to be held-to-maturity due to their nature and are carried at cost determined by specific identification.

Fair Value of Financial Instruments - The following methods and assumptions were used to estimate the fair value of each class of financial instrument for which it is practicable to estimate that value. For cash and cash equivalents and lines of credit, the carrying amount approximates their fair values due to the short-term maturities of these instruments. The fair value of the fixed rate National Rural Utilities Cooperative Finance Corporation (CFC) loans and the CoBank loans were estimated by discounting the future cash flows using rates currently available for loans of similar terms and maturities. The CFC loans (see Note 6) will be re-priced in six years to seven years. Due to the impracticality of determining the re-pricing interest rates on those dates, the re-pricing mechanism was not included in the fair value estimation. Investment in CFC capital term certificates was required as a condition of obtaining debt financing from CFC until December 31, 1993. The effective yield (net interest rate of

## NOTES TO FINANCIAL STATEMENTS

CFC debt less CFC investment income) is considered to be fair value. At December 31, 2006, the CFC loans utilizing the effective yield had a carrying amount of approximately \$42,600,000 and a fair value of \$45,700,000. At December 31, 2006, the CoBank loans had a carrying amount of approximately \$145,500,000 and a fair value of approximately \$154,500,000. For investments in associated organizations, the fair value of patronage capital is not determinable since no legal obligation exists to retire capital credits, even though some associated organizations have established retirement patterns. There is no ready market for the patronage capital certificates. The carrying amount of memberships approximates fair value.

Deferred Charges - Included in deferred charges is approximately \$229,000, primarily relating to amounts paid to another public utility for construction of certain transmission facilities. The original amount of \$1,300,000 was paid in 1992 to be amortized over 30 years. The deferral period was subsequently reduced to 15 years in 1996. The amortization associated with deferred charges was approximately \$45,000 in both 2006 and 2005.

Deferred charges also included an intangible pension asset of approximately \$446,000 and \$496,000 at the end of 2006 and 2005, respectively.

Memberships - LCEC memberships (\$5 per member), net of terminations, resulted in a balance of approximately \$769,800 and \$736,100 at December 31, 2006 and December 31, 2005, respectively.

Patronage Capital - LCEC did not have a general patronage capital distribution in 2006. LCEC distributed patronage capital of approximately \$4,700,000 in 2005. Active and inactive members received 2.12 percent of their patronage capital balances in 2005. Bad debts of approximately \$96,000 in 2005 were offset against the 2005 general distribution.

In addition, inactive members that disconnected in 1998 or prior received 100 percent of their patronage capital account balances. This resulted in an additional distribution of approximately \$4,700,000 and \$4,100,000 in 2006 and 2005, respectively. Bad debts of approximately \$83,000 in 2006 and \$97,000 in 2005 were offset against the distribution.

LCEC has a loan agreement stating that LCEC will not declare or pay any dividends or patronage refunds, or declare or grant any general cancellation or abatement of charges for electric energy or services furnished by LCEC, or purchase, retire, or redeem any patronage or other capital, or make any other distribution of any kind (whether in cash or property) to its members, stockholders, or consumers unless after giving thereto; LCEC's equity would equal or exceed 40 percent of its total assets (as determined in accordance with GAAP consistently applied).

Cash Equivalents - For purposes of the Statements of Cash Flows, LCEC considers all highly liquid instruments purchased with an original maturity of three months or less to be cash equivalents.

Income Tax Status - LCEC is exempt from federal income taxes under the provisions of Section 501(c)(12) of the Internal Revenue Code. It is also exempt from state income taxes. Accordingly, the accompanying financial statements include no provision for such taxes.

Reclassifications - Certain amounts in the 2005 financial statements have been reclassified to conform to the 2006 presentation.

Use of Estimates - The preparation of financial statements in conformity with accounting principles generally accepted in the United States 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.

LEE COUNTY ELECTRIC COOPERATIVE, INC.  
**NOTES TO FINANCIAL STATEMENTS**

Note 3. Utility Plant:

Electric plant in service includes the following:

	December 31,	
	2006	2005
Land and land rights	\$ 8,187,370	\$ 8,166,487
Transmission plant	54,082,109	54,082,109
Distribution plant	474,573,934	424,890,698
General plant	<u>56,510,400</u>	<u>43,940,883</u>
Utility plant in service	<u>\$ 593,353,813</u>	<u>\$ 531,080,177</u>
Construction work in progress	97,254,708	60,014,523
Less: accumulated depreciation	<u>(194,383,761)</u>	<u>(169,230,576)</u>
Net utility plant	<u>\$ 496,224,760</u>	<u>\$ 421,864,124</u>

Note 4. Investments:

Investments include the following:

	December 31,	
	2006	2005
Florida Electric Cooperatives Association	\$ 9,517	\$ 9,517
National Rural Utilities Cooperative Finance Corporation:		
Membership	1,000	1,000
Capital term certificates	7,391,077	7,975,240
Patronage capital certificates	2,582,666	2,693,470
Seminole Electric Cooperative, Inc.	21,937,101	18,979,933
CoBank:		
Membership	1,000	1,000
Patronage capital certificates	2,382,482	1,224,890
Other investments and patronage capital certificates	<u>237,241</u>	<u>166,523</u>
	<u>\$ 34,542,084</u>	<u>\$ 31,051,573</u>

As discussed in Note 2, investments in CFC Capital Term Certificates were required as a condition of obtaining debt financing from CFC until December 31, 1993. Of the \$7,391,077 and \$7,975,240 carrying amounts at December 31, 2006 and December 31, 2005, respectively, the maturity dates and interest rates vary from 2020 to 2080 and 0 percent to 5 percent, respectively.

Note 5. Accounts Receivable:

LCEC extends credit to its customers who are located in southwest Florida. Trade receivables are carried at original invoice amount less an estimate made for doubtful receivables. Management determines the allowance for doubtful accounts by identifying troubled accounts and by using historical experience applied to an aging of accounts. Trade receivables are written off when deemed uncollectible. Recoveries of trade receivables previously written off are recorded when received. The accounts receivable balance of approximately \$39 million in both 2006 and 2005 includes unbilled revenue of approximately \$15 million in 2006 and \$12 million in 2005.

LEE COUNTY ELECTRIC COOPERATIVE, INC.  
**NOTES TO FINANCIAL STATEMENTS**

A summary of the changes in the provision for uncollected accounts is as follows:

	2006	2005
Balance at beginning of year	\$ 528,017	\$ 692,634
Gross write-offs	(737,168)	(885,234)
Net recoveries	168,195	283,054
Reclassification of tax	1,133	12,563
Provision for uncollectible accounts	590,000	425,000
Balance at end of year	<u>\$ 550,177</u>	<u>\$ 528,017</u>

Note 6. Debt:

A summary of debt as of December 31, 2006 and 2005 follows:

Loan Number	Date of Note	Maturity Date	% Rate at 12/31/06	Outstanding Debt as of December 31,	
				2006	2005
<b>Obligations to CFC:</b>					
9023	11-25-86	09-30-21	6.95%	\$ 7,827,429	\$ 8,123,044
9024	11-06-87	09-30-22	6.85%	30,543,774	31,591,317
9031	11-01-97	03-31-25	6.95%	4,224,280	4,336,046
				<u>\$ 42,595,483</u>	<u>\$ 44,050,407</u>
<b>Obligations to CoBank:</b>					
001731405	03-01-04	10-20-33	6.01%	\$ 33,763,071	\$ 35,126,176
001787855	07-02-04	07-02-29	6.52%	12,128,283	12,617,934
001896183	04-22-05	03-20-30	5.98%	49,644,128	50,000,000
002077195	11-17-06	12-20-31	6.37%	50,000,000	-
				<u>\$ 145,535,482</u>	<u>\$ 97,744,110</u>
SunTrust line of credit				\$ 17,382,000	\$ 9,581,385
Bank of America line of credit				-	19,750,000
CoBank line of credit				21,000,000	24,500,000
CoBank revolving loan				30,000,000	-
				<u>\$ 68,382,000</u>	<u>\$ 53,831,385</u>
<b>Total debt</b>				<b>\$ 256,512,965</b>	<b>\$ 195,625,902</b>
Less current maturities				(7,403,073)	(3,663,552)
Less lines of credit				<u>(68,382,000)</u>	<u>(53,831,385)</u>
				<u>\$ 180,727,892</u>	<u>\$ 138,130,965</u>

Obligations to CFC - The CFC debt is represented by 28-year to 35-year notes at fixed rates with principal and interest payable quarterly. A pro-rata share of all assets are pledged as collateral for debt to CFC. As of December 31, 2006, LCEC has an additional \$10,000,000 in CFC notes available to draw upon at rates in effect at the time of withdrawal.

Maturities on CFC long-term debt in the years 2007 through 2011 are \$1,557,605; \$1,667,532; \$1,785,218; \$1,911,210 and \$2,046,095 respectively, with the remaining balance of \$33,627,823 due thereafter.

Obligations to CoBank - The CoBank debt is represented by 25-year and 29-year notes at fixed rates and principal and interest payments payable monthly. A pro-rata share of all assets are pledged as collateral for the debt to CoBank.

In November 2006, LCEC entered into an agreement to obtain a \$50,000,000 note at a fixed rate of 6.37 percent for 25 years from CoBank to convert lines of credit to long-term debt. The outstanding balance at December 31, 2006 was \$50,000,000.

In April 2005, LCEC entered into an agreement to obtain a \$50,000,000 note at a fixed rate of 5.98 percent for 25 years from CoBank. The outstanding balance at December 31, 2006 was \$49,644,128.

## NOTES TO FINANCIAL STATEMENTS

In March 2004, LCEC entered into an agreement to obtain a term note and a revolving note with CoBank. The term note bears interest at a stated fixed rate of 6.01 percent. The balance outstanding on this term note at December 31, 2006 was \$33,763,071. The revolving note was for \$30,000,000 at a variable interest rate (6.17 percent at December 31, 2006). The balance outstanding on the revolving note at December 31, 2006 was \$30 million.

In July 2004, LCEC entered into an additional agreement with CoBank to obtain financing to convert revolver debt to long-term debt at a stated fixed rate of 6.52 percent. The balance outstanding at December 31, 2006 was \$12,128,283.

Maturities on CoBank long-term debt in the years 2007 through 2011 are \$5,845,468 each year, with the remaining balance of \$116,308,141 due thereafter. All term notes with CoBank have monthly payments, with payments due on the 20<sup>th</sup> of each month.

Revolving Loan Facilities — LCEC has a perpetual \$35,000,000 variable rate line of credit agreement with CFC. There was no outstanding balance at December 31, 2006 or December 31, 2005.

LCEC has a \$25 million credit agreement with SunTrust Bank N.A. The credit agreement includes a revolving loan facility at competitive bid rates (5.69 percent at December 31, 2006) and expires April 30, 2007. The outstanding balance of the loan facility at December 31, 2006 and December 31, 2005 was \$17,382,000 and \$9,581,385, respectively.

On August 10, 2006, LCEC entered into a \$30,000,000 credit agreement with Bank of America N.A. The credit agreement includes a revolving loan facility at competitive bid rates and expires June 30, 2007. The outstanding balance of the loan facility at December 31, 2006 and December 31, 2005 was \$0 and \$19,750,000 respectively.

In April 2005, LCEC established a line of credit with CoBank for \$50,000,000 with a variable interest rate (6.17 percent at December 31, 2006). The outstanding line of credit at December 31, 2006 and December 31, 2005 was \$21,000,000 and \$24,500,000, respectively.

There are no commitment fees associated with either the SunTrust, Bank of America, CFC, or CoBank lines of credit.

The provisions of the obligations to CFC and CoBank and the other credit agreements contain various covenants and require LCEC to maintain certain financial ratios. LCEC was in compliance with all of the covenants at December 31, 2006.

Note 7. Gain on Debt Refinancing:

During 1987, LCEC extinguished \$93,747,483 of its long-term debt prior to scheduled maturity, resulting in a net gain of \$32,714,701. This gain has been deferred and is being amortized on a straight-line basis over the remaining lives of the extinguished notes. At December 31, 2006 and December 31, 2005 the remaining balance was \$9,580,824 and \$10,651,931, respectively.

Note 8. Employee Benefit Plans:

LCEC Pension Plan - LCEC provides a non-contributory defined-benefit pension plan for all full-time employees. The plan provides defined benefits based on years of service and final average salary. Mass Mutual, the Investment Manager, provides administrative and investment management for the pension plan. LCEC provides investment discretion to Mass Mutual over the plan's separate account assets within specified guidelines. LCEC has an Investment Committee that oversees performance of the pension plan and the Investment Manager. The basic goal underlying the establishment of LCEC's investment policy with respect to its retirement plan for employees is to provide that the assets of the plan shall be invested in a prudent manner. The primary investment objectives are to strive for a rate of return that would serve to control cost as a percent of payroll; to place a high priority on benefit security; and to earn a rate of return that keeps pace with inflation, is achievable under conditions of prudent risk, and is competitive with returns achieved by similar pension portfolios and by market averages.

LEE COUNTY ELECTRIC COOPERATIVE, INC.

NOTES TO FINANCIAL STATEMENTS

Health Care Plan — Employees hired prior to January 1, 1994, are eligible for lifetime continued health care coverage under LCEC’s health care plan, upon completing thirty years of service, or upon attaining age 62 and completing ten years of service.

Effective January 1, 1997, LCEC changed from a self-insured plan to premium-based insurance. This plan resulted in charges, net of employee premiums, of approximately \$2,400,000 and \$2,000,000 in 2006 and 2005 respectively. Additionally, effective January 1, 1997, LCEC established a maximum annual dollar cap for medical premiums paid for future retirees. LCEC continues to fund benefit costs on a pay-as-you-go basis.

Disclosures required by Statement of Financial Accounting Standards No. 132, “Employers’ Disclosures about Pensions and Other Postretirement Benefits”, with regard to LCEC’s pension and health care benefits are as follows:

	December 31,			
	2006	2005	2006	2005
	<u>Pension Benefits</u>		<u>Other Benefits</u>	
Obligations and funded status at end of years:				
Benefit obligation at December 31	\$ 21,121,000	\$ 18,871,000	\$ 3,240,000	\$ 3,355,000
Fair value of plan assets at December 31	<u>15,373,000</u>	<u>10,738,000</u>	<u>-</u>	<u>-</u>
Funded status (plan assets less than benefit obligations)	<u>\$ (5,748,000)</u>	<u>\$ (8,133,000)</u>	<u>\$ (3,240,000)</u>	<u>\$ (3,355,000)</u>
Amounts recognized in the statement of financial position:				
Prepaid benefit costs	\$ -	\$ -		
Intangible asset	446,000	496,000		
Accumulated other comprehensive loss	2,678,000	3,045,000		
Accrued benefit cost	<u>(2,080,000)</u>	<u>(4,832,000)</u>		
Net amount recognized	<u>\$ 1,044,000</u>	<u>\$ (1,291,000)</u>		
Accumulated benefit obligation for all defined benefit pension plans	\$ 17,453,000	\$ 15,571,000		
For pension plans with accumulated benefit obligations in excess of assets at December 31 of the respective years, aggregate amounts were:				
Projected benefit obligations	\$ 21,121,000	\$ 18,871,000	\$ 3,240,000	\$ 3,355,000
Accumulated benefit obligations	17,453,000	15,571,000	2,652,000	2,826,000
Plan assets	15,373,000	10,738,000	-	-
Increase in minimum liability included in other comprehensive income	\$ (367,000)	\$ 743,000		
Weighted-average assumptions used in computing ending obligations:				
Discount rate	6.00%	5.75%	6.00%	5.75%
Rate of compensation increase	4.00%	4.00%	N/A	N/A
Weighted-average assumptions used in computing net cost:				
Discount rate	5.75%	5.75%	5.75%	5.75%
Rate of compensation increase	4.00%	4.00%	N/A	N/A
Expected return on plan assets	9.00%	9.00%	N/A	N/A

LEE COUNTY ELECTRIC COOPERATIVE, INC.  
**NOTES TO FINANCIAL STATEMENTS**

The expected long-term rate of return on pension plan assets reflects the average rate of earnings expected on the funds invested or to be invested to provide for the benefits included in the projected benefit obligation. In estimating that rate, appropriate consideration is given to the returns being earned by the pension plan assets in the fund and rates of return expected to be available for reinvestment, and a building block method. The expected rate of return on each asset class is broken down into three components: (1) inflation, (2) the real risk-free rate of return (i.e., the long term estimate of future returns on default-free U.S. government securities), and (3) the risk premium for each asset class (i.e., the expected return in excess of the risk-free rate).

All three components are based primarily on historical data, with modest adjustments to take into account additional relevant information that is currently available. For the inflation and risk-free return components, the most significant additional information is that provided by the market for nominal and inflation-indexed U.S. Treasury securities. That market provides implied forecasts of both the inflation rate and risk-free rate for the period over which currently available securities mature. The historical data on risk premiums for each asset class is adjusted to reflect any systemic changes that have occurred in the relevant markets; e.g., the higher current valuations for equities, as a multiple of earnings, relative to the longer-term average for such valuations.

The exact expected return derived using the building block method will vary from year to year; however, as the rate is a long-term assumption, it remains constant as long as it remains within a reasonable range.

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. For measurement purposes, at the end of the years included in the foregoing tables, a 9 percent rate of increase was assumed for 2005, a 10 percent rate of increase was assumed for 2006, and gradually lower rates of increase assumed for years after 2006, until the rate of increase is assumed to be 5.0 percent in 2011 and remain at that level.

	Percentage of Pension Plan Assets at December 31,			
	2006	2005	2006	2005
	<u>Non-Union</u>		<u>Union</u>	
Equity Securities	74%	74%	74%	73%
Debt Securities	21	21	21	22
Real Estate	0	0	0	0
Other (Cash and cash equivalents)	5	5	5	5
Total	100%	100%	100%	100%
	<u>Pension Benefits</u>		<u>Other Benefits</u>	
	2006	2005	2006	2005
Benefits Payments:				
Benefit cost	\$ 2,569,000	\$ 1,897,000	\$ 73,000	\$ 21,000
Employer contribution	4,905,000	2,288,000	N/A	N/A
Plan participant's contribution	N/A	N/A	N/A	N/A
Benefits paid	1,640,000	4,072,000	247,000	255,000

LCEC expects to make a minimum contribution to the pension plan of approximately \$2.9 million in 2007. The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

<u>Year</u>	<u>Pension Benefits</u>	<u>Other Benefits</u>
2007	\$ 2,253,732	\$ 253,000
2008	1,290,668	277,000
2009	1,789,345	305,000
2010	2,522,218	305,000
2011	2,922,937	330,000
Years 2012-2016	15,177,219	1,535,000

LEE COUNTY ELECTRIC COOPERATIVE, INC.  
NOTES TO FINANCIAL STATEMENTS

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans* – an amendment of FASB Statements No. 87, 88, 106, and 132(R). SFAS No. 158 requires an employer that sponsors a defined benefit postretirement plan to report the current economic status (the overfunded or underfunded status) of the plan in its balance sheet, to measure the plan assets and plan obligations as of the balance sheet date, and to include enhanced disclosures about the plan. LCEC will be required to adopt the recognition and disclosure provisions of SFAS No. 158 for the fiscal year ending December 31, 2007, and the measurement date provision for the fiscal year ending December 31, 2008. LCEC does not anticipate adopting the provisions of SFAS No. 158 prior to those periods.

LCEC 401(k) Plan - LCEC also provides a retirement savings plan under Section 401(k) of the Internal Revenue Code available to all employees who have completed one full calendar month of service. Under the LCEC 401(k) Plan, eligible employees may contribute up to 50 percent of their annual base salary not to exceed amounts set by the Internal Revenue Service. Upon completion of one year of service, LCEC matches one-half of employee contributions of 6 percent or less. LCEC's 401(k) Plan contributions were approximately \$370,000 and \$319,000 for 2006 and 2005, respectively.

Note 9. Commitments and Contingencies:

LCEC is a party to litigation involving various claims arising in the normal course of business. In the opinion of management, the ultimate resolution of these matters will not have a materially adverse effect on the financial position, results of operations, or cash flows of LCEC.

Note 10. Related Party:

LCEC is a member of Seminole Electric Cooperative, Inc., a generation and transmission cooperative. Under the provisions of a wholesale power contract with Seminole expiring in 2020, LCEC is required to purchase all power for its system to the extent that Seminole shall have such power available. For the years ended December 31, 2006 and December 31, 2005, LCEC purchased approximately 22 percent of Seminole's output in each year. At December 31, 2006 and December 31, 2005, LCEC had accounts payable to Seminole for purchased power of approximately \$19,300,000 and \$19,400,000, respectively. LCEC received patronage capital credits from Seminole of \$3,112,109 and \$1,388,948 for 2006 and 2005, respectively.

LCEC and a like situated cooperative, Clay Electric Cooperative, Inc. (Clay), as plaintiffs filed a suit on December 30, 2003 against its power supplier, Seminole Electric Cooperative, Inc. The complaint, as filed, alleges a breach of the Wholesale Power Contract by Seminole Electric Cooperative, Inc. In addition to the breach of the contract, it is alleged that Seminole Electric Cooperative, Inc. has breached its fiduciary duty, implied covenant of good faith, fair dealing and commercial reasonableness to both LCEC and Clay. In 2005, Clay resolved its claims against Seminole and is no longer a party to the litigation.

Subsequently, LCEC filed a motion to move the case to Lee County which was granted by the Circuit Court in Clay County. Seminole appealed and the First District Court of Appeal ruled in favor of Lee County, and the case is now pending in Lee County.

LCEC and Seminole have continued in an attempt to resolve the litigation through negotiation. There has been no action taken in the litigation by agreement of the parties. The negotiations are ongoing, but have not yet produced a resolution that is acceptable to LCEC. No claims have been asserted against LCEC in this litigation.

LEE COUNTY ELECTRIC COOPERATIVE, INC.  
NOTES TO FINANCIAL STATEMENTS

Note 11. Recent Developments:

In 2006, LCEC became an active member with the Florida Reliability Coordinating Council (FRCC). This organization officially became the 10th Reliability Region of the North American Electric Reliability Corporation (NERC) in September of 1996. The FRCC participates in regulatory activities at the NERC, and in July of 2006 the Federal Energy Regulatory Commission (FERC) issued an order establishing the NERC as Electric Reliability Organization (ERO) for the United States under the Energy Policy Act (EPA) of 2005.

LCEC also actively monitors the ongoing activities of the Florida Public Service Commission (FPSC).

LCEC believes the regulatory activities at both the State and Federal level will not have a material adverse effect on the financial results.

During 2005, the counties in which LCEC provides electric services suffered hardship due to a number of hurricanes. The largest and most significant was hurricane Wilma, which came ashore in southwest Florida on October 24, 2005. This event caused LCEC to incur damages to its infrastructure. Expenses to repair and replace utility plant assets amounted to approximately \$7,600,000 of which \$1,875,000 was expensed during the year ended December 31, 2005. Approximately \$5,725,000 of this amount was eligible for Federal Emergency Management Agency (FEMA) reimbursement, and was recorded in receivables at December 31, 2005.



MONTGOMERY, ALABAMA

*Dothan*

*Fratville*

*Wetumpka*

## INDEPENDENT AUDITORS' REPORT

To the Board of Trustees  
Lee County Electric Cooperative, Inc.  
North Fort Myers, Florida

We have audited the accompanying balance sheets of Lee County Electric Cooperative, Inc. the Company, as of December 31, 2006 and 2005 and the related statements of revenue, expenses and changes in patronage capital, comprehensive income and changes of comprehensive income and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion 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 obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Lee County Electric Cooperative, Inc. as of December 31, 2006 and 2005 and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

*Jackson Thornton & Co. PC*

Montgomery, Alabama  
February 26, 2007