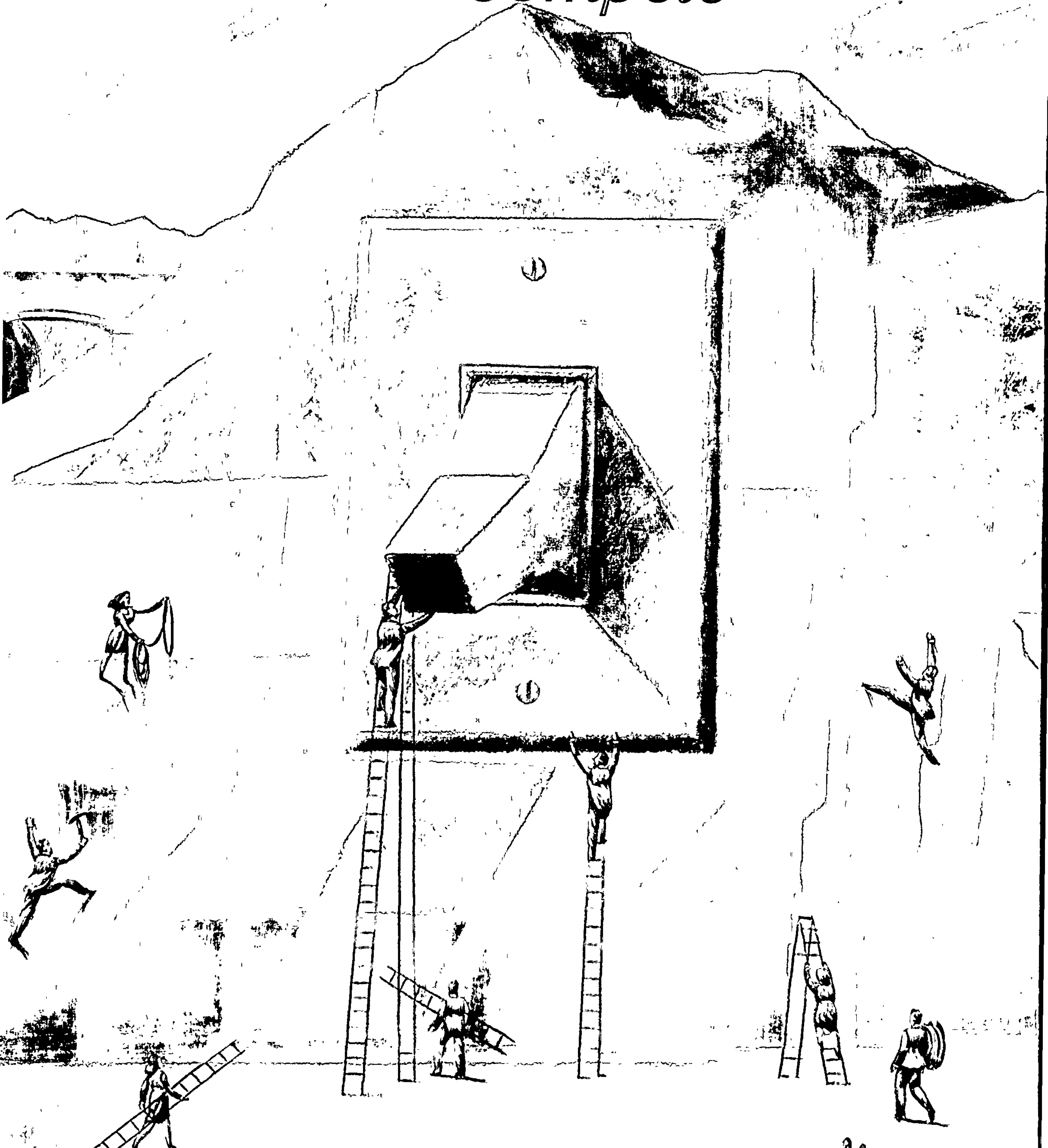
Choosing to Compete



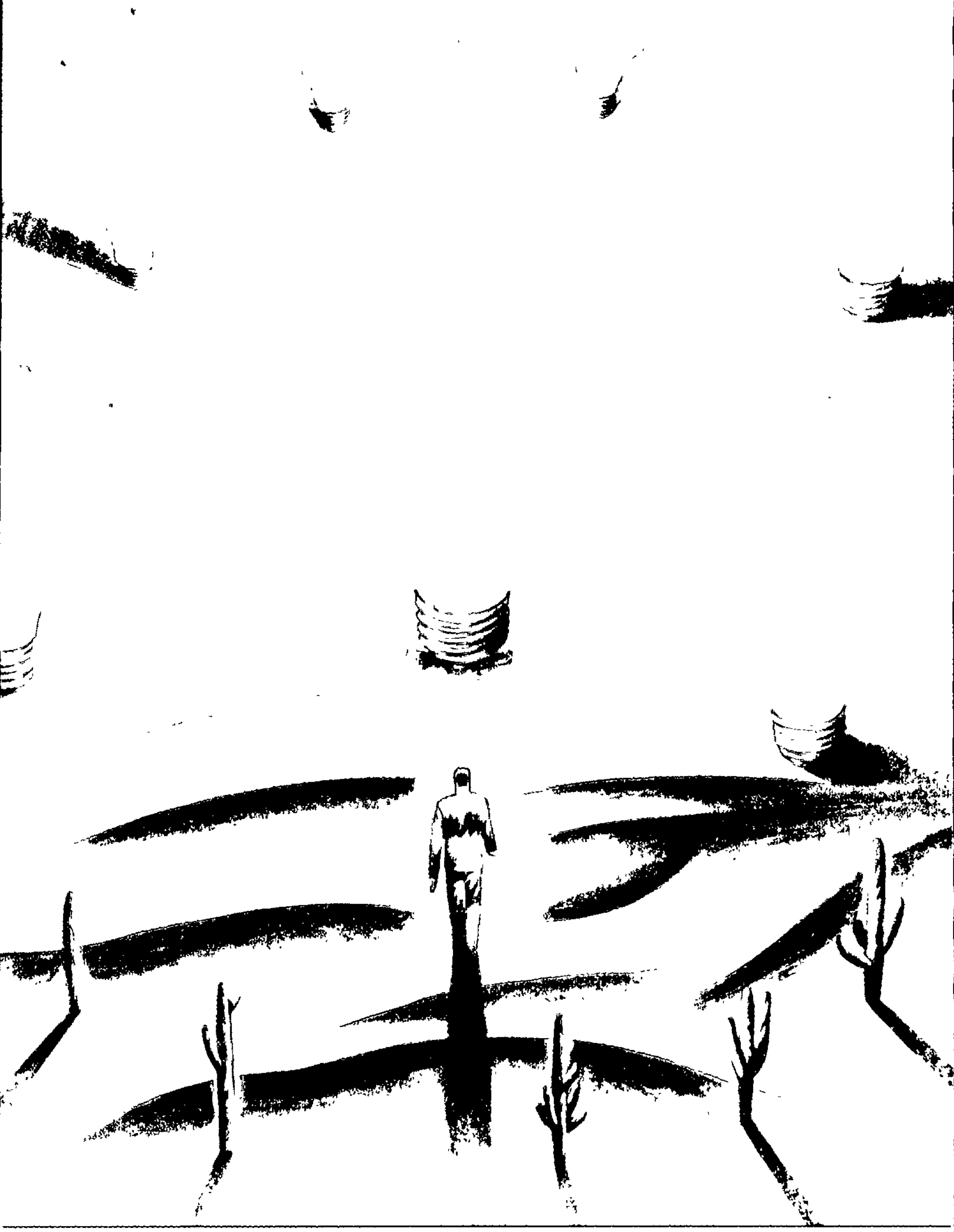
Salt River Project
1996-97 Annual Report

FIVE-YEAR FINANCIAL & OPERATIONAL REVIEW*

Financial Data ($000)	1997	1996	1995	1994	1993
Total operating revenues	$1,457,634	$1,355,391	$1,367,513	$1,269,004	$1,227,066
Electric revenues	1,446,114	1,345,366	1,357,258	1,261,004	1,219,908
Water and irrigation revenues	11,520	10,025	10,255	8,000	7,158
Total operating expenses	1,234,828	1,033,534	1,079,514	990,531	956,325
Total other income, net	40,134	(16,813)	28,182	14,568	20,427
Net financing costs	205,728	210,668	216,112	221,656	236,204
Net revenues for the year	57,212	94,376	100,069	71,385	54,962
Taxes and tax equivalents	87,219	102,457	105,856	101,821	98,142
Utility plant, gross	6,613,273	6,427,563	6,304,600	6,144,158	5,973,092
Long-term debt	3,432,108	3,517,049	3,593,072	3,653,309	3,648,626
Electric-revenue contributions to support water operations	38,584	28,170	31,791	36,153	26,530
Funds available for corporate purposes	$ 257,031	$ 313,705	$ 255,282	$ 200,948	$ 185,121

Selected Data					
Total energy sources (million kWh)**	26,926	23,368	24,649	21,177	20,620
Total electric sales (million kWh)	25,072	21,836	23,067	19,721	19,316
Total capacity over peak (kW)**	5,727,000	5,062,000	5,085,000	4,439,000	4,378,000
Peak-Project customers (kW)	4,246,000	4,070,000	3,854,000	3,456,000	3,440,000
Peak-overall power system (kW)	5,427,000	4,891,000	4,593,000	3,904,000	3,912,000
Water deliveries (acre-feet)	–	1,030,090	944,429	853,150	985,088
Runoff (af)	–	348,402	1,887,683	733,018	4,150,640
Debt service coverage ratio	2.45	2.72	2.50	2.25	2.11
Debt ratio (percent)	67.2	68.7	70.6	72.4	73.5
Employees at year-end	4,276	4,261	4,256	4,585	4,669
Customers at year-end	648,756	625,005	602,418	582,406	563,846

**Water data is by calendar year; all other data is by fiscal year.*
***Includes SRP participation in jointly owned projects.*



SECOND QUARTER REPORT
FISCAL YEAR 1997-98

MESSAGE FROM MANAGEMENT

In Arizona, efforts are being stepped up at the state Legislature, the Arizona Corporation Commission and at SRP to address the details of electric utility industry deregulation.

In the Arizona House of Representatives, a measure that proposes a faster transition to a competitive marketplace than called for by the corporation commission has received favorable committee action. The bill contains many important consumer protection elements and includes provisions for participation in competition by public power utilities such as SRP.

At the corporation commission, which regulates private utilities, key issues are being debated such as stranded costs.

SRP intends to hold proceedings this spring and summer to deal with stranded costs, unbundling of rates, and other details necessary to be ready for the phase-in of competition on Jan. 1, 1999.

We are involved in policy discussions at the state and federal levels to help ensure that the interests of our customers are served. We are strong supporters of customer choice, and favor a move toward a competitive industry sooner rather than later.

We realize, however, that competition will tempt some to use unfounded allegations and irresponsible tactics. For example, SRP responded to a recent challenge by clarifying once again that its for-profit affiliate, New West Energy, is competing on the same regulatory footing as private-sector firms. And that wholesale sales between SRP and New West, which is competing for retail sales in California, are valid activities.

In other activity during the second quarter, a refunding sale of electric system revenue bonds resulted in gross debt service savings of $112 million. A minibond refunding, started during the quarter and completed during the third quarter, will bring savings estimated at $42 million.

William P. Schrader
President

Richard H. Silverman
General Manager

ELECTRIC AND WATER OPERATIONS

Total revenues were up 6 percent from the first quarter of the fiscal year and increased 7 percent for the six months from May to October over the same period last year. Our residential and commercial sales revenue activity continues at a strong and healthy pace, ahead of projections at a 5 percent increase year-to-date over the same period last year. Likewise, a favorable resale market pushed revenues in this category up 38 percent year-to-date.

In water operations, storage in the SRP reservoir system remained at below-normal levels as the state continued to experience less-than-average precipitation during the quarter. The start of the new year, however, brings above-average precipitation, and as we enter the spring months, increased rain and runoff is expected to boost storage levels.

SRP Financial Highlights
($Millions - Unaudited)

	Three Months Ended October 31		Six Months Ended October 31	
	FY1998	FY1997	FY1998	FY1997
Funds Available for Corporate Purposes*	$184.0	$168.7	$322.6	$290.8
Debt Service Coverage	4.29	4.02	3.95	3.69
Debt Ratio (as of Oct. 31)	64.4	65.9	-	-
Cost per kWh sold (cents)	4.63	4.25	4.59	4.37

Operational Data

Sales (thousand kWh)	7,637,986	7,355,375	14,377,744	13,469,551
Electric Customers (as of Oct. 31)	655,173	632,363	-	-
Water Deliveries (acre-feet)	286,158	256,511	542,669	618,950
Water in Storage (af) (as of Oct. 31)	715,270	805,665	-	-

SRP Combined Statement of Net Revenues
($Thousands - Unaudited)

	Three Months Ended October 31		Six Months Ended October 31	
	FY1998	FY1997	FY1998	FY1997
Operating Revenues				
Electric	$505,876	$477,490	$935,416	$875,402
Water	2,121	1,816	4,718	4,818
Total Operating Revenues**	507,997	479,306	940,134	880,220
Operating Expenses				
Fuel	70,072	75,853	132,653	139,859
Purchased Power	67,496	55,750	126,707	104,835
Operations**	94,188	86,314	162,568	148,029
Maintenance	34,399	22,103	62,629	40,179
Depreciation	62,454	55,467	124,412	110,186
Taxes and Tax Equivalents	22,238	17,812	46,544	44,287
Total Operating Expenses	350,847	313,299	655,513	587,375
Net Operating Revenues	157,150	166,007	284,621	292,845
Other Income				
Interest income	11,331	10,714	21,359	19,912
Other income (deductions), net	(1,522)	(1,760)	(2,715)	(3,662)
Total Other Income	9,809	8,954	18,644	16,250
NET FINANCING COSTS	48,085	51,866	97,166	104,876
NET REVENUES	$118,874	$123,095	$206,099	$204,219

* Recalculated based on methodology applied to FY95-96.
** Intercompany transactions eliminated

SRP Combined Balance Sheets*

(October 31, 1997, and 1996 - $Thousands - Unaudited)

	FY1998	FY1997
ASSETS		
Utility Plant, at Original Cost	$6,731,854	$6,489,897
Less: Accumulated Depreciation	2,406,280	2,180,278
	4,325,574	4,309,619
Other Property and Investments	376,486	297,814
Current Assets		
Cash and Cash Equivalents	99,763	52,121
Temporary Investments	411,551	456,218
Current Portion, Segregated Funds	214,285	125,128
Receivables, Net	193,761	173,093
Fuel Stocks	18,328	26,563
Materials and Supplies	74,231	72,453
Other	19,826	19,329
	1,031,745	924,905
Deferred Charges	284,009	323,536
TOTAL ASSETS	$6,017,814	$5,855,874
CAPITALIZATION & LIABILITIES		
Capitalization		
Accumulated Net Revenues, beginning of quarter	1,776,456	1,682,591
Net Revenues for the quarter	118,874	123,095
Net unrealized Gain (Loss) on Securities, for the quarter	(3,877)	7,977
Accumulated Net Revenues, end of quarter	1,891,453	1,813,663
Long-Term Debt	3,414,763	3,511,110
	5,306,216	5,324,773
Current Liabilities		
Current Portion, Long-Term Debt	82,716	78,104
Accounts Payable	87,805	68,252
Accrued Taxes and Tax Equivalents	69,242	42,671
Accrued Interest	142,629	63,332
Other	110,801	123,049
	493,193	375,408
Deferred Credits	218,405	155,693
TOTAL CAPITALIZATION & LIABILITIES	$6,017,814	$5,855,874

*These unaudited financial statements should be read in conjunction with the Notes to the Financial Statements appearing in Salt River Project's 1996-97 Annual Report.

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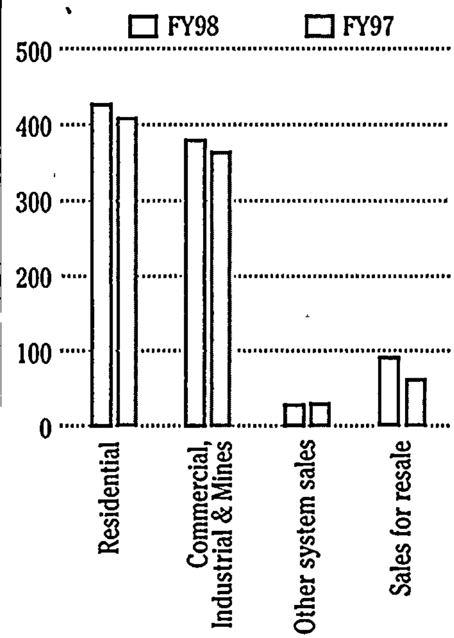
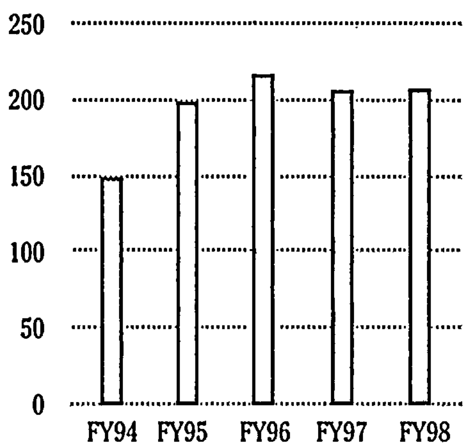
Electric Revenues

($Millions, Year to date)



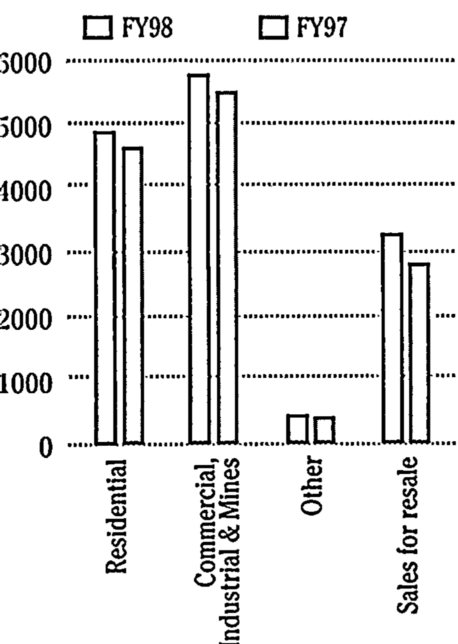
Combined Net Revenues

($Millions, Year to date)



Electric Sales

(GWh, Year to date)



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SRP (Salt River Project) is a major multipurpose reclamation project serving electric customers and water shareholders in the Phoenix 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.

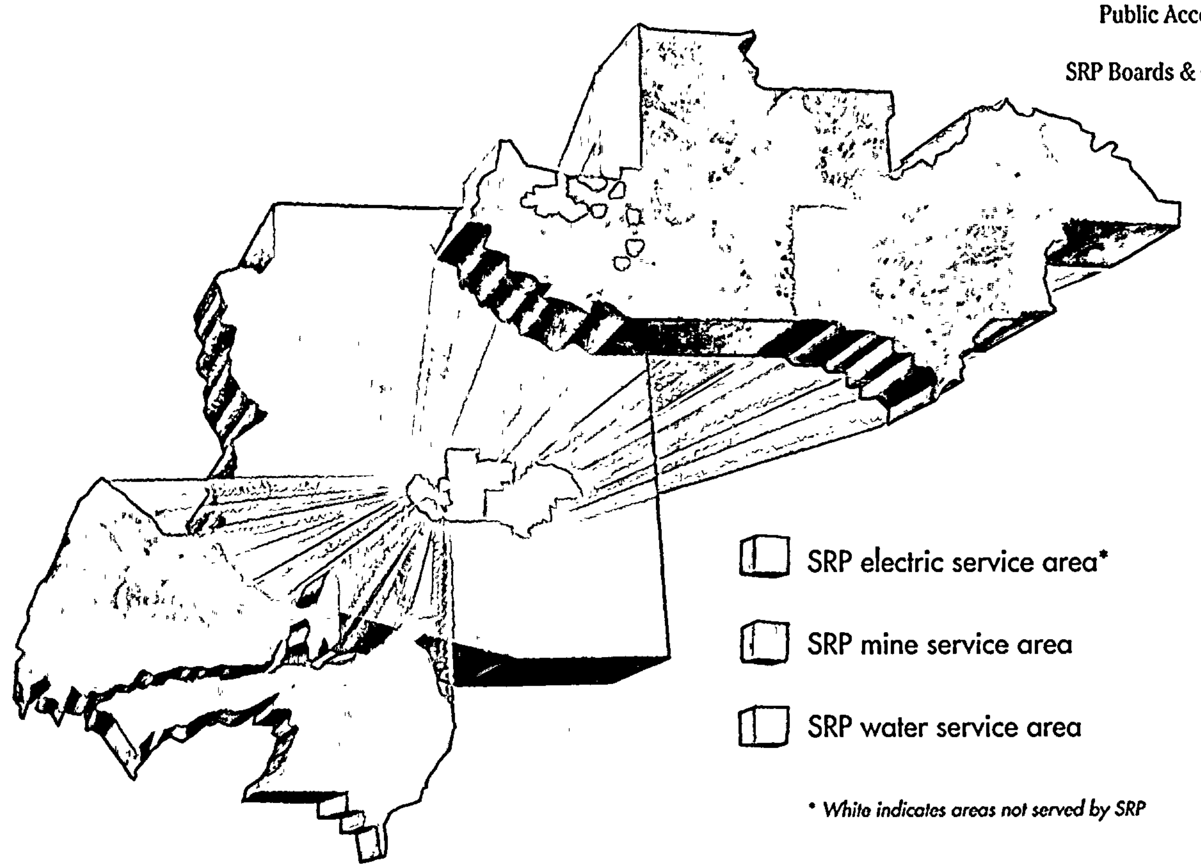
The District provides electricity to about 648,756 customers in the Phoenix area, which is commonly described as the Valley. SRP operates or participates in seven power plants and numerous other generating stations in Arizona, including thermal, nuclear and hydroelectric sources.

The District serves a 2,900-square-mile area spanning portions of Maricopa, Gila and Pinal counties in central Arizona.

The Association delivers nearly 1 million acre-feet of water to a 240,000-acre service area in central Arizona. An extensive water delivery system is maintained and operated by the Association.

SRP reservoirs feed a 131-mile canal system that, along with other smaller waterways, carries water to eight cities as well as agricultural and urban irrigators.

Contents



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SRP on the Internet: www.srp.gov

Letter to Bondholders, Shareholders & Customers

SRP's attention was captivated this year by Arizona's emerging interest in deregulating the electric utility industry. But if you take a look at our annual reports of the past few years, you'll see deregulation is no surprise.

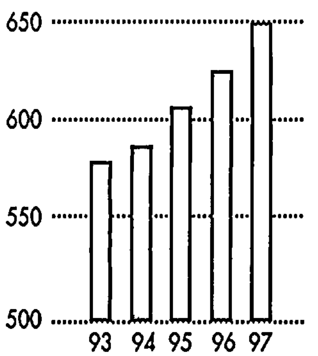
In fact, we've been preparing for years for what we consider to be the central issue in a deregulated industry: competition for customers. We have been making steady progress with operational improvements that better prepare us to bring the benefits of competition to our electric customers.

A tally of our financial measures for the year shows our progress. Net revenues were $57.2 million, although they would have topped last year's result had we not made the decision to restructure some long-term obligations to sharpen our future competitive position. We continue to trim our debt-to-capitalization ratio, and our internally generated cash continues to fund all capital programs without the need for increased borrowing.

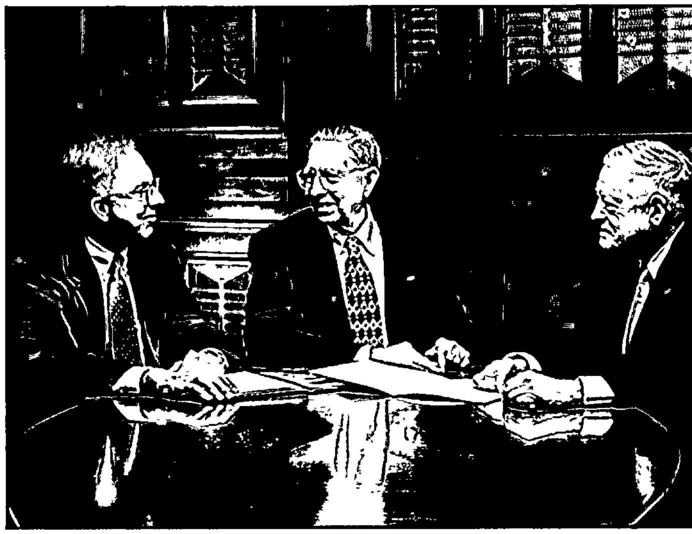
Despite recent rate reductions for all customers, operating revenues showed strong growth at 7.5 percent, buoyed by an increase in kilowatt-hour sales of nearly 15 percent and a vibrant local economy.

SRP's water business is a key ingredient to the Valley's continuing economic vitality and growth. Water is the lifeblood of our service area, fueling the electric business by supporting new industry and commerce. Of particular note is the semiconductor industry — water-dependent and requiring reliable power — which continues to be a major growth sector in our service territory. In fact, we have the second-largest semiconductor customer base in the West.

Electric Customers
(Thousands)



Customer growth continues at a healthy pace, up about 4 percent this year and up 13 percent over five years.



Richard H. Silverman, General Manager, *left*
William P. Schrader, President, *center*
John M. Williams Jr., Vice President, *right*

Population growth continues at above-average levels as people move to our beautiful state, assured of the potential for jobs and a high quality of life. Consequently, SRP customer growth continues to grow at a healthy pace. Customer numbers were up 4 percent for the year and 15 percent over five years.

This report discusses our commitment to compete in the new utility world, our involvement in the state and national debate, and how we are changing our organization to be primed for competition. The relationship between water and power is the essence of SRP's unique status, and offers us a great advantage in building loyalty and commitment with both electric customers and water shareholders.

We recognize we are entering a critical period, and we are committed to making the decisions that will be required. We are confident in our management team, and look to them to help guide us through the deregulation maze. Together, we manage this organization like we own it.

We are totally invested, with you, in the continued success of SRP.

William P. Schrader

William P. Schrader
President

John M. Williams Jr.

John M. Williams Jr.
Vice President

Message from the General Manager

The pace of change continues to accelerate in today's electric utility industry. At SRP, we are keeping step, ticking off the mileposts as we advance toward our strategic goals. We are moving ahead with certainty and dispatch.

In last year's report, I outlined SRP's four-point plan for utility restructuring:

- Facilitate customer choice of generation provider
- Continue as sole provider of distribution services in our historic retail service territory
- Preserve our political subdivision status, including support to water
- Form an affiliate, primarily to market energy displaced by competition.

Our plan envisions a different environment than exists today. We stand by it, convinced competition will allow us to serve our electric customers and water shareholders better than ever – and better than the competition.

In recent months, we have introduced a host of new products and services, from same-day turn-on service to customer-selected bill due dates. We've also formed alliances that enable us to offer services in telecommunications, power marketing, appliance warranties and home security. And, we have formed our power marketing affiliate.

These innovative products and services will help us gain and retain tomorrow's customers. The more relationships we maintain with our customers, the greater the likelihood we can retain those customers once choice becomes available.

Of course, we realize our actions alone cannot guarantee SRP's success. Bills in Congress continue to wend their way through the legislative process, even as the administrative branch of federal government works to develop its own restructuring proposal. The states, including Arizona, are proceeding independently to address the fundamentals of customer choice. A year ago, we expected most Arizona customers to gain the power to choose their generation supplier early in the next decade; now we're looking at a schedule that begins in this decade.

Unfortunately, there are those who want to slow the advent of customer choice, as well as to impede public power's participation in a competitive industry. For example, some investor-owned utilities want to prevent public power utilities from offering competitive generation to customers, or from selling retail generation outside of their service territories. They have adopted the strategy that it is better to increase public power's costs than to lower their own. It is a mistake, a shortsighted strategy that does little but postpone the advantages of customer choice that we are working in good faith to deliver.

Another way critics hope to hinder customer choice is by advocating further limits on the so-called "private use" restrictions, which apply to electricity that is produced or transported by facilities financed through tax-exempt municipal bonds. Private use restrictions run contrary to the goals of electric utility restructuring, acting as a barrier to competition and denying consumers access to electricity at the lowest possible price. Our contention is that competition does not discriminate, and private use restrictions should be resolved in a manner which would allow all utilities to compete.

For these and other reasons, SRP keeps a wary eye on the competition, but our principal focus remains the customer – which represents what we have always been: a locally owned, customer-driven organization.

We are confident we will prevail, and we are not alone. On its 10-point utility assessment scale, where a score of 1 reflects the strongest possible business profile, Standard & Poor's most recently scored SRP a 2. No other fully integrated utility scored better.

We accept S&P's assessment, but not the temptation to dig in and protect the status quo. At SRP, our outstanding and focused work force has what it takes to succeed in tomorrow's wide open utility industry. We choose to compete, and we look forward to the rigors of the competitive market.

Richard H. Silverman

Richard H. Silverman
General Manager

Competition & Customer Choice: Where We Are Heading

In a true competitive environment all customers, from homeowner to the largest industry, will select their generation provider.

Competing for their attention will be any number of electric utilities, power marketers, brokers and others.

Will this be good for customers? We believe it will be. As the electric industry changes from monopolistic to market-driven, customers will benefit from pressure on prices. New products and services will emerge.

At SRP, we embrace the prospect of customer choice and believe it must be offered to all customers, not just some. We also favor regulatory protections if needed to ensure a fair choice for all consumers, no matter how large or small.

The right to choose in a fair and balanced marketplace

As a strong advocate for customer choice, SRP is working at the state and federal levels to make it happen. We support the Arizona Corporation Commission's transition plan for competition, which calls for a phased-in approach. Key public policy decisions must be made to ensure a stable transition to a fair, restructured marketplace for customers.

There is consensus that deregulation will turn electricity into a commodity product. Electricity futures contracts are being traded today on the New York Mercantile Exchange. In a customer choice industry, generation providers will be evaluated on per-unit price and pricing options.

SRP generation, in aggregate, is among the most economical in the West. At the same time, though, SRP has neither the cheapest nor the most costly generation in the West. While we may be one of the low-cost suppliers, we have significant improvements to make to boost our position.

At SRP, the task of identifying all of the relevant costs for making power has taken on new form. We are embarking on a program to manage every power plant as a profit center.

Total operating revenues for the year were up nearly 7.5 percent this year, thanks to robust growth in electric customers and kilowatt-hour sales.

Total operating expenses increased about 20 percent this year from the previous year.

Enhancing visibility in the Grand Canyon, a $470 million scrubber retrofit project is under way at Navajo Generating Station in northern Arizona. Scrubbers are being installed on the station's three coal-fired units; the first unit is in service. The scrubbers will remove sulfur dioxide from the gases emitted through the plant's stacks.

Much of this was because of efforts to reduce future costs associated with our generation business; generation costs are a major portion of SRP's overall operating expenses.

Net revenues were $57.2 million, compared with $94.4 million the previous year, because of steps we took to lower our costs for the future. This included the expense associated with the restructuring of an uneconomic long-term contract; an increase to the already accelerated recovery of our investment in Palo Verde Nuclear Generating Station assets; an accelerated recovery of regulatory assets; and work force reductions.

One of the key strategies to lowering energy costs is to avoid expensive energy in the first place. Generation resources include a mix of SRP generation, purchased power, and power exchanges to control costs and meet demand. Our generation resources mix allows us to balance costs while responding with flexibility to changing future industry conditions. In fact, our electric system set a new peak of 4,246 megawatts this year.

Resource flexibility is in part possible because of the interconnected utility transmission network in the West.

Electric power transmission likely will remain regulated in the new industry environment, ensuring nondiscriminatory access and bringing pressure on rates. Changes in the operation of the interconnected grid system will significantly impact the transmission business.

Among these changes – and of particular interest to SRP – is the possibility of Independent System Operators (ISOs) in the Western states. This would bring centralized control and coordinated dispatch of transmission as a means of ensuring an economic and reliable transmission market.

California is establishing an ISO structure to support its retail choice environment, obligating utilities to provide customers with access to the grid. This structure is meant to guarantee unbiased, open transmission access and also to increase the efficient use of transmission by consolidating operation of the transmission network.

SRP and eight other electric utility companies are cooperating in a feasibility study of an ISO (called Desert STAR) for the Southwest. We believe that a regional ISO would be important to reliable transmission system operations in the West and would provide a framework for fair access to a market in which prices are set openly.

Last summer's regional power outages affecting millions of people in 15 Western states underscored the reality of power interconnection in the West, and resulted in a review of the reliability and security of the grid by the Western Systems Coordinating Council. SRP, as a member of the WSCC, is involved in the implementation of the WSCC-wide changes that should reduce the risk of another widespread power failure.

The WSCC has set a new regional plan in motion to provide additional monitoring and information exchange capabilities to boost both grid security and reliability. In a deregulated industry, an ISO could coordinate power restoration and scheduled facility outages. Results of the Desert STAR study are expected this fall; implementation of an ISO would be subject to approval by regulatory agencies.

A key new energy market for SRP is the country of Mexico. Our strategic transmission intentions include the development of a major interconnection between Arizona and the state of Sonora, Mexico, for both import and export of power.

For the distribution segment of the industry, SRP is

SRP is pursuing transmission interconnection with the state of Sonora, Mexico, at the southern border of Arizona. As both the U.S. and Mexican governments proceed with deregulating their electric industries, new opportunities emerge for power sales and purchases across the border. An increased integration of the power grids in the two countries may provide an increase in new generation capacity and additional revenues.

committed to maintaining current distribution service areas to guarantee all customers are provided safe, reliable and economic electric service to their homes and businesses.

Within our emerging business plan for distribution are objectives to also maintain a high standard of power quality. As a longtime supplier to high-tech industries in the Phoenix area, we know high-quality power can be critical to our customers' productivity. We are investing in electric system improvements to prevent and reduce customer down time, as well as to offer higher grades of power to customers who need it.

A strong team with a plan in hand to reach future opportunities

Assigning the metering function to utility companies such as SRP with distribution responsibilities will promote a universal and cost-efficient infrastructure. SRP is committed to developing and offering an array of services to accommodate the special metering requirements of a customer choice environment.

Energy services is another business line at SRP. In the past, a few energy services were offered, but the new industry environment brings new opportunities. Today, and in the future, we will offer full retail-services packages to satisfy, retain and attract customers. Many services will be offered by our in-house experts. In short, there's no limit to the opportunities in energy services.

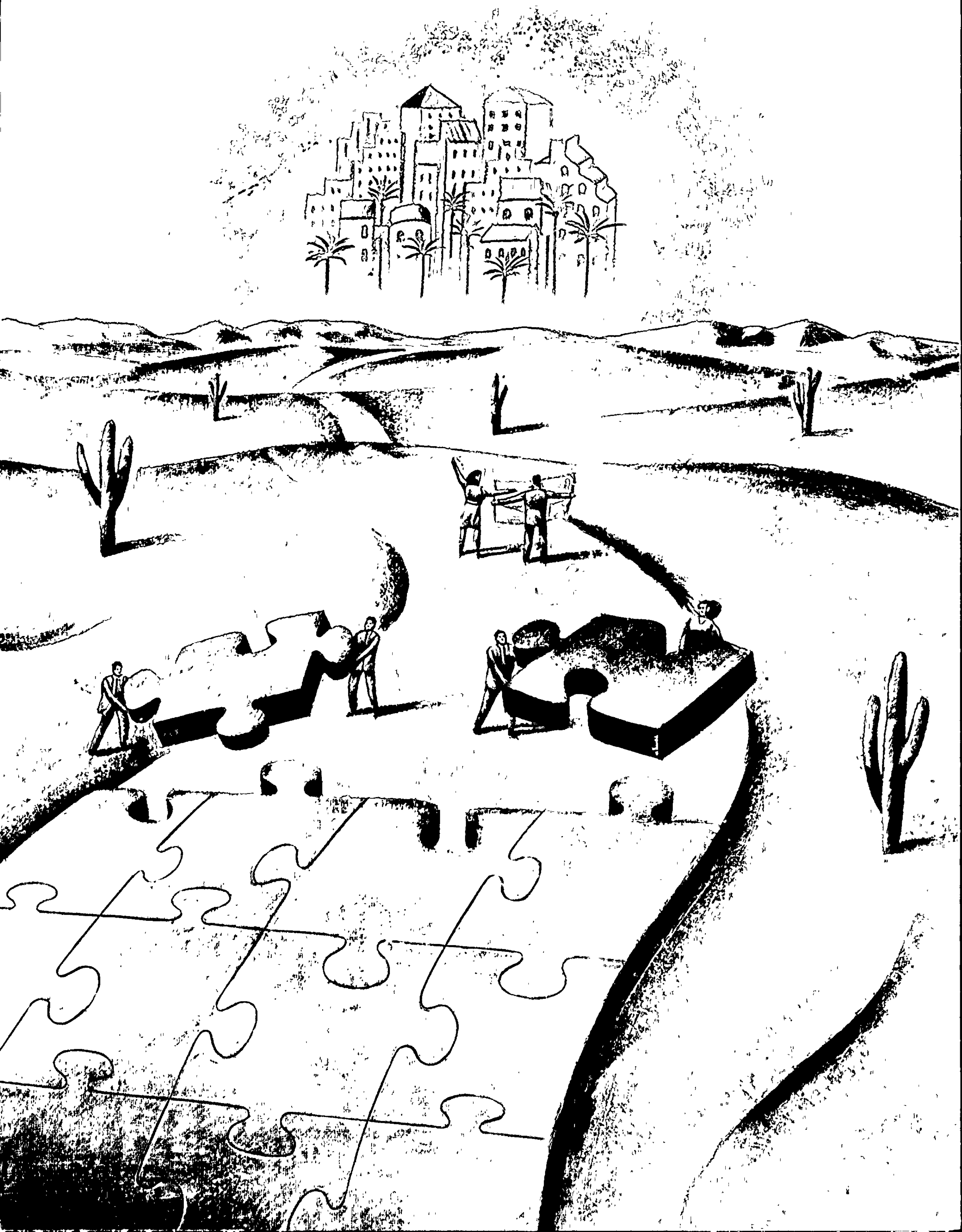
Deregulation and competition require a whole new way of marketing. We are redefining our markets, identifying and developing products and services for each of our customer groups.

As customer choice approaches, customer retention becomes the primary marketing objective for SRP, with a close secondary goal of growing our customer base. By seeing our business as our customers do, we can provide what they expect. In fact, pricing, products and services are cornerstones of SRP's customer initiatives.

Evidence of our customer retention efforts is demonstrated by new, long-term electric service agreements with our industrial customers.

These agreements commit SRP to the best possible pricing and service package available today. They involve some of our most energy-smart customers, who have a good understanding of how energy costs affect their operations and budgets. These agreements demonstrate our ability to offer competitive pricing and the confidence our customers have in SRP's future ability to serve them better than anyone else.

If the Arizona Corporation Commission's



Representatives of SRP government and legal affairs are active participants in the public policy process to restructure the utility industry at the state and federal levels. We anticipate state legislation next year addressing electric service in Arizona, while rulemakers and lawmakers in Washington, D.C., determine issues relating to the industry nationwide.

proposed phased-in plan for retail choice moves ahead in its present form, a percentage of smaller businesses and residential customers would be among the first group to obtain choice of energy providers. These also are the customers who have been less concerned with changes in the electric industry, because their electric consumption generally is low.

We want to help these customers understand the changes ahead, and in the coming months we will be communicating with them on this subject. When they do gain choice, they will have the information they need to make the best decision for them.

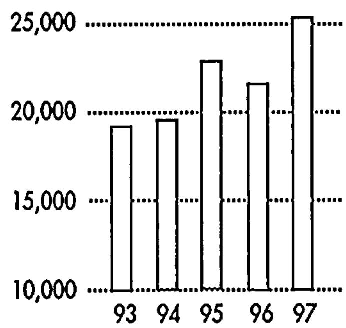
Solid relationships are essential for customer retention. At SRP, we recognize each customer group has its own needs and expectations. What our customers think about us, including the relationship we have with them and their communities, is central to our continued success.

Indeed, our true competitiveness will be determined by our customers: Specifically, how successful we have been in helping our customers to succeed and prosper. This involves not only the products and services we provide to them, but also our commitment to improve the communities in which they live, work and do business.

Our research shows that our customers recognize SRP as a stable and dependable company with a strong history of commitment to the communities and customers we serve.

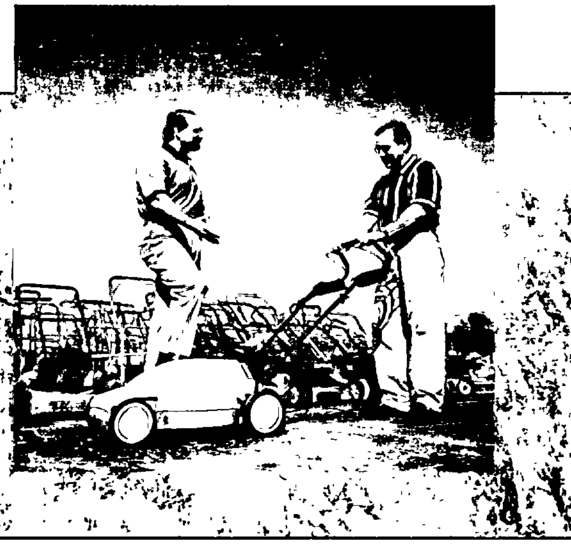
Community and industry leadership are

TOTAL ELECTRIC SALES
(Million kWh)



Electric sales rebounded this year, up nearly 15 percent, with a boost from an improving yet volatile wholesale sales market.

SRP's environmental efforts include programs for cleaner air. The past two years' successful corporate campaigns to replace gas-powered lawn mowers with electric ones will result in a reduction of as much as 330 tons of carbon monoxide and 36 tons of ozone-causing pollutants a year. Gas-powered lawn equipment is a significant contributor to the Valley's summer air-quality problem.



among our corporate goals. This commitment takes many shapes: contributions, volunteerism, education support, urban environmental efforts, and support of the arts.

As a major employer in Arizona, we provide support to community and cultural groups that seek to make the Phoenix area a better place. Volunteer efforts at SRP – resulting in countless hours given by hundreds of SRP employees – are supported by a corporate program that encourages volunteerism. Financial contributions to the community, from the company and employee contributors, topped $2 million last year.

Our community involvement includes a wide range of programs to support education in Arizona. Our in-house educational specialists bring unique and valued resources to teachers and administrators, extending our reach and impact into local schools through grants, curriculum resources and other services.

For nearly a century, SRP has been committed to its communities. We will not underestimate the impact we can have and our obligation to improve the areas we serve.

During the past two fiscal years, nearly all SRP customers saw the price reduced for the electricity they use. Next year, we will begin the next phase of rate redesign and reductions. Our cost reduction efforts are meant to build a competitive pricing structure. SRP's new pricing strategy will use market-based approaches rather than the industry's traditional cost-plus pricing.

We would like to think all customers will choose SRP once retail choice is available. But our research shows that SRP will share the experiences of other industries that have gone through deregulation before us: Regardless of what we do, some customers will choose an alternate energy provider for their electric power.

We will benefit from the healthy Phoenix

The SRP water business, while not subject to the same pace of change as the electric business, continues to seek new opportunities for operational efficiencies, both to improve services for shareholders and maintain reasonable costs. New advances in water management, including groundwater storage, and new direct services such as water measurement, were highlights of the year.

economy; population growth will help sustain us. But we must sustain and grow, which means we must develop the strategic opportunities today for business and revenue growth tomorrow.

One such opportunity is New West Energy, an affiliate of SRP that will sell excess generation and generation lost to retail competitors. New West Energy is targeting mid-size businesses in California that have retail choice next year. New West Energy became operational May 1, and it supports a main element in our corporate Four Point Plan for competition.

SRP's water strategies also address new business and revenue potential. To maintain a legacy of dependable and low-cost water, our Water Group is moving ahead with efforts at new revenue generation and new business creation. As the Valley's single largest water source, we embrace our responsibility for managing the watershed that serves the Valley and for delivering water in the most efficient and economic manner possible.

Innovation in resource management, delivery and services is the future of SRP's water activities. The past year was rich in terms of new business opportunities for the water side of our business, even in a year when precipitation was far below normal and runoff was the second-lowest on record.

Alliances are one avenue of new business creation, and at SRP a new alliance involving our water business has worldwide applications. With an Oregon-based company, SRP is producing a water monitoring system that uses two-way satellite communications to provide measurement information for dams, lakes, streams, canals, and hydrogeneration facilities. The Stevens AxSys™ Remote Station is manufactured and packaged by SRP and marketed by Stevens Water Monitoring Systems.

For the electric business, we are among

three partners in a wholesale power marketing alliance – called the PST Alliance – which will position us to sell bulk power over broader regions. We expect this alliance will increase our reach and flexibility in regional power sales. Our partners are Powerex, an electricity marketing subsidiary of Canada-based B.C. Hydro, and Tenaska, a Nebraska-based generation station builder. Importantly, the PST Alliance supports our corporate strategy to improve our ability to import and export power to key markets.

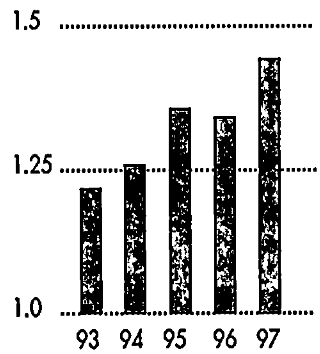
Another new strategic alliance, with a well-established telecommunications company, signals SRP's emergence into the communications industry. In a 15-year agreement with Washington-based Electric Lightwave Inc., SRP is combining its 250-mile (and growing) fiber-optics network with ELI's network and capabilities. The result will be a larger system for use as a public voice and data communications network.

This alliance lays the groundwork for new telecommunications products and services from ELI for SRP customers. For SRP, the alliance maximizes our fiber network assets, which we use to support electric-system-operation communications.

New products through alliances offer new revenue streams as well. In recent months we launched two products through alliances – an appliance warranty plan called ApplianceGard with American Bankers Insurance Group, and a home security plan with Protection One. Both products are intended to generate new income and provide new ways to link

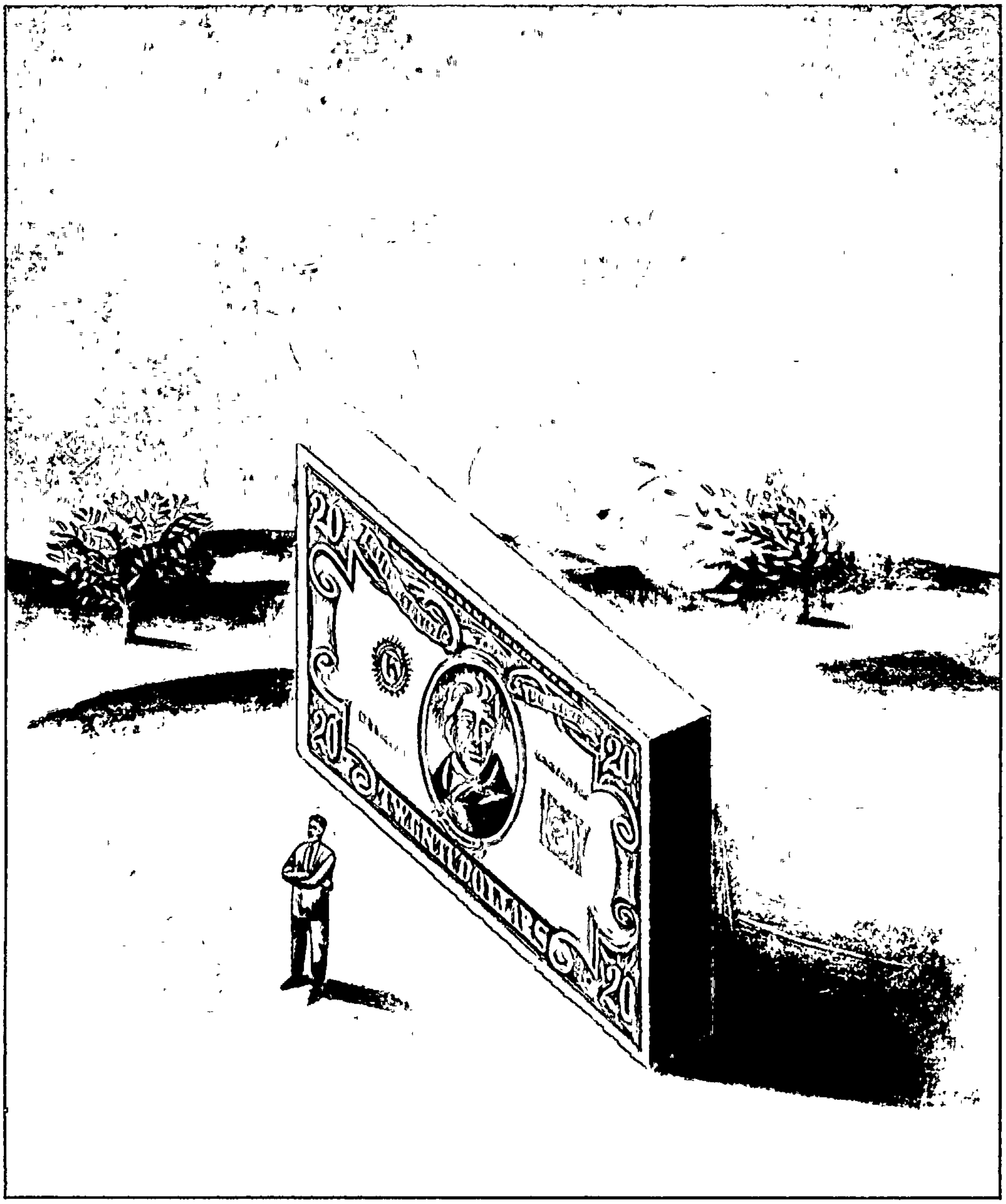
Total Operating Revenues

($Billions)



Total operating revenues grew 7.5 percent this year. Over five years, total operating revenues have grown nearly 19 percent.

Creating a culture at SRP where employees are highly valued and in turn value their opportunities to make meaningful contributions to the organization is a key corporate strategy as SRP heads into a deregulated industry environment. We will continue to build and retain a highly competent work force.



customers to us, beyond the traditional provision of water and power.

One of the most important public policy issues facing SRP – and for that matter, all electric utilities – is stranded costs. Stranded costs are the costs incurred during a regulated generation environment, which become uneconomic in a competitive environment.

Robust fiscal performance to weather the changes ahead

The degree to which the costs may be stranded is based upon projections of the effects of competition on the market price of generation. The more prices drop, the greater the potential for stranded costs.

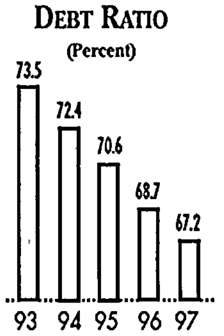
While California has provided for a surcharge to allow utilities to recover such costs to avoid debt that cannot be recouped through sales, it remains to be seen how Arizona will answer this critical question. SRP favors recovery of costs that become stranded, over a fixed time period and in a manner equitable to utilities, customers and investors.

We believe recovery of stranded costs through a pricing mechanism that fluctuates with the market price of generation is the best option. There could be different time frames for different types of costs. We do not advocate recovery by increasing retail prices. In fact, we support a cap, or freeze, on prices during the cost-recovery period.

Our debt ratio reflects the past six years' emphasis on paying down the organization's debt – improving the debt ratio by 10 percent since 1991. We have taken aggressive action to prepay and refinance millions of dollars in debt, and we plan to pay down nearly $900 million in principal in the six years ahead. We have taken on no new debt since 1995, and anticipate no new debt through at least the year 2003. The year closed with $257 million in internally generated cash, which we call funds available for corporate purposes. This healthy result allows us to continue to fund our entire capital improvement program without issuing new debt. Our new financial plan for the future calls for a continued funding of all capital improvements with this cash.

Improvements to our balance sheet, coupled with cost constraints and customer growth, continue to build our financial strength. Future financial flexibility is essential for companies that want to prevail as competition occurs, as customers switch power suppliers and prices are squeezed in the new marketplace.

Our new financial plan is the most focused and purposeful plan we ever have adopted, taking its lead from SRP's strategic initiatives. Today, SRP is building its competitive position. Opportunities will come to the companies that are first in the marketplace: We will be among them.



We continue to trim the ratio of debt-to-capitalization.

As of April 30	1997	1996
ASSETS	*(Thousands)*	
Utility Plant		
Plant in service –		
Electric	$ 5,728,650	$ 5,574,359
Irrigation	199,719	185,162
Common	343,740	373,623
Total plant in service	6,272,109	6,133,144
Less – Accumulated depreciation on plant in service	(2,284,846)	(2,115,701)
	3,987,263	4,017,443
Plant held for future use	35,288	31,712
Construction work in progress	265,722	222,015
Nuclear fuel	40,154	40,692
	4,328,427	4,311,862
Other Property and Investments		
Non-utility property and other investments	158,071	79,553
Segregated funds, net of current portion	236,146	205,782
	394,217	285,335
Current Assets		
Cash and cash equivalents	99,439	76,319
Temporary investments	275,585	350,576
Current portion segregated funds	85,202	86,202
Receivables, including unbilled revenue, net	120,558	114,538
Fuel stocks, at last-in, first-out cost	22,330	43,731
Materials and supplies, at average cost	72,252	67,312
Other current assets	17,208	16,442
	692,574	755,120
Deferred Charges and Other Assets	291,795	315,309
	$ 5,707,013	$ 5,667,626

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

As of April 30	1997	1996
CAPITALIZATION AND LIABILITIES		*(Thousands)*
Long-Term Debt		
Electric system revenue bonds, net of current portion	$ 3,057,108	$ 3,142,049
Commercial paper and other	375,000	375,000
	3,432,108	3,517,049
Accumulated Net Revenues *(Note 4)*	1,672,664	1,602,045
Total Capitalization	5,104,772	5,119,094
Current Liabilities		
Current portion of long-term debt	82,716	78,104
Accounts payable	90,466	70,771
Accrued taxes and tax equivalents	66,885	85,018
Accrued interest	59,839	62,385
Customers' deposits	19,143	33,170
Other current liabilities	74,571	72,344
	393,620	401,792
Deferred Credits and Other Non-Current Liabilities	208,621	146,740
Commitments and Contingencies *(Notes 3, 5, 7, 8, 9 and 10)*		
	$ 5,707,013	$ 5,667,626

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

COMBINED STATEMENTS OF NET REVENUES

For the Years Ended April 30	1997	1996
	(Thousands)	
Operating Revenues	$1,457,634	$1,355,391
Operating Expenses		
Power purchased	196,924	159,082
Fuel used in electric generation	313,044	222,683
Other operating expenses	303,389	245,626
Maintenance	95,742	93,216
Depreciation and amortization	238,510	210,470
Taxes and tax equivalents	87,219	102,457
Total operating expenses	1,234,828	1,033,534
Net operating revenues	222,806	321,857
Other Income (Expense)		
Interest income	42,163	40,153
Other expense, net	(2,029)	(56,966)
Total other income (expense), net	40,134	(16,813)
Net revenues before financing costs	262,940	305,044
Financing Costs		
Interest on bonds, net of capitalized interest	174,890	179,124
Amortization of bond discount, issuance and refinancing expenses	16,325	15,491
Interest on other obligations	14,513	16,053
Net financing costs	205,728	210,668
Net Revenues	$ 57,212	$ 94,376

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

For the Years Ended April 30	1997	1996
	(Thousands)	
Cash Flows from Operating Activities		
Net revenues	$ 57,212	$ 94,376
Non-cash items included in net revenues:		
Depreciation and amortization	238,510	210,470
Write-downs of plant held for future use	-	64,000
Postretirement benefits expense	17,252	17,552
Amortization of capitalized bond costs	16,325	15,491
Gain on sale of property	(5,437)	(6,423)
Long-term contract restructuring *(Note 3)*	58,092	-
Decrease in –		
Fuel stocks and materials & supplies	16,461	8,963
Other assets	7,609	5,431
Increase (decrease) in –		
Accounts payable	19,695	(46,714)
Accrued taxes and tax equivalents	(18,133)	7,414
Accrued interest	(2,546)	(1,951)
Other liabilities, net	(25,263)	(29,681)
Net cash flow provided by operating activities	379,777	338,928
Cash Flows from Investing Activities		
Additions to utility plant, net	(246,156)	(215,817)
Increase in investments	(7,009)	(99,758)
Net cash used for investing activities	(253,165)	(315,575)
Cash Flows from Financing Activities		
Repayment of long-term debt	(87,535)	(74,395)
Increase in segregated funds	(15,957)	(22,868)
Net cash used for financing activities	(103,492)	(97,263)
Net Increase (Decrease) in Cash and Cash Equivalents	23,120	(73,910)
Balance at Beginning of Year in Cash and Cash Equivalents	76,319	150,229
Balance at End of Year in Cash and Cash Equivalents	$ 99,439	$ 76,319
Supplemental Information:		
Cash Paid for Interest	$ 200,692	$ 206,712

The accompanying notes are an integral part of these combined 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) 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 to the Association operation and maintenance of the irrigation and water supply system of the Project.

▼ 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 include the combined accounts of the Association, the District and the District's wholly owned subsidiary, Papago Park Center, Inc. Collectively, these entities are referred to as Salt River Project (SRP). Papago Park Center, Inc. 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 (GAAP) and reflect the rate-making policies of the Board (see Note 3).

Financial statements prepared in accordance with GAAP require management to make estimates and assumptions that affect the amounts reported in the financial statements and disclosures of contingent assets and liabilities. Actual results could differ from those estimates.

▼ 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 the electric and general plant. Composite rates of 5.81 percent and 5.87 percent were used in fiscal 1997 and 1996, 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:

	1997	1996
Average electric depreciation rate	3.83%	3.40%
Average irrigation depreciation rate	1.82%	1.69%
Average common depreciation rate	6.57%	6.16%

Based on an analysis of the Palo Verde Nuclear Generating Station (PVNGS) assets, it was determined that a portion of PVNGS should be recovered by the District over a shortened period of time (see Note 3).

▼ Bond Expense

Bond discount, issuance and refinancing 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 PVNGS for the cost to dispose of the fuel. The District amortizes the cost of nuclear fuel, including its disposal, to fuel expense using the unit of production method.

▼ 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. Estimated decommissioning costs are accrued over the estimated useful life of PVNGS. The liability associated with decommissioning is included in deferred credits and other noncurrent liabilities in the accompanying combined balance sheets and amounted to $51.1 million and $44.3 million as of April 30, 1997 and 1996, respectively. Decommissioning expense net of earnings on trust fund assets of $4.3 million and $4.9 million were recorded in fiscal 1997 and 1996, respectively. The District contributes to an external trust set up in accordance with the NRC requirements. Decommissioning funds of approximately $65.8 million and $50.0 million, stated at market, as of April 30, 1997 and 1996, respectively, are held in the trust and are classified as segregated funds in the accompanying combined balance sheets.

▼ Income Taxes

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

▼ 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.

▼ Reclassifications

Certain amounts in fiscal 1996 have been reclassified to conform with fiscal 1997.

▼ Recently Issued and Prospective Accounting Standards

Statement of Financial Accounting Standards (SFAS) No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of," was issued by the Financial Accounting Standards Board (FASB) in March 1995, and adopted by SRP during fiscal 1997. The adoption of SFAS No. 121 did not materially impact SRP's financial position or results of operations.

Effective May 1, 1997, SRP will adopt 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. When adopted, SOP 96-1 is not expected to have a material impact on SRP's financial position or results of operations.

In February 1996, the FASB issued an exposure draft, "Accounting for Certain Liabilities Related to Closure or Removal of Long-Lived Assets." This standard, if adopted, 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 proposed standard also provides that the initial recognition of the liability will increase the cost of the associated long-lived asset. It is uncertain at this time when the FASB will issue its final standard. If the exposure draft is approved in the present form, it would affect SRP's accounting for decommissioning of its nuclear power plant, obligations for coal mine reclamation costs and any other activities related to the closure or removal of long-lived assets. However, it is not expected that implementation of the standard by SRP would be required before fiscal 1999. Although management is unable at this time to determine the exact impact of this exposure draft it does not believe that the proposed changes will have an adverse effect on SRP's financial position or results of operations.

(3) REGULATORY ISSUES:

▼ Regulatory Accounting

The District has recorded certain assets 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 include the impacts of regulatory decisions in their financial statements.

The District has two regulatory assets, unamortized bond defeasance losses and costs related to the termination of a contract with Kaiser Coal Company. As of April 30, 1997 and 1996, the District had approximately $228.7 million and $261.4 million, respectively, of regulatory assets which are included in deferred charges and other assets in the accompanying combined balance sheets. During fiscal 1997, the District determined acceleration of the regulatory assets would be appropriate given the competitive forces affecting the industry. The District will amortize the regulatory asset balance over an eight year period, beginning in fiscal 1997. The balances above reflect this change.

SRP has performed an analysis of PVNGS. This analysis continues to be refined based on more specific pricing and forecast changes in the production schedule. The District is authorized by the Board, which serves as the District's regulatory authority, to record an additional charge for recovery of the cost of a portion of utility plant each year, for seven years, beginning in fiscal 1996. This additional cost recovery resulted in $50 million and $30 million charges, which have been classified as depreciation expense, during fiscal 1997 and 1996, respectively.

The Board, which acts as the District's regulatory agent, and the current regulatory environment, support the District's accounting policies for these assets. If rate recovery of these assets is no longer probable, whether due to competition or other regulatory actions, the District would no longer be able to apply the provisions of SFAS No. 71, which could have a significant impact on the District's financial statements. If SRP is required to discontinue SFAS No. 71, all regulatory assets would have to be written off and the net realizable value of other assets would have to be reassessed.

▼ 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 comprehensive cost reductions and rate redesign that passes these cost savings on to its customers through lower rates. The District's financial plan provides for continued efforts to lower per-unit costs from existing assets, increased assets utilization and reduced exposure to stranded investments.

At the federal level, the Federal Energy Regulatory Commission (FERC) issued rules relating to, among other things, open access to transmission lines. Although the District is not generally subject to FERC's jurisdiction, it must provide reciprocal transmission service to others in order to use the open access tariffs of public utilities. As a member of the Southwest Regional Transmission Association (SWRTA), the District has filed an open access transmission tariff with SWRTA, consistent with the requirements of the FERC rules.

At the state level, the Arizona Corporation Commission (the Commission) has adopted rules providing a framework to open the state to competition in the electric utility industry over a four year period, beginning in 1999. Under the new rules, retail customers may select "standard offer" service, which is the traditional bundled electric service customers now have, or they may choose competitive unbundled services. On or before December 31, 1997, electric utilities regulated by the Commission will have to file, for Commission approval, unbundled tariffs describing their services, such as generation, transmission and distribution of electricity, meter reading, billing and collection, consumer information services, and the utility's maximum rates. The utility can charge lower rates, as long as those rates cover marginal costs.

Beginning January 1, 1999, affected utilities will have to make 20 percent of their peak 1995 retail demand available to all customers, increasing to 50 percent by January 1, 2001, with full competition beginning no later than January 1, 2003.

Affected utilities will be allowed to recover stranded costs to the extent allowed by the Commission. Affected utilities are required to take every feasible measure to mitigate or offset stranded costs by means such as expanding wholesale or retail markets, or offering a wider range of services.

As a political subdivision, the District is not subject to the new state rules. However, the District can enter into an intergovernmental agreement with the Commission to coordinate voluntarily opening its markets to competition on similar terms and conditions. In addition, on May 1, 1997, the District formed a new corporation, New West Energy Corporation (New West), to serve as a for-profit affiliate of the District. The District anticipates that New West will be involved in retail sales of electricity outside the District's service area.

The ultimate outcome of the various initiatives regarding competition and restructuring in the electric industry and their effect on the District is not certain. Several utilities have filed lawsuits against the Commission to challenge the jurisdiction of the Commission and the validity of the new rules. The District has intervened in certain of these lawsuits. The District also is active at both the state and federal levels in public policy discussions, state legislative task force committees on restructuring, and Commission working groups to resolve issues related to the new rules.

▼ Long-Term Contracts

To position itself for a more competitive environment in the electric utility industry, the District examined its long-term contracts and identified one contract with payment terms which are substantially above current and expected future market rates. The District has entered into negotiations to restructure that contract and has reached a tentative agreement whereby the District would pay $21 million in each of the next three fiscal years, starting in fiscal 1998, in return for a reduction in the long-term contract rate to the expected future market rate. The District has not been authorized by its Board to record this transaction as a regulatory asset. Accordingly, the present value of the payments, $58 million, has been recorded as fuel expense in the accompanying combined financial statements.

(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 Revenue and Cumulative Net Unrealized Gain
Balance, April 30, 1995	$ 1,489,798	$ 3,291	$ 1,493,089
Net revenues	94,376	–	94,376
Net unrealized gain on available-for-sale securities	–	14,580	14,580
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

(5) LONG-TERM DEBT:
Long-term debt consists of the following:

	Interest Rate	(Thousands) 1997	1996
Revenue Bonds (mature through 2031)	3.8-9.3%	$ 3,237,436	$ 3,324,972
Unamortized Bond Discount		(97,612)	(104,819)
Total Revenue Bonds Outstanding		3,139,824	3,220,153
Commercial Paper	3.3-4.4%	375,000	375,000
Total Long-term Debt		3,514,824	3,595,153
Less: Current Portion		(82,716)	(78,104)
Total Long-term Debt, net of Current Portion		$ 3,432,108	$ 3,517,049

The annual maturities of long-term debt (excluding commercial paper and unamortized bond discount) as of April 30, 1997, due in the fiscal years ending April 30, are as follows:

	(Thousands)
1998	$ 82,716
1999	88,691
2000	91,913
2001	100,664
2002	104,010
Thereafter	2,769,442
	$ 3,237,436

▼ 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 approximately $176.7 million and $177.7 million of debt service related funds as of April 30, 1997 and 1996, respectively.

The District has $275.3 million of mini-revenue bonds outstanding, of which approximately $178.0 million 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 is confident that these credit agreements are 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, 1997 and 1996, the debt service coverage ratio was approximately 2.45 and 2.72, respectively.

Interest and the amortization of discount on the various issues results in an effective rate of approximately 6.09 percent over the remaining terms of the bonds.

At April 30, 1997, the District has received authority from the Board to issue additional electric system revenue bonds totaling $72.8 million principal amount and electric system refunding revenue bonds totaling $3.2 billion principal amount.

▼ Commercial Paper

The District has issued $375.0 million of tax-exempt commercial paper at an average interest rate to the District of approximately 3.5 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 in the accompanying combined balance sheets in connection with refinancing terms under two revolving credit agreements which support the commercial paper. Under the terms of these two agreements, the District may borrow up to $375.0 million through February 5, 2001.

While the two agreements contain covenants which could prohibit borrowing under certain conditions, management is confident that financing will be available. The District has never borrowed under the two agreements and 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, 1997, the amount of defeased general obligation bonds outstanding was approximately $22.5 million.

▼ Line of Credit Arrangements

In addition to the $50.0 million revolving credit agreement which supports the mini-revenue bonds and the $375.0 million in revolving credit agreements which support the tax-exempt commercial paper, SRP has a $25.0 million revolving credit agreement available for general corporate purposes.

(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 on the balance sheet.

▼ 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 based on the short maturity period.

▼ 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 the short maturity period.

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

	(Thousands)			
	April 30, 1997		April 30, 1996	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Investments in marketable securities:				
Other investments	$ 87,600	$ 87,489	$ 5,977	$ 6,042
Segregated funds	91,535	90,742	91,535	90,472
Temporary investments	2,994	3,008	89,953	91,200
Long-term debt	3,139,824	3,275,873	3,220,153	3,315,322

▼ 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. 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. An $8.5 million contribution was made to the Plan in fiscal 1997. No contribution was required to be made in fiscal 1996.

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 eight years.

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

	(Thousands)	
	1997	1996
Service cost	$ 13,387	$ 12,389
Interest cost	31,250	29,592
Actual return on plan assets	(74,446)	(96,796)
Net amortization and deferral	35,993	58,005
Net periodic pension cost	$ 6,184	$ 3,190

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	**1997**	**1996**
Actuarial present value of projected benefit obligation		
Vested benefit obligation	$ (348,767)	$ (353,995)
Nonvested benefit obligation	(12,972)	(12,182)
Accumulated benefit obligation	(361,739)	(366,177)
Effect of projected future compensation levels	(65,906)	(74,859)
Projected benefit obligation	(427,645)	(441,036)
Plan assets at fair value	512,451	449,648
Funded status	84,806	8,612
Unrecognized transition asset	(20,065)	(24,082)
Unrecognized net (gain) loss	(46,318)	31,064
Unrecognized prior service cost	3,373	3,820
Prepaid pension cost	$ 21,796	$ 19,414

The discount rates used in determining the actuarial present value of the projected benefit obligation for the fiscal years ending April 30, 1997 and 1996 were 7.75 percent and 7.25 percent, respectively. The rate of increase used to determine future compensation levels was 4.5 percent for fiscal 1997 and 1996. The expected long-term rate of return on assets was 8.75 percent.

▼ Defined Contribution Plan

SRP maintains a defined contribution plan which receives employee contributions and partial employer matching contributions. Employer matching contributions to the 401k Plan were $4.3 million and $3.9 million for fiscal years ended April 30, 1997 and 1996, 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 vesting 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) are as follows:

	(Thousands)	
	1997	**1996**
Service cost	$ 3,653	$ 3,612
Interest cost	9,084	9,288
Actual return on plan assets	(146)	(857)
Amortization of transition obligation	5,850	5,850
Unrecognized gain	(1,189)	(341)
Postretirement benefit expense	$ 17,252	$ 17,552

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) 1997	1996
Plan assets at fair value	$ 5,378	$ 5,527
Actuarial present value of accumulated postretirement benefit obligations:		
Retirees	(64,458)	(69,404)
Fully eligible active employees	(12,438)	(9,386)
Other active employees	(48,404)	(49,528)
Accumulated benefit obligations	(125,300)	(128,318)
Accumulated benefit obligations in excess of plan assets	(119,922)	(122,791)
Unrecognized transition obligations	93,615	99,466
Unrecognized net gain	(36,717)	(27,513)
Benefits paid - February to April	1,173	1,315
Accrued postretirement benefit liability	$ (61,851)	$ (49,523)

For fiscal 1997, different health care cost trends are used for pre-Medicare and post-Medicare expenses. Pre-Medicare trend rates for fiscal 1997 are 10.5 percent grading down to 4.75 percent. Post-Medicare trend rates for fiscal 1997 are 7.5 percent grading down to 4.75 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, 1997 by approximately $20.7 million and increased the aggregate of the service and interest cost components by approximately $2.4 million for fiscal 1997. The annual discount rates used in both the January 31, 1997 and 1996 valuations were 7.75 and 7.25 percent, respectively. The expected long-term rate of return on plan assets is 6.5 percent.

▼ 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 for fiscal 1996 of $0.8 million is included in current liabilities in the accompanying combined balance sheets. This amount was paid to the employees in fiscal 1997. In fiscal 1997, based on the targets met, an estimated payout of approximately $18.0 million was accrued. This amount will be paid during fiscal 1998.

▼ Severance Plans

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

(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 combined statements of net revenues.

The following table reflects the District's ownership interest in jointly owned electric utility plants as of April 30, 1997:

(Thousands)

Plant Name	Ownership Share	Plant in Service	Accumulated Depreciation	Construction Work in Progress
Four Corners (NM) (Units 4&5)	10.00%	$ 96,900	$ (51,197)	$ 5,351
Mohave (NV) (Units 1&2)	10.00%	56,223	(31,318)	5,632
Navajo (AZ) (Units 1,2&3)	21.70%	244,524	(139,456)	2,225
Hayden (CO) (Unit 2)	50.00%	71,348	(43,009)	3,863
Craig (CO) (Units 1&2)	29.00%	235,132	(113,326)	2,807
Palo Verde Nuclear Generating Station (AZ) (Units 1,2&3)	17.49%	1,689,470	(547,270)	9,907
		$ 2,393,597	$ (925,576)	$ 29,785

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

The District retains an option to repurchase up to an additional 5.7 percent interest in PVNGS which was previously sold to another participant. The option requires five years notice, and the repurchase price would be based on reproduction cost new, less depreciation.

(9) COMMITMENTS:

▼ 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 1998-2003 period, SRP estimates capital expenditures of approximately $1.7 billion. Planned major construction projects include the addition of scrubbers at NGS and the Hayden Generating Station (Hayden) and other key strategic transmission projects.

▼ Long-Term Power Contracts

The District has 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 approximately $47.0 million annually, of which approximately $25.2 million annually is unconditionally payable regardless of the availability of power. Payments under these contracts totaled approximately $47.0 million in fiscal 1997 and 1996, respectively.

The District has 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 approximately $35.0 million per year. Total payments, including the minimum payments, under these two contracts were approximately $44.0 million and approximately $38.0 million in fiscal 1997 and 1996, respectively.

▼ Fuel Supply

At April 30, 1997, minimum long-term commitments of approximately $1.6 billion exist under coal supply contracts (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 currently insure for this potential liability through commercial insurance carriers to the maximum amount available ($200 million) with the balance covered by an industrywide retrospective assessment program which is 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) were 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 $26.1 million and has included this amount in the 1998-2003 construction program.

In addition, the District and the other owners of Craig have been named in a complaint alleging, among other things, violations of opacity standards by Craig Units 1&2. Although the impact of this complaint 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 approximately $1.3 million in penalties and will provide for additional pollution control equipment on Unit 2. The District has included approximately $34.0 million in its 1998-2003 construction program for additional pollution control equipment at Hayden.

Scrubbers are being installed at NGS. Capital expenditures of $36.0 million for the District's share of the cost of this project are included in the District's 1998-2003 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 financial statements, which represent the District's best estimate of the amount for which this obligation may be settled.

The District may be obligated to reimburse certain other 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, the District and the Association are 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 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.

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 SALT RIVER PROJECT as of April 30, 1997 and 1996, 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 Salt River Project as of April 30, 1997 and 1996, 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
June 11, 1997

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 power 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

Bruce B. Brooks
District/Division 3, Association & District

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

Carl E. Weiler
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 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

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.

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. Vanderway
District/Division 2, Association & District

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

Mario J. Herrera
District/Division 3, Association & District

John E. Anderson
District/Division 3, Association & District

Lloyd L. Banning
District/Division 4, Association & District

Byron G. Williams
District/Division 4, Association & District

Charles D. Coppinger
District/Division 4, Association & District

Wayne A. Weller
District/Division 5, Association & District

Edmund Navarro
District/Division 5, Association & District

Roy W. Cheatham
District/Division 5, Association & District

David Rousseau
Council Chairman
District/Division 6, Association & District

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

Clarence J. Duncan
District/Division 6, Association & District

Robert W. Warren
District 6, Association

Ben A. Butler
Division 6, District

Chas Erickson
District/Division 7, Association & District

Mark A. Lewis
District/Division 7, Association & District

Keith Woods
District/Division 7, Association & District

Mark V. Pace
District/Division 8, Association & District

Michael K. Gantzel
District/Division 8, Association & District

Robert G. Kempton
District/Division 8, Association & District

Edward E. Johnson
District/Division 9, Association & District

Arthur L. Freeman
District/Division 9, Association & District

W. Curtis Dana
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	William K. O'Neal
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

Other Executives Reporting to the General Manager

Corporate Counsel	Jane D. Alfano
Manager, Environmental, Land/Papago Park Center, & Risk Management	Richard M. Hayslip

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