1997-98 Salt River Project Annual Report

SRP Water and energy for the future of Arizona

On the cover: Guy and Paula Standard of Gilbert, with their children, Ashley and Ryan, say they will remain SRP residential electric customers because they appreciate the value SRP provides.

As a large and fast-growing public utility in the United States, SRP is a $1.5 billion water and electricity provider serving about 1 million electric customers and water shareholders in the thriving Phoenix metropolitan area.

SRP comprises two principal operating entities: the Salt River Project Agricultural Improvement and Power District, a political subdivision of the state of Arizona; and the Salt River Valley Water Users' Association, a private corporation.

The District provides electricity to customers in a 2,900-square-mile area spanning Maricopa, Gila and Pinal counties in central Arizona. The District is an integrated entity generating, transmitting and distributing electric power.

The Association, the Phoenix area's largest water supplier, delivers about 1 million acre-feet of water to a 240,000-acre service area. An extensive water delivery system is maintained and operated by the Association, including dams, canals, laterals and wells.

SRP has grown with the Phoenix area for nearly a century. We understand the complexities of this unique and prosperous region, its residents, communities and businesses.

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Letter To Customers, Bondholders & Shareholders

John M. Williams Jr., Vice President, *left*
William P. Schrader, President, *right*

SRP's dependable, low-cost water has formed the foundation for spectacular economic diversification and prosperity.

That statement, written on the occasion of SRP's golden anniversary, sums up the unique role SRP plays in ensuring the future of the Phoenix area.

In our 95th year, SRP continues its role as water steward, as well as providing vital electric services. Today, our customers benefit from local ownership. This is the legacy of the Arizona pioneers who staked their land to build the SRP water system and who established the electric power business to support it.

The relationship between power and water is at the core of SRP's unique status, helping to build the economy and delivering the benefits of local ownership through lower prices and outstanding service.

As we write, critical decisions are being made about how electric industry competition will unfold and how our customers will experience the advent of choice. We are engaging our customers in the decisions about competition, conducting public forums and board meetings that explain key issues and gather customer comment. Opinions may vary, but the substance of our shared interest is low-cost, high-quality electric power.

Speaking of low costs, SRP's attention to operating cost reductions continues to gain momentum. Power generating costs declined again this year. On the other hand, net income showed a gain at $64.5 million on total revenues of $1.54 billion. We refunded $518.5 million in revenue bonds this year, trimming our outstanding debt and improving our debt ratio to 65.1 percent.

Changing times are affecting our water activities, too. We are working with the city of Tempe in the Rio Salado project along the Salt River. SRP has expressed interest in operating and maintaining the two dams for the new Tempe Town Lake, planned for the now-dry river bed. This echoes our efforts with the city of Scottsdale on a canal-waterfront project, and we see even more potential for other canal-related opportunities in the future.

Our management team deserves recognition for their commitment to working through the complexities of competition with our customers and the communities we serve. We have every confidence that together, the foundation built nearly a century ago will be strengthened in the new era of customer choice.

William P. Schrader
William P. Schrader
President

John M. Williams Jr.
John M. Williams Jr.
Vice President

Message From the General Manager

We remain on target with our strategic plan to bring about customer choice.

While a number of challenges continue into the new fiscal year, many of the uncertainties in providing customer choice were resolved. Before highlighting our accomplishments, however, I want to acknowledge two groups: our elected policy makers, who are embracing the challenge of change; and our employees, who are responding to the challenge of this new environment.

New and needed legislation was enacted this year in Arizona. SRP supports the Electric Power Competition Act, which provides for customer choice to begin at the end of 1998. The state utilities commission is completing work on a competition schedule and rules for privately owned utilities.

Another milestone was reached in an agreement between SRP and a neighboring investor-owned utility. The agreement helps to clear the way for competition and customer choice by removing the long-standing boundaries of exclusive energy sales territories, permitting sales of energy by others. The distribution business – the delivery of energy – remains an exclusive territory.

Although Congress has yet to take action on deregulation legislation, a variety of bills have been introduced that will frame the issue next year. We believe that the task of redefining the industry is primarily for the states, except for certain circumstances that are national in scope. We will continue to participate in discussions at the national level.

In that regard, we are generally pleased with IRS's position on the use of tax-exempt financing by public utilities like SRP in a competitive market. The administration's position acknowledges the changing electric industry, while presenting a balanced approach to a controversial situation. Nonetheless, congressional action will be required to resolve the uncertainties and to provide the flexibility that publicly owned utilities need to be fully competitive.

As anticipated, competition is ushering in some questionable actions by a few of our soon-to-be competitors. We have responded aggressively to the attacks on the activities of our new marketing affiliate, New West Energy. Efforts to stir up federal intervention in SRP's business activities provide evidence of an industry in extreme upheaval. New West is participating in California's energy deregulation effort to learn how to market in anticipation of choice coming to Arizona.

We are confident that in the new environment, we can help our electric customers make the choice that is right for them. And we believe the choice is an easy one: SRP.

Richard H. Silverman, General Manager

Richard H. Silverman
General Manager

Choice: The ability of consumers to determine how and where they spend their money... A concept not new to the U.S. marketplace, but certainly a big adjustment for the electric utility industry. And it's just around the corner for Arizona.

For the first time in the history of the modern utility industry, Arizona consumers will be able to choose their power suppliers.

On December 31, SRP plans to offer about one-in-five electric customers the ability to choose the source of energy for their homes and businesses. At SRP, choice for customers offers a new and challenging future.

How Arizona's new Electric Power Competition Act affects SRP

A two-phased schedule begins Dec. 31, 1998. Phase One brings competition to customers equaling 20 percent of SRP's 1995 peak electric load. Phase Two brings choice to all customers in the SRP service territory by Dec. 31, 2000. For a definitive view on the Act, please call SRP at (602) 236-2598, and request a copy of our new brochure, "Customer Choice is Set to Begin in Arizona."

We have been preparing for the advent of competition for some time. This year saw intensive preparations for the day of customer choice. Organizationally, SRP is geared up for the new marketplace, and we are moving ahead with the development of new and exciting products and services.

We will be reaching out over the next several months with efforts to explain just how and when choice begins. Our goal is to ensure that our customers clearly understand what choices are available to them and how to make sound decisions.

In late 1998, all SRP customers will receive a special invitation to participate in Phase One of electric competition in Arizona. The invitation will explain how customers can authorize SRP to share their electric records with other companies that may want to sell energy to them. The goal of this solicitation is to gain 20 percent customer participation in the choice process.

We believe most of our customers will choose to remain with SRP. That's because SRP is in an especially good position to retain customers in the new competitive marketplace. With many customers, price will be the main determinant in how they make their choice. We've reduced prices by nearly 5 percent since 1991; in the Southwest, SRP is a low-price, retail energy provider.

Our research tells us that some customers will want to try another energy provider. For these customers, we will continue to provide the same highly reliable and safe energy delivery through our

Mesa Public Schools is Arizona's largest school district and growing. As an SRP customer, the district will be using a new SRP service developed with its particular power reliability needs in mind. Mesa Superintendent **Dr. Jim Zaharis** said that the service, mobile emergency generation, will help more than 40 district schools keep the lights on – and students learning – in the event of power outages. SRP plans to market this new service to other customers this fall.

distribution system. We also will continue to provide our customers the highest-quality service in accurate meter reads and billings. Actual customer bills will change in appearance and content as we itemize components of energy services more specifically, and as we help customers understand how competition in our industry affects them.

In the near future, the educated consumer will have the advantage in a marketplace where many companies will be vying for their business. By leveraging our assets now – low price, strong service, and product portfolios – we believe SRP will stand out as the right choice.

Everybody's talking about getting closer to the customer. We are doing it.

With SRP's largest customers – a diverse group – this is no small challenge. Every customer in this power consumption range (typically more than 1 megawatt a year) has special power requirements. Many are in the competitive semiconductor industry, with tight operating margins and sensitive manufacturing operations.

SRP has established close business relationships with our large customers. The complexity of their energy use deserves daily attention, which is why these customers each have an account manager working directly with them. We provide these customers with prices and customized products and services that reflect their energy consumption, use and operating needs.

For large customers...

- Power quality services
- Electrical testing services
- Telecommunications products
- Performance contracting services
- Mobile emergency generation services
- Customized solutions

This year, we introduced even more power quality services for these customers, and soon we will roll out a mobile emergency generation service for customers such as schools. Intensifying our efforts in power quality and reliability will give us an edge in the competitive marketplace.

The largest energy consumers – in metropolitan Phoenix, in Arizona and in the region – are very active in competition in the electric utility industry. We have many long-standing and loyal customers in this group, and we will work with them in the new marketplace to anticipate their needs, improve operational efficiencies and provide timely, valued products.

Rudy Vizzerra, an SRP business customer since 1995, owns and operates with his family two Mexican imports and iron-furniture shops called El Patio in the Phoenix area. Vizzerra says SRP's electric service to his establishments is affordable and reliable and that he intends to remain a business customer in the future. Vizzerra also is a residential customer, and takes advantage of several SRP billing and payment options, including Managed Payment Plan, Customer Selected Due Date and Time of Use.

Marsha MacIntosh, a Chandler resident and SRP customer for the past 13 years, was delighted to find a customized home energy analysis available on SRP's Web site called SRP Home Energy Manager™. Using the new, free service, SRP customers can conduct an energy use profile specific to their homes and energy use. Armed with the data provided, MacIntosh and other SRP residential customers can adjust their energy use, switch to other rate options, and save money. SRP also launched a free, business energy service on the SRP Web site this year, called SRP Business Energy Manager™.

Total commitment. Low prices. Cutting-edge programs and services.

This is SRP's promise to its general business customers. This customer group – typically with annual energy consumption of up to 1 megawatt – is the cornerstone of Arizona's economy. Many are locally owned operations that have grown into thriving enterprises.

A mid-size to small business customer doesn't always have the in-house resources or expertise to make decisions regarding energy use and how to maximize energy savings. That's why we are stepping up our efforts to help business customers understand the various price structures we offer and to broaden our portfolio of energy products and services especially for these customers.

Bringing simple solutions to the customer's door is welcomed by these busy people. We also offer a business customer service department, with specialists trained in the needs of this customer group. We want their experience with us to be as cost-efficient and convenient as possible.

Homebuyers know it's true: Look for a home in SRP's service area for energy savings.

It's been common knowledge – and documented fact – for many years that SRP is the low-price provider in the Phoenix metropolitan area. This is a major consideration for the budget-conscious homeowner or tenant.

Across all incomes, energy costs are a consideration – and so is service. We always have appreciated residential customers, who represent about 90 percent of our total retail customer numbers.

If we are to continue to succeed, we know the key is to serve these customers better than ever. We are trying harder, and it's making a difference... through new convenient services, more direct communications, and by advocating customer choice.

For General Business Customers...

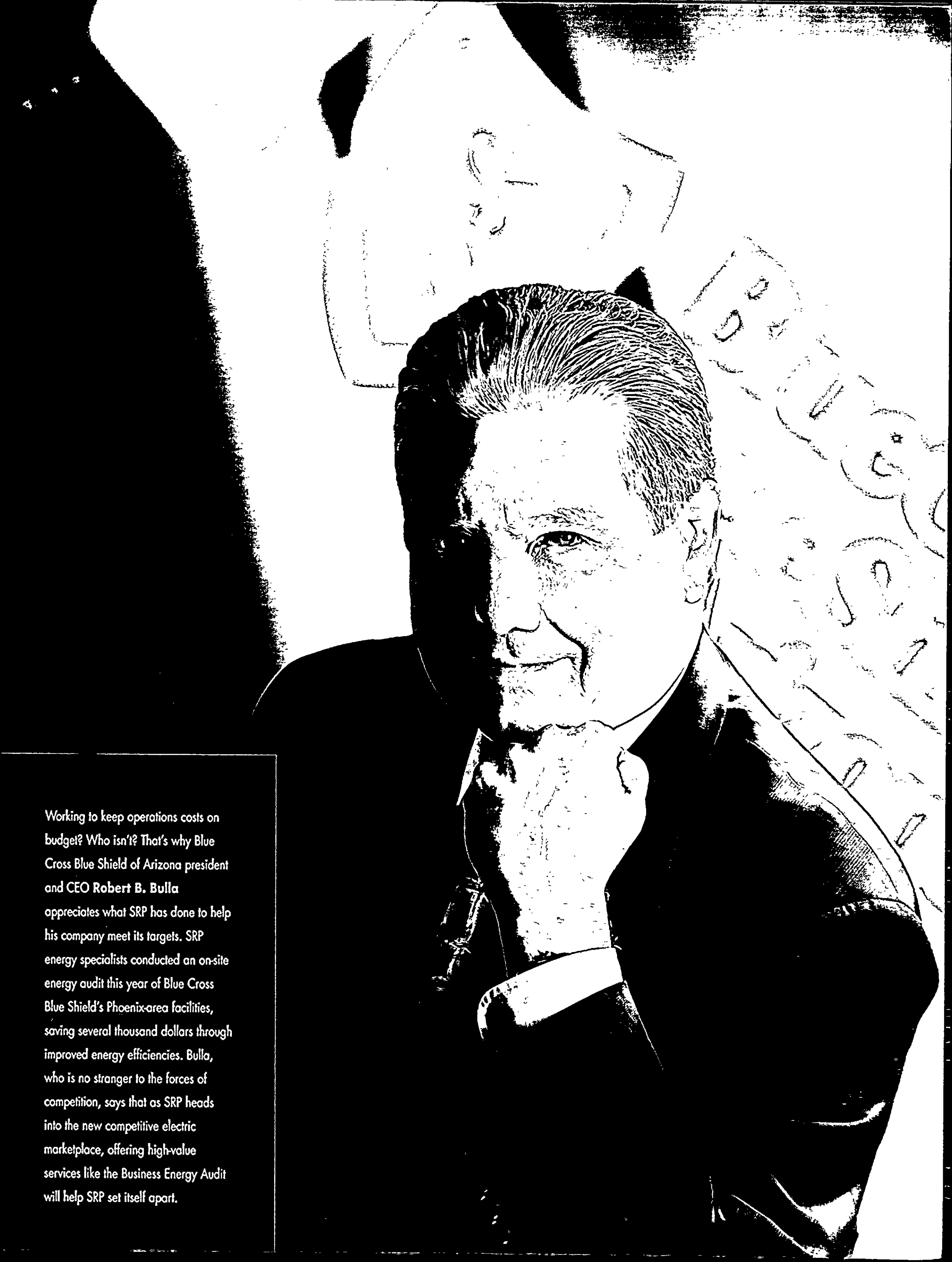
- SRP Business Energy Manager™
- Competitive Energy Cost Report
- Lighting Solutions
- Business Energy Audits
- Special billing and payment features
- Business security systems

For Residential Customers...

- SRP Home Energy Manager™
- Home security systems
- Appliance warranties
- Green pricing
- Heat pump incentives
- Bill due date choice
- Quick-pay terminals

One way we communicate with our residential customers, who often have questions about their service or bills, is through our call centers. Recognizing the value of time to our customers, we have added more call center employees to enable us to answer all calls with little to no wait time. And we are opening offices in our customers' neighborhoods to make it more convenient to visit us.

We are trying to make SRP more accessible to our residential customers in many other ways, too. We have expanded our Spanish-language customer outreach communications, and now can accept service signups and turnoffs through our Web site at *www.srp.gov.*



Working to keep operations costs on budget? Who isn't? That's why Blue Cross Blue Shield of Arizona president and CEO **Robert B. Bulla** appreciates what SRP has done to help his company meet its targets. SRP energy specialists conducted an on-site energy audit this year of Blue Cross Blue Shield's Phoenix-area facilities, saving several thousand dollars through improved energy efficiencies. Bulla, who is no stranger to the forces of competition, says that as SRP heads into the new competitive electric marketplace, offering high-value services like the Business Energy Audit will help SRP set itself apart.

The right choice: A lifelong commitment to our communities. We are here to help – and to stay.

SRP is the locally owned electric utility in the Phoenix metropolitan area. We were founded by Arizona pioneers who wanted to provide reasonably priced and reliable electricity and water to the Valley. The bond SRP has forged with its communities has grown stronger since those early years, woven into the economic, social and environmental fabric of our communities.

Our community efforts are achieved through the generosity of SRP employees and retirees, their families and friends. From building houses, to mentoring children, to supporting local arts, SRP volunteers give thousands of hours each year, along with corporate support of their efforts. Another SRP program brings resources to the education community through grants, curriculum assistance and other services.

Our commitment runs wider and deeper still, embracing urban environmental efforts. SRP's new "Solar for Schools" program, initiated at a community college this year, offers tremendous potential for teaching and training and opens a new window on the advancement of practical solar applications. This year, corporate grants and employee contributions to non-profit groups in Arizona exceeded $2 million.

As we look forward, with a future upon us full of changes, we remain firm in our responsibility to help. It's the choice we make, and it's the right choice.

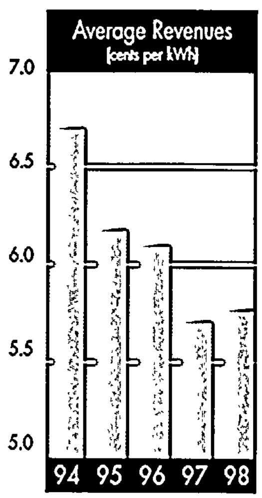
Ahoy Tempe! The Rio Salado project is under development just south of the SRP corporate offices. SRP is working with the city of Tempe and its administrator of economic development, Jan Schaefer, to operate and maintain the two dams that will contain the 2-mile-long Tempe Town Lake – the project's centerpiece. Schaefer says SRP's ability and experience in operating and maintaining a complex reservoir and water delivery system is a plus for the project. Tempe is one of many of SRP's large municipal electric customers in the Valley.

Power quality and reliability at Motorola's Phoenix-area facilities are of prime concern to **John Hackbarth**, director of facilities and global logistics for the company's Semiconductor Products Sector. SRP is working closely with Motorola this year, as in previous years, to help ensure that this valued customer can continue to produce world-class products without power interruptions. Hackbarth says that SRP has created a lasting partnership with Motorola through a score of services including a new storm-alert paging system, a root-cause outage analysis, and special testing and training.

MANAGEMENT'S FINANCIAL & OPERATIONAL SUMMARY

Fiscal 1998 was a good year for SRP, resulting in strong financial performance. Total operating revenues increased 5 percent over the previous year, driven by hot and humid weather conditions, continued customer growth, and a robust economy in the Phoenix area.

Total operating expenses increased 5 percent from the previous year, primarily as a result of strategic operating decisions made by SRP's Board in anticipation of a competitive environment.



A steady decline in average revenues per kWh demonstrates our commitment to passing along the results of our cost reductions to our customers.

Last year, we accelerated the amortization of our regulatory assets over the eight-year period of fiscal years 1997-2004. Accelerated cost recovery of two generating plants, Palo Verde Nuclear Generating Station and Coronado Generating Station, resulted in additional depreciation expense of $70 million in fiscal year 1998 (and $50 million in fiscal year 1997). These efforts are helping to reduce SRP's stranded costs in a competitive market.

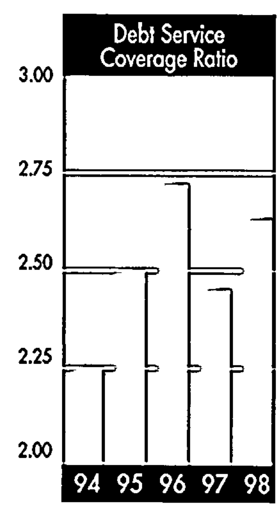
Cost reduction efforts, including workforce efficiencies gained through staff reductions, debt refinancing, and accelerated redemption of debt, have helped offset these additional costs.

Financing costs for fiscal year 1998 are 6 percent lower than the prior fiscal year. This is a direct result of our ongoing and concerted efforts to refinance and reduce corporate debt. In October 1997, a refunding sale of electric system revenue bonds resulted in estimated gross-debt-service savings of $112 million.

In December 1997, we completed a transaction to refund all of SRP's outstanding callable minibonds, with gross debt service savings estimated to be $42 million.

The transaction included a "rollover" option for minibond holders, the first minibond refunding transaction of its kind. SRP has incurred no new money debt since early 1994. Over the past five years, our debt ratio (long-term debt as a percentage of total capitalization) has decreased substantially.

Ongoing efforts to improve SRP cost economics remain a central focus and underscore our mission – to provide reliable, low-price power to our customers and reliable, low-cost water to our shareholders. As a locally owned utility, we are engaging in extensive dialogue with customers on a range of competition issues through a series of public meetings this summer and early fall.



Our debt service coverage ratio reflects the number of times we can cover current principal and interest obligations after paying operating expenses. Successes in cost control in our operations are reflected in the positive trend over the past five years.

The issues range from general topics such as consumer education, to more specific subjects such as the means by which generation-related stranded costs will be calculated and recovered. The outcome will affect our future pricing, products and services offerings.

During the past two fiscal years, all SRP customer classes saw a decline in the price they pay for our power, per kilowatt-hour, as price reductions were implemented. We are expecting to conduct yet another pricing redesign process later in 1998, to be completed by the end of the year.

An operational advantage for SRP as we move ahead is system reliability. SRP's distribution, generation and transmission systems reliability compares favorably to that of other systems within the United States.

Our major coal-fired plants again operated well above the industry average for comparable stations in terms of their availability during the year. The SRP distribution system surpassed its target for frequency and average length of outages, also scoring well below the target for average outage minutes per year. In 1997, SRP bested its target for outage frequency and duration for large industrial customers. Overall, SRP's transmission system performed well, compared to those of other U.S. utilities.

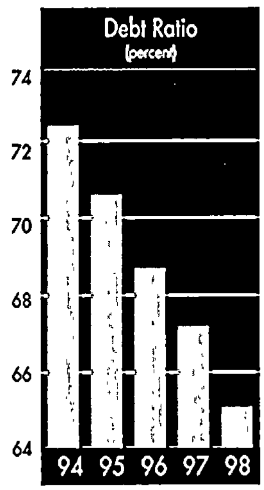
We will continue to invest in our systems to ensure that SRP's outstanding reliability record continues.

In water operations, the now-famous El Niño made its mark in early 1998 with heavy precipitation, and resulting runoff, that nearly doubled SRP's total reservoir storage to 1.5 million acre-feet.

This followed the 1997 results of slightly below-average levels of precipitation and runoff. But forecasts already were indicating a change for 1998, which allowed SRP to reduce groundwater pumping the last quarter of 1997 and to increase surface water deliveries from the reservoir system in anticipation of expected gains from El Niño.

The switch to surface water sources resulted in cost savings of more than $1 million by reducing the energy needed to pump from groundwater sources.

Water delivery revenues in fiscal year 1998 were $11.8 million, with water-related expenses slightly up for the year due to higher depreciation charges related to the installation of a new operation software system.



Our emphasis on reduction of debt capitalization is reflected in the steady decline of our debt ratio.

A key strategy for the future is to increase the revenue potential of the unique technologies, assets and expertise of employees engaged in SRP water activities. Water-related revenues for calendar year 1997 were up $1 million from the previous year, the sixth straight year for increased water revenues. Water services – such as pump design, pump testing, and pump removal and installation – are now offered to cities, large industrial customers and irrigation districts. As water delivery rates remain stable, revenue growth is due in part to the creative use of opportunities to market these services and launch new products. One such product is SPĀTIA™, a high-tech solution for cost-effective data collection and information analysis.

As expectations evolve and market conditions change, SRP's water activities emphasize core competencies, relationships, and the ever-increasing number of new business opportunities.

And as we focus on the future, SRP is working to minimize any potential effects of Year 2000 computer issues. We have implemented a comprehensive program to evaluate and modify our information systems, infrastructure and embedded systems to provide uninterrupted service to our water shareholders and electric customers.

We anticipate costs, excluding the costs of software, hardware and equipment upgrades and replacements, to be in the $15 million to $20 million range. These costs are included in SRP's long-range financial plan. Although we can make no assurances regarding potential effects of systems or third parties outside of our direct control, we do not anticipate any adverse impact on our operating results related to Year 2000 issues.

COMBINED BALANCE SHEETS

As of April 30	1998	1997
ASSETS	*(Thousands)*	
Utility Plant		
Plant in service –		
Electric	$ 5,908,059	$ 5,728,650
Irrigation	219,823	199,719
Common	368,563	343,740
Total plant in service	6,496,445	6,272,109
Less - Accumulated depreciation on plant in service	(2,575,374)	(2,284,846)
	3,921,071	3,987,263
Plant held for future use	33,029	35,288
Construction work in progress	262,569	265,722
Nuclear fuel, net	43,916	40,154
	4,260,585	4,328,427
Other Property and Investments		
Non-utility property and other investments	109,306	158,071
Segregated funds, net of current portion	282,472	236,146
	391,778	394,217
Current Assets		
Cash and cash equivalents	95,360	99,439
Temporary investments	342,441	275,585
Current portion of segregated funds	77,344	85,202
Receivables, including unbilled revenue, net	133,601	120,558
Fuel stocks	21,333	22,330
Materials and supplies	63,605	72,252
Other current assets	15,490	17,208
	749,174	692,574
Deferred Charges and Other Assets	273,583	291,795
	$ 5,675,120	$ 5,707,013

The accompanying notes are an integral part of these combined balance sheets.

COMBINED BALANCE SHEETS

As of April 30	1998	1997
CAPITALIZATION AND LIABILITIES	*(Thousands)*	
Long-Term Debt	$ 3,302,173	$ 3,432,108
Accumulated Net Revenues *(Note 4)*	1,768,530	1,672,664
Total Capitalization	5,070,703	5,104,772
Current Liabilities		
Current portion of long-term debt	73,910	82,716
Accounts payable	101,695	90,466
Accrued taxes and tax equivalents	64,390	66,885
Accrued interest	54,947	59,839
Customers' deposits	19,418	19,143
Other current liabilities	75,016	74,571
	389,376	393,620
Deferred Credits and Other Non-Current Liabilities	215,041	208,621
Commitments and Contingencies *(Notes 3, 5, 7, 8, 9 and 10)*		
	$ 5,675,120	$ 5,707,013

The accompanying notes are an integral part of these combined balance sheets.

COMBINED STATEMENTS OF NET REVENUES

For the Years Ended April 30	1998	1997
	(Thousands)	
Operating Revenues	$ 1,536,734	$ 1,457,634
Operating Expenses		
Power purchased	217,521	196,924
Fuel used in electric generation	243,467	309,081
Other operating expenses	266,046	283,156
Maintenance	134,028	95,742
Depreciation and amortization	354,288	271,344
Taxes and tax equivalents	93,046	87,219
Total operating expenses	1,308,396	1,243,466
Net operating revenues	228,338	214,168
Other Income (Expense)		
Interest income	44,759	42,163
Other expense, net	(4,806)	(2,029)
Total other income (expense), net	39,953	40,134
Net revenues before financing costs	268,291	254,302
Financing Costs		
Interest on bonds, net of capitalized interest	162,284	174,890
Amortization of bond discount and issuance expenses	5,994	7,687
Interest on other obligations	17,311	14,513
Net financing costs	185,589	197,090
Net Revenues Before Extraordinary Item	82,702	57,212
Extraordinary Item *(Notes 3 and 5)*	18,192	–
Net Revenues	$ 64,510	$ 57,212

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

COMBINED STATEMENTS OF CASH FLOWS

For the Years Ended April 30	1998	1997
	(Thousands)	
Cash Flows from Operating Activities		
Net revenues	$ 64,510	$ 57,212
Adjustments to reconcile net revenues to net cash provided by operating activities:		
Depreciation and amortization	354,288	271,344
Postretirement benefits expense	18,803	17,252
Amortization of bond discount and issuance expenses	5,994	7,687
(Gain)/Loss on sale of property	2,176	(5,437)
Long-term contract restructuring *(Note 3)*	-	58,092
Extraordinary item	18,192	-
Decrease (increase) in –		
Fuel stocks and materials & supplies	9,644	16,461
Receivables, including unbilled revenues, net	(13,043)	(6,020)
Other assets	(12,265)	22,267
Increase (decrease) in –		
Accounts payable	11,229	19,695
Accrued taxes and tax equivalents	(2,495)	(18,133)
Accrued interest	(4,892)	(2,546)
Other liabilities, net	(11,663)	(25,263)
Net cash provided by operating activities	440,478	412,611
Cash Flows from Investing Activities		
Additions to utility plant, net	(253,662)	(278,990)
Increase in investments	(20,856)	(7,009)
Net cash used for investing activities	(274,518)	(285,999)
Cash Flows from Financing Activities		
Proceeds from issuance of long-term debt	291,157	-
Proceeds from issuance of commercial paper	150,000	-
Repayment of long-term debt, including refundings	(604,084)	(87,535)
Increase in segregated funds	(7,112)	(15,957)
Net cash used for financing activities	(170,039)	(103,492)
Net Increase (Decrease) in Cash and Cash Equivalents	(4,079)	23,120
Balance at Beginning of Year in Cash and Cash Equivalents	99,439	76,319
Balance at End of Year in Cash and Cash Equivalents	$ 95,360	$ 99,439
Supplemental Information		
Cash Paid for Interest (Net of Capitalized Interest)	$ 184,525	$ 191,992

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

(1) BASIS OF PRESENTATION:

The Company

The Salt River Project Agricultural Improvement and Power District (the District) is an agricultural improvement district, organized under the laws of the State of Arizona, which provides electric service in parts of Maricopa, Gila and Pinal Counties in Arizona. The Salt River Valley Water Users' Association (the Association), predecessor of the District, was incorporated under the laws of the Territory of Arizona in February 1903, as a result of the passage of the National Reclamation Act. In 1937, the Association transferred all of its rights, title and interest in the Salt River Project (the Project or SRP) to the District. In 1949, the original agreement was amended so that the District would assume construction, operation and maintenance responsibilities for both the electric and irrigation systems. The District then delegated operation and maintenance of the irrigation systems of the Project to the Association.

On May 1, 1997, the District established a wholly owned, taxable subsidiary, New West Energy Corporation (New West Energy), to market, at retail, energy that may be rendered surplus by the introduction of retail competition in Arizona (*see Note 3*).

Possession and Use of Utility Plant

The United States of America retains a paramount right or claim in the Project which arises from the original construction and operation of certain 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.

Principles of Combination

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

Regulation and Electric Rates

Under Arizona law, the District's Board of Directors (the Board) serves as its regulatory and rate setting agency and has the exclusive authority to establish electric rates. The District is required to follow certain procedures, including public notice requirements and holding a board meeting, before implementing changes in standard electric rate schedules.

(2) SIGNIFICANT ACCOUNTING POLICIES:

Basis of Accounting

The accompanying combined financial statements are presented in accordance with generally accepted accounting principles and reflect the rate-making policies of the Board (*see Note 3*).

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts in the financial statements and disclosures of contingent assets and liabilities. Actual results could differ from those estimates.

Certain amounts in fiscal year 1997 have been reclassified to conform with fiscal year 1998 presentation.

Utility Plant, Depreciation and Maintenance

Utility plant is stated at the historical cost of construction. Construction costs include labor, materials, services purchased under contract, and allocations of indirect charges for engineering, supervision, transportation and administrative expenses. The cost of property that is replaced, removed or abandoned, together with removal costs, less salvage, is charged to accumulated depreciation.

Interest on funds used to finance construction work in progress is capitalized as a part of plant. A composite rate of 5.81 percent was used in fiscal years 1998 and 1997, resulting in $9.4 million and $8.7 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. The following table reflects SRP's average depreciation rates on the average cost of depreciable assets, for the fiscal years ended April 30:

	1998	1997
Average electric depreciation rate	5.00%	3.83%
Average irrigation depreciation rate	2.06%	1.82%
Average common depreciation rate	7.82%	6.57%

Bond Expense

Bond discount and issuance expenses are being amortized using the effective interest method over the terms of the related bond issues (*see Note 5*).

Nuclear Fuel

Under the provisions of the Nuclear Waste Act of 1982, the District is charged up to 1/10 of one cent per kilowatt hour on its share of net energy generation at Palo Verde Nuclear Generating Station (PVNGS) for the cost to dispose of the 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, 1998 and 1997 was $244.8 million and $224.6 million, respectively.

Decommissioning

The total cost to decommission the District's 17.49 percent share of PVNGS is estimated to be $251.3 million, in 1995 dollars, over a fourteen-year period beginning in 2024. 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. The District will complete an update to the PVNGS decommissioning study in the fall of 1998. Estimated decommissioning costs are accrued over the remaining estimated useful life of PVNGS. The liability associated with decommissioning is included in deferred credits and other non-current liabilities in the accompanying combined balance sheets and amounted to $60.0 million and $51.1 million as of April 30, 1998 and 1997, respectively. Decommissioning expense, net of earnings on trust fund assets, of $4.5 million and $4.3 million, was recorded in fiscal years 1998 and 1997, respectively. The District contributes to an external trust set up in accordance with the NRC requirements. Decommissioning funds of $88.0 million and $65.8 million, stated at market value, as of April 30, 1998 and 1997, respectively, are held in the trust and are classified as segregated funds in the accompanying combined balance sheets.

Accounting for Price Risk Management Activities

SRP engages in price risk management activities to hedge well-defined business risks. The goals of the price risk management program include reducing the impact of market fluctuations on energy commodity prices associated with excess generation and fuel expenses, meeting customer pricing needs, and maximizing the value of physical generating assets. Financial instruments used in hedging activities include futures, options, and other contractual arrangements. Hedge transactions are accounted for under the deferral method with gains and losses on these transactions initially deferred and classified as other current liabilities in the accompanying combined balance sheets and then recognized as a component of fuel expense when the hedged transaction occurs.

Additionally, SRP engages in physical trading activities. These activities are accounted for using the mark-to-market method of accounting.

Trading activity in price risk management was minimal in fiscal years 1998 and 1997 and net gains and losses associated with price risk management activities during fiscal years 1998 and 1997 were not material.

▼ 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.

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. The activity of New West Energy has been immaterial since its inception in May, 1997.

▼ Cash Equivalents

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

▼ Recognition of Unbilled Revenues

The District estimates and accrues revenue for electricity delivered to customers that has not yet been billed.

▼ Deferred Charges and Other Assets

Deferred charges and other assets consist primarily of two regulatory assets (*see Note 3*) and prepaid pension cost (*see Note 7*).

▼ Deferred Credits and Other Non-Current Liabilities

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

	(Thousands)	
	1998	1997
Accrued postretirement benefit liability (*see Note 7*)	$ 76,236	$ 61,851
Accrued decommissioning costs	60,018	51,127
Accrued long-term contract payable (*see Note 3*)	38,933	58,092
Other	39,854	37,551
	$ 215,041	$ 208,621

▼ Materials and Supplies, and Fuel Stocks

Material and supplies are stated at average cost. Fuel stocks are stated at cost using the last-in, first-out method.

▼ Recently Issued and Prospective Accounting Standards

During fiscal year 1998, SRP adopted the provisions of the American Institute of Certified Public Accountants Statement of Position (SOP) 96-1, "Environmental Remediation Liabilities." SOP 96-1 provides authoritative guidance for recognition, measurement, presentation, and disclosure of environmental remediation liabilities in financial statements. The adoption did not have a material impact on SRP's financial position or results of operations.

In 1996, the Financial Accounting Standards Board (FASB) issued an Exposure Draft (ED) entitled, "Accounting for Certain Liabilities Related to Closure and Removal of Long-Lived Assets." This ED was retitled in early 1998 to, "Accounting for Obligations Associated with the Retirement of Long-Lived Assets" and is currently under revision. The ED, if adopted in its current form, will require that certain closure or removal obligations be recognized as liabilities in the financial statements. These liabilities would be measured at the present value of the estimated future cash flows necessary to satisfy the obligations. The ED also provides that the initial recognition of the liability will increase the cost of the associated long-lived asset. This ED would affect SRP's accounting for decommissioning of PVNGS, obligations for coal mine reclamation costs and any other activities related to the closure or removal of long-lived assets. Although management is unable at this time to determine the exact impact of this ED, they do not believe that the proposed changes will have a material adverse effect on SRP's financial position or results of operations.

The FASB has issued Statement of Financial Accounting Standards (SFAS) No. 130, "Reporting Comprehensive Income," SFAS No. 131, "Disclosures About Segments of an Enterprise and Related Information" and SFAS No. 132, "Employers' Disclosure about Pensions and Other Postretirement Benefits," all of which are effective for fiscal year 1999. SRP is evaluating the effect these statements will have on its financial reporting and disclosures. The statements will have no effect on SRP's results of operations, financial position, capital resources or liquidity.

SFAS No. 130 established standards for reporting and display of comprehensive income and its components in the financial statements. This statement follows an "all inclusive" income concept and requires balances of items currently reported as a separate component of accumulated net revenues in a statement of financial position to be reported more prominently in a statement of comprehensive income.

SFAS No. 131 requires that public companies report certain information about operating segments in their financial statements. It also established related disclosures about products and services, geographic areas, and major customers. SRP is not required to adopt this standard, as it is applicable to public companies only. SRP is evaluating the new standard for relevancy and consistency within the industry.

SFAS No. 132.standardizes the disclosure requirement for pensions and other postretirement benefits to provide information that is comparable, understandable and concise.

(3) REGULATORY ISSUES:

▼ Competition/Restructuring in the Electric Utility Industry

The electric utility industry is undergoing fundamental changes leading to a more competitive environment. The District has responded to industry change in several ways, including continued comprehensive cost reductions and rate redesigns that pass these cost savings on to its customers through lower rates, and active involvement in the many efforts involved in defining electric competition at the state and federal levels.

The District's financial plan provides for continued efforts to lower per-unit costs from existing assets, increased asset utilization and reduced exposure to stranded investments. In fiscal year 1996, the Board approved acceleration of the cost recovery of certain generation-related assets. This additional cost recovery resulted in charges of $100.0 million and $50.0 million related to PVNGS during fiscal years 1998 and 1997, respectively, and $20.0 million of additional cost recovery for Coronado Generating Station during fiscal year 1998. These costs have been classified as depreciation and amortization expense in the accompanying combined statements of net revenues.

Several substantial efforts have taken place at the state level regarding competition over the past year. In May 1998, the Arizona Legislature enacted legislation which authorizes competition in generation service and related stranded cost recovery, competition in billing, metering, and meter reading. The legislation also mandated a rate cap through 2004.

Public power entities, such as SRP, must open their service territory to competition for the sale of electric generation service no later than December 31, 1998, for at least 20 percent of their 1995 retail load. At least 15 percent of the initial competitive load must be reserved for customers in the residential customer class. The entire service territory will be open to generation service competition no later than December 31, 2000. During the first two years of competition, customers who elect competitive electric services may also choose billing, collection and meter reading services on a competitive basis if their demand exceeds one megawatt. After December 31, 2000, those services will be provided to all customers on a competitive basis. Electric distribution territories will remain regulated monopolies; public power entities will not be allowed to provide distribution services in other utilities' distribution territories.

Electric utilities must provide for unbundled rates. Rates for electric transmission and distribution and other ancillary service prices must have terms and conditions that are nondiscriminatory and that reflect a just and reasonable price for providing the service. For retail customers who are unable to choose competitive electric generation, bundled rates will reflect a decrease of at least 10 percent over a 10-year period, apportioned among customer class. The public power entity selects the start date for the purpose of measuring the reduction, during the period January 1, 1991, through August 21, 1998, the effective date of the legislation.

In a competitive market, a utility's market-based revenues may not be sufficient to recover all costs of generating plants, other assets and contract commitments that were prudently incurred to serve power customers in a regulated environment. The legislation allows for a temporary surcharge on electric distribution service prices to pay for all or a portion of unmitigated stranded costs of electric generation service that were 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 will not continue past December 31, 2004, and will not cause rates to exceed the rates that were in effect on December 30, 1998. The District is currently evaluating its generation-related unmitigated stranded costs in connection with the legislation. Management believes that the District will fully recover its unmitigated stranded costs.

To aid in a smooth transition to a competitive environment, the legislation requires implementation of procedures and a public process for review by parties interested in the establishment of terms, conditions and pricing of electric service, including the factors used to determine the amount of stranded costs. In addition, public power entities must adopt a code of conduct designed to prevent anticompetitive activities and commence a public process to determine the terms and conditions of competition. SRP began this public process in June 1998. A special committee of the Board is hosting a series of meetings to receive input on competition-related issues from our customers and other interested parties. The full Board will hear the recommendations of the special board committee as well as public comments at the end of the process with a final decision on the key issues scheduled for August 1998. This process will be followed by a rate redesign process, which will incorporate the decisions reached by the Board during the first public process, as well as other changes recommended to the District's electric rates, to prepare for competition, including the methodology to calculate stranded costs.

The Arizona Corporation Commission (the Commission) is continuing the process of determining what revisions to its December 26, 1996 Competition Rules are needed and receiving additional input on issues faced by the investor-owned utilities in implementing the rules. Following an evidentiary hearing on recovery of stranded costs, the Commission issued an order giving investor-owned utilities the option of (a) 100 percent recovery of stranded costs if the utility sells its generation assets at a divestiture auction, or (b) a percentage recovery of stranded costs, as determined appropriate by the Commission, for each utility that transfers its generation assets to a separate corporate affiliate at a value determined by the Commission. Additional revisions to the Commission Competition Rules are expected this summer.

At the federal level, FERC issued rules in 1996 relating to, among other things, open access to transmission lines. The rules require the District to provide reciprocal transmission service to others in order to use the open access tariffs of public utilities. The District has filed an open access transmission tariff with FERC, pursuant to rules FERC developed for nonjurisdictional entities like the District. A ruling on the filing is pending.

In April 1998, the District and Arizona Public Service Company (APS) entered into a memorandum of agreement to resolve disputed issues relating to competition. The agreement calls for the amendment of the 1955 Territorial Agreement between the parties to remove barriers to the provision of competitive electricity supply and the amendment of the Power Coordination Agreement to lower the price that the District charges APS for purchased power. The agreement also resolves certain political disputes between the two parties relating to electric industry competition.

▼ Regulatory Accounting

The District accounts for the financial effects of regulation in accordance with the provisions of SFAS No. 71, "Accounting for the Effects of Certain Types of Regulation," which requires cost-based, rate-regulated utilities to reflect the impacts of regulatory decisions in their financial statements. The District has two regulatory assets, unamortized bond defeasance losses incurred prior to fiscal year 1998, and costs related to the termination of a contract with Kaiser Coal Company. As of April 30, 1998 and 1997, the District had $196.5 million and $228.7 million, respectively, of regulatory assets which are included in deferred charges and other assets in the accompanying combined balance sheets. During fiscal year 1997, the Board authorized the District to accelerate the amortization of the regulatory assets given the competitive forces affecting the industry. The District is amortizing the regulatory asset balance over an eight-year period, beginning in fiscal year 1997. Bond defeasance losses incurred during fiscal year 1998 have been recorded as an extraordinary loss from early extinguishment of debt in the accompanying combined statements of net revenues, as the District has not been authorized by its Board to recover these losses in its rates.

If the District's operations cease to qualify for accounting under SFAS No. 71, whether due to competition or other regulatory actions, it would have to apply the provisions of SFAS No. 101, "Regulated Enterprises: Accounting for the Discontinuation of Application of FASB Statement No. 71," to the portion of its business which no longer meets the provisions of SFAS No. 71. Absent full recovery of any generation-related stranded costs, the required application of SFAS No. 101 could have a significant impact on the District's financial position or results of operations.

During 1997, the Emerging Issues Task Force (EITF) of the FASB issued EITF 97-4, which requires that SFAS No. 71 be discontinued no later than when legislation is passed, or a rate order is issued that contains sufficient detail to determine its effect on the portion of the business being deregulated. The District will discontinue the application of SFAS No. 71 to its generation-related assets upon appropriate Board action. Management believes that the implementation of EITF 97-4 will not require the District to write off any of its generation-related assets, or its regulatory assets, on the balance sheets as of April 30, 1998, because the legislation referred to above makes probable their recovery through a non-bypassable transition charge to its distribution customers. The consensus reached by the EITF in 97-4 will also permit the recording of new generation-related regulatory assets during the transition period that are probable of recovery through the transition charge.

If, during the transition period, events were to occur that made the recovery of these generation-related 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. At this time, the District is unable to determine what provisions or changes will ultimately occur during the restructuring process, or the effect, after the transition period, that competition will have on its financial position, cash flows, or results of operations.

▼ Long-Term Contracts

The District has long-term contracts for coal and purchase power commitments that are above current and future expected market rates (*see Note 9*). To position itself for a competitive environment in the electric utility industry, the District renegotiated a contract during fiscal year 1997 whereby the District pays $21.0 million per year in fiscal years 1998, 1999 and 2000 in return for a reduction in the long-term contract rate to the expected future market rate. The District was not authorized by its Board to recover this amount in rates. Therefore, the present value of the payments, $58.0 million, was reflected as a component of fuel expense.

(4) ACCUMULATED NET REVENUES:

The following table summarizes the two activities in accumulated net revenues; net unrealized gain on available-for-sale securities and net revenues (*$ in thousands*):

	Accumulated Net Revenues	Cumulative Net Unrealized Gain on Available-For-Sale Securities	Accumulated Net Revenues & Cumulative Net Unrealized Gain
Balance, April 30, 1996	$ 1,584,174	$ 17,871	$ 1,602,045
Net revenues	57,212	—	57,212
Net unrealized gain on available-for-sale securities	—	13,407	13,407
Balance, April 30, 1997	1,641,386	31,278	1,672,664
Net revenues	64,510	—	64,510
Net unrealized gain on available-for-sale securities	—	31,356	31,356
Balance, April 30, 1998	$ 1,705,896	$ 62,634	$ 1,768,530

The majority of unrealized gains originates from decommissioning trust and postretirement medical investment assets.

(5) LONG-TERM DEBT:

Long-term debt consists of the following at April 30:

	Interest Rate	1998 (Thousands)	1997 (Thousands)
Revenue bonds (mature through 2031)	4.0 – 7.2%	$ 2,934,688	$ 3,237,436
Unamortized bond discount		(83,605)	(97,612)
Total revenue bonds outstanding		2,851,083	3,139,824
Commercial paper	3.3 – 3.8%	525,000	375,000
Total long-term debt		3,376,083	3,514,824
Less: current portion		(73,910)	(82,716)
Total long-term debt net of current portion		$ 3,302,173	$ 3,432,108

The annual maturities of long-term debt (excluding commercial paper and unamortized bond discount) as of April 30, 1998, due in the fiscal years ending April 30, are as follows:

	(Thousands)
1999	$ 73,910
2000	71,635
2001	74,255
2002	71,940
2003	95,120
Thereafter	2,547,828
	$ 2,934,688

▼ 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 are $157.6 million and $176.7 million of debt service related funds as of April 30, 1998 and 1997, respectively.

The District has $82.4 million of mini-revenue bonds outstanding which can be redeemed at the option of the bondholder under certain circumstances. The District has a $50.0 million revolving credit agreement available to refinance these bonds in the event significant redemption requests occur. Based on historical redemptions made on these bonds, management believes that these credit agreements are more than sufficient.

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, 1998 and 1997, the debt service coverage ratio was 3.02 and 2.45, respectively.

Interest and the amortization of the bond discount and issue expense on the various issues results in an effective rate of 5.85 percent over the remaining term of the bonds.

On October 15, 1997, and December 17, 1997, the District issued approximately $256.0 million, 1997 Series A Bonds and approximately $35.2 million, 1997 Series B and C Bonds, to refund, together with other available funds and the issuance of $150.0 million in commercial paper, approximately $286.5 million and $232.0 million Electric System Revenue Bonds, respectively. This refunding resulted in lower future debt service requirements as well as an extraordinary loss on early extinguishment of debt of $18.2 million.

The District has authorization from the Commission to issue additional electric system revenue bonds totaling $72.8 million principal amount and electric system refunding revenue bonds totaling $2.9 billion principal amount.

▼ Commercial Paper

The District has issued $525.0 million of tax-exempt commercial paper consisting of $375.0 million original issue and $150.0 million Series A issue, initiated in fiscal year 1998. Both issues have average interest rates to the District of 3.6 percent. The commercial paper matures not more than 270 days from the date of issuance and is an unsecured obligation of the District. The commercial paper has been classified as long-term debt in the accompanying combined balance sheets in connection with refinancing terms under two revolving line-of-credit agreements which support the commercial paper. Under the terms of these two agreements, the District may borrow up to $525.0 million through February 5, 2001.

While the two agreements contain covenants which could prohibit borrowing under certain conditions, management believes that financing will 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 which secured 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, a guarantee by the Association, and the District's taxing authority. As of April 30, 1998, the amount of defeased general obligation bonds outstanding was $18.2 million.

▼ Line-of-Credit Arrangements

In addition to the $50.0 million revolving line-of-credit agreement, which supports the mini-revenue bonds, and the $525.0 million in revolving line-of-credit agreements, which support the commercial paper, SRP has a $25.0 million revolving line-of-credit agreement available for general corporate purposes.

Among other restrictions, covenants within the line-of-credit agreements require SRP to maintain minimum accumulated net revenues of $1.1 billion plus 50 percent of accumulated net revenues earned subsequent to April 30, 1995, or $1.2 billion at April 30, 1998. Additionally, the agreements require SRP to maintain a minimum debt service coverage ratio of 1.35.

(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

SRP 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 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 to maturity.

▼ 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 to maturity.

▼ Other Current Assets and Liabilities

The carrying amounts of receivables, accounts payable, customer deposits and other current liabilities in the accompanying combined balance sheets approximate fair value because of their short term to maturity.

The estimated fair values of SRP's financial instruments, excluding those instruments where the carrying amount approximates fair value, at April 30, are as follows:

	(Thousands)			
	1998		1997	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Investments in marketable securities:				
Other investments	$ 41,878	$ 42,058	$ 87,600	$ 87,489
Segregated funds	359,816	360,476	321,348	320,555
Temporary investments	342,441	342,565	275,585	275,599
Long-term debt	$ 3,376,083	$ 3,528,775	$ 3,514,824	$ 3,592,596

▼ Accounting for Debt and Equity Securities

SRP's investments in debt securities are reported at amortized cost if the intent is to hold the security to maturity. At April 30, 1998, SRP investments in debt securities have maturity dates ranging from May 1, 1998 to July 1, 2004. Other debt and equity securities are reported at market, with unrealized gains or losses included as a separate component of accumulated net revenues. SRP's investments in debt and equity securities are included in temporary investments, segregated funds and non-utility plant and other investments in the accompanying combined balance sheets.

(7) EMPLOYEE BENEFIT PLANS, INCENTIVE PROGRAM AND SEVERANCE PLANS:

▼ Defined Benefit Pension Plan

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. Contributions of $10.5 million and $8.5 million were made to the Plan in fiscal years 1998 and 1997, respectively.

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. The unrecognized prior service cost is being amortized over a remaining average of seven years.

The components of the net periodic pension cost (a portion of which has been capitalized as a component of construction costs), at April 30, are as follows:

	(Thousands)	
	1998	1997
Service cost	$ 12,860	$ 13,387
Interest cost	32,367	31,250
Actual return on Plan assets	(97,637)	(74,446)
Net amortization and deferral	54,388	35,993
Net periodic pension cost	$ 1,978	$ 6,184

The following schedule reconciles the funded status of the Plan (based on January 31 actuarial valuation dates) with amounts reported in SRP's combined financial statements as of April 30:

	(Thousands)	
Measurement date	1998	1997
Actuarial present value of projected benefit obligation		
Vested benefit obligation	$ (423,325)	$ (348,767)
Nonvested benefit obligation	(13,065)	(12,972)
Accumulated benefit obligation	(436,390)	(361,739)
Effect of projected future compensation levels	(68,512)	(65,906)
Projected benefit obligation	(504,902)	(427,645)
Plan assets at fair value	599,766	512,451
Funded status	94,864	84,806
Unrecognized transition asset	(16,047)	(20,065)
Unrecognized net gain	(50,534)	(46,318)
Unrecognized prior service cost	2,831	3,373
Prepaid pension cost	$ 31,114	$ 21,796

The discount rates used in determining the actuarial present value of the projected benefit obligation for fiscal years 1998 and 1997, were 6.75 percent and 7.75 percent, respectively. The rate of increase used to determine future compensation levels was 4.0 percent and 4.5 percent for fiscal years 1998 and 1997, respectively. The expected long-term rate of return on assets was 8.25 percent and 8.75 percent for fiscal years 1998 and 1997, respectively.

▼ 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 $4.6 million and $4.3 million during fiscal years 1998 and 1997, respectively.

▼ Other Postretirement Benefits

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 all retired employees. Employees are eligible for coverage if they retire at age 65 or older with at least five years of vested service, or any time after age 55 with a minimum of ten years of vested service.

Plan assets consist of domestic bonds and commercial mortgage investments held by an external insurance company to provide for life insurance benefits. The funding policy is discretionary and is based on actuarial determinations. The unrecognized transition obligation is being amortized over 20 years, beginning in 1994.

The components of the postretirement benefit cost (a portion of which has been capitalized as a component of construction costs), at April 30, are as follows:

	(Thousands)	
	1998	1997
Service cost	$ 3,428	$ 3,653
Interest cost	9,476	9,084
Actual return on plan assets	(513)	(146)
Amortization of transition obligation	5,850	5,850
Unrecognized gain	(1,416)	(1,189)
Postretirement benefit expense	$ 16,825	$ 17,252

The following schedule reconciles the funded status of postretirement benefits (based on January 31 actuarial valuation dates) with amounts reported in SRP's combined financial statements as of April 30:

	(Thousands)	
	1998	1997
Plan assets at fair value	$ 5,602	$ 5,378
Actuarial present value of accumulated postretirement benefit obligations:		
Retirees	(64,200)	(64,458)
Fully eligible active employees	(12,756)	(12,438)
Other active employees	(46,324)	(48,404)
Accumulated benefit obligations	(123,280)	(125,300)
Accumulated benefit obligations in excess of plan assets	(117,678)	(119,922)
Unrecognized transition obligations	84,903	93,615
Unrecognized net gain	(44,798)	(36,717)
Benefits paid – February to April	1,337	1,173
Accrued postretirement benefit liability	$ (76,236)	$ (61,851)

For fiscal year 1998, different health care cost trends are used for pre-Medicare and post-Medicare expenses. Pre-Medicare trend rates for fiscal year 1998 are 10.0 percent grading down to 5.25 percent. Post-Medicare trend rates for fiscal year 1998 are 7.0 percent grading down to 5.25 percent. The effect of a one percent increase in the assumed health care cost trend rates for each future year would have increased the accumulated postretirement benefit obligation at January 31, 1998, by $14.0 million, and increased the aggregate of the service and interest cost components by approximately $1.7 million for fiscal year 1998. The annual discount rates used in the January 31, 1998 and 1997 valuations were 6.75 percent and 7.75 percent, respectively. The expected long-term rate of return on plan assets is 7.0 percent.

▼ Severance Plans

In fiscal year 1997, SRP adopted the 1997 Salaried Severance Plan and the 1997 Hourly Severance Plan (the Severance Plans). The Severance Plans provided for the targeted elimination of approximately 119 positions and the voluntary elimination of approximately 100 positions. The Severance Plans provided for a severance benefit in accordance with SRP's employee guidelines. SRP had accrued in other current liabilities in the accompanying combined balance sheets $8.7 million related to these Severance Plans as of April 30, 1997. During fiscal year 1998, $7.3 million was paid related to the Severance Plans and the remaining April 30, 1997 accrual was reversed.

▼ Employee Incentive Compensation Program

SRP has an incentive compensation program that covers substantially all regular employees. The incentive compensation amount is based on achievement of pre-established targets. An accrual of $14.1 million and $18.0 million for fiscal years ended April 30, 1998 and 1997, respectively, 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 $2.2 million and $3.0 million at April 30, 1998 and 1997, respectively.

(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, 1998:

		(Thousands)		
Generating Station	Ownership Share	Plant in Service	Accumulated Depreciation	Construction Work In Progress
Four Corners (NM) (Units 4 & 5)	10.00%	$ 97,194	$ (55,936)	$ 5,399
Mohave (NV) (Units 1 & 2)	10.00%	58,692	(33,413)	4,506
Navajo (AZ) (Units 1, 2 & 3)	21.70%	293,172	(146,094)	43,016
Hayden (CO) (Unit 2)	50.00%	72,392	(44,883)	13,427
Craig (CO) (Units 1 & 2)	29.00%	237,066	(119,702)	2,565
PVNGS (AZ) (Units 1, 2 & 3)	17.49%	1,694,752	(698,765)	6,425
		$ 2,453,268	$ (1,098,793)	$ 75,338

The District acts as the operating agent for the participants in the Navajo Generating Station (NGS).

The construction work in progress balances at NGS and Hayden of approximately $43.0 million and $13.4 million, respectively, represent primarily the installation of scrubbers *(see Notes 9 and 10)*.

(9) 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 counter-parties for financial hedge transactions, and power purchasers and sellers. The District's contingent liability under guarantees for New West Energy are limited to an aggregate of $40.0 million.

▼ Construction Program

The construction program represents SRP's six-year plan for major construction projects and ongoing improvements to existing generation, transmission, distribution and irrigation assets. For the 1999-2004 period, SRP estimates capital expenditures of approximately $1.7 billion. Planned major construction projects include the addition of scrubbers at NGS and Hayden as well as other key strategic distribution and transmission projects.

▼ Long-Term Power Contracts

The District entered into three contracts with the United States Bureau of Reclamation (United States), the Western Area Power Administration, and the Central Arizona Water Conservation District (CAWCD). The contracts, among other things, provide for the long-term sale to the District of NGS surplus through September 2011. The amount of NGS surplus available to the District varies annually and is expected to decline over the life of the contracts. The District has the right to use and to schedule power and energy associated with the United States' entitlement to NGS. The District pays a fixed amount for these benefits, pays the cost of NGS generation and other related costs, and supplies energy to CAWCD for Central Arizona Project facilities at cost. The fixed portion of the District's payment obligations under the three contracts totals $47.0 million annually through fiscal year 2003, and $402.7 million thereafter. Of the total obligation, $25.2 million annually through fiscal year 2003 and $214.0 million thereafter is unconditionally payable regardless of the availability of power. Payments under these contracts totaled $90.0 million and $86.0 million in fiscal years 1998 and 1997, respectively.

The District entered into two additional long-term power purchase agreements to obtain a portion of its projected load requirements through 2011. Minimum payments under these contracts are $36.0 million annually through fiscal year 2003, and $298.0 million thereafter. Total payments, including the minimum payments, under these two contracts were $48.0 million and $44.0 million in fiscal years 1998 and 1997, respectively.

▼ Fuel Supply

At April 30, 1998, minimum payments under long-term coal contract commitments range from $153 million to $123 million annually through fiscal year 2003, and $787 million thereafter *(see Note 3)*.

(10) CONTINGENCIES:

▼ Nuclear Insurance

Under existing law, public liability claims that could arise from a single nuclear incident are limited to $8.9 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 $75.5 million subject to a 5 percent surcharge which could be 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 $41.6 million, including the 5 percent surcharge, but would be limited to $5.2 million per incident in any one year.

▼ 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 which it believes may require remediation. Such requirements have resulted and will continue to result in increased costs associated with the operation of existing properties.

Δ Air Quality

The federal Clean Air Act (CAA), 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. Craig Generating Station (Craig) and Mohave Generating Station (Mohave) have been identified as possible sources of visibility impairment under the CAA and visibility studies are still underway at these plants. The District estimates its costs to comply with the CAA at Craig and Mohave to be approximately $43.0 million and has adequate amounts in the capital contingencies portion of the 1999-2004 construction program for potential CAA compliance programs.

In addition, the District and the other owners of Craig and Mohave have been named in complaints alleging, among other things, violations of opacity standards. Although the impact of these complaints cannot be estimated until further analysis is completed, management believes that existing environmental reserves will adequately cover any resulting liability.

The District and the other owners of Hayden negotiated an out-of-court settlement of a lawsuit alleging, among other things, visibility impairment and violations of opacity standards by Hayden Unit 2. Under terms of this settlement, the District paid $1.3 million in penalties and will provide for additional pollution control equipment on Unit 2.

Scrubbers are being installed at NGS and Hayden. Capital expenditures of $33.5 million for the District's share of the cost of these projects are included in the District's 1999-2004 construction program.

Δ Coal Mine Reclamation

The District believes it is contractually obligated to reimburse certain coal providers for amounts due for certain coal mine reclamation costs. In management's opinion, there are sufficient accruals in the accompanying combined financial statements, which represent the District's best estimate of the amounts for which this obligation may be settled.

The District may be obligated to reimburse certain coal providers for amounts due for certain other coal mine reclamation costs. However, neither the District's responsibility nor 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.

▼ 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. 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

SRP maintains self insurance retention on certain matters. In addition, SRP has indemnity coverage for amounts in excess of its self insurance retention levels. SRP 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 SRP's financial position or results of operations.

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, 1998 and 1997, and the related combined statements of net revenues 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 generally accepted auditing standards. 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, 1998 and 1997, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

Arthur Andersen LLP

Phoenix, Arizona
May 29, 1998

Boards

The two Boards of Salt River Project work with management to establish policies to further the business affairs of SRP.

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 utility and a political subdivision of Arizona.

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.

Most often, candidates seek election to both Boards.

Emil M. Rovey
District/Division 1, Association & District

Clarence C. Pendergast Jr.
District/Division 2, Association & District

Elvin E. Fleming
District/Division 3, Association & District

Gilbert R. Rogers
District/Division 4, Association & District

Carl E. Weller
District/Division 5, Association & District

James L. Diller
District/Division 6, Association & District

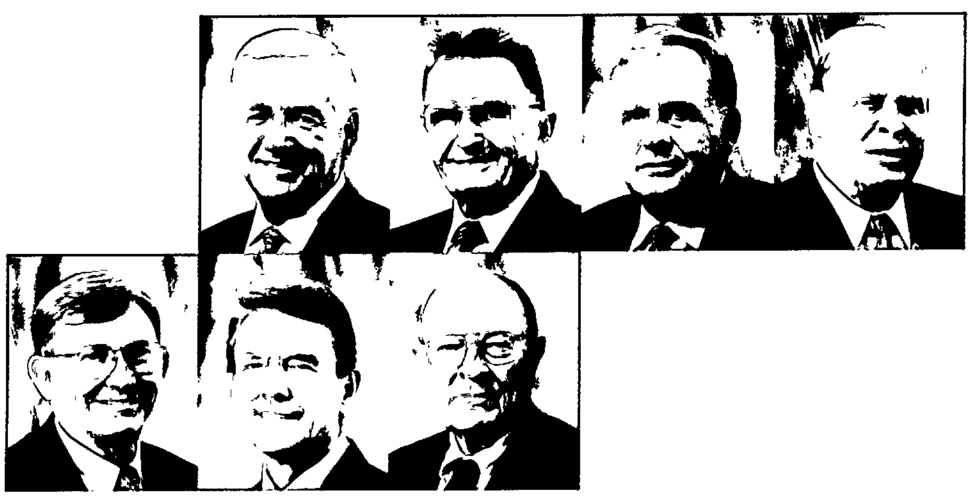
Ann Maitland Burton
District/Division 7, Association & District

Martin Kempton
District/Division 8, Association & District

Dale C. Riggins Jr.
District/Division 9, Association & District

Dwayne E. Dobson
District/Division 10, Association & District

Eldon Rudd
Director-At-Large, Seat 11

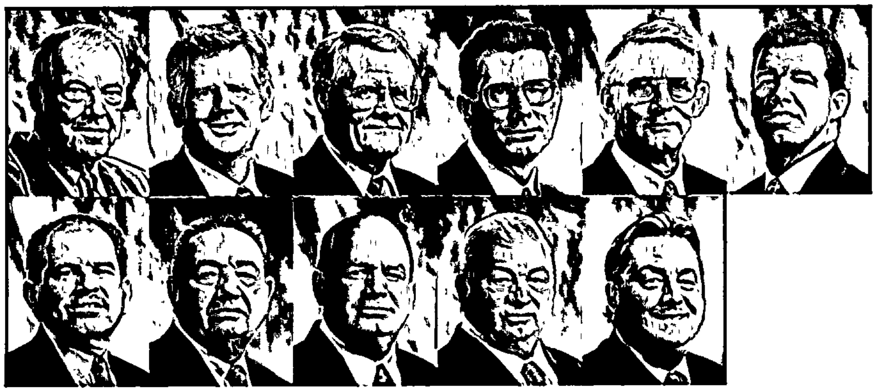


William W. Arnett
Director-At-Large, Seat 12

Fred J. Ash
Director-At-Large, Seat 13

James R. Marshall
Director-At-Large, Seat 14

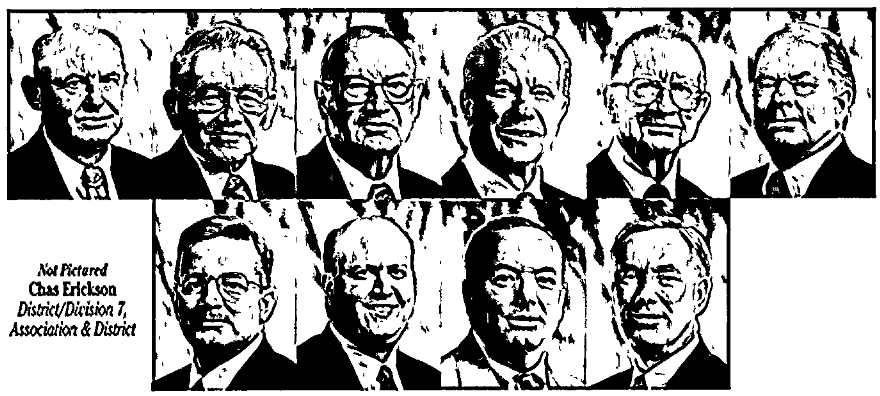
Robert L. Cook, District/Division 1, Association & District
Kevin J. Johnson, District/Division 1, Association & District
John R. Starr, District/Division 1, Association & District
Wayne A. Hart, District/Division 2, Association & District
John A. Vanderwey, District/Division 2, Association & District
Robert L. Van Hofwegen, District/Division 3, Association & District



Mario J. Herrera, District/Division 3, Association & District
John E. Anderson, District/Division 3, Association & District
Lloyd E. Banning, District/Division 4, Association & District
Charles D. Coppinger, District/Division 4, Association & District
Leslie C. Williams, District/Division 4, Association & District

Larry D. Rovey, Council Vice Chairman, District/Division 2, Association & District
David Rousseau, Council Chairman, District/Division 6, Association & District

Wayne A. Weiler, District/Division 5, Association & District
Edmund Navarro, District/Division 5, Association & District
Roy W. Cheatham, District/Division 5, Association & District
Ben A. Butler, Division 6, District
Clarence J. Duncan, District/Division 6, Association & District
Robert W. Warren, District 6, Association



Not Pictured
Chas Erickson, District/Division 7, Association & District

Mark A. Lewis, District/Division 7, Association & District
Keith Woods, District/Division 7, Association & District
John R. Hoopes, District/Division 8, Association & District
Robert G. Kempton, District/Division 8, Association & District

Councils

The two Councils of Salt River Project enact and amend bylaws relating to business affairs of SRP and also serve as liaisons to landowners. 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 in each of the 10 divisions.

The 30 Association Council members are elected to staggered four-year terms from the 10 districts within the Association.

Most often, candidates seek election to both Councils.

Mark V. Pace, District/Division 8, Association & District
W. Curtis Dana, District/Division 9, Association & District
Arthur L. Freeman, District/Division 9, Association & District
Edward E. Johnson, District/Division 9, Association & District

Orland R. Hatch, District/Division 10, Association & District
Lawrence P. Schrader, District/Division 10, Association & District
C. Dale Willis, District/Division 10, Association & District

Corporate Officers

President	William P. Schrader
Vice President	John M. Williams Jr.
Secretary	Terrill A. Lonon
Treasurer	Dean K. Yee

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

A special thank you to the SRP customers who took time from their busy schedules to participate in this annual report.

This report was produced by Susan Albrecht, Editor; Jeryl Jones, Designer; and Kevin Kriesel-Coons, Senior Photographer; SRP Public & Communications Services.

This report is printed on recycled paper.

FIVE-YEAR FINANCIAL & OPERATIONAL REVIEW*

Financial Data ($000)	1998	1997	1996	1995	1994
Total operating revenues	$1,536,734	$1,457,634	$1,355,391	$1,367,513	$1,269,004
Electric revenues	1,524,959	1,446,114	1,345,366	1,357,258	1,261,004
Water and irrigation revenues	11,775	11,520	10,025	10,255	8,000
Total operating expenses	1,308,396	1,243,466	1,042,162	1,088,472	997,848
Total other income, net	39,953	40,134	(16,813)	28,182	14,568
Net financing costs	185,589	197,090	202,040	207,154	214,339
Net revenues for the year	64,510	57,212	94,376	100,069	71,385
Taxes and tax equivalents	93,046	87,219	102,457	105,856	101,821
Utility plant, gross	6,835,959	6,613,273	6,427,563	6,304,600	6,144,158
Long-term debt	3,302,173	3,432,108	3,517,049	3,593,072	3,653,309
Electric-revenue contributions to support water operations	$ 36,216	$ 38,584	$ 28,170	$ 31,791	$ 36,153

Selected Data

Selected Data	1998	1997	1996	1995	1994
Total energy sources (million kWh)**	28,328	26,926	23,368	24,649	21,177
Total electric sales (million kWh)	26,202	25,072	21,836	23,067	19,721
Total capacity over peak (kW)**	5,730,000	5,727,000	5,062,000	5,085,000	4,439,000
Peak-SRP customers (kW)	4,244,000	4,246,000	4,070,000	3,854,000	3,456,000
Peak-overall power system (kW)	5,086,000	5,427,000	4,891,000	4,593,000	3,904,000
Water deliveries (acre-feet)	–	1,004,634	1,030,090	944,429	853,150
Runoff (af)	–	662,174	348,402	1,887,683	733,018
Debt service coverage ratio	2.63	2.45	2.72	2.50	2.25
Debt ratio (percent)	65.1	67.2	68.7	70.6	72.4
Employees at year-end	4,098	4,276	4,261	4,256	4,585
Customers at year-end	671,096	648,756	625,005	602,418	582,406

**Water data is by calendar year; all other data is by fiscal year ending April 30.*

***Includes SRP participation in jointly owned projects.*

-NOTICE-

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