

Alabama Municipal Electric Authority

Financial Statements as of and for the
Years Ended September 30, 2007 and 2006,
Additional Information for the Years Ended
September 30, 2007 and 2006, and
Independent Auditors' Report

ALABAMA MUNICIPAL ELECTRIC AUTHORITY

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ALABAMA MUNICIPAL ELECTRIC AUTHORITY

MANAGEMENT'S DISCUSSION AND ANALYSIS

Corporate Structure — The Alabama Municipal Electric Authority (the “Authority”) is a nonprofit joint action agency created on August 17, 1981 under Act No. 81-681 (the “Act”), General Laws of Alabama. The Authority is a public corporation whose primary purpose is to provide reliable and economical electric power to its eleven members.

Joint Action — The Authority is comprised of eleven members consisting of municipalities, utilities boards and an electric board, all located in the State of Alabama (the “Participating Members”), each of which owns and operates an electrical distribution system. Each Participating Member has signed a Purchase Power Contract with the Authority that expires on December 31, 2035.

Legal Authority — The Act provides that the Authority will establish rates and charges to produce revenues sufficient to cover its costs, including debt service. The Authority is specifically authorized by the Act to undertake projects for its members and to issue tax-exempt bonds and other obligations to finance the costs of such projects.

Overview of the Financial Statements — This discussion and analysis is intended to serve as an introduction to the Authority’s basic financial statements. These financial statements are designed to provide readers with an overview of the Authority’s finances, in a manner similar to private sector businesses.

The balance sheets present information on all of the Authority’s assets and liabilities, with the difference between the two being reported as net assets. The Authority limits the amount of net assets to amounts necessary to fund any capital assets that need to be purchased that are not funded by bond issues. All other excess funds are transferred to the rate stabilization account. The rate stabilization account funds will be used to help reduce future rate increases to the Participating Members.

The statements of revenues and expenses and changes in net assets present information relative to how the Authority’s net assets changed during the fiscal years presented. All changes in net assets are reported on the accrual basis as soon as the underlying event giving rise to the change occurs, regardless of the timing of the related cash flows. Therefore, revenues and expenses are reported in this statement for some items that will result in cash flow in future fiscal years.

Proprietary Funds — The Authority operates only one type of proprietary fund — the enterprise fund type. Enterprise funds are used to report business-type activities (as contrasted with tax-supported governmental activities).

Notes to Financial Statements — The notes provide additional information that is essential to a full understanding of the data provided in the financial statements.

Financial Analysis — 2007 Compared to 2006

Following are condensed balance sheets as of September 30:

	2007	2006
Total assets	\$ 113,445,594	\$ 115,112,834
Long-term debt	\$ 41,129,271	\$ 42,003,749
Other liabilities	<u>57,296,806</u>	<u>59,069,930</u>
Total liabilities	<u>\$ 98,426,077</u>	<u>\$ 101,073,679</u>
Net assets	<u>\$ 15,019,517</u>	<u>\$ 14,039,155</u>

Total Assets — The decrease in Total Assets of \$1,667,240 is driven by several factors. Annual amortization and depreciation of \$2,452,552 resulted in a decrease in total assets. The Total Funds Invested decreased by \$4,220,394 while current receivables increased by \$5,572,284 due primarily to a substantial increase in fuel costs under purchase power agreements and an increase in power sales to participants.

Total Liabilities — The decrease in Total Liabilities of \$2,647,602 was primarily a result of the following factors. The Net Costs to be Refunded to Participants decreased by \$3,768,636, a result of normal items charged to this account and a \$3,000,000 transfer out of the Rate Stabilization Account. This decrease was offset by an increase in payables under power supply contracts in the amount of \$2,764,623. This increase was caused primarily by an increase in the fuel component of power supply costs. Also, the liability associated with the Interest Rate Swap Agreement decreased by \$510,016 as a result of the sale of the Interest Swap Agreement.

Following is a summary of operations for the years ended September 30:

	2007	2006
Operating revenues	\$ <u>180,325,667</u>	\$ <u>166,222,709</u>
Operating expenses:		
Purchased power expenses	173,234,869	156,251,649
Plant operating expenses	2,428,190	3,201,550
Administrative, general and operating expenses	<u>7,462,669</u>	<u>8,088,270</u>
Total operating expenses	<u>183,125,728</u>	<u>167,541,469</u>
Operating loss	(2,800,061)	(1,318,760)
Other income, net	11,788	151,098
Changes in net costs to be refunded to participants	<u>3,768,635</u>	<u>3,214,748</u>
Excess of revenues over expenses	980,362	2,047,086
Net assets — beginning of year	<u>14,039,155</u>	<u>11,992,069</u>
Net assets — end of year	<u>\$ 15,019,517</u>	<u>\$ 14,039,155</u>

Operating Revenues — Total operating revenues increased by \$14,102,958. This increase is a result of substantial increases in sales to participants due to a substantial increase in fuel costs under purchase power agreements and a modest increase in power sales to participants.

Operating Expenses — Purchased Power Expenses increased by \$16,983,220 as a result of higher costs under the Power Supply Agreement (“PSA”) that became effective January 1, 2006, and an increase in fuel cost for the year. Plant operating expenses decreased as a result of the AMEA-Sylacauga Plant not being required to operate as often as the previous year.

Other Income, net — Other income, net decreased by \$139,310. Interest expense decreased by \$191,077 as a result of lower debt service requirements. Interest rate swap agreement gain decreased \$478,124 as result of the change in the market value of the interest rate swap, which was terminated during 2007.

Changes in Net Costs To Be Refunded To Participants — The change of \$553,887 in this account is due to a reduction of debt service payments and a transfer of \$3,000,000 from the Rate Stabilization Account. (See Note 6)

Liquidity and Capital Resources — The Authority has cash and cash equivalents of \$29,296,991 at September 30, 2007. Cash decreased by \$4,220,442, due primarily to the increases in participant receivables. Cash and investment balances are composed of working capital and the Rate Stabilization Account, as well as cash balances generated by the Authority’s daily operations.

The Authority’s debt classified as long-term as of September 30, 2007 is \$41,129,271. This debt was issued in 2003 to finance the construction of the AMEA-Sylacauga Plant. Future revenues from the sale of electricity to members are expected to be sufficient to fully retire this debt at scheduled maturity dates.

Financial Analysis — 2006 Compared to 2005

Following are condensed balance sheets as of September 30:

	2006	2005
Total assets	\$ 115,112,834	\$ 112,764,429
Long-term debt	\$ 42,003,749	\$ 42,858,019
Other liabilities	<u>59,069,930</u>	<u>57,914,341</u>
Total liabilities	<u>\$ 101,073,679</u>	<u>\$ 100,772,360</u>
Net assets	<u>\$ 14,039,155</u>	<u>\$ 11,992,069</u>

Total Assets — The increase in Total Assets of \$2,348,405 is driven by several factors. Annual amortization and depreciation of \$3,516,414 resulted in a decrease in total assets. The Total Funds Invested increased by \$2,273,492 while current receivables increased by \$1,008,264 due primarily to a small increase in the Authority's rates, a substantial increase in fuel costs under purchase power agreements and an increase in power sales to participants. Development costs increased by \$1,899,038 primarily resulting from implementation costs of the PSA and costs for a new delivery point.

Total Liabilities — The increase in Total Liabilities of \$301,319 was primarily a result of the following factors. The Net Costs to be Refunded to Participants decreased by \$3,214,748, a result of normal items charged to this account and a net \$1,000,000 transfer out of the Rate Stabilization Account. This decrease was offset by an increase in payables under power supply contracts in the amount of \$5,661,484. This increase was caused primarily by an increase in the fuel component of power supply costs. Also, the liability associated with the Interest Swap Agreement decreased by \$1,251,438 a result of change in the market value of this item.

Following is a summary of operations for the years ended September 30:

	2006	2005
Operating revenues	\$ <u>166,222,709</u>	\$ <u>140,683,853</u>
Operating expenses:		
Purchased power expenses	156,251,649	110,777,629
Plant operating expenses	3,201,550	2,256,752
Administrative, general and operating expenses	<u>8,088,270</u>	<u>11,354,894</u>
Total operating expenses	<u>167,541,469</u>	<u>124,389,275</u>
Operating income (loss)	(1,318,760)	16,294,578
Other income (expense)	151,098	(3,217,092)
Changes in net costs to be refunded to participants	<u>3,214,748</u>	<u>(12,247,428)</u>
Excess of revenues over expenses	2,047,086	830,058
Net assets — beginning of year	<u>11,992,069</u>	<u>11,162,011</u>
Net assets — end of year	<u>\$ 14,039,155</u>	<u>\$ 11,992,069</u>

Operating Revenues — Total operating revenues increased by \$25,538,856. This increase is a result of a small rate increase and substantial increases in sales to participants due to a small increase in the Authority's rates, a substantial increase in fuel costs under purchase power agreements and an increase in power sales to participants.

Operating Expenses — Purchased Power Expenses increased by \$45,474,020 as a result of the PSA that became effective January 1, 2006, and an increase in fuel cost for the year. Plant operating expenses increased as a result of the AMEA-Sylacauga Plant operating requirements under the new Power Supply Agreement.

Other Income (Expense) — Other income (expense) increased by \$3,368,190. Interest expense decreased by \$986,327 as a result of lower debt service requirements. The interest rate swap agreement gain (loss) increased \$2,236,994 (from a loss of \$985,556 in 2005 to a gain of \$1,251,438 in 2006) as result of the change in the market value of the asset.

Changes in Net Costs To Be Refunded To Participants — The change of \$15,462,176 in this account is due to a substantial reduction of debt service payments and a net transfer \$1,000,000 from the Rate Stabilization Account. (See Note 6)

Liquidity and Capital Resources — The Authority has cash and cash equivalents of \$33,517,433 at September 30, 2006. Cash increased by \$2,279,253, related primarily to the increases in sales to participants. Cash and investment balances are composed of working capital and the Rate Stabilization Account, as well as cash balances generated by the Authority's daily operations.

The Authority's debt classified as long-term as of September 30, 2006 is \$42,003,749. This debt was issued in 2003 to finance the construction of the AMEA-Sylacauga Plant. Future revenues from the sale of electricity to members are expected to be sufficient to fully retire this debt at scheduled maturity dates.

INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
Alabama Municipal Electric Authority:

We have audited the accompanying balance sheets of Alabama Municipal Electric Authority (the "Authority") as of September 30, 2007 and 2006, and the related statements of revenues and expenses and changes in net assets and statements of 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 financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. 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 controls over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of 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 significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the Authority as of September 30, 2007 and 2006, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The additional information on pages 22 through 24 is presented for the purpose of additional analysis and is not a required part of the basic financial statements. This additional information is the responsibility of the Authority's management. Such information has been subjected to the auditing procedures applied in our audits of the basic financial statements and, in our opinion, is fairly stated in all material respects when considered in relation to the basic financial statements taken as a whole.

Management's discussion and analysis on pages 1 through 5 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of the Authority's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information, and we do not express an opinion on it.

Deloitte & Touche LLP

February 14, 2008

ALABAMA MUNICIPAL ELECTRIC AUTHORITY

BALANCE SHEETS AS OF SEPTEMBER 30, 2007 AND 2006

	2007	2006
ASSETS		
PROPERTY AND EQUIPMENT — Net	\$ 37,509,156	\$ 39,337,561
OTHER LONG-TERM ASSETS:		
Investments	369,794	375,544
Participant receivables	211,018	229,617
Capital fund program receivable	717,668	516,500
Materials and supplies	<u> </u>	<u>548,522</u>
Total other long-term assets	<u>1,298,480</u>	<u>1,670,183</u>
SPECIAL FUNDS INVESTED:		
Debt service fund (restricted)	2,904,905	2,697,121
Reserve and contingency fund	<u>50,000</u>	<u>50,000</u>
Total special funds invested	<u>2,954,905</u>	<u>2,747,121</u>
CURRENT ASSETS:		
Funds invested:		
Revenue fund	17,211,085	20,210,974
Operation and maintenance fund	12,096,991	13,317,433
Special funds — debt service fund (restricted)	<u>243,841</u>	<u>243,904</u>
Total funds invested	29,551,917	33,772,311
Participant receivables	37,889,999	32,393,679
Other receivables	102,225	25,721
Materials and supplies	186,855	188,670
Capital fund program receivable	198,832	465,500
Prepaid expenses	112,308	90,300
Deposits	<u> </u>	<u>1,070,386</u>
Total current assets	<u>68,042,136</u>	<u>68,006,567</u>
DEFERRED COSTS:		
Regulatory assets	2,436,698	2,070,729
Unamortized bond issuance costs — net of accumulated amortization of \$321,548 (2007) and \$245,094 (2006)	<u>1,204,219</u>	<u>1,280,673</u>
Total deferred costs	<u>3,640,917</u>	<u>3,351,402</u>
TOTAL	<u>\$ 113,445,594</u>	<u>\$ 115,112,834</u>

(Continued)

ALABAMA MUNICIPAL ELECTRIC AUTHORITY

BALANCE SHEETS

AS OF SEPTEMBER 30, 2007 AND 2006

	2007	2006
LIABILITIES AND NET ASSETS		
LONG-TERM DEBT — Revenue bonds — net of unamortized discounts	<u>\$ 41,129,271</u>	<u>\$ 42,003,749</u>
REGULATORY LIABILITIES — Net costs to be refunded to participants	<u>20,481,282</u>	<u>24,249,918</u>
CURRENT LIABILITIES:		
Current maturities of revenue bonds	885,000	865,000
Amounts payable under power supply contracts	34,578,874	31,814,251
Interest rate swap agreement		510,016
Special funds — accrued interest on revenue bonds	170,091	171,821
Other current liabilities	<u>1,181,559</u>	<u>1,458,924</u>
Total current liabilities	<u>36,815,524</u>	<u>34,820,012</u>
NET ASSETS	<u>15,019,517</u>	<u>14,039,155</u>
TOTAL	<u>\$ 113,445,594</u>	<u>\$ 115,112,834</u>

See notes to financial statements.

(Concluded)

ALABAMA MUNICIPAL ELECTRIC AUTHORITY

STATEMENTS OF REVENUES AND EXPENSES AND CHANGES IN NET ASSETS FOR THE YEARS ENDED SEPTEMBER 30, 2007 AND 2006

	2007	2006
OPERATING REVENUES:		
Sales of electricity to participants	\$ 180,085,458	\$ 168,725,428
Rebates to participants		(4,000,000)
Sales of electricity — other	<u>240,209</u>	<u>1,497,281</u>
Total operating revenues	<u>180,325,667</u>	<u>166,222,709</u>
OPERATING EXPENSES:		
Firm purchase power services — purchased power		4,811,321
Partial requirements services:		
Purchased power	160,974,554	141,436,682
Transmission and distribution	12,111,703	8,850,043
Plant operating expenses	2,428,190	3,201,550
Cost of other electricity sales	148,612	1,153,603
Other operating and maintenance expenses	980,950	1,140,473
Administrative and general expenses	4,116,142	3,519,981
Amortization and depreciation	<u>2,365,577</u>	<u>3,427,816</u>
Total operating expenses	<u>183,125,728</u>	<u>167,541,469</u>
NET OPERATING LOSS	<u>(2,800,061)</u>	<u>(1,318,760)</u>
OTHER INCOME (EXPENSE):		
Interest expense — net of capitalized interest	(1,865,082)	(2,056,159)
Interest income	1,149,790	1,083,342
Investment loss	(5,750)	(76,857)
Interest rate swap agreement gain	773,314	1,251,438
Other income	46,491	38,032
Amortization of bond discounts, issuance costs, and excess costs of bond refundings	<u>(86,975)</u>	<u>(88,698)</u>
Total other income	<u>11,788</u>	<u>151,098</u>
CHANGES IN NET COSTS TO BE REFUNDED TO PARTICIPANTS	<u>3,768,635</u>	<u>3,214,748</u>
EXCESS OF REVENUES OVER EXPENSES	980,362	2,047,086
NET ASSETS:		
Balance — beginning of year	<u>14,039,155</u>	<u>11,992,069</u>
Balance — end of year	<u>\$ 15,019,517</u>	<u>\$ 14,039,155</u>

See notes to financial statements.

ALABAMA MUNICIPAL ELECTRIC AUTHORITY

STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED SEPTEMBER 30, 2007 AND 2006

	2007	2006
OPERATING ACTIVITIES:		
Cash received from sales of electricity	\$ 174,774,676	\$ 165,747,356
Cash paid under power supply contracts	(170,270,842)	(153,503,543)
Cash paid to other suppliers and employees	(7,614,661)	(7,890,770)
Refund of deposit	1,070,386	
Other cash receipts	<u>173,163</u>	
Net cash (used in) provided by operating activities	<u>(1,867,278)</u>	<u>4,353,043</u>
CAPITAL AND RELATED FINANCING ACTIVITIES:		
Payment for acquisition of property and equipment	(348,722)	(585,773)
Draw (repayment) line of credit	(511,700)	511,700
Principal paid on revenue bond maturities	(865,000)	(850,000)
Interest paid on revenue bonds	(2,061,847)	(2,077,998)
Other	<u></u>	<u>(48,716)</u>
Net cash used in capital and related financing activities	<u>(3,787,269)</u>	<u>(3,050,787)</u>
INVESTING ACTIVITIES:		
Purchases of investments	(3,090,381)	(3,084,157)
Proceeds from sale of investments	3,090,444	3,084,253
Interest income received	1,434,042	1,001,899
Interest expense paid	<u></u>	<u>(24,998)</u>
Net cash provided by investing activities	<u>1,434,105</u>	<u>976,997</u>
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(4,220,442)	2,279,253
CASH AND CASH EQUIVALENTS — Beginning of year	<u>33,517,433</u>	<u>31,238,180</u>
CASH AND CASH EQUIVALENTS — End of year	<u>\$ 29,296,991</u>	<u>\$ 33,517,433</u>

(Continued)

ALABAMA MUNICIPAL ELECTRIC AUTHORITY

STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED SEPTEMBER 30, 2007 AND 2006

	2007	2006
RECONCILIATION OF NET OPERATING LOSS TO NET CASH (USED IN) PROVIDED BY OPERATING ACTIVITIES:		
Net operating loss	\$ (2,800,061)	\$ (1,318,760)
Adjustments to reconcile net operating loss to net cash (used in) provided by operating activities:		
Amortization and depreciation	2,365,577	3,427,816
Non cash operating expense amount	13,085	
Changes in assets and liabilities:		
Increase in receivables	(5,470,207)	(975,173)
(Increase) decrease in prepaid expenses	(22,008)	9,149
Decrease in deposits	1,070,386	
(Increase) decrease in materials and supplies	(81,767)	27,184
Increase in amounts payable under power supply contracts	3,064,625	3,012,838
(Increase) decrease in other liabilities	(6,908)	169,989
Total adjustments	<u>932,783</u>	<u>5,671,803</u>
NET CASH (USED IN) PROVIDED BY OPERATING ACTIVITIES	<u>\$ (1,867,278)</u>	<u>\$ 4,353,043</u>

See notes to financial statements.

(Concluded)

ALABAMA MUNICIPAL ELECTRIC AUTHORITY

NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED SEPTEMBER 30, 2007 AND 2006

1. ORGANIZATION AND OPERATIONS

Alabama Municipal Electric Authority (the “Authority”) is a public corporation of the State of Alabama. The Authority was created on August 17, 1981, pursuant to the provisions of Act No. 81-681 of the State of Alabama Legislature for the purpose of securing an adequate, dependable, and economical power supply for its participating members. The Authority’s power supply is provided under the terms of contractual arrangements and the AMEA-Sylacauga Plant (see Note 4). The Authority sells power pursuant to Power Sales Contracts (see Note 3) to each of its eleven participating members (the “Participating Members”), which consist of municipalities, utility boards, and an electric board. Each Participating Member owns and operates its own electric distribution system.

The activities of the Authority are formally promulgated by and financed under The Power Supply System Revenue Bond Resolution (the “Resolution”), as supplemented and amended, adopted by the Board of Directors (the “Board”). The Resolution established special funds to hold proceeds from debt issuance; such proceeds are to be used for development and acquisition costs and to maintain certain reserves. The Resolution also established additional special funds in which revenues from participants are to be deposited and from which operating costs, debt service, and other specified payments are to be made.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting — The accounting records of the Authority are maintained on an accrual basis in accordance with accounting principles generally accepted in the United States of America (GAAP) issued by the Governmental Accounting Standards Board (GASB) applicable to governmental entities that use proprietary fund accounting and the Financial Accounting Standards Board (FASB) that do not conflict with accounting standards issued by the GASB. The Authority also complies with policies and practices prescribed by its Board and to practices common in the utility industry. Also, the accounts of the Authority are maintained in accordance with the Uniform System of Accounts of the Federal Energy Regulatory Commission (“FERC”).

Regulatory Assets and Liabilities — As the Board has the authority to set rates, the Authority follows FASB Statement No. 71, *Accounting for the Effects of Certain Types of Regulation*, which provides for the reporting of assets and liabilities consistent with the economic effect of the rate structure. Regulatory assets represent probable future revenues associated with certain costs that are expected to be recovered from customers through the ratemaking process. Regulatory liabilities represent probable future reductions in revenues associated with amounts that are expected to be credited to customers through the ratemaking process.

Regulatory assets reflected in the Authority's balance sheets at September 30, 2007 and 2006, relate to the following:

	2007	2006	Note
PSA implementation costs	\$ 555,428	\$ 622,752	(a)
Delivery point development costs	1,398,474	1,447,977	(b)
Load management inventory costs	<u>482,796</u>	<u> </u>	(c)
	<u>\$2,436,698</u>	<u>\$2,070,729</u>	

Notes:

- a. Power Supply Agreement ("PSA") implementation costs were incurred by the Authority in obtaining the PSA. The Authority Board of Directors directed the Authority to defer and amortize these costs over the term of the PSA contract. The recorded amounts are presented net of accumulated amortization of \$117,818 for 2007 and \$50,493 for 2006.
- b. Delivery point development costs were incurred by the Authority in the construction of transmission substations required in order for Participating Members to efficiently receive power. The Authority Board of Directors directed the Authority to defer and amortize these costs primarily over the life of the contract with the Participating Member or the life of the asset, whichever is shorter. The recorded amounts are presented net of accumulated amortization of \$66,005 for 2007 and \$16,501 for 2006.
- c. The Authority Board of Directors directed the Authority to defer and amortize these costs over a five-year period beginning October 1, 2006. The recorded amount is presented net of accumulated amortization of \$120,699 for 2007.

See Note 6 for discussion of the regulatory liability reflected in the Authority's balance sheet at September 30, 2007.

Amortization — Unamortized bond issuance costs are being amortized using the bonds outstanding method over the life of the bonds. The bond discounts are being amortized over the life of the bonds using the interest method.

Cash and Cash Equivalents — The Authority considers cash and cash equivalents to be all unrestricted, highly liquid instruments with original maturities of three months or less, the amounts of which are included in certain funds as follows:

	2007	2006
Revenue fund — rate stabilization	\$ 17,200,000	\$ 20,200,000
Operation and maintenance fund	<u>12,096,991</u>	<u>13,317,433</u>
	<u>\$29,296,991</u>	<u>\$33,517,433</u>

As of September 30, 2007, the Authority maintained all of its cash deposits in two Alabama financial institutions. The carrying amount of the Authority's deposits as of September 30, 2007, was \$29,296,991. Of this amount, \$200,000 was covered by the Federal Deposit Insurance Corporation ("FDIC") and \$29,096,991 was insured under the State of Alabama Security for Alabama Funds

Enhancement Act (“SAFE”) program for public funds. The SAFE program became effective on January 1, 2001, and in case of a failure of a public depositor in the State of Alabama, the SAFE program provides loss coverage for all public funds deposited in excess of amounts covered by the FDIC.

Investments — The Authority accounts for investments in accordance with Statement of Governmental Accounting Standards No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*. Under this statement, investments are recorded at fair value for purposes of reporting under GAAP. Investments are stated at amortized cost or cost for purposes of reporting in accordance with the terms of the Resolution.

Participant Receivables — Receivables derived from sales of electricity to participants represent a substantial portion of the total participant receivables balance. Also included within this classification are installment notes receivable totaling \$189,402 (2007) and \$268,399 (2006) from certain of the Participating Members with principal and interest payable monthly, which mature during the year ending September 30, 2012, and bear interest at 5%.

Capital Fund Program — In 2000, the Authority established the Capital Fund Program. The objective of this program is to assist its member communities in the development or improvement of sites and facilities available for economic development. If a member meets the criteria of the program, it would be eligible for a loan in \$200,000 increments. All loans are noninterest bearing. The maximum total amount of loans that can be made from this program in any one calendar year is \$1,000,000. The Authority’s Budget/Audit/Rate Committee of the Board administers this program. The loans are payable based on terms established by this committee.

Materials and Supplies — Generally, materials and supplies include the historical costs of generating plant materials. Materials are charged to inventory when purchased and then expensed or capitalized to plant, as appropriate, when installed.

Property and Equipment — All property and equipment are recorded at cost and depreciation is computed using the straight-line method over the estimated useful lives of 3 to 35 years. Depreciation expense was \$2,128,050 and \$2,085,123 for the years ended September 30, 2007 and 2006, respectively. Property and equipment consist of the following items:

	2007	2006
Electric plant	\$41,351,952	\$41,148,274
Building	1,407,486	1,401,395
Equipment	579,002	541,932
Transportation equipment	128,349	151,516
Load management and SCADA system	<u>4,112,986</u>	<u>4,083,108</u>
	47,579,775	47,326,225
Accumulated depreciation	<u>10,070,619</u>	<u>7,988,664</u>
Property and equipment — net	<u>\$37,509,156</u>	<u>\$39,337,561</u>

Derivative Financial Instruments — The fair values of the interest rate swap agreements (see Note 8) are determined by dealer quote. These values represent the estimated amount the Authority would receive or pay to terminate the agreements taking into consideration current interest rates.

Taxes — As an agency of the State of Alabama, the Authority’s income is exempt from federal and state income taxes. The Authority is exempted from property and franchise or other privilege taxes; however, the Authority is subject to a statutory requirement to make a payment in lieu of property, sales, and certain other taxes.

Revenue Recognition — Operating revenues are recognized in the period that electricity is supplied to Participating Members and others. All other revenues are reflected in other income. Costs associated with the acquisition and generation of electricity supplies are included in operating expenses.

Accounting Estimates — The preparation of financial statements in conformity with GAAP 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 may differ from those estimates.

3. POWER SALES CONTRACTS

Each Participating Member has entered into an Amended and Restated Power Sales Contract (the “Sales Contracts”) with the Authority, which extends through December 31, 2035. The Sales Contracts require that the Authority furnish, and each Participating Member take and pay for all power and energy requirements of the Participating Member (“full requirements services”) in excess of that supplied by the Southeastern Power Administration (“SEPA”) and any excluded power supply resources, as defined. Initially, the Participating Members are required to purchase all of their full-requirement services from the Authority. Beginning January 1, 2001, the power supply requirements may be limited by either the Participating Member or the Authority to equal the Participating Members’ “Contract Rate of Delivery,” which is defined as the highest billing demand of the Participating Member during the 24 billing periods preceding the effective date of the limitation, adjusted up or down by not more than 10% to provide for optimal utilization of the Authority’s resources.

Under the terms of the Sales Contracts, each Participating Member may acquire Excluded Power Supply Resources under certain conditions that include a provision that the total power obtained from such resources, excluding its SEPA allocation, cannot exceed 10% of the Participating Member’s adjusted maximum demand (as defined) in any preceding calendar year.

Retail electric rates charged by Participating Members to their local consumers are not subject to the regulatory control of the Alabama Public Service Commission (“PSC”). The Sales Contracts stipulate that each Participating Member maintain retail rates sufficient to enable it to pay all amounts due to the Authority.

4. POWER SUPPLY AGREEMENTS

The Authority’s power supply is provided under the terms of contractual arrangements, generation at the AMEA-Sylacauga Plant, or purchased on the open market.

Currently and in the past the Authority has entered into power supply agreements with Alabama Power Company (the “Company”). On December 20, 2001, the Authority entered into their most recent agreement with the Company. This agreement, the PSA, began January 1, 2006, and terminates December 31, 2015. Under the PSA the Company will deliver the capacity and energy sold to the Authority at the high voltage side of the transformers at the various generating units of the Company that provide capacity and energy under the PSA. The Company will provide 100% of the Authority’s capacity and energy needs, as determined by the Authority, during the contract period unless the

Authority provides the Company notice to supply up to 10% of its 2006 forecasted capacity needs during 2006, or up to 20% of its 2006 forecasted capacity needs during years 2007–2015. The Authority may provide all of the Authority’s load growth after the first five years of the contract period.

In order for the Authority to obtain transmission service to deliver the capacity and energy to the Authority’s metering points with its Participating Members, the Authority entered into the Agreement for Network Integration Transmission Service and the Network Operating Agreement, both dated December 29, 2005, with the Southern Companies. These agreements provide the transmission services required by the Authority to allow it to deliver the output of the resources defined in the PSA, the output of the AMEA-Sylacauga Plant (see further discussion below) and to deliver certain nonfirm energy transactions.

Pursuant to the provisions of Section 11-50A-25, *Code of Alabama 1975*, as amended, the Authority was required to file the PSA with the PSC. On May 7, 2002, the PSC ordered that “the Agreement and the rates to be charged by the Authority pursuant to the provisions of the Agreement are not disapproved by the Commission.” The PSA, pursuant to the FERC regulations, does not require PSC approval.

Prior to the PSA, the Authority was entered into the 1991 Firm Power Purchase Contract with the Company, which commenced in October 1991. The 1991 Firm Power Purchase Contract provided for delivery of additional firm capacity ranging from 30 megawatts to 80 megawatts annually through December 2005. The Authority paid the Company \$52.9 million for the additional firm capacity.

The AMEA-Sylacauga Plant is a 95 MW gas-fired peaking generation facility located within the city limits of the city of Sylacauga, Alabama. The AMEA-Sylacauga Plant was financed via the \$45,550,000 Power Supply System Revenue Bonds, 2003 Series A. The interconnection of the AMEA-Sylacauga Plant to the 115 kV transmission systems was agreed to by Alabama Power Company. Gas and water supply are provided by the Utilities Board of the City of Sylacauga.

As of September 30, 2006, the Authority has entered into interchange agreements with 31 electric utilities. The Authority has also entered into power purchase and sales agreements with 15 independent power producers and power marketers. A power purchase and sales agreement has been executed with Tenaska Power Services Co. (“Tenaska”). These agreements provide the Authority the opportunity to buy and sell replacement energy on an hour-to-hour, daily, weekly, and monthly basis. The energy that can be replaced or sold is associated with the contract with Tenaska.

5. INVESTMENTS

The Authority's cash and investments are summarized as follows:

	2007		2006	
	Fair Value	Cost	Fair Value	Cost
U.S. government Treasury bonds and agency certificates — held by trustee in the Authority's name (uninsured and unregistered)	\$ 2,904,905	\$ 2,925,000	\$ 2,860,109	\$ 2,925,000
Money market instruments — mutual funds composed of U.S. Treasury obligations	293,841	293,841	297,904	297,904
Interest rate swap agreement			(166,988)	
	<u>3,198,746</u>	<u>\$ 3,218,841</u>	2,991,025	<u>\$ 3,222,904</u>
Interest-bearing cash and cash equivalent accounts	29,296,991		33,517,433	
Accrued interest and other	<u>11,085</u>		<u>10,974</u>	
Total funds invested	<u>\$ 32,506,822</u>		<u>\$ 36,519,432</u>	
Consisting of:				
Special funds invested	\$ 3,198,746		\$ 2,991,025	
Current assets — funds invested	<u>29,308,076</u>		<u>33,528,407</u>	
	<u>\$ 32,506,822</u>		<u>\$ 36,519,432</u>	

Investments included in the funds invested categories are stated at fair values, plus any accrued interest.

Credit Risk — The Authority's policy regarding credit risk on investments is governed by the Resolution, which authorizes the Authority to invest in (1) direct obligations of, or obligations, which the principal and interest are unconditionally guaranteed by the United States of America; (2) direct and general obligations of any state in the United States of America, or of any agency or local government unit thereof whose obligations are fully secured as to principal and interest by cash or obligations of the character described in (1) above; (3) obligations of or guaranteed by any agency or corporation of the United States of America; (4) New Housing Authority Bonds or Project Notes issued by the public agencies and fully secured as to principal and interest by certain agreements with the United States of America; (5) obligations of any state, territory, or possession of the United States of America or of any political subdivision thereof whose securities are rated by a nationally recognized bond-rating agency in either of its two highest rating categories; (6) certificates of deposit issued by a bank, trust company or similar institution; the Authority's deposits in any such institution cannot exceed 5% of the institution's capital stock, surplus, and undivided profits unless fully insured by the FDIC or secured to the extent not insured by certain obligations acceptable under the Resolution; (7) obligations issued or guaranteed by any corporation which are rated similarly to that described in (5) above; (8) repurchase agreements with a member of the Federal Reserve System which are collateralized by the types of obligations described above; and (9) interest in a portfolio of money market instruments containing specified types of obligations.

Per the chart above, all investments held by the Authority are in compliance with the Resolution and are investments in federal government instruments, which were rated AAA by Moody's Investors Service and Standard & Poor's.

Interest Rate Risk — The Resolution states that funds will be reinvested to the fullest extent practicable in investment securities which mature no later than at such time when funds are required for payments to be made from each account. The Resolution also states that all funds held by depositaries must be held in accounts that are available by use at the time when needed.

6. NET COSTS TO BE REFUNDED TO PARTICIPANTS

Power rates charged to Participating Members are designed to cover the Authority's "costs" as defined by the Resolution and the Sales Contracts. The Authority's rates are structured to systematically provide for debt service requirements, operating funds and reserves specified by the Resolution. Recognition of "expenses" (defined according to GAAP), which are not included as "costs," is deferred to such period as it is intended that such "expenses" will be covered by rates. Recognition of the "revenues," which under the Resolution and the Sales Contracts are collected to cover "costs" that are not "expenses," is deferred to such period as it is intended that such "revenues" cover "expenses."

The Authority is required by the Resolution to review and, if necessary, revise its rate structure upon the occurrence of a material change in circumstances, but in any event, at least once every year. The Resolution also permits the Authority to implement rate stabilization practices whereby revenues collected currently may be deposited in a special account to provide for reductions in possible future rate increases that will be required in future years to cover the Authority's costs and other funds requirements mentioned above. Rates charged by the Authority are not subject to the regulatory control of the PSC or FERC.

Net costs to be refunded to participants include the following:

	Year Ended September 30		From Inception to September 30	
	2007	2006	2007	2006
GAAP items not included in billings to participants:				
Amortization of prepaid purchase power contracts	\$ -	\$ 1,248,381	\$ 152,900,000	\$ 152,900,000
Amortization of development costs			3,200,000	3,200,000
Amortization of bond discounts and issuance costs	86,975	88,695	10,787,443	10,700,468
Amortization of excess costs of bond refundings			15,026,369	15,026,369
Interest on revenue bonds			17,063,216	17,063,216
Expenses paid with bond proceeds			3,449,602	3,449,602
(Increase) decrease in fair value of investments	(207,784)	(30,880)	24,095	231,879
Deferred depreciation on plant	1,694,040	1,695,661	5,771,247	4,077,207
Other	62,071	64,141	2,517,545	2,455,474
	<u>1,635,302</u>	<u>3,065,998</u>	<u>210,739,517</u>	<u>209,104,215</u>
Bond resolution requirements included in billings to participants:				
Debt service	866,666	851,250	212,918,000	212,051,334
Special funds deposits	(3,000,000)	(1,000,000)	17,200,000	20,200,000
Investment income not available for operating purposes			1,102,799	1,102,799
	<u>(2,133,334)</u>	<u>(148,750)</u>	<u>231,220,799</u>	<u>233,354,133</u>
	<u>\$ 3,768,636</u>	<u>\$ 3,214,748</u>	<u>\$ (20,481,282)</u>	<u>\$ (24,249,918)</u>

7. LONG-TERM DEBT

Long-term debt at September 30, 2007, consists of the following serial bonds:

Maturity	2003 Bonds	
	Effective Interest Rate	Amount
2008	2.80 %	\$ 885,000
2009	3.10	910,000
2010	3.50	940,000
2011	3.75	970,000
2012	4.00	1,010,000
2013	4.10	1,050,000
2014	4.13	1,090,000
2015	5.50	1,135,000
2016	5.50	1,200,000
2017	5.50	1,265,000
2018	5.50	1,335,000
2019	5.50	1,410,000
2020	4.70	1,485,000
2021	4.80	1,555,000
2022	5.00	1,630,000
2023	5.00	1,710,000
2024	5.00	1,795,000
2025	5.00	1,885,000
2026	5.00	1,980,000
2027	5.00	2,080,000
2028	5.00	2,185,000
2029	5.00	2,295,000
2030	5.00	2,410,000
2031	5.00	2,530,000
2032	5.00	2,655,000
2033	5.00	2,785,000
2034		
		42,180,000
Less current maturities — net of current unamortized bond discount		885,000
Less unamortized bond discount		165,729
		\$41,129,271

Interest on all of the bond issues is payable semiannually.

The Authority's bonds are secured by a pledge of all revenues of the Authority and all special funds established by the Resolution subject to certain terms and conditions set forth therein. The Resolution requires that reserve deposits be maintained in the Debt Service Fund equal to 10% of the principal amount of a bond series outstanding or the highest annual debt service payment required under a series, calculated with respect to each series as of the date of issuance. The Resolution contains certain restrictive financial and operational covenants. At September 30, 2007, the Authority was in compliance with its debt covenants.

The Authority has a Master Note Agreement with its primary bank that provides the Authority with a maximum borrowing capacity of \$5 million through April 28 2008, at which time the Agreement expires and any notes outstanding thereunder are due. Interest is payable monthly at a rate equal to the 90-day London InterBank Offered Rate (LIBOR) plus 150 basis points (which was 6.99% at September 30, 2007). A condition of insufficient moneys in certain funds, as defined in the Resolution, is required by the Resolution to be cured before funds can be applied toward repayment of outstanding notes under the Master Note Agreement. Outstanding notes are secured by a pledge of the Authority's revenues, which is subordinated to the security interest for bonds issued pursuant to the Resolution. At September 30, 2007 and 2006, \$ 0 and \$511,700 was outstanding under this agreement, respectively.

The fair values were based on closing prices of comparable instruments.

	2007		2006	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Series 2003 Bonds	\$42,180,000	\$43,721,758	\$43,045,000	\$45,270,672

8. DERIVATIVE FINANCIAL INSTRUMENTS

In April 2007, all of the Interest Rate Swap Agreements help by the Authority were terminated. This and the change in fair value of the Interest Rate Swap Agreements resulted in a gain of \$773,314 being recognized in the year ended September 30, 2007, financial statements.

The Authority adopted FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and FASB Statement No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities* (collectively, "FASB Statement No. 133"), as of October 1, 2000. Under FASB Statement No. 133, the Authority is required to either designate derivative contracts as hedges and monitor the effectiveness of the hedges against the original financial instruments or mark the derivative instruments to market and report any changes in the derivatives' fair market values through the income statement. The Authority has not chosen to seek hedge accounting under FASB Statement No. 133. As such, the differential between rates to be paid or received is accrued as interest rates change in accordance with the agreements and recognized over the life of the agreements as an adjustment to interest expense. At September 30, 2007 and 2006, the Authority's derivative instruments represented a collective mark to market liability of \$ 0 and \$677,004, respectively. In accordance with the Resolution, \$0 and \$166,988 of the total liability at September 30, 2007 and 2006, respectively, is reflected in net costs to be refunded to participants as this portion of the Interest Rate Swap Agreements relates to underlying debt.

9. RETIREMENT PLAN

The Authority's employees participate in the Employees' Retirement System of Alabama's defined benefit pension plan. Employees currently contribute 5% of their gross pay to the plan, and the Authority contributed approximately 4.2% (2007) and 6.04% (2006). The Authority's contributions are designed to fund the normal contribution amount. The Authority's retirement expense for the years ended September 30, 2007 and 2006, was \$64,903 and \$77,949, respectively.

Retirement payments under the plan are future obligations of the Employees' Retirement System of Alabama. The Authority's obligations under the plan are limited to the funding described above. Valuation of the plan assets and accumulated benefits for the Authority is not available as the Employees' Retirement System of Alabama does not segregate this information.

10. RELATED-PARTY TRANSACTIONS

In addition to sales of electricity to participants as discussed in Note 1, the Authority has entered into a Natural Gas Purchase Agreement with the Utilities Board of the City of Sylacauga (“Sylacauga”), one of the Participating Members. The purpose of this agreement is to provide the natural gas requirements for the AMEA-Sylacauga Plant. The Authority also purchases water and sewer services for the plant from Sylacauga. During the years ended September 30, 2007 and 2006, the Authority paid Sylacauga \$2,105,352 and \$2,515,706, respectively, under the provisions of this agreement.

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ADDITIONAL INFORMATION

ALABAMA MUNICIPAL ELECTRIC AUTHORITY

STATEMENT OF CHANGES IN ASSETS OF FUNDS INVESTED FOR THE YEAR ENDED SEPTEMBER 30, 2007

	Funds Invested September 30, 2006	Power Billing Receipts	Income From Other Electricity Sales	Other Income	Investment Income (Loss)	Draw- Line of Credit	Disbursements	Transfers	Funds Invested September 30, 2007
DEBT SERVICE FUND:									
Debt service account	\$ 76,916	\$ -	\$ -	\$ -	\$ 210,953	\$ -	\$ (2,926,848)	\$ 2,882,820	\$ 243,841
Debt service reserve account	<u>2,864,109</u>				<u>157,991</u>			<u>(117,195)</u>	<u>2,904,905</u>
	<u>2,941,025</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>368,944</u>	<u>-</u>	<u>(2,926,848)</u>	<u>2,765,625</u>	<u>3,148,746</u>
GENERAL RESERVE FUND									
									<u>-</u>
RESERVE AND CONTINGENCY FUND									
	<u>50,000</u>				<u>2,438</u>			<u>(2,438)</u>	<u>50,000</u>
REVENUE FUND:									
Revenue account	10,974	174,528,740	245,936	354,794	111	(511,700)		(174,617,770)	11,085
Rate stabilization account	<u>20,200,000</u>							<u>(3,000,000)</u>	<u>17,200,000</u>
	<u>20,210,974</u>	<u>174,528,740</u>	<u>245,936</u>	<u>354,794</u>	<u>111</u>	<u>(511,700)</u>	<u>-</u>	<u>(177,617,770)</u>	<u>17,211,085</u>
OPERATION AND MAINTENANCE FUND:									
Operation and maintenance account							(177,020,311)	177,020,311	-
Working capital account	<u>13,317,433</u>				<u>945,286</u>			<u>(2,165,728)</u>	<u>12,096,991</u>
	<u>13,317,433</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>945,286</u>	<u>-</u>	<u>(177,020,311)</u>	<u>174,854,583</u>	<u>12,096,991</u>
	<u>\$36,519,432</u>	<u>\$174,528,740</u>	<u>\$245,936</u>	<u>\$354,794</u>	<u>\$1,316,779</u>	<u>\$(511,700)</u>	<u>\$(179,947,159)</u>	<u>\$ -</u>	<u>\$32,506,822</u>

ALABAMA MUNICIPAL ELECTRIC AUTHORITY

STATEMENT OF CHANGES IN ASSETS OF FUNDS INVESTED FOR THE YEAR ENDED SEPTEMBER 30, 2006

	Funds Invested September 30, 2005	Power Billing Receipts	Income From Other Electricity Sales	Other Income	Investment Income (Loss)	Draw- Line of Credit	Disbursements	Transfers	Funds Invested September 30, 2006
CONSTRUCTION FUND — Construction account	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -
DEBT SERVICE FUND:									
Debt service account	31,521				82,576		(2,927,997)	2,890,816	76,916
Debt service reserve account	<u>2,878,720</u>				<u>102,548</u>			<u>(117,159)</u>	<u>2,864,109</u>
	<u>2,910,241</u>	-	-	-	<u>185,124</u>	-	<u>(2,927,997)</u>	<u>2,773,657</u>	<u>2,941,025</u>
GENERAL RESERVE FUND					<u>28</u>			<u>(28)</u>	<u>-</u>
RESERVE AND CONTINGENCY FUND	<u>50,000</u>				<u>1,983</u>			<u>(1,983)</u>	<u>50,000</u>
REVENUE FUND:									
Revenue account	16,735	163,674,320	2,073,036	(59,790)	1,049	511,700		(166,206,076)	10,974
Rate stabilization account	<u>21,200,000</u>							<u>(1,000,000)</u>	<u>20,200,000</u>
	<u>21,216,735</u>	<u>163,674,320</u>	<u>2,073,036</u>	<u>(59,790)</u>	<u>1,049</u>	<u>511,700</u>	-	<u>(167,206,076)</u>	<u>20,210,974</u>
OPERATION AND MAINTENANCE FUND:									
Operation and maintenance account							(162,095,824)	162,095,824	-
Working capital account	<u>10,038,180</u>				<u>940,647</u>			<u>2,338,606</u>	<u>13,317,433</u>
	<u>10,038,180</u>	-	-	-	<u>940,647</u>	-	<u>(162,095,824)</u>	<u>164,434,430</u>	<u>13,317,433</u>
	<u>\$34,215,156</u>	<u>\$ 163,674,320</u>	<u>\$2,073,036</u>	<u>\$(59,790)</u>	<u>\$1,128,831</u>	<u>\$511,700</u>	<u>\$(165,023,821)</u>	<u>\$ -</u>	<u>\$36,519,432</u>

ALABAMA MUNICIPAL ELECTRIC AUTHORITY

SCHEDULES OF REVENUES AND EXPENSES PER BOND RESOLUTION FOR THE YEARS ENDED SEPTEMBER 30, 2007 AND 2006

	2007	2006
REVENUES:		
Sales of electricity to participants	\$ 180,085,458	\$ 168,725,428
Sales of electricity — other	240,209	1,497,281
Investment revenues available for operations	1,904,605	2,247,536
Withdrawal from rate stabilization	3,000,000	
Other income	46,491	38,032
	<u>185,276,763</u>	<u>172,508,277</u>
Total revenues		
EXPENSES:		
Firm purchase power services — purchased power		4,811,321
Partial requirements services:		
Purchased power	160,974,554	141,436,682
Transmission and distribution	12,111,703	8,850,043
Cost of other electricity sales	148,612	1,153,603
Deposit to rate stabilization account		3,000,000
Other operating and maintenance expenses	1,590,416	1,560,109
Administrative and general expenses	6,544,332	6,721,531
Debt service	2,926,784	2,927,902
	<u>184,296,401</u>	<u>170,461,191</u>
Total expenses		
EXCESS OF REVENUES OVER EXPENSES	<u>\$ 980,362</u>	<u>\$ 2,047,086</u>