

CHUGACH ELECTRIC ASSOCIATION, INC.
ANCHORAGE, ALASKA

February 16, 2006

To: Mike Cunningham, Chief Financial Officer

From: Sherri McKay-Highers, Manager, Corporate Budgeting

Subject: 2005 Audit Memo

Chugach closed 2005 with Operating Revenues of \$225.7 million, margins of \$9.8 million, a 1.42 Margins for Interest/Interest (MFI/I), current ratio of 1.25:1 and an equity to total capitalization ratio of 28.5%. The equity to total capitalization target as presented in the approved 2005 budget was 27.9%. The budget comparisons discussed below are based on the 2005 budget as revised throughout the year.

kWh Sales

	<u>2005 Actual</u>	<u>2005 Budget</u>	<u>2004 Actual</u>
Retail kWh Sales	1,216,808,429	1,237,661,489	1,225,049,125
Wholesale kWh Sales	1,251,747,190	1,219,048,480	1,197,639,776
Economy Energy kWh Sales	<u>294,129,130</u>	<u>188,756,000</u>	<u>206,706,290</u>
Total	2,762,684,749	2,645,465,969	2,629,395,191

The preliminary kWh sales totaled 2,762,684,749 which were 4.4% over budget and 5.1% over 2004. The budget variance is primarily due to higher than anticipated load growth to Matanuska Electric Association, Inc. (MEA) and a higher level of economy energy sales than was projected. The uncertainty of fuel oil prices makes it difficult to forecast sales to Golden Valley Electric Association (GVEA).

Retail kWh sales were under budget by 1.7%, while wholesale kWh sales were 2.7% higher than budgeted.

Retail kWh sales for 2005 decreased over 2004 by 0.7%, however, wholesale kWh sales for 2005 increased over 2004 by 4.5%. The decrease to retail sales was due to a mild winter, compared to the same period in 2004, as well as the impact of a 1.5% increase in distribution line losses in 2005. The increase in wholesale sales was due to increased sales to Homer Electric Association, Inc. (HEA) and strong load growth, especially in MEA's territory in 2005 over 2004. Economy energy sales increased by 42.3% from 2004, which is attributable to higher fuel oil prices in 2005. The higher fuel prices in 2005 made it more economical for GVEA to purchase power from Chugach, rather than generate its own.

Energy Revenue (in millions)

	<u>2005 Actual</u>	<u>2005 Budget</u>	<u>2004 Actual</u>
Retail Revenue	\$ 133.2	\$ 132.8	\$ 124.7
Wholesale Revenue	75.4	72.3	64.8
Economy Energy Revenue	<u>14.1</u>	<u>9.4</u>	<u>8.9</u>
Total	\$ 222.7	\$ 214.5	\$ 198.4

Revenue from sales totaled \$222.7 million in 2005 compared to \$214.5 in the 2005 budget and \$198.4 in 2004. Retail revenue increased from budget and from prior year due to increased recoverable fuel and purchased power expenses as a result of higher fuel prices and higher volume purchases. Wholesale revenue increased from budget and from prior year due to increased kWh sales as well as increased recoverable fuel and purchased power expenses.

Other Operating Revenue (in millions)

	<u>2005 Actual</u>	<u>2005 Budget</u>	<u>2004 Actual</u>
Other Operating Revenue	\$ 3.0	\$ 2.8	\$ 2.8

Other operating revenue for 2005 totaled \$3.0 million compared to \$2.8 million in the 2005 budget and \$2.8 million in 2004. The variance from the budget and from prior year was due to higher than anticipated miscellaneous revenue from late fees and wheeling revenue.

Power Production (in millions)

	<u>2005 Actual</u>	<u>2005 Budget</u>	<u>2004 Actual</u>
Operating & Maintenance	\$ 15.0	\$ 15.4	\$ 15.0
Fuel	<u>84.8</u>	<u>76.3</u>	<u>64.1</u>
Total	\$ 99.8	\$ 91.7	\$ 79.1

Actual power production operating and maintenance expense for 2005 was \$15.0 million compared to a budget of \$15.4 million. This variance was primarily due to lower than anticipated labor charged to power production expense which was offset by an increase in G&T labor charge to general and administrative expense, as well as lower than anticipated transportation expenses.

Fuel expense in 2005 was \$84.8 million compared to \$76.3 million projected in the budget. This variance is due to higher fuel prices and higher volume purchased during the year than those anticipated in the budget.

Power production operating and maintenance expense did not materially change from 2004 to 2005.

The increase in fuel expense from \$64.1 million in 2004 to \$84.8 million in 2005 is also a result of higher fuel prices and higher volume purchases.

Purchased Power (in millions)

	<u>2005 Actual</u>	<u>2005 Budget</u>	<u>2004 Actual</u>
Total Purchased Power	\$ 23.7	\$ 23.6	\$ 20.6

Purchased power cost for 2005 totaled \$23.7 million compared to \$23.6 million in the 2005 budget. The increase in purchased power expense from \$20.6 million in 2004 to \$23.7 million in 2005 is a result of higher fuel prices in 2005.

Transmission Operations and Maintenance (in millions)

	<u>2005 Actual</u>	<u>2005 Budget</u>	<u>2004 Actual</u>
Total Transmission	\$ 5.8	\$ 6.2	\$ 6.4

Transmission operations and maintenance expense totaled \$5.8 million in 2005 compared to \$6.2 million in the 2005 budget. The variance from budget is primarily due to lower than anticipated professional services associated with the maintenance of overhead lines and substations, as well as lower than anticipated wheeling costs associated with Eklutna.

Transmission operations and maintenance expense totaled \$6.4 million in 2004. The decrease from 2004 to 2005 was primarily due to a decrease in transmission substation maintenance performed in 2005.

Distribution Operations and Maintenance (in millions)

	<u>2005 Actual</u>	<u>2005 Budget</u>	<u>2004 Actual</u>
Total Distribution	\$ 11.8	\$ 11.8	\$ 11.5

Distribution operations and maintenance expenses totaled \$11.8 million compared to \$11.8 million in the 2005 budget and \$11.5 million in 2004.

The increase in distribution expense from 2004 to 2005 was primarily due to an increase in labor associated with line and station equipment maintenance.

Consumer Accounts (in millions)

	<u>2005 Actual</u>	<u>2005 Budget</u>	<u>2004 Actual</u>
Total Consumer Accounts	\$ 4.4	\$ 4.7	\$ 4.5

Consumer accounts expense totaled \$4.4 million compared to \$4.7 million in the budget. The variance in the 2005 budget was due to lower labor expense in the Member Services department as a result of four unfilled positions in early 2005.

Consumer accounts expense did not materially change from 2004 to 2005.

Customer Information (in millions)

	<u>2005 Actual</u>	<u>2005 Budget</u>	<u>2004 Actual</u>
Total Customer Information	\$ 0.9	\$ 1.0	\$ 0.8

Customer information expense totaled \$0.9 million compared to \$1.0 million in the 2005 budget and \$0.8 in 2004, with no significant variances.

Administrative and General (in millions)

	<u>2005 Actual</u>	<u>2005 Budget</u>	<u>2004 Actual</u>
Total Administrative and General	\$ 19.0	\$ 18.4	\$ 21.4

Administrative and general expenses totaled \$19.0 million for 2005 compared to \$18.4 million in the 2005 budget and \$21.4 million in 2004. The variance from budget was partially due to an increase in labor charged to administrative and general expense, which was offset, in part, by a decrease in labor charged to Power Production expense. The variance from budget was also due to higher than anticipated professional services associated with legal, information services and generation technical services.

The variance from 2004 to 2005 is primarily due to an update to the way in which workers' compensation claims were recorded. In 2004 the cost of workers' compensation claims were recorded directly to administrative and general expense, however, in 2005 the claims were directly charged to the employee's operating division following the employees direct labor charges.

The summary of all the above 2005 operations and maintenance expenses total \$165.3 million compared to \$157.5 million in the revised 2005 budget and \$144.3 million in 2004.

Depreciation expense totaled \$28.0 million for 2005 compared to \$28.7 in the revised 2005 budget and \$28.2 million in 2004. The variance from the budget was due to the implementation of RCA Order No. 9. The variance from 2004 to 2005 was due to plant additions in 2005, as well as the implementation of new rates in 2005.

Tax expense for 2005 totaled \$0.8 million compared to \$0.8 million in the 2005 budget and \$0.7 million in 2004. There were no significant changes or variances from the 2005 budget or 2004 actual expenses.

Long-term interest expense totaled \$23.4 million compared to \$22.8 million in the 2005 budget and \$22.0 million in 2004. The increase from the 2005 budget is the result of higher variable interest rates than anticipated. The increase from 2004 is due to higher variable interest rates.

Interest during construction totaled \$0.8 million compared to \$0.9 million in the budget and \$0.5 million in 2004. The variance from 2004 was due to higher average balances in Construction Work in Progress and higher interest rates.

Other interest expense totaled \$0.0 million compared to \$0.1 million in the budget and \$(0.1) million in 2004. The line of credit was used and paid back in March of 2005.

Other deductions include donations, preliminary survey and investigation charges of abandoned projects and obsolete inventory write-offs which are not properly attributable to operating or maintenance accounts. In 2005, other deductions totaled \$0.5 million compared to \$0.6 million in the budget and \$0.5 million in 2004, with no significant variances.

All of the foregoing expenses result in total cost of electric service of \$217.2 million compared to \$209.5 million in the budget and \$195.1 in 2004.

Non-operating margins include interest income, allowance for funds used during construction, capital credit and patronage capital allocations and extraordinary items. In 2005, non-operating margins totaled \$1.2 million compared to \$1.2 million in the budget and \$1.2 million in 2004, with no significant variances.

The net result of revenue and expenses in 2005 is margins of \$9.8 million compared to projected margins of \$9.0 million in the 2005 revised budget and margins of \$7.4 million in 2004. These results give Chugach an MFI/I of 1.42 and an equity-to-total-capitalization ratio of 28%. The Amended and Restated Indenture of Trust has certain covenants related to establishing electricity rates that are reasonably expected to yield an MFI/I of 1.10 in any 12 month period. This compares to a revised budgeted MFI/I of 1.39 and an equity-to total-capitalization ratio of 28%. The year-end current ratio (current assets divided by current liabilities) is 1.25:1.

The 2005 and 2004 margins differ from the audited financial statements in the amount of \$244,856 due to RCA Order No. 8. Order No. 8 required Chugach to adjust its underlying financial records for 2004, however, in accordance with Generally Accepted Accounting Principles (GAAP), the audited and published financial statements were not required to be restated.

CHUGACH ELECTRIC ASSOCIATION, INC.
COMPARATIVE FINANCIAL REPORT
STATEMENT OF OPERATIONS
DECEMBER 2005

CATEGORY	2005 ACTUALS YTD	2005 APPROVED BUDGET	2005 REVISED BUDGET
REVENUES:			
1. TOTAL REVENUE	\$225,697,349	\$217,538,640	\$217,351,373
EXPENSES:			
2. FUEL EXPENSE	84,776,131	76,282,516	76,282,516
3. POWER PRODUCTION EXPENSE	15,037,499	15,761,827	15,443,811
4. COST OF PURCHASED POWER	23,664,412	23,602,428	23,611,088
5. TRANSMISSION EXPENSE	5,847,648	6,221,818	6,187,401
6. DISTRIBUTION EXPENSE-OPERATIONS	5,006,909	5,260,967	5,230,593
7. DISTRIBUTION EXPENSE-MAINTENANCE	6,751,802	6,591,661	6,555,827
8. CONSUMER ACCOUNTS EXPENSE	4,351,628	4,767,714	4,729,668
9. CUSTOMER SERVICE/INFO EXPENSE	875,850	855,859	1,023,835
11. ADMINISTRATIVE/GENERAL EXPENSE	19,010,714	18,954,549	18,394,953
12. TOTAL OPERATIONS/MAINTENANCE EXP.	\$165,322,593	\$158,299,339	\$157,459,692
13. DEPRECIATION/AMORTIZATION EXPENSE	27,994,939	28,741,803	28,741,803
14. TAX EXPENSE-OTHER	812,174	833,700	833,700
15. INTEREST-LONG TERM DEBT	23,384,316	22,768,233	22,768,233
16. INTEREST ON CONSTRUCTION-CREDIT	(844,911)	(454,340)	(934,339)
17. INTEREST EXPENSE-OTHER	46,649	96,875	96,875
18. OTHER DEDUCTIONS	449,403	575,000	575,000
19. TOTAL COST OF ELECTRIC SERVICE	\$217,165,163	\$210,860,610	\$209,540,964
20. PATRONAGE CAPITAL/OPERATING MARGINS	\$8,532,186	\$6,678,030	\$7,810,409
21. NON-OPERATING MARGINS-INTEREST	560,418	360,170	360,170
22. ALLOWANCE FUNDS USED DURING CONST.	148,588	80,178	176,178
23. NON-OPERATING MARGINS-OTHER	(57,202)	0	0
24. GENER./TRANS. CAPITAL CREDITS	0	0	0
25. OTHER CAPITAL CREDITS/DIVIDENDS	575,597	650,000	650,000
26. EXTRAORDINARY ITEMS	0	0	0
27. PATRONAGE CAPITAL OR MARGINS	\$9,759,587	\$7,768,378	\$8,996,757
 MFI/I	 1.42	 1.34	 1.39