ALASKA ENERGY AUTHORITY
(A Component Unit of the State of Alaska)

Financial Statements and Schedules

June 30, 2006 and 2005

(With Independent Auditors' Report Thereon)

ALASKA ENERGY AUTHORITY
(A Component Unit of the State of Alaska)

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Overview of the Financial Statements

The Alaska Energy Authority's (AEA or Authority) operations are broken down into two major programs – the owned hydroelectric and intertie projects and the rural energy programs. Further information on AEA's programs can be found in note 1 to the financial statements.

This financial report consists of three sections: management's discussion and analysis, basic financial statements, and supplementary schedules. AEA's operations are business type activities and are considered an enterprise fund. The Authority is a component unit of the State of Alaska (the State) and is discretely presented in the State's financial statements. The Authority's basic financial statements are the Balance Sheets; the Statements of Revenues, Expenses and Changes in Net Assets; the Statements of Cash Flows and the Notes to Basic Financial Statements.

Basic Financial Statements

The *Balance Sheets* report the Authority's assets, liabilities, and resulting net assets. The net assets are reported as invested in capital assets less debt, restricted and unrestricted. Restricted net assets are subject to external limits such as bond resolutions, legal agreements or statutes.

The *Statements of Revenues, Expenses, and Changes in Net Assets* report the Authority's income, expenses, and resulting change in net assets during the periods reported.

Both statements report on the accrual basis of accounting and economic resources measurement focus.

The *Statements of Cash Flows* report the Authority's sources and uses of cash and change in cash balance resulting from the Authority's activities during the periods reported.

The *Notes to Basic Financial Statements* provide additional information required to fully understand the amounts reported in the basic financial statements.

Management's Discussion and Analysis

This Section presents AEA management's analysis of the Authority's financial position and results of operations at and for the years ended June 30, 2006 and 2005. This information is presented to help the reader focus on significant financial issues and provide additional information regarding the activities of the Authority. This information should be read in conjunction with the Independent Auditors' Report, the audited financial statements and accompanying notes.

Financial Highlights

AEA's assets exceeded its liabilities at June 30, 2006 and 2005 by $415 million. Of the total net assets at June 30, 2006, $138 million was invested in capital assets net of related debt, $44 million was restricted and $233 million was unrestricted. Of the total net assets at June 30, 2005, $142 million was invested in capital assets net of related debt, $45 million was restricted and $227 million was unrestricted.

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Financial Analysis

Financial Position

Total assets, total liabilities and total net assets at June 30, 2006, 2005, and 2004 follows (stated in thousands):

		2006	2005	2004
Current assets	$	6,760	11,196	6,483
Capital assets		265,650	273,321	281,831
Other noncurrent and restricted assets		296,270	290,352	301,656
Total assets		568,680	574,869	589,970
Current liabilities		31,242	34,174	40,614
Noncurrent liabilities		122,295	126,051	129,681
Total liabilities		153,537	160,225	170,295
Total net assets		415,143	414,644	419,675
Total liabilities and net assets	$	568,680	574,869	589,970

Current assets were $4.4 million lower at June 30, 2006 compared to June 30, 2005 and $4.7 million higher at June 30, 2005 compared to June 30, 2004. Components of the changes were (stated in millions):

		2006 vs. 2005	2005 vs. 2004
Department of Defense grant expended	$	—	1.7
Department of Energy construction grants final receipts in FY06		(0.9)	—
FEMA Grant received in FY05-no similar grant in FY06		(0.3)	—
Decrease in receivable from Denali Commission		(2.4)	—
Increase in receivable from other grants		—	1.3
Decrease due to short term loan term change to long term		(1.1)	—
Net increase due to loans originated, net of loan collections		0.3	1.7
	$	(4.4)	4.7

Capital assets were $7.7 million lower at June 30, 2006 compared to June 30, 2005 and $8.5 million lower at June 30, 2005 compared to June 30, 2004 substantially due to depreciation of capital assets, partially offset by improvements on the Bradley Lake Project.

(Continued)

Other noncurrent and restricted assets were $5.9 million higher at June 30, 2006 compared to June 30, 2005 and $11.3 million lower at June 30, 2005 compared to June 30, 2004. Components of the changes were (stated in millions):

		2006 vs. 2005	**2005 vs. 2004**
Decrease in PCE Endowment Fund securities lending	$	(1.0)	(3.5)
Department of Defense grant expended		—	(1.7)
Decrease in Bradley Fund due to increased project expenditure		(2.0)	—
Increase in PCE program for year end supplemental appropriation		3.8	—
Increase in PCE Endowment Fund fair value		3.4	1.8
Net increase in other program funds from investment income		0.6	—
Increase due to short term loan term changes to long term		1.1	—
Southeast Energy Fund grant expenditures		—	(7.9)
	$	5.9	(11.3)

Current liabilities were $2.9 million lower at June 30, 2006 compared to June 30, 2005 and $6.4 million lower at June 30, 2005 compared to June 30, 2004. Components of the changes were (stated in millions):

		2006 vs. 2005	**2005 vs. 2004**
Decrease in PCE Endowment Fund securities lending	$	(1.0)	(3.5)
Southeast Energy Fund grant payment expended		—	(5.4)
Increase in short-term borrowings		—	0.2
Increased (decreased) budgeted revenues in excess of actual expenses on hydro and intertie projects		(1.2)	1.4
Increase (decrease) in other accrued expenditures		(0.7)	0.9
	$	(2.9)	(6.4)

The decreases in noncurrent liabilities between June 30, 2006 and 2005 and between June 30, 2005 and 2004 were caused by the decrease in the long–term portion of bonds payable at each year end; there have been no new borrowings.

The decrease in net assets from June 30, 2005 to June 30, 2006 and between June 30, 2004 to June 30, 2005 resulted from the operating losses for those years offset by nonoperating investment income.

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Operations

Components of the Authority's operating revenues, operating expenses, nonoperating investment income and operating loss for the years ended June 30, 2006 through 2004 follows (stated in thousands):

		2006	2005	2004
Operating revenues:				
Federal grants	$	28,544	42,442	34,592
Revenue from operating plants		15,669	16,680	14,161
State of Alaska appropriations		12,192	2,952	9,530
Other		1,603	1,780	1,834
Total operating revenues		58,008	63,854	60,117
Operating expenses:				
Grants and projects		30,170	46,926	45,861
Power cost equalization grants		21,669	15,575	15,461
Depreciation		9,992	10,006	10,312
Interest expense		8,274	8,553	8,782
Plant operating		4,213	4,044	4,306
General and administrative		1,638	1,539	1,583
Provision for loan loss and bad debt expense		(326)	170	(30)
Total operating expense		75,630	86,813	86,275
Operating loss		(17,622)	(22,959)	(26,158)
Nonoperating – investment income, net		18,121	17,928	22,746
Increase (decrease) in net assets	$	499	(5,031)	(3,412)

Operating revenues decreased $5.8 million during the year ended June 30, 2006 compared to the prior year and were $3.7 million higher during the year ended June 30, 2005 compared to the prior year. Components of the changes were (stated in millions):

		FY 2006-2005 Net change	FY 2005-2004 Net change
Increased (decreased) grant revenue from Denali commission	$	(11.0)	6.6
Decreased grant revenue from Department of Energy		(1.5)	—
Increased (decreased) revenue from other grantors		(1.4)	1.1
Fluctiuations in Bradley Lake approved budget expenditures		(1.0)	2.0
Increased (decreased) revenue from State of Alaska for Power Cost Equlization program		8.7	(5.0)
Increased (decreased) revenue from State of Alaska general fund capital appropriations		0.4	(1.0)
	$	(5.8)	3.7

(Continued)

Operating expenses decreased $11.2 million during the year ended June 30, 2006 compared to the prior year and were $0.5 million higher during the year ended June 30, 2005 compared to the prior year. Components of the changes were (stated in millions):

		FY 2006-2005 Net change	FY 2005-2004 Net change
Increased (decreased) grant and project expenses in active rural energy construction projects	$	(17.0)	6.1
Increased PCE grant expenditures		6.0	—
Decreased grant expenditures for Southeast Alaska intertie project		—	(5.0)
Increased (decreased) Bradley Lake plant expenses		0.2	(0.3)
Decreased other expenses		(0.4)	(0.3)
	$	(11.2)	0.5

Nonoperating investment income increased during the year ended in 2006 due to $2.1 million increase in interest income and realized gains offset by $1.0 million decrease in fair value during the time period.

Nonoperating investment income increased during the year end ended 2005 substantially due to fair value gains in the year ended in 2005 on the PCE Endowment Fund investments. The PCE Endowment Fund is a managed long term fund intended to generate the income to fund the PCE program. The fund value fluctuates with market changes.

Outlook

Annual operation of the owned hydroelectric and intertie projects are per annual budgets approved by the utilities that use the assets and pursuant to bond resolutions and other agreements. Annual operation of the rural energy programs are per State of Alaska legislation, annual appropriations and federal grant awards.

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Independent Auditors' Report

The Board of Directors
Alaska Energy Authority:

We have audited the accompanying balance sheets of the Alaska Energy Authority (a Component Unit of the State of Alaska) (Authority) as of June 30, 2006 and 2005, and the related statements of revenues, expenses, and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these basic financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing auditing procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Authority'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 the 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 opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Authority as of June 30, 2006 and 2005, and the changes in its financial position and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 6, 2006, with subsequent event note dated October 16, 2006, on our consideration of the Authority's internal control over financial reporting and on 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 considered in assessing the results of our audit.

The Management's Discussion and Analysis on pages 1 through 5 are not a required part of the basic financial statements but is supplementary information required by U.S. generally accepted accounting principles. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

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Our audits were made for the purpose of forming an opinion on the financial statements taken as a whole. The supplementary information included in schedules 1 to 3 is presented for the purpose of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

KPMG LLP

October 6, 2006, except as noted
in note 1(b) dated October 16, 2006

ALASKA ENERGY AUTHORITY
(A Component Unit of the State of Alaska)

Balance Sheets

June 30, 2006 and 2005

(Stated in thousands)

Assets		**2006**	**2005**
Current assets:			
Grants receivable	$	2,952	6,581
Loans receivable (note 7)		1,937	2,745
Operating revenue receivable		553	554
Accrued interest receivable		1,318	1,316
Total current assets		6,760	11,196
Noncurrent assets:			
Restricted cash and investments (note 3)		22,323	22,025
Cash and investments designated for specific purposes (note 3)		251,394	247,146
Loans receivable, net of allowance (note 7)		22,553	21,181
Capital assets (note 5)		437,445	435,124
Less accumulated depreciation		(171,795)	(161,803)
Capital assets, net		265,650	273,321
Total noncurrent assets		561,920	563,673
Total assets	$	568,680	574,869
Liabilities and Net Assets			
Current liabilities:			
Due to State of Alaska	$	942	1,014
Accounts payable		21,262	24,191
Bonds payable – current portion (note 6)		5,800	5,665
Accrued interest		3,238	3,304
Total current liabilities		31,242	34,174
Noncurrent liabilities:			
Bonds payable – noncurrent portion, net (note 6)		121,482	125,485
Arbitrage interest payable (note 6)		710	463
Other liabilities		103	103
Total noncurrent liabilities		122,295	126,051
Total liabilities		153,537	160,225
Net assets:			
Invested in capital assets, net of related debt		138,368	142,171
Restricted for debt service		19,085	22,025
Restricted by agreements with external parties		25,168	23,392
Unrestricted net assets		232,522	227,056
Total net assets		415,143	414,644
Commitments and contingencies (notes 8 and 10)			
Total liabilities and net assets	$	568,680	574,869

See accompanying notes to basic financial statements.

ALASKA ENERGY AUTHORITY
(A Component Unit of the State of Alaska)

Statements of Revenues, Expenses, and Changes in Net Assets

Years ended June 30, 2006 and 2005

(Stated in thousands)

		2006	2005
Operating revenues:			
Federal grants	$	28,544	42,442
Revenue from operating plants		15,669	16,680
State of Alaska appropriations		12,192	2,952
Revenue from state agencies		651	913
Interest on loans		905	827
Other revenue		47	40
Total operating revenues		58,008	63,854
Operating expenses:			
Grants and projects		30,170	46,926
Power cost equalization grants		21,669	15,575
Depreciation		9,992	10,006
Interest expense		8,274	8,553
Plant operating		4,213	4,044
General and administrative		1,638	1,539
Provision for loan loss and bad debt expense		(326)	170
Total operating expenses		75,630	86,813
Operating loss		(17,622)	(22,959)
Nonoperating – investment income, net		18,121	17,928
Increase (decrease) in net assets		499	(5,031)
Net assets – beginning		414,644	419,675
Net assets – ending	$	415,143	414,644

See accompanying notes to basic financial statements.

ALASKA ENERGY AUTHORITY
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Statements of Cash Flows

Years ended June 30, 2006 and 2005

(Stated in thousands)

		2006	2005
Cash flows from operating activities:			
Receipts from federal grants	$	32,174	39,626
Receipts from customers and users		14,011	18,606
Receipts from State of Alaska appropriations		11,745	3,278
Principal collected on loans		7,935	5,763
Receipts from state agencies		897	913
Interest collected on loans		1,014	598
Other operating receipts		84	40
Loans originated		(8,163)	(7,294)
Payments to suppliers		(10,795)	(14,286)
Payments to grantees		(47,117)	(59,190)
Net cash (used) provided by operating activities		1,785	(11,946)
Cash flows from noncapital and related financing activities:			
Net unremitted interest earned (returned) on federal grant advances		(20)	18
Net unremitted interest earned (returned) on state appropriation advances		128	(6)
Net receipt from (payments on) operating loans from AIDEA		(121)	181
Net cash (used) provided by noncapital and related financing activities		(13)	193
Cash flows from capital and related financing activities:			
Principal paid on bonds		(5,665)	(5,370)
Interest paid on bonds		(6,564)	(6,756)
Purchase of capital assets		(2,321)	(1,496)
Net cash used by capital and related financing activities		(14,550)	(13,622)
Cash flows from investing activities:			
Purchase of investments		(53,840)	(36,824)
Proceeds from sales and maturities of investments		66,508	33,746
Interest received from investments		8,904	7,732
Net cash provided by investing activities		21,572	4,654
Net increase (decrease) in cash and cash equivalents		8,794	(20,721)
Cash and cash equivalents at beginning of year		14,723	35,444
Cash and cash equivalents at end of year (note 3)	$	23,517	14,723
Reconciliation of change in net assets to net cash (used) provided by operating activities:			
Operating loss	$	(17,622)	(22,959)
Adjustments to reconcile operating loss to net cash provided by operating activities:			
Depreciation		9,992	10,006
Provision for loan loss and bad debt expense		(326)	170
Bond interest expense		8,274	8,553
Changes in assets and liabilities:			
Increase (decrease) in due to State of Alaska		(199)	326
(Increase) decrease in grants receivable		3,630	(2,816)
Increase in loans receivable		(228)	(1,531)
(Increase) decrease in interest receivable		109	(229)
(Increase) decrease in operating revenue receivable		(9)	133
Decrease in operating accounts payable		(1,836)	(3,599)
Net cash (used) provided by operating activities	$	1,785	(11,946)

See accompanying notes to basic financial statements.

(1) Organization and Operations

The Alaska Energy Authority (Authority or AEA) was created by the Alaska State Legislature in 1976. AEA is a public corporation and a component unit of the State of Alaska (State). AEA's mission is to promote, develop, and advance the general prosperity and economic welfare of Alaskans by providing a means to operate and maintain existing power projects that tap Alaska's natural resources to achieve the lowest reasonable consumer power costs.

Throughout the 1980's, AEA worked to develop the State's energy resources as a key element in diversifying Alaska's economy. A number of large–scale projects were constructed; four of those projects were sold in 2002. Today, AEA's two hydroelectric projects have an installed capacity in excess of 90 megawatts, and the Alaska Intertie's 170 miles of transmission line link Interior Alaska with the cheaper energy available in the Southcentral portion of the State.

Pursuant to statute, on August 12, 1993, the board of directors of the Alaska Industrial Development and Export Authority (AIDEA), a public corporation and a political subdivision of the State, became the board of directors of AEA. Concurrently, the Executive Director of AIDEA was also appointed as Executive Director of AEA. Among other things, AIDEA provides personnel services for AEA. AEA continues to exist as a separate legal entity. The corporate structure and operating assets of AEA were retained but the ability to construct and acquire energy projects was eliminated. The intent of the legislation was that ongoing operation of the operating assets be assumed by the electric utility companies that use or purchase power from the assets with oversight responsibility retained by AEA; this has occurred to the extent possible. There is no commingling of funds, assets or liabilities between AIDEA and AEA and there is no responsibility of one for the debts or the obligations of the other. Consequently, the accounts of AIDEA are not included in the accompanying financial statements.

Pursuant to legislation effective July 1, 1999, rural energy programs previously administered by the former Department of Community and Regional Affairs, Division of Energy, were transferred to AEA for administration, as part of a larger reorganization of state agencies. Five general energy programs comprising more than twenty smaller programs were moved to AEA. Rural energy programs were originally part of AEA prior to the reorganization that occurred in 1993.

The following is a description of AEA's existing projects and programs:

(a) Bradley Lake Hydroelectric Project

The project has installed capability, under optimal conditions, of 126 megawatts and transmits its power to the State's main power grid via two parallel 20–mile transmission lines. The project, which cost in excess of $300 million, went into commercial operation in 1991. The project is now operated by Homer Electric Association under contract with AEA. Bradley Lake serves Alaska's Railbelt from Homer to Fairbanks as well as the Delta Junction area.

(b) Alaska Intertie Project

The 170–mile, 345–kilovolt transmission line interconnects the power distribution systems of Anchorage and Fairbanks. The Alaska Intertie allows Golden Valley Electric Association in Fairbanks to purchase electricity produced with lower cost energy, such as natural gas and hydroelectric, from the Anchorage and Kenai Peninsula utilities. The Alaska Intertie reduces the number of black/brownouts throughout the system. Operations and maintenance duties are overseen by the Intertie Operating Committee under the Alaska Intertie Agreement (Agreement).

Under legislation effective July 1, 2002, the State appropriated $20,300,000 to AEA to upgrade and extend a portion of the Alaska Intertie. During the year ended June 30, 2004, AEA incurred $64,000 in costs for preliminary design work. No costs were incurred in 2006 or 2005.

AEA management and utility members of the Intertie Operating Committee identified defects in the Agreement that AEA management believes threaten the long-term operational reliability and economic viability of the Alaska Intertie. The attempts to cure the identified defects were unsuccessful because amending the Agreement requires unanimous consent of each member of the Intertie Operating Committee, and at least one utility member objected to each proposed cure. As a first step to cure defects in the Agreement, AEA management on October 16, 2006, issued contractually required notice that the Agreement will terminate in 48 months, on October 17, 2010. AEA management anticipates that the necessary amendments to the Agreement can be implemented no later than the effective date of the termination of the existing Agreement, or earlier if Intertie Operating Committee members reach unanimous consent.

(c) Larsen Bay Hydroelectric Project

The 475–kilowatt project went into commercial operation in 1991. In addition to producing electricity for this isolated Kodiak Island community, the project replaced the City of Larsen Bay's old water supply system and provides a better source of water with reduced maintenance and improved water quality. The City of Larsen Bay operates the project.

(d) Rural Energy Programs

The rural energy programs of the Authority include Bulk Fuel Storage Upgrades, Rural Power System Upgrades, Power Cost Equalization, Alternative Energy, Utility Training, and Technical Assistance, two active loan programs funded from the Bulk Fuel Revolving Loan Fund and the Power Project Fund and one inactive loan program.

(2) Summary of Significant Accounting Policies

(a) Basis of Accounting – Enterprise Fund Accounting

The accounts of the Authority are organized as an Enterprise Fund. Accordingly, the financial activities of the Authority are reported using the economic resources measurement focus and the accrual basis of accounting, whereby revenues are recorded when earned and expenses are recorded when goods or services are received or the related liability is incurred.

GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, provides two options for reporting proprietary fund activities (including component units using proprietary fund accounting). The Authority has elected to apply all applicable GASB pronouncements and all FASB Statements and Interpretations, Accounting Principles Board Opinions and Accounting Research Bulletins issued on or before November 30, 1989, unless they conflict with or contradict GASB pronouncements.

Operating Revenue and Expense

The Authority considers all its revenues and expenses, except for investment income, to be part of its principal ongoing operations and therefore classifies these revenues and expenses as operating in the statement of revenues, expenses, and changes in net assets.

(b) Capital Assets

Capital assets are stated at cost and depreciation is charged to operations by use of the straight–line method over their estimated useful lives. The estimated economic lives of the assets are as follows:

Utility plant	Life in years
Intangible	30-50
Production	30-50
Transmission	20-40
General	5-30

The Authority recognizes impairment losses for long–lived assets whenever events or changes in circumstances result in the carrying amount of the assets exceeding the sum of the expected future cash flows associated with such assets.

(c) Cash and Investments

All of AEA's cash and investments are restricted. For the purposes of the statement of cash flows, cash and cash equivalents consist of cash, short term commercial paper and money market funds.

AEA's marketable securities are reported at fair value in the financial statements. Unrealized gains and losses are reported as components of the deficiency of revenues over expenses. Fair values are obtained from independent sources.

(d) Loans and Related Interest Income

Loans are generally carried at amounts advanced less principal payments collected. Interest income is accrued as earned. Accrual of interest is discontinued whenever the payment of interest or principal is more than ninety days past due or when the loan terms are restructured. The Authority considers lending activities to be part of its principal operations and classifies it as operating in the statement of revenues, expenses, and changes in net assets. For purposes of the statement of cash flows, loans are treated as program loans.

(Continued)

(e) Allowance for Loan Losses

The allowance for loan losses represents management's judgment as to the amount required to absorb potential losses in the loan portfolio. The factors used by management to determine the allowance required include historical loss experience, individual loan delinquencies, collateral values, economic conditions and other factors. Management's opinion is that the allowance is currently adequate to absorb known losses and inherent risks in the portfolio.

(f) Environmental Issues

The Authority's policy relating to environmental issues is to record a liability when the likelihood of Authority responsibility for clean–up is probable and the costs are reasonably estimable. At June 30, 2006 and 2005, there were no environmental issues which met both of these criteria and, accordingly, no provision has been made in the accompanying financial statements for any potential liability which may result.

(g) Income Taxes

The Internal Revenue Code provides that gross income for tax purposes does not include income accruing to a state or territory or any political subdivision thereof which is derived from the exercise of any essential governmental function or from any public utility. AEA is a political subdivision of the State performing an essential governmental function and is therefore exempt from State and federal income taxes.

(h) Appropriations and Grants

The Authority recognizes grant revenue under the provisions of GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*, whereby revenue is recognized when all applicable eligibility requirements, including time requirements, are met.

(i) Segment Information

The financial statements disclose all financial information required by the Authority's Bradley Lake bond indenture.

(j) Estimates

In preparing the financial statements, management of the Authority is required to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosures of contingent assets and liabilities as of the date of the balance sheet. These estimates impact revenue and expenses for the period. Actual results could differ from those estimates.

(3) Cash and Investments

Pursuant to various agreements, appropriations and statutory requirements relating to its operations, AEA has established accounts for assets restricted to construction, operation, and financing activities (as used herein, Fund means a separate account established by the State legislature and does not refer to a separate group of self balancing accounts as contemplated by accounting principles generally accepted in the United States of America).

At June 30, 2006 and 2005 the Authority's carrying amount of deposits (all of which were restricted) was $23,517,000 and $14,723,000, respectively. The total of all bank balances was $24,027,000 and $15,813,000, respectively.

The restricted and designated cash and investments were held in trust accounts for the following activities as of June 30, 2006 (stated in thousands):

		Cash and cash equivalents	**Investments**	**Total**
Power Cost Equalization Endowment Fund	$	5	194,752	194,757
Bradley Lake Hydroelectric Project		—	28,192	28,192
Rural Energy Loan Funds		13,390	7,451	20,841
Rural Energy Operations		1,404	18,311	19,715
Southeast Energy Fund		128	—	128
Funds advanced from State and federal agencies		842	—	842
Power Development Fund		1,988	—	1,988
Power Cost Equalization and Rural Electric Capitalization Fund		4,730	1,494	6,224
Alaska Intertie Project		1,030	—	1,030
Total cash and investments	$	23,517	250,200	273,717

The restricted and designated cash and investments were held in trust accounts for the following activities as of June 30, 2005 (stated in thousands):

	Cash and cash equivalents	Investments	Total
Power Cost Equalization Endowment Fund	$ 7	192,337	192,344
Bradley Lake Hydroelectric Project	679	29,509	30,188
Rural Energy Loan Funds	5,528	14,341	19,869
Rural Energy Operations	1,145	18,261	19,406
Southeast Energy Fund	123	—	123
Funds advanced from State and federal agencies	1,247	—	1,247
Power Development Fund	2,052	—	2,052
Power Cost Equalization and Rural Electric Capitalization Fund	2,434	—	2,434
Alaska Intertie Project	1,508	—	1,508
Total cash and investments	$ 14,723	254,448	269,171

At June 30, 2006 and 2005, amounts restricted for debt service totaled $22,323,000 and $22,025,000, respectively, for the Bradley Lake Hydroelectric Project.

Investment Holdings

Power Cost Equalization Fund – The Power Cost Equalization Endowment Fund (PCE Fund), created under Alaska Statute 42.45.070, is under the fiduciary authority of the State Department of Revenue, Treasury (Treasury). The purpose of the fund is to provide for a long–term stable financing source for power cost equalization in order to provide affordable levels of electric utility costs in otherwise high–cost service areas in the state.

State investments are managed in pools. PCE Fund assets are held in the State's Short–term and Broad Market Fixed Income Pools, managed by Treasury's investment officers, and the State's Domestic Equity account and International Equity Pool, managed by contracted external investment managers. A complete description of the investment policy for each pool is included in the State's CAFR (see Department of Revenue, Treasury Division, Policies and Procedures).

Fixed income and international equity securities are valued each business day using prices obtained from a pricing service. The Domestic Equity account is valued each business day by the Trustee Committee in good faith and pursuant to procedures established by the Trustee. Securities expressed in terms of foreign currencies are translated into U.S. dollars at the prevailing exchange rates. Income in the fixed income pools and the International Equity Pool is allocated to pool participants daily on a pro rata basis. Domestic equity income is distributed quarterly.

At June 30, 2006, AEA had the following cash and investments in the PCE Fund (stated in thousands):

	Cash	Investments at fair value			
Investment type	**Short-term fixed income pool**	**Broad market fixed income pool**	**Equity**	**Securities lending collateral**	**Total investments**
Overnight sweep account	$ 13	—	—	—	—
Money market	318	—	—	10,300	10,300
Commercial paper	637	—	—	—	—
U.S. Treasury Bills	—	3,420	—	—	3,420
U.S. Treasury Notes	—	3,790	—	—	3,790
U.S. Government Agency Discount Notes	—	1,016	—	—	1,016
U.S. Government Agency	—	7,043	—	—	7,043
Mortgage-backed	549	30,004	—	—	30,004
Other asset-backed	3,815	1,165	—	—	1,165
Corporate bonds	1,974	14,672	—	—	14,672
Yankee:					
Government	—	357	—	—	357
Corporate	80	961	—	—	961
Domestic equity	—	—	85,143	—	85,143
International equity	—	—	35,158	—	35,158
Total invested assets	7,386	62,428	120,301	10,300	193,029
Pool related net liabilities	(5)	(5,603)	(50)	—	(5,653)
Other pool ownership	(7,376)	7,376	—	—	7,376
Net invested assets	$ 5	64,201	120,251	10,300	194,752

At June 30, 2005, AEA had the following cash and investments in the PCE Fund (stated in thousands):

	Cash	Investments at fair value			
Investment type	**Short-term fixed income pool**	**Broad market fixed income pool**	**Equity**	**Securities lending collateral**	**Total investments**
Deposits	$ —	—	22	—	22
Overnight sweep account	3	—	—	—	—
Money market	—	—	863	11,231	12,094
Commercial paper	194	—	—	—	—
U.S. Treasury Bills	142	—	—	—	—
U.S. Treasury Notes	123	4,099	—	—	4,099
U.S. Treasury Bonds	—	4,485	—	—	4,485
U.S. Treasury Strips	—	915	—	—	915
U.S. Government Agency Discount Notes	31	154	—	—	154
U.S. Government Agency	—	3,262	—	—	3,262
Mortgage-backed	358	31,445	—	—	31,445
Other asset-backed	1,005	2,208	—	—	2,208
Corporate bonds	455	14,763	—	—	14,763
Yankee:					
Government	—	263	—	—	263
Corporate	17	318	—	—	318
Domestic equity	—	—	83,270	—	83,270
International equity	—	—	33,490	—	33,490
Total invested assets	2,328	61,912	117,645	11,231	190,788
Pool related net assets (liabilities)	22	(976)	182	—	(794)
Other pool ownership	(2,343)	2,343	—	—	2,343
Net invested assets	$ 7	63,279	117,827	11,231	192,337

Other AEA Cash and Investments – Bradley Lake Hydroelectric Project investments are substantially invested pursuant to investment agreements with JP Morgan Chase Bank that end the earlier of July 1, 2021 or the date of repayment of the Bradley Lake Power Revenue Bonds First and Second Series. All other AEA assets are managed by AIDEA staff for liquidity. There is no written investment policy; AIDEA staff manages AEA investments following AIDEA's internally managed investment policy for liquidity and minimal risk. The AEA managed portfolio consists of the following eligible securities:

- Debt instruments issued or guaranteed by the U.S. government, its agencies and instrumentalities, and Government Sponsored Enterprises (GSEs); and
- Money market funds and repurchase agreements collateralized by U.S. Treasury and agency securities.

At June 30, 2006, AEA had the following cash and investments in its other funds (stated in thousands):

Investment type		**Fair value Short-term fixed income**
Deposits	$	49
Money market		24,957
Mortgage-backed		25,762
Investment agreements		28,192
Total invested assets	$	78,960

At June 30, 2005, AEA had the following cash and investments in its other funds (stated in thousands):

Investment type		**Fair value Short-term fixed income**
Deposits	$	59
Money market		14,656
U.S. Government agency discount notes		19,721
Mortgage-backed		12,882
Investment agreements		29,509
Total invested assets	$	76,827

Interest Rate Risk – Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment.

Short–Term Fixed Income Pool – As a means of limiting its exposure to fair value losses arising from increasing interest rates, Treasury's investment policy limits individual fixed rate securities to fourteen months in maturity or fourteen months expected average life. Floating rate securities are limited to three years in maturity or three years expected average life. Treasury utilizes the actual maturity date for commercial paper and twelve month prepay speeds for other securities. At June 30, 2006, the expected average life of individual fixed rate securities ranged from three days to seven months. At June 30, 2005, the expected average life of individual fixed rate securities ranged from one day to ten months. At June 30, 2006 and 2005 the expected average life of floating rate securities ranged from less than one year to three years.

Broad Market Fixed Income Pool – Through its investment policy, Treasury manages its exposure to fair value losses arising from increasing interest rates by limiting the effective duration of its Broad Market Fixed Income Pool to ± 20% of the Lehman Brothers Aggregate Bond Index. The effective duration for the Lehman Brothers Aggregate Bond Index at June 30, 2006 and 2005, was 4.80 years and 4.16 years, respectively.

Investment Agreements – Bradley Lake Hydroelectric Project investments are invested pursuant to agreements with JP Morgan Chase Bank that guarantees annual interest earnings of 7.38% or 7.41% per annum until the earlier of July 1, 2021 or the date of repayment of the Bradley Lake Power Revenue Bonds, First and Second Series. The investment contracts are collateralized.

Under the Internal Revenue Code of 1986, certain earnings in excess of arbitrage yield on the Bradley Lake bonds must be rebated to the U.S. Treasury. The bulk of the Bradley Lake investments are subject to rebate.

AEA Internally Managed Investments – There is no written policy for interest rate risk for AEA's internally managed investments, but AIDEA's policy is followed. The duration for the investments is 2 years or less. The maximum maturity of any issue shall be 3 years from the date of purchase.

Duration – Duration is a measure of interest rate risk. It measures a security's sensitivity to a 100–basis point change in interest rates. Duration is a weighted average term–to–maturity of an investment's cash flows.

Treasury uses industry–standard analytical software developed by The Yield Book Inc. to calculate effective duration. The software takes into account various possible future interest rates, historical and estimated prepayment rates, call options and other variable cash flows for purposes of the effective duration calculation. Duration for the AEA managed investments are as reported on Bloomberg.

Treasury has no policy with regard to interest rate risk for the money market balance held in the International Equity Pool.

At June 30, 2006, the effective duration by investment type (not including the investment agreements) was as follows:

	Effective duration (in years)	
	Treasury managed	**AEA managed**
Money market	—	0.25
U.S. Treasury Notes	3.13	—
U.S. Treasury Bonds	9.74	—
U.S. Government agency	4.25	—
Mortgage-backed	3.75	0.69
Other asset-backed	0.87	—
Corporate bonds	4.99	—
Yankees:		
Government	8.83	—
Corporate	6.34	—
Portfolio effective duration	3.96	0.46

At June 30, 2005, the effective duration by investment type (not including the investment agreements) was as follows:

	Effective duration (in years)	
	Treasury managed	**AEA managed**
Money market	—	0.25
U.S. Treasury Notes	3.91	—
U.S. Treasury Bonds	10.39	—
U.S. Treasury Strips	15.97	—
U.S. Government agency	7.00	0.39
Mortgage-backed	2.41	1.76
Other asset-backed	1.31	—
Corporate bonds	5.39	—
Yankees:		
Government	6.50	—
Corporate	9.86	—
Portfolio effective duration	4.10	0.57

Credit Risk – Credit risk is the financial risk that an issuer or other counterparty to an investment will not fulfill its obligations and a loss will result.

Treasury's investment policy has the following limitations with regard to credit risk: With the exception of the sweep account, Short–term Fixed Income Pool investments are limited to instruments with a long–term credit rating of at least A3 or equivalent and instruments with a short–term credit rating of at least A1 or equivalent. For securities with long–term credit ratings, they may be purchased if the median rating of Standard & Poor's Corporation, Moody's and Fitch is A3 or equivalent. Asset–backed and nonagency mortgage securities may be purchased if only rated by one of the rating agencies mentioned above if they are rated AAA. Unexpected daily cash surpluses that arise in this pool are invested overnight in the custodian's repurchase agreement sweep account. Treasury does not have a policy to limit credit risk associated with the sweep account.

Broad Market Fixed Income Pool investments are limited to securities with a long–term credit rating of at least BBB3 or equivalent and securities with a short–term credit rating of at least A1 or equivalent. For securities with long–term credit ratings, they may be purchased if the median rating of Standard & Poor's Corporation, Moody's and Fitch is BBB3 or equivalent. Asset–backed and nonagency mortgage securities may be purchased if only rated by one of the rating agencies mentioned above if they are rated AAA.

Treasury has no policy with regard to credit risk for the money market balance held in the International Equity Pool.

There is no written policy with regard to credit risk for investments managed by AEA. Since AEA only invests in highly rated money markets and U.S. government and agency securities, and GSEs credit risk is minimal.

The Bradley Lake Hydroelectric Project investments are substantially invested in collateralized investment agreements, which minimizes credit risk.

At June 30, 2006, the Pools managed by Treasury and the investments managed by AEA consisted of investments with credit quality ratings issued by nationally recognized statistical rating organizations as follows (using Standard & Poor's Corporation rating scale).

Investment type	Rating[1]	Short-term fixed income pool	Broad market fixed income pool	International equity pool	AEA managed
Money market	AAA	—%	—%	—%	30%
Overnight sweep account	Not Rated	—	—	—	—
Short-term investment account	Not Rated	4	—	2	—
Commercial paper	A-1	9	—	—	—
U.S. Government agency discount notes	AAA	—	2	—	1
U.S. Government agency	AAA	—	12	—	—
Mortgage-backed	AAA	—	44	—	—
Mortgage-backed	Not Rated	7	9	—	—
Mortgage-backed (Agency)	AAA	—	—	—	33
Other asset-backed	AAA	48	2	—	—
Other asset-backed	A	3	—	—	—
Corporate bonds	AAA	2	2	—	—
Corporate bonds	AA	15	4	—	—
Corporate bonds	A	9	11	—	—
Corporate bonds	BBB	—	9	—	—
Yankees – corporate	AAA	1	—	—	—
Yankees – corporate	AA	1	—	—	—
Yankees – corporate	A	—	1	—	—
Yankees – corporate	BBB	—	1	—	—
No credit exposure		1	3	98	—
Investment agreements		—	—	—	36
		100%	100%	100%	100%

[1]Rating modifiers are not disclosed.

At June 30, 2005, the Pools managed by Treasury and the investments managed by AEA consisted of investments with credit quality ratings issued by nationally recognized statistical rating organizations as follows (using Standard & Poor's Corporation rating scale):

Investment type	Rating[1]	Short-term fixed income pool	Broad market fixed income pool	International equity pool	AEA managed
Money market	AAA	—%	—%	3%	19%
Commercial paper	A	8	—	—	—
U.S. Government agency discount notes	Not Rated	1	—	—	—
U.S. Government agency	Not Rated	—	6	—	—
U.S. Government agency	A	—	—	—	26
Mortgage-backed	AAA	15	11	—	—
Mortgage-backed (Agency)	Not Rated	—	41	—	—
Mortgage-backed (Agency)	AAA	—	—	—	17
Other asset-backed	AAA	39	3	—	—
Other asset-backed	A	3	—	—	—
Corporate bonds	AAA	1	2	—	—
Corporate bonds	AA	11	2	—	—
Corporate bonds	A	9	7	—	—
Corporate bonds	BBB	—	12	—	—
Yankees – corporate	A	1	—	—	—
No credit exposure		12	16	97	—
Investment agreements		—	—	—	38
		100%	100%	100%	100%

[1]Rating modifiers are not disclosed.

The Domestic Equity Pool managed by Treasury is an indexed account that is not rated.

At June 30, 2006 and 2005, the securities lending collateral was invested in a registered 2(a)–7 money market fund that was not rated (note 4).

Custodial Credit Risk – Custodial credit risk is the risk that deposits may not be returned in the event of a bank failure. Treasury's policy with regard to custodial credit risk is to collateralize State deposits to the extent possible. At June 30, 2006, AEA's deposits managed by Treasury were uncollateralized and uninsured.

With respect to AEA managed investments, amounts totaling approximately $23,463,000 at June 30, 2006 and $14,600,000 at June 30, 2005, are held in money market funds. The investment contracts are collateralized. All other investment securities are registered in AEA's name and are held by its custodian, the trust department of a commercial bank; therefore no custodial risk exists for these securities.

(Continued)

Foreign Currency Risk – The Commissioner of Revenue formally adopts asset allocation policies for AEA's PCE Fund at the beginning of each fiscal year which places policy limitations on the amount of international securities the PCE Fund is allowed to hold. The following policy was in place during fiscal years 2006 and 2005, and invested assets included the following holdings at June 30, 2006 and 2005, for the PCE fund's investment in the International Equity Pool:

	Policy	FY06 Actual	FY05 Actual
Power Cost Equlization Endowment Fund	17%±5%	19.03%	19.08%

At June 30, 2006 and 2005, AEA's PCE Fund had exposure to foreign currency risk as follows (stated in thousands):

Currency		FY06 Fair value	FY05 Fair value
Deposits:			
Euro Currency	$	1	—
Japanese Yen		34	22
Swiss Frank		1	—
		36	22
Investment – international equity:			
Australian Dollar		228	—
Euro Currency		14,227	14,044
Japanese Yen		6,432	7,391
Norwegian Krone		484	396
Pound Sterling		5,648	7,820
Singapore Dollar		—	384
Swedish Krona		297	—
Swiss Franc		3,185	3,455
		30,501	33,490
Total	$	30,537	33,512

Concentration of Credit Risk – Treasury's policy with regard to concentration of credit risk is to prohibit the purchase of more than five percent of a pool's holdings in corporate bonds of any one company or affiliated group. Federal National Mortgage Association and Federal Home Loan Mortgage Corporation securities are not classified as corporate bonds. AEA has no written policy with respect to concentration of credit risk for its other investments.

(Continued)

At June 30, 2006, AEA's investments included the following concentrations greater than 5% (dollar amounts stated in thousands):

Issuer		Amount	Percent
Federal National Mortgage Association	$	26,793	10%
Federal Home Loan Mortgage Corporation		31,915	11
JP Morgan Chase Bank collateralized investment agreements		28,409	10

At June 30, 2005, AEA's investments included the following concentrations greater than 5% (dollar amounts stated in thousands):

Issuer		Amount	Percent
Federal National Mortgage Association	$	26,793	10%
JP Morgan Chase Bank collateralized investment agreements		29,509	11

(4) Securities Lending

A portion of the funds managed by Treasury are in the Department of Revenue's securities lending program. Alaska Statute 37.10.071 authorizes the Commissioner of Revenue to lend assets, under an agreement and for a fee, against deposited collateral of equivalent fair value. The Commissioner entered into an agreement with State Street Corporation (the Bank) to lend fixed income and equity securities. The Bank, acting as the Commissioner's agent under the agreement, transfers securities to broker agents or other entities for collateral in the form of cash or securities and simultaneously agrees to return the collateral for the same securities in the future.

At June 30, 2006 and 2005, the fair value of securities on loan allocable to the PCE Fund totaled $10,165,875 and $10,897,000, respectively. Associated expense for securities lending, $1,546,000 for fiscal year 2006 and $462,000 for fiscal year 2005, is included in net investment income.

There is no limit to the amount that can be loaned and the Commissioner is able to sell securities on loan. International equity security loans are collateralized at not less than 105 percent of their fair value. Fixed income security loans are collateralized at not less than 102 percent of their fair value. Loaned securities and collateral is marked to market daily and collateral is received or delivered the following day to maintain collateral levels.

Cash collateral is invested in a registered 2(a)–7 money market fund. Maturities of investments in the money market fund generally do not match the maturities of the loaned securities because the lending agreements are terminable at will. Collateral securities may be pledged or sold upon borrower default. Since the Commissioner does not have the ability to pledge or sell the collateral securities unless the borrower defaults, they are not recorded in the financial statements. Securities under loan, cash collateral and cash collateral payable are recorded in the financial statements at fair value. The Bank, PCE Fund and the borrower receive a fee from earnings on invested collateral. The Bank and PCE Fund share a fee paid by the borrower for loans not collateralized with cash.

There is limited credit risk associated with the lending transactions since the Commissioner is indemnified by the Bank against any loss resulting from counterparty failure or default on a loaned security or its related income distributions. The Bank further indemnifies against loss due to borrower rebates in excess of earnings on cash collateral. Indemnifications are subject to limitation relating to war, civil unrest or revolution, or beyond the reasonable control of the Bank.

For the years ended June 30, 2006 and 2005, there were no losses incurred as a result of securities lending transactions and there were no significant violations of legal or contractual provisions or failures by any borrowers to return loaned securities.

(5) Capital Assets

Capital asset activity for the years ended June 30, 2006 and 2005 was as follows (stated in thousands):

	Balance at June 30, 2005	Additions	Deletions	Balance at June 30, 2006
Capital assets:				
Intangible	$ 14	—	—	14
Production	244,476	2,321	—	246,797
Transmission	185,600	—	—	185,600
General	5,034	—	—	5,034
Total capital assets	435,124	2,321	—	437,445
Less accumulated depreciation for:				
Intangible	(3)	—	—	(3)
Production	(69,071)	(5,032)	—	(74,103)
Transmission	(87,707)	(4,954)	—	(92,661)
General	(5,022)	(6)	—	(5,028)
Total accumulated depreciation	(161,803)	(9,992)	—	(171,795)
Capital assets, net	$ 273,321	(7,671)	—	265,650

	Balance at June 30, 2004	Additions	Deletions	Balance at June 30, 2005
Capital assets:				
Intangible	$ 14	—	—	14
Production	242,980	1,496	—	244,476
Transmission	185,600	—	—	185,600
General	5,034	—	—	5,034
Total capital assets	433,628	1,496	—	435,124
Less accumulated depreciation for:				
Intangible	(3)	—	—	(3)
Production	(64,057)	(5,014)	—	(69,071)
Transmission	(82,731)	(4,976)	—	(87,707)
General	(5,006)	(16)	—	(5,022)
Total accumulated depreciation	(151,797)	(10,006)	—	(161,803)
Capital assets, net	$ 281,831	(8,510)	—	273,321

(6) Long–Term Debt

Long–term debt activity for the years ended June 30, 2006 and 2005 was as follows (stated in thousands):

	Balance at June 30, 2005	Additions	Deletions	Balance at June 30, 2006	Due within one year
Bradley Lake Power Revenue Bonds:					
First Series (a)	$ 9,910	—	(3,270)	6,640	3,270
Second Series (a)	11,520	—	—	11,520	2,305
Refunding, Third Series (a)	45,035	—	(105)	44,930	110
Refunding, Fourth Series (a)	39,680	—	(2,290)	37,390	115
Refunding, Fifth Series (a)	30,640	—	—	30,640	—
Total bonds payable	136,785	—	(5,665)	131,120	5,800
Arbitrage interest payable (b)	463	—	247	710	—
Less bond discount and deferred interest	(5,635)	—	1,797	(3,838)	—
	$ 131,613	—	(3,621)	127,992	5,800

		Balance at June 30, 2004	Additions	Deletions	Balance at June 30, 2005	Due within one year
Bradley Lake Power						
Revenue Bonds:						
First Series (a)	$	9,910	—	—	9,910	3,270
Second Series (a)		11,520	—	—	11,520	—
Refunding, Third Series (a)		48,235	—	(3,200)	45,035	105
Refunding, Fourth Series (a)		41,850	—	(2,170)	39,680	2,290
Refunding, Fifth Series (a)		30,640	—	—	30,640	—
Total bonds payable		142,155	—	(5,370)	136,785	5,665
Arbitrage interest payable (b)		373	241	(151)	463	—
Less bond discount and deferred interest		(7,580)	—	1,945	(5,635)	—
	$	134,948	241	(3,576)	131,613	5,665

The minimum payments related to all bonds for the years subsequent to June 30, 2006 are as follows (stated in thousands):

		Principal	Interest	Total
Year ending June 30:				
2007	$	5,800	6,470	12,270
2008		5,810	6,457	12,267
2009		5,820	6,344	12,164
2010		6,030	6,127	12,157
2011		6,255	5,897	12,152
2012-2016		37,170	23,641	60,811
2017-2021		52,055	10,659	62,714
2022		12,180	327	12,507
	$	131,120	65,922	197,042

(a) AEA issued the Power Revenue Bonds, First and Second Series (Bradley Lake Bonds), in September 1989 and August 1990, respectively, for the long term financing of the construction costs of the Bradley Lake Hydroelectric Project and refunded AEA’s Variable Rate Demand Bonds which were issued in November 1985 to provide interim financing of the project. AEA issued the Power Revenue Refunding Bonds, Third and Fifth Series in April 1999 to refund a portion of the First Series Bonds and to provide costs of issuance. AEA issued the Power Revenue Refunding Bonds, Fourth Series in April 2000 to refund a portion of the Second Series Bonds and to provide costs of issuance. All of the revenues derived by AEA from the operation of the project and all moneys, securities and funds (except the excess earnings fund), including a capital reserve fund, held or set aside are pledged and assigned to secure the payment of principal, redemption premium, if any, and interest on the bonds. No other revenues of AEA are pledged as security for the payment of the bonds. AEA has covenanted to notify the State Legislature of any failure to maintain the capital reserve fund at its required level. The bonds are further secured by bond insurance. AEA collects from each power purchaser a percentage share of annual project costs. The outstanding Bradley Lake Bonds mature annually each July 1 through the year 2021 with interest rates ranging from 5% to 6.25%.

(b) The arbitrage interest payable is due to the Internal Revenue Service for the excess of investment income on the proceeds of each series of AEA's tax exempt Bradley Lake bonds over the related interest expense in accordance with Section 148 of the Internal Revenue Code of 1986. The accumulated arbitrage interest payable amount is computed each year, and the amount for each series is first due after the end of the fifth bond year and every five years thereafter. AEA maintains a separate account for each series with the trustee and each year sets aside a sufficient amount to satisfy the liability.

In addition, the Authority has participated in the following debt agreements:

- *Other Debt* – In 1982, AEA assumed $44,859,000 of 5% mortgage notes payable which require quarterly principal and interest payments to the Rural Utilities Service (RUS) in connection with the Solomon Gulch Hydroelectric Project. Concurrent with the assumption, AEA deposited with a trustee Treasury notes sufficient to satisfy and provide for timely repayment of all principal and interest due on the assumed RUS loans. Accordingly, the loans and related trust assets are not included in the financial statements of AEA. At June 30, 2006, the unpaid principal balance of the notes was $21,262,000 and the trust assets had a fair value of $28,086,000.

- *Conduit Financing – City and Borough of Sitka – Utility Revenue Refunding Bonds, Series 1997 and Utility Revenue Bonds, Series 1992* – In May 1992, AEA issued $56,890,000 of tax–exempt bonds that allowed the City and Borough of Sitka (Sitka) to refinance its 1979 municipal bonds, resulting in significant debt service savings to Sitka. In November 1997, AEA issued $22,080,000 of tax–exempt bonds to advance refund and defease $20,145,000 of the Series 1992 bonds (collectively with the Series 1992 bonds, the Sitka Bonds). The Sitka Bonds are not included in these financial statements. As of June 30, 2006, the outstanding balance was $43,000,000.

  The Sitka Bonds are special obligations of AEA secured under a trust indenture by and between AEA and U.S. Bank National Association, as trustee. The Sitka Bonds are payable solely from the sources provided under the trust indenture. They are equally and ratably secured by a pledge and assignment of the municipal revenue bonds of Sitka held by AEA under the trust indenture, the obligation of Sitka to make payments under its loan agreement with AEA and the money and securities held under the trust indenture, including a capital reserve fund. AEA has covenanted to notify the State Legislature of any failure to maintain the capital reserve fund at its required level. The bonds are further secured by bond insurance.

  The Sitka Bonds do not constitute an indebtedness or other liability of the State, including AEA, and do not directly, indirectly or contingently obligate the State, including AEA, or any political subdivision thereof to levy any form of taxation for the payment of the bonds. Neither the full faith and credit nor the taxing power of the State, including AEA, or Sitka is pledged for the payment of the Sitka Bonds.

(7) Loans

The Authority administers the Power Project Loan Program, the Rural Electrification Revolving Loan Program and the Bulk Fuel Revolving Loan Program. Loans outstanding at June 30, 2006 and 2005 are classified as follows (dollar amounts stated in thousands):

	2006		2005	
	No. of loans	**Amount**	**No. of loans**	**Amount**
Power Project Loan Program	39	$ 23,743	47	$ 23,621
Rural Electrification Revolving Loan Program	4	835	4	909
Bulk Fuel Revolving Loan Program	34	1,441	39	1,232
	77	26,019	90	25,762
Less allowance for loan losses		(1,529)		(1,836)
		$ 24,490		$ 23,926

Loans that are more than 90 days past due on which the accrual of interest has been discontinued amounted to $1,075,000 and $1,000,000 at June 30, 2006 and 2005, respectively.

An analysis of changes in the allowance for loan losses for the years ended June 30, 2006 and 2005 follows (stated in thousands):

	2006	2005
Balance at beginning of year	$ 1,836	1,491
Recoveries	28	175
Provision for loan loss	(335)	170
Balance at end of year	$ 1,529	1,836

(8) Risk Management

AEA is exposed to various risks of loss. AEA obtains coverage for its risks through the purchase of commercial insurance, participation in the State Risk Management Pool and the establishment of self–insurance plans.

(a) General Liability – Watercraft and Aviation

All risks are covered by the State insurance plan through an annual charge assessed by the State Division of Risk Management and payroll markup.

(b) Property

Alaska Intertie

The utilities participating in the Alaska Intertie operating agreement retain the property risk associated with the Alaska Intertie.

Bradley Lake and Larsen Bay Hydroelectric Projects

The risks are covered by commercial insurance purchased through the State Division of Risk Management, and the self–insured retentions are the responsibility of the respective projects from operating funds.

(c) Boiler and Machinery

These risks are covered by commercial insurance purchased through the State Division of Risk Management and a private carrier.

Additionally, utilities benefiting from the use of the facilities owned by AEA participate in the responsibility for deductibles and self insured retentions under the terms of the respective agreements.

(9) Related Parties

(a) Alaska Industrial Development and Export Authority

Pursuant to understandings and agreements between AIDEA and AEA, AIDEA provides administrative, treasury, personnel, legal, data processing, communications, and other services to AEA. During 2006 and 2005, AEA expensed \$2,770,000 and \$2,560,000, respectively, for such services. In addition, AEA has a borrowing arrangement with AIDEA to provide working capital funds. At June 30, 2006 and 2005, AEA had \$942,000 and \$1,014,000 payable to AIDEA for services and borrowings.

(b) Alaska Intertie Operating Committee

Effective May 1, 1986, AEA entered into an agreement with utilities using the Alaska Intertie for wheeling of electrical power. Pursuant to the agreement, the Intertie Operating Committee (IOC) was established to manage the system. The IOC is comprised of a representative from AEA and each of the utilities. AEA is reimbursed for operation and maintenance costs on a monthly basis with an annual settlement to adjust the payments to actual costs. AEA management on October 16, 2006, issued contractually required notice that the agreement will terminate in 48 months as a mechanism to implement cures to identified defects in the agreement (note 1(b)).

(c) Bradley Lake Project Management Committee

Effective December 7, 1987, AEA entered into a power sales agreement with entities purchasing electric power produced by the Bradley Lake Hydroelectric Project. Pursuant to the agreement, a Project Management Committee (PMC) was formed. The PMC is comprised of a representative from AEA and each of the power purchasers. The participating power purchasers make monthly payments directly to the bond trustee based on their respective percentage share of the estimated annual project costs, including debt service and annual administrative fee to AEA.

(10) Commitments and Contingencies

AEA, in the normal course of business, is involved in various claims and pending litigation. The State Department of Law manages all pending litigation of AEA, and any liability arising from the settlement of pending claims is a liability for which the Department of Law or AEA requests an appropriation from the Legislature to satisfy judgment in the event that the judgment exceeds available funds or the proceeds from applicable insurance policies. In the opinion of management, the disposition of current claims and pending litigation is not presently expected to have a material adverse effect on AEA's financial position.

In the normal course of business, AEA also has various commitments, such as commitments for the extension of credit. At June 30, 2006 and 2005, AEA had open loan commitments of $3,451,000 and $3,991,000, respectively. At June 30, 2006, AEA held approximately $5,174,000 of investments in escrow under an agreement.

Schedule 1

ALASKA ENERGY AUTHORITY
(A Component Unit of the State of Alaska)

Schedule of Bradley Lake Hydroelectric Project Trust Account Activities

Year ended June 30, 2006

(Stated in thousands)

	Debt service account	Capital reserve account	Renewal and contingency account	Construction unallocated account	Excess earnings account	Revenue account	Operating account	Operating reserve account	Total
Balance at June 30, 2005	$ 8,968	12,834	5,996	331	222	525	651	661	30,188
Interest received	546	614	370	11	—	273	49	46	1,909
Bond principal paid	(5,665)	—	—	—	—	—	—	—	(5,665)
Bond interest paid	(6,542)	—	—	—	—	—	—	—	(6,542)
Arbitrage interest paid	—	—	—	—	(13)	—	—	—	(13)
Construction expenditures	—	—	(1,983)	(342)	—	—	—	—	(2,325)
Operating revenue received	—	—	—	—	—	13,853	(528)	—	13,325
Operating expenses paid	—	—	—	—	—	—	(2,685)	—	(2,685)
Transfers between funds	11,731	(614)	(167)	—	242	(14,193)	3,047	(46)	—
Balance at June 30, 2006	$ 9,038	12,834	4,216	—	451	458	534	661	28,192

See accompanying independent auditors' report.

Schedule 2

ALASKA ENERGY AUTHORITY
(A Component Unit of the State of Alaska)

Schedule of Projects – Balance Sheet

June 30, 2006

(Stated in thousands)

Assets		Bradley Lake Hydroelectric Project	Alaska Intertie Project	Larsen Bay Hydroelectric Project	Administration and Power Development Fund	Rural Energy Programs	Combined balance
Current assets:							
Grants receivable	$	—	—	—	(56)	3,008	2,952
Loans receivable		—	—	—	—	1,937	1,937
Operating revenue receivable		71	376	—	—	106	553
Accrued interest receivable		1,014	—	—	—	304	1,318
Total current assets		1,085	376	—	(56)	5,355	6,760
Noncurrent assets:							
Restricted cash and investments		22,323	—	—	—	—	22,323
Designated for specific purposes		5,869	1,030	—	2,830	241,665	251,394
Loans receivable, net of allowance		—	—	—	—	22,553	22,553
Capital assets							
Less accumulated depreciation		211,182	54,468	—	—	—	265,650
Capital assets, net		211,182	54,468	—	—	—	265,650
Total noncurrent assets		239,374	55,498	—	2,830	264,218	561,920
Total assets	$	240,459	55,874	—	2,774	269,573	568,680
Liabilities and Net Assets							
Current liabilities:							
Due to State of Alaska	$	—	—	—	816	126	942
Accounts payable		709	1,389	201	(214)	19,177	21,262
Bonds payable – current portion		5,800	—	—	—	—	5,800
Accrued interest		3,238	—	—	—	—	3,238
Total current liabilities		9,747	1,389	201	602	19,303	31,242
Noncurrent liabilities:							
Long-term debt, net of current portion:							
Bonds payable – noncurrent portion, net		121,482	—	—	—	—	121,482
Arbitrage interest payable		710	—	—	—	—	710
Other liabilities		103	—	—	—	—	103
Total noncurrent liabilities		122,295	—	—	—	—	122,295
Total liabilities		132,042	1,389	201	602	19,303	153,537
Net assets:							
Investment in capital assets net of related debt		83,900	54,468	—	—	—	138,368
Restricted for debt service		19,085	—	—	—	—	19,085
Restricted by agreements with external parties		5,432	17	—	—	19,719	25,168
Unrestricted net assets		—	—	(201)	2,172	230,551	232,522
Total net assets		108,417	54,485	(201)	2,172	250,270	415,143
Commitments and contingencies							
Total liabilities and net assets	$	240,459	55,874	—	2,774	269,573	568,680

See accompanying independent auditors' report.

Schedule 3

ALASKA ENERGY AUTHORITY
(A Component Unit of the State of Alaska)

Schedule of Projects – Revenues, Expenses, and Changes in Net Assets

Year ended June 30, 2006

(Stated in thousands)

		Bradley Lake Hydroelectric Project	Alaska Intertie Project	Larsen Bay Hydroelectric Project	Administration and Power Development Fund	Rural Energy Programs	Combined balance
Operating revenues:							
Federal grants	$	—	—	—	—	28,544	28,544
Revenue from operating plants		14,448	1,220	1	—	—	15,669
State of Alaska appropriations		—	—	—	—	12,192	12,192
Revenue from state agencies		—	—	—	—	651	651
Interest on loans		—	—	—	—	905	905
Other revenue		—	—	—	—	47	47
Total operating revenues		14,448	1,220	1	—	42,339	58,008
Operating expenses:							
Grants and projects		—	—	—	—	30,170	30,170
Power cost equalization grants		—	—	—	—	21,669	21,669
Depreciation		6,612	3,380	—	—	—	9,992
Interest expense		8,274	—	—	—	—	8,274
Plant operating		3,010	1,157	46	—	—	4,213
General and administrative		239	103	12	—	1,284	1,638
Provision for loan loss and bad debt expense		—	—	9	—	(335)	(326)
Total operating expenses		18,135	4,640	67	—	52,788	75,630
Operating loss		(3,687)	(3,420)	(66)	—	(10,449)	(17,622)
Nonoperating:							
Investment income, net		1,704	40	—	—	16,377	18,121
Decrease in net assets		(1,983)	(3,380)	(66)	—	5,928	499
Net assets – beginning		110,400	57,865	(135)	2,172	244,342	414,644
Net assets – ending	$	108,417	54,485	(201)	2,172	250,270	415,143

See accompanying independent auditors' report.