



Entergy Operations, Inc.  
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**Charles A. Bottemiller**  
Manager  
Plant Licensing

GNRO-2004/00031

April 27, 2004

U.S. Nuclear Regulatory Commission  
Attn: Document Control Desk  
Washington, DC 20555-0001

Subject: South Mississippi Electric Power Association (SMEPA) 2003 Annual Report  
Grand Gulf Nuclear Station, Unit 1  
Docket No. 50-416  
License No. NPF-29

Dear Sir or Madam:

The 2003 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 2003 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.

Sincerely,

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

CAB/AMT;amt  
attachment: SMEPA 2003 Annual Report  
cc: (See Next Page)

G040031

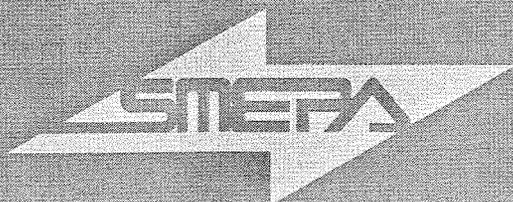
cc: Mr. Bruce S. Mallett (w/a)  
Regional Administrator  
U. S. Nuclear Regulatory Commission, Region IV  
611 Ryan Plaza Drive, Suite 400  
Arlington, TX 76011-4005

U. S. Nuclear Regulatory Commission  
Attn: ADDRESSEE ONLY  
Attn: Mr. Nageswaran Kalyanam (w/a)  
Mail Stop OWFN/7D-1  
Washington, DC 20555-0001

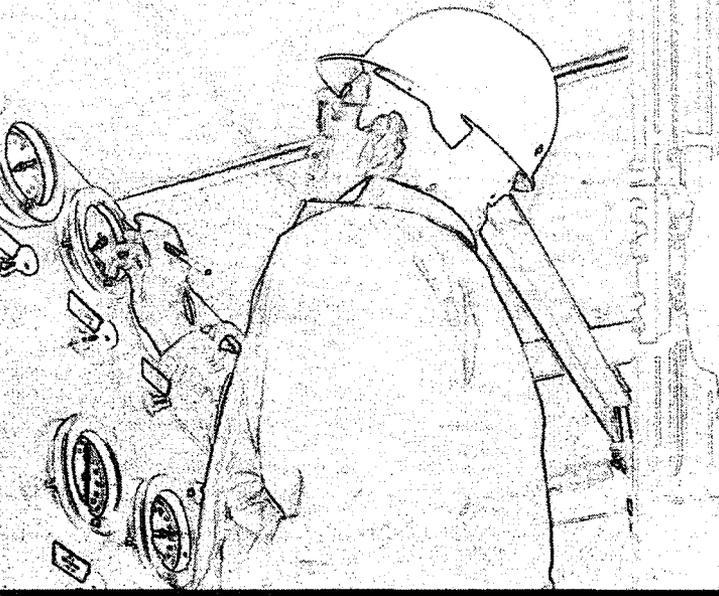
NRC Senior Resident Inspector (w/a)  
Grand Gulf Nuclear Station  
Port Gibson, MS 39150

Mr. D. E. Levanway (Wise Carter) (w/a)  
Mr. L. J. Smith (Wise Carter) (w/a)  
Mr. N. S. Reynolds (w/a)  
Mr. H. L. Thomas

# South Mississippi Electric Power Association



2003 Annual Report



# South Mississippi Electric Power Association

## Financial

Dollars in Thousands	2003	2002	Increase (Decrease)	% Increase (Decrease)
<b>Total Revenue</b>	\$ 411,588	\$ 393,524	\$ 18,064	4.6%
<b>Current Net Margins</b>	\$ 4,177	\$ 2,556	\$ 1,621	63.4%
<b>Total Assets</b>	\$ 873,855	\$ 839,943	\$ 33,912	4.0%
<b>Total Equity</b>	\$ 91,581	\$ 87,404	\$ 4,177	4.8%
<b>Equity as % of Assets</b>	10.5%	10.4%		
<b>TIER</b>	1.11	1.07		
<b>DSC</b>	1.03	1.04		
<b>Average Cost of Debt</b>	4.84%	5.40%		

## Operational

<b>Wholesale Rate to Members</b>				
<b>Mills/KWH</b>	47.27	45.27	2.00	4.4%
<b>Energy Sales (MWH)</b>				
<b>Members</b>	8,780,699	8,651,954	128,745	1.5%
<b>Non-Members</b>	12,775	16,361	(3,586)	(21.9%)
<b>Total</b>	8,793,474	8,668,315	125,159	1.4%
<b>Net Generation (MWH)</b>	4,159,337	3,806,529	352,808	9.3%
<b>Member Demand (MW)</b>	2,176	2,011	165	8.2%

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# Executive Report



Henry Thomas, General Manager

Dr. Harlan Rogers, President



## A Message to the Members

*Increased regional growth continues to place demands on South Mississippi Electric Power Association and its Members. As a result, SMEPA continues with an aggressive generation and transmission work plan. During 2003, 224 MW of additional generation was placed in service. Another 83 MW is scheduled for 2004 with additions of 83 MW in 2005 and 2006. These facilities required major transmission improvements in order to meet delivery schedules.*

*A dedicated work force and employee commitment to these projects have enabled them to be on schedule and within budget. Other ongoing activities in all areas are reflected in this report which illustrates the professionalism of a united workforce.*

A handwritten signature in cursive script that reads "Henry Thomas".

Henry Thomas  
General Manager

A handwritten signature in cursive script that reads "Harlan Rogers".

Dr. Harlan Rogers  
President

# Member Systems

1

## Coahoma EPA

Lyon

Giles Bounds, Manager  
Date energized 1/18/38  
1,556 miles of line  
7,663 meters

2

## Coast EPA

Bay St. Louis

Robert Occhi, General Manager  
Date energized 5/20/38  
5,233 miles of line  
67,040 meters

3

## Delta EPA

Greenwood

Ronald W. Robertson  
General Manager  
Date energized 1/30/39  
5,555 miles of line  
23,714 meters

4

## Dixie EPA

Laurel

James T. Dudley, Jr.  
General Manager  
Date energized 7/28/39  
4,461 miles of line  
34,699 meters

5

## Magnolia EPA

McComb

Darrell Smith  
General Manager  
Date energized 9/19/39  
3,684 miles of line  
27,378 meters

6

## Pearl River Valley EPA

Columbia

W. T. Shows  
General Manager  
Date energized 5/19/39  
5,860 miles of line  
39,373 meters

7

## Singing River EPA

Lucedale

Lee Hedegaard  
General Manager  
Date energized 12/5/39  
6,169 miles of line  
62,412 meters

8

## Southern Pine EPA

Taylorville

Donald Jordan  
General Manager  
Date energized 5/13/39  
9,595 miles of line  
61,737 meters

9

## Southwest MS EPA

Lorman

Percy McCaa, Manager  
Date energized 3/27/38  
4,189 miles of line  
24,472 meters

10

## Twin County EPA

Hollandale

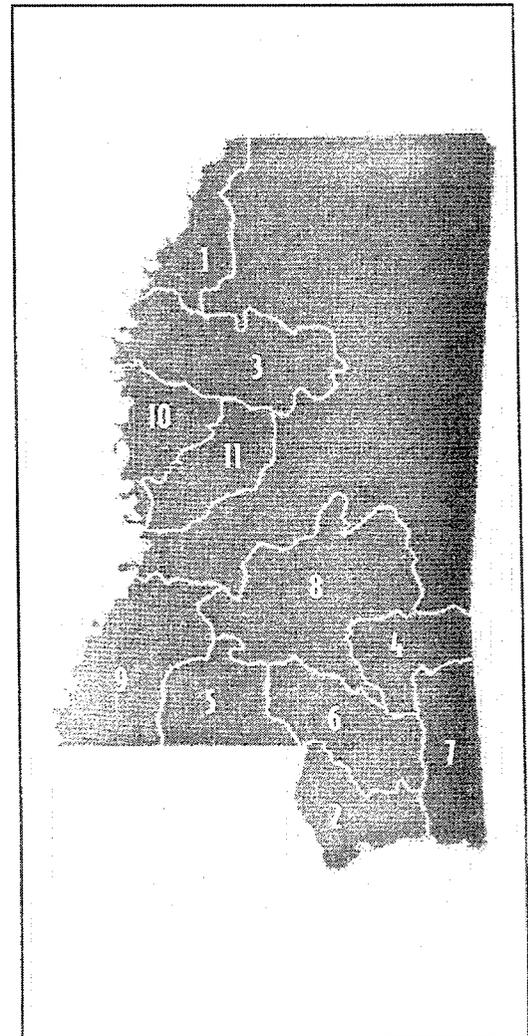
Vesper Bagley, Manager  
Date energized 12/24/38  
2,324 miles of line  
12,933 meters

11

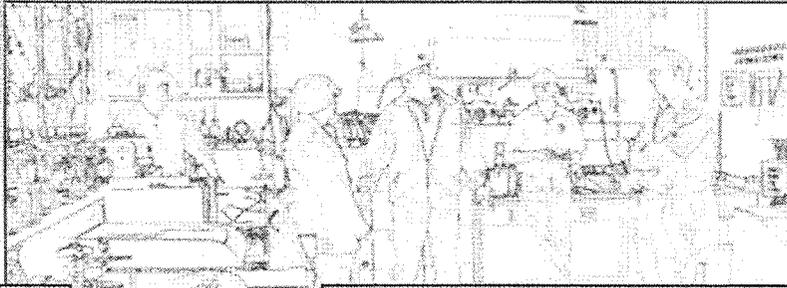
## Yazoo Valley EPA

Yazoo City

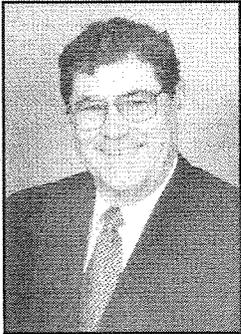
Charles H. Shelton, Manager  
Date energized 3/23/38  
2,734 miles of line  
10,065 meters



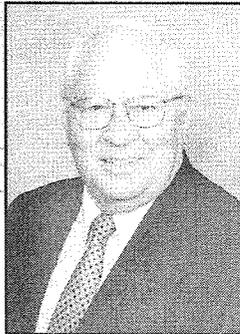
# Board of Directors



## Coahoma Electric Power Association



**Billy Hardin**

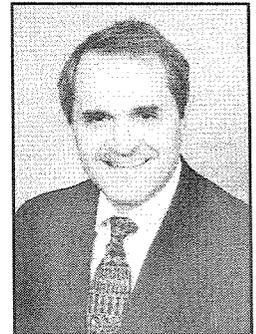


**Giles Bounds**  
Manager

## Coast Electric Power Association

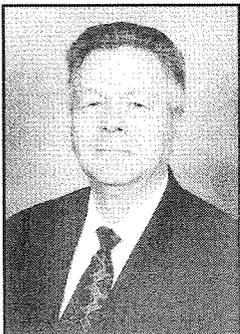


**Douglas Mooney**  
Vice-President

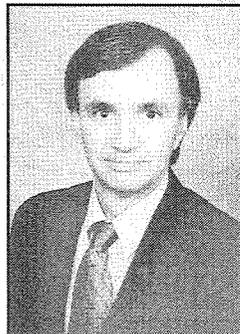


**Robert J. Occhi**  
General Manager

## Delta Electric Power Association

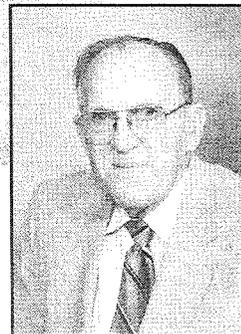


**Henry Waterer, Jr.**

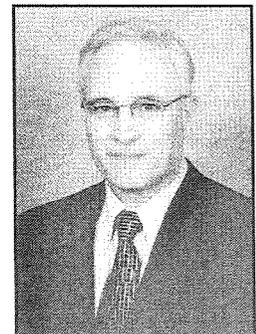


**Ronald W. Robertson**  
General Manager

## Dixie Electric Power Association



**L. G. Pierce**  
Secretary-Treasurer



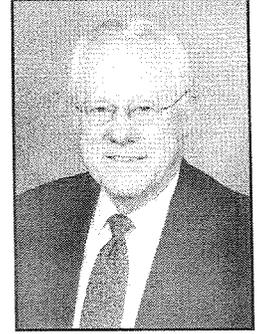
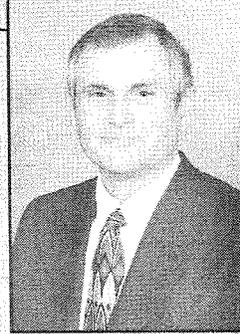
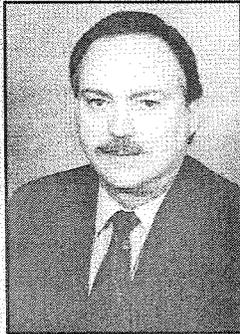
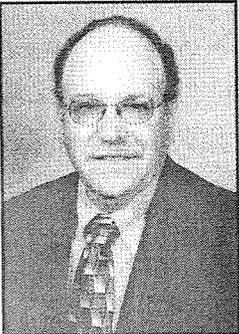
**James T. Dudley, Jr.**  
General Manager

# Board of Directors



## Magnolia Electric Power Association

## Pearl River Valley Electric Power Association



**Pat Ard**

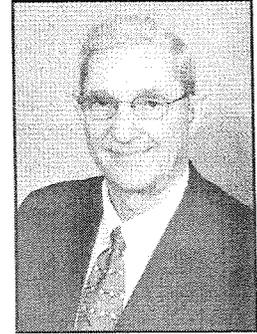
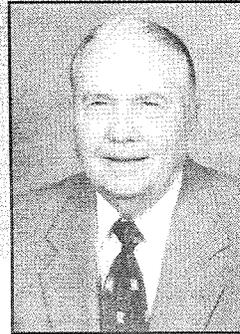
**Darrell Smith**  
General Manager

**Ben F. Hudson, Jr.**

**W. T. Shows**  
General Manager  
and Acting  
Secretary-Treasurer

## Singing River Electric Power Association

## Southern Pine Electric Power Association



**Ralph Hicks**

**Lee Hedegaard**  
General Manager

**Dr. Harlan Rogers**  
President

**Donald Jordan**  
General Manager

# Board of Directors

## Southwest Mississippi Electric Power Association



James A. Ventress



Percy McCaa  
Manager

## Yazoo Valley Electric Power Association



R. D. Hines



Charles H. Shelton  
General Manager

## Twin County Electric Power Association



Warren Hammett



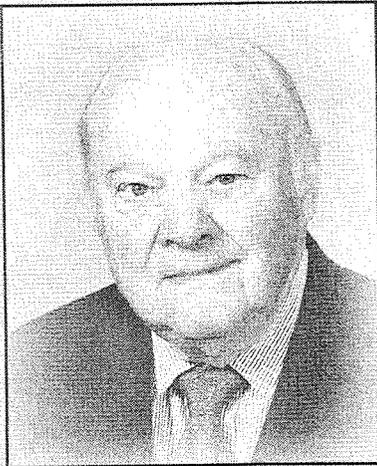
Vesper Bagley  
Manager

## A Tribute

South Mississippi Electric Power Association bids farewell to a dedicated friend. For 45 years, W. C. (Bill) McKamy offered his time and service to rural electrification in Mississippi and to the advancement of cooperatives. Mr. McKamy served as a board member for both South Mississippi Electric Power Association and Twin County Electric Power Association. Mr. McKamy passed away on Friday, October 3, 2003.

Since 1980, Mr. McKamy served on SMEPA's board of directors and was elected president in June, 1986. He became a board member for Twin County EPA 45 years ago, serving as the president for the last 17 years.

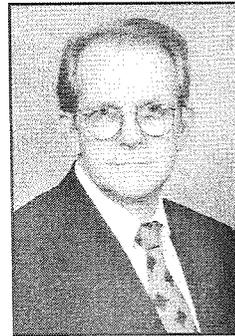
# SMEPA Departments



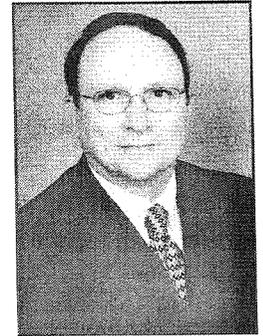
"He made great contributions to the success of our local cooperative and the rural electrification program in Mississippi. He was a man of great integrity and his leadership will be missed," said Manager of Twin County EPA, Vesper Bagley.

**Finance Department (L)**

**Engineering Department (R)**



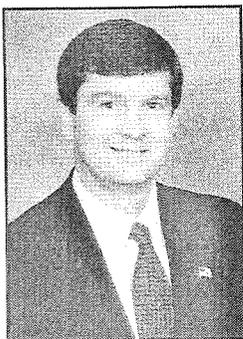
**Jack Harpole**



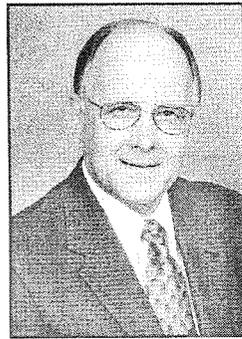
**Terry Lee**

**Power Supply Department (L)**

**Production Department (R)**



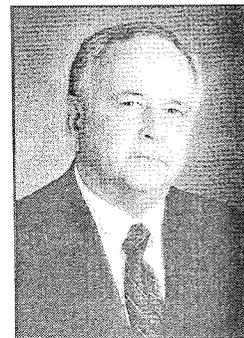
**Roger Smith**



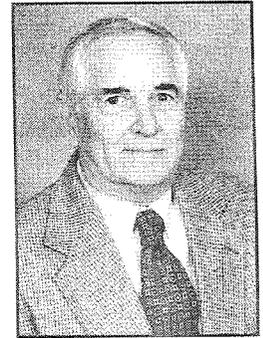
**Marcus Ware**

**Human Resources and  
Development Department (L)**

**Transmission Department (R)**

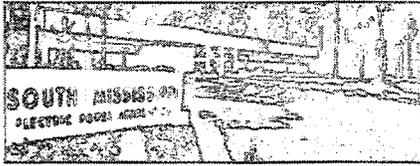


**Benny Murray**



**Jerry Pierce**

# Facilities

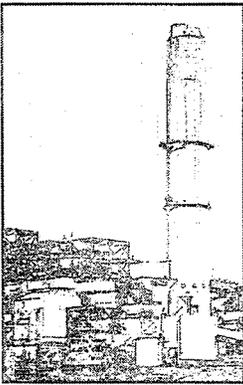


## SMEPA Headquarters

**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

## J. T. Dudley, Sr. Generation Complex Moselle Generating Station

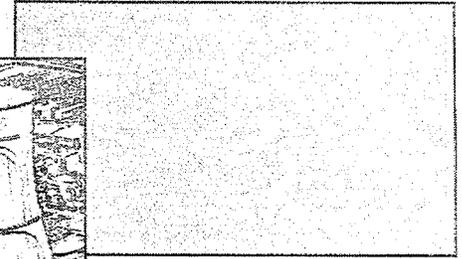
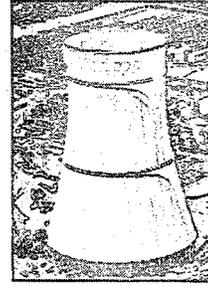
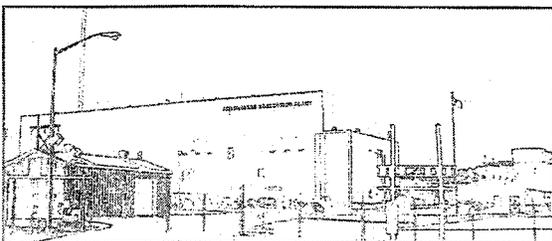
**Commercial Operation:** 1970

**Location:** Moselle, Jones County

**Capacity:** 260 MW

**Fuel:** Natural Gas/Fuel Oil

**Employees:** 32



## Grand Gulf Nuclear Station

(10% Undivided Interest)

**Commercial Operation:** 1985

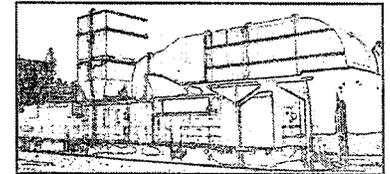
**Location:** Port Gibson, Claiborne County

**Capacity:** 1,250 MW

**Fuel:** Nuclear

**Employees:** 1

SMEPA counts one employee among Entergy's staff who work at the nuclear site. Grand Gulf Nuclear Station is located approximately 145 miles from SMEPA's headquarters.



## Paulding Station

**Commercial Operation:** 1972

**Location:** Jasper County

**Capacity:** 20.6 MW

**Fuel:** Diesel Fuel

SMEPA's four combustion turbine stations, Benndale, Paulding, Silver Creek and Sylvarena are unmanned plants remotely operated from the control center located at SMEPA's headquarters facility. Personnel from Plant Moselle maintain the units at the four sites.

During 2003, 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.

# Facilities

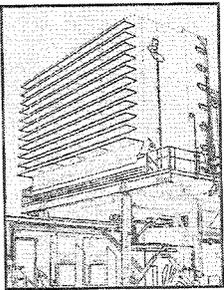
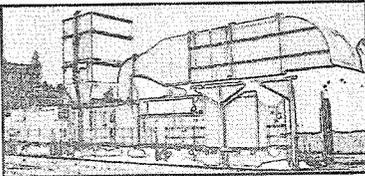
## Benndale Station

**Commercial Operation:** 1969

**Location:** George County

**Capacity:** 16.2 MW

**Fuel:** Natural Gas



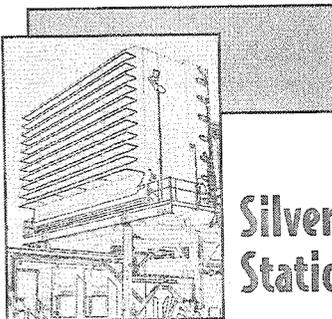
## Sylvarena Station

**Commercial Operation:** 2003

**Location:** Smith County

**Capacity:** 141MW

**Fuel:** Natural Gas



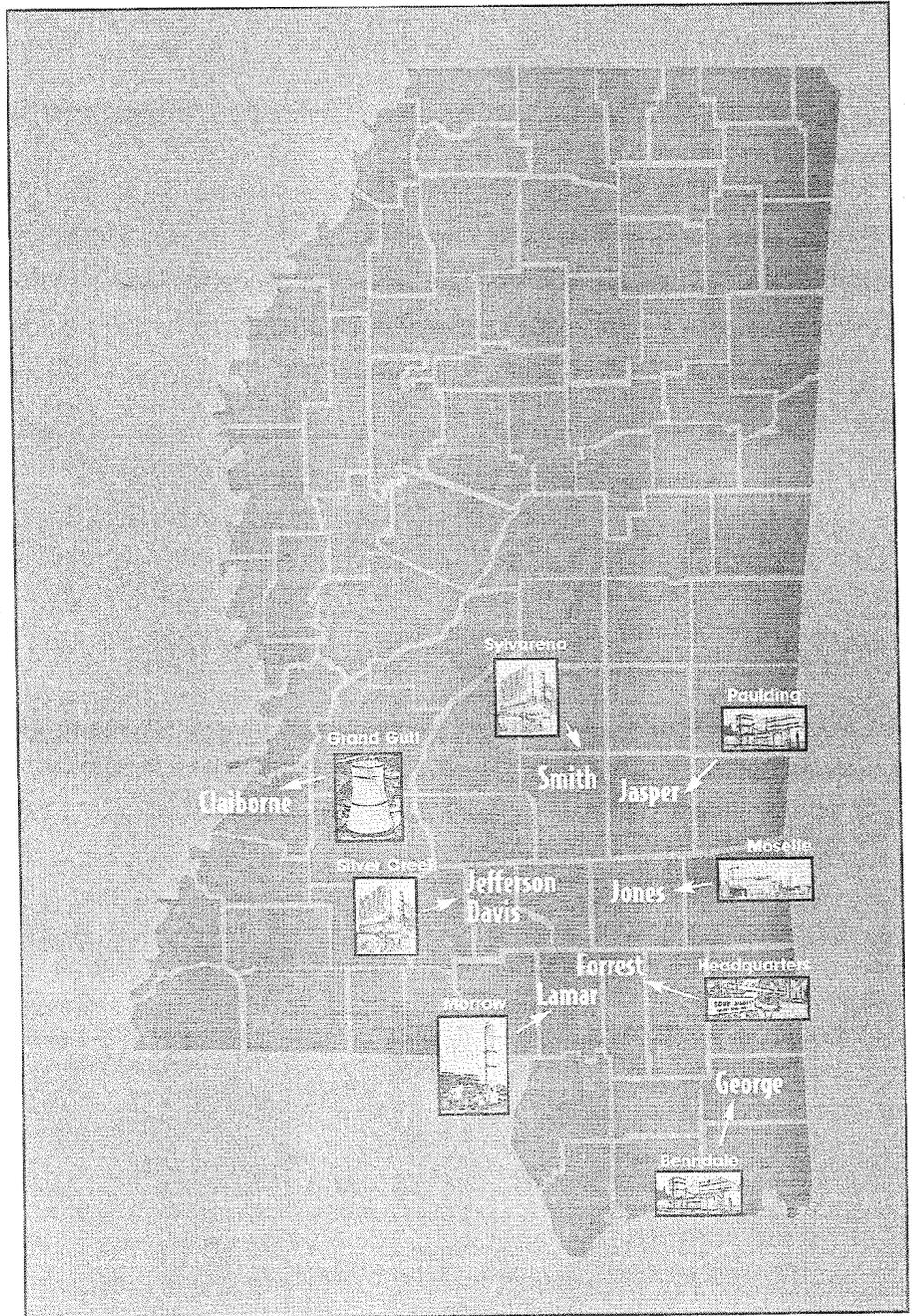
## Silver Creek Station

**Commercial Operation:** 2003

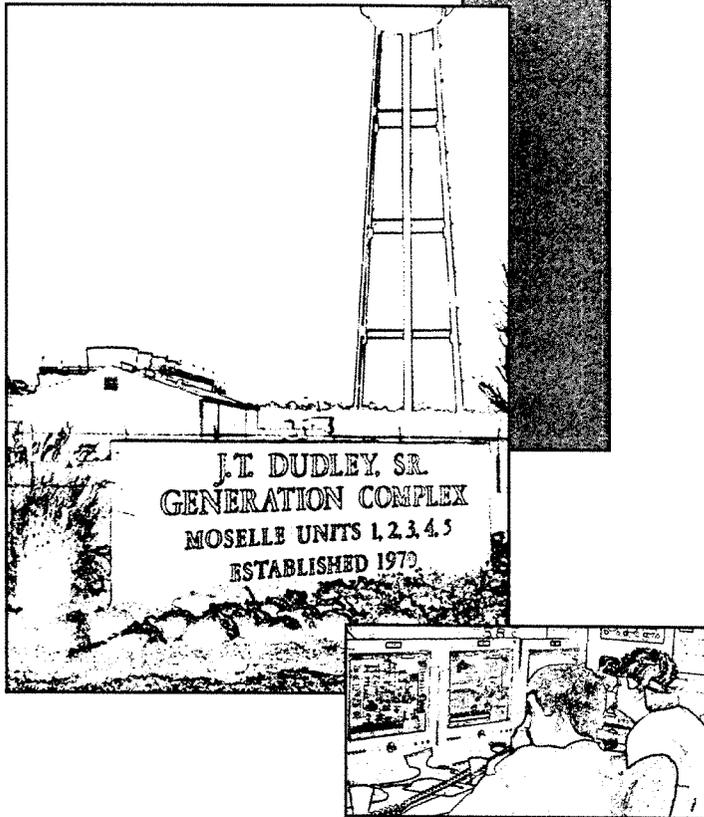
**Location:** Jefferson Davis County

**Capacity:** 83MW

**Fuel:** Natural Gas



# Operating Report



## Plant Moselle

The Moselle Station was operated in an intermediate mode to provide load support for the entire year. At least two units were in service, except for a 15-day period in December when only one unit was needed. All three of the steam units were active simultaneously for a 10-day period in February. The number of units in service varied according to load requirements, economic considerations, and the need for load regulation support. The 83.5 MW combustion turbine was operated as needed for load support.

Natural gas remained available in sufficient quantities to support operation during 2003. The cost, however, remained unfavorable throughout

the year, thus promoting efforts to minimize operation of the Moselle units to the extent possible.

The net generation from the steam units during 2003 amounted to 387,954 MWH. In addition, 7,846 MWH was produced by the Moselle combustion turbine. Output from the steam units was about 13% less than 2002 production, and generation from the combustion turbine was also less than the amount produced during the prior year. The decline in activity was the result of a combination of factors, including weather/load conditions; high cost of natural gas; and favorable availability of other SMEPA units.

Since entering commercial operation in June 1997, the 83.5 MW simple cycle combustion turbine has been utilized for peaking service as needed. Unit operability, availability, and reliability have met the high expectations which were established for the unit. During 2003, the unit was operated 104 hours and produced 7,846 MWH. The unit provided load support on a total of 23 separate days of the year.

There were several inspections conducted and maintenance projects completed throughout the year in order to maintain the availability and efficiency of Plant Moselle operations. As part of the preventative maintenance program, a five year major inspection was performed on the Unit #2 steam turbine. Also, attention was focused on upgrading the Unit #2 control system. The installation of the new control systems required the upgrade of most of the Unit #2 instrumentation, modifications to the turbine front standard, and modification of the plant control room. The Unit #2 Controls Upgrade should be complete during 2004, with similar upgrades to be conducted on Unit #3 beginning in early February. As part of the original equipment manufacturer recommended maintenance program, a combustion inspection was performed on the Unit #4 combustion turbine. Considering the peaking service that the unit provides, the components were found to be in relatively good condition.

Natural gas purchases were scheduled to provide flow on a monthly basis to meet projected

generation requirements. Portions of the anticipated requirements were purchased in advance to mitigate the potential of spikes in natural gas market pricing. Records indicate that usage amounted to 4,930,358 MMBtu for the Moselle Generating Plant, which is about 14% less than the volume used during 2002.

Fuel oil usage for 2003 amounted to 12,381 gallons, all of which was consumed by the Moselle combustion turbine, Unit #4. This quantity was used primarily for test purposes following the combustion inspection on the unit.

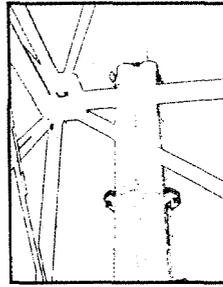
Since June 2001, SMEPA has, when needed, scheduled energy from Batesville Unit #3, a 280 MW combined cycle facility which is located at Batesville, Mississippi. In addition to the natural gas which was secured for Moselle, SMEPA arranged for the fuel for the Batesville unit. Fuel purchases for the unit during 2003 were procured through Aquila Energy, and totaled 2,929,183 MMBtu.

## Plant Morrow



The plant was primarily operated in an intermediate and base load mode during the year. Simultaneous operation of the two Morrow units occurred except when maintenance outages were scheduled in the spring and fall when load requirements were not demanding. During 2003, a total of 1,082,685 tons of coal were delivered to Plant Morrow, a record for an annual period. Coal consumption amounted to 1,135,586 tons, another annual record and an increase of 12% above 2002 usage. The extent of usage, coupled with the increase in receipts, resulted in a year-ending inventory of 185,768 tons. Fuel oil requirements for start-up and flame stabilization purposes totaled 303,716 gallons, the lowest annual usage since 1998.

The annual net generation from the facility was 2,642,506 MWH. The production was a record amount for an annual period, and almost 10% above the prior record, as was established in 2000. The output was 23% more than the average annual generation which was provided by the facility during the 10-year period 1993-2002.

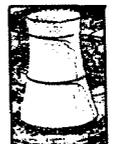


# Operating Report

A non-destructive examination of the boiler header and steam piping was conducted by an outside contractor on the Unit #1 boiler headers and high-energy steam piping. The results confirmed the integrity of the boiler headers and steam piping, and indicated that the equipment was fit for continued safe operation. This process is part of an ongoing program to assure the integrity of plant equipment and systems. Several areas of concern on the Unit #1 and #2 coal pipes were replaced due to deterioration over the years. These areas included high-wear locations such as elbows, sweeps, and adjacent piping. This is the first of a two-phase plan to replace all problem areas of the coal piping, thereby restoring the integrity of that system. Phase 2 of the project will take place in 2004.

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 41,896 tons. This reflects a 1% increase in volume and a 6% increase in income when compared to 2002 figures as a result of a slight improvement in sales activity. Approximately 33% of the ash produced during the year was marketed.



## Grand Gulf

The operating statistics for Grand Gulf during 2003 were exceptionally good even though there were two unexpected scrams within the first half of the year. Subsequently, there were no other outages during the year. In spite of the early events affecting plant power, the capacity factor was still 103.1%

# Operating Report



based upon the rated net maximum dependable capacity of 1210 MW. There were four months in the last half of the year in which there was only one scheduled and no forced power reduction. This is a testament to the value of performing as much maintenance on line as possible and not delaying tasks for a refueling outage.

The total net electrical energy generated during the year was 10,902,489 MWH, which is the highest yearly output ever for the plant. The year 2003 was the second year in a row, and the fourth in the 18 years of commercial operation, that the net electrical output of the plant exceeded 10,000,000 MWH. The average, net thermal efficiency (heat rate) for the year was 10,384 BTU/KWH, which is the best ever for the plant and 0.3% better than the previous best year, 2001.

SMEPA received a total of 1,090,233 MWH of energy from Grand Gulf during 2003, which represents the highest annual delivery into SMEPA's system from the facility. Deliveries to SMEPA were about 8.4% greater than that supplied during 2002.

The Institute of Nuclear Power Operations (INPO) performance indicator for Grand Gulf is 99.2. The indicator is designed to serve as an overall performance summary and is a weighted, rolling average composite of such indicators as the capability factor, forced loss rate, unplanned automatic scrams, safety system performance, collective radiation exposure, the fuel reliability index and the chemistry indicator. INPO performed an extensive evaluation of plant operations in January, 2003. The team identified a number of strengths as part of this process. In the final analysis, an INPO rating of "1," the highest rating, was awarded to Grand Gulf.

The plant was in the top category (green) for all the Nuclear Regulatory Commission (NRC) performance indicators all year. NRC's performance indicators cover reactor safety, radiation safety and safeguards (security). Green indicators suggest that the NRC needs only to conduct basic oversight and inspection of the plant.

Overall, 2003 was a very successful year for Grand Gulf. Of course, as always, the plant staff continues to strive to improve performance even more. For 2004 and beyond, four areas of focus have been identified: continued safe, event-free operation of the plant; a true zero tolerance for equipment failures; a commitment to execute a base refueling outage scope within 15 days and \$15M; and an improvement in the culture to achieve both a high level of team performance and accountability along with rewards, recognition, development and accomplishment.

The entire year was characterized by relatively high availability. Power was supplied from the unit on 359 of 365 days during the year and the unit was operated without disruption in nine of the twelve months, with only two unplanned outages being recorded (one in January and the other in April). The overall production and performance (heat rate) reflected the positive benefits which 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.

## **Benndale and Paulding Combustion Turbines.**

The two remotely located combustion turbines were not operated for load support during the year. The units are typically used when needed to support load requirements during peak demand periods or for system emergencies. During 2003, the units were placed into service only for test purposes at scheduled intervals in an effort to assure availability and reliability when needed.

Benndale was operated on two occasions and produced 31 MWH. Paulding was operated on four separate times and produced 50 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.

## Silver Creek and Sylvarena Combustion Turbine Projects

In conjunction with plans to meet the growing power supply needs of SMEPA's member systems, construction activities were initiated at two (2) new power plant sites during 2002. Subsequently, site development was completed for the Silver Creek Plant in Jefferson Davis County and for the Sylvarena Plant in Smith County. During 2003, the initial simple cycle combustion turbine-generators for these projects were added to SMEPA's generating unit fleet for use primarily for peaking purposes.

After the site development process was completed at each location, construction activities commenced under an engineering, procurement, and construction contract arrangement with Allegheny Energy Solutions (AES). At Silver Creek, construction activities were completed on Unit #1, and the unit was placed into commercial operation on June 1, 2003. Silver Creek Unit #2 was delivered and installation was essentially complete as 2003 came to an end. Startup and commissioning activities for Unit #2 were conducted during February 2004. The third and final Silver Creek unit is scheduled for delivery during 2004, with commercial operation planned for May 2005.

At Sylvarena, all three of the units for the facility were completed and placed into service during 2003.



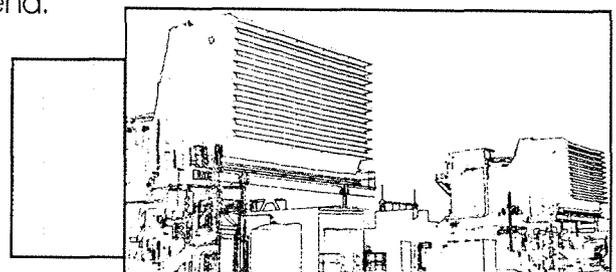
# Operating Report

Although some challenges were encountered and certain modifications are yet to be performed, the units were placed into commercial operation on July 1, 2003.

At the Silver Creek site, the units are each rated at 83 MW and are General Electric model 7EA turbine-generators, which are almost identical to the combustion turbine that was placed into service at Moselle in 1997 (Unit #4). The primary difference is that the Moselle unit can operate on both natural gas and diesel fuel, while the Silver Creek units will be operated solely on natural gas fuel. During 2003, production from Unit #1 totaled 5,236 MWH.

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 operate exclusively on natural gas. Production from the facility during 2003 amounted to 25,480 MWH as the units provided peaking support at various times during the year.

Although physical activity at the site has not yet begun, plans call for the addition of another 83 MW simple cycle combustion turbine at Moselle, for startup in 2006. Permitting efforts have been initiated and engineering and construction will be focused upon this location after completion of the initial phases of the project at Silver Creek and Sylvarena.



# Operating Report

## Kentucky Coal Property Activity



Chas Coal continued to pursue the development of 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 295,026 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 2004.

Under an Oil and 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, SMEPA's Director of Environmental Affairs and Fuels and representatives of Summit Engineering, SMEPA's mining consultant, visited the property on a quarterly basis. On each occasion, an inspection of the mining operations and the preparation plant was 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, Summit prepared and submitted a report to SMEPA of detailed findings, recommendations and other pertinent information relative to the property operations. While on the property, attention was also directed to developments under the oil and gas lease agreement and to timber removal operations.

## Environmental Affairs

Environmental efforts during 2003 focused upon continued compliance with existing regulations, maintaining permits and regulatory requirements for existing facilities and fulfilling regulatory requirements for the construction of new SMEPA generating units at Silver Creek, Sylvarena, and Moselle.

2003 marked the fourth year of participation of SMEPA's R.D. Morrow, Sr. and Moselle Generating Plants in Phase II of the Acid Rain Program. Emission rates of acid rain pollutants promoted the continued "banking" of emission credits for use in meeting future generation requirements. Continuous Emission Monitor Systems (CEMS), used to quantify and account for unit emissions, were successfully recertified at all of the SMEPA generating plants.

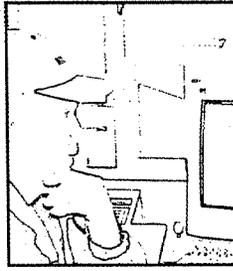
Efforts to obtain Title V air operating permit renewals for the Moselle and Morrow Generating Plants were continued during the year. The terms and conditions for the Moselle permit have been agreed upon with the Mississippi Department of Environmental Quality, and the permit was under review by the Environmental Protection Agency (EPA) at year's end. A draft version of the Morrow permit is expected for review and comment early in 2004. Each of these permits will be valid for a period of five years from the issuance date.

A National Pollutant Discharge Elimination System (NPDES) wastewater discharge permit was received for the Moselle Generating Plant during 2003. The renewal portion of the permit included permit coverage for existing plant operations. The modified portion of the permit included the addition of an evaporation pond for treatment and containment of metal cleaning wastes as well as the addition of a simple cycle combustion turbine. NPDES permits to discharge wastewater from the Sylvarena and Silver Creek Generating Plants were received in April 2003. These permits govern the quality of wastewater that is allowed to be discharged from the facilities.

Startup and certification of CEMS for the Silver Creek and Sylvarena Generating Plants were

completed during 2003. The addition of these generating units has doubled the number of Acid Rain affected units that SMEPA operates as well as the amount of effort required to ensure compliance with requirements.

Support was provided for start-up efforts at Silver Creek and Sylvarena during the year. Stack testing was conducted for Sylvarena Units #1, #2 and #3 as well as Silver Creek Unit #1. The results of this testing was used to verify contractual guarantees as well as environmental compliance with air permit requirements.



# Operating Report

## Power Supply Planning

During 2003, SMEPA completed new Power Requirements Studies for the years 2003 – 2023 for each of its eleven Members. Members were given the opportunity to review and revise their respective study. After all the Members' boards approved their respective studies, SMEPA compiled the eleven new Power Requirements Studies to produce SMEPA's new study which was approved by the SMEPA board in November. All of the Member Studies as well as SMEPA's Power Requirements Study have been forwarded for RUS approval.

SMEPA and other parties agreed to a settlement with Southern Company on its new formulary transmission rate determination. The settlement agreement was executed in late summer followed by Federal Energy Regulatory Commission (FERC) affirmation. The rate became effective October 1, 2003. The new rate results in cost savings to transmission customers, including specifics on return on equity and transmission losses for capacity and energy.

Prior to 2003, SMEPA and other parties had intervened in Entergy's transmission ancillary services filing. In January 2003, a FERC judge issued an initial decision that was largely favorable to the intervenors. In December 2003, the FERC issued an order that improved on the judge's initial decision. Assuming few changes result from the rehearing requests, which are due in January, 2004, the final order will provide significant savings for transmission ancillary services over what Entergy had originally proposed.

SMEPA, along with other interested parties also intervened in the annual Entergy transmission rate re-determination. Entergy had asked for a rate of \$1.03/KW-Mo. The parties agreed to a rate of \$1.00 per KW-Mo. This rate will apply to delivery of SMEPA's capacity and energy from Louisiana Generating and transmission of capacity and energy from other resources for delivery to SMEPA load across the Entergy transmission system from May 1, 2003 until April 30, 2004.

In December, SMEPA and Mississippi Power Company (MPCo) executed a revised service agreement and related transaction schedules for the market based delivery points served by MPCo. The new revised agreement will result in savings to serve the twelve market based delivery points and Wellman as well as define how costs will be determined in future years.

## Operations Control Center

During the year Control Center personnel made purchases of power from the market resulting in more than \$6 million in savings over published market prices. These savings were made possible by the addition of the four new combustion turbines (Sylvarena Units 1, 2, and 3 and Silver Creek Unit 1). System Operators were able to shop for and buy hourly spot market power while holding the new combustion turbines in reserve and as a back-up against high hourly market power prices, as opposed to committing to more costly day ahead market pricing.

Customer outages in the SMEPA G&T area (On-System) were held to a minimum representing a 99.99906 % customer hour in-service rate. This was made possible by utilizing new and existing

# Operating Report



remotely controlled switching stations and substations throughout the G&T area and with the assistance of SMEPA and Member personnel for locations not remotely operated.

## Engineering Systems

SMEPA signed a contract with General Electric to upgrade the existing seven-year-old Control Center computer system. The upgrade, which includes hardware and software improvements, will occur in 2004. The contract includes annual maintenance and software upgrades on the control system for six years.

Engineering Systems modified the Control Center computer software to better coordinate with the new Moselle Unit one controls. The arrangement was changed from a raise/lower scheme to a set-point control scheme. This improvement will also be implemented on the Moselle Units 2 and 3 new controls when they are installed in 2004.

## Marketing

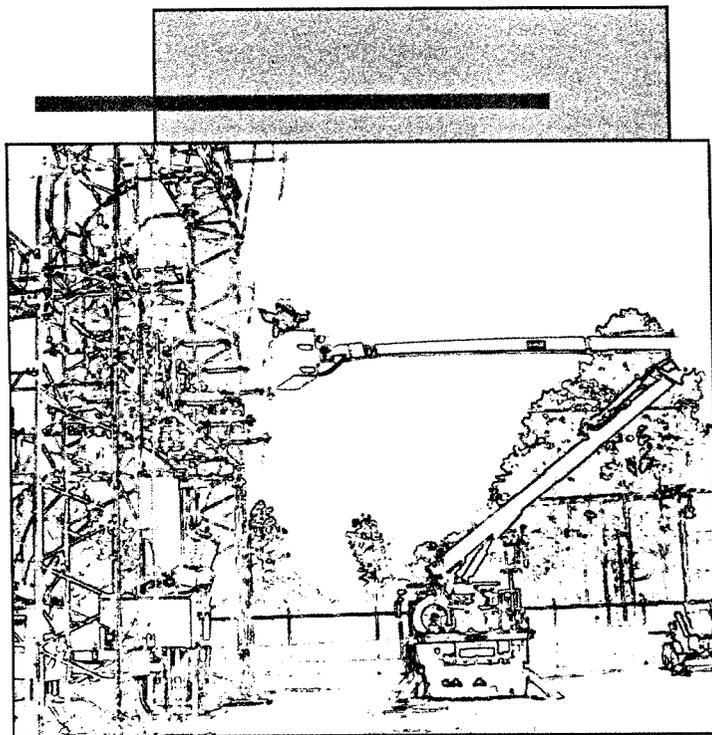
SMEPA marketing planned and provided a Member training workshop through the Electric Food Service Council, entitled Meeting the Needs of Food Service Customers. SMEPA provided consultation and research in the areas of marketing program planning, rate application, commercial load information, energy efficiency, legislative updates and orientation for new Member marketing employees. The Comfort Advantage program rebated over 1,300 homes in Member system territories.

## Transmission System Maintenance and Construction

An integral part of SMEPA's commitment to providing reliable power is 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 6,476 structures and completed 320 line maintenance work orders. In conjunction with the Sylvarena turbine project, 19.4 miles of transmission lines were rebuilt, and adjustments were made to several transmission lines for uprating.

The annual reclearing of right of way was performed over 5,627 acres. Pole groundline inspections and treatments were performed on 2,666 poles and a number of danger trees were removed from critical lines, and aerial patrol inspections were performed quarterly.



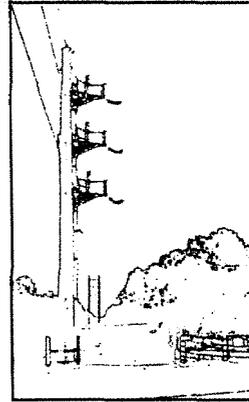
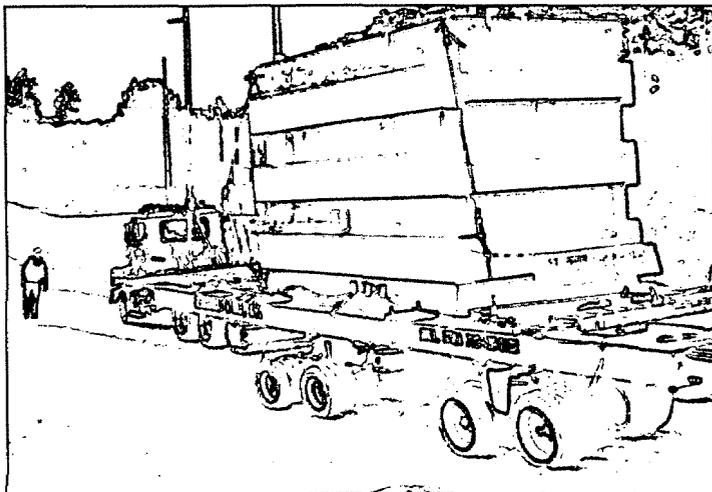
## Engineering Design and Electronic Maintenance

Engineering Design and Electronics Maintenance completed and placed into service six new digital microwave links and three new spread spectrum radio links.

SMEPA's design engineering staff completed and placed in-service three new substations with relaying and circuit breakers at Martinville – three gas circuit breakers; Gwinville Junction – three gas circuit breakers; and Sylvarena GT – nine gas circuit breakers, and installed a second 50MVA autotransformer and added a new transfer bus at Hintonville.

## Substation Maintenance

The Substation Maintenance section collected Dissolved Gas Analysis samples from 46 power transformers and 28 Load Tap Changers. Some other activities of this section include preventive maintenance on 16-161kV oil circuit breakers, three 161kV gas circuit breakers, 18 - 69kV gas circuit breakers, and one 115kV oil circuit breaker. Preventive maintenance was also performed on 131 motor operators located on remote controlled switches. This section continued with installation and testing on seven new 125VDC battery banks; preventive maintenance on 18 battery banks; preventive maintenance on 16 power



# Operating Report

transformers; and installation of one new 161kV gas circuit breaker and 14 new 69kV gas circuit breakers.

SMEPA performed the annual infrared survey/inspections for all substation, switching stations, and delivery point facilities.

## Transmission System Planning and System Protection

The Transmission System Planning section coordinated SMEPA's first NERC Planning Standards Audit. In addition to the Engineering Department, personnel from Production and Power Supply Departments were also involved. The audit was conducted by SERC. SMEPA was judged to be 100% compliant. This section also implemented an evaluation and coordination procedure for outage requests on SMEPA's transmission system.

Metering technicians checked calibration of all 206 wholesale revenue meters on the SMEPA system. They also calibrated underfrequency relay packages at 49 locations. Undervoltage packages were also installed at eight sites in southwest Mississippi. They also assisted with switch inspections at 87 sites. New Supervisory Control and Data Acquisition ("SCADA") projects include two new substation sites and two new generator sites.

Relay technicians in System Protection calibrated 1617 relays at 22 locations and were involved in checkout and installation of 122 new relays associated with one new substation site and five new generators.

# Operating Report



## Computer Information Systems

The Computer Information Systems (CIS) department completed two major software projects in 2003. The software migrated from in-house developed applications to third party off-the-shelf applications.

CIS and the Maximo Project Team completed implementation of the Enterprise Asset Management System. Maximo streamlined and redefined many of SMEPA's business processes. This system integrates purchasing, receiving and invoicing with the new asset work management and life-cycle maintenance functionality. Maximo's Enterprise Asset Management System will provide the software functionality to support and maximize SMEPA's transmission and generation assets while reducing costs. The implementation of Maximo was a two phase process, requiring SMEPA personnel to revamp many business processes. The first phase of implementation included the purchasing, inventory and work order systems. The second phase included the asset management systems and a customized capital budget application. Maximo went live in January 2003, offering an integrated system that reduces paperwork and makes information immediately available to employees.

The payroll and human resource systems were also migrated in 2003. The Abra software integrates two separate in-house developed systems. This system will provide additional functionality for payroll processing and human resource management.

CIS and the Engineering Department installed a new server to support the new ION meter data collection application. This application captures and stores meter information to support engineering analysis and trends.

Server operating system upgrades and new installations were completed in 2003. New servers and software upgrades were completed for SMEPA's Email and Firewall Servers.

## Safety

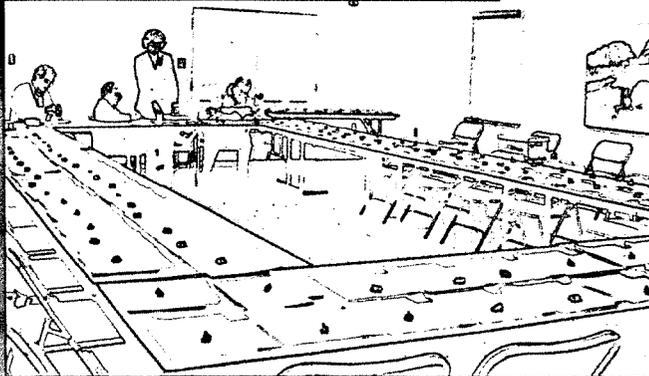
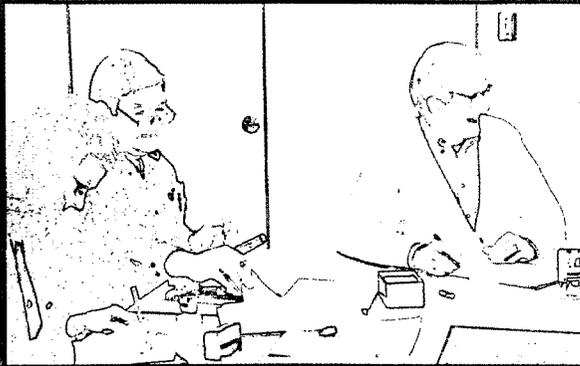
SMEPA employees continued to focus on performing their work safely during 2003. Employees achieved an extremely low incident rate, which was instrumental in containing workman's compensation insurance premium costs. The entire year was worked without a single lost time accident.

## Association Relations

SMEPA continues to be an integral part of the communities it serves with participation in economic development and through the support of community and civic organizations. Employees from all departments dedicate their time and energies by supporting charitable organizations such as United Way of both the Pine Belt Region and Southeast Mississippi, Salvation Army and the American Red Cross Adopt-A-Fire Family program. SMEPA is active in the Area Development Partnership and the local Adopt-A-School program. Throughout 2003, SMEPA supported the March of Dimes, local schools and other worthy organizations.



# Financial Report



## Investing in the Future

On January 22, 2004, President Harlan Rogers and Secretary-Treasurer L.G. Pierce met to sign 120 copies of the 30-year, permanent financing loan documents approved through the Rural Utilities Service (RUS). The documents were witnessed, sealed and notarized by Finance Manager Jack Harpole, Director of Finance Camille Daglio, Director of Accounting Cecil Gilmore and Director of Budgets Peggy McArthur. The large number of executed documents is necessary to file and record the mortgage in all the counties in Mississippi and Kentucky where SMEPA owns property.

The funding is for the construction of seven combustion turbine generators and related transmission facilities. The units are either completed or under construction, adding 475 MW to SMEPA's system. The \$275 million loan will replace temporary funding and provide funding for the completion of the turbine projects; the projects began in December 2000 and will be completed in 2006. Three of the units are located in Sylvarena, Mississippi, and another three will be located in Silver Creek, Mississippi. One unit is located at the Moselle Generating Station in Moselle, Mississippi. Manager of Production Marcus Ware is the project manager.

## Table of Contents for Financial Report

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Keys Indicators	21	Statements of Revenues, Expenses and Patronage Capital	26
Comparative Balance Sheets	22	Statement of Cash Flows	27
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Auditors' Report	24		

# Financial Report

2003 Financial Review

The year 2003 was another year of growth and solid financial results for SMEPA. Revenues from Member cooperatives were \$411 million, up 4.5%. Energy sales to Members were up slightly to 8.8 million megawatt hours, a new all-time record. Generation by SMEPA-owned plants was up 9% to 4.2 million megawatt hours, also a new all-time record. Demand billings for the year were below billings for 2002, but SMEPA experienced a new all-time peak load on January 24, 2003. Because of the extreme cold weather, SMEPA's Members needed almost 2,000 megawatts on that day to meet consumer demand. The measured concurrent peak load was 1,993 megawatts, about 16% higher than the winter peak load the prior year. SMEPA's eleven Members serve more than 365,000 customers throughout rural Mississippi.

The wholesale rate to Members for the year averaged 47.3 mills per kilowatt hour, up 2 mills or 4.4% compared to year 2002. The cost of natural gas during 2003 was a major problem for SMEPA and other utilities and led to a rare mid-year increase in the fuel cost adjustment rate. SMEPA's average price for natural gas for 2003 was more than \$6 per million British Thermal Unit (BTU). The average price in the prior year was \$3.53. The 70% increase in the cost of natural gas caused SMEPA to drastically reduce its gas generation when possible and shift to coal generation and other resources to meet Member load. In fact, generation from coal set a new all-time record, up 9.9% to 2.64 million megawatt hours thereby providing about 30% of the total energy required by SMEPA's Members.

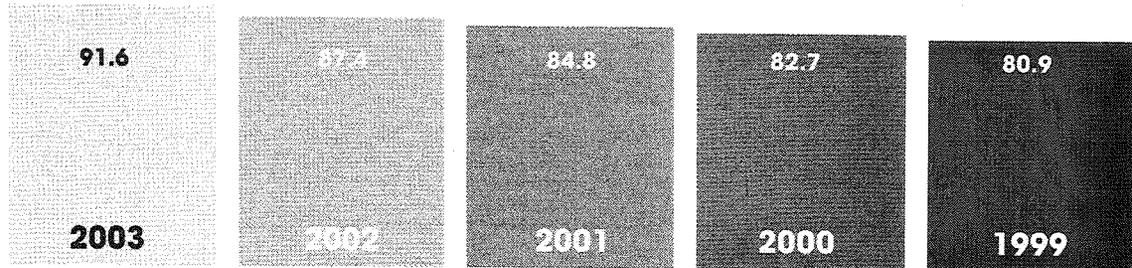
SMEPA invested \$59 million in new generation, transmission and other utility plant assets during 2003 bringing gross investment to \$1.1 billion. At mid-year, SMEPA successfully placed into service four new natural gas fueled combustion turbine generators valued at more than \$130 million including related transmission improvements. Three turbine generators are rated at 47 megawatts each and one is rated at 84 megawatts giving SMEPA a total of 225 megawatts of new peaking power resources using the latest modern technology and environmental controls. Three additional turbines rated at 84 megawatts each are at different stages of construction and installation. At year end 2003, SMEPA had about \$77 million invested in the ongoing combustion turbine project.

During December 2003, SMEPA received near-final approval from the Rural Utilities Service (RUS), formerly the REA, for a \$275 million loan guarantee to provide permanent 30 year financing for the combustion turbine project. Since the project was started in late 2000, SMEPA has primarily used interim financing provided by CFC under a "fast-track" loan program developed by CFC and RUS. The expedited loan program enabled SMEPA to go from concept to commercial operation in about thirty-six months. SMEPA expects to draw funds under the loan guarantee in early 2004 to replace the CFC interim funding.

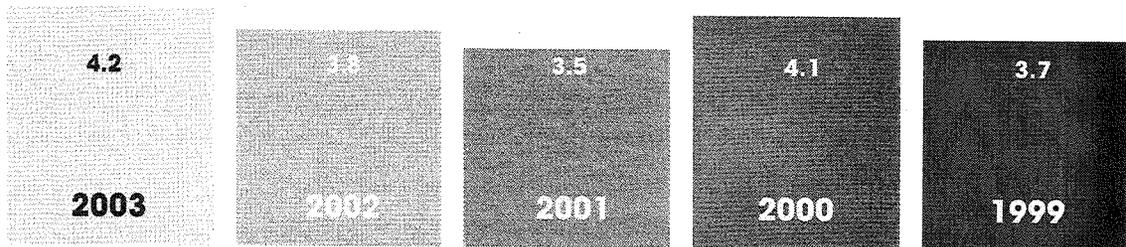
The net margin for the year was up noticeably to \$4.2 million. Total equity increased to \$91.6 million and improved slightly to 10.5% of net assets. The average cost of all debt (\$725 million) declined markedly to 4.84% from 5.40% the prior year. Market interest rates were historically low during 2003 and the temporary loans on the combustion turbine project are priced at short-term rates pending release of permanent long-term loan funds by RUS.

Looking forward, the cost of natural gas continues to cause problems for SMEPA and all utilities that rely on natural gas to fuel generators. Many economists consider the price of natural gas to be the most volatile of all commodities. SMEPA has a blend of resources including coal, nuclear, hydro and purchased power in addition to those using natural gas and remains committed to providing its core customer-owners, the eleven Member cooperatives, with reliable wholesale power and the best possible price.

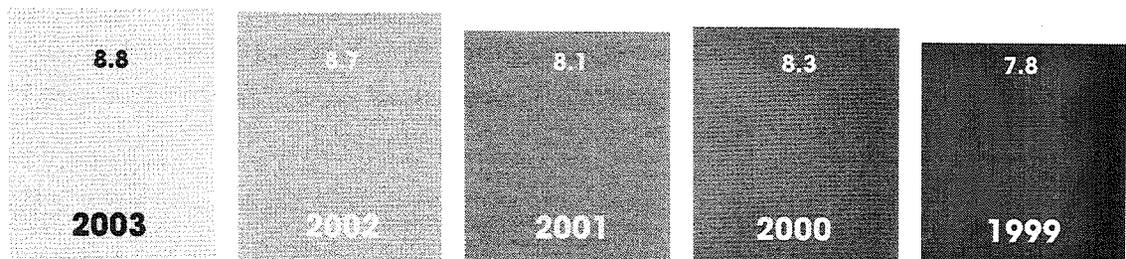
## Equities and Patronage Capital (Millions of Dollars)



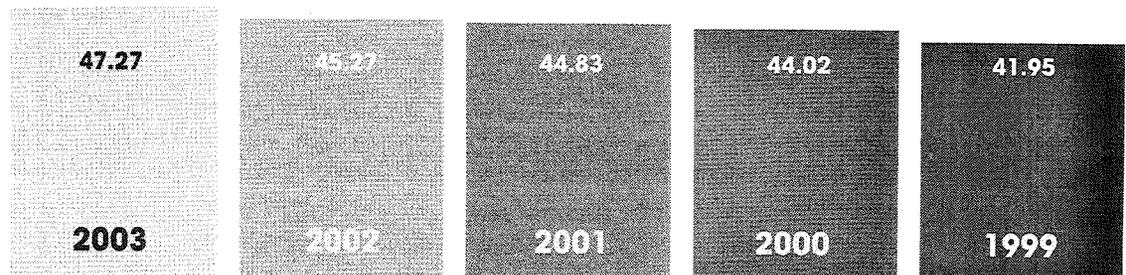
## Generation (Millions of MWH)



## Sales to Members (Millions of MWH)



## Wholesale Rate to Members (Mills per KWH)



# Financial Report

## South Mississippi Electric Power Association Comparative Balance Sheets

In thousands as of December 31,

2003                      2002                      2001                      2000                      1999

	2003	2002	2001	2000	1999
<b>ASSETS</b>					
<b>Electric Utility Plant</b>					
In Service - at Cost	\$ 996,241	\$ 859,736	\$ 845,253	\$ 828,332	\$ 820,003
Construction Work in Process	111,894	188,948	84,354	42,277	24,620
	1,108,135	1,048,684	929,607	870,609	844,623
Less Accumulated Depreciation	446,938	420,938	397,434	373,874	350,183
<b>Net Utility Plant</b>	<b>661,197</b>	<b>627,746</b>	<b>532,173</b>	<b>496,735</b>	<b>494,440</b>
<b>Investments</b>	<b>58,508</b>	<b>50,982</b>	<b>35,444</b>	<b>22,720</b>	<b>22,647</b>
<b>Current Assets</b>					
Cash - General Funds and Cash Equivalent Investments	12,468	15,434	24,639	22,119	23,122
Accounts Receivable - Members	37,343	31,731	28,952	33,745	27,498
Coal and Other Fuel Inventories	8,046	10,572	7,804	5,206	18,446
Other Current Assets	20,181	19,581	16,327	16,771	19,751
<b>Total Current Assets</b>	<b>78,038</b>	<b>77,318</b>	<b>77,722</b>	<b>77,841</b>	<b>88,817</b>
<b>Deferred Charges</b>	<b>76,112</b>	<b>83,897</b>	<b>86,212</b>	<b>90,084</b>	<b>106,335</b>
<b>TOTAL ASSETS</b>	<b>\$ 873,855</b>	<b>\$ 839,943</b>	<b>\$ 731,551</b>	<b>\$ 687,380</b>	<b>\$ 712,239</b>
<b>EQUITIES AND LIABILITIES</b>					
Patronage and Other Capital	\$ 91,581	\$ 87,404	\$ 84,848	\$ 82,722	\$ 80,883
<b>Long-Term Debt (excluding current maturities)</b>	<b>680,760</b>	<b>659,249</b>	<b>559,105</b>	<b>516,265</b>	<b>549,557</b>
<b>Accrued Decommissioning Obligation</b>	<b>12,718</b>	<b>10,021</b>	<b>10,501</b>	<b>10,407</b>	<b>10,220</b>
<b>Deferred Credits and Other Long-Term Liabilities</b>	<b>12,442</b>	<b>8,377</b>	<b>10,850</b>	<b>4,075</b>	<b>4,096</b>
<b>Current Liabilities</b>					
Accounts Payable	28,066	30,718	30,807	29,243	24,666
Notes Payable	10,600	8,000	2,000	-	18,000
Other Current Liabilities	37,688	36,174	33,440	44,668	24,817
<b>Total Current Liabilities</b>	<b>76,354</b>	<b>74,892</b>	<b>66,247</b>	<b>73,911</b>	<b>67,483</b>
<b>TOTAL EQUITIES AND LIABILITIES</b>	<b>\$ 873,855</b>	<b>\$ 839,943</b>	<b>\$ 731,551</b>	<b>\$ 687,380</b>	<b>\$ 712,239</b>
<b>Equity as % of Assets</b>	10.5%	10.4%	11.6%	12.0%	11.4%
<b>DEBT</b>					
Long-Term Debt and Notes Payable	\$ 691,360	\$ 667,249	\$ 561,105	\$ 516,265	\$ 567,557
Current Maturities on Long-Term Debt	33,921	32,736	30,591	34,277	22,124
<b>TOTAL DEBT</b>	<b>\$ 725,281</b>	<b>\$ 699,985</b>	<b>\$ 591,696</b>	<b>\$ 550,542</b>	<b>\$ 589,681</b>
<b>Average Interest Rate</b>	4.84%	5.40%	5.88%	6.30%	6.23%

South Mississippi Electric Power Association  
**Comparative Operating Statements**

# Financial Report

In thousands, for the years ended December 31,

	2003	2002	2001	2000	1999
<b>REVENUES</b>					
Electric Energy Revenue from Members	\$ 410,734	\$ 393,123	\$ 354,120	\$ 363,535	\$ 328,716
Interest Income and AFUDC	2,609	2,329	3,152	2,064	2,160
Other Revenue - net	934	446	603	3,068	643
<b>EXPENSES</b>					
Purchased Power	210,981	215,819	185,497	183,174	157,532
Fuel	82,927	67,086	63,881	78,217	66,641
Production	16,856	15,687	13,639	13,987	13,616
Transmission	13,661	12,245	11,710	12,171	11,977
Maintenance	14,894	14,888	13,216	11,430	11,857
Depreciation and Amortization	30,376	27,707	26,960	26,461	25,736
Interest	34,727	34,993	36,489	37,344	38,444
Administrative and General	5,640	4,883	4,328	4,030	3,661
Other Deductions	38	34	29	14	44
<b>NET MARGIN</b>	<b>\$ 4,177</b>	<b>\$ 2,556</b>	<b>\$ 2,126</b>	<b>\$ 1,839</b>	<b>\$ 2,011</b>
<b>FINANCIAL RATIOS</b>					
TIER	1.11	1.07	1.06	1.05	1.06
DSC	1.03	1.04	1.03	1.06	1.02
<b>RATES/COSTS - Mills per KWH</b>					
Wholesale Rate to Members	47.27	45.27	44.83	44.02	41.95
Average Cost of Purchased Power	44.02	43.07	39.86	41.66	36.29
Average Cost of Fuel (per net generation)	19.94	17.62	18.00	19.31	18.24
<b>ENERGY SOURCES - MWH</b>					
Generated	4,159,337	3,806,529	3,548,906	4,051,486	3,654,436
Purchased	4,792,965	5,010,337	4,653,782	4,396,938	4,340,954
<b>TOTAL ENERGY AVAILABLE</b>	<b>8,952,302</b>	<b>8,816,866</b>	<b>8,202,688</b>	<b>8,448,424</b>	<b>7,995,390</b>
<b>ENERGY SALES - MWH</b>					
<b>Members</b>					
Coahoma EPA	166,325	152,281	136,694	137,280	127,441
Coast EPA	1,553,667	1,538,159	1,429,392	1,497,819	1,345,675
Delta EPA	530,031	545,505	517,677	529,637	530,839
Dixie EPA	772,959	758,571	712,545	721,905	676,403
Magnolia EPA	602,981	583,274	549,602	559,367	522,275
Pearl River Valley EPA	922,775	900,961	826,141	831,542	761,825
Singing River EPA	1,326,422	1,323,324	1,232,291	1,280,415	1,189,922
Southern Pine EPA	1,852,988	1,826,044	1,670,862	1,678,363	1,634,359
Southwest Mississippi EPA	457,106	451,258	414,021	437,638	443,512
Twin County EPA	259,532	262,307	260,148	302,357	296,437
Yazoo Valley EPA	335,913	310,270	301,046	282,862	307,335
<b>Total Sales to Members</b>	<b>8,780,699</b>	<b>8,651,954</b>	<b>8,050,419</b>	<b>8,259,185</b>	<b>7,836,023</b>
Non-Members	12,775	16,361	26,269	81,704	12,716
<b>TOTAL SALES</b>	<b>8,793,474</b>	<b>8,668,315</b>	<b>8,076,688</b>	<b>8,340,889</b>	<b>7,848,739</b>
<b>Member Demand - KW (non-current peak)</b>	<b>2,176,084</b>	<b>2,010,942</b>	<b>1,976,642</b>	<b>2,030,075</b>	<b>1,892,133</b>

# Financial Report

## South Mississippi Electric Power Association Independent Auditors' Report

### To the Board of Directors of South Mississippi Electric Power Association

Hattiesburg, Mississippi

We have audited the accompanying balance sheet of South Mississippi Electric Power Association ("SMEPA") as of December 31, 2003, and the related statements of revenues, expenses and patronage capital, and cash flows for the year then ended. These financial statements are the responsibility of SMEPA's management. Our responsibility is to express an opinion on the financial statements based on our audit. The financial statements of SMEPA for the year ended December 31, 2002, were audited by other auditors, whose report dated January 28, 2003, expressed an unqualified opinion on those statements.

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

In our opinion, such financial statements present fairly, in all material respects, the financial position of SMEPA as of December 31, 2003, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

*Carr, Riggs & Ingram, LLC*

Ridgeland, Mississippi  
February 3, 2004

## Balance Sheets

# Financial Report

In thousands as of December 31,

	2003	2002
<b>Assets</b>		
Electric utility plant		
In service - at cost	\$ 996,241	\$ 859,736
Construction work in progress	111,894	188,948
	<b>1,108,135</b>	1,048,684
Less accumulated depreciation	446,938	420,938
Net utility plant	<b>661,197</b>	627,746
Investments		
Investments in associated organizations	35,771	28,946
Debt service reserve and other investments	4,648	4,626
Decommissioning trust investments	12,718	10,021
Debt service prepayments	5,371	7,389
Total investments	<b>58,508</b>	50,982
Current assets		
Cash - general funds and cash equivalent investments	12,468	15,434
Accounts receivable:		
Members	37,343	31,731
Others	1,214	2,794
Inventories (at average cost):		
Coal and other fuels	8,046	10,572
Materials and supplies	17,631	15,918
Other	1,336	869
Total current assets	<b>78,038</b>	77,318
Deferred charges	76,112	83,897
<b>Total assets</b>	<b>\$ 873,855</b>	\$ 839,943
<b>Equities and Liabilities</b>		
Equities		
Patronage Capital	\$ 91,046	\$ 86,869
Memberships and donated capital	535	535
Total equities	<b>91,581</b>	87,404
Long-term debt (excluding current maturities)	680,760	659,249
Accrued decommissioning obligation	12,718	10,021
Deferred credits and other long-term liabilities	12,442	8,377
Current liabilities		
Accounts payable	28,066	30,718
Notes payable	10,600	8,000
Accrued interest	1,660	1,444
Other accrued expenses	2,107	1,994
Current maturities of long-term debt	33,921	32,736
Total current liabilities	<b>76,354</b>	74,892
Commitments and contingencies (Notes 4 and 14)		
<b>Total equities and liabilities</b>	<b>\$ 873,855</b>	\$ 839,943

See Notes to Financial Statements

# Financial Report

## South Mississippi Electric Power Association Statements of Revenues, Expenses and Patronage Capital

In thousands for the years ended December 31,

	2003	2002
<b>Operating Revenues</b>		
Electric energy revenue from members	\$ 410,734	\$ 393,123
Other electric energy revenue	455	548
Other - net	399	(147)
<b>Total operating revenues</b>	<b>411,588</b>	393,524
<b>Operating Expenses</b>		
Fuel	82,927	67,086
Production	16,856	15,687
Purchased power	210,981	215,819
Transmission	13,661	12,245
Administrative and general	5,640	4,883
Maintenance expenses:		
Production	11,121	11,229
Transmission	2,768	2,834
General	1,005	825
Depreciation and amortization	30,376	27,707
<b>Total operating expenses</b>	<b>375,335</b>	358,315
<b>Operating margin before interest and other deductions</b>	<b>36,253</b>	35,209
<b>Interest and Other Deductions</b>		
Interest	34,727	34,993
Other deductions	38	34
<b>Total interest and other deductions</b>	<b>34,765</b>	35,027
<b>Operating margin</b>	<b>1,488</b>	182
<b>Nonoperating Margin</b>		
Interest income	2,348	1,933
Allowance for funds used during construction	261	396
Other	80	45
<b>Total Nonoperating Margin</b>	<b>2,689</b>	2,374
<b>Net Margin</b>	<b>4,177</b>	2,556
Patronage Capital at Beginning of Year	86,869	84,313
<b>Patronage Capital at End of Year</b>	<b>\$ 91,046</b>	\$ 86,869

See Notes to Financial Statements

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

# Financial Report

*In thousands for the years ended December 31,*

	2003	2002
<b>Operating Activities</b>		
Net margin	\$ 4,177	\$ 2,556
Adjustments necessary to reconcile net margin to net cash provided by operating activities:		
Depreciation, amortization, and depletion	34,069	31,431
Allowance for funds used during construction	(261)	(396)
Change in operating assets and liabilities:		
Accounts receivable	(4,032)	(4,850)
Inventories	815	(3,520)
Other assets	(466)	(2,854)
Accounts payable and other liabilities	(2,842)	(380)
Accrued interest payable	216	903
Nuclear outage maintenance costs	-	(1,905)
Fuel cost adjustments	4,366	(2,497)
Accrued decommissioning obligation	1,993	(480)
Net cash provided by operating activities	<b>38,035</b>	18,008
<b>Investing Activities</b>		
Construction and acquisitions of electric utility plant	(57,323)	(119,973)
Purchase of available for sale securities	(2,836)	(576)
Sale of available for sale securities	843	1,056
Investment in associated organizations	(6,823)	(15,651)
Maturities of held to maturity securities	-	190
Purchase of held to maturity securities	(22)	(557)
Net cash used in investing activities	<b>(66,161)</b>	(135,511)
<b>Financing Activities</b>		
Principal payments on long-term debt	(30,941)	(30,524)
Debt prepayment penalties	(2,161)	
Proceeds from long-term borrowings	55,662	132,822
Proceeds from short-term borrowings	2,600	6,000
Net cash provided by financing activities	<b>25,160</b>	108,298
<b>Net decrease in cash and cash equivalents</b>	<b>(2,966)</b>	(9,205)
Cash and cash equivalents at beginning of year	15,434	24,639
<b>Cash and cash equivalents at end of year</b>	<b>\$ 12,468</b>	\$ 15,434
Additional Cash Flow Disclosures:		
Non-cash investing and financing activity - redemption of cushion of credit investments applied as a reduction of related debt	\$ 2,018	-
Interest paid	\$ 36,923	\$ 35,905

See Notes to Financial Statements

# Financial Report

## South Mississippi Electric Power Association Notes to Financial Statements

### Note 1 - Nature of Operations

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.

### Note 2 - Summary of Significant Accounting Principles

#### 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.

### **Cost of Decommissioning Nuclear Plant**

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

### **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 imputed interest cost related to construction and development projects funded without specific borrowings during construction is reflected as allowance for funds used during construction.

### **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.

# Financial Report

## South Mississippi Electric Power Association Notes to Financial Statements

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

### **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.

### **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 \$76.1 million, including \$50.8 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.

## 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.

## 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.

## Note 3 - Electric Utility Plant

Electric utility plant consisted of the following:

<i>In thousands as of December 31,</i>	Cost		Accumulated Depreciation	
	2003	2002	2003	2002
Grand Gulf Nuclear	\$ 414,203	\$ 411,454	\$ 193,758	\$ 182,014
Morrow Steam	191,730	191,601	138,047	132,255
Moselle Steam	23,996	23,996	22,617	21,874
Moselle Gas Turbine	21,723	21,723	4,250	3,600
Silver Creek/Sylvarena Gas Turbines	114,739		1,795	
Benndale/Paulding Gas Turbines	4,420	4,420	3,644	3,513
<b>Total Generating Plant</b>	<b>770,811</b>	653,194	<b>364,111</b>	343,256
Transmission Plant	179,429	161,330	55,340	51,595
General Plant and Equipment	20,854	20,065	11,906	10,876
Electric Plant Leased to Others	25,147	25,147	15,856	15,268
Electric Plant in Service	996,241	859,736	447,213	420,995
Construction Work in Process	111,894	188,948	(275)	(57)
<b>Total Utility Plant</b>	<b>\$1,108,135</b>	\$ 1,048,684	<b>\$ 446,938</b>	\$ 420,938

# Financial Report

## South Mississippi Electric Power Association Notes to Financial Statements

### 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, with SMEPA generally obligated to pay 10% of all operating and capital costs and entitled to receive 10% of the electricity generated by the plant. SMEPA paid \$19,830,000 and \$22,392,000 under the contract in 2003 and 2002, 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 \$10.1 million for each nuclear incident involving licensed reactors, payable at a rate of \$1 million per reactor 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 \$1.8 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 \$80 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. Yucca Mountain, Nevada has been legislated to be the permanent spent fuel repository in the United States. The DOE will proceed with 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 2007, 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. SMEPA is currently funding \$1,050,000 on an annual basis through 2024. The estimated funding requirement is recalculated and adjusted periodically based on market changes.

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 in annual increments through 2007.

# Financial Report

## South Mississippi Electric Power Association Notes to Financial Statements

### Note 5 - Investments in Associated Organizations

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

<i>In thousands as of December 31,</i>	<b>2003</b>	2002
National Rural Utilities Cooperative Finance Corporation ("CFC") Certificates:		
Membership subscription	\$ 6,223	\$ 6,223
Loan and guarantee	29,059	22,355
Other	489	368
	<b>\$ 35,771</b>	\$ 28,946

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 2004 through 2007.

## Note 6 - Investment Securities

The amortized cost and related approximate fair values of investment securities were as follows:

<i>In thousands as of December 31, 2003</i>	<b>Amortized Cost</b>	<b>Gross Unrealized Gains</b>	<b>Gross Unrealized Losses</b>	<b>Estimated Fair Value</b>
Decommissioning Trust:				
Equity mutual funds	\$ 11,137		\$ 1,008	\$ 10,129
Fixed income mutual funds	2,508	\$ 81		2,589
	<b>\$ 13,645</b>	<b>\$ 81</b>	<b>\$ 1,008</b>	<b>\$ 12,718</b>
Securities to be held to maturity:				
Obligations of states and political subdivisions	\$ 4,648	\$ 503	\$ -	\$ 5,151

*In thousands as of December 31, 2002*

Decommissioning trust:				
Equity mutual funds	\$ 8,301	\$ -	\$ 1,787	\$ 6,514
Fixed income mutual funds	3,352	155	-	3,507
	<b>\$ 11,653</b>	<b>\$ 155</b>	<b>\$ 1,787</b>	<b>\$ 10,021</b>
Securities to be held to maturity:				
Obligations of states and political subdivisions	\$ 4,626	\$ 413	\$ -	\$ 5,039

The amortized cost and approximate fair value of investment securities to be held to maturity, by contractual maturity, were as follows:

<i>In thousands as of December 31, 2003</i>	<b>Amortized Cost</b>	<b>Fair Value</b>
Due after five years through ten years	<b>\$ 4,648</b>	<b>\$ 5,151</b>

# Financial Report

## South Mississippi Electric Power Association Notes to Financial Statements

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 \$843,000 in 2003 and \$1,056,000 in 2002, resulting in a realized gain of \$6,000 in 2003 and \$1,000 in 2002 under the specific identification method.

### Note 7 - Deferred Charges (Including Regulatory Assets)

The following is a summary of amounts recorded as deferred charges:

<i>In thousands as of December 31,</i>	<b>2003</b>	<b>2002</b>
Unamortized costs of abandoned plant	<b>\$ 50,846</b>	\$ 54,099
Unamortized penalties on repriced debt	<b>22,884</b>	22,814
Unamortized debt discount and issuance cost	<b>577</b>	655
Nuclear outage maintenance cost	<b>157</b>	1,570
Deferred DOE assessments (see Note 4)	<b>712</b>	878
Other	<b>936</b>	3,881
	<b>\$ 76,112</b>	\$ 83,897

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 \$3,253,000 and \$3,170,000 in 2003 and 2002, 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 \$2,091,000 in 2003 and \$1,936,000 in 2002.

In 2003, SMEPA repriced \$44,300,000 of debt and paid a penalty of \$2,161,000. The interest rate on the debt for the remaining life will be 3.76% in lieu of 7.68%.

## Note 8 - Patronage Capital

Patronage capital consisted of the following:

<i>In thousands as of December 31,</i>	<b>2003</b>	2002
Cumulative margins	<b>\$ 96,900</b>	\$ 92,723
Less: Retirements to date	<b>5,854</b>	5,854
	<b>\$ 91,046</b>	\$ 86,869

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 10.4% and 10.3% of the total assets at December 31, 2003 and 2002, respectively.

# Financial Report

## South Mississippi Electric Power Association Notes to Financial Statements

### Note 9 - Long-Term Debt

Long-term debt consisted of the following:

*In thousands as of December 31,*

	2003	2002
Mortgage notes payable in quarterly installments to Federal Financing Bank ("FFB") at interest rates varying from 3.873% to 10.705%, maturing in 2030	<b>\$ 408,268</b>	\$ 432,396
CFC advances at interest rates ranging from 3.48% to 6.45% to finance construction of new turbines	<b>225,861</b>	171,435
Mortgage notes payable in quarterly installments to CFC (2.55% at December 31, 2003, 3.40% in 2002), maturing in 2022	<b>4,207</b>	4,324
RUS mortgage notes payable in monthly or quarterly installments: 2% notes maturing in 2009	<b>2,946</b>	4,832
5% - 5.75% notes maturing in 2015 through 2020	<b>25,591</b>	27,201
Mortgage notes payable in quarterly installment to CoBank (4.96% at December 31, 2003, 4.37% in 2002), maturing in 2019	<b>1,849</b>	1,946
Lamar County, Mississippi, Pollution Control Bonds: 1978 A Series, 6.125%, due semi-annually through 2008	<b>805</b>	955
1993 S Series, 4.65% to 4.95%, due annually through 2007	<b>9,609</b>	11,751
Claiborne County, Mississippi, Pollution Control Bonds: 1985 G Series, variable interest rates (1.15% to 1.26% at December 31, 2003), due annually through 2015	<b>35,545</b>	37,145
	<b>714,681</b>	691,985
Less current maturities	<b>33,935</b>	32,736
Long-term debt (excluding current maturities)	<b>\$ 680,746</b>	\$ 659,249

In January, 2004 the RUS approved a \$275 million loan guarantee for SMEPA that will provide permanent financing for its combustion turbine project (See Note 14). In the interim, CFC has provided \$275 million construction financing for the project in the form of a four-year loan. It is SMEPA's intent to repay the CFC loan and its bank line of credit in 2004 after the permanent financing from the FFB is received. At December 31, 2003 SMEPA owed \$197.6 million on the CFC loan related to the combustion turbine project and \$8 million on the bank line of credit.

A condition of the CFC interim \$275 million loan required SMEPA to purchase equity certificates in CFC and CFC also provided a \$39 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, 2003 SMEPA owed \$28.2 million on this loan.

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):

2004	\$ 33,921
2005	35,024
2006	40,395
2007	42,733
2008	42,446
	<hr/>
	\$ 194,519

In 2001, RUS approved a \$58,653,000 guaranteed loan from the FFB to SMEPA to finance the addition of transmission facilities. At December 31, 2003, the remaining unadvanced commitment was \$22,622,000.

SMEPA is required by debt compliance covenants to maintain certain financial ratios of interest coverage and annual debt service coverage. SMEPA was in compliance with such requirements at December 31, 2003 and 2002.

# Financial Report

## South Mississippi Electric Power Association Notes to Financial Statements

### Note 10 - Deferred Credits and Other Long-Term Liabilities

The following is a summary of deferred credits and other long-term liabilities:

<i>In thousands as of December 31,</i>	<b>2003</b>	2002
Deferred revenue (fuel cost adjustment)	\$ <b>8,653</b>	\$ 4,286
Postretirement benefit obligation (other than pensions)	<b>3,312</b>	3,298
Deferred DOE assessments (see Note 4)	<b>355</b>	521
Miscellaneous	<b>122</b>	272
	<b>\$ 12,442</b>	\$ 8,377

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) amounts of \$8,653,000 (2003) and \$4,286,000 (2002) were collected from Members in the year deferred and will be or have been recognized as revenue in the succeeding year.

### Note 11 - Short-Term Borrowings

SMEPA has a \$25,000,000 short-term line of credit available with CFC that is subject to renewal in September 2004 and a \$10,000,000 short-term line of credit with a bank that expires May 1, 2004. SMEPA had \$2,600,000 of borrowings against the CFC line of credit at December 31, 2003, at an interest rate of 2.8% and \$8,000,000 of borrowings against the bank line of credit at December 31, 2003 and 2002, at an interest rate of 3.5% and 3.75%, respectively.

### 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 and long-term debt

The carrying amount reported in the balance sheets for notes payable approximates fair value. The fair values of SMEPA's long-term debt are estimated using discounted cash flow analysis 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):

	2003		2002	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
FFB	\$ 408,268	\$ 465,612	\$ 432,396	\$ 500,844
RUS	28,537	29,198	32,033	29,205
Pollution Control Bonds	45,959	46,690	49,851	50,910
CFC and CoBank advances and notes	231,917	231,917	177,705	177,705
	<b>\$ 714,681</b>	<b>\$ 773,417</b>	<b>\$ 691,985</b>	<b>\$ 758,664</b>

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.

# Financial Report

## Notes to Financial Statements

### 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:

<i>In thousands as of December 31,</i>	<b>2003</b>	2002
Service cost of benefits earned	<b>\$ 57</b>	\$ 52
Interest cost on accumulated benefit obligation	<b>136</b>	127
Amortization of actuarial gain	<b>(75)</b>	(75)
<b>Total current year expense</b>	<b>\$ 118</b>	\$ 104

Payments relating to postretirement benefits other than pensions were approximately \$104,000 in 2003 and 2002.

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

<i>In thousands as of December 31,</i>	<b>2003</b>	2002
Retirees and dependents	<b>\$ 879</b>	\$ 983
Fully eligible active plan participants	<b>45</b>	45
Active participants not yet eligible	<b>1,219</b>	1,026
Unrecognized gain	<b>1,169</b>	1,244
	<b>\$ 3,312</b>	\$ 3,298

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 is 8.0% in 2004, declining to 5.5 percent by the year 2009.

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 \$1,387,000 in pension expense for the defined benefit pension plan in 2003 and \$1,220,000 in 2002. 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 \$455,000 and \$421,000 for 2003 and 2002, 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 \$1,247,000 and \$1,080,000, respectively, for the fiscal years ended December 31, 2003 and 2002.

## **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. SMEPA is obligated to load no less than 85% of its rail shipments through 2006 with a specified party at contractual rates that are adjusted quarterly.

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. All such commitments are expected to be recovered through normal operating revenue.

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 in 2001, aggregating approximately \$20 million on an annual basis. SMEPA has the right to

# Financial Report

## South Mississippi Electric Power Association Notes to Financial Statements

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 usage 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 were placed in service in 2003 and one turbine is scheduled to be placed in service in each of the three following years. The project includes four turbines rated at 84 megawatts each and 3 turbines rated at 47 megawatts each for a total of 477 megawatts. These natural gas fired simple cycle generators will be used to augment SMEPA's peaking resources and replace power 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 \$206.3 and \$159.3 million at December 31, 2003 and 2002, respectively.

In 2003, SMEPA became aware of an underbilling error involving a Member of SMEPA and one of its major customers. SMEPA is working with all parties to resolve the underbilling which involves three years of service and a power supplier other than SMEPA. No receivables or payables have been recorded in the accompanying financial statements and SMEPA believes the settlement of the matter will not be material to SMEPA's financial statements.

After conducting hearings on the matter, the Mississippi Public Service Commission ("MPSC") indicated in May, 2000 that starting retail competition in the electric utility industry at that 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. Management is unable to determine what effect, if any, changes related to retail competition in Mississippi would 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 \$179 million invested in transmission assets as of December 31, 2003.

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.

