ARKANSAS ELECTRIC COOPERATIVE CORPORATION 2006 ANNUAL REPORT

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FINANCIALS • BALANCE SHEETS

As of October 31, 2006 and 2005 (In Thousands)

ASSETS	2006	2005
Utility plant:		
Electric plant in service	$ 1,438,428	$ 1,432,027
Construction work in progress	26,930	12,099
Total utility plant	1,465,358	1,444,126
Less accumulated depreciation	728,378	690,652
Net utility plant	736,980	753,474
Long-term investments:		
Marketable securities	9,026	15,363
Gas reserves	53,081	56,572
Other	26,480	14,843
Total long-term investments	88,587	86,778
Current assets:		
Cash and cash equivalents	64,544	84,645
Short–term marketable securities	3,474	
Accounts receivable, members	41,341	41,928
Fuel inventories and prepaid fuel supply	22,018	10,650
Material and supply inventories	12,499	12,036
Other current assets	6,389	3,133
Total current assets	150,265	152,392
Deferred charges	132,153	137,279
Total assets	$ 1,107,985	$ 1,129,923

(Continued)

FINANCIALS • BALANCE SHEETS *(continued)*

As of October 31, 2006 and 2005 (In Thousands)

LIABILITIES AND MEMBERS' EQUITIES	2006	2005
Members' equities and liabilities:		
Membership fees	$ 2	$ 2
Patronage capital	277,745	266,348
Accumulated margins	34,108	33,769
Other equities	118,140	118,140
Net unrealized loss on investments	(132)	(278)
Total members' equities	429,863	417,981
Long-term debt:		
Federal Financing Bank	299,865	254,335
Independence Steam Electric Station finance obligation	137,219	149,411
CoBank interim term loan		65,000
Ellis finance obligation	41,734	49,011
National Rural Utilities Cooperative Finance Corporation – Guaranteed Pollution Control Revenue Bonds	1,088	3,215
Rural Utilities Service	3,239	3,953
Other long-term debt	81	87
Total long-term debt	483,226	525,012
Current liabilities:		
Notes payable, members	91,564	77,447
Accounts payable and other accrued liabilities	42,523	40,767
Current maturities of long-term debt	41,789	50,890
Accrued property taxes	5,651	5,179
Accrued interest	5,280	5,980
Total current liabilities	186,807	180,263
Deferred credits	8,089	6,667
Commitments and contingencies	—	—
Total liabilities and members' equities	$ 1,107,985	$ 1,129,923

See notes to financial statements.

FINANCIALS • STATEMENTS OF OPERATIONS

For the three years in the period ended October 31, 2006 (In Thousands)

	2006	2005	2004
Operating revenues	$ 620,084	$ 517,841	$ 414,733
Operating expenses:			
Operation and maintenance, generation	251,149	230,590	204,224
Power purchased	220,976	162,616	87,117
Operation and maintenance, transmission	39,722	33,823	32,164
Administrative and general	17,650	17,726	16,932
Depreciation	42,689	38,803	38,065
Interest	34,685	32,548	33,460
Taxes	158	242	251
Total operating expenses	607,029	516,348	412,213
Margin from electric operations	13,055	1,493	2,520
Other income, net	4,508	4,855	4,157
Interest income, net	2,053	1,331	1,084
Allowance for funds used during construction	494	61	—
Net margin	$ 20,110	$ 7,740	$ 7,761

See notes to financial statements.

FINANCIALS • STATEMENTS OF MEMBERS' EQUITIES

For the three years in the period ended October 31, 2006 (In Thousands)

	Membership Fees	Patronage Capital	Accum. Margins	Other Equities	Net Unrealized Gain/(Loss) on Investments	Total Members' Equities
Balance, October 31, 2003	$ 2	$ 264,125	$ 28,711	$ 118,140	$ 745	$ 411,723
Comprehensive income:						
Net margin	—	—	7,761		—	7,761
Net unrealized gain on investments	—	—	—	—	147	147
Reclassification of realized gains into net margin					(971)	(971)
Total comprehensive income						6,937
Allocation of patronage capital	—	8,863	(8,863)	—	—	—
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**

See notes to financial statements.

FINANCIALS • STATEMENTS OF CASH FLOWS

For the three years in the period ended October 31, 2006 (In Thousands)

	2006	2005	2004
Operating activities			
Net margin	$ 20,110	$ 7,740	$ 7,761
Adjustments to reconcile net margin to net cash provided by operating activities:			
Depreciation	42,689	38,803	38,065
Net realized gains on marketable securities	—	—	(971)
Amortization of gas reserves	3,491	3,417	3,938
Allowance for funds used during construction	(494)	(61)	—
Allocation for patronage from associated organization	(422)	—	—
Changes in operating assets and liabilities:			
Accounts receivable, members	587	(7,923)	(7,709)
Fuel inventories and prepaid fuel supply	(11,368)	3,371	2,399
Material and supply inventories	(463)	(1,773)	(418)
Other current assets	(3,256)	1,755	1,257
Deferred charges	5,126	4,052	2,872
Accounts payable and accrued liabilities	(229)	9,690	3,895
Other deferred credits	(153)	1,105	224
Net cash provided by operating activities	55,618	60,176	51,313
Investing activities			
Sales of marketable securities	3,009	—	—
Net sales (purchases) of marketable securities	—	2,785	(1,974)
Purchases of other investments	(10,000)	—	—
Sales of other investments	360	—	—
Net (purchases) of other investments	—	(438)	100
Capital expenditures	(23,944)	(8,867)	(9,698)
Acquisition of power plant	—	(85,036)	—
Net cash used in investing activities	(30,575)	(91,556)	(11,572)
Financing activities			
Net borrowings (payments) on notes payable	14,117	10,993	(5,002)
Principal payments on long-term debt	(115,887)	(36,882)	(36,170)
Proceeds from long-term debt	65,000	102,500	10,000
Redemption of patronage capital	(8,374)	(8,220)	(9,559)
Net cash provided by (used in) financing activities	(45,144)	68,391	(40,731)
Net change in cash and cash equivalents	(20,101)	37,011	(990)
Cash and cash equivalents, beginning of year	84,645	47,634	48,624
Cash and cash equivalents, end of year	$ 64,544	$ 84,645	$ 47,634
Supplemental disclosure of cash flow information			
Non-cash transaction,			
Increase in accounts payable related to capital expenditures	$ 1,757	—	—

See notes to financial statements.

NOTES TO FINANCIAL STATEMENTS

As of October 31, 2006 and 2005, and for each of the three years in the period ended October 31, 2006

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 $127.7 million attributable to premiums associated with debt refinancing 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

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)*

	2006	2005
Generation plant	**$ 1,330,882**	$ 1,324,334
Transmission plant	**80,055**	80,083
General plant	**27,491**	27,610
Electric plant in service	**1,438,428**	1,432,027
Construction work in progress	**26,930**	12,099
	$ 1,465,358	$ 1,444,126

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

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 of ash disposal ponds at the coal-fired plants. As of October 31, 2006 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, 2006 is as follows (in thousands):

Balance, October 31, 2005	$	656
Adoption of FIN 47		749
Accretion expense		79
Balance, October 31, 2006	$	1,484

Electronic 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.

AECC received APSC approval for a wholesale rate increase, which became effective October 1, 2005.

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

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. In addition, for the years ended October 31, 2006 and 2005, the carrying costs capitalized relating to projects funded without specific borrowings were approximately $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. No interest costs were capitalized during 2004.

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 $34.4 million, $32.6 million, and $32.0 million for the years ended October 31, 2006, 2005, and 2004, respectively. No amounts were paid for income taxes for the years ended October 31, 2006, 2005, and 2004.

Inventories

Fuel inventories and materials 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.

NOTES TO FINANCIAL STATEMENTS

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

Recently Issued Accounting Pronouncements

FASB Interpretation No. 48 ("FIN 48"), *Accounting for Uncertainty in Income Taxes* was issued in July 2006 and will be effective for the year ended October 31, 2008. 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.

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, 2006, 2005, and 2004.

The differences between the statutory federal income tax rate on income before income taxes and AECC's effective income rate are summarized as follows: *(Dollars in Thousands)* ▼

	2006	**Percent**	2005	Percent	2004	Percent
Statutory federal income tax rate	**$ 7,039**	35.0%	$ 2,709	35.0%	$ 2,716	35.0%
Non-taxable member income	**(7,039)**	(35.0)	(2,709)	(35.0)	(2,716)	(35.0)
Tax credit carry forwards not benefited	**—**	—	—	—	—	—
Effective income tax rate	**$ —**	—%	$ —	—%	$ —	—%

The components of the net deferred tax liability at October 31 were as follows: *(In Thousands)* ▼

	2006	2005
Deferred tax assets:		
Patronage exclusions available	**$ 64,403**	$ 61,054
Alternative minimum tax (AMT) credit carry forwards	**4,052**	4,052
Other	**1,625**	1,865
	70,080	66,971
Valuation allowance	**(4,052)**	(4,052)
	66,028	62,919
Deferred tax liabilities:		
Utility plant	**(40,330)**	(42,056)
Safe harbor lease	**(11,678)**	(10,444)
Ellis sale and leaseback	**(11,514)**	(7,783)
Other	**(2,506)**	(2,636)
	(66,028)	(62,919)
Net deferred tax liability	**$ —**	$ —

At October 31, 2006, AECC had AMT credit carry forwards of approximately $4.1 million. Based on AECC's historical transactions' resulting in non member 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, 2006. Accordingly, AECC has established a valuation allowance for these credits as reflected above.

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 gains and losses were $1.0 million for the year ended October 31, 2004. 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)* ▼

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

	2005			
Description	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Fair Value
Other U.S. government agency securities	$ 15,641	$ —	$ 278	$ 15,363

At October 31, 2006, contractual maturities of marketable securities available for sale were as follows: *(In Thousands)* ▼

Description	**Less Than One Year**	**One Through Five Years**	**After Five Years**	**Total**
Other U.S. government agency securities	$ 3,474	$ 9,026	—	$ 12,500

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 $7.5 million and $7.7 million at October 31, 2006 and 2005, 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, 2006 and 2005, AECC's leasehold interests in the gas reserves totaled approximately $53.1 million and $56.6 million, respectively. The net revenue interests received, less the depletion of the gas reserves, resulted in other income of approximately $3.6 million, $4.8 million, and $3.2 million for the years ended October 31, 2006, 2005, and 2004, 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 $19.8 million, $1.6 million, and $8.9 million of patronage capital were allocated for the years ended October 31, 2006, 2005, and 2004, 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, 2006 and 2005, total members' equities as a percentage of total assets amounted to 38.8% and 37.0%, respectively.

The Board authorized patronage retirements of approximately $8.4 million and $8.2 million for the years ended October 31, 2006 and 2005, respectively. There was no retirement authorized during the year ended October 31, 2004.

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, 2006, the guaranteed amount by CFC was approximately $11.7 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's 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: *(In Thousands)* ▼

	2006	2005
Mortgage notes payable to Federal Financing Bank ("FFB") at varying interest rates (4.32% to 6.77% at October 31, 2006), due in quarterly installments through December 2035	**$ 319,335**	$ 272,643
ISES 2 finance obligation under sale and leaseback, at an implicit rate of 6.05% at October 31, 2006 and 2005, due in semiannual installments through 2019	**149,410**	160,869
CoBank interim term loan for the Wrightsville Generating Station acquisition at periodic fixed rates with the quoted fixed rate of 4.75% at October 31, 2005, due in quarterly interest-only payments	**—**	65,000
Ellis finance obligation under sale and leaseback, at an implicit interest rate of 4.29%, at October 31, 2006 and 2005, due in semiannual installments through 2013	**49,011**	67,370
CFC Guaranteed Pollution Control Revenue Bonds: City of Siloam Springs and Jefferson County, Arkansas, at an interest rates of 5.00%, at October 31, 2006, due in semiannual installments through 2008	**3,218**	5,245
RUS 2% mortgage notes due in quarterly installments through May 2018	**1,116**	1,447
RUS 5% mortgage notes due in quarterly installments through August 2015	**2,837**	3,235
	3,953	4,682
Other long-term debt	**88**	93
Total long-term debt	**525,015**	575,902
Less current maturities of long-term debt	**41,789**	50,890
	$ 483,226	$ 525,012

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: *(In Thousands)* ▼

	2007	2008	2009	2010	2011	Thereafter	Total Debt
FFB	$19,470	$21,344	$22,537	$23,811	$25,166	$207,007	$319,335
ISES 2 finance obligation	12,192	12,531	9,321	9,894	10,502	94,970	149,410
Ellis finance obligation	7,277	7,600	7,667	8,401	8,839	9,227	49,011
CFC Guaranteed Pollution Control Revenue Bonds	2,130	1,088	—	—	—	—	3,218
RUS	713	712	629	514	537	848	3,953
Other	7	7	8	9	10	47	88
	$41,789	$43,282	$40,162	$42,629	$45,054	$312,099	$525,015

Under the debt agreements, all of AECC's assets were pledged as security at October 31, 2006. 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, 2006.

During 2001, the RDUP approved a loan guarantee commitment in the amount of $57.5 million related to the re-powering 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 Wrightsville Generating Station ("Wrightsville") (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%. The proceeds were used for the repayment of the CoBank interim term loan of $65.0 million. It is anticipated that AECC will receive the remainder of the loan funds during 2007. Interest rates and payment terms have not been finalized on the remaining unadvanced loan funds.

NOTES TO FINANCIAL STATEMENTS

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, 2007, which bears interest at 65 basis points above the 30 day LIBOR rate. There was no outstanding balance at October 31, 2006 or 2005, 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, 2006 and 2005, member advances to AECC totaled approximately $91.6 million and $77.4 million, respectively. At October 31, 2006 and 2005, the interest rate on the notes payable was 5.67% and 4.20%, respectively.

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

	2006	2005	2004
Operating interest, included in interest expense	**$ 2,289**	$ 1,232	$ 1,431
Non-operating interest, included in interest income, net	**2,627**	1,639	478
Total interest expense	**$ 4,916**	$ 2,871	$ 1,909

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 $4.1 million, $3.8 million, and $3.6 million for the years ended October 31, 2006, 2005, and 2004, 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, 2006 and 2005, 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, 2006 and 2005, AECC had accrued deferred compensation liabilities of $6.3 million and $5.7 million, respectively, which is reflected in other deferred credits in the accompanying balance sheets. In addition, at October 31, 2006 and 2005, AECC had $7.6 million and $6.0 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 post retirement benefits to employees. In accordance with SFAS No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*, and the accumulated post retirement benefit obligation was calculated to be $0.3 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 $0.3 million for each of the years ended October 31, 2006 and 2005.

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, 2006, 2005, and 2004, were approximately $2.4 million, $2.3 million, and $2.2 million, respectively. AECI owed AECC approximately $0.2 million at both October 31, 2006 and 2005, 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 $2.6 million, $2.0 million, and $1.8 million for the years ended October 31, 2006, 2005, and 2004, respectively. At October 31, 2006 and 2005, AECC owed AECI approximately $0.2 million and $0.1 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%.

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, 2006, 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 Under Construction	Current Available Net Capacity (MW) *(unaudited)*
Flint Creek	50%	$ 86,322	$ 65,792	$ 5,834	264 MW
White Bluff 1 and 2	35	296,015	213,390	6,752	580
ISES 1 and 2	35	340,519	225,246	8,266	588
Fitzhugh	100	72,687	16,657	87	171
Bailey	100	13,178	13,060	167	122
McClellan	100	18,439	18,207	74	134
Ellis	100	70,993	49,569	3	26
Whillock	100	75,677	19,515	611	17
Electric Cooperatives of Arkansas	100	184,293	25,761	10	35
Fulton CT-1	100	58,621	9,428	29	153
Wrightsville	100	83,935	3,133	0	548

Under a purchase agreement with Southwestern Power Administration ("SPA"), which expires June 30, 2013, 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 Wrightsville, 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 Wrightsville, 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 $5.5 million in capitalized costs as of October 31, 2006.

RDUP regulatory accounting requires AECC to record Wrightsville at the original cost incurred by the entity which first devoted the property to utility service, along with a related acquisition adjustment. Accordingly, AECC has recorded the Wrightsville purchase at its original cost of $325.1 million with the related $32.2 million of accumulated depreciation, representing depreciation on Wrightsville from its initial commercial operation in July 2002 through AECC's acquisition in September 2005. As a result of acquiring Wrightsville 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 $5.5 million to place the plant into commercial operation. AECC has recorded a related acquisition adjustment credit in the amount of $203.4 million as of October 31, 2006.

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 plants approximately $7.6 million for start-up costs at the North Antelope/Rochelle coal mine complex, the primary source of coal of 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, 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.

12. Rental and Lease Commitments *(continued)*

Related expenses for the years ended October 31, 2006, 2005, and 2004, were $15.6 million each year. These expenses include depreciation expense of approximately $4.0 million for each of the years ended October 31, 2006, 2005, and 2004. In addition, interest expense was approximately $9.6 million, $10.2 million, and $10.9 million for the years ended October 31, 2006, 2005, and 2004, respectively. Amortization expense on the regulatory created asset was approximately $2.0 million, $1.4 million, and $0.7 million for the years ended October 31, 2006, 2005, and 2004, 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
2007	$ 21,332
2008	20,944
2009	16,982
2010	16,982
2011	16,982
Thereafter	120,510
	213,732
Less amounts representing interest (implicit rate – 6.05%)	64,322
Capitalized lease obligation	$149,410

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, 2011, 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, 2011.

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
2007	$ 150
2008	150
2009	150
2010	150
2011	150
Thereafter	75
	$ 825

Rent expense was approximately $0.2 million, $0.2 million, and $0.3 million under the lease agreement for the years ended October 31, 2006, 2005, and 2004, respectively.

NOTES TO FINANCIAL STATEMENTS

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 $25.4 million and $24.3 million at October 31, 2006 and 2005, 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 $3.9 million, $3.2 million, and $2.9 million for the years ended October 31, 2006, 2005, and 2004, respectively. Interest expense, net of amortized gain, was approximately $2.3 million, $3.0 million, and $3.3 million for the years ended October 31, 2006, 2005, and 2004, 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
2007	$ 9,278
2008	9,292
2009	8,999
2010	9,385
2011	9,447
Thereafter	10,080
	$ 56,481

Rental payments related to the Ellis lease were approximately $20.9 million, $9.3 million, and $7.6 million for the years ended October 31, 2006, 2005, and 2004, 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, 2006, contractual commitments have been entered into for construction totaling approximately $26.3 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 is required to refund to AECC all excess amounts billed to AECC within 30 days after the order becomes final. AECC estimates that this will result in a refund in excess of $20.0 million. On November 22, 2006 Entergy requested a rehearing of the FERC's decision. If the FERC order is upheld, AECC will refund amounts received due to this order to AECC's patrons through the fuel adjustment clause.

14. Significant Customers

Sales to members amounted to 95%, 90%, and 89% of operating revenues for the years ended October 31, 2006, 2005, and 2004, respectively. AECC had the following members that accounted for more than 10% of operating revenue for the years ended October 31: *(Dollars In Thousands)* ▼

	2006		2005		2004	
Customer	**Amount**	**Percent**	Amount	Percent	Amount	Percent
Mississippi County Electric Cooperative, Inc.	**$140,669**	**22.7%**	$108,643	21.0%	$88,336	21.3%
First Electric Cooperative Corporation	**91,144**	**14.7**	74,710	14.4	57,587	13.9
Carroll Electric Cooperative Corporation	**87,633**	**14.1**	67,729	13.1	52,150	12.6

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, 2006 and 2005, 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, 2006. 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)* ▼

	2006		2005	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Long-term investments:				
Gas reserves	$ 53,081	$ 76,347	$ 56,572	$ 97,856
Other	26,480	26,480	14,843	14,843
Cash and cash equivalents	64,544	64,544	84,645	84,645
Long-term debt:				
FFB	319,335	327,400	272,643	283,538
ISES 2	149,410	154,103	160,869	166,152
CoBank	—	—	65,000	65,000
Ellis	49,011	48,190	67,370	66,521
CFC	3,218	3,269	5,245	5,370
RUS	3,953	3,988	4,682	4,772
Notes payable	91,564	91,564	77,447	77,447

16. Marketing Agreement with Tenaska

On July 24, 2006, AECC signed a one-year agreement with Tenaska Power Services ("Tenaska") to market available power from the Wrightsville facility. AECC has rights to the first 100 MW generated from the facility. Tenaska markets generation in excess of 100 MW, or any generation that AECC does not need to meet the needs of its members.

17. Subsequent Event

On December 5, 2006, AECC's Board approved the construction of a 60 MW gas-fired combustion turbine generating facility subject to APSC and RDUP approval. The facility, known as Elkins Generating Station, will reduce the risk of voluntary curtailments or rotating blackouts in Northwest Arkansas. It is anticipated that this $30.0 million facility will be available beginning June 15, 2007.