



ALASKA ENERGY AUTHORITY
(A Component Unit of the State of Alaska)
Basic Financial Statements and Schedules
June 30, 2011 and 2010
(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, 2011 and 2010

Overview of the Financial Statements

The Alaska Energy Authority's (AEA or Authority) is composed of the following programs – AEA owned hydroelectric and intertie projects, rural energy programs, and energy development 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, 2011 and 2010. 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 \$1,076 million and \$643 million at June 30, 2011 and 2010, respectively. Of the total net assets at June 30, 2011, \$126 million was invested in capital assets net of related debt, \$37 million was restricted and \$913 million was unrestricted. Of the total net assets at June 30, 2010, \$129 million was invested in capital assets net of related debt, \$40 million was restricted and \$474 million was unrestricted.

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Management's Discussion and Analysis

June 30, 2011 and 2010

Financial Analysis

Financial Position

Total assets, total liabilities, and total net assets at June 30, 2011, 2010, and 2009 follows (stated in thousands):

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Current assets	\$ 410,251	32,092	12,355
Capital assets, net	227,438	236,472	245,054
Other noncurrent and restricted assets	579,130	504,105	515,785
Total assets	<u>1,216,819</u>	<u>772,669</u>	<u>773,194</u>
Current liabilities	44,932	27,809	38,894
Noncurrent liabilities	95,978	101,812	107,578
Total liabilities	<u>140,910</u>	<u>129,621</u>	<u>146,472</u>
Total net assets	<u>1,075,909</u>	<u>643,048</u>	<u>626,722</u>
Total liabilities and net assets	<u>\$ 1,216,819</u>	<u>772,669</u>	<u>773,194</u>

Current assets were \$378.2 million higher at June 30, 2011 compared to June 30, 2010 and \$19.7 million higher at June 30, 2010 compared to June 30, 2009. Components of the changes were (stated in millions):

	<u>2011 vs. 2010</u>	<u>2010 vs. 2009</u>
Increase in PCE Endowment Fund non-operating transfer due from the State of Alaska	\$ 400.0	—
(Decrease) increase in other fund non-operating transfers due from the State of Alaska	(22.8)	24.9
Increase in receivables due from state agencies and component units	0.9	0.5
Increase in investment interest receivable	—	0.1
(Decrease) increase in receivable from Department of Energy	(0.4)	0.2
Increase in operating receivable from operating plants	0.7	0.5
Increase (decrease) in receivable from Denali Commission	0.6	(1.9)
Increase (decrease) in receivable for advanced grant funds to grantees	0.2	(4.9)
Decrease in loan interest receivable	(0.3)	—
Net (decrease) increase in short-term loans originated, net of loan collections	(0.7)	0.3
	<u>\$ 378.2</u>	<u>19.7</u>

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Capital assets were \$9.0 million lower at June 30, 2011 compared to June 30, 2010 and \$8.6 million lower at June 30, 2010 compared to June 30, 2009 substantially due to depreciation of capital assets, offset by improvements and the transfer of the Larsen Bay Project to the City of Larsen Bay. Improvements and transfers to the below projects (stated in millions) were:

	2011 vs. 2010	2010 vs. 2009
Bradley Lake Hydroelectric Project	\$ 1.0	1.6
Alaska Intertie Project	0.2	—
Larsen Bay Project	(0.4)	—
Napakiak Intertie Project	—	0.1
	<u>\$ 0.8</u>	<u>1.7</u>

Other noncurrent and restricted assets were \$75.0 million higher at June 30, 2011 compared to June 30, 2010 and \$11.7 million lower at June 30, 2010 compared to June 30, 2009. Components of the changes were (stated in millions):

	2011 vs. 2010	2010 vs. 2009
Increase from PCE Endowment Fund realized investment income	\$ 13.8	5.0
Increase in PCE Endowment Fund fair value	53.8	33.3
Increase due to Renewable Energy Grant Fund contribution	50.0	—
Increase due to Power Project Loan Fund contribution	10.0	—
Net increase in other funds from investment income and fair value	3.2	4.7
Decrease due to TAPL, PCE and Renewable Energy Funds expenditures	(65.4)	(49.0)
Increase in investments relating to operating plants	2.2	0.6
Decrease from loan activity	(1.8)	—
Net increase (decrease) in cash from State advances on appropriations	<u>9.2</u>	<u>(6.3)</u>
	<u>\$ 75.0</u>	<u>(11.7)</u>

PCE (Power Cost Equalization)
TAPL (Trans-Alaska Pipeline Liability)

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Current liabilities were \$17.1 million higher at June 30, 2011 compared to June 30, 2010 and \$11.1 million lower at June 30, 2010 compared to June 30, 2009. Components of the changes were (stated in millions):

	<u>2011 vs. 2010</u>	<u>2010 vs. 2009</u>
Net increase (decrease) in amount due to the State of Alaska	\$ 6.9	(2.0)
Decrease in short-term borrowings	—	(0.1)
Decrease in current portion of arbitrage interest payable	(0.1)	(0.2)
Increase in payables related to operating plants	4.5	1.7
Increase (decrease) in other accrued expenditures	5.8	(10.5)
	<u>\$ 17.1</u>	<u>(11.1)</u>

The \$5.8 million decrease in noncurrent liabilities between June 30, 2011 and 2010 was substantially caused by a decrease in the long-term portion of bonds payable, offset by increases in the noncurrent portion of arbitrage interest payable and other noncurrent liabilities. The \$5.8 million decrease between June 30, 2010 and 2009 was caused by decreases in the long-term portion of bonds payable and the noncurrent portion of arbitrage interest payable.

The increase in net assets from June 30, 2010 to June 30, 2011 resulted primarily from a \$400 million contribution from the State of Alaska to the Power Cost Equalization Endowment Fund, \$37 million in contributions from the State of Alaska to other funds, and \$71 million of investment income, offset by a \$71 million operating loss and a \$4 million loss from the sale of Power Project Fund loans. The increase in net assets from June 30, 2009 to June 30, 2010 resulted primarily from the \$25 million Renewable Energy Fund contribution from the State of Alaska and \$38 million of investment income in the PCE Endowment Fund, offset by the \$52 million operating loss.

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Management's Discussion and Analysis

June 30, 2011 and 2010

Operations

Components of the Authority's operating revenues, operating expenses, nonoperating investment income and operating loss for the years ended June 30, 2011 through 2009 follows (stated in thousands):

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Operating revenues:			
Federal grants	\$ 11,758	14,184	20,545
Revenue from operating plants	17,613	18,709	17,890
State appropriations	14,645	21,292	61,394
Other	3,252	1,849	1,763
Total operating revenues	<u>47,268</u>	<u>56,034</u>	<u>101,592</u>
Operating expenses:			
Grants and projects	62,072	52,791	72,010
PCE grants	31,180	31,210	37,074
Depreciation	10,291	10,277	10,233
Interest expense	5,540	6,393	7,116
Plant operating	5,674	5,201	5,077
General and administrative	3,933	1,787	1,940
Provision for loan loss	(14)	(3)	(40)
Total operating expenses	<u>118,676</u>	<u>107,656</u>	<u>133,410</u>
Operating loss	(71,408)	(51,622)	(31,818)
Nonoperating:			
Loss on sale of Power Project Fund loans	(3,850)	—	—
Decrease in contingent liability from loan sale	22	—	—
State of Alaska contribution to the Emerging Energy Technology Fund	2,400	—	—
State of Alaska contribution to the Power Project Fund	10,000	—	—
State of Alaska contribution to the Bulk Fuel Revolving Loan Fund	—	—	5,500
State of Alaska contribution to the Renewable Energy Fund	25,000	25,000	100,001
State of Alaska contribution to the Power Cost Equalization Endowment Fund	400,000	—	—
State of Alaska contribution to the Power Cost Equalization and Rural Electric Capitalization Fund	(200)	199	—
Investment income (loss), net	70,897	42,749	(43,628)
Increase in net assets	<u>\$ 432,861</u>	<u>16,326</u>	<u>30,055</u>

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Management's Discussion and Analysis

June 30, 2011 and 2010

Operating revenues decreased \$8.7 million during the year ended June 30, 2011 compared to the prior year and decreased \$45.6 million during the year ended June 30, 2010 compared to the same period in 2009. Components of the changes were (stated in millions):

	FY 2011-2010	FY 2010-2009
	Net change	Net change
Decreased grant revenue from Denali Commission	\$ (1.2)	(3.5)
Decreased grant revenue from Department of Energy	(0.3)	(0.4)
Decreased revenue from other federal grantors	(0.9)	(2.8)
Fluctuations in revenue from operating plants	(1.1)	0.8
Decreased revenue from State for PCE grants	(2.7)	(8.1)
Decreased revenue from State general fund for Swan Tyee Intertie capital project	—	(32.6)
(Decreased) increased revenue from other State general fund operating and capital appropriations	(3.9)	0.7
Increased revenue from other State agencies	2.1	0.3
Decreased revenue from loan interest and other miscellaneous revenues	(0.7)	—
	<u>\$ (8.7)</u>	<u>(45.6)</u>

Operating expenses increased \$11.0 million during the year ended June 30, 2011 compared to the prior year and decreased \$25.8 million during the year ended June 30, 2010 compared to the same period in 2009. Components of the changes were (stated in millions):

	FY 2011-2010	FY 2010-2009
	Net change	Net change
Decreased federally funded grant and project expenses in active rural energy construction projects	\$ (2.4)	(6.3)
Increased (decreased) State funded grant and project expenses	9.6	(13.2)
Increased State agency and component unit funded expenses for interagency contracts	2.1	0.3
Decreased PCE grant expenditures	—	(5.9)
Decreased bond interest expense	(0.9)	(0.7)
Increased operating plants expense	0.5	0.1
Increased (decreased) other expenses	2.1	(0.1)
	<u>\$ 11.0</u>	<u>(25.8)</u>

During the year ended June 30, 2011, investment income substantially consisted of PCE Endowment Fund unrealized gains of \$53.9 million, \$12.1 million in net interest income and unrealized gains from other funds, and realized gains of \$4.9 million.

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During the year ended June 30, 2010, the PCE Endowment Fund had unrealized gains of \$33.3 million and \$11.1 million in net interest income and realized gains from other funds which were offset by realized losses of \$1.7 million.

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 and energy development 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, 2011 and 2010, 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 opinion.

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, 2011 and 2010, 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 26, 2011, 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 7 is 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 basic financial statements taken as a whole. The supplementary information included in schedules 1 through 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 26, 2011

ALASKA ENERGY AUTHORITY
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Balance Sheets

June 30, 2011 and 2010

(Stated in thousands)

Assets	2011	2010
Current assets:		
Grants receivable	\$ 1,940	1,772
Loans receivable (note 6)	1,571	2,265
Operating revenue receivable	3,032	1,252
Due from State of Alaska	402,594	25,415
Accrued interest receivable	1,114	1,388
Total current assets	410,251	32,092
Noncurrent assets:		
Restricted cash and investments (note 3)	22,370	22,407
Cash and investments designated for specific purposes (note 3)	555,006	456,987
Loans receivable, net of allowance (note 6)	1,754	24,711
Capital assets (note 4)	449,812	448,971
Less accumulated depreciation	(222,374)	(212,499)
Capital assets, net	227,438	236,472
Total noncurrent assets	806,568	740,577
Total assets	\$ 1,216,819	772,669
Liabilities and Net Assets		
Current liabilities:		
Due to State of Alaska	\$ 7,232	320
Accounts payable	28,400	18,104
Bonds payable – current portion (note 5)	6,495	6,255
Arbitrage interest payable – current portion (note 5)	—	122
Accrued interest payable	2,805	3,008
Total current liabilities	44,932	27,809
Noncurrent liabilities:		
Bonds payable – noncurrent portion, net (note 5)	94,676	101,424
Arbitrage interest payable-noncurrent portion (note 5)	494	285
Other liabilities	808	103
Total noncurrent liabilities	95,978	101,812
Total liabilities	140,910	129,621
Net assets:		
Invested in capital assets, net of related debt	126,267	128,793
Restricted for debt service	19,565	19,399
Restricted by agreements with external parties	17,083	21,080
Unrestricted	912,994	473,776
Total net assets	1,075,909	643,048
Commitments and contingencies (notes 7 and 9)		
Total liabilities and net assets	\$ 1,216,819	772,669

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, 2011 and 2010

(Stated in thousands)

	<u>2011</u>	<u>2010</u>
Operating revenues:		
Federal grants	\$ 11,758	14,184
Revenue from operating plants	17,613	18,709
State of Alaska appropriations	14,645	21,292
Revenue from state agencies and component units	2,670	581
Interest on loans	484	1,147
Other revenue	98	121
Total operating revenues	<u>47,268</u>	<u>56,034</u>
Operating expenses:		
Grants and projects	62,072	52,791
Power cost equalization grants	31,180	31,210
Depreciation	10,291	10,277
Interest expense	5,540	6,393
Plant operating	5,674	5,201
General and administrative	3,933	1,787
Provision for loan loss (note 6)	(14)	(3)
Total operating expenses	<u>118,676</u>	<u>107,656</u>
Operating loss	<u>(71,408)</u>	<u>(51,622)</u>
Nonoperating:		
Loss on sale of Power Project Fund loans	(3,850)	—
Decrease in contingent liability on sold loans	22	—
State of Alaska contribution to the Emerging Energy Technology Fund	2,400	—
State of Alaska contribution to the Power Project Fund	10,000	—
State of Alaska contribution to the Power Cost Equalization Endowment Fund	400,000	—
State of Alaska contribution to the Power Cost Equalization and Rural Electric Capitalization Fund	(200)	199
State of Alaska contribution to the Renewable Energy Fund	25,000	25,000
Investment income, net	70,897	42,749
Total nonoperating	<u>504,269</u>	<u>67,948</u>
Increase in net assets	432,861	16,326
Net assets – beginning	<u>643,048</u>	<u>626,722</u>
Net assets – ending	<u>\$ 1,075,909</u>	<u>643,048</u>

See accompanying notes to basic financial statements.

ALASKA ENERGY AUTHORITY
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Statements of Cash Flows
Years ended June 30, 2011 and 2010
(Stated in thousands)

	2011	2010
Cash flows from operating activities:		
Receipts from federal grants	\$ 11,591	15,977
Receipts from customers and users	21,490	19,451
Receipts from State of Alaska appropriations	21,684	23,422
Principal collected on loans	11,166	10,609
Proceeds from sale of Power Project Fund loans	20,631	—
Receipts from state agencies and component units	1,717	443
Interest collected on loans	519	1,063
Other operating receipts	129	211
Loans originated	(11,028)	(10,305)
Payments to suppliers	(11,842)	(20,603)
Payments to grantees	(85,262)	(79,833)
Net cash used by operating activities	(19,205)	(39,565)
Cash flows from noncapital and related financing activities:		
Net unremitted interest returned on State appropriation advances	(2)	(24)
Renewable Energy Fund contribution from State appropriation	50,000	—
Power Project Fund contribution from State appropriation	10,000	—
Subrecipient grant advances	(278)	(158)
Net receipt (payment) related to operating loans from AIDEA	174	(280)
Net cash provided (used) by noncapital and related financing activities	59,894	(462)
Cash flows from capital and related financing activities:		
Principal paid on bonds	(36,895)	(6,030)
Interest paid on bonds	(5,944)	(6,127)
Net proceeds from bond refunding	30,851	—
Costs associated with bond refunding	(262)	—
Purchase of capital assets	(1,454)	(1,463)
Net cash used by capital and related financing activities	(13,704)	(13,620)
Cash flows from investing activities:		
Purchase of investments	(212,085)	(182,083)
Proceeds from sales and maturities of investments	204,526	215,382
Interest received from investments	12,064	11,227
Net cash provided by investing activities	4,505	44,526
Net increase (decrease) in cash and cash equivalents	31,490	(9,121)
Cash and cash equivalents at beginning of year	48,119	57,240
Cash and cash equivalents at end of year (note 3)	\$ 79,609	48,119
Reconciliation of operating loss to net cash used by operating activities:		
Operating loss	\$ (71,408)	(51,622)
Adjustments to reconcile operating loss to net cash used by operating activities:		
Depreciation	10,291	10,277
Provision for loan loss and bad debt expense	(14)	(3)
Bond interest expense	5,540	6,393
Loss on sale of Power Project Fund loans	(3,850)	—
Changes in assets and liabilities:		
Increase (decrease) in due to State of Alaska	6,912	(2,020)
Decrease (increase) in due from the State of Alaska	21	(55)
(Increase) decrease in grants receivable	(168)	1,793
Decrease in loans receivable	24,391	303
Decrease (increase) in interest receivable	263	(84)
(Increase) decrease in operating revenue receivable	(1,611)	4,432
Increase (decrease) in operating accounts payable	10,428	(8,979)
Net cash used by operating activities	\$ (19,205)	(39,565)
Noncash capital and investing activities:		
Amount included in accounts payable for capital asset additions	\$ 285	482
Net increase in fair value of investments	54,040	33,133

See accompanying notes to basic financial statements.

ALASKA ENERGY AUTHORITY
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Notes to Basic Financial Statements

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(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 and one was transferred to the City of Larsen Bay in the fall of 2010. The Bradley Lake Hydroelectric project together with the Alaska Intertie's 170 miles of transmission line help provide 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. AEA continues to exist as a separate legal entity. The corporate structure and operating assets of AEA were retained but the ability to have employees, and construct or acquire energy projects was eliminated. Effective July 14, 2011, the legislature empowered AEA to acquire, construct, own and operate a hydroelectric project located on the Susitna River. Under this legislative authorization, AEA is working on planning, design and licensing of the Susitna-Watana Hydroelectric Project. Among other things, AIDEA provides personnel services for AEA. The AEA executive director is an employee of AIDEA, but is separate and independent and is not subject to supervision by AIDEA's executive director. 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. The 1993 legislation required AEA, to the maximum extent feasible, to enter contracts with public utilities and other entities to carry out AEA duties respecting the ongoing operation and maintenance of the AEA owned operating assets; this has occurred with oversight responsibility retained by AEA.

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. During fiscal year 2009, legislation added energy development programs to AEA.

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

(a) *Bradley Lake Hydroelectric Project*

The project has 120 megawatts of installed capacity 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 the Kenai Peninsula to Fairbanks as well as the Delta Junction area.

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(b) *Alaska Intertie Project*

The Alaska Intertie is a 170-mile transmission line, designed for 345 kilovolts and is operating at 138 kilovolts. It runs between Willow and Healy, and interconnects the power systems in the Anchorage and Fairbanks areas. The Intertie reduces the number of black/brownouts throughout the system by enabling power to move either north or south when major system disturbances occur. The Alaska Intertie allows Golden Valley Electric Association (GVEA) in Fairbanks to purchase lower cost electricity produced by Chugach Electric (CEA) and the Municipality of Anchorage, d/b/a Municipal Light and Power (ML&P). It also allows Southcentral Alaska utilities to purchase power from Fairbanks during power shortages. AEA contracts with Participating Utilities for operations and maintenance. These duties are overseen by the Intertie Operating Committee and AEA under the Alaska Intertie Agreement (Agreement).

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, 2008, AEA incurred \$489,000 in costs for preliminary design work. In August 2007, AEA issued a contract to ML&P for \$19,500,000 for the upgrade; the work began in September 2007.

Effective July 1, 2008, the State re-appropriated \$10,000,000 of the original funds for certain specific capital repairs on the Intertie. As a result, AEA amended the existing contract with ML&P to reduce scope of work regarding extending a portion of the Intertie, and entered into a separate \$10,000,000 contract on August 26, 2010 with ML&P to repair static VAR compensators and a tower foundation.

Effective July 1, 2011 the State appropriated an additional \$5,000,000 for substation upgrades and repairs related to the Alaska Intertie.

Tower foundation repairs are now underway, and proposals for the repair of static VAR compensators are being reviewed. The estimated completion date of the second contract is December 31, 2013. AEA continues to work with the Railbelt Utilities on the completion of upgrades and repairs to the Alaska Intertie.

AEA management and Participating Utilities identified defects in the Agreement that AEA management believes should be corrected. 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. AEA management, on October 16, 2006, issued contractually required notice that the Agreement would terminate in 48 months. This termination deadline has been extended to November 15, 2011, to enable AEA, the Participating Utilities, and the United States Army to complete negotiations on amendments to the Agreement. AEA management anticipates that amendments to extend the term of the Agreement will be implemented on or before the existing agreement terminates in November 2011.

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(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 Authority conveyed the project to the City in the fall of 2010.

(d) *Susitna-Watana Hydroelectric Project*

The Alaska Legislature appropriated \$10 million in funding to AEA effective July 1, 2010 for the preliminary planning and conceptual design for a large hydroelectric project to be built in the Railbelt Region. A number of hydroelectric generation alternatives were studied and in November 2010, AEA issued a Preliminary Decision Document selecting the Susitna Hydroelectric Project – Low Watana Non-Expandable Alternative (now known as the Susitna-Watana Hydroelectric Project) as the primary large hydroelectric project for the State to pursue. The proposed Susitna-Watana Hydroelectric Project would be located approximately half-way between Anchorage and Fairbanks on the upper Susitna River. The Susitna-Watana dam would be located within a steep-sided valley of the Susitna River at River Mile 184 above the mouth, approximately 15 miles upstream of the Devil's Canyon rapids. The single dam would be at the same location below Watana Creek. The Alaska Legislature unanimously passed and the Governor signed Senate Bill 42 effective July 14, 2011, which authorized the Alaska Energy Authority to acquire a Susitna river power project. Senate Bill 46 appropriated \$65.7 million, effective July 1, 2011, to planning, design and permitting the project.

(e) *Rural Energy Programs*

The rural energy programs include Bulk Fuel Storage Upgrades, Rural Power System Upgrades, Power Cost Equalization (PCE), 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.

(f) *Energy Development Programs*

The energy development programs include the Renewable Energy Grants Fund & Recommendation Program, Alternative Energy and Energy Efficiency Programs, and the Emerging Energy Technology Fund Grant Program.

(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

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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, the sale of program loans, 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 there is a significant unexpected decline in service utility.

(c) Cash and Investments

All of AEA's cash and investments are restricted as to use by AEA. 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 change in net assets. Fair values are obtained from independent sources.

(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.

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(e) Allowance for Loan Losses

The allowance for loan losses represents management's judgment as to the amount required to absorb probable 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, including pollution and contamination remediation obligations to address the current or potential detrimental effects of existing pollution by participating in pollution remediation activities such as site assessments and cleanups, 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, 2011 and 2010, there were no outstanding 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) 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 U.S. generally accepted accounting principles).

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At June 30, 2011 and 2010, the Authority's carrying amount of deposits (all of which were restricted or designated for specific purposes) was \$79,609,000 and \$48,119,000, respectively. The total of all bank balances was \$80,440,000 and \$48,589,000, respectively.

The restricted and designated cash and investments were held in trust accounts for the following activities as of June 30, 2011 (stated in thousands):

	Cash and cash equivalents	Investments	Total
Power Cost Equalization Endowment Fund	\$ 2,714	361,815	364,529
Renewable Energy Grant Fund	—	87,822	87,822
Bradley Lake Hydroelectric Project	9,300	21,014	30,314
Rural Energy Loan Funds	34,570	22,085	56,655
Rural Energy and Energy Development Programs	6,897	5,031	11,928
Funds advanced from State and federal agencies	16,722	—	16,722
Renewable Energy Grant Program	3,824	—	3,824
Power Development Fund	1,213	—	1,213
Alaska Intertie Project	4,369	—	4,369
Total cash and investments	<u>\$ 79,609</u>	<u>497,767</u>	<u>577,376</u>

The restricted and designated cash and investments were held in trust accounts for the following activities as of June 30, 2010 (stated in thousands):

	Cash and cash equivalents	Investments	Total
Power Cost Equalization Endowment Fund	\$ 16	320,697	320,713
Renewable Energy Grant Fund	—	58,392	58,392
Bradley Lake Hydroelectric Project	9,449	19,863	29,312
Rural Energy Loan Funds	7,497	18,974	26,471
Rural Energy and Energy Development Programs	2,427	13,349	15,776
Funds advanced from State and federal agencies	7,448	—	7,448
Renewable Energy Grant Program	17,652	—	17,652
Power Development Fund	2,171	—	2,171
Alaska Intertie Project	1,459	—	1,459
Total cash and investments	<u>\$ 48,119</u>	<u>431,275</u>	<u>479,394</u>

At June 30, 2011 and 2010, amounts restricted for debt service totaled \$22,370,000 and \$22,407,000, respectively, for the Bradley Lake Hydroelectric Project.

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Investment Holdings

Power Cost Equalization Endowment Fund and Renewable Energy Grant Fund – The Power Cost Equalization Endowment Fund (PCE Fund), created under Alaska Statute 42.45.070, and the Renewable Energy Grant Fund (RE Fund), created under Alaska Statute 42.45.045, are under the fiduciary authority of the State Department of Revenue, Treasury Division (Treasury). The purpose of the PCE Fund is to provide 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. The purpose of the RE Fund is to finance renewable energy projects in Alaska.

State investments are managed in pools. PCE Fund assets are held in the State's internally managed Short-term Fixed Income Pool and the Conservative Broad Market Pool (which consists solely of investments in the Broad Market and U.S. Treasury Fixed Income Pools), as well as the State's externally managed Domestic Equity account and International Equity Pool. RE Fund assets are held in the State's internally managed General Fund and Other Non-Segregated Investments Pool (GeFONSI). The GeFONSI consists of investments in the State's internally managed Short-term and Intermediate-term Fixed Income Pools. The complete financial activity of the funds is shown in the Comprehensive Annual Financial Report available from the Division of Finance in the Department of Administration.

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.

The accrual basis of accounting is used for investment income. Income in the other 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, 2011, AEA had the following cash and investments in the PCE and RE Funds (stated in thousands):

Investment type	Cash	Investments at fair value			Total
	PCE Fund	RE Fund	PCE FUND		
	Short-term fixed income pool	Short and intermediate- terms fixed income pool	Broad market and U.S. Treasuries fixed income pools	Equity	
Commercial paper	\$ 1,383	3,799	—	—	—
U.S. Treasury bonds	—	—	2,454	—	2,454
U.S. Treasury bills	2,891	7,657	—	—	—
U.S. Treasury notes	—	27,159	40,590	—	40,590
U.S. Treasury strip	—	25	—	—	—
U.S. government agency	341	2,719	3,927	—	3,927
U.S. government agency discount notes	506	1,339	971	—	971
Mortgage-backed	284	2,128	38,903	—	38,903
Other asset-backed	6,138	16,900	2,838	—	2,838
Overnight sweep account	165	437	—	—	—
Corporate bonds	6,117	23,154	21,864	—	21,864
Yankee:					
Government	—	308	1,067	—	1,067
Corporate	121	1,471	5,189	—	5,189
Domestic equity	—	—	—	177,311	177,311
International equity	—	—	—	51,411	51,411
Total invested assets	17,946	87,096	117,803	228,722	346,525
Pool related net assets (liabilities)	8	726	(15,540)	15,590	50
Other pool ownership	(15,240)	—	15,240	—	15,240
Net invested assets	\$ 2,714	87,822	117,503	244,312	361,815

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At June 30, 2010, AEA had the following cash and investments in the PCE and RE Funds (stated in thousands):

Investment type	Cash	Investments at fair value			
	PCE Fund	RE Fund	PCE FUND		
	Short-term fixed income pool	Short and intermediate- terms fixed income pool	Broad market and U.S. Treasuries fixed income pools	Equity	Total
Deposit	\$ (31)	(54)	—	57	57
Short-term Investment Fund	—	—	—	1,880	1,880
Municipal Bond	—	—	41	—	41
Commercial paper	830	1,435	—	—	—
U.S. Treasury bonds	—	—	7,516	—	7,516
U.S. Treasury bills	2,020	3,492	—	—	—
U.S. Treasury notes	—	8,891	35,139	—	35,139
U.S. Treasury when-issued	311	12,084	—	—	—
U.S. government agency	1,103	4,925	5,117	—	5,117
U.S. government agency discount notes	—	654	—	—	—
Mortgage-backed	131	1,923	44,521	—	44,521
Other asset-backed	3,648	6,353	2,544	—	2,544
Corporate bonds	7,774	17,515	25,617	—	25,617
Yankee:					
Government	—	257	1,330	—	1,330
Corporate	218	1,426	4,283	—	4,283
Domestic equity	—	—	—	127,800	127,800
International equity	—	—	—	59,605	59,605
Total invested assets	16,004	58,901	126,108	189,342	315,450
Pool related net liabilities	(32)	(509)	(11,048)	339	(10,709)
Other pool ownership	(15,956)	—	15,956	—	15,956
Net invested assets	\$ 16	58,392	131,016	189,681	320,697

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 Series.

All other AEA assets are managed by internal staff for liquidity and minimal risk. There is no AEA board approved investment policy, but 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

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- Money market funds collateralized by U.S. Treasury and agency securities.

At June 30, 2011 and 2010, the fair values of AEA's cash and investments in its other funds (stated in thousands) were:

Investment type	2011	2010
Deposits	\$ 65	288
Money market funds	76,831	54,642
GSE-Mortgage-backed securities	—	12,146
U.S. Treasury notes	27,115	13,349
Investment agreements	21,014	19,863
Total invested assets	\$ <u>125,025</u>	<u>100,288</u>

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

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 to maturity or fourteen months expected average life upon purchase. Floating rate securities are limited to three years to maturity or three years expected average life upon purchase. Treasury utilizes the actual maturity date for commercial paper and twelve-month prepay speeds for other securities. At June 30, 2011, the expected average life of individual fixed rate securities ranged from one day to one year and the expected average life of floating rate securities ranged from eight days to fourteen years. At June 30, 2010, the expected average life of individual fixed rate securities ranged from one day to twenty-nine years and the expected average life of floating rate securities ranged from one day to nine and three-quarters years.

Intermediate-Term Fixed Income Pool – Through its investment policy, Treasury manages its exposure to fair value losses arising from increasing interest rates by limiting effective duration of the Intermediate-term Fixed Income Pool to $\pm 20\%$ of the Merrill Lynch 1-5 year Government Bond Index. The effective duration for the Merrill Lynch 1-5 year Government Bond Index at June 30, 2011 was 2.54 years. The effective duration for the Merrill Lynch 1-5 year Government Bond Index at June 30, 2010 was 2.49 years.

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Broad Market and U.S. Treasury Fixed Income Pools – Through its investment policy, Treasury manages its exposure to fair value losses arising from increasing interest rates by limiting the effective duration of its other fixed income pool portfolios to the following:

Broad Market Fixed Income Pool: $\pm$ 20% of the Barclay's Capital U.S. Aggregate Bond Index. The effective duration of the Index at June 30, 2011 was 5.19 years. The effective duration of the Index at June 30, 2010 was 4.3 years.

U.S. Treasury Fixed Income Pool: $\pm$ 20% of the Barclay's Capital U.S. Aggregate Treasury Index. The effective duration of the Index at June 30, 2011 was 3.94 years. The effective duration of the Index at June 30, 2010 was 5.27 years.

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 Series. The investment contracts are collateralized.

Under the Internal Revenue Code of 1986, as amended, 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 computation.

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 investments is 2 years or less. The maximum maturity of any issue is 3 years from the date of purchase.

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

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At June 30, 2011 and 2010, the effective duration by investment type (not including the investment agreements) was as follows:

Managed by Treasury	Intermediate- term fixed income pool	Broad market fixed income pool	U.S. Treasury fixed income pool
		2011	
U.S. Treasury notes	3.09	4.74	3.89
U.S. Treasury strip	6.37	—	—
U.S. Treasury bonds	—	14.64	—
U.S. government agency	2.65	5.74	—
U.S. government agency discount notes	—	0.01	—
Mortgage-backed	1.52	3.25	—
Other asset-backed	1.08	0.97	—
Commercial Paper	0.05	—	—
Corporate bonds	2.01	5.93	—
Yankees:			
Government	1.92	6.38	—
Corporate	2.28	—	—
Portfolio effective duration	2.53	4.46	3.89
		2010	
U.S. Treasury notes	2.91	4.37	3.60
U.S. Treasury when-issued	2.73	—	—
U.S. Treasury bonds	—	9.94	8.34
U.S. government agency	1.69	4.74	4.70
U.S. government agency discount notes	0.67	—	—
Mortgage-backed	1.71	2.70	—
Other asset-backed	0.65	3.10	—
Corporate bonds	2.24	6.18	2.01
Municipal bonds	—	12.56	—
Yankees:			
Government	1.87	4.95	4.29
Corporate	2.65	5.32	—
Portfolio effective duration	2.47	4.29	3.97

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	Managed by AEA	
	2011	2010
Money market	0.07	0.07
U.S. Treasury notes	0.57	0.23
U.S. government agency and GSE discount notes	—	0.62
Portfolio effective duration	0.20	0.18

Credit Risk – Credit risk is the financial risk that an issuer or other counter party to an investment will not fulfill its obligations. Treasury’s investment policy has the following limitations with regard to credit risk:

Short-Term Fixed Income Pool – 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 P-1 or equivalent. Asset-backed and non-agency mortgage securities must be rated A3 or equivalent. The A3 rating is defined as the median rating of the following three rating agencies: Standard & Poor’s Corporation, Moody’s and Fitch. Asset-backed and non-agency mortgage securities may be purchased only if they are rated AAA.

Intermediate-Term Fixed Income Pool – Intermediate-term Fixed Income Pool investments are limited to securities with a long-term credit rating of at least Baa3 or equivalent and securities with a short-term credit rating of at least P-1 or equivalent. Asset-backed and non-agency mortgage securities must be rated investment grade. The investment grade rating is defined as the median rating of the following three rating agencies: Standard & Poor’s Corporation, Moody’s and Fitch. Asset-backed and non-agency mortgage securities may be purchased if only rated by one of these agencies if they are rated AAA.

Broad Market Fixed Income Pool – The Broad Market Fixed Income Pool investments are limited to securities with a long-term credit rating of at least Baa3 or equivalent and securities with a short-term credit rating of at least P-1 or equivalent. Asset-backed and non-agency mortgage securities must be rated investment grade. The investment grade rating is defined as the median rating of the following three rating agencies: Standard & Poor’s Corporation, Moody’s and Fitch. Asset-backed and non-agency mortgage securities may be purchased if only rated by one of these agencies if they are rated AAA.

U.S. Treasury Fixed Income Pool – In the U.S. Treasury Fixed Income Pool, commercial paper must be rated at least P-1 by Moody’s and A-1 by Standard & Poor’s Corporation. In addition, corporate, asset-backed and non-agency mortgage securities must be rated investment grade. The investment grade rating is defined as the median rating of the following three rating agencies: Standard & Poor’s Corporation, Moody’s and Fitch. In addition, asset-backed and non-agency mortgage securities may be purchased if only rated by one of these agencies if they are rated AAA. Corporate bonds may be purchased if rated by two of these agencies.

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.

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

At June 30, 2011, 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	Short-term fixed income pool	Intermediate- term fixed income pool	Broad market fixed income pool	U.S. Treasury income pool	AEA managed
Money market	AAA	—%	—%	—%	—%	61%
Commercial paper	A-1	7	—	—	—	—
Commercial paper	Not Rated	1	—	—	—	—
U.S. Treasury notes	AAA	—	62	28	100	22
U.S. Treasury bills	AAA	16	—	2	—	—
U.S. government agency	AAA	2	4	4	—	—
U.S. government agency discount notes	Not Rated	3	1	1	—	—
Mortgage-backed	AAA	1	3	19	—	—
Mortgage-backed	AA	—	—	1	—	—
Mortgage-backed	A	—	—	1	—	—
Mortgage-backed	Not Rated	—	—	16	—	—
Other asset-backed	AAA	30	1	2	—	—
Other asset-backed	Not Rated	4	—	—	—	—
Corporate bonds	AAA	24	10	2	—	—
Corporate bonds	AA	1	1	3	—	—
Corporate bonds	A	3	3	9	—	—
Corporate bonds	BBB	—	1	6	—	—
Corporate bonds	Not Rated	6	—	—	—	—
Yankees – government	AA	—	1	1	—	—
Yankees – corporate	AAA	—	1	1	—	—
Yankees – corporate	AA	1	1	1	—	—
Yankees – corporate	A	—	1	2	—	—
Yankees – corporate	BBB	—	—	1	—	—
No credit exposure		1	10	—	—	—
Investment agreements	Not Rated	—	—	—	—	17
		100%	100%	100%	100%	100%

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At June 30, 2010, 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	Short-term fixed income pool	Intermediate- term fixed income pool	Broad market fixed income pool	U.S. Treasury income pool	AEA managed
Money market	AAA	—%	—%	—%	—%	55%
Commercial paper	A-1	1	—	—	—	—
Commercial paper	Not Rated	4	—	—	—	—
U.S. Treasury notes	AAA	—	28	22	74	13
U.S. Treasury bills	AAA	13	—	—	—	—
U.S. Treasury bonds	AAA	—	—	5	10	—
U.S. Treasury When-Issued	AAA	2	36	—	—	—
U.S. government agency and GSE discount notes	AAA	1	9	4	6	—
U.S. government agency and GSE	Not Rated	6	2	—	—	12
Mortgage-backed	AAA	1	5	27	—	—
Mortgage-backed	AA	—	—	1	—	—
Mortgage-backed	Not Rated	—	1	9	—	—
Other asset-backed	AAA	21	—	2	—	—
Other asset-backed	Not Rated	1	—	—	—	—
Corporate bonds	AAA	42	7	2	9	—
Corporate bonds	AA	2	2	3	—	—
Corporate bonds	A	4	3	9	—	—
Corporate bonds	BBB	—	1	7	—	—
Corporate bonds	Not Rated	1	—	—	—	—
Yankees – government	AAA	—	—	1	—	—
Yankees – government	AA	—	1	—	1	—
Yankees – corporate	AAA	1	2	1	—	—
Yankees – corporate	AA	—	1	1	—	—
Yankees – corporate	A	—	—	1	—	—
Yankees – corporate	BBB	—	—	1	—	—
No credit exposure		—	2	4	—	—
Investment agreements	Not Rated	—	—	—	—	20
		100%	100%	100%	100%	100%

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, 2011, AEA's deposits managed by Treasury were uncollateralized and uninsured.

With respect to AEA managed investments, amounts totaling approximately \$67,531,000 at June 30, 2011 and \$45,193,000 at June 30, 2010, are held in money market funds not registered in AEA's name. The investment agreements 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 2011 and 2010, and invested assets included the following holdings at June 30, 2011 and 2010, for the PCE Fund’s investment in the International Equity Pool:

	<u>Policy</u>	<u>Actual</u>
FY11	10%+5%	14.73%
FY10	20%+5%	19.29%

At June 30, 2011 and 2010, AEA’s PCE Fund had exposure to foreign currency risk as follows (stated in thousands):

<u>Currency</u>	<u>FY11 Fair value</u>	<u>FY10 Fair value</u>
Deposits:		
Euro Currency	\$ 9	1
Japanese Yen	69	54
Danish Krone	2	—
	<u>80</u>	<u>55</u>
Investment – international equity:		
Australian Dollar	1,632	453
Canadian Dollar	821	1,238
Danish Krone	—	563
Euro Currency	11,894	10,848
Hong Kong Dollar	511	1,465
Japanese Yen	8,660	11,240
New Zealand Dollar	576	—
Norwegian Krone	355	390
Pound Sterling	12,224	13,988
Singapore Dollar	—	525
Swedish Krona	947	—
Swiss Franc	2,536	4,727
	<u>40,156</u>	<u>45,437</u>
Total	<u>\$ 40,236</u>	<u>45,492</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. However, such prohibition does not apply to securities backed by the full faith and credit of the U.S. Government. Federal National Mortgage Association 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, 2011, AEA's investments (excluding U.S. Treasury securities) included the following concentrations greater than 5% (dollar amounts stated in thousands):

Issuer	Amount	Percent
Federal National Mortgage Association	\$ 28,777	5%

At June 30, 2010, AEA's investments (excluding U.S. Treasury securities) included the following concentrations greater than 5% (dollar amounts stated in thousands):

Issuer	Amount	Percent
Federal National Mortgage Association	\$ 42,134	9%

(4) Capital Assets

Capital asset activity for the years ended June 30, 2011 and 2010 was as follows (stated in thousands):

	Balance at July 1, 2010	Additions	Deletions	Balance at June 30, 2011
Capital assets:				
Intangible	\$ 14	—	—	14
Production	253,296	953	(238)	254,011
Transmission	189,642	1	(178)	189,465
General	6,019	303	—	6,322
Total capital assets	448,971	1,257	(416)	449,812
Less accumulated depreciation for:				
Intangible	(4)	—	—	(4)
Production	(94,956)	(5,290)	238	(100,008)
Transmission	(112,424)	(4,960)	178	(117,206)
General	(5,115)	(41)	—	(5,156)
Total accumulated depreciation	(212,499)	(10,291)	416	(222,374)
Capital assets, net	\$ 236,472	(9,034)	—	227,438

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	Balance at July 1, 2009	Additions	Deletions	Balance at June 30, 2010
Capital assets:				
Intangible	\$ 14	—	—	14
Production	252,541	755	—	253,296
Transmission	188,726	916	—	189,642
General	5,995	24	—	6,019
Total capital assets	<u>447,276</u>	<u>1,695</u>	<u>—</u>	<u>448,971</u>
Less accumulated depreciation for:				
Intangible	(4)	—	—	(4)
Production	(89,678)	(5,278)	—	(94,956)
Transmission	(107,465)	(4,959)	—	(112,424)
General	(5,075)	(40)	—	(5,115)
Total accumulated depreciation	<u>(202,222)</u>	<u>(10,277)</u>	<u>—</u>	<u>(212,499)</u>
Capital assets, net	<u>\$ 245,054</u>	<u>(8,582)</u>	<u>—</u>	<u>236,472</u>

In September 2010, AEA conveyed the fully depreciated Larsen Bay Hydroelectric Project to the City of Larsen Bay.

On August 19, 2011, AEA conveyed the Napakiak Intertie assets to the Napakiak IRECINRAQ Power Corporation pursuant to the federal grant agreement that provided funding for the project. The book value of the transferred assets was \$3,131,000.

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(5) Long-Term Debt

Long-term debt activity for the years ended June 30, 2011 and 2010 was as follows (stated in thousands):

	<u>Balance at July 1, 2010</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance at June 30, 2011</u>	<u>Due within one year</u>
Bradley Lake Power					
Revenue Bonds:					
First Series (a)	\$ 100	—	—	100	—
Second Series (a)	2,305	—	(2,305)	—	—
Refunding, Third Series (a)	37,720	—	(3,810)	33,910	4,040
Refunding, Fourth Series (a)	36,895	—	(140)	36,755	2,455
Refunding, Fifth Series (a) (b)	30,640	—	(30,640)	—	—
Refunding, Sixth Series (a) (b)	—	28,800	—	28,800	—
Total bonds payable	107,660	28,800	(36,895)	99,565	6,495
Arbitrage interest payable (c)	407	211	(124)	494	—
Bond discount and deferred interest	18	2,299	(711)	1,606	—
	<u>\$ 108,085</u>	<u>31,310</u>	<u>(37,730)</u>	<u>101,665</u>	<u>6,495</u>
	<u>Balance at July 1, 2009</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance at June 30, 2010</u>	<u>Due within one year</u>
Bradley Lake Power					
Revenue Bonds:					
First Series (a)	\$ 100	—	—	100	—
Second Series (a)	4,605	—	(2,300)	2,305	2,305
Refunding, Third Series (a)	41,315	—	(3,595)	37,720	3,810
Refunding, Fourth Series (a)	37,030	—	(135)	36,895	140
Refunding, Fifth Series (a) (b)	30,640	—	—	30,640	—
Total bonds payable	113,690	—	(6,030)	107,660	6,255
Arbitrage interest payable (c)	531	233	(357)	407	122
Bond discount and deferred interest	(359)	—	377	18	—
	<u>\$ 113,862</u>	<u>233</u>	<u>(6,010)</u>	<u>108,085</u>	<u>6,377</u>

- (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,

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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, except for the Sixth Series, are further secured by bond insurance. AEA collects 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 2.5% to 6.25%.

- (b) In July 2010 the Authority issued \$28,800,000 of Power Revenue Refunding Bonds, Sixth Series, to refund and defease \$30,640,000 aggregate outstanding principal amount of the Authority's Power Revenue Refunding Bonds, Fifth Series, and to pay costs of issuing the bonds. The refunding resulted in aggregate debt service payments over the next eleven years of approximately \$3,316,000 less than the debt service payments which would have been due on the refunded bonds. There was an economic gain of approximately \$2,350,000 which is calculated as the net difference between the present value of the old debt service requirements and the present value of the new debt service requirements, discounted at the effective interest rate and adjusted for additional cash paid. The refunded bonds were called on August 2, 2010.
- (c) The arbitrage interest payable is due to the U.S. 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, as amended. 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.

The minimum payments related to all bonds for the years subsequent to June 30, 2011 are as follows (stated in thousands):

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
Year ending June 30:			
2012	\$ 6,495	5,416	11,911
2013	6,880	5,014	11,894
2014	7,300	4,589	11,889
2015	7,735	4,138	11,873
2016	8,570	3,655	12,225
2017 – 2021	51,715	10,130	61,845
2022 – 2022	10,870	292	11,162
	<u>\$ 99,565</u>	<u>33,234</u>	<u>132,799</u>

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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 requires 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, 2011, the unpaid principal balance of the notes was \$8,836,000 and the trust assets had a fair value of \$9,660,000.
- *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.

In December 2010, the Alaska Municipal Bond Bank issued bonds, the proceeds of which were used to refund and defease the Sitka Bonds. The Series 1992 bonds were defeased and \$12,900,000 remain outstanding at June 30, 2011. The Series 1997 bonds were called and redeemed in January 2011.

(6) 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, 2011 and 2010 are classified as follows (dollar amounts stated in thousands):

	2011		2010	
	No. of loans	Amount	No. of loans	Amount
Power Project Loan Program	5	\$ 1,329	42	\$ 25,635
Rural Electrification Revolving Loan Program	2	539	2	593
Bulk Fuel Revolving Loan Program	17	1,550	17	1,582
	24	3,418	61	27,810
Less allowance for loan losses		(93)		(834)
		\$ 3,325		\$ 26,976

Pursuant to legislation and an agreement, on September 30, 2010 AEA sold to AIDEA for \$20,631,000, thirty-seven (37) Power Project Fund loans with a then outstanding balance of \$24,254,000, plus accrued interest. Under the agreement, at AIDEA's request, AEA is required to repurchase any loan upon a

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payment default. As a result AEA has recognized an estimated liability equal to AIDEA's allowance for doubtful accounts on the remaining outstanding principal balance of the sold loans. On June 30, 2011, the outstanding principal balance of the loans sold was \$23,510,000, for which AEA has recognized an estimated liability of \$705,000.

Loans that are more than 90 days past due on which the accrual of interest has been discontinued amounted to \$68,842 and \$69,121 at June 30, 2011 and 2010, respectively.

An analysis of changes in the allowance for loan losses for the years ended June 30, 2011 and 2010 follows (stated in thousands):

	2011	2010
Balance at beginning of year	\$ 834	1,052
Loan sale	(727)	—
Write-offs	—	(215)
Provision for loan loss	(14)	(3)
Balance at end of year	<u>\$ 93</u>	<u>834</u>

(7) Risk Management

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

(8) Related Parties

(a) Alaska Industrial Development and Export Authority

Pursuant to understandings and agreements between AIDEA and AEA, AIDEA provides administrative, treasury, personnel, data processing, communications, and other services to AEA. During 2011 and 2010, AEA expensed \$5,678,000 and \$5,238,000, respectively, for such services. During 2011 and 2010, AEA capitalized \$14,000 and \$7,000, respectively, for such services. AEA has a borrowing arrangement with AIDEA to provide working capital funds. At June 30, 2011 and 2010, AEA had \$1,671,000 and \$1,770,000, respectively, payable to AIDEA for services and borrowings.

As discussed in note 6, during 2011, AEA sold loans to AIDEA for \$20,631,000.

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(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 would terminate in 48 months. This termination deadline has been extended to November 15, 2011, to enable AEA, the Participating Utilities, and the United States Army to complete negotiations on amendments to the Agreement. AEA management anticipates that amendments to extend the term of the Agreement will be implemented before the existing agreement terminates in November 2011.

(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.

(9) Commitments and Contingencies

AEA from time to time may be a defendant in legal proceedings and contract disputes related to the conduct of its business. 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 financial position of AEA will not be affected materially by the final outcome of any present legal proceedings or other contingent liabilities and commitments.

In the normal course of business, AEA also has various commitments, such as commitments for the extension of credit and award of grants. At June 30, 2011 and 2010, AEA had open loan commitments of \$23,516,000 and \$12,947,000, respectively. At June 30, 2011 and 2010, AEA had committed to grant awards to be funded by State appropriations and federal awards; the amounts committed were \$87,729,000 and \$117,918,000, respectively.

(10) Subsequent Event

On August 5, 2011, Standard & Poor's downgraded its long-term sovereign credit rating on U.S. issued and U.S. backed securities from AAA to AA+. If this event had occurred on or prior to June 30, 2011, then the U.S. issued and U.S. backed securities shown in note 3 at June 30, 2011 would have been reported with a rating of AA.

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Schedule of Bradley Lake Hydroelectric Project Trust Account Activities

Year ended June 30, 2011

(Stated in thousands)

	Debt service account	Capital reserve account	Renewal and contingency account	Excess earnings account	Revenue account	Operating account	Operating reserve account	Construction account	Total
Balance at July 1, 2010	\$ 9,394	12,834	2,978	178	2,150	973	805	—	29,312
Interest received	333	810	265	9	340	87	68	—	1,912
Bond principal paid	(6,255)	—	—	—	—	—	—	—	(6,255)
Bond interest paid	(5,813)	—	—	—	—	—	—	(131)	(5,944)
Reduction of capital reserve	—	(55)	—	—	—	—	—	55	—
Refunding bond proceeds	—	—	—	—	—	—	—	30,851	30,851
Bond defeasance, net	—	—	—	—	—	—	—	(30,640)	(30,640)
Arbitrage paid	—	—	—	(122)	(2)	—	—	—	(124)
Operating budget surplus paid	—	—	—	—	—	(281)	—	—	(281)
Construction expenditures	—	—	(803)	—	(543)	—	—	—	(1,346)
Operating revenue received	—	—	—	—	17,353	—	—	—	17,353
Operating expenses paid	—	—	—	—	—	(4,262)	—	—	(4,262)
Bond issuance costs paid	—	—	—	—	—	—	—	(262)	(262)
Transfers between funds	11,641	(810)	1,432	226	(17,073)	4,427	30	127	—
Balance at June 30, 2011	\$ 9,300	12,779	3,872	291	2,225	944	903	—	30,314

See accompanying independent auditors' report.

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Schedule of Projects – Balance Sheet

June 30, 2011

(Stated in thousands)

Assets	Bradley Lake Hydroelectric Project	Alaska Intertie Project	Rural Energy Projects	Administration and Power Development Fund	Rural Energy and Energy Development Programs	Combined balance
Current assets:						
Grants receivable	\$ —	—	—	(30)	1,970	1,940
Loans receivable	—	—	—	—	1,571	1,571
Operating revenue receivable	190	1,235	—	—	1,607	3,032
Due from State of Alaska	—	—	—	—	402,594	402,594
Accrued interest receivable	1,027	—	—	—	87	1,114
Total current assets	1,217	1,235	—	(30)	407,829	410,251
Noncurrent assets:						
Restricted cash and investments	22,370	—	—	—	—	22,370
Cash and investments designated for specific purposes	7,944	4,369	—	17,868	524,825	555,006
Loans receivable, net of allowance	—	—	—	—	1,754	1,754
Capital assets, net of accumulated depreciation	185,627	38,680	3,131	—	—	227,438
Total noncurrent assets	215,941	43,049	3,131	17,868	526,579	806,568
Total assets	<u>\$ 217,158</u>	<u>44,284</u>	<u>3,131</u>	<u>17,838</u>	<u>934,408</u>	<u>1,216,819</u>
Liabilities and Net Assets						
Current liabilities:						
Due (from) to State of Alaska	\$ —	(185)	—	15,911	(8,494)	7,232
Accounts payable	2,904	5,772	248	(245)	19,721	28,400
Bonds payable – current portion	6,495	—	—	—	—	6,495
Accrued interest payable	2,805	—	—	—	—	2,805
Total current liabilities	12,204	5,587	248	15,666	11,227	44,932
Noncurrent liabilities:						
Bonds payable – noncurrent portion, net	94,676	—	—	—	—	94,676
Arbitrage interest payable – noncurrent portion	494	—	—	—	—	494
Other liabilities	103	—	—	—	705	808
Total noncurrent liabilities	95,273	—	—	—	705	95,978
Total liabilities	107,477	5,587	248	15,666	11,932	140,910
Net assets:						
Invested in capital assets, net of related debt	84,456	38,680	3,131	—	—	126,267
Restricted for debt service	19,565	—	—	—	—	19,565
Restricted by agreements with external parties	5,660	17	—	—	11,406	17,083
Unrestricted	—	—	(248)	2,172	911,070	912,994
Total net assets	109,681	38,697	2,883	2,172	922,476	1,075,909
Total liabilities and net assets	<u>\$ 217,158</u>	<u>44,284</u>	<u>3,131</u>	<u>17,838</u>	<u>934,408</u>	<u>1,216,819</u>

See accompanying independent auditors' report.

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

Year ended June 30, 2011

(Stated in thousands)

	Bradley Lake Hydroelectric Project	Alaska Intertie Project	Rural Energy Projects	Administration and Power Development Fund	Rural Energy and Energy Development Programs	Combined balance
Operating revenues:						
Federal grants	\$ —	—	1	—	11,757	11,758
Revenue from operating plants	15,814	1,787	12	—	—	17,613
State of Alaska appropriations	—	259	—	—	14,386	14,645
Revenue from state agencies	—	—	—	—	2,670	2,670
Interest on loans	—	—	—	—	484	484
Other revenue	—	—	—	—	98	98
Total operating revenues	15,814	2,046	13	—	29,395	47,268
Operating expenses:						
Grants and projects	—	—	—	—	62,072	62,072
Power cost equalization grants	—	—	—	—	31,180	31,180
Depreciation	6,931	3,360	—	—	—	10,291
Interest expense	5,540	—	—	—	—	5,540
Plant operating	3,952	1,716	6	—	—	5,674
General and administrative	279	83	1	—	3,570	3,933
Provision for loan loss	—	—	—	—	(14)	(14)
Total operating expenses	16,702	5,159	7	—	96,808	118,676
Operating (loss) income	(888)	(3,113)	6	—	(67,413)	(71,408)
Nonoperating:						
Loss on sale of Power Project Fund loans	—	—	—	—	(3,850)	(3,850)
Decrease in contingent liability on sold loans	—	—	—	—	22	22
State of Alaska fund transfers	—	—	—	—	437,200	437,200
Investment income, net	1,729	1	—	—	69,167	70,897
Increase (decrease) in net assets	841	(3,112)	6	—	435,126	432,861
Net assets – beginning	108,840	41,809	2,877	2,172	487,350	643,048
Net assets – ending	\$ 109,681	38,697	2,883	2,172	922,476	1,075,909

See accompanying independent auditors' report.