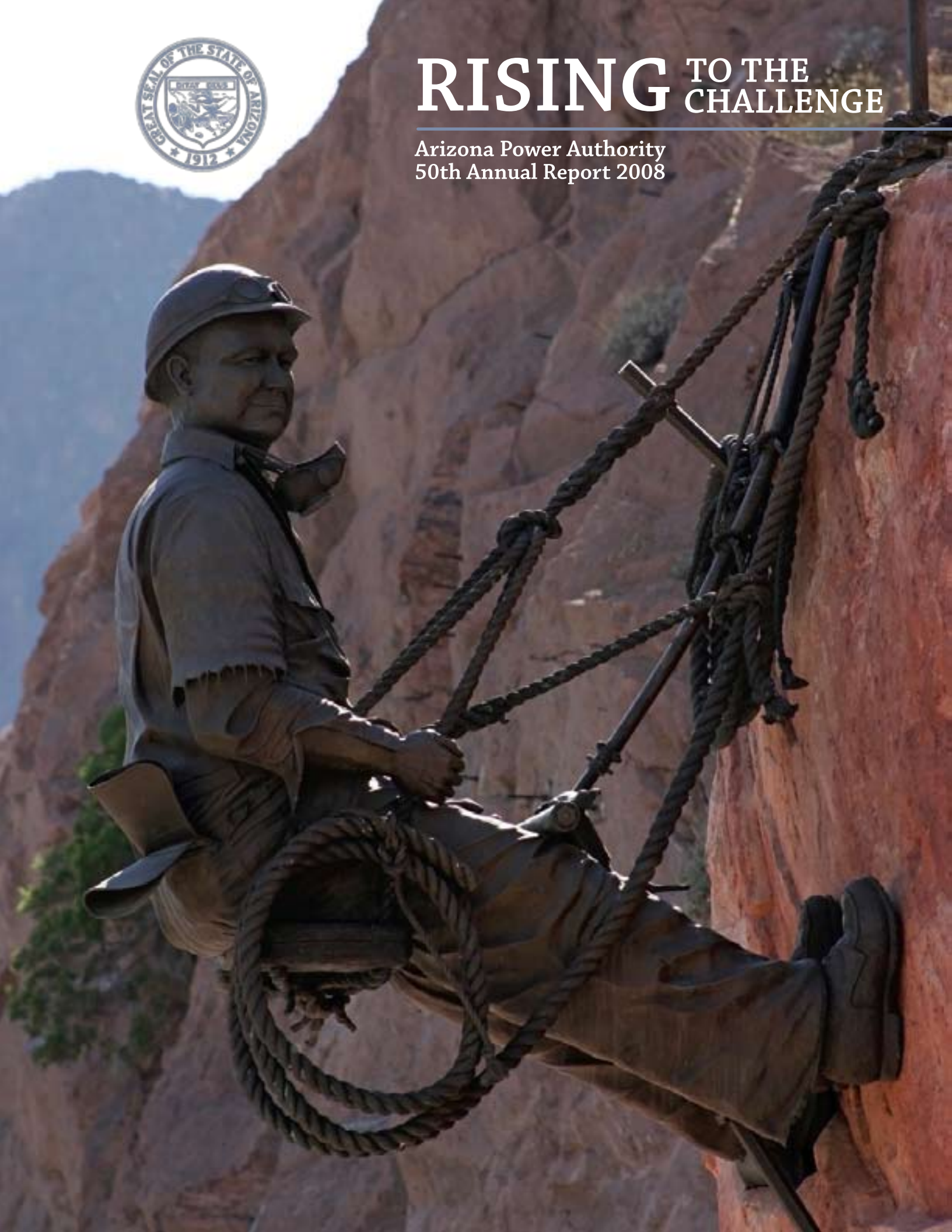

RISING TO THE CHALLENGE

Arizona Power Authority
50th Annual Report 2008

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Commission
DALTON H. COLE
Chairman

RICHARD S. WALDEN
Vice-Chairman

WENDY FELDMAN-KERR
JOHN I. HUDSON
DELBERT R. LEWIS

ARIZONA POWER AUTHORITY
1810 W. Adams Street • Phoenix, AZ 85007-2697
(602) 542-4263 • FAX (602) 253-7970

Staff
JOSEPH W. MULHOLLAND
Executive Director

MICHAEL A. GAZDA
Deputy Director

RITA K. GALLANT
Executive Secretary

December 1, 2008

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

Dear Governor:

On behalf of the Arizona Power Authority's Commissioners and staff, I submit our 50th Annual Report. This report details the Authority's operational and financial activities for the fiscal year ending June 30, 2008. It also highlights the Authority's efforts in administering Arizona's hydroelectric power entitlement generated at Hoover Dam and Powerplant.

Although the Colorado River system experienced an increase in rainfall this year, the River continues to be impacted by a severe drought cycle, which has yielded the lowest nine-year average water flows in 100 years of record keeping. Due to the prolonged drought conditions, impounded water in Lake Mead continues to decrease, thereby reducing the amount of hydroelectric generation available to Arizona. As of June 30, 2008, storage in Lake Mead was 46% of its capacity, down 3% from June 2007.

The Authority remains actively involved in federal and state efforts to mitigate the drought's impact to Arizona.

Sincerely,

Dalton H. Cole

Dalton H. Cole
Chairman

With the prolonged drought cycle of the Colorado River system, it is increasingly important for the Arizona Power Authority to manage its federal hydropower allocation from Hoover Dam prudently. Critical decisions must be made in concert with the other Hoover hydropower allottees in order to assure the maximum efficiency and cost effective management of this valuable resource. The continual interaction of the Authority with the federal agencies responsible for the generation and transmission of this key Arizona resource is our primary obligation and commitment.

"Accept the Challenges so that you may feel the exhilaration of victory"

– General George S. Patton

Dalton H. Cole, Chairman

Appointed to the Commission in January 2002 for a term to run until 2008, Dalton Cole was elected to be the Chairman in January 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. 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.

Richard S. Walden

Appointed to the Commission in 1984 and re-appointed through his present term expiring in 2010, 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.

Wendy Feldman-Kerr

Wendy Feldman-Kerr was appointed to the commission in 2008. She is owner and operator of The Feldman Agency, and is consistently is ranked as one of the top Insurance agents in Arizona. Having served on the Queen Creek Town Council as Council Member, Vice Mayor and Mayor, Ms. Feldman-Kerr has overseen and helped facilitate much of its substantial growth. Feldman-Kerr is a Member of the National Association of Insurance and Financial Advisors, the Society of Financial Services Professionals, San Tan Mountain PRIDE and serves on the board of the Arizona Investment Council.

Lt. General John I. Hudson USMC (Ret.)

First appointed to the Arizona Power Authority Commission in March 2000, John I. Hudson was elected Chairman in January 2006 with his current term expiring in 2012. A retired Lieutenant General in the U.S. Marine Corps where he served for 37 years, John Hudson is Chairman 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, and past president of Yuma's 78-CRIME Board of Directors.

Delbert R. Lewis

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

REPORT OF THE EXECUTIVE DIRECTOR

Serious challenges face our state, our nation, and our world with energy centered at the source and solution of many of them. New sources of energy are desperately needed, but finding and developing those new energy sources is a long way off. Today, we must make the best use of those energy facilities we have; and that is where the Hoover generators have a vital role. In the coming years, numerous alternative energy sources will be discussed and assessed, from nuclear to solar, wind and others. While it is difficult to predict which new source or combination of sources will ultimately make the difference, it's clear that careful planning must be conducted and wise choices must be made.

Joe Mulholland

As the steward of Arizona's allotment of Hoover power, the Arizona Power Authority has a critical role to play in helping the state meet the energy challenges we face. Hoover generators are highly efficient and responsive with the ability to rapidly meet changes in demand for power as the need requires. In addition, the Hoover hydroelectric power is very affordable and that cost advantage is passed directly to our customers. Furthermore, Hoover power produces no pollutants making it environmentally friendly to the atmosphere.

All these factors serve to make the Arizona Power Authority a source of stability in an otherwise uncertain industry. This stability uniquely positions the Authority to help ensure affordable energy for its customers. The Authority's credibility in the financial markets remains strong, which enables us to gain competitive financing for key Arizona energy priorities. In the future, this could include financing renewable energy initiatives to assist in the transition to alternative sources.

In addition to developing renewable energy, Arizona must also continue to develop its existing transmission infrastructure. As the price of land has increased, the cost of building new transmission facilities has gone up as well. The Arizona Power Authority can help respond to this challenge through financing, and by collaborating and coordinating with state and regional utility companies to correctly plan, design and engineer transmission corridors for maximum efficiency. The staff of the Authority stands ready and able to lend its expertise to these efforts.

"In the middle of difficulty lies opportunity."
– Albert Einstein

Another challenge we face is the reallocation of Hoover power scheduled for 2017. Negotiations for this reallocation involving California and Nevada public and private entities have already begun. Our commitment is to work to make certain that Arizona receives its proper share of the Hoover generation.

While rainfall increased this year, long term drought conditions still plague us. The Authority is actively monitoring these conditions in order to make necessary adjustments on an on-going basis. In addition, as a participant in the Multi Species Conservation Program, the Authority continues to support conservation in the Colorado River Basin.

Our Commissioners bring a wealth of experience in agricultural, energy and financial issues that is an invaluable asset as we move forward. In addition, the Arizona Power Authority maintains excellent relations with both the Federal Department of Energy and the Department of the Interior, which will serve the state well in addressing national policy that impacts Arizona. Making the correct choices today will help ensure the energy future of Arizona and the Southwest. The Authority is poised and prepared to do its part in meeting these challenges.

NEW VOICES

Mike Gazda

Michael (Mike) Gazda is the Deputy Director for APA. Mike has a Bachelor of Science Degree from the University of Illinois in Electrical Engineering with a Power Option. He has more than 30 years of technical experience in many aspects of the electrical utility industry ranging from power plant supervision to transmission and distribution activities including planning, operations & maintenance along with substation design, protective relaying and SCADA communications. Mike has also provided technical support for the Southwire/DOE Superconductor demonstration project located at Southwire's Carrolton, Georgia plant that carries the full load of the plant and is successfully operating today. Mike is currently registered as a Professional Engineer in Arizona and South Carolina.

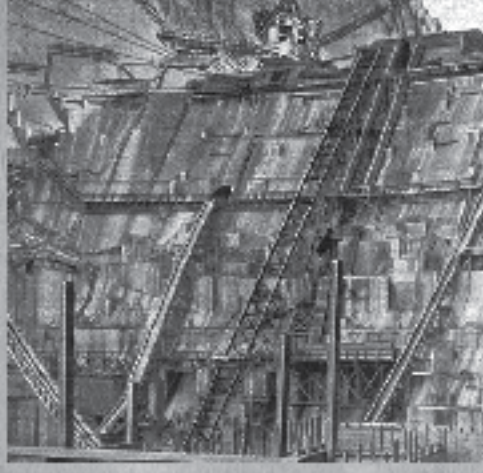
Linda Sullivan

Linda Sullivan serves as the Arizona Power Authority's Administrative Assistant. In addition to coordination and administrative duties, she is responsible for power scheduling and billing. Linda has experience in customer service and banking operations including legal order processing and auto finance. Linda graduated from California State Polytechnic University with a degree in Philosophy, and she is currently a member of the City of Mesa Board of Adjustments and the Mesa Leadership Training and Development Program Board of Directors.

Robert Nieto

Robert Nieto is the Arizona Power Authority's Information Technology Coordinator and Rate Specialist. Robert has a Bachelor's degree in Computer Information Systems and a Masters Degree in Network Communication Systems with a focus in Network Security. Robert comes to the Power Authority with a complete and diverse understanding of network systems and security, providing the organization with the experience needed to maintain and adapt to the fast changing world of technology in the industry. Robert also brings an understanding of software development, allowing for the implementation of custom built applications that makes for better data and organization management. In addition, Robert has a deep understanding of the Power Authority's power market and processes, bringing support to the internal power management procedures. Robert also is strongly involved with his community church and is often part of community service projects to help the poor and orphans.

Celebrating 50 Annual Reports
Arizona Power Authority



1958 Authority submits an application to the Federal Power Commission to construct, operate, and maintain hydroelectric dams at Bridge (including Prospect) and Marble Canyons.

1952 In April, Authority receives and delivers its first power from Hoover Dam (165,000 kWh).

1936 Hoover Dam completed and three of seventeen units installed in the power plant.

1950 M.J. Dougherty becomes first Chairman of Commission

1965 Authority proposes development of Montezuma Pumped Storage Project south of Phoenix.

1944 Arizona Power Authority Act passed by Arizona State Legislature and approved by Governor Sidney P. Osborne

1967 Arizona enacts State Water and Power Plan for the development and utilization of Colorado River water, as well as the State's power resources. Potential projects included the Central Arizona Project, Bridge Canyon Project, Marble Canyon Project, Montezuma Pumped Storage Project, and Havasu Pumped Storage Project.

1951 Authority delivers its first energy from the Colorado River through a contract with the U.S. Bureau of Reclamation (USBR) for the delivery of 45,775 kWh of power from Davis Powerplant

1962 USBR extends the Authority's contract to sell Hoover power to its customers through 1970. In 1970 contracts are renewed to the same customers in substantially the same amount and are effective until May 1987.

1954 Authority concludes agreements to buy and transmit power from Arizona Public Service's Saguaro Steam Generating Plant. Authority purchases a tract of land near State Capitol, constructs and occupies its new office building.

OPERATIONS AND ENVIRONMENTS

The Colorado River Basin experienced above average stream flows during 2008, despite the continuation of a severe, nine-year drought cycle that has seen the lowest average water flows in 100 years of record keeping. Snowpack conditions throughout the 2007-2008 winter season were 124% of average, easing drought conditions for central Arizona. These above average inflows to Colorado River reservoirs resulted in a net gain in the total system storage, even though precipitation was below average for much of the year. Unregulated inflow to Lake Powell in water year 2008 was 102% of the 30-year average. However, levels at Lake Mead were down five feet from September 2007, due to overall water management.

A major overhaul on Unit N7 was completed at Hoover Dam during the 2007/2008 maintenance period. The overhaul included installing new stainless steel wicket gates and increasing the gate opening to maximize water flow through the turbines. Three other units were also modified to increase the gate opening. The changes achieved an addition of 29 megawatts of capacity at lake levels below 1145 feet.

ARIZONA POWER AUTHORITY HISTORY

Honoring the 50th Annual Report

1974 Governor Williams signs Senate Bill 1282. The legislation revised the Authority's statute to encourage the Authority to promote development of solar, nuclear and geothermal energy.

1984 The Hoover Power Plant Act authorized the U.S. Department of the Interior to "increase the capacity of existing operating equipment ... at Hoover Power Plant." (known as The Uprating Program)

1987 Arizona Power Authority signs 30-year electric service contract increasing the amount of Hoover power for the state. The number of customers increases from 17 to 38.

1988 The Salt River Project signs a contract with the Authority to serve as their Scheduling Entity.

2005 The Multi-Species Conservation Program becomes effective. The Authority is a participant of this 50-year program, which will rejuvenate many of the endangered and threatened species that dwell in the Lower Colorado River Basin.

A unit overhaul is planned for 2008/2009, which will yield 14 megawatts of additional capacity. The re-stroking of another unit is also planned, which should add 4 megawatts of capacity at these lower lake levels, for a total improvement of 18 megawatts.

"The greatest challenge to any thinker is stating the problem in a way that will allow a solution"

– Bertrand Russell

MANAGEMENT'S DISCUSSION AND ANALYSIS

Introduction

The following is a discussion and analysis of the Arizona Power Authority's ("Authority") financial performance for the fiscal years ended June 30, 2008 and 2007. 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
(c) identify changes in the Authority's financial position

The Management's Discussion and Analysis ("MD&A") focuses on the 2008 and 2007 fiscal years' activities, resulting changes and known facts, and should be read in conjunction with the Authority's annual report for the years ended June 30, 2008 and 2007. 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 19 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.

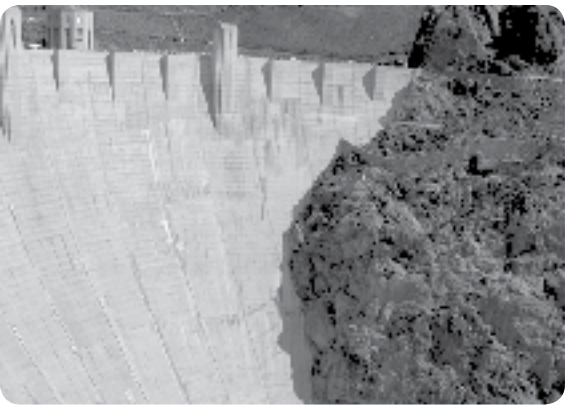
Using this Annual Report

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 19, 20 and 21, 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.

Authority Highlights

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 years ended June 30, 2008 and 2007, the Authority advanced a net prepaid deposit of $231,597 and $182,360, respectively, which is included in the Statements of Net Assets. This contract gives Western greater flexibility and allows them to work more effectively with the Authority and other customers.

Contributions – During fiscal years 2008 and 2007, the Authority contributed $60,000 via the Arizona Power Authority Scholarship Program. The following schools each received $20,000: Arizona State University, The University of Arizona, and Northern Arizona University.



Effects of Drought on Hoover Energy – The Colorado River Basin has been experiencing severe drought conditions for the past nine 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 books, resulting in higher revenue and purchased power costs.

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 wrote off the lost investment amount as of June 30, 2003. As of June 30, 2008, a total of $120,934 has been recovered. $2,365 was received in fiscal year 2008 and is presented as Other Income.

Revenues

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. The Arizona Power Authority Commission is solely responsible for periodically adjusting rates, as appropriate.

Market Impacts on Investment Income – Unfavorable market conditions during fiscal year 2008 resulted in a decrease in interest rates, yielding less investment income for the year.

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 resulting from reduced water levels.

Expenses

Introduction of New Programs – There were no changes during this fiscal 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. Fiscal year 2008 staffing costs (salary and related benefits) represent 3.02% of the Authority's operating costs. For fiscal year 2007, staffing costs represent 3.12% 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 2008 net assets decreased by $(42,641) or (1.1%), due mainly to a decrease in sales and an increase in expenses, which results in a reduction in net asssets. Operating expenses increased due to an advance payment required for transmission services.

- The Authority's 2007 net assets increased by $531,355 or 16.02%, due mainly to increased rates.

- The Authority's 2008 operating revenues decreased by $(168,976) or (0.60%), due to a decrease in sales of supplemental power.

- The Authority's 2007 operating revenues increased by $1,972,386 or 7.49%, due to an increase in rates.

Statements of Net Assets

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

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

Principal Payment on Debt – which will reduce current assets and reduce long-term debt.

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

Condensed Statements of Net Assets
Business Type Activities

	JUNE 30			
	2008	**2007**	**DIFF $**	**DIFF %**
CURRENT ASSETS	$ 13,705,375	$ 14,327,162	$ (621,787)	(4.3) %
LONG–TERM ASSETS	43,116,959	46,500,896	(3,383,937)	(7.3) %
CAPITAL ASSETS, NET	186,290	200,159	(13,869)	(7.0) %
TOTAL ASSETS	**57,008,624**	**61,028,217**	**(4,019,593)**	**(6.6) %**
CURRENT LIABILITIES	7,073,364	7,492,262	(418,898)	(5.6) %
LONG-TERM (BONDS PAYABLE, NET)	46,129,415	49,687,469	(3,558,054)	(7.2) %
TOTAL LIABILITIES	53,202,779	57,179,731	(3,976,952)	(7.0) %
NET ASSETS				
INVESTED IN CAPITAL ASSETS	186,290	200,159	(13,869)	(7.0) %
UNRESTRICTED	3,619,555	3,648,327	(28,772)	(0.8) %
TOTAL NET ASSETS	3,805,845	3,848,486	(42,641)	(1.1) %
TOTAL LIABILITIES & NET ASSETS	**$57,008,624**	**$61,028,217**	**$ (4,019,593)**	**(6.6) %**

Fiscal Year 2008 Condensed Statements of Net Assets Discussion

Current Assets decreased due to a decrease in prepaid purchased power and a decrease in Accounts Receivable.

Long-Term Assets decreased because of a payment of principal for the current year debt service for the Uprating Program.

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

Current Liabilities decreased due to a decrease in amounts owed for supplemental power.

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

Net Assets are explained on page 15.

Condensed Statements of Net Assets

Business Type Activities

	JUNE 30			
	2007	**2006**	**DIFF $**	**DIFF %**
CURRENT ASSETS	$ 14,327,162	$ 13,774,025	$ 553,137	4.0 %
LONG–TERM ASSETS	46,500,896	49,307,084	(2,806,188)	(5.7) %
CAPITAL ASSETS, NET	200,159	235,769	(35,610)	(15.1) %
TOTAL ASSETS	**61,028,217**	**63,316,878**	**(2,288,661)**	**(3.6) %**
CURRENT LIABILITIES	7,492,262	7,077,825	414,437	5.9 %
LONG–TERM (BONDS PAYABLE, NET)	49,687,469	52,921,922	(3,234,453)	(6.1) %
TOTAL LIABILITIES	57,179,731	59,999,747	(2,820,016)	(4.7) %
NET ASSETS				
INVESTED IN CAPITAL ASSETS	200,159	235,769	(35,610)	(15.1) %
UNRESTRICTED	3,648,327	3,081,362	566,965	18.4 %
TOTAL NET ASSETS	3,848,486	3,317,131	531,355	16.0 %
TOTAL LIABILITIES & NET ASSETS	**$61,028,217**	**$63,316,878**	**$(2,288,661)**	**(3.6) %**

Fiscal Year 2007 Condensed Statements of Net Assets Discussion

Current Assets increased due to an increase in prepaid purchased power, increased accounts receivable, and an increase in the Debt Service cash account.

Long-Term Assets decreased because of a payment of principal for the current year debt service for the Uprating Program.

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

Current Liabilities increased due to an increase in amounts owed for purchased power pursuant to power contracts with the Western Area Power Administration as of June 30, 2007 and an increase in current Debt Service payable.

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

Net Assets are explained on page 17.

Capital Assets

As of fiscal year end, the Authority had $186,290 invested in a variety of capital assets, as reflected in the following schedule, which represents a net decrease (additions less retirements and depreciation) of $13,869 or 7% during fiscal year 2008 and a net decrease of $35,610, or 15% during fiscal year 2007.

	JUNE 30	
	2008	**2007**
TRANSMISSION PLANT	$ 21,361	$ 24,413
DISTRIBUTION PLANT	20,729	23,032
GENERAL PLANT – OFFICE	144,200	152,714
INVESTED IN CAPITAL ASSETS, END OF YEAR	**$ 186,290**	**$ 200,159**

The following reconciliation summarizes the change in Capital Assets for the years ended June 30, 2008 and 2007, which is presented in detail in Note 4:

	JUNE 30	
	2008	**2007**
BEGINNING BALANCE	$ 200,159	$ 235,769
ADDITIONS	16,726	3,084
DEPRECIATION	(30,595)	(38,694)
ENDING BALANCE	**$ 186,290**	**$ 200,159**

Debt Outstanding

As of June 30, 2008, the Authority had $49,015,000 in debt outstanding, compared to $52,135,000 in the prior year, as a result of a principal payment of $3,120,000, which was paid on October 1, 2007. As of June 30, 2007, the Authority had $52,135,000 in debt outstanding, compared to $54,960,000 in the prior year, as a result of a principal payment of $2,825,000, which was paid on October 1, 2006. 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 fiscal year 2006, the Commission raised rates 15% effective February 1, 2006 in response to reduced energy generation and other business conditions. No rate changes were effected during fiscal year 2007 or 2008.

Statements of Revenues, Expenses, and Changes in Net Assets

There are normal transactions that will affect the comparability of the Statements of Revenues, Expenses and Changes in Net Assets 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.

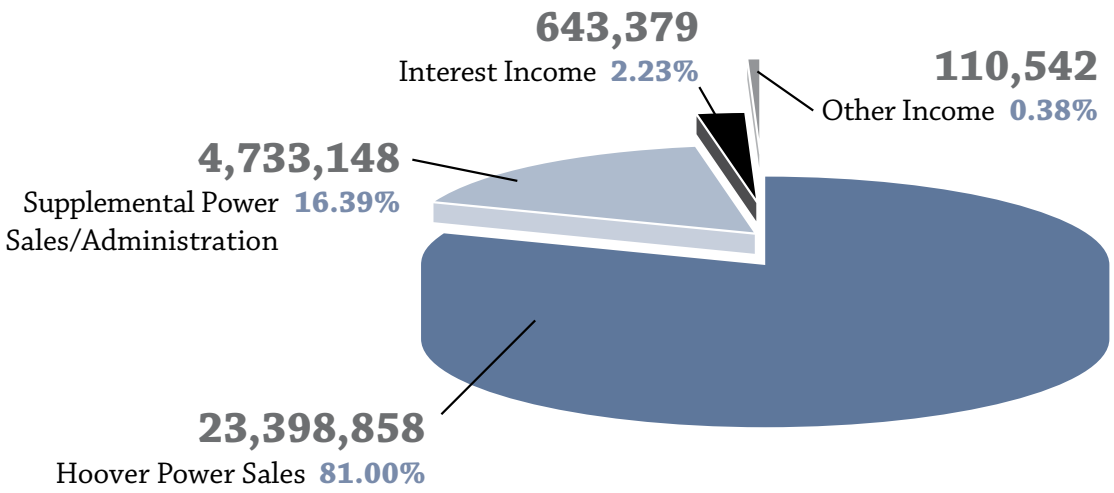
Other Income (Deductions) – which increase/decrease as a result of investment market conditions.

Statements of Revenue, Expenses, and Changes in Net Assets

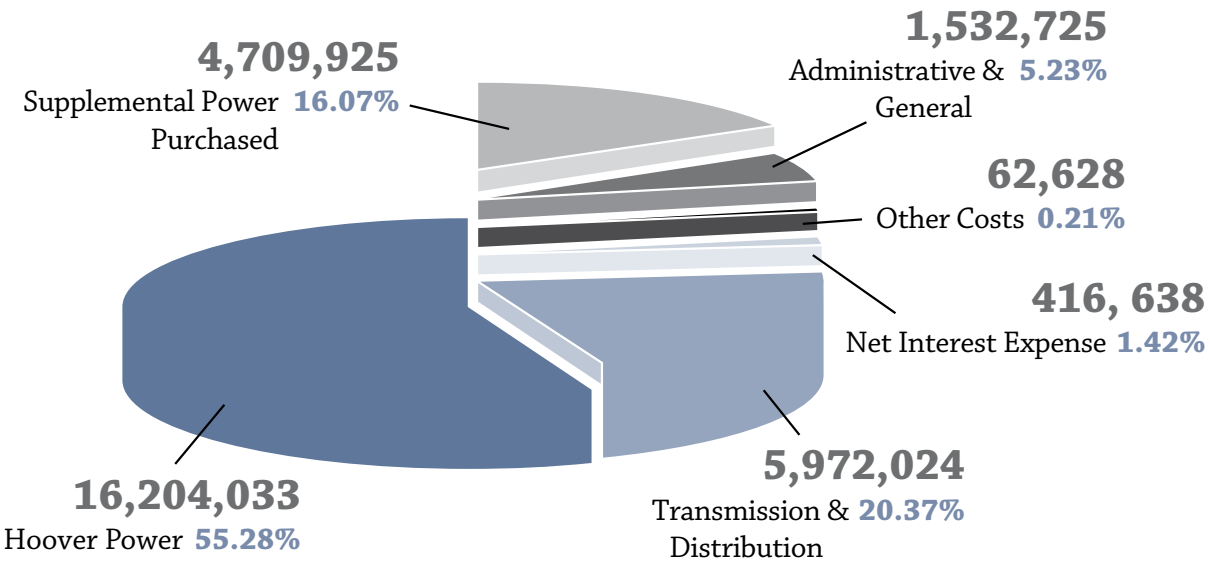
Business Type Activities

	JUNE 30			
	2008	**2007**	**DIFF $**	**DIFF %**
OPERATING REVENUES	$ 28,132,006	$ 28,300,982	$ (168,976)	(0.6) %
OPERATING EXPENSES				
PURCHASED POWER	20,913,958	21,359,826	(445,868)	(2.1) %
WESTERN CREDITS	(5,838,211)	(5,523,334)	(314,877)	5.7 %
AMORTIZATION OF HOOVER UPRATING PROGRAM COSTS	5,838,211	5,523,334	314,877	5.7 %
TRANSMISSION & DISTRIBUTION	5,972,024	5,303,199	668,825	12.6 %
ADMINISTRATIVE & GENERAL	1,532,725	1,481,035	51,690	3.5 %
DEPRECIATION	30,595	38,694	(8,099)	(20.9) %
OTHER	62,628	87,088	(24,460)	(28.1) %
TOTAL OPERATING EXPENSES	28,511,930	28,269,842	242,088	0.9 %
OPERATING INCOME (LOSS)	(379,924)	31,140	(411,064)	
OTHER (DEDUCTIONS) INCOME				
INTEREST EXPENSE	(2,572,114)	(2,724,425)	152,311	(5.6) %
DEFERRED INTEREST EXPENSE	2,155,476	2,273,992	(118,516)	(5.2) %
AMORTIZATION	108,054	114,453	(6,399)	(5.6) %
INTEREST INCOME	643,379	794,593	(151,214)	(19.0) %
OTHER	2,488	41,602	(39,114)	(94.0) %
TOTAL OTHER INCOME	337,283	500,215	(162,932)	(32.6) %
CHANGES IN NET ASSETS	(42,641)	531,355	(573,996)	(108.0) %
NET ASSETS, BEGINNING OF YEAR	3,848,486	3,317,131	531,355	16.0 %
NET ASSETS, END OF YEAR	**$ 3,805,845**	**$ 3,848,486**	**$ (42,641)**	**(1.1) %**

The following chart depicts the sources of revenues for the fiscal year 2008:



The following chart depicts the types of expenses for the fiscal year 2008:



Fiscal Year 2008 Changes in Net Assets Discussion

Net Assets decreased overall because of the following:

- Operating Revenues decreased due to a decrease in sales of supplemental power.
- Total Operating Expenses increased due to an increase in transmission expenses.
- Western Credits increased because of changes in debt payments and associated costs related to the Uprating Program.
- Amortization of the Uprating Program increased because of the increase in the amortization of long-term bond costs.
- Administrative and General expenses increased due to an increase in legal expenses, hospitalization insurance and office building repairs.
- Depreciation decreased due to the normal attrition of capital assets.
- Other expenses decreased due to a reduction in expenditures for special projects, such as the National Renewable Energy Laboratory (NREL) study.

Statements of Revenues, Expenses, and Changes in Net Assets

There are basic or normal transactions that will affect the comparability of the Statements of Changes in the Net Assets 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 rates, transmission costs, and operating costs.

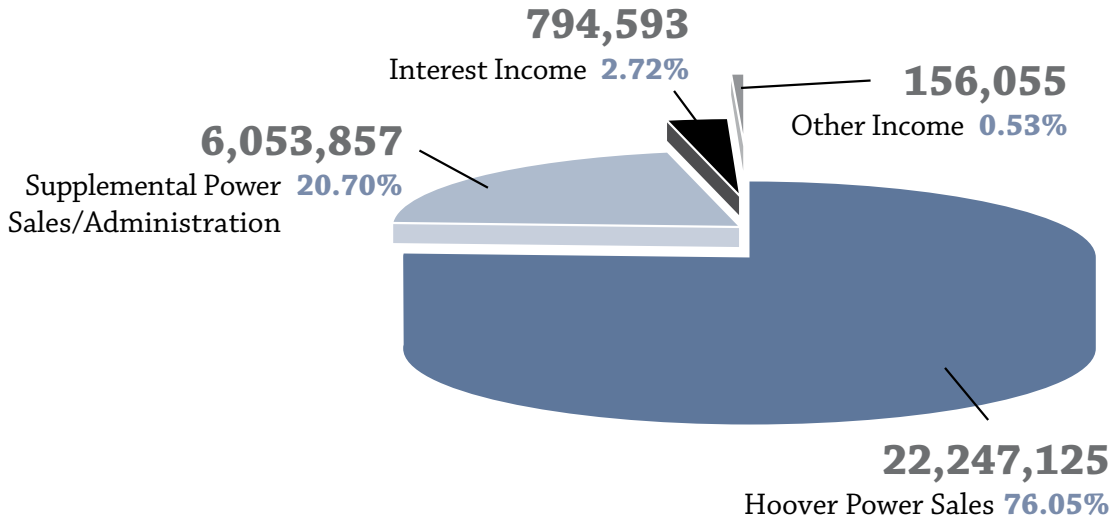
Other Income (Deductions) – which increase/decrease as a result of investment market conditions.

Statements of Revenues, Expenses, and Changes in Net Assets

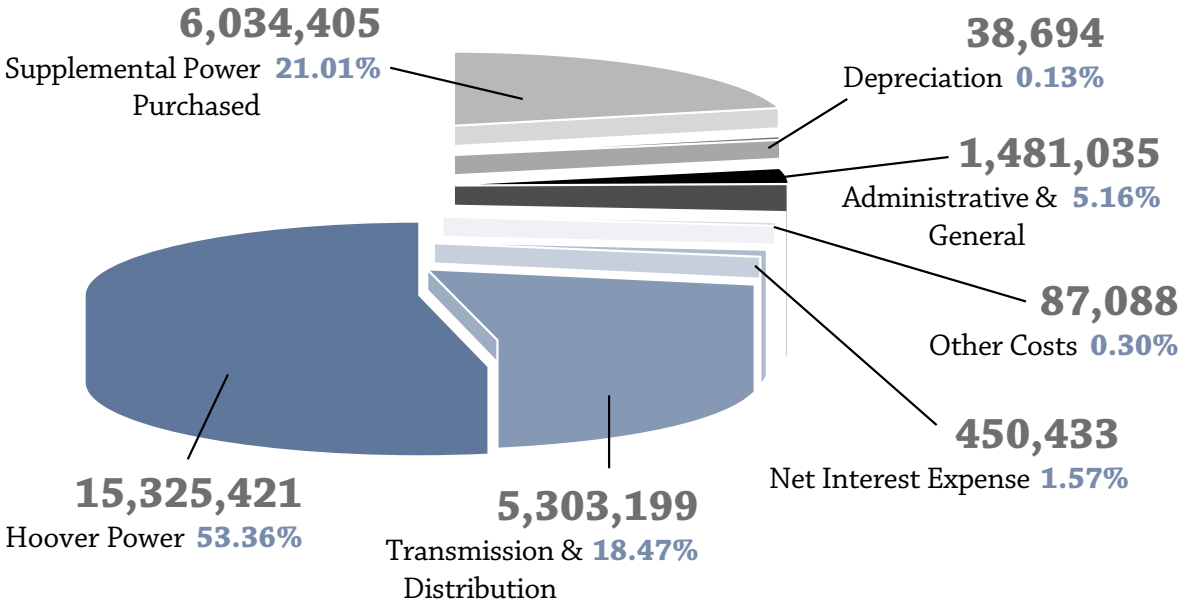
Business Type Activities

	JUNE 30			
	2007	**2006**	**DIFF $**	**DIFF %**
OPERATING REVENUE	$ 28,300,982	$ 26,328,596	$ 1,972,386	7.5 %
OPERATING EXPENSES				
PURCHASED POWER	21,359,826	19,404,200	1,955,626	10.1 %
WESTERN CREDIT	(5,523,334)	(5,167,368)	(355,966)	6.9 %
AMORTIZATION OF HOOVER UPRATING PROGRAM COSTS	5,523,334	5,167,368	355,966	6.9 %
TRANSMISSION & DISTRIBUTION	5,303,199	5,258,886	44,313	0.8 %
ADMINISTRATIVE & GENERAL	1,481,035	1,405,247	75,788	5.4 %
DEPRECIATION	38,694	40,265	(1,571)	(3.9) %
OTHER	87,088	109,518	(22,430)	(20.5) %
TOTAL OPERATING EXPENSES	28,269,842	26,218,116	2,051,726	7.8 %
OPERATING INCOME (LOSS)	31,140	110,480	(79,340)	(71.8) %
OTHER (DEDUCTIONS) INCOME				
INTEREST EXPENSE	(2,724,425)	(2,862,363)	137,938	(4.8) %
DEFERRED INTEREST EXPENSE	2,273,992	2,347,319	(73,327)	(3.1) %
AMORTIZATION	114,453	120,255	(5,802)	(4.8) %
INTEREST INCOME	794,593	750,465	44,128	5.9 %
OTHER, NET	41,602	95,483	(53,881)	(56.4) %
TOTAL OTHER (DEDUCTIONS) INCOME	500,215	451,159	49,056	10.9 %
CHANGES IN NET ASSETS	531,355	561,639	(30,284)	(5.4) %
NET ASSETS, BEGINNING OF YEAR	3,317,131	2,755,492	561,639	20.4 %
NET ASSETS, END OF YEAR	**$ 3,848,486**	**$ 3,317,131**	**$ 531,355**	**16.0 %**

The following chart depicts the sources of revenues for the fiscal year 2007:



The following chart depicts the types of expenses for the fiscal year 2007:



Fiscal Year 2007 Changes in Net Assets Discussion

Net Assets increased overall because of the following:

- Operating Revenues increased due to an increase in rates.
- Total Operating Expenses increased due to an increase in purchased power expenses.
- Western Credits increased because of changes in debt payments and associated costs related to the Uprating Program.
- Amortization of the Uprating Program increased because of the increase in the amortization of long-term bond costs.
- Administrative and General expenses increased due to staffing and related expenses, resulting from all staff positions being filled for the entire year in fiscal year 2007, as opposed to fiscal year 2006 when several positions remained unfilled for a portion of the year.
- Depreciation decreased due to the normal attrition of capital assets.
- Other expenses decreased due to a reduction in expenditures for special projects, such as the Colorado River Legal Defense Fund.

Clifton Gunderson LLP
Certified Public Accountants & Consultants

Independent Auditor's Report

To The Arizona Power Authority Commission
Phoenix, Arizona

We have audited the accompanying statement of net assets of Arizona Power Authority (A Body, Corporate and Politic, of the State of Arizona) as of June 30, 2008, and the related statements of revenues, expenses and changes in net assets and cash flows for the year then ended. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of Arizona Power Authority as of and for the year ended June 30, 2007, were audited by other auditors whose report, dated December 7, 2007, expressed an unqualified opinion on those financial statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our 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 June 30, 2008, and the changes in its financial position and its cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

Management's discussion and analysis on pages 8 through 17 is not a required part of the basic 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 required supplementary information. However, we did not audit the information and express no opinion on it.

Clifton Gunderson LLP

Phoenix, Arizona
November 6, 2008

FINANCIAL HIGHLIGHTS

Statements of Net Assets

June 30, 2008 and 2007

Assets

	APA General Fund		Hoover Uprating Fund		Total	
	2008	2007	2008	2007	2008	2007
CURRENT ASSETS						
CASH AND CASH EQUIVALENTS	$ 3,637,003	$ 3,514,101	$ 1,783,650	$ 1,741,630	$ 5,420,653	$ 5,255,731
INVESTMENTS – SHORT-TERM	–	–	3,274,368	3,105,380	3,274,368	3,105,380
ACCOUNTS RECEIVABLE, CUSTOMER POWER PURCHASES	1,935	834,828	2,524,738	2,392,037	2,526,673	3,226,865
INTEREST RECEIVABLE	13,360	24,592	91,082	88,753	104,442	113,345
OTHER ASSETS	233,193	298,163	–	–	233,193	298,163
PREPAID PURCHASED POWER	–	–	2,146,046	2,327,678	2,146,046	2,327,678
TOTAL CURRENT ASSETS	3,885,491	4,671,684	9,819,884	9,655,478	13,705,375	14,327,162
CAPITAL ASSETS	186,290	200,159	–	–	186,290	200,159
INVESTMENT – LONG-TERM	–	–	6,546,558	6,546,641	6,546,558	6,546,641
ADVANCES FOR HOOVER UPRATING PROGRAM, NET	–	–	36,338,804	39,771,895	36,338,804	39,771,895
PREPAID TRANSMISSION	231,597	182,360	–	–	231,597	182,360
TOTAL ASSETS	**$ 4,303,378**	**$ 5,054,203**	**$ 52,705,246**	**$ 55,974,014**	**$ 57,008,624**	**$ 61,028,217**
CURRENT LIABILITIES						
ACCOUNTS PAYABLE AND OTHER	$ 14,538	$ 8,173	$ 116,889	$ 120,956	$ 131,427	$ 129,129
CUSTOMER REFUNDS	–	–	1,287,925	1,289,933	1,287,925	1,289,933
POWER CONTRACTS PAYABLE	–	833,207	1,570,730	1,447,713	1,570,730	2,280,920
ACCRUED INTEREST PAYABLE	–	–	633,282	672,280	633,282	672,280
BONDS PAYABLE – SHORT-TERM	–	_	3,450,000	3,120,000	3,450,000	3,120,000
TOTAL CURRENT LIABILITIES	14,538	841,380	7,058,826	6,650,882	7,073,364	7,492,262
LONG-TERM LIABILITIES						
BONDS PAYABLE – LONG-TERM	–	–	45,565,000	49,015,000	45,565,000	49,015,000
PREMIUM (DISCOUNTS) ON BONDS PAYABLE	–	–	564,415	672,469	564,415	672,469
TOTAL LONG-TERM LIABILITIES	–	–	46,129,415	49,687,469	46,129,415	49,687,469
TOTAL LIABILITIES	14,538	841,380	53,188,241	56,338,351	53,202,779	57,179,731
NET ASSETS (DEFICIT)						
INVESTED IN CAPITAL ASSETS	186,290	200,159	-	-	186,290	200,159
UNRESTRICTED	4,102,550	4,012,664	(482,995)	(364,337)	3,619,555	3,648,327
TOTAL NET ASSETS (DEFICIT)	4,288,840	4,212,823	(482,995)	(364,337)	3,805,845	3,848,486
TOTAL LIABILITIES AND NET ASSETS (DEFICIT)	**$ 4,303,378**	**$ 5,054,203**	**$ 52,705,246**	**$ 55,974,014**	**$ 57,008,624**	**$ 61,028,217**

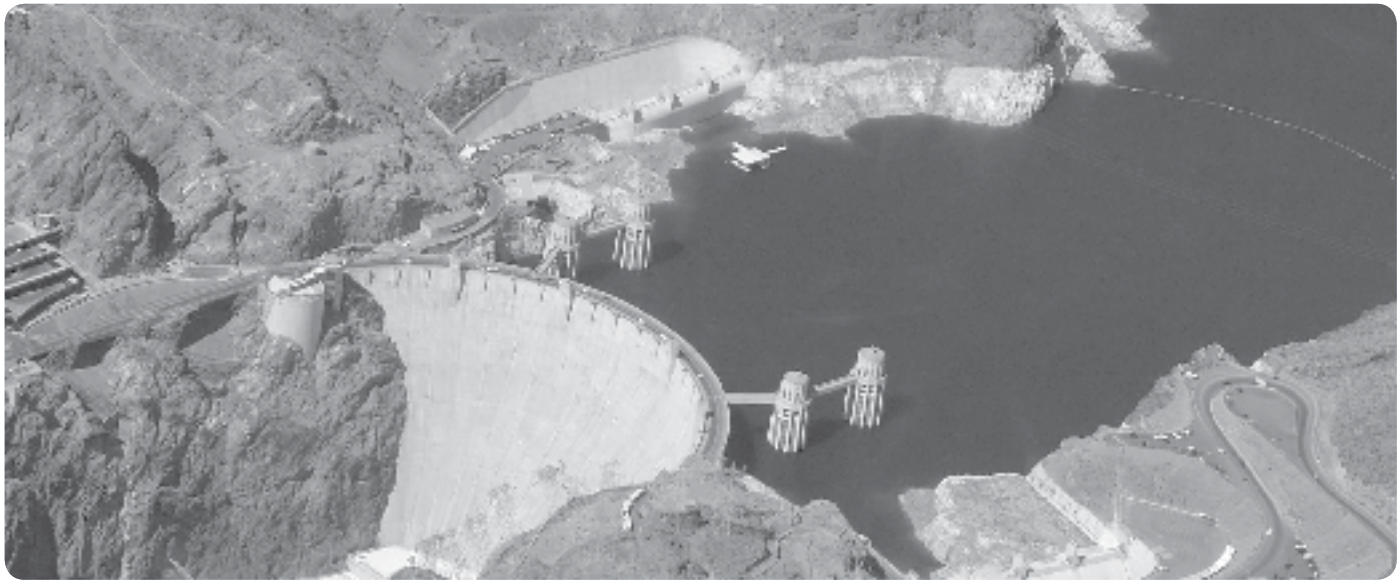
The accompanying notes are an integral part of the financial statements.

Statements of Revenues, Expenses, and Changes in Net Assets

Years Ended June 30, 2008 and 2007

	APA General Fund		Hoover Uprating Fund		Total	
	2008	2007	2008	2007	2008	2007
OPERATING REVENUES	$ 4,733,148	$ 6,053,857	$ 23,398,858	$ 22,247,125	$ 28,132,006	$ 28,300,982
OPERATING EXPENSES						
PURCHASED POWER	4,709,925	6,034,405	16,204,033	15,325,421	20,913,958	21,359,826
WESTERN CREDITS	–	–	(5,838,211)	(5,523,334)	(5,838,211)	(5,523,334)
AMORTIZATION OF HOOVER UPRATING PROGRAM COSTS	–	–	5,838,211	5,523,334	5,838,211	5,523,334
TRANSMISSION AND DISTRIBUTION	4,178	9,842	5,967,846	5,293,357	5,972,024	5,303,199
ADMINISTRATIVE AND GENERAL	–	19,839	1,532,725	1,461,196	1,532,725	1,481,035
DEPRECIATION	30,595	38,694	–	–	30,595	38,694
OTHER	38,325	61,433	24,303	25,655	62,628	87,088
TOTAL OPERATING EXPENSES	4,783,023	6,164,213	23,728,907	22,105,629	28,511,930	28,269,842
OPERATING INCOME (LOSS)	(49,875)	(110,356)	(330,049)	141,496	(379,924)	31,140
OTHER (DEDUCTIONS) INCOME						
INTEREST EXPENSE	–	–	(2,572,114)	(2,724,425)	(2,572,114)	(2,724,425)
DEFERRED INTEREST EXPENSE	–	–	2,155,476	2,273,992	2,155,476	2,273,992
AMORTIZATION	–	–	108,054	114,453	108,054	114,453
INTEREST INCOME	124,339	177,172	519,040	617,421	643,379	794,593
OTHER	1,553	29,834	935	11,768	2,488	41,602
TOTAL OTHER INCOME	125,892	207,006	211,391	293,209	337,283	500,215
CHANGES IN NET ASSETS	76,017	96,650	(118,658)	434,705	(42,641)	531,355
NET ASSETS (DEFICIT), BEGINNING OF YEAR	4,212,823	4,116,173	(364,337)	(799,042)	3,848,486	3,317,131
NET ASSETS (DEFICIT), END OF YEAR	**$ 4,288,840**	**$ 4,212,823**	**$ (482,995)**	**$ (364,337)**	**$ 3,805,845**	**$ 3,848,486**

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



Statements of Cash Flows

Years Ended June 30, 2008 and 2007

	APA General Fund		Hoover Uprating Fund		Total	
	2008	2007	2008	2007	2008	2007
CASH FLOWS FROM OPERATING ACTIVITIES						
CASH RECEIVED FROM CUSTOMERS	$ 5,631,011	$ 5,689,508	$ 23,266,157	$ 22,204,691	$ 28,897,168	$ 27,894,199
CASH PAYMENTS TO SUPPLIERS FOR GOODS OR SERVICES	(5,628,507)	(5,893,034)	(22,714,630)	(22,089,056)	(28,343,137)	(27,982,090)
CASH PAYMENTS TO EMPLOYEES FOR SERVICES	–	–	(715,703)	(709,205)	(715,703)	(709,205)
NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES	2,504	(203,526)	(164,176)	(593,570)	(161,672)	(797,096)
CASH FLOWS FROM INVESTING ACTIVITES						
INTEREST ON INVESTMENTS	137,124	202,741	517,646	669,170	654,770	871,911
PURCHASE OF INVESTMENTS, NET	–	–	(7,119,444)	(5,979,348)	(7,119,444)	(5,979,348)
PROCEEDS FROM SALE AND MATURITIES OF INVESTMENTS	–	–	6,950,539	5,692,273	6,950,539	5,692,273
NET CASH PROVIDED BY INVESTING ACTIVITIES	137,124	202,741	348,741	382,095	485,865	584,836
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES						
INTEREST PAYMENTS ON BONDS PAYABLE	–	–	(2,611,112)	(2,759,738)	(2,611,112)	(2,759,738)
PAYMENTS ON BONDS PAYABLE	–	–	(3,120,000)	(2,825,000)	(3,120,000)	(2,825,000)
ACQUISITION OF CAPITAL ASSETS	(16,726)	(3,083)	–	–	(16,726)	(3,083)
OTHER COSTS RELATING TO HOOVER UPRATING PROGRAM	–	–	(249,644)	(443,082)	(249,644)	(443,082)
REDUCTION IN ADVANCES FOR HOOVER UPRATING PROGRAM	–	–	5,838,211	5,523,334	5,838,211	5,523,334
NET CASH USED IN CAPITAL AND RELATED FINANCING ACTIVITIES	(16,726)	(3,083)	(142,545)	(504,486)	(159,271)	(507,569)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	122,902	(3,868)	42,020	(715,961)	164,922	(719,829)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	3,514,101	3,517,969	1,741,630	2,457,591	5,255,731	5,975,560
CASH AND CASH EQUIVALENTS, END OF YEAR	**$ 3,637,003**	**$ 3,514,101**	**$ 1,783,650**	**$ 1,741,630**	**$ 5,420,653**	**$ 5,255,731**
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES						
OPERATING LOSS	$ (49,875)	$ (110,356)	$ (330,049)	$ 141,496	$ (379,924)	$ 31,140
ADJUSTMENTS TO RECONCILE OPERATING INCOME (LOSS) TO NET CASH TO PROVIDED BY (USED IN) OPERATING ACTIVITIES						
DEPRECIATION	30,595	38,694	–	–	30,595	38,694
INCREASE (DECREASE) IN CASH RESULTING FROM CHANGES IN:						
ACCOUNTS RECEIVABLE	832,893	(236,251)	(132,701)	(42,435)	700,192	(278,686)
OTHER ASSETS	64,970	(128,097)	–	–	64,970	(128,097)
PREPAID PURCHASED POWER	–	–	181,632	(614,895)	181,632	(614,895)
PREPAID TRANSMISSION	(49,237)	–	–	–	(49,237)	–
ACCOUNTS PAYABLE AND OTHER	6,365	(7,267)	(4,067)	24,717	2,298	17,450
CUSTOMER REFUNDS	–	–	(2,008)	(214,761)	(2,008)	(214,761)
POWER CONTRACTS PAYABLE	(833,207)	239,751	123,017	112,308	(710,190)	352,059
TOTAL ADJUSTMENTS	52,379	(93,170)	165,873	(735,066)	218,252	(828,236)
NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES	**$ 2,504**	**$ (203,526)**	**$ (164,176)**	**$ (593,570)**	**$ (161,672)**	**$ (797,096)**
SUPPLEMENTAL SCHEDULE OF NONCASH CAPITAL AND RELATING FINANCING ACTIVITIES						
DEFERRED INTEREST EXPENSE	**$ –**	**$ –**	**$ 2,155,476**	**$ 2,273,992**	**$ 2,155,476**	**$ 2,273,992**

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

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 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 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 (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 in capital assets 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

Governmental Accounting Standards Board ("GASB") Statement 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 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.

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.

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 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 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 Uprating Program as amounts to be recovered from future credits. These amounts are included in the Amortization of Hoover Uprating Program Costs in the Statements of Revenues, Expenses and Changes in Net Assets.

Operating Revenues

Operating revenues are derived from the sale of power to customers or from other contractual agreements. Operating revenues include $5,400,000 received from Salt River Project for scheduling entity services during the years ended June 30, 2008 and 2007. The revenues are the result of an agreement between the Authority and the Salt River Project which will yield $5,400,000 annual revenues to the Authority thereby reducing the overall revenue requirements to be paid by the Authority's customers through power rates. The agreement will expire on September 30, 2011.

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.

Customer Credits

The Authority operates on a nonprofit 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 $1,098,002 and $1,504,693 were paid to the customers during the years ended June 30, 2008 and 2007, respectively.

The amounts accrued for customer refunds during the years ended June 30, 2008 and 2007 was $1,095,993 and $1,289,933, 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 Uprating 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.

2. Fund Accounting

Hoover Uprating 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 ("Uprating Program"). Instead of appropriating further federal funds for the Uprating 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 Uprating Program. The Uprating Program was determined to be complete in September 1995. The Authority financed a portion of the total Uprating Program by issuing bonds.

The Hoover Uprating Fund accounts for advances by the Authority in connection with the Uprating 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 Uprating Fund.

APA General Fund

The Authority's operations other than those applicable to the Hoover Uprating 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. Cash and 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. 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 June 30, 2008 and 2007.

4. Capital Assets

Capital assets of the Authority at June 30, 2008 and 2007 were as follows:

	JUNE 30, 2007			JUNE 30, 2008
	BALANCES	**ADDITIONS**	**DELETIONS**	**BALANCES**
TRANSMISSION PLANT	$ 319,565	$ –	$ –	$ 319,565
DISTRIBUTION PLANT	227,518			227,518
GENERAL PLANT – OFFICE	779,965	16,726	(11,722)	784,969
TOTAL DEPRECIABLE ASSETS	1,327,048	16,726	(11,722)	1,332,052
LESS: ACCUMULATED DEPRECIATION FOR				
TRANSMISSION PLANT	(295,152)	(3,052)	–	(298,204)
DISTRIBUTION PLANT	(204,486)	(2,303)	–	(206,789)
GENERAL PLANT – OFFICE	(627,251)	(25,240)	11,722	(640,769)
TOTAL ACCUMULATED DEPRECIATION	(1,126,889)	(30,595)	11,722	(1,145,762)
CAPITAL ASSETS, AT COST, NET	**$ 200,159**	**$ (13,869)**	**$ –**	**$ 186,290**

	JUNE 30, 2006			JUNE 30, 2007
	BALANCES	**ADDITIONS**	**DELETIONS**	**BALANCES**
TRANSMISSION PLANT	$ 319,565	$ –	$ –	$ 319,565
DISTRIBUTION PLANT	227,518			227,518
GENERAL PLANT – OFFICE	777,076	3,084	(195)	779,965
TOTAL DEPRECIABLE ASSETS	1,324,159	3,084	(195)	1,327,048
LESS: ACCUMULATED DEPRECIATION FOR				
TRANSMISSION PLANT	(292,100)	(3,052)	–	(295,152)
DISTRIBUTION PLANT	(195,761)	(8,725)	–	(204,486)
GENERAL PLANT – OFFICE	(600,529)	(26,917)	195	(627,251)
TOTAL ACCUMULATED DEPRECIATION	(1,088,390)	(38,694)	195	(1,126,889)
CAPITAL ASSETS, AT COST, NET	**$ 235,769**	**$ (35,610)**	**$ –**	**$ 200,159**

The Authority's depreciation expense was $30,595 and $38,694 for the years ended June 30, 2008 and 2007, respectively.

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

5. Advances for Hoover Uprating Program

Advances for the Hoover Uprating Program were reimbursed by Western through credits on the Authority's power bills in the amount of $5,838,211 and $5,523,334 for the years ended June 30, 2008 and 2007, respectively. Credits were received for the upraters' portion of principal and interest expense on the bonds and other costs associated with the Hoover Uprating Program.

6. Bonds Payable

Bonds payable consists of the following:

	JUNE 30, 2007	INCREASES	REDUCTIONS	TRANSFERS	JUNE 30, 2008
BOND PAYABLE CURRENT	$ 3,120,000	$ –	$ (3,120,000)	$3,450,000	$ 3,450,000
BOND PAYABLE LONG–TERM	49,015,000	–	–	(3,450,000)	$ 45,565,000
TOTAL BONDS PAYABLE	**$ 52,135,000**	**$ –**	**$ (3,120,000)**	**$ –**	**$ 49,015,000**

	JUNE 30, 2006	INCREASES	REDUCTIONS	TRANSFERS	JUNE 30, 2007
BOND PAYABLE CURRENT	$ 2,825,000	$ –	$ (2,825,000)	$3,120,000	$ 3,120,000
BOND PAYABLE LONG–TERM	52,135,000	–	–	(3,120,000)	$ 49,015,000
TOTAL BONDS PAYABLE	**$ 54,960,000**	**$ –**	**$ (2,825,000)**	**$ –**	**$ 52,135,000**

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 corresponding liability has been removed from the Hoover Uprating Fund. Accordingly, the trust account assets and related liabilities are not included in the Authority's financial statements.

The Authority's outstanding bonds, totaling $49,015,000, bear interest ranging from 5.00% to 5.25%, are due through 2018, 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 ending June 30 and thereafter are to the right:

	PRINCIPAL	INTEREST
2009	$ 3,450,000	$ 2,446,863
2010	3,815,000	2,265,238
2011	4,220,000	2,064,363
2012	4,585,000	1,844,238
2013	4,810,000	1,603,351
2014–2018	28,135,000	3,844,182
	$ 49,015,000	**$ 14,068,235**

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 principal amount, maturity date and interest rates as the crossover bonds. The Authority 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.

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, 2008 and 2007 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 5.00% 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. 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 $231,737 and $245,464 for the years ended June 30, 2008 and 2007, respectively, resulting in a net deferred amount of $1,210,438 and $1,442,175 in the Statements of Net Assets, 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 $339,791 and $359,917 for the years ended June 30, 2008 and 2007, respectively, resulting in a net premium of bonds payable of $1,774,853 and $2,114,644 in the Statements of Net Assets, respectively.

7. Commitments & 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 June 30, 2008 and 2007, the Authority paid $141,253 and $133,518, 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.

8. Investments Held By Trustee

As of June 30, 2008 and 2007, investments are collateralized with securities held by the Authority's trustee. The fair value of the investment securities at June 30 is as follows:

	JUNE 30	
	2008	**2007**
Repurchase Agreement	$ 6,546,558	$ 6,546,641
U.S. Government Securities	3,274,368	3,105,380
Total Investments Held by Trustee	**$ 9,820,926**	**$ 9,652,021**

On October 2, 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 5.00%. The securities are held in trust by The Bank of New York. If at any time the aggregate market value of all purchased securities is less than the amount required under the repurchase and custody agreement (referred to as the Security ratio), the Authority may require IMC to transfer additional securities so the aggregate market value of all securities will equal or exceed such requirement. The security ratio is 104% for Direct Obligations, 105% for FMNA's and FHLMCs, and 100% for cash being held in the accounts. At June 30, 2008, the aggregate market value of all purchased securities exceeded the amount required under the repurchase and custody agreement.

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 9.45% (8.95% retirement and 0.50% long-term disability) and 9.60% (9.10% retirement and 0.50% long–term disability) of their compensation for the years ended June 30, 2008 and 2007, respectively, with the contributions made through payroll deductions. Employee contributions vest immediately. Total contributions to the Plan for the years ended June 30, 2008 and 2007, by the Authority's covered employees were $67,653 and $64,180, respectively.

Matching employer member contributions were actuarially determined and fixed at the same rate as employee member contributions for the years ended June 30, 2008 and 2007. 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 to 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, 2008 and 2007 was $715,703 and $709,205, 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.

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:

		Member		Member & Dependent(s)	
Years of Credited Service	Percent of Premium Benefit	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

11. Purchased Power, Sales, & Transmission Commitments

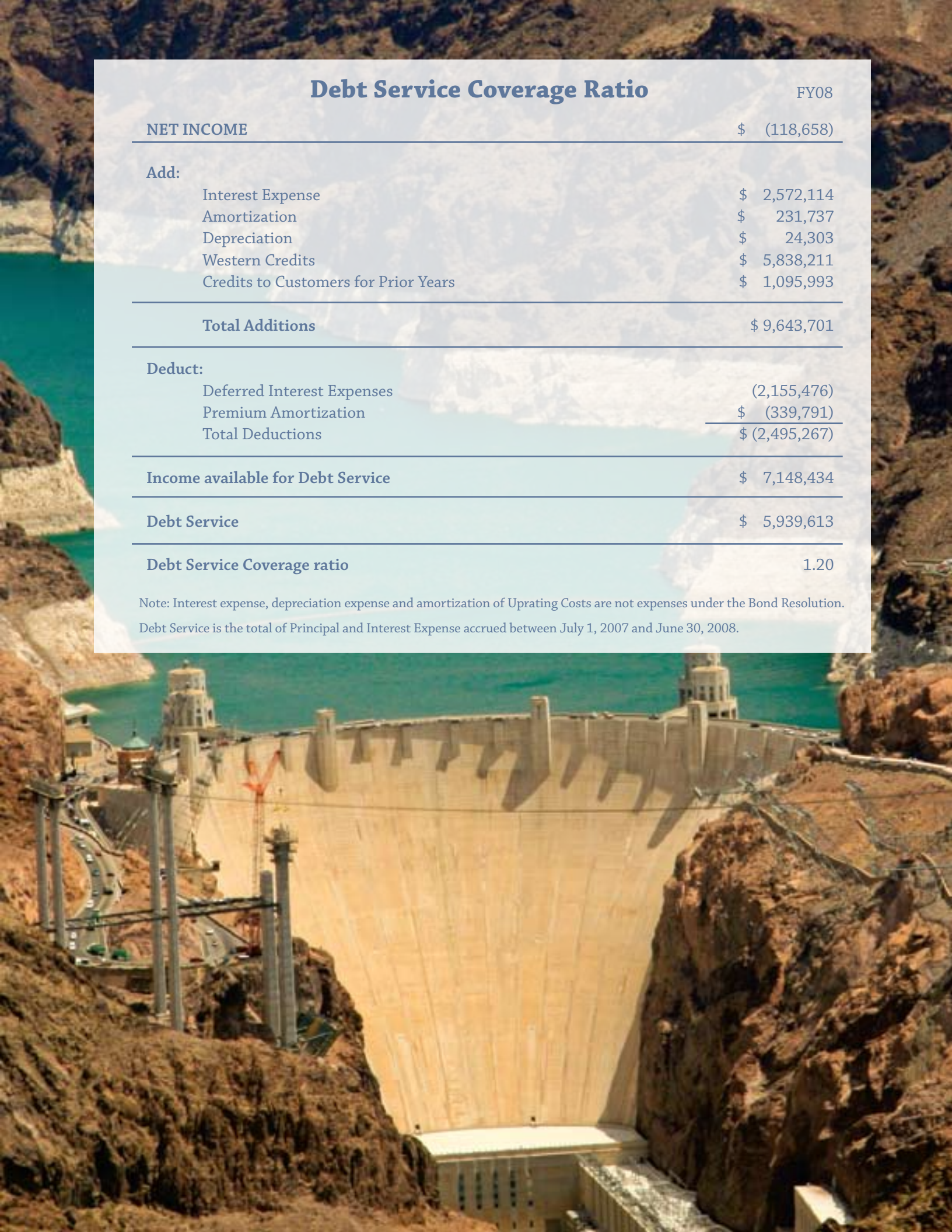
The Authority is party to Firm Electric Service and Transmission Service Contracts with terms expiring September 30, 2017. This requires the Authority to pay approximately 19% of Western's revenue requirements each operating year until the contract expires. During the years ended June 30, 2008 and 2007, the Authority paid $16,204,033 and $15,325,421, 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, 2008 and 2007, the Authority paid $5,967,846 and $5,293,357, 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, 2008 and 2007, the Authority recognized a prepayment of $231,597 and $182,360, respectively, that applies to the last payment 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, 2008 and 2007, the Authority paid $4,709,925 and $6,034,405, respectively, for purchased power under this contract for its customers.

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



Debt Service Coverage Ratio

	FY08
NET INCOME	$ (118,658)
Add:	
Interest Expense	$ 2,572,114
Amortization	$ 231,737
Depreciation	$ 24,303
Western Credits	$ 5,838,211
Credits to Customers for Prior Years	$ 1,095,993
Total Additions	$ 9,643,701
Deduct:	
Deferred Interest Expenses	(2,155,476)
Premium Amortization	$ (339,791)
Total Deductions	$ (2,495,267)
Income available for Debt Service	$ 7,148,434
Debt Service	$ 5,939,613
Debt Service Coverage ratio	1.20

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 July 1, 2007 and June 30, 2008.

Arizona Power Authority

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Photos Courtesy of the Bureau of Reclamation