



**ALASKA ENERGY AUTHORITY**  
(A Component Unit of the State of Alaska)

Financial Statements and Schedules

June 30, 2007 and 2006

(With Independent Auditors' Report Thereon)

**ALASKA ENERGY AUTHORITY**  
(A Component Unit of the State of Alaska)

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**ALASKA ENERGY AUTHORITY**  
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Management's Discussion and Analysis

June 30, 2007 and 2006

**Overview of the Financial Statements**

The Alaska Energy Authority's (AEA or Authority) operations fall within two major programs – the AEA owned hydroelectric and intertie projects and the rural energy programs. Further information on AEA's programs can be found in note 1 to the financial statements.

This financial report consists of three sections: management's discussion and analysis, basic financial statements, and supplementary schedules. AEA's operations are business type activities and are considered an enterprise fund. The Authority is a component unit of the State of Alaska (State) and is discretely presented in the State's financial statements. The Authority's basic financial statements are the Balance Sheets; the Statements of Revenues, Expenses and Changes in Net Assets; the Statements of Cash Flows and the Notes to Basic Financial Statements.

**Basic Financial Statements**

The *Balance Sheets* report the Authority's assets, liabilities, and resulting net assets. The net assets are reported as invested in capital assets less debt, restricted and unrestricted. Restricted net assets are subject to external limits such as bond resolutions, legal agreements or statutes.

The *Statements of Revenues, Expenses, and Changes in Net Assets* report the Authority's income, expenses, and resulting change in net assets during the periods reported.

Both statements report on the accrual basis of accounting and economic resources measurement focus.

The *Statements of Cash Flows* report the Authority's sources and uses of cash and change in cash balance resulting from the Authority's activities during the periods reported.

The *Notes to Basic Financial Statements* provide additional information required to fully understand the amounts reported in the basic financial statements.

**Management's Discussion and Analysis**

This section presents AEA management's analysis of the Authority's financial position and results of operations at and for the years ended June 30, 2007 and 2006. This information is presented to help the reader focus on significant financial issues and provide additional information regarding the activities of the Authority. This information should be read in conjunction with the Independent Auditors' Report, the audited financial statements and the accompanying notes.

**Financial Highlights**

AEA's assets exceeded its liabilities by \$630 million at June 30, 2007 and by \$415 million at June 30, 2006. Of the total net assets at June 30, 2007, \$137 million was invested in capital assets net of related debt, \$42 million was restricted and \$450 million was unrestricted. Of the total net assets at June 30, 2006, \$138 million was invested in capital assets net of related debt, \$44 million was restricted and \$233 million was unrestricted.

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Management's Discussion and Analysis

June 30, 2007 and 2006

**Financial Analysis**

***Financial Position***

Total assets, total liabilities, and total net assets at June 30, 2007, 2006, and 2005 follows (stated in thousands):

|                                        | <u>2007</u>       | <u>2006</u>    | <u>2005</u>    |
|----------------------------------------|-------------------|----------------|----------------|
| Current assets                         | \$ 7,386          | 6,760          | 11,196         |
| Capital assets                         | 259,816           | 265,650        | 273,321        |
| Other noncurrent and restricted assets | 524,425           | 296,270        | 290,352        |
| Total assets                           | <u>791,627</u>    | <u>568,680</u> | <u>574,869</u> |
| Current liabilities                    | 44,137            | 31,242         | 34,174         |
| Noncurrent liabilities                 | 118,234           | 122,295        | 126,051        |
| Total liabilities                      | <u>162,371</u>    | <u>153,537</u> | <u>160,225</u> |
| Total net assets                       | <u>629,256</u>    | <u>415,143</u> | <u>414,644</u> |
| Total liabilities and net assets       | <u>\$ 791,627</u> | <u>568,680</u> | <u>574,869</u> |

Current assets were \$0.6 million higher at June 30, 2007 compared to June 30, 2006 and \$4.4 million lower at June 30, 2006 compared to June 30, 2005. Components of the changes were (stated in millions):

|                                                                         | <u>2007 vs.<br/>2006</u> | <u>2006 vs.<br/>2005</u> |
|-------------------------------------------------------------------------|--------------------------|--------------------------|
| Increase in investment interest receivable                              | \$ 0.1                   | —                        |
| Department of Energy construction grants final receipts in FY06         | —                        | (0.9)                    |
| Decrease in operating receivable from operating plants                  | (0.1)                    | —                        |
| FEMA Grant received in FY05-no similar grant in FY06 or FY07            | —                        | (0.3)                    |
| Decrease in receivable from Denali Commission                           | (0.3)                    | (2.4)                    |
| Increase in receivable from other grants                                | 0.4                      | —                        |
| Decrease due to short term loan term change to long term                | —                        | (1.1)                    |
| Net increase in short-term loans originated,<br>net of loan collections | <u>0.5</u>               | <u>0.3</u>               |
|                                                                         | <u>\$ 0.6</u>            | <u>(4.4)</u>             |

Capital assets were \$5.8 million lower at June 30, 2007 compared to June 30, 2006 and \$7.7 million lower at June 30, 2006 compared to June 30, 2005 substantially due to depreciation of capital assets, offset by improvements to the Bradley Lake Project.

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June 30, 2007 and 2006

Other noncurrent and restricted assets were \$228.2 million higher at June 30, 2007 compared to June 30, 2006 and \$5.9 million higher at June 30, 2006 compared to June 30, 2005. Components of the changes were (stated in millions):

|                                                                   | <b>2007 vs.<br/>2006</b> | <b>2006 vs.<br/>2005</b> |
|-------------------------------------------------------------------|--------------------------|--------------------------|
| Increase (decrease) in PCE Endowment Fund securities lending      | \$ 5.4                   | (1.0)                    |
| Contribution to PCE Endowment Fund                                | 182.7                    | —                        |
| Increase in PCE Endowment Fund realized investment income         | 7.4                      | —                        |
| Decrease due to increased capital expenditure                     | (0.9)                    | (2.0)                    |
| Increase in restricted cash for bond arbitrage liability          | 0.3                      | —                        |
| Increase in PCE program due to FY06 supplemental appropriation    | —                        | 3.8                      |
| Increase in PCE Endowment Fund fair value                         | 22.9                     | 3.4                      |
| Net increase in other funds from investment income and fair value | 0.8                      | 0.6                      |
| Increase in long-term loan fundings                               | 1.0                      | 1.1                      |
| Net increase in State advances on appropriations                  | 8.6                      | —                        |
|                                                                   | <u>\$ 228.2</u>          | <u>5.9</u>               |

Current liabilities were \$12.8 million higher at June 30, 2007 compared to June 30, 2006 and \$2.9 million lower at June 30, 2006 compared to June 30, 2005. Components of the changes were (stated in millions):

|                                                                                                             | <b>2007 vs.<br/>2006</b> | <b>2006 vs.<br/>2005</b> |
|-------------------------------------------------------------------------------------------------------------|--------------------------|--------------------------|
| Increase (decrease) in PCE Endowment Fund securities lending                                                | \$ 5.4                   | (1.0)                    |
| Net increase in State advances on appropriations                                                            | 8.6                      | —                        |
| Decrease in short-term borrowings                                                                           | (0.2)                    | —                        |
| Increased (decreased) budgeted revenues in excess of actual expenses on hydroelectric and intertie projects | 0.5                      | (1.2)                    |
| Decrease in other accrued expenditures                                                                      | (1.5)                    | (0.7)                    |
|                                                                                                             | <u>\$ 12.8</u>           | <u>(2.9)</u>             |

The decreases in noncurrent liabilities between June 30, 2007 and 2006 and between June 30, 2006 and 2005 were caused by the decrease in the long-term portion of bonds payable at each year end; there were no new borrowings.

The increase in net assets from June 30, 2006 to June 30, 2007 resulted from the \$182.7 million contribution to the PCE Endowment Fund and resulting increased investment income offset by operating losses. The decrease in net assets from June 30, 2005 to June 30, 2006 resulted from the operating loss offset by nonoperating investment income.

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June 30, 2007 and 2006

**Operations**

Components of the Authority's operating revenues, operating expenses, nonoperating investment income and operating loss for the years ended June 30, 2007 through 2005 follows (stated in thousands):

|                                              | <u>2007</u>       | <u>2006</u>     | <u>2005</u>     |
|----------------------------------------------|-------------------|-----------------|-----------------|
| Operating revenues:                          |                   |                 |                 |
| Federal grants                               | \$ 21,881         | 28,544          | 42,442          |
| Revenue from operating plants                | 16,962            | 15,669          | 16,680          |
| State appropriations                         | 14,539            | 12,192          | 2,952           |
| Other                                        | 1,718             | 1,603           | 1,780           |
| Total operating revenues                     | <u>55,100</u>     | <u>58,008</u>   | <u>63,854</u>   |
| Operating expenses:                          |                   |                 |                 |
| Grants and projects                          | 24,239            | 30,170          | 46,926          |
| PCE grants                                   | 25,145            | 21,669          | 15,575          |
| Depreciation                                 | 10,034            | 9,992           | 10,006          |
| Interest expense                             | 7,938             | 8,274           | 8,553           |
| Plant operating                              | 4,242             | 4,213           | 4,044           |
| General and administrative                   | 1,673             | 1,638           | 1,539           |
| Provision for loan loss and bad debt expense | (349)             | (326)           | 170             |
| Total operating expense                      | <u>72,922</u>     | <u>75,630</u>   | <u>86,813</u>   |
| Operating loss                               | <u>(17,822)</u>   | <u>(17,622)</u> | <u>(22,959)</u> |
| Nonoperating:                                |                   |                 |                 |
| PCE Endowment Fund contribution              | 182,700           | —               | —               |
| Investment income, net                       | 49,235            | 18,121          | 17,928          |
| Increase (decrease) in net assets            | <u>\$ 214,113</u> | <u>499</u>      | <u>(5,031)</u>  |

Operating revenues decreased \$2.9 million during the year ended June 30, 2007 compared to the prior year and \$5.8 million during the year ended June 30, 2006 compared to the same period in 2005. Components of the changes were (stated in millions):

|                                                                  | <u>FY 2007-2006</u><br><u>Net change</u> | <u>FY 2006-2005</u><br><u>Net change</u> |
|------------------------------------------------------------------|------------------------------------------|------------------------------------------|
| Decreased grant revenue from Denali Commission                   | \$ (8.2)                                 | (11.0)                                   |
| Increase (decreased) grant revenue from Department of Energy     | 0.6                                      | (1.5)                                    |
| Increased (decreased) revenue from other grantors                | 1.0                                      | (1.4)                                    |
| Fluctuations in Bradley Lake approved budget expenditures        | 1.3                                      | (1.0)                                    |
| Increased revenue from State for PCE grants                      | 2.1                                      | 8.7                                      |
| Increased revenue from State general fund capital appropriations | 0.3                                      | 0.4                                      |
|                                                                  | <u>\$ (2.9)</u>                          | <u>(5.8)</u>                             |

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Operating expenses decreased \$2.7 million during the year ended June 30, 2007 compared to the prior year and were \$11.2 million lower during the year ended June 30, 2006 compared to the same period in 2005. Components of the changes were (stated in millions):

|                                                                                   | <u><b>FY 2007-2006</b></u><br><u><b>Net change</b></u> | <u><b>FY 2006-2005</b></u><br><u><b>Net change</b></u> |
|-----------------------------------------------------------------------------------|--------------------------------------------------------|--------------------------------------------------------|
| Decreased grant and project expenses in active rural energy construction projects | \$ (5.9)                                               | (17.0)                                                 |
| Increased PCE grant expenditures                                                  | 3.5                                                    | 6.0                                                    |
| Decreased bond interest expense                                                   | (0.3)                                                  | —                                                      |
| Increased Bradley Lake plant expenses                                             | —                                                      | 0.2                                                    |
| Decreased other expenses                                                          | —                                                      | (0.4)                                                  |
|                                                                                   | <u><u>\$ (2.7)</u></u>                                 | <u><u>(11.2)</u></u>                                   |

During the year ended June 30, 2007, the PCE Endowment received a contribution of \$182.7 million from the State general fund. This contribution created increased interest income and realized gains by \$7.4 million and increased fair value of investments by \$22.9 million during the year ended in 2007.

Nonoperating investment income increased during the year ended in 2006 compared to 2005 due to a \$2.1 million increase in interest income and realized gains, offset by a \$1.0 million decrease in fair value during the time period.

**Outlook**

Annual operation of the owned hydroelectric and intertie projects are per annual budgets approved by the utilities that use the assets and pursuant to bond resolutions and other agreements. Annual operation of the rural energy programs are per State legislation, annual appropriations and federal grant awards.



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## Independent Auditors' Report

The Board of Directors  
Alaska Energy Authority:

We have audited the accompanying balance sheets of the Alaska Energy Authority (a Component Unit of the State of Alaska) (Authority) as of June 30, 2007 and 2006, and the related statements of revenues, expenses, and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these basic financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing auditing procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and the 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.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Authority as of June 30, 2007 and 2006, and the changes in its financial position and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 25, 2007, on our consideration of the Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis on pages 1 through 5 are not a required part of the basic financial statements but is supplementary information required by U.S. generally accepted accounting principles. 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.

Our audits were made for the purpose of forming an opinion on the financial statements taken as a whole. The supplementary information included in schedules 1 to 3 is presented for the purpose of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

KPMG LLP

October 25, 2007

**ALASKA ENERGY AUTHORITY**  
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Balance Sheets

June 30, 2007 and 2006

(Stated in thousands)

| <b>Assets</b>                                                  | <b>2007</b> | <b>2006</b> |
|----------------------------------------------------------------|-------------|-------------|
| Current assets:                                                |             |             |
| Grants receivable                                              | \$ 3,072    | 2,952       |
| Loans receivable (note 7)                                      | 2,471       | 1,937       |
| Operating revenue receivable                                   | 409         | 553         |
| Accrued interest receivable                                    | 1,434       | 1,318       |
| Total current assets                                           | 7,386       | 6,760       |
| Noncurrent assets:                                             |             |             |
| Restricted cash and investments (note 3)                       | 22,585      | 22,323      |
| Cash and investments designated for specific purposes (note 3) | 478,390     | 251,394     |
| Loans receivable, net of allowance (note 7)                    | 23,450      | 22,553      |
| Capital assets (note 5)                                        | 441,645     | 437,445     |
| Less accumulated depreciation                                  | (181,829)   | (171,795)   |
| Capital assets, net                                            | 259,816     | 265,650     |
| Total noncurrent assets                                        | 784,241     | 561,920     |
| Total assets                                                   | \$ 791,627  | 568,680     |
| <b>Liabilities and Net Assets</b>                              |             |             |
| Current liabilities:                                           |             |             |
| Due to State of Alaska                                         | \$ 8,286    | 942         |
| Accounts payable                                               | 26,809      | 21,262      |
| Bonds payable – current portion (note 6)                       | 5,810       | 5,800       |
| Accrued interest                                               | 3,232       | 3,238       |
| Total current liabilities                                      | 44,137      | 31,242      |
| Noncurrent liabilities:                                        |             |             |
| Bonds payable – noncurrent portion, net (note 6)               | 117,147     | 121,482     |
| Arbitrage interest payable (note 6)                            | 984         | 710         |
| Other liabilities                                              | 103         | 103         |
| Total noncurrent liabilities                                   | 118,234     | 122,295     |
| Total liabilities                                              | 162,371     | 153,537     |
| Net assets:                                                    |             |             |
| Invested in capital assets, net of related debt                | 136,859     | 138,368     |
| Restricted for debt service                                    | 19,353      | 19,085      |
| Restricted by agreements with external parties                 | 22,892      | 25,168      |
| Unrestricted net assets                                        | 450,152     | 232,522     |
| Total net assets                                               | 629,256     | 415,143     |
| Commitments and contingencies (notes 8 and 10)                 |             |             |
| Total liabilities and net assets                               | \$ 791,627  | 568,680     |

See accompanying notes to basic financial statements.

**ALASKA ENERGY AUTHORITY**  
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Statements of Revenues, Expenses, and Changes in Net Assets

Years ended June 30, 2007 and 2006

(Stated in thousands)

|                                                       | <u>2007</u>       | <u>2006</u>     |
|-------------------------------------------------------|-------------------|-----------------|
| Operating revenues:                                   |                   |                 |
| Federal grants                                        | \$ 21,881         | 28,544          |
| Revenue from operating plants                         | 16,962            | 15,669          |
| State of Alaska appropriations                        | 14,539            | 12,192          |
| Revenue from state agencies                           | 690               | 651             |
| Interest on loans                                     | 980               | 905             |
| Other revenue                                         | 48                | 47              |
| Total operating revenues                              | <u>55,100</u>     | <u>58,008</u>   |
| Operating expenses:                                   |                   |                 |
| Grants and projects                                   | 24,239            | 30,170          |
| Power Cost Equalization grants                        | 25,145            | 21,669          |
| Depreciation                                          | 10,034            | 9,992           |
| Interest expense                                      | 7,938             | 8,274           |
| Plant operating                                       | 4,242             | 4,213           |
| General and administrative                            | 1,673             | 1,638           |
| Provision for loan loss and bad debt expense (note 7) | (349)             | (326)           |
| Total operating expenses                              | <u>72,922</u>     | <u>75,630</u>   |
| Operating loss                                        | <u>(17,822)</u>   | <u>(17,622)</u> |
| Nonoperating:                                         |                   |                 |
| State of Alaska PCE Endowment contribution (note 3)   | 182,700           | —               |
| Investment income, net                                | 49,235            | 18,121          |
| Total nonoperating                                    | <u>231,935</u>    | <u>18,121</u>   |
| Increase in net assets                                | 214,113           | 499             |
| Net assets – beginning                                | 415,143           | 414,644         |
| Net assets – ending                                   | <u>\$ 629,256</u> | <u>415,143</u>  |

See accompanying notes to basic financial statements.

**ALASKA ENERGY AUTHORITY**  
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Statements of Cash Flows

Years ended June 30, 2007 and 2006

(Stated in thousands)

|                                                                                       | <u>2007</u>      | <u>2006</u>     |
|---------------------------------------------------------------------------------------|------------------|-----------------|
| Cash flows from operating activities:                                                 |                  |                 |
| Receipts from federal grants                                                          | \$ 21,760        | 32,174          |
| Receipts from customers and users                                                     | 16,967           | 14,011          |
| Receipts from State of Alaska appropriations                                          | 22,011           | 11,745          |
| Principal collected on loans                                                          | 8,702            | 7,935           |
| Receipts from state agencies                                                          | 690              | 897             |
| Interest collected on loans                                                           | 937              | 1,014           |
| Other operating receipts                                                              | 47               | 84              |
| Loans originated                                                                      | (9,784)          | (8,163)         |
| Payments to suppliers                                                                 | (12,687)         | (10,795)        |
| Payments to grantees                                                                  | (44,407)         | (47,117)        |
| Net cash provided by operating activities                                             | <u>4,236</u>     | <u>1,785</u>    |
| Cash flows from noncapital and related financing activities:                          |                  |                 |
| Net unremitted interest returned on federal grant advances                            | (1)              | (20)            |
| Net unremitted interest earned (returned) on State appropriation advances             | (127)            | 128             |
| Endowment fund contribution from State appropriation                                  | 182,700          | —               |
| State appropriation advance held in trust for others                                  | 971              | —               |
| Net receipt from (payments on) operating loans from AIDEA                             | 125              | (121)           |
| Net cash provided (used) by noncapital and related financing activities               | <u>183,668</u>   | <u>(13)</u>     |
| Cash flows from capital and related financing activities:                             |                  |                 |
| Principal paid on bonds                                                               | (5,800)          | (5,665)         |
| Interest paid on bonds                                                                | (6,470)          | (6,564)         |
| Purchase of capital assets                                                            | (3,201)          | (2,321)         |
| Net cash used by capital and related financing activities                             | <u>(15,471)</u>  | <u>(14,550)</u> |
| Cash flows from investing activities:                                                 |                  |                 |
| Purchase of investments                                                               | (207,885)        | (53,840)        |
| Proceeds from sales and maturities of investments                                     | 29,527           | 66,508          |
| Interest received from investments                                                    | 15,573           | 8,904           |
| Net cash (used) provided by investing activities                                      | <u>(162,785)</u> | <u>21,572</u>   |
| Net increase in cash and cash equivalents                                             | 9,648            | 8,794           |
| Cash and cash equivalents at beginning of year                                        | <u>23,517</u>    | <u>14,723</u>   |
| Cash and cash equivalents at end of year (note 3)                                     | <u>\$ 33,165</u> | <u>23,517</u>   |
| Reconciliation of generating loss to net cash provided by operating activities:       |                  |                 |
| Operating loss                                                                        | \$ (17,822)      | (17,622)        |
| Adjustments to reconcile operating loss to net cash provided by operating activities: |                  |                 |
| Depreciation                                                                          | 10,034           | 9,992           |
| Provision for loan loss and bad debt expense                                          | (349)            | (326)           |
| Bond interest expense                                                                 | 7,938            | 8,274           |
| Changes in assets and liabilities:                                                    |                  |                 |
| Increase (decrease) in due to State of Alaska                                         | 7,472            | (199)           |
| (Increase) decrease in grants receivable                                              | (121)            | 3,630           |
| Increase in loans receivable                                                          | (1,082)          | (228)           |
| (Increase) decrease in interest receivable                                            | (43)             | 109             |
| Decrease (increase) in operating revenue receivable                                   | 144              | (9)             |
| Decrease in operating accounts payable                                                | (1,935)          | (1,836)         |
| Net cash provided by operating activities                                             | <u>\$ 4,236</u>  | <u>1,785</u>    |
| Noncash capital activities:                                                           |                  |                 |
| Amount included in accounts payable for fixed asset additions                         | <u>\$ 999</u>    | <u>—</u>        |

See accompanying notes to basic financial statements.

**ALASKA ENERGY AUTHORITY**  
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Notes to Basic Financial Statements

June 30, 2007 and 2006

**(1) Organization and Operations**

The Alaska Energy Authority (Authority or AEA) was created by the Alaska State Legislature in 1976. AEA is a public corporation and a component unit of the State of Alaska (State). AEA's mission is to reduce the cost of energy in Alaska.

Throughout the 1980's, AEA worked to develop the State's energy resources as a key element in diversifying Alaska's economy. A number of large-scale projects were constructed; four of those projects were sold in 2002. Today, AEA's two hydroelectric projects have an installed capacity in excess of 90 megawatts, and the Alaska Intertie's 170 miles of transmission line link Interior Alaska with the cheaper energy available in the Southcentral portion of the State.

Pursuant to statute, on August 12, 1993, the board of directors of the Alaska Industrial Development and Export Authority (AIDEA), a public corporation and a political subdivision of the State, became the board of directors of AEA. Concurrently, the Executive Director of AIDEA was also appointed as Executive Director of AEA. Among other things, AIDEA provides personnel services for AEA. AEA continues to exist as a separate legal entity. The corporate structure and operating assets of AEA were retained but the ability to construct and acquire energy projects was eliminated. The intent of the legislation was that ongoing operation of the operating assets be assumed by the electric utility companies that use or purchase power from the assets with oversight responsibility retained by AEA; this has occurred to the extent possible. There is no commingling of funds, assets or liabilities between AIDEA and AEA and there is no responsibility of one for the debts or the obligations of the other. Consequently, the accounts of AIDEA are not included in the accompanying financial statements.

Pursuant to legislation effective July 1, 1999, rural energy programs previously administered by the former Department of Community and Regional Affairs, Division of Energy, were transferred to AEA for administration, as part of a larger reorganization of state agencies. Five general energy programs comprising more than twenty smaller programs were moved to AEA. Rural energy programs were originally part of AEA prior to the reorganization that occurred in 1993.

The following is a description of AEA's existing projects and programs:

**(a) *Bradley Lake Hydroelectric Project***

The project has installed capability, under optimal conditions, of 126 megawatts and transmits its power to the State's main power grid via two parallel 20-mile transmission lines. The project, which cost in excess of \$300 million, went into commercial operation in 1991. The project is now operated by Homer Electric Association under contract with AEA. Bradley Lake serves Alaska's Railbelt from Homer to Fairbanks as well as the Delta Junction area.

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Notes to Basic Financial Statements

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**(b) *Alaska Intertie Project***

The 170-mile, 345-kilovolt transmission line runs between Willow and Healy, and interconnects the power distribution systems of Anchorage and Fairbanks. The Alaska Intertie allows Golden Valley Electric Association in Fairbanks to purchase electricity produced with lower cost energy, such as natural gas and hydroelectric, from the Anchorage and Kenai Peninsula utilities. The Alaska Intertie reduces the number of black/brownouts throughout the system. Operations and maintenance duties are overseen by the Intertie Operating Committee under the Alaska Intertie Agreement (Agreement).

Under legislation effective July 1, 2002, the State appropriated \$20,300,000 to AEA to upgrade and extend a portion of the Alaska Intertie. Through June 30, 2004, AEA incurred \$152,000 in costs for preliminary design work. No further costs were incurred as of June 30, 2007. In August, 2007, AEA issued a contract to the Municipality of Anchorage dba Municipal Light and Power for \$19,500,000 for the upgrade and authorized project commencement in September, 2007. The project is estimated to be completed by late 2013.

AEA management and utility members of the Intertie Operating Committee identified defects in the Agreement that AEA management believes threaten the long-term operational reliability and economic viability of the Alaska Intertie. The attempts to cure the identified defects were unsuccessful because amending the Agreement requires unanimous consent of each member of the Intertie Operating Committee, and at least one utility member objected to each proposed cure. As a first step to cure defects in the Agreement, AEA management on October 16, 2006, issued contractually required notice that the Agreement will terminate in 48 months, on October 17, 2010. AEA management anticipates that the necessary amendments to the Agreement can be implemented no later than the effective date of the termination of the existing Agreement, or earlier if Intertie Operating Committee members reach unanimous consent.

**(c) *Larsen Bay Hydroelectric Project***

The 475-kilowatt project produces electricity and provides water for the City of Larsen Bay (City), an isolated Kodiak Island community. It went into commercial operation in 1991 and replaced the City's old water supply system and provided a better source of water with reduced maintenance and improved water quality. The City operates the project.

The Authority and the City have agreed that the Authority will convey the project to the City and the City will accept all responsibility for it when the Authority completes repair work currently being performed under a project management agreement with the City.

**(d) *Rural Energy Programs***

The rural energy programs of the Authority include Bulk Fuel Storage Upgrades, Rural Power System Upgrades, Power Cost Equalization (PCE), Alternative Energy, Utility Training, and Technical Assistance, two active loan programs funded from the Bulk Fuel Revolving Loan Fund and the Power Project Fund and one inactive loan program.

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**(2) Summary of Significant Accounting Policies**

**(a) Basis of Accounting – Enterprise Fund Accounting**

The accounts of the Authority are organized as an Enterprise Fund. Accordingly, the financial activities of the Authority are reported using the economic resources measurement focus and the accrual basis of accounting, whereby revenues are recorded when earned and expenses are recorded when goods or services are received or the related liability is incurred.

GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, provides two options for reporting proprietary fund activities (including component units using proprietary fund accounting). The Authority has elected to apply all applicable GASB pronouncements and all FASB Statements and Interpretations, Accounting Principles Board Opinions and Accounting Research Bulletins issued on or before November 30, 1989, unless they conflict with or contradict GASB pronouncements.

**Operating Revenue and Expense**

The Authority considers all its revenues and expenses, except investment income and fund transfers with the State, to be part of its principal ongoing operations and therefore classifies these revenues and expenses as operating in the statement of revenues, expenses, and changes in net assets.

**(b) Capital Assets**

Capital assets are stated at cost and depreciation is charged to operations by use of the straight-line method over their estimated useful lives. The estimated economic lives of the assets are as follows:

| <u>Utility plant</u> | <u>Life in years</u> |
|----------------------|----------------------|
| Intangible           | 30-50                |
| Production           | 30-50                |
| Transmission         | 20-40                |
| General              | 5-30                 |

The Authority recognizes impairment losses for long-lived assets whenever events or changes in circumstances result in the carrying amount of the assets exceeding the sum of the expected future cash flows associated with such assets.

**(c) Cash and Investments**

All of AEA's cash and investments are restricted. For the purposes of the statement of cash flows, cash and cash equivalents consist of cash, short term commercial paper and money market funds.

AEA's marketable securities are reported at fair value in the financial statements. Unrealized gains and losses are reported as components of the deficiency of revenues over expenses. Fair values are obtained from independent sources.

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**(d) *Loans and Related Interest Income***

Loans are generally carried at amounts advanced less principal payments collected. Interest income is accrued as earned. Accrual of interest is discontinued whenever the payment of interest or principal is more than ninety days past due or when the loan terms are restructured. The Authority considers lending activities to be part of its principal operations and classifies it as operating in the statement of revenues, expenses, and changes in net assets. For purposes of the statement of cash flows, loans are treated as program loans.

**(e) *Allowance for Loan Losses***

The allowance for loan losses represents management's judgment as to the amount required to absorb potential losses in the loan portfolio. The factors used by management to determine the allowance required include historical loss experience, individual loan delinquencies, collateral values, economic conditions and other factors. Management's opinion is that the allowance is currently adequate to absorb known losses and inherent risks in the portfolio.

**(f) *Environmental Issues***

The Authority's policy relating to environmental issues is to record a liability when the likelihood of Authority responsibility for clean-up is probable and the costs are reasonably estimable. At June 30, 2007 and 2006, there were no environmental issues which met both of these criteria and, accordingly, no provision has been made in the accompanying financial statements for any potential liability which may result.

**(g) *Income Taxes***

The Internal Revenue Code provides that gross income for tax purposes does not include income accruing to a state or territory or any political subdivision thereof which is derived from the exercise of any essential governmental function or from any public utility. AEA is a political subdivision of the State performing an essential governmental function and is therefore exempt from State and federal income taxes.

**(h) *Appropriations and Grants***

The Authority recognizes grant revenue under the provisions of GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*, whereby revenue is recognized when all applicable eligibility requirements, including time requirements, are met.

**(i) *Segment Information***

The financial statements disclose all financial information required by the Authority's Bradley Lake bond indenture.

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**(j) Estimates**

In preparing the financial statements, management of the Authority is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosures of contingent assets and liabilities as of the date of the balance sheet. These estimates impact revenue and expenses for the period. Actual results could differ from those estimates.

**(3) Cash and Investments**

Pursuant to various agreements, appropriations and statutory requirements relating to its operations, AEA has established accounts for assets restricted to construction, operation, and financing activities (as used herein, Fund means a separate account established by the State legislature and does not refer to a separate group of self balancing accounts as contemplated by accounting principles generally accepted in the United States of America).

At June 30, 2007 and 2006 the Authority's carrying amount of deposits (all of which were restricted) was \$33,165,000 and \$23,517,000, respectively. The total of all bank balances was \$34,785,000 and \$24,027,000, respectively.

The restricted and designated cash and investments were held in trust accounts for the following activities as of June 30, 2007 (stated in thousands):

|                                                                   | <b>Cash and cash<br/>equivalents</b> | <b>Investments</b> | <b>Total</b> |
|-------------------------------------------------------------------|--------------------------------------|--------------------|--------------|
| Power Cost Equalization Endowment Fund                            | \$ 2                                 | 415,935            | 415,937      |
| Bradley Lake Hydroelectric Project                                | 9,042                                | 18,317             | 27,359       |
| Rural Energy Loan Funds                                           | 8,643                                | 11,810             | 20,453       |
| Rural Energy Operations                                           | 1,745                                | 18,260             | 20,005       |
| Funds advanced from State and<br>federal agencies                 | 9,419                                | —                  | 9,419        |
| Power Development Fund                                            | 1,974                                | —                  | 1,974        |
| Power Cost Equalization and Rural<br>Electric Capitalization Fund | 1,751                                | 3,488              | 5,239        |
| Alaska Intertie Project                                           | 589                                  | —                  | 589          |
| Total cash and investments                                        | \$ 33,165                            | 467,810            | 500,975      |

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The restricted and designated cash and investments were held in trust accounts for the following activities as of June 30, 2006 (stated in thousands):

|                                                                   | <b>Cash and cash<br/>equivalents</b> | <b>Investments</b> | <b>Total</b>   |
|-------------------------------------------------------------------|--------------------------------------|--------------------|----------------|
| Power Cost Equalization Endowment Fund                            | \$ 5                                 | 194,752            | 194,757        |
| Bradley Lake Hydroelectric Project                                | —                                    | 28,192             | 28,192         |
| Rural Energy Loan Funds                                           | 13,390                               | 7,451              | 20,841         |
| Rural Energy Operations                                           | 1,404                                | 18,311             | 19,715         |
| Southeast Energy Fund                                             | 128                                  | —                  | 128            |
| Funds advanced from State and<br>federal agencies                 | 842                                  | —                  | 842            |
| Power Development Fund                                            | 1,988                                | —                  | 1,988          |
| Power Cost Equalization and Rural<br>Electric Capitalization Fund | 4,730                                | 1,494              | 6,224          |
| Alaska Intertie Project                                           | 1,030                                | —                  | 1,030          |
| Total cash and investments                                        | <u>\$ 23,517</u>                     | <u>250,200</u>     | <u>273,717</u> |

At June 30, 2007 and 2006, amounts restricted for debt service totaled \$22,585,000 and \$22,323,000, respectively, for the Bradley Lake Hydroelectric Project.

***Investment Holdings***

***Power Cost Equalization Fund*** – The Power Cost Equalization Endowment Fund (PCE Fund), created under Alaska Statute 42.45.070, is under the fiduciary authority of the State Department of Revenue, Treasury (Treasury). The purpose of the fund is to provide for a long-term stable financing source for power cost equalization in order to provide affordable levels of electric utility costs in otherwise high-cost service areas in the state. During 2007, the Authority received an appropriation of \$182,700,000 from the State of Alaska for the PCE Fund.

State investments are managed in pools. PCE Fund assets are held in the State's Short-term and Broad Market Fixed Income Pools, managed by Treasury's investment officers, and the State's Domestic Equity account and International Equity Pool, managed by contracted external investment managers. A complete description of the investment policy for each pool is included in the State's CAFR (see Department of Revenue, Treasury Division, Policies and Procedures).

Fixed income and international equity securities are valued each business day using prices obtained from a pricing service. The Domestic Equity account is valued each business day by the Trustee Committee in good faith and pursuant to procedures established by the Trustee. Securities expressed in terms of foreign currencies are translated into U.S. dollars at the prevailing exchange rates. Income in the fixed income pools and the International Equity Pool is allocated to pool participants daily on a pro rata basis. Domestic equity income is distributed quarterly.

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At June 30, 2007, AEA had the following cash and investments in the PCE Fund (stated in thousands):

| Investment type              | Cash                               | Investments at fair value            |         |                                     |                      |
|------------------------------|------------------------------------|--------------------------------------|---------|-------------------------------------|----------------------|
|                              | Short-term<br>fixed<br>income pool | Broad market<br>fixed<br>income pool | Equity  | Securities<br>lending<br>collateral | Total<br>investments |
| Overnight sweep account      | \$ 121                             | —                                    | —       | —                                   | —                    |
| Short-term investment fund   | 787                                | —                                    | —       | —                                   | —                    |
| Commercial paper             | 1,743                              | 118                                  | —       | —                                   | 118                  |
| U.S. Treasury Notes          | —                                  | 11,048                               | —       | 15,687                              | 26,735               |
| U.S. Treasury Bonds          | —                                  | 6,549                                | —       | —                                   | 6,549                |
| U.S. Government Agency       | —                                  | 10,678                               | —       | —                                   | 10,678               |
| Mortgage-backed              | 1,347                              | 73,077                               | —       | —                                   | 73,077               |
| Other asset-backed           | 9,676                              | 6,908                                | —       | —                                   | 6,908                |
| Corporate bonds              | 5,017                              | 25,383                               | —       | —                                   | 25,383               |
| Yankee:                      |                                    |                                      |         |                                     |                      |
| Government                   | —                                  | 542                                  | —       | —                                   | 542                  |
| Corporate                    | 1,058                              | 2,936                                | —       | —                                   | 2,936                |
| Domestic equity              | —                                  | —                                    | 191,881 | —                                   | 191,881              |
| International equity         | —                                  | —                                    | 77,927  | —                                   | 77,927               |
| Total invested assets        | 19,749                             | 137,239                              | 269,808 | 15,687                              | 422,734              |
| Pool related net liabilities | (90)                               | (25,550)                             | (906)   | —                                   | (26,456)             |
| Other pool ownership         | (19,657)                           | 19,657                               | —       | —                                   | 19,657               |
| Net invested assets          | \$ 2                               | 131,346                              | 268,902 | 15,687                              | 415,935              |

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At June 30, 2006, AEA had the following cash and investments in the PCE Fund (stated in thousands):

| Investment type                          | Cash                               | Investments at fair value            |         |                                     |                      |
|------------------------------------------|------------------------------------|--------------------------------------|---------|-------------------------------------|----------------------|
|                                          | Short-term<br>fixed<br>income pool | Broad market<br>fixed<br>income pool | Equity  | Securities<br>lending<br>collateral | Total<br>investments |
| Overnight sweep account                  | \$ 13                              | —                                    | —       | —                                   | —                    |
| Money market                             | 318                                | —                                    | —       | 10,300                              | 10,300               |
| Commercial paper                         | 637                                | —                                    | —       | —                                   | —                    |
| U.S. Treasury Bills                      | —                                  | 3,420                                | —       | —                                   | 3,420                |
| U.S. Treasury Notes                      | —                                  | 3,790                                | —       | —                                   | 3,790                |
| U.S. Government Agency<br>Discount Notes | —                                  | 1,016                                | —       | —                                   | 1,016                |
| U.S. Government Agency                   | —                                  | 7,043                                | —       | —                                   | 7,043                |
| Mortgage-backed                          | 549                                | 30,004                               | —       | —                                   | 30,004               |
| Other asset-backed                       | 3,815                              | 1,165                                | —       | —                                   | 1,165                |
| Corporate bonds                          | 1,974                              | 14,672                               | —       | —                                   | 14,672               |
| Yankee:                                  |                                    |                                      |         |                                     |                      |
| Government                               | —                                  | 357                                  | —       | —                                   | 357                  |
| Corporate                                | 80                                 | 961                                  | —       | —                                   | 961                  |
| Domestic equity                          | —                                  | —                                    | 85,143  | —                                   | 85,143               |
| International equity                     | —                                  | —                                    | 35,158  | —                                   | 35,158               |
| Total invested assets                    | 7,386                              | 62,428                               | 120,301 | 10,300                              | 193,029              |
| Pool related net<br>liabilities          | (5)                                | (5,603)                              | (50)    | —                                   | (5,653)              |
| Other pool ownership                     | (7,376)                            | 7,376                                | —       | —                                   | 7,376                |
| Net invested assets                      | \$ 5                               | 64,201                               | 120,251 | 10,300                              | 194,752              |

**Other AEA Cash and Investments** – Bradley Lake Hydroelectric Project investments are substantially invested pursuant to investment agreements with JP Morgan Chase Bank that end the earlier of July 1, 2021 or the date of repayment of the Bradley Lake Power Revenue Bonds First and Second Series. All other AEA assets are managed by AIDEA staff for liquidity and minimal risk. There is no AEA board approved investment policy, but AIDEA staff follows AIDEA's board approved investment policy. The AEA managed portfolio consists of the following eligible securities:

- Debt instruments issued or guaranteed by the U.S. government, its agencies and instrumentalities, and Government Sponsored Enterprises (GSEs); and
- Money market funds and repurchase agreements collateralized by U.S. Treasury and agency securities.

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At June 30, 2007 and 2006, AEA had the following cash and investments in its other funds (stated in thousands):

| <b>Investment type</b> | <b>2007<br/>Fair value<br/>Short-term<br/>fixed income</b> | <b>2006<br/>Fair value<br/>Short-term<br/>fixed income</b> |
|------------------------|------------------------------------------------------------|------------------------------------------------------------|
| Deposits               | \$ 17                                                      | 49                                                         |
| Money market           | 33,146                                                     | 24,957                                                     |
| Mortgage-backed        | 33,557                                                     | 25,762                                                     |
| Investment agreements  | 18,317                                                     | 28,192                                                     |
| Total invested assets  | <u>\$ 85,037</u>                                           | <u>78,960</u>                                              |

**Interest Rate Risk** – Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment.

**Short-Term Fixed Income Pool** – As a means of limiting its exposure to fair value losses arising from increasing interest rates, Treasury’s investment policy limits individual fixed rate securities to fourteen months in maturity or fourteen months expected average life. Floating rate securities are limited to three years in maturity or three years expected average life. Treasury utilizes the actual maturity date for commercial paper and twelve month prepay speeds for other securities. At both June 30, 2007 and 2006, the expected average life of individual fixed rate securities ranged from three days to seven months. At June 30, 2007 and 2006 the expected average life of floating rate securities ranged from less than one year to three years.

**Broad Market Fixed Income Pool** – Through its investment policy, Treasury manages its exposure to fair value losses arising from increasing interest rates by limiting the effective duration of its Broad Market Fixed Income Pool to  $\pm 20\%$  of the Lehman Brothers Aggregate Bond Index. The effective duration for the Lehman Brothers Aggregate Bond Index at June 30, 2007 and 2006, was 4.7 years and 4.8 years, respectively.

**Investment Agreements** – Bradley Lake Hydroelectric Project investments are invested pursuant to agreements with JP Morgan Chase Bank that guarantees annual interest earnings of 7.38% or 7.41% per annum until the earlier of July 1, 2021 or the date of repayment of the Bradley Lake Power Revenue Bonds, First and Second Series. The investment contracts are collateralized.

Under the Internal Revenue Code of 1986, certain earnings in excess of arbitrage yield on the Bradley Lake bonds must be rebated to the U.S. Treasury. The bulk of the Bradley Lake investments are subject to rebate.

**AEA Internally Managed Investments** – There is no written policy for interest rate risk for AEA’s internally managed investments, but AIDEA’s policy is followed. The duration for the investments is 2 years or less. The maximum maturity of any issue shall be 3 years from the date of purchase.

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**Duration** – Duration is a measure of interest rate risk. It measures a security’s sensitivity to a 100–basis point change in interest rates. Duration is a weighted average term–to–maturity of an investment’s cash flows.

Treasury uses industry–standard analytical software developed by The Yield Book Inc. to calculate effective duration. The software takes into account various possible future interest rates, historical and estimated prepayment rates, call options and other variable cash flows for purposes of the effective duration calculation. Duration for the AEA managed investments are as reported on Bloomberg.

Treasury has no policy with regard to interest rate risk for the money market balance held in the International Equity Pool.

At June 30, 2007 and 2006, the effective duration by investment type (not including the investment agreements) was as follows:

|                                               | <b>2007</b>                 |                        | <b>2006</b>                 |                        |
|-----------------------------------------------|-----------------------------|------------------------|-----------------------------|------------------------|
|                                               | <b>Treasury<br/>managed</b> | <b>AEA<br/>managed</b> | <b>Treasury<br/>managed</b> | <b>AEA<br/>managed</b> |
| Money market                                  | —                           | 0.18                   | —                           | 0.25                   |
| U.S. Treasury Notes                           | 3.92                        | —                      | 3.13                        | —                      |
| U.S. Treasury Bonds                           | 11.26                       | —                      | 9.74                        | —                      |
| U.S. Government agency                        | 5.79                        | —                      | 4.25                        | —                      |
| U.S. Government agency and GSE discount notes | —                           | 0.29                   | —                           | —                      |
| Mortgage-backed                               | 4.22                        | 0.72                   | 3.75                        | 0.69                   |
| Other asset-backed                            | 5.53                        | —                      | 0.87                        | —                      |
| Corporate bonds                               | 5.26                        | —                      | 4.99                        | —                      |
| Yankees:                                      |                             |                        |                             |                        |
| Government                                    | 10.87                       | —                      | 8.83                        | —                      |
| Corporate                                     | 5.84                        | —                      | 6.34                        | —                      |
| Portfolio effective duration                  | 4.06                        | 0.38                   | 3.96                        | 0.38                   |

**Credit Risk** – Credit risk is the financial risk that an issuer or other counterparty to an investment will not fulfill its obligations and a loss will result.

Treasury’s investment policy has the following limitations with regard to credit risk: With the exception of the sweep account, Short–term Fixed Income Pool investments are limited to instruments with a long–term credit rating of at least A3 or equivalent and instruments with a short–term credit rating of at least A1 or equivalent. For securities with long–term credit ratings, they may be purchased if the median rating of Standard & Poor’s Corporation, Moody’s and Fitch is A3 or equivalent. Asset–backed and nonagency mortgage securities may be purchased if only rated by one of the rating agencies mentioned above if they are rated AAA. Unexpected daily cash surpluses that arise in this pool are invested overnight in the custodian’s repurchase agreement sweep account. Treasury does not have a policy to limit credit risk associated with the sweep account.

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Broad Market Fixed Income Pool investments are limited to securities with a long-term credit rating of at least BBB3 or equivalent and securities with a short-term credit rating of at least A1 or equivalent. For securities with long-term credit ratings, they may be purchased if the median rating of Standard & Poor's Corporation, Moody's and Fitch is BBB3 or equivalent. Asset-backed and nonagency mortgage securities may be purchased if only rated by one of the rating agencies mentioned above if they are rated AAA.

Treasury has no policy with regard to credit risk for the money market balance held in the International Equity Pool.

There is no written policy with regard to credit risk for investments managed by AEA. Since AEA only invests in highly rated money markets and U.S. government and agency securities and GSEs, credit risk is minimal.

The Bradley Lake Hydroelectric Project investments are substantially invested in collateralized investment agreements, which minimizes credit risk.

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At June 30, 2007, the Pools managed by Treasury and the investments managed by AEA consisted of investments with credit quality ratings issued by nationally recognized statistical rating organizations as follows (using Standard & Poor's Corporation rating scale).

| <b>Investment type</b>                           | <b>Rating<sup>1</sup></b> | <b>Short-term<br/>fixed income<br/>pool</b> | <b>Broad market<br/>fixed income<br/>pool</b> | <b>International<br/>equity pool</b> | <b>AEA<br/>managed</b> |
|--------------------------------------------------|---------------------------|---------------------------------------------|-----------------------------------------------|--------------------------------------|------------------------|
| Money market                                     | AAA                       | —%                                          | —%                                            | —%                                   | 39%                    |
| Overnight sweep account                          | Not Rated                 | 1                                           | —                                             | —                                    | —                      |
| Short-term investment account                    | Not Rated                 | 4                                           | —                                             | —                                    | —                      |
| Commercial paper                                 | AA                        | 2                                           | —                                             | —                                    | —                      |
| Commercial paper                                 | A                         | 3                                           | —                                             | —                                    | —                      |
| Commercial paper                                 | Not Rated                 | 4                                           | —                                             | —                                    | —                      |
| U.S. Government agency<br>discount notes         | AAA                       | —                                           | 7                                             | —                                    | —                      |
| U.S. Government agency and GSE<br>discount notes | Not Rated                 | —                                           | —                                             | —                                    | 12                     |
| U.S. Government agency and GSE                   | AAA                       | —                                           | 2                                             | —                                    | 27                     |
| U.S. Government agency                           | Not Rated                 | —                                           | 1                                             | —                                    | —                      |
| Mortgage-backed                                  | AAA                       | 7                                           | 55                                            | —                                    | —                      |
| Mortgage-backed                                  | Not Rated                 | —                                           | —                                             | —                                    | —                      |
| Mortgage-backed (Agency)                         | Not Rated                 | —                                           | 11                                            | —                                    | —                      |
| Other asset-backed                               | AAA                       | 41                                          | 5                                             | —                                    | —                      |
| Other asset-backed                               | AA                        | 1                                           | —                                             | —                                    | —                      |
| Other asset-backed                               | A                         | 6                                           | —                                             | —                                    | —                      |
| Other asset-backed                               | BBB                       | —                                           | 1                                             | —                                    | —                      |
| Other asset-backed                               | Not Rated                 | 1                                           | —                                             | —                                    | —                      |
| Corporate bonds                                  | AAA                       | 2                                           | 2                                             | —                                    | —                      |
| Corporate bonds                                  | AA                        | 15                                          | 4                                             | —                                    | —                      |
| Corporate bonds                                  | A                         | 8                                           | 7                                             | —                                    | —                      |
| Corporate bonds                                  | BBB                       | —                                           | 8                                             | —                                    | —                      |
| Corporate bonds                                  | Not Rated                 | —                                           | 1                                             | —                                    | —                      |
| Yankees – corporate                              | AAA                       | —                                           | —                                             | —                                    | —                      |
| Yankees – corporate                              | AA                        | 3                                           | —                                             | —                                    | —                      |
| Yankees – corporate                              | A                         | 2                                           | 2                                             | —                                    | —                      |
| Yankees – corporate                              | BBB                       | —                                           | 1                                             | —                                    | —                      |
| No credit exposure                               |                           | —                                           | (7)                                           | 100                                  | —                      |
| Investment agreements                            |                           | —                                           | —                                             | —                                    | 22                     |
|                                                  |                           | <u>100%</u>                                 | <u>100%</u>                                   | <u>100%</u>                          | <u>100%</u>            |

<sup>1</sup>Rating modifiers are not disclosed.

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At June 30, 2006, the Pools managed by Treasury and the investments managed by AEA consisted of investments with credit quality ratings issued by nationally recognized statistical rating organizations as follows (using Standard & Poor's Corporation rating scale):

| Investment type                                  | Rating <sup>1</sup> | Short-term<br>fixed income<br>pool | Broad market<br>fixed income<br>pool | International<br>equity pool | AEA<br>managed |
|--------------------------------------------------|---------------------|------------------------------------|--------------------------------------|------------------------------|----------------|
| Money market                                     | AAA                 | —%                                 | —%                                   | —%                           | 30%            |
| Overnight sweep account                          | Not Rated           | —                                  | —                                    | —                            | —              |
| Short-term investment account                    | Not Rated           | 4                                  | —                                    | 2                            | —              |
| Commercial paper                                 | A-1                 | 9                                  | —                                    | —                            | —              |
| U.S. Government agency and GSE<br>discount notes | AAA                 | —                                  | 2                                    | —                            | 1              |
| U.S. Government agency                           | AAA                 | —                                  | 12                                   | —                            | —              |
| Mortgage-backed                                  | AAA                 | —                                  | 44                                   | —                            | —              |
| Mortgage-backed                                  | Not Rated           | 7                                  | 9                                    | —                            | —              |
| Mortgage-backed (Agency and GSE)                 | AAA                 | —                                  | —                                    | —                            | 33             |
| Other asset-backed                               | AAA                 | 48                                 | 2                                    | —                            | —              |
| Other asset-backed                               | A                   | 3                                  | —                                    | —                            | —              |
| Corporate bonds                                  | AAA                 | 2                                  | 2                                    | —                            | —              |
| Corporate bonds                                  | AA                  | 15                                 | 4                                    | —                            | —              |
| Corporate bonds                                  | A                   | 9                                  | 11                                   | —                            | —              |
| Corporate bonds                                  | BBB                 | —                                  | 9                                    | —                            | —              |
| Yankees – corporate                              | AAA                 | 1                                  | —                                    | —                            | —              |
| Yankees – corporate                              | AA                  | 1                                  | —                                    | —                            | —              |
| Yankees – corporate                              | A                   | —                                  | 1                                    | —                            | —              |
| Yankees – corporate                              | BBB                 | —                                  | 1                                    | —                            | —              |
| No credit exposure                               |                     | 1                                  | 3                                    | 98                           | —              |
| Investment agreements                            |                     | —                                  | —                                    | —                            | 36             |
|                                                  |                     | <u>100%</u>                        | <u>100%</u>                          | <u>100%</u>                  | <u>100%</u>    |

<sup>1</sup>Rating modifiers are not disclosed.

The Domestic Equity Pool managed by Treasury is an indexed account that is not rated.

At June 30, 2007 and 2006, the securities lending collateral was invested in a registered 2(a)–7 money market fund that was not rated (note 4).

**Custodial Credit Risk** – Custodial credit risk is the risk that deposits may not be returned in the event of a bank failure. Treasury's policy with regard to custodial credit risk is to collateralize State deposits to the extent possible. At June 30, 2007, AEA's deposits managed by Treasury were uncollateralized and uninsured.

With respect to AEA managed investments, amounts totaling approximately \$24,104,000 at June 30, 2007 and \$23,463,000 at June 30, 2006, are held in money market funds not registered in AEA's name. The investment contracts are collateralized. All other investment securities are registered in AEA's name and are held by its custodian, the trust department of a commercial bank; therefore no custodial risk exists for these securities.

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**Foreign Currency Risk** – The Commissioner of Revenue formally adopts asset allocation policies for AEA’s PCE Fund at the beginning of each fiscal year which places policy limitations on the amount of international securities the PCE Fund is allowed to hold. The following policy was in place during fiscal years 2007 and 2006, and invested assets included the following holdings at June 30, 2007 and 2006, for the PCE fund’s investment in the International Equity Pool:

|      | <u>Policy</u> | <u>Actual</u> |
|------|---------------|---------------|
| FY07 | 18%±5%        | 19.24%        |
| FY06 | 17%±5%        | 19.08%        |

At June 30, 2007 and 2006, AEA’s PCE Fund had exposure to foreign currency risk as follows (stated in thousands):

| <u>Currency</u>                    | <u>FY07 Fair<br/>value</u> | <u>FY06 Fair<br/>value</u> |
|------------------------------------|----------------------------|----------------------------|
| Deposits:                          |                            |                            |
| Euro Currency                      | \$ 3                       | 1                          |
| Japanese Yen                       | 27                         | 34                         |
| Swiss Frank                        | —                          | 1                          |
|                                    | <u>30</u>                  | <u>36</u>                  |
| Investment – international equity: |                            |                            |
| Australian Dollar                  | —                          | 228                        |
| Euro Currency                      | 30,235                     | 14,227                     |
| Japanese Yen                       | 11,434                     | 6,432                      |
| New Zealand Dollar                 | 718                        | —                          |
| Norwegian Krone                    | —                          | 484                        |
| Pound Sterling                     | 21,329                     | 5,648                      |
| Singapore Dollar                   | 1,361                      | —                          |
| Swedish Krona                      | 1,130                      | 297                        |
| Swiss Franc                        | 6,514                      | 3,185                      |
|                                    | <u>72,721</u>              | <u>30,501</u>              |
| Total                              | \$ <u>72,751</u>           | <u>30,537</u>              |

**Concentration of Credit Risk** – Treasury’s policy with regard to concentration of credit risk is to prohibit the purchase of more than five percent of a pool’s holdings in corporate bonds of any one company or affiliated group. Federal National Mortgage Association and Federal Home Loan Mortgage Corporation securities are not classified as corporate bonds. AEA has no written policy with respect to concentration of credit risk for its other investments.

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At June 30, 2007, AEA's investments included the following concentrations greater than 5% (dollar amounts stated in thousands):

| Issuer                                | Amount    | Percent |
|---------------------------------------|-----------|---------|
| Federal National Mortgage Association | \$ 55,044 | 11%     |

At June 30, 2006, AEA's investments included the following concentrations greater than 5% (dollar amounts stated in thousands):

| Issuer                                                    | Amount    | Percent |
|-----------------------------------------------------------|-----------|---------|
| Federal National Mortgage Association                     | \$ 26,793 | 10%     |
| Federal Home Loan Mortgage Corporation                    | 31,915    | 11      |
| JP Morgan Chase Bank collateralized investment agreements | 28,409    | 10      |

**(4) Securities Lending**

A portion of the funds managed by Treasury are in the State Department of Revenue's securities lending program. Alaska Statute 37.10.071 authorizes the Commissioner of Revenue to lend assets, under an agreement and for a fee, against deposited collateral of equivalent fair value. The Commissioner entered into an agreement with State Street Corporation (the Bank) to lend fixed income and equity securities. The Bank, acting as the Commissioner's agent under the agreement, transfers securities to broker agents or other entities for collateral in the form of cash or securities and simultaneously agrees to return the collateral for the same securities in the future.

At June 30, 2007 and 2006, the fair value of securities on loan allocable to the PCE Fund totaled \$15,687,000 and \$10,165,000, respectively. Associated expense for securities lending, \$870,000 for fiscal year 2007 and \$1,546,000 for fiscal year 2006, is included in net investment income.

There is no limit to the amount that can be loaned and the Commissioner is able to sell securities on loan. International equity security loans are collateralized at not less than 102% of their fair value. Fixed income security loans are collateralized at not less than 102% of their fair value. Loaned securities and collateral is marked to market daily and collateral is received or delivered the following day to maintain collateral levels.

Cash collateral is invested in a registered 2(a)-7 money market fund. Maturities of investments in the money market fund generally do not match the maturities of the loaned securities because the lending agreements are terminable at will. Collateral securities may be pledged or sold upon borrower default. Since the Commissioner does not have the ability to pledge or sell the collateral securities unless the borrower defaults, they are not recorded in the financial statements. Securities under loan, cash collateral and cash collateral payable are recorded in the financial statements at fair value. The Bank, PCE Fund and the borrower receive a fee from earnings on invested collateral. The Bank and PCE Fund share a fee paid by the borrower for loans not collateralized with cash.

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There is limited credit risk associated with the lending transactions since the Commissioner is indemnified by the Bank against any loss resulting from counterparty failure or default on a loaned security or its related income distributions. The Bank further indemnifies against loss due to borrower rebates in excess of earnings on cash collateral. Indemnifications are subject to limitation relating to war, civil unrest or revolution, or beyond the reasonable control of the Bank.

For the years ended June 30, 2007 and 2006, there were no losses incurred as a result of securities lending transactions and there were no significant violations of legal or contractual provisions or failures by any borrowers to return loaned securities.

**(5) Capital Assets**

Capital asset activity for the years ended June 30, 2007 and 2006 was as follows (stated in thousands):

|                                    | <u>Balance at<br/>June 30, 2006</u> | <u>Additions</u> | <u>Deletions</u> | <u>Balance at<br/>June 30, 2007</u> |
|------------------------------------|-------------------------------------|------------------|------------------|-------------------------------------|
| Capital assets:                    |                                     |                  |                  |                                     |
| Intangible                         | \$ 14                               | —                | —                | 14                                  |
| Production                         | 246,797                             | 4,140            | —                | 250,937                             |
| Transmission                       | 185,600                             | 60               | —                | 185,660                             |
| General                            | 5,034                               | —                | —                | 5,034                               |
| Total capital assets               | <u>437,445</u>                      | <u>4,200</u>     | <u>—</u>         | <u>441,645</u>                      |
| Less accumulated depreciation for: |                                     |                  |                  |                                     |
| Intangible                         | (3)                                 | (1)              | —                | (4)                                 |
| Production                         | (74,103)                            | (5,095)          | —                | (79,198)                            |
| Transmission                       | (92,661)                            | (4,936)          | —                | (97,597)                            |
| General                            | (5,028)                             | (2)              | —                | (5,030)                             |
| Total accumulated depreciation     | <u>(171,795)</u>                    | <u>(10,034)</u>  | <u>—</u>         | <u>(181,829)</u>                    |
| Capital assets, net                | <u>\$ 265,650</u>                   | <u>(5,834)</u>   | <u>—</u>         | <u>259,816</u>                      |

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|                                    | <b>Balance at<br/>June 30, 2005</b> | <b>Additions</b> | <b>Deletions</b> | <b>Balance at<br/>June 30, 2006</b> |
|------------------------------------|-------------------------------------|------------------|------------------|-------------------------------------|
| Capital assets:                    |                                     |                  |                  |                                     |
| Intangible                         | \$ 14                               | —                | —                | 14                                  |
| Production                         | 244,476                             | 2,321            | —                | 246,797                             |
| Transmission                       | 185,600                             | —                | —                | 185,600                             |
| General                            | 5,034                               | —                | —                | 5,034                               |
| Total capital assets               | 435,124                             | 2,321            | —                | 437,445                             |
| Less accumulated depreciation for: |                                     |                  |                  |                                     |
| Intangible                         | (3)                                 | —                | —                | (3)                                 |
| Production                         | (69,071)                            | (5,032)          | —                | (74,103)                            |
| Transmission                       | (87,707)                            | (4,954)          | —                | (92,661)                            |
| General                            | (5,022)                             | (6)              | —                | (5,028)                             |
| Total accumulated depreciation     | (161,803)                           | (9,992)          | —                | (171,795)                           |
| Capital assets, net                | \$ 273,321                          | (7,671)          | —                | 265,650                             |

**(6) Long-Term Debt**

Long-term debt activity for the years ended June 30, 2007 and 2006 was as follows (stated in thousands):

|                                          | <b>Balance<br/>at June 30,<br/>2006</b> | <b>Additions</b> | <b>Deletions</b> | <b>Balance<br/>at June 30,<br/>2007</b> | <b>Due within<br/>one year</b> |
|------------------------------------------|-----------------------------------------|------------------|------------------|-----------------------------------------|--------------------------------|
| Bradley Lake Power                       |                                         |                  |                  |                                         |                                |
| Revenue Bonds:                           |                                         |                  |                  |                                         |                                |
| First Series (a)                         | \$ 6,640                                | —                | (3,270)          | 3,370                                   | 3,270                          |
| Second Series (a)                        | 11,520                                  | —                | (2,305)          | 9,215                                   | 2,305                          |
| Refunding, Third Series (a)              | 44,930                                  | —                | (110)            | 44,820                                  | 115                            |
| Refunding, Fourth Series (a)             | 37,390                                  | —                | (115)            | 37,275                                  | 120                            |
| Refunding, Fifth Series (a)              | 30,640                                  | —                | —                | 30,640                                  | —                              |
| Total bonds payable                      | 131,120                                 | —                | (5,800)          | 125,320                                 | 5,810                          |
| Arbitrage interest payable (b)           | 710                                     | —                | 274              | 984                                     | —                              |
| Less bond discount and deferred interest | (3,838)                                 | —                | 1,475            | (2,363)                                 | —                              |
|                                          | \$ 127,992                              | —                | (4,051)          | 123,941                                 | 5,810                          |

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|                                             | Balance<br>at June 30,<br>2005 | Additions | Deletions | Balance<br>at June 30,<br>2006 | Due within<br>one year |
|---------------------------------------------|--------------------------------|-----------|-----------|--------------------------------|------------------------|
| Bradley Lake Power                          |                                |           |           |                                |                        |
| Revenue Bonds:                              |                                |           |           |                                |                        |
| First Series (a)                            | \$ 9,910                       | —         | (3,270)   | 6,640                          | 3,270                  |
| Second Series (a)                           | 11,520                         | —         | —         | 11,520                         | 2,305                  |
| Refunding, Third Series (a)                 | 45,035                         | —         | (105)     | 44,930                         | 110                    |
| Refunding, Fourth Series (a)                | 39,680                         | —         | (2,290)   | 37,390                         | 115                    |
| Refunding, Fifth Series (a)                 | 30,640                         | —         | —         | 30,640                         | —                      |
| Total bonds payable                         | 136,785                        | —         | (5,665)   | 131,120                        | 5,800                  |
| Arbitrage interest payable (b)              | 463                            | —         | 247       | 710                            | —                      |
| Less bond discount and<br>deferred interest | (5,635)                        | —         | 1,797     | (3,838)                        | —                      |
|                                             | \$ 131,613                     | —         | (3,621)   | 127,992                        | 5,800                  |

The minimum payments related to all bonds for the years subsequent to June 30, 2007 are as follows (stated in thousands):

|                      | Principal  | Interest | Total   |
|----------------------|------------|----------|---------|
| Year ending June 30: |            |          |         |
| 2008                 | \$ 5,810   | 6,457    | 12,267  |
| 2009                 | 5,820      | 6,344    | 12,164  |
| 2010                 | 6,030      | 6,127    | 12,157  |
| 2011                 | 6,255      | 5,897    | 12,152  |
| 2012                 | 6,495      | 5,583    | 12,078  |
| 2013-2017            | 39,955     | 21,336   | 61,291  |
| 2018-2022            | 54,955     | 7,708    | 62,663  |
|                      | \$ 125,320 | 59,452   | 184,772 |

- (a) AEA issued the Power Revenue Bonds, First and Second Series (Bradley Lake Bonds), in September 1989 and August 1990, respectively, for the long term financing of the construction costs of the Bradley Lake Hydroelectric Project and refunded AEA's Variable Rate Demand Bonds which were issued in November 1985 to provide interim financing of the project. AEA issued the Power Revenue Refunding Bonds, Third and Fifth Series in April 1999 to refund a portion of the First Series Bonds and to provide costs of issuance. AEA issued the Power Revenue Refunding Bonds, Fourth Series in April 2000 to refund a portion of the Second Series Bonds and to provide costs of issuance. All of the revenues derived by AEA from the operation of the project and all moneys, securities and funds (except the excess earnings fund), including a capital reserve fund, held or set aside are pledged and assigned to secure the payment of principal, redemption premium, if any, and interest on the bonds. No other revenues of AEA are pledged as security for the payment of the bonds. AEA has covenanted to notify the State Legislature of any failure to maintain the capital reserve fund at its required level. The bonds are further secured by bond insurance. AEA collects

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from each power purchaser a percentage share of annual project costs. The outstanding Bradley Lake Bonds mature annually each July 1 through the year 2021 with interest rates ranging from 5% to 6.25%.

- (b) The arbitrage interest payable is due to the United States Treasury for the excess of investment income on the proceeds of each series of AEA's tax exempt Bradley Lake bonds over the related interest expense computed in accordance with Section 148 of the Internal Revenue Code of 1986. The accumulated arbitrage interest payable amount is computed each year, and the amount for each series is first due after the end of the fifth bond year and every five years thereafter. AEA maintains a separate account for each series with the trustee and each year sets aside a sufficient amount to satisfy the liability.

In addition, the Authority has participated in the following debt agreements:

- *Other Debt* – In 1982, AEA assumed \$44,859,000 of 5% mortgage notes payable which require quarterly principal and interest payments to the Rural Utilities Service (RUS) in connection with the Solomon Gulch Hydroelectric Project. Concurrent with the assumption, AEA deposited with a trustee Treasury notes sufficient to satisfy and provide for timely repayment of all principal and interest due on the assumed RUS loans. Accordingly, the loans and related trust assets are not included in the financial statements of AEA. At June 30, 2007, the unpaid principal balance of the notes was \$17,524,000 and the trust assets had a fair value of \$17,770,000.
- *Conduit Financing – City and Borough of Sitka – Utility Revenue Refunding Bonds, Series 1997 and Utility Revenue Bonds, Series 1992* – In May 1992, AEA issued \$56,890,000 of tax-exempt bonds that allowed the City and Borough of Sitka (Sitka) to refinance its 1979 municipal bonds, resulting in significant debt service savings to Sitka. In November 1997, AEA issued \$22,080,000 of tax-exempt bonds to advance refund and defease \$20,145,000 of the Series 1992 bonds (collectively with the Series 1992 bonds, the Sitka Bonds). The Sitka Bonds are not included in these financial statements. As of June 30, 2007, the outstanding balance was \$41,325,000.

The Sitka Bonds are special obligations of AEA secured under a trust indenture by and between AEA and U.S. Bank National Association, as trustee. The Sitka Bonds are payable solely from the sources provided under the trust indenture. They are equally and ratably secured by a pledge and assignment of the municipal revenue bonds of Sitka held by AEA under the trust indenture, the obligation of Sitka to make payments under its loan agreement with AEA and the money and securities held under the trust indenture, including a capital reserve fund. AEA has covenanted to notify the State Legislature of any failure to maintain the capital reserve fund at its required level. The bonds are further secured by bond insurance.

The Sitka Bonds do not constitute an indebtedness or other liability of the State, including AEA, and do not directly, indirectly or contingently obligate the State, including AEA, or any political subdivision thereof to levy any form of taxation for the payment of the bonds. Neither the full faith and credit nor the taxing power of the State, including AEA, or Sitka is pledged for the payment of the Sitka Bonds.

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**(7) Loans**

The Authority administers the Power Project Loan Program, the Rural Electrification Revolving Loan Program and the Bulk Fuel Revolving Loan Program. Loans outstanding at June 30, 2007 and 2006 are classified as follows (dollar amounts stated in thousands):

|                                                 | <b>2007</b>         |                  | <b>2006</b>         |                  |
|-------------------------------------------------|---------------------|------------------|---------------------|------------------|
|                                                 | <b>No. of loans</b> | <b>Amount</b>    | <b>No. of loans</b> | <b>Amount</b>    |
| Power Project Loan Program                      | 41                  | \$ 24,403        | 39                  | \$ 23,743        |
| Rural Electrification Revolving<br>Loan Program | 3                   | 763              | 4                   | 835              |
| Bulk Fuel Revolving Loan<br>Program             | 31                  | 1,932            | 34                  | 1,441            |
|                                                 | <u>75</u>           | <u>27,098</u>    | <u>77</u>           | <u>26,019</u>    |
| Less allowance for loan losses                  |                     | (1,177)          |                     | (1,529)          |
|                                                 |                     | <u>\$ 25,921</u> |                     | <u>\$ 24,490</u> |

Loans that are more than 90 days past due on which the accrual of interest has been discontinued amounted to \$1,117,000 and \$1,075,000 at June 30, 2007 and 2006, respectively.

An analysis of changes in the allowance for loan losses for the years ended June 30, 2007 and 2006 follows (stated in thousands):

|                              | <b>2007</b>     | <b>2006</b>  |
|------------------------------|-----------------|--------------|
| Balance at beginning of year | \$ 1,529        | 1,836        |
| Recoveries                   | —               | 28           |
| Write-offs                   | (3)             | —            |
| Provision for loan loss      | <u>(349)</u>    | <u>(335)</u> |
| Balance at end of year       | <u>\$ 1,177</u> | <u>1,529</u> |

**(8) Risk Management**

AEA is exposed to various risks of loss. AEA obtains coverage for its risks through the purchase of commercial insurance, participation in the State Risk Management Pool and the establishment of self-insurance plans.

**(a) General Liability – Watercraft and Aviation**

All risks are covered by the State insurance plan through an annual charge assessed by the State Division of Risk Management and payroll markup.

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**(b) Property**

**Alaska Intertie**

The utilities participating in the Alaska Intertie operating agreement retain the property risk associated with the Alaska Intertie.

**Bradley Lake and Larsen Bay Hydroelectric Projects**

The risks are covered by commercial insurance purchased through the State Division of Risk Management, and the self-insured retentions are the responsibility of the respective projects from operating funds.

**(c) Boiler and Machinery**

These risks are covered by commercial insurance purchased through the State Division of Risk Management and a private carrier.

Additionally, utilities benefiting from the use of the facilities owned by AEA participate in the responsibility for deductibles and self insured retentions under the terms of the respective agreements.

**(9) Related Parties**

**(a) Alaska Industrial Development and Export Authority**

Pursuant to understandings and agreements between AIDEA and AEA, AIDEA provides administrative, treasury, personnel, legal, data processing, communications, and other services to AEA. During 2007 and 2006, AEA expensed \$2,972,000 and \$2,770,000, respectively, for such services. AEA has a borrowing arrangement with AIDEA to provide working capital funds. At June 30, 2007 and 2006, AEA had \$718,000 and \$942,000 payable to AIDEA for services and borrowings.

**(b) Alaska Intertie Operating Committee**

Effective May 1, 1986, AEA entered into an agreement with utilities using the Alaska Intertie for wheeling of electrical power. Pursuant to the agreement, the Intertie Operating Committee (IOC) was established to manage the system. The IOC is comprised of a representative from AEA and each of the utilities. AEA is reimbursed for operation and maintenance costs on a monthly basis with an annual settlement to adjust the payments to actual costs. AEA management on October 16, 2006, issued contractually required notice that the agreement will terminate in 48 months as a mechanism to implement cures to identified defects in the agreement (note 1(b)).

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**(c) *Bradley Lake Project Management Committee***

Effective December 7, 1987, AEA entered into a power sales agreement with entities purchasing electric power produced by the Bradley Lake Hydroelectric Project. Pursuant to the agreement, a Project Management Committee (PMC) was formed. The PMC is comprised of a representative from AEA and each of the power purchasers. The participating power purchasers make monthly payments directly to the bond trustee based on their respective percentage share of the estimated annual project costs, including debt service and annual administrative fee to AEA.

**(10) Commitments and Contingencies**

AEA, in the normal course of business, is involved in various claims and pending litigation. The State Department of Law manages all pending litigation of AEA, and any liability arising from the settlement of pending claims is a liability for which the Department of Law or AEA requests an appropriation from the Legislature to satisfy judgment in the event that the judgment exceeds available funds or the proceeds from applicable insurance policies. In the opinion of management, the disposition of current claims and pending litigation is not presently expected to have a material adverse effect on AEA's financial position.

In the normal course of business, AEA also has various commitments, such as commitments for the extension of credit. At June 30, 2007 and 2006, AEA had open loan commitments of \$3,769,000 and \$3,451,000, respectively. At June 30, 2007 and 2006, AEA held approximately \$5,364,000 and \$5,174,000, respectively, of investments in escrow under an agreement.

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Schedule of Bradley Lake Hydroelectric Project Trust Account Activities  
Year ended June 30, 2007  
(Stated in thousands)

|                            | <b>Debt<br/>service<br/>account</b> | <b>Capital<br/>reserve<br/>account</b> | <b>Renewal and<br/>contingency<br/>account</b> | <b>Excess<br/>earnings<br/>account</b> | <b>Revenue<br/>account</b> | <b>Operating<br/>account</b> | <b>Operating<br/>reserve<br/>account</b> | <b>Total</b>  |
|----------------------------|-------------------------------------|----------------------------------------|------------------------------------------------|----------------------------------------|----------------------------|------------------------------|------------------------------------------|---------------|
| Balance at June 30, 2006   | \$ 9,038                            | 12,834                                 | 4,216                                          | 451                                    | 458                        | 534                          | 661                                      | 28,192        |
| Interest received          | 321                                 | 805                                    | 327                                            | —                                      | 327                        | 34                           | 60                                       | 1,874         |
| Bond principal paid        | (5,800)                             | —                                      | —                                              | —                                      | —                          | —                            | —                                        | (5,800)       |
| Bond interest paid         | (6,470)                             | —                                      | —                                              | —                                      | —                          | —                            | —                                        | (6,470)       |
| Construction expenditures  | —                                   | —                                      | (3,221)                                        | —                                      | —                          | —                            | —                                        | (3,221)       |
| Operating revenue received | —                                   | —                                      | —                                              | —                                      | 15,925                     | —                            | —                                        | 15,925        |
| Operating expenses paid    | —                                   | —                                      | —                                              | —                                      | —                          | (3,141)                      | —                                        | (3,141)       |
| Transfers between funds    | 11,953                              | (805)                                  | 412                                            | 258                                    | (15,178)                   | 3,395                        | (35)                                     | —             |
| Balance at June 30, 2007   | <u>\$ 9,042</u>                     | <u>12,834</u>                          | <u>1,734</u>                                   | <u>709</u>                             | <u>1,532</u>               | <u>822</u>                   | <u>686</u>                               | <u>27,359</u> |

See accompanying independent auditors' report.

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Schedule of Projects – Balance Sheet

June 30, 2007

(Stated in thousands)

| <b>Assets</b>                                    | <b>Bradley Lake<br/>Hydroelectric<br/>Project</b> | <b>Alaska<br/>Intertie<br/>Project</b> | <b>Rural<br/>Energy<br/>Projects</b> | <b>Administration<br/>and Power<br/>Development<br/>Fund</b> | <b>Rural Energy<br/>Programs</b> | <b>Combined<br/>balance</b> |
|--------------------------------------------------|---------------------------------------------------|----------------------------------------|--------------------------------------|--------------------------------------------------------------|----------------------------------|-----------------------------|
| Current assets:                                  |                                                   |                                        |                                      |                                                              |                                  |                             |
| Grants receivable                                | \$ —                                              | —                                      | 60                                   | 15                                                           | 2,997                            | 3,072                       |
| Loans receivable                                 | —                                                 | —                                      | —                                    | —                                                            | 2,471                            | 2,471                       |
| Operating revenue receivable                     | —                                                 | 306                                    | —                                    | —                                                            | 103                              | 409                         |
| Accrued interest receivable                      | 959                                               | —                                      | —                                    | —                                                            | 475                              | 1,434                       |
| Total current assets                             | 959                                               | 306                                    | 60                                   | 15                                                           | 6,046                            | 7,386                       |
| Noncurrent assets:                               |                                                   |                                        |                                      |                                                              |                                  |                             |
| Restricted cash and investments                  | 22,585                                            | —                                      | —                                    | —                                                            | —                                | 22,585                      |
| Designated for specific purposes                 | 4,774                                             | 589                                    | —                                    | 11,393                                                       | 461,634                          | 478,390                     |
| Loans receivable, net of allowance               | —                                                 | —                                      | —                                    | —                                                            | 23,450                           | 23,450                      |
| Capital assets                                   | 316,923                                           | 124,246                                | 476                                  | —                                                            | —                                | 441,645                     |
| Less accumulated depreciation                    | (108,276)                                         | (73,137)                               | (416)                                | —                                                            | —                                | (181,829)                   |
| Capital assets, net                              | 208,647                                           | 51,109                                 | 60                                   | —                                                            | —                                | 259,816                     |
| Total noncurrent assets                          | 236,006                                           | 51,698                                 | 60                                   | 11,393                                                       | 485,084                          | 784,241                     |
| Total assets                                     | \$ 236,965                                        | 52,004                                 | 120                                  | 11,408                                                       | 491,130                          | 791,627                     |
| <b>Liabilities and Net Assets</b>                |                                                   |                                        |                                      |                                                              |                                  |                             |
| Current liabilities:                             |                                                   |                                        |                                      |                                                              |                                  |                             |
| Due to State of Alaska                           | \$ —                                              | —                                      | —                                    | 8,475                                                        | (189)                            | 8,286                       |
| Accounts payable                                 | 1,882                                             | 879                                    | 277                                  | 761                                                          | 23,010                           | 26,809                      |
| Bonds payable – current portion                  | 5,810                                             | —                                      | —                                    | —                                                            | —                                | 5,810                       |
| Accrued interest                                 | 3,232                                             | —                                      | —                                    | —                                                            | —                                | 3,232                       |
| Total current liabilities                        | 10,924                                            | 879                                    | 277                                  | 9,236                                                        | 22,821                           | 44,137                      |
| Noncurrent liabilities:                          |                                                   |                                        |                                      |                                                              |                                  |                             |
| Long-term debt, net of current portion:          |                                                   |                                        |                                      |                                                              |                                  |                             |
| Bonds payable – noncurrent portion, net          | 117,147                                           | —                                      | —                                    | —                                                            | —                                | 117,147                     |
| Arbitrage interest payable                       | 984                                               | —                                      | —                                    | —                                                            | —                                | 984                         |
| Other liabilities                                | 103                                               | —                                      | —                                    | —                                                            | —                                | 103                         |
| Total noncurrent liabilities                     | 118,234                                           | —                                      | —                                    | —                                                            | —                                | 118,234                     |
| Total liabilities                                | 129,158                                           | 879                                    | 277                                  | 9,236                                                        | 22,821                           | 162,371                     |
| Net assets:                                      |                                                   |                                        |                                      |                                                              |                                  |                             |
| Investment in capital assets net of related debt | 85,690                                            | 51,109                                 | 60                                   | —                                                            | —                                | 136,859                     |
| Restricted for debt service                      | 19,353                                            | —                                      | —                                    | —                                                            | —                                | 19,353                      |
| Restricted by agreements with external parties   | 2,764                                             | 16                                     | —                                    | —                                                            | 20,112                           | 22,892                      |
| Unrestricted net assets                          | —                                                 | —                                      | (217)                                | 2,172                                                        | 448,197                          | 450,152                     |
| Total net assets                                 | 107,807                                           | 51,125                                 | (157)                                | 2,172                                                        | 468,309                          | 629,256                     |
| Commitments and contingencies                    |                                                   |                                        |                                      |                                                              |                                  |                             |
| Total liabilities and net assets                 | \$ 236,965                                        | 52,004                                 | 120                                  | 11,408                                                       | 491,130                          | 791,627                     |

See accompanying independent auditors' report.

**ALASKA ENERGY AUTHORITY**  
(A Component Unit of the State of Alaska)

Schedule of Projects – Revenues, Expenses, and Changes in Net Assets

Year ended June 30, 2007

(Stated in thousands)

|                                              | <b>Bradley Lake<br/>Hydroelectric<br/>Project</b> | <b>Alaska<br/>Intertie<br/>Project</b> | <b>Rural<br/>Energy<br/>Projects</b> | <b>Administration<br/>and Power<br/>Development<br/>Fund</b> | <b>Rural Energy<br/>Programs</b> | <b>Combined<br/>balance</b> |
|----------------------------------------------|---------------------------------------------------|----------------------------------------|--------------------------------------|--------------------------------------------------------------|----------------------------------|-----------------------------|
| Operating revenues:                          |                                                   |                                        |                                      |                                                              |                                  |                             |
| Federal grants                               | \$ —                                              | —                                      | 60                                   | —                                                            | 21,821                           | 21,881                      |
| Revenue from operating plants                | 15,567                                            | 1,388                                  | 7                                    | —                                                            | —                                | 16,962                      |
| State of Alaska appropriations               | —                                                 | —                                      | —                                    | —                                                            | 14,539                           | 14,539                      |
| Revenue from state agencies                  | —                                                 | —                                      | —                                    | —                                                            | 690                              | 690                         |
| Interest on loans                            | —                                                 | —                                      | —                                    | —                                                            | 980                              | 980                         |
| Other revenue                                | 6                                                 | —                                      | —                                    | —                                                            | 42                               | 48                          |
| Total operating revenues                     | <u>15,573</u>                                     | <u>1,388</u>                           | <u>67</u>                            | <u>—</u>                                                     | <u>38,072</u>                    | <u>55,100</u>               |
| Operating expenses:                          |                                                   |                                        |                                      |                                                              |                                  |                             |
| Grants and projects                          | —                                                 | —                                      | —                                    | —                                                            | 24,239                           | 24,239                      |
| Power cost equalization grants               | —                                                 | —                                      | —                                    | —                                                            | 25,145                           | 25,145                      |
| Depreciation                                 | 6,674                                             | 3,360                                  | —                                    | —                                                            | —                                | 10,034                      |
| Interest expense                             | 7,938                                             | —                                      | —                                    | —                                                            | —                                | 7,938                       |
| Plant operating                              | 2,871                                             | 1,349                                  | 22                                   | —                                                            | —                                | 4,242                       |
| General and administrative                   | 245                                               | 75                                     | 1                                    | —                                                            | 1,352                            | 1,673                       |
| Provision for loan loss and bad debt expense | —                                                 | —                                      | —                                    | —                                                            | (349)                            | (349)                       |
| Total operating expenses                     | <u>17,728</u>                                     | <u>4,784</u>                           | <u>23</u>                            | <u>—</u>                                                     | <u>50,387</u>                    | <u>72,922</u>               |
| Operating income (loss)                      | <u>(2,155)</u>                                    | <u>(3,396)</u>                         | <u>44</u>                            | <u>—</u>                                                     | <u>(12,315)</u>                  | <u>(17,822)</u>             |
| Nonoperating:                                |                                                   |                                        |                                      |                                                              |                                  |                             |
| State of Alaska PCE Endowment contribution   | —                                                 | —                                      | —                                    | —                                                            | 182,700                          | 182,700                     |
| Investment income, net                       | 1,545                                             | 36                                     | —                                    | —                                                            | 47,654                           | 49,235                      |
| Increase (decrease) in net assets            | <u>(610)</u>                                      | <u>(3,360)</u>                         | <u>44</u>                            | <u>—</u>                                                     | <u>218,039</u>                   | <u>214,113</u>              |
| Net assets – beginning                       | <u>108,417</u>                                    | <u>54,485</u>                          | <u>(201)</u>                         | <u>2,172</u>                                                 | <u>250,270</u>                   | <u>415,143</u>              |
| Net assets – ending                          | <u>\$ 107,807</u>                                 | <u>51,125</u>                          | <u>(157)</u>                         | <u>2,172</u>                                                 | <u>468,309</u>                   | <u>629,256</u>              |

See accompanying independent auditors' report.