

Independent Auditors' Report

The Board of Directors
Chugach Electric Association, Inc.

We have audited the accompanying balance sheets of Chugach Electric Association, Inc. (the Company) as of December 31, 2005 and 2004, and the related statements of revenue, expenses and patronage capital, and cash flows for each of the years in the three-year period ended December 31, 2005. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards as established by the Auditing Standards Board (United States) and in accordance with the auditing standards of the Public Company Accounting Oversight Board (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. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Chugach Electric Association, Inc. as of December 31, 2005 and 2004, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2005, in conformity with U.S. generally accepted accounting principles.

February 10, 2006
Anchorage, AK

Chugach Electric Association, Inc.
Balance Sheets
December 31, 2005 and 2004

<u>Assets</u>	<u>December 31, 2005</u>	<u>December 31, 2004</u>
Utility Plant:		
Electric plant in service (notes 1d, 3, 11 and 12)	\$762,859,198	\$748,484,527
Construction work in progress	32,505,401	25,278,388
Total utility plant	<u>795,364,599</u>	<u>773,762,915</u>
Less accumulated depreciation	<u>(327,384,961)</u>	<u>(305,932,001)</u>
Net utility plant	467,979,638	467,830,914
Other property and investments, at cost:		
Nonutility property	24,461	24,461
Investments in associated organizations (note 4)	11,883,053	11,768,457
Total other property and investments	<u>11,907,514</u>	<u>11,792,918</u>
Current assets:		
Cash and cash equivalents, including repurchase agreements of \$11,446,907 in 2005 and \$12,826,644 in 2004	10,650,594	10,465,004
Special deposits	216,191	217,191
Fuel cost under-recovery (note 1o)	1,781,833	0
Accounts receivable, net, less provision for doubtful accounts of \$398,321 in 2005 and \$364,261 in 2004	27,436,278	23,740,383
Materials and supplies	23,809,691	23,691,509
Prepayments	1,801,104	805,670
Other current assets	282,939	260,115
Total current assets	<u>65,978,630</u>	<u>59,179,872</u>
Deferred charges, net (notes 5 and 13)	<u>19,269,718</u>	<u>20,550,883</u>
Total assets	<u><u>\$565,135,500</u></u>	<u><u>\$559,354,587</u></u>

See accompanying notes to financial statements.

Chugach Electric Association, Inc.
Balance Sheets, Continued
December 31, 2005 and 2004

<u>Liabilities and Equities</u>	<u>December 31, 2005</u>	<u>December 31, 2004</u>
Equities and margins (notes 6 and 7):		
Memberships	\$1,250,398	\$1,202,538
Patronage capital	136,185,378	130,750,269
Other	7,603,376	7,045,992
Total equities and margins	145,039,152	138,998,799
Long-term obligations, excluding current installments (notes 8 and 9):		
2001 Series A Bond payable	150,000,000	150,000,000
2002 Series A Bond payable	120,000,000	120,000,000
2002 Series B Bond payable	41,000,000	46,200,000
National Bank for Cooperatives promissory notes payable	53,532,099	47,157,786
Total long-term obligations	364,532,099	363,357,786
Current liabilities:		
Current installments of long-term obligations (notes 8 and 9)	8,325,687	15,931,393
Accounts payable	9,598,958	7,890,172
Consumer deposits	1,980,285	1,947,511
Fuel cost over-recovery (note 1o)	0	2,714,345
Accrued interest	6,360,652	6,201,769
Salaries, wages and benefits	5,373,496	5,530,740
Fuel	18,123,139	12,919,623
Other current liabilities	3,035,915	1,416,400
Total current liabilities	52,798,132	54,551,953
Deferred credits (note 5)	2,766,117	2,446,049
Total liabilities and equities	\$565,135,500	\$559,354,587

See accompanying notes to financial statements.

Chugach Electric Association, Inc.
Statements of Revenues, Expenses and Patronage Capital
Years ended December 31, 2005, 2004 and 2003

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Operating revenues (notes 1n, 2 and 13)	\$225,697,349	\$201,246,615	\$184,032,413
Operating expenses:			
Fuel (note 13)	84,776,131	64,113,474	48,667,262
Power production	15,005,786	15,378,858	13,961,565
Purchased power	23,664,412	20,579,992	18,244,921
Transmission	5,847,648	6,526,684	4,511,002
Distribution	11,780,502	11,723,316	10,866,251
Consumer accounts	5,227,478	5,308,353	5,589,788
Administrative, general and other	20,272,291	21,719,908	26,520,189
Depreciation	<u>28,249,717</u>	<u>27,989,452</u>	<u>27,792,051</u>
Total operating expenses	194,823,965	173,340,037	156,153,029
Interest expense:			
On long-term obligations	23,384,316	21,984,371	23,110,239
On short-term obligations	46,649	0	11,901
Charged to construction-credit	<u>(844,911)</u>	<u>(492,506)</u>	<u>(411,312)</u>
Net interest expense	<u>22,586,054</u>	<u>21,491,865</u>	<u>22,710,828</u>
Net operating margins	8,287,330	6,414,713	5,168,556
Nonoperating margins:			
Interest income	560,418	453,606	325,324
Capital credits, patronage dividends and other	<u>666,983</u>	<u>734,137</u>	<u>759,240</u>
Total nonoperating margins	<u>1,227,401</u>	<u>1,187,743</u>	<u>1,084,564</u>
Assignable margins	<u>9,514,731</u>	<u>7,602,456</u>	<u>6,253,120</u>
Patronage capital at beginning of period	130,750,269	126,341,413	120,148,502
Retirement of capital credits and estate payments, including discounted capital credits transferred to other equities and margins (note 6)	<u>(4,079,622)</u>	<u>(3,193,600)</u>	<u>(60,209)</u>
Patronage capital at end of period	<u>\$136,185,378</u>	<u>\$130,750,269</u>	<u>\$126,341,413</u>

See accompanying notes to financial statements.

Chugach Electric Association, Inc.
Statements of Cash Flows
Years ended December 31, 2005, 2004 and 2003

	<u>2005</u>	<u>2004</u>	<u>2003</u>
<u>Cash flows from operating activities:</u>			
Assignable margins	\$9,514,731	\$7,602,456	\$6,253,120
Adjustments to reconcile assignable margins to net cash provided by operating activities:			
Provision for rate refund	0	0	(1,400,000)
Depreciation and amortization	30,341,574	31,586,948	33,780,103
Capitalized interest	(993,499)	(571,013)	(487,359)
Impairment of long-lived asset	0	0	1,846,816
Property (gains) losses, net	57,202	(11,190)	(80,061)
Write-off of deferred charges	0	217,665	1,088,260
Investments in associated organizations	(114,596)	(386,661)	(418,081)
Changes in assets and liabilities:			
(Increase) decrease in assets:			
Accounts receivable	(3,695,895)	(4,928,184)	7,598,064
Fuel cost under-recovery	(1,781,833)	2,032,730	(2,032,730)
Materials and supplies	(118,182)	(1,802,715)	1,858,796
Prepayments	(995,434)	652,979	494,702
Special deposits/other	(21,824)	102,122	(20,468)
Deferred charges	(810,692)	(854,481)	(1,887,037)
Increase (decrease) in liabilities:			
Accounts payable	1,114,809	213,266	(43,068)
Provision for rate refund	0	(671,071)	(4,978,929)
Consumer deposits	32,774	112,759	8,487
Fuel cost over-recovery	(2,714,345)	2,714,345	(363,862)
Accrued interest	158,883	35,979	(215,316)
Salaries, wages and benefits	(157,244)	644,140	(90,994)
Fuel	5,203,516	3,912,865	1,911,356
Other liabilities	2,213,492	630,640	(1,242,178)
Deferred credits	(143,138)	(92,314)	(210,681)
Net cash provided by operating activities	37,090,299	41,141,265	41,368,940
<u>Investing activities:</u>			
Extension and replacement of plant	(27,462,144)	(27,810,212)	(26,526,858)
Net cash used in investing activities	(27,462,144)	(27,810,212)	(26,526,858)
<u>Financing activities:</u>			
Net transfer of restricted construction funds	0	488,846	110,018
Repayments of long-term obligations	(6,431,393)	(10,545,000)	(5,165,821)
Repayments of short-term borrowings	0	0	(6,081,250)
Memberships and donations received	605,244	373,821	545,316
Retirement of patronage capital and estate payments	(4,079,622)	(3,193,600)	(60,209)
Net receipts of consumer advances for construction	463,206	(1,175,202)	(289,342)
Net cash used in financing activities	(9,442,565)	(14,051,135)	(10,941,288)
Net changes in cash and cash equivalents	185,590	(720,082)	3,900,794
Cash and cash equivalents at beginning of period	\$10,465,004	\$11,185,086	\$7,284,292
Cash and cash equivalents at end of period	<u>\$10,650,594</u>	<u>\$10,465,004</u>	<u>\$11,185,086</u>
Supplemental disclosure of cash flow information - interest expense paid, excluding amounts capitalized	\$22,427,171	\$21,354,036	\$23,076,144

See accompanying notes to financial statements.

Chugach Electric Association, Inc.
Notes to Financial Statements
December 31, 2005 and 2004

(1) Description of Business and Significant Accounting Policies

a. Description of Business

Chugach Electric Association, Inc., (Chugach) is the largest electric utility in Alaska. Chugach is engaged in the generation, transmission and distribution of electricity to directly serve retail customers in the Anchorage and upper Kenai Peninsula areas. Through an interconnected regional electrical system, Chugach's power flows throughout Alaska's Railbelt, a 400-mile-long area stretching from the coastline of the southern Kenai Peninsula to the interior of the state, including Alaska's largest cities, Anchorage and Fairbanks.

Chugach also supplies much of the power requirements of three wholesale customers, Matanuska Electric Association, Inc. (MEA), Homer Electric Association, Inc. (HEA) and the City of Seward (Seward). Chugach's members are the consumers of the electricity sold.

Chugach operates on a not-for-profit basis and, accordingly, seeks only to generate revenues sufficient to pay operating and maintenance costs, the cost of purchased power, capital expenditures, depreciation, and principal and interest on all indebtedness and to provide for reasonable margins and reserves. Chugach is subject to the regulatory authority of the Regulatory Commission of Alaska (RCA).

b. Management Estimates

In preparing the financial statements, management of Chugach is required to make estimates and assumptions relating to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities as of the date of the balance sheet and revenues and expenses for the reporting period. Critical estimates include the provision for rate refund and allowance for doubtful accounts. Actual results could differ from those estimates.

c. Regulation

The accounting records of Chugach conform to the Uniform System of Accounts as prescribed by the Federal Energy Regulatory Commission (FERC). Chugach meets the criteria, and accordingly, follows the accounting and reporting requirements of Statement of Financial Accounting Standards (SFAS) No. 71, *Accounting for the Effects of Certain Types of Regulation (SFAS 71)*.

Chugach Electric Association, Inc.
Notes to Financial Statements
December 31, 2005 and 2004

(1) Description of Business and Significant Accounting Policies (continued)

d. Utility Plant and Depreciation

Additions to electric plant in service are recorded at original cost of contracted services, direct labor and materials, indirect overhead charges and capitalized interest. For property replaced or retired, the average unit cost of the property unit, plus removal cost, less salvage, is charged to accumulated provision for depreciation. The cost of replacement is added to electric plant. Renewals and betterments are capitalized, while maintenance and repairs are charged to expense as incurred. In accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets (SFAS 144)*, utility plant is reviewed for impairment whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of are separately presented in the balance sheet and reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated. The assets and liabilities of a disposed group classified as held for sale are presented separately in the appropriate asset and liability section of the balance sheet. During the second quarter of 2003, Chugach entered into a plan to take a generation asset out of service. The asset was physically abandoned in September of 2003. In accordance with SFAS 144, paragraph 28, Chugach adjusted the remaining depreciable life of the asset. Chugach determined the depreciation that would have been recorded in the third quarter of 2003 was immaterial, therefore Chugach committed to a plan to abandon the asset. The value of that asset was reduced by \$1,846,816 to its estimated salvage value. This amount is included in the 2003 Statement of Revenues, Expenses and Patronage Capital, "Administrative, general and other," category.

Depreciation and amortization rates have been applied on a straight-line basis and at December 31 are as follows:

	Annual Depreciation Rate Ranges					
	<u>2005</u>			<u>2002 - 2004</u>		
Steam production plant	2.55%	-	3.24%	2.55%	-	2.80%
Hydraulic production plant	1.63%	-	2.94%	0.04%	-	1.56%
Other production plant	3.32%	-	9.81%	2.67%	-	7.62%
Transmission plant	1.72%	-	5.26%	1.50%	-	4.24%
Distribution plant	2.10%	-	9.98%	2.13%	-	9.22%
General plant	2.23%	-	27.25%	2.21%	-	20.40%
Other	2.75%	-	2.75%	2.35%	-	2.75%

Chugach Electric Association, Inc.
Notes to Financial Statements
December 31, 2005 and 2004

(1) Description of Business and Significant Accounting Policies (continued)

Chugach uses remaining life rates set forth in the most recent depreciation study. In 2003 an update of the 1999 Depreciation Study was completed utilizing Electric Plant in Service balances as of December 31, 2002. In an order dated January 10, 2006, the RCA approved the study with certain changes to the proposed depreciation rates and allowed Chugach to revise its depreciation rates effective January 1, 2005 to reflect the new depreciation rates. The impact on Chugach's financial statements to depreciation expense was a decrease of \$1.0 million.

e. Capitalized Interest

Allowance for funds used during construction (AFUDC) and interest charged to construction - credit (IDC) are the estimated costs during the period of construction of equity and borrowed funds. Chugach capitalized such funds at the weighted average rate (adjusted monthly) of 5.0% during 2005, 4.6% during 2004 and 4.8% during 2003.

f. Investments in Associated Organizations

Investments in associated organizations represent capital requirements as part of financing arrangements. These investments are non-marketable and accounted for at cost.

g. Fair Value of Financial Instruments

SFAS No. 107, *Disclosures About the Fair Value of Financial Instruments (SFAS 107)*, requires disclosure of the fair value of certain on and off balance sheet financial instruments for which it is practicable to estimate that value. The following methods are used to estimate the fair value of financial instruments:

Cash and cash equivalents and restricted cash - the carrying amount approximates fair value because of the short maturity of those instruments.

Investments in associated organizations - the carrying amount approximates fair value because of limited marketability and the nature of the investments.

Consumer deposits - the carrying amount approximates fair value because of the short refunding term.

Long-term obligations - the fair value is estimated based on the quoted market price for same or similar issues (notes 8 and 9).

Chugach Electric Association, Inc.
Notes to Financial Statements
December 31, 2005 and 2004

(1) Description of Business and Significant Accounting Policies (continued)

h. Financial Instruments and Hedging

Chugach used U.S. Treasury forward rate lock agreements to hedge expected interest rates on the February 2002 debt re-financings. Chugach accounted for the agreements under SFAS 133. For rate-making purposes, Chugach did not adjust rates for gains and losses prior to settlement, and the loss on settlement will be an adjustment to rates over the lives of the associated debt. This rate-making treatment was approved by the RCA in Order U-01-108(26). See note 2, "Regulatory Matters." Accordingly, the unrealized loss was not recorded and was treated as a regulatory asset upon settlement (note 5). At December 31, 2005, the regulatory asset associated with the rate lock agreements was \$3.4 million.

i. Cash and Cash Equivalents

For purposes of the statement of cash flows, Chugach considers all highly liquid debt instruments with a maturity of three months or less upon acquisition by Chugach (excluding restricted cash and investments) to be cash equivalents.

j. Accounts Receivable

Trade accounts receivable are recorded at the invoiced amount. The allowance for doubtful accounts is management's best estimate of the amount of probable credit losses in existing accounts receivable. Chugach determines the allowance based on its historical write-off experience and current economic conditions. Chugach reviews its allowance for doubtful accounts monthly. Past due balances over 90 days in a specified amount are reviewed individually for collectibility. All other balances are reviewed in aggregate. Account balances are charged off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote. Chugach does not have any off-balance-sheet credit exposure related to its customers.

k. Materials and Supplies

Materials and supplies are stated at average cost.

l. Deferred Charges and Credits

In accordance with SFAS 71, Chugach's financial statements reflect regulatory assets and liabilities. Continued accounting under SFAS 71 requires that certain criteria be met. Management believes Chugach's operations currently satisfy these criteria. However, if events or circumstances should change so the criteria are not met, the write off of regulatory assets and liabilities could have a material effect on the financial position and results of operations. Deferred charges, representing regulatory assets, are amortized to operating expense over the period allowed for rate-making purposes.

Chugach Electric Association, Inc.
Notes to Financial Statements
December 31, 2005 and 2004

(1) **Description of Business and Significant Accounting Policies (continued)**

Deferred credits, representing regulatory liabilities, are amortized to operating expense over the period allowed for rate-making purposes. It also includes nonrefundable contributions in aid of construction, which are credited to the associated cost of construction of property units. Refundable contributions in aid of construction are held in deferred credits pending their return or other disposition.

m. Patronage Capital

Revenues in excess of current period costs (net operating margins and nonoperating margins) in any year are designated on Chugach's statement of revenues and expenses as assignable margins. These excess amounts (i.e. assignable margins) are considered capital furnished by the members, and are credited to their accounts and held by Chugach until such future time as they are retired and returned without interest at the discretion of the Board of Directors. Retained assignable margins are designated on Chugach's balance sheet as patronage capital. This patronage capital constitutes the principal equity of Chugach. The Board of Directors may also return capital credits to former members and estates who request early retirements at discounted rates under a discounted capital credits retirement plan authorized by the Board in September 2002.

n. Operating Revenues

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Revenues are recognized upon delivery of electricity. Operating revenues are based on billing rates authorized by the RCA, which are applied to customers' usage of electricity. Chugach's rates are established, in part, on test period sales levels that reflect actual operating results. Included in operating revenue are billings rendered to customers adjusted for differences in meter read dates from year to year to insure the recognition of a full year's revenue. Chugach accrued \$6,231,072 and \$5,675,996 of unbilled retail revenue at December 31, 2005 and 2004, respectively. Wholesale revenue is recorded from metered locations, so no accrual is made. Chugach's tariffs include provisions for the flow through of gas costs according to existing gas supply contracts, as well as purchased power costs.

o. Fuel and Purchased Power Costs

The expenses associated with electric services include fuel used to generate electricity and power purchased from others. These costs are recognized in the month incurred, both on an expense and revenue basis. Actual fuel and purchased power used is included in revenue to directly offset the actual fuel expense in the month it was incurred. Chugach is authorized by the RCA to recover fuel and purchased power costs through the fuel surcharge mechanism, which is adjusted quarterly to reflect increases and decreases of such costs. Revenues are adjusted for differences between recoverable fuel costs and amounts actually recovered through rates. Fuel costs were under-recovered by \$1.8 million in 2005, over-recovered by \$2.7 million in 2004 and under-recovered by \$2.0 million in 2003. Total fuel and purchased power costs in 2005, 2004 and 2003 were approximately \$108 million, \$85 and \$67 million, respectively.

Chugach Electric Association, Inc.
Notes to Financial Statements
December 31, 2005 and 2004

(1) Description of Business and Significant Accounting Policies (continued)

p. Environmental Remediation Costs

Chugach accrues for losses and establishes a liability associated with environmental remediation obligations when such losses are probable and can be reasonably estimated. Such accruals are adjusted as further information develops or circumstances change. Estimates of future costs for environmental remediation obligations are not discounted to their present value. However, various remediation costs may be recoverable through rates and accounted for as a regulatory asset.

q. Income Taxes

Chugach is exempt from federal income taxes under the provisions of Section 501(c)(12) of the Internal Revenue Code, except for unrelated business income. For the years ended December 31, 2005, 2004 and 2003, Chugach received no unrelated business income.

r. Reclassifications

Certain reclassifications, which have no effect on assignable margins, have been made to the 2003 and 2004 financial statements to conform to the 2005 presentation.

s. New Accounting Pronouncements

FASB Interpretation No. 47 (FIN 47) "Accounting for Conditional Asset Retirement Obligations"

In March, 2005, the FASB issued FASB Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations* (FIN 47). FIN 47, effective for fiscal years ending after December 15, 2005, is an interpretation of FASB Statement No. 143, *Accounting for Asset Retirement Obligations* (Statement 143). FIN 47 Interpretation clarifies that conditional obligations meet the definition of an asset-retirement obligation in Statement 143 and therefore should be recognized if their fair value is reasonably estimable. It also provides additional guidance to evaluate whether fair value is reasonably estimable. Chugach evaluated the provisions of FIN 47 and implemented the Interpretation effective January 1, 2005. The implementation of the statement had no significant impact on the financial statements.

SEAS 154 "Accounting Changes and Error Corrections"

This statement replaces Accounting Principles Board (APB) Opinion No. 20, *"Accounting Changes"* and FASB Statement No. 3, *"Reporting Changes in Interim Financial Statements,"* and establishes, unless impracticable, retrospective application as the required method for reporting a change in accounting principle in the absence of explicit transition

Chugach Electric Association, Inc.
Notes to Financial Statements
December 31, 2005 and 2004

(1) Description of Business and Significant Accounting Policies (continued)

requirements specific to the newly adopted accounting principle. It applies to all voluntary changes in accounting principle, and to changes required by an accounting pronouncement in the unusual instance that the pronouncement does not include specific transition provisions. When a pronouncement includes specific transition provisions, those provisions should be followed. This Statement is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. Chugach will implement the Statement effective January 1, 2006.

SFAS 153 “Exchanges of Nonmonetary Assets”

This Statement addresses the measurement of exchanges of nonmonetary assets. It eliminates the exception from fair value measurement for nonmonetary exchanges of similar productive assets in APB Opinion No. 29, “*Accounting for Nonmonetary Transactions*,” and replaces it with an exception for exchanges that do not have commercial substance. This Statement specifies that a nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. The provisions of this Statement are effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. Chugach implemented the statement effective July 1, 2005. The implementation of the statement had no significant impact on the financial statements.

SFAS 150 “Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity”

In May 2003, the Financial Accounting Standards Board (FASB) issued SFAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity (SFAS 150)*. This Statement establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. Many of those instruments were previously classified as equity. Some of the provisions of this Statement are consistent with the current definition of liabilities in FASB Concepts Statement No. 6, *Elements of Financial Statements*. The remaining provisions of this Statement are consistent with FASB's proposal to revise that definition to encompass certain obligations that a reporting entity can or must settle by issuing its own equity shares depending on the nature of the relationship established between the holder and the issuer. While FASB still plans to revise that definition through an amendment to Concepts Statement 6, FASB decided to defer issuing that amendment until it has concluded its deliberations on the next phase of this project. That next phase will deal with certain compound financial instruments including puttable shares, convertible bonds, and dual-indexed financial instruments. Chugach implemented SFAS 150 effective January 1, 2004. The impact of this statement on its financial statements was immaterial.

Chugach Electric Association, Inc.
Notes to Financial Statements
December 31, 2005 and 2004

(2) **Regulatory Matters**

Docket U-01-108

Chugach filed a general rate case on July 10, 2001, based on the 2000 test year and subsequently implemented interim and refundable rate increases as approved by the RCA. In an updated filing on April 15, 2002, Chugach reduced its base rate increase request from 6.5% to 5.7%. Three wholesale customers and the Public Advocacy staff of the RCA participated in the rate case.

Order No. 26

On February 6, 2003, Chugach received Order U-01-108(26) (Order 26) from the RCA, which required a refund of revenues collected in 2001 and 2002 of approximately \$7.1 million, which resulted in a net operating loss of approximately \$2 million in 2002. Under the Order, Chugach's financial performance for 2002 fell below the 1.10 level contained in the Rate Covenants in its currently effective indenture, the Amended and Restated Indenture, the CoBank Master Loan Agreement and the MBIA Insurance Corporation's (MBIA) Reimbursement and Indemnity Agreement. (note 8)

In accordance with the Rate Covenant in the Amended and Restated Indenture, on February 13, 2003, Chugach filed a Motion with the RCA asking the RCA to stay the effect of Order 26 until after the RCA considered Chugach's Petition for Reconsideration. On February 18, 2003, the RCA granted, in part, Chugach's motion for stay. Chugach filed the Petition for Reconsideration with the RCA on February 28, 2003.

Order No. 30

On April 14, 2003, the RCA issued Order No. 30 in Docket U-01-108, significantly revising its earlier ruling. On April 28, 2003, Chugach submitted a revised revenue requirement and cost of service study in compliance with RCA Order No. 30. This order increased Chugach's revenue requirement by \$3.1 million and adjusted the required refund from \$7.1 million to \$1.9 million.

Order No. 33

On August 26, 2003, the RCA issued Order No. 33 and accepted, in part, Chugach's April 28, 2003, compliance filing.

Chugach Electric Association, Inc.
Notes to Financial Statements
December 31, 2005 and 2004

(2) **Regulatory Matters (continued)**

Order No. 36

Effective November 7, 2003, the RCA approved Chugach's compliance filing to Order 33 and final rates in this docket. As a result, and in relation to prior-approved permanent rates, Chugach's rates on a system basis increased 0.07 percent, or an increase of 3.5 percent to retail customers and a decrease of 7.9 percent to wholesale customers.

The results of the RCA's decision on final rates were implemented on November 10, 2003.

Appeal of RCA Orders

Chugach filed a timely appeal of RCA Orders Nos. 26, 30 and 33 to the Alaska Superior Court. In a November 25, 2004, decision, the Alaska Superior Court upheld all decisions of the RCA.

Provision For Rate Refund

At December 31, 2002, Chugach recorded a provision for rate refund of \$7.1 million. On April 15, 2003, the RCA issued Order No. 30 in Docket U-01-108, significantly revising its earlier ruling in which \$5.2 million of that provision was reversed. Between March and November of 2003, additional provisions were recorded in the amount of \$3.8 million reflecting RCA decisions through Order No. 30, in addition to RCA orders that continued through the period. In October and November of 2003, Chugach's wholesale customers were refunded \$5.0 million. Between March 19 and April 19, 2004, Chugach issued refunds totaling \$0.6 million to its Small General Service class for customer bills rendered between January 31 and November 10, 2003.

Docket No. U-04-102 (Revision to Current Depreciation Rates)

In 2004, Chugach implemented new depreciation rates based on an update of the 1999 Depreciation Study utilizing Electric Plant in Service balances as of December 31, 2002. The 2002 Depreciation Study resulted in a net impact on 2004 depreciation expense of approximately \$259 thousand, which, in aggregate, was not material to the financial statements. The 2002 Depreciation Study was submitted to the RCA for approval on November 19, 2004, resulting in the RCA opening a docket to review the proposed new rates, however, Chugach implemented the new rates effective January 1, 2004. Chugach did not request a change in electric rates charged to customers based on the proposed revisions to depreciation rates.

Order No. 2

On March 9, 2005, the RCA ruled in Order No. 2 that depreciation rates may not be implemented without prior approval of the RCA. On August 8, 2005, Chugach filed a motion proposing an alternate implementation plan.

Chugach Electric Association, Inc.
Notes to Financial Statements
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(2) **Regulatory Matters (continued)**

Order No. 8

On September 21, 2005, the RCA issued Order No. 8 denying our motion and granting a motion filed by a wholesale customer of Chugach to enforce Order No. 2. Order No. 8 required that Chugach adjust its underlying 2004 financial records to reflect the results as if Chugach had not implemented unapproved rates. In November of 2005, Chugach reversed the 2004 depreciation expense and depreciation reserves that were previously recorded using the 2002 Depreciation Study rates and calculated 2004 depreciation expense for all categories of plant using the 1999 Depreciation Study rates as approved by the RCA in Docket U-01-108. The adjustment was not material to Chugach's financial statements.

Order No. 9

In Order No. 9 dated January 10, 2006, the RCA ruled substantially in Chugach's favor approving the 2002 Depreciation Study with certain changes to the proposed depreciation rates. The main effect of this decision is to allow Chugach to revise its depreciation rates effective as of January 1, 2005, to reflect new depreciation rates. In comparison to the old depreciation rates resulting from the last rate case (U-01-108), implementation of Order No. 9 increased depreciation expense for Generation & Transmission (G&T) plant of approximately \$2.2 million, decreased depreciation expense for Distribution plant of approximately \$1.2 million and decreased depreciation expense for General Plant of approximately \$2.0 million. The overall impact to Chugach is an estimated decrease in annual depreciation expense of \$1.0 million. No issues were raised in relation to the proposed Distribution depreciation adjustments. Because Chugach did not request changes to the electric rates charged to our customers based on the proposed new depreciation rates, there is no immediate electric rate impact. Wholesale customers MEA and HEA were active in the proceeding. MEA filed a motion for reconsideration of the effective date of January 1, 2005, for the changes to depreciation rates based on the RCA's ruling. Management is uncertain of the outcome of the reconsideration.

Chugach Electric Association, Inc.
Notes to Financial Statements
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(3) Utility Plant

Major classes of electric plant as of December 31 are as follows:

	<u>2005</u>	<u>2004</u>
Electric plant in service:		
Steam production plant	\$60,462,671	\$60,462,671
Hydraulic production plant	20,241,725	18,180,685
Other production plant	132,990,991	134,495,475
Transmission plant	226,544,759	222,483,924
Distribution plant	219,597,822	213,119,035
General plant	52,606,167	53,678,686
Unclassified electric plant in service	43,651,171	39,300,159
Other	<u>6,763,892</u>	<u>6,763,892</u>
Total electric plant in service	762,859,198	748,484,527
Construction work in progress	<u>32,505,401</u>	<u>25,278,388</u>
Total electric plant in service and construction work in progress	<u>\$795,364,599</u>	<u>\$773,762,915</u>

Unclassified electric plant in service consists of complete unclassified of general plant, generation, transmission and distribution projects. Depreciation of unclassified electric plant in service has been included in functional plant depreciation accounts in accordance with the anticipated eventual classification of the plant investment.

(4) Investments in Associated Organizations

Investments in associated organizations, which are non-marketable and accounted for at cost, include the following at December 31:

	<u>2005</u>	<u>2004</u>
National Rural Utilities Cooperative Finance Corporation (NRUCFC)	\$6,095,980	\$6,095,980
National Bank for Cooperatives (CoBank)	5,628,192	5,513,192
NRUCFC capital term certificates	41,677	42,662
Other	<u>117,204</u>	<u>116,623</u>
Total Investments in Associated Organizations	<u>\$11,883,053</u>	<u>\$11,768,457</u>

Chugach Electric Association, Inc.
Notes to Financial Statements
December 31, 2005 and 2004

(4) Investments in Associated Organizations (continued)

The Farm Credit Administration, CoBank's federal regulators, requires minimum capital adequacy standards for all Farm Credit System institutions. CoBank's loan agreements require, as a condition of the extension of credit, that an equity ownership position be established by all borrowers. Chugach's investment in NRUCFC similarly was required by Chugach's financing arrangements with NRUCFC.

(5) Deferred Charges and Credits

Deferred Charges

Deferred charges, or regulatory assets, net of amortization, consisted of the following at December 31:

	<u>2005</u>	<u>2004</u>
Debt issuance and reacquisition costs	\$9,392,807	\$10,981,260
Refurbishment of transmission equipment	206,791	216,050
Computer software and conversion	330,946	740,771
Studies	5,758,382	4,646,181
Business venture studies	171,378	172,578
Fuel supply negotiations	233,314	256,030
Major overhaul of steam generating unit	1,503,192	1,895,329
Environmental matters and other	149,879	74,304
Other regulatory deferred charges	<u>1,523,029</u>	<u>1,568,380</u>
Total deferred charges	<u>\$19,269,718</u>	<u>\$20,550,883</u>

At December 31, 2005 and 2004, \$6.4 million and \$5.6 million, respectively, of total deferred charges represent regulatory assets in progress and are not currently being amortized, however, Chugach expects recovery, as well as a recovery period determination in the future. The majority of these charges represent costs associated with the Cooper Lake Power Plant FERC re-licensing effort. Over/under recovered fuel costs is not included in Deferred Charges or Deferred Credits.

Chugach Electric Association, Inc.
Notes to Financial Statements
December 31, 2005 and 2004

(5) Deferred Charges and Credits (continued)

Deferred Credits

Deferred credits, or regulatory liabilities, at December 31 consisted of the following:

	<u>2005</u>	<u>2004</u>
Refundable consumer advances for construction	1,816,275	\$1,353,069
Estimated initial installation costs for transformers and meters	436,786	387,336
Post retirement benefit obligation	480,900	480,900
Other	<u>32,156</u>	<u>224,744</u>
Total deferred credits	<u>\$2,766,117</u>	<u>\$2,446,049</u>

(6) Patronage Capital

Chugach has an approved capital credit retirement policy, which is contained in the Chugach Financial Management Plan. This establishes, in general, a plan to return the capital credits of wholesale and retail customers based on the members' proportionate contribution to Chugach's assignable margins on an approximately 15-year rotation. At December 31, 2005, Chugach had assigned \$120,255,933 of patronage capital (net of capital credit retirements). Approval of actual capital credit retirements is at the discretion of Chugach's Board of Directors. Chugach records a liability when the retirements are approved by the Board of Directors. The Amended and Restated Indenture prohibits Chugach from making any distribution of patronage capital to Chugach's customers if an event of default under the Amended and Restated Indenture exists. (note 8)

In 2003, the Board of Directors was unable to authorize a capital credit retirement due to covenant restrictions contained in the Amended and Restated Indenture of Trust. (note 8)

Chugach Electric Association, Inc.
Notes to Financial Statements
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(6) Patronage Capital (continued)

In November 2004, the Board of Directors authorized the retirement of \$3,126,560 of retail patronage for 1985 and 1986.

In December 2004, the Board of Directors authorized \$125,000 for capital credit payments to those former members and estates who have requested early retirements at discounted rates under the discounted capital credit retirement plan authorized by the Board in September 2002.

In December 2004, the Board of Directors authorized \$500,000 for capital credit payments to be distributed during 2005 under the discounted capital credit retirement plan.

In December 2005, the Board of Directors authorized the retirement of \$3,801,228 of retail patronage for 1986 and 1987.

In 2005, the retirement of \$3,801,228 included discounted estate payments in the amount of \$394,520. In addition, Chugach retained \$282,479, which represented discounted capital credits transferred to other equities and margins under the discounted capital credit retirement program.

In 2004, the retirement of \$3,126,560 included discounted estate payments in the amount of \$55,639. In addition, Chugach retained \$65,990, which represented discounted capital credits transferred to other equities and margins under the discounted capital credit retirement program.

Estate payments in the amount of \$60,209 were made in 2003.

The discount rate for discounted payments, including discounted estate payments in 2005 and 2004 was 9.20%.

Following is a five-year summary of anticipated capital credit retirements:

<u>Year ending</u> <u>December 31,</u>	<u>Total</u>
2006	\$ 3,900,000
2007	\$ 6,000,000
2008	\$ 5,500,000
2009	\$ 5,000,000
2010	\$ 3,500,000

Chugach Electric Association, Inc.
Notes to Financial Statements
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(7) Other Equities

A summary of other equities at December 31 follows:

	<u>2005</u>	<u>2004</u>
Nonoperating margins, prior to 1967	\$23,625	\$23,625
Donated capital	532,103	249,624
Unclaimed capital credit retirement*	<u>7,047,648</u>	<u>6,772,743</u>
Total other equities	<u>\$7,603,376</u>	<u>\$7,045,992</u>

* Represents unclaimed capital credits that have met all requirements of section 34.45.200 of Alaska's unclaimed property law and has therefore reverted to Chugach

(8) Debt

Long-term obligations at December 31 are as follows:

	<u>2005</u>	<u>2004</u>
CoBank 7.76% fixed rate note maturing in 2005, with interest payable monthly; unsecured	\$0	\$10,000,000
CoBank 5.50% fixed rate note maturing in 2010, with interest payable monthly; unsecured	\$9,500,000	\$0
CoBank 5.96% variable rate notes maturing in 2022, with interest payable monthly and principal due annually beginning in 2003; unsecured	42,157,786	43,189,179
CoBank 5.96% variable rate note, with interest payable monthly and principal due in 2007; unsecured	5,000,000	5,000,000
2001 Series A Bond of 6.55%, maturing in 2011, with interest payable semi-annually March 15 and September 15; unsecured	150,000,000	150,000,000
2002 Series A Bond of 6.20%, maturing in 2012, with interest payable semi-annually February 1 and August 1; unsecured	120,000,000	120,000,000
2002 Series B Bond of a rate set for 28-day auction periods, maturing in 2012, with interest payable monthly and principal due annually; unsecured	<u>46,200,000</u>	<u>51,100,000</u>
Total long-term obligations	372,857,786	379,289,179
Less current installments	<u>8,325,687</u>	<u>15,931,393</u>
Long-term obligations, excluding current installments	<u>\$364,532,099</u>	<u>\$363,357,786</u>

Chugach Electric Association, Inc.
Notes to Financial Statements
December 31, 2005 and 2004

(8) Debt (continued)

Covenants

Chugach is required to comply with all covenants set forth in the Amended and Restated Indenture, dated April 1, 2001, which became effective January 22, 2003. The indenture initially governing the outstanding bonds of Chugach, 2001 Series A, 2002 Series A and 2002 Series B, provided that the bonds were secured by a mortgage on substantially all of Chugach's assets so long as any amounts remained outstanding to CoBank on bonds issued under the indenture. Upon the retirement of the bonds issued to CoBank, Chugach's outstanding bonds became subject to the Amended and Restated Indenture pursuant to which the bonds became unsecured obligations of Chugach.

Chugach is also required to comply with the Master Loan Agreement between Chugach and CoBank dated December 27, 2002, pursuant to which CoBank and Chugach replaced the bonds issued to CoBank with unsecured promissory notes not governed by the indenture. CoBank returned the old CoBank bonds to Chugach on January 22, 2003. The CoBank Master Loan Agreement requires Chugach to establish and collect rates reasonably expected to yield margins for interest equal to at least 1.10 times interest expense.

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Security

Substantially all assets were pledged as collateral for the long-term obligations until retirement of the 1991 Series A Bonds and subsequent institution of the Amended and Restated Indenture. On January 22, 2003, the Bonds became general unsecured and unsubordinated obligations. Under the Amended and Restated Indenture, Chugach is prohibited from creating or permitting to exist any mortgage, lien, pledge, security interest or encumbrance on Chugach's properties and assets (other than those arising by operation of law) to secure the repayment of borrowed money or the obligation to pay the deferred purchase price of property unless Chugach equally and ratably secure all bonds subject to the Amended and Restated Indenture, except that Chugach may incur secured indebtedness in an amount not to exceed \$5 million or enter into sale and leaseback or similar agreements.

Chugach Electric Association, Inc.
Notes to Financial Statements
December 31, 2005 and 2004

(8) Debt (continued)

Rate

The Amended and Restated Indenture requires Chugach, subject to any necessary regulatory approval, to establish and collect rates reasonably expected to yield margins for interest equal to at least 1.10 times total interest expense. The CoBank Master Loan Agreement also requires Chugach to establish and collect rates reasonably expected to yield margins for interest equal to at least 1.10 times interest expense. Margins for interest generally consist of Chugach's assignable margins plus total interest expense. If there occurs any material change in the circumstances contemplated at the time rates were most recently reviewed, the Amended and Restated Indenture requires Chugach to seek appropriate adjustments to those rates so that they would generate revenues reasonably expected to yield margins for interest equal to at least 1.10 times interest charges.

Distributions to Members

The Amended and Restated Indenture prohibits Chugach from making any distribution of patronage capital to Chugach's customers if an event of default under the Amended and Restated Indenture exists. Otherwise, Chugach may make distributions to Chugach's members in each year equal to the lesser of 5% of Chugach's patronage capital or 50% of assignable margins for the prior fiscal year. This restriction does not apply if, after the distribution, Chugach's aggregate equities and margins as of the end of the immediately preceding fiscal quarter are equal to at least 30% of Chugach's total liabilities and equities and margins.

Chugach Electric Association, Inc.
Notes to Financial Statements
December 31, 2005 and 2004

(8) Debt (continued)

Maturities of Long-term Obligations

Long-term obligations at December 31, 2005, mature as follows:

Year ending December 31	Sinking Fund Requirements	Sinking Fund Requirements	Sinking Fund Requirements	Principal Maturities	Total
	2001 Series A Bonds	2002 Series A Bonds	2002 Series B Bonds	CoBank Promissory Notes	
2006	0	0	5,200,000	3,125,687	8,325,687
2007	0	0	5,500,000	8,228,569	13,728,569
2008	0	0	5,900,000	3,340,725	9,240,725
2009	0	0	6,300,000	3,463,358	9,763,358
2010	0	0	6,700,000	3,097,157	9,797,157
Thereafter	<u>150,000,000</u>	<u>120,000,000</u>	<u>16,600,000</u>	<u>35,402,290</u>	<u>322,002,290</u>
	<u>\$150,000,000</u>	<u>\$120,000,000</u>	<u>\$46,200,000</u>	<u>\$56,657,786</u>	<u>\$372,857,786</u>

Short-term obligations

Chugach had maintained a \$20 million line of credit with CoBank, ACB (CoBank). On October 27, 2005, Chugach reduced the line of credit to \$7.5 million due to a decrease in short-term borrowing projections. The CoBank line of credit expires October 31, 2006, subject to annual renewal at the discretion of the parties. Chugach utilized this line of credit in March of 2005, however, the balance was subsequently paid back in the same month. Chugach had an annual line of credit of \$20,000,000 available at December 31, 2004, with CoBank. Chugach did not utilize this line of credit in 2004. At December 31, 2005 and 2004, there was no outstanding balance on this line of credit. At December 31, 2005 and 2004, the borrowing rate would have been 5.95% and 3.80%, respectively. In addition, Chugach had an annual line of credit of \$50,000,000 available at December 31, 2005 and 2004, with NRUCFC. Chugach did not utilize this line of credit in 2005. At December 31, 2005 and 2004, there was no outstanding balance on this line of credit. At December 31, 2005 and 2004, the borrowing rate would have been 6.10% and 4.05%, respectively. The NRUCFC line of credit expires October 15, 2007.

Refinancing

On August 31, 2005, Chugach refinanced its \$10 million promissory note with CoBank. The new \$10 million, 5.50% fixed rate promissory note will mature September 20, 2010 and contains consecutive monthly installment payments commencing October 20, 2005.

Chugach Electric Association, Inc.
Notes to Financial Statements
December 31, 2005 and 2004

(8) Debt (continued)

2002 Series B Bonds

The 2002 Series B Bonds (the “Auction Rate Bonds”) will mature on February 1, 2012. The applicable interest rate for any 28-day auction period is the term rate established by the auction agent based on the terms of the auction. The Auction Rate Bonds may be converted, in Chugach’s discretion, to a daily, seven-day, 35-day, three-month or a semi-annual period or a flexible auction period. The Auction Rate Bonds are not subject to redemption at the option of the bondholders under any circumstances. Chugach may elect to redeem the bonds and Chugach is required to redeem the bonds in pre-established incremental amounts over time through a sinking fund. The Auction Rate Bonds are subject to a remarketing agreement on a best efforts basis, however in the event of unsuccessful remarketing, the bonds are returned to the bondholders and continue as auction rate bonds subject to a maximum auction rate (15%). Under no circumstances would Chugach be obligated to pay off the Bonds in the event of an unsuccessful remarketing effort. Chugach has not provided any protection to the bondholders in the event of an unsuccessful remarketing, therefore, Chugach has classified the Bonds as long-term, with the exception of the mandatory sinking fund payment due in 2006.

The 2002 Series A Bond and the Auction Rate Bonds (collectively the “Bonds”) are unsecured obligations, ranking equally with Chugach’s other unsecured and unsubordinated obligations. In addition, Chugach’s ability is limited to secure obligations for borrowed money or the deferred purchase price of property unless Chugach equally and ratably secures Chugach’s outstanding indebtedness subject to the Amended and Restated Indenture governing the Bonds.

The following table provides information regarding auction dates and rates in 2005.

<u>Auction</u> <u>Date</u>	<u>Interest</u> <u>Rate</u>
January 26, 2005	2.50%
February 23, 2005	2.62%
March 23, 2005	3.00%
April 20, 2005	3.05%
May 18, 2005	3.09%
June 15, 2005	3.22%
July 13, 2005	3.38%
August 10, 2005	3.56%
September 7, 2005	3.65%
October 5, 2005	3.74%
November 2, 2005	4.04%
December 28, 2005	4.40%

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(8) Debt (continued)

Treasury Rate Lock Agreements

On March 17, 1999, Chugach entered into a U.S. Treasury rate lock transaction with Lehman Brothers Financial Products Inc., (Lehman Brothers) for the purpose of taking advantage of favorable market interest rates in anticipation of refinancing Chugach's Series A Bond due 2022 on their optional call date (March 15, 2002). On May 11, 2001, Chugach terminated the \$18.7 million 30-year U.S. Treasury portion of the Treasury Rate Lock Agreement in receipt of payment of \$10,000 by Lehman. On December 7, 2001, Chugach terminated 50%, or \$98.0 million, of the 10-year U.S. Treasury portion of the U.S. Treasury Rate Lock Agreement for a settlement payment of \$4 million to Lehman Brothers. Chugach settled the remaining 50% of the 10-year U.S. Treasury portion of the Treasury Rate Lock Agreement for \$3 million on December 19, 2001. On January 14, 2002, Chugach entered into an 18-day rate lock agreement with JP Morgan on the 2002 refinancing. Chugach terminated the rate lock on February 1, 2002, which generated a payment to Chugach of \$1.2 million. The settlement payments were accounted for as regulatory assets and amortized over the life of the corresponding debt, which was authorized by the RCA in Order U-01-108(26).

(9) Fair Value of Long-Term Obligations

The estimated fair values (in thousands) of the long-term obligations included in the financial statements at December 31 are as follows:

	2005		2004	
	<u>Carrying Value</u>	<u>Fair Value</u>	<u>Carrying Value</u>	<u>Fair Value</u>
Long-term obligations (including current installments)	\$372,858	\$390,927	\$379,289	\$408,791

Fair value estimates are dependent upon subjective assumptions and involve significant uncertainties resulting in variability in estimates with changes in assumptions.

(10) Employee Benefit Plans

Pension Plans

Pension benefits for substantially all union employees are provided through the Alaska Electrical Pension Trust Fund and the Alaska Hotel, Restaurant and Camp Employees Health and Welfare and Pension Trust Fund, multi-employer plans. Chugach pays an hourly amount per eligible union employee pursuant to the collective bargaining unit agreements. In these master, multi-employer plans, the accumulated benefits and plan assets are not determined or allocated separately to the individual employer. The costs

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(10) Employee Benefit Plans (continued)

for the union plans were approximately \$2.4 million, \$2.5 million and \$2.4 million in 2005, 2004 and 2003, respectively. The Company has no responsibility for any unfunded benefit obligation of the Plan at this time.

Pension benefits for non-union employees are provided by the National Rural Electric Cooperative Association (NRECA) Retirement and Security Program, a multi-employer plan. Chugach makes annual contributions to the pension plan equal to the amounts accrued for pension expense. Chugach contributed \$1.8 million, \$1.6 million and \$1.5 million in 2005, 2004 and 2003, respectively, to the NRECA plan. The Company has no responsibility for any unfunded benefit obligation of the Plan at this time.

Health and Welfare Plans

Health and welfare benefits for union employees are provided through the Alaska Electrical Health and Welfare Trust and the Alaska Hotel, Restaurant and Camp Employees Health and Welfare and Pension Trust Fund. Chugach participates in multi-employer plans that provide substantially all union workers with health care and other welfare benefits during their employment with Chugach. Chugach pays a defined amount per union employee pursuant to collective bargaining unit agreements. Amounts charged to benefit costs and contributed to the health and welfare plans for these benefits for the years ending December 31, 2005, 2004 and 2003 totaled \$3.0 million, \$2.9 million and \$2.9 million respectively.

Chugach participates in a multi-employer plan through the Group Benefits Program of NRECA for non-union employees. Amounts charged to benefit cost and contributed to this Plan for those benefits for the years ended December 31, 2005, 2004 and 2003 totaled \$2.0 million, \$2.0 million and \$1.7 million, respectively.

Money Purchase Pension Plan

Chugach participates in a multi-employer defined contribution money purchase pension plan covering some employees who are covered by a collective bargaining agreement. Contributions to the Plan are made based on a percentage of each employee's compensation. Contributions to the money purchase pension plan for the years ending December 31, 2005, 2004 and 2003 were \$80.7 thousand, \$90.1 thousand and \$82.2 thousand, respectively.

401(k) Plan

Effective March 1, 1988, Chugach has a defined contribution 401(k) retirement plan which covers substantially all employees who have completed ninety days of continuous service during a twelve month period. Employees who elect to participate may contribute up to the Internal Revenue Service's maximum of \$14,000, \$13,000 and \$12,000 in 2005, 2004 and 2003, respectively.

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(11) Bradley Lake Hydroelectric Project

Chugach is a participant in the Bradley Lake Hydroelectric Project (Bradley Lake). Bradley Lake was built and financed by the Alaska Energy Authority (AEA) through State of Alaska grants and \$166,000,000 of revenue bonds. Chugach and other participating utilities have entered into take-or-pay power sales agreements under which shares of the project capacity have been purchased and the participants have agreed to pay a like percentage of annual costs of the project (including ownership, operation and maintenance costs, debt service costs and amounts required to maintain established reserves). Under these take-or-pay power sales agreements, the participants have agreed to pay all project costs from the date of commercial operation even if no energy is produced. Chugach has a 30.4% share of the project's capacity. The share of debt service exclusive of interest, for which Chugach has guaranteed, is approximately \$40,000,000. Under a worst-case scenario, Chugach could be faced with annual expenditures of approximately \$4.7 million as a result of Chugach's Bradley Lake take-or-pay obligations. Management believes that such expenditures, if any, would be recoverable through the fuel surcharge ratemaking process. Upon the default of a Bradley Lake participant, and subject to certain other conditions, AEA, through Alaska Industrial Development and Export Authority, is entitled to increase each participant's share of costs pro rata, to the extent necessary to compensate for the failure of another participant to pay its share, provided that no participant's percentage share is increased by more than 25%.

The following represents information with respect to Bradley Lake at June 30, 2005 (the most recent date for which information is available). Chugach's share of expenses was \$4,993,670 in 2005, \$4,205,657 in 2004 and \$4,212,072 in 2003 and is included in purchased power in the accompanying financial statements.

(In thousands)	Total	Proportionate Share
Plant in service	\$ 310,463	\$ 94,381
Accumulated depreciation	(94,990)	(28,877)
Long-term debt	125,485	129,205
Interest expense	8,553	2,600

Other electric plant represents Chugach's share of a Bradley Lake transmission line financed internally and Electric Plant Held for Future Use.

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Notes to Financial Statements
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(12) Eklutna Hydroelectric Project

During October 1997, the ownership of the Eklutna Hydroelectric Project formally transferred from the Alaska Power Administration to the participating utilities. This group, including their corresponding interest in the project, consists of Chugach (30%), MEA (16.7%) and Anchorage Municipal Light & Power (AML&P) (53.3%).

Plant in service in 2005 includes \$2,616,854, net of accumulated depreciation of \$525,457, which represents Chugach's share of the Eklutna Hydroelectric Plant. In 2004 plant in service included \$2,469,350, net of accumulated depreciation of \$432,654. Chugach and AML&P jointly operate the facility. Each participant contributes their proportionate share for operation, maintenance and capital improvement costs to the plant, as well as to the transmission line between Anchorage and the plant. Under net billing arrangements, Chugach then reimburses MEA for their share of the costs. Chugach's share of expenses was \$476,739, \$784,264 and \$490,338 in 2005, 2004 and 2003, respectively and is included in power production and depreciation in the accompanying financial statements.

Chugach provides personnel for the daily operation and maintenance of the power plant. ML&P performs major maintenance at the plant. Chugach personnel perform daily plant inspections, meter reading, monthly report preparation, and other activities as required.

(13) Commitments, Contingencies and Concentrations

Contingencies

Chugach is a participant in various legal actions, rate disputes, personnel matters and claims both for and against Chugach's interests. Management believes the outcome of any such matters will not materially impact Chugach's financial condition, results of operations or liquidity.

Long-Term Fuel Supply Contracts

Chugach has entered into long-term fuel supply contracts from various producers at market terms. The current contracts will expire at the end of the currently committed volumes or the contract expiration dates of 2015 and 2025. The committed volumes for the 2015 contract should be used by early 2011. The currently priced volumes for the 2025 contract should also be used by early 2011, however, there is an additional 120 BCF reserved if satisfactory terms and conditions can be negotiated. In 2005, 88% of our power was generated from gas, while in 2004 and 2003, 86% of our power was generated from gas. Of that gas-fired generation, in 2005 and 2004, 86% took place at Beluga, while in 2003 85% of gas-fired generation took place at Beluga.

Concentrations

Approximately 70% of Chugach's employees are represented by the International Brotherhood of Electrical Workers (IBEW). Chugach has three Collective Bargaining Unit

Chugach Electric Association, Inc.
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December 31, 2005 and 2004

(13) Commitments, Contingencies and Concentrations (continued)

Agreements (CBA) with the IBEW, which expire on June 30, 2006. The CBA's are under review at this time.

Chugach is the principal supplier of power under long-term wholesale power contracts with MEA and HEA. These contracts represented \$72.1 million or 32.4% of operating revenues in 2005, \$62.0 million or 31.2% in 2004 and \$55.8 million or 30.8% in 2003. The HEA contract expires January 1, 2014, and the MEA contract expires December 31, 2014.

Fuel is purchased directly from Marathon Oil Company, ChevronTexaco, ML&P and ConocoPhillips. The following represents the cost of fuel purchased from these vendors as a percentage of total fuel costs for the years ended December 31:

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Marathon Oil Company	48.8%	48.8%	47.4%
Chevron Texaco	19.5%	19.5%	20.0%
Municipal Light & Power (ML&P)	15.8%	15.8%	16.2%
ConocoPhillips	15.8%	15.8%	16.2%

DRAFT

Cooper Lake Hydroelectric Plant

Chugach discovered polychlorinated biphenyls (PCBs) in paint, caulk and grease at the Cooper Lake Hydroelectric plant during initial phases of a turbine overhaul in 2000. A FERC approved plan, prepared in consultation with the Environmental Protection Agency (EPA), was implemented to remediate the PCBs in the plant. In an order in Chugach's general rate case, Order U-01-108(26), the RCA permitted the costs associated with the overhaul and the PCB remediation to be recovered through rates. The costs of PCB sampling and analysis in Kenai Lake were accounted for as an expense.

Legal Proceedings

Matanuska Electric Association, Inc., v. Chugach Electric Association, Inc., Superior Court Case No. 3AN-99-8152 Civil

In this action filed in 1999, Matanuska Electric Association, Inc. (MEA) alleged that Chugach breached the Power Sales Agreement under which Chugach is obligated to sell MEA power for 25 years, from 1989 through 2014. MEA asserted that Chugach failed to provide it certain information, failed to properly manage Chugach's long-term debt, and failed to bring Chugach's base rate action to a Joint Committee before presenting it to the Regulatory Commission of Alaska (RCA). All of MEA's claims were dismissed by the Superior Court.

On April 29, 2002, MEA appealed to the Alaska Supreme Court the Superior Court's

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(13) Commitments, Contingencies and Concentrations (continued)

dismissal of its claims related to Chugach's financial management and Chugach's decision not to bring its base rate action to the Joint Committee before filing with the RCA. Chugach cross-appealed the Superior Court's decision not to also dismiss the financial management claim on jurisprudential and res judicata grounds. The Alaska Supreme Court, on October 8, 2004, issued an order upholding Chugach's right to not bring its base rate action to the Joint Committee before filing with the RCA. But the Court rejected Chugach's cross-appeal and reversed the Superior Court's decision dismissing MEA's financial management claim. The Supreme Court remanded that claim to the Superior Court for further proceedings.

On January 24, 2005, Chugach filed for summary judgment on that claim asserting that in the 2000 Test Year rate case the RCA had fully reviewed and decided the prudence of Chugach's financial management. In a decision dated August 22, 2005, the Superior Court granted Chugach's summary judgment motion, finding that the RCA had adjudicated the question of Chugach's financial management and that its decision should be given res judicata effect. The Superior Court also found that the RCA had exercised its primary jurisdiction in reviewing Chugach's financial management, and that its decision should be given deference.

The Superior Court entered final judgment on November 10, 2005, after which Chugach sought its costs and fees. On December 14, 2005, the Superior Court entered judgment awarding Chugach fees and costs from MEA in the amount of \$104,732, which has not been recorded in the financial statements.

On December 9, 2005, however, MEA appealed to the Alaska Supreme Court the Superior Court's grant of summary judgment. On December 23, 2005, Chugach cross-appealed the Superior Court's failure to also grant summary judgment based on the doctrine of collateral estoppel. This appeal is pending. Management is uncertain of the outcome of the proceeding before the Supreme Court. No reserves have been established for this matter.

Matanuska Electric Association, Inc. v. Chugach Electric Association, Inc. Superior Court Case No. 3AN-04-11776 Civil

On October 12, 2004, MEA filed suit in Superior Court alleging that Chugach had violated its bylaws in allocating margins (capital credits) during the years 1998 through 2003. The margins Chugach earns each year are allocated to the customers who contributed them and are booked as capital credits to those customers' accounts. Capital credits are eventually repatriated to customers at the discretion of the board of directors, typically many years after the margins are earned.

In this suit, MEA asks the Court to hold that Chugach breached its bylaws in the manner in which it allocated capital credits in 1998 through 2003. MEA also asks the court to enjoin Chugach to re-calculate MEA's capital credits applying MEA's interpretation of Chugach's

Chugach Electric Association, Inc.
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(13) Commitments, Contingencies and Concentrations (continued)

bylaws and in accordance with what MEA refers to as “generally accepted accounting practices for nonprofit cooperatives and cooperative principles”. The suit also seeks damages in an unspecified amount to compensate MEA for the alleged breach of contract. This matter currently is scheduled for a five-day trial beginning October 9, 2006. Management is vigorously defending against the claim. The ultimate resolution of this matter is not currently determinable.

Chugach has certain additional litigation matters and pending claims that arise in the ordinary course of Chugach’s business. In the opinion of management, no individual matter or the matters in the aggregate is likely to have a material adverse effect on Chugach’s results of operations, financial condition or liquidity.

Regulatory Cost Charge

In 1992 the State of Alaska Legislature passed legislation authorizing the Department of Revenue to collect a Regulatory Cost Charge from utilities in order to fund the governing regulatory commission, which is currently the RCA. The tax is assessed on all retail consumers and is based on kilowatt-hour (kWh) consumption. The tax is collected monthly and remitted to the State of Alaska quarterly. The Regulatory Cost Charge has changed since its inception (November 1992) from an initial rate of \$0.000626 per kWh to the current rate of \$0.000433, effective July 1, 2005. The tax is reported on a net basis and the tax is not included in revenue or expense.

Sales Tax

Chugach collects sales tax on retail electricity sold to Kenai and Whittier consumers. The tax is collected monthly and remitted to the State of Alaska quarterly. Sales tax is reported on a net basis and the tax is not included in revenue or expense.

Gross Receipts Tax

Chugach pays to the State of Alaska a gross receipts tax in lieu of state and local ad valorem, income and excise taxes on electricity sold in the retail market. The tax is accrued monthly and remitted annually. The tax is reported on a net basis and the tax is not included in revenue.

Excise taxes

Excise taxes on Chugach fuel purchases are paid directly to our gas producers and are recorded under “Fuel” in Chugach’s financial statements and are not directly passed through to our consumers.

Chugach Electric Association, Inc.
Notes to Financial Statements
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(13) Commitments, Contingencies and Concentrations (continued)

Underground Compliance Charge

In 2005 the Anchorage Municipal Assembly adopted an ordinance to require utilities to convert overhead distribution lines to underground. To comply with the ordinance, Chugach must invest two percent of gross retail revenue in the Municipality of Anchorage annually in moving existing distribution overhead lines underground. Consistent with a State of Alaska undergrounding requirement, Chugach is permitted to amend its rates by adding a 2% surcharge to its member's bills to recover the actual costs of the program. The rate amendments are not subject to RCA review or approval. Chugach implemented the surcharge in June 2005. At December 31, 2005, Chugach had collected \$1,064,058 from its retail members for this surcharge.

(14) Quarterly Results of Operations (unaudited)

	<u>2005 Quarter Ended</u>			
	<u>Dec. 31</u>	<u>Sept. 30</u>	<u>June 30</u>	<u>March 31</u>
Operating Revenue	\$63,847,123	\$54,323,791	\$50,314,401	57,212,034
Operating Expense	53,773,333	49,766,632	44,308,718	46,975,282
Net Interest	5,753,831	5,748,482	5,597,536	5,486,205
Net Operating Margins	4,319,959	(1,191,323)	408,147	4,750,547
Non-Operating Margins	<u>706,961</u>	<u>196,363</u>	<u>166,942</u>	<u>157,135</u>
Assignable Margins	<u>\$5,026,920</u>	<u>\$(994,960)</u>	<u>\$575,089</u>	<u>\$4,907,682</u>
	<u>2004 Quarter Ended</u>			
	<u>Dec. 31</u>	<u>Sept. 30</u>	<u>June 30</u>	<u>March 31</u>
Operating Revenue	\$55,221,563	\$47,991,700	\$46,388,411	\$51,644,941
Operating Expense	46,010,061	43,778,224	41,441,061	42,110,691
Net Interest	5,512,148	5,373,404	5,254,092	5,352,221
Net Operating Margins	3,699,354	(1,159,928)	(306,742)	4,182,029
Non-Operating Margins	<u>805,322</u>	<u>145,698</u>	<u>122,788</u>	<u>113,935</u>
Assignable Margins	<u>\$4,504,676</u>	<u>\$(1,014,230)</u>	<u>\$(183,954)</u>	<u>\$4,295,964</u>