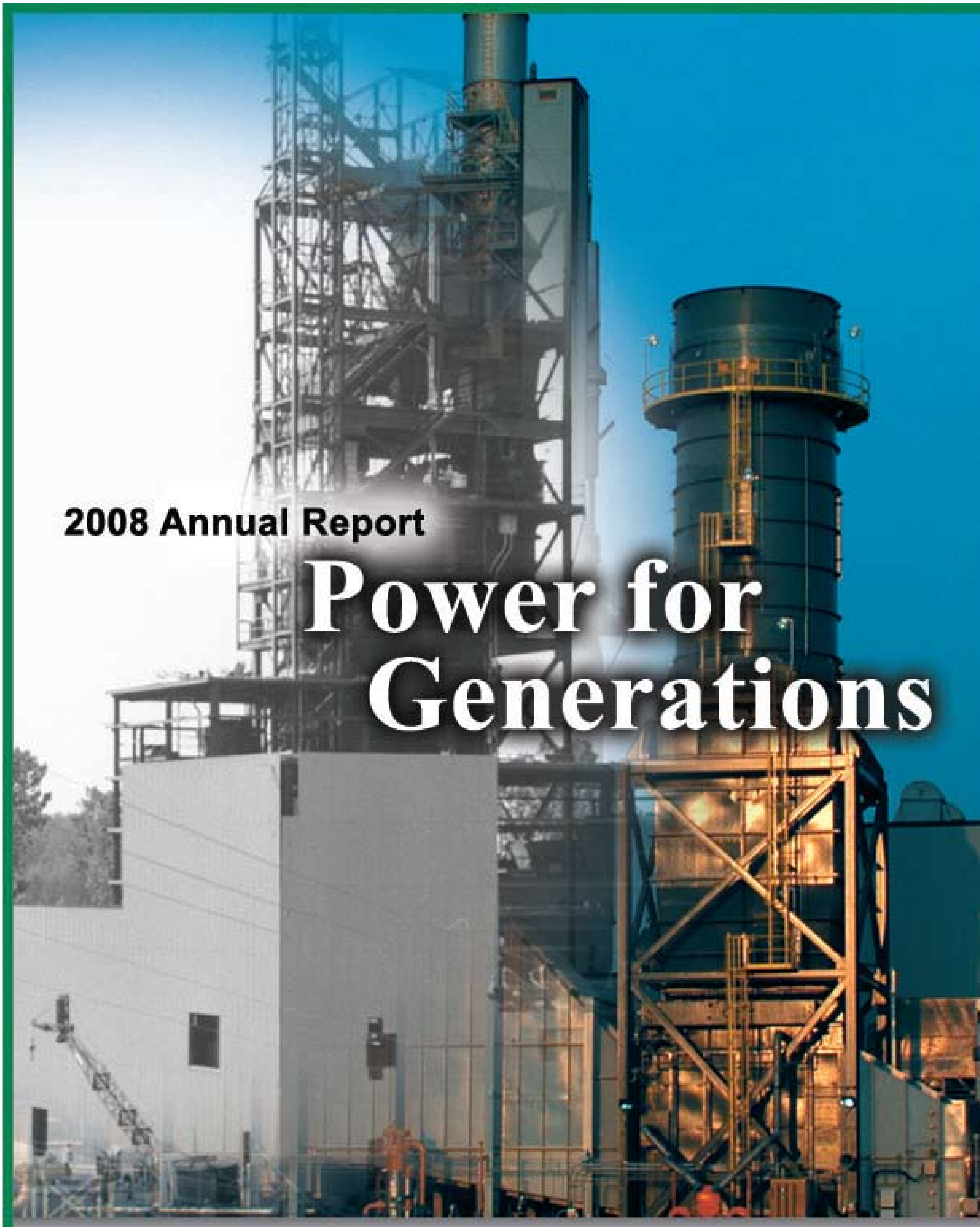

2008 Annual Report

Power for Generations

Arkansas Electric Cooperative Corporation

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Deloitte.

INDEPENDENT AUDITORS' REPORT

Board of Directors
Arkansas Electric Cooperative Corporation:
Little Rock, Arkansas

We have audited the accompanying balance sheets of Arkansas Electric Cooperative Corporation ("AECC") as of October 31, 2008 and 2007, and the related statements of operations, members' equities, and of cash flows for each of the three years in the period ended October 31, 2008. These financial statements are the responsibility of AECC's management. Our responsibility is to express an opinion on these financial statements based on our audits.

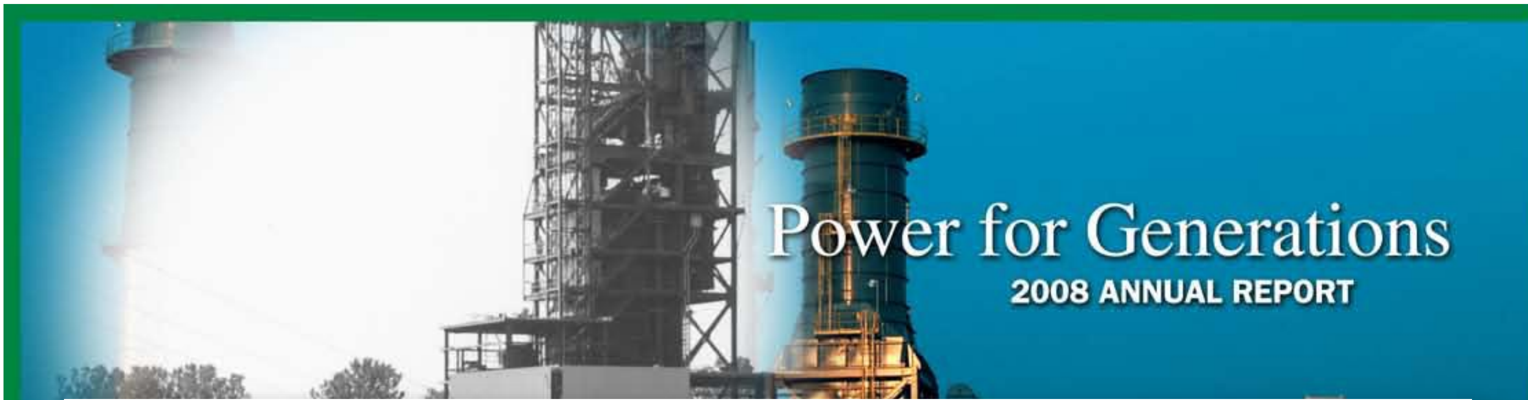
We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of AECC's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and 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 AECC as of October 31, 2008 and 2007, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated January 6, 2009, on our consideration of AECC's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Deloitte & Touche LLP

January 6, 2009



BALANCE SHEETS

As Of October 31, 2008 And 2007 (In Thousands)

ASSETS	2008	2007
Utility Plant:		
Electric plant in service	$1,462,931	$1,453,934
Construction work in progress	83,527	56,546
Total utility plant	**1,546,458**	1,510,480
Less accumulated depreciation	799,550	764,004
Net utility plant	**746,908**	746,476
Long-Term Investments:		
Marketable securities	5,072	2,987
Gas reserves	47,681	50,282
Other	25,333	25,822
Total long-term investments	**78,086**	79,091
Current Assets:		
Cash and cash equivalents	45,263	46,374
Short-term marketable securities	1,000	6,124
Accounts receivable — members	36,632	49,635
Fuel inventories and prepaid fuel supply	28,563	29,771
Material and supply inventories	15,444	15,377
Other current assets	6,040	5,787
Total current assets	**132,942**	153,068
Deferred Charges	**120,491**	126,614
Total	**$1,078,427**	$1,105,249

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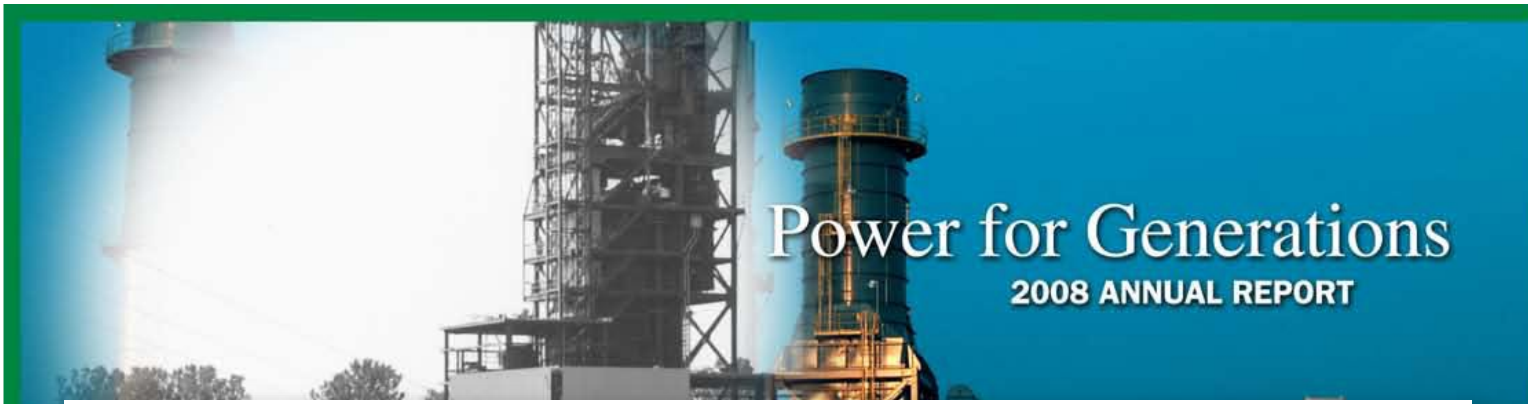
Arkansas Electric Cooperative Corporation



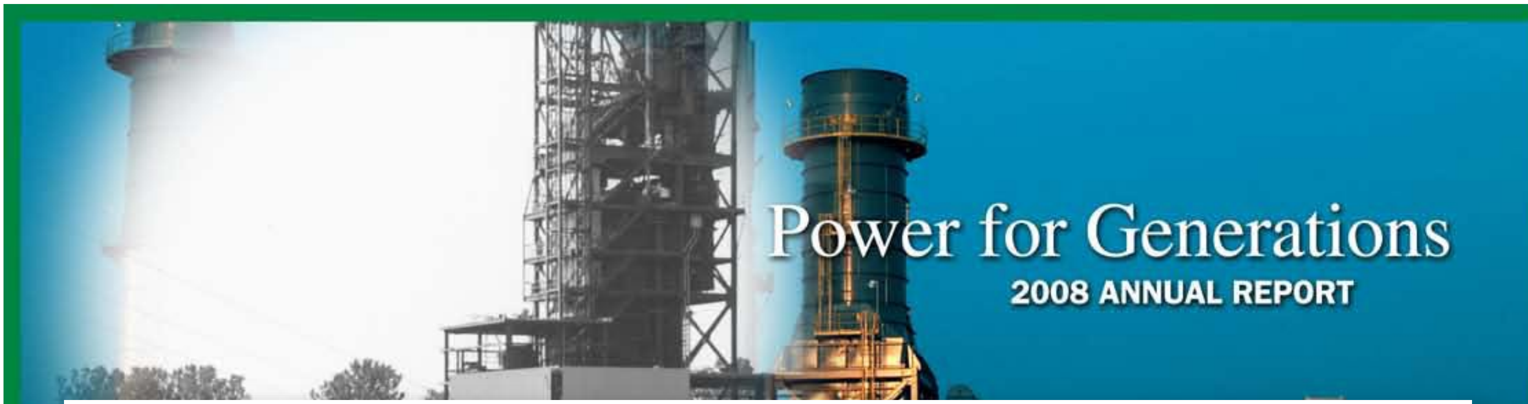
BALANCE SHEETS

As Of October 31, 2008 And 2007 (In Thousands)

LIABILITIES AND MEMBERS' EQUITIES	2008	2007
Members' Equities And Liabilities:		
Membership fees	$2	$2
Patronage capital	290,160	276,651
Accumulated margins	28,951	27,300
Other equities	118,140	118,140
Net unrealized loss on investments	(48)	(15)
Total members' equities	**437,205**	422,078
Long-Term Debt:		
Federal Financing Bank	275,263	298,168
Independence Steam Electric Station finance obligation	115,366	124,687
Ellis finance obligation	26,467	34,134
Rural Utilities Service	1,899	2,528
Other long-term debt	65	74
Total long-term debt	**419,060**	459,591
Current Liabilities:		
Notes payable — members	123,626	105,954
Accounts payable and other accrued liabilities	39,311	54,273
Current maturities of long-term debt	40,531	43,594
Accrued property taxes	5,898	5,870
Accrued interest	4,471	4,919
Total current liabilities	**213,837**	214,610
Deferred credits	**8,325**	8,970
Commitments and contingencies		
Total	**$1,078,427**	$1,105,249

See notes to financial statements. (Concluded)

Arkansas Electric Cooperative Corporation

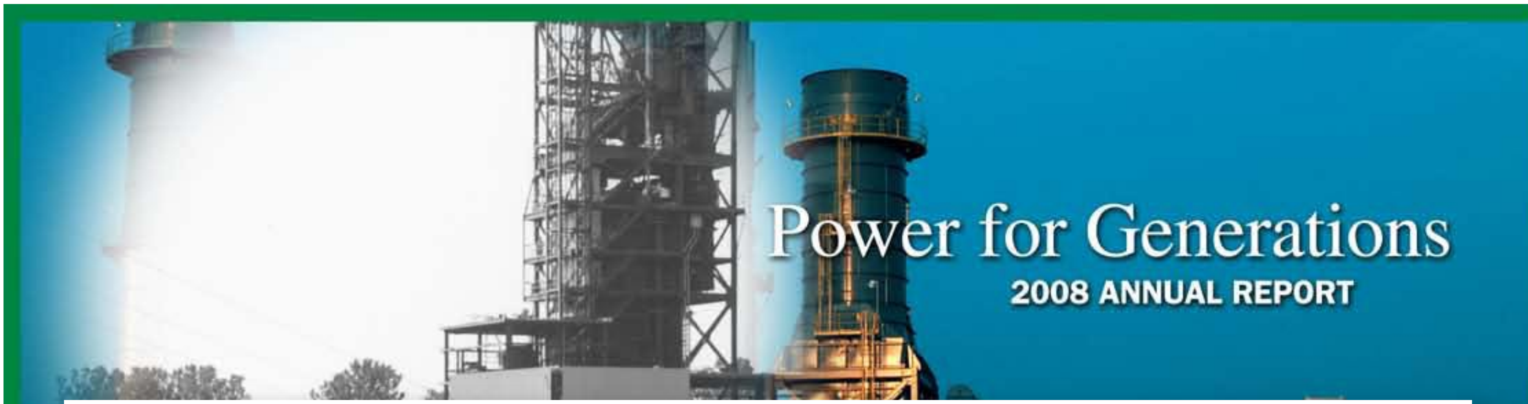


STATEMENTS OF OPERATIONS
For Each Of The Three Years In The Period Ended October 31, 2008
(In Thousands)

	2008	2007	2006
Operating Revenues	$668,566	$586,973	$620,084
Operating Expenses:			
Operation and maintenance — generation	312,279	276,747	251,149
Power purchased	202,524	170,735	220,976
Operation and maintenance — transmission	48,288	48,094	39,722
Administrative and general	18,107	18,266	17,650
Depreciation	42,878	42,232	42,689
Interest	36,221	36,985	34,685
Taxes	156	142	158
Total Operating Expenses	**$660,453**	$593,201	$607,029
Margin (Loss) From Electric Operations	**8,113**	(6,228)	13,055
Other Income — Net	**3,878**	1,246	4,508
Interest Income — Net	**2,023**	4,627	2,053
Allowance For Funds Used During Construction	**1,146**	818	494
Net Margin	**$15,160**	$463	$20,110

See notes to financial statements.

Arkansas Electric Cooperative Corporation



STATEMENTS OF MEMBERS' EQUITIES

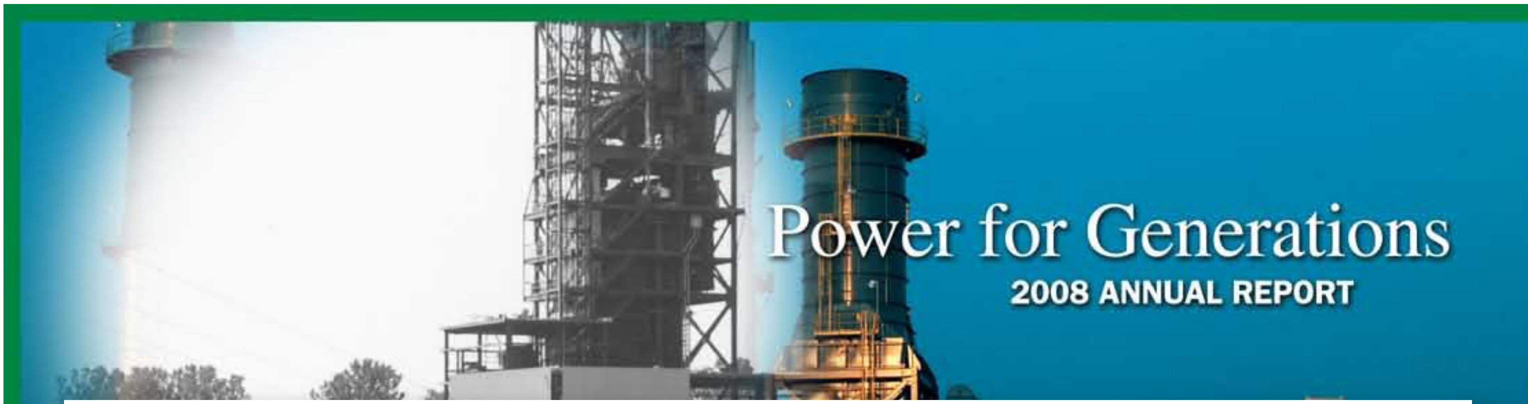
For Each Of The Three Years In The Period Ended October 31, 2008

(In Thousands)

	Membership fees	Patronage Capital	Accumulated Margins	Other Equities	Net Unrealized Gain (Loss) on Investments	Total Members' Equities
BALANCE — October 31, 2005	$2	$266,348	$33,769	$118,140	$(278)	$417,981
Comprehensive income:						
Net margin			20,110			20,110
Net unrealized gain on investments					146	146
Total comprehensive income						20,256
Allocation of patronage capital		19,771	(19,771)			-
Redemption of patronage capital		(8,374)				(8,374)
BALANCE — October 31, 2006	2	277,745	34,108	118,140	(132)	429,863
Comprehensive income:						
Net margin			463			463
Net unrealized gain on investments					117	117
Total comprehensive income						580
Allocation of patronage capital		7,271	(7,271)			-
Redemption of patronage capital		(8,365)				(8,365)
BALANCE — October 31, 2007	2	276,651	27,300	118,140	(15)	422,078
Comprehensive income:						
Net margin			15,160			15,160
Net unrealized loss on investments					(33)	(33)
Total comprehensive income						15,127
Allocation of patronage capital		13,509	(13,509)			-
BALANCE — October 31, 2008	**$2**	**$290,160**	**$28,951**	**$118,140**	**$(48)**	**$437,205**

See notes to financial statements.

Arkansas Electric Cooperative Corporation



STATEMENTS OF CASH FLOWS

For Each Of The Three Years In The Period Ended October 31, 2008 (In Thousands)

	2008	2007	2006
Operating Activities:			
Net margin	**$15,160**	$463	$20,110
Adjustments to reconcile net margin to net cash provided by operating activities:			
Depreciation	**42,878**	42,232	42,689
Net realized loss on marketable securities	**3**	15	
Amortization of gas reserves	**2,601**	2,799	3,491
Allowance for funds used during construction	**(1,146)**	(818)	(494)
Allocation of patronage from associated organization	**(588)**	(624)	(422)
Changes in operating assets and liabilities:			
Accounts receivable — members	**13,003**	(8,294)	587
Fuel inventories and prepaid fuel supply	**1,208**	(7,753)	(11,368)
Material and supply inventories	**(67)**	(2,878)	(463)
Other current assets	**(269)**	592	(3,256)
Deferred charges	**6,123**	5,539	5,126
Accounts payable and other accrued liabilities	**(22,133)**	8,979	(229)
Other deferred credits	**(87)**	1,669	(153)
Net cash provided by operating activities	**56,686**	41,921	55,618

(Continued)

Arkansas Electric Cooperative Corporation

STATEMENTS OF CASH FLOWS

For Each Of The Three Years In The Period Ended October 31, 2008 (In Thousands)

	2008	2007	2006
Investing Activities:			
Sales of marketable securities	**3,019**	3,500	3,009
Purchases of other investments			(10,000)
Sales of other investments	**519**	494	360
Capital expenditures	**(35,413)**	(48,280)	(23,944)
Net cash used in investing activities	**(31,875)**	(44,286)	(30,575)
Financing Activities:			
Net borrowings on notes payable	**17,672**	14,390	14,117
Principal payments on long-term debt	**(43,594)**	(41,830)	(115,887)
Proceeds from long-term debt		20,000	65,000
Redemption of patronage capital		(8,365)	(8,374)
Net cash used in financing activities	**(25,922)**	(15,805)	(45,144)
Decrease In Cash And Cash Equivalents	**(1,111)**	(18,170)	(20,101)
Cash And Cash Equivalents — Beginning Of Year	**46,374**	64,544	84,645
Cash And Cash Equivalents — End Of Year	**$45,263**	$46,374	$64,544
Supplemental Disclosure Of Cash Flow Information:			
Noncash transactions — Increase in accounts payable related to capital expenditures	**$6,751**	$2,629	$1,757

See notes to financial statements. (Concluded)

NOTES TO FINANCIAL STATEMENTS

As Of October 31, 2008 And 2007, And For Each Of The Three Years In The Period Ended October 31, 2008

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization

Arkansas Electric Cooperative Corporation ("AECC"), an electric generation and transmission cooperative, follows the Uniform System of Accounts prescribed by the Rural Development Utilities Programs ("RDUP"), formally the Rural Utilities Service ("RUS"); and the Federal Energy Regulatory Commission ("FERC").

AECC was organized and exists under Arkansas law to provide wholesale electric power and associated energy to its 17 members. AECC provides electric power to its members under wholesale power contracts, which may be terminated only upon 60 months prior written notice and, in any event, no earlier than January 1, 2036. On December 9, 2008, the Board of Directors (the "Board") took action to amend and restate the wholesale power contracts to January 1, 2042, which the RDUP approved on December 19, 2008. The wholesale power contracts require members to purchase, with the limited exception of two members, 100% of their energy requirements at a demand charge and energy rate, the combination of which is designed to recover the operating costs of AECC, plus a margin as approved by AECC's Board, the RDUP, and the Arkansas Public Service Commission ("APSC").

AECC's power supply resources are primarily comprised of owned, co-owned, and leased generating facilities. AECC delivers energy over its owned and contracted transmission facilities. Additionally, AECC maintains interchange agreements with certain utility companies that allow for the purchase and/or sale of electricity.

Carrying Value of Certain Assets and Liabilities

AECC's accounting policies and the accompanying financial statements conform to accounting principles generally accepted in the United States of America applicable to rate-regulated enterprises and reflect for financial reporting purposes the effects of the rate-making process in accordance with Statement of Financial Accounting Standards Board ("FASB") Statement No. 71, *Accounting for the Effects of Certain Types of Regulation*. In accordance with FASB Statement No. 71, AECC has regulatory assets in the amount of approximately $115.4 million attributable to premiums associated with debt refinancings and retirements (which are being amortized over the life of the related debt instruments), the deferred depreciation associated with the Clyde T. Ellis Hydroelectric Station ("Ellis") lease, and the purchase of the lease residual and subsequent reclassification from an operating lease to a capital lease for the Independence Steam Electric Station Unit 2 ("ISES 2") in June 2003. See "Rental and Lease Commitments" (Note 12) for further discussion. In the event operations are no longer subject to the provisions of Financial Accounting Standards Board No. 71, as a result of a change in regulation or the effects of competition, AECC would be required to recognize the effects of any regulatory change in assets currently in its statements of operations.

Utility Plant and Related Depreciation

All utility plant is recorded at original cost. The cost of additions to utility plant includes contracted work, direct labor, materials, allocable overhead, and an allowance for funds used during construction as allowed by the APSC. The major classes of utility plant at October 31, 2008 and 2007, are listed below (in thousands):

	2008	2007
Generation plant	**$1,350,670**	$1,342,192
Transmission plant	**83,999**	83,646
General plant	**28,262**	28,096
Electric plant in service	**1,462,931**	1,453,934
Construction work in progress	**83,527**	56,546
	$1,546,458	$1,510,480

The cost of retirements, replacements, or betterments are removed from utility plant and, in accordance with industry practice, the cost of the unit and its removal cost, less salvage, are charged to accumulated depreciation. Maintenance and repairs are charged to operating expenses as incurred.

Depreciation of utility plant is recorded using guidelines prescribed by the RDUP. A provision has been made for depreciation of steam generation plant, gas turbine generation plant, hydroelectric generation plant, and transmission plant at annual straight-line composite rates of 3.1%, 3%, 2%, and 2.75%, respectively. General plant depreciation rates are applied on an annual straight-line composite basis as follows:

Structures and improvements	2%
Office furniture and equipment	4.8 and 9.6
Transportation equipment	20
Power-operated equipment	15
Tools, shop, and garage equipment	5
Communication equipment	8
Other general plant	5 and 6

The Ellis facility is unique in that it is being depreciated in accordance with rate-making treatment. See “Rental and Lease Commitments” (Note 12) for further discussion.

Asset Retirement Obligations

AECC has recognized a conditional asset retirement obligation ("ARO") related to the future removal and disposal of asbestos from three oil/gas-fired plants and one coal-fired plant. As of October 31, 2008 there are no assets legally restricted for the purpose of settling any AROs. These AROs are recorded as other deferred credits on the balance sheet. A reconciliation of the aggregate carrying amount of the obligation as of October 31, 2008 is as follows (in thousands):

Balance — October 31, 2007	$1,568
Accretion expense	88
Balance — October 31, 2008	**$1,656**

Electric Revenues and Fuel

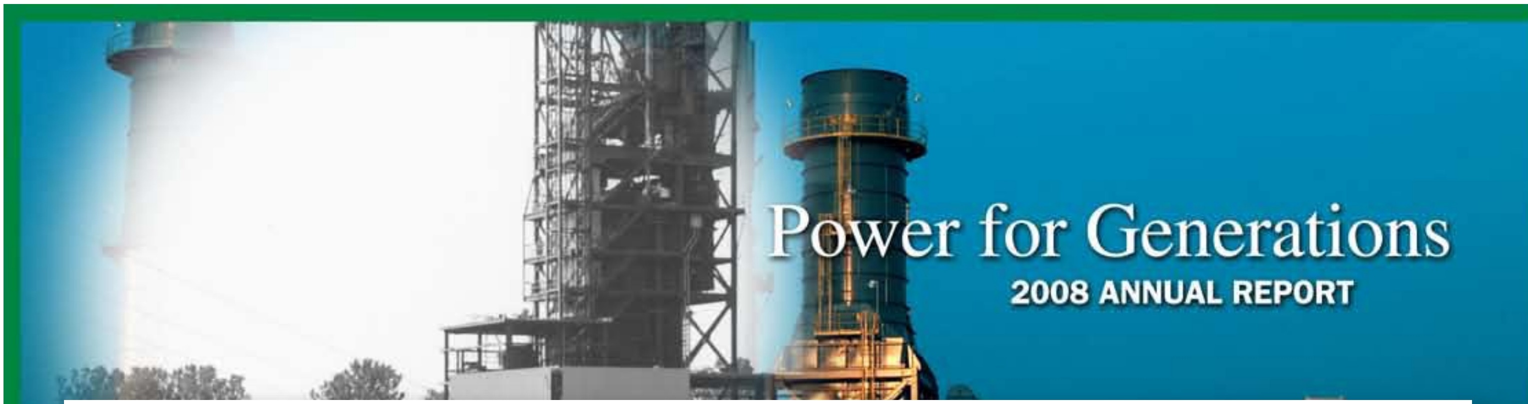
Revenues are recorded in the same month that power is generated and billed. AECC charges the cost of fuel to expense as fuel is consumed. Uncollectible accounts have historically been negligible, so AECC does not provide an allowance for doubtful accounts.

Carrying Costs Capitalized During Construction

AECC capitalizes the carrying costs on certain significant construction and development projects while in progress. Under approval from the APSC, AECC is allowed to capitalize the interest costs for debt specifically borrowed to finance projects during construction and development. Additionally, for the portion of construction and development projects funded without specific borrowings, the APSC allows AECC to capitalize carrying costs based first on the incremental rate incurred in relation to its notes payable; and, to the extent the construction and development project costs exceed the balance of the notes payable, AECC may capitalize carrying costs attributable to the remaining costs based on the weighted-average interest rate of AECC's long term debt, excluding any amounts representing specific borrowings.

AECC records the interest costs capitalized related to debt specifically borrowed for construction and development projects as interest during construction, which is reflected as a credit to interest expense as part of operating expenses in the accompanying statements of operations. Additionally, AECC is allowed to record the carrying costs capitalized related to construction and development projects funded without specific borrowings as an allowance for funds used during construction, which is reflected below the margin from operations in the accompanying statements of operations.

Interest costs capitalized related to debt specifically borrowed was approximately $1.7 million for the year ended October 31, 2006, and was recorded as a reduction in interest expense. There was no interest capitalized related to debt specifically borrowed for the years ended October 31, 2008 and 2007. In addition, for the years ended October 31, 2008, 2007, and 2006, the carrying costs capitalized relating to projects funded without specific borrowings



were approximately $1.1 million, $0.8 million, and $0.5 million, respectively, and were recorded as an allowance for funds used during construction in the accompanying statements of operations.

Statements of Cash Flows

For purposes of the statements of cash flows, cash and cash equivalents represent demand deposits in financial institutions and securities with original maturity dates of three months or less. Cash paid for interest was approximately $32.3 million, $35.2 million, and $34.4 million for the years ended October 31, 2008, 2007, and 2006, respectively. No amounts were paid for income taxes for the years ended October 31, 2008, 2007, and 2006.

Inventories

Fuel inventories and material and supply inventories are stated at average cost.

Use of Estimates

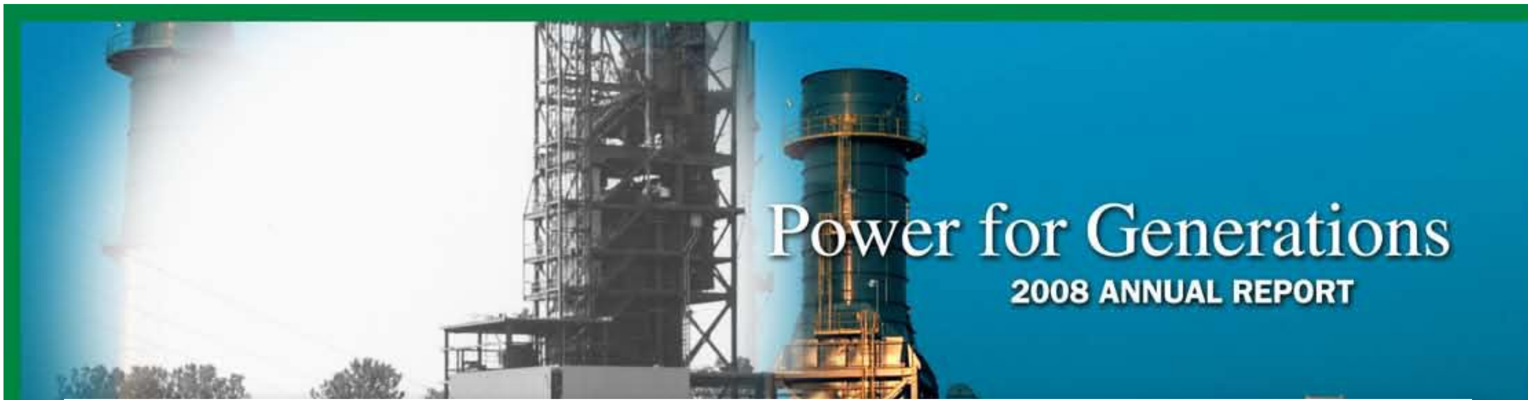
The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates and assumptions used in preparing the accompanying financial statements.

Recently Issued Accounting Pronouncements

FIN No. 48, *Accounting for Uncertainty in Income Taxes — an interpretation of FASB Statement No. 109*, was issued in July 2006 and was to be effective for the year ended October 31, 2008. However, the implementation has been delayed for two years for nonpublic companies and will now be effective for the year ending October 31, 2010. The FASB's objective in issuing this interpretation is to increase comparability among companies in financial reporting of income taxes. FIN No. 48 establishes a more-likely-than-not recognition threshold that must be met before a tax benefit can be recognized in the financial statements. If a tax deduction is taken on a tax return, but does not meet the more-likely-than-not recognition threshold, an increase in income tax liability, above what is payable on the tax return, is required to be recorded. As a result of the delay in implementation for nonpublic companies, the impact of adoption of FIN No. 48 on AECC's financial statements has not been determined.

In September 2006, the FASB issued FASB Statement No. 157, *Fair Value Measurements*. FASB Statement No. 157 provides a single definition of fair value, establishes a framework for measuring fair value, and requires additional disclosures about the use of fair value to measure assets and liabilities. FASB Statement No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007. AECC is currently evaluating the provisions of FASB Statement No. 157.

In February 2007, the FASB issued FASB Statement No. 159, *The Fair Value Option for Financial Assets and Liabilities — Including an amendment of FASB Statement No. 115*. FASB Statement No. 159 provided entities the



one-time election to measure financial instruments and certain other assets and liabilities at fair value on an instrument-by-instrument basis under a fair value option. FASB Statement No. 159 is effective for financial statements as of the beginning of the first fiscal year that begins after November 15, 2007. Its provision may be applied to an earlier period only if the following conditions are met: (1) the decision to adopt is made after the issuance of FASB Statement No. 159, but within 120 days after the first day of the fiscal year of adoption, and no financial statements, including footnotes, for any interim period of the adoption year have yet been issued and (2) the requirements of FASB Statement No. 157 are adopted concurrently with or prior to the adoption of FASB Statement No. 159. AECC is currently evaluating the provisions of FASB Statement No. 159.

Regional Transmission Organization Accounting

Beginning February 1, 2007, AECC began participation in an Energy Imbalance Services Market under the Southwest Power Pool Regional Transmission Organization (“RTO”). A RTO is an organization that is established to control and manage the transportation and flows of electricity over an area that is generally larger than a single power company’s system. AECC records RTO transactions on an hour-to-hour basis. Transactions within each individual hour are netted to a single purchase or sale based on actual load and net megawatt hour generation.

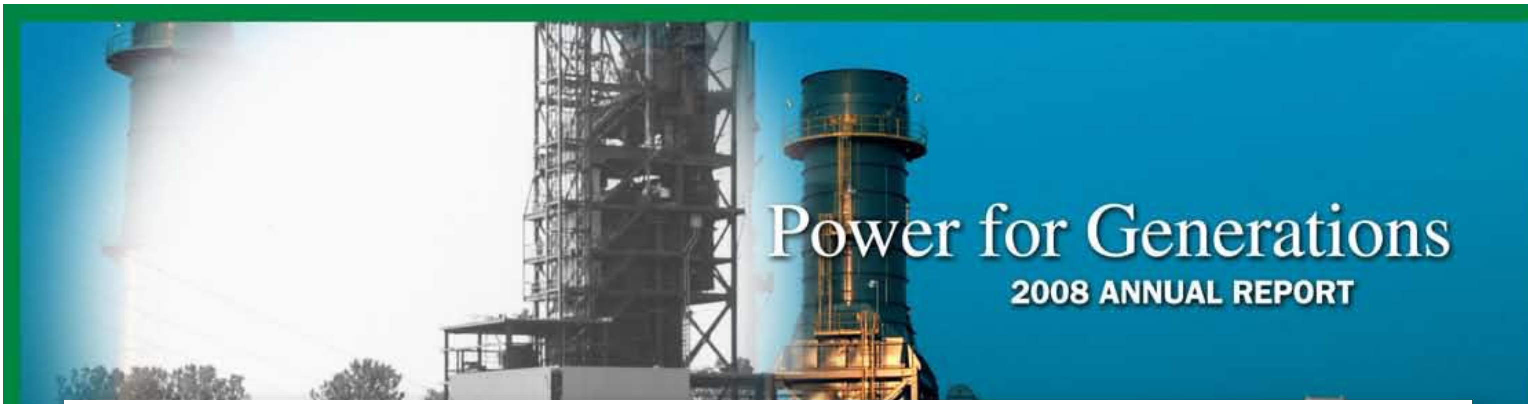
2. INCOME TAXES

In December 1982, AECC elected to revoke its tax-exempt status for federal income tax purposes. For state income tax purposes, AECC operates as a tax-exempt cooperative under Arkansas statutes. No amounts were expensed for income taxes for the years ended October 31, 2008, 2007, and 2006.

The differences between the statutory federal income tax rate on income before income taxes and AECC’s effective income tax rate are summarized as follows (dollars in thousands):

	2008	Percent	2007	Percent	2006	Percent
Statutory federal income	**$5,306**	35.0%	$162	35.0%	$7,039	35.0%
Nontaxable member income	**(5,306)**	(35.0)	(162)	(35.0)	(7,039)	(35.0)
Tax credit carryforwards not benefited						
Effective income tax rate	**$ -**	-%	$ -	-%	$ -	-%

Arkansas Electric Cooperative Corporation



The components of the net deferred tax liability at October 31, 2008 and 2007, were as follows (in thousands):

	2008	2007
Deferred tax assets:		
Patronage exclusions available	**$70,494**	$65,904
Alternative minimum tax ("AMT") credit carryforwards	**4,052**	4,052
Other	**1,595**	2,595
	76,141	72,551
Valuation allowance	**(4,052)**	(4,052)
	72,089	68,499
Deferred tax liabilities:		
Utility plant	**(37,514)**	(38,919)
Safe harbor lease	**(15,170)**	(13,226)
Ellis sale and leaseback	**(16,927)**	(13,977)
Other	**(2,478)**	(2,377)
	(72,089)	(68,499)
Net deferred tax liability	**$ -**	$ -

At October 31, 2008, AECC had AMT credit carryforwards of approximately $4.1 million. Based on AECC's historical transactions' resulting in nonmember losses and the patronage provisions of its bylaws, AECC does not anticipate any future taxable income sufficient to realize the benefit of the tax credits existing at October 31, 2008. Accordingly, AECC has established a valuation allowance for these credits as reflected above.

3. INVESTMENTS

AECC uses FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. In accordance with FASB Statement No. 115, AECC has classified all marketable investments as available for sale. Available-for-sale investments are stated at fair value with unrealized gains and losses included in members' equities. Net realized losses were $3,527 and $15,313 in 2008 and 2007, respectively. There were no realized gains or losses in 2006. Realized gains and losses are included in other income. The cost of investments sold is based on the specific-identification method.

Long-term marketable securities classified as available-for-sale at October 31, 2008 and 2007, were as follows (in thousands):

	2008			
Description	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Fair Value
Other U.S. government agency securities	$6,120	$-	$48	$6,072

	2007			
Description	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Fair Value
Other U.S. government agency securities	$9,126	$-	$15	$9,111

At October 31, 2008, contractual maturities of marketable securities available for sale were as follows:

Description	Less Than One Year	One Through Five Years	After Five Years	Total
Other U.S. government agency securities	$1,000	$5,072	$-	$6,072

Subordinated term certificates were purchased in connection with the issuance of the National Rural Utilities Cooperative Finance Corporation ("CFC") Guaranteed Pollution Control Revenue Bonds. These amounts are recorded in the accompanying balance sheets as part of long-term investments — other, and totaled $7.1 million and $7.3 million at October 31, 2008 and 2007, respectively. In accordance with FASB Statement No. 115, these investments have been classified as held to maturity and, accordingly, are recorded at amortized cost. These investments have maturity dates which extend through 2080.

AECC has a leasehold interest in the revenue stream of certain gas wells. AECC is accounting for its mineral interest using the successful efforts method of accounting and the mineral interest is being depleted on a field-by-field basis using the unit-of-production method based on estimated proven reserves. At October 31, 2008 and 2007, AECC's leasehold interests in the gas reserves totaled approximately $47.7 million and $50.3 million, respectively. The net revenue interests received, less the depletion of the gas reserves, resulted in other income of approximately $3.9 million, $1.3 million, and $3.6 million for the years ended October 31, 2008, 2007, and 2006, respectively.

4. PATRONAGE CAPITAL

Patronage allocations are based on an amount not less than the fiscal year's taxable income for federal income tax purposes. Patronage allocations are assigned to patrons' accounts as credits on a patronage basis. Using this allocation method, approximately $13.5 million, $7.3 million, and $19.8 million of patronage capital were allocated for the years ended October 31, 2008, 2007, and 2006, respectively.

Patronage retirements are restricted by the terms of the RUS mortgage and AECC's bylaws. The mortgage requires the RDUP approval for payments which reduce members' equities below 30.0% of total assets. At October 31, 2008 and 2007, total members' equities as a percentage of total assets amounted to 40.5% and 38.2%, respectively.

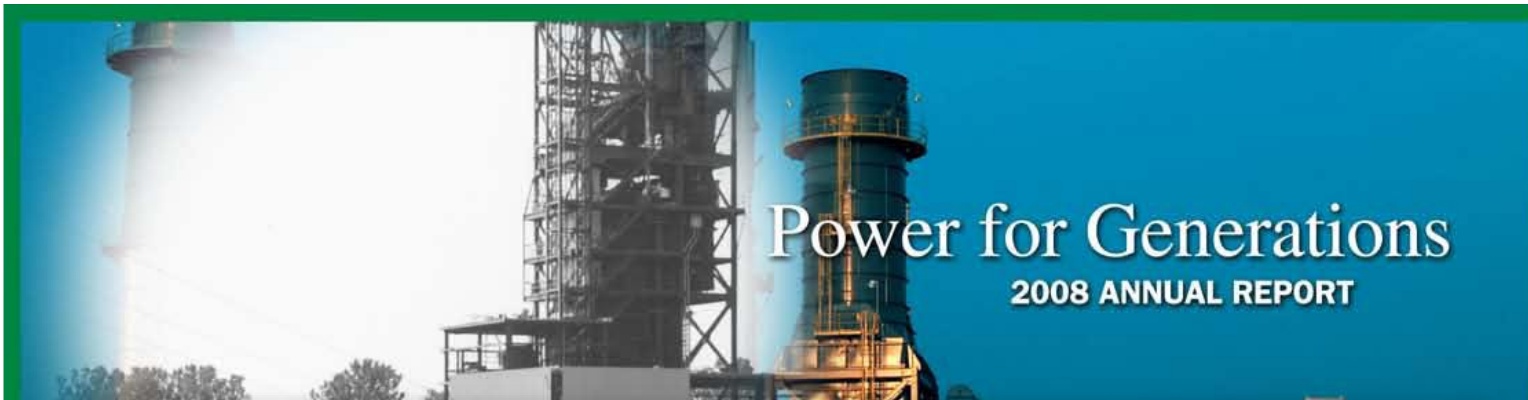
During the years ended October 31, 2007 and 2006, the Board authorized patronage retirements of approximately $8.4 million each year. There was no patronage retirement for the year ended October 31, 2008.

5. OTHER EQUITIES

Other equities include proceeds of approximately $43.2 million from the sale of tax benefits under the Economic Recovery Tax Act of 1981 — net of applicable expenses. The tax benefits sold were the depreciation and tax credits applicable to the Independence Steam Electric Station Unit No. 1 ("ISES 1") boiler and turbine, coal handling equipment, and certain common and related items having a cost of approximately $113.6 million.

In connection with the sale of tax benefits, AECC has agreed to indemnify the purchaser against the loss of such tax benefits. CFC, in turn, agreed to guarantee up to $58.9 million of the indemnification, with the guaranteed amount decreasing annually until expiration during fiscal year 2013. At October 31, 2008, the guaranteed amount by CFC was approximately $7.9 million. The maximum exposure under the indemnification clause is dependent upon the facts, circumstances, and timing of any loss; however, management is not aware of any existing conditions that would result in such a loss.

The other equities balance also includes income related to the amortization of the deferred gain resulting from a sale and leaseback transaction. During December 1984, AECC sold and leased back its 35% undivided interest in ISES 2. The sales price was $275.0 million, which resulted in a gain of approximately $143.3 million. In accordance with FASB Statement No. 71, due to rate-making treatment, the gain from this sale was recognized for financial reporting purposes over the lease term until July 31, 2003, when AECC purchased the ISES 2 lease residual resulting in the operating lease being reclassified as a capital lease. See "Rental and Lease Commitments" (Note 12) for further discussion.



6. LONG-TERM DEBT

Long-term debt consisted of the following at October 31, 2008 and 2007, (in thousands):

	2008	2007
Mortgage notes payable to Federal Financing Bank ("FFB") at varying interest rates from 4.32% to 6.77%, due in quarterly installments through December 2035	**$298,168**	$319,822
ISES 2 finance obligation under sale and leaseback, at an implicit rate of 6.05% at October 31, 2008 and 2007, due in semiannual installments through 2019	**124,687**	137,219
Ellis finance obligation under sale and leaseback, at an implicit interest rate of 4.29%, at October 31, 2008 and 2007, due in semiannual installments through March 2013	**34,134**	41,734
CFC Guaranteed Pollution Control Revenue Bonds: City of Siloam Springs and Jefferson County, Arkansas, at an interest rate of 5.00% at October 31, 2007, due in semiannual installments through 2008		1,090
RUS 2% mortgage notes due in quarterly installments through May 2018	**548**	820
RUS 5% mortgage notes due in quarterly installments through August 2015	**1,980**	2,419
	2528	3239
Other long-term debt	**74**	81
Total long-term debt	**459,591**	503,185
Less current maturities of long-term debt	**40,531**	43,594
	$419,060	$459,591

Arkansas Electric Cooperative Corporation

Following are the estimated maturities of long-term debt for each of the next five years ending October 31 and in the aggregate thereafter:

	2009	2010	2011	2012	2013	Thereafter	Total
FFB	$22,905	$24,196	$25,568	$23,406	$15,528	$186,565	$298,168
ISES 2 finance obligation	9,321	9,894	10,502	11,147	11,832	71,991	124,687
Ellis finance obligation	7,667	8,401	8,839	(406)	9,633		34,134
RUS	629	514	537	438	260	150	2,528
Other	9	9	10	10	11	25	74
	$40,531	$43,014	$45,456	$ 34,595	$37,264	$258,731	$459,591

Under the debt agreements associated with the RUS mortgage, substantially all of AECC's assets were pledged as security at October 31, 2008. The debt agreements contain provisions which, among other restrictions, require AECC to maintain certain financial ratios. AECC was in compliance with these financial ratios at October 31, 2008.

During 2005, the RDUP approved a loan guarantee commitment in the amount of $85.0 million for the purpose of financing AECC's acquisition of the Harry S. Oswald Generating Station ("Oswald"). The loan commitment has a maturity date of December 31, 2035. During 2006, AECC received an advance from FFB in the amount of $65.0 million at an interest rate of 5.378%. During 2007, the remaining $20.0 million was advanced from FFB at interest rates of 4.735% and 4.847%.

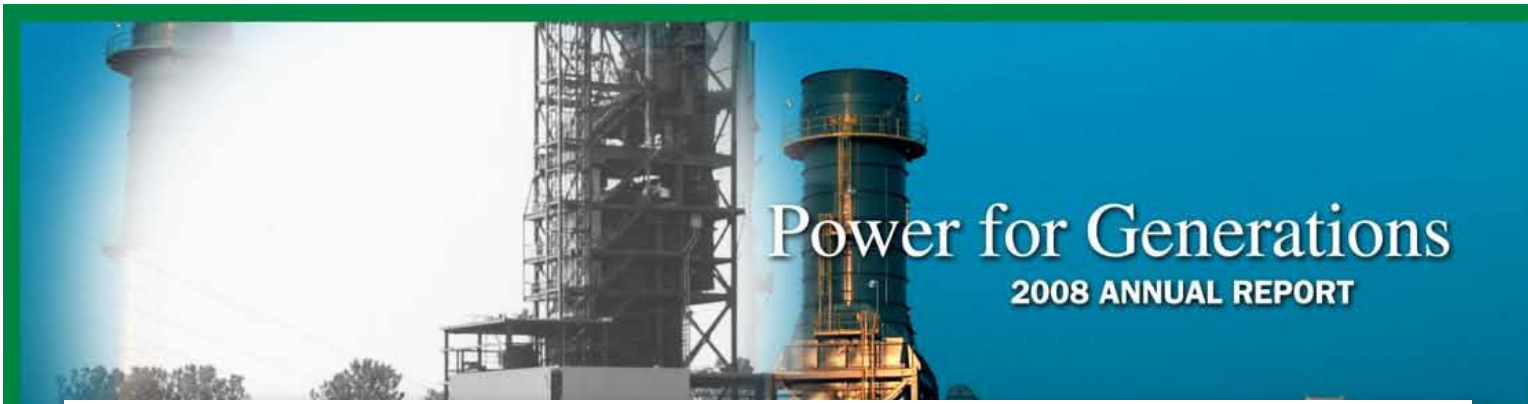
On November 11, 2008, AECC entered into a long-term loan agreement with CFC in the amount of $185.5 million for the purpose of financing AECC's share of the proposed John W. Turk, Jr. Power Plant ("Turk"), a 600 MW coal-fired ultra supercritical steam turbine generating unit and related facilities to be located in Hempstead County, Arkansas (see Note 10). The loan commitment has a maximum draw period ending on December 31, 2012, and a maturity date of December 31, 2041.

7. NOTES PAYABLE

AECC maintains a $75.0 million perpetual line of credit with CFC which bears interest at 1% above the prime rate or such lesser total rate per annum as may be fixed by CFC. AECC also has a $10.0 million committed line of credit with Regions Bank through July 15, 2010, which bears interest at 0.5% below the prime rate. In addition, AECC has a $30.0 million committed line of credit with CoBank through July 14, 2009, which bears interest at 62.5 basis points above the 30-day London InterBank Offered Rate. There was no outstanding balance at October 31, 2008 or 2007, under these lines of credit.

AECC has signed related party master promissory notes with all of its member distribution cooperatives. These

Arkansas Electric Cooperative Corporation



notes allow members to advance AECC funds with such advances payable upon demand. When needed, AECC may use such advances for its own operating requirements and recognizes interest as a component of interest expense in the statements of operations. However, when AECC is in a financial position such that it does not require these advances for operations, members may continue to advance funds to AECC for investment purposes, in which case AECC recognizes the interest expense in interest income — net, in the statements of operations. AECC collectively invests such funds, along with AECC's general funds, and pays its members an interest rate comparable to the monthly average rate earned on the combined investments. AECC invests these funds in U.S. Treasury notes, bills and bonds, other U.S. government agency securities, and various other debt securities, such as corporate notes, bonds, and commercial paper.

At October 31, 2008 and 2007, member advances to AECC totaled approximately $123.6 million and $106.0 million, respectively. At October 31, 2008 and 2007, the variable interest rate on the notes payable was 3.99% and 5.77%, respectively.

Total interest expense related to the notes payable was as follows for the years ended October 31, 2008 and 2007, (in thousands):

	2008	2007	2006
Operating interest, included in interest expense	$4,174	$4,067	$2,289
Nonoperating interest, included in interest income — net	675	2,112	2,627
Total interest expense	$4,849	$6,179	$4,916

On July 3, 2008, AECC entered into a $210.5 million credit agreement with a syndication of financial institutions to provide a committed line of credit for three years as support for a commercial paper program of an equal amount. There was no outstanding balance on the credit agreement as of October 31, 2008.

AECC also entered into an agreement with Goldman Sachs to act as dealer for commercial paper notes issued by AECC. As of October 31, 2008, there were no outstanding commercial paper notes.

8. EMPLOYEE BENEFITS

Retirement benefits for substantially all employees are provided through participation in the National Rural Electric Cooperative Association ("NRECA") Retirement, Safety and Insurance Program. In this master multiemployer plan, which is available to all member cooperatives of NRECA, the accumulated benefits and plan assets are not determined or allocated separately by individual employer. AECC also has a defined contribution plan for eligible employees, for which contributions are determined annually. Additionally, AECC contributes a portion of the premiums related to medical insurance for eligible employees. Total benefit costs were approximately $5.0 million, $4.6 million, and $4.1 million for the years ended October 31, 2008, 2007, and 2006, respectively.

AECC has deferred compensation agreements with certain employees that provide benefits upon death, disability, or retirement. The present value of total estimated deferred compensation is being accrued over the remaining years to the full eligibility date. Contributions to the plans were $0.1 million for each of the fiscal years ended

October 31, 2008 and 2007. AECC has acquired certain assets, principally life insurance policies and mutual fund shares, to provide benefits under the deferred compensation agreements. At October 31, 2008 and 2007, AECC had accrued deferred compensation liabilities of $5.7 million and $6.9 million, respectively, which is reflected in other deferred credits in the accompanying balance sheets. In addition, at October 31, 2008 and 2007, AECC had $6.2 million and $6.8 million, respectively, related to life insurance policies and mutual fund shares to fund the deferred compensation plans, which is reflected in other long-term investments in the accompanying balance sheets.

AECC provides certain postretirement benefits to employees. In accordance with FASB Statement No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*, the accumulated postretirement benefit obligation was calculated to be $0.5 million, which is included in deferred credits on AECC's balance sheets.

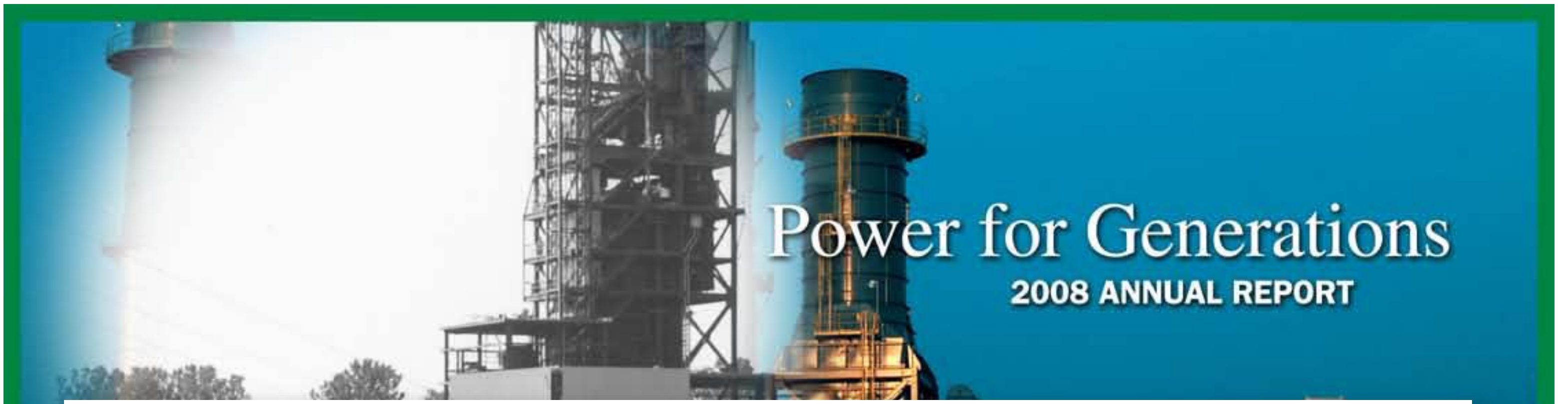
9. RELATED-PARTY TRANSACTIONS

AECC has limited joint management with Arkansas Electric Cooperatives, Inc. ("AECI") and certain members of AECC's Board also serve on the AECI Board. AECI, among other things, is engaged in the production and repair of transformers, construction and maintenance of electrical substations and transmission facilities, and the marketing of new pole-mount and pad-mount transformers and pole-line hardware. Under contractual agreements, AECC and AECI share certain facilities and personnel. Separate accounting records and related information are maintained for each cooperative. AECC had patronage allocations from AECI in the amount of $0.6 million and $0.4 million for the years ended October 31, 2008 and 2007, respectively.

AECI pays AECC monthly rent for use of the general office facilities and other expenses. The total amounts paid to AECC for the years ended October 31, 2008, 2007, and 2006, were approximately $3.2 million, $2.8 million, and $2.4 million, respectively. AECI owed AECC approximately $0.4 million and $0.2 million at October 31, 2008 and 2007, respectively, related to the reimbursement of these expenses.

AECI provides various services for AECC. The amounts incurred by AECC for shared salaries, reimbursement of expenses, purchases of supplies and services, and right-of-way clearing and construction were approximately $4.8 million, $3.7 million, and $2.6 million for the years ended October 31, 2008, 2007, and 2006, respectively. At October 31, 2008 and 2007, AECC owed AECI approximately $0.6 million and $0.3 million, respectively, for materials and services.

AECI has a wholly owned subsidiary, Electric Research and Manufacturing Cooperative, Inc. ("ERMCO"). On November 4, 2005, AECC purchased $10.0 million preferred stock in ERMCO with a cumulative dividend rate of 8%.



10. POWER PLANTS

AECC has an ownership or leasehold interest in and is responsible for providing its share of the costs for jointly owned or certain leased facilities in Arkansas, with the corresponding direct expenses included in the statements of operations as operating expenses. AECC's share of each operating facility at October 31, 2008, is as follows (dollars in thousands):

Generating Plants	Ownership or Leasehold Interest %	Utility Plant in Service	Accumulated Provision for Depreciation	Amount of Plant Under Construction	Current Available Net Capacity (MW) (Unaudited)	
Flint Creek	50%	$91,318	$70,361	$12,094	264	MW
White Bluff 1 and 2	35	304,641	226,202	7,784	580	
ISES 1 and 2	35	343,226	243,068	17,992	588	
Fitzhugh	100	72,720	21,078	419	171	
Bailey	100	13,251	13,141	122	122	
McClellan	100	18,471	18,327	93	134	
Ellis	100	70,348	55,169	28	26	
Whillock	100	75,677	22,550	22	17	
Electric Cooperatives of Arkansas	100	184,293	33,127	43	35	
Fulton CT 1	100	58,649	12,919		153	
Oswald	100	84,749	9,116	367	548	

Under a purchase agreement with Southwestern Power Administration ("SPA"), which expires June 30, 2020, AECC has the right to purchase, except in certain circumstances, up to 189 MW of power and associated energy from SPA. AECC can draw power and energy under this contract for up to 200 hours a month, but not over 600 hours in any four consecutive months and not over 1,200 hours in any 12 month period.

Under a unit power sales agreement with Entergy Power Ventures, L.P., AECC has the right to call on up to 150 MW of unit contingent power and associated energy. The agreement is for a five-year period through December 31, 2008. The unit contingency provision is based on the availability of the Harrison County Plant near Marshall, Texas.

On October 3, 2007, the Board passed a resolution approving AECC's purchase of 11.667% (70 MW) of Turk. On December 13, 2007, AECC signed the Construction, Ownership and Operating Agreement ("COOA") for its ownership share of Turk which is currently estimated to cost approximately $230 million. AECC has made a $2.0 million initial payment as a result of the air permit being granted to Southwestern Electric Power Company ("SWEPCO").

AECC has applied to the APSC for a Certificate of Convenience and Necessity in order to fulfill its obligation under the COOA and has sought all written approvals of RDUP that are necessary to permit AECC's ownership participation in the Turk project. AECC has also made application to the RDUP for a lien accommodation to be granted in favor of CFC as security for a long-term loan commitment (see Note 6). When AECC receives these required approvals, it must pay accrued project costs for Turk and thereafter share on-going construction costs.

Turk is being constructed by SWEPCO, an American Electric Power operating subsidiary. SWEPCO has received regulatory approval from the states of Arkansas, Texas, and Louisiana to build the facility. On November 21, 2007, the APSC granted conditional approval for Turk. On November 5, 2008, SWEPCO was granted an air permit for the operation of Turk from the Arkansas Department of Environmental Quality ("ADEQ"). Subsequently, on December 1, 2008, the Sierra Club and the Audubon Society filed an appeal of the Turk air permit with the ADEQ.

11. FUEL SUPPLY AGREEMENTS

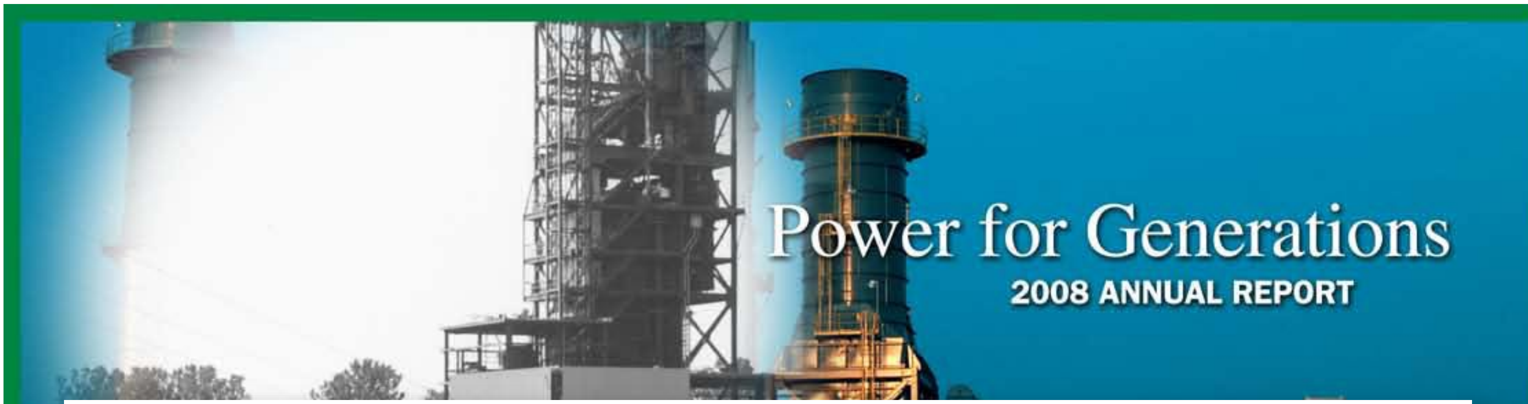
AECC pays Entergy Arkansas, Inc. ("Entergy"), in accordance with provisions of joint operating agreements, for its 35% interest in the coal stockpiles at the White Bluff and ISES generating plants. Entergy retains all ownership rights to the coal. AECC makes monthly payments to Entergy to maintain the stockpiles. These payments are classified as prepaid fuel supply in the accompanying balance sheets. In addition, in prior years AECC paid the coal supplier of the ISES units approximately $7.6 million for start-up costs at the North Antelope/Rochelle coal mine complex, the primary source of coal for ISES 1 and 2. These amounts have been recorded as deferred charges in the accompanying balance sheets, and such amounts are being amortized into fuel expense over the life of the agreements.

AECC also has a joint operating agreement with SWEPCO, in connection with its 50% interest of the Flint Creek generating station, whereby AECC pays for its share of the fuel consumed at that station.

12. RENTAL AND LEASE COMMITMENTS

AECC leases ISES 2 under a 35-year leveraged lease, pursuant to the terms of a sale-leaseback agreement dated December 4, 1984, whereby AECC sold and leased back its 35% undivided interest in ISES 2. On June 27, 2003, AECC repurchased its future ownership interest in the leased ISES 2 assets at the end of the current lease period. The $26.5 million purchase price was funded through the use of general funds. As a result of this payment, the facility's ownership will now transfer back to AECC on December 31, 2019, as long as AECC complies with all other terms of the lease through that date. Therefore, effective June 27, 2003, the operating lease was reclassified as a capital lease and will be accounted for accordingly through the remainder of the lease term.

The change to a capital lease resulted in AECC's recording ISES 2 assets of $128.1 million, accumulated depreciation of $71.8 million, a regulatory created asset in the amount of $105.7 million, and a lease finance obligation in the amount of $181.5 million. In addition, AECC removed from its balance sheet the unamortized deferred gain on the ISES 2 sale-leaseback in the amount of $67.5 million and deferred rent expense under the operating lease in the amount of $21.5 million.



The reclassification from an operating to a capital lease had a balance sheet impact only, with the exception of the $26.5 million lease residual purchase, as far as the total expense recognized through the term of the lease. The impact to the income statement is to recognize depreciation, interest, and the amortization of regulatory asset expenses under the capital lease versus rent expense and gain amortization under the operating lease. The difference between the consideration paid for the leased assets and their carrying value has been recorded as a regulatory created asset at the transaction date. This asset has been recorded as “Unamortized Loss on Reacquired Debt” and will be amortized over the remaining lease period. The annual straight-line expense recognized through the capital lease is $15.6 million since it is treated as an operating lease for rate-making purposes.

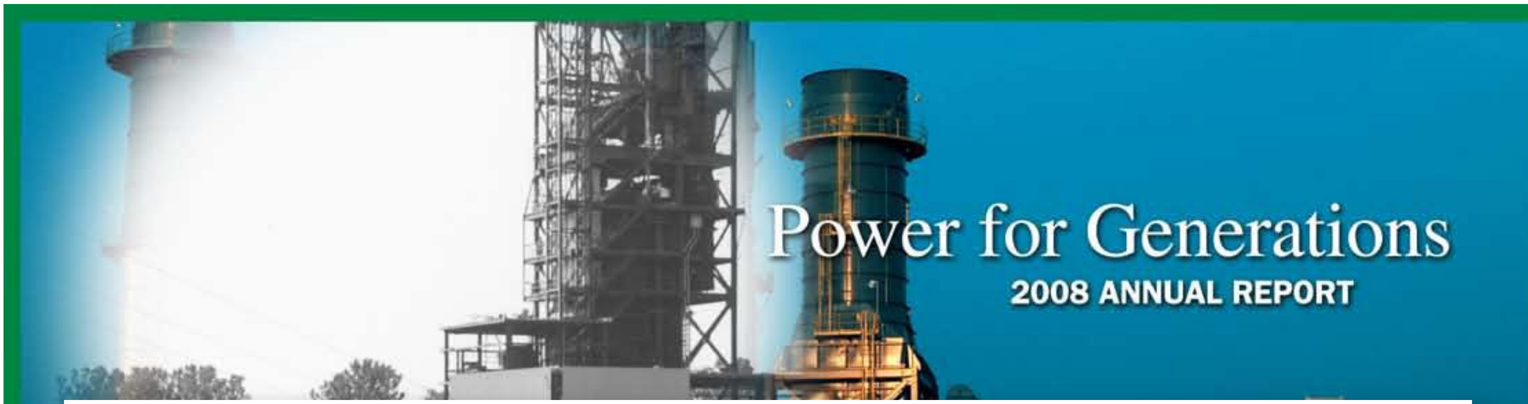
Related expenses for the years ended October 31, 2008, 2007, and 2006, were $15.6 million each year. These expenses include depreciation expense of approximately $3.9 million, $4.0 million, and $4.0 million for the years ended October 31, 2008, 2007, and 2006, respectively. In addition, interest expense was approximately $8.2 million, $8.9 million, and $9.6 million for the years ended October 31, 2008, 2007, and 2006, respectively. Amortization expense on the regulatory created asset was approximately $3.5 million, $2.7 million, and $2.0 million for the years ended October 31, 2008, 2007, and 2006, respectively.

Future ISES 2 minimum lease payments for the next five years ending October 31 and in the aggregate thereafter are as follows (in thousands):

	Year	Amount
	2009	$16,982
	2010	16,982
	2011	16,982
	2012	16,982
	2013	16,982
	Thereafter	86,547
		171,457
Less amounts representing interest (implicit rate — 6.05%)		46,770
Capitalized lease obligation		$124,687

In conjunction with the ISES lease, AECC has agreed to indemnify, under certain circumstances, the beneficial owner against loss of certain tax benefits related to ownership of ISES 2. The maximum exposure under the indemnification clause is dependent upon the facts, circumstances, and timing of any loss; however, management does not believe there are existing conditions which will result in such a loss.

On December 29, 1988, AECC sold and leased back its interest in Ellis. The proceeds from the sale were $105.0 million. The sale and leaseback terms contain a provision which allows AECC to repurchase the property for its fair market value (at an amount not to exceed $139.4 million) at future specified dates. In anticipation of repurchasing the Ellis facility, AECC has segregated investments of $28.3 million and $27.0 million at October 31, 2008 and 2007, respectively.



As a result of the above sale and leaseback, under the provisions of FASB Statement No. 98, *Accounting for Leases*, this transaction is reflected in the accompanying balance sheets as a long-term finance obligation. This lease was treated as an operating lease for rate-making purposes. In accordance with FASB Statement No. 71, the recognition of the gain on the sale of the facility and the timing of expense recognition will be modified during the lease term to conform with rate treatment. The lease rentals include a return to the owner participant as well as principal and interest on the outstanding debt. The interest portion of lease rental payments, less the amortization of the gain on the sale allowed for rate-making, determine the annual charge to interest expense. The amount of straight-line expense that would be recognized under an operating lease, in excess of the net interest expense charged under the capital lease method, determines the amount of depreciation to be recorded each year with respect to the facility. This facility will be fully depreciated at the end of the 25-year base lease term. Depreciation expense was approximately $4.6 million, $4.3 million, and $3.9 million for the years ended October 31, 2008, 2007, and 2006, respectively. Interest expense — net of amortized gain, was approximately $1.6 million, $1.9 million, and $2.3 million for the years ended October 31, 2008, 2007, and 2006, respectively.

Related to the Ellis lease, the future minimum lease payments for the next five years ending October 31 and in the aggregate thereafter are as follows (in thousands):

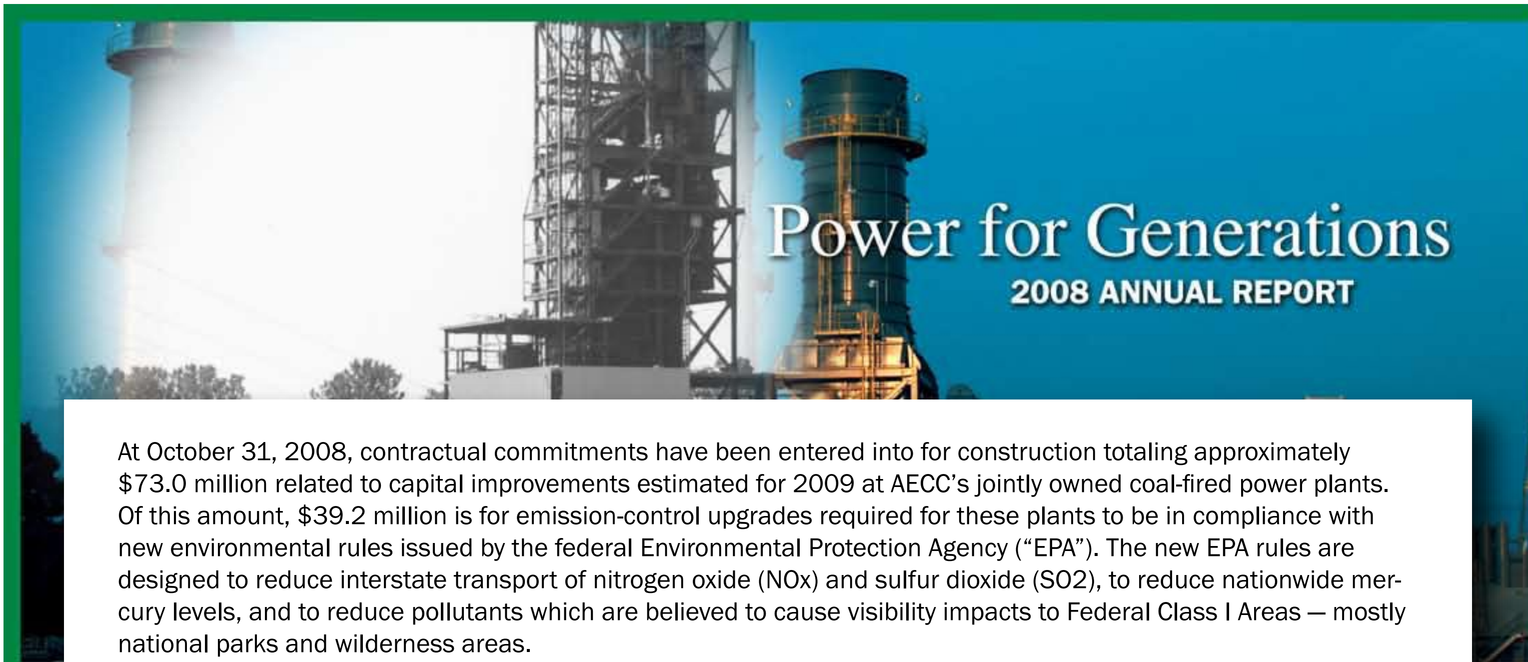
Year	Amount
2009	$8,999
2010	9,385
2011	9,447
2012	
2013	10,080
	$37,911

Rental payments related to the Ellis lease were approximately $9.3 million, $9.3 million, and $20.9 million for the years ended October 31, 2008, 2007, and 2006, respectively.

AECC has also agreed to indemnify, under certain circumstances, the beneficial owner against loss of certain tax benefits related to the ownership of Ellis. The maximum exposure under the indemnification clause is dependent upon the facts, circumstances, and timing of loss; however, management does not believe there are existing conditions which will result in such a loss.

13. COMMITMENTS AND CONTINGENCIES

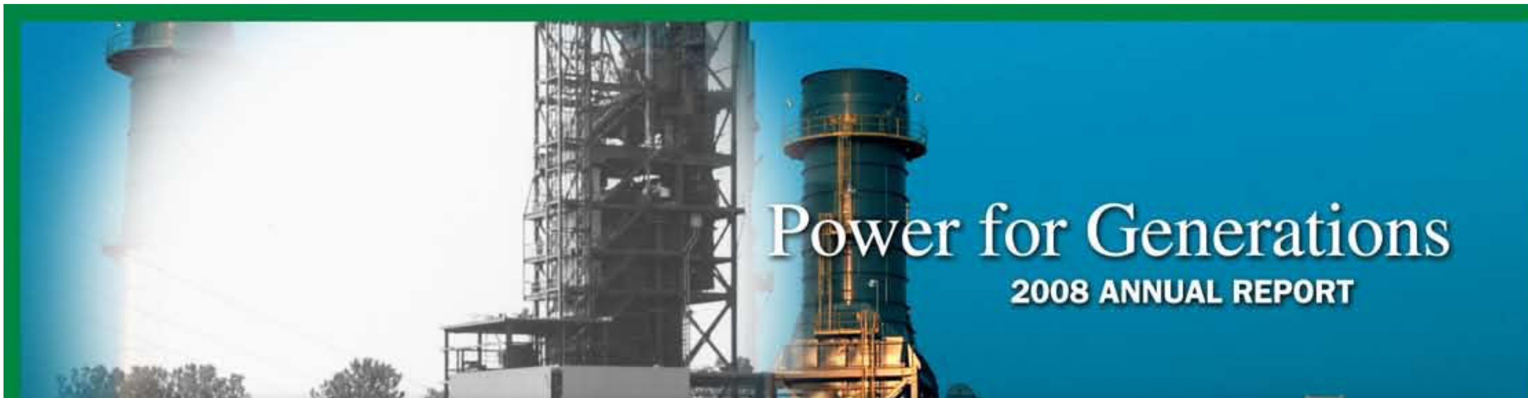
AECC is not a party to any pending legal proceedings which management believes to be material to the financial condition or results of its operations. AECC maintains liability insurance against risks, subject to certain self-insurance limits, arising out of the normal course of its business.



At October 31, 2008, contractual commitments have been entered into for construction totaling approximately $73.0 million related to capital improvements estimated for 2009 at AECC's jointly owned coal-fired power plants. Of this amount, $39.2 million is for emission-control upgrades required for these plants to be in compliance with new environmental rules issued by the federal Environmental Protection Agency ("EPA"). The new EPA rules are designed to reduce interstate transport of nitrogen oxide (NOx) and sulfur dioxide (SO2), to reduce nationwide mercury levels, and to reduce pollutants which are believed to cause visibility impacts to Federal Class I Areas — mostly national parks and wilderness areas.

AECC's current estimates, based on certain plans and cost estimates provided by Entergy and SWEPCO, for its ownership share of these emission control equipment upgrades is approximately $518.4 million in total. In addition to the $39.2 million estimated for 2009, approximately $479.2 million in capital expenditures is estimated to be incurred in the 2010 through 2012 time period. AECC intends to finance the majority of these environmental upgrades through RDUP financing once a Construction Work Plan ("CWP") is filed with and approved by RDUP. AECC anticipates the filing of the CWP and related FFB loan application in early 2009. Capital expenditures will be financed in the interim through AECC's commercial paper program.

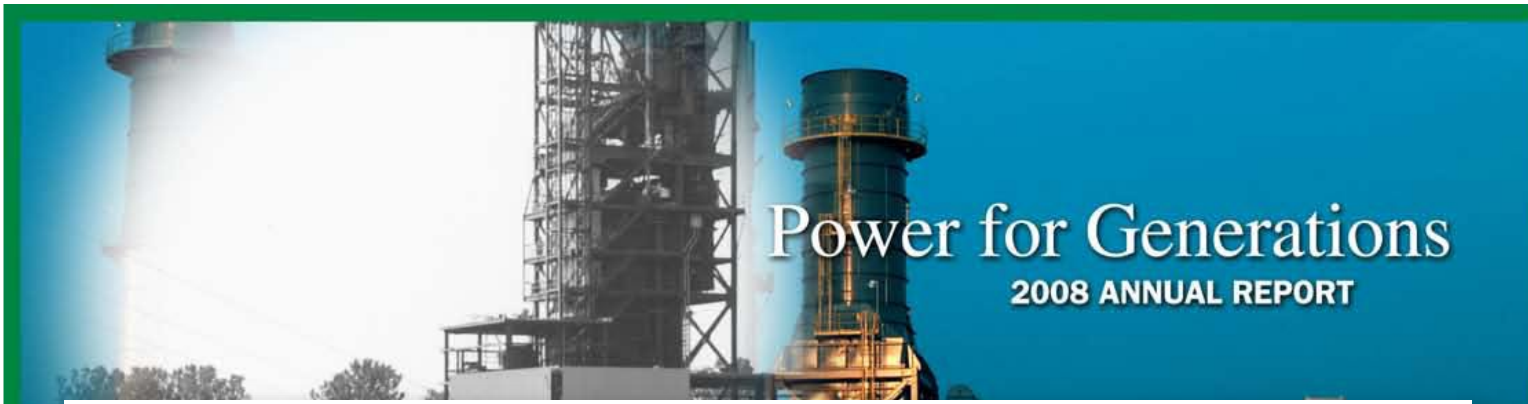
AECC filed a complaint with the FERC against Entergy in October 2004 related to a billing dispute with regards to the transmission, operating, and ownership agreements associated with the operation and maintenance of the White Bluff and ISES generating plants. On October 25, 2006, the FERC issued an order in favor of AECC. Based on the order, Entergy refunded the disputed amount for the period December 24, 2004 through September 30, 2006, in the amount of $22.1 million, including interest. AECC refunded $21.9 million to patrons through the fuel adjustment clause. On August 24, 2007, Entergy appealed the FERC's ruling to the U.S. Court of Appeals for the D.C. Circuit. AECC believes that Entergy's position lacks merit and AECC is vigorously defending its position. However, the outcome cannot be predicted. In the event that Entergy prevails in their appeal, any charges that AECC would be required to pay would be recovered through the fuel adjustment clause. In addition, AECC has filed a protest with the FERC to recover the billing dispute for the period July 1, 2004 through December 23, 2004. AECC estimates this dispute to be in excess of $2.5 million, excluding interest. If the FERC approves AECC's protest, the amount received will be refunded to AECC's patrons through the fuel adjustment clause.



14. SIGNIFICANT CUSTOMERS

Sales to members amounted to 93%, 94%, and 95% of operating revenues for the years ended October 31, 2008, 2007, and 2006, respectively. AECC had the following members that accounted for more than 10% of operating revenue for the years ended October 31, 2008, 2007, and 2006, (dollars in thousands):

	2008		2007		2006	
Customer	**Amount**	**%**	**Amount**	**%**	**Amount**	**%**
Mississippi County Electric Cooperative, Inc.	**$155,597**	**23.3%**	$129,518	22.1%	$140,669	22.7%
First Electric Cooperative Corporation	**96,027**	**14.4**	85,906	14.6	91,144	14.7
Carroll Electric Cooperative Corporation	**93,343**	**14.0**	83,087	14.2	87,633	14.1



15. FAIR VALUE OF FINANCIAL INSTRUMENTS

The following methods and assumptions were used to estimate the fair value of each class of financial instruments, other than those instruments recorded at fair value in the accompanying balance sheets, at October 31, 2008 and 2007, for which it is possible to estimate the fair value:

Long-Term Investments — The fair value of the gas reserves is estimated based on reserve estimates provided by an independent oil and gas consulting firm and using current market prices at October 31, 2008. Future cash flows were discounted using a rate of 5.5%.

Cash and Cash Equivalents — The carrying amount of cash and cash equivalents approximates fair value.

Long-Term Debt — The fair value of long-term debt is estimated based on quoted market prices for the same or similar issues or on the current rates available to AECC for debt of the same remaining maturation.

Notes Payable — The carrying amount of the notes payable to distribution members and others represents the fair value as these notes are due on demand and bear interest at market rates.

Based on the above methods and assumptions, the following amounts represent the carrying amount and fair value of each financial instrument of AECC at October 31, 2008 and 2007, (in thousands):

	2008		2007	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Long-term investments:				
Gas reserves	**$47,681**	**$85,402**	$50,282	$73,231
Other	**25,333**	**25,333**	25,822	25,822
Cash and cash equivalents	**45,263**	**45,263**	46,374	46,374
Long-term debt:				
FFB	**298,168**	**318,272**	319,822	334,759
ISES 2	**124,687**	**126,561**	137,219	141,849
Ellis	**34,134**	**34,668**	41,734	41,610
CFC			1,090	1,097
RUS	**2,528**	**2,595**	3,239	3,256
Notes payable	**123,626**	**123,626**	105,954	105,954

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