

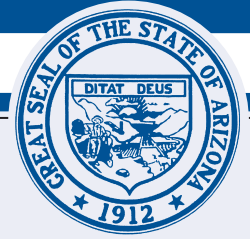


**SECURING RELIABILITY, BROADENING HORIZONS.**



**ARIZONA POWER AUTHORITY - 46TH ANNUAL REPORT**

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December 1, 2004

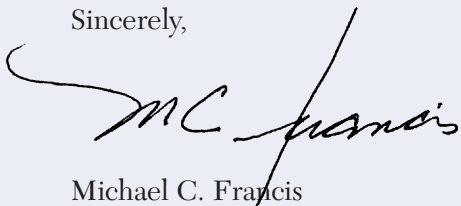
The Honorable  
Janet A. Napolitano  
Governor of Arizona  
State Capitol  
Ninth Floor, West Wing  
Phoenix, AZ 85007

Dear Governor:

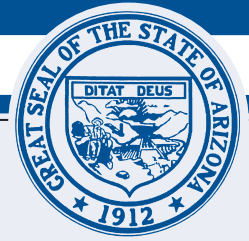
This 46th Annual Report of the Arizona Power Authority details the Authority's operation and financial activities for the fiscal year ending June 30, 2004. This report highlights the Authority's efforts in administering Arizona's hydroelectric power entitlement generated at Hoover Dam and Powerplant located on the Colorado River. Although the Colorado River system is entering into the sixth year of a severe drought condition the system, including Lake Mead and other reservoirs, is impounding approximately fifty percent of its storage capability. Therefore, the state's water and power entitlements, although at reduced levels of electric generation, will be available.

The Authority is actively engaged in researching and studying supplemental electric power generation resources that might be cost effective if developed within the state to supplement our valuable hydro resource. The development of renewable, electric power resources within the state will further the long-term goal of reducing Arizona's dependency on external energy resources.

Sincerely,

A handwritten signature in black ink, appearing to read "MC Francis", with a large, sweeping flourish extending to the left.

Michael C. Francis  
Chairman



JOE MULHOLLAND



## THE OPTIMISM OF EFFICIENCY

The drought in the Colorado River Basin remains a serious challenge for the Authority, the state of Arizona and its residents. Some contend it marks a new period of reduced rainfall over time. Others consider that given the dry years, wet winters are due. In fact, it is virtually impossible to know for certain. What we do know is it that improving performance is the best preparation for either eventuality.

The Authority has achieved significant savings as a result of streamlined budgets implemented this year. In early 2005, the Authority will be refunding a total of about \$1 million to customers, which represents about a 7% discount in their total expenditure. Monthly rate reviews will continue to verify that rates are in line with our costs, ensuring stability and the lowest rates possible without jeopardizing operations.

To further control expenditures and mitigate any price jumps that could result from drought-limited power production, the Authority is exploring several additional cost-saving measures. These include the possibility of purchasing long-term transmission rights on Western Transmission System through the pre-payment of high interest debt, which in turn could lower charges to our customers by approximately \$800,000 annually.

The Authority has analyzed the flows of Colorado River to develop a better understanding of what we might expect for the future. In addition, we are examining the feasibility of installing low water-level turbines at Hoover, to facilitate effective operation if drought conditions continue.

As always, security at Hoover Dam remains a top priority. Construction to reroute non-essential traffic away from the dam continues. The new bridge between Arizona and Nevada is expected to be completed in 2008.

The Authority is participating in the Multi-Species Conservation Program to protect the availability of Hoover power as well as the environment. This pro-active, 50-year program helps guard against any interruptions in generation caused by judicial intervention on behalf of endangered species.

The Authority is also looking ahead in the area of renewable energy, having recently received a grant from the National Renewable Energy Laboratory to study integrating wind and hydro power generation. This may lead to a multi-year feasibility contract to help introduce new, renewable energy sources to Arizona.

Through these and other initiatives, we remain optimistic about the Authority's ability to meet its mandate to provide low cost power, while assisting in developing and improving power availability to citizens throughout the State of Arizona.

The Arizona Power Authority was established in 1944 to administer Arizona's entitlement to hydroelectric power generated at Hoover Dam and Powerplant located on the Colorado River. Additionally, the Authority is authorized to develop low-cost, electrical power generation and transmission facilities within the state for Arizona's citizens. The Authority recently passed its 40th anniversary of faithfully providing low-cost hydroelectric power to the consumers of the state. Due to the continued severe drought impacting the Colorado River Basin, the Authority is aggressively investigating and researching new and sustainable renewable energy resources that could help reduce Arizona's dependency on external power resources.



**MICHAEL C. FRANCIS** – *Chairman*

Starting his tenure on the commission in 1999, Mr. Francis was selected Chairman in April 2003. In addition to his invaluable work on the commission, Mr. Francis is a partner in Santa Lucia Farms, producer of over 3.7 million garden rose bushes annually. Mr. Francis also owns and operates Frances Insurance Agency, which insures Arizona and California farmers. Mr. Francis is a Board of Directors member for M&I Thunderbird Bank, Arizona Region. He is also a member of the American Rose Society. His current term expires in January 2008.



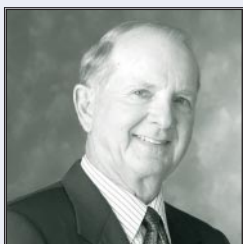
**LT GEN JOHN I. HUDSON** – *Vice Chairman*

First appointed to the Arizona Power Authority Commission in March 2000, John I. Hudson was elected to the Vice Chair in May 2003 with his current term expiring in 2006. A retired Lieutenant General in the U.S. Marine Corps where he served for 37 years, John Hudson is a member of the Board of Directors of the Yuma Regional Medical Center. In addition, he is a member and past chairman of the Greater Yuma Port Authority Board of Directors, a founding Director of the Foothills Bank of Yuma, a member of the Foothills Rotary Club of Yuma and past president of Yuma's 78-CRIME Board of Directors.



**RICHARD S. WALDEN**

Appointed to the Commission in 1984 and re-appointed through his present term expiring in 2010, Mr. Walden is the President and CEO of Farmers Investment Co., a family-owned, pecan growing and processing company headquartered in Sahuarita, Arizona. Mr. Walden 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 and Education associated with the Nutrition and Education Foundation. Mr. Walden is also a member of the Advisory Council on Small Business and Agriculture for the Federal Reserve Bank of San Francisco and a member of the Board of the National Pecan Shellers Association.



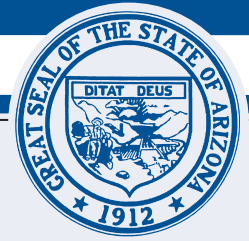
**DALTON H. COLE**

Appointed to the Commission in January 2002 for a term to run until 2008, 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. For 18 years he also served on the board of Electrical District No. 2 in Pinal County 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.



**DELBERT R. LEWIS**

First appointed to the Arizona Power Commission in April 2003, Delbert Lewis has been reappointed for a six-year term ending in January 2010. As one of the founders of KTVK Channel 3 and the CEO of MAC America Communications, Inc, Mr. Lewis' past and present civic affiliations include the Arizona Broadcasters Association, Metropolitan Phoenix Broadcasters, Phoenix Chamber of Commerce, Samaritan Health Services, Greater Phoenix Leadership, the National Conference, Maricopa County Sports Authority and Orpheum Theatre Foundation. Now farming 4,000 acres of farmland near Florence, Arizona. Mr. Lewis and his late wife, Dr. Jewell Lewis, have been nationally recognized for their financial support and commitment to education and community service.



## COLORADO RIVER OPERATIONS

Water year 2004 marked the fifth consecutive year with below average inflow into Colorado River reservoirs, including Lake Mead. Unregulated inflow to Lake Powell, upriver of Lake Mead, was 62, 59, 25, 51, and 51 percent for water years 2000 through 2004 respectively. Reservoir storage at Lakes Powell and Mead declined for the fifth straight year. During the year, Lake Mead reservoir storage decreased by 1.681 million acre-feet (maf) and Powell decreased by 2.941 maf. At the beginning of the 2004 water year, the Colorado River system's total storage was 57 percent of capacity. As of September 30, 2004, total system storage was down 7 more percent to 50 percent of capacity, a decrease of approximately 4.238 maf.

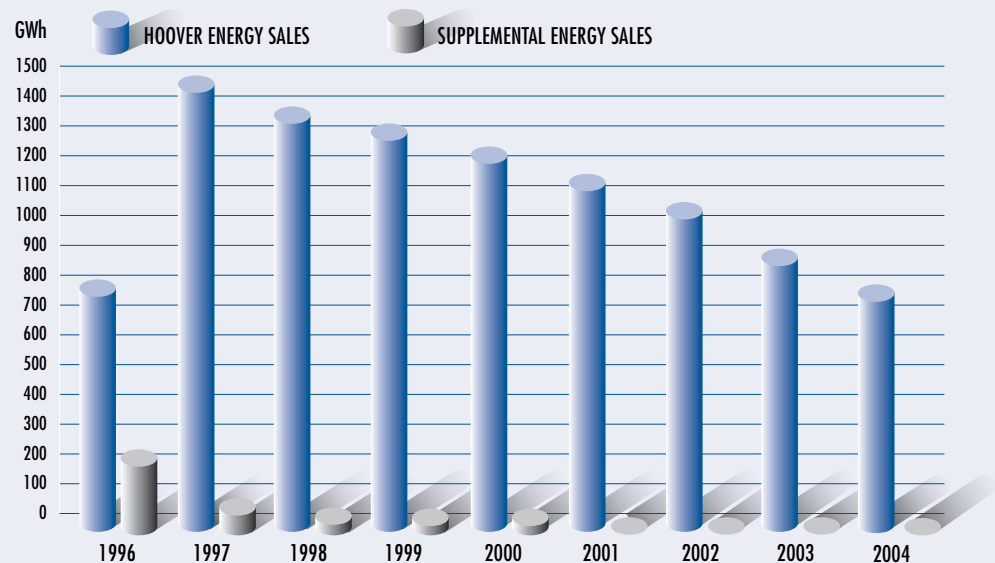
Under the most probable inflow scenario, the downstream delivery requirements are expected to control water releases from Hoover Dam. Therefore, the normal condition is the criterion governing the operation of Lake Mead for calendar year 2005 pursuant to the Colorado River Annual Operating Plan and Supreme Court Decree. Reclamation does not anticipate any available unused state water apportionment for calendar year 2005.

## THE ENVIRONMENT

The voluntary Lower Colorado River Multi-Species Conservation Program has continued in development throughout the past year. Most notably accomplished, the Memorandum of Agreement was executed among the Secretary of the Interior and the states of Arizona, California and Nevada on September 14, 2004. This is a 50-year agreement whereby the federal and non-federal participants each share fifty percent of the total \$626 million program cost. Various implementation documents and agreements are now being negotiated among the parties, which will place the Memorandum of Agreement into effect.

## HISTORICAL ENERGY SALES

The following graph illustrates the Authority's historical energy sales (GWh) since 1996 for power obtained from the Hoover Powerplant and for supplemental sales. Supplemental power is obtained by the Authority for sale to customers on an "as requested" basis. This energy augments the customers' allocation from the Authority.



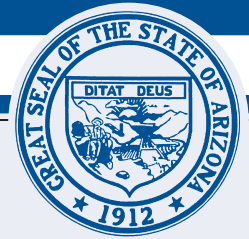
FISCAL YEAR	1996	1997	1998	1999	2000	2001	2002	2003	2004
HOOVER	792	1,485	1,389	1,318	1,205	1,103	1,098	899	753
SUPPLEMENTAL	224	79	3	2	4	0	0	0	0
TOTAL	1,016	1,564	1,392	1,320	1,209	1,103	1,098	899	753

# SCHEDULE OF CAPACITY AND ENERGY SALES

SALE OF HYDRO POWER Customers	AVERAGE BILLING DEMAND (KW)	ENERGY DELIVERED (KWH)	SALES (\\$)	MILLS PER KWH	PRIOR YEAR ADJ. (\\$)
Aguila Irrigation District	4,740	9,430,000	181,636	19.26	(\$6,460.68)
Avra Valley Irrigation & Drainage District	475	2,495,000	35,298	14.15	(\$890.73)
Buckeye Water Conseration District	2,245	7,243,000	122,391	16.90	(\$3,325.41)
Central Arizona Water Conservation District	121,758	175,918,000	3,796,409	21.58	(\$159,554.62)
Chandler Heights Citrus Irrigation District	701	2,681,000	33,580	12.53	(\$1,244.30)
Cortaro-Marana Irrigation District	4,852	22,007,000	273,761	12.44	(\$7,841.61)
Electrical District No. 1, Pinal	0	0	0	0.00	\$0.00
Electrical District No. 2, Pinal	14,656	54,281,000	854,213	15.74	(\$24,115.82)
Electrical District No. 3, Pinal	11,980	70,735,000	1,055,343	14.92	(\$19,687.18)
Electrical District No. 4, Pinal	14,655	51,809,000	745,062	14.38	(\$25,528.03)
Electrical District No. 5, Pinal	11,129	37,443,000	534,532	14.28	(\$18,823.38)
Electrical District No. 5, Maricopa	265	1,421,000	17,879	12.58	(\$473.82)
Electrical District No. 6, Pinal	6,035	18,264,000	242,632	13.28	(\$9,993.32)
Electrical District No. 7, Maricopa	7,910	12,350,000	253,418	20.52	(\$10,710.32)
Electrical District No. 8, Maricopa	18,234	57,236,000	972,224	16.99	(\$26,295.76)
Harquahala Valley Power District	1,876	9,262,000	142,538	15.39	(\$2,829.13)
Maricopa County Municipal Water District #1	6,661	14,444,000	272,793	18.89	(\$9,316.85)
McMullen Valley Water Conservation & Drainage District	6,850	15,297,000	284,204	18.58	(\$9,436.30)
Ocotillo Water Conservation District	1,801	6,962,000	88,363	12.69	(\$2,930.23)
Queen Creek Irrigation District	1,334	2,121,000	27,138	12.79	(\$2,035.17)
Roosevelt Irrigation District	2,426	12,579,000	190,512	15.15	(\$3,986.75)
Roosevelt Water Conservation District	5,094	18,361,000	257,522	14.03	(\$8,779.92)
Salt River Project	29,225	119,046,000	1,727,480	14.51	(\$47,430.34)
San Tan Irrigation District	393	1,641,000	20,724	12.63	(\$797.03)
Silverbell Irrigation & Drainage District	536	4,455,000	54,058	12.13	(\$1,129.46)
Tonopah Irrigation District	1,168	4,668,000	75,324	16.14	(\$1,770.70)
Wellton-Mohawk Irrigation & Drainage District	2,192	8,824,000	129,992	14.73	(\$3,559.02)
City of Page	784	983,000	23,399	23.80	(\$1,031.91)
City of Safford	1,568	3,598,000	62,057	17.25	(\$2,371.92)
Town of Thatcher	792	2,476,000	36,887	14.90	(\$1,287.19)
Town of Wickenburg	1,725	4,916,000	82,757	16.83	(\$2,982.24)
Ak-Chin Indian Community	0	0	0	0.00	0
Arizona Electric Power Cooperative	0	0	0	0.00	0
Arizona Public Service Company	0	0	0	0.00	0
Citizens Utilities Company	0	0	0	0.00	0
City of Mesa	0	0	0	0.00	0
Tohono O'odham Utilities Authority	0	0	0	0.00	0
San Carlos Project	0	0	0	0.00	0
Tucson Electric Power Company	0	0	0	0.00	0
<b>TOTAL HYDRO POWER SALES</b>	284,056	752,946,000	\$12,594,126	16.73	
<b>TOTAL NET PRIOR YEAR ADJUSTMENT</b>					\$(416,619)
<b>TOTAL SUPPLEMENTAL POWER SALES</b>	781,443	22,626,000	\$4,835,337		
<b>OTHER ELECTRIC SERVICES INCOME**</b>			\$8,433,127		
<b>TOTAL POWER INCOME</b>			\$25,445,970*		

\*Difference between Total Electric Sales and Operating Revenue is due to post-closing reconciliation of estimate to actuals between the Authority and Western Area Power Administration.

\*\*Includes Administrative fees, facilities charges, late charges, and Scheduling Entity revenue.



To the Arizona Power Authority Commission

In our opinion, the accompanying statements of net assets and the related statements of revenues, expenses, and changes in net assets, and statements of cash flows present fairly, in all material respects, the financial position of the Arizona Power Authority (the "Authority") (A Body, Corporate and Politic, of the State of Arizona) at June 30, 2004 and 2003, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. 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 of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

The accompanying management's discussion and analysis is not a required part of the financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

*PricewaterhouseCoopers LLP*

November 8, 2004

The following is a discussion and analysis of the Arizona Power Authority's (Authority) financial performance for the fiscal year ended June 30, 2004. 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 current year's activities, resulting changes and known facts, and should be read in conjunction with the Authority's financial statements beginning on page fourteen.

## HIGHLIGHTS

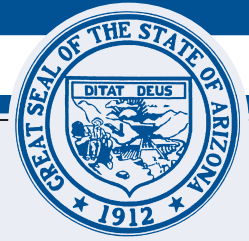
### **AUTHORITY HIGHLIGHTS**

**Scheduling Entity Agreement** – The Authority and Salt River Project were parties to a Scheduling Entity Agreement, which expired on September 30, 2004. A new Scheduling Entity Agreement provides for Salt River Project (SRP) to pay the Authority \$5.4 million each year in return for allowing Salt River Project to be the Scheduling Entity of the Hoover generation in Arizona. This Agreement became effective as of October 1, 2004 and expires on September 30, 2011. The effect of this agreement is that the energy banking program with SRP has been increased, to the advantage of our customers. However, because payment from SRP has been reduced by \$3 million each year, the rates for Hoover power increased accordingly.

**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 Authority had an existing agreement with Western that provided for the delivery of power and energy. The agreement provides for the Authority to advance funds to Western on a monthly basis to fund operations, maintenance and replacement costs associated with Western's transmission services. For the year ended June 30, 2004, the Authority advanced a net prepaid deposit of \$182,360, which is included in the Statements of Net Assets. This has demonstrated our cooperation and has given our customers greater flexibility in working with Western.

**Arizona State Treasurer-held investment write-off** – The Authority is statutorily required to invest funds through the Arizona State Treasurer (Treasurer), who has sole investment decision-making authority. In November 2002, the Authority was advised that one of the Treasurer's chosen investments managed by National Century Financial Enterprises was under investigation for fraud. In December 2002, the Authority was informed that the Treasurer was vitiating the investment in question, thereby reducing the value to zero. Since that time, litigation was initiated and continues. There is no guarantee that the litigation will result in the recovery of the Authority's funds, which total \$227,224. Therefore, the Authority has written off the lost investment amount as of June 30, 2003.

**Effects of Drought on Hoover Energy** – The Colorado River Basin has been experiencing severe drought conditions for the past five years. This has resulted in a reduction in Lake Mead's storage and the power production at Hoover Dam. Several Authority customers requested that the Authority purchase supplemental power to offset the reduced energy production at Hoover. The supplemental power costs are significantly higher, and are passed directly to the requesting customers. These supplemental revenues and costs are reflected on the Authority's books, resulting in higher revenue and purchased power costs.



**Contributions** – During Fiscal Year 2004, the Authority contributed \$20,000 via the Arizona Power Authority Scholarship Program to each of the following schools: the Arizona State University, the University of Arizona, and Northern Arizona University.

**APA Fund** – The APA Fund was established by the Arizona Power Authority Commission in 1971 and has grown significantly over the years. The APA Fund's Operating Revenues exceeded 2004 Budget by \$1,441,450 (or 30%) due to increased supplemental power sales. Correspondingly, the Fund's Operating Expenses exceeded the budgeted amount by \$1,352,051 (or 27%) due to increased supplemental power purchases.

**Other Changes That Will Improve or Provide Future Benefit to the Arizona Power Authority** – No other agreements or new customers were added nor were there any other significant impacting events during the reporting period.

## FINANCIAL HIGHLIGHTS

- The Authority's net assets increased by \$598,398, or 20 percent, partly due to reduced amount of long-term debt payable associated with the defeasance of the 1993 Bonds in October 2003.
- The Authority's Revenue increased by \$432,317, primarily due to an increase in the sale of supplemental power. The purchase and concomitant sale of additional supplemental power resulted from additional customer energy requirements brought on by reduced Hoover power generation caused by the sustained drought currently being experienced throughout the Colorado River Basin. See Authority Highlights, above.

## USING THIS ANNUAL REPORT

This annual report consists of a series of financial statements. The Statements of Net Assets, the Statements of Revenues, Expenses and Changes in Net Assets and the Statements of Cash Flows (on pages 14 - 17, 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 in this Annual Report 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*.

There are six basic or normal transactions that will affect the comparability of the Statements of Net Assets summary presentation:

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

**Borrowing for Capital** – which increases assets and long-term debt.

**Spending Borrowed Proceeds on New Capital** – which reduces current assets and increases capital assets. There is a second impact, an increase in invested capital assets and an increase in related net debt, which however, does not change the investment in capital assets, net of debt.

**Spending of Non-borrowed Current Assets on New Capital** – which (a) reduces current assets and increases capital assets and (b) reduces unrestricted net assets and increases investment in capital assets, net of debt.

**Principal Payment on Debt** – which reduces current assets and reduces long-term debt.

**Reduction of Capital Assets through Depreciation** – which reduces capital assets and investment in capital assets, net of debt.

## OVERVIEW OF THE FINANCIAL STATEMENTS

This Discussion and Analysis 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 14 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 and are independent of each other. Most of the Authority's financial dealings are with contracts outside of state government. A separate fund is not maintained for government activities. The Authority does not act as a fiduciary.

## CONDENSED STATEMENTS OF NET ASSETS

	June 30, 2004	June 30, 2003	Diff \$	Diff %
Current assets	\$ 13,045,876	\$ 14,952,938	\$ (1,907,062)	(13%)
Long-term assets	54,296,784	56,666,028	(2,369,244)	(4%)
Capital assets	159,403	160,664	(1,261)	(1%)
	67,502,063	71,779,630	(4,277,567)	(6%)
Current liabilities	5,421,283	4,854,228	567,055	12%
Long-term (bonds payable, net)	58,551,481	63,994,501	(5,443,020)	(9%)
	63,972,764	68,848,729	(4,875,965)	(7%)
Net assets				
Invested in capital assets	159,403	160,664	(1,261)	(1%)
Unrestricted	3,369,896	2,770,237	599,659	22%
Net assets, end of year	\$ 3,529,299	\$ 2,930,901	\$ 598,398	20%

## CONDENSED STATEMENT OF NET ASSETS DISCUSSION

**Current Assets** decreased because the Cash with Trustee was used to reduce long-term debt.

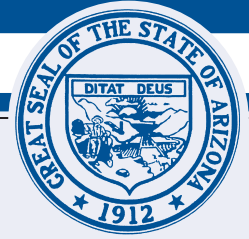
**Long Term Assets** decreased because of the reduction in the cost of the current year Upgrading Program, associated with debt and other costs related to improvements at Hoover Dam.

**Current Liabilities** increased primarily due to the increased bonds payable for principal and increased power contracts payable.

**Long Term Liabilities** decreased due to a change in the investments held by the Trustee, attributable to the Crossover Refunding of the 1993 Bonds, and the paydown of bond principal.

**Net Assets** are explained on page 12.

These are the basic or normal transactions that will affect the comparability of the Statements of Changes in the Net Assets summary presentation.



## REVENUES

**Economic Drought Condition** – The sustained drought condition in the Colorado River Basin has resulted in a decline in power production from Hoover Dam, and this has caused an increase in supplemental power consumption, and revenues from power sold.

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

**Market Impacts on Investment Income** – Market conditions cause investment income to fluctuate in both the long-term and shorter-term venues.

## EXPENSES

**Introduction of New Programs** – Individual programs may be added or deleted to meet changing Authority needs; however, none has been added during this fiscal year.

**Increase/Decrease in Authorized Personnel** – Changes in the Authority's services may result in increasing/decreasing authorized staffing. Staffing costs (salary and related benefits) represent 3.53 percent of the Authority's operating costs, and are stable.

**Salary Increases (cost of living, merit and market adjustment)** – The ability to attract and retain competent personnel requires the Authority to provide a competitive salary structure, which are reviewed annually.

The following condensed financial information was derived from the Statements of Revenues, Expenses and Changes in Net Assets and reflects how the Authority's net assets changed during the fiscal year.

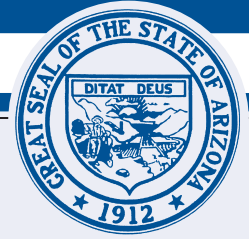
### STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS - BUSINESS TYPE ACTIVITIES

	June 30, 2004	June 30, 2003	Diff \$	Diff %
Operating revenues	\$ 25,445,767	\$ 25,013,450	\$ 432,317	2%
Operating expenses				
Purchased Power	18,014,692	18,048,125	(33,433)	(0.2%)
Western Credits	(5,224,715)	(5,325,522)	100,807	(2%)
Amortization of Hoover Upgrading Program Costs	5,224,715	5,325,522	(100,807)	(2%)
Transmission and Distribution	5,247,155	5,229,802	17,353	0.3%
Administrative and general	1,564,083	1,427,504	136,579	10%
Depreciation	35,870	30,711	5,159	17%
Other	102,322	155,357	(53,035)	(34%)
Total operating expenses	24,964,122	24,891,499	72,623	.30%
Operating income (loss)	481,645	121,951	359,694	295%
Other (deductions) income				
Interest expense	(3,209,937)	(3,593,036)	383,099	11%
Deferred interest expense	2,735,366	2,958,718	(223,352)	(8%)
Amortization	47,177	(82,842)	130,019	157%
Interest income	541,265	627,332	(86,067)	(14%)
Other, net	2,882	(225,382)	228,264	101%
Total other (deductions) income	116,753	(315,210)	431,963	137%
Change in net assets	598,398	(193,259)	791,657	410%
Net Assets, Beginning of Year	2,930,901	3,124,160	(193,259)	(6%)
Net Assets, End of Year	\$ 3,529,299	\$ 2,930,901	\$ 598,398	20%

### CHANGES IN NET ASSETS DISCUSSION

Net Assets increased overall because of the following:

- Operating Revenues and Total Operating Expenses increased because of increased supplemental power sales. Both of these items are discussed elsewhere in this report.
- Upgrading credits decreased because of decreases in debt payments and other costs related to the Upgrading Program.
- Amortization of the Upgrading Program decreased because of the decrease in interest payments, due to the Crossover Refunding of the 1993 bonds.
- Administrative and General expenses increased due to increases in personnel costs, occupancy expenses, and CREDA expenses.
- Depreciation increased because additional capital assets were acquired.
- "Other" Expenses decreased due to the fact that the LGIP loss was recorded as of 6/30/03. This is discussed elsewhere in the Authority Highlights under the "Arizona State Treasurer - held investment write-off" section.



### CAPITAL ASSETS

As of fiscal year end, the Authority had \$159,403 invested in a variety of capital assets, as reflected in the following schedule, which represents a net decrease (additions less retirements and depreciation) of \$1,261 or one (1) percent from the end of last year.

	June 30, 2004	June 30, 2003
Distribution Plant	\$ 24,203	\$ 32,273
General Plant - Office	135,200	128,391
	<u>\$ 159,403</u>	<u>\$ 160,664</u>

The following reconciliation summarizes the change in Capital Assets, which is presented in detail on page 22 of the Notes to the Financial Statements:

	June 30, 2004
Beginning Balance	\$ 160,664
Additions	34,609
Depreciation	(35,870)
Ending Balance	<u>\$ 159,403</u>

### DEBT OUTSTANDING

As of fiscal year-end, the Authority had \$60,065,000 in debt outstanding, compared to \$67,495,000 last year, as a result of the defeasance of the 1993 Bonds, including a principal payment of \$2,320,000, which was paid on October 1, 2003. Also see page 23 of the Notes to the Financial Statements for a detailed summary of debt activity during the year.

### BUSINESS TYPE ACTIVITIES

The following chart depicts the sources of revenues for the fiscal year.

- 1- Hoover Power Sales - \$20,577,506 (79.17%)
- 2- Supplemental Power Sales/Administrative Charges - \$4,868,261 (18.73%)
- 3- Interest Income - \$541,265 (2.08%)
- 4- Other Income - \$2,882 (0.01%)

The Authority's revenues from sale of Hoover power may decrease in the coming year(s) due to drought conditions. Insufficient rain and snow pack results in less water through the turbines at Hoover Dam, thereby producing less hydroelectric power available for sale. Additional wet years, and other factors, could help stabilize revenues.

The following chart depicts the types of expenses for the fiscal year.

- 1- Hoover Purchased Power - \$13,179,355 (51.81%)
- 2- Transmission & Distribution - \$5,247,155 (20.63%)
- 3- Supplemental Power Purchased - \$4,835,337 (19.01%)
- 4- Administrative & General - \$1,564,083 (6.15%)
- 5- Net Interest Expense - \$474,571 (1.87%)
- 6- Other Costs - \$102,322 (0.40%)
- 7- Depreciation - \$35,870 (0.14%)

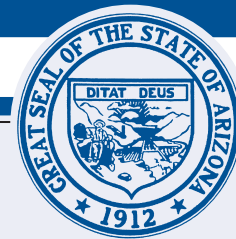
For further information and/or questions on this report, please call the Power Authority Office at 602-542-4263.

## STATEMENTS OF NET ASSETS

June 30th, 2004 and 2003

	APA General Fund		Hoover Uprating Fund		Total	
	2004	2003	2004	2003	2004	2003
<b>Assets</b>						
Current assets						
Cash and cash equivalents	\$ 3,757,939	\$ 3,894,085	\$ 2,148,362	\$ 2,098,840	\$ 5,906,301	\$ 5,992,925
Cash with Trustee	-	-	-	2,694,576	-	2,694,576
Investments held by Trustee	-	-	2,653,463	2,592,771	2,653,463	2,592,771
Accounts receivable, customers power purchases	703,846	235,854	2,136,496	1,950,056	2,840,342	2,185,910
Interest receivable	7,818	10,802	117,562	130,383	125,380	141,185
Prepaid purchased power	-	-	1,520,390	1,345,571	1,520,390	1,345,571
Total current assets	4,469,603	4,140,741	8,576,273	10,812,197	13,045,876	14,952,938
Capital assets, net	159,403	160,664	-	-	159,403	160,664
Investments held by Trustee	-	-	6,546,550	7,146,663	6,546,550	7,146,663
Advances for Hoover Uprating Program, net	-	-	47,567,874	49,337,005	47,567,874	49,337,005
Prepaid transmission	182,360	182,360	-	-	182,360	182,360
Total assets	\$ 4,811,366	\$ 4,483,765	\$ 62,690,697	\$ 67,295,865	\$ 67,502,063	\$ 71,779,630
<b>Liabilities</b>						
Current liabilities						
Accounts payable and other	\$ 12,607	\$ 3,830	\$ 99,682	\$ 107,768	\$ 112,289	\$ 111,598
Power contracts payable	693,222	232,500	1,298,732	1,296,311	1,991,954	1,528,811
Accrued interest payable	-	-	772,040	893,819	772,040	893,819
Bonds payable	-	-	2,545,000	2,320,000	2,545,000	2,320,000
Total current liabilities	705,829	236,330	4,715,454	4,617,898	5,421,283	4,854,228
Bonds payable	-	-	57,520,000	65,175,000	57,520,000	65,175,000
Premium (discounts) on bonds payable	-	-	3,243,535	(1,180,499)	3,243,535	(1,180,499)
Deferred amounts, net	-	-	(2,212,054)	-	(2,212,054)	-
Bonds payable, net	-	-	58,551,481	63,994,501	58,551,481	63,994,501
Total liabilities	\$ 705,829	\$ 236,330	\$ 63,266,935	\$ 68,612,399	\$ 63,972,764	\$ 68,848,729
<b>Net Assets</b>						
Net assets						
Invested in capital assets	\$ 159,403	\$ 160,664	\$ -	\$ -	\$ 159,403	\$ 160,664
Unrestricted	3,946,134	4,086,771	(576,238)	(1,316,534)	3,369,896	2,770,237
Total net assets	4,105,537	4,247,435	(576,238)	(1,316,534)	3,529,299	2,930,901
Total liabilities and net assets	\$ 4,811,366	\$ 4,483,765	\$ 62,690,697	\$ 67,295,865	\$ 67,502,063	\$ 71,779,630

The accompanying notes are an integral part of these financial statements.



## STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS

June 30th, 2004 and 2003

	APA General Fund		Hoover Upgrading Fund		Total	
	2004	2003	2004	2003	2004	2003
<b>Operating revenues</b>	\$ 4,868,261	\$ 3,117,041	\$ 20,577,506	\$ 21,896,409	\$ 25,445,767	\$ 25,013,450
<b>Operating expenses</b>						
Purchased power	4,835,337	3,076,952	13,179,355	14,971,173	18,014,692	18,048,125
Western credits	-	-	(5,224,715)	(5,325,522)	(5,224,715)	(5,325,522)
Amortization of Hoover Upgrading Project costs	-	-	5,224,715	5,325,522	5,224,715	5,325,522
Transmission and distribution	19,593	11,996	5,227,562	5,217,806	5,247,155	5,229,802
Administrative and general	81,471	68,552	1,482,612	1,358,952	1,564,083	1,427,504
Depreciation	35,870	30,711	-	-	35,870	30,711
Other	76,299	133,846	26,023	21,511	102,322	155,357
Total operating expenses	5,048,570	3,322,057	19,915,552	21,569,442	24,964,122	24,891,499
Operating income (loss)	(180,309)	(205,016)	661,954	326,967	481,645	121,951
<b>Other (deductions) income</b>						
Interest expense	-	-	(3,209,937)	(3,593,036)	(3,209,937)	(3,593,036)
Deferred interest expense	-	-	2,735,366	2,958,718	2,735,366	2,958,718
Amortization	-	-	47,177	(82,842)	47,177	(82,842)
Interest income	38,411	66,177	502,854	561,155	541,265	627,332
Other, net	-	(137,441)	2,882	(87,941)	2,882	(225,382)
Total other (deductions) income	38,411	(71,264)	78,342	(243,946)	116,753	(315,210)
Increase (decrease) in net assets	(141,898)	(276,280)	740,296	83,021	598,398	(193,259)
Net assets, beginning of the year	4,247,435	4,523,715	(1,316,534)	(1,399,555)	2,930,901	3,124,160
Net assets, end of the year	\$ 4,105,537	\$ 4,247,435	\$ (576,238)	\$ (1,316,534)	\$ 3,529,299	\$ 2,930,901

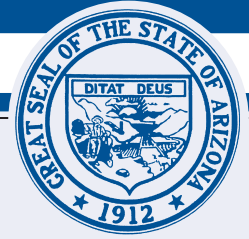
The accompanying notes are an integral part of these financial statements.

## STATEMENTS OF CASH FLOWS

June 30th, 2004 and 2003

	APA General Fund		Hoover Uprating Fund		Total	
	2004	2003	2004	2003	2004	2003
<b>Cash flows from operating activities</b>						
Cash received from customers	\$ 4,400,269	\$ 3,096,556	\$ 20,391,066	\$ 21,595,325	\$ 24,791,335	\$ 24,691,881
Cash payments to suppliers for goods or services	(4,543,201)	(3,457,807)	(19,436,486)	(22,264,987)	(23,979,687)	(25,722,794)
Cash payments to employees for services	-	-	(659,550)	(611,569)	(659,550)	(611,569)
Net cash provided by (used in) operating activities	(142,932)	(361,251)	295,030	(1,281,231)	152,098	(1,642,482)
<b>Cash flows from capital and related financing activities</b>						
Interest payments on obligations	-	-	(3,331,716)	(3,610,797)	(3,331,716)	(3,610,797)
Payments on obligations	-	-	(62,255,424)	(1,450,000)	(62,255,424)	(1,450,000)
Proceeds from refunding, net	-	-	59,779,157	-	59,779,157	-
Acquisition of capital assets	(34,609)	(9,877)	-	-	(34,609)	(9,877)
Advances for Hoover Uprating Program	-	-	4,507,379	5,456,308	4,507,379	5,456,308
Net cash provided by (used in) capital and related financing activities	(34,609)	(9,877)	(1,300,604)	395,511	(1,335,213)	385,634
<b>Cash flows from investing activities</b>						
Interest on investments	41,395	73,144	515,675	565,628	557,070	638,772
Loss on investments	-	(137,441)	-	(89,783)	-	(227,224)
Purchase of investment securities	-	-	(6,189,167)	(7,355,125)	(6,189,167)	(7,355,125)
Proceeds from sale and maturities of investment securities	-	-	6,728,588	7,331,264	6,728,588	7,331,264
Net cash provided by (used in) investing activities	41,395	(64,297)	1,055,096	451,984	1,096,491	387,687
Net change in cash and cash equivalents	(136,146)	(435,425)	49,522	(433,736)	(86,624)	(869,161)
Cash and cash equivalents, beginning of year	3,894,085	4,329,510	2,098,840	2,532,576	5,992,925	6,862,086
Cash and cash equivalents, end of year	\$ 3,757,939	\$ 3,894,085	\$ 2,148,362	\$ 2,098,840	\$ 5,906,301	\$ 5,992,925

The accompanying notes are an integral part of these financial statements.



## STATEMENTS OF CASH FLOWS (CONTINUED)

June 30th, 2004 and 2003

	APA General Fund		Hoover Uprating Fund		Total	
	2004	2003	2004	2003	2004	2003
<b>Reconciliation of operating income (loss) to net cash provided by (used in) operating activities</b>						
Operating income (loss)	\$ (180,309)	\$ (205,016)	\$ 661,954	\$ 326,967	\$ 481,645	\$ 121,951
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities						
Depreciation	35,870	30,711	-	-	35,870	30,711
Changes in assets and liabilities						
(Increase) in accounts receivable	(467,992)	(20,485)	(186,440)	(301,084)	(654,432)	(321,569)
(Increase) in prepaid transmission	-	(182,360)	-	-	-	(182,360)
(Increase) decrease in prepaid purchased power	-	-	(174,819)	183,739	(174,819)	183,739
Increase (decrease) in accounts payable and other	8,777	(3,858)	(8,086)	21,115	691	17,257
Increase (decrease) in power contracts payable	460,722	19,757	2,421	(1,511,968)	463,143	(1,492,211)
Total adjustments	37,377	(156,235)	(366,924)	(1,608,198)	(329,547)	(1,764,433)
Net cash provided by (used in) operating activities	\$ (142,932)	\$ (361,251)	\$ 295,030	\$ (1,281,231)	\$ 152,098	\$ (1,642,482)
<b>Supplemental schedule of noncash capital and related financing activities</b>						
Deferred interest	\$ -	\$ -	\$ 2,735,366	\$ 2,958,718	\$ 2,735,366	\$ 2,958,718
<b>Supplemental schedule of cash paid for interest</b>						
	\$ -	\$ -	\$ 3,209,937	\$ 3,593,036	\$ 3,209,937	\$ 3,593,036

The accompanying notes are an integral part of these financial statements.

## 1. DESCRIPTION OF BUSINESS AND 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 hydropower 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 and has been in continuous operation since. 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 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.

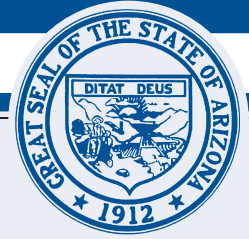
### Measurement Focus

The Authority’s funds are accounted for on a flow of economic resources measurement focus. All assets and liabilities (whether current or noncurrent) associated with their activity are included in the Statements of Net Assets. The Statements of Revenues, Expenses, and Changes in Net Assets present increases (revenues) and decreases (expenses) in total net assets. The Authority’s reported total net assets are segregated into invested capital assets and unrestricted components.

### Basis of Accounting

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.

The accompanying financial statements are presented in conformity with accounting principles generally accepted in the United States of America (“GAAP”). The accompanying financial statements have been prepared in accordance with the reporting model defined by Governmental Accounting Standards Board (“GASB”) Statement No. 34, *Basic Financial Statements - and Management’s Discussion and Analysis - for State and Local Governments*, as amended by GASB Statement No. 37, *Basic Financial Statements and Management’s Discussion and Analysis - for State and Local Governments: Omnibus - an Amendment of GASB Statements No. 21 and No. 34*, and GASB Statement No. 38, *Certain Financial Statement Note Disclosures*.



## 1. DESCRIPTION OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### Accounting Standards

GASB No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, requires that governments' proprietary activities apply all GASB pronouncements as well as the following pronouncements issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements, Financial Accounting Standards Board ("FASB") Statements and Interpretations, Accounting Principles Board Opinions and Accounting Research Bulletins. Governments are given the option whether or not to apply all FASB Statements and Interpretations issued after November 30, 1989, except for those that conflict with or contradict GASB pronouncements. The Authority has elected not to implement FASB Statements and Interpretations issued after November 30, 1989.

### New Accounting Pronouncements

In November 2003, the GASB published Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. The provisions of this Statement require governments to report the effects of capital asset impairment in their financial statements when it occurs. Furthermore, the Statement requires that all governmental entities consistently account for insurance recoveries. The Statement requires governments to evaluate major events affecting capital assets to determine whether they are impaired. Those events include physical damage, changes in legal or environmental factors, technological changes or obsolescence, changes in manner or duration of use and construction stoppage. GASB Statement No. 42 is effective for fiscal periods beginning after December 15, 2004. The Authority believes the implementation of GASB Statement No. 42 will not have a material impact on the financial statements.

### Revenue Recognition

The Authority recognizes revenue when power is delivered and billed 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.

All cash and cash equivalent balances 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 which is substantially the same as the value of the LGIP shares. 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.

## **1. DESCRIPTION OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

### **Capital Assets and Depreciation**

Capital assets are 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 within the Statements of Revenues, Expenses, and Changes in Net Assets. 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.

### **Advances for Hoover Uprating Program**

Proceeds from bonds payable were advanced by the Authority for uprating 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 are 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 Uprating Program as amounts to be recovered from future credits.

### **Schedule C Energy**

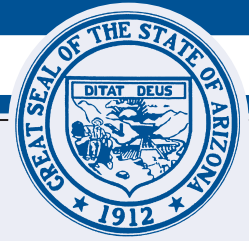
Under its Electric Service Contract with Western, the Authority has preferential rights to excess energy ("Schedule C energy") generated at the Hoover Power Plant. The Authority buys Schedule C energy when available from Western during an operating year (October 1 to September 30). The Authority's financial statements are prepared on a fiscal year (July 1 to June 30) basis. When excess energy is available, the Authority bills its customers as Schedule C energy is delivered and receives payment during a given operating year, but Western does not bill for the cost of such Schedule C energy until the following operating year. An estimate of such amounts is accrued at the end of the fiscal year. The Statement of Net Assets as of June 30, 2004 does not include an accrual for Schedule C energy as no Schedule C energy was available during the operating year.

### **Operating and Nonoperating Revenues**

Operating revenues are revenues derived from the sale of power to customers or from other contractual agreements. Operating revenues include \$8,400,000 received from Salt River Project for scheduling entity services during the years ended June 30, 2004 and 2003, respectively. The revenue is the result of an agreement between the Authority and the Salt River Project which will yield \$8,400,000 annual revenues to the Authority thereby reducing the overall revenue requirements to be paid by the Authority's customers through power rates. The agreement expired September 30, 2004. A new agreement was executed on December 16, 2003, which will yield \$5,400,000 annual revenues, effective October 1, 2004. The agreement will expire on September 30, 2011. Nonoperating revenues are from sources other than the sale of power to customers and primarily consist of income earned on investments.

### **Application of Net Assets to Expenses Incurred**

The Authority applies unrestricted, undesignated net assets to expenses incurred. To the extent undesignated net assets are unavailable, unrestricted, designated net assets will be applied to expenses incurred.



## 1. DESCRIPTION OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

### Customer Credits

The Authority operates on a nonprofit basis and reduces charges to its customers, through credits on power bills, 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.

As of June 30, 2004, there were no accrued credits to be applied to customers' power bills based upon rates from Western's operating year ending September 30, 2004.

### Income Taxes

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

### 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 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 these estimates.

### Geographic and Product Concentration

The Authority's revenues are derived from the sale of electrical power and services to 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 accompanying financial statements for June 30, 2003 have been reclassified to conform to the June 30, 2004 presentation. Such reclassifications had no effect on net assets as previously reported.

## 2. FUND ACCOUNTING

### Hoover Upgrading Fund

The Hoover Power Plant Act of 1984 ("Hoover Act") authorized the U.S. government to increase the capacity i.e., "uprate," 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 nonfederal purchasers of the uprated 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.

**2. FUND ACCOUNTING (CONTINUED)****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.

**3. CAPITAL ASSETS, NET**

Capital assets, net, of the APA General Fund at June 30, 2004 and 2003 were as follows:

	2004	2003
Transmission and distribution plant	\$ 508,683	\$ 508,683
General plant	694,719	669,766
	<u>1,203,402</u>	<u>1,178,449</u>
Less: Accumulated depreciation	(1,043,999)	(1,017,785)
Capital assets, net	<u>\$ 159,403</u>	<u>\$ 160,664</u>

	June 30, 2003	Additions	Disposals	June 30, 2004
<b>Capital assets</b>				
Transmission plant	\$ 289,049	\$ -	\$ -	\$ 289,049
Distribution plant	219,634	-	-	219,634
General plant - office	669,766	34,609	(9,656)	694,719
Total capital assets	<u>1,178,449</u>	<u>34,609</u>	<u>(9,656)</u>	<u>1,203,402</u>
<b>Accumulated depreciation</b>				
Transmission plant	(289,049)	-	-	(289,049)
Distribution plant	(187,361)	(8,069)	-	(195,430)
General plant - office	(541,375)	(27,801)	9,656	(559,520)
Total accumulated depreciation	<u>(1,017,785)</u>	<u>(35,870)</u>	<u>9,656</u>	<u>(1,043,999)</u>
Capital assets, net	<u>\$ 160,664</u>	<u>\$ (1,261)</u>	<u>\$ -</u>	<u>\$ 159,403</u>

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

**4. 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 \$5,224,715 and \$5,325,522 for the years ended June 30, 2004 and 2003, 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. During the year ended June 30, 2004, principal amortization, interest expense and other related costs on the bonds issued to finance the Upgrading Program exceeded interest income by \$5,312,526.



## 5. BONDS PAYABLE

Bonds payable consists of the following:

	June 30, 2003	Increases	Reductions	Transfers	June 30, 2004
Bond payable current	\$ 2,320,000	\$ -	\$ (2,320,000)	\$ 2,545,000	\$ 2,545,000
Bond payable long-term	65,175,000	57,520,000	(62,630,000)	(2,545,000)	57,520,000
Total bonds payable	\$ 67,495,000	\$ 57,520,000	\$(64,950,000)	\$ -	\$ 60,065,000

In prior years, the Authority defeased 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 liability for these bonds has been removed from the Hoover Upgrading Fund. Accordingly, these trust account assets and related liabilities are not included in the Authority's financial statements.

The Authority's outstanding bonds, totaling \$60,065,000, bear interest ranging from 5.0% to 5.3%, are due from 2004 through 2017, 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 effective interest method. Principal amounts due over the next five fiscal years ended June 30 and thereafter are as follows: \$2,545,000 in 2005, \$2,560,000 in 2006, \$2,825,000 in 2007, \$3,120,000 in 2008, \$3,450,000 in 2009, \$22,495,000 in 2010 through 2014, and \$23,070,000 in 2015 through 2018. Interest amounts due over the next five fiscal years ended June 30 and thereafter are as follows: \$3,023,261 in 2005, \$2,894,363 in 2006, \$2,759,738 in 2007, \$2,611,113 in 2008, \$2,446,863 in 2009, \$9,121,321 in 2010 through 2014, and \$2,500,051 in 2015 through 2018.

### Crossover Refunding

On September 12, 2001, the Authority issued \$57,520,000 of Special Obligation Crossover Refunding Bonds. Proceeds from the sale of the bonds along with a fund contribution by the Authority were held in an escrow trust account invested in government securities until October 1, 2003 (the "Crossover Date") when a crossover refunding took place. The crossover refunding resulted in \$57,520,000 of Special Obligation Crossover Refunding Bonds being exchanged for 2001 Series Power Resource Revenue Refunding Bonds of the same principle amount, maturity date and interest rates as the crossover bonds. In addition, as part of the crossover and as required by regulation, the Authority applied an additional \$600,113 of funds held in the Debt Service Reserve Account (see page 4 - Statement of Net Assets, Investment held by Trustee) to effect the crossover transaction and called the \$62,630,000 of the 1993 Series Power Resource Revenue Refunding Bonds maturing on and after October 1, 2005.

The proceeds in the government securities escrow trust account, together with the income realized from investment of trust assets served as collateral for the Special Obligation Crossover Bonds and paid the debt service on those bonds until the Crossover Date. The Special Obligation Crossover Bonds were payable solely from the amounts in the escrow trust account and were not payable from any other source. Because they were not payable from revenues derived by the Authority or secured by any assets held by the Authority, neither the Special Obligation Crossover Bonds nor the assets held in the escrow trust account were reflected on the Authority's Statements of Net Assets at June 30, 2003. However, in conjunction with the issuance of the Crossover Bonds, the Authority deposited \$2,694,676 with a crossover bond trustee which is reflected as "Cash with Trustee" in the Authority's Statement of Net Assets at June 30, 2003.

**5. BONDS PAYABLE (CONTINUED)*****(Crossover Refunding - Continued)***

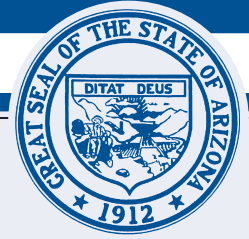
As a result of the crossover refunding transaction on October 1, 2003, the 2001 Series Bonds are reflected as obligations of the Authority at June 30, 2004 and the called portion of the 1993 Series Bonds are no longer outstanding and cease to be entitled to any lien on the revenues pledged to payment of those bonds. Instead, the revenue stream originally pledged to secure the called portion of the 1993 Series bonds “crossed over” to pay debt service on the 2001 Series Bonds on October 1, 2003. The 2001 Series Bonds bear interest at a rate of 5% and 5.25% payable on April 1 and October 1 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. 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 effective interest method as a component of interest expense over the life of the refunded bonds. The Authority amortized \$199,902 for the year ended June 30, 2004 resulting in a net deferred amount of \$2,212,054 in the Statement of Net Assets. 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 effective interest method. The Authority amortized \$293,117 for the year ended June 30, 2004. The cash flows required to service the new debt are \$4,572,093 less than the cash flows required to service the old debt.

**6. Investments Held by Trustee**

As of June 30, 2004 and 2003, investments are collateralized with securities held by the Authority’s trustee. The fair value of the investment securities at June 30 is as follows:

	2004	2003
Repurchase agreement	\$ 6,546,550	\$ 7,146,663
U.S. government securities	2,653,463	2,592,771
Total investments held by Trustee	<u>\$ 9,200,013</u>	<u>\$ 9,739,434</u>

On September 19, 1996, the Authority entered into a repurchase and custody agreement with MBIA Investment Management Corporation (“IMC”) wherein the Authority agreed to effect a series of repurchase transactions with IMC, in investments allowable under the bond resolution agreements and state law, with a fixed earnings rate of 6.95%. The securities are held in trust by JP Morgan Institutional Trust Services. If at any time the aggregate market value of all purchased securities is less than the amount required under the repurchase and custody agreement (calculated using a percentage of 104%), the Authority may require IMC to transfer additional securities so the aggregate market value of all securities will equal or exceed such requirement. At June 30, 2004, the aggregate market value of all purchased securities exceeded the amount required under the repurchase and custody agreement.



## 7. 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. A report may be obtained by writing or calling the Plan at 1020 East Missouri Avenue, Phoenix, Arizona 85014, (602) 255-5575. The Plan was established by the State of Arizona to provide benefits for employees of the state and employees of participating political subdivisions and school districts. The Plan became effective on July 1, 1971. By actuarial computation, employee member and Authority contributions to the Plan were fixed at 5.70% (5.20% retirement and .50% long-term disability) of their compensation for the years ended June 30, 2004 and 2003, with the contributions made through payroll deductions. Employee contributions vest immediately. Total contributions to the Plan for the years ended June 30, 2004 and 2003 by the Authority’s covered employees were \$38,991 and \$14,854, respectively.

Matching employer member contributions were actuarially determined and fixed at the same rate as employee member contributions for the years ended June 30, 2004 and 2003. In the event the Plan’s actuary determines that additional contributions are needed in order to amortize an unfunded accrued liability, every employer 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 June 30, 2004 and 2003 were \$659,550 and \$611,569, 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.

## 8. 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. The following chart illustrates the maximum amount of the monthly available benefit for eligible members and their dependents:

Years of Credited Service	Percent of Premium Benefit	Member		Member and 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

### 9. Purchased Power, Sales and Transmission Commitments

The Authority is party to Firm Electric Service and Transmission Service Contracts with terms expiring September 30, 2017. This requires the Authority to pay approximately 19% of Western's revenue requirements each operating year until the contract expires. During the years ended June 30, 2004 and 2003, the Authority paid \$13,179,355 and \$14,971,173, 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 June 30, 2004 and 2003, the Authority paid \$5,227,562 and \$5,217,806, 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 Western's transmission services. The advanced funds are then applied to the subsequent month's transmission invoice. As of June 30, 2004, the Authority recognized a prepaid deposit of \$182,360 that is refundable upon termination of the contract.

The Authority has sales contracts with all customers. Under these contracts, customers are obligated to pay for their percentage allocation if any Hoover power is 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.

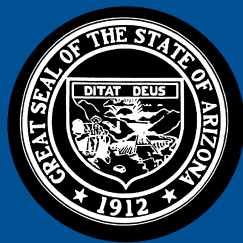
The Authority also has contracts with Salt River Project for the purchase and transmission of power to the Authority's customers. Under the transmission contract, the Authority must pay an annual transmission fee of \$63,898 until September 30, 2017. The Authority has a power contract with SRP in which 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 June 30, 2004 and 2003, the Authority paid \$4,835,337 and \$3,067,952, respectively, for purchased power under this contract for its customers.

### DEBT SERVICE COVERAGE RATIO

<b>NET INCOME</b>	\$ 740,296
<b>Add:</b>	
Interest Expense (1)	3,209,937
Amortization (1)	245,940
Depreciation (1)	26,023
Western Credits	5,224,715
Credits to Customers for Prior Year	416,619
<b>Total Additions</b>	<b>9,863,530</b>
<b>Deduct:</b>	
Deferred Interest Expense	(2,735,366)
Premium Amortization	(293,125)
Total Deductions	(3,028,491)
<b>Income available for debt service</b>	<b>\$ 6,835,039</b>
<b>Debt Service</b>	<b>\$ 5,698,687</b>
<b>Debt service coverage ratio</b>	<b>1.2</b>

(1) Interest expense, depreciation expense and amortization of Upgrading Costs are not expenses under the Bond Resolution.

(2) Debt Service is the total of Principal and Interest Expense accrued between July 1, 2003 and June 30, 2004.



## ARIZONA POWER AUTHORITY