

Toward **Optimum** **Outcomes** for Arizona



Arizona Power Authority
49th Annual Report 2007





1 Letter to the Governor

2 Report of the Commission

4 Report of the Executive Director

5 Operations and Environments

6 Historical Energy Sales

7 Management's Discussion and Analysis

17 Report of the Independent Accountants

18 Financial Statements

22 Notes to Financial Statements

We understand that the policies we pursue today have a real impact on the welfare of Arizona. That's why every decision we make is with an eye on long-term results.



December 1, 2007

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

Dear Governor:

On behalf of the Commissioners and staff, I submit the Arizona Power Authority's 49th Annual Report. This report details the Authority's operational and financial activities for the fiscal year ending June 30, 2007. It also highlights the Authority's efforts in administering Arizona's hydroelectric power entitlement generated at Hoover Dam and Powerplant.

The Colorado River system continues to experience a severe drought cycle with the lowest eight-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 July 2007, storage in Lake Mead was 49% of its capacity, down 6% from 2006.

Nevertheless, the State's water and power entitlements, although at reduced levels of electric generation, are still available for the State's use. The Authority maintains its aggressive and active involvement in federal and state efforts to mitigate the drought's impact.

The Authority is also continuing to investigate opportunities for development of various renewable electric power generating resources to provide our customers with more diverse generation, reducing their dependency on fossil-fuel energy resources. These resources, if developed, would supplement the hydro resource and provide clean energy for Arizona.

Sincerely,

John I. Hudson, LT GEN, USMC (Ret.)
Chairman



Report of the Commission

With the prolonged drought cycle of the Colorado River system, it is increasingly important for the Arizona Power Authority to manage its federal allocation prudently. Critical decisions must be made in concert with the other Hoover hydro power allottees 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.

"The past cannot be changed. The future is yet in your power."

- Hugh White (1773 - 1840)



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

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 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, and past president of Yuma's 78-CRIME Board of Directors.



Dalton H. Cole, Vice-Chairman

Appointed to the Commission in January 2002 for a term to run until 2008, Dalton Cole was elected to be the Vice-Chairman in January 2006. 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.



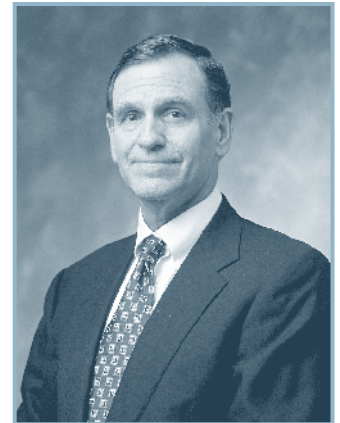
Delbert R. Lewis

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, 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, Delbert Lewis and his wife, Sharron, are nationally recognized for their financial support and commitment to education and community service.



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 and Education associated with the Nutrition 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 member of the Board of the National Pecan Shellers Association.



Michael C. Francis

Starting his tenure on the Commission in 1999, Mr. Francis was selected Chairman in April 2003 and re-elected to this position in 2005. His current term expires in January 2008. Michael Francis is a partner in Santa Lucia Farms, producer of over 3.7 million garden rose bushes annually. He is also a member of the American Rose Society. Additionally, he owns and operates Francis Insurance Agency, which insures Arizona and California farmers. Michael Francis is a Board of Directors member of M&I Bank, Arizona Region.



“Advice is judged by results, not by intentions.”

- Cicero, Roman author, orator, & politician (106 BC - 43 BC)



Report of the Executive Director

Optimizing performance at every level

To ensure we are delivering the best possible outcomes for our Arizona customers and the state as a whole, the Arizona Power Authority continually seeks ways to enhance efficiency and overall performance. This begins with refining our strategy for maximizing the impact of Arizona's Hoover Power allotment, and extends to streamlining our internal, day-to-day operations at the Authority.

Hydro power is especially well-suited to responding to peaking power needs. By simply opening the wicket gates at Hoover, more power can be generated almost instantaneously to meet increasing loads. This makes Hoover Power unique when compared to other forms of power generation which are less responsive. Typically, our agricultural customers don't require such a rapid response. Their needs are scheduled and more predictable.

To make the best use of Arizona's Hoover Power, the Authority has entered into an agreement that provides for the best use of Hoover Power to meet the power needs of Arizona. This agreement benefits everyone involved. The Authority receives payment for Hoover's scheduling flexibility, which helps reduce operating costs, while the state as a whole benefits from lower pollution and operating costs. Consumers, of course, are the ultimate beneficiaries because they receive the instantaneous power they expect when they flip on a switch, plus lower cost and less pollution. This generation optimization agreement helps reduce pollution that would otherwise be generated by the gas- or coal-fired plants that would have been required to ramp up to meet rising loads. In this way, the Authority is helping to ensure Arizona makes the most of its Hoover Power allotment.

As drought conditions continue in the western United States, the water levels in Lake Mead, the largest man-made lake and reservoir in the U.S., have reached historically low levels, at just 49% of capacity. The challenge at Hoover Dam and the Arizona Power Authority is to utilize the water available to maximum efficiency. Optimizing software as well as upgrades in the physical plant at Hoover makes this possible.

The Authority recognizes that for Arizonians, every dollar counts. That's why we are working closely with the State's congressional delegation in Washington to craft legislation that will open the way for lowering the cost of high voltage transmission. Such legislation would save the people of Arizona approximately \$60 million. This would be achieved by allowing the Authority to purchase transmission capacity from the Western Area Power Administration (Western) in advance. This lump sum payment would then be used to pay down Western's debt. Financing for this payment would be attained at considerably lower interest rates than Western's original loan, creating a significant savings.

The Authority is optimizing its internal operations as well. Staff assignments are being fine-tuned to take advantage of our peoples' strengths. We have also rewritten many accounting and billing programs to make them much more user-friendly, efficient, and minimize the amount of labor-intensive input required.

The Authority is also enhancing its communications processes. Reports to our Commissioners have been

re-designed to make them easier to understand, supporting clearer, more informed decision making. In addition, the Authority is maintaining close communications with our sister state agencies, as well as the Governor's Office. These direct channels of communication are essential to supporting the clear decisions regarding energy in Arizona.

From how Hoover Power is distributed to the efficiency of our own internal operation, the Authority is committed to optimizing our performance. In this way, we can ensure we continue to support Arizona's growth and the best interest of its citizens.

"Change is the law of life. And those who look only to the past or present are certain to miss the future."

- John F. Kennedy (1917 - 1963)

Operations and Environments

As a severe drought cycle continues in the Colorado River system, with the lowest eight-year average water flows in 100 years of record keeping, impounded water in Lake Mead has decreased, reducing further the amount of hydroelectric generation available. As of July 2007, storage in Lake Mead was 49% of its capacity, down 6% from 2006. To increase Hoover generation capabilities at lower lake levels, Hoover Dam personnel completed two generating unit overhauls and two unit wicket gates re-stroking during the 2006/2007 maintenance cycle. This increased the total plant capacity by approximately 27 megawatts at lake levels below 1145 feet.

A two-unit overhaul was proposed for the 2007/2008 maintenance period. APA and other Hoover customers recommended an alternate approach which resulted in Hoover personnel adopting a new plan including re-stroking and redesigning the unit Pressure Relief Valve (PRV) connection, thereby improving unit capacity and PRV operating characteristics while reducing future maintenance costs of the PRVs. With the re-stroking of three units and the overhaul of one unit, substantial improvements are expected--an estimated additional 31 megawatts at lake levels below 1145 feet.

Environmentally, the voluntary Lower Colorado River Multi-Species Conservation Program is actively pursuing the work plan established by the steering committee. Proposed federal legislation that would codify the LCRMSCP in law has been introduced and committee hearings have been conducted. Passage of the legislation will be addressed after the Congress reconvenes in 2008.

"You cannot escape the responsibility of tomorrow by evading it today."

- Abraham Lincoln (1809 - 1865)

Schedule of Capacity and Energy Sales Year Ending June 30, 2007

July 1, 2006 thru June 30, 2007

	Average Billing Demand (kW)	Energy Delivered (kWh)	Sales (\$)
Sale of Hydro Power			
Aguila Irrigation District	3,363	10,995,000	\$ 257,381
Avra Valley Irrigation & Drainage District	578	1,623,000	\$ 40,075
Buckeye Water Conservation District	1,869	8,926,000	\$ 184,882
Central Arizona Water Conservation District	118,556	149,823,000	\$ 5,504,671
Chandler Heights Citrus Irrigation District	682	2,964,000	\$ 63,036
Cortaro-Marana Irrigation District	2,121	18,573,000	\$ 337,338
Electrical District No. 2, Pinal	14,883	56,109,000	\$ 1,246,899
Electrical District No. 3, Pinal	32,277	52,697,000	\$ 1,661,619
Electrical District No. 4, Pinal	12,886	55,066,000	\$ 1,178,717
Electrical District No. 5, Pinal	9,846	44,474,000	\$ 935,966
Electrical District No. 5, Maricopa	280	1,046,000	\$ 23,306
Electrical District No. 6, Pinal	3,850	17,887,000	\$ 374,399
Electrical District No. 7, Maricopa	5,345	22,088,000	\$ 478,419
Electrical District No. 8, Maricopa	14,646	51,577,000	\$ 1,174,477
Harquahala Valley Power District	1,726	7,349,000	\$ 157,245
Maricopa County Municipal Water District No. 1	6,359	28,738,000	\$ 603,969
McMullen Valley Water Conserv. & Drainage Dist.	4,821	16,903,000	\$ 386,310
Ocotillo Water Conservation District	1,769	7,415,000	\$ 159,280
Queen Creek Irrigation District	471	1,657,000	\$ 38,052
Roosevelt Irrigation District	2,687	14,255,000	\$ 286,625
Roosevelt Water Conservation District	1,875	8,451,000	\$ 180,102
Salt River Project	28,458	100,917,000	\$ 2,293,503
San Tan Irrigation District	378	1,504,000	\$ 32,783
Silverbell Irrigation & Drainage District	568	4,204,000	\$ 78,284
Tonopah Irrigation District	1,061	4,703,000	\$ 99,456
Wellton-Mohawk Irrigation & Drainage District	2,135	8,401,000	\$ 184,059
City of Page	283	837,000	\$ 20,561
City of Safford	1,281	1,937,000	\$ 64,218
Town of Thatcher	851	1,097,000	\$ 39,728
Town of Wickenburg	675	2,191,000	\$ 51,700
Ak-Chin Indian Community	0	0	\$ -
Arizona Electric Power Cooperative	0	0	\$ -
Arizona Public Service Company	0	0	\$ -
Citizens Utilities Company	0	0	\$ -
City of Mesa	0	0	\$ -
Tohono O'odham Utilities Authority	0	0	\$ -
San Carlos Project	0	0	\$ -
Tucson Electric Power Company	0	0	\$ -
Total Hydro Power Sales	276,582	704,407,000	\$18,137,058
Total Net Prior Year Adjustment (FY07 Accrual)			\$(1,289,933)
Total Supplemental Power Sales	528,296	45,421,000	\$6,034,405
Other Electric Services Income**			\$5,419,452
Total Power Income			\$28,300,982 *

* Any 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.



Management's Discussion and Analysis

The following is a discussion and analysis of the Arizona Power Authority's ("Authority") financial performance for the fiscal years ended June 30, 2007 and 2006. 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 2007 and 2006 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, 2007 and 2006.

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 10 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 18-21) 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, 2007 and 2006, the Authority advanced a net prepaid deposit of \$182,360, 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 2007 and 2006, 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 eight 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, 2007, a total of \$118,569 has been recovered. \$29,784 was received in fiscal year 2007 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

Favorable market conditions during fiscal year 2007 resulted in an increase in interest rates, yielding greater 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 2007 staffing costs (salary and related benefits) represent 3.12% of the Authority's operating costs. For fiscal year 2006, staffing costs represent 2.60% 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. During fiscal year 2007, the Authority was at full staff, as opposed to 2006 when several staff positions remained open for a portion of the year.



Financial Highlights

- The Authority's 2007 net assets increased by \$531,355, or 16.02%, due mainly to increased rates that resulted in increased retained earnings.
- The Authority's 2006 net assets increased by \$561,639, or 20.4%, due mainly to increased rates.
- The Authority's 2007 operating revenues increased by \$1,972,386, or 7.49%, due to an increase in rates. The accrual for the fiscal year 2007 customer refunds has been included in the Operating Revenue number.
- The Authority's 2006 operating revenues decreased by \$143,839, or 0.5%, due to accrual of fiscal year 2006 customer refunds.

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			
	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 and 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 12.

Net Assets

Are explained on page 13.



Condensed Statements of Net Assets Business Type Activities

June 30

	2006	2005	Diff \$	Diff%
Current assets	\$ 13,774,025	\$ 11,558,522	\$ 2,215,503	19.2%
Long-Term assets	49,307,084	52,113,652	(2,806,568)	(5.4%)
Capital assets, net	235,769	211,786	23,983	11.3%
Total assets	63,316,878	63,883,960	(567,082)	(0.9%)
Current liabilities	7,077,825	5,261,291	1,816,534	34.5%
Long-term (bonds payable, net)	52,921,922	55,867,177	(2,945,255)	(5.3%)
Total liabilities	59,999,747	61,128,468	(1,128,721)	(1.8%)
Net assets				
Invested in capital assets	235,769	211,786	23,983	11.3%
Unrestricted	3,081,362	2,543,706	537,656	21.1%
Total net assets	3,317,131	2,755,492	561,639	20.4%
Total liabilities and net assets	\$ 63,316,878	\$ 63,883,960	\$ (567,082)	(0.9%)

Fiscal Year 2006 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 Upgrading Program.

Capital Assets, Net

Increased due to the investment in the new parking lot for the office building.

Current Liabilities

Increased due to an increase in amounts owed pursuant to power contracts at June 30, 2006 and an accrual for fiscal year 2006 customer refunds.

Long-Term Liabilities

Decreased due to a pay down of the bond principal. See further explanation on page 12.

Net Assets

Are explained on page 13



Capital Assests

As of fiscal year end, the Authority had \$200,159 invested in a variety of capital assets, as reflected in the following schedule, which represents a net decrease (additions less retirements and depreciation) of \$(35,610), or (15.1)%, during fiscal year 2007 and a net increase of \$23,983, or 11.3%, during fiscal year 2006.

	June 30	
	2007	2006
Transmission Plant	\$ 24,413	\$ 27,464
Distribution Plant	23,032	31,757
General plant - office	152,714	176,548
	\$ 200,159	\$ 235,769
Invested in capital assests, end of year		

The following reconciliation summarizes the change in Capital Assets for the years ended June 30, 2007 and 2006, which is presented in detail in Note 3:

	June 30	
	2007	2006
Beginning Balance	\$ 235,769	\$ 211,786
Additions	3,084	64,248
Disposals	-	-
Depreciation	(38,694)	(40,265)
	\$ 200,159	\$ 235,769
Ending Balance		

Debt Outstanding

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. As of June 30, 2006, the Authority had \$54,960,000 in debt outstanding, compared to \$57,520,000 in the prior year, as a result of a principal payment of \$2,560,000, which was paid on October 1, 2005. These payments were scheduled principal payments during the year. Also see Note 5 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.

Statements of Revenues, Expenses, and Changes in Net Assets

There are three 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

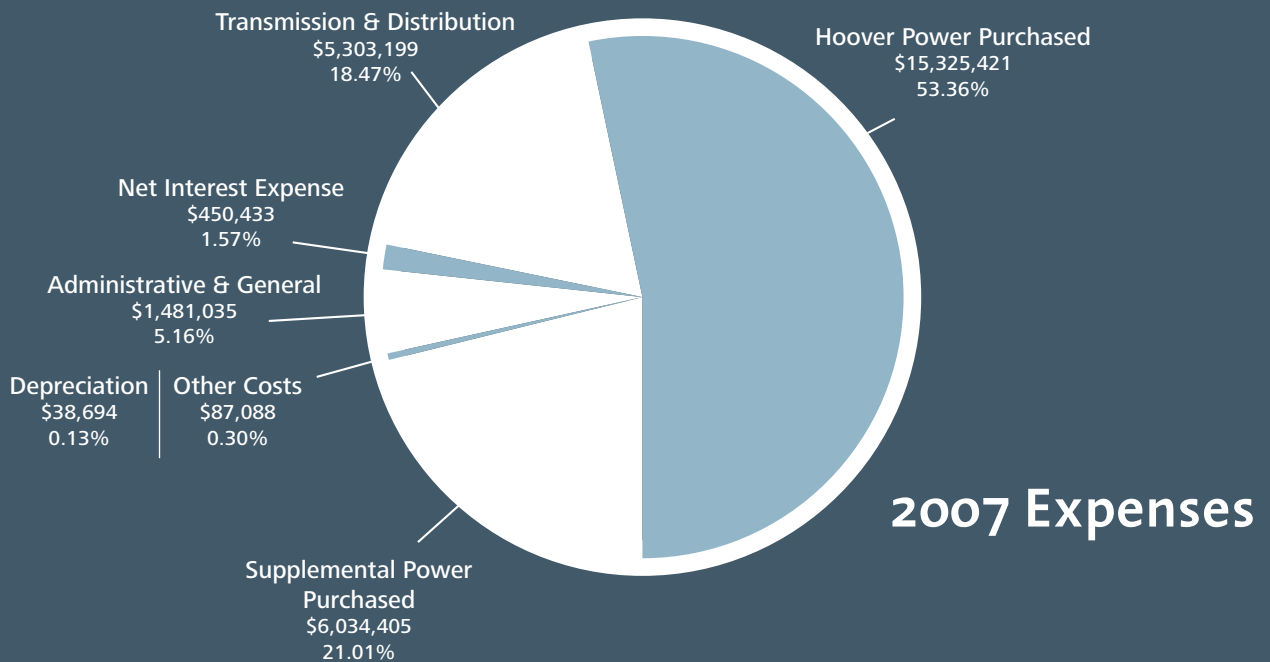
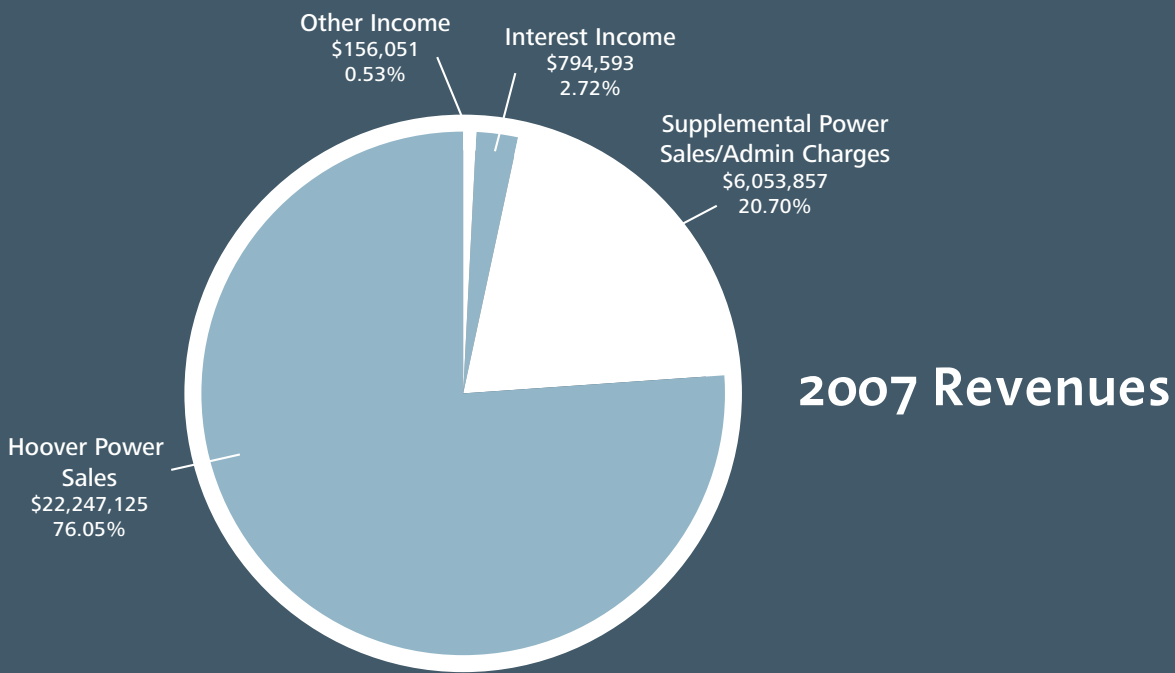
which increase/decrease as a result of purchased power costs, transmission costs, and operating costs.

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		Diff \$	Diff%
	2007	2006		
Operating revenues	\$ 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 credits	(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 and distribution	5,303,199	5,258,886	44,313	0.8%
Administrative and 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%
Change 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%



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 purchase power expenses.
- Western Credits increased because of changes in debt payments and associated costs related to the Upgrading Program.
- Amortization of the Upgrading 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.



Statements of Revenues, Expenses, and Changes in Net Assets

There are three 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 costs, transmission costs, and operating costs.

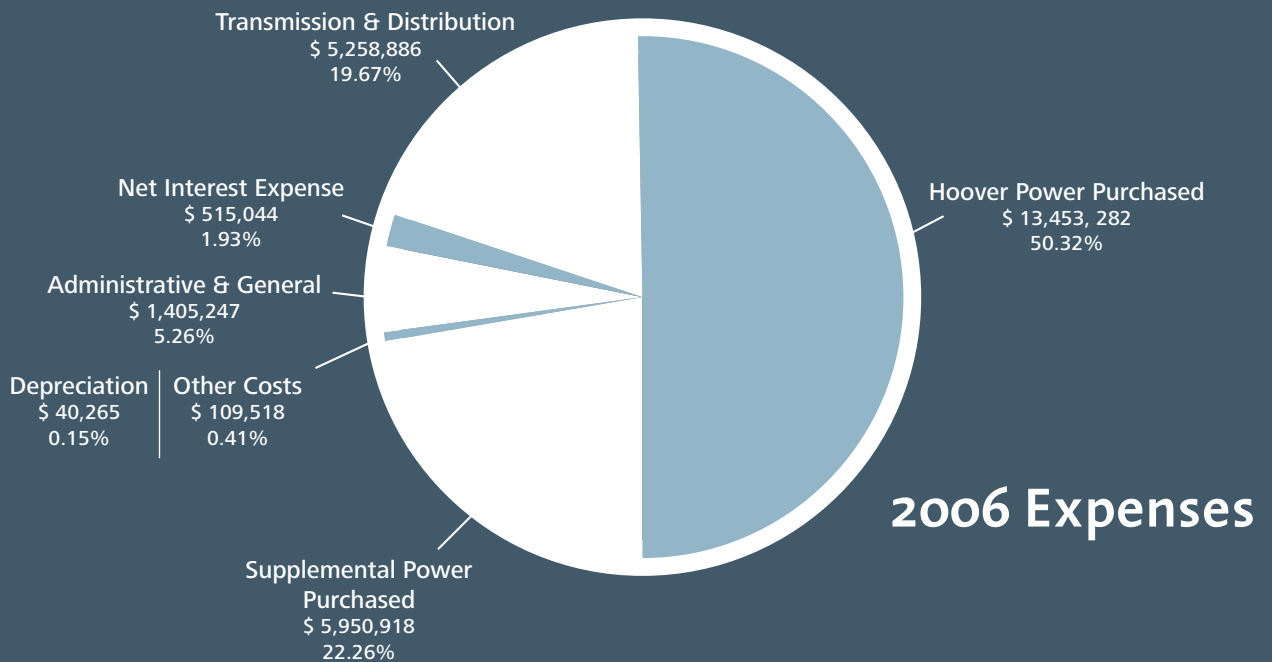
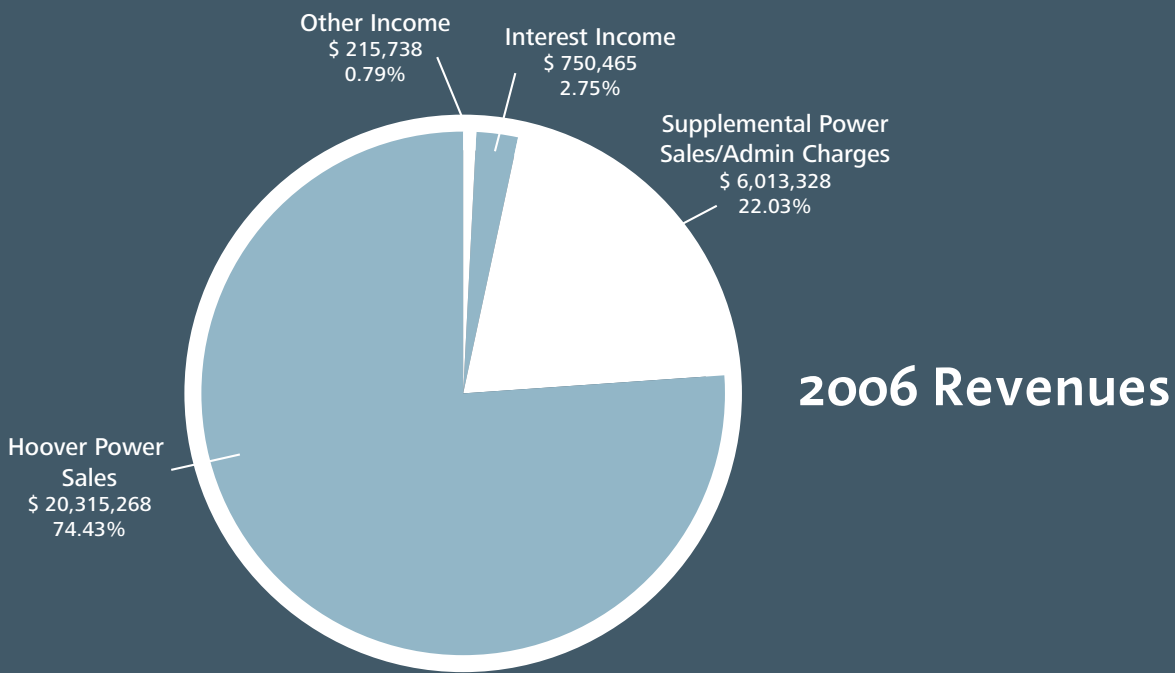
Other Income (Deductions)

which increase/decrease as a result of investment market conditions.

Statements of Revenues, Expenses, and Changes in Net Assets Business Type Activities

June 30

	2006	2005	Diff \$	Diff%
Operating revenues	\$ 26,328,596	\$ 26,472,435	\$ (143,839)	(0.5%)
Operating expenses				
Purchased power	19,404,200	20,805,429	(1,401,229)	(6.7%)
Western credits	(5,167,368)	(5,119,484)	(47,884)	0.9%
Amortization of Hoover Upgrading Program costs	5,167,368	5,119,484	47,884	0.9%
Transmission and distribution	5,258,886	5,256,841	2,045	0.0%
Administrative and general	1,405,247	1,348,146	57,101	4.2%
Depreciation	40,265	41,024	(759)	(1.9%)
Other	109,518	70,837	38,681	54.6%
Total operating expenses	26,218,116	27,522,277	(1,304,161)	(4.7%)
Operating income (loss)	110,480	(1,049,842)	1,160,322	110.5%
Other (deductions) income				
Interest expense	(2,862,363)	(2,990,812)	128,449	(4.3%)
Deferred interest expense	2,347,319	2,520,052	(172,733)	(6.9%)
Amortization	120,255	124,304	(4,049)	(3.3%)
Interest income	750,465	596,597	153,868	25.8%
Other, net	95,483	25,894	69,589	268.7%
Total other (deductions) income	451,159	276,035	175,124	63.4%
Change in net assets	561,639	(773,807)	1,335,446	172.6%
Net assets, beginning of year	2,755,492	3,529,299	(773,807)	(21.9%)
Net assets, end of year	\$ 3,317,131	\$ 2,755,492	\$ 561,639	20.4%



Fiscal Year 2006 Changes in Net Assets Discussion

Net Assets increased overall because of the following:

- Operating Revenues decreased due to the accrual of fiscal year 2006 customer refunds.
- Total Operating Expenses decreased due to a decrease in purchased power.
- Western Credits increased because of changes in debt payments and associated costs related to the Upgrading Program.
- Amortization of the Upgrading Program increased because of the increase in the amortization of long-term bond costs.
- Administrative and General expenses increased due to Lower Colorado River Multi-Species Conservation Program (MSCP) expenses.
- Depreciation decreased due to the normal attrition of capital assets.
- Other expenses increased due to the initiation of special expenses, such as the Colorado River Legal Defense Fund and National Renewable Energy Laboratory (NREL)



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, 2007 and 2006, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. 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

December 7, 2007

Financial Highlights

Statements of Net Assets

June 30, 2007 and 2006

	APA General Fund		Hoover Uprating Fund		Total	
	2007	2006	2007	2006	2007	2006
Assets						
Current Assets						
Cash and cash equivalents	\$ 3,514,101	\$ 3,517,969	\$ 1,741,630	\$ 2,457,591	\$ 5,255,731	\$ 5,975,560
Investments held by Trustee - Short Term	-	-	3,105,380	2,818,376	3,105,380	2,818,376
Accounts receivable, customer power						
purchases	834,828	598,577	2,392,037	2,349,602	3,226,865	2,948,179
Interest receivable	24,592	20,331	88,753	128,733	113,345	149,064
Other assets	298,163	170,063	-	-	298,163	170,063
Prepaid purchased power	-	-	2,327,678	1,712,783	2,327,678	1,712,783
Total current assets	4,671,684	4,306,940	9,655,478	9,467,085	14,327,162	13,774,025
Capital assets, net	200,159	235,769	-	-	200,159	235,769
Investments Held by Trustee - Long Term	-	-	6,546,641	6,546,569	6,546,641	6,546,569
Advances for Hoover Uprating Program, net	-	-	39,771,895	42,578,155	39,771,895	42,578,155
Prepaid transmission	182,360	182,360	-	-	182,360	182,360
Total assets	\$ 5,054,203	\$ 4,725,069	\$ 55,974,014	\$ 58,591,809	\$ 61,028,217	\$ 63,316,878
Liabilities						
Current liabilities						
Accounts payable and other	\$ 8,173	\$ 15,440	\$ 120,956	\$ 96,239	\$ 129,129	\$ 111,679
Customer refunds	-	-	1,289,933	1,504,693	1,289,933	1,504,693
Power contracts payable	833,207	593,456	1,447,713	1,335,405	2,280,920	1,928,861
Accrued interest payable	-	-	672,280	707,592	672,280	707,592
Bonds payable	-	-	3,120,000	2,825,000	3,120,000	2,825,000
Total current liabilities	841,380	608,896	6,650,882	6,468,929	7,492,262	7,077,825
Bonds payable	-	-	49,015,000	52,135,000	49,015,000	52,135,000
Premium (discounts) on bonds payable	-	-	672,469	786,922	672,469	786,922
Bonds payable, net	-	-	49,687,469	52,921,922	49,687,469	52,921,922
Total liabilities	841,380	608,896	56,338,351	59,390,851	57,179,731	59,999,747
Net Assets						
Invested in capital assets	200,159	235,769	-	-	200,159	235,769
Unrestricted	4,012,664	3,880,404	(364,337)	(799,042)	3,648,327	3,081,362
Total net assets	4,212,823	4,116,173	(364,337)	(799,042)	3,848,486	3,317,131
Total liabilities and net assets	\$ 5,054,203	\$ 4,725,069	\$ 55,974,014	\$ 58,591,809	\$ 61,028,217	\$ 63,316,878

*the accompanying notes are an integral part of these financial statements



Statements of Revenues, Expenses and Changes in Net Assets

June 30, 2007 and 2006

	APA General Fund		Hoover Upgrading Fund		Total	
	2007	2006	2007	2006	2007	2006
Operating Revenues	\$ 6,053,857	\$ 6,013,328	\$ 22,247,125	\$ 20,315,268	\$ 28,300,982	\$ 26,328,596
Operating Expenses						
Purchased power	6,034,405	5,950,918	15,325,421	13,453,282	21,359,826	19,404,200
Western credits	-	-	(5,523,334)	(5,167,368)	(5,523,334)	(5,167,368)
Amortization of Hoover Upgrading						
Program costs	-	-	5,523,334	5,167,368	5,523,334	5,167,368
Transmission and distribution	9,842	324	5,293,357	5,258,562	5,303,199	5,258,886
Administrative and general	19,839	70,558	1,461,196	1,334,689	1,481,035	1,405,247
Depreciation	38,694	40,265	-	-	38,694	40,265
Other	61,433	82,899	25,655	26,619	87,088	109,518
Total operating expenses	6,164,213	6,144,964	22,105,629	20,073,152	28,269,842	26,218,116
Operating income (loss)	(110,356)	(131,636)	141,496	242,116	31,140	110,480
Other (deductions) income						
Interest expense	-	-	(2,724,425)	(2,862,363)	(2,724,425)	(2,862,363)
Deferred interest expense	-	-	2,273,992	2,347,319	2,273,992	2,347,319
Amortization	-	-	114,453	120,255	114,453	120,255
Interest income	177,172	131,356	617,421	619,109	794,593	750,465
Other	29,834	67,927	11,768	27,556	41,602	95,483
Total other (deductions) income	207,006	199,283	293,209	251,876	500,215	451,159
Changes in net assets	96,650	67,647	434,705	493,992	531,355	561,639
Net assets, beginning of year	4,116,173	4,048,526	(799,042)	(1,293,034)	3,317,131	2,755,492
Net assets, end of year	\$ 4,212,823	\$ 4,116,173	(364,337)	(799,042)	\$ 3,848,486	\$ 3,317,131

*the accompanying notes are an integral part of these financial statements

Statements of Cash Flows

June 30, 2007 and 2006

	APA General Fund		Hoover Uprating Fund		Total	
	2007	2006	2007	2006	2007	2006
Cash flows from operating activities						
Cash received from customers	\$ 5,689,508	\$ 5,759,578	\$ 22,204,691	\$ 21,651,791	\$ 27,894,199	\$ 27,411,369
Cash payments to suppliers for goods or services	(5,893,034)	(5,991,416)	(22,089,056)	(20,512,553)	(27,982,090)	(26,503,969)
Cash payments to employees for services	-	-	(709,205)	(603,132)	(709,205)	(603,132)
Net cash (used in) provided by operating activities	(203,526)	(231,838)	(593,570)	536,106	(797,096)	304,268
Cash flows from capital and related financing activities						
Interest payments on bonds payable	-	-	(2,759,738)	(2,894,363)	(2,759,738)	(2,894,363)
Payments on bonds payable	-	-	(2,825,000)	(2,560,000)	(2,825,000)	(2,560,000)
Acquisition of capital assets	(3,083)	(64,248)	-	-	(3,083)	(64,248)
Other costs relating to Hoover Uprating Program	-	-	(443,082)	(233,594)	(443,082)	(233,594)
Reduction in advances for Hoover Uprating Program	-	-	5,523,334	5,167,368	5,523,334	5,167,368
Net cash (used in) provided by capital and related financing activities	(3,083)	(64,248)	(504,486)	(520,589)	(507,569)	(584,837)
Cash flows from investing activities						
Interest on investments	202,741	194,429	669,170	640,895	871,911	835,324
Purchase on investments	-	-	(5,979,348)	(7,467,429)	(5,979,348)	(7,467,429)
Proceeds from sale and maturities of investments	-	-	5,692,273	7,295,443	5,692,273	7,295,443
Net cash provided by (used in) investing activities	202,741	194,429	382,095	468,909	584,836	663,338
Net change in cash and cash equivalents	(3,868)	(101,657)	(715,961)	484,426	(719,829)	382,769
Cash and cash equivalents, beginning of year	3,517,969	3,619,626	2,457,591	1,973,165	5,975,560	5,592,791
Cash and cash equivalents, end of year	\$ 3,514,101	\$ 3,517,969	\$ 1,741,630	\$ 2,457,591	\$ 5,255,731	\$ 5,975,560

*the accompanying notes are an integral part of these financial statements



Statements of Cash Flows (continued)

June 30, 2007 and 2006

	APA General Fund		Hoover Uprating Fund		Total	
	2007	2006	2007	2006	2007	2006
Reconciliation of operating income						
(loss) to net cash provided by						
(used in) operating activities						
Operating income (loss)	\$ (110,356)	\$(131,636)	\$ 141,496	\$ 242,116	\$ 31,140	\$ 110,480
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities						
Depreciation	38,694	40,265	-	-	38,694	40,265
Loss on disposal of capital asset	-	-	-	-	-	-
Changes in assets and liabilities						
(increase) decrease in accounts receivable	(236,251)	(134,389)	(42,435)	(168,170)	(278,686)	(302,559)
(increase) decrease in other assets	(128,097)	(119,361)	-	-	(128,097)	(119,361)
(increase) decrease in prepaid purchase power	-	-	(614,895)	(1,008,091)	(614,895)	(1,008,091)
(increase) decrease in accounts payable and other	(7,267)	(18,200)	24,717	(16,681)	17,450	(34,881)
(increase) decrease in customer refunds	-	-	(214,761)	1,504,693	(214,761)	1,504,693
(increase) decrease in power contracts payable	239,751	131,483	112,308	(17,761)	352,059	113,722
Total adjustments	(93,170)	(100,202)	(735,066)	293,990	(828,236)	193,788
Net cash provided by (used in) operating activities	\$ (203,526)	\$(231,838)	\$ (593,570)	\$ 536,106	\$ (797,096)	\$ 304,268
Supplemental schedule of noncash capital and related financing activities						
Deferred interest expense	\$ -	\$ -	\$ 2,273,992	\$ 2,347,319	\$ 2,273,992	\$ 2,347,319
Supplemental schedule of cash paid for interest	-	-	2,759,738	2,894,363	2,759,738	2,894,363

**the accompanying notes are an integral part of these financial statements*



Notes to 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 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

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*.

Accounting Standards

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.



New Accounting Pronouncements

In September 2006, the GASB published Statement No. 48 (“GASB No. 48”), *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*. This Statement establishes accounting and financial reporting standards for transactions in which a government receives, or is entitled to, resources in exchange for future cash flows generated by collecting specific receivables or specific future revenues. It also contains provisions that apply to certain situations in which a government does not receive resources but, nevertheless, pledges or commits future cash flows generated by collecting specific future revenues. This Statement is effective for financial statements for periods beginning after December 15, 2006. The impact of GASB No. 48 is currently being evaluated by the Authority.

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.

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.

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 Upgrading Program

Proceeds from bonds payable were advanced by the Authority for upgrading the Hoover Power Plant and are recorded as advances. Such advances, including debt issue costs, plus net interest expense incurred by the Authority are reimbursed in the form of credits on the monthly power bills rendered by the Western Area Power Administration of the Department of Energy (“Western”). These credits will be issued over the 30-year life of the bonds. Substantially all advances, net interest expense and other related costs on the bonds are charged to the Upgrading Program as amounts to be recovered from future credits. These amounts are included in the Amortization of Hoover Upgrading Program Costs in the Statement 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 each year from Salt River Project for scheduling entity services during the years ended June 30, 2007 and 2006. 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 \$1,504,693 and \$297,405 were paid to the customers during the years ended June 30, 2007 and 2006, respectively.

During the year ended June 30, 2007, the accrued amount to be refunded to the customers was \$1,289,933.

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

2. Fund Accounting

Hoover Upgrading Fund

The Hoover Power Plant Act of 1984 ("Hoover Act") authorized the U.S. government to increase the capacity of existing generating equipment at the Hoover Dam Power Plant ("Upgrading Program"). Instead of appropriating further federal funds for the Upgrading Program, Congress implemented

an advancement of funds procedure whereby prospective 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.

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, 2007 and 2006 were as follows:

	2007	2006
Transmission plant	\$ 319,565	\$ 319,565
Distribution plant	227,518	227,518
General plant	779,965	777,076
	<u>1,327,048</u>	<u>1,324,159</u>
Less: Accumulated depreciation	(1,126,889)	(1,088,390)
Capital assets, net	<u>\$ 200,159</u>	<u>\$ 235,769</u>

The Authority had additions of \$3,084 and \$64,248 for the years ended June 30, 2007 and 2006, respectively. The Authority had disposals of \$195 and \$13,980 for the years ended June 30, 2007 and 2006, respectively.

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 \$5,523,334 and \$5,167,368 for the years ended June 30, 2007 and 2006, respectively. Credits were received for the upgraders' portion of principal and interest expense on the bonds and other costs associated with the Hoover Upgrading Program.

5. Bonds Payable

Bonds payable consists of the following:

	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	<u>\$ 54,960,000</u>	<u>\$ -</u>	<u>\$ (2,825,000)</u>	<u>\$ -</u>	<u>\$ 52,135,000</u>

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 Upgrading Fund. Accordingly, the trust account assets and related liabilities are not included in the Authority's financial statements.

The Authority's outstanding bonds, totaling \$52,135,000, bear interest ranging from 5.00% to 5.25%, are due from fiscal year 2007 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 and interest amounts due over the next five fiscal years ending June 30 and thereafter are as follows:

	Principal	Interest
2008	\$ 3,120,000	\$ 2,611,113
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
2013-2017	26,725,000	5,284,258
2018	6,220,000	163,275

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, 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 effective interest method as a component of interest expense over the life of the refunded bonds. The Authority amortized \$245,460 and \$257,883 for the years ended June 30, 2007 and 2006, respectively, resulting in a net deferred amount of \$1,442,179 and \$1,687,639 in the Statement 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 effective interest method. The Authority amortized \$359,917 and \$378,138 for the years ended June 30, 2007 and 2006, respectively, resulting in a net premium of bonds payable of \$2,114,644 and \$2,474,561 in the Statement of Net Assets, respectively.

6. Commitments and Contingencies

The Lower Colorado Multi-Species Conservation Program (“MSCP”) is a cooperative effort between Federal and non-federal entities that will create more than 8,100 acres of riparian, marsh and backwater habitat for 31 species of fish, birds, mammals and plants. The program became effective on April 4, 2005 and expires April 30, 2055. As a party to this Agreement, the Arizona Power Authority’s financial obligation is approximately \$119,000 per year (in 2003 dollars, adjusted annually for inflation). For the years ended June 30, 2007 and 2006, the Authority paid \$133,518 and \$128,877, respectively. 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 business financial condition or results of operations of the Authority.

7. Investments Held by Trustee

As of June 30, 2007 and 2006, investments are collateralized with securities held by the Authority’s trustee. The fair value of the investment securities at June 30 is as follows:

	2007	2006
Repurchase agreement	\$ 6,546,641	\$ 6,546,569
U.S. government securities	3,105,380	2,818,376
Total investments held by Trustee	<u>\$ 9,652,021</u>	<u>\$ 9,364,945</u>

On October 2, 2006, 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 (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, 2007, the aggregate market value of all purchased securities exceeded the amount required under the repurchase and custody agreement.



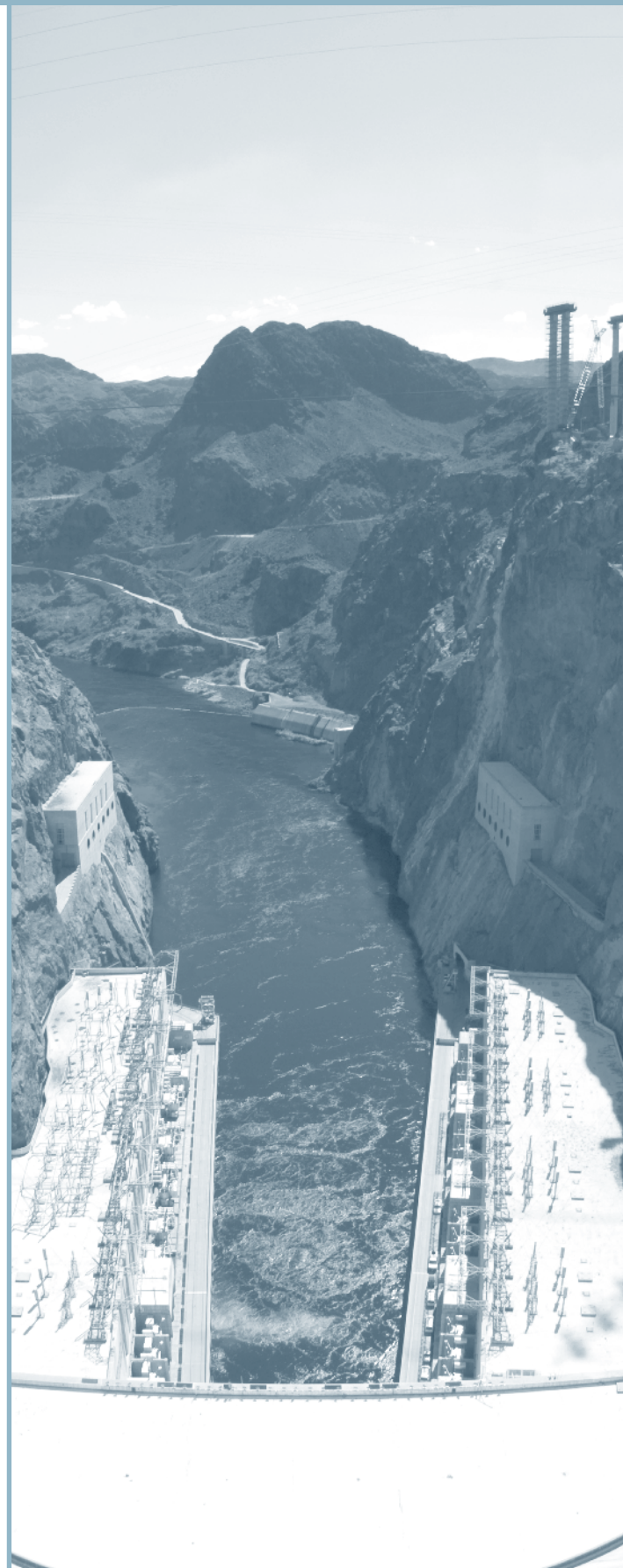
8. Retirement Plan

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 9.10% (8.60% retirement and 0.50% long-term disability) and 8.25% (7.75% retirement and 0.50% long-term disability) of their compensation for the years ended June 30, 2007 and 2006, respectively, with the contributions made through payroll deductions. Employee contributions vest immediately. Total contributions to the Plan for the years ended June 30, 2007 and 2006 by the Authority’s covered employees were \$64,180 and \$45,864, respectively.

Matching employer member contributions were actuarially determined and fixed at the same rate as employee member contributions for the years ended June 30, 2007 and 2006. 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, 2007 and 2006 was \$709,205 and \$603,132, 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.





9. Additional Benefits

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

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

10. 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, 2007 and 2006, the Authority paid \$15,325,421 and \$13,453,282, 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, 2007 and 2006, the Authority paid \$5,293,357 and \$5,258,562, 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, 2007 and 2006, 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, 2007 and 2006, the Authority paid \$6,034,405 and \$5,950,918, respectively, for purchased power under this contract for its customers.

Debt Service Coverage Ratio

NET INCOME	\$ 434,705
<hr/>	
Add:	
Interest Expense	\$ 2,724,425
Amortization	\$ 245,460
Depreciation	\$ 25,655
Western Credits	\$ 5,523,334
Credits to Customers for Prior Years	\$ 1,289,933
<hr/>	
Total Additions	\$ 10,243,512
<hr/>	
Deduct:	
Deferred Interest Expenses	(2,273,992)
Premium Amortization	\$ (359,913)
Total Deductions	\$ (2,633,905)
<hr/>	
Income available for debt service	\$ 7,609,607
<hr/>	
Debt Service	\$ 5,770,676
<hr/>	
Debt service Coverage ratio	1.32

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, 2006 and June 30, 2007.



Arizona Power Authority

1810 West Adams Street
Phoenix, Arizona 85007

(602) 542-4263
FAX (602) 253-7970

PHOTOS COURTESY OF THE BUREAU OF RECLAMATION