

**CHUGACH ELECTRIC ASSOCIATION, INC.**  
**Anchorage, Alaska**

**AUDIT COMMITTEE MEETING**  
**AGENDA ITEM SUMMARY**

**March 5, 2008**

**ACTION REQUIRED**

**AGENDA ITEM NO. VI.**

Information Only  
 Motion  
 Resolution  
 Executive Session  
 Other

---

**TOPIC**

Review and Recommendation on the 2007 Audited Financial Statements and Footnotes

**DISCUSSION**

KPMG will present the results of the 2007 audited financial statements of Chugach Electric Association, Inc. to the Audit Committee.

**MOTION**

Move that the Audit Committee recommend to the Board of Directors the approval of the 2007 audited financial statements and footnotes as presented by KPMG.

## **Report of Independent Registered Public Accounting Firm**

The Board of Directors  
Chugach Electric Association, Inc.

We have audited the accompanying balance sheets of Chugach Electric Association, Inc. as of December 31, 2007 and 2006, and the related statements of operations, changes in equities and margins, and cash flows for each of the years in the three-year period ended December 31, 2007. 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, 2007 and 2006, and the results of its operations and its cash flows for each of the years in the three-year period ended December 31, 2007, in conformity with U.S. generally accepted accounting principles.

March 9, 2008  
Anchorage, Alaska

**Chugach Electric Association, Inc.**  
**Balance Sheets**  
**December 31, 2007 and 2006**

<u>Assets</u>	<u>2007</u>	<u>2006</u>
Utility Plant (notes 1d, 3, 11 and 12):		
Electric plant in service	\$805,631,207	\$787,005,028
Construction work in progress	17,712,884	20,688,363
Total utility plant	<u>823,344,091</u>	<u>807,688,363</u>
Less accumulated depreciation	(367,391,921)	(347,736,514)
Net utility plant	<u>455,952,170</u>	<u>459,951,849</u>
Other property and investments, at cost:		
Nonutility property	24,461	24,461
Special Funds	768,041	645,582
Investments in associated organizations (note 4)	11,993,378	11,888,530
Total other property and investments	<u>12,785,880</u>	<u>12,558,573</u>
Current assets:		
Cash and cash equivalents, including repurchase agreements of \$9,730,078 in 2007 and \$10,496,037 in 2006	6,209,936	9,844,914
Special deposits	125,117	206,191
Accounts receivable, less provision for doubtful accounts of \$541,368 in 2007 and \$586,221 in 2006	31,355,481	32,899,571
Materials and supplies	28,422,088	25,424,493
Prepayments	1,357,980	1,487,966
Other current assets	264,501	280,562
Total current assets	<u>67,735,103</u>	<u>70,143,697</u>
Deferred charges, net (notes 5 and 13)	<u>21,252,965</u>	<u>21,031,611</u>
Total assets	<u><u>\$557,726,118</u></u>	<u><u>\$563,685,730</u></u>

See accompanying notes to financial statements.

**Chugach Electric Association, Inc.**  
**Balance Sheets (continued)**  
**December 31, 2007 and 2006**

<u>Liabilities, Equities and Margins</u>	<u>2007</u>	<u>2006</u>
Equities and margins (notes 6 and 7):		
Memberships	\$1,345,013	\$1,297,633
Patronage capital	138,713,338	141,117,620
Other	9,252,085	8,300,847
Total equities and margins	<u>149,310,436</u>	<u>150,716,100</u>
Long-term obligations, excluding current installments (notes 8 and 9):		
Bonds payable	299,600,000	305,500,000
National Bank for Cooperatives promissory notes payable	45,823,500	45,303,530
Total long-term obligations	<u>345,423,500</u>	<u>350,803,530</u>
Current liabilities:		
Current installments of long-term obligations (notes 8 and 9)	10,106,804	13,728,569
Accounts payable	7,935,566	10,308,668
Consumer deposits	2,403,051	2,217,613
Fuel cost over-recovery (note 1o)	1,596,010	300,567
Accrued interest	6,304,609	6,364,100
Salaries, wages and benefits	5,953,873	6,021,473
Fuel	22,337,653	16,158,783
Other current liabilities	3,680,212	4,112,020
Total current liabilities	<u>60,317,778</u>	<u>59,211,793</u>
Deferred Compensation	768,041	645,582
Deferred credits (note 5)	<u>1,906,363</u>	<u>2,308,725</u>
Total liabilities, equities and margins	<u><u>\$557,726,118</u></u>	<u><u>\$563,685,730</u></u>

See accompanying notes to financial statements.

**Chugach Electric Association, Inc.**  
**Statements of Operations**  
**Years Ended December 31, 2007, 2006 and 2005**

	<u>2007</u>	<u>2006</u>	<u>2005</u>
Operating revenues (notes 1n, 2 and 13)	\$257,443,919	\$267,542,713	\$225,697,349
Operating expenses:			
Fuel (note 13)	106,023,734	120,280,509	84,776,131
Power production (note 1o)	16,171,717	15,050,338	15,005,786
Purchased power	33,947,828	25,979,919	23,664,412
Transmission	6,781,166	6,283,845	5,847,648
Distribution	13,716,105	12,134,087	11,780,502
Consumer accounts	4,899,878	4,982,313	5,227,478
Administrative, general and other	21,776,968	21,728,555	20,272,291
Depreciation	<u>29,049,627</u>	<u>28,529,763</u>	<u>28,249,717</u>
Total operating expenses	232,367,023	234,969,329	194,823,965
Interest expense:			
On long-term obligations	24,239,343	24,459,852	23,384,316
On short-term obligations	90,648	0	46,649
Charged to construction-credit	<u>(617,194)</u>	<u>(448,978)</u>	<u>(844,911)</u>
Net interest expense	<u>23,712,797</u>	<u>24,010,874</u>	<u>22,586,054</u>
Net operating margins	1,364,099	8,562,510	8,287,330
Nonoperating margins:			
Interest income	710,480	879,481	560,418
Capital credits, patronage dividends and other	<u>810,677</u>	<u>597,068</u>	<u>666,983</u>
Total nonoperating margins	<u>1,521,157</u>	<u>1,476,549</u>	<u>1,227,401</u>
Assignable margins	<u><u>\$2,885,256</u></u>	<u><u>\$10,039,059</u></u>	<u><u>\$9,514,731</u></u>

See accompanying notes to financial statements.

**Chugach Electric Association, Inc.**  
**Statements of Changes in Equities and Margins**  
**Years Ended December 31, 2007, 2006 and 2005**

	<u>Memberships</u>	<u>Other Equities and Margins</u>	<u>Patronage Capital</u>	<u>Total</u>
Balance, January 1, 2005	\$1,202,538	\$7,045,992	\$130,750,269	\$138,998,799
Assignable margins	0	0	9,514,731	9,514,731
Retirement of capital credits	0	0	(4,079,622)	(4,079,622)
Unclaimed capital credit retirements	0	282,479	0	282,479
Memberships and donations received	47,860	274,905	0	322,765
Balance, December 31, 2005	<u>1,250,398</u>	<u>7,603,376</u>	<u>136,185,378</u>	<u>145,039,152</u>
Assignable margins	0	0	10,039,059	10,039,059
Retirement of capital credits	0	0	(5,106,817)	(5,106,817)
Unclaimed capital credit retirements	0	346,821	0	346,821
Memberships and donations received	47,235	350,650	0	397,885
Balance, December 31, 2006	<u>1,297,633</u>	<u>8,300,847</u>	<u>141,117,620</u>	<u>150,716,100</u>
Assignable margins	0	0	2,885,256	2,885,256
Retirement of capital credits	0	0	(5,289,538)	(5,289,538)
Unclaimed capital credit retirements	0	681,254	0	681,254
Memberships and donations received	47,380	269,984	0	317,364
Balance, December 31, 2007	<u>\$1,345,013</u>	<u>\$9,252,085</u>	<u>\$138,713,338</u>	<u>\$149,310,436</u>

See accompanying notes to financial statements.

**Chugach Electric Association, Inc.**  
**Statements of Cash Flows**  
**Years Ended December 31, 2007, 2006 and 2005**

	<u>2007</u>	<u>2006</u>	<u>2005</u>
<u>Cash flows from operating activities:</u>			
Assignable margins	\$2,885,256	\$10,039,059	\$9,514,731
Adjustments to reconcile assignable margins to net cash provided by operating activities:			
Depreciation and amortization	32,426,335	31,494,702	30,341,574
Capitalized interest	(891,443)	(1,328,459)	(993,499)
Property (gains) losses, net	16,748	(13,919)	57,202
Write-off of deferred charges	10,896	406,239	0
Investments in associated organizations	(105,872)	(108,989)	(114,596)
Changes in assets and liabilities:			
(Increase) decrease in assets:			
Accounts receivable	1,544,090	(5,463,293)	(3,695,895)
Fuel cost under-recovery	0	1,781,833	(1,781,833)
Materials and supplies	(2,997,595)	(1,614,802)	(118,182)
Prepayments	129,986	313,138	(995,434)
Special deposits/other	98,159	115,889	(21,824)
Deferred charges	(4,018,730)	(4,873,727)	(810,692)
Increase (decrease) in liabilities:			
Accounts payable	(124,362)	276,837	1,071,321
Consumer deposits	185,438	237,328	32,774
Fuel cost over-recovery	1,295,443	300,567	(2,714,345)
Accrued interest	(59,491)	3,448	158,883
Salaries, wages and benefits	(67,600)	647,977	(157,244)
Fuel	6,178,870	(1,964,356)	5,203,516
Other liabilities	(1,525,783)	947,674	1,688,402
Deferred credits	16,646	(264,655)	(143,138)
<b>Net cash provided by operating activities</b>	<b>34,996,991</b>	<b>30,932,491</b>	<b>36,521,721</b>
<u>Investing activities:</u>			
Extension and replacement of plant	(26,014,221)	(18,986,067)	(27,418,656)
<b>Net cash used in investing activities</b>	<b>(26,014,221)</b>	<b>(18,986,067)</b>	<b>(27,418,656)</b>
<u>Financing activities:</u>			
Repayments of long-term obligations	(9,001,795)	(8,325,687)	(6,431,393)
Memberships and donations received	998,618	744,706	605,244
Retirement of patronage capital and estate payments	(4,195,563)	(4,978,386)	(3,554,532)
Net receipts of consumer advances for construction	(419,008)	(192,737)	463,206
<b>Net cash used in financing activities</b>	<b>(12,617,748)</b>	<b>(12,752,104)</b>	<b>(8,917,475)</b>
Net changes in cash and cash equivalents	(3,634,978)	(805,680)	185,590
Cash and cash equivalents at beginning of period	\$9,844,914	\$10,650,594	\$10,465,004
Cash and cash equivalents at end of period	<u>\$6,209,936</u>	<u>\$9,844,914</u>	<u>\$10,650,594</u>
Supplemental disclosure of non-cash investing and financing activities			
Retirement of plant	\$9,473,461	\$8,240,458	\$6,980,227
Extension and replacement of plant	\$2,084,120	\$3,503,009	\$3,562,685
Retirement and patronage capital estate payments payable	\$2,416,552	\$1,322,577	\$1,194,146
Special Funds/Deferred Compensation	\$122,459	\$361,658	\$60,740
Supplemental disclosure of cash flow information – interest expense paid, excluding amounts capitalized	<u>\$23,772,288</u>	<u>\$24,086,565</u>	<u>\$22,427,171</u>

See accompanying notes to financial statements.

**Chugach Electric Association, Inc.**  
**Notes to Financial Statements**  
**December 31, 2007 and 2006**

**(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 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. Estimates include allowance for doubtful accounts, unbilled revenue and the estimated useful life of utility plant. 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)*.

SFAS No. 71 provides for the recognition of regulatory assets and liabilities as allowed by regulators for costs or credits that are reflected in current rates or are considered probable of being included in future rates. The regulatory assets or liabilities are then reduced as the cost or credit is reflected in rates.

**Chugach Electric Association, Inc.**  
**Notes to Financial Statements**  
**December 31, 2007 and 2006**

**(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 book value of the property, plus removal cost, less salvage, is charged to accumulated provision for depreciation. 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.

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

	Annual Depreciation Rate Ranges		
	<u>2005-2007</u>		
Steam production plant	2.55%	-	3.24%
Hydraulic production plant	1.63%	-	2.94%
Other production plant	3.32%	-	9.81%
Transmission plant	1.72%	-	5.26%
Distribution plant	2.10%	-	9.98%
General plant	2.23%	-	27.25%
Other	2.75%	-	2.75%

Chugach currently uses remaining life rates set forth in the 2002 depreciation study. In an order dated January 10, 2006, the RCA approved the 2002 depreciation 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. An update to depreciation rates was included in a general rate case filed by Chugach with the RCA on September 29, 2006, see Note (2) – “*Regulatory Matters - 2005 Test Year General Rate Case (Docket No. U-06-134)*.” Chugach anticipates an order from the RCA by March 31, 2008, regarding this 2005 update.

**Chugach Electric Association, Inc.**  
**Notes to Financial Statements**  
**December 31, 2007 and 2006**

**(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. AFUDC and IDC are non-cash credits, which represent the estimated cost of funds used to finance the construction of utility plant. AFUDC and IDC are applied to applicable projects during construction. AFUDC and IDC include the net cost of borrowed funds and a rate of return on other funds when used and is recovered through rates as utility plant is depreciated. Chugach capitalized such funds at the weighted average rate (adjusted monthly) of 6.3% in 2007, 6.1% during 2006 and 5.0% during 2005.

*f. Investments in Associated Organizations*

The loan agreements with CoBank and National Rural Utilities Cooperative Finance Corporation (NRUCFC) require as a condition of the extension of credit, that an equity ownership position be established by all borrowers. Chugach's equity ownership in these organizations is approximately 1%. 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 - the carrying amount approximates fair value because of the short maturity of those instruments.

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, 2007 and 2006**

**(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 was and will continue to be an adjustment to rates over the life of the associated debt. This rate making treatment was approved by the RCA on January 31, 2003, in Order U-01-108(26). Accordingly, the unrealized loss was not recorded and was treated as a regulatory asset upon settlement (note 5). At December 31, 2007, the remaining regulatory asset associated with the rate lock agreements was \$2,289,222.

*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 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 collectability. 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, 2007 and 2006**

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

*l. Deferred Charges and Credits (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 approve the return of capital 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 \$8,300,461 and \$9,346,702 of unbilled retail revenue at December 31, 2007 and 2006, 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*

Expenses associated with electric services include fuel used to generate electricity and power purchased from others. 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 \$1,596,010 in 2007 and over-recovered by \$300,567 in 2006. Total fuel and purchased power costs in 2007, 2006, and 2005 were \$139,971,562, \$146,260,428, and \$108,440,543, respectively.

**Chugach Electric Association, Inc.**  
**Notes to Financial Statements**  
**December 31, 2007 and 2006**

**(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, 2007, 2006 and 2005, Chugach received no unrelated business income.

*r. Recently Issued Accounting Pronouncements*

*SFAS 159 “The Fair Value Option for Financial Assets and Financial Liabilities – Including an amendment of FASB Statement No. 115”*

In February 2007, the Financial Accounting Standards Board (“FASB”) issued Statement of Financial Standard (“SFAS”) No. 159, “The Fair Value Option for Financial Assets and Financial Liabilities – Including an amendment of FASB Statement No. 115.” SFAS No. 159 allows for certain financial assets and liabilities to be measured at fair value on an instrument-by-instrument basis subject to certain restrictions. SFAS No. 159 is effective for financial statements issued for fiscal years beginning after November 15, 2007. Chugach will begin application of SFAS No. 159 on January 1, 2008, and does 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 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 does not expect it to have a material affect on our results of operations, financial position, and cash flows.

**Chugach Electric Association, Inc.**  
**Notes to Financial Statements**  
**December 31, 2007 and 2006**

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

*r. Recently Issued Accounting Pronouncements (continued)*

*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. Application of SFAS No. 156 on January 1, 2007, did not have a material affect on our results of operations, financial position, and cash flows.

*SFAS 155 “Accounting for Certain Hybrid Instruments”*

In February 2006, the FASB issued 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. Application of SFAS No. 155 on January 1, 2007, did not have a material affect on our results of operations, financial position, and cash flows.

*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. Chugach implemented this Staff Position effective January 1, 2007. Because Chugach does not accrue in advance for planned major maintenance activities, the implementation of FSP AUG AIR-1 did not have an impact on our results of operations or financial condition.

**Chugach Electric Association, Inc.**  
**Notes to Financial Statements**  
**December 31, 2007 and 2006**

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

*s. Presentation of Financial Information*

Certain reclassifications have been made to the 2005 and 2006 financial statements to conform to the 2007 presentation.

**(2) Regulatory Matters**

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

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, which 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. 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.

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 September 21, 2005, the RCA issued Order No. 8 requiring Chugach to 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.

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.

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. Subsequently, MEA and HEA filed an appeal of the RCA's decision in Superior Court, see Note (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, 2007 and 2006**

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

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

HEA later dismissed its appeal leaving MEA's claim focusing mainly on the question of whether implementation of the new depreciation rates as of January 1, 2005 constituted illegal retroactive rate making. Briefing is complete and oral argument before the Superior Court is scheduled for April 29, 2008. Thereafter, an appeal to the Alaska Supreme Court is possible.

***2005 Test Year General Rate Case (Docket No. U-06-134)***

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 requested 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 were proposed to increase \$2.8 million in the initial filing. Chugach expects adjudication by the RCA to be completed by March 31, 2008, assuming no delay in the regulatory process. Thereafter, post-decision motions and an appeal to the Superior Court may occur.

The RCA 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. It also permitted intervention of a single Chugach retail member. A scheduling order was issued on January 23, 2007, establishing a hearing schedule to adjudicate the case. Discovery from the intervenors in the case on Chugach's filing and pre-filed initial testimony has been completed. Intervenor testimony has been submitted. Chugach's reply testimony was submitted May 29, 2007.

A settlement agreement between several of the intervenors and Chugach, reached in August 2007, has been accepted by the RCA. The settlement agreement results in an estimated 3% overall decrease for Chugach retail members and an estimated 3.5% overall increase for HEA and Seward.

The hearing scheduled to occur in August 2007 with the remaining intervenors was canceled. The remaining active intervener, MEA, and Chugach entered into a stipulation to resolve outstanding procedural issues on October 16, 2007. This stipulation agrees to a procedure whereby the RCA will decide the matter based on the written record with provisions for RCA written questions and optional oral questioning by the RCA of selected witnesses. Chugach and MEA filed closing briefs on December 5, 2007. The RCA did not engage in oral questioning of witnesses.

**Chugach Electric Association, Inc.**  
**Notes to Financial Statements**  
**December 31, 2007 and 2006**

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

*2005 Test Year General Rate Case (Docket No. U-06-134) (continued)*

Chugach submitted to the RCA permanent rates to implement the settlement agreement as well as interim and refundable rates for MEA, the party that did not settle, for implementation in the fourth quarter of 2007. The RCA declined to implement any tariff changes at that time and as a result, the implementation date of the rate changes for all parties has been delayed, pending a ruling on the rate changes associated with MEA.

Chugach expects a decision from the RCA on the outstanding rate issues with MEA by March 31, 2008.

Rates resulting from the settlement agreement approved by the RCA for Chugach retail members, HEA and SES will result in an annual revenue reduction of \$2.7 million. The proposed rate change contained in Chugach's original rate filing would increase revenues from MEA by \$3.3 million. If the RCA approves the MEA rate changes as proposed in Chugach's original filing, Chugach's annual system revenue would increase \$0.6 million.

(3) **Utility Plant**

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

	<u>2007</u>	<u>2006</u>
Electric plant in service:		
Steam production plant	\$60,462,671	\$60,462,671
Hydraulic production plant	20,262,890	20,257,091
Other production plant	133,235,755	124,371,318
Transmission plant	245,914,683	232,654,766
Distribution plant	230,074,513	219,453,660
General plant	47,962,159	50,267,742
Unclassified electric plant in service	60,954,644	72,773,888
Other	<u>6,763,892</u>	<u>6,763,892</u>
Total electric plant in service	805,631,207	787,005,028
Construction work in progress	<u>17,712,884</u>	<u>20,683,335</u>
Total electric plant in service and construction work in progress	<u>\$823,344,091</u>	<u>\$807,688,363</u>

**Chugach Electric Association, Inc.**  
**Notes to Financial Statements**  
**December 31, 2007 and 2006**

**(3) Utility Plant (continued)**

Unclassified electric plant in service consists of complete unclassified general plant, generation plant, transmission plant and distribution plant. 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 include the following at December 31:

	<u>2007</u>	<u>2006</u>
National Rural Utilities Cooperative Finance Corporation (NRUCFC)	\$6,095,980	\$6,095,980
National Bank for Cooperatives (CoBank)	5,841,631	5,738,181
NRUCFC capital term certificates	39,708	40,693
Other	<u>16,059</u>	<u>13,676</u>
Total Investments in Associated Organizations	<u>11,993,378</u>	<u>\$11,888,530</u>

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.

**Chugach Electric Association, Inc.**  
**Notes to Financial Statements**  
**December 31, 2007 and 2006**

**(5) Deferred Charges and Credits**

*Deferred Charges*

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

	<u>2007</u>	<u>2006</u>
Debt issuance and reacquisition costs	\$6,215,899	\$7,804,354
Refurbishment of transmission equipment	188,272	197,531
Studies	729,392	366,681
Beluga Gas Compression	5,441,205	3,797,000
Cooper Lake Relicensing	5,919,899	5,849,957
Fuel supply negotiations	225,076	215,037
Major overhaul of steam generating unit	787,711	1,111,867
Other regulatory deferred charges	313,183	211,505
Environmental matters and other	<u>1,432,328</u>	<u>1,477,679</u>
Total deferred charges	<u>\$21,252,965</u>	<u>\$21,031,611</u>

At December 31, 2007 and 2006, \$852,560 and \$10,229,583, respectively, of total deferred charges represent regulatory assets in progress and are not currently being amortized. Chugach, however, expects recovery and a determination of a recovery period in the future. In 2007, the majority of these charges represent costs associated with Chugach's exploration of new generation options.

*Deferred Credits*

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

	<u>2007</u>	<u>2006</u>
Refundable consumer advances for construction	\$1,204,530	\$1,623,538
Estimated initial installation costs for meters	121,342	104,696
Post retirement benefit obligation	558,900	558,900
Other	<u>21,591</u>	<u>21,591</u>
Total deferred credits	<u>\$1,906,363</u>	<u>\$2,308,725</u>

**Chugach Electric Association, Inc.**  
**Notes to Financial Statements**  
**December 31, 2007 and 2006**

**(6) Patronage Capital**

Chugach has a Board approved capital credit retirement policy, which is contained in Chugach's 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. At December 31, 2007, Chugach had \$138,713,338 of patronage capital (net of capital credits retired in 2007), which included \$116,029,438 of patronage capital that had been assigned and \$22,683,900 of patronage capital to be assigned to its members. 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 members in the event of default under the Amended and Restated Indenture exists (note 8).

Capital credits retired were \$5,289,538, \$5,106,817, and \$4,079,622 for the years ended December 31, 2007, 2006, and 2005, respectively. The outstanding liability for capital credits authorized but not paid was \$2,416,552 and \$1,322,577 at December 31, 2007 and 2006, respectively.

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

<u>Years ending December 31</u>	<u>Total</u>
2008	\$ 2,900,000
2009	\$ 4,500,000
2010	\$ 4,500,000
2011	\$ 5,000,000
2012	\$ 3,500,000

**(7) Other Equities**

A summary of other equities at December 31 follows:

	<u>2007</u>	<u>2006</u>
Nonoperating margins, prior to 1967	\$23,625	\$23,625
Donated capital	1,148,907	878,923
Unclaimed capital credit retirement*	<u>8,079,553</u>	<u>7,398,299</u>
Total other equities	<u>\$9,252,085</u>	<u>\$8,300,847</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.

**Chugach Electric Association, Inc.**  
**Notes to Financial Statements**  
**December 31, 2007 and 2006**

**(8) Debt**

Long-term obligations at December 31 are as follows:	<u>2007</u>	<u>2006</u>
CoBank 2, 5.50% fixed rate note maturing in 2010, with interest and principal payable monthly; unsecured	\$5,500,000	\$7,500,000
CoBank 3 and 4, 5.79% variable rate notes maturing in 2022, with interest payable monthly and principal due annually beginning in 2003; unsecured	39,803,530	41,032,099
CoBank 5, 5.79% variable rate note maturing in 2012, with interest and principal payable monthly; unsecured	4,726,774	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>35,500,000</u>	<u>41,000,000</u>
Total long-term obligations	\$355,530,304	\$364,532,099
Less current installments	<u>10,106,804</u>	<u>13,728,569</u>
Long-term obligations, excluding current installments	<u>\$345,423,500</u>	<u>\$350,803,530</u>

**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 CoBank, 2001 Series A, 2002 Series A and 2002 Series B bonds, provided that the bonds were secured by a mortgage on substantially all of Chugach's assets so long as any amounts were outstanding to CoBank on bonds issued under the indenture. Upon the retirement of the then outstanding bonds on January 22, 2003, the 2001 Series A, 2002 Series A and 2002 Series B bonds (the Bonds) became subject to the Amended and Restated Indenture pursuant to which the Bonds became unsecured obligations of Chugach.

**Chugach Electric Association, Inc.**  
**Notes to Financial Statements**  
**December 31, 2007 and 2006**

**(8) Debt (continued)**

*Covenants (continued)*

Chugach is also required to comply with the Master Loan Agreement, which covers the CoBank 2, 3, 4 and 5 promissory notes, between Chugach and CoBank dated December 27, 2002, pursuant to which CoBank and Chugach replaced the CoBank 2, 3, 4 and 5 bonds issued to CoBank with the above stated 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 electric rates reasonably expected to yield margins for interest equal to at least 1.10 times interest expense.

*Security*

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 secures the 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.

*Rates*

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.

**Chugach Electric Association, Inc.**  
**Notes to Financial Statements**  
**December 31, 2007 and 2006**

**(8) Debt (continued)**

*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, 2007, 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>	
2008	0	0	5,900,000	4,206,804	10,106,804
2009	0	0	6,300,000	4,403,653	10,703,653
2010	0	0	6,700,000	4,118,028	10,818,028
2011	150,000,000	0	7,100,000	2,851,501	159,951,500
2012	0	120,000,000	9,500,000	2,693,543	132,193,543
Thereafter	<u>0</u>	<u>0</u>	<u>0</u>	<u>31,756,775</u>	<u>31,756,775</u>
	<u>\$150,000,000</u>	<u>\$120,000,000</u>	<u>\$35,500,000</u>	<u>\$50,030,304</u>	<u>\$355,530,304</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 17, 2007, the Board of Directors approved a resolution to renew this line of credit. The CoBank line of credit expires October 31, 2008, subject to annual renewal at the discretion of the parties. In March of 2007, Chugach borrowed \$3.5 million and repaid the balance in April. In September of 2007, Chugach borrowed \$1.0 million and repaid the balance in the same month. Chugach did not utilize this line of credit in 2006. At December 31, 2007 and 2006, there was no outstanding balance on this line of credit. The borrowing rate is calculated using the CoBank Base Rate

**Chugach Electric Association, Inc.**  
**Notes to Financial Statements**  
**December 31, 2007 and 2006**

**(8) Debt (continued)**

*Short-term obligations (continued)*

on the first business day of the week plus 3%. The average borrowing rate for 2007 and 2006 was 6.47% and 6.51%, respectively. In addition, Chugach had an annual line of credit of \$50,000,000 available at December 31, 2007 and 2006, with NRUCFC. Chugach did not utilize this line of credit in 2007 or 2006. At December 31, 2007 and 2006, there was no outstanding balance on this line of credit. The borrowing rate is calculated using the total rate per annum as may be fixed by CFC and will not exceed the Prevailing Prime Rate, plus one percent per annum. At December 31, 2007 and 2006, the borrowing rate would have been 6.40% and 7.15%, respectively. The NRUCFC line of credit expires October 17, 2012.

*Refinancing*

On August 20, 2007, Chugach refinanced its \$5 million promissory note (CoBank 5) with CoBank. The new \$5,000,000, variable rate promissory note will mature August 20, 2012 and contains consecutive monthly installment payments commencing September 20, 2007.

*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. Chugach has not experienced an unsuccessful auction since the bonds have been outstanding. The average interest rate for the 2002 Series B Bonds in 2007, 2006, and 2005 was 5.34%, 5.07%, and 3.42%, respectively.

**Chugach Electric Association, Inc.**  
**Notes to Financial Statements**  
**December 31, 2007 and 2006**

**(8) Debt (continued)**

*2002 Series B Bonds (continued)*

The following table provides information regarding auction dates and rates in 2007:

<u>Auction Date</u>	<u>Interest Rate</u>
January 24, 2007	5.29%
February 21, 2007	5.29%
March 22, 2007	5.30%
April 18, 2007	5.25%
May 16, 2007	5.32%
June 13, 2007	5.30%
July 11, 2007	5.29%
August 8, 2007	5.33%
September 5, 2007	6.15%
October 3, 2007	5.25%
October 31, 2007	5.00%
November 28, 2007	5.25%
December 26, 2007	5.35%

**(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>2007</u>		<u>2006</u>	
	<u>Carrying Value</u>	<u>Fair Value</u>	<u>Carrying Value</u>	<u>Fair Value</u>
Long-term obligations (including current installments)	\$355,530	\$371,868	\$364,532	\$375,611

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

**Chugach Electric Association, Inc.**  
**Notes to Financial Statements**  
**December 31, 2007 and 2006**

**(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 for the union plans were approximately \$2.9 million, \$2.5 million, and \$2.4 million in 2007, 2006, and 2005, 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 \$1.9 million, \$1.6 million, and \$1.8 million in 2007, 2006, and 2005, 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, 2007, 2006, and 2005 were \$3.3 million, \$2.9 million, and \$3.0 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, 2007, 2006, and 2005 totaled \$1.9 million, \$2.0 million, and \$2.0 million respectively.

**Chugach Electric Association, Inc.**  
**Notes to Financial Statements**  
**December 31, 2007 and 2006**

**(10) Employee Benefit Plans (continued)**

*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, 2007, 2006, and 2005 were \$142.1 thousand, \$85.4 thousand, and \$80.7 thousand, respectively.

*401(k) Plan*

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 \$15,500, \$15,000, and \$14,000 in 2007, 2006, and 2005 respectively. Chugach does not make contributions to the plan.

*Deferred Compensation*

Chugach adopted NRECA's unfunded Deferred Compensation Program (the Program) to allow highly compensated employees who elect to participate in the Program to defer a portion of their current compensation and avoid paying tax on the deferrals until received. The program is a non-qualified plan under Internal Revenue Code 457(b).

Deferred compensation accounts are established for the individual employees, however, they are considered to be owned by Chugach until a distribution is made. The amounts credited to the deferred compensation account, including gains or losses, are retained by Chugach until the entire amount credited to the account has been distributed to the participant or to the participant's beneficiary. The balance of the Program for the years ending December 31, 2007, 2006 and 2005 was \$768,041, \$645,582 and \$283,924, respectively.

**Chugach Electric Association, Inc.**  
**Notes to Financial Statements**  
**December 31, 2007 and 2006**

**(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 \$37,000,000. 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 rate making 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, 2007 (the most recent date for which information is available). Chugach's share of expenses was \$4,816,790 in 2007, \$4,219,321 in 2006, and \$4,993,670 in 2005 and is included in purchased power in the accompanying financial statements.

(In thousands)	<u>Total</u>	Proportionate <u>Share</u>
Plant in service	\$ 208,647	\$ 63,429
Long-term debt	117,147	35,613
Interest expense	7,938	2,413

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

**(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%).

**Chugach Electric Association, Inc.**  
**Notes to Financial Statements**  
**December 31, 2007 and 2006**

**(12) Eklutna Hydroelectric Project (continued)**

Plant in service in 2007 includes \$2,540,275, net of accumulated depreciation of \$719,186, which represents Chugach's share of the Eklutna Hydroelectric Plant. In 2006 plant in service included \$2,644,397, net of accumulated depreciation of \$608,495. 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 \$712,552, \$591,903, and \$476,739 in 2007, 2006, and 2005, 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. AML&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 215 BCF for the 2015 contract should be used by late 2010 or early 2011. The currently committed 180 BCF for the 2025 contract should also be used by early 2011. Chugach is currently working with Cook Inlet producers on future supply contracts. In 2007, 91% of our power was generated from gas, while in 2006 and 2005, 90% and 88%, respectively, of our power was generated from gas. Of that gas-fired generation, 85% took place at Beluga in 2007, while in 2006 and 2005, 87% and 86%, respectively, of gas-fired generation took place at Beluga.

**Chugach Electric Association, Inc.**  
**Notes to Financial Statements**  
**December 31, 2007 and 2006**

**(13) Commitments, Contingencies and Concentrations (continued)**

*Long-Term Fuel Supply Contracts (continued)*

Fuel is purchased directly from Marathon Oil Company, ChevronTexaco, AML&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>2007</u>	<u>2006</u>	<u>2005</u>
Marathon Oil Company	46.4%	49.2%	48.8%
Chevron Texaco	20.4%	19.4%	19.5%
Municipal Light & Power (AML&P)	16.1%	15.7%	15.8%
ConocoPhillips	16.9%	15.7%	15.8%

*Concentrations*

Approximately 70% of Chugach’s employees are represented by the International Brotherhood of Electrical Workers (IBEW). Chugach has three Collective Bargaining Unit Agreements (CBA) with the IBEW, which expire on June 30, 2010.

Chugach is the principal supplier of power under long-term wholesale power contracts with MEA and HEA. These contracts represented \$93.4 million or 36.7% of operating revenues in 2007, \$90.1 million or 34.1% in 2006, and \$72.1 million or 32.4% in 2005. The HEA contract expires January 1, 2014, and the MEA contract expires December 31, 2014. All rates are established by the RCA.

*Legal Proceedings*

*Matanuska Electric Association, Inc. (MEA) 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 “Footnote 2, Regulatory Matters – Revision to Current Depreciation Rates (Docket No. U-04-102).” On appeal, MEA claims the RCA’s decision dated January 10, 2006, to authorize Chugach to implement new depreciation rates as of January 1, 2005, constituted illegal retroactive rate making. MEA further contends that the RCA’s reliance on avoidance of regulatory lag as a basis for its decision was improper. MEA also challenged certain of the RCA’s discovery rulings. Chugach has joined the State of Alaska in defending the RCA’s rulings. HEA stipulated with the other parties to dismiss its cross appeal which the Court granted by order dated September 11, 2007. All of the parties have filed their respective briefs and the Court scheduled oral argument for April 29, 2008.

**Chugach Electric Association, Inc.**  
**Notes to Financial Statements**  
**December 31, 2007 and 2006**

**(13) Commitments, Contingencies and Concentrations (continued)**

*Legal Proceedings (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. No reserves have been established for this matter.

*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 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 \$0.000274, effective July 1, 2007. 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 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.

**Chugach Electric Association, Inc.**  
**Notes to Financial Statements**  
**December 31, 2007 and 2006**

**(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 State of Alaska undergrounding requirement, Chugach is permitted to amend its rates by adding a 2% surcharge to its retail members' 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. Chugach's liability was \$571,530 and \$2,044,001 for this surcharge at December 31, 2007 and December 31, 2006, respectively.

*Environmental Matters*

The Clean Air Act and Environmental Protection Agency (EPA) regulations under the act (the "Clean Air Act") establish ambient air quality standards and limit the emission of many air pollutants. Some Clean Air Act programs that regulate electric utilities, notably the Title IV "acid rain" requirements, do not apply to facilities located in Alaska. The EPA's anticipated regulations to limit mercury emissions from fossil-fired steam-electric generating facilities are not expected to materially impact Chugach because our thermal power plants burn exclusively natural gas.

New Clean Air Act regulations impacting electric utilities may result from future events or may result from new regulatory programs that may be established to address problems such as global warming. While we cannot predict whether any new regulation would occur or its limitation, it is possible that new laws or regulations could increase our capital and operating costs. We have obtained or applied for all Clean Air Act permits currently required for the operation of our generating facilities.

In March 2007 Chugach conducted emissions testing at the Bernice Lake Power Plant which indicated that two of the gas turbines at the facility were exceeding the New Source Performance Standards (NSPS) emission limit for nitrogen oxides (NOx). Chugach voluntarily limited the power output of these turbines to ensure interim compliance with the NSPS regulations and is currently in the final stages of commissioning a water injection system to control NOx emissions from the turbines. With the water injection system, Chugach will again be able to fully utilize the power output from these turbines while complying with the NSPS regulations.

Chugach is also currently negotiating with the Alaska Department of Environmental Conservation (ADEC) to resolve the issue of past non-compliance with the Bernice Lake turbines. To date ADEC has not issued a formal Notice of Violation (NOV) to Chugach regarding the NSPS issues. However, Chugach anticipates that ADEC likely will issue a NOV and seek to recover a civil penalty for the NSPS exceedances. Given that ADEC has

**Chugach Electric Association, Inc.**  
**Notes to Financial Statements**  
**December 31, 2007 and 2006**

**(13) Commitments, Contingencies and Concentrations (continued)**

*Environmental Matters (continued)*

not yet issued a NOV to Chugach, it is not possible to reasonably estimate the amount of any potential penalty.

Chugach is subject to numerous other environmental statutes including the Clean Water Act, the Resource Conservation and Recovery Act, the Toxic Substances Control Act, the Endangered Species Act, and the Comprehensive Environmental Response, Compensation and Liability Act and to the regulations implementing these statutes. We do not believe that compliance with these statutes and regulations to date has had a material impact on our financial condition or results of operation. However, new laws or regulations, implementation of final regulations or changes in or new interpretations of these laws or regulations could result in significant additional capital or operating expenses.

**(14) Quarterly Results of Operations (unaudited)**

	<u>2007 Quarter Ended</u>			
	<u>Dec. 31</u>	<u>Sept. 30</u>	<u>June 30</u>	<u>March 31</u>
Operating Revenue	\$69,809,448	\$57,053,772	\$59,127,575	\$71,453,124
Operating Expense	62,808,159	53,280,744	55,162,909	61,115,211
Net Interest	<u>5,770,903</u>	<u>5,960,305</u>	<u>5,962,574</u>	<u>6,019,015</u>
Net Operating Margins	1,230,386	(2,187,277)	(1,997,908)	4,318,898
Non-Operating Margins	<u>766,720</u>	<u>250,880</u>	<u>233,637</u>	<u>269,920</u>
Assignable Margins	<u>\$ 1,997,106</u>	<u>\$(1,936,397)</u>	<u>\$(1,764,271)</u>	<u>\$4,588,818</u>
	<u>2006 Quarter Ended</u>			
	<u>Dec. 31</u>	<u>Sept. 30</u>	<u>June 30</u>	<u>March 31</u>
Operating Revenue	\$77,164,939	\$63,243,634	\$60,248,547	\$66,885,593
Operating Expense	67,830,660	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	3,328,188	(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>\$ 4,017,902</u>	<u>\$118,057</u>	<u>\$714,427</u>	<u>\$5,188,673</u>