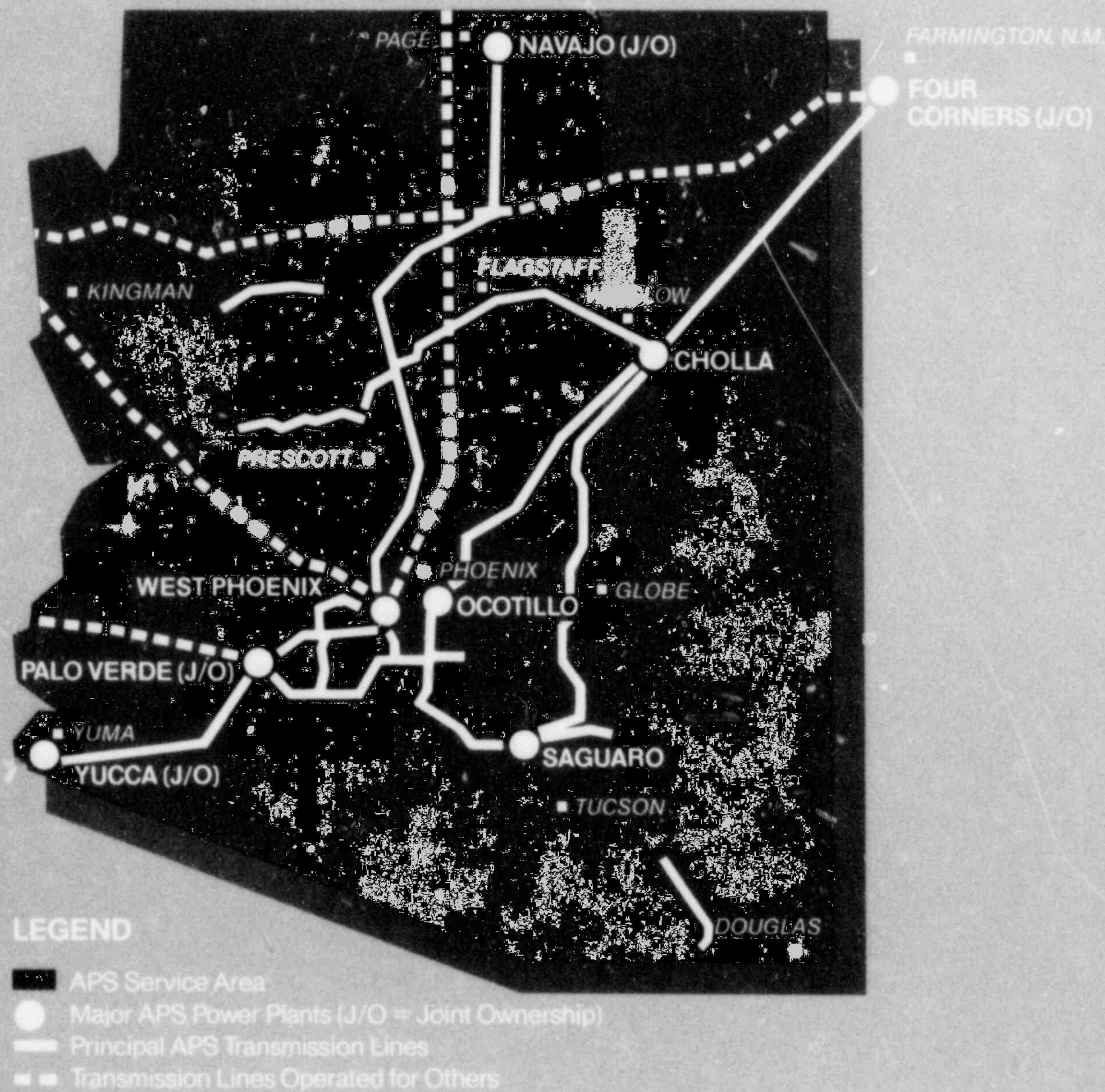
Arizona Public Service Company
1984 Annual Report



About the Company

Arizona Public Service Company is engaged principally in the generation and sale of electricity. Successor to a series of small utility operations originating in 1886, the company was incorporated in 1920 under the laws of Arizona and has operated under its present name since 1952.

Our electric service reaches approximately 1,382,000 people, or about 45 percent of the state's population, in an area that includes all or part of 11 of Arizona's 15 counties.

Annual Report

This report is published to provide general information concerning the company and not in connection with any sale, offer for sale, or solicitation of an offer to buy, any securities.

Annual Meeting of Stockholders

All stockholders are invited to attend the company's sixty-fifth annual meeting. It will be held at 10 a.m. Thursday, April 18, 1985 in the Grand Ballroom of the Phoenix Hilton, 111 North Central Avenue, Phoenix, Arizona.

Our cover: The majesty of Arizona's Grand Canyon is captured by APS Senior Photographer Paul Escen.
Annual Report Design: Karen Daugherty, APS Graphic Services.

Highlights 1984

	1984	1983	1982
Property and Plant:			
Total utility plant, year-end	**$5,088,243,000**	$4,761,265,000	$4,198,466,000
Funds used for capital expenditures	**$ 408,935,000**	$ 454,854,000	$ 451,856,000
Sales and Customers:			
Operating revenues—continuing electric operations	**$ 994,967,000**	$ 871,875,000	$ 866,486,000
Operating revenues—discontinued gas operations	**$ 174,728,000**	$ 202,134,000	$ 197,967,000
Total electric sales (mwh)	**13,054,987**	12,753,542	12,950,727
Electric customers, year-end	**499,751**	468,768	449,244
Income, Earnings, Dividends:			
Net income	**$ 271,067,000**	$ 264,797,000	$ 231,043,000
Earnings for common stock	**$ 222,692,000**	$ 221,056,000	$ 196,227,000
Average common shares outstanding	**68,308,131**	63,865,210	59,549,685
Earnings (loss) (based on average shares outstanding)			
Continuing operations	**$ 3.65**	$ 3.53	$ 3.25
Discontinued operations	**$ (0.39)**	$ (0.07)	$ 0.05
Total	**$ 3.26**	$ 3.46	$ 3.30
Dividends declared per share of common stock	**$ 2.60**	$ 2.56	$ 2.40
Shareholders:			
Common	**124,274**	127,387	120,623
Preferred	**8,615**	8,990	9,033
Employees, year-end:	**7,358**	7,642	7,047

Common Stock Price Ranges

(Symbol: AZP)

1984	High	Low	Dividend Per Share
1st Quarter	21	18	$.65
2nd Quarter	18¼	14½	.65
3rd Quarter	20⅜	16	.65
4th Quarter	22⅝	19¼	.65
1983			
1st Quarter	26	22¾	.63
2nd Quarter	26⅛	23¼	.63
3rd Quarter	26½	23⅛	.65
4th Quarter	25⅜	17¾	.65

TO OUR SHAREHOLDERS

Those of you who have followed our progress through the past 12 months know that we were challenged in 1984 as never before. We're pleased to be able to report to you that we not only met our challenges with marked success, but consider 1984 to be a turnaround year for our company.

The year produced the greatest growth in our company's history: we added a record 30,900 new electric customers to our service area.

More significantly, our overall financial results for the year were the best ever, showing improvements in both cash flow and earnings quality.

Earnings per common share totaled $3.26 in 1984, compared to the $3.46 earned in 1983, reflecting a non-recurring 39 cents-per-share loss from the sale of our gas business. Countering this were earnings from our continuing operations, which increased by 12¢ to produce a record total figure of $3.65 per share.

Contributing to our financial picture were favorable rate decisions, chief among them the Arizona Corporation Commission's approval of the inclusion of some Construction Work In Progress (CWIP) in our rates, a factor that will help restore our financial integrity while reducing the overall impact of rising rates.

Especially gratifying was our success at the Arizona Nuclear Power Project, where 1984 saw the resolution of construction and testing problems that had surfaced the year before. Thanks to the skills and commitment of our experienced project management team, we began loading fuel into the Palo Verde Unit 1 reactor on January 7, nearly three months ahead of the anticipated date announced last year.

Now we have begun the lengthy testing phase that will lead to operation later this year. During these tests, Palo Verde will be producing significant amounts of electric energy for our customers. We are confident that Unit 1 will be brought on-line successfully, followed by the swift completion of its two sister units.

Though the sale of our gas distribution system in November marks the end of a long tradition of natural gas service to customers in many parts of Arizona, it is allowing us to focus our efforts on the more profitable business of generating and selling electricity.

Meanwhile, new and innovative programs launched during the year have helped reinforce our long-standing commitment to making quality customer service our first priority.

These programs involve our customers more directly in efforts to control rising energy costs; they provide the tools customers can use to get more for their energy dollars. Our goal is to reduce the need for construction of large and increasingly expensive generating units. In turn, we can lessen the impact such massive utility expenditures have on our customers.

If we are successful in our efforts, our rates in the decade ahead should increase at a pace much slower than the anticipated rate of inflation.

But we are managing a far more complex business today. Many of our actions have become matters of public debate as well as important considerations before regulatory bodies. Consumers are insisting on public accountability;

they demand a greater role in determining rates, plant siting, technological choices and other decisions formerly the prerogative of utility management. Thus we are developing new approaches to solving the critical issues that have an impact on us.

Throughout these years of change, we have not lost sight of our responsibility to supply our customers with affordable and reliable service, to ensure our shareholders a strong and secure dividend, to provide our employees challenging and satisfying work, and to operate our business in a safe and socially responsible manner.

Though there is still much to do—we must capitalize on our success of the year past in order to see additional improvement in our financial picture—our future looks promising. Still, efforts made in 1984 to improve our position have begun to take effect; we can see the beginnings of a very positive future, for our company, for our employees, and for you, our shareholders.

In the final analysis, our success at improving our profitability will depend on how well we work in harmony with our customers and the public at large; by how well we demonstrate our ability to perform.

In this report we have spelled out how our efforts to improve our performance—for both shareholder and consumer—have succeeded in the year past, and how we expect this performance to continue into the months ahead.

We hope you will read our report, and that you will feel free to call or write us if you have questions.

We could not have accomplished the tasks we set for ourselves in 1984 without your support. We'll need continued support as we take our company in new directions in the years ahead.

Keith L. Turley, O. Mark DeMichele

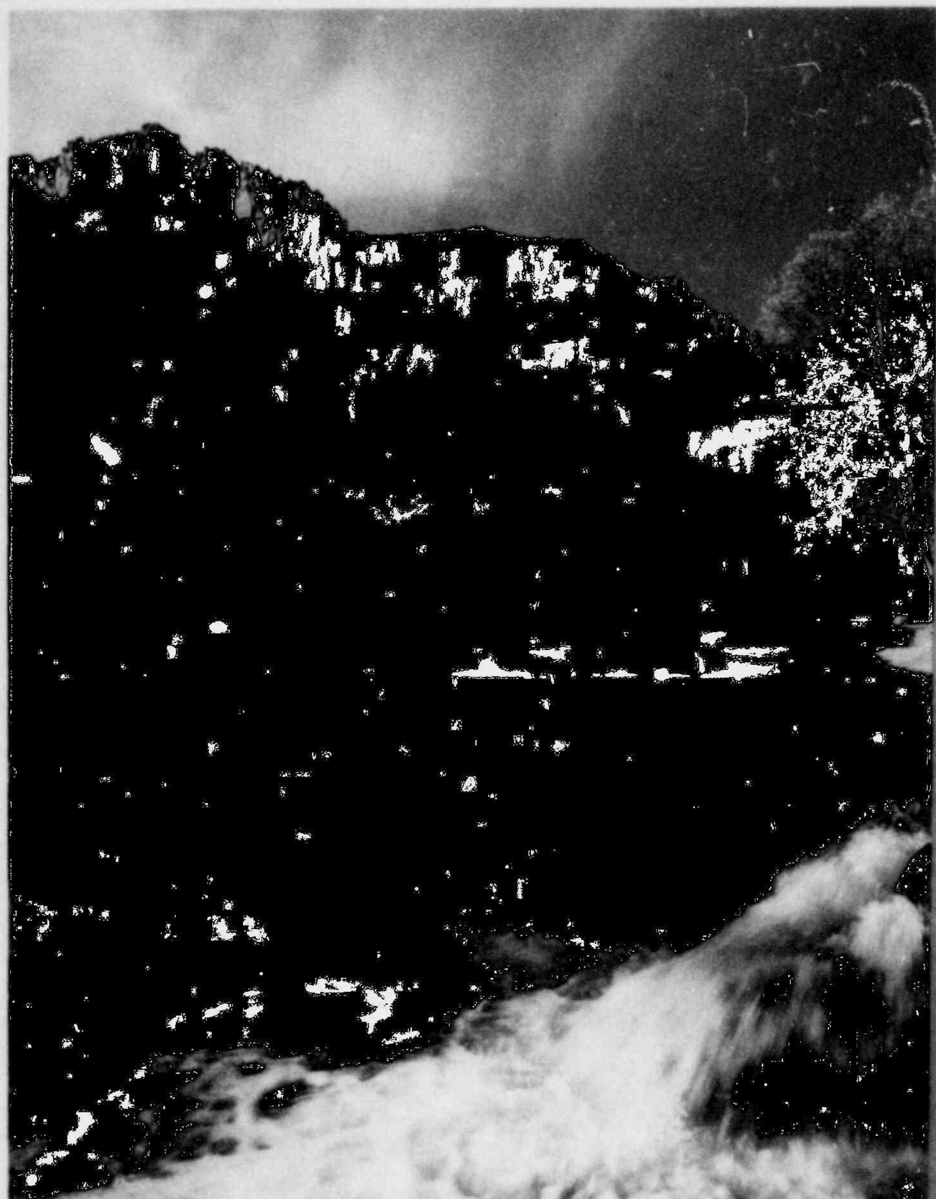
Our future will be both interesting and demanding. We hope you will be with us to share in the results of our efforts.

Keith L. Turley

Keith L. Turley
Chairman and Chief Executive Officer

O. Mark DeMichele

O. Mark De Michele
President and Chief Operating Officer



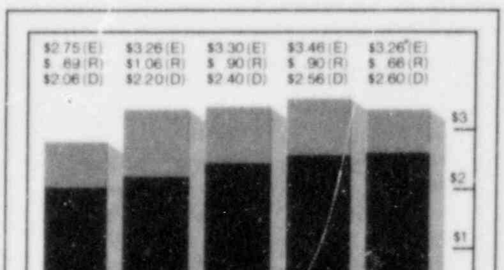
THE YEAR IN REVIEW

Though the financial challenges that have been our constant companions during recent years continued in 1984 and, indeed, will again test us in 1985, we can look back over the past twelve months with genuine satisfaction and optimism.

We knew at the outset that we would be pressed by the demands of a rapidly growing service area; that we would again need to tap a tight financial market for funds vital to our growth; and that we held, in our management of the Arizona Nuclear Power Project, the responsibility to demonstrate that nuclear power, indeed, is healthy and sound.

We also knew that, like most utilities, we would need to continue devoting a great deal of time, resources and energy to building a stronger financial base and to maintaining confidence and pride in our company and our industry.

The year's successes did not come easily. Operating economies initiated several years ago in all areas of our operations grew into dramatic budget cuts in 1984. We made a more concerted effort to improve our productivity and we



Earnings, Reinvested Earnings, and Dividends Per Average Share of Common Stock

recommitted ourselves to finding new and better ways to conduct our day-to-day business.

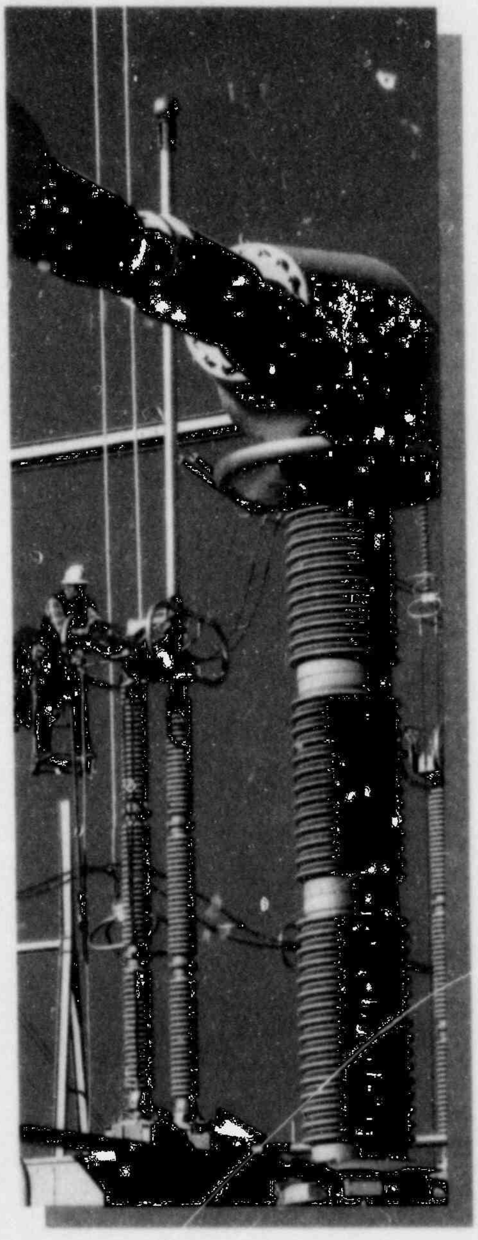
Our financial results show steady improvement

Still feeling the effects of 1983's lowered credit ratings, insufficient rate relief and decreased cash flow, we took aggressive steps in 1984 to improve our company's financial position.

Results of such efforts do not come quickly, but by continuing to seek ways to reduce operating budgets and continue a tight, no-frills operation, we began seeing steady improvements in almost all financial indicators.

For example, earnings from our continuing operations increased by 12¢ to produce a total of $3.65 per share. However, after accounting for a non-recurring loss of 39¢ per share resulting from the sale of our gas properties, 1984 year-end earnings per share totaled $3.26.

The quality of our earnings was improved by the Corporation Commission's October approval (discussed later in this report) of some Construction Work in Progress in rate base. The CWIP allowance reversed the trend wherein a growing portion of our reported income was comprised of noncash earnings (AFC).



Dividends paid per common share totaled $2.60 in 1984 compared to $2.56 in 1983. The current annual dividend rate remains $2.60 per share.

Satisfactory dividend levels continue to be a major factor in our ability to raise needed capital. We will make every effort to continue protecting your investment by pursuing a competitive dividend policy in 1985 and beyond.

As a single-energy utility, we're seeing a more competitive marketplace

We charted a new course for our company in 1984 when we sold our gas facilities to Southwest Gas Corporation of Las Vegas, Nevada. Though the sale marks the end of a long tradition of natural gas service to customers in many parts of Arizona, it is allowing us to better concentrate our efforts on the effective marketing of electric service.

The transaction with Southwest brought a sale price near $112 million, amounting to approximately 85 percent of book value. As part of the final sale arrangement, we agreed to purchase up to $50 million of Southwest's preference stock, if necessary, over a three-year period. The purchase will help finance Southwest's continuation of a program, launched by our company several weeks before the sale, to replace older plastic pipe in the distribution system.

Throughout sale negotiations, a primary concern was for the economic security of approximately 700 of our employees who would be displaced. We're pleased to say that all affected employees obtained new positions, most with Southwest Gas, others within APS. Still, we continue to feel a personal loss at the departure of those many experienced and dedicated individuals who helped build our company.

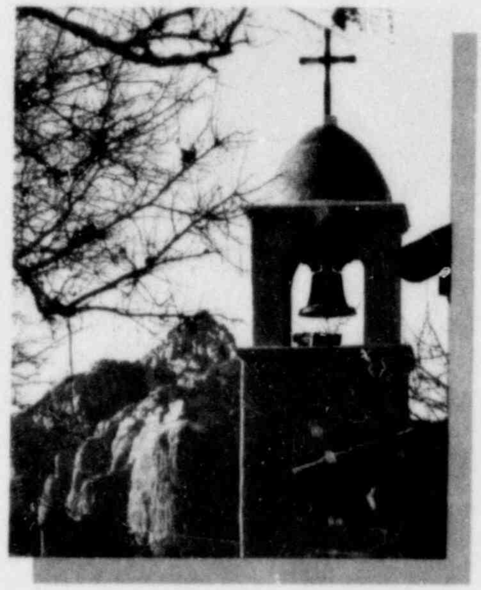
Our decision to sell was reinforced by the fact that, in recent years, the natural gas distribution business had not been profitable for us, nor did it offer significant opportunities for long-term growth and earnings.

On the other hand, electricity currently enjoys a major share of the new-home market, with the prospects for continued dominance in the years ahead. This can be attributed both to an established consumer preference for electric energy and our own plans for a more aggressive marketing program.

Arizona's growth continues tc test our resources

We take pride in our ability to provide the electric energy our customers need. But unlike many other areas of the nation where the demand for electricity has peaked, the Southwest continues to see growth in both customers and demand.

Arizona remains one of the fastest-growing states in the nation, having added more than 97,000 new citizens during 1984. According to Arizona State University economists, Arizona's 1984 economic growth rate was the highest in more than two decades; and though a match is not expected in 1985, the year ahead should still be outstanding, with some 70,000 new jobs created statewide in an economy that will continue to

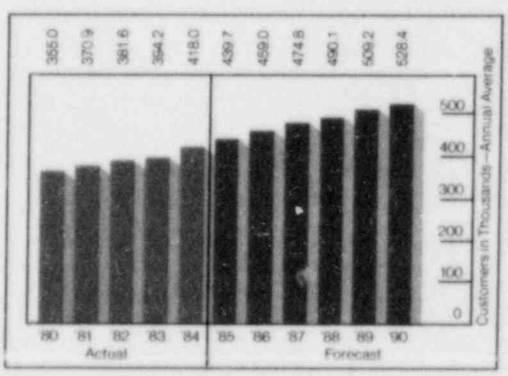


outperform national marks.

Construction should also be strong, with retail sales projected to increase by 11 percent. And through the coming decade, our state's population is expected to increase by 36 percent.

During 1984, Maricopa County issued a record number of new housing permits, outpaced only by the Dallas area in the nation's home building market. This marked the greatest growth year in our company's history and helped bring a record 30,900 new electric customers to our service area.

Some of this growth resulted from the late 1984 aquisition of



Customer Growth Expectations—Residential Electric

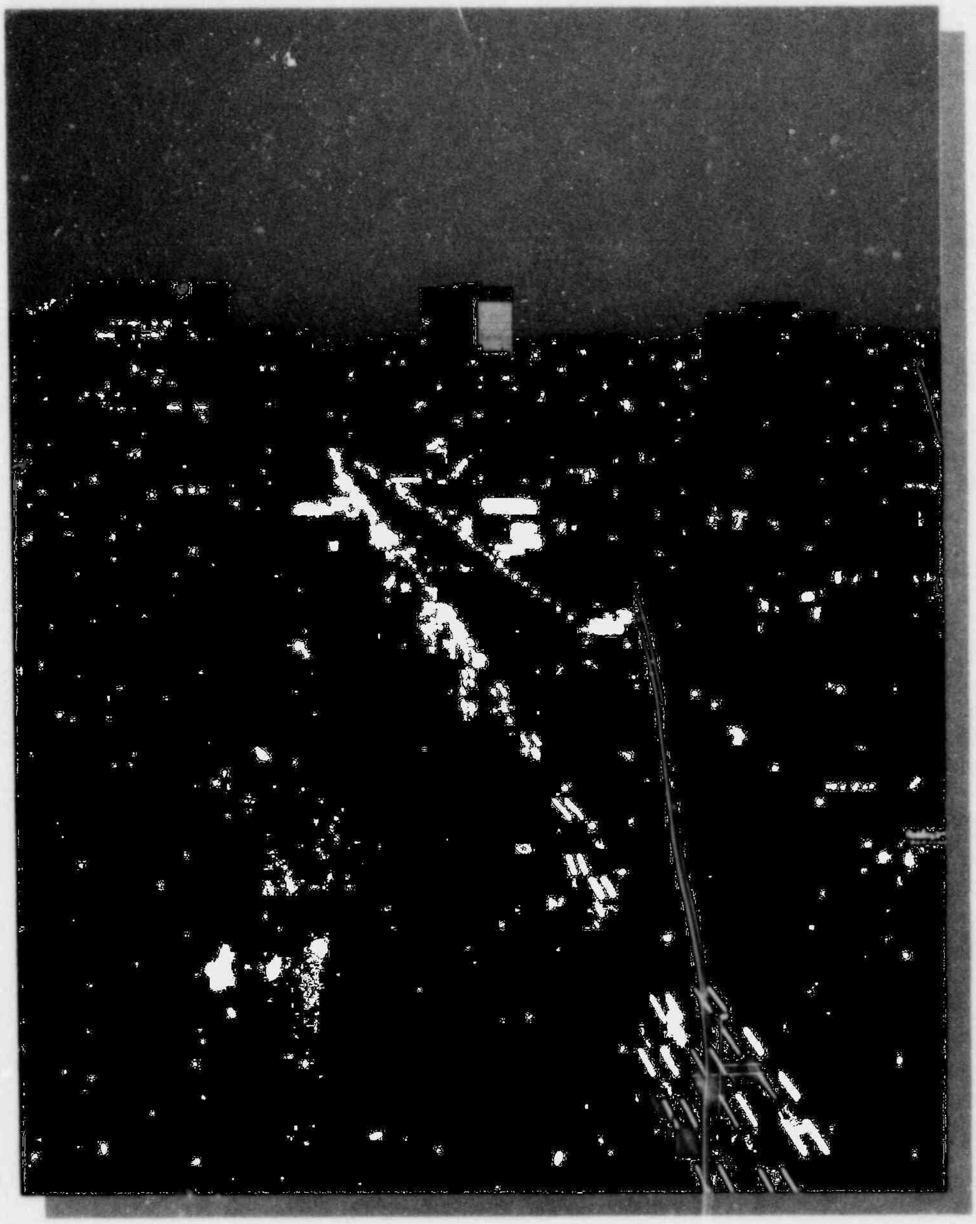
the Arizona portion of the Colorado River Indian Irrigation Project's off-reservation electric facilities, serving approximately 2,100 residential and 200 commercial electric customers.

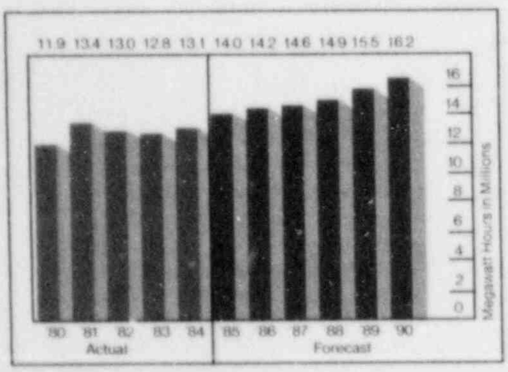
Our state's improving economy contributed to increased sales as well. Our system peak reached just over 2,970 megawatts, a 2.5 percent increase over 1983. This occurred despite lost sales resulting from a reduction in operations at a major copper mine, one of our largest customers.

Residential and commercial sales were up due primarily to increased customer growth; irrigation loads were higher as the result of the lifting of the federal Payment-In-Kind program which had reduced farm production in 1983.

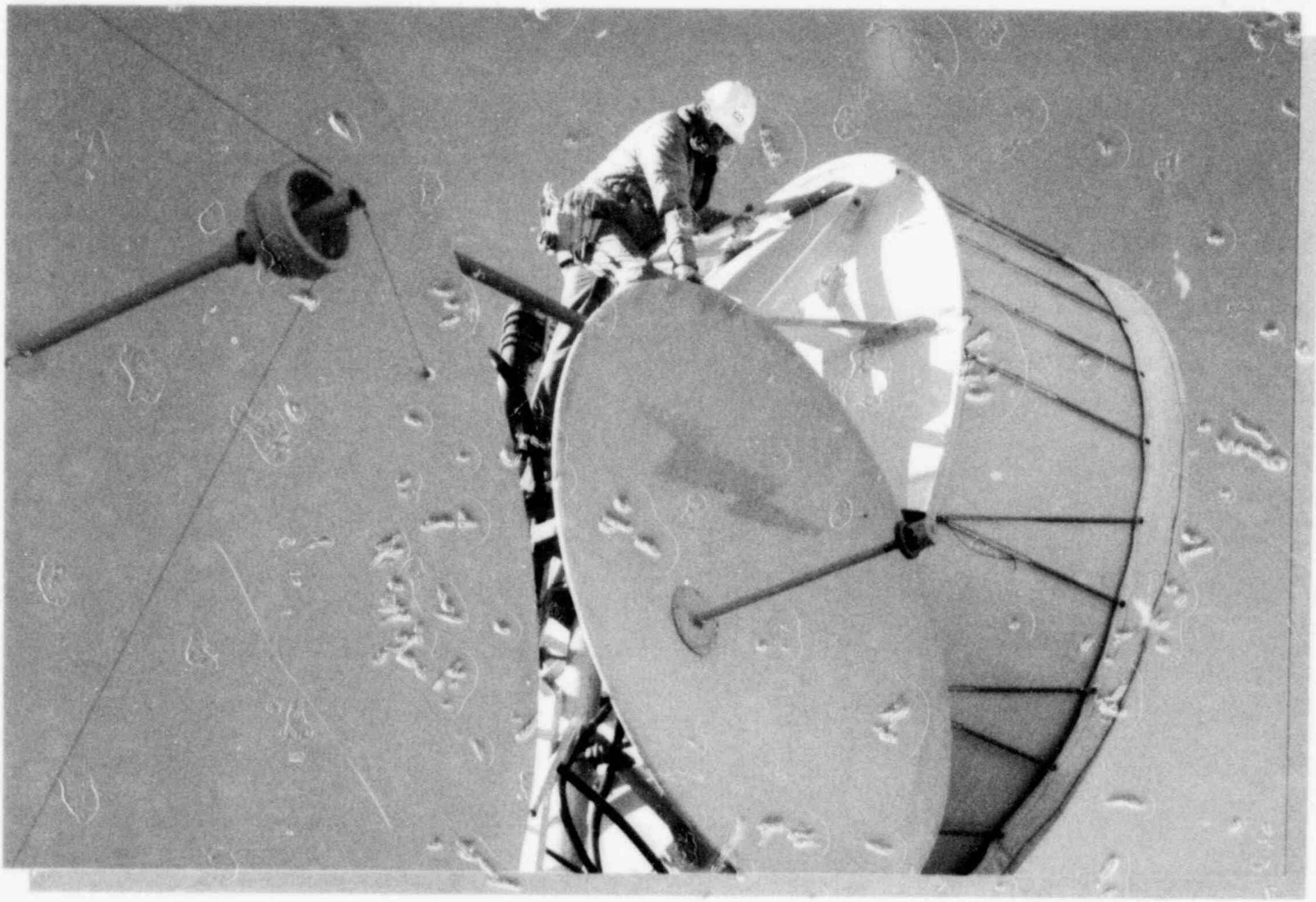
Overall, our year's energy sales were increased from the previous year by approximately 2.4 percent, to 13 million megawatthours.

Our sales came from a diversity of customers, about one-third residential, one-third commercial and one-third industrial, agricultural and other. A similar mix is projected through 1994, thus providing additional stability to our overall sales revenues and minimizing the effects of changes in any one category.



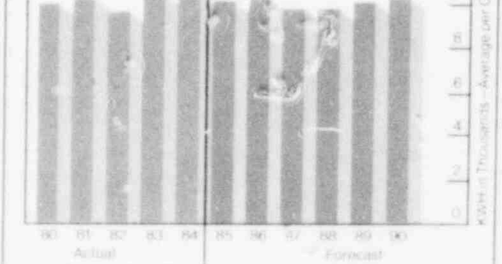


Total Electric Sales



Also projected are efforts by our customers to make increasingly efficient use of electric energy. However, we believe that population increases, continued economic development and the influx of new light industry will more than offset any effect on sales.

We estimate that our peak electric demand will increase by about 3.6 percent each year, reaching approximately 4,200 megawatts by 1994. Electric sales are expected to continue to grow by about 3.8 percent annually, reaching approximately 18.9 million megawatthours in 1994.



Customer Use Trends — Residential Electric

Though less than requested, rate increases granted have helped our financial picture

In an October ruling, the Arizona Corporation Commission made permanent a 7.3 percent interim electric rate increase that had been in effect since February 1. The commission also granted an additional 1.5 percent rate increase, effective immediately.

The commission's approval of the inclusion of $260 million of Construction Work In Progress (CWIP) for Palo Verde Unit 1 in our rate base was a major factor in the rate increase. (The Federal Energy Regulatory Commission also approved the allowance of some CWIP in increased wholesale electric rates.)

The Arizona regulatory body's ruling came on the heels of one of the most vigorously debated rate actions in our company's history. Opponents of CWIP argued that ratepayers should not pay for Palo Verde-related financing costs until after the plant becomes operational.

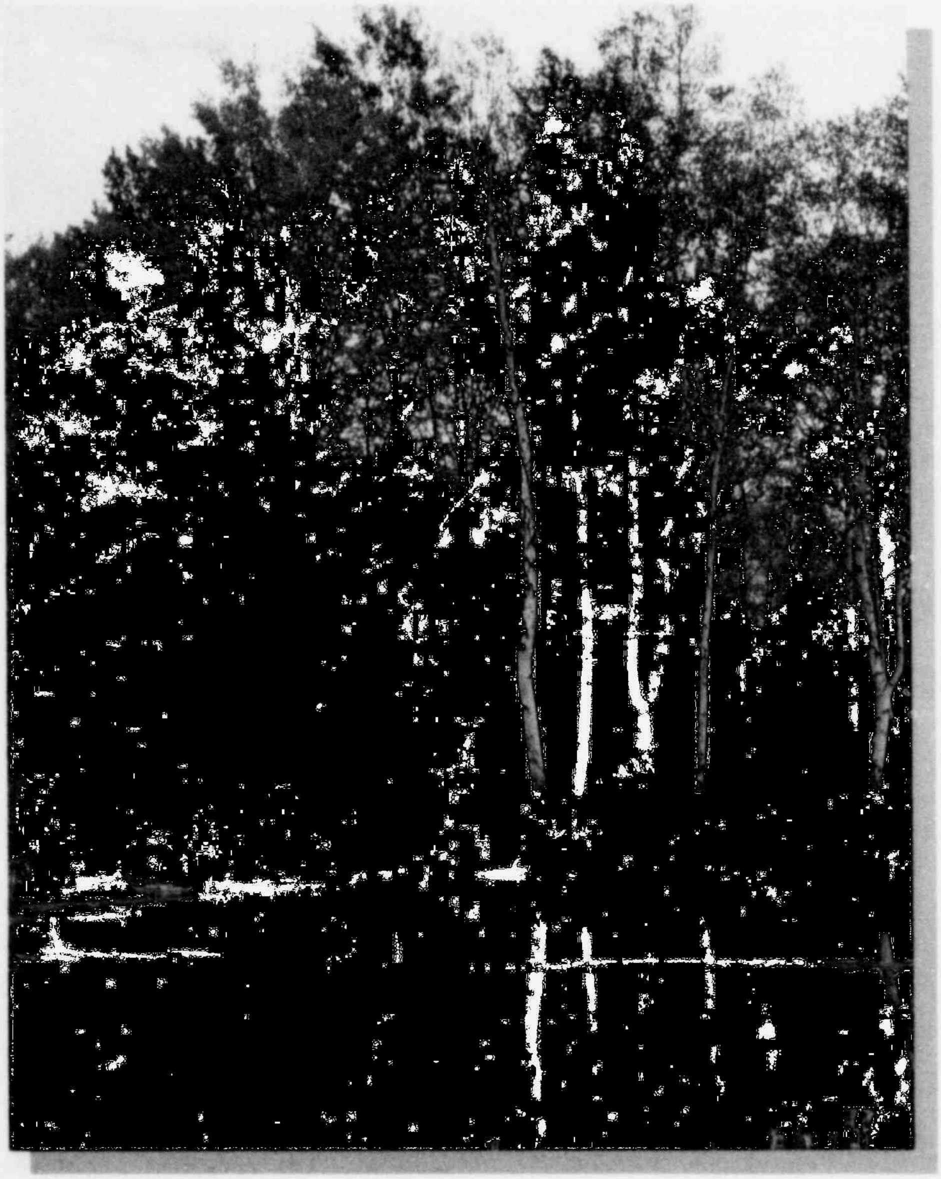
But the commission's decision recognized that phasing in those costs will lessen customer "rate shock" by reducing the interest costs incurred in completing the facility.

Late in November, the commission approved an additional rate increase of 5 percent, which became effective in February of 1985, after fuel loading at Palo Verde Unit 1 was completed.

The rate increase, which added another $200 million of CWIP to our rate base, was coupled with a comprehensive incentive/penalty plan based on operating performances at both Palo Verde Unit 1 and our Four Corners power plants, and timing and construction costs for the three Palo Verde units.

The plan adopted by the commission, which includes a $2.86 billion cap on our share of Palo Verde construction costs, is more severe than the plan proposed by APS at the commission's request; but it was a major factor in gaining the commission's approval of additional rate relief.

Overall, the three increases approved in 1984 resulted in a 14.4 percent increase in base electric rates.



While we were disappointed that the new rate level allowed us was less than we had requested, we were understandably pleased by the inclusion of CWIP.

The commission's decision marks the first time we have been allowed to earn a permanent cash return on our investment in the Arizona Nuclear Power Project, and represents an important first step in easing the plant's potential impact on electric rates as it becomes operational over the next few years.

We will continue to seek approval of the inclusion of additional portions of Palo Verde's costs in our rates as Unit 1 nears commercial operation, in order to improve our overall financial condition.

We are providing our customers the tools to play more active roles in controlling costs

We acknowledge our customers' fears about what tomorrow's electric rates may be. While rates must reflect the costs of providing service, making some increases unavoidable, we *can* reduce the effect higher rates have on our customers.

Through the past few years, we have provided our customers a series of programs that help them control their energy use...in ways that also reduce our service costs.

Our variety of "energy-efficiency" rates, for example, give customers the incentive to gain greater control over their monthly bills and, at the same time, cut peak energy demand.

As do our efficiency rates, our load-management programs encourage the off-peak use of electricity. This slows the increase in our system peak, thereby postponing the need for expensive new power plants. Since our first load-management programs were introduced in 1977, we have reduced our peak demand by a total of 263 megawatts from what it would have been without such an effort.

Also included in the program are home energy audits, a comprehensive plan for educating customers about energy use, and a recently reinstated Energy Control Credit (ECC) program that had achieved notable success when first introduced in 1982.

Under the ECC program, residential customers who purchase heat pumps or air conditioners with high efficiency ratings can receive rebates of up to several hundred dollars as a credit on their monthly bills. Credit rebates are also available for other products that help customers control the way they use electricity.

Later this year we will introduce a second phase of the program through which customers may obtain interest-free, no-money-down loans for the purchase and installation of certain load-control products.

Although our load-management programs have helped reduce our cumulative peak load and delayed the need for new generating units, new capacity will be needed if we are to meet Arizona's future growth.

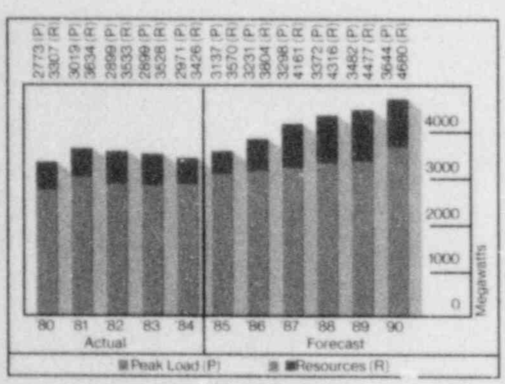
But because the investments required for major plant additions—and the impact they have on the rates we must charge our customers—have grown so great, a flexible approach is dictated.

For example, in 1980 we contracted to sell the entire output of new Cholla Unit 4 to Southern California Edison Company, in exchange for its payment of all incremental and fixed costs of the unit, including a return to our shareholders for their investment in the plant.

We will need to purchase some

power in 1985 to meet our own customers' demands, but our costs will be substantially less than the revenue derived from the Cholla 4 sale. Additionally, the retrieval of Cholla 4 in mid-1989 will mean our recapture of economical coal-fired generation tomorrow, from a plant built at yesterday's lower construction costs.

Looking further into the future, we are developing a strategy



Peak Load and Electric Resources

that would avoid building any large, baseload generating units until the turn of the century. This approach may enable us to delay construction of a fifth unit at Cholla.

An important factor in our strategy is a continuing effort to upgrade and improve the reliability of our existing generating stations. We're also looking to develop additional interties with neighboring utilities, to review reserve margins and reliability indices, to expand the size and scope of our load-management program, and to explore investments in cogeneration and third-party-financed facilities.

But our strategy also includes examination of renewable energy sources that could help meet our future energy requirements.

If our efforts are successful, our rates through the remaining 15 years of this century will increase at a much slower pace than they did through the 10 years just past and, in the decade beyond, at a pace below the anticipated rate of inflation.

We must complete, quickly and efficiently, those projects now being built

During 1984 we spent approximately $329 million to meet Arizona's growing electric needs as well as to upgrade our facilities. Absorbing the largest portion of that construction expenditure was our share of funding for the Arizona Nuclear Power Project.

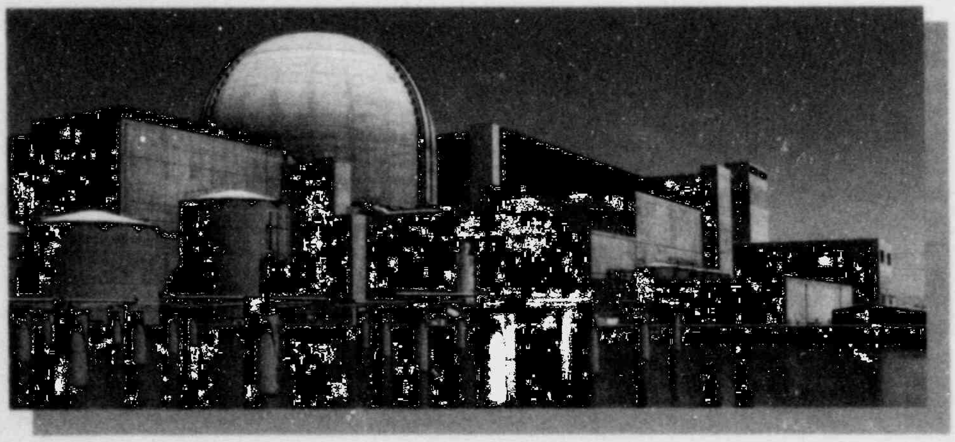
Palo Verde's progress in late 1983 and 1984 was delayed for a period of about one year as we modified low pressure safety injection pumps, made repairs to reactor coolant pumps that were damaged, and implemented a revised start-up program to assure the safety and quality of the plant.

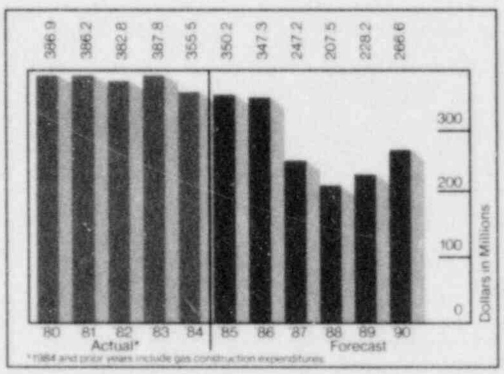
Although we continued to enjoy relatively strong support for Palo Verde, we were challenged by allegations that the project's prime contractor, Bechtel Power Corporation, had buried usable tools and equipment on the plant site.

While a network television news story tended to give credence to the allegations, a thorough investigation by the Arizona attorney general—financed by a $300,000 contribution from Bechtel—proved the charges groundless.

Meanwhile, our project management team pressed forward with the completion of Palo Verde Unit 1, where fuel loading was completed on January 11. Commercial operation of the unit is anticipated by the end of 1985.

Unit 2 is expected to be ready for fuel loading in the last quarter





Construction Expenditures *(Excl. AFC)*

of 1985 and operation in 1986; Unit 3 is scheduled for fuel loading in the first quarter of 1987 and operation later that year.

We are proud of our accomplishments at Palo Verde, considered to be one of the best-managed nuclear construction projects in the nation. Though ANPP costs have increased, a recent update of a study done early last year for Southern California Edison Co. shows Palo Verde Unit 1 was completed at a cost about 12 percent below the average for 23 other nuclear projects built in the same time frame.

The study also shows the time elapsed between the first concrete pour and fuel loading of Unit 1 to be one year less than the average.

We continue to invest in Arizona's future . . . our future

Because of our efforts to ensure the quality and safe operation of Palo Verde, we believe the project will be a positive example of the safety and efficiency of nuclear power.

More importantly, we expect Palo Verde to play a key role in

Arizona Nuclear Power Project Ownership

Arizona Public Service Company—29.1%
Salt River Project—23.19%
Public Service Company of New Mexico—10.2%
El Paso Electric Company 15.8%
Southern California Edison—15.8%
Southern California Public Power Authority—5.91%

Upon commerical operation of Unit 1, the Salt River Project will transfer 5.7% of its ownership in all three units of Palo Verde to the Los Angeles Department of Water and Power.

providing the energy needed in our fast-growing Southwest.

To make this energy available to our customers whenever needed, we must have a transmission and distribution system capable of delivering the power.

During 1984 we invested some $111 million in programs to build or upgrade transmission and distribution facilities designed to connect our generating plants with our customers or with the systems of other utilities.

One major project completed in 1984 was a 120-mile 500-kilovolt line extending from the switchyard at Palo Verde to a Yuma substation and beyond to the California border. A joint project with San Diego Gas and Electric Company and the Imperial Irrigation District, the new line will help meet Yuma's growing energy needs while at the same time allowing SDG&E to purchase power from APS and other Southwestern utilities.

Our new computer-based Energy Management System, the first phase of which began operating early in 1985, will increase our electric system's overall reliability.

Our responsibility, however, extends beyond providing energy. We must also ensure that our facilities do not adversely affect the surrounding environment.

By year-end 1984 we had completed two sulfur dioxide removal projects at our Four Corners Power Plant. Upgrading of equipment for Units 1, 2 and 3 was completed ahead of schedule in mid-1984, while work on Units 4 and 5 was completed on December 31.

The SO_2-removal projects were part of a multi-faceted environmental improvement program designed to minimize particulate and sulfur dioxide emissions from our Four Corners plant. The program was launched in 1980 following an agreement by APS, other owners of the plant, the Environmental Protection Agency, the New Mexico Environmental Improvement Board and various environmental groups. The $450 million total effort will make Four Corners one of the cleanest coal-fired plants of its size and vintage in the country.

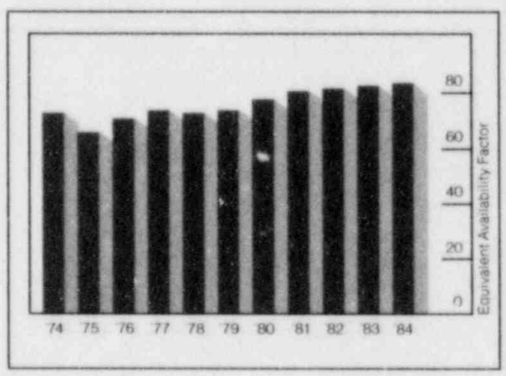
Our fuel mix helps provide a hedge against tomorrow's uncertainties

Though nuclear-powered Palo Verde will soon become a major source of baseload generation, economical coal-fired plants will continue to provide the lion's share of the electric energy our customers use.

During 1984, we were able to meet approximately 92 percent of our customers' needs with coal-fired generation from the jointly owned Four Corners and Navajo projects, as well as the APS-owned Cholla Power Plant.

This was due in part to the exceptional performance of our coal-fired units. During 1984, we achieved the highest equivalent availability on record for our share of these plants. This mark was substantially above the industry average for comparably sized units.

A tentative agreement has been reached with the Navajo Tribe and our supplier regarding Four Corner's coal. The agreement would increase royalty rates in exchange for a new pricing formula for transmission rights-of-



Total Coal Base

way, additional ash disposal area and firmed up future water rights.

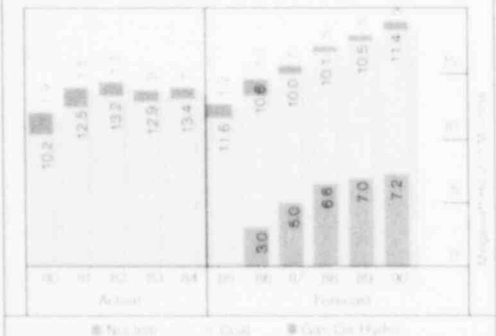
As we end this decade with all three of Palo Verde's nuclear-powered units on line, we look for 95 percent of our customers' energy requirements to be met with a combination of coal and nuclear fuels. We believe this combination will offer the most economical generation available, while protecting our company from unexpected fuel supply interruptions or cost increases.

While we strive to get the most out of today's fuels and technologies, we recognize that conventional fuels are finite. Alternative energies must be developed if we are to ensure that energy needed for the survival of our state and our nation is available.

Thus our research group will focus its efforts on analyzing the feasibility of renewable energy sources (such as solar, biomass, wind and additional hydro) that will help meet APS' future energy requirements. They'll also examine the potential of new technologies for enhancing conservation and reducing our peak requirements.

We have already positioned ourselves as a leader in solar technology. During 1984, we continued to produce energy from the 225-kilowatt Sky Harbor solar photovoltaic facility; and we met approximately 40 percent of the energy needs of an experimental photovoltaic home in southern Arizona.

In another area, 20 electric-powered fleet vehicles used by APS since 1981 are providing important experience that should help accelerate the development of electric vehicles. During the next few years, we will continue looking at ways to make them even more competitive.



Generation Fuel Mix Trend

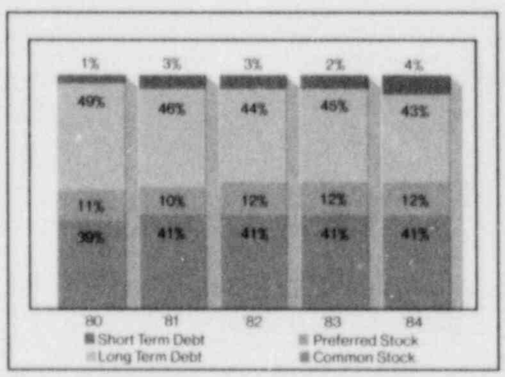
Financing our progress is a major challenge

We financed 21 percent of our construction program with internally generated cash in 1984, compared with about 4 percent generated internally during 1983. In so doing we reached a goal we had set for ourselves in 1975, an accomplishment that can be considered a major achievement.

We made no new public common stock offerings in 1984; but approximately 2.3 million shares of common stock were issued through our Stock Purchase and Dividend Reinvestment Plan. The equity from these sales enabled us to maintain our capital structure at our targeted level of 40 percent.

Rate increases and continued cost-control efforts in 1984 improved our cash flow and helped us meet our overall funding requirements. Still, the demands of financing an aggressive construction program require that we continue using the capital markets for many of our needs.

In March, we borrowed $37.5 million in pollution control



Capitalization Ratios

bonds for Palo Verde, followed by additional pollution control borrowings of approximately $60 million in late 1984. This brings the total of Palo Verde pollution control bonds issued in late 1983 and 1984 to $254 million, approximately $107 million of which is still subject to IRS ruling.

The issues bear interest at significantly lower rates than are otherwise available and also enabled us to remain out of the commercial paper market throughout the entire first quarter of 1984.

In May, we took advantage of one of the last leveraged preferred stock issues prior to their dissallowance by the Tax Act of 1984. A total of 500,000 shares issued produced net proceeds of about $50 million. The transaction yielded a lower dividend rate (11.5 percent) than conventional preferred issues.

Proceeds of the preferred sale were used primarily to reduce short-term debt, as were proceeds from a public sale of $100 million in 10-year first mortgage bonds. The bonds carry a 15 percent coupon.

In other financing, we called for the early redemption of two separate bond issues in 1984. Proceeds from the gas sale were used to redeem $100 million of 16 percent first mortgage bonds. We also called $60 million of 17¼ percent Eurobonds, originally due in October 1986.

More recently, the Arizona Corporation Commission approved our 1985 financing plans. Though we do not anticipate using all of the financing approved, we asked for the maximum allowable in each category to provide flexibility in today's changing financial market.

Providing additional reassurance is a $200 million revolving

line of credit arranged with six major banks. The credit will supplement existing short-term lines of credit and help ensure our financing capabilities.

Our responsibility extends beyond the electric meter, throughout the communities in which we serve

A utility company can only be as strong as the community it serves. Thus we believe it is in our own self-interest to help meet the social needs of our community.

During 1984, our social responsibility commitment included such efforts as Project S.H.A.R.E., a program to help needy Arizonans confronted with unexpected energy-related problems. Funds for the project are donated by employees, stockholders and customers, and distributed by the Salvation Army. During 1984, more than 3,155 Arizona families benefitted from Project S.H.A.R.E..

We have initiated several programs aimed at developing partnerships with our customers. Among these was the launching of Project VOICE, the heart of which is a panel of customer volunteers who will provide consumer input and help us respond more effectively to customers' concerns.

	Amount ($ millions)	Rate	Month Issued	Maturity Date
Debt				
First Mortgage Bonds	$100.0	15%	June	1994
Pollution Control Bonds				
Series A[1]	$ 28.0	Floating	Mar.	1985
Series B[2]	$ 9.5	Floating	Mar.	1985
Series C	$ 28.0	Floating	Apr.	1986
Series D[3]	$ 9.5	Floating	May	1986
Series E	$ 42.0	Floating	Nov.	1985
Series F	$ 10.0	Floating	Nov.	1985
Series G	$ 57.0	Adjustable	Dec.	2009
Series H	$ 2.0	Floating	Dec.	1985
Series I	$ 25.0	Floating	Nov.	1985
1 Refunded by Series C 2 Refunded by Series D 3 Refunded by Series G				
Preferred Stock				
Series R				
Private Leveraged Preferred	$ 50.0	11.50%	May	Final Maturity 2004

Summary of 1984 Financings.

We also laid the groundwork for a forum dedicated to the unique energy needs of older Arizonans. The Arizona Energy and Older Adult Network, comprised of leaders from government, public and private organizations, will be active by mid-1985.

We believe such programs will help us maintain a positive business environment in which the public can gain a greater understanding of our business.

Outstanding employee volunteers were honored through the third annual *Those Who Care* program, a company-sponsored effort which recognizes employees for their unselfish contributions to their communities.

Last year, we reported that our confidence in our ability to meet 1984's many challenges stemmed in great part from the strengths of our employees. During 1984, our employees improved productivity records, provided innovative new ideas, and aggressively supported our goals and positions.

All of our employees can be proud of their accomplishments; their safety has always been one of our top priorities. Though in recent years we have set industry records for safety, this past year was not as positive. We experienced fewer

total accidents, but their severity was greater.

We cannot allow our safety record to continue to deteriorate. In 1985 we have rededicated ourselves to maintaining our company's position as an industry leader in terms of employee safety.

We encourage your participation

Throughout this report, we've tried to give you—our shareholders—a clear picture of how we're managing your investment in Arizona Public Service Company. But our commitment to keeping you informed goes well beyond this annual report. We offer a number of programs aimed at helping meet your information needs.

For example, we publish three quarterly reports each year to update you on events as they develop.

We also maintain a shareholder information phone line, and invite your comments, questions and suggestions throughout the year. Out-of-state shareholders may call our toll-free number, 1-800-457-2983; if you live in Arizona, call 1-800-621-9093. We also invite you to write to our Shareholder Relations Department, P.O. Box 21666, Phoenix, AZ. 85036.

Finally, we hope to see you at our annual meeting on April 18, 1985; our annual Sun City shareholder meeting in May 1985; or at one of our other shareholder meetings planned for 1985 in key cities nationwide.

Financial Data

Selected consolidated financial data

	1984	1983	1982	1981	1980
	(Dollars in Thousands, Except Per Share Amounts)				
Continuing Operations:					
Electric Operating Revenues	$ 994,967	$ 871,875	$ 866,486	$ 730,788	$ 621,864
Operating Expenses:					
Operation and maintenance	358,665	349,150	349,975	311,479	311,784
Depreciation and amortization	87,494	83,707	79,676	70,988	59,559
Taxes*	285,548	185,606	173,736	98,597	86,475
Total	731,707	618,463	603,387	481,064	457,818
Operating Income	263,260	253,412	263,099	249,724	164,046
Other Income*	190,818	134,459	83,040	58,617	43,300
Interest Deductions—Net	156,508	118,819	117,838	106,073	65,133
Income from Continuing Operations	297,570	269,052	228,301	202,268	142,213
Income (Loss) from Discontinued Operations	(26,503)	(4,255)	2,742	(4,834)	1,077
Net Income	271,067	264,797	231,043	197,434	143,290
Preferred Dividend Requirements	48,375	43,741	34,816	26,786	25,062
Earnings for Common Stock	$ 222,692	$ 221,056	$ 196,227	$ 170,648	$ 118,228
Total Assets	$ 4,653,774	$ 4,386,312	$ 3,888,536	$ 3,396,790	$ 2,928,484
Long-term Debt and Redeemable Preferred Stock	$ 1,967,486	$ 1,892,477	$ 1,610,486	$ 1,618,048	$ 1,455,286
Common Stock Data:					
Book value per share	$ 24.18	$ 23.78	$ 22.94	$ 22.13	$ 21.97
Earnings (loss) per share (based on average shares outstanding):					
Continuing Operations	$ 3.65	$ 3.53	$ 3.25	$ 3.36	$ 2.73
Discontinued Operations	$ (0.39)	$ (0.07)	$ 0.05	$ (0.10)	$ 0.02
Total	$ 3.26	$ 3.46	$ 3.30	$ 3.26	$ 2.75
Dividends declared per share	$ 2.60	$ 2.56	$ 2.40	$ 2.20	$ 2.06
Shares of common					
—year-end	70,128,329	66,710,852	62,894,490	57,648,791	47,813,847
—average	68,308,131	63,865,210	59,549,685	52,289,259	42,960,655
Number of common shareholders	124,274	127,387	120,623	119,825	110,416

*Federal and State income taxes are included in Taxes and in Other Income.
Total income tax expense was as follows (in thousands): 1984, $137,072; 1983, $93,930; 1982, $93,100; 1981, $19,876; 1980, $15,719.

Other financial and operating statistics

	1984	1983	1982	1981	1980
			(Thousands of Dollars)		
Capitalization:					
Common equity	**$ 1,695,923**	$ 1,586,671	$ 1,442,639	$ 1,275,623	$ 1,050,651
Non-redeemable preferred stock	**218,561**	218,561	168,561	118,561	118,561
Redeemable preferred stock	**282,740**	237,400	241,220	199,280	185,280
Long-term debt	**1,684,746**	1,655,077	1,369,266	1,418,768	1,048,500
Project financing liability	—	—	—	—	221,506
Total	**$ 3,881,970**	$ 3,697,709	$ 3,221,686	$ 3,012,232	$ 2,624,498
Utility Plant—Gross	**$ 5,088,243**	$ 4,761,265	$ 4,198,466	$ 3,688,270	$ 3,199,927
Utility Plant—Net	**$ 4,344,083**	$ 4,033,400	$ 3,551,949	$ 3,111,773	$ 2,694,408
Number of Employees at Year-End	**7,358**	7,642	7,047	6,231	5,538
Average Wage per Hour	**$ 13.61**	$ 13.11	$ 12.27	$ 11.20	$ 10.12
Electric:					
Electric resources (kw)	**3,425,900**	3,528,400	3,532,900	3,634,300	3,307,200
Peak load (kw)	**2,970,600**	2,899,000	2,898,700	3,018,700	2,772,700
Electric sales—total (mwh)	**13,054,987**	12,753,542	12,950,727	13,387,998	11,877,722
Number of customers at year-end	**499,751**	468,768	449,244	438,853	421,803

Operating revenues

	1984	1983	1982	1981	1980
			(Thousands of Dollars)		
Continuing Operations—Electric					
Residential	**$378,536**	$314,404	$294,498	$252,907	$220,920
Commercial	**343,971**	296,364	286,262	238,975	210,226
Industrial	**126,187**	122,184	128,464	113,736	95,644
Irrigation	**25,540**	15,113	23,391	22,916	19,215
Other	**86,394**	90,118	92,490	81,565	59,391
Total	**960,628**	838,183	825,105	710,099	605,396
Transmission for others	**13,023**	12,555	11,104	9,173	8,817
Miscellaneous services	**21,316**	21,137	30,277	11,516	7,651
Total Operating Revenues—Continuing Operations	**$994,967**	$871,875	$866,486	$730,788	$621,864

Management's discussion and analysis of financial condition and results of operation

Liquidity and Capital Resources

The Company's large capital requirements for its ongoing construction program and for the refunding of maturing securities, and its heavy reliance on external financing to meet those requirements, are discussed earlier in this report and in Notes 3 and 4 of Notes to Consolidated Financial Statements. The Company has a degree of flexibility in adjusting its construction program to its financing capability. However, that flexibility is limited, and the Company's long-term liquidity will depend on its access to the capital markets, which in turn will depend on sufficiency of the Company's rates to provide adequate coverages on its senior securities and an adequate rate of return on its common stock equity. Adequate earnings and coverage are critical to the maintenance of satisfactory credit ratings on the Company's senior securities, and, as calculated in accordance with the governing instruments, are prerequisite to the Company's legal ability to issue such securities.

See Page 21 with respect to the Company's capital structure at December 31, 1984. Its target structure consists of no more than 50% debt (including current maturities and short-term obligations) and 40% common stock equity, with the balance consisting of preferred stock. The Company regards common stock equity as its most expensive form of permanent financing, but it intends to maintain that category at approximately the 40% level in order to support the credit ratings on its senior securities. If interest and dividend rates on new issues of long-term debt and preferred stock rise rapidly in the future, the Company's average cost of capital will rise accordingly as maturing securities, bearing relatively low rates, are refunded and the Company's plant expands.

See Note 5 of Notes to Consolidated Financial Statements with respect to short-term borrowings available to the Company (there being a statutory limitation on the amount of such borrowings that can be outstanding without consent from the ACC). Funds from operations after the payment of dividends have contributed only marginally to total sources of funds in the last few years (see Consolidated Statements of Changes in Financial Position). This situation is expected to continue to some degree until Palo Verde Unit 1 is fully included in rate base so as to give rise to additional cash earnings rather than the non-cash allowance for funds used during construction. The Company's retention of funds from operations has also been affected by the Company's policy of increasing common stock dividends periodically.

Operating Results

Total operating revenues reflect the effects of rate increases and adjustment clauses (see Note 1d of Notes to Consolidated Financial Statements) on prices of units sold. Operating revenues also reflect the volume changes in unit sales shown on page 21. The foregoing factors contributed to annual increases in electric revenues for the preceding calendar years as follows:

	Year Ended December 31, 1984	1983	1982
	(Thousands of Dollars)		
Energy related:			
Volume increases (decreases) (1)	$ 29,216	$ 13,438	$ (16,267)
Price increases (decreases) (2)	93,229	(360)	131,273
Non-energy related:			
Revenue increases (decreases) (3)	647	(7,689)	20,692
Net increase	$123,092	$ 5,389	$135,698

(1) Calculated by summing the products derived by multiplying the year-to-year increases in units sold in each customer class by the weighted average of the applicable rate levels in effect for the prior year.

(2) Calculated by summing the products derived by multiplying the year-to-year increases in the weighted average of rate levels in each customer class times the applicable number of units sold in the current year. Relative contributions by rate increases and by effects of the adjustment clauses vary according to the timing of general rate proceedings and the extent to which accumulated effects of the adjustment clauses are incorporated in new rates.

(3) Includes revenues for miscellaneous service and transmission for others.

The increase in volume-related electric revenues in 1984 was primarily due to higher sales in the residential and commercial classes. These sales increases were mainly the result of customer growth and the more humid weather conditions experienced during the summer of 1984. These factors were partially offset by decreased industrial sales to the copper industry and decreased resale sales resulting from the loss of a major customer. The increase in unit sales of electricity in 1983 was primarily due to customer growth in the residential and commercial classes partially offset by decreased retail and resale irrigation usage resulting from the U.S. Government's Payment-In-Kind Program. Unit sales of electricity were depressed in 1982 due to a general slowdown in the economy and more normal temperatures than had been experienced in 1981. Conservation efforts by customers in response to higher energy costs have affected unit sales, are expected to continue to do so, and are being aided by the Company's own load-management programs. The year-to-year changes in non-energy related electric revenues reflect changes in capacity sold to other utilities.

Although unit fuel costs have continued to rise, the Company's cost of fuel per kilowatt-hour generated has been tempered by the large portion of coal in the fuel mix and the continuing high capacity factors achieved at the Company's coal-fired plants. In 1984, increases in the unit costs of fuel for generation were offset by the improved fuel mix and high capacity factors. The slight increase in fuel expenses in 1984 reflects increased generation requirements. In 1983, increases in fuel expenses reflect increases in the unit costs of fuel for generation partially offset by decreased unit sales.

Variations in purchased power and interchange-net reflect varying degrees of availability of relatively low-priced power from other sources, the needs of the Company to augment its own generating sources from time to time, and the Company's ability to sell energy to neighboring utilities. In 1984, an increase due to the accounting treatment for the Company's fuel and purchased power expense discussed in Note 1d of Notes to Consolidated Financial Statements was largely offset by increased interchange sales to other utilities. The decrease in purchased power and interchange-net expense in 1983 was primarily due to the accounting treatment for fuel and purchased power. Also contributing to the decrease in 1983 was an allowance permitted by the ACC for recovery of costs associated with certain losses of electricity in the transmission and distribution process and the exclusion of the effect of a portion of profits on interchange sales from the recoverable fuel costs reflected in the account. This decrease was partially offset by reduced interchange sales to other utilities.

See "Effects of Inflation" below in regard to maintenance expense, which is also a function of the size of the Company's utility plant and is affected by the timing of major overhauls. The increase in operations excluding fuel expense in 1984 was due in large part to higher franchise expenses directly related to increased residential and commercial revenues, as well as rising insurance expenses.

Depreciation and amortization expenses increase with the size of the Company's utility plant. Ad valorem taxes, also affected by such increases, were offset in 1983 and 1984 by a change in assessment rates. See Note 10 of Notes to Consolidated Financial Statements for both ad valorem and sales taxes (the latter being a function of operating revenues), which are the principal components of other taxes.

The income tax increase in 1984 was largely a result of the Company's compliance with an ACC accounting order, effective October 1, 1983, the aggregate effect of which was to require the Company to normalize substantially all income tax timing differences (see Note 1f of Notes to Consolidated Financial Statements).

The aggregate amount of AFC, shown as other income and a credit to interest deductions, is primarily a function of the amount of construction work in progress during any given period and ceases to accrue on those portions of construction work in progress that are included in rate base. See Note 1e of Notes to Consolidated Financial Statements for changes in rates of AFC. See "Liquidity and Capital Resources" above with respect to the non-cash aspect of AFC.

The increase in interest on long-term debt in recent years reflects large amounts of new borrowings at relatively high interest rates. See "Liquidity and Capital Resources" above and Note 4 of Notes to Consolidated Financial Statements. The increase in interest on short-term borrowings in 1982 and 1984 resulted primarily from increased borrowings; in 1983 the decrease was primarily due to reduced interest rates.

Consolidated net income and earnings for common stock represent composite of cash and non-cash items (see Consolidated Statements of Changes in Financial Position) and, in part, reflect accounting practices unique to regulated public utilities.

Effects of Inflation

In contrast to the analysis of increases in operating revenues in the table at the beginning of "Operating Results" above, it is sometimes difficult, in the case of operation and maintenance expenses, to distinguish between effects of volume increases and rises in unit costs (which, for purposes of this discussion, are all attributed to inflationary pressures).

Certain inflationary effects, such as those on costs of generating fuel, are passed through to customers pursuant to rate adjustment procedures (see Note 1d of Notes to Consolidated Financial Statements). Nevertheless, the Company attempts to minimize such effects by means that include increasing the availability of its coal-fired units to result in a more economical fuel mix. This increase has been achieved by an intensive maintenance program, the cost of which is not covered by the adjustment clauses. There are a number of other major expense items that are also beyond the scope of the adjustment clauses. Inflationary pressures on these items have given rise to a significant earnings attrition between general rate increases. See earlier discussion with respect to the Company's most recent rate filings.

See Note 13 of Notes to Consolidated Financial Statements for perspectives on other effects of inflation.

Accountants' Opinion

Arizona Public Service Company:

We have examined the consolidated balance sheets of Arizona Public Service Company and its subsidiaries as of December 31, 1984 and 1983 and the related consolidated statements of income, retained earnings and changes in financial position for each of the three years in the period ended December 31, 1984. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, such consolidated financial statements present fairly the financial position of Arizona Public Service Company and its subsidiaries at December 31, 1984 and 1983 and the results of their operations and the changes in their financial position for each of the three years in the period ended December 31, 1984, in conformity with generally accepted accounting principles applied on a consistent basis.

Deloitte Haskins & Sells

Phoenix, Arizona
February 22, 1985

Consolidated statements of income

	Year Ended December 31, 1984	1983	1982
	(Dollars in Thousands Except Per Share Amounts)		
Electric Operating Revenues (Note 11)	$ 994,967	$ 871,875	$ 866,486
Fuel Expenses:			
Fuel for electric generation	186,276	185,504	177,095
Purchased power and interchange—net	6,647	6,454	27,358
Total	192,923	191,958	204,453
Operating Revenues Less Fuel Expenses	802,044	679,917	662,033
Other Operating Expenses:			
Operations excluding fuel expenses	97,535	94,511	84,887
Maintenance	68,207	62,681	60,635
Depreciation and amortization	87,494	83,707	79,676
Income taxes (Note 7)	191,100	103,186	90,248
Other taxes (Note 10)	94,448	82,420	83,488
Total	538,784	426,505	398,934
Operating Income	263,260	253,412	263,099
Other Income (Deductions):			
Allowance for equity funds used during construction	134,359	121,390	79,846
Income taxes (Note 7)	54,028	9,256	(2,852)
Other—net	2,431	3,813	6,046
Total	190,818	134,459	83,040
Income Before Interest Deductions	454,078	387,871	346,139
Interest Deductions:			
Interest on long-term debt	191,079	170,830	161,239
Interest on short-term borrowings	12,281	11,430	14,496
Debt discount, premium and expense	2,465	1,959	2,201
Allowance for borrowed funds used during construction	(49,317)	(65,400)	(60,098)
Total	156,508	118,819	117,838
Income From Continuing Operations	297,570	269,052	228,301
Discontinued Operations (Note 11):			
Income (loss) from operations of gas system—net of tax	(33)	(4,255)	2,742
Loss on disposal of gas system—net of tax	(26,470)	—	—
Income (Loss) From Discontinued Operations	(26,503)	(4,255)	2,742
Net Income	271,067	264,797	231,043
Preferred Dividend Requirements	48,375	43,741	34,816
Earnings for Common Stock	$ 222,692	$ 221,056	$ 196,227
Average Common Shares Outstanding	68,308,131	63,865,210	59,549,685
Per Share of Common Stock:			
Earnings (Loss) (based on average shares outstanding):			
Continuing operations	3.65	3.53	3.25
Discontinued operations	(0.39)	(0.07)	0.05
Total	$ 3.26	$ 3.46	$ 3.30
Dividends declared	$ 2.60	$ 2.56	$ 2.40

See Notes to Consolidated Financial Statements.

Consolidated statements of changes in financial position

	1984	1983	1982
		Year Ended December 31, (Thousands of Dollars)	
Source of Funds:			
Funds from operations:			
Continuing operations:			
Income from continuing operations	$ 297,570	$ 269,052	$ 228,301
Principal non-fund charges (credits) to income:			
Depreciation and amortization	87,494	83,707	79,676
Allowance for equity funds used during construction	(134,359)	(121,390)	(79,846)
Deferred income taxes—net	43,464	27,033	22,966
Deferred investment tax credit—net	56,002	29,960	52,158
Other	(385)	4,967	(6,537)
Total funds from continuing operations	349,786	293,329	296,718
Discontinued operations:			
Income (Loss) from discontinued operations	(26,503)	(4,255)	2,742
Principal non-fund charges to income:			
Loss on disposal of gas system—noncurrent	19,513	—	—
Other—net	3,897	9,371	8,581
Total funds from discontinued operations	(3,093)	5,116	11,323
Total funds from operations	346,693	298,445	308,041
Funds from external sources:			
Proceeds from sale of gas system	114,657	—	—
Common stock	63,800	86,918	115,707
Preferred stock	50,000	48,875	94,843
Long-term debt	264,179	419,126	298,278
Short-term borrowings—net	73,492	(3,308)	1,616
Other items—net	(3,916)	4,141	(3,080)
Total funds from external sources	562,212	555,752	507,364
Total source of funds	$ 908,905	$ 854,197	$ 815,405
Application of Funds:			
Funds used for capital expenditures:			
Continuing operations	$ 377,278	$ 425,130	$ 431,578
Discontinued operations	31,657	29,724	20,278
Investments and other assets	(13,299)	(4,955)	15,277
Repayment of long-term debt	275,833	185,653	174,085
Redemption of redeemable preferred stock	4,660	3,820	5,060
Dividends on preferred and common stock	225,615	206,558	176,953
Increase (Decrease) in working capital*	7,161	8,267	(7,826)
Total application of funds	$ 908,905	$ 854,197	$ 815,405
Increase (Decrease) in Working Capital*:			
Cash and temporary cash investments	$ (25,704)	$ 24,801	$ 1,098
Accounts receivable	(2,216)	(950)	16,160
Materials, supplies and fuel	(1,420)	(2,760)	6,662
Deferred fuel and other assets	(4,191)	(2,048)	4,400
Accounts payable and accrued expenses	32,881	(23,904)	(16,241)
Deferred fuel and other liabilities	7,811	13,128	(19,905)
Net increase (decrease)	$ 7,161	$ 8,267	$ (7,826)

*Excluding short-term borrowings—net and current maturities of long-term debt.

See Notes to Consolidated Financial Statements.

Consolidated balance sheets

Assets	December 31, 1984	1983
	(Thousands of Dollars)	
Utility Plant (Notes 4, 6 and 11):		
Plant in service:		
Electric	$2,747,464	$2,476,126
Gas	—	174,038
Common, used in all services	—	90,577
Total	2,747,464	2,740,741
Construction work in progress	2,304,306	1,986,052
Plant held for future use	36,473	34,472
Total Utility Plant	5,088,243	4,761,265
Less accumulated depreciation and amortization	744,160	727,865
Utility Plant—net	4,344,083	4,033,400
Investments and Other Assets:		
Investments in and receivables from subsidiaries	61,693	44,740
Time deposits designated for capital expenditures	—	30,141
Other investments and notes receivable	5,588	5,699
Total Investments and Other Assets	67,281	80,580
Current Assets:		
Cash (Note 5)	7,565	11,735
Temporary cash investments	—	21,000
Special deposits and working funds (Note 5)	3,339	3,873
Accounts receivable:		
Service customers	70,560	89,428
Other	35,329	19,686
Allowance for doubtful accounts	(1,434)	(2,443)
Materials and supplies (at average cost)	42,942	41,261
Fuel (at average cost)	30,163	33,264
Deferred fuel	927	7,463
Other	6,036	3,691
Total Current Assets	195,427	228,958
Deferred Debits:		
Unamortized gas exploration cost	12,967	14,728
Unamortized debt issue costs	13,931	14,422
Other	20,085	14,224
Total Deferred Debits	46,983	43,374
Total	$4,653,774	$4,386,312

Consolidated balance sheets

Liabilities	December 31, 1984	1983
	(Thousands of Dollars)	
Capitalization (Notes 2, 3 and 4):		
Common stock	$ 175,321	$ 166,777
Premiums and expenses—net	1,015,188	959,932
Retained earnings	505,414	459,962
Common stock equity	1,695,923	1,586,671
Non-redeemable preferred stock	218,561	218,561
Redeemable preferred stock	282,740	237,400
Long-term debt less current maturities	1,684,746	1,655,077
Total Capitalization	3,881,970	3,697,709
Current Liabilities:		
Notes payable (Note 5)	1,800	86,308
Commercial paper	158,000	—
Current maturities of long-term debt (Note 4)	70,890	115,833
Accounts payable	68,090	91,176
Accrued taxes	49,348	52,369
Accrued interest	55,906	63,112
Accrued dividends	4,143	3,711
Deferred fuel	—	14,146
Other	32,405	26,070
Total Current Liabilities	440,582	452,725
Deferred Credits and Other:		
Deferred investment tax credit	138,120	82,118
Deferred income taxes	110,821	73,361
Unamortized credit related to sale of tax benefits (Note 7)	45,333	47,020
Customers' advances for construction	21,351	18,039
Other	15,597	15,340
Total Deferred Credits and Other	331,222	235,878
Commitments (Note 9)		
Total	$4,65[illegible],774	$4,386,312

See Notes to Consolidated Financial Statements.

Consolidated statements of retained earnings

	Year Ended December 31, 1984	1983	1982
		(Thousands of Dollars)	
Retained earnings at beginning of year	$459,962	$401,723	$347,633
Add—Net income	271,067	264,797	231,043
Total	731,029	666,520	578,676
Deduct—Dividends:			
Common stock (Notes 2 and 3)	177,240	162,817	142,137
Preferred stock (see below)	48,375	43,741	34,816
Total	$225,615	206,558	176,953
Retained earnings at end of year	$505,414	$459,962	$401,723
Dividends on preferred stock:			
$1.10 preferred	$ 172	$ 172	$ 172
$2.50 preferred	258	258	258
$2.36 preferred	94	94	94
$4.35 preferred	326	326	326
Serial preferred:			
$2.40 Series A	576	576	576
$2.625 Series C	630	630	630
$2.275 Series D	455	455	455
$3.25 Series E	1,040	1,040	1,040
$8.50 Series F	—	—	61
$8.50 Series G	401	500	561
$10 Series H	3,147	3,307	3,467
$10.70 Series I	2,595	2,875	2,956
$8.32 Series J	4,160	4,160	4,160
$8.80 Series K	5,280	5,280	5,280
$9.70 Series L	4,656	4,656	4,656
$11.95 Series M	2,330	2,330	2,330
$12.90 Series N	4,773	4,773	3,235
$3.58 Series O	7,160	7,160	4,455
Adjustable Rate Series P	1,250	1,250	104
Adjustable Rate Series Q	5,223	3,899	—
$11.50 Series R	3,849	—	—
Total	$ 48,375	$ 43,741	$ 34,816

See Consolidated Statements of Income for dividends per share of common stock.

See Notes to Consolidated Financial Statements.

Notes to consolidated financial statements

1. Summary of Significant Accounting Policies.

a. System of accounts—The accounting records of Arizona Public Service Company (the "Company") are maintained in accordance with the uniform system of accounts prescribed by the Federal Energy Regulatory Commission ("FERC").

b. Consolidation—The consolidated financial statements include the accounts of the Company and those of two of its wholly-owned subsidiaries, APS Finance Company N.V. ("Finance"), organized to serve as a financing corporation to raise funds outside the United States of America, and APS Fuels Company, organized to manage investments in certain fuel resources. All significant intercompany balances and transactions have been eliminated. Other subsidiaries, which are shown on the equity basis, are not considered material for financial reporting purposes.

c. Plant and depreciation—Property is stated at original cost as defined for regulatory purposes. The cost of additions to utility plant and replacements of retirement units is capitalized. Replacements of minor items of property are charged to expense as incurred. In addition to direct costs, capitalized items include the present value of certain future lease payments (see Note 4), research and development expenditures pertaining to construction projects, indirect charges for engineering, supervision, transportation and similar costs, and an allowance for funds used during construction. Costs of depreciable units of plant retired are eliminated from plant accounts and such costs plus removal expenses less salvage are charged to accumulated depreciation. Contributions in aid of construction are credited to plant cost.

Depreciation is provided on a straight-line basis at rates authorized by the Arizona Corporation Commission ("ACC") annually. The applicable rates for 1982 through 1984 range from 3.07% to 4.16% for electric plant and 2.86% to 9.60% for common and general plant.

d. Revenues and fuel costs—Operating revenues are recognized when billed on a monthly cycle billing basis. Retail rate schedules include adjustment clauses which permit recovery of costs of certain fuel and purchased power. Regulatory hearings are held periodically to adjust the rates applicable under fuel adjustment clauses to more nearly match actual fuel costs. Temporary net under- or over-recoveries of costs resulting from application of the adjustment clauses are recognized as a deferred fuel asset or liability, respectively, with an offsetting amount recognized in purchased power and interchange-net expense. As of October 1983, allowances permitted by the ACC for recovery costs associated with certain losses of electricity in the transmission and distribution process and the exclusion of the effect of a portion of profits on interchange sales are reflected in the Company's fuel adjustment accounting. Other procedures apply to the recovery of fuel costs to wholesale customers and of specified taxes.

e. Allowance for funds used during construction—In accordance with the regulatory accounting practice prescribed by the FERC and the ACC, the Company capitalizes an allowance for the cost of funds used to finance its construction program ("AFC"). AFC, which does not represent current cash earnings, is defined as the net cost during the period of construction of borrowed funds for construction, and a reasonable rate of return on equity funds so used. The calculated amount is capitalized as a part of the cost of utility plant.

AFC has been calculated using composite rates of 12.75%, 13.00% and 13.25% in 1984, 1983 and 1982, respectively. In July 1983 the Company began compounding AFC semi-annually and, in October 1983, recording the borrowed funds portion on a "net of tax" basis through charges to income taxes—operating expense and credits to income taxes—other income. AFC ceases to accrue on those portions of construction work in progress allowed in rate base.

f. Income taxes—The Company uses accelerated depreciation methods for income tax purposes. As prescribed by the ACC, deferred income taxes are provided for certain timing differences arising from the recording, for income tax and financial reporting purposes, of depreciation of property placed in service after January 1, 1977. In October 1983 the Company, in accordance with an ACC order, began deferring amounts equal to the change in income taxes arising from substantially all other timing differences. Prior to October, such differences were reflected currently in income. At December 31, 1984 the Company had flowed through to income currently approximately $275,000,000 of income tax benefits arising from income tax timing differences for which deferred taxes have not been provided.

In 1982 the Company, in compliance with an ACC order, began deferring amounts equal to the reduction in federal income taxes arising from investment tax credits and amortizing these amounts to other income over the estimated life of the related assets. Before 1982 such amounts were flowed through income currently. Investment tax credits previously recognized as a reduction of deferred income taxes are being recovered over a twelve-year period.

g. Research and development costs—The Company expenses research and development costs on a current basis, except that costs which may result in additions to utility plant are deferred for subsequent inclusion in plant or to be written off if the applicable project is abandoned.

h. Gas exploration costs—The excess of costs over sales proceeds of the Company's discontinued gas exploration program has been deferred to be recovered, without interest, over a 10-year period pursuant to an order of the ACC, from certain classes of gas customers. Such amounts are now to be remitted to the Company by Southwest Gas Corporation as a result of the sale of the gas distribution system. See Note 11.

i. Discontinued Operations—As described in Note 11, the Company sold its gas distribution system effective November 1, 1984. Accordingly, prior years' statements of income have been reclassified to report separately this discontinued operation.

2. Common and Non-Redeemable Preferred Stock.

The balances at December 31, 1984 and 1983 of common stock, and of preferred stock which is not redeemable except pursuant to call by the Company at its option, are shown below.

	Number of Shares			Par Value			
		Outstanding at December 31,			Outstanding at December 31,		Call Price Per Share (a)
	Authorized	1984	1983	Per Share	1984	1983	
					(Thousands of Dollars)		
Common Stock	100,000,000	**70,128,329**	66,710,852	$ 2.50	**$175,321**	$166,777	
Non-Redeemable Preferred Stock (cumulative):							
$1.10 preferred	160,000	**155,945**	155,945	$ 25.00	**$ 3,898**	$ 3,898	$ 27.50
$2.50 preferred	105,000	**103,254**	103,254	50.00	**5,163**	5,163	51.00
$2.36 preferred	120,000	**40,000**	40,000	50.00	**2,000**	2,000	51.00
$4.35 preferred	150,000	**75,000**	75,000	100.00	**7,500**	7,500	102.00
Serial preferred	1,000,000						
$2.40 Series A		**240,000**	240,000	50.00	**12,000**	12,000	50.50
$2.625 Series C		**240,000**	240,000	50.00	**12,000**	12,000	51.00
$2.275 Series D		**200,000**	200,000	50.00	**10,000**	10,000	50.50
$3.25 Series E		**320,000**	320,000	50.00	**16,000**	16,000	51.00
Serial preferred	4,000,000(b)						
$8.32 Series J		**500,000**	500,000	100.00	**50,000**	50,000	(c)
Adjustable rate series Q		**500,000**	500,000	100.00	**50,000**	50,000	(d)
Serial preferred	10,000,000						
$3.58 Series O		**2,000,000**	2,000,000	25.00	**50,000**	50,000	(e)
Total		**4,374,199**	4,374,199		**$218,561**	$218,561	

(a) In each case plus accrued dividends.

(b) This authorization also covers outstanding redeemable preferred shares shown in Note 3, as well as the non-redeemable shares indicated above.

(c) At $105.50 through August 31, 1987; at $103.00 through August 31, 1992; and at $101.00 thereafter.

(d) Bears dividends at a rate, adjusted on a quarterly basis, 2% below the rate borne by certain United States Treasury Securities, but in no event less than 6% per annum, or greater than 12% per annum. Redeemable on or after March 1, 1988 at the option of the Company at $103.00 through February 28, 1993; and at $100.00 thereafter.

(e) Not redeemable prior to June 1, 1987 through certain refunding operations that would result in a lower rate of cost to the Company than the dividend rate on the shares to be redeemed; otherwise at $28.58 through May 31, 1987; at $27.39 through May 31, 1992; at $26.19 through May 31, 1997; and at $25.00 thereafter.

The holders of preferred stock are entitled to one vote for each share held of record, as are holders of common stock. Special requirements for favorable votes of holders of preferred stock, voting by the classes respectively prescribed for the several purposes, pertain to (i) certain conversions or exchanges of outstanding preferred stock, (ii) the authorization of any stock ranking prior to the preferred stock, (iii) making any change in the terms and provisions of preferred stock that would adversely affect the rights and preferences of the holders thereof, (iv) the issuance of any additional shares of preferred stock except under prescribed circumstances or (v) a merger, consolidation or sale of substantially all the assets of the Company. The foregoing voting rights attach to both redeemable and non-redeemable preferred stock, as do the rights that would arise out of dividend arrearages as discussed in Note 3.

Common and non-redeemable preferred stock sales and changes in premiums and expenses during each of the three years in the period ended December 31, 1984 were as follows (dollars in thousands):

Description	Common Stock Number of Shares	Common Stock Par Value Amount	Non-Redeemable Preferred Stock (cumulative) Number of Shares	Non-Redeemable Preferred Stock (cumulative) Par Value Amount	Premiums and Expenses Net*
Balance, December 31, 1981	57,648,791	$144,122	1,874,199	$118,561	$ 783,868
Common Stock	5,245,699	13,114	—	—	101,744
Non-Redeemable Preferred Stock, $3.58 Series O	—	—	2,000,000	50,000	(1,932)
Balance, December 31, 1982	62,894,490	157,236	3,874,199	168,561	883,680
Common Stock	3,816,362	9,541	—	—	77,557
Non-Redeemable Preferred Stock, Adjustable Rate Series Q	—	—	500,000	50,000	(1,305)
Balance, December 31, 1983	66,710,852	166,777	4,374,199	218,561	959,932
Common Stock	3,417,477	8,544	—	—	55,256
Balance, December 31, 1984	70,128,329	$175,321	4,374,199	$218,561	$1,015,188

*Premiums and expenses—net also include those of redeemable preferred stock issues (see Note 3).

The Company has a stock purchase and dividend reinvestment plan whereby newly issued shares of its common stock may be purchased at market on the applicable dates by any participant in the plan. It also has an employee savings plan under which the investment of certain funds contributed by participating employees could, and its own contributions (pursuant to provisions calling for the matching of employee contributions on certain terms or provisions pursuant to which limited federal tax credits can be obtained by reason of voluntary contributions) would, involve its issuance of new shares of common stock. Contributions made by the Company to its employee retirement plan may also involve one or more such issuances.

3. Redeemable Preferred Stock.

The balances at December 31, 1984 and 1983 of preferred stock which is redeemable at the option of the holders or pursuant to sinking fund obligations, in addition to being callable by the Company, are shown below.

	Number of Shares Outstanding at December 31, 1984	Number of Shares Outstanding at December 31, 1983	Par Value Per Share	Par Value Outstanding at December 31, 1984 (Thousands of Dollars)	Par Value Outstanding at December 31, 1983 (Thousands of Dollars)	Call Price Per Share(b)
Redeemable Preferred Stock (cumulative) serial preferred: (a)						
$8.50 Series G	38,400	54,000	$100.00	$ 3,840	$ 5,400	(c)
$10 Series H	304,000	320,000	100.00	30,400	32,000	(d)
$10.70 Series I	240,000	255,000	100.00	24,000	25,500	(e)
$8.80 Series K	600,000	600,000	100.00	60,000	60,000	(f)
$9.70 Series L	480,000	480,000	100.00	48,000	48,000	(g)
$11.95 Series M	195,000	195,000	100.00	19,500	19,500	(h)
$12.90 Series N	370,000	370,000	100.00	37,000	37,000	(i)
Adjustable Rate Series P	100,000	100,000	100.00	10,000	10,000	(j)
$11.50 Series R	500,000	—	100.00	50,000	—	(k)
Total	2,827,400	2,374,000		$282,740	$237,400	

(a) See Note 2 for authorized number of shares.

(b) In each case plus accrued dividends.

(c) Redeemable at par at the option of either the Company or the respective holders. Sinking fund provisions require the redemption of a total of 3,600 shares at par semi-annually (representing annual payments of $720,000).

(d) Redeemable at $106.48 through September 1, 1985 and thereafter declining by $0.36 per year to par after September 1, 2002. Applicable sinking fund provisions require the redemption of 16,000 shares at par annually (representing annual payments of $1,600,000).

(e) Not callable by the Company prior to December 1, 1985 through certain refunding operations that would result in a lower rate of cost to the Company than the dividend rate on the shares to be redeemed; otherwise at $107.00 through November 30, 1985, at $103.00 through

November 30, 1990, and at $101.00 thereafter. Applicable sinking fund provisions require the redemption of 15,000 shares at par annually (representing annual payments of $1,500,000). The Company may, but is not required to, redeem an additional 15,000 shares at par on December 1 in any year.

(f) Redeemable at $106.00 through February 28, 1989; at $103.00 through February 28, 1994; and thereafter declining in steps to $101.00. Applicable sinking fund provisions require the redemption of 22,500 shares at par annually commencing March 1, 1986 (representing annual payments of $2,250,000). The Company may, but is not required to, redeem an additional 22,500 shares at par on March 1 in any year beginning in 1986.

(g) Redeemable at the option of the Company at $105.39 through February 28, 1985, declining by $1.08 per year to $101.07 after March 1, 1989. Applicable sinking fund provisions require the redemption of 96,000 shares at par annually commencing March 1, 1986 (representing annual payments of $9,600,000).

(h) Redeemable on or after May 1, 1986 at the option of the Company at $101.99 through April 30, 1987; and thereafter at par. All shares then outstanding are required to be redeemed on May 1, 1988 at par.

(i) Redeemable after June 1, 1992 at the option of the Company at $106.11 through June 1, 1993, declining by $0.68 per year to $100.00 after June 1, 2002. Applicable sinking fund provisions require the redemption between 1988 and 2002 of all shares according to a predetermined schedule.

(j) Bears a dividend of $12.50 per share through December 1, 1987 and a dividend thereafter to be fixed by a formula related to the average prime interest rate in 1987. Redeemable at par on or after December 1, 1987 at the option of the Company. Applicable sinking fund provisions require the redemption of 20,000 shares at par each December 1 beginning in 1988 (representing annual payments of $2,000,000). All shares then outstanding are required to be redeemed on December 1, 1992.

(k) Redeemable after June 1, 1994 at the option of the Company at $105.45, declining each year by a predetermined amount to $100.00 after June 1, 2004. Applicable sinking fund provisions require the redemption between 1990 and 2004 of all shares according to a predetermined schedule.

If there were to be any arrearage in dividends on any of its preferred stock or in the sinking funds requirements applicable to any of its redeemable preferred stock (each such dividend being cumulative and of equal ranking with other such dividends, and each such requirement being cumulative and of equal ranking with other such requirements), the Company could not pay dividends on its common stock or acquire any shares thereof for consideration. If any such dividend arrearage were to equal six or more quarterly dividends, the holders of preferred stock, in addition to their other voting rights and voting by the classes prescribed for this purpose, could elect a total of six directors (all series of serial preferred stock, regardless of par value and whether redeemable or non-redeemable, comprising one such class and being entitled to elect two of the six directors). See Note 2 in regard to other voting rights of holders of preferred stock.

The combined aggregate amount of redemption requirements for the above issues each year through 1989 are as follows: $3,820,000 in 1985, $15,670,000 in 1986 and 1987, $39,760,000 in 1988, and $20,600,000 in 1989.

Redeemable preferred stock transactions during each of the three years in the period ended December 31, 1984 were as follows (dollars in thousands):

Description	Number of Shares	Par Value Amount
Balance, December 31, 1981	1,992,800	$199,280
$12.90 Series N	370,000	37,000
Adjustable Rate Series P	100,000	10,000
Sinking fund retirements:		
$8.50 Series F	(12,400)	(1,240)
$8.50 Series G	(7,200)	(720)
$10 Series H	(16,000)	(1,600)
$10.70 Series I	(15,000)	(1,500)
Balance, December 31, 1982	2,412,200	241,220
Sinking fund retirements:		
$8.50 Series G	(7,200)	(720)
$10 Series H	(16,000)	(1,600)
$10.70 Series I	(15,000)	(1,500)
Balance, December 31, 1983	2,374,000	237,400
$11.50 Series R	500,000	50,000
Sinking fund retirements:		
$8.50 Series G	(15,600)	(1,560)
$10 Series H	(16,000)	(1,600)
$10.70 Series I	(15,000)	(1,500)
Balance December 31, 1984	2,827,400	$282,740

Premiums and expenses—net related to redeemable preferred stock issues are included in the amounts presented in the second table in Note 2.

4. Long-Term Debt.

Details of long-term debt outstanding at December 31, 1984 and 1983 are as follows:

	December 31, 1984	December 31, 1983
	(Thousands of Dollars)	
First mortgage bonds:		
3¼% Series due March 1, 1984	$ —	$ 15,000
10⅜% Series due February 1, 1985 (a)	60,250	60,250
Less securities held by trustee (b)	(16,127)	(26,372)
5⅛% Series due October 1, 1987	15,000	15,000
4.70% Series due March 1, 1989	20,000	20,000
4.80% Series due November 1, 1991	35,000	35,000
16% Series due April 15, 1992	—	100,000
4.45% Series due June 1, 1992	25,000	25,000
4.40% Series due December 1, 1992	25,000	25,000
4.50% Series due September 1, 1993	15,000	15,000
15% Series due June 15, 1994	100,000	—
6.25% Series due September 1, 1997	25,000	25,000
12.875% Series due May 15, 2000	185,000	185,000

10.625% Series due November 15, 2000	62,977	65,977
7.45% Series due March 15, 2002	60,000	60,000
9.95% Series due March 1, 2004	75,000	75,000
6.20% Series due April 1, 2004	50,000	50,000
6.45% Series due April 15, 2007	43,000	43,000
6% Series due January 15, 2008	34,000	34,000
12⅛% Series due October 15, 2009	75,000	75,000
12.75% Series due July 1, 2013	100,000	100,000
13.5% Series due October 15, 2013	100,000	100,000
Unamortized discount and premium	(1,965)	(1,772)
Total first mortgage bonds	1,087,135	1,095,083
Pollution control indebtedness due December 15, 1985 Series E (c)	42,000	—
Less securities held by trustee (b)	(4,124)	—
Pollution control indebtedness due December 15, 1985 Series F (d)	10,000	—
Less securities held by trustee (b)	(4,478)	—
Pollution control indebtedness due December 15, 1985 Series I (e)	25,000	—
Less securities held by trustee (b)	(2,449)	—
Pollution control indebtedness due April 1, 1986 Series C (e)	28,000	—
Less securities held by trustee (b)	(218)	—
Pollution control indebtedness due April 1, 1986 (f)	55,200	55,200
Pollution control indebtedness due December 1, 2009 (g)	90,000	90,000
Less securities held by trustee (b)	(14,448)	(22,741)
Pollution control indebtedness due December 1, 2009, Series G (g)	57,000	
Less securities held by trustee (b)	(8,804)	
Pollution control indebtedness due May 1, 2013 (h)	65,750	65,750
Less securities held by trustee (b)		(97)
Unsecured notes payable due 1983 and 1984 (i)	—	96,003
Unsecured notes payable due 1987 (j)	70,000	70,000
17¼% guaranteed debentures due October 15, 1986 (k)	—	60,000
16¼% guaranteed debentures due July 15, 1988 (k)	50,000	50,000
16¼% guaranteed debentures due February 1, 1989 (k)	75,000	75,000
16% guaranteed debentures due February 15, 1989 (k)	25,000	25,000
11¾% guaranteed debentures due January 15, 1990 (k)	60,000	60,000
Capitalized lease obligation (l)	48,472	49,926
Unamortized discount	(780)	(970)
Other	2,380	2,756
Total long-term debt	1,755,636	1,770,910
Less current maturities		
3¼% Series due March 1, 1984	—	15,000
Pollution control indebtedness, due December 15, 1985 Series E, net of securities held by trustee	37,876	—
Pollution control indebtedness, due December 15, 1985 Series F, net of securities held by trustee	5,522	—
Pollution control indebtedness, due December 15, 1985 Series I, net of securities held by trustee	22,551	—
Sinking fund requirement on 10.625% Series due November 15, 2000	3,000	3,000
Unsecured notes payable due 1983 and 1984 (i)	—	96,003
Capitalized lease obligation (l)	1,565	1,454
Other	376	376
Total current maturities	70,890	115,833
Total long-term debt less current maturities	$1,684,746	$1,655,077

(a) The portion outstanding of the $60,250,000 of 10⅜% first mortgage bonds due February 1, 1985 was classified as long-term as such debt was partially refinanced on January 29, 1985 when the Company borrowed the proceeds of $49,400,000 of adjustable-rate annual tender pollution control revenue bonds due February 1, 2015. The bonds will bear interest through January 31, 1986 at the rate of 6½% and thereafter at such rate, determined annually, which will cause the bonds to have a market value which approximates as nearly as possible, their par value. The remaining portion of the 10⅜% first mortgage bonds was retired on January 29, 1985 with funds held from the original issue by a revenue bond trustee.

(b) Representing pollution control funds deposited with a revenue bond trustee and to be disbursed as needed to pay the costs of acquiring, constructing, reconstructing, improving, maintaining, equipping or furnishing the facilities financed.

(c) Supported by an irrevocable letter of credit issued by a bank. The bonds mature on December 15, 1985, and, contingent on the receipt of a favorable Internal Revenue Service Ruling on the qualification for tax-exempt financing of certain facilities, these bonds will bear interest at 62%

of the prime rate. In the event that certain conditions relating to the obtaining of such favorable ruling are not satisfied, interest will become payable at 110% of this prime rate from the date of issuance.

(d) Consisting of the borrowing from a governmental authority which has funded that amount through the issuance of a series of bonds. These bonds bear interest equal to 62% of the prime rate.

(e) Contingent upon the receipt of a favorable Internal Revenue Service Ruling on the qualification for the tax-exempt financing of certain facilities, these bonds will bear interest at 65% of the prime rate. In the event that certain conditions relating to the obtaining of such favorable ruling are not satisfied, interest will become payable at 110% of the prime rate from the date of issuance.

(f) Consisting of a borrowing from a governmental authority which is funding that amount with a series of commercial paper borrowings supported by irrevocable letters of credit issued by banks and with five year, revolving loan commitments from the banks allowing the authority to obtain borrowings thereunder in the event of disruptions in the commercial paper market. The cost to the Company of its borrowings from the authority is equal to the latter's cost of money in the commercial paper market plus fees and interest payable to the banks.

(g) Consisting of the borrowing from a governmental authority which has funded that amount through issuance of a series of par value demand bonds supported by a long-term irrevocable letter of credit issued by a bank. These bonds bear interest at such rate, determined weekly, as will cause the bonds to have a market value which approximates, as nearly as possible, their par value.

(h) On May 23, 1983 the Company borrowed from a governmental authority the proceeds of a $65,750,000 issue of par value demand pollution control bonds for the purpose of refunding $65,000,000 in aggregate principal amount of previously issued pollution control bonds due October 1, 1983, plus accrued interest. The $65,750,000 issue is supported by a long-term irrevocable letter of credit issued by a bank. The bonds bear interest at such rate, determined weekly, as will cause bonds to have a market value which approximates, as nearly as possible, their par value.

(i) Paid in four installments, with the final payment made on December 1, 1984.

(j) Consisting of two long-term bank loans of $50,000,000 and $20,000,000, both due in 1987. The principal amounts of such loans bear interest, at the Company's option, at one or more of the following annual interest rates through mid-September 1985: (a) the Prime Rate, (b) the CD Rate plus ½%, or (c) the Eurodollar Rate plus ⅜%. Thereafter, at the Company's option, the annual interest rates will become: (a) in the case of the first loan, 102% of the Prime Rate or, in the case of the second loan, the Prime Rate plus ¼%, (b) the CD Rate plus ⅝%, or (c) the Eurodollar Rate plus ½%.

(k) Representing debentures issued by Finance, the payment of principal and interest on which has been unconditionally guaranteed by the Company. The debentures are redeemable at the option of Finance as follows:

16¼% debentures due July 15, 1988; redeemable at 101½% from July 15, 1985 through July 14, 1986; then at 100¾% through July 14, 1987; and thereafter at 100%.

16¼% debentures due February 1, 1989; redeemable at 101% from February 1, 1986 through January 31, 1987; and thereafter at 100%;

16% debentures due February 15, 1989; redeemable at 101% from February 15, 1986 through February 14, 1987; and thereafter at 100%;

11¼% debentures due January 15, 1990; redeemable at 101½% from January 15, 1987 through January 14, 1988; then at 100¾% through January 14, 1989; and thereafter at 100%.

17¼% debentures due October 15, 1986 were redeemed on October 15, 1984 at 101½% plus accrued interest.

(l) Represents the present value of future lease payments (discounted at the interest rate of 7.48%) on a combined cycle plant sold and leased back from the independent owner-trustee formed to own the facility. The lease requires semi-annual payments of $2,582,000 through June 2001, and includes renewal and purchase options based on fair market value. This plant is included in plant in service at its original cost of $54,405,000; accumulated amortization at December 31, 1984 was $19,138,000.

Subsequent to December 31, 1984, the Company issued $125,000,000 of 12% Series First Mortgage Bonds which are due January 15, 1995. The Company also issued in an overseas market $75,000,000 of 12½% Debentures due 1992.

Aggregate annual payments due on long-term debt and for sinking fund requirements through 1989 are as follows: 1985, $81,971,000; 1986, $100,656,000; 1987, $102,620,000; 1988, $67,795,000; and 1989, $137,985,000. Other sinking fund requirements for each year through 1989 for the outstanding first mortgage bonds are as follows: 1985 and 1986, $2,200,000; 1987 and 1988, $2,050,000; and 1989, $1,850,000; as allowed in the bond indenture, requirements of this type have in the past been satisfied by certification of property additions of 1⅔ times the amount stated and the Company expects to meet similar requirements in that manner in the future. For sinking fund requirements and redemptions at the option of the holders of redeemable preferred stock, see Note 3.

Substantially all utility plant, other than the combined cycle plant mentioned above, is subject to the lien of the first mortgage bonds. The indenture respecting the first mortgage bonds includes provisions which would restrict the payment of dividends on common stock under certain conditions which did not exist at December 31, 1984.

5. Short-Term Borrowings and Compensating Balances.

The Company's lines of credit at December 31, 1984 and 1983 are summarized below. No amounts were outstanding under the lines at December 31, 1984 or 1983.

	1984	1983
	(Thousands of Dollars)	
Commercial paper backup lines:		
Domestic banks	$125,000	$105,000
Foreign banks	50,000	50,000
Other domestic bank lines	245,000(a)	45,000
Total	$420,000	$200,000

(a) Including $200,000,000 available under a credit agreement between the Company and various banks. Such credit agreement commenced May 31, 1984 and carries a commitment fee of ¼% per annum.

The commitment fees for the commercial paper backup lines with domestic banks were ⅜% per annum in 1984 and 1983. Compensating balances required (but which were not legally restricted) for the other domestic bank lines (exclusive of the credit agreement referred to in (a) above) were generally 7½% of the lines plus 5% of the borrowings in 1984 and 1983. Substantially all cash shown on the balance sheets is considered compensating balances.

Under foreign bank lines, commitment fees were payable at ¼% per annum in 1984 and 1983. The interest rate on borrowings under these facilities was approximately ½% per annum over the applicable Eurodollar Rate in effect from time to time.

At December 31, 1983, the Company had borrowings of $30,141,000 from foreign banks which were not participants in the lines of credit described above. No amounts were outstanding at December 31, 1984. The interest rate on such borrowings was approximately ½% per annum over the applicable Eurodollar Rate in effect from time to time.

On December 21, 1984, the Company borrowed from a governmental authority the proceeds of $1,980,000 of short-term pollution control indebtedness issued to a bank. Such indebtedness matures September 30, 1985 and, contingent upon the receipt of a favorable Internal Revenue Service ruling on the qualifications for tax-exempt financing of certain facilities, bears interest at 65% of the bank's prime rate. In the event that certain conditions relating to the obtaining of such favorable ruling are not satisfied, interest will become payable at the bank's prime rate from the date of issuance. At December 31, 1984, $180,000 of the loan proceeds were on deposit with a revenue bond trustee, to be disbursed as construction progresses on the financed facilities.

By statute the Company's short-term borrowings cannot exceed 7% of total capitalization without the consent of the ACC.

6. Jointly-Owned Facilities.

At December 31, 1984, the Company owned the following interests in jointly-owned electric generating and transmission facilities (dollars in thousands):

	Percent owned by Company	Plant in Service	Accumulated Depreciation	Net Plant in Service	Construction Work in Progress
Generating Facilities:					
Arizona Nuclear Power Project (ANPP)—Units 1, 2, and 3	29.1%	$ —	$ —	$ —	$2,045,671
Four Corners Steam Generating Plant—Units 4 and 5	15.0%	115,893	16,998	98,895	924
Navajo Steam Generating Plant—Units 1, 2 and 3	14.0%	119,081	33,933	85,148	—
Transmission Facilities:					
ANPP Transmission System	35.8%(a)	7,362	595	6,767	36,909
Navajo Southern Transmission System	31.4%(b)	28,198	8,187	20,011	—
Palo Verde—Yuma 500 KV System	23.9%(c)	15,638	186	15,452	1,581
Total		$286,172	$59,899	$226,273	$2,085,085

(a) Weighted average of interests varying from 34.6% to 43.95%.
(b) Weighted average of interests varying from 14% to 100%.
(c) Weighted average of interests varying from 11% to 100%.

The foregoing dollar amounts correlate to the Company's percentage interest in each facility. Financing for such interests is provided by the Company. The Company's share of related operating and maintenance expenses is included in operating expenses.

7. Income Tax Expense.

The components of income tax expense—continuing operations for each of the three years in the period ended December 31, 1984 were as follows:

	Year Ended December 31,		
	1984	1983	1982
	(Thousands of Dollars)		
Currently payable:			
Federal	$ 14,578	$14,224	$ 6,267
State	16,340	10,742	11,619
Other	3,606	2,870	1,774
Total current	34,524	27,836	19,660
Deferred:			
Depreciation—net	26,276	22,571	20,709
Taxes, pension costs and other—net	18,367	5,627	2,260
Investment tax credit—net	59,592	39,583	52,158
Total deferred	104,235	67,781	75,127
Amortization of tax benefits sold	(1,687)	(1,687)	(1,687)
Total	$137,072	$93,930	$93,100

In 1981 the Company sold to another corporation certain federal income tax benefits in exchange for cash. The Company, pursuant to an order of the ACC, has recorded the proceeds of the sales as a deferred credit and is amortizing the amount of such proceeds on a straight-line basis over approximately 30 years.

Following is a summary of the difference between income tax expense—continuing operations and the amount obtained by multiplying income before income taxes by the statutory federal income tax rate.

	Year Ended December 31,		
	1984	1983	1982
Federal income tax at statutory rate	$199,935	$166,972	$147,844
Increases (reductions) in taxes resulting from:			
Tax under book depreciation	14,165	10,213	8,867
Allowance for funds used during construction	(84,491)	(83,799)	(63,169)
Investment tax credit	(2,827)	(1,970)	(1,378)
Taxes, pension costs and other items capitalized	—	(6,640)	(8,340)
State income tax—net of federal income tax benefit	11,172	7,070	7,338
Other	(882)	2,084	1,938
Total provision for federal & state income tax	$137,072	$ 93,930	$ 93,100

At December 31, 1984 the Company had approximately $12,000,000 of investment tax carryforward which will expire through 1999.

8. Pension Plan and Other Benefits.

The Company's pension plan, a defined benefit plan, covers virtually all employees. Pension cost, including administrative cost, for 1984, 1983, and 1982 was $16,370,000, $15,248,000, and $11,865,000, respectively, of which approximately $6,512,000, $6,871,000, and $4,971,000, respectively, was charged to expense; the remainder was either capitalized as a component of construction costs or billed to participants of jointly owned facilities.

The following is a summary of plan data as of the most recent benefit information date:

	January 1,	
	1984	1983
Actuarial present value of accumulated plan benefits:	(Thousands of Dollars)	
Vested	$115,984	$109,818
Non-vested	10,499	6,166
Total	$126,483	$115,984
Net assets available for benefits	$182,577	$154,542

The actuarial present value (assuming a 9.00% rate of return) of accumulated plan benefits presented above has not been calculated with reference to the effects of projected inflation, whereas such effects are considered by the Company with reference to the adequacy of plan assets; accordingly, the Company considers the utility of the comparison suggested to be extremely limited.

In addition to providing pension benefits, the Company provides certain health care and life insurance benefits for retired employees. Life insurance benefits are provided through an insurance company whereas health care costs are paid as expenses are incurred under a self-insured plan. The cost of providing those benefits for 1,081 retirees is not separable from the cost of providing benefits for the 7,403 active employees. The total cost for such in 1984 was $13,786,000, of which approximately $5,689,000 was charged to expense; the remainder was either capitalized as a component of construction costs or billed to participants of jointly owned facilities.

9. Commitments.

The Company has significant purchase commitments in connection with its continuing construction program. Construction expenditures in 1985 have been estimated at $350,000,000.

10. Supplementary Income Statement Information.

Other taxes charged to operations during each of the three years in the period ended December 31, 1984 are as follows:

	Year Ended December 31,		
	1984	1983	1982
	(Thousands of Dollars)		
Ad valorem	$42,581	$44,691	$47,611
Sales	45,495	32,169	31,284
Other	6,372	5,560	4,593
Total other taxes	$94,448	$82,420	$83,488

11. Discontinued Operations.

Effective November 1, 1984 (the "Closing Date") the Company sold its gas distribution system to Southwest Gas Corporation ("Southwest"). The purchase price paid to the Company on the Closing Date (the "Interim Purchase Price") was $112,390,000, approximately $100,000,000 of which was used to redeem certain of the Company's first mortgage bonds. The Interim Purchase Price is subject to final adjustment to reflect a certain percentage of the net book value of the gas distribution system as of October 31, 1984, estimated at $134,000,000, and to reflect a certain percentage of the value (also as of October 31, 1984) of certain rights purchased and obligations assumed by Southwest with respect to the gas distribution system. Any such adjustment is not expected to be significant. The final sales price is expected to result in a non-recurring loss of approximately $26,470,000, net of an income tax benefit of $7,094,000, (approximately $0.39 per average share of common stock) in 1984.

The Company has also agreed to fund a portion of the costs associated with the accelerated replacement of certain gas pipe included in the gas distribution system acquired by Southwest by purchasing, under certain conditions, up to $50,000,000 in aggregate par value of cumulative preference stock (the "Stock") to be issued by Southwest. Any such purchases would be made by the Company within approximately three years following the Closing Date. The Stock would yield an annual dividend of between 3% and 16% (payable quarterly) based on a formula relating to the operating performance of the gas distribution system. The Stock is also redeemable by Southwest, at its option, on any dividend payment date, (at the issue price plus accrued dividends), but must be redeemed no later than seven years after the issuance date as to any issue.

Revenues from the Company's discontinued gas operations for December 31, 1984, 1983, and 1982 were $174,728,000, $202,134,000, and $197,967,000, respectively.

12. Selected Quarterly Financial Data (Unaudited)

Quarter	Revenue from Continuing Operations	Income from Continuing Operations	Income (loss) from Discontinued Operations	Net Income	Earnings for Common Stock	Earnings (loss) per share of common stock: Continuing Operations	Discontinued Operations
	(Dollars in Thousands, Except Per Share Amounts)						
1984							
First	$203,937	$ 51,324	$1,397	$ 52,721	$41,598	$0.60	$0.02
Second	236,712	61,889	(185)	61,704	49,600	0.73	—
Third	311,845	103,118	(1,028)	102,090	89,456	1.32	(0.02)
Fourth	242,473	81,239	(26,687)	54,552	42,038	0.99	(0.39)
1983							
First	190,618	49,096	1,979	51,075	40,954	0.62	0.03
Second	205,831	59,795	(2,555)	57,240	46,008	0.77	(0.04)
Third	266,939	92,597	(3,633)	88,964	77,750	1.28	(0.06)
Fourth	208,487	67,564	(46)	67,518	56,344	0.86	--

13. Supplementary Information to Disclose the Effects of Changing Prices (Unaudited).

The following supplementary information is furnished pursuant to Statement No. 33 as amended by Statement No. 82 of the Financial Accounting Standards Board for the purpose of illustrating the effects of changing prices in an inflationary environment. It offers some perspectives of approximated effects of inflation, and is not intended as precise measurements of those effects.

The Company and other public utilities similarly situated are subject to rate-making procedures which, by law and practice, in large part utilize the historical cost of utility plant in the determination of the allowed recovery (through depreciation) of the investment therein and return thereon. This precludes or restricts a rate-making response to the effects of realizing such recovery and return in inflated dollars, compared to those in which the investment was made. The first table below presents an approximate measurement of those effects from the perspective of that portion of the investment, which was not reflected in 1984 depreciation or in the Company's return, and which is therefore not "recoverable."

For these presentations, "current cost" amounts were calculated by applying certain indices (or ratios derived therefrom) to certain historical or other amounts. The primary index was the Handy Whitman Index of Public Utility Construction Costs (an estimate of which was used for the last half of 1984), although the Consumer Price Index was used for construction work in progress. The Company believes that the Handy Whitman Index is the more accurate of the two in estimating the prices it would incur to duplicate at various times its utility plant in service at the indicated dates. Over the period from 1980 through 1984 the Consumer Price Index rose faster than the Handy Whitman Index.

Electric depreciation expense for 1984 was recalculated by applying the Company's composite depreciation rate to depreciable base determined by indexing certain appraised values from the times of appraisal. The amount by which the expense so recalculated exceeds that shown on the Company's 1984 Consolidated Statement of Income appears as an adjustment to income from continuing operations.

The sum of the depreciation adjustment and the figure shown lower as the "reduction to net recoverable cost" was derived through application of 1984 increases in the Consumer Price Index to historical costs of the Company's utility plant.

The Company did not make adjustments to asset values, or related consolidated income statement amounts, other than those discussed above in regard to utility plant and depreciation thereon. Fuel inventories and fuel expenses are, in effect, monetary items, due to applicable rate-making procedures which include adjustment clauses. In accordance with Statement No. 33, as amended by Statement No. 82, income taxes were not adjusted.

As contrasted to the assumed net value losses which, in the presentation below, are associated with the holding of assets committed to a regulated business, there is an assumed "holding gain" associated with borrowings that will be repaid with inflated dollars. The 1984 decline in the purchasing power of net amounts owed by the Company (measured by the Consumer Price Index) appears to result in a "net" difference between the assumed holding losses and gain.

Inferences which, in the case of some industries, may be drawn from information in the nature of that presented below as to the adequacy of future cash flows in relation to future plant replacement requirements are believed by the Company to be less valid in the case of public utilities which, like itself, should be able to establish rates to cover increased costs of new plant. However, the information may provide some indication of the expanded capital structure that will be required for making plant replacements and additions with inflated dollars.

Income From Operations Adjusted for Changing Prices for the Year Ended December 31, 1984

	Current Cost Average 1984 Dollars
	(Dollars in Thousands, Except Per Share Amounts)
Income from continuing operations as reported in Consolidated Statements of Income	$297,570
Adjustment to restate depreciation expense	(74,931)
Income from continuing operations (excluding reduction to net recoverable cost)	$222,639
Income from continuing operations per common share (after preferred stock dividend requirements and excluding reduction to net recoverable cost)	$ 2.55
Increase in specific prices (current cost) of utility plant held during the year (a)	$195,404
Reduction to net recoverable cost	(36,899)
Effect of increase in general price level	(242,350)
Excess of increase in general price level over increase in specific prices after reduction to net recoverable cost	(83,845)
Gain from decline in purchasing power of net amounts owed	89,940
Net	$ 6,095

(a) At December 31, 1984, Current Cost of Utility Plant—net was $6,565,228.

Five-Year Comparison of Selected Supplementary Financial Data Adjusted for Effect of Changing Prices

	1984	1983	1982	1981	1980
	Year Ended December 31,				
	(Average 1984 Dollars in Thousands, Except Per Share Amounts)				
Electric operating revenues	$ 994,967	$ 908,982	$ 932,424	$ 834,611	$ 783,881
Current cost information					
Income from continuing operations (excluding reduction to net recoverable cost)	$ 222,639	$ 203,662	$ 170,261	$ 158,071	$ 111,254
Income from continuing operations per common share (after dividend requirements on preferred stock and excluding reduction to net recoverable cost)	$ 2.55	$ 2.47	$ 2.23	$ 2.43	$ 1.86
Excess of increase in general price level over increase in specific prices after reduction to net recoverable cost	$ (83,845)	$ (65,901)	$ (54,717)	$ (201,062)	$ (285,641)
Net assets at year-end at net recoverable cost*	$1,887,784	$1,850,437	$1,714,241	$1,540,783	$1,407,669
Reduction to net recoverable cost	$ 36,899	$ 42,834	$ 32,226	$ 198,892	$ 208,252
General information					
Gain from decline in purchasing power of net amounts owed	$ 89,940	$ 82,516	$ 76,941	$ 165,159	$ 214,989
Cash dividends declared per common share	$ 2.60	$ 2.67	$ 2.59	$ 2.51	$ 2.60
Market price per common share at year-end	$ 22.00	$ 19.86	$ 25.94	$ 21.41	$ 21.22
Average consumer price index	311.1	298.4	289.1	272.4	246.8

*Consisting of common stock equity and non-redeemable preferred stock.

Acosta, Simmons, Korf, Morgan, Williams, Woods

DeMichele, Rhodes, DeConcini, Soldwedel

Warren, Sargent, Schwada, Norton, Morrison

Turley, Eller, Garland, Wall, Tanner, Snell

Board of Directors

†*Joe Acosta, 61,* founder, Acosta, Cordova & Pittman, C.P.A.s, P.A., Phoenix, Arizona

Dino DeConcini, 51, attorney at law, of counsel to DeConcini McDonald Brammer Yetwin & Lacy, P.C., Phoenix, Arizona

*O. *Mark De Michele, 51,* president and chief operating officer of the company, Phoenix, Arizona

**Karl Eller, 56,* chairman of the board, The Circle K Corporation, Phoenix, Arizona

**William T. Garland, 68,* president of Garland Land Co. (land development), Sedona, Arizona

†*Pamela Grant Korf, 46,* chairman & chief executive officer, Goldwaters, Division of Associated Dry Goods (General Mercantile), Scottsdale, Arizona

†*Jack M. Morgan, 61,* attorney at law and state senator, Farmington, New Mexico

Marvin R. Morrison, 61, farmer, cattle feeder and dairyman, Morrison Brothers Ranch, Higley, Arizona

John R. Norton III, 56, president, J.R. Norton Co. (agricultural production), Phoenix, Arizona

John J. Rhodes, 68, former member of the U.S. House of Representatives and partner in the law firm of Rhodes & Taylor, Washington, D.C.

Henry B. Sargent, Jr., 50, executive vice president and chief financial officer of the company, Phoenix, Arizona

Wilma W. Schwada, 58, civic leader and homemaker, Tempe, Arizona

James P. Simmons, 60, chairman of the board, United Bank of Arizona, Phoenix, Arizona

**Richard Snell, 54,* chairman of the board and president, Ramada Inns, Inc., Phoenix, Arizona

**Donald N. Soldwedel, 60,* president, Western Newspapers, Inc., Yuma, Arizona

**Maurice R. Tanner, 63,* chairman of the board and chief executive officer, The Tanner Companies (construction and materials supply), Phoenix, Arizona

**Keith L. Turley, 61,* chairman of the board and chief executive officer of the company, Phoenix, Arizona

*†*Douglas J. Wall, 58,* member of the law firm of Mangum Wall Stoops & Warden, Flagstaff, Arizona

†*Morrison F. Warren, 61,* professor emeritus of education, Arizona State University, Tempe, Arizona

†*Ben F. Williams, Jr., 55,* mayor of the City of Douglas and attorney at law, Douglas, Arizona

Thomas G. Woods, Jr., 58, executive vice president for the Arizona Nuclear Power Project, Phoenix, Arizona

*Member of Executive Committee
†Member of Audit Review Committee

Officers

D. Louis Broussard, 64, vice president, Research and Development (Ret. 6/84)

O. Mark De Michele, 51, president and chief operating officer

Walter F. Ekstrom, 47, vice president, Electric Operations

Karl Eller, 56, chairman of the executive committee

David W. Ellis, 46, vice president, Research, Development and Alternative Energy Applications

Kathryn A. Forbes, 34, general auditor

Joseph A. Gelinas, 40, vice president, Employee Relations

B. Paul Hart, 61, vice president, Rates and Regulation

Russell D. Hulse, 57, vice president, Resources Planning

Jerry Human, 54, vice president, Customer Services, State Region

Charles D. Jarman, 49, vice president, Engineering and Construction

Guy W. Lunt, Jr., 51, vice president, Customer Services, Metro Region

Jaron B. Norberg, 47, senior vice president and corporate counsel

John C. Ogden, 39, vice president, Customer and Administrative Services

William J. Post, 34, controller

Shirley A. Richard, 38, vice president, Corporate Relations

H. B. Sargent, Jr., 50, executive vice president and chief financial officer, Corporate Finance, Planning and Control

Keith L. Turley, 61, chairman and chief executive officer

**E. E. Van Brunt*, Jr., 53, vice president, Arizona Nuclear Power Project

Faye Widenmann, 36, secretary

Paul A. Williams, 39, vice president and treasurer, Finance and Tax Services

**Thomas G. Woods*, Jr., 58, executive vice president, Arizona Nuclear Power Project (Ret. 2/85)

(Age on Annual Meeting date, April 18, 1985)

*In February 1985 Thomas G. Woods, Jr. retired from the company and Edwin Van Brunt, Jr., formerly vice president, Nuclear, was named executive vice president for the Arizona Nuclear Power Project. Woods will remain on the APS Board of Directors.

Shareholder Information

Stocklisting (Symbol: AZP)

Common stock of the company; the $10.70 cumulative preferred stock, Series I; the $3.58 cumulative preferred stock, Series O; and the adjustable cumulative preferred stock, Series Q, which ended the year at $2.438; are listed for trading on the New York Stock Exchange. Common Stock is also listed on the Pacific Stock Exchange.

Transfer Agents

First Interstate Bank of Arizona, N.A.
Corporate Trust Operations
Dept. 958, P.O. Box 29715
Phoenix, Arizona 85038
(602) 271-1620

The First National Bank of Boston
Shareholder Relations
P.O. Box 644
Boston, Massachusetts 02102
(617) 929-6498 (common stock only)

Registrars

The Valley National Bank of Arizona, Phoenix, Arizona

The First National Bank of Boston Boston, Massachusetts (common stock only)

General Counsel

Snell & Wilmer, Phoenix, Arizona

Auditors

Deloitte Haskins & Sells
Phoenix, Arizona

Stock Purchase and Dividend Reinvestment Plan

A Prospectus describing this plan for holders of the company's stock is available to shareholders upon request. Write: Office of the Secretary, Sta. 1892, at the address below.

Form 10-K

A copy of our Annual Report to the Securities and Exchange Commission, Form 10-K, will be available after March 31, 1985, without charge, upon written request of shareholders. Write: Office of the Secretary, Sta. 1892, at the address below.

Statistical Report

A detailed Statistical Report for Financial Analysis 1974-1984 will be available by mid-April on request. Write: Office of the Treasurer, Sta. 1820, at the address below.

MAILING ADDRESS:
P.O. Box 21666
Phoenix, Arizona 85036

ARIZONA PEOPLE SERVING YOU.

APS