It's Our Nature To Be Cooperative

ARKANSAS ELECTRIC COOPERATIVE CORPORATION | 2007 ANNUAL REPORT

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INDEPENDENT AUDITORS' REPORT

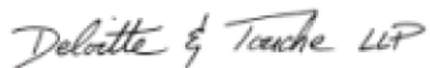
Board of Directors
Arkansas Electric Cooperative Corporation
Little Rock, Arkansas

We have audited the accompanying balance sheets of Arkansas Electric Cooperative Corporation ("AECC") as of October 31, 2007 and 2006, and the related statements of operations, members' equities and of cash flows for each of the years then ended. 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. The financial statements of AECC for the year ended October 31, 2005 were audited by other auditors whose report dated December 21, 2005 expressed an unqualified opinion on those statements.

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, 2007 and 2006, 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 9, 2008, 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.



January 9, 2008

It's Our Nature To Be Cooperative

BALANCE SHEETS

AS OF OCTOBER 31, 2007 AND 2006 *(In thousands)*

Assets	**2007**	2006
Utility plant:		
Electric plant in service	$1,453,934	$1,438,428
Construction work in progress	56,546	26,930
Total utility plant	**1,510,480**	1,465,358
Less accumulated depreciation	764,004	728,378
Net utility plant	**746,476**	736,980
Long-term investments:		
Marketable securities	2,987	9,026
Gas reserves	50,282	53,081
Other	25,822	26,480
Total long-term investments	**79,091**	88,587
Current assets:		
Cash and cash equivalents	46,374	64,544
Short-term marketable securities	6,124	3,474
Accounts receivable — members	49,635	41,341
Fuel inventories and prepaid fuel supply	29,771	22,018
Material and supply inventories	15,377	12,499
Other current assets	5,787	6,389
Total current assets	**153,068**	150,265
Deferred charges	**126,614**	132,153
Total	**$1,105,249**	$1,107,985

(Continued)

BALANCE SHEETS

AS OF OCTOBER 31, 2007 AND 2006 *(In thousands)*

Liabilities and members' equities	**2007**	2006
Members' equities and liabilities:		
Membership fees	$2	$2
Patronage capital	276,651	277,745
Accumulated margins	27,300	34,108
Other equities	118,140	118,140
Net unrealized loss on investments	(15)	(132)
Total members' equities	**422,078**	429,863
Long-term debt:		
Federal Financing Bank	298,168	299,865
Independence Steam Electric Station Finance Obligation	124,687	137,219
Ellis finance obligation	34,134	41,734
National Rural Utilities Cooperative Finance Corporation — Guaranteed Pollution Control Revenue Bonds		1,088
Rural Utilities Service	2,528	3,239
Other long-term debt	74	81
Total long-term debt	**459,591**	483,226
Current liabilities:		
Notes payable — members	105,954	91,564
Accounts payable and other accrued liabilities	54,273	42,523
Current maturities of long-term debt	43,594	41,789
Accrued property taxes	5,870	5,651
Accrued interest	4,919	5,280
Total current liabilities	**214,610**	186,807
Deferred credits	**8,970**	8,089
Commitments and contingencies		
Total	**$1,105,249**	$1,107,985

See notes to financial statements.

(Concluded)

STATEMENTS OF OPERATIONS

FOR THE THREE YEARS IN THE PERIOD ENDED OCTOBER 31, 2007 *(In thousands)*

	2007	2006	2005
Operating revenues	**$586,973**	$620,084	$517,841
Operating expenses:			
Operation and maintenance, generation	276,747	251,149	230,590
Power purchased	170,735	220,976	162,616
Operation and maintenance, transmission	48,094	39,722	33,823
Administrative and general	18,266	17,650	17,726
Depreciation	42,232	42,689	38,803
Interest	36,985	34,685	32,548
Taxes	142	158	242
Total operating expenses	**593,201**	607,029	516,348
Margin (loss) from electric operations	**(6,228)**	13,055	1,493
Other income, net	**1,246**	4,508	4,855
Interest income, net	**4,627**	2,053	1,331
Allowance for funds used during construction	**818**	494	61
Net margin	**$463**	$20,110	$7,740

See notes to financial statements.

STATEMENTS OF MEMBERS' EQUITIES

FOR THE THREE YEARS IN THE PERIOD ENDED OCTOBER 31, 2007 *(In thousands)*

	Membership Fees	Patronage Capital	Accum. Margins	Other Equities	Net Unrealized Gain (loss) Investments	Total Members' Equities
Balance, October 31, 2004	$2	$272,988	$27,609	$118,140	$(79)	$418,660
Comprehensive income:						
Net margin			7,740			7,740
Net unrealized loss on investments					(199)	(199)
Total comprehensive income						7,541
Allocation of patronage capital		1,580	(1,580)			
Redemption of patronage capital		(8,220)				(8,220)
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**

See notes to financial statements.

STATEMENTS OF CASH FLOWS

FOR THE THREE YEARS IN THE PERIOD ENDED OCTOBER 31, 2007 *(In thousands)*

	2007	2006	2005
Operating activities:			
Net margin	**$463**	$20,110	$7,740
Adjustments to reconcile net margin to net cash provided by operating activities:			
Depreciation	**42,232**	42,689	38,803
Net realized loss on marketable securities	**15**		
Amortization of gas reserves	**2,799**	3,491	3,417
Allowance for funds used during construction	**(818)**	(494)	(61)
Allocation of patronage from associated organization	**(624)**	(422)	
Changes in operating assets and liabilities:			
Accounts receivable — members	**(8,294)**	587	(7,923)
Fuel inventories and prepaid fuel supply	**(7,753)**	(11,368)	3,371
Material and supply inventories	**(2,878)**	(463)	(1,773)
Other current assets	**592**	(3,256)	1,755
Deferred charges	**5,539**	5,126	4,052
Accounts payable and other accrued liabilities	**8,979**	(229)	9,690
Other deferred credits	**1,669**	(153)	1,105
Net cash provided by operating activities	**41,921**	55,618	60,176
Investing activities:			
Sales of marketable securities	**3,500**	3,009	
Net sales of marketable securities			2,785
Purchases of other investments		(10,000)	
Sales of other investments	**494**	360	
Net purchases sales of other investments			(438)
Capital expenditures	**(48,280)**	(23,944)	(8,867)
Acquisition of power plant			(85,036)
Net cash used in investing activities	**(44,286)**	(30,575)	(91,556)
Financing activities:			
Net borrowings on notes payable	**14,390**	14,117	10,993
Principal payments on long-term debt	**(41,830)**	(115,887)	(36,882)
Proceeds from long-term debt	**20,000**	65,000	102,500
Redemption of patronage capital	**(8,365)**	(8,374)	(8,220)
Net cash (used in) provided by financing activities	**(15,805)**	(45,144)	68,391
Net change in cash and cash equivalents	**(18,170)**	(20,101)	37,011
Cash and cash equivalents — beginning of year	**64,544**	84,645	47,634
Cash and cash equivalents — end of year	**$46,374**	$64,544	$84,645
Supplemental disclosure of cash flow information:			
Non-cash transactions,			
Increase in accounts payable related to capital expenditures	**$2,629**	$1,757	

See notes to financial statements.

NOTES TO FINANCIAL STATEMENTS

AS OF OCTOBER 31, 2007 AND 2006, AND FOR EACH OF
THE THREE YEARS IN THE PERIOD ENDED OCTOBER 31, 2007

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. 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 of Directors (the "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 ("SFAS") No. 71, *Accounting for the Effects of Certain Types of Regulation*. In accordance with SFAS No. 71, AECC has regulatory assets in the amount of approximately $121.9 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 SFAS 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 statement of operations.

NOTES TO FINANCIAL STATEMENTS

AS OF OCTOBER 31, 2007 AND 2006, AND FOR EACH OF THE THREE YEARS IN THE PERIOD ENDED OCTOBER 31, 2007

1. Summary Of Significant Accounting Policies *(continued)*

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 are listed below (in thousands):

	2007	2006
Generation plant	**$1,342,192**	$1,330,882
Transmission plant	**83,646**	80,055
General plant	**28,096**	27,491
Electric plant in service	**1,453,934**	1,438,428
Construction work in progress	**56,546**	26,930
	$1,510,480	$1,465,358

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%, 3.0%, 2.0%, 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.

NOTES TO FINANCIAL STATEMENTS

AS OF OCTOBER 31, 2007 AND 2006, AND FOR EACH OF
THE THREE YEARS IN THE PERIOD ENDED OCTOBER 31, 2007

1. Summary Of Significant Accounting Policies *(continued)*

Asset Retirement Obligations

SFAS No. 143, *Accounting for Asset Retirement Obligations*, requires the recording of liabilities for all legal obligations associated with the retirement of long-lived assets that result from the normal operations of those assets. These liabilities are recorded at their fair values (based on the present values of the estimated future cash outflows) in the period in which they are incurred, with an accompanying addition to the recorded cost of the long-lived asset. The asset retirement obligation ("ARO") is accreted each year through a charge to expense, to reflect the time value of money for this present value obligation. The amounts added to the carrying amounts of the long-lived assets are depreciated over the useful lives of the assets. Upon settlement of an ARO, any difference between the ARO liability and actual costs is recognized as income or expense.

In March 2005, the Financial Accounting Standards Board ("FASB") issued Interpretation No. 47 ("FIN 47"), *Accounting for Conditional Asset Retirement Obligations*. FIN 47 clarifies that the term "conditional asset retirement obligation" as used in SFAS No. 143 refers to a legal obligation to perform an asset retirement activity in which the timing and/or method of settlement are conditional on a future event that may or may not be within the control of the entity. FIN 47 also clarifies when an entity would have sufficient information to reasonably estimate the fair value of an ARO. As a result, FIN 47 requires conditional AROs to be recognized if: 1) a legal obligation exists to perform asset retirement activities, 2) the timing and/or method of settlement related to such asset retirement activities is conditional on a future event, and 3) a reasonable estimate of the ARO's fair value can be made.

AECC adopted the provisions of FIN 47 on November 1, 2005. As a result, AECC has recognized conditional AROs related to the future removal and disposal of asbestos from three oil/gas-fired plants and one coal-fired plant. Upon adoption of FIN 47, AECC recorded an ARO of $0.7 million, net asset retirement costs of $0.2 million, and a cumulative effect of change in accounting principle of $0.5 million. The cumulative effect adjustment was recorded as operating expense.

Previous to FIN 47, AECC had recorded AROs in the amount of $0.7 million primarily related to landfill closure costs associated with ash disposal ponds at the coal-fired plants. As of October 31, 2007 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, 2007 is as follows (in thousands):

Balance — October 31, 2006	$1,484
Accretion expense	84
Balance — October 31, 2007	**$1,568**

NOTES TO FINANCIAL STATEMENTS

AS OF OCTOBER 31, 2007 AND 2006, AND FOR EACH OF
THE THREE YEARS IN THE PERIOD ENDED OCTOBER 31, 2007

1. Summary Of Significant Accounting Policies *(continued)*

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 were approximately $1.7 million and $0.3 million for the years ended October 31, 2006 and 2005 respectively, and were recorded as a reduction in interest expense. There was no interest capitalized related to debt specifically borrowed for the year ended October 31, 2007. In addition, for the years ended October 31, 2007, 2006, and 2005, the carrying costs capitalized relating to projects funded without specific borrowings were approximately $0.8 million, $0.5 million, and $0.1 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 $35.2 million, $34.4 million, and $32.6 million for the years ended October 31, 2007, 2006, and 2005, respectively. No amounts were paid for income taxes for the years ended October 31, 2007, 2006, and 2005.

Inventories

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

NOTES TO FINANCIAL STATEMENTS

AS OF OCTOBER 31, 2007 AND 2006, AND FOR EACH OF
THE THREE YEARS IN THE PERIOD ENDED OCTOBER 31, 2007

1. Summary Of Significant Accounting Policies *(continued)*

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

FASB Interpretation No. 48 ("FIN 48"), *Accounting for Uncertainty in Income Taxes*, was issued in July 2006 and was to be effective for the year ended October 31, 2008. However, the implementation has been delayed for one year and will now be effective for the year ended October 31, 2009. The FASB's objective in issuing this interpretation is to increase comparability among companies in financial reporting of income taxes. FIN 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. The impact of adoption of FIN 48 on AECC's financial statements has not been determined.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* ("SFAS No. 157"). SFAS 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. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007. AECC is currently evaluating the provisions of SFAS No. 157.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Liabilities* ("SFAS No. 159"). SFAS 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. SFAS 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 SFAS 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 SFAS No. 157 are adopted concurrently with or prior to the adoption of SFAS No. 159. AECC is currently evaluating the provisions of SFAS 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.

NOTES TO FINANCIAL STATEMENTS

AS OF OCTOBER 31, 2007 AND 2006, AND FOR EACH OF THE THREE YEARS IN THE PERIOD ENDED OCTOBER 31, 2007

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, 2007, 2006, and 2005.

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):

	2007	**Percent**	2006	Percent	2005	Percent
Statutory federal income	**$ 162**	**35.0%**	$7,039	35.0%	$2,709	35.0%
Nontaxable member income	**(162)**	**(35.0)**	(7,039)	(35.0)	(2,709)	(35.0)
Tax credit carryforwards not benefited	—	—	—	—	—	—
Effective income tax rate	**$ —**	**— %**	$ —	— %	$ —	— %

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

	2007	2006
Deferred tax assets:		
Patronage exclusions available	**$ 65,904**	$ 64,403
Alternative minimum tax ("AMT") credit carryforwards	**4,052**	4,052
Other	**2,595**	1,625
	72,551	70,080
Valuation allowance	**(4,052)**	(4,052)
	68,499	66,028
Deferred tax liabilities:		
Utility plant	**(38,919)**	(40,330)
Safe harbor lease	**(13,226)**	(11,678)
Ellis sale and leaseback	**(13,977)**	(11,514)
Other	**(2,377)**	(2,506)
	(68,499)	(66,028)
Net deferred tax liability	**$ —**	$ —

At October 31, 2007, 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, 2007. Accordingly, AECC has established a valuation allowance for these credits as reflected above.

NOTES TO FINANCIAL STATEMENTS

AS OF OCTOBER 31, 2007 AND 2006, AND FOR EACH OF THE THREE YEARS IN THE PERIOD ENDED OCTOBER 31, 2007

3. INVESTMENTS

AECC uses SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities.* In accordance with SFAS 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 $15,313 in 2007. There were no realized gains or losses in 2006 or 2005. 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 were as follows (in thousands):

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

	2006			
Description	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Fair Value
Other U.S. government agency securities	$ 12,632	$	$ 132	$ 12,500

At October 31, 2007, 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	$ 6,124	$ 2,987	$	$ 9,111

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 $7.3 million and $7.5 million at October 31, 2007 and 2006, respectively. In accordance with SFAS 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, 2007 and 2006, AECC's leasehold interests in the gas reserves totaled approximately $50.3 million and $53.1 million, respectively. The net revenue interests received, less the depletion of the gas reserves, resulted in other income of approximately $1.3 million, $3.6 million, and $4.8 million for the years ended October 31, 2007, 2006, and 2005, respectively.

NOTES TO FINANCIAL STATEMENTS

AS OF OCTOBER 31, 2007 AND 2006, AND FOR EACH OF THE THREE YEARS IN THE PERIOD ENDED OCTOBER 31, 2007

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 $7.3 million, $19.8 million, and $1.6 million of patronage capital were allocated for the years ended October 31, 2007, 2006, and 2005, 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, 2007 and 2006, total members' equities as a percentage of total assets amounted to 38.2% and 38.8%, respectively.

During the years ended October 31, 2007, 2006 and 2005, the Board authorized patronage retirements of approximately $8.4 million, $8.4 million and $8.2 million, respectively.

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, 2007, the guaranteed amount by CFC was approximately $9.8 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 SFAS 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.

NOTES TO FINANCIAL STATEMENTS

AS OF OCTOBER 31, 2007 AND 2006, AND FOR EACH OF
THE THREE YEARS IN THE PERIOD ENDED OCTOBER 31, 2007

6. LONG-TERM DEBT

Long-term debt consisted of the following at October 31 *(in thousands)*:

	2007	2006
Mortgage notes payable to Federal Financing Bank ("FFB") at varying interest rates (4.32% to 6.77% at October 31, 2007), due in quarterly installments through December 2035	**$319,822**	$319,335
ISES 2 finance obligation under sale and leaseback, at an implicit rate of 6.05% at October 31, 2007 and 2006, due in semiannual installments through 2019	**137,219**	149,410
Ellis finance obligation under sale and leaseback, at an implicit interest rate of 4.29%, at October 31, 2007 and 2006, due in semiannual installments through 2013	**41,734**	49,011
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**	3,218
RUS 2% mortgage notes due in quarterly installments through May 2018	**820**	1,116
RUS 5% mortgage notes due in quarterly installments through August 2015	**2,419**	2,837
Other long-term debt	**81**	88
Total long-term debt	**503,185**	525,015
Less current maturities of long-term debt	**43,594**	41,789
	$459,591	$483,226

NOTES TO FINANCIAL STATEMENTS

AS OF OCTOBER 31, 2007 AND 2006, AND FOR EACH OF
THE THREE YEARS IN THE PERIOD ENDED OCTOBER 31, 2007

6. LONG-TERM DEBT *(continued)*

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

	2008	2009	2010	2011	2012	Thereafter	Total
FFB	$21,654	$22,905	$24,196	$25,568	$23,406	$202,093	$319,822
ISES 2 finance obligation	12,532	9,321	9,894	10,502	11,147	83,823	137,219
Ellis finance obligation	7,600	7,667	8,401	8,839	(406)	9,633	41,734
CFC Guaranteed Pollution Control Revenue Bonds	1,090						1,090
RUS	711	629	514	537	438	410	3,239
Other	7	8	9	10	10	37	81
	$43,594	$40,530	$43,014	$45,456	$34,595	$295,996	$503,185

Under the debt agreements, all of AECC's assets were pledged as security at October 31, 2007. 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, 2007.

During 2001, the RDUP approved a loan guarantee commitment in the amount of $57.5 million related to the repowering of the Fitzhugh plant. The loan commitment has a maturity date of December 31, 2031. During 2003, AECC received the initial advance from FFB in the amount of $10.0 million at an interest rate of 5.041%. During 2004, $10.0 million was advanced at an interest rate of 4.767% and in 2005 the remaining $37.5 million was advanced at an interest rate of 4.320%.

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") (see Note 10). 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%.

NOTES TO FINANCIAL STATEMENTS

AS OF OCTOBER 31, 2007 AND 2006, AND FOR EACH OF
THE THREE YEARS IN THE PERIOD ENDED OCTOBER 31, 2007

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 line of credit with Regions Bank, 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, 2008, which bears interest at 65 basis points above the 30 day LIBOR rate. There was no outstanding balance at October 31, 2007 or 2006, under these lines of credit.

AECC has signed related party master promissory notes with all of its member distribution cooperatives. These 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 statement 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 statement 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, 2007 and 2006, member advances to AECC totaled approximately $106.0 million and $91.6 million, respectively. At October 31, 2007 and 2006, the interest rate on the notes payable was 5.77% and 5.67%, respectively.

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

	2007	**2006**	**2005**
Operating interest, included in interest expense	**$4,067**	$2,289	$1,232
Nonoperating interest, included in interest income — net	**2,112**	2,627	1,639
Total interest expense	**$6,179**	$4,916	$2,871

NOTES TO FINANCIAL STATEMENTS

AS OF OCTOBER 31, 2007 AND 2006, AND FOR EACH OF THE THREE YEARS IN THE PERIOD ENDED OCTOBER 31, 2007

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 multi-employer 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 $4.6 million, $4.1 million, and $3.8 million for the years ended October 31, 2007, 2006, and 2005, 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 for the fiscal years ended October 31, 2007 and 2006, were $0.1 million and $0.1 million, respectively. AECC has acquired certain assets, principally life insurance policies and mutual fund shares, to provide benefits under the deferred compensation agreements. At October 31, 2007 and 2006, AECC had accrued deferred compensation liabilities of $6.9 million and $6.3 million, respectively, which is reflected in other deferred credits in the accompanying balance sheets. In addition, at October 31, 2007 and 2006, AECC had $6.8 million and $7.6 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 SFAS 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 and overlapping Boards of Directors with Arkansas Electric Cooperatives, Inc. ("AECI"). 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 $0.4 million and $0.3 million for the years ended October 31, 2007 and 2006, 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, 2007, 2006, and 2005, were approximately $2.8 million, $2.4 million, and $2.3 million, respectively. AECI owed AECC approximately $0.2 million at both October 31, 2007 and 2006, 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 $3.7 million, $2.6 million, and $2.0 million for the years ended October 31, 2007, 2006, and 2005, respectively. At October 31, 2007 and 2006, AECC owed AECI approximately $0.3 million and $0.2 million, respectively, for materials and services.

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

NOTES TO FINANCIAL STATEMENTS

AS OF OCTOBER 31, 2007 AND 2006, AND FOR EACH OF THE THREE YEARS IN THE PERIOD ENDED OCTOBER 31, 2007

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, 2007, is as follows *(dollars in thousands)*:

Generating Plants	Ownership or Leasehold Interest %	Utility Plant in Service — Net of Acquisition Adjustment	Accumulated Provision for Depreciation	Amount of Plant Under Construction	Current Available Net Capacity (MW) *(Unaudited)*
Flint Creek	50%	$89,992	$68,403	$5,446	264MW
White Bluff 1 and 2	35	299,944	220,337	11,958	580
ISES 1 and 2	35	341,744	233,515	7,812	588
Fitzhugh	100	72,720	18,868	168	171
Bailey	100	13,251	13,137	111	122
McClellan	100	18,471	18,324	70	134
Ellis	100	70,348	52,370	3	26
Whillock	100	75,677	21,025	4	17
Electric Cooperatives of Arkansas	100	184,293	29,444	10	35
Fulton CT 1	100	58,649	11,173		153
Oswald	100	84,119	6,087	217	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 2008. The unit contingency provision is based on the availability of the Harrison County Plant near Marshall, Texas.

During 2005, AECC completed the acquisition of Oswald, a 548 MW natural gas fired, combined-cycle power plant. AECC purchased the plant from Mirant Corporation on September 28, 2005 for $85.0 million. The purchase was financed with a $65.0 million interim term loan from CoBank (see Note 6) and with $20.0 million of AECC general funds. Prior to AECC's purchase of Oswald, Mirant Corporation had taken the plant out of commercial operation. AECC placed the plant into commercial operation on May 1, 2006, and in the process has incurred an additional $5.7 million in capitalized costs as of October 31, 2007.

RDUP regulatory accounting required AECC to record Oswald at the original cost incurred by the entity which first devoted the property to utility service, along with a related acquisition adjustment. Accordingly, AECC recorded the Oswald purchase at its original cost of $325.1 million with the related $32.2 million of accumulated depreciation, representing depreciation on Oswald from its initial commercial operation in July 2002 through AECC's acquisition in September 2005. As a result of acquiring Oswald at its original net book value cost of $292.9 million for $84.0 million (purchase price net of $1.0 million inventory purchased) and incurring an additional $5.7 million to place the plant into commercial operation, AECC recorded a related acquisition adjustment credit in the amount of $203.2 million as of October 31, 2007.

NOTES TO FINANCIAL STATEMENTS

AS OF OCTOBER 31, 2007 AND 2006, AND FOR EACH OF THE THREE YEARS IN THE PERIOD ENDED OCTOBER 31, 2007

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 Southwestern Electric Power Company ("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.

NOTES TO FINANCIAL STATEMENTS

AS OF OCTOBER 31, 2007 AND 2006, AND FOR EACH OF THE THREE YEARS IN THE PERIOD ENDED OCTOBER 31, 2007

12. RENTAL AND LEASE COMMITMENTS *(continued)*

Related expenses for the years ended October 31, 2007, 2006, and 2005, were $15.6 million each year. These expenses include depreciation expense of approximately $4.0 million for each of the years ended October 31, 2007, 2006, and 2005. In addition, interest expense was approximately $8.9 million, $9.6 million, and $10.2 million for the years ended October 31, 2007, 2006, and 2005, respectively. Amortization expense on the regulatory created asset was approximately $2.7 million, $2.0 million, and $1.4 million for the years ended October 31, 2007, 2006, and 2005, 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
2008	$20,944
2009	16,982
2010	16,982
2011	16,982
2012	16,982
Thereafter	103,529
	192,401
Less amounts representing interest (implicit rate — 6.05%)	55,182
Capitalized lease obligation	$137,219

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.

In October 1983, AECC entered into an operating lease for coal mining equipment at the North Antelope/Rochelle mine complex near Gillette, Wyoming. The equipment was sublet to a coal supplier. The lease and sublease expired January 2, 2004. During January 2004, AECC renewed the lease for the coal mining equipment. The lease renewal divided the equipment into two groups, "Equipment A" and "Equipment B." AECC's operating lease with respect to Equipment A expires January 2, 2012, and its renewal option with respect to Equipment A is at fair rental value, $75,083 semiannually in arrears, for one or more successive one-year periods as specified by AECC. AECC exercised its purchase option with respect to Equipment B at the expiration of the lease term, January 2, 2005. Effective January 2, 2004, both groups of equipment were sublet to the coal supplier. The sublease expires January 2, 2012.

Related to the North Antelope/Rochelle lease, the future minimum lease payments for the next five years ending October 31 and in the aggregate thereafter is as follows *(in thousands)*:

Year	Amount
2008	$150
2009	150
2010	150
2011	150
2012	75
	$675

Rent expense was approximately $0.2 million under the lease agreement for each of the years ended October 31, 2007, 2006, and 2005, respectively.

NOTES TO FINANCIAL STATEMENTS

AS OF OCTOBER 31, 2007 AND 2006, AND FOR EACH OF
THE THREE YEARS IN THE PERIOD ENDED OCTOBER 31, 2007

12. RENTAL AND LEASE COMMITMENTS *(continued)*

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 $27.0 million and $25.4 million at October 31, 2007 and 2006, respectively.

As a result of the above sale and leaseback, under the provisions of SFAS 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 SFAS 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 $4.3 million, $3.9 million, and $3.2 million for the years ended October 31, 2007, 2006, and 2005, respectively. Interest expense, net of amortized gain, was approximately $1.9 million, $2.3 million, and $3.0 million for the years ended October 31, 2007, 2006, and 2005, 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
2008	$9,292
2009	8,999
2010	9,385
2011	9,447
2012	
Thereafter	10,080
	47,203

Rental payments related to the Ellis lease were approximately $9.3 million, $20.9 million, and $9.3 million for the years ended October 31, 2007, 2006, and 2005, 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.

NOTES TO FINANCIAL STATEMENTS

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THE THREE YEARS IN THE PERIOD ENDED OCTOBER 31, 2007

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, 2007, contractual commitments have been entered into for construction totaling approximately $45.2 million relating to AECC's jointly owned coal plants.

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.

On October 3, 2007, AECC's Board of Directors passed a resolution approving AECC's purchase of 11.667% (70 MW) of the proposed John W. Turk Plant ("Turk"), a 600 MW coal-fired ultra supercritical steam turbine generating unit and related facilities to be located in Hempstead County, Arkansas. Turk is being constructed by SWEPCO, an American Electric Power operating subsidiary. SWEPCO is currently seeking 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. SWEPCO is still seeking an air permit from the Arkansas Department of Environmental Quality.

On December 13, 2007, AECC signed the Construction, Ownership and Operating Agreement ("COOA") for its ownership share of Turk which is estimated to cost $185.5 million. Once the air permit is granted to SWEPCO for the operation of Turk, AECC must make an initial payment to SWEPCO of $2.0 million. AECC will subsequently apply to the APSC for a Certificate of Convenience and Necessity in order to fulfill its obligation under the COOA and seek all written approvals of RUS that are necessary to permit AECC's ownership participation in the Turk project. When AECC receives these regulatory approvals, it must pay accrued project costs for Turk and thereafter share on-going construction costs.

On October 17, 2007, AECC received a draft report from the FERC assessing a charge for headwater benefits related to AECC's licenses to operate its three hydroelectric generating stations. Headwater benefit assessments are a function of both energy gains due to the regulation by the headwater project and certain costs allocated to the power function. These costs are apportioned among the headwater project and downstream beneficiaries based on the energy gains computed for the particular assessment period. FERC's proposed assessment to AECC amounted to $3.1 million covering the period of operation of these hydroelectric generating stations from 1994 to 2007. For 2008 forward, the headwater benefit assessment proposed by the FERC is approximately $354,000. AECC is contesting these amounts and the final amount has not been determined or billed to AECC. Based on internal analysis, a portion of this assessment has been accrued in the accompanying financial statements. In addition, it is AECC's intention to seek APSC approval to recover this assessment through the fuel adjustment clause; however, there are no assurances that this will be approved.

14. SIGNIFICANT CUSTOMERS

Sales to members amounted to 94%, 95%, and 90% of operating revenues for the years ended October 31, 2007, 2006, and 2005, respectively. AECC had the following members that accounted for more than 10% of operating revenue for the years ended October 31 *(dollars in thousands)*:

	2007		2006		2005	
Customer	**Amount**	**%**	**Amount**	**%**	**Amount**	**%**
Mississippi County Electric Cooperative, Inc.	**$129,518**	**22.1%**	$140,669	22.7%	$108,643	21.0%
First Electric Cooperative Corporation	**85,906**	**14.6**	91,144	14.7	74,710	14.4
Carroll Electric Cooperative Corporation	**83,087**	**14.2**	87,633	14.1	67,729	13.1

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, 2007 and 2006, 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, 2007. 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 *(in thousands)*:

	2007		2006	
	Carrying Amount	**Fair Value**	Carrying Amount	Fair Value
Long-term investments:				
Gas reserves	**$ 50,282**	**$ 73,231**	$ 53,081	$ 76,347
Other	**25,822**	**25,822**	26,480	26,480
Cash and cash equivalents	**46,374**	**46,374**	64,544	64,544
Long-term debt:				
FFB	**319,822**	**334,759**	319,335	327,400
ISES 2	**137,219**	**141,849**	149,410	154,103
Ellis	**41,734**	**41,610**	49,011	48,190
CFC	**1,090**	**1,097**	3,218	3,269
RUS	**3,239**	**3,256**	3,953	3,988
Notes payable	**105,954**	**105,954**	91,564	91,564