




STRATEGIC PLANNING FOR LONG-TERM STABILITY

56TH ANNUAL REPORT ARIZONA POWER AUTHORITY 2014



TABLE OF CONTENTS

- 
- 01** PRESENTATION OF THE REPORT
 - 02** REPORT OF THE COMMISSION
 - 04** OPERATIONS AND ENVIRONMENTS
 - 06** MANAGEMENT'S DISCUSSION AND ANALYSIS
 - 21** REPORT OF THE INDEPENDENT AUDITORS
 - 22** FINANCIAL HIGHLIGHTS
 - 26** NOTES TO FINANCIAL STATEMENTS
 - 35** DEBT SERVICE COVERAGE RATIO

PRESENTATION OF THE REPORT

COMMISSION

Stephen M. Brophy
Chairman

Joe A. Albo
Vice Chairman

Dalton H. Cole
Russell L. Jones
Richard S. Walden



Arizona Power Authority

1810 W. Adams St. Phoenix, AZ 85007
(602) 368-4265 Fax (602) 253-7970

STAFF

Executive Director

Susan E. Angulo
Executive Secretary

June 2015

The Arizona Power Authority presents the Operating Year 2014 Annual Report. This report details the Authority's operational and financial activities for the operating year ending September 30, 2014. It also highlights the Authority's efforts in administering Arizona's hydroelectric power entitlement generated at Hoover Dam and Power plant.

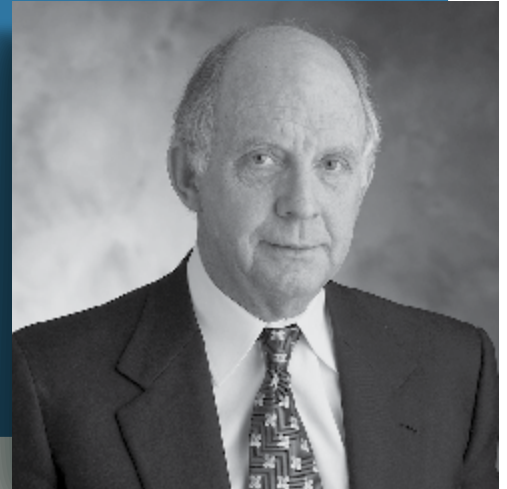
The Authority continues to be actively involved in federal and state efforts to mitigate the significant, ongoing drought, which impacts the Colorado River System. During Operating Year 2014, the southwest again received below normal rainfall. Despite this challenge, the Authority continued serving Arizona power users, as it has for more than 50 years.

The Arizona Power Authority will continue in its ongoing efforts to ensure that irrigation and electrical districts, cities, and towns located throughout the State of Arizona have access to low cost, dependable hydroelectric power.

ARIZONA POWER AUTHORITY

REPORT OF THE COMMISSION

Appointed to the Commission in 2009 and re-appointed through his present term expiring in 2020, Stephen M. Brophy is president of Page Land & Cattle Co., Aztec Land and Cattle Company, Ltd. and a partner in Santa Lucia Farms. Among his affiliations, he is a member of the boards of the Arizona Cattle Growers Association, Mountain States Legal Foundation, the National Cowboy Museum and former member of the Economic Advisory Council of the Federal Reserve Bank of San Francisco. He received a bachelor's degree from the University of Arizona and an M.B.A. from Stanford University.



STEPHEN M. BROPHY
CHAIRMAN

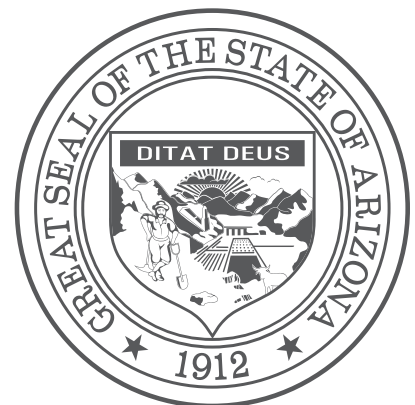


Appointed to the Commission in 2010 and re-appointed through his present term expiring in 2016, Joe Albo served an earlier partial term as Commissioner on the Arizona Power Authority Commission from 1983 to 1984. Joe Albo is a fourth generation native Arizonan. He is a career public sector attorney. Mr. Albo is a graduate of Northern Arizona University and of the University of Arizona College of Law.

JOE A. ALBO
VICE-CHAIRMAN

“Success is to be measured not so much by the position one has reached in life, as by the obstacles which he has overcome.”

– **Booker T. Washington**





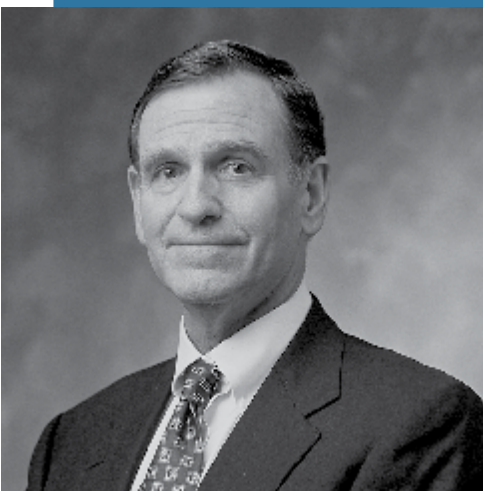
Appointed to the Commission in January 2002 and re-appointed through his present term expiring in 2020, Dalton Cole is a retired businessman and farmer. A past member of the Central Arizona Water Conservation District Board, Mr. Cole co-founded and chaired the HoHoKam Irrigation District. He also served on the board of Electrical District No. 2 in Pinal County for 18 years and is a past chairman. In addition, Mr. Cole is a past chairman of the State Board of Directors for Community Colleges. He has served on the Ground Water Management Committee for Pinal County, as well as advisory committees to the Arizona Legislature regarding water and power issues.

DALTON H. COLE
COMMISSIONER

Appointed upon the retirement of Lt. Gen. John I. Hudson, USMC (Ret.), to the Commission in January 2014, for a term to expire in 2018. Russ Jones is the Chairman of R.L. Jones Management Group and R.L. Jones Customs Brokers, with offices serving along the U.S./ Mexican Border, established in 1938. Russ served 3 terms in the Arizona House of Representatives, where he was the Chairman of the Agriculture and Water Committee. He holds a National Customs Broker license, is a licensed Surplus Lines Insurance Broker, and sits on the Executive Committee and Boards of several organizations including the Arizona/Mexico Commission, Arizona Community Foundation of Yuma, the U.S./Mexico Border Philanthropy Partnership, is the Chair Elect of the Border Trade Alliance and sits on the Arizona Sonora Desert Museum Board of Directors.



RUSSELL L. JONES
COMMISSIONER



Appointed to the Commission in 1984 and re-appointed through his present term expiring in 2016, Richard Walden is the President and CEO of Farmers Investment Co., a family-owned, pecan growing and processing company headquartered in Sahuarita, Arizona. He is a member of the Board of the International Tree Nut Council and in that capacity serves as the chairman of the Committee for Nutrition Research and Education associated with the Nutrition Research and Education Foundation. He is also a former member of the Advisory Council on Small Business and Agriculture for the Federal Reserve Bank of San Francisco and a past member of the Board of the National Pecan Shellers Association.

RICHARD S. WALDEN
COMMISSIONER



Operations

The severe drought cycle conditions continued in 2014, yielding below-average stream flows in the Colorado River Basin. Due to heavy precipitation in September, the soil moisture helped to increase snowpack in most areas and average temperatures contributed to higher stream flows than those of the previous year. Snowpack conditions for the 2013-2014 winter season were 115% of normal.

Through September 30, 2014, the overall precipitation accumulated was 106% of average based on the 30-year average. These elements combined for Lake Powell to realize approximately 96% of its average inflow for the year. Lake Mead's water level increased 14 feet, as of September 2014, compared to its water level in September 2013.

Responding to lower water levels has been the priority driving ongoing maintenance on the Hoover plant. A1 and A8 wide head range turbines are designed for more stability and higher efficiency while operating at lower lake levels. The A8 is a "half-sized" unit that operates at low loads more efficiently than "full-sized" units, and can now be used for ramping, regulation and reserves, which the unit it replaced could not do.

The new turbines installed in 2014 have generated efficiency improvements, as reported by the Technical Review Committee, of which APA is a member. Further improvements are anticipated through the installation of two more new turbines – N6 in 2015 and N5 in 2016.



Environment

The Arizona Power Authority's participation in the Lower Colorado River Multi Species Conservation Plan (LCR MSCP) continues to yield positive outcomes. This proactive plan for maintaining compliance with federal mandates regarding environmental protection supports the conservation of numerous species along the LCR from Lake Mead to the Southerly International Boundary with Mexico through implementation of a Habitat Conservation Plan (HCP). To date, the LCR MSCP has helped revitalize a range of areas including Hart Mine Marsh, Big Bend Conservation Area, Yuma East Wetlands, Laguna Division Conservation Area and Pretty Water Conservation Area.

The Plan supports the restoration of land along the Colorado River, including reinstalling pre-existing flora that may have been lost due to development. This, in turn, supports the well being of the species native to these environments. From removing invasive plant species to tracking animal reproductive, living and migratory behaviors, the activities enabled by LCR MSCP are generating real results.

At the same time, this long-term program accommodates current water diversions and power production, and optimizes opportunities for future water and power development. Unique in its breadth and impact, the LCR MSCP has proved a successful strategy for pre-empting costly and time consuming litigation, and injecting funds directly into making a real difference in the environment.



MANAGEMENT'S DISCUSSION & ANALYSIS

Introduction

The following is a discussion and analysis of the Arizona Power Authority's ("Authority") financial performance for the operating years ended September 30, 2014 and 2013. This discussion is designed to: (a) assist the reader in focusing on significant financial issues, (b) provide an overview of the Authority's financial activity, and (c) identify changes in the Authority's financial position.

The Management's Discussion and Analysis ("MD&A") focuses on the 2014 and 2013 operating years' activities, resulting changes and known facts, and should be read in conjunction with the Authority's basic financial statements as of and for the years ended September 30, 2014 and 2013.

This MD&A is an introduction to the basic financial statements of the Authority, which are comprised of two components.

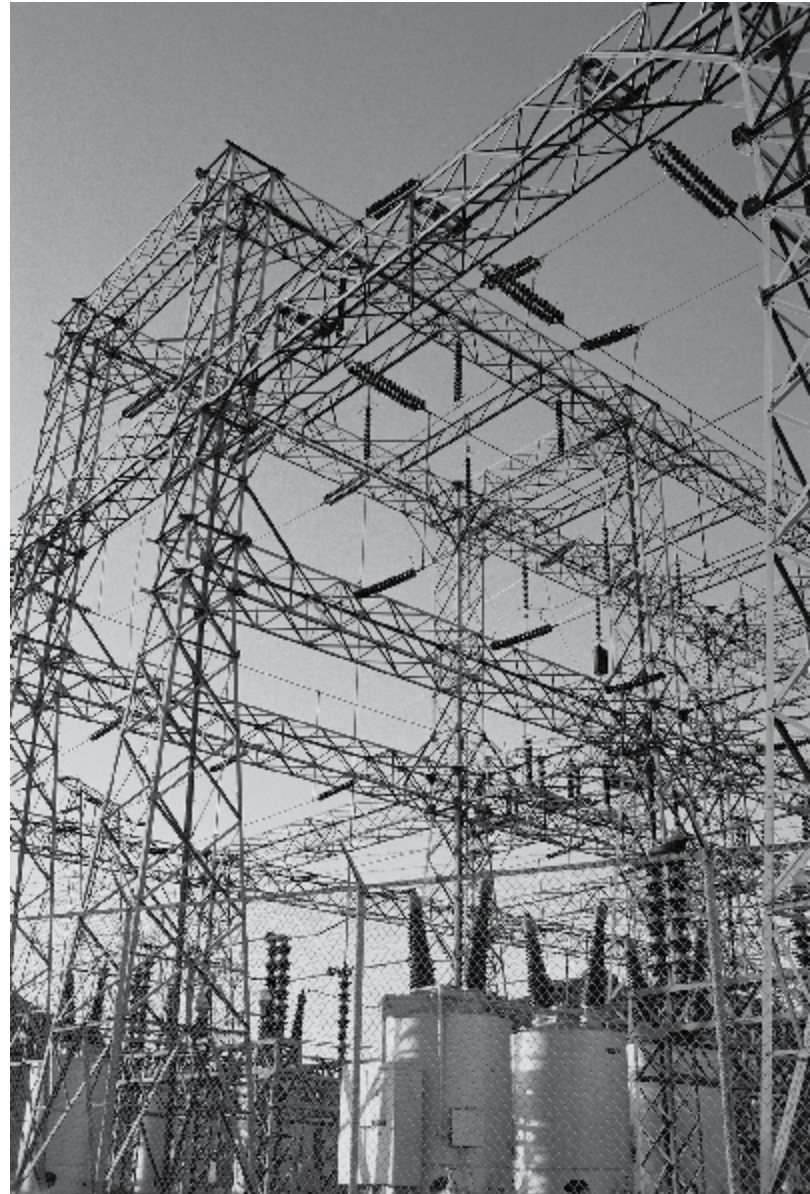
(1) Fund Financial Statements

(2) Notes to the Financial Statements

The Fund Financial Statements begin on page 22 and provide detailed information about the individual funds. A fund is a fiscal and accounting entity with a self-balancing set of accounts that the Authority uses to keep track of specific sources of revenues and disbursements for specific purposes. The Authority's funds are treated as proprietary funds and are independent of each other. See Note 2 for more information on these two separate funds. Most of the Authority's financial dealings are with contracts outside of state government with Federal Government or municipal power entities. The Authority does not act as a fiduciary.

Using This Financial Report

This financial report consists of a series of financial statements. The Statements of Net Position, the Statements of Revenues, Expenses and Changes in Net Position and the Statements of Cash Flows (on pages 22, 23 and 24-25, respectively) provide information about the activities of the Authority as a whole and present a longer-term view of the Authority's finances. The Authority is a body, corporate and politic, of the State of Arizona and is a special-purpose government entity engaged only in business-type activities. Accordingly, the financial statements presented are the required basic financial statements in accordance with the provisions of Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments, as amended*.



**“Change is the law of life,
and those who look only
to the past or present are
certain to miss the future.”
– John F. Kennedy**

Authority Highlights

On March 12, 2014, the Authority and all other contractors for Hoover power completed a program for repayment of high interest rate Federal loans incurred for certain improvements at Hoover Dam ("Prepayment Program"). The Prepayment Program will reduce future expenses at Hoover Dam and provide approximately \$10 million in power cost savings to the Authority. The Authority financed its proportionate share of the costs of the Prepayment Project through the issuance of \$26,565,000 Power Resource Revenue Bonds, 2014 Series (Hoover Prepayment Project) which are payable on a parity with the Authority's outstanding Power Resource Revenue Bonds, 2001 Series.

Effects of Drought on Hoover Energy - The Colorado River Basin has been experiencing severe drought conditions for the past fifteen years. This has resulted in a reduction in Lake Mead's storage and the power production at Hoover Dam. In response to customer requests, the Authority continues to purchase supplemental power to offset the reduced energy production at Hoover. The supplemental power costs are significantly higher than Hoover rates, and are passed directly to the requesting customers. These supplemental revenues and costs are reflected on the Authority's records, resulting in higher revenue and purchased power costs.

Transmission Agreement - On January 24, 2003, the Authority and the Western Area Power Administration ("Western") entered into an agreement for the Advancement of Funds for Transmission Services. The agreement with Western provides for the delivery of power and energy generated at Hoover Dam and received by the Authority for resale to its contracted customers. The Authority advances funds to Western on a monthly basis to fund operations, maintenance and replacement costs associated with Western's transmission services. For the years ended September 30, 2014 and 2013, the Authority advanced a net prepaid deposit of \$599,055 and \$589,507, respectively, which is included in the Statements of Net Position. This contract gives Western greater flexibility and allows them to work more effectively with the Authority and other customers.





Revenues

Increase/Decrease in Commission Approved Power Rates – State statute requires the rates be set at levels to recover the cost of supplying services. In addition, contracts between the Authority and its customers provide specific details regarding rate determination. The Arizona Power Authority Commission is solely responsible for periodically adjusting rates, as appropriate.

Market Impacts on Investment Income – During operating year 2014 market conditions have resulted in historic low investment returns.

Economic Drought Condition – Although the drought condition in the Colorado River Basin continues, increased efficiency improvements at Hoover Dam have helped to offset the decreases in power production resulting from reduced water levels.

Expenses

Introduction of New Programs – There were no changes to existing programs during this operating year; however, individual programs may be added or deleted to meet changing Authority needs.

Increase/Decrease in Authorized Personnel – Changes in the Authority's services may result in increasing/decreasing authorized staffing. Operating year 2014 staffing costs (salary and related benefits) represent 2.81% of the Authority's operating costs. For operating year 2013, staffing costs represent 3.14% of the Authority's operating costs.

Salary Structure – The ability to attract and retain competent personnel requires the Authority to provide a competitive salary structure, which is reviewed annually, and is within State guidelines.



Financial Highlights

- The Authority's 2014 net position decreased by \$1,145,347 due to expensing in the current year costs related to the Power Resource Revenue Bonds, 2014 Series (Hoover Prepayment Project), as required under GASB Statement 65 and the reduction in supplemental power sales, which resulted in a decrease in revenues.
- The Authority's 2013 net position increased by \$253,851 due to a Reduction in operating expenses related to purchased power, and an increase in other income, due to recovered funds from the National Century Financial Enterprises, Inc. (NCFE) prior year write-off.
- The Authority's 2014 operating revenues decreased by \$(1,173,777) due largely to a reduction in supplemental power sales.
- The Authority's 2013 operating revenues decreased by \$(4,130,562) due largely to a reduction in supplemental power sales.

Statements of Net Position

There are three normal transactions that will affect the comparability of the Statements of Net Position summary presentation:

Net Results of Activities – which will impact (increase/decrease) current assets and unrestricted net position.

Principal Payment on Debt – which will reduce current assets and reduce long-term debt, and impact restricted net position.

Reduction of Capital Assets through Depreciation – which will reduce capital assets and investment in capital assets.

“Perseverance is a great
element of success.”
– Henry Wadsworth
Longfellow

MANAGEMENT'S DISCUSSION & ANALYSIS

Condensed Statements of Net Position

Business-type Activities

| | September 30 | | Difference | % |
|---------------------------------------|---------------------|---------------------|-----------------------|---------------|
| | 2014 | 2013 | | |
| CURRENT ASSETS | \$ 15,632,243 | \$ 15,344,856 | \$ 287,387 | 1.9 |
| LONG-TERM ASSETS | 8,357,154 | 7,149,167 | 1,207,987 | 16.9 |
| CAPITAL ASSETS, NET | 88,688 | 103,212 | (14,524) | (14.1) |
| TOTAL ASSETS | 24,078,085 | 22,597,235 | 1,480,850 | 6.6 |
| DEFERRED OUTFLOWS OF RESOURCES | 32,519,629 | 13,841,448 | 18,678,181 | 134.9 |
| CURRENT LIABILITIES | 8,702,458 | 8,582,188 | 120,270 | 1.4 |
| LONG-TERM LIABILITIES | 44,384,567 | 23,200,459 | 21,184,108 | 91.3 |
| TOTAL LIABILITIES | 53,087,025 | 31,782,647 | 21,304,378 | 67.0 |
| NET INVESTMENT IN CAPITAL ASSETS | 88,688 | 103,212 | (14,524) | (14.1) |
| RESTRICTED FOR DEBT SERVICE | 14,740,464 | 12,740,485 | 1,999,979 | 15.7 |
| UNRESTRICTED | (11,318,463) | (8,187,661) | (3,130,802) | 38.2 |
| TOTAL NET POSITION | \$ 3,510,689 | \$ 4,656,036 | \$ (1,145,347) | (24.6) |

Operating Year 2014 Condensed Statement of Net Position Discussion

Current Assets increased slightly due to an increase in short-term investments due to the payment of interest capitalized to October 1, 2014 from the proceeds of the 2014 Series Bonds.

Long-Term Assets increased due to the creation of the Debt Service Reserve Fund for the 2014 Series Bonds.

Capital Assets, Net decreased due to normal depreciation/attrition of capital assets.

Deferred Outflows of Resources increased significantly due to the recognition of the future benefit of reduced power rates resulting from the issuance of the 2014 Series Bonds. This was partially offset by the amortization of the advances for the Hoover Upgrading Program.

Current Liabilities increased slightly. See further explanation on pages 11 and 13.

Long-Term Liabilities increased due to the long-term bonds payable amount of the 2014 Series Bonds. See further explanation on page 13.

Net Position decreased primarily due to the recognition of bond issuance costs associated with the increase in long-term bonds payable, as a result of issuing the 2014 Series Bonds. See further explanation on page 15.

Condensed Statements of Net Position

Business-type Activities

| | September 30 | | Difference | % |
|---------------------------------------|---------------------|---------------------|--------------------|---------------|
| | 2013 | 2012 | | |
| CURRENT ASSETS | \$ 15,344,856 | \$ 14,940,065 | \$ 404,791 | 2.7 |
| LONG-TERM ASSETS | 7,149,167 | 7,081,456 | 67,711 | 1.0 |
| CAPITAL ASSETS, NET | 103,212 | 115,725 | (12,513) | (10.8) |
| TOTAL ASSETS | 22,597,235 | 22,137,246 | 459,989 | 2.1 |
| DEFERRED OUTFLOWS OF RESOURCES | 13,841,448 | 18,742,075 | (4,900,627) | (26.1) |
| CURRENT LIABILITIES | 8,582,188 | 8,149,625 | 432,563 | 5.3 |
| LONG-TERM LIABILITIES | 23,200,459 | 28,327,511 | (5,127,052) | (18.1) |
| TOTAL LIABILITIES | 31,782,647 | 36,477,136 | (4,694,489) | (12.9) |
| NET INVESTMENT IN CAPITAL ASSETS | 103,212 | 115,725 | (12,513) | (10.8) |
| RESTRICTED FOR DEBT SERVICE | 12,740,485 | 12,568,935 | 171,550 | 1.4 |
| UNRESTRICTED | (8,187,661) | (8,282,475) | 94,814 | (1.1) |
| TOTAL NET POSITION | \$ 4,656,036 | \$ 4,402,185 | \$ 253,851 | 5.8 |

Operating Year 2013 Condensed Statement of Net Position Discussion

Current Assets increased due to an expense normally paid within the operating year, which was not paid during Operating Year 2013, due to a delay in receipt of the invoice. The expense was accrued in the Operating Year 2013.

Long-Term Assets changed because of the application of credits for the payment of principal for the current year debt service for the Upgrading Program (a reclassification of long-term debt to current debt).

Capital Assets, Net decreased because of normal depreciation/attrition of capital assets.

Deferred Outflows of Resources decreased due to amortization of advances for the Hoover Upgrading Program.

Current Liabilities increased due to an expense normally paid within the operating year, which was not paid during Operating Year 2013, due to a delay in receipt of the invoice. The expense was accrued as a liability in the Operating Year 2013.

Long-Term Liabilities decreased due to a pay down of the bond principal. See further explanation on page 13.

Net Position is explained on page 18.

MANAGEMENT'S DISCUSSION & ANALYSIS

Capital Assets

As of September 30, 2014, the Authority had \$88,688 invested in a variety of capital assets, as reflected in the following schedule, which represents a net decrease (additions less retirements and depreciation) of \$14,524 during operating year 2014, and a net decrease of \$9,132 during operating year 2013.

| | September 30 | |
|--|------------------|-------------------|
| | 2014 | 2013 |
| TRANSMISSION PLANT | \$ 2,289 | \$ 5,340 |
| DISTRIBUTION PLANT | 6,334 | 8,637 |
| GENERAL PLANT - OFFICE | 80,065 | 89,235 |
| NET INVESTMENT IN CAPITAL ASSETS, END OF YEAR | \$ 88,688 | \$ 103,212 |

The following reconciliation summarizes the change in Capital Assets for the years ended September 30, 2014 and 2013, which is presented in detail in Note 4:

| | September 30 | |
|-----------------------|------------------|-------------------|
| | 2014 | 2013 |
| BEGINNING BALANCE | \$ 103,212 | \$ 115,725 |
| ADDITIONS | 5,141 | 7,758 |
| DEPRECIATION | (19,665) | (20,271) |
| ENDING BALANCE | \$ 88,688 | \$ 103,212 |



Debt Outstanding

As of September 30, 2014, the Authority had \$23,070,000 in debt outstanding for the 2001 Series Bonds, compared to \$28,135,000 in the prior year, as a result of the scheduled principal payment of \$5,065,000, which was paid on October 1, 2013. In addition, the Authority had \$26,565,000 in debt outstanding for the 2014 Series Bonds, which were issued on March 27, 2014. The 2014 Series Bonds are payable on a parity with the 2001 Series Bonds.

As of September 30, 2013, the Authority had \$28,135,000 in debt outstanding, compared to \$32,945,000 in the prior year, as a result of a principal payment of \$4,810,000, which was paid on October 1, 2012. These payments were scheduled principal payments during the year. Also see Note 6 to the Financial Statements for a detailed summary of debt activity during the year.

Liquidity

Pursuant to Arizona Revised Statutes (A.R.S.) Section 30-124, the Commission of the Authority shall establish electric rates to include such price components as are necessary to maintain the Authority, to provide and maintain reasonable working capital and depreciation and other necessary and proper reserves. Components that are necessary to maintain the Authority include employee payroll, occupancy costs, cost of purchases or construction of generation and transmission services, and any cost factors chargeable to the cost of providing service as the Commission deems necessary or advisable to establish and maintain the financial integrity of the Authority.

Contracts for sale of electric power to the Authority's customers include rates which may be modified upon 24-hour notice when such action is necessary in the sole judgment of the Commission in order to achieve the purposes of A.R.S. Section 30-124. The Commission, on a monthly basis, reviews the financial status of the Authority, including expenses and revenues and the adequacy of the rates to maintain the Authority's financial integrity. During operating year 2014, the Commission did not change rates. During operating year 2013, the Commission lowered rates by 2.33% in October 2012, and increased rates in July 2013 by 1.37%.



“The object of all work is production or accomplishment and to either of these ends there must be forethought, system, planning, intelligence, and honest purpose, as well as perspiration.”

– Thomas Edison

MANAGEMENT'S DISCUSSION & ANALYSIS

Statements of Revenue, Expenses, and Changes in Net Position

There are normal transactions that will affect the comparability of the Statements of Revenues, Expenses and Changes in Net Position summary presentation:

Operating Revenues – which increase/decrease as a result of economic conditions and power usage.

Operating Expenses – which increase/decrease as a result of purchased power costs, transmission costs, and operating costs.

Other Income (Expenses) – which increase/decrease primarily as a result of investment market conditions.



| | September 30 | | Difference | % |
|--|---------------------|---------------------|-----------------------|------------------|
| | 2014 | 2013 | | |
| OPERATING REVENUES | \$ 27,589,456 | \$ 28,763,233 | \$ (1,173,777) | (4.1) |
| OPERATING EXPENSES | | | | |
| Purchased power | 17,878,282 | 19,989,421 | (2,111,139) | (10.6) |
| Western credits | (6,600,115) | (6,579,145) | (20,970) | 0.3 |
| Amortization of Hoover Upgrading Program costs | 6,600,115 | 6,579,145 | 20,970 | 0.3 |
| Transmission and distribution | 7,345,228 | 6,871,637 | 473,591 | 6.9 |
| Administrative and general | 1,972,252 | 1,658,010 | 314,242 | 19.0 |
| Depreciation | 19,665 | 20,271 | (606) | (3.0) |
| Other | 14,310 | 34,992 | (20,682) | (59.1) |
| TOTAL OPERATING EXPENSES | 27,229,737 | 28,574,331 | (1,344,594) | (4.7) |
| OPERATING INCOME | 359,719 | 188,902 | 170,817 | 90.4 |
| OTHER INCOME (EXPENSES) | | | | |
| Interest expense | (1,822,522) | (1,477,088) | (345,434) | 23.4 |
| Deferred interest expense | 1,163,108 | 1,415,723 | (252,615) | (17.8) |
| Amortization | 50,892 | 62,052 | (11,160) | (18.0) |
| Interest income | 6,029 | 12,521 | (6,492) | (51.8) |
| Bond issuance costs | (918,340) | – | (918,340) | (100.0) |
| Other, net | 15,767 | 51,741 | (35,974) | (69.5) |
| TOTAL OTHER INCOME | (1,505,066) | 64,949 | (1,570,015) | (2,417.3) |
| CHANGE IN NET POSITION | (1,145,347) | 253,851 | (1,399,198) | (551.2) |
| NET POSITION, BEGINNING OF YEAR | 4,656,036 | 4,402,185 | 253,851 | 5.8 |
| NET POSITION, END OF YEAR | \$ 3,510,689 | \$ 4,656,036 | \$ (1,145,347) | (24.6) |



Operating Year 2014 Changes in Net Position Discussion

Net Position decreased overall because of the following:

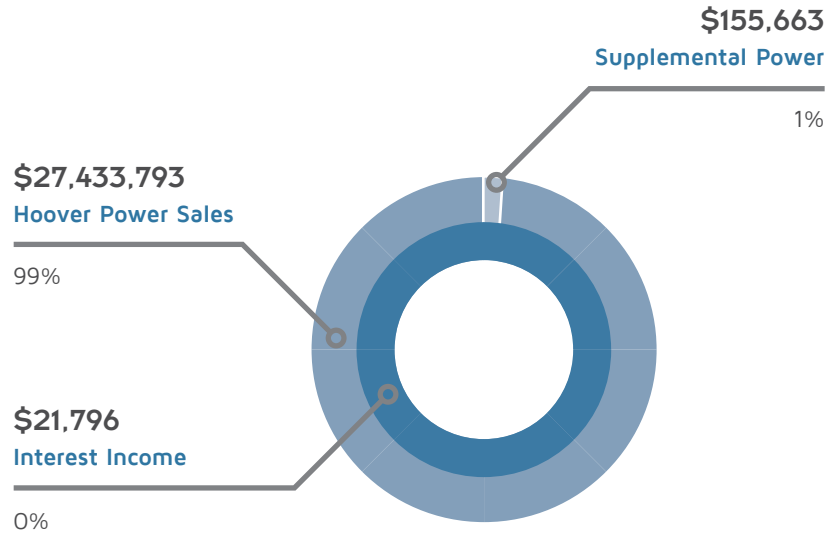
- Operating Revenues decreased due to reduction in supplemental power sales.
- Total Operating Expenses decreased due to a reduction in supplemental power purchases.
- Western Credits changed because of scheduled debt payments and associated costs related to the Uprating Program.
- Amortization of the Hoover Uprating Program costs changed because of the debt payments and associated costs related to the Uprating Program.
- Administrative and General Expenses increased due to an increase in miscellaneous outside professional services.
- Depreciation decreased due to the full amortization of capital assets.
- Bond Issuance Costs were included in the 2014 financial statements in accordance with GASB Statement No. 65.
- Net other income decreased during Operating Year 2014.



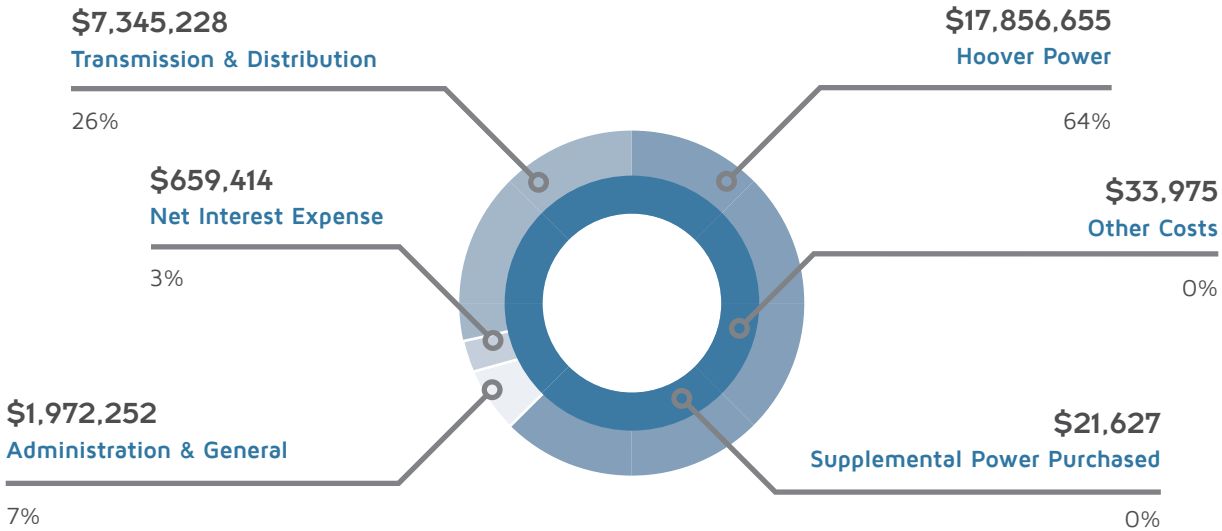
MANAGEMENT'S DISCUSSION & ANALYSIS

Business-type Activities

The following charts depict the sources of revenues & expenses for the operating year 2014:



REVENUES 2014



EXPENSES 2014

Statements of Revenues, Expenses, and Changes in Net Position

There are normal transactions that will affect the comparability of the Statements of Revenues, Expenses and Changes in Net Position summary presentation:

Operating Revenues – which increase/decrease as a result of economic conditions and power usage.

Operating Expenses – which increase/decrease as a result of purchased power costs, transmission costs, and operating costs.

Other Income (Expenses) – which increase/decrease primarily as a result of investment market conditions.

| | September 30 | | Difference | % |
|--|---------------------|---------------------|--------------------|---------------|
| | 2013 | 2012 | | |
| OPERATING REVENUES | \$ 28,763,233 | \$ 32,893,795 | \$ (4,130,562) | (12.6) |
| OPERATING EXPENSES | | | | |
| Purchased power | 19,989,421 | 24,861,520 | (4,872,099) | (19.6) |
| Western credits | (6,579,145) | (6,559,715) | (19,430) | 0.3 |
| Amortization of Hoover Upgrading Program costs | 6,579,145 | 6,559,715 | 19,430 | 0.3 |
| Transmission and distribution | 6,871,637 | 6,299,538 | 572,099 | 9.1 |
| Administrative and general | 1,658,010 | 1,632,612 | 25,398 | 1.6 |
| Depreciation | 20,271 | 18,121 | 2,150 | 11.9 |
| Other | 34,992 | 60,002 | (25,010) | (41.7) |
| TOTAL OPERATING EXPENSES | 28,574,331 | 32,871,793 | (4,297,462) | (13.1) |
| OPERATING INCOME | 188,902 | 22,002 | 166,900 | 758.6 |
| OTHER INCOME (EXPENSES) | | | | |
| Interest expense | (1,477,088) | (1,729,613) | 252,525 | (14.6) |
| Deferred interest expense | 1,415,723 | 1,657,185 | (241,462) | (14.6) |
| Amortization | 62,052 | 72,660 | (10,608) | (14.6) |
| Interest income | 12,521 | 14,756 | (2,235) | (15.1) |
| Other, net | 51,741 | 653 | 51,088 | 7,823.6 |
| TOTAL OTHER INCOME | 64,949 | 15,641 | 49,308 | 315.2 |
| CHANGE IN NET POSITION | 253,851 | 37,643 | 216,208 | 574.4 |
| NET POSITION, BEGINNING OF YEAR | 4,402,185 | 4,364,542 | 37,643 | 0.9 |
| NET POSITION, END OF YEAR | \$ 4,656,036 | \$ 4,402,185 | \$ 253,851 | 5.8 |

MANAGEMENT'S DISCUSSION & ANALYSIS

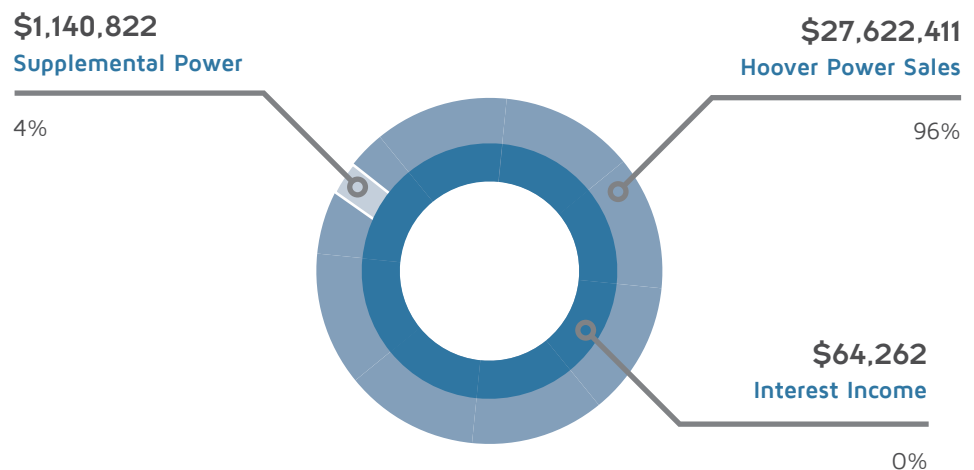
Operating Year 2013 Changes in Net Position Discussion Net Position increased overall because of the following:

- Operating Revenues decreased due to a reduction in supplemental power purchases.
- Total Operating Expenses decreased due to a reduction in purchased power expenses.
- Western Credits changed because of scheduled debt payments and associated costs related to the Uprating Program.
- Amortization of the Uprating Program changed because of the debt payments and associated costs related to the Uprating Program.
- Administrative and General Expenses increased. Although staff expenses decreased due to reduced number of employees, legal and outside services expenses increased.
- Depreciation increased due to acquisition of capital assets.
- Other Expenses decreased during Operating Year 2013 due largely to the elimination of the annual Scholarship Fund contribution.

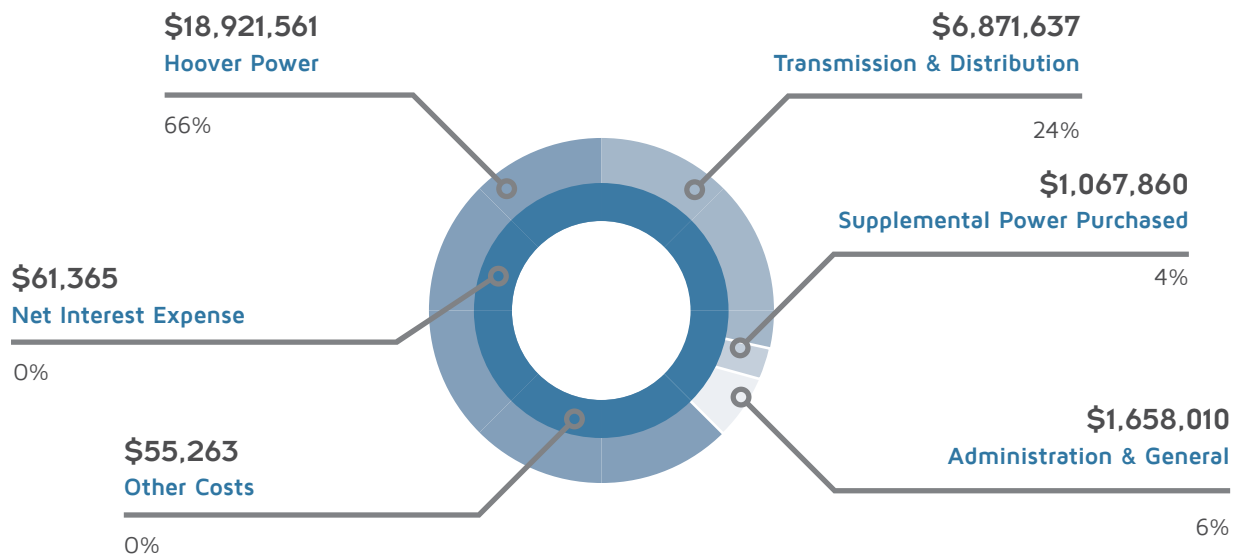


Business-type Activities

The following charts depict the sources of revenues & expenses for the operating year 2013:



REVENUES 2013



EXPENSES 2013

MANAGEMENT'S DISCUSSION & ANALYSIS



Request for Financial Information

The information contained in the Management's Discussion and Analysis is intended to provide a general overview of the Authority's finances. Questions concerning any of the information provided in this report, or requests for additional financial information should be addressed to the Accounting Department.

Arizona Power Authority

1810 W. Adams St.
Phoenix, Arizona 85007
p: (602) 368 – 4265

REPORT OF INDEPENDENT AUDITORS



CliftonLarsonAllen

Board of Directors
Arizona Power Authority
Phoenix, Arizona

Report on the Financial Statements

We have audited the accompanying financial statements of the Arizona Power Authority (A Body, Corporate and Politic, of the State of Arizona) (the Authority), which comprise the statements of net position as of September 30, 2014 and 2013, and the related statements of revenues, expenses and changes in net position, and cash flows for the years then ended, and the related notes to the financial statements, which collectively comprise the Authority's basic financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion.

An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Arizona Power Authority as of September 30, 2014 and 2013, and the changes in its financial position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of a Matter

Change in Accounting Principle

As discussed in Note 1 to the basic financial statements, in 2014 the Authority adopted GASB Statement No. 65, Items Previously Reported as Assets and Liabilities. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management discussion and analysis on pages 3 through 16 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

A handwritten signature in cursive script that reads "CliftonLarsonAllen LLP".

February 9, 2015

FINANCIAL HIGHLIGHTS

Statements of Net Position September 30, 2014 and 2013

| | APA General Fund | | Hoover Upgrading Fund | | TOTAL | |
|---|---------------------|---------------------|-----------------------|-------------------|---------------------|---------------------|
| | 2014 | 2013 | 2014 | 2013 | 2014 | 2013 |
| ASSETS | | | | | | |
| CURRENT ASSETS | | | | | | |
| Cash and cash equivalents | \$ 3,215,919 | \$ 3,066,074 | \$ 3,005,350 | \$ 3,705,351 | \$ 6,221,269 | \$ 6,771,425 |
| Investments – short-term | - | - | 6,982,365 | 6,180,827 | 6,982,365 | 6,180,827 |
| Accounts receivable customer power purchases | 5,217 | 175,303 | 2,423,392 | 2,217,301 | 2,428,609 | 2,392,604 |
| Total current assets | 3,221,136 | 3,241,377 | 12,411,107 | 12,103,479 | 15,632,243 | 15,344,856 |
| NON-CURRENT ASSETS | | | | | | |
| Capital assets, net | 88,688 | 103,212 | - | - | 88,688 | 103,212 |
| Investments – long-term | - | - | 7,758,099 | 6,559,658 | 7,758,099 | 6,559,658 |
| Prepaid transmission | 527,507 | 527,507 | 71,548 | 62,002 | 599,055 | 589,509 |
| Total non-current assets | 616,195 | 630,719 | 7,829,647 | 6,621,660 | 8,445,842 | 7,252,379 |
| TOTAL ASSETS | 3,837,331 | 3,872,096 | 20,240,754 | 18,725,139 | 24,078,085 | 22,597,235 |
| DEFERRED OUTFLOWS OF RESOURCES | | | | | | |
| Advances for Hoover Upgrading Program, net | - | - | 8,676,460 | 13,841,448 | 8,676,460 | 13,841,448 |
| Future benefit of reduced power rates | - | - | 23,843,169 | - | 23,843,169 | - |
| Total deferred outflows of resources | - | - | 32,519,629 | 13,841,448 | 32,519,629 | 13,841,448 |
| LIABILITIES | | | | | | |
| CURRENT LIABILITIES | | | | | | |
| Accounts payable and other | - | 162,149 | 194,972 | 103,236 | 194,972 | 265,385 |
| Customer refunds | - | - | 603,956 | 738,477 | 603,956 | 738,477 |
| Power contracts payable | - | - | 1,356,595 | 1,774,781 | 1,356,595 | 1,774,781 |
| Accrued interest payable | - | - | 1,216,935 | 738,545 | 1,216,935 | 738,545 |
| Bonds payable – short-term | - | - | 5,330,000 | 5,065,000 | 5,330,000 | 5,065,000 |
| Total current liabilities | - | 162,149 | 8,702,458 | 8,420,039 | 8,702,458 | 8,582,188 |
| LONG-TERM LIABILITIES | | | | | | |
| Bonds payable – long-term | - | - | 44,305,000 | 23,070,000 | 44,305,000 | 23,070,000 |
| Premium on bonds payable, net of discounts | - | - | 79,567 | 130,459 | 79,567 | 130,459 |
| Total long-term liabilities | - | - | 44,384,567 | 23,200,459 | 44,384,567 | 23,200,459 |
| TOTAL LIABILITIES | - | 162,149 | 53,087,025 | 31,620,498 | 53,087,025 | 31,782,647 |
| NET POSITION | | | | | | |
| Net investment in capital assets | 88,688 | 103,212 | - | - | 88,688 | 103,212 |
| Restricted for debt service | - | - | 14,740,464 | 12,740,485 | 14,740,464 | 12,740,485 |
| Unrestricted | 3,748,643 | 3,606,735 | (15,067,106) | (11,794,396) | (11,318,463) | (8,187,661) |
| TOTAL NET POSITION | \$ 3,837,331 | \$ 3,709,947 | \$ (326,642) | \$ 946,089 | \$ 3,510,689 | \$ 4,656,036 |

See Accompanying Notes to Financial Statements.

Statements of Revenues, Expenses and Changes in Net Position
 Years ended September 30, 2014 and 2013

| | APA General Fund | | Hoover Upgrading Fund | | TOTAL | |
|--|---------------------|---------------------|-----------------------|-------------------|---------------------|---------------------|
| | 2014 | 2013 | 2014 | 2013 | 2014 | 2013 |
| OPERATING REVENUES | \$ 155,663 | \$ 1,140,822 | \$ 27,433,793 | \$ 27,622,411 | \$ 27,589,456 | \$ 28,763,233 |
| OPERATING EXPENSES | | | | | | |
| Purchased power | 21,627 | 1,067,860 | 17,856,655 | 18,921,561 | 17,878,282 | 19,989,421 |
| Western credits | - | - | (6,600,115) | (6,579,145) | (6,600,115) | (6,579,145) |
| Amortization of Hoover Upgrading Program costs | - | - | 6,600,115 | 6,579,145 | 6,600,115 | 6,579,145 |
| Transmission and distribution | 3,941 | 83,821 | 7,341,287 | 6,787,816 | 7,345,228 | 6,871,637 |
| Administrative and general | - | - | 1,972,252 | 1,658,010 | 1,972,252 | 1,658,010 |
| Depreciation | 19,665 | 20,271 | - | - | 19,665 | 20,271 |
| Other | - | 20,076 | 14,310 | 14,916 | 14,310 | 34,992 |
| Total operating expenses | 45,233 | 1,192,028 | 27,184,504 | 27,382,303 | 27,229,737 | 28,574,331 |
| OPERATING INCOME (LOSS) | 110,430 | (51,206) | 249,289 | 240,108 | 359,719 | 188,902 |
| OTHER INCOME (EXPENSES) | | | | | | |
| Interest expense | - | - | (1,822,522) | (1,477,088) | (1,822,522) | (1,477,088) |
| Deferred interest expense | - | - | 1,163,108 | 1,415,723 | 1,163,108 | 1,415,723 |
| Amortization | - | - | 50,892 | 62,052 | 50,892 | 62,052 |
| Interest income | 1,762 | 2,553 | 4,267 | 9,968 | 6,029 | 12,521 |
| Bond issuance costs | - | - | (918,340) | - | (918,340) | - |
| Other, net | 15,192 | 31,297 | 575 | 20,444 | 15,767 | 51,741 |
| TOTAL OTHER INCOME | 16,954 | 33,850 | (1,522,020) | 31,099 | (1,505,066) | 64,949 |
| CHANGES IN NET POSITION | 127,384 | (17,356) | (1,272,731) | 271,207 | (1,145,347) | 253,851 |
| NET POSITION, BEGINNING OF YEAR | 3,709,947 | 3,727,303 | 946,089 | 674,882 | 4,656,036 | 4,402,185 |
| NET POSITION, END OF YEAR | \$ 3,837,331 | \$ 3,709,947 | \$ (326,642) | \$ 946,089 | \$ 3,510,689 | \$ 4,656,036 |

See Accompanying Notes to Financial Statements.

FINANCIAL HIGHLIGHTS

Statements of Cash Flow Years ended September 30, 2014 and 2013

| | APA General Fund | | Hoover Uprating Fund | | TOTAL | |
|--|---------------------|---------------------|----------------------|---------------------|---------------------|---------------------|
| | 2014 | 2013 | 2014 | 2013 | 2014 | 2013 |
| CASH FLOWS FROM OPERATING ACTIVITIES | | | | | | |
| Cash received from customers | \$ 325,749 | \$ 969,241 | \$ 27,227,702 | \$ 27,870,727 | \$ 27,553,451 | \$ 28,839,968 |
| Cash payments to suppliers for goods or services | (187,717) | (1,031,290) | (27,073,802) | (26,630,562) | (27,261,519) | (27,661,852) |
| Cash payments to employees for services | - | - | (581,219) | (650,385) | (581,219) | (650,385) |
| NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES | 138,032 | (62,049) | (427,319) | 589,780 | (289,287) | 527,731 |
| CASH FLOWS FROM INVESTING ACTIVITIES | | | | | | |
| Purchase of future benefit of reduced power rates | - | - | (23,843,169) | - | (23,843,169) | - |
| Interest on investments | 1,762 | 2,553 | 4,267 | 9,968 | 6,029 | 12,521 |
| Loss on investments recovered | 15,192 | 31,297 | 575 | 20,444 | 15,767 | 51,741 |
| Purchase of investments, net | - | - | (34,123,905) | (171,551) | (34,123,905) | (171,551) |
| Proceeds from sale and maturities of investments | - | - | 32,123,926 | - | 32,123,926 | - |
| NET CASH PROVIDED BY (USED IN) INVESTING ACTIVITIES | 16,954 | 33,850 | (25,838,306) | (141,139) | (25,821,352) | (107,289) |
| CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES | | | | | | |
| Payments for bond issuance costs | - | - | (918,340) | - | (918,340) | - |
| Proceeds from bond issuance | - | - | 26,565,000 | - | 26,565,000 | - |
| Interest payments on bonds payable | - | - | (1,344,132) | (1,603,350) | (1,344,132) | (1,603,350) |
| Payments on bonds payable | - | - | (5,065,000) | (4,810,000) | (5,065,000) | (4,810,000) |
| Acquisition of capital assets | (5,141) | (7,758) | - | - | (5,141) | (7,758) |
| Other costs relating to Hoover Uprating Program | - | - | (272,019) | (262,794) | (272,019) | (262,794) |
| Reduction in advances for Hoover Uprating Program | - | - | 6,600,115 | 6,579,145 | 6,600,115 | 6,579,145 |
| NET CASH PROVIDED BY (USED IN) CAPITAL & RELATED FINANCING ACTIVITIES | (5,141) | (7,758) | 25,565,624 | (96,999) | 25,560,483 | (104,757) |
| NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS | 149,845 | (35,957) | (700,001) | 351,642 | (550,156) | 315,685 |
| CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR | 3,066,074 | 3,102,031 | 3,705,351 | 3,353,709 | 6,771,425 | 6,455,740 |
| CASH AND CASH EQUIVALENTS, END OF YEAR | \$ 3,215,919 | \$ 3,066,074 | \$ 3,005,350 | \$ 3,705,351 | \$ 6,221,269 | \$ 6,771,425 |

Statements of Cash Flow (continued)
 Years ended September 30, 2014 and 2013

| | APA General Fund | | Hoover Uprating Fund | | TOTAL | |
|--|-------------------|--------------------|----------------------|-------------------|---------------------|-------------------|
| | 2014 | 2013 | 2014 | 2013 | 2014 | 2013 |
| RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES | | | | | | |
| Operating Income (loss) | \$ 110,430 | \$ (51,206) | \$ 249,289 | \$ 240,108 | \$ 359,719 | \$ 188,902 |
| ADJUSTMENTS TO RECONCILE OPERATING INCOME (LOSS) TO NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES: | | | | | | |
| Depreciation | 19,665 | 20,271 | - | - | 19,665 | 20,271 |
| INCREASE (DECREASE) IN CASH RESULTING FROM CHANGES IN: | | | | | | |
| Accounts receivable | 170,086 | (171,581) | (206,091) | 248,316 | (36,005) | 76,735 |
| Prepaid purchased power | - | - | - | - | - | - |
| Prepaid transmission | - | - | (9,546) | (62,002) | (9,546) | (62,002) |
| Accounts payable and other | (162,149) | 140,467 | 91,736 | (68,766) | (70,413) | 71,701 |
| Customer refunds | - | - | (134,521) | 58,363 | (134,521) | 58,363 |
| Power contracts payable | - | - | (418,186) | 173,761 | (418,186) | 173,761 |
| Total adjustments | 27,602 | (10,843) | (676,608) | 349,672 | (649,006) | 338,829 |
| Net cash provided by (used in) operating activities | \$ 138,032 | \$ (62,049) | \$ (427,319) | \$ 589,780 | \$ (289,287) | \$ 527,731 |
| SUPPLEMENTAL SCHEDULE OF NON-CASH CAPITAL AND RELATING FINANCING ACTIVITIES | | | | | | |
| Deferred Interest Expense | \$ - | \$ - | \$ 1,163,108 | \$ 1,415,723 | \$ 1,163,108 | \$ 1,415,723 |

See Accompanying Notes to Financial Statements.

NOTES TO FINANCIAL STATEMENTS

Note 1 - Summary of Significant Accounting Policies

Description of Business

The Arizona Power Authority (the "Authority") is a body, corporate and politic, without taxing power, established by the Arizona Legislature on May 27, 1944 by the Power Authority Act. Under the Power Authority Act, the Authority is directed to obtain electric power developed from the mainstream of the Colorado River and sell such power to certain qualified purchasers. The Power Authority Act provides that the Authority must be a self-supporting agency and prohibits the Authority from incurring any obligation, which would be binding upon the State of Arizona.

The Authority supplies capacity and energy on a wholesale basis to certain power purchasers in the State of Arizona. The Authority's primary source of power and energy is the Hoover Power Plant at Hoover Dam, located approximately 25 miles from Las Vegas, Nevada. Hoover power is produced by the Boulder Canyon Project hydro-power plant owned by the Bureau of Reclamation. Hoover Dam is the highest and third largest concrete dam in the United States of America. Hoover Dam was dedicated in 1935 and the first generator of the Hoover Power Plant was in full operation in October 1936. The Hoover Power Plant has been in continuous operation since that time. Power and energy from the Hoover Power Plant is transmitted to load centers in Arizona, California and Nevada. The Authority first contracted for Arizona's share of Hoover power in 1952 and has continuously provided power and energy to its customers since that time.

The Authority is governed by a commission of five members appointed by the Governor and approved by the State Senate (the "Commission"). The term of office for each member is six years and the members select a chairman and vice-chairman from among its membership for two-year terms.

Pursuant to Arizona law, the Commission serves as the Authority's regulatory body with the exclusive authority to establish electric prices. The Authority is required to follow certain procedures, pertaining to public notice requirements and public meetings, before implementing changes in electric price schedules.

Measurement Focus

The Authority's funds are accounted for on a flow of economic resources measurement focus. All assets and liabilities, deferred outflows and inflows, (whether current or non-current) associated with their activity are included in the Statements of Net Position. The Statements of Revenues, Expenses and Changes in Net Position present increases (revenues) and decreases (expenses) in total net position. The Authority's reported total net position is segregated into net investment in capital assets, restricted and unrestricted components.

Basis of Accounting

The accompanying financial statements are presented in conformity with accounting principles generally accepted in the United States of America ("GAAP") applicable to a governmental entity.

Basis of accounting refers to the time at which revenues and expenses are recognized in the accounts and reported in the financial statements, regardless of the measurement focus applied. The accrual basis of accounting is used by the Authority whereby revenues are recognized in the accounting period in which they are earned and become measurable, and expenses are recognized when incurred.

Accounting Standards

As a governmental entity, the Authority is required to present its financial statements in accordance with principles promulgated by the Governmental Accounting Standards Board ("GASB"). During 2014 the Authority adopted GASB Statement No. 65, Items Previously Reported as Assets and Liabilities ("GASB Statement No. 65"), which reclassified the presentation of certain Authority financial information. In particular, GASB Statement No. 65 mandates governmental entities to charge against income all expenses associated with the issuance of debt obligations in the year incurred. During 2014 the Authority issued its 2014 Series Bonds which funded the repayment of high interest rates loans included in the cost of power purchased by the Authority from the Hoover Dam power plant and significantly reduced future Hoover power costs. This issuance expense amount, totaling \$918,340, was paid from the proceeds of the 2014 Series Bonds and not from revenue generated by the Authority through the sale of power to its customers. This payment classification is reflected on the Statements of Revenues, Expenses and Changes in Net Position as a deduction from Other Income contributing to the stated loss of \$1,145,347.

Under GASB accounting procedures in effect prior to the adoption of GASB Statement No. 65, issuance expenses were amortized over the life of the associated debt issue and would have resulted in a stated deduction of \$918,340 from Other Income in the Statements of Revenues, Expenses and Changes in Net Position. Income generated from Authority operations during 2014 increased to \$359,719 from \$188,902 in 2013.

Note 1 – Summary of Significant Accounting Policies (continued)

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make a number of estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Revenue Recognition

The Authority recognizes revenue when power is delivered to the customers.

Cash and Cash Equivalents

The Authority treats short-term temporary cash investments with original maturities, when purchased, of three months or less as cash equivalents.

Investments

The Authority's investments are U.S. Treasury obligations which are used to fund its debt service obligation. All such investments are stated at fair value based on quoted market prices.

Capital Assets and Depreciation

Capital assets are initially stated at original cost less accumulated depreciation. Depreciation is provided on the straight-line method based on the estimated useful lives of the property items, which range from 3 to 20 years. The costs of additions and replacements are capitalized. Repairs and maintenance are charged to expense as incurred. Retirements, sales and disposals are recorded by removing the cost and accumulated depreciation from the asset and accumulated depreciation accounts with any resulting gain or loss reflected in other income or expense within the Statements of Revenues, Expenses and Changes in Net Position. Assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. If the fair value is less than the carrying amount of the asset, a loss is recognized for the difference.

Presentation of Deferred Outflows of Resources

Deferred outflows of resources are reported in the basic statements of net position in a separate section following assets. The Authority elected the optional statement of net position presentation. The future benefit of reduced power rates will be amortized through 2045 corresponding with the amortization of expected reduction in Western rates.

Advances for Hoover Upgrading Program

Proceeds from bonds payable were advanced by the Authority to Western for upgrading the Hoover Power Plant and are recorded as advances. Such advances, including debt issue costs, plus net interest expense incurred by the Authority are reimbursed in the form of credits on the monthly power bills rendered by the Western Area Power Administration of the Department of Energy ("Western"). These credits will be issued over the 30-year life of the bonds. Substantially all advances, net interest expense and other related costs on the bonds are charged to the Upgrading Program as amounts to be recovered from future credits. These amounts are included in the Amortization of Hoover Upgrading Program Costs in the Statements of Revenues, Expenses and Changes in Net Position.

Operating Revenues

Operating revenues are derived from the sale of power to customers or from other contractual agreements. Operating revenues include funds received as a result of an agreement between the Authority and the Salt River Project. These revenues amounted to \$5,452,000 during the year ended September 30, 2014, and \$5,452,000 during the year ended September 30, 2013. These scheduling entity revenues reduce the overall revenue requirements to be paid by the Authority's customers through power rates. The current Scheduling Entity Agreement was approved and implemented as of October 1, 2013, and that Agreement will expire on September 30, 2017.

Application of Net Position to Expenses Incurred

The Authority's restricted resources are funds held by the trustee in the debt service and debt service reserve accounts. The Authority uses restricted resources solely for debt service associated with its outstanding bonds. The Authority would apply unrestricted, undesignated net position to expenses incurred which are not restricted. To the extent undesignated net position is unavailable, unrestricted, designated net position will be applied to expenses incurred.

NOTES TO FINANCIAL STATEMENTS

Note 1 – Summary of Significant Accounting Policies (continued)

Customer Credits

The Authority operates on a non-profit basis and reduces charges to its customers through credits on power bills or checks to customers, for any revenues in excess of expenses after the close of the operating year. Likewise, the Authority bills its customers for any deficit in revenues versus expenses incurred during the operating year.

Refunds of \$738,477 and \$680,114 were paid to the customers during the years ended September 30, 2014 and 2013, respectively.

Income Taxes

The Authority is exempt from federal and Arizona state corporate income taxes. Accordingly, no provision for income taxes has been recorded in the accompanying financial statements.

Geographic and Product Concentration

The Authority's revenues are derived from the sale of electrical power and services to water districts, electrical and irrigation districts, and cities, which represent contracted customers in the state of Arizona. The Hoover Upgrading Fund is used to purchase electric power solely from Western. The Authority's APA General Fund is used to purchase electric power from various providers.

Reclassifications

Certain amounts in the 2013 financial statements have been reclassified to conform to the 2014 basic financial statement presentation with no effect on previously reported 2013 net position or changes in net position.

Note 2 – Fund Accounting

Hoover Upgrading Fund

The Hoover Power Plant Act of 1984 ("Hoover Act") authorized the U.S. government to increase the capacity of existing generating equipment at the Hoover Dam Power Plant ("Upgrading Program"). Instead of appropriating further federal funds for the Upgrading Program, Congress implemented an advancement of funds procedure whereby prospective non-federal purchasers of the upgraded Hoover capacity and associated energy contribute to the financing of the Upgrading Program. The Upgrading Program was determined to be complete in September 1995. The Authority financed a portion of the total Upgrading Program by issuing bonds.

The Hoover Upgrading Fund accounts for advances by the Authority in connection with the Upgrading Program. Effective June 1, 1987, the Authority executed new power contracts with Western and its customers which expire in 2017. The revenues and expenditures applicable to the sale and transmission of power and energy received by the Authority from Western under these contracts are accounted for in the Hoover Upgrading Fund.

APA General Fund

The Authority's operations other than those applicable to the Hoover Upgrading Fund are accounted for in the APA General Fund. The purchase of supplemental power and the sale and transmission of such power to the Authority's customers comprise the majority of this fund's activity.

Note 3 – Cash And Cash Equivalents

All cash and cash equivalent balances except for bond funds held by the Trustee are maintained by the State of Arizona Treasurer within the Local Government Investment Pool ("LGIP"). The LGIP is not registered with the Securities and Exchange Commission and investments are not subject to custodial credit risk. The State Board of Investment conducts monthly reviews of investment activity and performance. LGIP amounts are carried at fair value. Participant shares are purchased and sold based on the Net Asset Value ("NAV") of the shares. The NAV is determined by dividing the fair value of the portfolio by the total shares outstanding.

The Authority's LGIP investment balance represents its cash and cash equivalents as of September 30, 2014 and 2013.

Note 4 – Capital Assets

Capital assets of the Authority at September 30, 2014 were as follows:

| | Balances September 30 | | ADDITIONS | DELETIONS | Balances September 30 | |
|---------------------------------------|--------------------------|--------------------|-------------|-------------|--------------------------|--|
| | 2013 | | | | 2014 | |
| Transmission plant | \$ 319,565 | \$ - | \$ - | \$ - | \$ 319,565 | |
| Distribution plant | 227,518 | - | - | - | 227,518 | |
| General plant - office | 780,123 | 5,141 | - | - | 785,264 | |
| TOTAL DEPRECIABLE ASSETS | 1,327,206 | 5,141 | - | - | 1,332,347 | |
| LESS ACCUMULATED DEPRECIATION FOR: | | | | | | |
| Transmission plant | 314,225 | 3,051 | - | - | 317,276 | |
| Distribution plant | 218,881 | 2,303 | - | - | 221,184 | |
| General plant - office | 690,888 | 14,311 | - | - | 705,199 | |
| Total accumulated depreciation | 1,223,994 | 19,665 | - | - | 1,243,659 | |
| CAPITAL ASSETS, NET | \$ 103,212 | \$ (14,524) | \$ - | \$ - | \$ 88,688 | |

Capital assets of the Authority at September 30, 2013 were as follows:

| | Balances September 30 | | ADDITIONS | DELETIONS | Balances September 30 | |
|---------------------------------------|--------------------------|--------------------|-----------------|-------------|--------------------------|--|
| | 2012 | | | | 2013 | |
| Transmission plant | \$ 319,565 | \$ - | \$ - | \$ - | \$ 319,565 | |
| Distribution plant | 227,518 | - | - | - | 227,518 | |
| General plant - office | 782,664 | 7,758 | (10,299) | | 780,123 | |
| TOTAL DEPRECIABLE ASSETS | 1,329,747 | 7,758 | (10,299) | | 1,327,206 | |
| LESS ACCUMULATED DEPRECIATION FOR: | | | | | | |
| Transmission plant | 311,173 | 3,052 | - | - | 314,225 | |
| Distribution plant | 216,577 | 2,304 | - | - | 218,881 | |
| General plant - office | 686,272 | 14,915 | (10,299) | | 690,888 | |
| Total accumulated depreciation | 1,214,022 | 20,271 | (10,299) | | 1,223,994 | |
| CAPITAL ASSETS, NET | \$ 115,725 | \$ (12,513) | \$ - | \$ - | \$ 103,212 | |

The Authority's depreciation expense was \$19,665 and \$20,271 for the years ended September 30, 2014 and 2013, respectively.

The transmission and distribution plants are comprised of a substation and related equipment. Purchased power is delivered over transmission facilities owned by Western.

NOTES TO FINANCIAL STATEMENTS

Note 5 – Advances for Hoover Upgrading Program

Advances for the Hoover Upgrading Program were reimbursed by Western through credits on the Authority's power bills in the amount of \$6,600,115 and \$6,579,145 for the years ended September 30, 2014 and 2013, respectively. Credits were received for the upraters' portion of principal and interest expense on the bonds and other costs associated with the Hoover Upgrading Program.

Note 6 – Bonds Payable

Bonds Payable Consists of the Following:

| | Balances September 30 | | Increases | Reductions | Transfers | Balances September 30 | |
|----------------------------|--------------------------|----------------------|-----------------------|--------------|----------------------|--------------------------|--|
| | 2013 | | | | | 2014 | |
| Bonds payable short-term | \$ 5,065,000 | \$ - | \$ (5,065,000) | \$ 5,330,000 | \$ 5,330,000 | | |
| Bonds payable long-term | 23,070,000 | 26,565,000 | - | (5,330,000) | 44,305,000 | | |
| TOTAL BONDS PAYABLE | \$ 28,135,000 | \$ 26,565,000 | \$ (5,065,000) | \$ - | \$ 49,635,000 | | |

| | Balances September 30 | | Increases | Reductions | Transfers | Balances September 30 | |
|----------------------------|--------------------------|-------------|-----------------------|--------------|----------------------|--------------------------|--|
| | 2012 | | | | | 2013 | |
| Bonds payable short-term | \$ 4,810,000 | \$ - | \$ (4,810,000) | \$ 5,065,000 | \$ 5,065,000 | | |
| Bonds payable long-term | 28,135,000 | - | - | (5,065,000) | 23,070,000 | | |
| TOTAL BONDS PAYABLE | \$ 32,945,000 | \$ - | \$ (4,810,000) | \$ - | \$ 28,135,000 | | |

Long-term debt outstanding increased by \$26,565,000 in 2014 due to the issuance of the Power Resource Revenue Bonds, 2014 Series (Hoover Prepayment Project). The 2014 Series Bonds were issued to prepay the Authority's proportionate share of the high interest rate obligations incurred by the United States Bureau of Reclamation for certain improvements at Hoover Dam. This prepayment of \$23,843,169 will result in a reduction of future costs paid by the Authority for the power and energy from the Boulder Canyon Project. It is shown as part of Deferred Outflows of Resources on the 2014 Statement of Net Position.

In prior years, the Authority eased various issues of bonds by purchasing U.S. government securities which were deposited in an irrevocable trust with an escrow agent to provide for future debt service until the call dates. As a result, those bonds are considered to be defeased and the corresponding liability has been removed from the Hoover Upgrading Fund. Accordingly, the trust account assets and related liabilities are not included in the Authority's financial statements.

Note 6 – Bonds Payable (continued)

The Authority's outstanding bonds, totaling \$49,635,000, bear interest ranging from 1.799% to 5.25%, are due through Operating Year 2045, and are secured by the pledged property, as defined by the Resolution, which includes the proceeds from the sale of the bonds, rights and interest in various contracts and revenues. The Authority amortizes the bond premium (discount) using the interest method. Principal and interest amounts due over the next five operating years ending September 30 and thereafter are as follows:

| Fiscal Year | | Principal | | Interest |
|--------------|-----------|-------------------|-----------|-------------------|
| 2015 | \$ | 5,330,000 | \$ | 1,822,521 |
| 2016 | | 5,615,000 | | 2,127,462 |
| 2017 | | 5,905,000 | | 1,832,675 |
| 2018 | | 6,220,000 | | 1,522,662 |
| 2019 | | 540,000 | | 1,196,112 |
| 2020-2024 | | 2,900,000 | | 5,782,836 |
| 2025-2029 | | 3,440,000 | | 5,246,918 |
| 2030-2034 | | 4,240,000 | | 4,437,956 |
| 2035-2039 | | 5,380,000 | | 3,293,831 |
| 2040-2044 | | 6,835,000 | | 1,834,660 |
| 2045-2046 | | 3,230,000 | | 240,244 |
| TOTAL | \$ | 49,635,000 | \$ | 29,337,878 |

Crossover Refunding

On September 12, 2001, the Authority issued \$57,520,000 of Special Obligation Crossover Refunding Bonds which refunded on October 1, 2003 \$62,630,000 1993 Series Power Resource Revenue Refunding Bonds maturing on and after October 1, 2005. The 2001 Series Bonds bear interest at a rate of 5.00% and 5.25% payable on April 1 and October 1, respectively, of each year, commencing April 1, 2004 and maturing in 2017. In addition, the Authority recognized an economic gain (difference between the present value of the old and new debt service payments) of \$2,095,648 in 2003 as a result of the cross-over.

The crossover refunding also resulted in the recognition of a deferred amount of \$2,411,956 that has been reflected as a decrease in bonds payable and which will be amortized using the interest method as a component of interest expense over the life of the refunded bonds. The Authority amortized \$109,116 and \$133,080 for the years ended September 30, 2014 and 2013, respectively, resulting in a net deferred amount of \$170,701 and \$279,817 in the Statements of Net Position, respectively. The Authority also recognized a premium of \$3,536,652 on the crossover refunding which has been reflected as an increase in bonds payable and which will be amortized using the interest method. The Authority amortized \$160,008 and \$195,132 for the years ended September 30, 2014 and 2013, respectively, resulting in a net premium of bonds payable of \$250,268 and \$410,276 in the Statements of Net Position, respectively.

“To be prepared is half the victory.”
– Miguel de Cervantes

NOTES TO FINANCIAL STATEMENTS

Note 7 – Commitments and Contingencies

The Lower Colorado Multi-Species Conservation Program ("MSCP") is a cooperative effort between Federal and non-federal entities that will create more than 8,100 acres of riparian, marsh and backwater habitat for 31 species of fish, birds, mammals and plants. The program became effective on April 4, 2005 and expires April 30, 2055. As a party to this Agreement, the Arizona Power Authority's financial obligation is approximately \$119,000 per year (in 2003 dollars, adjusted annually for inflation). For the years ended September 30, 2014 and 2013, the Authority paid \$162,495 and \$149,613 respectively, for the MSCP.

The Authority is involved in various claims arising in the ordinary course of business, none of which, in the opinion of management, if determined adversely against the Authority, will have a material adverse effect on the financial condition or results of operations of the Authority.

Note 8 – Investments Held By Trustee

Certain funds of the Authority are secured under the Authority's bond resolution and held by the Authority's trustee. Such funds are invested in U. S. Government securities collaborated with U.S. Government obligations held by the Authority's trustee. The fair value of these investment securities at September 30 is as follows:

| | 2014 | | 2013 | |
|---------------------------|-----------|-------------------|-----------|-------------------|
| U.S. TREASURY OBLIGATIONS | \$ | 14,740,464 | \$ | 12,740,485 |
| TOTAL | \$ | 14,740,464 | \$ | 12,740,485 |

These funds are invested in direct U.S. Treasury obligations, which mature on dates coinciding with the principal and interest payment dates for the Authority's outstanding bonds.

As of September 30, 2014, the investments held by the trustee consists of U.S. Treasury obligations, which are direct obligations of the United States of America, as required by the Bond Resolution. The U.S. Treasury obligations are rated AA+ by the rating agencies. There is minimal interest rate risk.

Note 9 – Retirement Plan

The Authority contributes to the retirement plan described below. Benefits are established by state statute and generally provide retirement, death, long-term disability, survivor, and health insurance premium benefits.

The Arizona State Retirement System (the "Plan" or "ASRS") administers a cost-sharing multiple-employer defined benefit pension plan that covers permanent, full-time employees of the Authority. The ASRS is governed by the Arizona State Retirement System Board according to the provisions of ARS Title 38, Chapter 5, Article 2. The ASRS issues a publicly available financial report that includes its financial statements and required supplementary information.

By actuarial computation, employee member and Authority contributions to the Plan were fixed at 11.54% (11.30% retirement and 0.24% long-term disability) from October 1, 2012 through June 30, 2014. On July 1, 2014, the rates changed to 11.60% (11.48% retirement and 0.12% long-term disability), with the contributions made through payroll deductions.

Note 9 – Retirement Plan (continued)

Employee contributions vest immediately. Total contributions to the Plan for the years ended September 30, 2014, 2013 and 2012, by the Authority's covered employees were \$67,213, \$71,476 and \$77,346, respectively.

Matching employer member contributions were actuarially determined and fixed at the same rate as employee/member contributions for the years ended September 30, 2014 and 2013. In the event the Plan's actuary determines that additional contributions are needed in order to amortize an unfunded accrued liability, every employer and member will be required to contribute the revised contribution percentage which is established by the Arizona State Legislature.

All full-time employees of the Authority are required to become members of the Plan. The Authority's total payroll for employees covered by this Plan for the years ended September 30, 2014 and 2013 was \$581,219 and \$650,385, respectively. Contributions to the Plan by the Authority for its covered employees vest over five years. All required employer contributions are made to the Plan by the end of each month.

Note 10 – Additional Benefits

In addition to the pension benefits described above, ASRS offers health care benefits to retired and disabled members who are no longer eligible for health care benefits through their former member employer's group health plan. Retired is defined as actively receiving an annuity benefit and disabled is defined as receiving a long-term disability ("LTD") benefit through the LTD program administered by ASRS. A premium benefit is applied to the member's health insurance cost. The following chart illustrates the maximum amount of the monthly available benefit supplement for eligible members and their dependents:

| Years of Credited Service | Percent of Premium Benefit | Member | | Member & Dependent(s) | |
|---------------------------|----------------------------|-----------------------|-------------------|-----------------------|-------------------|
| | | Not Medicare Eligible | Medicare Eligible | Not Medicare Eligible | Medicare Eligible |
| 5.0 - 5.9 | 50% | \$ 75.00 | \$ 50.00 | \$ 130.00 | \$ 85.00 |
| 6.0 - 6.9 | 60% | 90.00 | 60.00 | 156.00 | 102.00 |
| 7.0 - 7.9 | 70% | 105.00 | 70.00 | 182.00 | 119.00 |
| 8.0 - 8.9 | 80% | 120.00 | 80.00 | 208.00 | 136.00 |
| 9.0 - 9.9 | 90% | 135.00 | 90.00 | 234.00 | 153.00 |
| 10.0 + | 100% | 150.00 | 100.00 | 260.00 | 170.00 |



Note 11 – Purchased Power, Sales and Transmission Commitments

The Authority has sales contracts with its customers. Under these contracts, customers are obligated to pay for their proportionate share of Hoover power and transmission costs if delivered or made available for delivery. These sales contracts expire September 30, 2017, but some can be terminated by the Authority on June 1, 2007 or thereafter.

The Authority is party to a Firm Electric Service and Transmission Service Contract which expires September 30, 2017. This requires the Authority to pay approximately 19% of Westerns revenue requirements each operating year until the contract expires. During the years ended September 30, 2014 and 2013, the Authority paid \$17,856,655 and \$18,921,561, respectively, for purchased power under this contract. The Authority is obligated to pay these costs under the contract even in the unlikely event that no power is supplied.

The Authority also has a contract with Western for transmission services. During the years ended September 30, 2014 and 2013, the Authority paid \$7,337,346 and \$6,703,995, respectively, for transmission costs to Western. On January 24, 2003, the Authority entered into the Advancement of Funds for Transmission Services contract with Western.

The contract provides for the Authority to advance funds to Western on a monthly basis to fund operations, maintenance and replacement costs associated with Westerns transmission services. The advanced funds are then applied to the subsequent month's transmission invoice. As of September 30, 2014 and 2013, the Authority recognized a prepayment of \$599,055, and \$589,507, respectively, that applies to the last payment upon termination of the contract.

The Authority also has contracts with Salt River Project for the purchase and transmission of power to the Authority's customers. Under the transmission contract, the Authority must pay an annual transmission fee of \$63,898 until September 30, 2017. The Authority has a power contract with SRP in which supplemental power purchases can be made by the Authority on behalf of its customers. There are no minimum quantities that the Authority is required to purchase. This agreement is applicable when supplemental power is necessary, during such times of low production of Hoover energy, and during summer months when customers require higher levels of energy. During the years ended September 30, 2014 and 2013, the Authority paid \$21,627 and \$1,067,860, respectively, for purchased power under this contract for its customers.

Note 12 – Subsequent Events

Management evaluated subsequent events through February 9, 2015, the date the financial statements were available to be issued.

- END OF NOTES TO THE FINANCIAL STATEMENTS -

Debt Service Coverage Ratio

Unaudited; not covered by the Independent Auditor's Report

OY 14

| | | | |
|-----------------------------------|--------------------------------------|-----------|--------------------|
| NET POSITION | | \$ | (1,272,731) |
| Add: | Interest Expense | | 1,822,522 |
| | Amortization | | 109,116 |
| | Depreciation | | 14,310 |
| | Western Credits | | 6,600,115 |
| | 2014 Interest Received | | 611,346 |
| | Bond Issuance Costs | | 918,340 |
| | Credits to Customers for Prior Years | | 603,956 |
| TOTAL ADDITIONS | | \$ | 9,406,525 |
| Deduct: | Deferred Interest Expenses | | (1,163,108) |
| | Premium Amortization | | (160,008) |
| TOTAL DEDUCTIONS | | \$ | (1,323,113) |
| Income available for Debt Service | | \$ | 8,083,412 |
| Debt Service | | \$ | 6,541,175 |

DEBT SERVICE COVERAGE RATIO

1.24

NOTE: Interest expense, depreciation expense and amortization of Uprating Costs are not expenses under the Bond Resolution.

Debt Service is the total of Principal and Interest Expense accrued between October 1, 2013 and September 30, 2014



ARIZONA POWER AUTHORITY

1810 W. Adams St.
Phoenix, Arizona 85007

p: (602) 368 – 4265
f: (602) 253 – 7970

WWW.POWERAUTHORITY.ORG