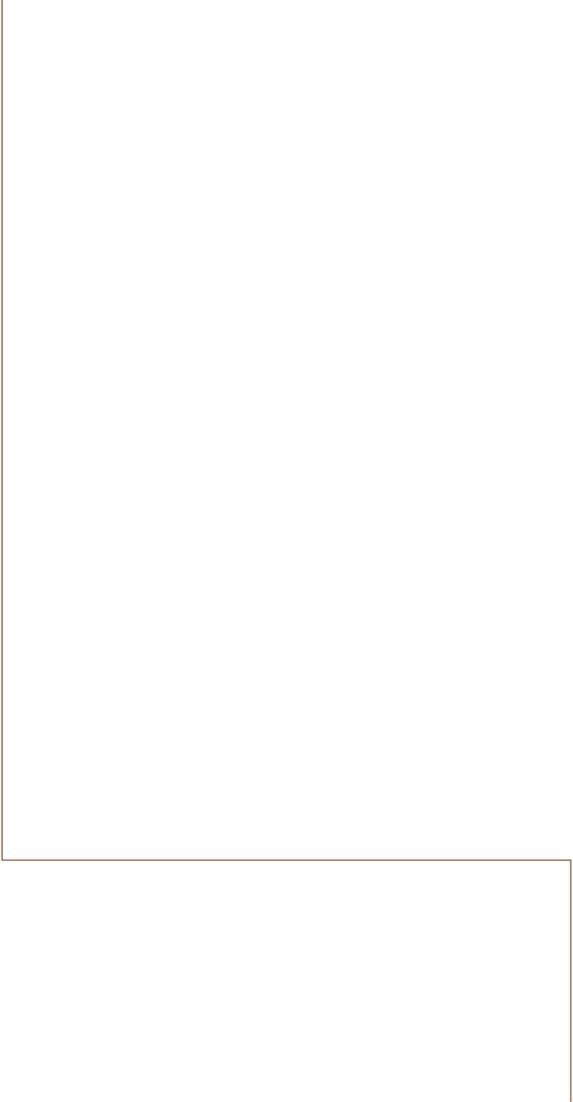


CELEBRATING A CENTURY OF SERVICE



Salt River Project 2002 Annual Report



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Under the glare of the Arizona sun, men and women in the Salt River Valley farmed the land and wrestled with the river's unpredictable nature.

Through droughts and floods, these early settlers persevered. But the prospects of prosperity stopped at their doorsteps as uncertain water conditions prevailed.

In 1903, with the formation of what became known as SRP, a lasting solution emerged. Early activities included construction of Theodore Roosevelt Dam, which stabilized the water supply and offered new promise to agriculture and industry in the Valley.

Over the century that followed, SRP enhanced water supply and delivery as well as developed an extensive electrical system that is among the most efficient in the nation.

SRP's story is compelling and complex — of men and women, hardship and foresight, commitment and success. It is woven into the economic, cultural and social fabric of the Salt River Valley.

As SRP approaches its 100th year of service, it still can be said with conviction:

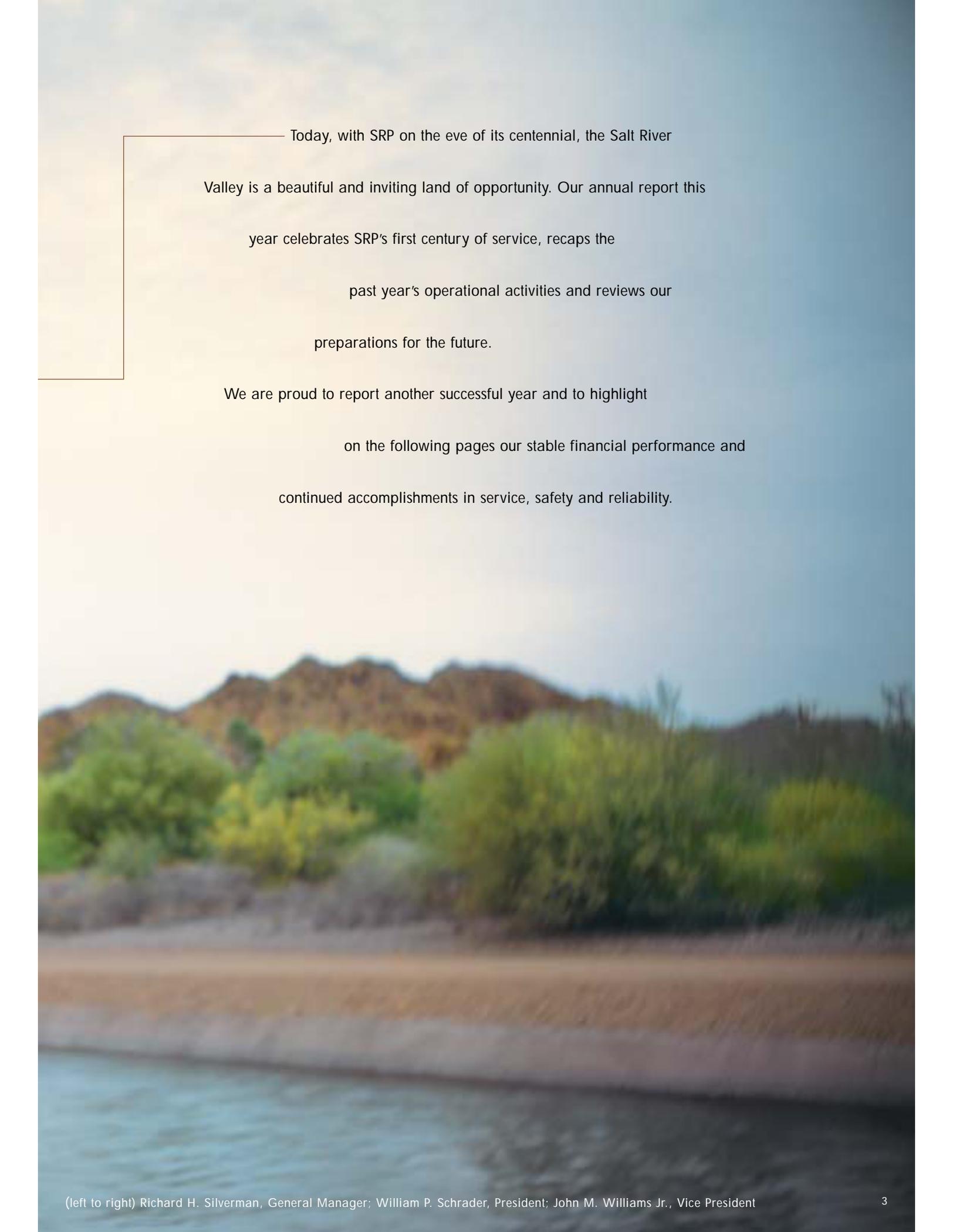
***“Great things will take place in the Salt River Valley
due to this project.”***

— Theodore Roosevelt, March 18, 1911, at the
dedication ceremony of the dam named in his honor

A LETTER TO OUR CUSTOMERS,

BONDHOLDERS AND SHAREHOLDERS





Today, with SRP on the eve of its centennial, the Salt River Valley is a beautiful and inviting land of opportunity. Our annual report this year celebrates SRP's first century of service, recaps the past year's operational activities and reviews our preparations for the future.

We are proud to report another successful year and to highlight on the following pages our stable financial performance and continued accomplishments in service, safety and reliability.

Safety is always a priority – for employees and our communities. This year, we again received the American Public Power Association’s first place award for safety among public power utilities in the U.S.

Combined net revenues of \$19.8 million for the year, while less than expected, are respectable in the industry today. Our debt service coverage ratio – the number of times we cover principal and interest from net operating revenues on a cash basis – was a very strong 3.09. Funds available – internally generated cash from operations after expenses and debt service – were a robust \$364.3 million. We consider this a very solid level of performance in view of the dramatic decreases in wholesale prices and the continuation of statutorily established price caps for retail prices in our service area.

Today, deregulation of the electric industry is at a crossroads. The future of deregulation of the wholesale electric market as well as competition in the retail electric market is ambiguous at best. For SRP and many utilities in the West, the Federal Energy Regulatory Commission’s price mitigation plan of last summer brought an end to superheated prices and volatility in the Western wholesale market.

However, we have entered a new era of uncertainty, with multiple efforts to restructure the wholesale market and to investigate participant conduct.

Arizona also is re-examining issues that have emerged as the result of failures in deregulated markets. The Arizona Corporation Commission, which regulates investor-owned utilities, and the state Legislature, which establishes parameters for publicly owned entities like SRP, are re-examining retail competition. We favor a thorough review of the successes and failures of energy deregulation, always with a close eye on the protection of consumer interests and a platform of local control. We must ensure that current uncertainties do not pose an unacceptable risk when dealing with a commodity that is central and essential to the health and lifestyle of the Valley.

SRP is fortunate to provide services in ever-expanding central Arizona, where population growth and power demand are consistently above national averages. We added 26,000 new customers this past year, up 3.5 percent from the year before. At the same time, average household electricity consumption per month reached nearly 1,275 kilowatt-hours.

Our generating resources have increased substantially from the previous year, adding both natural-gas and coal-fired facilities. The SRP electric system

*Community commitment is a cornerstone
of our business. This year, SRP received the
American Public Power Association's top award
for service to our communities.*

performed very well last summer, and with the additional generation available, we are in good condition for summer 2002. We will continue construction of additional gas-fired generation this year, and we are in discussions on new coal-fired generation, reinforcing our commitment to fuel diversity.

Significant concerns with fuel diversity have led us to pursue some unique solutions to ensure future natural gas supplies. The existing pipeline system in the West is expected to be strained to its limits by increased construction of gas-fired generation. As a result, we are pursuing the development of new gas storage and pipeline capacity.

A most pressing issue in our industry is the lack of transmission investment in the West. SRP is moving ahead with major transmission lines to serve our customers, with two 500-kilovolt transmission lines under construction or in development in our service area. These expansions will permit import of new generating sources and increase access to other markets during times of surplus.

SRP owns about 80 percent of the generation resources needed to serve our retail customers.

Favorable long-term contracts cover the balance. As a result, our trading operations are small relative to core operations, dealing mostly with seasonal sales of excess energy or temporary reserves. In a volatile market, we continue to enhance our ability to manage the financial risks inherent in electricity and natural gas transactions. We have improved our analytical capability, strengthened our procedures, and implemented new strategies to mitigate risk.

Meanwhile, public power's unique role in the wholesale electric market continues to be challenged. At SRP, we restate our conviction that local control provides significant benefits for customers and communities.

We continue our commitment to customer service. Our M-Power® program, the prepaid metering option developed to assist customers in controlling energy costs, has become a successful and popular option for many customers. In fact, with M-Power, "Custom Due Date" and several other programs, SRP signed up more than 60,000 customers to



new service options this year. In all, nearly 94 percent of electric customers surveyed said they are “highly satisfied” with our service.

Currently, our water business faces a unique set of challenges. A major drought is entering its fourth year in Arizona on the Salt and Verde river watersheds. A similar situation is developing on the Colorado River watershed. The Phoenix metropolitan area has avoided serious impacts of the drought because of prior planning efforts, including access to the Central Arizona Project (CAP) aqueduct, which delivers water from the Colorado River. SRP has acquired significant quantities of CAP water and has maximized pumping. However, continued drought conditions could result in reductions in allocations to water users and restrictions on usage.

Through it all, SRP maintains a solid commitment to the communities we serve. Early company pioneers were community builders, and this tradition endures. SRP embraces the future of the Valley with long-range planning to ensure reliable, affordable power and water supplies. We continue to support and provide community programs that build and enrich lives.

We are ever mindful of the public trust established by SRP over time. Due to the tragic events of

September 11 and their aftermath, we increased security measures at power and water facilities and operations centers, which remain in effect today.

As we enter SRP’s centennial year, we extend sincere appreciation to the men and women who demonstrated the dedication and foresight to make this milestone possible. To SRP’s outstanding employees, we say “thank you” for your hard work this year as we continue our legacy of excellent service. And once again, SRP’s elected officials demonstrated their commitment to our communities, electric customers and water shareholders.

Looking to the future, we offer this guarantee: SRP will hold true to our mission of ensuring the vitality of the Salt River Valley.


William P. Schrader
President


John M. Williams Jr.
Vice President


Richard H. Silverman
General Manager

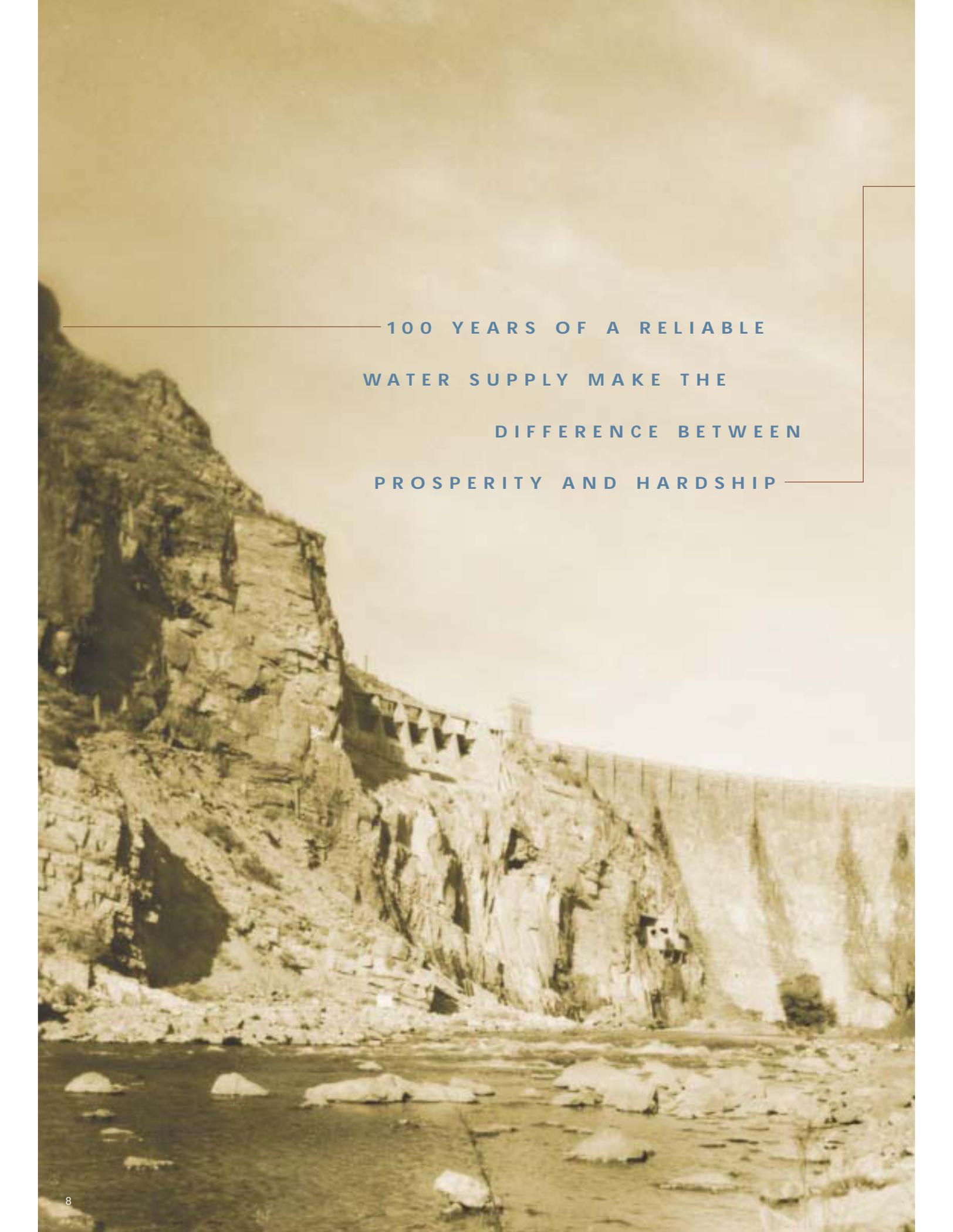


The year Benjamin A. Fowler moved to Arizona was a dire one for water. Two years of drought and low flows in the Salt River combined to kill crops and run off residents. The Valley was at a water crossroads.

Fowler, a book publisher from the East who came to Arizona for a new career as rancher and businessman, took on the challenge. It was 1899.

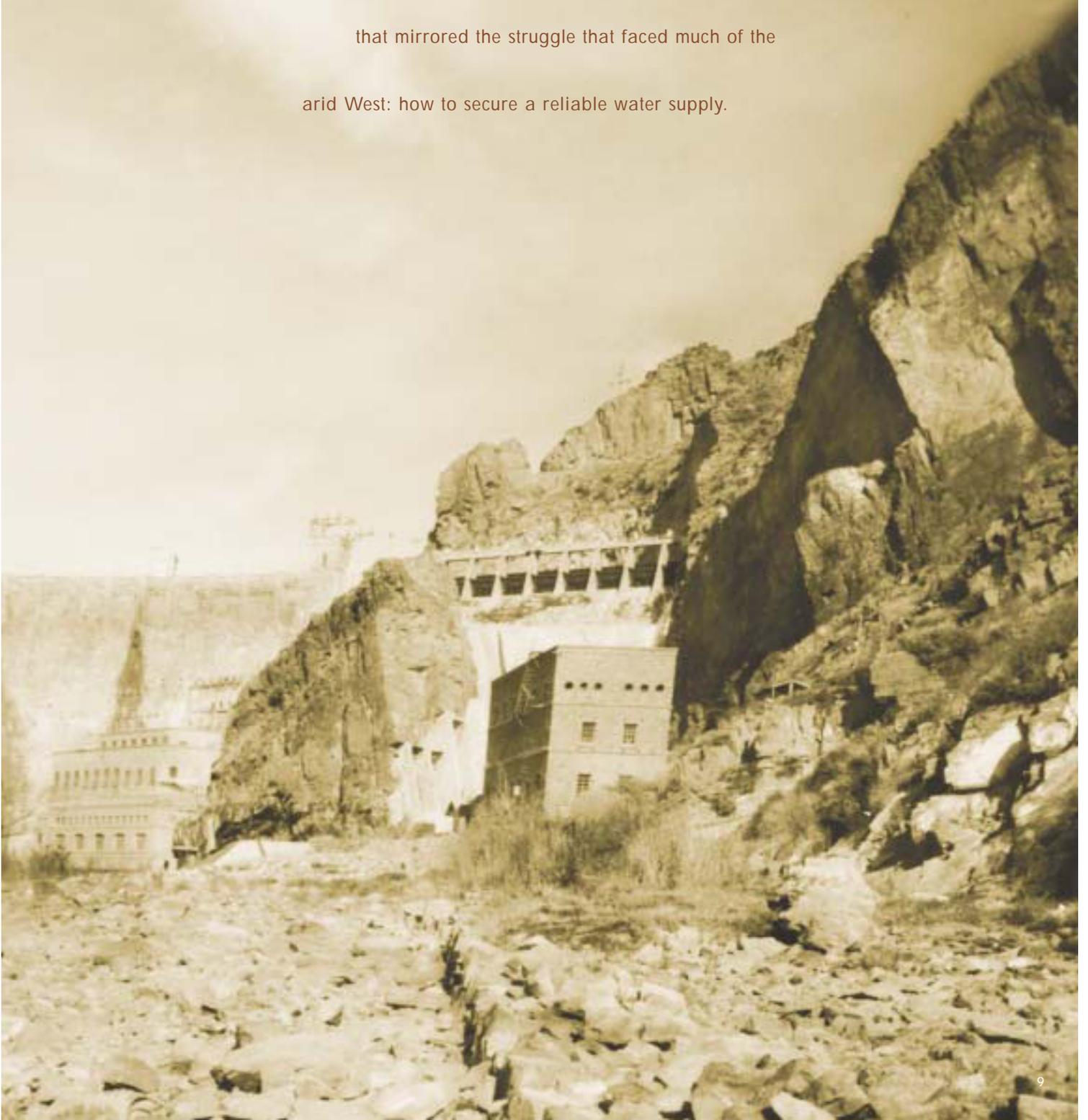
Elected to the Arizona Territorial Legislature, Fowler argued in Arizona and Washington, D.C., for passage of the National Reclamation Act of 1902. Working with landowners, Fowler gathered the support needed to form the Salt River Valley Water Users' Association. These landowners pledged their lands to secure a loan to build Theodore Roosevelt Dam, the cornerstone of the Salt River Federal Reclamation Project. In doing so, Fowler and other community leaders secured a stable water supply for the Valley. Fowler served as the first SRP president.

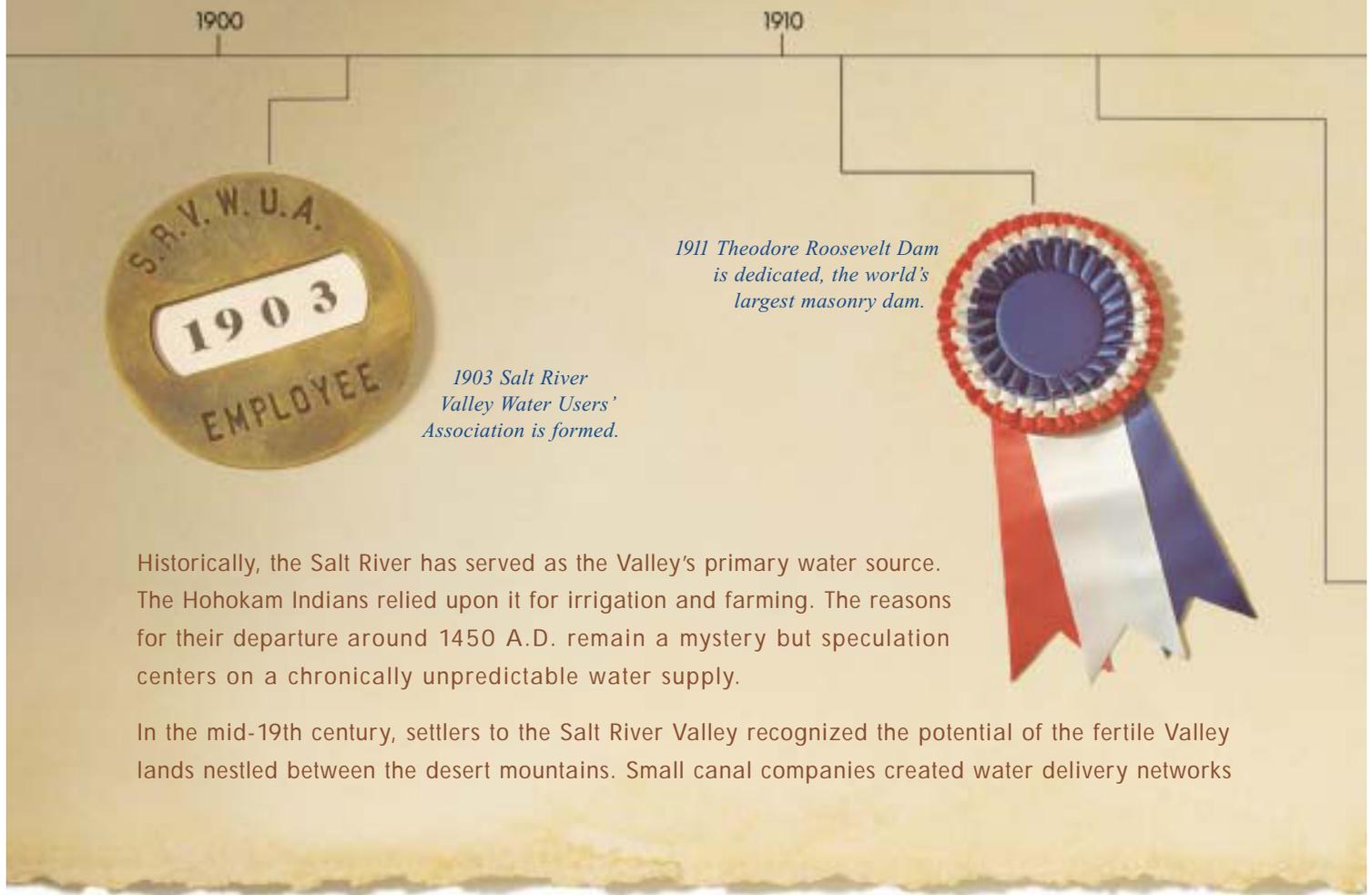
Today, the thriving Phoenix metropolitan area is a testament to Fowler and so many others who recognized federal reclamation as "*a magnificent experiment*" – one that would bring long-lasting water security and economic prosperity to the Salt River Valley.



— 100 YEARS OF A RELIABLE
WATER SUPPLY MAKE THE
DIFFERENCE BETWEEN
PROSPERITY AND HARDSHIP —

When SRP was incorporated in 1903, the Valley was in the grips of a severe drought. The Salt River ran dry, crops withered, and many farmers moved elsewhere. It was a situation that mirrored the struggle that faced much of the arid West: how to secure a reliable water supply.





Historically, the Salt River has served as the Valley's primary water source. The Hohokam Indians relied upon it for irrigation and farming. The reasons for their departure around 1450 A.D. remain a mystery but speculation centers on a chronically unpredictable water supply.

In the mid-19th century, settlers to the Salt River Valley recognized the potential of the fertile Valley lands nestled between the desert mountains. Small canal companies created water delivery networks

Water Year In Review

As our centennial year approaches, the Salt River Valley and Arizona are in the midst of four consecutive years of below-normal precipitation. Winter and spring runoff into the Salt and Verde river watersheds during that period is the lowest since reliable gauging records began. Meanwhile, water stored in the SRP reservoir system is far below normal.

This challenge is similar to the one when SRP was formed, and we are prepared to meet it. To supplement the limited surface water supply, more groundwater will be pumped for the balance of 2002 and throughout 2003, or until the dry conditions subside.

Water also will be purchased or "exchanged" with the Central Arizona Project (CAP) to supplement Salt and Verde surface water. And by expanding our underground water storage

efforts, we are providing an opportunity for the state to maximize its Colorado River allocation.

For the year, water deliveries were about 1 million acre-feet. Gauged runoff was 75 percent of normal, water in storage was 34 percent of capacity, and groundwater pumping was more than double the norm. These data are for calendar year 2001.

In collaboration with other water agencies in the state, this past year we worked with the CAP and the Arizona Legislature to enact a law that permits multi-year water exchanges. This provides greater flexibility in managing water supplies for our growing population by allowing the acquisition of excess Colorado River water through multi-year arrangements.

Keys to future water supplies for both urban and rural users are water rights education, resource

1920

1930

1940

1921 Aggressive expansion begins with three new hydropower dams built on the Salt River.

across the basin. But lack of water during the summer growing season was a constant worry. Toward the end of the 19th century, various attempts to develop dams and reservoirs failed for lack of funding.



SRP completes the last of seven dams on the Verde and Salt rivers to support Valley water needs and the burgeoning agriculture industry.

The National Reclamation Act enacted by Congress and approved by President Theodore Roosevelt offered a solution to the water dilemma. It provided a new funding mechanism to finance irrigation projects to store and deliver water.

Upon passage of the Act, Valley ranchers and farmers took action. They formed the Salt River Valley Water Users' Association, and pledged their lands as collateral on federal loans to build what was known as the



It was June 1915, and the first water spilled from Theodore Roosevelt Dam was being carried to New York City by an Arizona delegation for the christening of the USS Arizona.

Newspaper accounts from the time tell the story of a controversy over whether champagne or water would be used to christen the most powerful battleship ever built for the U.S. Navy. Then-Arizona Gov. George W.P. Hunt, to settle the controversy, made an 11th-hour decision – both would be used!

Upon completion, Roosevelt Dam was widely recognized as an extraordinary example of engineering and vision. The water that had been captured some weeks earlier just for the event represented liquid gold for Arizona – sustenance for a land of promise and opportunity. The glass bottle in which it was contained was wrapped in a copper wire mesh provided by two Arizona mining companies.

SRP has managed the dam for 85 years. A major modification completed in 1996 added space for storage, flood control and dam safety, all in the interest of prudent water management for future generations.

1950

1960

1970



1952 SRP enters water delivery contract for municipal water in the Valley.



1955 Final payment is made for construction of Roosevelt Dam.

“Salt River Federal Reclamation Project.” Soon, the newly formed U.S. Reclamation Service began to build the “Project,” which included Theodore Roosevelt Dam and water system improvements that would boost the area’s farming industry. The Association took over operation and maintenance of the Project in 1917 from the Reclamation Service and, in doing so, assumed responsibility for building and sustaining the Valley’s water supply.

SRP and local communities worked together through the decades to meet the needs of an increasing population. Additional dams were constructed on the Salt and Verde Rivers, and over time urban water users outnumbered agricultural users. Urbanization led to improved water facilities, increased water

planning and scientific studies to identify water available for growth. We are participating in planning activities overseen by rural organizations to address water resource issues, and we continue to provide technical assistance in evaluating water rights to meet changing needs.

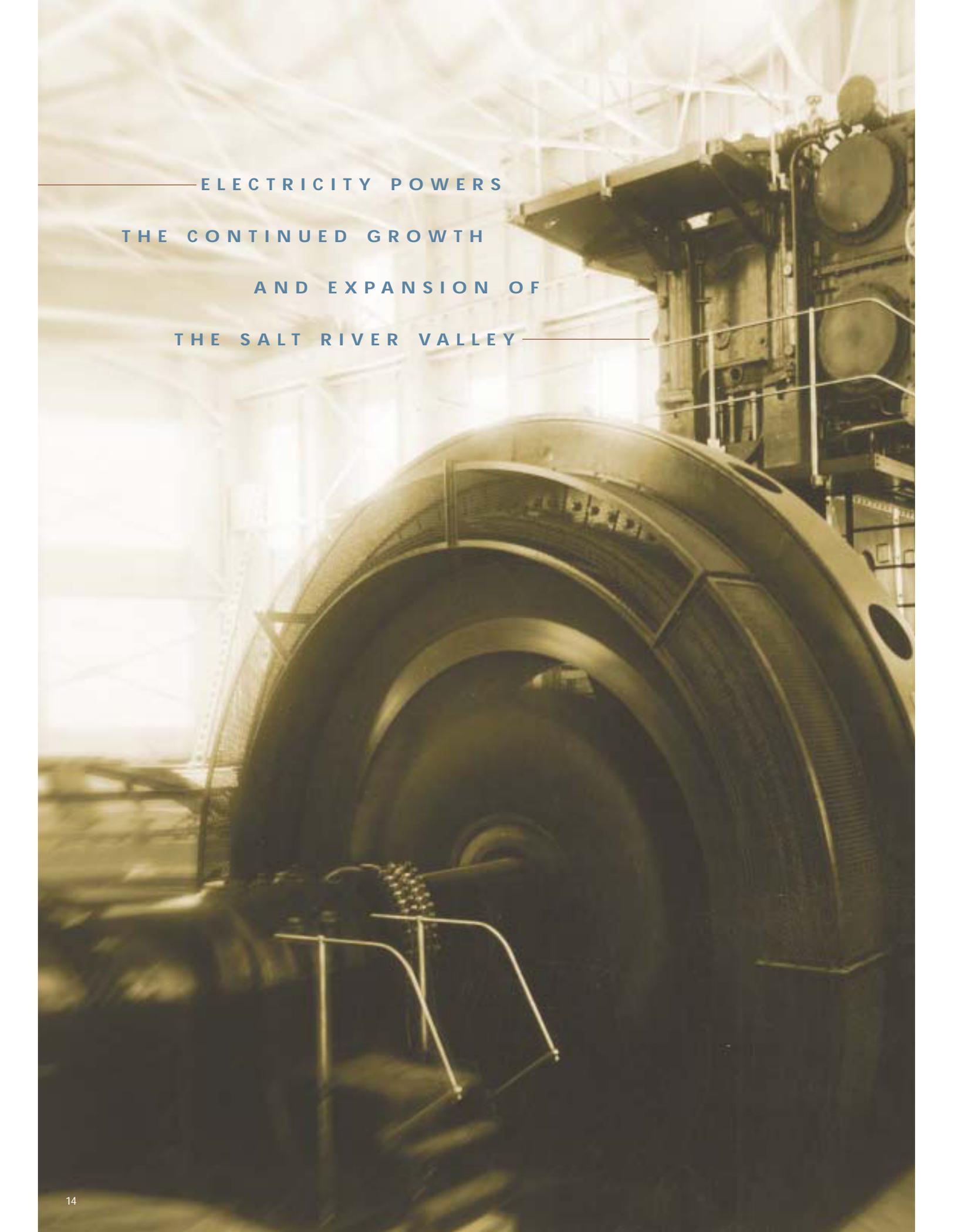
Conservation also plays an important role in managing the water supply. We provide water-saving advice to urban and agricultural users throughout the Valley and partner with cities to encourage water conservation by municipal residential users. In addition, SRP takes municipal effluent for power plant cooling purposes and in exchange provides surface water to Valley cities.

Underground storage facilities “bank” water for tomorrow

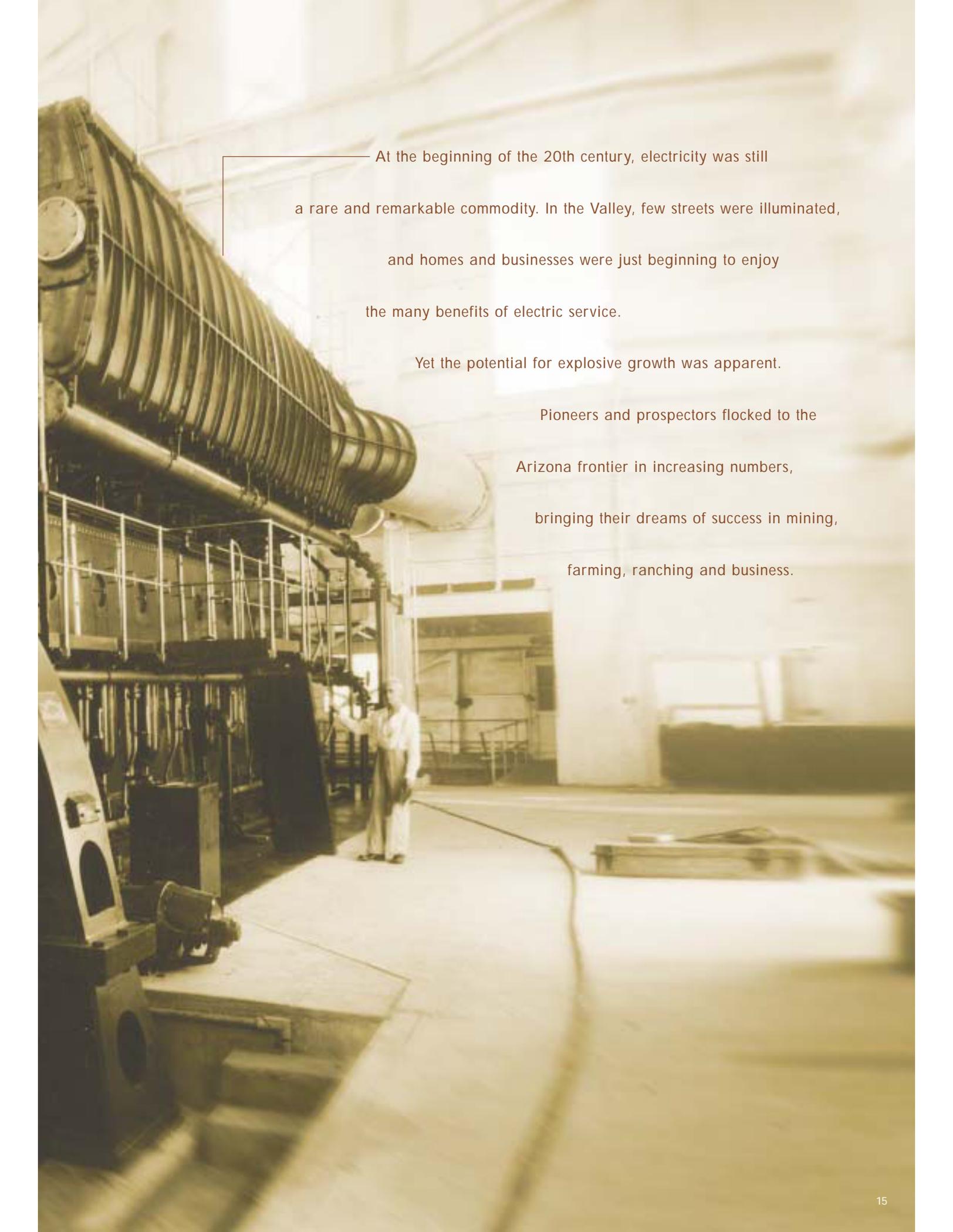
With a look to the future and continued growth, we are working with local municipalities to put water “in the bank” for the years ahead.

The New River-Agua Fria River Underground Storage Project will store excess water in natural underground aquifers for future use. SRP will operate the new facility, which when complete will have the capacity to store up to 100,000 acre-feet of water per year.

A similar recharge facility, also operated by SRP and known as the Granite Reef Underground Storage Project, has “banked” more than 600,000 acre-feet of water since 1995. An acre-foot is enough water for a family of four for one year.

A large industrial turbine in a power plant. The turbine is a massive, dark-colored metal structure with a large, circular opening in the center. It is surrounded by various pipes, valves, and structural elements. The lighting is warm and golden, creating a dramatic atmosphere. The text is centered over the image in a blue, sans-serif font.

ELECTRICITY POWERS
THE CONTINUED GROWTH
AND EXPANSION OF
THE SALT RIVER VALLEY



At the beginning of the 20th century, electricity was still a rare and remarkable commodity. In the Valley, few streets were illuminated, and homes and businesses were just beginning to enjoy the many benefits of electric service.

Yet the potential for explosive growth was apparent.

Pioneers and prospectors flocked to the Arizona frontier in increasing numbers, bringing their dreams of success in mining, farming, ranching and business.

1900

1910



1909 First power to the Valley is delivered from Roosevelt Dam.

1912 SRP agrees to supply hydroelectricity to mining activities in central Arizona.

When the National Reclamation Act of 1902 made possible the construction of Theodore Roosevelt Dam, the door also opened to a new era in electric generation and delivery. Specifically, power was needed at the remote site for the dam's construction. By 1909, the Roosevelt hydropower plant was built and power from it was being delivered to the Valley.

In 1917, SRP assumed responsibility for management of the water and power facilities from the U.S. Reclamation Service. Over the next two decades, six new hydroelectric plants were constructed. In the late 1920s, SRP initiated a rural electric system for Valley farmers – almost a decade ahead of a similar national program – which expanded electricity to outlying agricultural lands and spurred local development. Meanwhile, small private companies continued to supply power to the towns in the Valley.

As SRP's electric business grew, so too did the need for financing operational growth. Under a state law that provided municipal status to entities engaged in reclamation activities, the SRP Agricultural

Power Year In Review

Staying ahead of the demand curve is our specialty. Over the years, planning for electricity needs has supported growth and development of the Valley. Today, to keep pace with ever-increasing demand, we continue to upgrade electricity supply and delivery capabilities in ways that recognize the environmental sensitivities of our local communities.

We are testing a newly completed 250-megawatt (MW) urban generating station in the Valley community of Tempe. This plant will be among the cleanest natural-gas-fueled generators in the nation. We continue to move ahead on a new 825-MW natural gas plant in neighboring Gilbert, with construction scheduled to begin in 2003. In addition, we began receiving power under a 10-year agreement for 598 MWs from a new generating plant south of our service area.

As a result of aggressive maintenance, our Navajo and Coronado generating stations made significant improvements to forced-outage rates during the summer of 2001. The "effective availability" (ability to respond when needed) of our three Valley plants also improved. We expect similar results this year due to extensive, continued maintenance.

We are diversifying our fuels portfolio and are working to improve supply reliability. One project under consideration, a natural gas storage and transportation system, would deliver natural gas from near Las Vegas, Nev., to southwestern Arizona and connect with all major interstate pipelines in Arizona and southern Nevada. In addition, we received federal approval to mine low-sulfur coal at the proposed Fence Lake Mine in western New Mexico. The project will provide coal to our Coronado Generating Station in eastern Arizona.

1920

1930

1940



*1928 SRP
expands electric
system to serve
Valley agriculture.*



*1937 SRP
Power District
is formed, serving
5,800 customers.*

*1941 SRP begins major Valley
generating plant expansion to
serve growing population.*

Improvement and Power District was created in 1937. That same year, SRP began work on its first diesel-powered generating plant and plans were initiated for other facilities that would lessen dependence upon unpredictable hydropower.

The District helped to finance and repay debt on water operations, as a means of covering the costs of continued improvements to water storage and delivery. This proved an invaluable benefit to water system development in the post-Depression years and in the years since.

The Valley's population exploded after World War II and so too did demand for electricity, spurred by the advent of air conditioning and a rapidly expanding high-tech industry. The rural landscape began

And the numbers have changed over time...

Since its inception, the SRP power business has experienced phenomenal growth. Initially serving 13 customers in 1909, the number grew to 22,000 in 1950, to nearly 773,000 customers today.

SRP's original generating capacity was just 8 megawatts, enough to supply a few regional mines, small communities and farms. Since then, necessity and technology have increased SRP's capacity to more than 6,000 megawatts. (A megawatt is 1,000 kilowatts).

Today the technology age, with its numerous electricity-consuming devices, contributes to the average SRP residential customer's use of about 1,275 kilowatt-hours per month.

From some 165 miles of transmission lines in 1920, SRP now owns or shares ownership in more than 2,650 miles of transmission lines throughout the West. This extensive system allows SRP to import electricity when needed and to export excess generation in times of surplus.

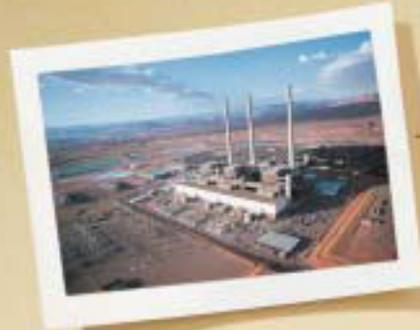
SRP's electric prices to retail customers, when adjusted for inflation, are just about the same as they were 50 years ago. Our long-standing commitment to low prices is a cornerstone of our electric business.

1950



SRP serves 22,000 electric customers.

1960



1968 Plans announced for \$328 million power plant near Page.

1970

1975 Power district now serves 249,000 customers.

1975 SRP becomes a partner in Palo Verde Nuclear Generating Station, the first nuclear power plant to serve Arizona.

its dramatic transition to cityscape. By this time, SRP had developed additional generation and transmission facilities and was delivering power to urban customers.

In an area where the population has increased 10-fold since 1950, staying ahead of the growth curve is an engineering, financial and operational challenge. SRP increased generating capacity 30-fold from 1950 to 2000 by building more power plants and partnering with others on new facilities. Today, new plants are located closer to customers and incorporate cleaner technologies. Renewable energy sources are available and more are in development.

To manage growing transmission needs, we are participating with other electric transmission line owners in the Southwest to form WestConnect, a regional transmission organization (RTO). The Federal Energy Regulatory Commission has proposed RTOs to facilitate development and operation of transmission on a regional basis. In addition, we received state approval to construct a high-voltage transmission line, with Arizona Public Service Co., to serve population and business growth in the western reaches of our service area.

We also began a public involvement process to site a 500-kilovolt (kV) electric transmission line. The line will transport power from an area near the Palo Verde Nuclear Generating Station, west of the Valley, to northern Pinal County. In addition, a 230-kV line will be sited from the Pinal County location into east Mesa in our service area.

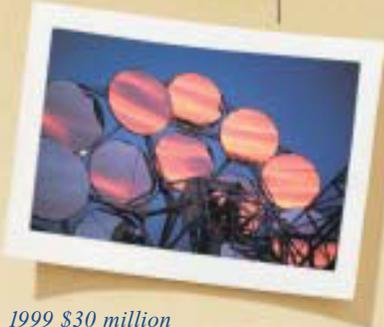
New distribution facilities are critical to our ability to continue delivering reliable service. Forty miles of new or upgraded 69-kV and 230-kV distribution lines and nearly 50 distribution substations are planned in the next five years. We also will increase the capacity of 127 miles of existing 69-kV lines through wire replacement.

We continue to replace older wood poles with heavy-duty steel poles in strategic areas to guard against damage during storms. To date, more than \$32 million has been dedicated to these upgrade efforts. In addition, we have invested about \$133 million since 1996 in underground cable replacement. These investments already are paying off. Our system reliability performance this past year compared very favorably to other utilities across the nation.

1980

1990

2003



1999 \$30 million renewable energy expansion program begins for SRP customers.

2000 First of many new SRP power plant and transmission expansion initiatives is launched.

2000 SRP reduces prices for the fourth time in six years, making average prices 10 percent lower than a decade earlier.

2002 SRP serves nearly 773,000 electric customers.

Over the past decade, SRP retail electric prices have dropped an average of 10 percent. In fact, SRP's prices consistently remain lower than those of utilities in neighboring states and other major utilities in Arizona. As a public power utility, cost savings are reinvested into operating and capital needs to better serve our customers.

Through every boom and bust cycle of the 20th century, SRP managed the power system to meet the needs of customers, applying new technologies and operational efficiencies along the way. Today, SRP is one of the nation's largest public power utilities, serving nearly 773,000 customers with low-priced, reliable electricity and continuing to plan for the Valley's future.

Past meets future at historic canal site

The new Arizona Falls Hydroelectricity Project takes us back to our roots. Using the flowing water of a canal to produce power, the plant will generate about 750 kilowatts in "green" energy each year while serving as an example of the benefits of renewable energy.

In the early 1900s, this same central Phoenix location was the site of the community's first hydroelectric generator. The plant also was one of the first of its kind in the West, and featured a waterfall that drew Phoenicians for picnicking and playing alongside the canal.

The new Arizona Falls will be much more than a hydroelectric plant. SRP, the neighborhood and the city of Phoenix are working together to re-create the historic site as a gathering place.

The original generator building will be transformed into a "water room" where visitors will be able to view some of the old gear works through sheets of cascading water. Water flowing from two mini-canals will create a waterfall reminiscent of the historic structure. The project also will include solar panels for on-site electricity.



— COMMITMENT TO THE VALLEY'S
SUCCESS CREATES A LASTING
BOND BETWEEN SRP
AND LOCAL COMMUNITIES —



In a very real way, the Salt River Valley and SRP grew up together. In 1903, when SRP was incorporated, the Valley was predominantly rural. Small towns, including Phoenix, dotted the agricultural landscape.

The need for an assured supply of water created a lasting bond between SRP and these communities.

With reliable water, farming prospered and attracted more business to local towns. By 1920, the Valley's population approached 100,000 and continued to climb.



1900

1910

*“You may see the day when
75,000 to 100,000 people will live
in this Valley.”*

— Theodore Roosevelt, 1911, at
Tempe Normal School, now ASU



*1912 Arizona becomes
the 48th state.*

Of course, local community needs were much different in the early years than they are today. The basic foundations of social and cultural life were being established. Schools and hospitals were needed, as were libraries and improvements to local sanitation and law enforcement.

Like today, SRP was locally owned, with board and council members elected from the area who were as concerned about building the community as they were about securing the water and power resources critical to economic vitality.

Over the years, SRP and Valley communities have worked together to enhance the positive image of the Salt River Valley. The first beautification efforts were launched in the 1920s, with SRP engaged in

Community Service Year in Review

We believe a company can make a positive difference in the communities it serves. Our long-standing ties to local communities mean we take seriously our responsibility to protect the environment, and to support programs that help improve education, expand human services, and promote water and electric safety.

Our company-sponsored efforts included the *SRP Solar Splash 2002* regatta, in which dozens of high school students built and raced boats equipped with photovoltaic systems funded by SRP grants. *Solar Splash* is part of our renewable energy education program reaching schools throughout Arizona.

We also awarded more than \$40,000 to schools across the Valley through SRP's *Project RESOURCE* grant program. This program funds special activities that can benefit an entire school population.

For example, elementary school children in the community of Buckeye will learn science by building rockets, while students in Mesa will receive additional help learning to read.

Another SRP-sponsored program provides school-based mentoring for at-risk teenagers. Participating middle school students serve as tutors for elementary school children, and the results are promising: improved grades and better communications between the students' families and schools.

Our community outreach this past year included the seventh annual *SRP Mowing Down Pollution*, the largest gas-mower-recycling program in the nation. This effort has retired about 14,175 gas mowers, helping to eliminate thousands of tons of carbon monoxide and ozone-causing pollutants from the Valley's air every year. This year's program collected nearly 1,100

1920

1930

1940



Phoenix area population approaches 100,000 and doubles over the next 20 years.

1941 WWII stimulates major economic upswing in Phoenix area, marking the opening of an era of industrial expansion and prosperity.

1947 Building permits in the Valley reach record \$10 million.

maintaining roads, trails and canals as the Valley promoted its image to attract new residents and business. Economic development activities, supported by local businesses including SRP, sought to lure more commerce and industry to the area.

SRP's community commitment has taken many forms. For example, during the difficult years of the Great Depression, SRP secured a loan to provide



Ella Fowler, wife of the first president of SRP, is one of scores of women who are a lasting tribute to community building in the Valley.

While her husband campaigned in Washington, D.C., for legislation that would result in the formation of SRP, Ella Fowler worked to build upon the basic foundations of local communities in the early 1900s.

She was among the founders of the Phoenix Women's Club, which was a wellspring of initiatives for social and cultural reforms, including the Arizona juvenile court system, Phoenix Carnegie Library, and public sanitation improvements. She served as president of important organizations, and founded a child welfare organization that was the predecessor to the Arizona Parent-Teacher Association.

Ella Fowler is remembered in Arizona history as an accomplished speaker and a woman with great executive ability. Her legacy of community commitment is mirrored today by the efforts of SRP employees and their families who give their time and resources to improve lives in the Valley.

1950

1960

1970

Maricopa County population grows to 330,000.

1955 Manufacturing replaces farming as the Valley's #1 economic source, with tourism moving up to third place.

1948 Residential air conditioning comes to the Valley.

1968 Salt River Pete served as the face for SRP's community safety efforts in the 1960s and '70s, reaching hundreds of thousands of school children and gaining water safety program in the United States.




emergency financing for Valley farmers, saving homes and farms that might otherwise have been lost.

By mid-century, SRP adopted an aesthetics program that was responsive to neighborhood needs. Power lines were placed underground, and substations were designed to complement their surroundings. Community aesthetics continue today as a corporate priority.

The Valley's post-WWII population explosion is credited in part to the assurance of essential resources including ample water and electricity. SRP undertook major electric and water system improvements in the 1940s and 1950s to keep pace with demand and ensure readiness for the future. In this way, SRP's commitment is directly linked to the success of local communities.

gas-powered lawn mowers and replaced them with new electric models.

Other efforts include *SRP Safety Connection™*, which provides electricity- and water-related safety information to our customers and the public. The safety campaign includes radio and print advertising, newsletter articles and participation in Valley events. Through *SRP Safety Connection*, we distribute more than 200,000 electric and water safety coloring books in English and Spanish each year.

In recognition of Arizona's 90th anniversary this year and our long history with the state, we contributed \$76,000 to the Arizona Capitol Restoration Project. The donation is being used to fund the restoration of the rotundas on the first, second and third floors of the historic capitol.

SRP and our employees contribute to the Valley's United Way campaigns, supporting the programs and services of more than 400 local nonprofit agencies. Employee contributions this past year to the United Way and other community service organizations topped \$1 million. SRP corporate contributions and in-kind services to nonprofit agencies and events throughout Arizona totaled \$2.3 million for the year.

1980

1990

2003



1993 Valley population reaches 3.5 million.

2000 SRP offers "EarthWise Energy" to customers for the continued expansion of environmentally friendly electricity.



2002 SRP centennial celebration begins.

Through the 1960s, the Valley and SRP continued to grow. During this period, SRP embraced environmental stewardship as a cornerstone of our community commitment. Major efforts were undertaken to improve water quality management and build cleaner power plants.

In the past 30 years, SRP has developed programs to fund and support education, human services, cultural programs and community safety. SRP employees are active in local organizations and are committed volunteers. In fact, community efforts to ensure the vitality of the Salt River Valley are so central to SRP's identity that they are included in our mission statement:

"We will deliver ever-improving contributions to the people we serve through the provision of low-cost, reliable water and power, and community programs, to ensure the vitality of the Salt River Valley."



SRP employees show volunteer spirit

Each year, SRP employees contribute approximately 700,000 hours of personal time to their communities. Through the *SRP VOLUNTEERS* program, 85 percent of SRP employees donate an average 3.3 hours per week to nonprofit organizations to improve life locally and statewide.

SRP employees' community efforts earned us the American Public Power Association's (APPA) Community Service award this year. This award recognizes activities that demonstrate commitment to the community. APPA is the trade association for the 2,000 community-owned electric utilities that serve more than 40 million Americans.

The dedication of our employee volunteers reflects our century-long tradition of support for Arizona and its future.

— SRP EXECUTIVE

MANAGEMENT —



(left to right)

D. Michael Rappoport *Associate General Manager -- Public & Communications Services*

L.J. U'Ren *Associate General Manager -- Operations, Information & Human Resources Services*

Jane D. Alfano *Corporate Counsel*

Richard H. Silverman *General Manager*

John F. Sullivan *Associate General Manager -- Water Group*

Mark B. Bonsall *Associate General Manager -- Commercial & Customer Services*

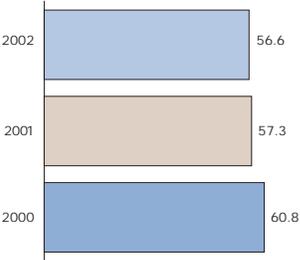
Richard M. Hayslip *Manager -- Environmental, Land, Risk Management & Telecom Services*

David G. Areghini *Associate General Manager -- Power, Construction & Engineering Services*



MANAGEMENT'S FINANCIAL AND OPERATIONAL SUMMARY

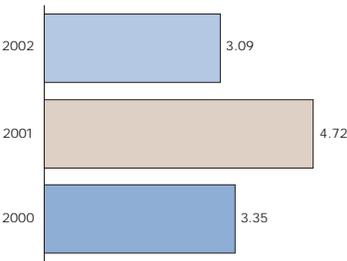
Debt Ratio
(Percent)



This section explains the general financial condition and results of operations for SRP. SRP includes the Salt River Project Agricultural Improvement and Power District (the District), its subsidiaries, and the Salt River Valley Water Users' Association. The results of these entities are combined for financial reporting purposes.

Overview of Business – The District owns and operates an electric system which generates, purchases and distributes electric power and energy, and provides electric service to residential, commercial, industrial and agricultural power users in a 2,900-square-mile service territory spanning portions of Maricopa, Gila and Pinal counties, plus mine loads in an adjacent 2,400-square-mile area in Gila and Pinal counties.

Debt Service Coverage Ratio



The District has remained a vertically integrated organization. It has retained 100 percent of its existing generation assets and is developing additional resources to keep up with load growth. The fuel sources for existing generation are diversified, and planned additions include coal as well as natural gas resources.

SRP manages a system of dams and reservoirs and has responsibility for the construction, maintenance and operation of a water supply system to deliver raw water for irrigation and municipal treatment purposes. It provides the water supply for an area of approximately 248,200 acres located within the major portions of the cities of Phoenix, Avondale, Glendale, Mesa, Tempe, Chandler, Gilbert, Peoria, Scottsdale and Tolleson.

Net Financing Costs
(\$Millions)



In 1997, the District formed a wholly-owned, taxable subsidiary, New West Energy Corporation (New West Energy), to market retail energy available to the District that is surplus to the needs of its retail customers, and energy that is rendered surplus by retail competition in Arizona. At this time, New West Energy does not market excess energy due to the turmoil in the California energy market. It continues to provide energy-related services to various customers and to monitor the market situation in the Southwest in contemplation of future activity.

The District's other subsidiary, Papago Park Center, Inc., manages a mixed-use commercial development known as Papago Park Center located on land owned by the District adjacent to its administrative offices. The District accumulated this land over a number of years for use by the District. The District has a long-range plan, which includes the private development of portions of Papago Park Center.

Results of Operations – SRP's net revenues for the fiscal year ended April 30, 2002, were \$19.8 million compared to \$309.7 million for the previous year. SRP adopted a new accounting standard in fiscal year 2002 that requires certain derivative instruments to be recorded at market value.

The effect of adopting this new standard on net revenues was a net loss of \$44.2 million. SRP's net revenues would have been \$64.0 million before applying this new standard. (This is discussed in more detail in **Accounting Change**.) Other items that influenced the decrease are described below.

Operating revenues were \$2.2 billion for fiscal year 2002, compared to \$3.0 billion for fiscal year 2001. The revenue decline this past year was due to several factors that impacted SRP and the utility industry, including a price mitigation order issued by the Federal Energy Regulatory Commission (FERC), excess generation resources in the marketplace, consumer conservation, and a general economic downturn.

The main factors were:

- In June 2001, the FERC imposed a price mitigation plan on wholesale electricity in the West. This action, combined with weather conditions and surplus energy supplies, drove down wholesale prices very significantly to levels more in line with historical norms. The District experienced more than a \$400 million decline in gross revenues from the wholesale market.
- The California situation prevented New West Energy, the District's affiliate, from selling into that market. As such, there were no energy sales made by New West Energy in fiscal year 2002. New West Energy focused on offering and providing energy-related services.
- The economic downturn impacted small and large industrial customers, with revenues from these customer classes decreasing by an aggregate of \$14.7 million.

Operating expenses were \$2.1 billion for fiscal year 2002, compared with \$2.6 billion for fiscal year 2001. The change between years is attributed to:

- Purchased power costs decreased as the market was affected by the FERC price mitigation plan and by excess supply.
- Fuel expense decreased due to lower prices on natural gas. The market price for natural gas was significantly lower than the previous year.
- Fiscal year 2001 had an additional \$85.0 million in expense as the District took a write-down on regulatory assets related to its implementation of direct access to its Generation services.
- As a result of our continued emphasis on reduction of debt capitalization, financing costs decreased by 13 percent from the prior year.
- The effect of accounting for derivatives under a new accounting standard resulted in an additional \$44.2 million net loss. See **Accounting Change** for further explanation.

In water operations, water delivery revenues were \$14.3 million compared to \$12.6 million the previous year. Water-related operating expenses were 14 percent lower than the prior year due to increased efficiencies.

Accounting Change – Effective May 1, 2001, the District adopted Statement of Financial Accounting Standards (SFAS) No. 133, "*Accounting for Derivative Instruments and Hedging Activities*," as amended. SFAS No. 133 requires that entities recognize all derivatives as either assets or liabilities in the balance sheet and measure those instruments at fair value. Changes in the fair value of derivative financial instruments are either recognized periodically in net revenues or accumulated net revenues.

As of April 30, 2002, the valuation of market changes for the District's derivative instruments resulted in an unrealized net loss of \$44.2 million. Most of this impact relates to multi-year hedges on transportation costs from two major gas basins in the Southwest for natural gas used for retail generation. The District's net

MANAGEMENT'S FINANCIAL AND OPERATIONAL SUMMARY

revenues would have been \$64.0 million without the effects of SFAS No. 133. For a detailed explanation of the effects of SFAS No. 133 on the District's financial results, see Note 3 in the accompanying notes to the combined financial statements.

Energy Risk Management Program – The District's mission to serve its retail customers is the cornerstone of its risk management approach. This means that the District builds or acquires resources to serve retail customers, not the wholesale market. However, as a summer-peaking utility, there are times of the year when the District's resources and/or reserves are in excess of its retail load, thus giving rise to some wholesale activity. The District has an Energy Risk Management Program to limit exposure to risks inherent in normal retail and wholesale energy business operations by measuring and minimizing exposure to price risks, credit risks, and control risks. To meet the goals of the Energy Risk Management Program, the District uses various physical and financial instruments, including forward contracts, futures, swaps, and options. Certain of these transactions are accounted for under SFAS No. 133. For a detailed explanation of the effects of SFAS No. 133 on the District's financial results, see Note 3 in the accompanying notes to the combined financial statements.

The Energy Risk Management Program is managed according to a policy approved by the District's Board of Directors and overseen by a Risk Oversight Committee. The policy covers areas such as strategies, specific price and control risk issues and the credit policy that the District applies to its wholesale counterparties. The Risk Oversight Committee is comprised of senior executives. The District maintains an Energy Risk Management Department, separate from the energy marketing area, that regularly reports to the Risk Oversight Committee. In addition, the District has established a credit reserve for its activity in wholesale markets. The District believes that its existing risk management structure is appropriate and that any exposures are adequately covered by existing reserves.

Electric Pricing – The District has a diversified customer base and no single customer provides more than 2.9 percent of its operating revenues. The District has implemented projects and programs geared toward enhancing customer loyalty by offering customers a range of pricing and service options. Moreover, the District has reduced retail prices and is one of the low price leaders in the Southwest.

The District is a summer-peaking utility and for many years has made an effort to balance the summer-winter load relationships through seasonal price differentials. In addition, the District prices on a time-of-day basis for large commercial and industrial, and certain residential and small commercial users.

On November 26, 2001, the District completed a review of its price plans and the level of its Competitive Transition Charge (CTC) associated with stranded cost recovery. The District elected to retain the CTC at its current level until June 1, 2004, and approved a Fuel and Purchase Power Adjustment Mechanism that became effective May 1, 2002. Other changes to price plans became effective December 31, 2001.

Recapitalization Plan – The District has undertaken a plan to improve its operating efficiency and financing flexibility so that it is better positioned to remain competitive and to respond to future changes.

As part of the Recapitalization Plan, in December 2001, the District issued \$580.6 million Salt River Project Electric System Refunding Revenue Bonds, 2001 Series A, and in February 2002, the District issued \$432.6 million Salt River Project Electric System Refunding Revenue Bonds, 2002 Series A, to refund certain outstanding Revenue Bonds.

The District intends to use the proceeds of additional Revenue Bonds or available cash on hand to fund the cost of the refunding and redemption of, and/or purchase through the execution of an open market tender offer for, certain of the District's outstanding Revenue Bonds.

The goals of the Recapitalization Plan are: (1) to accelerate debt retirement by the District of its Revenue Bonds; (2) to provide the District with increased financing and operating flexibility in the future; (3) to issue new Revenue Bonds for distribution expenses; (4) to adopt a modern and more flexible bond resolution; and (5) to recognize debt service savings. If the District issues additional Revenue Bonds to finance distribution facilities, such issuance would enable the District to allocate revenues, which would have otherwise been used to pay for the costs of distribution facilities, to the payment of debt service.

Capital – The Capital Improvement Program is driven by the need to expand the generation, transmission and distribution systems of the District to meet growing customer electricity needs and to maintain a satisfactory level of service reliability. Of the total Capital Improvement Program, more than 30 percent of the funds are directed to generation projects. These include the expansion of the Kyrene and Santan Generating Stations in the southeast portion of the District's service territory. Another 30 percent of the funds are planned for expansion of the electrical distribution system to meet new growth and to replace aging underground cable. The addition of new 69-kV transmission facilities and the construction of a new high-voltage transmission line account for an additional 7 percent of the funds.

The District pays a portion of the cost for its Capital Improvement Program from internally generated funds and a portion from the proceeds of Revenue Bonds.

During the year, SRP increased its ownership position to 20 percent from 10 percent in the Mohave Generating Station, a coal-fired plant in Clark County, Nevada.

The District has entered into an agreement with UniSource Energy Development Company (UniSource) to explore the joint development of two additional coal-fired generating units, approximately 400 MW each in size, to be located at the existing Springerville (Arizona) Generating Station. The units would be operated by UniSource's affiliate, Tucson Electric Power Company. Construction of the units is subject to numerous conditions, and no assurance can be given that such conditions will be satisfied. Among other things, the parties are still exploring various options for the timing, financing and ownership of the two units.

Code of Conduct – In accordance with the requirements of the 1998 Arizona Electric Power Competition Act, the District developed and implemented a Code of Conduct. The underlying principles of the Code are to protect the public interest and provide all competitors a fair opportunity to compete in the electric generation and other competitive services markets. Effective January 1, 2001, the District amended the Code to more closely isolate the distribution functions and services provided by the District and to simplify the Code.

The District is subject to an annual independent audit of adherence to the Code. The audit covering calendar year 2001 was completed in February 2002. The audit report confirmed the District has complied in all material respects with the Code's requirements.

COMBINED BALANCE SHEETS

As of April 30 (Thousands)

ASSETS	2002	2001
Utility Plant		
Plant in service —		
Electric	\$ 6,652,164	\$ 5,948,320
Irrigation	246,974	234,392
Common	385,897	391,698
Total plant in service	7,285,035	6,574,410
Less — Accumulated depreciation on plant in service	(3,313,051)	(3,102,243)
	3,971,984	3,472,167
Plant held for future use	31,144	31,134
Construction work in progress	482,568	326,215
Nuclear fuel, net	42,966	37,044
	4,528,662	3,866,560
Other Property and Investments		
Non-utility property and other investments	110,166	87,573
Segregated funds, net of current portion	368,296	352,302
	478,462	439,875
Current Assets		
Cash and cash equivalents	594,523	636,954
Temporary investments	185,463	348,031
Current portion of segregated funds	81,044	72,312
Receivables, net of allowance for doubtful accounts	140,843	348,307
Fuel stocks	35,612	25,480
Materials and supplies	70,063	60,500
Other current assets	14,964	39,519
	1,122,512	1,531,103
Deferred Charges and Other Assets		
	458,291	516,410
	\$ 6,587,927	\$ 6,353,948

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

COMBINED BALANCE SHEETS

As of April 30 (Thousands)

CAPITALIZATION AND LIABILITIES	2002	2001
Long-Term Debt	\$ 3,033,931	\$ 3,098,273
Accumulated Net Revenues and Other Comprehensive Income	2,330,268	2,312,014
Total Capitalization	5,364,199	5,410,287
Current Liabilities		
Current portion of long-term debt	114,340	71,940
Accounts payable	121,727	207,129
Accrued taxes and tax equivalents	57,821	31,551
Accrued interest	40,981	52,279
Customers' deposits	26,645	23,336
Other current liabilities	117,706	111,355
	479,220	497,590
Deferred Credits and Other Non-Current Liabilities	744,508	446,071
Commitments and Contingencies <i>(Notes 5, 7, 8, 9, 10, 11 and 12)</i>		
	\$ 6,587,927	\$ 6,353,948

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

COMBINED STATEMENTS OF NET REVENUES & COMPREHENSIVE INCOME

(Thousands)

<i>For the years ended April 30</i>	2002	2001
Operating Revenues	\$ 2,214,378	\$ 3,026,787
Operating Expenses		
Power purchased	713,797	914,646
Fuel used in electric generation	420,070	514,049
Other operating expenses	338,176	471,670
Maintenance	139,908	156,002
Depreciation and amortization	411,915	473,334
Taxes and tax equivalents	86,255	82,335
Total operating expenses	2,110,121	2,612,036
Net operating revenues	104,257	414,751
Other Income (Expenses)		
Interest income	55,801	68,147
Other expenses, net	(3,497)	(2,662)
Total other income (expenses), net	52,304	65,485
Net revenues before financing costs	156,561	480,236
Financing Costs		
Interest on bonds	137,544	148,110
Amortization of bond discount/premium and issuance expenses	1,732	4,951
Interest on other obligations	23,721	24,011
Capitalized interest	(14,398)	(6,532)
Net financing costs	148,599	170,540
Net Revenues Before Cumulative Effect of Change in Accounting Principle	7,962	309,696
Cumulative Effect of Change in Accounting Principle	11,834	-
Net Revenues	19,796	309,696
Other Comprehensive Income		
Net unrealized loss on securities and derivative instruments	(1,542)	(36,575)
Comprehensive Income	\$ 18,254	\$ 273,121

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

COMBINED STATEMENTS OF CASH FLOWS

(Thousands)

<i>For the years ended April 30</i>	2002	2001
Cash Flows from Operating Activities		
Net revenues	\$ 19,796	\$ 309,696
Adjustments to reconcile net revenues to net cash provided by operating activities:		
Depreciation and amortization	411,915	473,334
Post-retirement benefits expense	27,900	23,800
Amortization of provision for loss on long-term contracts	(13,281)	(13,281)
Amortization of net bond discount/premium and issuance expenses	1,732	4,951
Amortization of spent nuclear fuel storage	1,446	1,333
Cumulative effect of change in accounting principle	11,834	-
Decrease (increase) in —		
Fuel stocks and materials & supplies	(19,695)	4,299
Receivables, including unbilled revenues, net	207,464	(167,937)
Other assets	(96,188)	(11,620)
Increase (decrease) in —		
Accounts payable	(85,402)	94,702
Accrued taxes and tax equivalents	26,270	(1,221)
Accrued interest	(11,298)	(750)
Other liabilities, net	105,286	70,861
Net cash provided by operating activities	587,779	788,167
Cash Flows from Investing Activities		
Additions to utility plant, net	(643,564)	(372,863)
Decrease in investments	141,568	228,138
Net cash used for investing activities	(501,996)	(144,725)
Cash Flows from Financing Activities		
Proceeds from issuance of long-term debt	1,013,150	-
Repayment of long-term debt, including refundings	(1,097,470)	(73,859)
Payment of capital lease obligation	(15,371)	-
Increase in segregated funds	(28,523)	(21,564)
Net cash used for financing activities	(128,214)	(95,423)
Net Increase (Decrease) in Cash and Cash Equivalents	(42,431)	548,019
Balance at Beginning of Year in Cash and Cash Equivalents	636,954	88,935
Balance at End of Year in Cash and Cash Equivalents	\$ 594,523	\$ 636,954
Supplemental Information		
Cash Paid for Interest (Net of capitalized interest)	\$ 158,165	\$ 166,339
Noncash Financing Activities		
Utility plant acquired under capital lease	\$ 292,068	-
Loss on defeasance	\$ 60,646	-

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

NOTES TO COMBINED FINANCIAL STATEMENTS

April 30, 2002 and 2001

1. Basis of Presentation:

The Company – The Salt River Project Agricultural Improvement and Power District (the District) is an agricultural improvement district organized in 1937 under the laws of the State of Arizona. It operates the Salt River Project (the Project), a federal reclamation project, under contracts with the Salt River Valley Water Users' Association (the Association) by which it has assumed the obligations of the Association to the United States of America for the care, operation and maintenance of the Project. The District owns and operates an electric system that generates, purchases and distributes electric power and energy, and provides electric service to residential, commercial, industrial and agricultural power users in a 2,900 square mile service territory in parts of Maricopa, Gila and Pinal counties, plus mine loads in an adjacent 2,400 square mile area in Gila and Pinal counties. The Association, incorporated under the laws of the Territory of Arizona in 1903, operates an irrigation system as the District's agent.

In 1997, the District established a wholly-owned, taxable subsidiary, New West Energy Corporation (New West Energy), to market, at retail, energy available to the District that is surplus to the needs of its retail customers, and energy that may be rendered surplus by retail competition in Arizona in the supply of generation. In addition, New West Energy provides other retail energy-related services to current and prospective energy customers as part of its program to market surplus energy. However, as a result of the turmoil in the California energy market, the District has reassessed the business plan of New West Energy. At the current time, New West Energy does not market excess energy. It continues to provide energy-related services to various customers, and monitor the market situation in the Southwest in contemplation of future activity.

Possession and Use of Utility Plant – The United States of America retains a paramount right or claim in the Project that arises from the original construction and operation of certain of the Project's electric and water facilities as a federal reclamation project. Rights to the possession and use of, and to all revenues produced by, these facilities are evidenced by contractual arrangements with the United States of America.

Principles of Combination – The accompanying combined financial statements reflect the combined accounts of the Association and the District (together referred to as SRP). The District's financial statements are consolidated with its two wholly-owned taxable subsidiaries, New West Energy and Papago Park Center, Inc. (PPC). PPC is a real estate management company. All material intercompany transactions and balances have been eliminated.

Regulation and Pricing Policies – Under Arizona law, the District's publicly elected Board of Directors (the Board) serves as its regulatory body and has the exclusive authority to establish electric prices. The District is required to follow certain procedures, including public notice requirements and special Board meetings, before implementing changes in standard electric price schedules.

2. Significant Accounting Policies:

Basis of Accounting – The accompanying combined financial statements are presented in conformity with accounting principles generally accepted in the United States of America (GAAP) and reflect the pricing policies of the Board. The District's "regulated" operations apply Statement of Financial Accounting Standards No. 71, "Accounting for the Effects of Certain Types of Regulation" (SFAS No. 71), while "non-regulated" operations follow GAAP for enterprises in general. Classification of regulated and non-regulated operations is determined in accordance with applicable GAAP accounting guidelines.

NOTES TO COMBINED FINANCIAL STATEMENTS

April 30, 2002 and 2001

The preparation of financial statements in compliance with GAAP requires management to make estimates and assumptions that affect the reported amounts in the financial statements and disclosures of contingencies. Actual results could differ from the estimates.

Utility Plant – Utility plant is stated at the historical cost of construction, less any impairment losses. Capitalized construction costs include labor, materials, services purchased under contract, and allocations of indirect charges for engineering, supervision, transportation and administrative expenses and capitalized interest or an allowance for funds used during construction (AFUDC). AFUDC is the estimated cost of funds used to finance regulated plant additions and is recovered in prices through depreciation expense over the useful life of the related asset. The cost of property that is replaced, removed or abandoned, together with removal costs, less salvage, is charged to accumulated depreciation.

A composite rate of 5.45% and 5.54% was used in fiscal years 2002 and 2001 to calculate interest on funds used to finance construction work in progress for non-regulated projects, resulting in \$14.4 million and \$6.5 million of interest capitalized, respectively.

Depreciation expense is computed on the straight-line basis over the estimated useful lives of the various classes of plant assets. The following table reflects the District's average depreciation rates on the average cost of depreciable assets, for the fiscal years ended April 30:

	2002	2001
Average electric depreciation rate	3.92%	3.58%
Average irrigation depreciation rate	2.88%	2.20%
Average common depreciation rate	6.41%	5.84%

Bond Expense – Bond discount/premium and issuance expenses are being amortized using the effective interest method over the terms of the related bond issues.

Allowance for Doubtful Accounts – The District has provided for an allowance for doubtful accounts of \$67.5 million and \$76.4 million as of April 30, 2002 and 2001, respectively.

Nuclear Fuel – The District amortizes the cost of nuclear fuel using the units of production method. The nuclear fuel amortization and the disposal expense are components of fuel expense. Accumulated amortization of nuclear fuel at April 30, 2002 and 2001, was \$318.4 million and \$301.0 million, respectively.

Nuclear Decommissioning – The total cost to decommission the District's 17.49% share of Palo Verde Nuclear Generating Station (PVNGS) is estimated to be \$344.9 million, in 2001 dollars. This estimate is based on a site-specific study prepared by an independent consultant, assuming the prompt removal/dismantlement method of decommissioning authorized by the Nuclear Regulatory Commission (NRC). This study is updated as required, every three years, and was last updated in the fall of 2001. Based on the 2001 site study, the District estimates its share of ultimate decommissioning expenditures will be \$1.8 billion. Current decommissioning funding levels assume earnings on the decommissioning funds of 7.65%, as well as a future annual escalation rate of 5.92% in decommissioning costs. The actual decommissioning costs may vary from the estimate. Expenditures for decommissioning activities are anticipated over a fourteen-year period beginning in 2024. Estimated decommissioning costs are accrued over the estimated useful life of PVNGS. The liability associated with

NOTES TO COMBINED FINANCIAL STATEMENTS

April 30, 2002 and 2001

decommissioning is included in deferred credits and other non-current liabilities in the accompanying Combined Balance Sheets and amounted to \$93.5 million and \$84.9 million as of April 30, 2002 and 2001, respectively. Decommissioning expense, net of earnings on trust fund assets, of \$3.6 million and \$4.3 million was recorded in fiscal years 2002 and 2001, respectively. The District contributes to a trust set up in accordance with the NRC requirements. Decommissioning funds of \$121.4 million and \$113.5 million, stated at market value, as of April 30, 2002 and 2001, respectively, are held in the trust and are classified as segregated funds in the accompanying Combined Balance Sheets. Unrealized gains on decommissioning fund assets of \$28.2 million and \$30.2 million at April 30, 2002 and 2001, respectively, are included in accumulated comprehensive income as a component of accumulated net revenues.

Accounting for Energy Risk Management Activities – The District has an energy risk management program to limit exposure to risks inherent in normal energy business operations. The goal of the energy risk management program is to measure and minimize exposure to price risks, credit risks and control risks. Specific goals of the energy risk management program include reducing the impact of market fluctuations on energy commodity prices associated with customer energy requirements, excess generation and fuel expenses, in addition to meeting customer pricing needs, and maximizing the value of physical generating assets. The District employs established policies and procedures to meet the goals of the energy risk management program using various physical and financial instruments, including forward contracts, futures, swaps and options. Certain of these transactions are accounted for under Statement of Financial Accounting Standards No. 133, *“Accounting for Derivative Instruments and Hedging Activities,”* as amended (SFAS No. 133). Under SFAS No. 133, derivative instruments are recorded in the balance sheet as either an asset or liability measured at their fair value. The standard also requires changes in the fair value of the derivative be recognized each period in current earnings or other comprehensive income depending on the purpose for using the derivative and/or its qualification, designation and effectiveness as a hedging transaction. Most of the District’s contractual agreements qualify for the normal purchases and sales exception allowed under SFAS No. 133 and are not recorded at market value. For a detailed explanation of the effects of SFAS No. 133 on the District’s financial results, see Note 3, Accounting for Derivative Instruments and Hedging Activities.

Concentrations of Market and Credit Risk – Market risk is the risk that changes in market prices or customer demand will adversely affect earnings and cash flows. Industry movements towards competition in electric generation subject the District to market risk associated with energy commodities such as electric power and natural gas. Recovery of costs to produce electricity in a non-regulated environment will be affected by changes in competitive market prices for both production resources and the market price of energy sales to ultimate customers.

The use of contractual arrangements to manage the risks associated with changes in energy commodity prices creates credit risk exposure resulting from the possibility of nonperformance by counterparties pursuant to the terms of their contractual obligations. In addition, volatile energy prices can create significant credit exposure from energy market receivables. The District has a credit policy for wholesale counterparties, and continuously monitors credit exposures, routinely assesses the financial strength of its counterparties, minimizes credit risk by dealing primarily with creditworthy counterparties, entering into standardized agreements which allow netting of exposures to and from a single counterparty and by requiring letters of credit, parent guarantees or other collateral when it does not consider the financial strength of a counterparty sufficient.

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

NOTES TO COMBINED FINANCIAL STATEMENTS

April 30, 2002 and 2001

New West Energy recognizes deferred tax liabilities and assets for the expected future tax consequences of events that have been recognized in its financial statements or tax returns. Deferred tax liabilities and assets are determined based on differences between the financial statement carrying amounts and tax bases of assets and liabilities using enacted tax rates in effect in the years in which the differences are expected to reverse. Since its inception in May 1997, the tax effect of New West Energy's results of operations has been immaterial.

Cash Equivalents – The District treats short-term temporary cash investments with original maturities of three months or less as cash equivalents.

Revenue Recognition – The District recognizes revenue when billed and accrues estimated revenue for electricity delivered to customers that has not yet been billed.

Materials and Supplies, and Fuel Stocks – Materials and supplies are stated at lower of market or average cost. Fuel stocks are stated at lower of market or cost using the last-in, first-out method.

Reclassifications – For comparative purposes, certain prior year amounts have been reclassified to conform with the current year presentation.

Recently Issued Accounting Standards – During fiscal year 2002, the Financial Accounting Standards Board (FASB) issued SFAS Nos. 141-145:

SFAS No. 141, *"Business Combinations,"* requires all business combinations initiated after June 30, 2001 be accounted for using the purchase method. The District evaluated the effect of SFAS No. 141 and determined there were no financial impacts related to its adoption by the District.

SFAS No. 142, *"Goodwill and Other Intangible Assets,"* modifies the accounting and reporting of goodwill and other intangible assets. Under SFAS No. 142, entities are required to determine the useful life of intangible assets and amortize them over that period; if the useful life is determined to be indefinite, no amortization is to be recorded. For intangible assets recognized prior to the adoption of SFAS No. 142, the useful life is to be reassessed. The District evaluated the impact of SFAS No. 142 and determined there were no financial impacts related to its adoption by the District.

SFAS No. 143, *"Accounting for Asset Retirement Obligations,"* requires the recognition, as an Asset Retirement Obligation (ARO), of a liability for dismantlement and restoration costs associated with the retirement of tangible long-lived assets in the period the liability is incurred. Upon initial recognition, the probability-weighted future cash flows for the associated retirement costs, discounted using a credit-adjusted risk-free rate, are recognized as both a liability and as an increase in the capitalized carrying amount of the related long-lived assets. Capitalized asset retirement costs are depreciated over the life of the related asset, with accretion of the ARO liability classified as an operating expense on the income statement. SFAS No. 143 must be applied by the District at the beginning of fiscal year 2004. The District is evaluating the impact of SFAS No. 143 on the combined financial statements.

SFAS No. 144, *"Accounting for the Impairment or Disposal of Long-Lived Assets,"* supercedes SFAS No. 121, *"Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of."* SFAS No. 144 retains the fundamental provisions of SFAS No. 121 for the measurement and recognition of the impairment of

NOTES TO COMBINED FINANCIAL STATEMENTS

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long-lived assets to be held and used, as well as the measurement of long-lived assets to be disposed of by sale. SFAS No. 144 resolves significant implementation issues related to SFAS No. 121, broadens the component of an entity to be included in the presentation for discontinued operations, and measures long-lived assets held for sale at the lower of their carrying amount or fair value (less cost to sell), while ceasing depreciation. SFAS No. 144 also retains the amendments in SFAS No. 121 pertaining to regulatory assets under SFAS No. 71 and SFAS No. 90, *"Regulated Enterprises – Accounting for Abandonments and Disallowances of Plant Costs."* The adoption of SFAS No. 144 did not have a significant impact on the combined financial statements.

SFAS No. 145, *"Rescission of FAS Nos. 4, 44, and 64, Amendment of FAS 13, and Technical Corrections,"* rescinds various pronouncements regarding early extinguishment of debt and allows extraordinary accounting treatment for early extinguishment only when the provisions of Accounting Principles Board Opinion No. 30, *"Reporting the Results of Operations, Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions,"* have been met. SFAS No. 145 provisions regarding early extinguishment of debt are generally effective for fiscal years beginning after May 15, 2002. Management does not believe that the adoption of this statement will have a material impact on SRP's combined financial statements.

3. Accounting for Derivative Instruments and Hedging Activities:

Effective May 1, 2001, the District adopted SFAS No. 133 as amended. SFAS No. 133 requires that entities recognize all derivatives as either assets or liabilities in the balance sheet and measure those instruments at fair value. Changes in the fair value of derivative financial instruments are either recognized periodically in net revenues or accumulated net revenues (as a component of other comprehensive income), depending on whether or not the derivative meets specific hedge accounting criteria. These criteria include a requirement for hedge effectiveness, which is measured based on the relative changes in fair value between the derivative contract and the hedged item over time. Any change in the fair value resulting from ineffectiveness is recognized immediately in net revenues. This new standard may result in additional volatility in the District's net revenues and comprehensive income.

The District enters into contracts for electricity, natural gas and other energy commodities to meet the expected needs of its retail customers. During periods when it is not needed to meet retail requirements, the District sells any excess capacity. The District's energy risk management program uses various physical and financial contracts to hedge exposures to fluctuating commodity prices. The District examines contracts at inception to determine the appropriate accounting treatment. If a contract does not meet the derivative criteria or if it qualifies for the SFAS No. 133 normal purchases and sales scope exception, the District accounts for the contract using settlement accounting (this means that costs and revenues are recorded when physical delivery occurs). For contracts that qualify as a derivative and do not meet the SFAS No. 133 normal purchases and sales scope exception, the District further examines the contract to determine if it will qualify for hedge accounting. If a contract does not meet the hedging criteria in SFAS No. 133, the District recognizes the changes in the fair value of the derivative instrument in net revenues each period (mark-to-market). If the contract does qualify for hedge accounting, changes in the fair value are recorded in accumulated net revenues and other comprehensive income (as a component of other comprehensive income).

The District formally documents all relationships between hedging instruments and hedged items, as well as its risk-management objective and strategy for undertaking various hedge transactions. This process includes linking all derivatives to the forecasted transactions. The District also formally assesses (both at the hedge's inception

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and on an ongoing basis) whether the derivatives that are used in hedging transactions have been highly effective in offsetting changes in cash flows of hedged items and whether those derivatives may be expected to remain highly effective in future periods. When it is determined that a derivative is not (or has ceased to be) highly effective as a hedge, the District discontinues hedge accounting prospectively, as discussed below.

The District discontinues hedge accounting prospectively when: (1) it determines that the derivative is no longer effective in offsetting changes in cash flows of a hedged item; (2) the derivative expires or is sold, terminated, or exercised; (3) it is no longer probable that the forecasted transaction will occur; or (4) management determines that designating the derivative as a hedging instrument is no longer appropriate.

When the District discontinues hedge accounting because it is no longer probable that the forecasted transaction will occur in the originally expected period, the gain or loss on the derivative is reclassified into earnings. If the derivative remains outstanding, the District will carry the derivative at its fair value on the balance sheet, recognizing changes in the fair value in current-period earnings.

Initial Adoption – Upon adoption of SFAS No. 133, the District examined all contracts to determine the appropriate accounting treatment and concluded that some of the contracts entered into for supply and energy risk management activities were considered to be derivatives based on the accounting guidance at that time. The District's supply and energy risk management activities include the following types of contracts:

- Long-term contracts – purchases and sales of firm capacity and energy for periods of more than one year under unique contracts.
- Forward contracts – purchases and sales of a specified amount of capacity, energy or fuel at a specified price over a given period of time, typically for one month, three months or one year, under standard industry contracts.
- Futures contracts – similar to forward contracts with standardized terms and typically traded on an exchange. The District has a passively managed futures contract portfolio in which contracts are entered into and held to delivery, and an actively managed futures contracts portfolio in which contracts are purchased and sold to take advantage of positive market changes.
- Option contracts – purchases and sales of financial instruments that provide the right to buy or sell energy commodities.
- Swap contracts – financial contracts to exchange cash flows based on agreed-upon parameters and price fluctuations in an energy-related commodity.
- Short-term contracts – economy energy purchases and sales in the daily or hourly markets at fluctuating spot market prices and other non-firm energy sales.

NOTES TO COMBINED FINANCIAL STATEMENTS

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Based on the District's interpretation of SFAS No. 133 and other guidance, the District classified its energy risk management contracts as follows:

<i>Contract Type</i>	<i>Normal Purchases and Sales</i>	<i>Cash Flow Hedge</i>	<i>Non-Qualifying Hedging Contracts</i>
Energy Risk Management Contracts:			
Long-term supply contracts	X		
Forward contracts	X		X
Futures contracts – passively managed		X	
Futures contracts – actively managed			X
Option contracts			X
Swap contracts			X
Short-term contracts			X

The accounting treatments for the various classifications are as follows:

- **Normal Purchases and Sales:** The contracts that qualify for the normal purchases and sales scope exception under SFAS No. 133 are accounted for using settlement accounting. The realized gains and losses on these contracts are reflected in net revenues as a component of net operating revenues at the contract settlement date.
- **Cash Flow Hedge:** The unrealized gains and losses related to these contracts are included in accumulated net revenues and other comprehensive income (as a component of other comprehensive income). As the contracts are settled, the realized gains and losses are recorded in net revenues as a component of net operating revenues and the unrealized gains and losses are reversed from other comprehensive income.
- **Non-qualifying Hedging Contracts:** These contracts hedge the risk of future commodity price fluctuations the District faces. However, they do not meet the requirements of SFAS No. 133 for hedge accounting. The unrealized gains and losses related to the contracts are reflected in net revenues as a component of net operating revenues.

As a result of adopting SFAS No. 133 and guidance issued by the FASB's Derivative Implementation Group (DIG) effective during fiscal year 2002, the District recognized \$98.1 million of derivative assets and \$80.5 million of derivative liabilities in the Combined Balance Sheets as of May 1, 2001. Also as of May 1, 2001, the District recorded an \$11.8 million gain in net revenues and a \$5.8 million gain in accumulated net revenues and other comprehensive income (as a component of other comprehensive income), both as a cumulative effect of a change in accounting principle.

As of April 30, 2002, the valuation of market changes for the District's energy risk management contracts resulted in a decrease in electric revenues of \$11.6 million and an increase in fuel expenses of \$44.4 million. The impact to net revenues for fiscal year 2002 was an unrealized loss of \$44.2 million. Without the effect of market changes, the net revenues for the period would have been \$64.0 million. Accumulated net revenues and other comprehensive income (as a component of other comprehensive income), was increased by \$2.3 million due to unrealized cash flow hedge gains as of April 30, 2002. Most of this impact relates to a multi-year hedge on transportation costs from two major gas basins in the Southwest for natural gas used for retail generation.

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The following table summarizes the District's net revenues and balance sheet impact from market valuation of contracts as of April 30, 2002 (in thousands):

Net Revenues	
Operating Revenues before effects of SFAS No. 133	\$ 2,225,985
Operating Expenses, Other Income and Net Financing Costs before effects of SFAS No. 133	2,161,990
<hr/>	
Net Revenues before effects of SFAS No. 133	63,995
Cumulative Effect of Change in Accounting Principle at May 1, 2001 on:	
Revenues – gain	10,502
Expenses – gain	(1,332)
Effects of SFAS No. 133 at April 30, 2002, on:	
Revenues – loss	(11,606)
Expenses – loss	44,427
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Net Revenues	\$ 19,796
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Balance Sheet	
Other Current Assets	\$ 3,383
Deferred Charges and Other Assets	12,514
Other Current Liabilities	(18,552)
Deferred Credits and Other Non-Current Liabilities	(39,289)
<hr/>	
Net Asset (Liability)	\$ (41,944)
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As of April 30, 2002, the maximum length of time over which the District hedged its exposure to the variability in future cash flows for forecasted transactions was eighteen months. During the twelve months ending April 30, 2003, the District estimates that a net gain of \$0.3 million will be reclassified from accumulated other comprehensive income as an offset to the effect on earnings of market price changes for the related hedged transactions.

In December 2001, the DIG issued revised guidance on the accounting for electricity contracts with option characteristics and the accounting for contracts that combine a forward contract and a purchased option contract. The effective date for the revised guidance for the District is May 1, 2002. The District is currently evaluating the new guidance to determine what impact, if any, it will have on the District's financial statements.

To date, the DIG has issued more than 100 interpretations to provide guidance in applying SFAS No. 133. As the DIG or the FASB continues to issue interpretations, the District may change the conclusions reached and, as a result, the accounting treatment and the impact on the combined financial statements could change in the future.

NOTES TO COMBINED FINANCIAL STATEMENTS

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4. Accumulated Net Revenues and Other Comprehensive Income:

The following table summarizes accumulated net revenues and other comprehensive income (in thousands):

	<i>Accumulated Net Revenues</i>	<i>Accumulated Other Comprehensive Income</i>	<i>Accumulated Net Revenues and Other Comprehensive Income</i>
Balance , April 30, 2000	\$ 1,936,095	\$ 102,798	\$ 2,038,893
Net revenues	309,696	-	309,696
Net unrealized loss on available-for-sale securities	-	(36,575)	(36,575)
Balance , April 30, 2001	2,245,791	66,223	2,312,014
Net revenues	19,796	-	19,796
Cumulative effect of change in accounting principle	-	5,765	5,765
Unrealized gain on derivative instruments	-	2,255	2,255
Reclassification of realized loss to income	-	(5,765)	(5,765)
Net unrealized loss on available-for-sale securities	-	(3,797)	(3,797)
Balance , April 30, 2002	\$ 2,265,587	\$ 64,681	\$ 2,330,268

The majority of net unrealized loss on available-for-sale securities originates from decommissioning trust and segregated fund investments. Net unrealized gain (loss) on available-for-sale securities consists of gross unrealized (loss) on equity funds of \$(2.0) million and \$(41.1) million and gross unrealized gain (loss) on debt funds of \$(1.8) million and \$4.5 million at April 30, 2002 and 2001, respectively.

NOTES TO COMBINED FINANCIAL STATEMENTS

April 30, 2002 and 2001

5. Long-Term Debt:

Long-term debt consists of the following at April 30 (in thousands):

	<i>Interest Rate</i>	<i>2002</i>	<i>2001</i>
Revenue bonds (mature through 2031)	3.0% – 7.0%	\$ 2,613,259	\$ 2,713,999
Unamortized bond discount/premium		10,012	(68,786)
Total revenue bonds outstanding		2,623,271	2,645,213
Commercial paper	1.2% – 1.7%	525,000	525,000
Total long-term debt		3,148,271	3,170,213
Less — current portion		(114,340)	(71,940)
Total long-term debt, net of current portion		\$ 3,033,931	\$ 3,098,273

The annual maturities of long-term debt (excluding commercial paper and unamortized bond discount/premium) as of April 30, 2002, due in the fiscal years ending April 30, are as follows (in thousands):

2003	\$ 114,340
2004	264,291
2005	215,616
2006	323,727
2007	79,995
Thereafter	1,615,290
	\$ 2,613,259

Revenue Bonds – Revenue bonds are secured by a pledge of, and a lien on, the revenues of the electric system, after deducting operating expenses, as defined in the bond resolution. Under the terms of the bond resolution, the District is required to maintain a debt service fund for the payment of future principal and interest. Included in segregated funds in the accompanying Combined Balance Sheets is \$149.1 million and \$283.7 million of debt service related funds as of April 30, 2002 and 2001, respectively.

The District has \$80.2 million of mini-revenue bonds outstanding and redeemable at the option of the bondholder under certain circumstances. Based on historical redemptions made on these bonds, management believes there are sufficient funds available to cover potential redemptions in any year.

The debt service coverage ratio, as defined in the bond resolution, is used by bond rating agencies to help evaluate the financial viability of the District. For the years ended April 30, 2002 and 2001, the debt service coverage ratio was 3.09 and 4.72, respectively.

Interest and the amortization of the bond discount and issue expense on the various issues results in an effective rate of 5.38% over the remaining term of the bonds.

The District has authorization to issue additional Electric System Revenue Bonds totaling \$1.2 billion principal amount and Electric System Refunding Revenue Bonds totaling \$2.7 billion principal amount, net of amounts issued in current year. These amounts include \$675.0 million in Electric System Revenue Bonds and \$750.0 million in Electric System Refunding Revenue Bonds authorized by the Arizona Corporation Commission on December 4, 2001, pursuant to applications filed earlier that year.

NOTES TO COMBINED FINANCIAL STATEMENTS

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In December 2001, the District issued \$580.6 million of Electric System Refunding Revenue Bonds. The net proceeds from these bonds were used to defease outstanding bonds with par amounts of \$605.1 million. The defeasance is expected to reduce total debt payments over the life of the bonds by \$426.2 million and is expected to result in present value savings of approximately \$30.2 million. This transaction resulted in a net loss for accounting purposes of \$34.6 million, which was deferred and will be amortized over the life of the bonds to be refunded, as authorized by the Board.

In February 2002, the District issued \$432.6 million of Electric System Refunding Revenue Bonds. The net proceeds from these bonds were used to defease outstanding bonds with par amounts of \$437.4 million. The defeasance is expected to reduce total debt payments over the life of the bonds by \$21.4 million and is expected to result in present value savings of approximately \$29.6 million. This transaction resulted in a net loss for accounting purposes of \$26.1 million, which was deferred and will be amortized over the life of the bonds to be refunded, as authorized by the Board.

Commercial Paper – The District has issued \$525.0 million of tax-exempt commercial paper consisting of \$375.0 million Series B Issue and \$150.0 million Series A Issue, initiated in fiscal year 1998. The issues have an average weighted interest rate to the District of 1.47%. The commercial paper matures not more than 270 days from the date of issuance and is an unsecured obligation of the District. The District has the ability to refinance the outstanding commercial paper on a long-term basis in connection with its revolving lines of credit that support the commercial paper and are available through May 6, 2003. As such, the District has classified the commercial paper as long-term debt in the Combined Balance Sheets as of April 30, 2002.

While the revolving credit agreements contain covenants that could prohibit borrowing under certain conditions, management believes financing would be available. The District has never borrowed under the two agreements and management does not expect to do so in the future. Alternative sources of funds to support the commercial paper program include existing funds on hand or the issuance of alternative debt, such as revenue bonds.

General Obligation Bonds – In 1984, the District refunded its then-outstanding general obligation bonds. Although the refunding constituted an in-substance defeasance of the prior lien on revenues securing the bonds, the general obligation bonds continue to be general obligations of the District, secured by a lien upon the real property of the District and a guarantee by the Association. As of April 30, 2002, the amount of defeased general obligation bonds outstanding was \$2.5 million.

Line-of-Credit Arrangements – The District has \$525.0 million in revolving line-of-credit agreements supporting the commercial paper program. These agreements have various covenants, with which the District is in compliance at April 30, 2002.

6. Fair Value of Financial Instruments:

The following methods and assumptions were used to estimate the fair value of each class of financial instruments identified in the following items in the accompanying Combined Balance Sheets.

Investments in Marketable Securities – The District invests in U.S. government obligations, certificates of deposit and other marketable investments. Such investments are classified as other investments, segregated funds, cash and cash equivalents, or temporary investments in the accompanying Combined Balance Sheets, depending on the purpose and duration of the investment. The fair value of marketable securities with original maturities greater

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than one year is based on published market data. The carrying amount of marketable securities with original maturities of one year or less approximates their fair value because of their short-term maturities.

Long-Term Debt – The fair value of the District’s revenue bonds, including the current portion, was estimated by using pricing scales from independent sources. The carrying amount of commercial paper approximates the fair value because of its short-term maturity.

Other Current Assets and Liabilities – The carrying amounts of receivables, accounts payable, customers’ deposits and other current liabilities in the accompanying Combined Balance Sheets approximate fair value because of their short-term maturities.

The estimated carrying amounts and fair values of the District’s financial instruments, at April 30, are as follows (in thousands):

	2002		2001	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Investments in marketable securities:				
Other investments	\$ 34,000	\$ 34,579	\$ 13,000	\$ 13,117
Segregated funds	449,340	451,144	424,614	422,788
Temporary investments	185,463	186,294	348,031	348,060
Long-term debt	3,148,271	3,245,100	3,170,213	3,294,173

Accounting for Debt and Equity Securities – The District’s investments in debt securities are reported at amortized cost if the intent is to hold the security to maturity. At April 30, 2002, the District’s investments in debt securities have maturity dates ranging from May 3, 2002, to February 28, 2012. Other debt and equity securities are reported at market, with unrealized gains or losses included as a separate component of Accumulated Net Revenues and Other Comprehensive Income. The District’s investments in debt and equity securities are included in temporary investments, segregated funds and non-utility property and other investments in the accompanying Combined Balance Sheets.

7. Employee Benefit Plans and Incentive Programs:

Defined Benefit Pension Plan and Other Post-Retirement Benefits – SRP’s Employees’ Retirement Plan (the Plan) covers substantially all employees. The Plan is funded entirely from SRP contributions and the income earned on invested Plan assets. No contributions were required in fiscal years 2002 or 2001.

The Plan assets consist primarily of stocks, U.S. government obligations, corporate bonds and real estate funds. The unrecognized net transition asset is being amortized over 15 years, beginning in 1988.

SRP provides a non-contributory defined benefit medical plan for retired employees and their eligible dependents and a non-contributory defined benefit life insurance plan for retired employees. Employees are eligible for coverage if they retire at age 65 or older with at least five years of vested service under the Plan (ten years for those hired January 1, 2000, or later), or anytime after attainment of age 55 with a minimum of ten years of vested service under the Plan (20 years for those hired January 1, 2000, or later). The funding policy is discretionary

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and is based on actuarial determinations. The unrecognized transition obligation is being amortized over 20 years, beginning in 1994.

The following tables outline changes in benefit obligations, plan assets, the funded status of the plans and amounts included in the combined financial statements as of April 30, based on January 31 valuation dates (in thousands):

	<i>Pension Benefits</i>		<i>Other Benefits</i>	
	<i>2002</i>	<i>2001</i>	<i>2002</i>	<i>2001</i>
Change in benefits obligation:				
Benefit obligation at beginning of year	\$ 567,300	\$ 510,800	\$ 215,400	\$ 170,400
Service cost	17,000	14,300	5,600	4,400
Interest cost	41,600	40,100	15,800	13,400
Amendments	-	8,400	-	-
Actuarial loss	48,600	17,700	52,100	34,200
Benefits paid	(29,800)	(24,000)	(9,000)	(7,000)
Benefit obligations at end of year	\$ 644,700	\$ 567,300	\$ 279,900	\$ 215,400
Change in plan assets:				
Fair value of plan assets				
at beginning of year	\$ 705,100	\$ 699,100	\$ -	\$ -
Actual return on plan assets	(35,700)	30,000	-	-
Employer contributions	-	-	9,000	7,000
Benefits paid	(29,800)	(24,000)	(9,000)	(7,000)
Fair value of plan assets at end of year	\$ 639,600	\$ 705,100	\$ -	\$ -
Funded status	\$ (5,000)	\$ 137,800	\$ (279,900)	\$ (215,400)
Unrecognized transition obligation (asset)	-	(4,000)	62,300	67,900
Unrecognized net actuarial (gain) loss	37,000	(111,000)	83,500	32,500
Unrecognized prior service cost	8,700	9,900	-	-
Post January 31 contributions	-	-	3,000	1,800
Net asset (liability) recognized	\$ 40,700	\$ 32,700	\$ (131,100)	\$ (113,200)
Prepaid benefit cost	\$ 40,700	\$ 32,700	\$ -	\$ -
Accrued benefit liability	-	-	(131,100)	(113,200)
Net amount recognized	\$ 40,700	\$ 32,700	\$ (131,100)	\$ (113,200)

The Plan was amended to provide a retiree pension enhancement, effective January 1, 2001, and to provide enhanced benefits for selected employees effective September 19, 2000.

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The District internally funds its other post-retirement benefit obligations. At April 30, 2002 and 2001, \$163.9 million and \$148.0 million of segregated funds, respectively, were designated for this purpose.

Weighted average assumptions used to calculate actuarial present values of benefit obligations were as follows:

	<i>Pension Benefits</i>		<i>Other Benefits</i>	
	<i>2002</i>	<i>2001</i>	<i>2002</i>	<i>2001</i>
Discount rate	7.25%	7.5%	7.25%	7.5%
Expected return on plan assets	8.75%	9.0%	N/A	N/A
Rate of compensation increase	4.0%	4.0%	4.0%	4.0%

For employees who retire at age 65 or younger, for measurement purposes, a 9.0% annual increase before attainment of age 65 and an 11.0% annual increase on and after attainment of age 65 in per capita costs of health care benefits were assumed during 2002; these rates were assumed to decrease uniformly until equaling 5.25% in all future years.

Components of net periodic benefit (gain) costs for the years ended April 30, are as follows (in thousands):

	<i>Pension Benefits</i>		<i>Other Benefits</i>	
	<i>2002</i>	<i>2001</i>	<i>2002</i>	<i>2001</i>
Service cost	\$ 17,000	\$ 14,300	\$ 5,600	\$ 4,400
Interest cost	41,600	40,100	15,800	13,400
Expected return on plan assets	(61,300)	(59,100)	-	-
Amortization of transition obligation (asset)	(4,000)	(4,000)	5,700	5,700
Recognized net actuarial loss (gain)	(2,400)	(2,400)	800	300
Amortization of prior service cost	1,100	400	-	-
Net periodic benefit (gain) cost	\$ (8,000)	\$ (10,700)	\$ 27,900	\$ 23,800

Assumed health care cost trend rates have a significant effect on the amounts reported for health care plans. A one-percentage-point change in the assumed health care cost trend rates would have the following effect (in thousands):

	<i>One-Percentage-Point Increase</i>	<i>One-Percentage-Point Decrease</i>
Effect on total service cost and interest cost components	\$ 2,600	\$ (2,400)
Effect on post-retirement benefit obligations	\$ 38,100	\$ (33,700)

Defined Contribution Plan – SRP's Employees' 401(k) Plan (the 401(k) Plan) covers substantially all employees. The 401(k) Plan receives employee contributions and partial employer matching contributions. Employer matching contributions to the 401(k) Plan were \$7.1 million and \$5.9 million during fiscal years 2002 and 2001, respectively.

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Employee Incentive Compensation Program – SRP has an incentive compensation program covering substantially all regular employees. The incentive compensation amount is based on achievement of pre-established targets. These targets were not met in fiscal year 2002. An accrual of \$28.2 million for fiscal year ended April 30, 2001, is included in other current liabilities in the accompanying Combined Balance Sheets. This liability is stated net of a receivable from participants in jointly-owned electric utility plants of \$3.3 million at April 30, 2001.

8. Interests in Jointly-Owned Electric Utility Plants:

The District has entered into various agreements with other electric utilities for the joint ownership of electric generating and transmission facilities. Each participating owner in these facilities must provide for the cost of its ownership share. The District's share of expenses of the jointly-owned plants is included in operating expenses in the accompanying Combined Statements of Net Revenues.

The following table reflects the District's ownership interest in jointly-owned electric utility plants as of April 30, 2002 (in thousands):

<i>Generating Station</i>	<i>Ownership Share</i>	<i>Plant in Service</i>	<i>Accumulated Depreciation</i>	<i>Construction Work in Progress</i>
Four Corners (NM) (Units 4 & 5)	10.00%	\$ 102,564	\$ (83,510)	\$ 2,991
Mohave (NV) (Units 1 & 2)	20.00%	198,131	(86,905)	8,703
Navajo (AZ) (Units 1, 2 & 3)	21.70%	345,017	(203,704)	1,075
Hayden (CO) (Unit 2)	50.00%	110,939	(61,050)	1,902
Craig (CO) (Units 1 & 2)	29.00%	242,759	(148,518)	3,119
PVNGS (AZ) (Units 1, 2 & 3)	17.49%	1,103,240	(775,599)	36,107
		\$2,102,650	\$ (1,359,286)	\$ 53,897

The District acts as the operating agent for the participants in the Navajo Generating Station (NGS). On November 30, 2001, the District acquired half (10%) of the shares in the Mohave Generating Station held by the Los Angeles Department of Water and Power, thereby increasing the District's total share to 20%.

9. Capital Lease:

In fiscal year 2001, the District entered into a ten-year contract with Reliant Energy Desert Basin, LLC (Reliant) for the long-term exclusive purchase of power and energy produced at Reliant's facility located in Central Arizona. The amount of capacity available to the District is approximately 598 MW annually. The payments include costs for both capacity and operation and maintenance of the facility. Upon inception of the contract, the present value of the fixed payment attributable to capacity costs meets the requirement for accounting for this contract as a capital lease. Accordingly, in fiscal year 2002, the District recorded the present value of the capacity payments of \$292.1 million as utility plant and the related capital lease obligation in deferred credits and other non-current liabilities (long-term portion) and other current liabilities (short-term portion). At April 30, 2002, the utility plant under the capital lease was \$277.0 million, net of accumulated amortization of \$15.1 million and the capital lease obligation was \$276.7 million. The capacity payments required under the agreement total \$40.9 million annually through fiscal year 2007, and \$149.2 million thereafter. The operation and maintenance payments required under the agreement total \$21.5 million annually through fiscal year 2007, and \$78.5 million thereafter.

10. Regulatory Issues:

Fundamental Changes in the Electric Utility Industry – The District historically operated in a highly-regulated environment in which it had an obligation to deliver electric service to customers within its service area. In May 1998, the Arizona Electric Power Competition Act (the Act) authorized competition in the retail sale of electric generation, recovery of stranded costs and competition in billing, metering and meter reading.

The Act allows a temporary surcharge on electric distribution service prices to pay for all or a portion of unmitigated stranded costs of electric generation service incurred as a direct result of the onset of competition. Such costs must have been incurred to serve customers in Arizona before December 26, 1996. This surcharge may not continue past December 31, 2004, and must not cause prices to exceed the prices in effect on December 30, 1998.

The legislature, in May 2002, established a study committee to examine the status of deregulation and determine whether the Act should be modified. The study committee will be meeting over the summer of 2002. It is unclear at this point if changes to the Act will result.

In 1999, the Arizona Corporation Commission (the Commission), which regulates public service corporations, approved final rules for retail electric competition. The Commission subsequently entered into settlement agreements with each of its regulated utilities, establishing terms and conditions precedent to a framework for stranded cost recovery and unbundled tariffs. Beginning January 1, 2001, all customers were given the right to select an alternative generation provider. In recent months, due to California's unsuccessful experience with competition and other market developments, the Commission began a review of its existing competition rules to determine whether changes or additions were necessary to provide additional safeguards for consumers. The Commission is focusing its attention on such issues as asset transfers, affiliated interest rules and market power. The process is ongoing and the District is uncertain of the impact any changes to retail electric competition may have on its operations or financial condition.

The Federal Energy Regulatory Commission (FERC) regulates the electric utility industry under the authority of various statutes. FERC issued rules in 1996 mandating, among other things, open nondiscriminatory access to transmission lines. The rules require comparable transmission service in order to use the transmission systems of public utilities. The District has filed a comparable open access transmission tariff to ensure reciprocal access, pursuant to rules FERC developed for non-jurisdictional entities like the District. In addition, FERC issued its Order No. 2000 in December 1999, requiring all jurisdictional public utilities that own, operate or control interstate transmission to attempt to develop proposals for regional transmission organizations (RTO). The District is participating in the development of an RTO for the Southwest.

The Changing Regulatory Environment – The service area of the District was opened to competition in generation beginning June 1, 2000, and to competition in billing, metering and meter reading beginning December 31, 2000. The District's electric distribution area remains regulated by its Board and the District will not provide distribution services in the distribution areas of other utilities.

The District's price plans have been unbundled since 1999. The District reviewed its price plans in November 2001 and approved, among other things, a Fuel and Purchase Power Adjustment Mechanism (Adjustment Mechanism) that became effective May 1, 2002. The Adjustment Mechanism provides for a prospective collection of amounts for fuel and purchased power costs above predetermined levels. Other changes to the District's price plans became effective December 31, 2001. The District prices its electric generation based upon market and cost of service factors.

NOTES TO COMBINED FINANCIAL STATEMENTS

April 30, 2002 and 2001

Since December 31, 1998, the District has been recovering stranded costs through a competitive transition charge (CTC) paid by all distribution customers. Effective June 2004, the District will stop collecting the CTC. In fiscal year 2001, management determined, based upon projections using current economic conditions, that the full CTC of \$795.0 million may not be collected. Management, therefore, reduced the amount of the CTC asset and took a charge to depreciation and amortization expense of \$85.0 million as of April 30, 2001. Further, as part of the November 2001 price plans review, the District reviewed the level of its CTC associated with stranded cost recovery and elected to retain the CTC at its current level until June 1, 2004.

Through a surcharge to the District's transmission and distribution customers, the District recovers the costs of programs benefiting the general public, such as discounted rates for the elderly or impoverished, efficiency programs, demand-side management measures, renewable energy programs, economic development, research and development and nuclear decommissioning, including the cost of spent fuel storage. These surcharges have been separately identified and included in the District's price plans for the regulated portion of its operations.

Regulatory Accounting – The District accounts for the financial effects of the regulated portion of its operations in accordance with the provisions of SFAS No. 71, which requires cost-based, rate-regulated utilities to reflect the impacts of regulatory decisions in their financial statements.

As a result of the Board actions in August 1998 to open the District's service area to competition in generation, the District discontinued the application of SFAS No. 71 for its electric generation operations in fiscal year 1999. From that time forward, the provisions of SFAS No. 101, "*Regulated Enterprises: Accounting for the Discontinuation of Application of FASB Statement No. 71,*" have been applied to the portion of its business no longer meeting the provisions of SFAS No. 71.

In fiscal year 1999, the District evaluated the carrying amounts of its generation operations in relation to future cash flows expected to be generated from their use in a competitive environment and determined that \$850.2 million of these assets were impaired. Impairment of \$631.8 million was attributable to generation operations, and \$163.7 million was attributable to long-term energy contracts. Of the total impairment, a maximum of \$795.0 million may be recovered through the CTC, and such amount was recorded as a regulatory asset (CTC regulatory asset). The CTC regulatory asset will be recovered through the competitive transition charge over the period beginning December 31, 1998, and continuing through May 31, 2004. Since December 31, 1998, the District has amortized or charged \$530.5 million of CTC asset to depreciation and amortization expense and recovered \$460.1 million through CTC revenue.

Regulatory assets for spent nuclear fuel storage are being amortized over the life of the nuclear plant. Bond defeasance regulatory assets are being amortized over different periods, beginning in fiscal year 1997 and ending in fiscal year 2031. Regulatory assets are included in deferred charges and other assets on the accompanying Combined Balance Sheets.

NOTES TO COMBINED FINANCIAL STATEMENTS

April 30, 2002 and 2001

Deferred charges and other assets consist primarily of the following at April 30 (in thousands):

	<i>2002</i>	<i>2001</i>
CTC regulatory asset	\$ 264,931	\$ 392,097
Bond defeasance regulatory asset	84,475	36,600
Spent nuclear fuel storage regulatory asset	22,209	21,974
Prepaid pension benefits	40,700	32,700
Other	45,976	33,039
	\$ 458,291	\$ 516,410

If events were to occur making full recovery of these regulatory assets no longer probable, the District would be required to write-off the remaining balance of such assets as a one-time charge to net revenues.

Deferred credits and other non-current liabilities consist primarily of the following at April 30 (in thousands):

	<i>2002</i>	<i>2001</i>
Capital lease obligation	\$ 251,364	\$ -
Provision for contract losses	119,460	132,741
Accrued post-retirement benefit liability	131,100	113,200
Accrued decommissioning costs	93,532	84,946
Derivatives market valuation	39,289	-
Accrued spent nuclear fuel storage	25,657	24,915
Other	84,106	90,269
	\$ 744,508	\$ 446,071

Operating results from the separable portion of the District's operations not meeting the provisions of SFAS No. 71 are as follows (in thousands):

	<i>Fiscal Year Ended April 30, 2002</i>	<i>Fiscal Year Ended April 30, 2001</i>
Operating revenues	\$ 1,459,451	\$ 2,277,240
Operating expenses	1,387,367	1,770,065
Net operating revenues from non-regulated operations	\$ 72,084	\$ 507,175

NOTES TO COMBINED FINANCIAL STATEMENTS

April 30, 2002 and 2001

Utility plant assets used in the separable portion of the District's operations no longer meeting the provisions of SFAS No. 71 are as follows at April 30 (in thousands):

	2002	2001
Electric plant in service	\$ 3,887,948	\$ 3,460,089
Less accumulated depreciation	(2,119,902)	(1,985,330)
Net utility plant assets used in non-regulated operations	\$ 1,768,046	\$ 1,474,759

11. Commitments:

Subsidiary Guarantees – The District acts as guarantor for New West Energy's contractual obligations as necessary to satisfy performance security requirements under agreements with utility distribution companies, brokers and counterparties for financial hedge transactions and power purchasers and sellers. No payments were made under these guarantees during fiscal years 2002 and 2001.

Improvement Program – The Improvement Program represents SRP's six-year plan for major construction projects and capital expenditures for existing generation, transmission, distribution and irrigation assets. For the 2003-2008 period, SRP estimates capital expenditures of approximately \$2.9 billion. Major construction projects include expansion of generation at the Santan Generating Station, as well as other key strategic distribution and transmission projects.

Long-Term Power Contracts – The District entered into three contracts, collectively, with the United States Bureau of Reclamation (United States), the Western Area Power Administration and the Central Arizona Water Conservation District (CAWCD) for the long-term sale, through September 2011 to the District, of power and energy associated with the United States' entitlement to NGS. The amount of energy available to the District varies annually and is expected to decline over the life of the contracts. The District pays a fixed amount under the contracts, pays the cost of NGS generation and other related costs, and supplies energy at cost to CAWCD for Central Arizona Project facilities. The fixed portion of the District's payment obligations under the three contracts totals \$47.0 million annually through fiscal year 2007, and \$207.4 million thereafter. Of the total obligation, \$25.2 million annually through fiscal year 2007 and \$111.3 million thereafter are unconditionally payable regardless of the availability of power. Payments under these contracts totaled \$74.6 million and \$76.5 million in fiscal years 2002 and 2001, respectively.

The District entered into two other long-term power purchase agreements to obtain a portion of its projected load requirements through 2011. Minimum payments under these contracts are \$38.9 million annually through fiscal year 2007 and \$150.0 million thereafter. Total payments under these two contracts, including the minimum payments, were \$61.7 million and \$62.9 million in fiscal years 2002 and 2001, respectively. In conjunction with the impairment analysis performed on generation-related operations, the District has recorded provisions for losses on these contracts. The provisions recorded in August 1998, of \$163.7 million, are being amortized over the life of the contracts, commencing January 1, 1999. Amortization of \$13.3 million has been reflected as a reduction in purchased power expense in fiscal years 2002 and 2001. The remaining liability at April 30, 2002, of \$119.5 million is included in deferred credits and other non-current liabilities in the Combined Balance Sheets.

Fuel Supply – At April 30, 2002, minimum payments under long-term coal supply contract commitments are estimated to be \$148.4 million in fiscal year 2003, \$153.4 million in fiscal year 2004, \$144.6 million in fiscal year 2005, \$118.3 million in fiscal year 2006, \$90.7 million in fiscal year 2007, and \$345.4 million thereafter.

12. Contingencies:

Nuclear Insurance – Under existing law, public liability claims arising from a single nuclear incident are limited to \$9.5 billion. PVNGS participants insure for this potential liability through commercial insurance carriers to the maximum amount available (\$200.0 million), with the balance covered by an industry-wide retrospective assessment program as required by the Price-Anderson Act. If losses at any nuclear power plant exceed available commercial insurance, the District could be assessed retrospective premium adjustments. The maximum assessment per reactor per nuclear incident under the retrospective program is \$88.1 million including a 5% surcharge, applicable in certain circumstances, but not more than \$10.0 million per reactor may be charged in any one year for each incident.

Based on the District's ownership share in PVNGS, the maximum potential assessment would be \$46.2 million, including the 5% surcharge, but would be limited to \$5.2 million per incident in any one year.

Spent Nuclear Fuel – Under the Nuclear Waste Policy Act of 1982, the District pays 1/10 of one cent per kWh on its share of net energy generation at PVNGS to the Department of Energy (DOE). The DOE was responsible for the selection and development of repositories for permanent storage and disposal of spent nuclear fuel not later than December 31, 1998. Because of the significant delays in the DOE's schedule, it cannot be determined when the DOE will accept waste from PVNGS or from the other owners of spent nuclear fuel. It is unlikely, due to PVNGS' position in DOE's queue for receiving spent fuel, that Arizona Public Service Company (APS), the operating agent of PVNGS, will be able to initiate shipments to DOE during the licensed life of PVNGS. Accordingly, APS is constructing an on-site dry cask storage facility to receive and store PVNGS' spent fuel. The facility is expected to receive and store spent fuel at the end of 2002.

The District's share of on-site interim storage at PVNGS is estimated to be \$26.5 million for costs to store spent nuclear fuel from inception of the plant to date, and \$1.8 million per year going forward. These costs have been included in the District's regulated operations price plans for transmission and distribution.

Navajo Nation Lawsuit – In June 1999, the Navajo Nation filed a lawsuit in the United States District Court in Washington D.C., alleging that the coal supplier for the Navajo and Mohave Generating Stations (Peabody Coal Company), Southern California Edison Company, the District, and other defendants, had induced the United States to breach its fiduciary duty to the Navajo Nation and had violated federal racketeering statutes. The lawsuit arises out of negotiations that culminated in 1987 with amendments to the coal royalty and lease agreements for mining coal for the Navajo and Mohave Generating Stations. The suit alleges \$600.0 million in damages and seeks treble damages along with punitive damages of not less than \$1.0 billion. In March 2001, the Hopi Tribe intervened in the suit. However, the claims of both the Navajo Nation and the Hopi Tribe have been dismissed in their entirety with respect to the District. While the District has moved for the entry of final judgment in its favor, the Navajo Nation and Hopi Tribe have moved for restoration of the dismissed claims. These motions are pending. If final judgment is entered in favor of the District, it is anticipated that the Navajo Nation and Hopi Tribe will appeal such a judgment.

Previously, the Navajo Nation had filed a lawsuit against the United States Government based on similar allegations. That lawsuit had been dismissed, but on appeal, it was reinstated and the Court of Appeals, in August 2001, held that the United States had breached its fiduciary duty to the Navajo Nation, and that a claim for damages was within the jurisdiction of the Court of Federal Claims. On March 15, 2002, the United States filed a petition for review of that decision with the United States Supreme Court. The District does not believe that these disputes will have material adverse effects on its operations or financial condition.

NOTES TO COMBINED FINANCIAL STATEMENTS

April 30, 2002 and 2001

Environmental – SRP is subject to numerous legislative, administrative and regulatory requirements relative to air quality, water quality, hazardous waste disposal and other environmental matters. SRP conducts ongoing environmental reviews of its properties for compliance and to identify those properties it believes may require remediation. Such requirements have resulted and will continue to result in increased costs associated with the operation of existing properties.

Air Quality – The federal Clean Air Act, as amended, among other things, requires reductions in sulfur dioxide and nitrogen oxide emissions from electric generating stations and regulates emissions of hazardous air pollutants by generating stations.

In December 1999, the participants in Mohave Generating Station settled a lawsuit alleging numerous and continuing violations of opacity and sulfur dioxide standards. Under the terms of the settlement, the participants must install by January 1, 2006, a sulfur dioxide scrubber and other pollution control equipment. Major plant modifications, including emissions controls, are required for continued operation as a coal-fired plant. Capital costs are estimated at \$411.6 million, of which the District's share would be \$82.3 million. These costs are included in the capital contingencies portion of the 2003-2008 Improvement Program. However, the Hopi Tribe has demanded that pumping water for the slurry pipeline cease by the end of 2005. The Mohave Participants have refused to commit to install pollution abatement equipment without reasonable assurance that water would be available to deliver coal to the plant; therefore, because of the time required to order and install the pollution abatement equipment, the plant will likely cease operations at the end of 2005 for some period of time. The District believes that it will be able to replace the energy from Mohave from other sources. Although the Mohave Participants and the Tribe are working diligently to reach a settlement, it is not certain if, and when, a resolution will be reached. If a settlement is not reached, the District believes that the site can continue as a generation source and options for such are under review.

In January 2001, the participants in the Craig Generating Station agreed to settle a lawsuit that alleged, among other things, numerous violations of opacity standards by Craig Units 1 and 2. Under the terms of the settlement, the participants must install fabric filter baghouses and other equipment on Units 1 and 2 by December 31, 2003, and June 30, 2004, respectively. Capital costs are estimated at \$92.8 million, of which the District's share would be \$26.9 million. These costs are included in the capital contingencies portion of the 2003-2008 Improvement Program.

The U.S. Environmental Protection Agency (EPA) is in the process of developing regulations for the control of mercury emissions from coal and oil-fired utility boilers. Regulations are scheduled to be proposed in late 2003 with a compliance date of late 2007. These regulations will affect all new and existing units. The EPA has not yet determined the level of control that will be required. This rule could affect the District's coal-fired units and the District is still uncertain of the impact, which could range from no change to the installation of new emission controls.

President Bush recently proposed a Clear Skies Initiative (CSI) intended to achieve dramatic reductions of sulfur dioxide (SO₂), oxides of nitrogen (NO_x) and mercury (Hg) emissions in a coordinated and phased manner. The administration expects that the CSI will result in substantial power plant emission reductions and provide the electric power generation industry with regulatory certainty while maintaining fuel supply diversity. A number of other bills are also under consideration in Congress that call for significant reductions in SO₂, NO_x and Hg, as well as carbon dioxide (CO₂). The current Clean Air Act contains several provisions that are directed at emissions of SO₂, NO_x, and Hg. The District is planning on future emission reductions at its coal-fired power plants as a result of these legislative and regulatory initiatives. The specific level of reduction and compliance cost will not be known until new legislation is passed or the EPA and the states finalize existing Clean Air Act regulatory programs.

NOTES TO COMBINED FINANCIAL STATEMENTS

April 30, 2002 and 2001

Coal Mine Reclamation – In management's opinion, there are sufficient accruals in the accompanying combined financial statements for the District's obligation to reimburse certain coal providers for amounts due for certain coal reclamation costs. However, the District is contesting certain other coal mine reclamation costs. Neither the District's responsibility or the ultimate amount of liability, if any, can be determined at this time. Management does not believe that the outcome of these matters will have a material adverse effect on the District's financial position or results of operations.

Gas Supply – The District has a full-requirements contract with El Paso Natural Gas Company (El Paso) for the transportation of natural gas. This contract is under challenge at FERC from producers and marketers who are unhappy with the uncertainty of their deliveries on the El Paso System. At a hearing on the matter held on May 30, 2002, FERC approved the issuance of an order directing El Paso to convert its full-requirements customers to fixed entitlements. While the outcome of this matter is unsettled, the District's available transportation for existing and planned gas generation facilities could be substantially reduced. The financial impact of this dispute cannot be determined, but it could be significant. The District is considering alternatives, including gas storage and construction of additional pipeline, in order to mitigate the impact of an adverse outcome.

California Energy Market Issues – In 1996, California adopted a restructuring program for its electric utility industry that combined generation divestiture and reliance on wholesale spot markets with rigid retail price controls. The situation was further compounded by significant increases in fuel costs, transmission constraints between northern and southern California, and a relatively dry period in the Northwest that significantly reduced the amount of hydroelectric power available. The result was a dysfunctional energy market, exponentially high wholesale prices, bankruptcy of California's largest investor-owned utility (Pacific Gas and Electric Company), and inadequate resources to serve customers.

Multiple federal and state agencies, as well as individual claimants, are pursuing numerous investigations and lawsuits, alleging manipulation and other improprieties, including antitrust violations, in connection with the wholesale energy market in California. Because the District was a market participant during the relevant time period (2000 and 2001), the District, along with other participants in the California market, has been named as a defendant in several of these suits and investigations. The District denies any wrongdoings and is cooperating with the federal and state agencies.

Indian Matters – From time to time, SRP is involved in litigation and disputes with various Indian tribes on issues concerning regulatory jurisdiction, royalty payments, taxes and water rights, among others (see Navajo Nation Lawsuit and Air Quality above). Resolution of these matters may result in increased operating expenses.

Other Litigation – In the normal course of business, SRP is exposed to various litigation or is a defendant in various litigation matters. In management's opinion, the ultimate resolution of these matters will not have a material adverse effect on SRP's financial position or results of operations.

Self-Insurance – The District maintains various self-insurance retentions for certain casualty and property exposures. In addition, the District has insurance coverage for amounts in excess of its self-insurance retention levels. The District provides for reserves based on management's best estimate of claims, including incurred but not reported claims. In management's opinion, the reserves established for these claims are adequate, and any changes will not have a material adverse effect on the District's financial position or results of operations.

REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors of
Salt River Project Agricultural Improvement
and Power District, and
the Board of Governors of
Salt River Valley Water Users' Association

In our opinion, the accompanying combined balance sheets as of April 30, 2002 and the related combined statements of net revenues and comprehensive income and of cash flows present fairly, in all material respects, the financial position of Salt River Project Agricultural Improvement and Power District and its subsidiaries and Salt River Valley Water Users' Association (collectively, the Company) at April 30, 2002 and the results of their operations and their cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit of these statements in accordance with auditing standards generally accepted in the United States of America, which 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, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion. The combined financial statements of the Company as of April 30, 2001 and for the year then ended were audited by other independent accountants whose report dated June 11, 2001 expressed an unqualified opinion on those statements.

As discussed in Note 3 to the combined financial statements, on May 1, 2001 the Company adopted Statement of Financial Accounting Standards No. 133 and changed its method of accounting for derivative instruments.

PricewaterhouseCoopers LLP

May 30, 2002

REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To the Board of Directors,
Salt River Project Agricultural Improvement
and Power District, and
Board of Governors,
Salt River Valley Water Users' Association:

We have audited the accompanying combined balance sheets of the SALT RIVER PROJECT AGRICULTURAL IMPROVEMENT AND POWER DISTRICT AND SUBSIDIARIES, and the SALT RIVER VALLEY WATER USERS' ASSOCIATION (collectively, the Company) as of April 30, 2001 and 2000, and the related combined statements of net revenues and comprehensive income and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of April 30, 2001 and 2000, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States.

Arthur Andersen LLP

Phoenix, Arizona
June 11, 2001

This is a copy of a previously issued report. The report has not been reissued by Arthur Andersen.

BOARDS Association & District



Larry D. Rovey
District/Division 1



Clarence C. Pendergast Jr.
District/Division 2



Elvin E. Fleming
District/Division 3



Gilbert R. Rogers
District/Division 4



Carl E. Weiler
District/Division 5



John M. White Jr.
District/Division 6



Ann M. Burton
Division 7



Keith B. Woods
District 7



Robert G. Kempton
District/Division 8



Dale C. Riggins Jr.
District/Division 9

SRP BOARDS The two Boards of Salt River Project work with management to establish policies to further the business affairs of SRP. The 10 members of the Salt River Valley Water Users' Association Board of Governors serve staggered four-year terms and are elected from voting districts by the landowners within the water service territory. The Association is SRP's private water corporation, which administers the water rights of SRP's 240,000-acre area, and operates and maintains the irrigation and drainage system.

The 14 members of the Salt River Project Agricultural Improvement and Power District Board of Directors serve staggered four-year terms. Ten District Board members are elected from voting divisions and four are elected at-large by landowners within the District's boundaries. The District is SRP's public power utility and a political subdivision of Arizona. Most often, candidates seek election to both Boards.

Note: Director-at-large, Seat 14, pending run-off election.

SRP COUNCILS The two Councils of Salt River Project enact and amend bylaws relating to business affairs of SRP and also serve as liaisons to District electors and Association shareholders.

As with the SRP Boards, there is one Council for the District and one for the Association. The 30 District Council members are elected to staggered four-year terms from 10 divisions. The 30 Association Council members are elected to staggered four-year terms from 10 districts. Most often, candidates seek election to both Councils.

In Memoriam: Board Member Eldon Rudd, February 8, 2002; Council Member Lawrence P. Schrader, August 2, 2001.



Dwayne E. Dobson
District/Division 10



David Rousseau
Director-at-large, Seat 11



William W. Arnett
Director-at-large, Seat 12



Fred J. Ash
Director-at-large, Seat 13

Immediate past members



James L. Diller
District/Division 6



James R. Marshall
Director-at-large, Seat 14

COUNCILS Association & District

District/Division 1

(left to right)

Robert L. Cook
Kevin J. Johnson
John R. Starr



District/Division 2

(left to right)

Wayne A. Hart,
Vice Chairman
John A. Vanderwey
Paul E. Rovey



District/Division 3

(left to right)

John E. Anderson
Mario J. Herrera
Robert T. Van
Hofwegen



District/Division 4

(left to right)

Lloyd (Lee) E. Banning
Charles D. Coppinger
Leslie C. Williams



District/Division 5

(left to right)

Roy W. Cheatham
Wayne A. Weiler
Stephen H. Williams



District/Division 6

(left to right)

Ben A. Butler
Robert W. Warren
Jacqueline (Jacque)
Miller



District/Division 7

(left to right)

Mark A. Lewis
Keith B. Woods, Division
Ann M. Burton, District
Harmen Tjaarda Jr.



District/Division 8

(left to right)

Deborah S. Hendrickson
John R. Hoopes,
Chairman
Mark V. Pace



District/Division 9

(left to right)

Edward E. Johnson
Arthur L. Freeman
W. Curtis Dana



District/Division 10

(left to right)

Orland R. Hatch
William P. Schrader Jr.
C. Dale Willis



SRP's centennial celebrates the vision of Valley pioneers and our rich history of building and sustaining successful communities. Our legacy is also our vision for the future – a continued commitment to work in partnership with the communities we serve to ensure the vitality of the Salt River Valley. We look forward to our next century of service.



CORPORATE INFORMATION

Corporate Officers

President

William P. Schrader

Vice President

John M. Williams Jr.

Secretary

Terrill A. Lonon

Treasurer

Steven J. Hulet

Executive Management

General Manager

Richard H. Silverman

Associate General Managers

David G. Areghini

Mark B. Bonsall

D. Michael Rappoport

John F. Sullivan

L.J. U'Ren

Corporate Counsel

Jane D. Alfano

Manager

Richard M. Hayslip

Corporate Headquarters

Street address

SRP
1521 N. Project Drive
Tempe, AZ
85281-1298

Mailing address

SRP
P.O. Box 52025
Phoenix, AZ
85072-2025

Web site

www.srpnet.com

Inquiries

Dean Yee, Manager
SRP Financial Services
602-236-5231

Bondholder Information

SRP Treasury Department
602-236-2222

Historic Photographs in the SRP 2002 Annual Report

- Cover——— On the bank of a Valley canal, circa 1900, *SRP Heritage, Ashton Collection*
- p. 7——— Benjamin A. Fowler, *SRP Research Archives*
- pp. 8-9—— Theodore Roosevelt Dam, 1970, *SRP Research Archives*
- p. 11——— Arizona delegation at the USS Arizona christening, June 19, 1915, *Special Collections, University of Arizona*
- p. 12——— SRP makes final payment to the federal government on construction costs for Roosevelt Dam, 1955, *SRP Research Archives*
- pp. 14-15—— SRP's new Crosscut Generating Station, 1938, *SRP Research Archives*
- p. 16——— Buggy and transmission line on the Apache Trail, circa 1909, *SRP Research Archives*
- p. 19——— Arizona Falls on the Arizona Canal, circa 1900, *Arizona History and Archives Division, Arizona State Library, Archives & Public Records*
- pp. 20-21—— Laying the cornerstone for the Phoenix Women's Club building, 1911, *Herb and Dorothy McLaughlin Collection, Arizona State University Libraries, photo illustration by SRP*
- p. 22——— One of two original Arizona flags adopted in 1917 by the Arizona Legislature as the official state flag, *Arizona Capitol Museum, Arizona State Library, Archives & Public Records*
- p. 23——— Ella Francis Quimby Fowler, *Connecticut Valley Historical Museum*

