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Charles A. Bottemiller  
Manager  
Plant Licensing

April 28, 2003

U.S. Nuclear Regulatory Commission  
Washington, D.C. 20555

Attention: Document Control Desk

Subject: South Mississippi Electric Power Association (SMEPA) 2002 Annual  
Report  
Grand Gulf Nuclear Station  
Docket No. 50-416  
License No. NPF-29

GNRO-2003/00026

Ladies and Gentlemen:

The 2002 Annual Financial Report for South Mississippi Electric Power Association (SMEPA), one of the licensees of Grand Gulf Nuclear Station, is herein submitted in response to the requirement of 10CFR50.71(b).

The 2002 Annual Financial Reports for System Energy Resources, Inc., Entergy Mississippi, Inc., and Entergy Operations, Inc., will be submitted as part of the Entergy Corporation Annual Report by our Corporate Staff.

This letter does not contain any commitments.

Should there be any questions concerning this submittal, please contact this office.

Yours truly,

A handwritten signature in black ink, appearing to be "CAB".

CAB/AMT:amt  
attachment:  
cc:

SMEPA 2002 Annual Report  
(See Next Page)

April 28, 2003  
GNRO-2003/00026  
Page 2 of 2

cc:

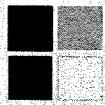
Hoeg	T. L.	(GGNS Senior Resident)	(w/a)
Levanway	D. E.	(Wise Carter)	(w/a)
Reynolds	N. S.		(w/a)
Smith	L. J.	(Wise Carter)	(w/a)
Thomas	H. L.		(w/o)

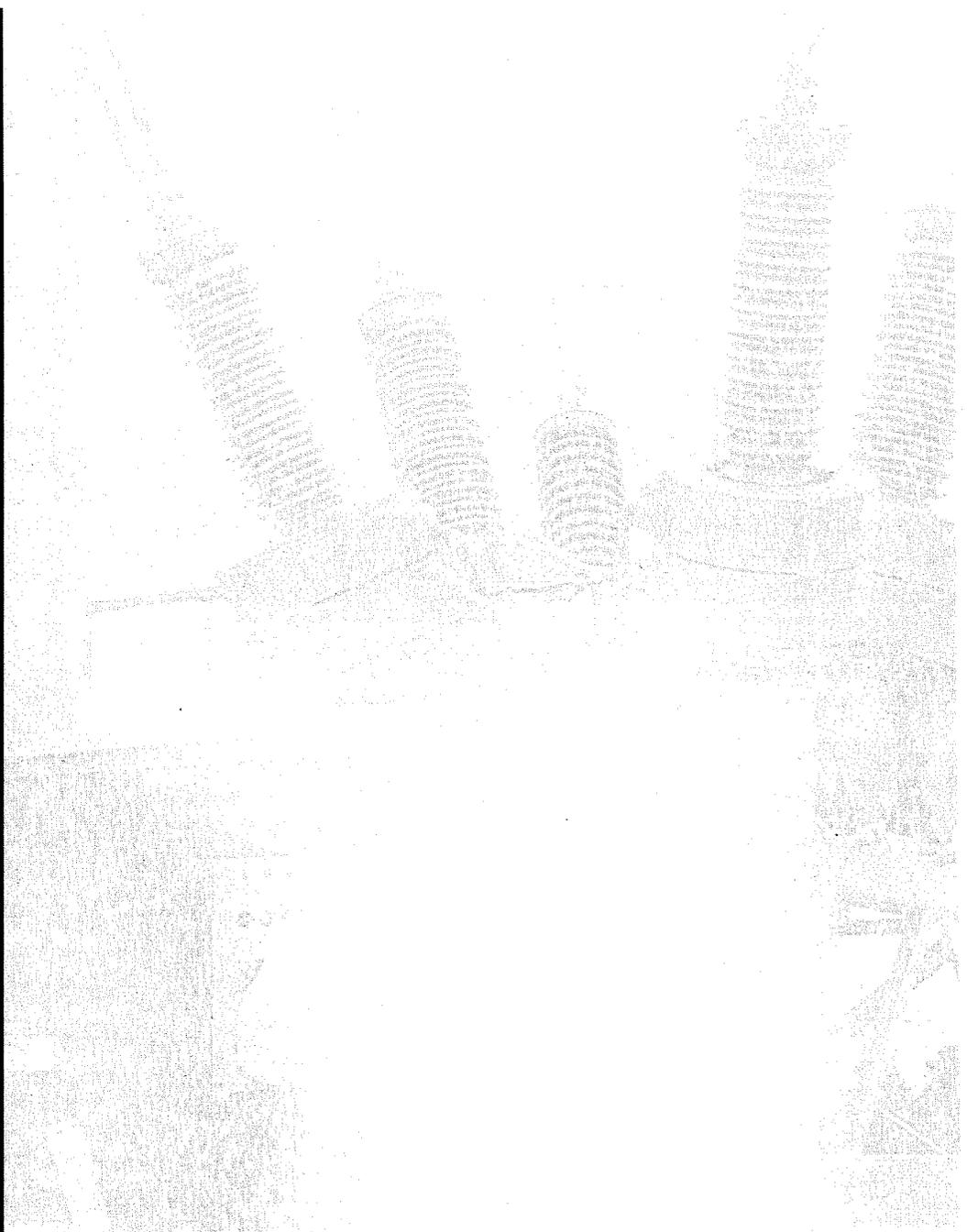
U.S. Nuclear Regulatory Commission  
ATTN: Mr. E. W. Merschoff (w/a)  
611 Ryan Plaza Drive, Suite 400  
Arlington, TX 76011-4005

U.S. Nuclear Regulatory Commission  
ATTN: Mr. Bhalchandra Vaidya, NRR/DLPM (w/a)  
**ATTN: ADDRESSEE ONLY**  
ATTN: U.S. Postal Delivery Address Only  
Mail Stop OWFN/7D-1  
Washington, D.C. 20555-0001



# SMEPA ANNUAL REPORT

2002 



# SOUTH MISSISSIPPI ELECTRIC POWER ASSOCIATION

## 2002 PERFORMANCE HIGHLIGHTS

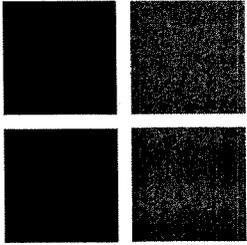
<b>Financial</b>				
(\$ In Thousands)	2002	2001	Increase (Decrease)	% Increase (Decrease)
Total Revenue	\$393,524	\$354,447	\$39,077	11.0%
Current Net Margins	\$2,556	\$2,126	\$430	20.2%
Total Assets	\$839,943	\$731,551	\$108,392	14.8%
Total Equity	\$87,404	\$84,848	\$2,556	3.0%
Equity as % of Assets	10.4%	11.6%		
TIER	1.07	1.06		
DSC	1.04	1.03		
Average Cost of Debt	5.40%	5.88%		

<b>Operational</b>				
Wholesale Rate to Members — Mills/KWH	45.27	44.83	0.44	1.0%
Energy Sales (MWH)				
Members	8,651,954	8,050,419	601,535	7.5%
Non-Members	16,361	26,269	(9,908)	(37.7%)
Total	8,668,315	8,076,688	591,627	7.3%
Net Generation (MWH)	3,806,529	3,548,906	257,623	7.3%
Member Demand (MW)	2,011	1,977	34	1.7%

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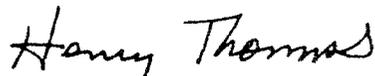
# EXECUTIVE MESSAGE



South Mississippi Electric Power Association's operations have experienced the challenge of change during 2002. No department has escaped the reality of the changing environment that is being experienced by all utilities, yet SMEPA's employees have stepped forward with positive contributions in a unified manner to ensure that all challenges were met or exceeded.

The Transmission and Production Departments continue to experience ever-increasing workloads due to growth and generation additions that exceed past years, and each demand continues to be met in a timely manner without interruption. The Engineering and Power Supply Departments continue to explore and identify the most cost-effective ways to meet the growth and needs of our members. The Finance Department continues to meet its goals as the Association's business system goes through extreme change, and the Human Resources Department continues to refine and develop employment programs that address organizational needs.

This report illustrates the cooperative spirit of SMEPA's workforce.



Henry Thomas  
*General Manager*



W.C. McKamy, Jr.  
*President*



# MEMBER SYSTEMS

**1** COAHOMA EPA  
**Lyon**  
 Giles Bounds, Manager  
 Date energized 1/18/38  
 1,548 miles of line  
 7,184 meters

**2** COAST EPA  
**Bay St. Louis**  
 Robert Occhi, General Manager  
 Date energized 5/20/38  
 5,133 miles of line  
 66,366 meters

**3** DELTA EPA  
**Greenwood**  
 Ronald W. Robertson,  
 General Manager  
 Date energized 1/30/39  
 5,527 miles of line  
 23,704 meters

**4** DIXIE EPA  
**Laurel**  
 James T. Dudley, Jr.,  
 General Manager  
 Date energized 7/28/39  
 4,491 miles of line  
 34,159 meters

**5** MAGNOLIA EPA  
**McComb**  
 Darrell Smith, General Manager  
 Date energized 9/19/39  
 3,626 miles of line  
 26,996 meters

**6** PEARL RIVER VALLEY EPA  
**Columbia**  
 W.T. Shows, General Manager  
 Date energized 5/19/39  
 5,779 miles of line  
 38,544 meters

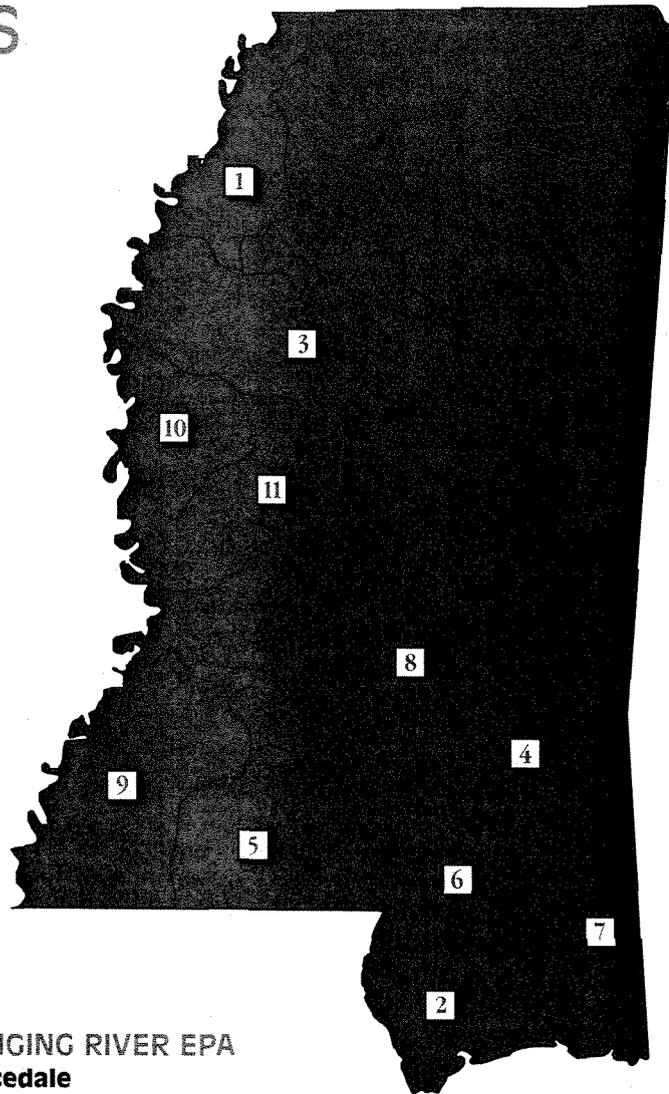
**7** SINGING RIVER EPA  
**Lucedale**  
 Lee Hedegaard, General Manager  
 Date energized 12/5/39  
 6,055 miles of line  
 61,223 meters

**8** SOUTHERN PINE EPA  
**Taylorville**  
 Donald Jordan, General Manager  
 Date energized 5/13/39  
 9,538 miles of line  
 60,743 meters

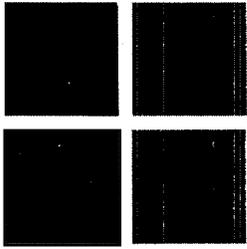
**9** SOUTHWEST MISSISSIPPI EPA  
**Lorman**  
 Percy McCaa, Manager  
 Date energized 3/27/38  
 4,165 miles of line  
 24,286 meters

**10** TWIN COUNTY EPA  
**Hollandale**  
 Vesper Bagley, Manager  
 Date energized 12/24/38  
 2,232 miles of line  
 12,752 meters

**11** YAZOO VALLEY EPA  
**Yazoo City**  
 Charles H. Shelton,  
 General Manager  
 Date energized 3/23/38  
 2,733 miles of line  
 9,923 meters



# BOARD OF DIRECTORS



## COAHOMA ELECTRIC POWER ASSOCIATION

**Billy Hardin**  
*(left)*

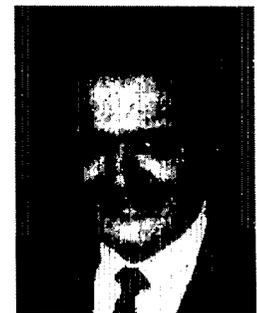
**Giles Bounds, Manager**  
*(right)*



## COAST ELECTRIC POWER ASSOCIATION

**Douglas Mooney**  
*(left)*

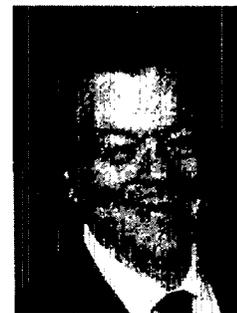
**Robert J. Occhi, General Manager**  
*(right)*



## DELTA ELECTRIC POWER ASSOCIATION

**Henry Waterer, Jr.**  
*(left)*

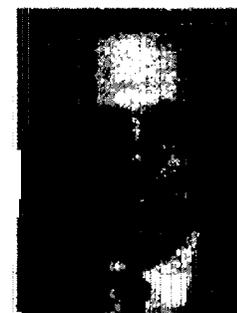
**Ronald W. Robertson, General Manager**  
*(right)*

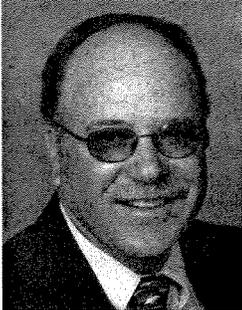


## DIXIE ELECTRIC POWER ASSOCIATION

**L.G. Pierce, Secretary-Treasurer**  
*(left)*

**James T. Dudley, Jr., General Manager**  
*(right)*

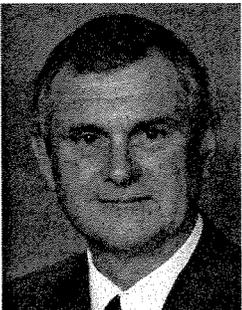




## MAGNOLIA ELECTRIC POWER ASSOCIATION

**Pat Ard**  
*(left)*

**Darrell Smith, General Manager**  
*(right)*



## PEARL RIVER VALLEY ELECTRIC POWER ASSOCIATION

**Ben F. Hudson, Jr.**  
*(left)*

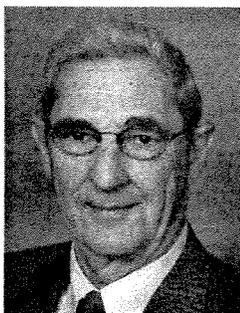
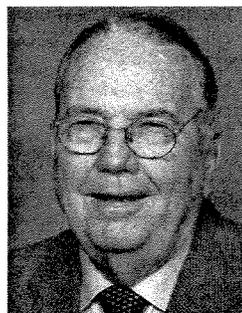
**W.T. Shows, General Manager  
and Acting Secretary-Treasurer**  
*(right)*



## SINGING RIVER ELECTRIC POWER ASSOCIATION

**Ronald "Bo" Hall**  
*(left)*

**Lee Hedegaard, General Manager**  
*(right)*

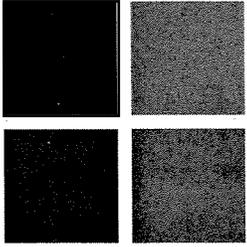


## SOUTHERN PINE ELECTRIC POWER ASSOCIATION

**Harlan Rogers, Vice President**  
*(left)*

**Donald Jordan, General Manager**  
*(right)*

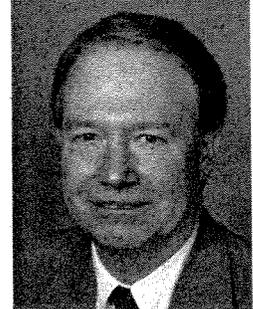
# BOARD OF DIRECTORS



## SOUTHWEST MISSISSIPPI ELECTRIC POWER ASSOCIATION

**James P. Mullins**  
*(left)*

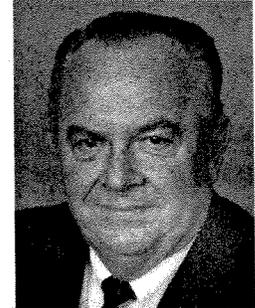
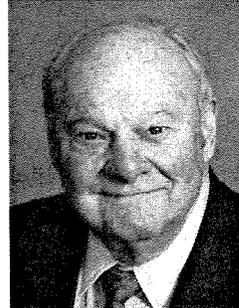
**Percy McCaa, Manager**  
*(right)*



## TWIN COUNTY ELECTRIC POWER ASSOCIATION

**W.C. McKamy, Jr., President**  
*(left)*

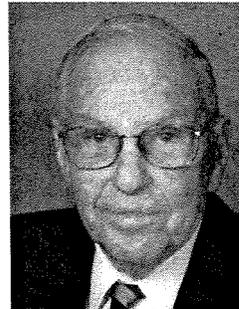
**Vesper Bagley, Manager**  
*(right)*



## YAZOO VALLEY ELECTRIC POWER ASSOCIATION

**R.D. Hines**  
*(left)*

**Charles H. Shelton, General Manager**  
*(right)*



# GENERAL INFORMATION



## SMEPA HEADQUARTERS

**Location:** Hattiesburg, Forrest County  
**Employees:** 122

SMEPA is fortunate to have its Morrow and Moselle generating stations each located approximately fifteen miles from Headquarters. Energy from both stations is dispatched from SMEPA's Control Center in Hattiesburg.



## R.D. MORROW, SR., GENERATING STATION

**Commercial Operation:** 1978  
**Location:** Lamar County  
**Capacity:** 400 MW  
**Fuel:** Bituminous Coal  
**Employees:** 96



## MOSELLE GENERATING STATION

**Commercial Operation:** 1970  
**Location:** Moselle, Jones County  
**Capacity:** 260 MW  
**Fuel:** Natural Gas/Fuel Oil  
**Employees:** 32



## GRAND GULF NUCLEAR STATION

(10% Undivided Interest)  
**Commercial Operation:** 1985  
**Location:** Port Gibson, Claiborne County  
**Capacity:** 1,250 MW  
**Fuel:** Nuclear  
**Employees:** 1

SMEPA counts one employee among Entergy's 800+ who work at the nuclear site. Joe Czaika is the Association's nuclear specialist. Grand Gulf Nuclear Station is located approximately 145 miles from SMEPA's headquarters.



## BENNDALE UNIT

**Commercial Operation:** 1969  
**Location:** George County  
**Capacity:** 16.2 MW  
**Fuel:** Natural Gas

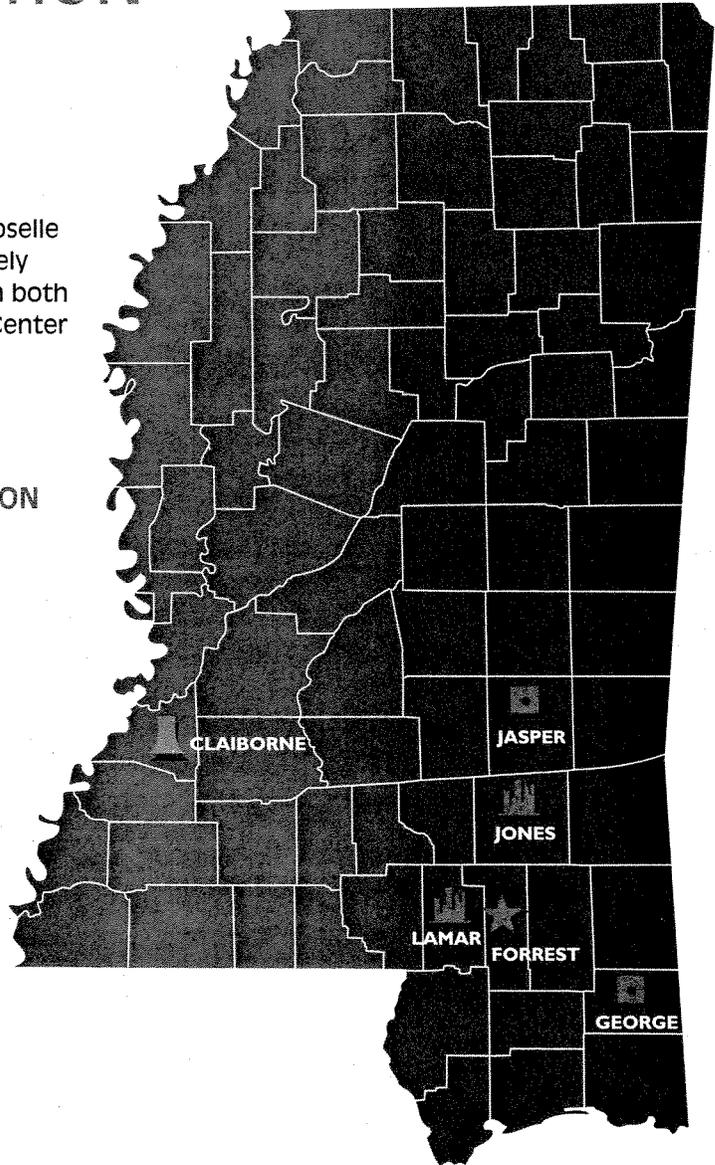


## PAULDING UNIT

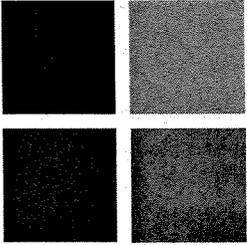
**Commercial Operation:** 1972  
**Location:** Jasper County  
**Capacity:** 20.6 MW  
**Fuel:** Diesel Fuel

SMEPA's two combustion turbines, Benndale and Paulding, are unmanned stations remotely operated from the Control Center located at SMEPA's headquarters facility. Personnel from Plant Moselle maintain the two units.

During 2002, the units were operated on occasion to support load demand. The units were also placed into service from time to time for test purposes to assure continued availability and reliability.



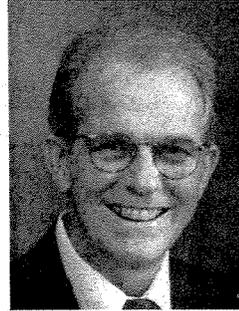
# SMEPA DEPARTMENTS



SMEPA's management team continues to strive for excellence in an ever-changing industry. This experienced leadership maintains an ongoing dedication to facing future challenges and obtaining successful resolutions.

## FINANCE DEPARTMENT

**Jack Harpole**  
*(left)*

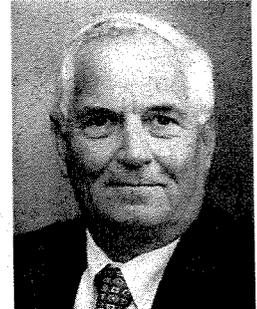
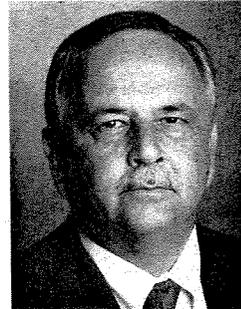


## ENGINEERING DEPARTMENT

**Terry Lee**  
*(right)*

## HUMAN RESOURCES & DEVELOPMENT DEPARTMENT

**Benny Murray**  
*(left)*

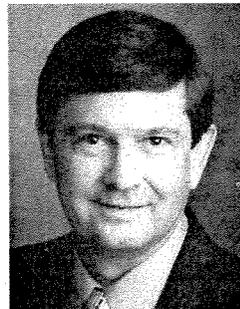


## TRANSMISSION DEPARTMENT

**Jerry Pierce**  
*(right)*

## POWER SUPPLY DEPARTMENT

**Roger Smith**  
*(left)*



## PRODUCTION DEPARTMENT

**Marcus Ware**  
*(right)*

# OPERATING REPORT

## PLANT MOSELLE

The Moselle Station was operated in an intermediate mode to provide load support for the entire year. Availability of the Moselle units remained especially good for the year, and operating efficiency improved by 0.7% due primarily to an increase in capacity factor at the facility. The number of units in service varied according to load requirements, economic considerations, and the need for load regulation support. At least two units were in service all year, with the exception of a short period in February when only one unit was needed. The 83.5 MW combustion turbine was operated as needed for load support.

Natural gas remained available in sufficient quantities to support operations throughout the year. The cost proved to be more stable than during the previous year, even though prices increased substantially in the last quarter. The favorable fuel cost situation favored the economics of operating the Moselle units.

The net generation during 2002 amounted to 471,855 MWH. This includes 25,550 MWH of production from the Moselle combustion turbine. This is 17% more than the 2001 production. Output from the steam units was 15% more than 2001 production, while generation from the combustion turbine was 77% more than the amount produced during the previous year.

Since entering commercial operation in June 1997, the 83.5 MW simple cycle combustion turbine has been utilized in peaking service as needed. Unit operability, availability, and reliability have met the high expectations that were established for the unit. During 2002, the unit was operated 345 hours and produced 25,550 MWH.

There were several inspections conducted and maintenance projects successfully completed throughout the year in order to maintain the efficiency of Plant Moselle operations. These maintenance projects included maintenance on the Paulding, Benndale and Moselle combustion turbines.

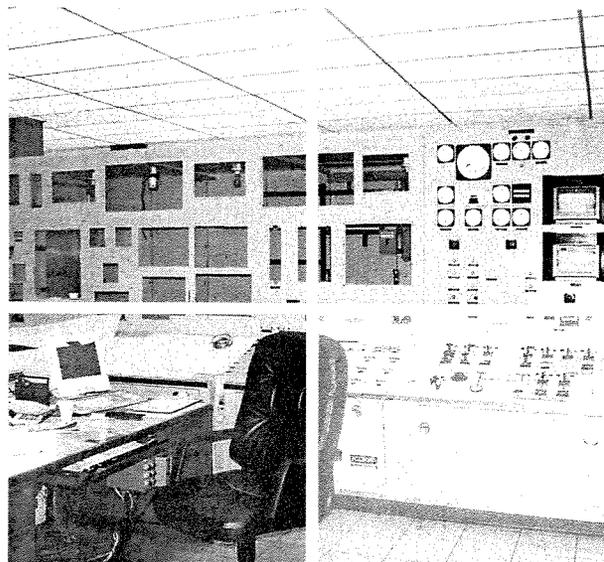
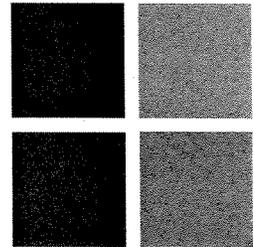
The existing controls for the boiler, turbine, and generator voltage control systems were original equipment. Due to the age of the equipment, obtaining spare parts had become a challenge and in some cases impossible. Specifications

were prepared for the design, engineering, testing, and supply of modern control components for these three systems. Yokogawa provided the new boiler control system, replacing the existing combustion control, burner management system, and motor control. GE Global Controls provided the new turbine and generator voltage controls. The installation of the new control systems required the upgrade of most of the Unit #1 instrumentation, modifications to the turbine front standard, and modifications to the plant control room. The Unit #1 controls upgrade should be complete during January of 2003, with similar upgrades to be conducted on Unit #2 in the fall of 2003, and on Unit #3 in the spring of 2004.

Natural gas purchases were scheduled for flow on a monthly basis to meet projected generation requirements. Portions of the projected requirements were purchased in advance to mitigate the potential of spikes in natural gas market pricing. Records indicate that usage amounted to 5,629,762 MMBtu for the Moselle Generating Plant units, which is 17% more than the volume used during 2001.

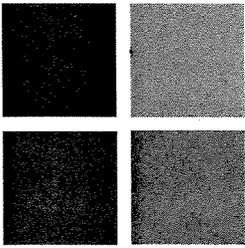
Fuel oil usage for 2002 amounted to 11,997 gallons. This quantity was used primarily for test purposes.

In June 2001, SMEPA began receiving energy from Batesville Unit #3, a 280 MW combined cycle facility that is located at Batesville, Mississippi. In addition to the natural gas that was secured for Moselle, SMEPA arranged for the fuel for the Batesville unit. Fuel purchases for the unit during 2002 were procured through Aquila Energy, and totaled 6,071,922 MMBtu.



*Plant Moselle control systems receive upgrades.*

# OPERATING REPORT



## PLANT MORROW

Plant Morrow was primarily operated in an intermediate and base load mode during the year. Simultaneous operation of the two Morrow units occurred during the peak load periods. Maintenance outages were scheduled when load requirements were not demanding. A total of 1,055,058 tons of coal were delivered to Plant Morrow, a record for an annual period. Coal consumption amounted to 1,012,557 tons, representing an increase of 4.8% above 2001 usage. For the year, 9,975 carloads of coal were received and handled at the Morrow Station.

The annual net generation from the facility was 2,328,407 MWH. The production was 8% above 2001 output, and only 3.2% below the record-setting production of 2000. The output was 12% more than the average annual generation that was provided by the facility during the 10-year period 1992-2001.

A scheduled preventive maintenance turbine inspection was performed during a spring outage. This inspection was the first inspection performed on this unit since the outage intervals were increased to six years. Repairs were completed to restore the unit to its original condition.

Invensys/Foxboro field service engineers and plant technicians completed upgrades to both Unit #1 and Unit #2 boiler controls during 2002. The upgrades consisted of new workstations and application processors which improved control performance and control screen update time. Additional system input/output hardware was added for future system expansion.

The Plant Morrow track scale weighing system, which is used to monitor rail-delivered coal volumes, also received an upgrade. The in-motion coal car weigh system was replaced with the latest technology in train weighing. The new system software allows for collection, manual entry, manual correction, storage and printing of critical information required for weight processing. The scale diagnostics allows technicians to access data for analyzing system faults. Calibration faults, zero errors, and system errors are examples of data that are available.

Scheduled preventive maintenance was performed throughout the plant to maintain

continued, efficient, reliable and safe operations. A number of tasks were performed to improve the integrity of various plant systems.

The combined volume of dry fly ash and landfill material marketed during the year totaled 41,500 tons. This reflects a 15% decrease in volume when compared to 2001 figures and is a result of a decline in sales activity. Approximately 38% of the ash produced during the year was marketed.

## GRAND GULF

Overall, 2002 was a very successful year for Grand Gulf. The operating statistics for the facility were again quite favorable even though a refueling outage was scheduled in September and an unexpected scram occurred in June. There were no forced outages in 2002 other than the scram, which was due to an external event. The plant capacity factor was 95.1% based upon the net maximum dependable capacity of 1,210 MW, which increased the three-year average from 91.4% at the end of 2001 to 96.4% at the end of 2002. The capacity factor for 2002 places Grand Gulf among the top ten percent of all domestic nuclear plants. The plant availability factor was 92.9% for 2002, which is the plant's best for a refueling outage year.

The net generation for 2002 was 10,059,000 MWH, which is the highest amount ever for a refueling outage year and is the plant's third best year historically. The other two years in which the milestone was exceeded were non-outage years. The year 2002 was the first in which the plant exceeded 10,000,000 MWH of net generation in an outage year. Production was up by 1.4% from 2001, another refueling year. The average net thermal efficiency for the year was 10,420 Btu/KWH, which is the second best ever for the plant.

The plant staff is continuing to pursue a goal of improving performance. Before 2002, in addition to reducing the plant heat rate by 14.7% since the plant went commercial in 1985, the staff had improved plant capacity by adding approximately 84 MW to the output through various improvements. In 2002, the plant staff improved capacity even more. Additionally, the staff sought and received from the Nuclear

Regulatory Commission (NRC), a 1.7% increase in the licensed power of the plant through the NRC's "measurement uncertainty recovery" initiative (better known as the Appendix K power uprate). The new license limit on reactor power for Grand Gulf is now 3,898 MW (thermal), which added an additional 22 MW to plant output.

The plant broke a plant net generation record and a domestic record for Boiling Water Reactor (BWR) unit on November 27, 2002, by producing 31,285 MW within a 24-hour period at an average power of 1,304 MW. The record setting day, a 0.8% increase over the previous record, was due primarily to upgrades completed in previous years, contributions from the new auxiliary cooling tower, the Appendix K power uprate, and the cold ambient temperature at the time. Just prior to this event, the plant broke a record for net generation for an hourly period. On November 24, the plant produced 1,313 MW between 8:00 p.m. and 9:00 p.m., which established a new domestic record for a BWR unit.

The twelfth (RFO12) refueling outage was a great success. The duration of RFO12 was 22 days, 18 hours, and 7 minutes, the second shortest for the facility and short of the record by only 24.4 hours. In addition to plant outage issues, the plant staff had to endure the remnants of two hurricanes that came through the area during the outage time period. The heavy winds and rain made moving about the site uncomfortable and hazardous.

The plant staff continues to strive to improve efficiency in operations. The staff is committed to continued excellent performance, but at the same time is striving to do better to keep ahead of the industry. Plant equipment reliability has benefited from a continual focus, and further improvement is anticipated. In order to maintain short outage durations, the staff will continue to conduct more and more work with the plant on-line. This requires very careful planning and execution, with a great deal of innovation at times. However, as experience is gained, this becomes more natural and routine. Significant planned on-line work is scheduled for 2003 for several plant safety systems.

SMEPA received a total of 1,005,878 MWH of energy from Grand Gulf during 2002, which is 1.3% more than 2001 deliveries. This represents

the highest annual delivery into SMEPA's system from the facility during a refueling outage year, and was the third highest delivery for an annual period. The entire year was characterized by relatively high availability. Power was supplied from the unit on 340 of 365 days during the year and the unit was operated without disruption in 9 of the 12 months. The overall production and performance (heat rate) reflected the positive benefits that have been realized from recent high pressure and low-pressure turbine upgrades, cooling tower fill replacement, addition of the auxiliary cooling tower, and the Appendix K power uprate.

## COMBUSTION TURBINES

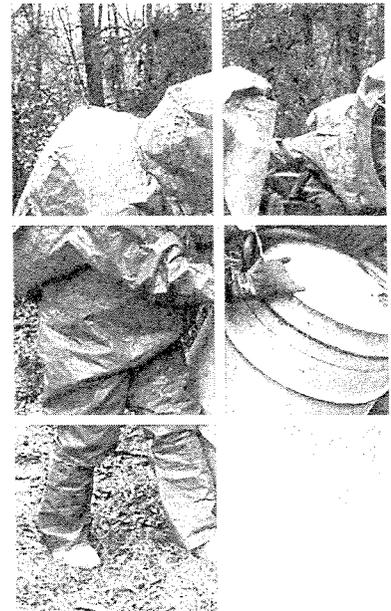
The two remotely located combustion turbines were operated sparingly for load support during the year. The units were used when needed to support load requirements during peak demand periods or for system emergencies. The units were placed into service for test purposes at scheduled intervals in an effort to assure availability and reliability.

Benndale was operated on nine separate days of the year and produced 284 MWH. Paulding was operated on six separate days and produced 105 MWH. Both units are intended to provide critically needed support when system demand is high or during emergency situations.

As usual, Moselle maintenance personnel completed routine maintenance work at the remote sites; conducted periodic operating tests at each location; and responded on occasion when starting and operating problems were identified with the units.

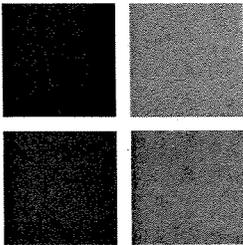
## CONSTRUCTION ACTIVITIES

In conjunction with plans to meet the growing power supply needs of SMEPA's member systems, construction activities were initiated at two new power plant sites during 2002. Site



*Plant personnel continuously undergo Hazardous Materials training.*

# OPERATING REPORT



development began for the Silver Creek Plant in Jefferson Davis County and for the Sylvarena Plant in Smith County. Simple cycle combustion turbine-generators are being added to SMEPA's generating unit fleet for use primarily for peaking purposes.

The site development process was completed at each location, and construction activities commenced under an engineering, procurement, and construction contract arrangement with Allegheny Energy Solutions. As the year progressed, Unit #1 equipment, including the turbine-generator, was delivered to Silver Creek and equipment associated with Units #1, #2, and #3 was delivered to Sylvarena. The components were placed on the respective foundations, and significant progress was made in the installation of piping, conduit, wiring, and associated equipment, in preparation for initial operation in May 2003.

At the Silver Creek site, the single 83 MW unit is a General Electric model 7EA turbine-generator, which is almost identical to the combustion turbine that was placed into service at Moselle in 1997. The primary difference is that the Moselle unit can operate on both natural gas and diesel fuel, while the Silver Creek unit will be operated solely on natural gas fuel. Two additional units will follow at Silver Creek with completion in May 2004 and May 2005.

The Sylvarena units are each rated at 47 MW. The General Electric model LM 6000 units are the first aero-derivative type turbines in SMEPA's system. These units are of a more efficient design, and will be operated exclusively on natural gas.

The natural gas supply pipeline has been constructed into each of the sites, and required metering and regulating stations have been installed. Also, transmission lines have been routed into the new Silver Creek and Sylvarena switchyards. Silver Creek is connected to Entergy's grid at 115kV, while Sylvarena is tied to SMEPA's own 69kV system.

Although physical activity has not yet begun, plans call for the addition of another 83 MW simple cycle combustion turbine at Moselle, for startup in 2006. Attention will return to this location upon completion of the initial phase of the projects at Silver Creek and Sylvarena.

## KENTUCKY COAL PROPERTY ACTIVITY

Chas Coal continued plans to develop the coal reserves and maintained active mining operations on the SMEPA property under provisions of the Coal Property Lease Agreement. For the year, clean coal production amounted to 268,556 tons from surface, highwall, and deep mine operations. This reflects the highest annual production from the property since 1999. Further increases in production are expected during 2003.

Under an Oil & Gas Lease Agreement, SMEPA received royalty payments as a result of oil and gas production from the property. A relatively small but steady volume of gas flowed from a total of 31 wells throughout the year. Revenue was generated from a limited amount of oil production each month.

As part of the effort to monitor and adequately manage developments on SMEPA's Kentucky property, quarterly inspections of the mining operations and the preparation plant were conducted. Meetings were held with Chas Coal management personnel to review current and planned development of the coal reserves. At the conclusion of each of the visits, SMEPA's mining consultants prepared and submitted a report of detailed findings, recommendations, and other pertinent information relative to the property operations. Attention was also directed to developments under the Oil & Gas Lease Agreement and to timber removal operations.

## ENVIRONMENTAL AFFAIRS

Environmental efforts during 2002 focused upon continued compliance with existing regulations while completing permitting efforts required for the construction of new SMEPA generating units at Silver Creek, Sylvarena, and Moselle. This year marked the third year of participation of SMEPA's R. D. Morrow, Sr. and Moselle Generating Plants in Phase II of the Acid Rain Program. Limited emission rates of acid rain pollutants provided for the continued "banking" of emission credits for use in meeting future generation requirements. Continuous Emission Monitors (CEMS), used to quantify and account

for unit emissions, were successfully recertified at all SMEPA generating plants.

A Title V air permit renewal application was prepared and submitted for the Moselle Generating Plant during the year. The Mississippi Department of Environmental Quality (MDEQ) will issue this permit for a period of five years from the issuance date.

The MDEQ issued Title V Operating Permits for the Benndale and Paulding combustion turbine facilities. These permits allow continued operation of these facilities for a period of five years, when permit renewal will again be necessary.

The Rural Utilities Service (RUS) issued Findings-Of-No-Significant-Impacts for the Silver Creek, Sylvarena, and Moselle combustion turbine projects. This determination included essential environmental approval of these projects by RUS, thus allowing construction and project financing to proceed. This determination was based upon information that was submitted to RUS by SMEPA at the end of 2001.

The MDEQ issued air and storm water construction and operating permits for the Silver Creek and Sylvarena Generating Plants during 2002. The issuance of these permits by the agency was necessary prior to commencement of construction of the new plants. Anti-Degradation Studies for these facilities were prepared and submitted to this agency in order to complete the application process for wastewater discharge permits.

Design and construction of CEMS for the Silver Creek and Sylvarena Generating Plants were completed during the year. Monitoring plans for these facilities were also submitted to and approved by the Environmental Protection Agency. The addition of these generating units will double the number of acid rain-affected units that SMEPA operates.

## POWER SUPPLY PLANNING

During 2002, as part of the initial phase-in to coincident peak billing, SMEPA provided its members with sample bills based on coincident peaks. For 2003, SMEPA's Board decided to

continue billing members based on non-coincident peaks as well as to continue providing members with sample coincident peak bills. Beginning with the January 2004 bills, SMEPA will begin a three-year phase-in of coincident peak billing.

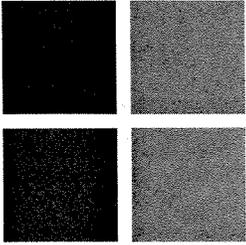
SMEPA participated in interventions for transmission rate redetermination and ancillary services on the Entergy transmission system and transmission rate on the Southern Company transmission system. As the year ended, the Entergy rate issue was resolved and is awaiting final Federal Energy Regulatory Commission (FERC) ruling. Filing of comments on the Entergy transmission ancillary services issue was completed by year's end and the parties were awaiting FERC ruling that is expected to be issued in 2003. SMEPA also intervened in the Southern Company transmission formula rate filing and participated in negotiations with Southern Company representatives after a FERC Technical Conference in August. All parties have reached a settlement agreement and will be seeking FERC approval in 2003. The settlement provides significant savings for delivery of capacity and energy to the Borderline System.

SMEPA negotiated and signed an interconnection agreement with Entergy for the new Silver Creek generating facility. Entergy filed this unilaterally executed document with FERC in November. The agreement outlines the responsibilities of SMEPA and Entergy for interconnecting the new plant to Entergy's transmission system. Capacity and energy generated by the plant will be delivered to SMEPA member load using transmission service provided in the 1979 Interconnection and Operating Agreement between SMEPA and Entergy Mississippi, formerly Mississippi Power & Light Company.

## OPERATIONS CONTROL CENTER

SMEPA's Control Center personnel, in conjunction with Production personnel, implemented plans for optimizing the use of generation resources, both owned and purchased. Through a combination of fuel

# OPERATING REPORT



management, economic dispatch of generating units, timely purchases and the use of risk management tools, fuel and energy costs to serve SMEPA's members for the year were reduced to \$3.43 million below budget.

SMEPA Control Center personnel also worked with Engineering personnel to update data in the state estimator model. This included adding new SMEPA switching stations, transformers and capacitor banks to the model. The model is used by the regional reliability coordinator to monitor regional transmission system operating conditions in order to assure regional transmission reliability.

## MARKETING

During 2002 SMEPA acknowledged approximately 1500 new Comfort Advantage Homes in member service territories. SMEPA marketing developed member employee-training presentations aimed at internal communication/customer service and coincident peak rate education. Additional online training for member employees enhanced marketing skill levels. SMEPA provided consultation and research for members in the areas of e-procurement, lighting, energy efficiency, interdepartmental relationship marketing, rate application, promotional brochure development, and distributed generation.

## TRANSMISSION SYSTEM MAINTENANCE AND CONSTRUCTION

SMEPA maintains its commitment to providing reliable power through the maintenance of 1,623 miles of transmission line, right of way, and numerous switches. Transmission system personnel also coordinated the surveying and construction management of fiber optic installations and several transmission lines, including those necessary for the Silver Creek and Sylvarena turbine projects.

SMEPA's line crews performed climbing inspections on 5,818 poles and completed 360 line maintenance work orders. Construction for

four new transmission lines was completed, and line adjustments were made on several SMEPA transmission lines for line uprating.

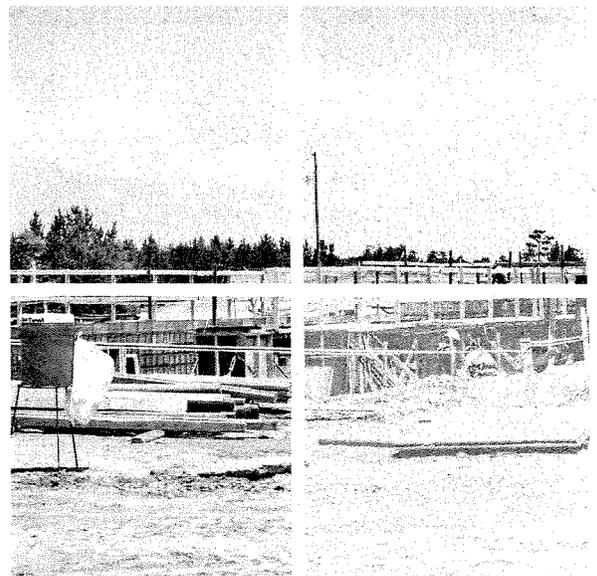
The annual reclearing of right of way was performed on more than 4,358 acres. Pole groundline inspections and treatments were performed on 2,300 poles, and aerial patrol inspections were performed bi-monthly.

## TRANSMISSION SYSTEM PLANNING AND SYSTEM PROTECTION

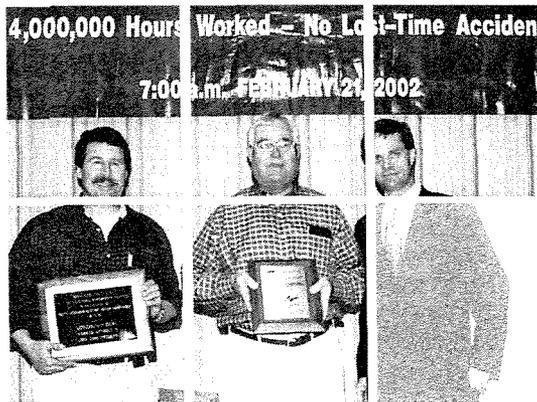
The Transmission System Planning personnel of SMEPA's Engineering Department prepared a new SMEPA Long Range Transmission Plan for the years 2003 through 2017 and a new Construction Work Plan for the years 2003 through 2007. Both studies were delivered to RUS for their review and approval.

Metering technicians checked calibration of all 206 wholesale revenue meters on the SMEPA system. They also calibrated under-frequency relay packages at 49 locations.

Relay technicians calibrated 2,874 relays at 44 locations and were involved in checkout and installation of new relays and panels at six sites (four sites were new substations).



*Construction for the Silver Creek turbine projects begins.*



*Ross Bell (right – Stewart, Sneed, Hewes, BancorpSouth Inc., Insurance) presents Roy Foster, Mr. Thomas and SMEPA employees with a congratulatory plaque for achieving more than 4 million man-hours without a lost time accident.*

## ENGINEERING DESIGN AND ELECTRONICS MAINTENANCE

SMEPA's Engineering Design and Electronics Maintenance staff completed and placed in service 39 miles of fiber optic ground wire (OPGW), two gas circuit breakers (GCBs), three digital microwave projects, bus and switch upgrades, and a new 115kV switchyard at the new Silver Creek location.

SMEPA's Engineering staff also completed various stages of design and construction for two new 69kV switching stations, a new 69kV switchyard at the new Sylvarena location, a 1.5 mile OPGW project, and two more digital microwave links.

## SUBSTATION MAINTENANCE

Substation maintenance activities included the collection of Dissolved Gas Analysis samples from 44 power transformers and 28 load tap changers. Annual routine preventive maintenance was performed on 24 motor operated switches, 17 battery banks, twelve 161kV oil circuit breakers, seven 161kV GCBs, six 69kV GCBs and seven new 125VDC battery banks were installed and tested.

SMEPA's Engineering Department also performed the annual infrared survey/inspections for all substation, switching stations and delivery point facilities.

## COMPUTER INFORMATION SYSTEMS

The Computer Information Systems' staff completed the transition to the PC lease program that began in 2000. This lease covers all employee desktop and laptop computers at Headquarters, Plants Morrow and Moselle. This also includes general purpose PCs for the Control Center and test equipment laptops for Engineering.

SMEPA entered into the Enterprise Asset Management System (EAM) Project beginning in 2002. MRO's Maximo was selected to replace SMEPA's in-house developed Material Management System, Vehicle Maintenance System, and Work Order System. This system will provide data collection and reporting capabilities for headquarters, plants, and field personnel. A new Sunfire V880 database server was also purchased to centralize data collection for the Oracle Financials and the new EAM system. A new tape backup library system was installed for disaster recovery and provides data backups for the production databases.

A Remote Access System was installed in 2002 to provide controlled access for emergency and traveling personnel. Employees can check emails, transfer files, and access business system resources without using the Internet.

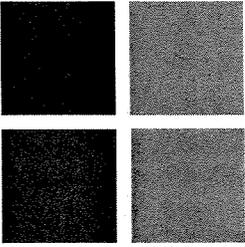
## SAFETY

SMEPA employees continued to achieve an exceptional safety record during 2002. Employee commitment to safety was evidenced by an extremely low incidence rate, which was reflected in workman's compensation insurance premium reductions. During January 2002, SMEPA employees achieved a milestone record of more than 4 million man-hours worked without a lost time accident.

## ASSOCIATION RELATIONS

SMEPA continues to be an integral part of the communities it serves with participation in economic development and by supporting several community organizations. Employees from all departments dedicate their time and energies to supporting such organizations as United Way of both the Pine Belt Region and Southeast Mississippi, Adopt-A-Family, the American Red Cross, Kiwanis Club, the EPA's Youth Leadership Tour program, MathCounts, the Hattiesburg Area Education Foundation, the Interaction Factory, the Area Development Partnership and the Adopt-A-School partnership.

# FINANCIAL REPORT



The electric utility industry remains stressed as reported by the trade press during 2002. Some of the issues include the war economy, foreign acquisitions, credit ratings downgrades, corporate misconduct, capacity mismatch, regulatory initiatives, volatile fuel prices, and severe weather changes. SMEPA achieved strong results during 2002 and remains committed to its core customers, the eleven member cooperatives that in turn serve 366,000 customers throughout rural Mississippi.

The year 2002 was another year of solid financial results for SMEPA. The wholesale rate collected for the year was right on budget while the net margin was slightly above budget. SMEPA invested \$120 million in new utility plant assets bringing total life-to-date infrastructure investments to more than one billion dollars.

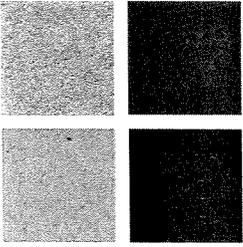
Revenues from members amounted to \$393 million for 2002, up 11% or \$39 million from the previous year. Energy sales to members were up 7.5% to 8.7 million megawatt hours — the highest ever. Generation by SMEPA owned plants was up 7.3% over 2001 to 3.8 million megawatt hours. Demand billings to members were up 10.4% with a monthly average of 1,699 megawatts, an increase of 160 megawatts. All eleven of the member cooperatives increased their purchases of energy from SMEPA. Member purchases were down during the previous year, as the economy experienced a brief recession, but collectively, the member cooperatives show a strong five-year compounded growth rate of 4.7%.

The \$2.6 million margin for 2002 was close to budget and up slightly from the \$2.1 million earned last year. SMEPA's equity increased to \$87.4 million and is now 10.4% of total assets. Discretionary investments amounted to \$23 million at year-end 2002 compared to \$32 million at the start.

Total debt outstanding at year-end 2002 was \$700 million, up \$108 million from the previous year due to the construction of the 481

megawatt combustion turbine project. SMEPA invested \$107 million in the project during 2002 bringing the project-to-date investment to \$158 million (57% of total project estimate). SMEPA is financing the project under a \$275 million "fast-track" loan program approved in 2001 by RUS and CFC. CFC is providing the interim construction financing while RUS is taking the necessary steps to provide permanent guaranteed financing to replace the interim funding. SMEPA expects RUS to start providing long-term funding before the end of 2003. The combustion turbine project includes seven turbines with four to be placed in service before June of 2003. The remaining three turbines are scheduled to be placed in service one at a time over the following three years. The turbines are needed to provide peaking power for summer and winter peaking demand and also to improve load management capabilities. The "fast-track" loan program established by RUS and CFC enabled SMEPA to move from the request for proposals stage to commercial operation in 36 months.

# FINANCIAL REPORT



**EQUITIES AND PATRONAGE CAPITAL**  
(millions of dollars)

1998	1999	2000	2001	2002
78.9	80.9	82.7	84.8	87.4

**GENERATION**  
(millions of MWh)

1998	1999	2000	2001	2002
4.0	3.7	4.1	3.5	3.8

**SALES TO MEMBERS**  
(millions of MWh)

1998	1999	2000	2001	2002
7.5	7.8	8.3	8.1	8.7

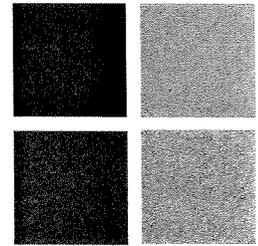
**WHOLESALE RATE TO MEMBERS**  
(mills per kWh)

1998	1999	2000	2001	2002
40.75	41.95	44.02	44.83	45.27

## Comparative Balance Sheets and Selected Financial Ratios (\$ in Thousands)

<u>ASSETS</u>	<u>2002</u>	<u>2001</u>	<u>2000</u>	<u>1999</u>	<u>1998</u>
<b>ELECTRIC UTILITY PLANT</b>					
In Service - at cost	\$ 859,736	\$ 845,253	\$ 828,332	\$ 820,003	\$ 815,305
Construction work in process	188,948	84,354	42,277	24,620	20,861
	<u>1,048,684</u>	<u>929,607</u>	<u>870,609</u>	<u>844,623</u>	<u>836,166</u>
Less accumulated depreciation	420,938	397,434	373,874	350,183	330,062
<b>Net Utility Plant</b>	<b>\$ 627,746</b>	<b>\$ 532,173</b>	<b>\$ 496,735</b>	<b>\$ 494,440</b>	<b>\$ 506,104</b>
<b>INVESTMENTS</b>					
Investments in associated organizations	28,946	13,295	7,719	7,814	7,905
Debt service reserve investments	4,626	4,617	4,594	4,613	5,488
Decommissioning trust investments	10,021	10,501	10,407	10,220	9,666
Debt service prepayments	7,389	7,031	-	-	-
<b>Total Investments</b>	<b>50,982</b>	<b>35,444</b>	<b>22,720</b>	<b>22,647</b>	<b>23,059</b>
<b>CURRENT ASSETS</b>					
Cash - general funds and cash equivalent investments	15,434	24,639	22,119	23,122	17,124
Other invested funds	-	-	-	2,251	11,727
Accounts Receivable - Members	31,731	28,952	33,745	27,498	24,091
Accounts Receivable - Others	2,794	723	1,502	1,003	1,088
Coal and other fuel inventories	10,572	7,804	5,206	18,446	11,022
Materials and supplies inventories	15,918	15,167	14,712	15,467	15,836
Other	869	437	557	1,030	3,602
<b>Total Current Assets</b>	<b>77,318</b>	<b>77,722</b>	<b>77,841</b>	<b>88,817</b>	<b>84,490</b>
<b>DEFERRED CHARGES</b>					
	<b>83,897</b>	<b>86,212</b>	<b>90,084</b>	<b>106,335</b>	<b>99,455</b>
<b>TOTAL ASSETS</b>	<b>\$ 839,943</b>	<b>\$ 731,551</b>	<b>\$ 687,380</b>	<b>\$ 712,239</b>	<b>\$ 713,108</b>
<b><u>EQUITIES AND LIABILITIES</u></b>					
<b><u>EQUITIES</u></b>					
Patronage capital	\$ 86,869	\$ 84,313	\$ 82,187	\$ 80,348	\$ 78,337
Memberships and donated capital	535	535	535	535	535
	<u>87,404</u>	<u>84,848</u>	<u>82,722</u>	<u>80,883</u>	<u>78,872</u>
<b>Long-Term Debt (excluding current maturities)</b>	<b>659,249</b>	<b>559,105</b>	<b>516,265</b>	<b>549,557</b>	<b>571,672</b>
<b>Accrued Decommissioning Obligation</b>	<b>10,021</b>	<b>10,501</b>	<b>10,407</b>	<b>10,220</b>	<b>9,666</b>
<b>Deferred Credits and Other Long-Term Liabilities</b>	<b>8,377</b>	<b>10,850</b>	<b>4,075</b>	<b>4,096</b>	<b>3,962</b>
<b>CURRENT LIABILITIES</b>					
Accounts payable	30,718	30,807	29,243	24,666	20,326
Notes payable	8,000	2,000	-	18,000	-
Accrued interest	1,444	541	8,052	566	804
Other accrued expenses	1,994	2,308	2,339	2,127	2,166
Current maturities of long-term debt	32,736	30,591	34,277	22,124	25,640
	<u>74,892</u>	<u>66,247</u>	<u>73,911</u>	<u>67,483</u>	<u>48,936</u>
<b>TOTAL EQUITIES AND LIABILITIES</b>	<b>\$ 839,943</b>	<b>\$ 731,551</b>	<b>\$ 687,380</b>	<b>\$ 712,239</b>	<b>\$ 713,108</b>
<b><u>RATIOS</u></b>					
TIER	1.07	1.06	1.05	1.06	1.05
DSC	1.04	1.03	1.06	1.02	1.06
Equity as % of Assets	10.4%	11.6%	12.0%	11.4%	11.1%
<b><u>DEBT</u></b>					
Long-Term Debt and Notes Payable	\$ 667,249	\$ 561,105	\$ 516,265	\$ 567,557	\$ 571,672
Current Maturities on Long-Term Debt	32,736	30,591	34,277	22,124	25,640
<b>TOTAL DEBT</b>	<b>\$ 699,985</b>	<b>\$ 591,696</b>	<b>\$ 550,542</b>	<b>\$ 589,681</b>	<b>\$ 597,312</b>
Average Interest Rate	5.40%	5.88%	6.30%	6.23%	6.27%

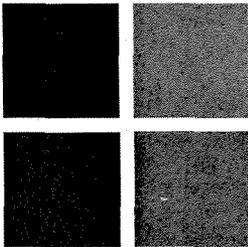
# FINANCIAL REPORT



## Comparative Operating Statements (\$ in Thousands)

	<u>2002</u>	<u>2001</u>	<u>2000</u>	<u>1999</u>	<u>1998</u>
<b>OPERATING REVENUES</b>					
Electric energy revenue from members	\$ 393,123	\$ 354,120	\$ 363,535	\$ 328,716	\$ 305,751
Other electric energy revenue	548	731	3,216	547	7,301
Other - net	(147)	(404)	(307)	11	373
	<u>\$ 393,524</u>	<u>\$ 354,447</u>	<u>\$ 366,444</u>	<u>\$ 329,274</u>	<u>\$ 313,425</u>
<b>OPERATING EXPENSES</b>					
Fuel	67,086	63,881	78,217	66,641	74,885
Production	15,687	13,639	13,987	13,616	12,970
Purchased Power	215,819	185,497	183,174	157,532	132,977
Transmission	12,245	11,710	12,171	11,977	11,424
Administrative and General	4,883	4,328	4,030	3,661	3,424
Maintenance expenses:					
Production	11,229	10,297	8,508	8,871	9,789
Transmission	2,834	2,188	2,186	2,294	1,810
General Plant	825	731	736	692	609
Depreciation and amortization	27,707	26,960	26,461	25,736	25,776
	<u>358,315</u>	<u>319,231</u>	<u>329,470</u>	<u>291,020</u>	<u>273,664</u>
<b>OPERATING MARGIN BEFORE INTEREST AND OTHER DEDUCTIONS</b>	<b>35,209</b>	<b>35,216</b>	<b>36,974</b>	<b>38,254</b>	<b>39,761</b>
<b>INTEREST AND OTHER DEDUCTIONS</b>					
Interest	34,993	36,489	37,344	38,444	40,594
Other Deductions	34	29	14	44	54
	<u>35,027</u>	<u>36,518</u>	<u>37,358</u>	<u>38,488</u>	<u>40,648</u>
<b>OPERATING MARGIN</b>	<b>182</b>	<b>(1,302)</b>	<b>(384)</b>	<b>(234)</b>	<b>(887)</b>
<b>NONOPERATING MARGIN:</b>					
Interest income	1,933	1,534	1,709	1,943	2,590
Allowance for funds used during construction	396	1,618	355	217	258
Other	45	276	159	85	77
<b>Total Nonoperating Margin</b>	<b>2,374</b>	<b>3,428</b>	<b>2,223</b>	<b>2,245</b>	<b>2,925</b>
<b>NET MARGIN</b>	<b>\$ 2,556</b>	<b>\$ 2,126</b>	<b>\$ 1,839</b>	<b>\$ 2,011</b>	<b>\$ 2,038</b>

# FINANCIAL REPORT



## Selected Financial Data

	<u>2002</u>	<u>2001</u>	<u>2000</u>	<u>1999</u>	<u>1998</u>
<u>Mills per KWh</u>					
Wholesale Rate to Members	45.27	44.83	44.02	41.95	40.75
Wholesale Rate to Non-Members	33.49	27.82	39.36	42.95	26.05
Average Cost of Purchased Power	43.07	39.86	41.66	36.29	33.77
Average Cost of Fuel (per net generation)	17.62	18.00	19.31	18.24	18.72

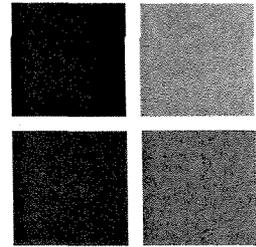
## Comparative Summary / Energy Sources and Sales

	<u>2002</u>	<u>2001</u>	<u>2000</u>	<u>1999</u>	<u>1998</u>
<b>ENERGY SOURCES - MWH</b>					
Generated	3,806,529	3,548,906	4,051,486	3,654,436	4,000,428
Purchased	<u>5,010,337</u>	<u>4,653,782</u>	<u>4,396,938</u>	<u>4,340,954</u>	<u>3,950,485</u>
<b>TOTAL ENERGY AVAILABLE FOR SALE - MWH</b>	<u><b>8,816,866</b></u>	<u><b>8,202,688</b></u>	<u><b>8,448,424</b></u>	<u><b>7,995,390</b></u>	<u><b>7,950,913</b></u>

## ENERGY SALES - MWH

Members					
Coahoma EPA	152,281	136,694	137,280	127,441	128,845
Coast EPA	1,538,159	1,429,392	1,497,819	1,345,675	1,186,129
Delta EPA	545,505	517,677	529,637	530,839	521,834
Dixie EPA	758,571	712,545	721,905	676,403	669,078
Magnolia EPA	583,274	549,602	559,367	522,275	514,763
Pearl River EPA	900,961	826,141	831,542	761,825	717,346
Singing River EPA	1,323,324	1,232,291	1,280,415	1,189,922	1,143,285
Southern Pine EPA	1,826,044	1,670,862	1,678,363	1,634,359	1,584,680
Southwest Mississippi EPA	451,258	414,021	437,638	443,512	445,689
Twin County EPA	262,307	260,148	302,357	296,437	294,815
Yazoo Valley EPA	<u>310,270</u>	<u>301,046</u>	<u>282,862</u>	<u>307,335</u>	<u>296,939</u>
<b>TOTAL SALES TO MEMBERS</b>	<b>8,651,954</b>	<b>8,050,419</b>	<b>8,259,185</b>	<b>7,836,023</b>	<b>7,503,403</b>
Non-Members	<u>16,361</u>	<u>26,269</u>	<u>81,704</u>	<u>12,716</u>	<u>291,913</u>
<b>TOTAL SALES</b>	<u><b>8,668,315</b></u>	<u><b>8,076,688</b></u>	<u><b>8,340,889</b></u>	<u><b>7,848,739</b></u>	<u><b>7,795,316</b></u>
<b>MEMBER DEMAND -- KW</b> (Non-Concurrent Peak)	<u><b>2,010,942</b></u>	<u><b>1,976,642</b></u>	<u><b>2,030,075</b></u>	<u><b>1,892,133</b></u>	<u><b>1,762,216</b></u>

# INDEPENDENT AUDITORS' REPORT



## **RSI** Richards, Sims & Iupe, PLLC

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### **INDEPENDENT AUDITORS' REPORT**

To the Board of Directors of  
South Mississippi Electric Power Association

We have audited the accompanying balance sheets of South Mississippi Electric Power Association ("SMEPA") as of December 31, 2002 and 2001, and the related statements of revenues, expenses and patronage capital, and cash flows for the years then ended. These financial statements are the responsibility of SMEPA's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, such financial statements present fairly, in all material respects, the financial position of SMEPA as of December 31, 2002 and 2001, 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.

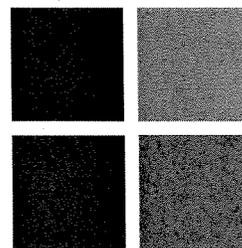
*Richards, Sims + Iupe, PLLC*  
January 28, 2003

**South Mississippi Electric Power Association**  
**Balance Sheets**  
(In Thousands)

	<b>December 31</b>	
	<u><b>2002</b></u>	<u><b>2001</b></u>
<b>ASSETS</b>		
<b>ELECTRIC UTILITY PLANT</b>		
In service - at cost	\$859,736	\$845,253
Construction work in process	188,948	84,354
	<u>1,048,684</u>	<u>929,607</u>
Less accumulated depreciation	420,938	397,434
	<u><b>627,746</b></u>	<u><b>532,173</b></u>
Net Utility Plant		
<b>INVESTMENTS</b>		
Investments in associated organizations	28,946	13,295
Debt service reserve and other investments	4,626	4,617
Decommissioning trust investments	10,021	10,501
Debt service prepayments	7,389	7,031
	<u>50,982</u>	<u>35,444</u>
Total Investments		
<b>CURRENT ASSETS</b>		
Cash - general funds and cash equivalent investments	15,434	24,639
Accounts receivable:		
Members	31,731	28,952
Others	2,794	723
Inventories (at average cost):		
Coal and other fuel	10,572	7,804
Materials and supplies	15,918	15,167
Other	869	437
	<u>77,318</u>	<u>77,722</u>
Total Current Assets		
<b>DEFERRED CHARGES</b>	<u><b>83,897</b></u>	<u><b>86,212</b></u>
<b>TOTAL ASSETS</b>	<u><u><b>\$839,943</b></u></u>	<u><u><b>\$731,551</b></u></u>

See "Notes to Financial Statements"

# FINANCIAL REPORT



## South Mississippi Electric Power Association

### Balance Sheets *continued*

(In Thousands)

	December 31	
	<u>2002</u>	<u>2001</u>
<b>EQUITIES AND LIABILITIES</b>		
<b>EQUITIES</b>		
Patronage capital	\$86,869	\$84,313
Memberships and donated capital	535	535
	<u>87,404</u>	<u>84,848</u>
<b>LONG-TERM DEBT</b> (excluding current maturities)	659,249	559,105
<b>ACCRUED DECOMMISSIONING OBLIGATION</b>	10,021	10,501
<b>DEFERRED CREDITS AND OTHER LONG-TERM LIABILITIES</b>	8,377	10,850
<b>CURRENT LIABILITIES</b>		
Accounts payable	30,718	30,807
Notes payable	8,000	2,000
Accrued interest	1,444	541
Other accrued expenses	1,994	2,308
Current maturities of long-term debt	32,736	30,591
	<u>74,892</u>	<u>66,247</u>
<b>COMMITMENTS AND CONTINGENCIES</b> (Notes 4 and 14)		
	<u><u>\$839,943</u></u>	<u><u>\$731,551</u></u>

See "Notes to Financial Statements"

**South Mississippi Electric Power Association**  
**Statements of Revenues, Expenses and Patronage Capital**  
(In Thousands)

	December 31	
	<u>2002</u>	<u>2001</u>
<b>OPERATING REVENUES</b>		
Electric energy revenue from members	\$393,123	\$354,120
Other electric energy revenue	548	731
Other - net	(147)	(404)
	<u>393,524</u>	<u>354,447</u>
<b>OPERATING EXPENSES</b>		
Fuel	67,086	63,881
Production	15,687	13,639
Purchased power	215,819	185,497
Transmission	12,245	11,710
Administrative and general	4,883	4,328
Maintenance expenses:		
Production	11,229	10,297
Transmission	2,834	2,188
General	825	731
Depreciation and amortization	27,707	26,960
	<u>358,315</u>	<u>319,231</u>
<b>OPERATING MARGIN BEFORE INTEREST AND OTHER DEDUCTIONS</b>	<b>35,209</b>	<b>35,216</b>
<b>INTEREST AND OTHER DEDUCTIONS</b>		
Interest	34,993	36,489
Other deductions	34	29
	<u>35,027</u>	<u>36,518</u>
<b>OPERATING MARGIN</b>	<b>182</b>	<b>(1,302)</b>
<b>NONOPERATING MARGIN:</b>		
Interest income	1,933	1,534
Allowance for funds used during construction	396	1,618
Other	45	276
<b>Total Nonoperating Margin</b>	<b>2,374</b>	<b>3,428</b>
<b>NET MARGIN</b>	<b>2,556</b>	<b>2,126</b>
<b>PATRONAGE CAPITAL AT BEGINNING OF YEAR</b>	<b>84,313</b>	<b>82,187</b>
<b>PATRONAGE CAPITAL AT END OF YEAR</b>	<b><u>86,869</u></b>	<b><u>84,313</u></b>

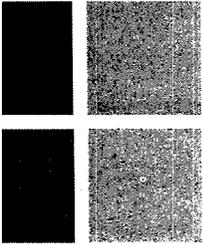
See "Notes to Financial Statements"

**South Mississippi Electric Power Association**  
**Statements of Cash Flows**

(In Thousands)

	December 31	
	<u>2002</u>	<u>2001</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net Margin	\$2,556	\$2,126
Adjustments necessary to reconcile net margin to net cash provided by operating activities:		
Depreciation, amortization, and depletion	31,431	30,070
Allowance for funds used during construction	(396)	(1,618)
Change in Operating Assets and Liabilities:		
Accounts receivable	(4,850)	5,571
Inventories	(3,520)	(3,053)
Other assets	(2,854)	(871)
Accounts payable and other liabilities	(380)	1,526
Accrued interest payable	903	(7,511)
Nuclear outage maintenance costs	(1,905)	(1,654)
Fuel Cost Adjustments	(2,497)	6,783
Accrued decommissioning payable	(480)	94
	<u>18,008</u>	<u>31,463</u>
<b>Net Cash Provided by Operating Activities</b>	<b>18,008</b>	<b>31,463</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Construction and acquisitions of electric utility plant	(119,973)	(57,379)
Purchase of available for sale securities	(576)	(694)
Sale of available for sale securities	1,056	600
Investment in associated organizations	(15,651)	(5,577)
Maturities of held to maturity securities	190	-
Purchase of held to maturity securities	(557)	(7,054)
	<u>(135,511)</u>	<u>(70,104)</u>
<b>Net Cash Used in Investing Activities</b>	<b>(135,511)</b>	<b>(70,104)</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Principal payments on long-term debt	(30,524)	(34,249)
Proceeds from long-term borrowings	132,822	73,410
Proceeds from short-term borrowings	6,000	2,000
	<u>108,298</u>	<u>41,161</u>
<b>Net Cash Provided By Financing Activities</b>	<b>108,298</b>	<b>41,161</b>
<b>NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS</b>	<b>(9,205)</b>	<b>2,520</b>
<b>CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR</b>	<b><u>24,639</u></b>	<b><u>22,119</u></b>
<b>CASH AND CASH EQUIVALENTS AT END OF YEAR</b>	<b><u><u>\$15,434</u></u></b>	<b><u><u>\$24,639</u></u></b>

See "Notes to Financial Statements"



# South Mississippi Electric Power Association

## Notes to Financial Statements

### Years Ended December 31, 2002 and 2001

#### **NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

South Mississippi Electric Power Association ("SMEPA") is a member-owned, not-for-profit electric generation and transmission cooperative supplying wholesale electricity and other services to eleven member systems, which, in turn, provide retail electric service to approximately 365,000 consumers in certain areas of Mississippi. Under long-term wholesale power contracts with each of its members, SMEPA is obligated to provide all of the power required by the member systems to the extent that SMEPA has power available. Financing assistance is provided by the United States Department of Agriculture, Rural Utilities Service ("RUS"). In addition to being subject to regulation by its own governing board of directors, SMEPA is subject to certain rules and regulations promulgated for rural electric borrowers by RUS. SMEPA maintains its accounting records in accordance with the Federal Energy Regulatory Commission's ("FERC") Chart of Accounts as modified and adopted by RUS. 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 disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. As a regulated utility, the methods of allocating costs and revenue to time periods may differ from those principles generally applied to nonregulated companies.

SMEPA owns a 10% undivided interest in a nuclear generating plant known as Grand Gulf Unit 1 ("Grand Gulf"). System Energy Resources, Inc. ("System Energy"), a subsidiary of Entergy Corporation ("Entergy"), owns the remaining 90% either outright or through leasehold interests. Entergy Operations, also a subsidiary of Entergy, operates the plant along with other nuclear plants owned by Entergy, subject to owner oversight. Grand Gulf commenced commercial operation on July 1, 1985.

The more significant accounting policies are generally described as follows:

a. **Electric Utility Plant and Depreciation**

Electric utility plant is stated at cost, which includes contract work, materials and direct labor, allowance for funds used during construction, and allocable overhead costs. The cost of electric generating stations and related facilities also includes costs of training and production incurred, less revenue earned, prior to the date of commercial operation.

Depreciation is provided by the straight-line method for utility plant at the following annual composite rates:

Nuclear generation plant	2.85%
Non-nuclear generation plant	3.00% to 3.10%
Transmission plant	2.75%
General plant and transportation equipment	2.00% to 25.00%

At the time units of electric utility plant are retired, their original cost and cost of removal, less salvage value, are charged to accumulated depreciation. Replacements of electric utility plant involving less than a designated unit of property are charged to maintenance expense. At each balance sheet date, SMEPA evaluates the recoverability of long-lived assets based upon expectations of nondiscounted cash flows and operating income.

b. Cost of Decommissioning Nuclear Plant

SMEPA's portion of the estimated decommissioning cost of Grand Gulf is charged to operating expenses over the estimated service life of the plant. The current operating license received from the Nuclear Regulatory Commission terminates in 2024.

c. Allowance for Funds Used During Construction

SMEPA capitalizes interest on certain significant construction and development projects while in progress. The interest cost capitalized related to debt specifically borrowed for construction and development projects during construction is reflected as a reduction in interest expense. The interest cost related to construction and development projects funded without specific borrowings during construction is reflected as allowance for funds used during construction.

d. Investment Securities

Debt service reserve and other investments are categorized as held to maturity and are carried on the balance sheet at amortized cost. SMEPA has the intent and ability to hold these securities until their estimated maturities but may sell them under certain circumstances.

Decommissioning trust investments are categorized as available for sale and are carried at fair value. In accordance with the regulatory treatment for decommissioning trust funds, realized and unrealized gains on investment securities are also included as a regulatory liability as part of the accrued decommissioning obligation.

Premiums and discounts are amortized and accreted to operations using the level yield method, adjusted for prepayments as applicable.

e. Deferred Charges

SMEPA was a 10% owner in a second unit at the Grand Gulf site when construction was terminated in 1989. With the approval of the RUS, SMEPA is amortizing its remaining investment over a 27-year period ending in 2016.

As a condition of repricing certain outstanding debt in recent years so as to significantly reduce annual interest expense, SMEPA paid penalties of varying amounts that are accounted for as deferred charges to be amortized over the remaining life of the debt.

Bond issue costs are being amortized by the straight-line method, which does not differ materially from the interest method, over the term of the related debt. The amortization during the period of construction is capitalized.

Nuclear outage maintenance costs represent SMEPA's ten percent share of Grand Gulf's incremental maintenance costs associated with refueling outages. These costs are recorded as deferred charges when incurred and are amortized by the straight-line method over the eighteen months between outages.

From time to time, the Board of Directors will set a benchmark fuel cost adjustment rate to be collected from Members so as to match revenues with actual and forecasted fuel and purchased power costs consistent with the cooperative not-for-profit operation of SMEPA. Material variances between these revenues and costs may cause the recognition of deferred credits or deferred charges from one year to the next.

SMEPA's accounting policies include compliance with Statement of Financial Accounting Standards ("SFAS") 71, "Accounting for the Effects of Certain Types of Regulation." In accordance with SFAS 71, SMEPA has regulatory assets of approximately \$83.9 million, including \$54.1 million relating to the unamortized cost of abandoned plant (Note 7). In the event that SMEPA is no longer able to comply with SFAS 71 as the result of a change in regulation or effects of competition, SMEPA would be required to recognize the effects of its regulatory assets and liabilities currently in its statements of revenue, expenses, and patronage capital.

f. Patronage Capital

The bylaws of SMEPA provide that any excess of revenue over expenses and accumulated prior-year deficits shall be treated as advances of capital by the member patrons and credited to them on the basis of their patronage.

g. Income Taxes

SMEPA is exempt from United States income taxes pursuant to Section 501(c)(12) of the Internal Revenue Code, which requires that at least 85% of SMEPA's gross income be derived from its members.

h. Cash and Cash Equivalents

For purposes of reporting cash flows, all temporary investments with original maturities of three months or less are deemed to be cash equivalents.

**NOTE 2 - ACCOUNTING STANDARD TO BE ADOPTED IN THE FUTURE**

In June 2001, the Financial Accounting Standards Board ("FASB") issued SFAS No. 143, "Accounting for Asset Retirement Obligations," which is effective for fiscal years beginning after June 15, 2002. This Statement addresses financial accounting and reporting for asset retirement obligations, and requires that the fair value of a liability for an asset retirement obligation be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made.

SMEPA does not believe that the adoption of this Statement will have a material effect on the financial statements.

**NOTE 3 - ELECTRIC UTILITY PLANT**

Electric utility plant consisted of the following (in thousands):

	Cost		Accumulated Depreciation	
	2002	2001	2002	2001
Grand Gulf Nuclear	\$411,454	\$411,246	\$182,014	\$170,597
Morrow Steam	191,601	191,386	132,255	126,499
Moselle Steam	23,996	23,979	21,874	21,132
Moselle Gas Turbine	21,723	21,723	3,600	2,949
Benndale/Paulding Gas Turbines	<u>4,420</u>	<u>4,420</u>	<u>3,513</u>	<u>3,379</u>
Total Generating Plant	653,194	652,754	343,256	324,556
Transmission Plant	161,330	148,698	51,595	48,041
General Plant and Equipment	20,065	18,654	10,876	10,159
Electric Plant Leased to Others	<u>25,147</u>	<u>25,147</u>	<u>15,268</u>	<u>14,682</u>
Electric Plant in Service	859,736	845,253	420,995	397,438
Construction Work in Process	<u>188,948</u>	<u>84,354</u>	(57)	(4)
Total Utility Plant	<u>\$1,048,684</u>	<u>\$929,607</u>	<u>\$420,938</u>	<u>\$397,434</u>

**NOTE 4 - COMMITMENTS REGARDING GRAND GULF**

SMEPA and System Energy are co-licensees and parties to a joint ownership contract that sets forth the rights and obligations of the Grand Gulf owners, and SMEPA is generally obligated to pay 10% of all operating and capital costs and is entitled to receive 10% of the electricity generated by the plant. SMEPA paid \$22,392,000 and \$18,837,000 under the contract in 2002 and 2001, respectively. Ownership of nuclear capacity entails risks and uncertainties somewhat more complex than those for non-nuclear capacity, and these are discussed below.

Nuclear Insurance and Assessments

As the 90% majority co-owner of Grand Gulf, System Energy is responsible for arranging appropriate insurance and industry assessment programs for itself and SMEPA. SMEPA is obligated to pay 10% of all appropriate costs and assessments, if any. Under the program,

SMEPA could be assessed up to approximately \$9 million for each nuclear incident involving licensed reactors, payable at a rate of \$1 million per reactor per incident per year.

The property insurance presently arranged by System Energy exceeds the NRC's minimum requirement for nuclear power plant licensees of \$1.06 billion per site. NRC regulations provide that the proceeds of this insurance must be used, first, to place and maintain the reactor in a safe and stable condition and, second, to complete decontamination operations. Only after proceeds are dedicated for such use and regulatory approval is secured would any remaining proceeds be made available for the benefit of plant owners or their creditors. Under a member assessment program, SMEPA could be assessed approximately \$1.6 million for property damage, decontamination, or premature decommissioning expense involving other members' nuclear generation plants.

#### Nuclear Fuel

System Energy contracts with System Fuels Inc., another Entergy subsidiary company, for nuclear fuel for Grand Gulf, including maintaining inventories. System Energy has a nuclear fuel lease arrangement for up to \$95 million with respect to Grand Gulf. SMEPA pays for nuclear fuel as it is consumed; and such payments include appropriate charges for processing, fabrication, storage, inventory, shipment, and handling.

#### Spent Nuclear Fuel

System Energy and SMEPA provide for estimated future disposal costs for spent nuclear fuel in accordance with the Nuclear Waste Policy Act of 1982. System Energy entered into contracts with the United States Department of Energy ("DOE"), whereby the DOE will furnish disposal service at a cost of one mill per net KWh generated and sold. The fees payable to the DOE may be adjusted in the future to assure full recovery. Delays have occurred in the DOE's program for the acceptance and disposal of spent nuclear fuel at a permanent repository. After twenty years of study, the DOE, in February 2002, formally recommended, and President Bush approved, Yucca Mountain, Nevada as the permanent spent fuel repository. DOE will now proceed with the licensing and, if the license is granted by the NRC, eventual construction of the repository will begin and receipt of spent fuel may begin as early as approximately 2010. Considerable uncertainty remains regarding the time frame under which the DOE will begin to accept spent fuel for storage or disposal and as a result, future expenditures will be required to increase spent fuel storage capacity. Pending DOE acceptance and disposal of spent nuclear fuel, the owners of nuclear plants are responsible for their own spent fuel storage. Current on-site spent fuel storage capacity at Grand Gulf is estimated to be sufficient until approximately 2006, at which time dry cask storage facilities will be placed into service.

#### Decommissioning Costs

The total cost to decommission Grand Gulf has been estimated to be approximately \$601 million (based on a 1999 cost study using 1999 dollars). SMEPA is responsible for 10% of the estimated cost and has submitted a formal plan to the NRC that demonstrated assurance that sufficient financial resources would be available at the time it becomes necessary to decommission. In addition, SMEPA received approval from the Internal Revenue Service to establish a "tax-free" grantor trust as a vehicle to fund the estimated decommissioning costs. Because of decreases in the market value of securities maintained in the trust, the actual market value of the trust at December 31, 2002 was below the target value. Because of that deficiency, SMEPA will increase its annual funding to \$1,050,000 through 2024 in place of the \$800,000 annual funding previously planned. The estimated funding requirement will continue to be recalculated and adjusted periodically.

The Energy Policy Act of 1992 has a provision that assesses nuclear utilities with fees for the decontamination and decommissioning of the DOE's past uranium enrichment operations. The decontamination and decommissioning assessments will last for fifteen years and will be used to set up a fund into which contributions from utilities and the federal government will be placed. SMEPA's aggregate liability is estimated at \$2,500,000 and is being paid over the fifteen-year term.

#### Depreciation Rate

Except for the years 1996 and 1997, SMEPA has used a 2.85% annual rate for depreciation for Grand Gulf since its commercial operation starting in 1985. For years 1996 and 1997, SMEPA tentatively used a 3.33% rate, which was being used by System Energy pending approval by its regulators. At December 31, 2002, the accumulated depreciation account includes \$3,966,000 in depreciation charges related to the higher rate. Management believes that the impact, if any, of final action on this matter will be accounted for prospectively and will not have a material effect on the financial statements.

#### NOTE 5 - INVESTMENTS IN ASSOCIATED ORGANIZATIONS

Investments in associated organizations are stated at cost and consisted of the following (in thousands):

	<u>2002</u>	<u>2001</u>
National Rural Utilities Cooperative Finance Corporation ("CFC") Certificates:		
Membership subscription	\$6,223	\$6,223
Loan and guarantee	22,355	6,693
Other	<u>368</u>	<u>379</u>
	<u>\$28,946</u>	<u>\$13,295</u>

CFC membership subscription certificates bear interest at a 5.0% rate and mature in 2070 through 2080. The loan and guarantee certificates bear interest at rates of 3.0%, 5.2% and 5.8% and mature in 2005 through 2007. SMEPA is required to purchase loan and guarantee certificates in CFC as a condition of borrowing loan funds for the combustion turbine project (see Note 14).

#### NOTE 6 - INVESTMENT SECURITIES

The amortized cost and related approximate fair values of investment securities were as follows (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2002				
Decommissioning Trust:				
Equity mutual funds	\$8,301	\$0	\$1,787	\$6,514
Fixed income mutual funds	<u>3,352</u>	<u>155</u>	<u>0</u>	<u>3,507</u>
	<u>\$11,653</u>	<u>\$155</u>	<u>\$1,787</u>	<u>\$10,021</u>
Securities to be Held to Maturity:				
Obligations of states and political subdivisions	<u>\$4,626</u>	<u>\$413</u>	<u>\$0</u>	<u>\$5,039</u>
December 31, 2001				
Decommissioning Trust:				
Equity mutual funds	\$6,714	\$390	\$20	\$7,084
Fixed income mutual funds	<u>3,407</u>	<u>11</u>	<u>1</u>	<u>3,417</u>
	<u>\$10,121</u>	<u>\$401</u>	<u>\$21</u>	<u>\$10,501</u>
Securities to be Held to Maturity:				
Obligations of states and political subdivisions	<u>\$4,617</u>	<u>\$0</u>	<u>\$17</u>	<u>\$4,600</u>

The amortized cost and approximate fair value of investment securities to be held to maturity at December 31, 2002, by contractual maturity, were as follows (in thousands):

	Amortized Cost	Fair Value
Due after five years through ten years	<u>\$4,626</u>	<u>\$5,039</u>

Actual maturities may differ from nominal maturities because of the borrowers' right to call or prepay obligations.

Sales of decommissioning trust assets by the trustee aggregated \$1,056,000 in 2002 and \$600,000 in 2001, resulting in a realized gain of \$880 in 2002 and no realized gains in 2001 under the specific identification method.

**NOTE 7 - DEFERRED CHARGES (INCLUDING REGULATORY ASSETS)**

The following is a summary of amounts recorded as deferred charges (in thousands):

	<u>2002</u>	<u>2001</u>
Unamortized costs of abandoned plant	\$54,099	\$57,268
Unamortized penalties on repriced debt	22,814	24,750
Unamortized debt discount and issuance cost	655	733
Nuclear outage maintenance cost	1,570	845
Deferred DOE assessments (see Note 4)	878	1,036
Other	<u>3,881</u>	<u>1,580</u>
	<u>\$83,897</u>	<u>\$86,212</u>

Plans for constructing a second unit at the Grand Gulf site were terminated in 1989. SMEPA was to have been a 10% owner in the second unit and had invested approximately \$104 million, net of recoveries and transfers. With the written approval of the RUS, SMEPA is amortizing its remaining investment in the abandoned plant over a 27-year period ending in 2016, and amortization was \$3,170,000 and \$3,089,000 in 2002 and 2001, respectively.

SMEPA repriced or refinanced significant amounts of its outstanding debt in recent years. As a condition of the transactions, SMEPA paid various prepayment penalties, which are treated as deferred charges to be amortized over the remaining life of the debt. Amortization of all such penalties was \$1,936,000 in 2002 and 2001.

On January 2, 2003, SMEPA repriced \$44,300,000 of debt and paid a penalty of \$2,200,000. The interest rate on the debt for the remaining life will be 3.76% in lieu of 7.68%. The penalty will be amortized similar to other repricings.

**NOTE 8 - PATRONAGE CAPITAL**

Patronage capital consisted of the following (in thousands):

	<u>2002</u>	<u>2001</u>
Cumulative margins	\$92,723	\$90,167
Less: Retirements to date	<u>5,854</u>	<u>5,854</u>
	<u>\$86,869</u>	<u>\$84,313</u>

Under the provisions of debt covenants, until the patronage capital equals or exceeds forty percent of the total assets of SMEPA, the return to patrons of contributed capital is generally limited to twenty-five percent of the patronage capital or margins received by SMEPA in the prior calendar year. The patronage capital of SMEPA represents 10.3% and 11.7% of the total assets at December 31, 2002 and 2001, respectively.

**NOTE 9 - SHORT-TERM BORROWINGS**

SMEPA has a \$25,000,000 short-term line of credit available with CFC that is subject to renewal in September 2003 and a \$10,000,000 short-term line of credit with a bank that expires May 1, 2003. SMEPA had \$8,000,000 and \$2,000,000 of borrowings against the bank line of credit at December 31, 2002 and 2001, at an interest rate of 3.75% and 4.25 %, respectively.

**NOTE 10 - LONG-TERM DEBT**

Long-term debt consisted of the following (in thousands):

	<u>2002</u>	<u>2001</u>
Mortgage notes payable to Federal Financing Bank ("FFB") at interest rates varying from 4.935% to 10.705%, due in quarterly installments through 2030	\$432,396	\$448,674
CFC advances at interest rates ranging from 4.10% to 6.45% to finance construction of new turbines	171,435	45,373
2% RUS mortgage notes payable, due in quarterly installments through 2009	4,832	6,996
5% RUS mortgage notes payable, due in quarterly installments through 2015	10,979	12,018
5%, 5.375%, 5.125% and 5.75% RUS mortgage notes payable, due in monthly installments through 2020	16,222	16,714
Mortgage notes payable to CoBank at 4.370% at December 31, 2002 and 6.12% at December 31, 2001 due in quarterly installments through 2019	1,946	2,043
Mortgage notes payable to CFC bearing interest at variable rates (3.40% at December 31, 2002 and 4.70% at December 31, 2001) due in quarterly installments through 2022	4,324	4,434
Lamar County, Mississippi, Pollution Control Bonds: 1978 A Series, 6.125%, due semi-annually through 2008	955	1,095
1993 S Series, 4.35% to 4.95%, due annually through 2007	11,751	13,804
Claiborne County, Mississippi, Pollution Control Bonds: 1985 G Series, variable interest rates (1.30% to 1.40% at December 31, 2002), due annually through 2015	<u>37,145</u>	<u>38,545</u>
	\$691,985	\$589,696
Less current maturities	<u>32,736</u>	<u>30,591</u>
	<u>\$659,249</u>	<u>\$559,105</u>

SMEPA has applied to the RUS for a \$275 million loan guarantee that would provide permanent financing for its combustion turbine project (See Note 14). RUS has requested additional information from SMEPA. SMEPA expects RUS to approve the application sometime in 2003. In the meantime, CFC has agreed to provide \$275 million interim financing for the project. The CFC loan is a four-year loan which can be converted to a 20 year mortgage loan should the RUS ultimately determine not to approve SMEPA's application for the loan guarantee. RUS has granted CFC a priority claim to certain debt service payments so long as the CFC four-year loan is outstanding. It is SMEPA's plan to borrow permanent financing from the FFB and repay the CFC loan once RUS has approved the loan guarantee.

A condition of the CFC interim \$275 million loan requires SMEPA to purchase equity certificates in CFC and CFC has also provided a \$37 million loan to SMEPA for this purpose. The equity certificates earn interest income and can be redeemed as the \$275 million loan is repaid.

At December 31, 2002 SMEPA owed \$150 million and \$21.4 million on the two CFC loans related to the combustion turbine project and \$8 million on the bank line of credit.

Substantially all assets of SMEPA are pledged as collateral on long-term debt.

Approximate annual maturities (scheduled periodic principal payments) of long-term debt for the next five years are as follows (in thousands):

2003	\$32,736
2004	\$36,502
2005	\$38,094
2006	\$40,589
2007	\$42,680

SMEPA paid approximately \$35,905,000 and \$42,099,000 in 2002 and 2001, respectively, in interest on long-term debt.

On January 31, 2001, RUS gave final approval for a \$58,653,000 guaranteed loan from the FFB to SMEPA to finance the addition of transmission facilities. At December 31, 2002, the remaining unadvanced commitment was \$23,857,000.

SMEPA is required by mortgage covenants to maintain certain financial ratios of interest coverage and annual debt service coverage. SMEPA was in compliance with such requirements at December 31, 2002 and 2001.

**NOTE 11 - DEFERRED CREDITS AND OTHER LONG-TERM LIABILITIES**

The following is a summary of deferred credits and other long-term liabilities (in thousands):

	<u>2002</u>	<u>2001</u>
Deferred revenue (fuel cost adjustment)	\$4,286	\$6,783
Postretirement benefit obligation (other than pensions)	3,298	3,189
Deferred DOE assessments (see Note 4)	521	682
Miscellaneous	<u>272</u>	<u>196</u>
	<u>\$8,377</u>	<u>\$10,850</u>

The benchmark fuel cost adjustment rate approved by the Board and collected from Members may result in under-recovery or over-recovery of actual costs and cause a deferred charge or deferred credit. The deferred revenue (fuel cost adjustment) of \$4,286,000 shown above was collected from Members in 2002 but will be recognized as revenue in 2003. During 2001, \$6,783,000 was collected from Members and recognized as revenue in 2002.

**NOTE 12 - FAIR VALUES OF FINANCIAL INSTRUMENTS**

The following methods and assumptions were used by SMEPA in estimating its fair value disclosures for financial instruments:

Cash and cash equivalents: The carrying amount reported in the balance sheets for cash and cash equivalents approximates fair value.

Investment securities: The fair values for debt and equity securities are based on quoted market prices when available and the present value of future cash flows discounted at a commensurate market rate. Medium-term CFC obligations have been estimated based upon published terms of recent issues of comparable instruments since quoted market prices are not available. See Note 6 for additional information.

Investments in associated organizations: The fair value of investments in associated organizations is not estimable since these instruments must be held by SMEPA and can only be returned to CFC. CFC requires SMEPA to hold these investments as a condition of CFC financing.

Notes payable: The carrying amount reported in the balance sheets for notes payable approximates fair value.

Long-term debt: The fair values of SMEPA's long-term debt are estimated using discounted cash flow analyses based on SMEPA's current incremental borrowing rates for similar types of borrowing arrangements and rates which would be charged by the applicable issuer where appropriate.

The carrying amounts and approximate fair values of long-term debt, including current maturities, are as follows (in thousands):

	2002		2001	
	Carrying Amount	Estimated Fair Value	Carrying Value	Estimated Fair Value
FFB	\$432,396	\$500,844	\$448,674	\$477,520
RUS	32,033	29,205	35,728	32,325
Pollution Control Bonds	49,851	50,910	53,444	54,095
Other	<u>177,705</u>	<u>177,705</u>	<u>51,850</u>	<u>51,850</u>
	<u>\$691,985</u>	<u>\$758,664</u>	<u>\$589,696</u>	<u>\$615,790</u>

There was no material difference between the contract or notional amount and the estimated fair value of loan commitments.

The aggregate estimated fair value amounts presented do not represent the underlying value of SMEPA and may not be indicative of amounts that might ultimately be realized upon disposition or settlement of these assets and liabilities.

#### NOTE 13 - EMPLOYEE BENEFITS

SMEPA sponsors a defined benefit plan that provides certain health insurance benefits to retired employees and their eligible dependents and also provides life insurance benefits to a closed group of seven employees who retired prior to January 1, 1990. The estimated costs of these benefits are accrued over the years that the employees render service. The approximate periodic expense for postretirement benefits, other than pensions, included the following components (in thousands):

	2002	2001
Service cost of benefits earned	\$52	\$94
Interest cost on accumulated benefit obligation	127	134
Amortization of actuarial gain	(75)	(36)
Total current year expense	<u>\$104</u>	<u>\$192</u>

Payments relating to postretirement benefits other than pensions were \$104,000 in 2002 and \$84,000 in 2001.

The Accumulated Postretirement Benefit Obligation ("APBO") is accrued as an unfunded long-term liability and is composed of the following (in thousands):

	2002	2001
Retirees and dependents	\$983	\$913
Fully eligible active plan participants	45	45
Active participants not yet eligible	1,026	911
Unrecognized gain	<u>1,244</u>	<u>1,320</u>
	<u>\$3,298</u>	<u>\$3,189</u>

The weighted average discount rate used in determining the APBO was 7.0 percent. The assumed health care cost trend rate of increase used in measuring the APBO was 9.0 and 7.5 percent in 2002 and 2001, respectively, declining to 5.5 percent by the year 2009. For measurement purposes, an 8.5 percent annual rate of increase in cost of covered health care benefits was assumed for 2003.

The health care cost trend rate of increase assumption has a significant effect on the APBO and periodic expense. A one percentage point increase in the trend rate for health care costs would have increased the APBO by approximately 6.9% and service and interest costs by approximately 6.9%.

Substantially all of SMEPA's employees participate in the National Rural Electric Cooperative Association ("NRECA") retirement programs, which include both a defined benefit pension plan and a defined contribution pension plan. Both plans are qualified under Section 401 and are tax-exempt under Section 501(a) of the Internal Revenue Code. The defined benefit pension plan is a multi-employer plan available to all member cooperatives of NRECA, but the accumulated benefits and plan assets are not determined or allocated separately by individual employer. SMEPA incurred \$1,220,000 in pension expense for the defined benefit pension plan in 2002 and \$1,095,000 in 2001. SMEPA makes monthly payments to NRECA for the benefit of those employees who voluntarily participate in the defined contribution pension plan. SMEPA expenses the payments as they are accrued, and such expense amounted to \$421,000 and \$384,000 for 2002 and 2001, respectively.

SMEPA provides medical benefits to current employees through a managed care program. SMEPA makes payments during the year to a trust account controlled by an independent administrator for the claims and expenses considered appropriate. SMEPA made payments to the trust and recorded expenses amounting to \$1,080,000 and \$861,000, respectively, for the fiscal years ended December 31, 2002 and 2001.

#### **NOTE 14 - COMMITMENTS AND CONTINGENCIES**

In the normal course of doing business, SMEPA has entered into significant contractual commitments for coal, coal transportation, gas, and purchased power. The commitments require minimum annual purchases that extend through the year 2020. Such commitments are significantly less than anticipated purchases, and all such contractual costs will be recovered through normal operating revenue.

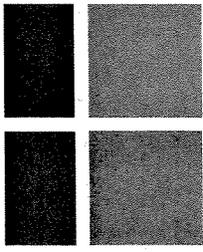
In its normal operations, SMEPA consumes 900,000 tons or more of coal each year. SMEPA's present coal supplier is in the process of restructuring by means of Chapter 11 bankruptcy. SMEPA cannot be certain what effect, if any, this situation will have on its coal supply but believes the coal supplier will continue to supply coal in accordance with the terms of its contract which expires in 2007.

During 2002 SMEPA settled an arbitration action with its rail shipper regarding the appropriate rate per ton of coal shipped by rail from eastern Kentucky. The settlement rate is good through December 2003 at which time the rail shipper may seek a revised rate.

SMEPA uses natural gas as the fuel for several of its generating units and also purchases power from others that use natural gas as fuel. Substantially all natural gas purchases are subject to short-term changes in the market price for gas, and such market prices have greatly increased since early 2000 and remain quite volatile. In the normal course of operations, SMEPA enters into forward purchase commitments for certain quantities of gas at agreed-to prices. At December 31, 2002, such commitments were not material.

SMEPA has a 20-year contract for rights to the output of a 280-megawatt gas-fired, combined-cycle combustion turbine-generator located near Batesville, Mississippi. SMEPA began monthly capacity payments on June 1, 2001, amounting to approximately \$20 million on an annual basis. SMEPA has the right to substantially direct how the generating unit is operated and also is obligated to pay for gas fuel consumed and certain operating and maintenance costs that will vary as the output for SMEPA's use increases or decreases.

SMEPA has contracts for the purchase and installation of seven gas-fired combustion turbine-generators on three sites owned by SMEPA ("the combustion turbine project"). The total cost of the project is budgeted to be \$275 million including the purchase cost of the seven turbines, engineering and installation, transmission system improvements, internal costs and so forth. Four of the turbines are scheduled to be placed in service by May 1, 2003 with one turbine to be placed in service in each of the three following years. The project includes four turbines rated at 85 megawatts each and 3 turbines rated at 47 megawatts each for a total of 481 megawatts. These natural gas fired simple cycle



generators will be used to augment SMEPA's peaking resources and power that was previously purchased from other suppliers. SMEPA is using both internal funds and loan funds to pay for the project and total investment in the project was \$159.3 and \$51.4 million at December 31, 2002 and 2001, respectively. SMEPA expects to invest approximately \$61 million in the project in 2003.

Prior to 2000, the Mississippi Public Service Commission ("MPSC") had conducted hearings on the possibility of restructuring the electric utility industry in Mississippi. On May 2, 2000, the MPSC indicated that starting retail competition at this time was "premature" and not in the public interest. The MPSC indicated that it would monitor national developments and review the issue at a future date if appropriate. Neither SMEPA nor its Members are currently subject to MPSC rate regulation but were participating in the hearings to protect the long-term interests of retail customers. Management is unable to determine what effect, if any, changes related to retail competition in Mississippi will have on SMEPA's financial statements.

The FERC has issued rulings supporting major changes in the ownership and operation of transmission assets throughout the United States. While not regulated by FERC, SMEPA is cooperating in discussions with neighboring utilities regarding mutually beneficial changes and is assessing what affect, if any, the presence of regional transmission organizations and the implementation of other FERC proposed rules will have on SMEPA's financial statements. SMEPA has over \$161 million invested in transmission assets as of December 31, 2002.

SMEPA is a defendant in certain litigation incurred in the normal course of business. Management, based on advice of legal counsel, is of the opinion that the ultimate resolution of the litigation will not have a material adverse effect on SMEPA's financial statements.