FINANCIALS • FINANCIAL HIGHLIGHTS

As of October 31 (In Thousands)

	2005	2004
Energy sales to members	**11,627,224 MWh**	11,110,936 MWh
Sales to others	**416,151 MWh**	518,320 MWh
Excess energy sales	**699,043 MWh**	794,592 MWh
Total	**12,742,418 MWh**	12,423,848 MWh
Average cost to members	**$ 40.24/MWh**	$ 33.15/MWh
Total operating revenues	**$ 517,840,586**	$ 414,732,991
Operating margins	**$ 1,492,952**	$ 2,520,040
Net margins	**$ 7,739,796**	$ 7,760,907
Cash flows from operations	**$ 60,176,201**	$ 51,313,003
Times interest earned ratio	**1.27**	1.26
Debt service coverage ratio	**1.15**	1.12
Earnings to fixed charges	**1.24**	1.23
Total assets	**$ 1,129,923,213**	$ 1,043,195,052
Net utility plant	**$ 753,474,057**	$ 698,312,586
Total long-term debt	**$ 525,011,850**	$ 473,398,794
Total equity	**$ 417,980,897**	$ 418,658,900
Equity to assets ratio	**36.99%**	40.13%
Equity as % of capitalization	**44.32%**	46.93%
Long-term debt to equity ratio	**1.26**	1.13

FINANCIALS • BALANCE SHEETS

As of October 31 (In Thousands)

ASSETS	2005	2004
Utility plant:		
Electric plant in service	$ 1,432,027	$ 1,310,716
Construction work in progress	12,099	9,466
Total utility plant	1,444,126	1,320,182
Less accumulated depreciation	690,652	621,869
Net utility plant	753,474	698,313
Long-term investments:		
Marketable securities	15,363	18,347
Gas reserves	56,572	59,989
Other	14,843	14,405
Total long-term investments	86,778	92,741
Current assets:		
Cash and cash equivalents	84,645	47,634
Accounts receivable, members	41,928	34,005
Fuel inventories	10,650	14,021
Material and supply inventories	12,036	10,263
Other current assets	3,133	4,888
Total current assets	152,392	110,811
Deferred charges	137,279	141,331
Total assets	$ 1,129,923	$ 1,043,196

See accompanying notes.

FINANCIALS • BALANCE SHEETS *(continued)*

As of October 31 (In Thousands)

MEMBERS' EQUITIES AND LIABILITIES	2005	2004
Members' equities:		
Membership fees	$ 2	$ 2
Patronage capital	266,348	272,988
Accumulated margins	33,769	27,609
Other equities	118,140	118,140
Net unrealized loss on investments	(278)	(79)
Total members' equities	417,981	418,660
Long-term debt:		
Federal Financing Bank	254,335	235,143
Independence Steam Electric Station finance obligation	149,411	160,869
CoBank interim term loan	65,000	—
Ellis finance obligation	49,011	67,370
National Rural Utilities Cooperative Finance Corporation – Guaranteed Pollution Control Revenue Bonds	3,215	5,240
Rural Utilities Service	3,953	4,683
Other long-term debt	87	94
Total long-term debt	525,012	473,399
Current liabilities:		
Notes payable	77,447	66,454
Accounts payable and other accrued liabilities	40,767	30,815
Current maturities of long-term debt	50,890	36,885
Accrued property taxes	5,179	5,413
Accrued interest	5,980	6,008
Total current liabilities	180,263	145,575
Deferred credits	6,667	5,562
Commitments and contingencies	—	—
Total members' equities and liabilities	$ 1,129,923	$ 1,043,196

See accompanying notes.

FINANCIALS • STATEMENTS OF OPERATIONS

For the years ended in October 31 (In Thousands)

	2005	2004	2003
Operating revenues	$ 517,841	$ 414,733	$ 412,692
Operating expenses:			
Operation and maintenance, generation	230,590	204,224	187,030
Power purchased	162,616	87,117	109,285
Operation and maintenance, transmission	33,823	32,164	33,970
Administrative and general	17,726	16,932	16,612
Depreciation	38,803	38,065	34,187
Interest	32,548	33,460	25,721
Taxes	242	251	254
Total operating expenses	516,348	412,213	407,059
Margin from operations	1,493	2,520	5,633
Interest income, net	1,331	1,084	992
Other income	4,855	4,157	6,370
Allowance for funds used during construction	61	—	500
Net margin	$ 7,740	$ 7,761	$ 13,495

See accompanying notes.

FINANCIALS • STATEMENTS OF MEMBERS' EQUITIES

For the years ended in October 31 (In Thousands)

	Membership Fees	Patronage Capital	Accum. Margins	Other Equities	Net Unrealized Gain/(Loss) on Investments	Total Members' Equities
Balance, November 1, 2002	$ 2	$ 261,625	$ 30,149	$ 115,266	$ 830	$ 407,872
Comprehensive income:						
Net margin	—	—	10,621	2,874	—	13,495
Net unrealized loss on investments	—	—	—	—	(85)	(85)
Total comprehensive income						13,410
Allocation of patronage capital	—	12,059	(12,059)	—	—	—
Redemption of patronage capital	—	(9,559)	—	—	—	(9,559)
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 gain 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**

See accompanying notes.

FINANCIALS • STATEMENTS OF CASH FLOWS

For the years ended in October 31 (In Thousands)

	2005	2004	2003
Operating activities			
Net margin	$ 7,740	$ 7,761	$ 13,495
Adjustments to reconcile net margin to net cash provided by operating activities:			
Depreciation	38,803	38,065	34,187
Net realized gains on marketable securities	—	(971)	—
Amortization of gain on sale and leaseback	—	—	(2,874)
Amortization of gas reserves	3,417	3,938	4,026
Allowance for funds used during construction	(61)	—	(500)
Changes in operating assets and liabilities:			
Accounts receivable, members	(7,923)	(7,709)	54
Fuel inventories	3,371	2,399	(200)
Material and supply inventories	(1,773)	(418)	(285)
Other current assets	1,755	1,257	(830)
Deferred charges	4,052	2,872	(5,022)
Accounts payable and accrued liabilities	9,690	3,895	(1,716)
Other deferred credits	1,105	224	(115)
Net cash provided by operating activities	60,176	51,313	40,220
Investing activities			
Net sales (purchases) of marketable securities	2,785	(1,974)	8,704
Net sales (purchases) of other investments	(438)	100	(233)
Capital expenditures	(8,867)	(9,698)	(19,748)
Acquisition of power plant	(85,036)	—	—
Repurchase of ISES 2 residual	—	—	(26,500)
Net cash used in investing activities	(91,556)	(11,572)	(37,777)
Financing activities			
Net borrowings (payments) on notes payable	10,993	(5,002)	(9,322)
Principal payments on long-term debt	(36,882)	(36,170)	(17,860)
Proceeds from long-term debt	102,500	10,000	23,900
Redemption of patronage capital	(8,220)	(9,559)	—
Net cash provided by (used in) financing activities	68,391	(40,731)	(3,282)
Net change in cash and cash equivalents	37,011	(990)	(839)
Cash and cash equivalents, beginning of year	47,634	48,624	49,463
Cash and cash equivalents, end of year	$ 84,645	$ 47,634	$ 48,624

See accompanying notes.

NOTES TO FINANCIAL STATEMENTS

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 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 members. On January 1, 2006, AECC will begin providing wholesale electric power and associated energy to Farmers Electric Cooperative Corporation, which will bring its total membership to 17. 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 three 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 RUS, and the Arkansas Public Service Commission (APSC).

AECC's power supply resources primarily comprise 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 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 $132.4 million attributable to premiums associated with debt refinancings and retirements (which are being amortized over the life of the related debt instruments), the deferred depreciation associated with the Clyde T. Ellis Hydroelectric Station (Ellis) lease, and the purchase of the lease residual and subsequent reclassification from an operating lease to a capital lease for the Independence Steam Electric Station Unit 2 (ISES 2) in June 2003. See "Rental and Lease Commitments" (Note 12) for further discussion. In the event operations are no longer subject to the provisions of 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.

Electric Industry Restructuring

During 1999, the Arkansas General Assembly (the Legislature) approved Act 1556 of 1999 (the Act) to provide consumer choice for electric generation services. Although the Act preserved existing distribution service territory, retail consumers would be allowed to purchase electric power from any qualified generation provider beginning as early as January 1, 2002. In February 2001, the Legislature amended the Act to delay the start of competition to October 1, 2003, but permitted the APSC, under certain conditions, to further delay competition to no later than October 1, 2005. During the regular session of 2003, the Legislature approved Act 204, which repealed retail open access in Arkansas. Under this legislation, electric cooperatives retained their expanded authorities granted by the Act.

NOTES TO FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies (continued)

Act 204 also required the APSC to file a report with the Legislature by September 30, 2004, setting forth the APSC's view on whether retail access for large users was warranted. The report filed by the APSC stated that such an action by the Legislature would be unwise. In the regular session of 2005, the Legislature took no further action on this subject.

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. Listed below are the major classes of utility plant at October 31: *(In Thousands)*▼

	2005	2004
Generation plant	**$ 1,324,334**	$ 1,210,963
Transmission plant	**80,083**	72,574
General plant	**27,610**	27,179
Electric plant in service	**1,432,027**	1,310,716
Construction work in progress	**12,099**	9,466
	$ 1,444,126	$ 1,320,182

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 RUS. 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 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. The asset retirement obligation at October 31, 2005, was $0.7 million.

Electric Revenues and Fuel

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

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

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 $0.3 million and $0.2 million for the years ended October 31, 2005 and 2003, respectively, and were recorded as a reduction in interest expense. In addition, for the years ended October 31, 2005 and 2003, the carrying costs capitalized relating to projects funded without specific borrowings were approximately $0.1 million and $0.5 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.

NOTES TO FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies (continued)

Statements of Cash Flows

For purposes of the statements of cash flows, cash and cash equivalents represent demand deposits in financial institutions and securities with original maturity dates of three months or less. Cash paid for interest was approximately $32.6 million, $32.0 million, and $25.8 million for the years ended October 31, 2005, 2004, and 2003, respectively. No amounts were paid for income taxes for the years ended October 31, 2005, 2004, and 2003.

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.

Reclassifications

Certain reclassifications have been made to the October 31, 2003, financial statement presentation to conform with the October 31, 2005 and 2004, presentation. These reclassifications did not have an effect on net margins.

NOTES TO FINANCIAL STATEMENTS

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, 2005, 2004, and 2003.

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

	2005	**Percent**	2004	Percent	2003	Percent
Statutory federal income tax rate	**$ 2,709**	35.0%	$ 2,716	35.0%	$ 4,723	35.0%
Non-taxable member income	**(2,709)**	(35.0)	(2,716)	(35.0)	(4,723)	(35.0)
Tax credit carryforwards not benefited	**—**	—	—	—	—	—
Effective income tax rate	**$ —**	—%	$ —	—%	$ —	—%

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

Deferred tax assets:	**2005**	2004
Patronage exclusions available	**$ 61,054**	$ 54,914
Alternative minimum tax (AMT) credit carryforwards	**4,052**	4,052
Other	**1,865**	2,199
	66,971	61,165
Valuation allowance	**(4,052)**	(4,052)
	62,919	57,113
Deferred tax liabilities:		
Utility plant	**(42,056)**	(42,020)
Safe harbor lease	**(10,444)**	(9,463)
Ellis sale and leaseback	**(7,783)**	(2,865)
Other	**(2,636)**	(2,765)
	(62,919)	(57,113)
Net deferred tax liability	**$ —**	$ —

At October 31, 2005, AECC had AMT credit carryforwards of approximately $4.1 million. Based on AECC's historical transactions' resulting in nonmember losses and the patronage provisions of its bylaws, AECC does not anticipate any future taxable income sufficient to realize the benefit of the tax credits existing at October 31, 2005. Accordingly, AECC has established a valuation allowance for these credits as reflected above.

NOTES TO FINANCIAL STATEMENTS

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, which were $1.0 million in 2004 and immaterial for 2005 and 2003, 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)* ▼

2005

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

2004

Description	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Fair Value
Other U.S. government agency securities	$ 18,169	$ 4	$ 76	$ 18,097
Other debt securities	257	—	7	250
	$ 18,426	$ 4	$ 83	$ 18,347

At October 31, 2005, contractual maturities of marketable securities were as follows: *(In Thousands)* ▼

Description	Less Than One Year	One Through Five Years	After Five Years	Total
Other U.S. government agency securities	$ —	$ 12,406	$ 2,957	$ 15,363
	$ —	$ 12,406	$ 2,957	$ 15,363

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 $7.7 million and $7.9 million at October 31, 2005 and 2004, 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 being administered by Sedna Energy, Inc. (Sedna). Sedna is a wholly owned subsidiary of Dernick Resources, Inc., located in Houston, Texas. According to the agreements with AECC, Sedna disburses AECC's proportionate share of net revenue interests on a monthly basis. 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, 2005 and 2004, AECC's leasehold interests in the gas reserves totaled approximately $56.6 million and $60.0 million, respectively. The net revenue interests received, less the depletion of the gas reserves, resulted in other income of approximately $4.8 million, $3.2 million, and $3.3 million for the years ended October 31, 2005, 2004, and 2003, respectively.

NOTES TO FINANCIAL STATEMENTS

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 $1.6 million, $8.9 million, and $12.1 million of patronage capital were allocated for the years ended October 31, 2005, 2004, and 2003, respectively.

Patronage retirements are restricted by the terms of the RUS mortgage and AECC bylaws. The mortgage requires the RUS approval for payments which reduce members' equities below 30.0% of total assets. At October 31, 2005 and 2004, total members' equities as a percentage of total assets amounted to 37.0% and 40.1%, respectively.

The Board authorized patronage retirements of approximately $8.2 million and $9.6 million for the years ended October 31, 2005 and 2003, 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, 2005, the guaranteed amount by CFC was approximately $13.5 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 sale 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)*

	2005	2004
Mortgage notes payable to Federal Financing Bank (FFB) at varying interest rates (4.32% to 6.77% at October 31, 2005), due in quarterly installments through December 2031	$ 272,643	$ 251,773
ISES 2 finance obligation under sale and leaseback, at an implicit rate of 6.05% at October 31, 2005 and 2004, due in semiannual installments through 2019	160,869	171,587
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, 2005 and 2004, due in semiannual installments through 2013	67,370	73,639
North Antelope finance obligation, with no stated interest rate at October 31, 2004, due in monthly installments through January 2005	—	253
CFC Guaranteed Pollution Control Revenue Bonds:		
City of Siloam Springs and Jefferson County, Arkansas, at varying interest rates (4.85% to 5.00%, at October 31, 2005), due in semiannual installments through 2008	5,245	7,175
RUS 2% mortgage notes due in quarterly installments through May 2018	1,447	2,143
RUS 5% mortgage notes due in quarterly installments through August 2015	3,235	3,614
	4,682	5,757
Other long-term debt	93	100
Total long-term debt	575,902	510,284
Less current maturities of long-term debt	50,890	36,885
	$ 525,012	$ 473,399

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)*

	2006	2007	2008	2009	2010	Thereafter	Total Debt
FFB	$18,308	$19,219	$20,307	$21,450	$22,668	$170,691	$272,643
ISES 2 finance obligation	11,458	12,192	12,532	9,321	9,894	105,472	160,869
CoBank	—	—	—	—	—	65,000	65,000
Ellis finance obligation	18,359	7,277	7,600	7,667	8,401	18,066	67,370
CFC Guaranteed Pollution Control Revenue Bonds	2,030	2,130	1,085	—	—	—	5,245
RUS	729	713	712	629	514	1,385	4,682
Other	6	7	7	8	9	56	93
	$50,890	$41,538	$42,243	$39,075	$41,486	$360,670	$575,902

Under the debt agreements, all of AECC's assets were pledged as security at October 31, 2005. 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, 2005.

During 2001, the RUS approved two loan guarantee commitments in the amount of $58.9 million and $57.5 million related to the construction of the Fulton plant and the repowering of the Fitzhugh plant, respectively. The loan commitments have a maturity date of December 31, 2031. During 2002, AECC received advances from FFB of $45.0 million under the Fulton loan at an average interest rate of 5.586%. During 2003, AECC received the remaining $13.9 million advance from FFB under the Fulton loan at an interest rate of 4.835%. AECC also received an advance from FFB of $10.0 million under the Fitzhugh loan at an interest rate of 5.041%. During 2004, AECC received an advance from FFB of $10.0 million under the Fitzhugh loan at an interest rate of 4.767%. During 2005, AECC received the remaining $37.5 million advance from FFB under the Fitzhugh loan at an interest rate of 4.32%.

During 2005, the RUS 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. No funds have been advanced under the Wrightsville loan and AECC expects to receive the loan funds during the second quarter of 2006.

Interest rates and payment terms have not been finalized on the unadvanced loan funds. The proceeds will be used for the repayment of the CoBank interim term loan of $65.0 million and to reimburse AECC's general 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. There was no outstanding balance at October 31, 2005 or 2004, 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, 2005 and 2004, member advances to AECC totaled approximately $77.4 million and $66.5 million, respectively. At October 31, 2005 and 2004, the interest rate on the notes payable was 4.20% and 2.86%, respectively.

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

	2005	2004	2003
Operating interest, included in interest expense	**$ 1,232**	$ 1,431	$ 989
Non-operating interest, included in interest income, net	**$ 1,639**	$ 478	$ 871
Total interest expense	**$ 2,871**	$ 1,909	$ 1,860

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 $3.8 million, $3.6 million, and $3.2 million for the years ended October 31, 2005, 2004, and 2003, respectively.

AECC provides certain postretirement benefits to employees. An actuarial valuation was prepared as of January 1, 2002, in accordance with SFAS No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions,* and the accumulated postretirement 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.

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, 2005, 2004, and 2003, were approximately $2.3 million, $2.2 million, and $2.5 million, respectively. AECI owed AECC approximately $0.2 million at both October 31, 2005 and 2004, 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 $2.0 million, $1.8 million, and $2.1 million for the years ended October 31, 2005, 2004, and 2003, respectively. At October 31, 2005, and 2004, AECC owed AECI approximately $0.1 million and $0.1 million, respectively, for materials and services. The prices charged by AECI to AECC for supplies and services are based on quotations submitted by AECI (i.e., "bids") and, in management's opinion, are lower or at least comparable to prices AECC would be required to pay other suppliers.

NOTES TO FINANCIAL STATEMENTS

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, 2005, is as follows *(Dollars In Thousands):* ▼

Generating Plants	Ownership or Leasehold Interest %	Amount of Utility Plant in Service	Accumulated Provision for Depreciation	Amount of Plant Under Construction	Current Available Net Capacity (MW) *(unaudited)*
Flint Creek	50%	$ 86,123	$ 63,176	$ 1,875	264 MW
White Bluff 1 and 2	35	295,596	204,295	2,299	580
ISES 1 and 2	35	339,811	215,001	3,670	588
Fitzhugh	100	72,647	14,462	76	171
Bailey	100	13,013	12,977	114	122
McClellan	100	18,319	17,604	31	134
Ellis	100	70,342	46,780	555	26
Whillock	100	75,671	18,005	531	17
Electric Cooperatives of Arkansas	100	184,293	22,078	10	35
Fulton CT-1	100	58,616	7,684	—	153
Wrightsville	100	79,764	232	—	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. On May 16, 2005, there was a gas leak at the power facility; therefore, this energy source is currently unavailable. It it expected to be operational on May 1, 2006.

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 is currently working to prepare the plant for commercial operation, which is anticipated to be May 1, 2006, and in the process will incur an additional estimated $6.0 million in capitalized costs.

RUS 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 $85.0 million, AECC has recorded a related acquisition adjustment credit in the amount of $207.9 million as of October 31, 2005.

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 fuel inventories 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.

NOTES TO FINANCIAL STATEMENTS

12. Rental and Lease Commitments (continued)

Related expenses for the years ended October 31, 2005, 2004, and 2003, were $15.6 million, $15.6 million, and $17.6 million, respectively. These expenses include depreciation expense of approximately $4.0 million, $4.0 million, and $1.3 million for the years ended October 31, 2005, 2004, and 2003, respectively. In addition, interest expense was approximately $10.2 million, $10.9 million, and $3.7 million for the years ended October 31, 2005, 2004, and 2003, respectively. Amortization expense on the regulatory created asset was approximately $1.4 million, $0.7 million, and $0.2 million for the years ended October 31, 2005, 2004, and 2003, respectively. For the year ended October 31, 2003, related expenses also included rent expense of approximately $12.4 million.

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
2006	$ 21,284
2007	21,332
2008	20,944
2009	16,982
2010	16,982
Thereafter	137,492
	235,016
Less amounts representing interest (implicit rate – 6.05%)	74,147
Capitalized lease obligation	$160,869

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 semi-annually 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
2006	$ 150
2007	150
2008	150
2009	150
2010	150
Thereafter	225
	$ 975

Rent expense was approximately $0.2 million, $0.3 million, and $1.2 million under the lease agreement for the years ended October 31, 2005, 2004, and 2003, 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 $24.3 million and $23.7 million at October 31, 2005 and 2004, 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, determines 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 $3.2 million, $2.9 million, and $2.8 million for the years ended October 31, 2005, 2004, and 2003, respectively. Interest expense, net of amortized gain, was approximately $3.0 million, $3.3 million, and $3.3 million for the years ended October 31, 2005, 2004, and 2003, 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
2006	$ 20,930
2007	9,278
2008	9,292
2009	8,999
2010	9,385
Thereafter	19,527
	$ 77,411

Rental payments related to the Ellis lease were approximately $9.3 million, $7.6 million, and $3.9 million for the years ended October 31, 2005, 2004, and 2003, respectively. AECC has also agreed to indemnify, under certain circumstances, the beneficial owner against loss of certain tax benefits related to the ownership of Ellis. The maximum exposure under the indemnification clause is dependent upon the facts, circumstances, and timing of loss; however, management does not believe there are existing conditions which will result in such a loss.

NOTES TO FINANCIAL STATEMENTS

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, 2005, contractual commitments have been entered into for construction totaling approximately $18.4 million relating to AECC's jointly owned coal plants.

AECC filed a complaint with 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. AECC has paid all disputed amounts under protest. The hearing is scheduled in January 2006.

On January 23, 2004, AECC filed suit in the Circuit Court of Sebastian County, Arkansas, against Providence Exploration & Production, Inc. (Providence) related to a calculation error in computing the original purchase price of AECC's leasehold interest in the revenue stream of certain gas wells. The calculation error resulted in a $2.5 million overpayment by AECC. On August 30, 2004, Providence filed a $4.9 million counterclaim against AECC seeking damages of an alleged oral contract and unjust enrichment. On September 19, 2005, Providence amended its counterclaim to seek rescission of the contract and the sale of the wells and a "restoration of the status quo." Discovery remains ongoing with respect to both AECC's claim and Providence's counterclaim. It is impossible to accurately assess the outcome at this time.

14. Significant Customers

Sales to members amounted to 90%, 89%, and 88% of operating revenues for the years ended October 31, 2005, 2004, and 2003, respectively. AECC had the following members that accounted for more than 10% of operating revenue for the years ended October 31 : *(Dollars In Thousands)* ▼

	2005		2004		2003	
Customer	**Amount**	**Percent**	Amount	Percent	Amount	Percent
Mississippi County Electric Cooperative, Inc.	**$108,643**	**21.0%**	$88,336	21.3%	$82,732	20.1%
First Electric Cooperative Corporation	**74,710**	**14.4**	57,587	13.9	57,711	14.0
Carroll Electric Cooperative Corporation	**67,729**	**13.1**	52,150	12.6	52,397	12.7

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, 2005 and 2004, 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, 2005. Future cash flows were discounted using a rate of 5.5%. Based on the nature of other investments, the carrying amount approximates fair value.

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)* ▼

	2005		2004	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Long-term investments:				
Gas reserves	$ 56,572	$ 97,856	$ 59,989	$ 72,413
Other	14,843	14,843	14,404	14,404
Cash and cash equivalents	84,645	84,645	47,634	47,634
Long-term debt:				
FFB	272,643	283,538	251,773	271,848
ISES 2	160,869	166,152	171,587	188,564
CoBank	65,000	65,000	—	—
Ellis	67,370	66,521	73,639	76,564
CFC	5,250	5,375	7,185	7,516
RUS	4,682	4,772	5,757	5,804
Notes payable	77,447	77,447	66,454	66,454