Alabama Municipal Electric Authority

Financial Statements as of and for the Years Ended September 30, 2006 and 2005, Additional Information for the Years Ended September 30, 2006 and 2005, 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—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 liabilites	59,069,930	57,914,341
Total liabilities	$ 101,073,679	$ 100,772,360
Net assets	$ 14,039,155	$ 11,992,069

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 Power Supply Agreement ("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	$ 166,222,709	$ 140,683,853
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	8,088,270	11,354,894
Total operating expenses	167,541,469	124,389,275
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	3,214,748	(12,247,428)
Excess of revenues over expenses	2,047,086	830,058
Net assets—beginning of year	11,992,069	11,162,011
Net assets—end of year	$ 14,039,155	$ 11,992,069

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. The interest expense decreased by $986,327 as a result of lower debt service requirements. Interest rate swap agreement gain (loss) increased $2,236,994 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.

Financial Analysis—2005 Compared to 2004

Following are condensed balance sheets as of September 30:

	2005	2004
Total assets	$ 112,764,429	$ 111,267,943
Long-term debt	$ 42,858,019	$ 43,659,794
Other liabilites	57,914,341	56,446,138
Total liabilities	$ 100,772,360	$ 100,105,932
Net assets	$ 11,992,069	$ 11,162,011

Total Assets—The increase in total assets of $1,496,486 is driven by several factors. Annual amortization of $7,496,966 resulted in substantial decreases in total assets. Special Funds Invested decreased as a result of the use of reserve funds to pay the final payment of the 1993 bond issue and the final disbursements of all funds in the Construction Fund. The Revenue Fund increased by $5,790,897 while current receivables increased by $9,282,153 due primarily to an increase in the Authority's rates, an increase in fuel costs under purchase power agreements, and a slight increase in power sales to participants. In Current Assets, the deposits were added to account for the required deposit to obtain services from the Open Access Transmission Tariff with Southern Company, beginning January 1, 2006.

Total Liabilities—The increase in Total Liabilities of $666,428 is also driven by several factors. The Net Costs to be Refunded to Participants increased by $12,247,428, a result of normal items charged to the account and a $6,400,000 transfer to the Rate Stabilization Account. The increase was offset by a decrease in current maturities of the revenue bonds in the amount of $18,015,000. Also, payables under power supply contracts increased by $7,629,145 as a result of higher payables to Alabama Power Company.

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

	2005	2004
Operating revenues	$ 140,683,853	$ 119,915,152
Operating expenses:		
Purchased power expenses	110,777,629	101,197,404
Plant operating expenses	2,256,752	403,229
Administrative, general and operating expenses	11,354,894	10,203,538
Total operating expenses	124,389,275	111,804,171
Operating income	16,294,578	8,110,981
Other income (expense)	(3,217,092)	(2,393,703)
Changes in net costs to be refunded to participants	(12,247,428)	(5,102,984)
Excess of revenues over expenses	830,058	614,294
Net assets—beginning of year	11,162,011	10,547,717
Net assets—end of year	$ 11,992,069	$ 11,162,011

Operating Revenues—Total operating revenues increased by $20,768,701. This increase is a result of substantial increases in sales to participants due to an increase in the Authority's rates, an increase in fuel costs under purchase power agreements, and a slight increase in power sales to participants. Sales of Electricity to Others also increased because of an increased sales effort in this area.

Operating Expenses—Purchased power expenses increased by $9,580,225 because of higher fuel costs and a small increase in participants power requirements. Plant operating expenses increased as result of the AMEA-Sylacauga Plant being operational for 12 months and the increased production of the plant during the year.

Changes in Net Costs To Be Refunded To Participants—The increases of $7,144,444 in this account is due to a transfer of $6,400,000 to the rate stabilization account and increases in deferred depreciation on the AMEA-Sylacauga Plant. (See Note 6)

Liquidity and Capital Resources—The Authority has cash and cash equivalents of $31,238,180 at September 30, 2005. Cash increased by $7,391,044, 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, 2005 is $42,858,019. 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.

Deloitte.

Deloitte & Touche LLP
Suite 1500
191 Peachtree Street NE
Atlanta, GA 30303-1924
USA

Tel: +1 404 220 1500
www.deloitte.com

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, 2006 and 2005, 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 includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes 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, 2006 and 2005, and the results of its operations, the changes in net assets, and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

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 required supplementary information. However, we did not audit the information and express no opinion on it.

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 24-26 is presented for purposes 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.

Deloitte & Touche LLP

January 26, 2007

ALABAMA MUNICIPAL ELECTRIC AUTHORITY

BALANCE SHEETS
AS OF SEPTEMBER 30, 2006 AND 2005

	2006	2005
ASSETS		
PROPERTY AND EQUIPMENT—Net	$ 39,337,561	$ 40,711,505
PREPAID PURCHASE POWER CONTRACTS—Net of accumulated amortization of $52,900,000 (2006) and $51,651,622 (2005)		1,248,378
OTHER LONG-TERM ASSETS:		
Investments	375,544	452,401
Participant receivables	229,617	270,062
Capital fund program receivable	516,500	782,000
Inventories	548,522	354,073
Total other long-term assets	1,670,183	1,858,536
SPECIAL FUNDS INVESTED:		
Debt service fund (restricted)	2,697,121	2,666,241
Reserve and contingency fund	50,000	50,000
Total special funds invested	2,747,121	2,716,241
CURRENT ASSETS:		
Funds invested:		
Revenue fund	20,210,974	21,216,735
Operation and maintenance fund	13,317,433	10,038,180
Special funds—debt service fund (restricted)	243,904	244,000
Total funds invested	33,772,311	31,498,915
Participant receivables	32,393,679	31,385,415
Other receivables	25,721	113,171
Inventories	188,670	466,602
Capital fund program receivable	465,500	65,500
Prepaid expenses	90,300	99,448
Deposits	1,070,386	1,070,386
Total current assets	68,006,567	64,699,437
DEFERRED COSTS:		
Development costs, net of accumulated amortization of $974,727 (2006) and $881,946 (2005)	2,070,729	171,691
Unamortized bond issuance costs, net of accumulated amortization of $958,380 (2006) and $880,412 (2005)	1,280,673	1,358,641
Total deferred costs	3,351,402	1,530,332
TOTAL	$ 115,112,834	$ 112,764,429

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ALABAMA MUNICIPAL ELECTRIC AUTHORITY

BALANCE SHEETS
AS OF SEPTEMBER 30, 2006 AND 2005

LIABILITIES AND NET ASSETS	2006	2005
LONG-TERM DEBT—Revenue bonds—net of unamortized discounts	$ 42,003,749	$ 42,858,019
DEFERRED LIABILITIES—Net costs to be refunded to participants	24,249,918	27,464,666
CURRENT LIABILITIES:		
Current maturities of revenue bonds	865,000	850,000
Amounts payable under power supply contracts	31,814,251	26,152,767
Interest rate swap agreement	510,016	1,761,454
Special funds—accrued interest on revenue bonds	171,821	173,166
Other current liabilities	1,458,924	1,512,288
Total current liabilities	34,820,012	30,449,675
NET ASSETS	14,039,155	11,992,069
TOTAL	$ 115,112,834	$ 112,764,429

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, 2006 AND 2005

	2006	2005
OPERATING REVENUES:		
Sales of electricity to participants	$ 168,725,428	$ 136,925,430
Rebates to participants	(4,000,000)	
Sales of electricity—other	1,497,281	3,758,423
Total operating revenues	166,222,709	140,683,853
OPERATING EXPENSES:		
Firm purchase power services—purchased power	4,811,321	14,224,847
Partial requirements services:		
Purchased power	141,436,682	91,394,926
Transmission and distribution	8,850,043	1,938,459
Plant operating expenses	3,201,550	2,256,752
Cost of other electricity sales	1,153,603	3,219,397
Other operating and maintenance expenses	1,140,473	887,761
Administrative and general expenses	3,519,981	3,290,126
Amortization and depreciation	3,427,816	7,177,007
Total operating expenses	167,541,469	124,389,275
NET OPERATING INCOME (LOSS)	(1,318,760)	16,294,578
OTHER INCOME (EXPENSE):		
Interest expense—net of capitalized interest	(2,056,159)	(3,042,486)
Interest income	1,083,342	1,051,729
Investment income (loss)	(76,857)	10,389
Interest rate swap agreement gain (loss)	1,251,438	(985,556)
Other income	38,032	68,791
Amortization of bond discounts, issuance costs, and excess costs of bond refundings	(88,698)	(319,959)
Total other income (expense)	151,098	(3,217,092)
CHANGES IN NET COSTS TO BE REFUNDED TO PARTICIPANTS	3,214,748	(12,247,428)
EXCESS OF REVENUES OVER EXPENSES	2,047,086	830,058
NET ASSETS:		
Balance—beginning of year	11,992,069	11,162,011
Balance—end of year	$ 14,039,155	$ 11,992,069

See notes to financial statements.

ALABAMA MUNICIPAL ELECTRIC AUTHORITY

STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED SEPTEMBER 30, 2006 AND 2005

	2006	2005
OPERATING ACTIVITIES:		
Cash received from sales of electricity	$ 165,747,356	$ 131,065,858
Cash paid under power supply contracts	(153,503,543)	(102,784,317)
Cash paid to other suppliers and employees	(7,890,770)	(5,454,424)
Net cash provided by operating activities	4,353,043	22,827,117
CAPITAL AND RELATED FINANCING ACTIVITIES:		
Payment for acquisition of property and equipment	(585,773)	(3,459,279)
Draw-line of credit	511,700	
Principal paid on revenue bond maturities	(850,000)	(18,865,000)
Interest paid on revenue bonds	(2,077,998)	(2,992,022)
Other	(48,716)	34,986
Net cash used in capital and related financing activities	(3,050,787)	(25,281,315)
INVESTING ACTIVITIES:		
Purchases of investments	(3,084,157)	(16,288,833)
Proceeds from sale of investments	3,084,253	25,151,659
Interest income received	1,001,899	1,316,634
Interest expense paid	(24,998)	(334,218)
Net cash provided by investing activities	976,997	9,845,242
NET INCREASE IN CASH AND CASH EQUIVALENTS	2,279,253	7,391,044
CASH AND CASH EQUIVALENTS—Beginning of year	31,238,180	23,847,136
CASH AND CASH EQUIVALENTS—End of year	$ 33,517,433	$ 31,238,180

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ALABAMA MUNICIPAL ELECTRIC AUTHORITY

STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED SEPTEMBER 30, 2006 AND 2005

	2006	2005
RECONCILIATION OF NET OPERATING INCOME (LOSS) TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Net operating income (loss)	$ (1,318,760)	$ 16,294,578
Adjustments to reconcile net operating income (loss) to net cash provided by operating activities:		
Amortization and depreciation	3,427,816	7,177,007
Changes in assets and liabilities:		
Increase in receivables	(975,173)	(9,364,492)
Decrease in prepaid expenses	9,149	121,810
Decrease in plant inventory	27,184	
Increase in amounts payable under power supply contracts	3,012,838	8,252,074
Increase in other liabilities	169,989	346,140
Total adjustments	5,671,803	6,532,539
NET CASH PROVIDED BY OPERATING ACTIVITIES	$ 4,353,043	$ 22,827,117

See notes to financial statements. (Concluded)

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, which consist of municipalities, utility boards, and an electric board. Each 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.

During 2003, the Authority issued $45,550,000 of 2003 Series A revenue bonds for the primary purpose of funding the construction of the Peaking Power Project (see Note 4). Bond proceeds were also used to pay debt issuance costs and to establish the special funds referred to above.

Additional bonds may be issued pursuant to the Resolution subject to compliance with certain conditions defined therein.

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. As the Board has the authority to set rates, the Authority has historically followed Statement of Financial Accounting Standards ("SFAS") 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 (see Note 6). Also, the accounts of the Authority are maintained in accordance with the Uniform System of Accounts of the Federal Energy Regulatory Commission ("FERC").

Amortization—The prepaid purchase power contracts and deferred costs are presented net of accumulated amortization. The power contracts are being amortized based on the amount of firm power to be supplied each year as a percentage of total firm power to be supplied over the lives of the respective contracts. The purchased power contracts were completely amortized as of December 31, 2005.

Unamortized bond issuance costs are being amortized using the bonds outstanding method over the life of the bonds. Development costs were primarily being amortized on a straight-line basis over the term of the 1986 prepaid purchase power contract, as amended, which ended on December 31, 2005. 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:

	2006	**2005**
Revenue fund—rate stabilization	$ 20,200,000	$ 21,200,000
Operation and maintenance fund	13,317,433	10,038,180
	$ 33,517,433	$ 31,238,180

As of September 30, 2005, the Authority maintained all of its cash deposits in four Alabama financial institutions. The carrying amount of the Authority's deposits as of September 30, 2006 was $33,517,433. Of this amount, $400,000 was covered by the Federal Deposit Insurance Corporation ("FDIC") and $33,117,433 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 $268,399 (2006) and $351,688 (2005) from certain of the Authority's 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 administers this program. The loans are payable based on terms established by this committee.

Inventories—Inventories are stated at the lower of cost (first-in, first-out method) or market.

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 $2,085,123 and $2,074,216 for the years ended September 30, 2006 and 2005, respectively. Property and equipment consist of the following items:

	2006	2005
Electric plant	$ 41,148,274	$ 40,728,462
Building	1,401,395	1,308,980
Equipment	541,932	498,671
Transportation equipment	151,516	125,233
Load management and SCADA system	4,083,108	4,023,241
	47,326,225	46,684,587
Accumulated depreciation	7,988,664	5,973,082
Property and equipment—net	$ 39,337,561	$ 40,711,505

Excess Costs of Bond Refundings—Excess costs of bond refundings represent the excess costs associated with the advance refunding (defeasance) of bonds. Such costs are deferred and amortized over the life of the refunding bonds using a method which approximates the interest method.

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 that it 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 participants 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 member take and pay for, all power and energy requirements of the 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. From January 1, 2001, the power supply requirements may be limited by either the participating member or the Authority to equal the members' "Contract Rate of Delivery," which is defined as the highest billing demand of the 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 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 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 member maintain retail rates sufficient to enable it to pay all amounts due to the Authority.

4. POWER SUPPLY AGREEMENTS

The Authority entered into power supply agreements with Alabama Power Company (the "Company"). In October 1991, the Authority commenced a power supply contract agreement with the Company. 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 energy charge under the 1991 Firm Power Purchase Contract was based upon the same energy rate (excluding the capital substitution component) contained in the Partial Requirements Service Agreement (the "Agreement") described below and was based on average costing energy rate concepts which underlaid those rates previously charged by the Company to the participating members under the MUN-1 Tariff prior to the Authority's commencing power sales.

The Company's performance under the 1991 Firm Power Purchase Contract was secured by a Liquidated Damages Note, which must be paid with interest thereon to the Authority in the event of a default, as defined. The Liquidated Damages Note was secured by First Mortgage Bonds, which were issued by the Company in the name of an escrow agent. The bonds were redeemed at the conclusion of the contract.

On February 4, 1986, the Authority also entered into the Agreement whereby the Authority purchased power in excess of that received from other Authority power supply resources in order to meet the total requirements of the participating members. In addition, the Agreement provided transmission services to deliver power to the participating members' points of delivery.

To allow for greater resource flexibility by the Authority, the Company, on July 8, 1994, filed an amended agreement with FERC that was negotiated between the Company and the Authority. The amended agreement, filed with an effective date of October 1, 1994, extended through December 31, 2005. Among other things, the amended agreement allowed (i) for the constant rate design over the contract term, (ii) the Authority to operate base, intermediate or peaking resources and (iii) the Authority to purchase from the Company or a third-party transmission services, control center services, load regulation services, reserve services, or backup services.

In connection with the amended agreement, each of the participating members executed a Guaranty and Indemnity Agreement with the Company whereby each member guaranteed their pro rata share of payments owed the Company by the Authority for partial requirements services.

The Authority also had a Firm Power Sale Agreement with Entergy Power, Inc. ("EPI") for EPI to provide 50 megawatts of firm peaking capacity and associated energy to the Authority annually through December 31, 2005. Under this agreement, the Authority received a guaranteed savings of $1 per kilowatt per month provided the Authority scheduled the capacity over its billing peak and did not schedule more than 67 hours in a month or 804 hours in a year.

On April 10, 1995, the Authority entered into a short-term Nonfirm Transmission Service Tariff with Southern Company Services, Inc. This tariff allows the Authority to wheel nonfirm power through the operating companies of the Southern Company.

Effective October 1, 1996, the Agreement was amended ("Amendment No. 1") to reflect a rate reduction for partial requirements ("PR") service. The rate reduction reflected an approximate 5.4% reduction in revenue requirements for PR service.

Effective May 1, 1998, the Agreement was amended ("Amendment No. 2") to reflect a reduction in the May through September billing demand rate beginning May 1, 1999, and continued through May 1, 2001. The first reduction was 1% below the current rate, the second reduction (May 1, 2000) was 2% below the current rate, and the third reduction (May 1, 2001) was 4.2% below the current rate and remained at the level for the May through September billing period for the remainder of the contract. The Authority and the Company agreed to a rate moratorium from May 1, 2001 until January 1, 2006. Amendment No. 2 also reflected the parties' agreement regarding certain notice provisions under Article II of the Amended PR Agreement, which pertained to changes in the amount of load to be serviced by alternative resources.

On December 20, 2001, the Authority entered into a Power Supply Agreement ("PSA") with the Company. The PSA will begin January 1, 2006, and end December 31, 2015. 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 needs for 2006 and after 2006 up to 20% of its needs for 2007. The Authority may provide all of the Authority's load growth after the first five years of the contract period. The Authority is responsible for obtaining transmission service to deliver the capacity and energy to the Authority's metering points with its members from the Southern Company. 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 and to deliver certain nonfirm energy transactions.

In connection with the PSA, the Authority's members will not be required to execute a guaranty and indemnity agreement with the Company so long as the Authority has outstanding debt.

Pursuant to the provisions of Section 11-50A-25, *Code of Alabama 1975*, as amended, the Authority is 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.

The Board of the Authority authorized the acquisition and construction of the Peaking Power Project on December 31, 2002. The Peaking Power Project includes the cost of designing, equipping, constructing and acquiring land for a 95 MW gas-fired peaking generation facility. The site was purchased and is located within the city limits of the city of Sylacauga, Alabama.

All permits were acquired, and all necessary actions were taken by the PSC. Financing was completed via the $45,550,000 Power Supply System Revenue Bonds, 2003 Series A. Design was completed and construction began in August 2003. The interconnection to the 115 kV transmission systems has been agreed to by Alabama Power Company. Gas and water supply are provided by the Utilities Board of the City of Sylacauga. The Board has identified the Peaking Power Project as the AMEA-Sylacauga Plant. The AMEA-Sylacauga Plant began commercial operation on May 1, 2004.

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 18 independent power producers and power marketers. The Authority has also entered into one "Hub Service" agreement with Dynegy, Inc., a power marketer. A power purchase and sales agreement has been executed with Tenaska Power Services Co. 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 the Tenasca Power Services Co.

5. INVESTMENTS

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

	2006		2005		
	Fair Value	Cost	Fair Value	Cost	2005 Rating
U.S. government Treasury bonds and agency certificates—held by trustee in the Authority's name (uninsured and unregistered)	$ 2,860,109	$ 2,925,000	$ 2,874,720	$ 2,925,000	AAA
Money market instruments—mutual funds composed of U.S. Treasury obligations	297,904	297,904	298,000	298,000	AAA
Interest rate swap agreement	(166,988)		(212,479)		N/A
	2,991,025	$ 3,222,904	2,960,241	$ 3,223,000	
Interest-bearing cash and cash equivalent accounts	33,517,433		31,238,180		N/A
Accrued interest and other	10,974		16,735		N/A
Total funds invested	$ 36,519,432		$ 34,215,156		
Consisting of:					
Special funds invested	$ 2,991,025		$ 2,960,241		
Current assets—funds invested	33,528,407		31,254,915		
	$ 36,519,432		$ 34,215,156		

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 depositarys 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 gradual rate increases which 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	
	2006	2005	2006	2005
GAAP items not included in billings to participants:				
Amortization of prepaid purchase power contracts	$ 1,248,381	$ 4,993,510	$ 152,900,000	$ 151,651,619
Amortization of development costs			3,200,000	3,200,000
Amortization of bond discounts and issuance costs	88,695	152,292	10,700,468	10,611,773
Amortization of excess costs of bond refundings		167,666	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	(30,880)	(150,881)	231,879	262,759
Deferred depreciation on plant	1,695,661	1,695,661	4,077,207	2,381,546
Other	64,141	71,074	2,455,474	2,391,333
	3,065,998	6,929,322	209,104,215	206,038,217
Bond resolution requirements included in billings to participants:				
Debt service	851,250	12,776,750	212,051,334	211,200,084
Special funds deposits	(1,000,000)	6,400,000	20,200,000	21,200,000
Investment income not available for operating purposes			1,102,799	1,102,799
	(148,750)	19,176,750	233,354,133	233,502,883
	$ 3,214,748	$(12,247,428)	$ (24,249,918)	$ (27,464,666)

7. LONG-TERM DEBT

Long-term debt at September 30, 2006, consists of the following serial bonds:

	2003 Bonds	
Maturity	Effective Interest Rate	Amount
2007	2.40 %	$ 865,000
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
		43,045,000
Less current maturities—net of current unamortized bond discount		865,000
Less unamortized bond discount		176,251
		$ 42,003,749

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, 2006, the Authority was in compliance with its debt covenants.

The Authority has a Master Note Agreement with its primary bank which provides the Authority with a maximum borrowing capacity of $5 million through April 27, 2007, 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 6.87% at September 30, 2006). 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, 2006 $511,700 was outstanding under this agreement and at September 30, 2005 no amount was outstanding under this agreement.

8. DERIVATIVE FINANCIAL INSTRUMENTS

The Authority enters into certain interest rate swap agreements to manage its exposure to interest rate movements by effectively converting a portion of its debt from fixed to variable rates. During the year ended September 30, 2004, the Authority entered into an additional interest rate swap agreement for which $45,550,000 was matched to underlying debt and the balance of $54,450,000 did not have any underlying debt. This agreement, which matures in 2009, involves the exchange of fixed rate payments for variable rate payments based upon the $100 million notional amount. Variable rates are based on the Bond Market Association ("BMA") Index.

The Authority is party to an additional interest rate swap agreement for which there is no underlying debt. This agreement, which matures in 2014, involves the exchange of variable rate payments for variable rate payments based upon the $50 million notional amount. Variable rates are based on the one-month U.S. dollar LIBOR and the BMA Index.

On October 1, 2004, the Authority entered into an additional interest rate swap agreement for which there is no underlying debt. This agreement, which matures in 2016, involves the exchange of variable rate payments for variable rate payments based on the $50 million notional amount. Variable rates are based on the on month U.S. dollar LIBOR and the BMA Index.

The Authority adopted SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and SFAS No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities* (collectively, "SFAS No. 133"), as of October 1, 2000. Under SFAS 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 SFAS 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, 2006 and 2005, the Authority's derivative instruments represented a collective mark to market liability of $677,004 and $1,973,933, respectively. In accordance with the Resolution, $166,988 and $212,479 of the total liability at

September 30, 2006 and 2005, respectively, representing interest rate swap agreements for which there is underlying debt, is reflected in net costs to be refunded to participants.

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 contributes approximately 6.04% (2006) and 6.04% (2005). The Authority's contributions are designed to fund the normal contribution amount. The Authority's retirement expense for the years ended September 30, 2006 and 2005, was $77,949 and $69,805, 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 year ended September 30, 2006 and 2005, the Authority paid Sylacauga $2,515,706 and $1,055,284, 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, 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	2,878,720				102,548			(117,159)	2,864,109
	2,910,241				185,124		(2,927,997)	2,773,657	2,941,025
GENERAL RESERVE FUND					28			(28)	
RESERVE AND CONTINGENCY FUND	50,000				1,983			(1,983)	50,000
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	21,200,000							(1,000,000)	20,200,000
	21,216,735	163,674,320	2,073,036	(59,790)	1,049	511,700		(167,206,076)	20,210,974
OPERATION AND MAINTENANCE FUND:									
Operation and maintenance account							(162,095,824)	162,095,824	
Working capital account	10,038,180				940,647			2,338,606	13,317,433
	10,038,180				940,647		(162,095,824)	164,434,430	13,317,433
	$ 34,215,156	$ 163,674,320	$ 2,073,036	$ (59,790)	$ 1,128,831	$ 511,700	$ (165,023,821)	$	$ 36,519,432

ALABAMA MUNICIPAL ELECTRIC AUTHORITY

STATEMENT OF CHANGES IN ASSETS OF FUNDS INVESTED
FOR THE YEAR ENDED SEPTEMBER 30, 2005

	Funds Invested September 30, 2004	Power Billing Receipts	Income From Other Electricity Sales	Other Income	Investment Income (Loss)	Disbursements	Transfers	Funds Invested September 30, 2005
CONSTRUCTION FUND—								
Construction account	$ 2,698,408	$	$	$	$ 12,252	$ (2,350,673)	$ (359,987)	$
DEBT SERVICE FUND:								
Debt service account	984,721				394,823	(21,857,022)	20,508,999	31,521
Debt service reserve account	7,604,508				329,736		(5,055,524)	2,878,720
	8,589,229				724,559	(21,857,022)	15,453,475	2,910,241
GENERAL RESERVE FUND	334,549				9,338		(343,887)	
RESERVE AND CONTINGENCY FUND	50,000				961		(961)	50,000
REVENUE FUND:								
Revenue account	625,838	127,598,865	3,462,809	(208,775)	(34,364)		(131,427,638)	16,735
Rate stabilization account	14,800,000						6,400,000	21,200,000
	15,425,838	127,598,865	3,462,809	(208,775)	(34,364)		(125,027,638)	21,216,735
OPERATION AND MAINTENANCE FUND:								
Operation and maintenance account						(109,877,656)	109,877,656	
Working capital account	9,047,136				589,702		401,342	10,038,180
	9,047,136				589,702	(109,877,656)	110,278,998	10,038,180
	$36,145,160	$127,598,865	$ 3,462,809	$ (208,775)	$1,302,448	$(134,085,351)	$	$34,215,156

ALABAMA MUNICIPAL ELECTRIC AUTHORITY

SCHEDULES OF REVENUES AND EXPENSES PER BOND RESOLUTION
FOR THE YEARS ENDED SEPTEMBER 30, 2006 AND 2005

	2006	2005
REVENUES:		
Sales of electricity to participants	$ 168,725,428	$ 136,925,430
Sales of electricity—other	1,497,281	3,758,423
Investment revenues (expenses) available for operations	2,247,536	(200,952)
Other income	38,032	68,791
Total revenues	172,508,277	140,551,692
EXPENSES:		
Firm purchase power services—purchased power	4,811,321	14,224,847
Partial requirements services:		
Purchased power	141,436,682	91,394,926
Transmission and distribution	8,850,043	1,938,459
Cost of other electricity sales	1,153,603	3,219,397
Deposit to rate stabilization account	3,000,000	6,400,000
Other operating and maintenance expenses	1,560,109	1,304,523
Administrative and general expenses	6,721,531	5,546,878
Debt service	2,927,902	15,692,604
Total expenses	170,461,191	139,721,634
EXCESS OF REVENUES OVER EXPENSES	$ 2,047,086	$ 830,058