

CHUGACH ELECTRIC ASSOCIATION, INC.
Anchorage, Alaska

AUDIT COMMITTEE

February 27, 2007

ACTION REQUIRED

AGENDA ITEM NO: VI.

Information Only
 Motion
 Resolution
 Executive Session
 Other

TOPIC

2006 Audit

DISCUSSION

KPMG LLC will present the results of the 2006 independent audit of Chugach's financial statements to the Audit Committee.

RECOMMENDATION

Motion: Move that the Audit Committee forward to the full board approval of the 2006 independent audit as presented by KPMG.

DRAFT

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, 2006 and 2005, 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, 2006. 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 the 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. 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, 2006 and 2005, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2006, in conformity with U.S. generally accepted accounting principles.

As more fully described in Note 1 to the financial statements, effective January 1, 2006 the Company implemented Staff Accounting Bulletin SAB No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements*.

March 2, 2007
Anchorage, Alaska

Chugach Electric Association, Inc.
Balance Sheets
December 31, 2006 and 2005

<u>Assets</u>	<u>2006</u>	<u>2005</u>
Utility Plant (notes 1d, 3, 11 and 12):		
Electric plant in service	\$787,005,028	\$762,859,198
Construction work in progress	20,254,298	32,505,401
Total utility plant	<u>807,259,326</u>	<u>795,364,599</u>
Less accumulated depreciation	(347,736,514)	(327,384,961)
Net utility plant	<u>459,522,812</u>	<u>467,979,638</u>
Other property and investments, at cost:		
Nonutility property	24,461	24,461
Investments in associated organizations (note 4)	11,888,530	11,883,053
Total other property and investments	<u>11,912,991</u>	<u>11,907,514</u>
Current assets:		
Cash and cash equivalents, including repurchase agreements of \$10,496,037 in 2006 and \$11,446,907 in 2005	9,844,914	10,650,594
Special deposits	206,191	216,191
Fuel cost under-recovery (note 1o)	0	1,781,833
Accounts receivable, less provision for doubtful accounts of \$586,221 in 2006 and \$398,321 in 2005	32,899,571	27,436,278
Materials and supplies	25,424,493	23,809,691
Prepayments	1,487,966	1,801,104
Other current assets	280,562	282,939
Total current assets	<u>70,143,697</u>	<u>65,978,630</u>
Deferred charges, net (notes 5 and 13)	<u>21,460,648</u>	<u>19,269,718</u>
Total assets	<u>\$563,040,148</u>	<u>\$565,135,500</u>

See accompanying notes to financial statements.

Chugach Electric Association, Inc.
Balance Sheets (continued)
December 31, 2006 and 2005

<u>Liabilities and Equities</u>	<u>2006</u>	<u>2005</u>
Equities and margins (notes 6 and 7):		
Memberships	\$1,297,633	\$1,250,398
Patronage capital	141,117,620	136,185,378
Other	8,300,847	7,603,376
Total equities and margins	150,716,100	145,039,152
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	35,500,000	41,000,000
National Bank for Cooperatives promissory notes payable	45,303,530	53,532,099
Total long-term obligations	350,803,530	364,532,099
Current liabilities:		
Current installments of long-term obligations (notes 8 and 9)	13,728,569	8,325,687
Accounts payable	10,308,668	9,598,958
Consumer deposits	2,217,613	1,980,285
Fuel cost over-recovery (note 1o)	300,567	0
Accrued interest	6,364,100	6,360,652
Salaries, wages and benefits	6,021,473	5,373,496
Fuel	16,158,783	18,123,139
Other current liabilities	4,112,020	3,035,915
Total current liabilities	59,211,793	52,798,132
Deferred credits (note 5)	2,308,725	2,766,117
Total liabilities and equities	\$563,040,148	\$565,135,500

See accompanying notes to financial statements.

Chugach Electric Association, Inc.
Statements of Revenues, Expenses and Patronage Capital
Years ended December 31, 2006, 2005 and 2004

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Operating revenues (notes 1n, 2 and 13)	\$266,071,713	\$225,697,349	\$201,246,615
Operating expenses:			
Fuel (note 13)	120,280,509	84,776,131	64,113,474
Power production (note 1o)	15,050,338	15,005,786	15,378,858
Purchased power	25,979,919	23,664,412	20,579,992
Transmission	6,283,845	5,847,648	6,526,684
Distribution	12,134,087	11,780,502	11,723,316
Consumer accounts	4,982,313	5,227,478	5,308,353
Administrative, general and other	20,184,078	20,272,291	21,719,908
Depreciation	<u>28,529,763</u>	<u>28,249,717</u>	<u>27,989,452</u>
Total operating expenses	233,424,852	194,823,965	173,340,037
Interest expense:			
On long-term obligations	24,459,852	23,384,316	21,984,371
On short-term obligations	0	46,649	0
Charged to construction-credit	<u>(448,978)</u>	<u>(844,911)</u>	<u>(492,506)</u>
Net interest expense	<u>24,010,874</u>	<u>22,586,054</u>	<u>21,491,865</u>
Net operating margins	8,635,987	8,287,330	6,414,713
Nonoperating margins:			
Interest income	879,481	560,418	453,606
Capital credits, patronage dividends and other	<u>597,068</u>	<u>666,983</u>	<u>734,137</u>
Total nonoperating margins	<u>1,476,549</u>	<u>1,227,401</u>	<u>1,187,743</u>
Assignable margins	<u>10,112,536</u>	<u>9,514,731</u>	<u>7,602,456</u>
Patronage capital at beginning of period, as previously stated	136,185,378	130,750,269	126,341,413
Cummulative effect adjustment for adoption of SAB 108 (note 1r)	<u>(73,477)</u>	<u>0</u>	<u>0</u>
Balance as of January 1, 2006, as adjusted	<u>\$136,111,901</u>	<u>\$130,750,269</u>	<u>\$126,341,413</u>
Retirement of capital credits and estate payments, including discounted capital credits transferred to other equities and margins (note 6)	<u>(5,106,817)</u>	<u>(4,079,622)</u>	<u>(3,193,600)</u>
Patronage capital at end of period	<u>\$141,117,620</u>	<u>\$136,185,378</u>	<u>\$130,750,269</u>
See accompanying notes to financial statements.			

Chugach Electric Association, Inc.
Statements of Cash Flows
Years ended December 31, 2006, 2005 and 2004

	<u>2006</u>	<u>2005</u>	<u>2004</u>
<u>Cash flows from operating activities:</u>			
Assignable margins	\$ 10,112,536	\$ 9,514,731	\$ 7,602,456
Adjustments to reconcile assignable margins to net cash provided by operating activities:			
Depreciation and amortization	31,494,702	30,341,574	31,586,948
Capitalized interest	(1,328,459)	(993,499)	(571,013)
Property (gains) losses, net	(13,919)	57,202	(11,190)
Write-off of deferred charges	406,239	0	217,665
Investments in associated organizations	(108,989)	(114,596)	(386,661)
Changes in assets and liabilities:			
(Increase) decrease in assets:			
Accounts receivable	(3,992,293)	(3,695,895)	(4,928,184)
Fuel cost under-recovery	1,781,833	(1,781,833)	2,032,730
Materials and supplies	(3,159,279)	(118,182)	(1,802,715)
Prepayments	313,138	(995,434)	652,979
Special deposits/other	115,889	(21,824)	102,122
Deferred charges	(4,873,727)	(810,692)	(854,481)
Increase (decrease) in liabilities:			
Accounts payable	709,710	1,114,809	213,266
Provision for rate refund	0	0	(671,071)
Consumer deposits	237,328	32,774	112,759
Fuel cost over-recovery	300,567	(2,714,345)	2,714,345
Accrued interest	3,448	158,883	35,979
Salaries, wages and benefits	647,977	(157,244)	644,140
Fuel	(1,964,356)	5,203,516	3,912,865
Other liabilities	1,076,105	2,213,492	630,640
Deferred credits	(264,655)	(143,138)	(92,314)
Net cash provided by operating activities	31,493,795	37,090,299	41,141,265
<u>Investing activities:</u>			
Extension and replacement of plant	(19,418,940)	(27,462,144)	(27,810,212)
Net cash used in investing activities	(19,418,940)	(27,462,144)	(27,810,212)
<u>Financing activities:</u>			
Net transfer of restricted construction funds	0	0	488,846
Repayments of long-term obligations	(8,325,687)	(6,431,393)	(10,545,000)
Memberships and donations received	744,706	605,244	373,821
Retirement of patronage capital and estate payments, including discounted capital credits transferred to other equities and margins	(5,106,817)	(4,079,622)	(3,193,600)
Net receipts of consumer advances for construction	(192,737)	463,206	(1,175,202)
Net cash used in financing activities	(12,880,535)	(9,442,565)	(14,051,135)
Net changes in cash and cash equivalents	(805,680)	185,590	(720,082)
Cash and cash equivalents at beginning of period	\$ 10,650,594	\$ 10,465,004	\$ 11,185,086
Cash and cash equivalents at end of period	\$ 9,844,914	\$ 10,650,594	\$ 10,465,004
Supplemental disclosure of non-cash investing and financing activities			
Retirement of plant	\$ 8,240,458	\$ 6,980,227	\$ 15,419,893
Transfer of pre-capitalized transformers to inventory	\$ 935,778	\$ -	\$ -
Supplemental disclosure of cash flow information - interest expense paid, excluding amounts capitalized	\$ 24,086,565	\$ 22,427,171	\$ 21,354,036

See accompanying notes to financial statements.

Chugach Electric Association, Inc.
Notes to Financial Statements
December 31, 2006 and 2005

(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 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, 2006 and 2005

(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.

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

	Annual Depreciation Rate Ranges					
	<u>2005-2006</u>			<u>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 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 \$1,000,000.

Chugach Electric Association, Inc.
Notes to Financial Statements
December 31, 2006 and 2005

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

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 6.1% in 2006, 5.0% during 2005, and 4.6% during 2004.

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).

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, 2006, the regulatory asset associated with the rate lock agreements was \$2,861,530.

Chugach Electric Association, Inc.
Notes to Financial Statements
December 31, 2006 and 2005

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

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.

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.

Chugach Electric Association, Inc.
Notes to Financial Statements
December 31, 2006 and 2005

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

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

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. Chugach calculates unbilled revenue at the end of each month to insure the recognition of a full year's revenue. Chugach accrued \$7,875,702 and \$6,231,072 of unbilled retail revenue at December 31, 2006 and 2005, respectively. Wholesale revenue is recorded from metered locations on a calendar month basis, 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 over-recovered by \$300,567 in 2006 and under-recovered by \$1,781,833 in 2005. Total fuel and purchased power costs in 2006, 2005, and 2004 were \$146,260,428, \$108,440,543, and \$84,693,466, respectively.

Chugach Electric Association, Inc.
Notes to Financial Statements
December 31, 2006 and 2005

(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, 2006, 2005 and 2004, Chugach received no unrelated business income.

r. Implementation of Staff Accounting Bulletin 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements"

In September 2006, the SEC issued Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements" (SAB 108). SAB 108 was issued in order to eliminate the diversity of practice surrounding how public companies quantify financial statement misstatements. SAB 108 requires an entity to quantify misstatements using a balance sheet and income-statement approach and to evaluate whether either approach results in an error that is material in light of relevant quantitative and qualitative factors.

We completed our analysis and adopted SAB 108 as of January 1, 2006. In accordance with SAB 108, we reduced patronage capital at January 1, 2006 by the net amount of \$73,477.

Chugach reduced its inventory balance by \$1,544,477 due to the recognition of obsolete inventory. As a result of addressing the need for inventory specific to re-powering generation requirements in 2006 we determined that some material should have been considered obsolete in 2003. Chugach believes the write-down of these items would have been immaterial to the financial statements had the inventory been written off during 2003. In accordance with the transition provisions of SAB 108, it has recorded the cumulative effect of this adjustment from prior years as a reduction of patronage capital at January 1, 2006.

Previously, Chugach included in operating revenue billings rendered to customers adjusted for differences in meter read dates from year to year and did not accrue unbilled revenue to the end of any particular accounting period. Chugach believes that our revenue recognition policy resulted in revenues that did not materially differ from recording unbilled revenue at

Chugach Electric Association, Inc.
Notes to Financial Statements
December 31, 2006 and 2005

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

the end of any accounting period. However, in accordance with the transition provisions of SAB 108, Chugach has recorded the cumulative effect of unbilled revenues in the amount of \$1,471,000 as an increase to patronage capital at January 1, 2006.

s. Recently Issued Accounting Pronouncements

SFAS 155 “Accounting for Certain Hybrid Instruments”

In February 2006, the Financial Accounting Standards Board (“FASB”) issued Statement of Financial Standard “(SFAS”) No. 155, “*Accounting for Certain Hybrid Instruments*”, which is an amendment of SFAS No. 133, “*Accounting for Derivative Instruments and Hedging Activities*”, and SFAS No. 140, “*Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities — a replacement of FASB Statement No. 125.*” SFAS No. 155 allows financial instruments that have embedded derivatives to be accounted for as a whole (eliminating the need to bifurcate the derivative from its host) if the holder elects to account for the whole instrument on a fair value basis. The Statement also establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation and clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives. Chugach will begin application of SFAS No. 155 on January 1, 2007, and do not expect it to have a material affect on our results of operations, financial position, and cash flows.

SFAS 156 “Accounting for Servicing of Financial Assets”

In March 2006, the FASB issued SFAS No. 156, “*Accounting for Servicing of Financial Assets — an amendment of FASB Statement No. 140.*” SFAS No. 156 requires an entity to recognize a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract in specific situations. Additionally, the servicing asset or servicing liability is initially measured at fair value; however, an entity may elect the “amortization method” or “fair value method” for subsequent balance sheet reporting periods. Chugach will begin application of SFAS No. 156 on January 1, 2007, and do not expect it to have a material affect on our results of operations, financial position, and cash flows.

SFAS 157 “Fair Value Measurements”

In September 2006, the FASB issued SFAS No. 157, “*Fair Value Measurements.*” SFAS No. 157 provides guidance for using fair value to measure assets and liabilities. In addition, this statement defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. This statement applies when other accounting pronouncements require fair value measurement; it does not require

Chugach Electric Association, Inc.
Notes to Financial Statements
December 31, 2006 and 2005

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

new fair value measurements. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. Chugach will begin application of SFAS No. 157 on January 1, 2008, and do not expect it to have a material affect on our results of operations, financial position, and cash flows.

SFAS 158 “Employers’ Accounting for Defined Pension and Other Postretirement Plans

In September 2006, the FASB issued SFAS No. 158, “Employers’ Accounting for Defined Pension and Other Postretirement Plans.” SFAS No. 158 requires an employer to recognize in its statement of financial position the overfunded or underfunded status of a defined benefit postretirement plan measured as the difference between the fair value of plan assets and the benefit obligation. Employers must also recognize as a component of other comprehensive income, net of tax, the actuarial gains and losses and the prior service costs and credits that arise during the period.

The Statement is effective for public entities for fiscal years ending after December 15, 2006 (December 31, 2006 financial statements for public entities with a calendar year end), and for nonpublic entities for fiscal years ending after June 15, 2007.

Chugach have multi-employer plans and a defined contribution plan and adoption of this statement is not expected to have a material effect on our results of operations or financial condition.

FSP AUG AIR-1 “Accounting for Planned Major Maintenance Activities”

In September 2006, the FASB issued FASB Staff Position (“FSP”) AUG AIR-1, “Accounting for Planned Major Maintenance Activities.” FSP AUG AIR-1 prohibits the use of the accrue-in-advance method of accounting for planned major maintenance activities in annual and interim financial reporting periods. An entity shall apply the same method of accounting for planned major maintenance activities in annual and interim financial reporting periods. Chugach are currently evaluating the impact this Staff Position may have on our results of operations or financial condition.

(2) Regulatory Matters

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 an increase to 2004 depreciation expense of approximately \$259 thousand, which, in aggregate, was not material to the financial

Chugach Electric Association, Inc.
Notes to Financial Statements
December 31, 2006 and 2005

(2) Regulatory Matters (continued)

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. Chugach, however, 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 (Revision to Current Depreciation Rates)

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 implementation plan.

Order No. 8 (Revision to Current Depreciation Rates)

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 (Revision to Current Depreciation Rates)

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. The overall impact to Chugach is an estimated decrease in annual depreciation expense of \$1.0 million. Because Chugach did not request changes to the electric rates charged to our customers based on the proposed new depreciation rates, there was 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. The Commission did not rule on MEA's motion for reconsideration resulting in its automatic denial. Subsequently, MEA filed an appeal of the RCA's decision in Superior Court, see "*Item 13 Commitments, Contingencies and Concentrations –Legal Proceedings – Matanuska Electric Association, Inc. v. State of Alaska, Regulatory Commission of Alaska, Superior Court Case No. 3AN-06-8243 Civil.*"

Chugach Electric Association, Inc.
Notes to Financial Statements
December 31, 2006 and 2005

(2) Regulatory Matters (continued)

Seward Contract request for review and approval

We currently provide nearly all the power needs of the City of Seward. Sales to Seward represent approximately 2.5% of Chugach's total sales of energy (including both retail and wholesale). In February 1998, we entered into a power sales agreement (Old Contract) with Seward that allowed us to interrupt service to Seward up to 12 times per year, not to exceed seventy-two cumulative hours annually and also reduce the demand charge by 1/3 (approximately \$350,000 annually). This agreement was scheduled to expire January 31, 2006, however, Seward and Chugach jointly requested, and the RCA granted a four-month extension to May 31, 2006, of the old contract to allow the parties to complete negotiations on a new contract. Negotiations with Seward were successful and on April 14, 2006, Chugach filed a request for approval by the RCA of a proposed new power sales agreement with the City of Seward (2006 Agreement) with a nominal effective date of June 1, 2006.

The proposed contract was for five years with two automatic five-year extensions unless notice of termination is given by either party and resulted in a 5 percent increase in revenues in relation to the Old Contract.

The 2006 Agreement is an interruptible, all-requirements/no reserves contract. It has many of the attributes of firm service, especially in the requirement that so long as Chugach has sufficient power available, it must meet Seward's needs for power. However, service is interruptible because Chugach is under no obligation to supply or plan for generation capacity reserves to supply Seward and there is no limit on the number of times or hours per year that the supply can be interrupted.

Counterbalancing this is the requirement that Chugach must provide power to Seward if Chugach has the power available after first meeting its obligations to its other customers for whom Chugach has an obligation to provide reserves (MEA, HEA and Chugach retail customers).

The price under the 2006 Agreement reflects the reduced level of service because no costs of generation in excess of that needed to meet the system peak will be assigned to Seward.

In Order No. 1 the RCA opened the docket and suspended the filing. However, the RCA allowed the parties to operate under the terms of the proposed new 2006 Contract pending review. Approval was contested by Chugach's wholesale customer, MEA and Chugach's wholesale customer, HEA also intervened in the proceeding. A hearing was set to begin November 30, 2006. Chugach filed a Motion for Summary Disposition.

The Motion was granted in part and, citing this decision, MEA withdrew from the case. The remaining parties entered into a stipulation to allow additional review of the agreement before an automatic extension of the agreement which is permitted after the first five years of the term of the agreement. On the basis of the stipulation, the Commission cancelled the hearing and the 2006 Agreement with Seward was approved as amended.

Chugach Electric Association, Inc.
Notes to Financial Statements
December 31, 2006 and 2005

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

2005 Test Year General Rate Case

On September 27, 2006, the Chugach Board of Directors authorized and instructed management to file a general rate case with the RCA. On September 29, 2006, Chugach filed a general rate case based on a 2005 test year and requesting a revenue increase of \$10.6 million for the Generation and Transmission (G&T) function and a revenue decrease of \$7.8 million for the Distribution function. Overall revenues are proposed to increase \$2.8 million.

Chugach expects the case to be fully adjudicated by January 1, 2008, assuming no appeals or other delay in the regulatory process.

Order No. 1 (2005 Test Year General Rate Case)

On December 4, 2006, the Commission issued Order No. 1 which suspended the filing and opened Docket U-06-134 to adjudicate the case. The Commission permitted intervention from Chugach's wholesale customers and the Regulatory Affairs and Public Advocacy (RAPA) section within the Attorney General's office of the State of Alaska. In the order, the Commission identified specific areas that either needed or did not need additional investigation. The Commission also appointed an Administrative Law Judge to conduct proceedings in the case.

On December 19, RAPA requested partial reconsideration of Order No. 1, citing that the Commission's actions on limiting to the scope of inquiry were erroneous. The Commission issued Order No. 2 on January 17, extending the reconsideration period for Order No. 1 to February 16, 2007.

Order No. 3 (2005 Test Year General Rate Case)

A scheduling order was issued on January 23, establishing a hearing schedule to adjudicate the case. Discovery from the intervenors in the case has been on-going since mid-December 2006.

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>2006</u>	<u>2005</u>
Electric plant in service:		
Steam production plant	\$60,462,671	\$60,462,671
Hydraulic production plant	20,257,091	20,241,725
Other production plant	124,371,318	132,990,991
Transmission plant	232,654,766	226,544,759
Distribution plant	219,453,660	219,597,822
General plant	50,267,742	52,606,167
Unclassified electric plant in service	72,773,888	43,651,171
Other	<u>6,763,892</u>	<u>6,763,892</u>
Total electric plant in service	787,005,028	762,859,198
Construction work in progress	<u>20,254,298</u>	<u>32,505,401</u>
Total electric plant in service and construction work in progress	<u>\$807,259,326</u>	<u>\$795,364,599</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>2006</u>	<u>2005</u>
National Rural Utilities Cooperative Finance Corporation (NRUCFC)	\$6,095,980	\$6,095,980
National Bank for Cooperatives (CoBank)	5,738,181	5,5628,192
NRUCFC capital term certificates	40,693	41,677
Other	<u>13,676</u>	<u>117,204</u>
Total Investments in Associated Organizations	<u>\$11,888,530</u>	<u>\$11,883,053</u>

Chugach Electric Association, Inc.
Notes to Financial Statements
December 31, 2006 and 2005

(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>2006</u>	<u>2005</u>
Debt issuance and reacquisition costs	\$7,804,354	\$9,392,807
Refurbishment of transmission equipment	197,531	206,791
Computer software and conversion	429,037	330,946
Studies	6,216,638	5,758,382
Beluga Gas Compression	3,797,000	171,378
Fuel supply negotiations	215,037	233,314
Major overhaul of steam generating unit	1,111,867	1,503,192
Environmental matters and other	211,505	149,879
Other regulatory deferred charges	<u>1,477,679</u>	<u>1,523,029</u>
Total deferred charges	<u>\$21,460,648</u>	<u>\$19,269,718</u>

At December 31, 2006 and 2005, \$10,658,620 and \$6,383,202, 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 and the Beluga gas compression project. Over/under recovered fuel costs is not included in Deferred Charges or Deferred Credits.

Chugach Electric Association, Inc.
Notes to Financial Statements
December 31, 2006 and 2005

(5) Deferred Charges and Credits (continued)

Deferred Credits

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

	<u>2006</u>	<u>2005</u>
Refundable consumer advances for construction	\$1,623,538	\$1,816,275
Estimated initial installation costs for transformers and meters	104,696	436,786
Post retirement benefit obligation	558,900	480,900
Other	<u>21,591</u>	<u>32,156</u>
Total deferred credits	<u>\$2,308,725</u>	<u>\$2,766,117</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, 2006, Chugach had assigned \$131,005,084 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 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 2004, the retirement of \$3,126,560 included discounted payments, which also 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.

Chugach Electric Association, Inc.
Notes to Financial Statements
December 31, 2006 and 2005

(6) Patronage Capital (continued)

In November 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 payments, which also 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 November 2006, the Board of Directors authorized the retirement of \$4,757,365 of retail patronage for 1987 and 1988.

In 2006, the retirement of \$4,757,365 included discounted payments, which also included discounted estate payments, in the amount of \$481,935. In addition, Chugach retained \$346,821, which represented discounted capital credits transferred to other equities and margins under the discounted capital credit retirement program.

In December 2006, the Board of Directors authorized \$700,000 for capital credit payments to be distributed during 2007 under the discounted capital credit retirement plan.

The discount rate for discounted payments, including discounted estate payments in 2006 and 2005 was 9.75% and 9.20% respectively.

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

<u>Year ending</u> <u>December 31, 2006</u>	<u>Total</u>
2007	\$ 5,000,000
2008	\$ 4,500,000
2009	\$ 4,000,000
2010	\$ 4,500,000
2011	\$ 5,000,000

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>2006</u>	<u>2005</u>
Nonoperating margins, prior to 1967	\$23,625	\$23,625
Donated capital	878,923	532,103
Unclaimed capital credit retirement*	<u>7,398,299</u>	<u>7,047,648</u>
Total other equities	<u>\$8,300,847</u>	<u>\$7,603,376</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>2006</u>	<u>2005</u>
CoBank 5.50% fixed rate note maturing in 2010, with interest payable monthly; unsecured	\$7,500,000	\$9,500,000
CoBank 6.72% variable rate notes maturing in 2022, with interest payable monthly and principal due annually beginning in 2003; unsecured	41,032,099	42,157,786
CoBank 6.72% 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>41,000,000</u>	<u>46,200,000</u>
Total long-term obligations	\$364,532,099	\$372,857,786
Less current installments	<u>13,728,569</u>	<u>8,325,687</u>
Long-term obligations, excluding current installments	<u>\$350,803,530</u>	<u>\$364,532,099</u>

Chugach Electric Association, Inc.
Notes to Financial Statements
December 31, 2006 and 2005

(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.

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.

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

Chugach Electric Association, Inc.
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(8) Debt (continued)

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.

Maturities of Long-term Obligations

Long-term obligations at December 31, 2006, mature as follows:

<u>Year ending</u> <u>December 31</u>	<u>Sinking Fund</u> <u>Requirements</u>	<u>Sinking Fund</u> <u>Requirements</u>	<u>Sinking Fund</u> <u>Requirements</u>	<u>Principal</u> <u>Maturities</u>	<u>Total</u>
	<u>2001 Series A</u> <u>Bonds</u>	<u>2002 Series A</u> <u>Bonds</u>	<u>2002 Series B</u> <u>Bonds</u>	<u>CoBank</u> <u>Promissory Notes</u>	
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
2011	150,000,000	0	7,100,000	1,743,149	158,843,149
Thereafter	<u>0</u>	<u>120,000,000</u>	<u>9,500,000</u>	<u>33,659,141</u>	<u>163,159,141</u>
	<u>\$150,000,000</u>	<u>\$120,000,000</u>	<u>\$41,000,000</u>	<u>\$53,532,099</u>	<u>\$364,532,099</u>

Short-term obligations

Chugach had maintained a \$20,000,000 line of credit with CoBank, ACB (CoBank). On October 25, 2005, Chugach reduced the line of credit to \$7.5 million due to a decrease in short-term borrowing projections. On October 18, 2006, the Board of Directors approved a resolution to renew this line of credit. The CoBank line of credit expires October 31, 2007, subject to annual renewal at the discretion of the parties. Chugach did not utilize this line of credit in 2006. Chugach utilized this line of credit in March of 2005, however, the

Chugach Electric Association, Inc.
Notes to Financial Statements
December 31, 2006 and 2005

(8) Debt (continued)

balance was subsequently paid back in the same month. At December 31, 2006 and 2005, there was no outstanding balance on this line of credit. At December 31, 2006 and 2005, the borrowing rate would have been 6.72% and 5.95%, respectively. In addition, Chugach had an annual line of credit of \$50,000,000 available at December 31, 2006 and 2005, with NRUCFC. Chugach did not utilize this line of credit in 2006 or 2005. At December 31, 2006 and 2005, there was no outstanding balance on this line of credit. At December 31, 2006 and 2005, the borrowing rate would have been 7.15% and 6.10%, 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 \$10,000,000, 5.50% fixed rate promissory note will mature September 20, 2010 and contains consecutive monthly installment payments commencing October 20, 2005.

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 2007.

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.

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(8) Debt (continued)

The following table provides information regarding auction dates and rates in 2006:

<u>Auction Date</u>	<u>Interest Rate</u>
January 25, 2006	4.49%
February 22, 2006	4.55%
March 22, 2006	4.69%
April 19, 2006	4.80%
May 17, 2006	5.05%
June 14, 2006	5.18%
July 12, 2006	5.35%
August 9, 2006	5.35%
September 6, 2006	5.29%
October 4, 2006	5.31%
November 1, 2006	5.30%
November 29, 2006	5.29%
December 27, 2006	5.31%

(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:

	<u>2006</u>		<u>2005</u>	
	<u>Carrying Value</u>	<u>Fair Value</u>	<u>Carrying Value</u>	<u>Fair Value</u>
Long-term obligations (including current installments)	\$364,532	\$375,611	\$372,858	\$390,927

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.

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(10) Employee Benefit Plans (continued)

The costs for the union plans were approximately \$ 2.5 million, \$2.4 million, and \$2.5 million in 2006, 2005, and 2004, respectively. Chugach 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 \$ 1.6 million, \$1.8 million, and \$1.6 million in 2006, 2005, and 2004, respectively, to the NRECA plan. Chugach 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, 2006, 2005, and 2004 \$ 2.9 million, \$3.0 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, 2006, 2005, and 2004 totaled \$2.0 million, \$2.0 million, and \$2.0 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, 2006, 2005, and 2004 were \$85.4 thousand, \$80.7 thousand, and \$90.1 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.

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(10) Employee Benefit Plans (continued)

Employees who elect to participate may contribute up to the Internal Revenue Service's maximum of \$15,000, \$14,000, and \$13,000 in 2006, 2005, and 2004 respectively.

(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 \$39,000,000. Under a worst-case scenario, Chugach could be faced with annual expenditures of approximately \$5.0 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, 2006 (the most recent date for which information is available). Chugach's share of expenses was \$4,219,321 in 2006, \$4,993,670 in 2005, and \$4,205,657 in 2004 and is included in purchased power in the accompanying financial statements.

(In thousands)	<u>Total</u>	Proportionate <u>Share</u>
Plant in service	\$ 211,182	\$ 64,199
Long-term debt	121,182	36,839
Interest expense	8,274	2,515

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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(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 2006 includes \$2,644,397, net of accumulated depreciation of \$608,495, which represents Chugach's share of the Eklutna Hydroelectric Plant. In 2005 plant in service included \$2,616,854, net of accumulated depreciation of \$525,457. 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 \$591,903, \$476,739, and \$784,264 in 2006, 2005, and 2004, 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 late 2010 or 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 2006, 90% of our power was generated from gas, while in 2005, 88% and 2004, 86% of our power was generated from gas. Of that gas-fired generation, in 2006 87% took place at Beluga, while in 2005 and 2004, 86% 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

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(13) Commitments, Contingencies and Concentrations (continued)

Agreements (CBA) with the IBEW, which expired on June 30, 2006. The *Outside Agreement* was approved by the Board of Directors in December 2006. Chugach and the union have continued to honor the prior *Generation* and *Office and Engineering Agreements* while new agreements are negotiated.

Chugach is the principal supplier of power under long-term wholesale power contracts with MEA and HEA. These contracts represented \$90.1 million or 34.1% of operating revenues in 2006, \$72.1 million or 32.4% in 2005, and \$62.0 million or 31.2% in 2004. 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>2006</u>	<u>2005</u>	<u>2004</u>
Marathon Oil Company	49.2%	48.8%	48.8%
Chevron Texaco	19.4%	19.5%	19.5%
Municipal Light & Power (ML&P)	15.7%	15.8%	15.8%
ConocoPhillips	15.7%	15.8%	15.8%

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, 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 RCA. All of MEA's claims were dismissed by the Superior Court.

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

On April 29, 2002, MEA appealed to the Alaska Supreme Court the Superior Court's 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, upheld 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, as yet, been recorded in the financial statements.

On December 9, 2005, 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. All briefing has been completed and this appeal is now ready to be decided. The ultimate resolution of this matter is not determinable. In the opinion of management, an adverse outcome is not likely to have a material adverse effect on Chugach's results of operations, financial condition or liquidity. 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.

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

On February 17, 2006, MEA filed a Motion to File an Amended Complaint and an Amended Complaint in this case. The proposed Amended Complaint was identical to MEA's initial Complaint except for changes made to accommodate one new claim. The new claim challenges Chugach's failure to provide MEA with a capital credit allocation for 2004.

In this suit, MEA asked the Court to hold that Chugach breached its bylaws in the manner in which it allocated capital credits in 1998 through 2004. MEA also asked the Court to enjoin Chugach to re-calculate MEA's capital credits applying MEA's interpretation of Chugach's bylaws and in accordance with what MEA referred to as "generally accepted accounting practices for nonprofit cooperatives and cooperative principles". The suit also sought damages in an unspecified amount to compensate MEA for the alleged breach of contract.

On December 8, 2006, the Court granted Chugach summary judgment dismissing six of the eight claims MEA alleged. The Court did not allow MEA to amend its complaint to add its new claim involving Chugach's 2004 capital credit allocations, which meant that only two of MEA's claims survived. On December 27, 2006, MEA agreed to dismiss its remaining two claims, release any claims it might have based on Chugach's capital credit allocations for the years 1998 – 2004 and abandon its right to appeal the Court's summary judgment decisions. In exchange, Chugach agreed to release its right to recover any of the attorneys fees and costs it incurred in defending the case.

Matanuska Electric Association, Inc. v. State of Alaska, Regulatory Commission of Alaska, Superior Court Case No. 3AN-06-8243 Civil

On May 17, 2006, MEA appealed and on May 30, 2006, Homer Electric Association, Inc., (HEA) cross appealed the RCA's decision in Commission Docket No. U-04-102, see "*Item 2 – Regulatory Matters – Docket No. U-04-102 (Revision to Current Depreciation Rates)*." On appeal, MEA claims the Commission's decision dated January 10, 2006, to authorize Chugach to implement new depreciation rates as of January 1, 2005 constituted illegal retroactive ratemaking. MEA also contends that the Commission's reliance on avoidance of regulatory lag as a basis for its decision was improper. HEA's points on appeal challenge several decisions by the Commission on estimated lives of General Plant on the ground that there is not substantial evidence in the record to support such a decision. HEA and MEA both challenge the discovery rulings of the Commission. Chugach will join the State of Alaska in defending the Commission's rulings. No briefing schedule has been set.

The ultimate resolution of this matter is not currently determinable. In the opinion of management, an adverse outcome is not likely to have a material adverse effect on Chugach's results of operations, financial condition or liquidity. No reserves have been established for this matter.

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

Matanuska Electric Association, Inc. v. Chugach Electric Association, Inc., Superior Court Case No. 3PA-06-1295 Civil

On May 17, 2006, MEA filed suit against Chugach in Superior Court asserting three claims. In this action, MEA contends that by publishing unbundled financial statements Chugach has *in effect* stated that MEA owes Chugach a debt. Chugach denies having made statements to this effect.

Unbundled financial statements are an analytic tool developed by Chugach that separate the financial statements into two business units consisting of the Generation and Transmission (G&T) and the Distribution functions of the company. The unbundled financial statements reflect the operating results of each separate entity. Statements of Revenues, Expenses and Patronage Capital, Balance Sheets and Statements of Cash Flows are prepared monthly for each business unit. MEA's action is based on the result of Chugach's financial analysis showing intercompany receivable/payable entries on unbundled balance sheets.

The first of MEA's claims is that it is entitled to declaratory judgment to the effect that MEA does not owe a debt to Chugach or to Chugach's Distribution function. Second, MEA claims that Chugach has breached its Bylaws and the Power Sales Agreement under which Chugach is obligated to sell MEA power and by publishing its unbundled financial analysis and seeks a declaration that Chugach's actions violate Bylaws and the Power Sales Agreement. MEA's third claim alleges that Chugach's published assertions regarding the underperformance of its G&T function defamed MEA. In its request for relief, MEA also asks for an injunction against further assertions, which Chugach denies having made, that MEA owes Chugach or Chugach's Distribution function a debt. Finally, MEA seeks damages, including punitive damages, to punish Chugach and deter it from continuing to publish the analysis.

Chugach moved to dismiss the first (declaratory judgment) and third (defamation) counts of the complaint. Following oral argument, the court denied Chugach's motion to dismiss the declaratory judgment claim and granted Chugach's motion to dismiss the defamation claim.

With respect to the declaratory judgment claim, the court indicated that it needed to look beyond the pleadings to determine whether Chugach's publications suggest that MEA owes a substantial debt to Chugach. Trial is currently scheduled for June 2007.

The ultimate resolution of this matter is not determinable. In the opinion of management, an adverse outcome is not likely to have a material adverse effect on Chugach's results of operations, financial condition or liquidity. No reserves have been established for this matter.

Chugach believes the claims are without merit and will vigorously defend against them. Management is uncertain of the outcome of the proceeding before the Superior Court.

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

The ultimate resolution of this matter is not currently determinable. In the opinion of management, an adverse outcome is not likely to have a material adverse effect on Chugach's results of operations, financial condition or liquidity.

Matanuska Electric Association, Inc. v. Chugach Electric Association, Inc., Superior Court Case No. 3PA-06-1591 Civil

On August 7, 2006, MEA served Chugach with a Summons and Complaint requesting the Court grant MEA declaratory judgment, breach of contract and costs and attorney fees. MEA seeks a declaratory judgment that Chugach has wrongfully refused to grant MEA access to the books and records of the cooperative in violation of state statute, common law and Chugach bylaws. MEA also alleges that by refusing to grant access to these records, Chugach has breached its bylaws on which MEA bases a breach of contract claim against Chugach. MEA has filed a motion for summary judgment, requesting entry of an order declaring that Chugach has wrongfully denied MEA's records request; Chugach has cross-moved for summary judgment based on the fact that MEA has never presented Chugach with a sufficient demand and that Chugach has never denied MEA access to any records to which it is entitled. In its Complaint, MEA asks the Court to (1) grant it access to, and the right to inspect and copy, unspecified Chugach records, and (2) order Chugach to cooperate in facilitating MEA's inspection and copying of the same. Chugach has answered MEA's complaint and believes the claims are without merit and will vigorously defend against them. Management is uncertain of the outcome of the proceeding before the Superior Court. The ultimate resolution of this matter is not currently determinable. In the opinion of management, an adverse outcome is not likely to have a material adverse effect on Chugach's results of operations, financial condition or liquidity.

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 \$0.000364, effective September 1, 2006. The tax is reported on a net basis and the tax is not included in revenue or expense.

Chugach Electric Association, Inc.
Notes to Financial Statements
December 31, 2006 and 2005

(13) Commitments, Contingencies and Concentrations (continued)

Sales Tax

Chugach collects sales tax on retail electricity sold to Kenai and Whittier consumers. The tax is collected monthly and remitted to the Kenai Peninsula Borough 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.

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, 2006, Chugach had collected \$3,072,833 from its retail members for this surcharge.

Chugach Electric Association, Inc.
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(14) Quarterly Results of Operations (unaudited)

	<u>2006 Quarter Ended</u>			
	<u>Dec. 31</u>	<u>Sept. 30</u>	<u>June 30</u>	<u>March 31</u>
Operating Revenue	\$75,693,939	\$63,243,634	\$60,248,547	\$66,885,593
Operating Expense	66,286,182	57,365,207	53,802,570	55,970,892
Net Interest	<u>6,006,091</u>	<u>6,073,345</u>	<u>6,011,147</u>	<u>5,920,291</u>
Net Operating Margins	3,401,666	(194,918)	434,830	4,994,410
Non-Operating Margins	<u>689,713</u>	<u>312,975</u>	<u>279,597</u>	<u>194,263</u>
Assignable Margins	<u>\$4,091,379</u>	<u>\$118,057</u>	<u>\$714,427</u>	<u>\$5,188,673</u>
	<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	<u>5,753,831</u>	<u>5,748,482</u>	<u>5,597,536</u>	<u>5,486,205</u>
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>