1987 ANNUAL REPORT

ARIZONA PUBLIC SERVICE COMPANY

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ABOUT THE COMPANY

Arizona Public Service Company (the "Company" or "APS") is engaged principally in the generation and sale of electricity. APS, a successor to a series of small utility operations originating in 1886, was incorporated in 1920 under the laws of Arizona and has operated under its present name since 1952. The Company's electric service reaches approximately 1,561,000 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.

All the shares of common stock of the Company are owned by Pinnacle West Capital Corporation ("Pinnacle West") (formerly AZP Group, Inc.), which became the Company's corporate parent, effective in April 1985, pursuant to a corporate restructuring. The restructuring did not affect the Company's preferred stock or any of its outstanding debt securities, all of which remain obligations of the Company. APS Finance Company N.V., Bixco, Inc., and APS Fuels Company are wholly-owned subsidiaries of the Company. APS Finance Company N.V. was dissolved as of June 30, 1987, APS Fuels Company is in the process of dissolution, and Bixco, Inc. is currently inactive.

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-eighth annual meeting at 10:00 a.m. on Thursday, April 21, 1988 at the Sheraton Phoenix, 111 North Central Avenue, Phoenix, Arizona.

APS OFFICERS

O. Mark De Michele, 54, President and Chief Executive Officer
Walter F. Ekstrom, 50, Vice President, Electric Operations
Karl Eller, 59, Chairman of the Executive Committee
David W. Ellis, 49, Vice President, Marketing and Energy Management
Kathryn A. Forbes, 37, Vice President and Controller
Joseph A. Gelinas, 43, Vice President, Employee Relations
Jerry G. Haynes, 53, Vice President, Nuclear Production
William J. Hemelt, 34, Treasurer and Assistant Secretary
Russell D. Hulse, 60, Vice President, Resources Planning
Jerry Human, 57, Vice President, Customer Services, State Region
Charles D. Jarman, 52, Vice President, Construction
Donald B. Karner, 36, Vice President, Engineering
Nancy C. Loftin, 34, Secretary
Jaron B. Norberg, 50, Executive Vice President and Chief Financial Officer
William J. Post, 37, Vice President, Finance and Rates
Shirley A. Richard, 41, Vice President, Corporate Relations and Marketing
Keith L. Turley, 64, Chairman of the Board
Edwin E. Van Brunt, Jr., 56, Executive Vice President, Arizona Nuclear Power Project

(Age on Annual Meeting date, April 21, 1988)

To Our APS Preferred Shareholders:

Although 1987 saw many positive accomplishments for your company, the highlight undoubtedly was the December 4 dedication ceremony marking the completion of construction of the Palo Verde Nuclear Generating Station. Commenting at the dedication ceremony, John Herrington, the Secretary of the U.S. Department of Energy, labeled Palo Verde "the energy cornerstone of the Southwest" and stated that it ranks among the finest nuclear power plants in the world.

Bringing all three of the Palo Verde units into commercial operation within a two year period is an achievement of which we as management are justifiably proud. It is also a feat never before accomplished by any other utility. However, we recognize that it was made possible only through the dedication of our employees, our partners in the Project, and the support of our investors. With the completion of Palo Verde, we have the resources to continue to fuel the growing electrical needs of our service territory well into the next century.

Obviously, uncertainties remain with respect to the rate treatment for Units 2 and 3. At the time this report went to press, we were awaiting regulatory decisions on a phase-in plan for the costs of Unit 2 and an accounting order to defer recovery of the costs of Unit 3. Both of these proposals were designed by the company to minimize the impact on our customers of bringing the Palo Verde units into service. Regardless of the outcome of those pending rate matters, however, the marketplace itself has dictated that we take a hard look at how we do business now and plan to do business in the future.

The reality is that the utility business is changing. For the first time in our company's history, we're facing intense competition in every segment of our business — from natural gas suppliers, from promoters of municipal takeover, from co-generation entrepreneurs, from other utilities who may bargain for wholesale customers, and more. Meeting this competition requires a whole new strategy for doing business.

In 1987 we began a strategic marketing plan for marketing and selling such products as off-peak security lighting, industrial heat pumps and thermal storage, power conditioning, induction cooking, and more. We are devoting more resources to increasing economic development in Arizona, thereby enhancing our electric sales, and investigating new bulk power marketing opportunities outside our state.

Frankly, these rate and marketing strategies will probably not be enough, so we are considering a wide range of other options that will reduce our costs in 1988 and beyond. We have already begun streamlining our organizational structure and reducing levels of management. These efforts, combined with our corporate goal of reducing staff positions, will lead to a lower employee level in 1988 than in 1986.

Additionally, we have asked every level of management to review their operations for ways in which costs may be reduced. We are convinced that, through innovation, efficiency, and productivity improvements, our costs — both capital and operations and maintenance — can be reduced.

At the same time, we have emphasized to our employees that cutting costs cannot be done at the expense of service quality. To that end, we launched our Service *Plus* program in 1987. We're instilling a greater awareness of how each individual job affects the ultimate cost of our product and how each employee can help make APS a more productive, efficient, and socially responsible entity.

The completion of Palo Verde brings to a successful conclusion a tremendous challenge of the past. The uncertain future we face brings formidable challenges as well. We are confident, however, that through the creativity and dedication of our employees, those challenges will be successfully met.

We invite you to study the detailed financial information in the following pages and to attend our Annual Meeting of Stockholders on April 21 in Phoenix.

Sincerely,

Keith L. Turley
Chairman of the Board

O. Mark De Michele
President and
Chief Executive Officer

ARIZONA PUBLIC SERVICE COMPANY
SELECTED CONSOLIDATED FINANCIAL DATA

	1987	1986	1985	1984	1983
	(Dollars in Thousands, Except Per Share Amounts)				
Electric Operating Revenues	$ 1,313,438	$ 1,249,912	$ 1,174,502	$ 994,967	$ 871,875
Electric Operating Expenses:					
Operation and maintenance	586,861	541,108	447,985	358,665	349,150
Depreciation and amortization	160,298	139,541	99,221	87,494	83,707
Taxes*	323,204	305,909	320,312	285,548	185,606
Palo Verde cost deferral	(84,289)	(25,526)	—	—	—
Total	986,074	961,032	867,518	731,707	618,463
Operating Income	327,364	288,880	306,984	263,260	253,412
Other Income*	126,456	173,847	190,047	190,818	134,459
Interest Deductions - Net	156,057	188,607	171,608	156,508	118,819
Income from Continuing Operations Before Cumulative Effect of Accounting Change	297,763	274,120	325,423	297,570	269,052
Loss from Discontinued Operations	—	—	—	(26,503)	(4,255)
Cumulative Effect of Accounting Change - Net of Tax*	16,110	—	—	—	—
Net Income	313,873	274,120	325,423	271,067	264,797
Preferred Stock Dividend Requirements	32,950	39,279	44,412	48,375	43,741
Earnings for Common Stock	$ 280,923	$ 234,841	$ 281,011	$ 222,692	$ 221,056
Total Assets	$ 5,818,558	$ 5,595,883	$ 5,251,327	$ 4,653,774	$ 4,386,312
Long-term Debt and Redeemable Preferred Stock	$ 2,503,928	$ 2,107,219	$ 2,425,361	$ 1,967,486	$ 1,892,477
Common Stock Data:					
Book value per share	$ 26.74	$ 25.76	$ 25.42	$ 24.18	$ 23.78
Earnings (Loss) per average common share outstanding:					
Continuing Operations Before Accounting Change	$ 3.71	$ 3.30	$ 3.96	$ 3.65	$ 3.53
Discontinued Operations	—	—	—	(0.39)	(0.07)
Cumulative Effect of Accounting Change - Net	0.23	—	—	—	—
Total	$ 3.94	$ 3.30	$ 3.96	$ 3.26	$ 3.46
Dividends declared per share	$ 2.88	$ 2.94	$ 2.73	$ 2.60	$ 2.56
Common shares outstanding:					
Year-end	71,264,947	71,264,947	71,264,947	70,128,329	66,710,852
Average	71,264,947	71,264,947	71,031,228	68,308,131	63,865,210
Number of common shareholders	1**	1**	1**	124,274	127,387

* Federal and state income taxes are included in Taxes, Other Income and Cumulative Effect of Accounting Change. Total income tax expense was as follows (thousands of dollars): 1987, $197,314; 1986, $156,820; 1985, $165,279; 1984, $137,072; 1983, $93,930. Palo Verde cost deferral included in Other Income for 1987 and 1986 was $71,961 and $38,262, respectively.

** See Note 2 of Notes to Consolidated Financial Statements for a description of the 1985 corporate restructuring.

OTHER FINANCIAL AND OPERATING STATISTICS

	1987	1986	1985	1984	1983
	(Dollars in Thousands, Except Per Hour Amounts)				
Capitalization:					
Common equity	$ 1,905,577	$ 1,835,616	$ 1,811,405	$ 1,695,923	$ 1,586,671
Non-redeemable preferred stock	168,561	218,561	218,561	218,561	218,561
Redeemable preferred stock	221,978	178,728	219,421	282,740	237,400
Long-term debt	2,281,950	1,928,491	2,205,940	1,684,746	1,655,077
Total	$ 4,578,066	$ 4,161,396	$ 4,455,327	$ 3,881,970	$ 3,697,709
Utility plant—gross	$ 6,229,446	$ 5,880,435	$ 5,712,507	$ 5,088,243	$ 4,761,265
Utility plant—net	$ 5,093,035	$ 4,904,325	$ 4,873,823	$ 4,344,083	$ 4,033,400
Number of employees at year-end	8,926	8,966	8,324	7,358	7,642
Average wage per hour	$ 16.09	$ 15.23	$ 14.48	$ 13.61	$ 13.11
Electric resources (kw)	3,925,600	3,592,100	3,570,800	3,425,900	3,528,400
Peak load (kw)	3,159,300	3,194,600	3,197,800	2,970,600	2,899,000
Electric sales—total (mwh)	14,769,603	13,863,473	13,971,314	13,054,987	12,753,542
Number of customers at year-end	566,384	545,018	521,567	499,751	468,768

OPERATING REVENUES

	1987	1986	1985	1984	1983
	(Thousands of Dollars)				
Electric					
Residential	$ 505,525	$ 466,816	$ 438,265	$ 378,536	$ 314,404
Commercial	467,643	441,236	401,439	343,971	296,364
Industrial	146,925	141,729	135,254	126,187	122,184
Irrigation	16,641	21,547	22,853	25,540	15,113
Other	79,138	80,671	97,728	86,394	90,118
Total	1,215,872	1,151,999	1,095,539	960,628	838,183
Transmission for others	14,254	19,692	16,602	13,023	12,555
Miscellaneous services	83,312	78,221	62,361	21,316	21,137
Total operating revenues	$ 1,313,438	$ 1,249,912	$ 1,174,502	$ 994,967	$ 871,875

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Liquidity and Capital Resources

The Company has capital requirements for its ongoing construction program (see Note 12 of Notes to Consolidated Financial Statements) and for the refunding of maturing securities. Its reliance on external financing to meet those requirements is detailed in Notes 4, 5, and 6 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 common stock equity. Adequate earnings and coverages 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 5 with respect to the Company's capitalization at December 31, 1987. 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 in the future, the Company's average cost of capital will rise accordingly. During 1986 the Company entered into sale and leaseback transactions under which it sold and leased back approximately 42% of its 29.1% ownership interest in Unit 2 ("Unit 2") of the Palo Verde Nuclear Generating Station ("Palo Verde"). The leases are accounted for as operating leases and, accordingly, are not reflected in the Company's consolidated capitalization (see Note 9 of Notes to Consolidated Financial Statements).

See Note 7 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 Arizona Corporation Commission (the "ACC")). The funds available from operations after the payment of dividends, although less than the amount considered appropriate by management, have increased in the last few years as compared to recent periods (see Consolidated Statements of Changes in Financial Position). This situation may deteriorate unless the Company receives adequate and timely rate relief for the recovery of costs of Palo Verde Unit 2. See Note 3 of Notes to Consolidated Financial Statements for further information. In addition, the Company's retention of funds from operations has been affected by its policy of increasing common stock dividends periodically.

The ACC has regulatory authority over the Company in matters relating to retail electric rates and the issuance of securities. In November 1984, the ACC issued an order that set a construction cost limit of $2.86 billion for the Company's share of Palo Verde, with any amounts expended above that figure to be presumed as imprudently incurred for ratemaking purposes (although no presumption of prudence will attach to expenditures made up to such limit). The Company considers Palo Verde Unit 3 ("Unit 3") to have commenced commercial operation on January 8, 1988, at which time the Company's share of total Palo Verde construction costs was estimated to be $2.77 billion.

On September 4, 1986, the ACC issued an order establishing the format for a prudence audit of Palo Verde costs. Ernst & Whinney, a national accounting firm, is overseeing the prudence audit and is expected to complete the audit sometime in 1988. Pursuant to the order, the Company submitted for review ten areas in which it believes its performance in the construction of Palo Verde exceeds the prudence audit standard of "reasonableness." Any Palo Verde costs disallowed by the ACC for inclusion in the Company's rates (whether as a result of the prudence audit or otherwise) will be recognized as a loss by the Company at such time as it becomes probable that the costs will be disallowed for ratemaking purposes. Although the Company is unable to predict the ultimate outcome of this matter, management believes that, overall, Palo Verde was constructed and planned in a prudent manner.

Palo Verde Unit 1 Rate Matters

On October 9, 1986, the ACC issued an order in the rate case in which the Company requested an increase in annual retail electric rates premised on Palo Verde Unit 1 ("Unit 1") being fully included in the Company's rate base. The order provided that those revenues attributable to the inclusion in the Company's rate base of $210 million of the capital costs of Unit 1 (representing approximately 25% of total Unit 1 costs) were to be deemed "interim or temporary in nature until further Order of the [ACC]." The Company estimates that up to $47 million in revenues collected through December 31, 1987 are to be deemed "interim or temporary" pending the outcome of the Palo Verde prudence audit. The order also granted the Company's request that, for ACC purposes, the facilities common to all three Palo Verde units (the "Common Facilities") be treated as entering rate base in three equal installments, each tied to the commercial operation date of a Palo Verde unit. Consequently, for ACC purposes the Company ceases to accrue a carrying charge on, and begins expensing the cost of owning, operating, and maintaining, its share of the Common Facilities in one-third increments.

Palo Verde Unit 2 Rate Matters

Palo Verde Unit 2 commenced commercial operation on September 19, 1986. On December 5, 1986, the ACC issued an accounting and ratemaking order (the "December Order") that allows the Company, for ACC purposes, to defer substantially all operating costs relating to, and accrue a carrying charge on, its ownership interest in Unit 2 and one-third of the Common Facilities for the period of time between the commercial operation date of Unit 2 and the effective date of new rates to cover the costs relating to Unit 2. In accordance with Statement of Financial Accounting Standards No. 92, Regulated Enterprises—Accounting for Phase-in Plans ("SFAS No. 92"), effective January 1, 1988, the Company is no longer able to accrue an equity return on Unit 2 cost deferrals, which will adversely affect net income by approximately $2.7 million per month. The impact, however, should be short-term as a decision in the Unit 2 Rate Case (defined below) is expected in early 1988. See Note 3 of Notes to Consolidated Financial Statements for a discussion of SFAS No. 92.

On December 18, 1985, the Company filed an application with the ACC for an increase in annual retail electric rates to recover the costs of Unit 2 and other increased costs of service (the "Unit 2 Rate Case"). On December 19, 1986, and again on June 10, 1987, the Company updated its filing to a requested increase in retail electric rates of approximately $183 million, which includes approximately $3.7 million annually for decommissioning Unit 1 and Unit 2, to be effective in two steps: an increase, at the earliest possible date, of approximately 15.5%, which would be partially offset by a reduction in the Company's cost of fuel (equivalent to a 9.2% base rate reduction) and an increase of approximately 2.6% on January 1, 1989. Hearings in the Unit 2 Rate Case began on March 19, 1987, and ended on June 22, 1987. A decision in the Unit 2 Rate Case is expected in early 1988. If the ACC does not grant adequate rate relief in the Unit 2 Rate Case, the Company expects its future earnings to be adversely affected.

Palo Verde Unit 3 Rate Matters

The Company considers Unit 3 to have commenced commercial operation on January 8, 1988. A specific rate application designed for the recovery of Unit 3 costs has not yet been filed with the ACC. However, the Company filed on July 24, 1987 and amended on October 2, 1987, an application with the ACC seeking an accounting and ratemaking order allowing the Company to defer substantially all operating costs relating to, and accrue a carrying charge on, its ownership interest in Unit 3 and one-third of the Common Facilities for the period of time between the commercial operation date of Unit 3 and the effective date of new rates to cover the costs relating to Unit 3. A decision in the Unit 3 accounting and ratemaking proceeding is expected in early 1988. Failure to grant the requested Unit 3 accounting and ratemaking order would adversely affect the Company's net income by approximately $7.5 million per month from the date that Unit 3 has commenced commercial operation. In accordance with SFAS No. 92, effective January 8, 1988, the Company will not be able to accrue an equity return for Unit 3, which will adversely affect net income by approximately $2.5 million per month. See Note 3 of Notes to Consolidated Financial Statements for a discussion of SFAS No. 92.

Operating Results

Total operating revenues include the effects of rate increases and adjustment clauses on prices of units sold. Operating revenues also reflect volume changes in unit sales. The foregoing factors contributed to annual increases in electric operating revenues over the preceding calendar year as follows:

	Year Ended December 31,		
	1987	1986	1985
	(Thousands of Dollars)		
Energy related:			
Volume increases (1)	$ 80,509	$ 3,742	$ 71,169
Revenue per KWH increases (decreases) (2)	(14,608)	52,718	63,742
Non-energy related:			
Revenue increases (decreases) (3)	(2,375)	18,950	44,624
Total increase	$ 63,526	$75,410	$179,535

(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.

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

In 1987, 1986, and 1985, the volume-related increases in electric revenues were primarily due to increased customers and sales per customer in the residential and commercial classes. In 1987, increases in residential sales per customer were largely due to colder weather conditions in the winter months of 1987. In 1986, the increase was partially offset by lower sales to resale customers. In 1985, the volume related increases were primarily due to warm weather conditions during the summer of that year. 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. Price related revenue increases and decreases reflect the timing and amounts of base rate changes, the operation of the Company's purchased power and fuel adjustment mechanism (the "PPFAM") (See Note 1d of Notes to Consolidated Financial Statements), the incentive for customers to migrate over time to that rate which produces the lowest bill, and the interaction of weather and seasonal rates on revenues. The year-to-year changes in non-energy related electric revenues reflect changes in the revenues collected for the capacity sold to other utilities.

Unit fuel costs decreased in 1987 largely due to increased nuclear generation associated with the commercial operation of Unit 2. Fuel expenses, however, increased in 1987 as increased system energy requirements, reflecting increased energy sales, more than offset lower unit fuel costs. In 1986, fuel expenses decreased due to lower unit fuel costs associated with the commercial operation of Units 1 and 2 which displaced higher cost gas and coal generation.

Variations in purchased power expense reflect contractual commitments with other utilities for purchasing power as a means of augmenting the Company's own generating sources from time to time, the testing schedule of the Company's own nuclear generating units, and the operation of the Company's PPFAM. Fluctuations in net interchange expense reflect the market demand for interchange power purchasing and sales associated with varying weather conditions and the Company's ability to produce inexpensive energy to sell to neighboring utilities.

The decrease in purchased power and interchange expense in 1987 was primarily due to reduced purchased power and increased interchange sales due to increased nuclear generation. In 1986, the increase in purchased power and interchange expense was primarily due to the operation of the Company's PPFAM, partially offset by reduced purchased power due to the availability of energy from Units 1 and 2, the availability of low cost interchange power and reduced system energy requirements.

Operations, excluding fuel expenses, increased in 1987 due primarily to increased expenses resulting from the commercial operation of Unit 2, particularly the lease expense associated with the sale and leaseback of a portion of the Company's interest in that unit. See Note 9 of Notes to Consolidated Financial Statements.

Depreciation and amortization expenses and ad valorem taxes increase with the size of the Company's utility plant. See Note 13 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.

In December 1987, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 96, Accounting for Income Taxes. The Company will adopt the new standard in 1988 or 1989 and expects it to have little impact on earnings. See Note 10 of Notes to Consolidated Financial Statements.

Palo Verde cost deferrals result from the deferral of substantially all costs of owning, operating, and maintaining Unit 2, and a carrying charge thereon, from the commercial operation date (September 19, 1986) until the effective date of new rates to cover those costs. The increase in 1987 reflects a full year of recorded cost deferrals. See "Liquidity and Capital Resources" above and Note 3 of Notes to Consolidated Financial Statements.

The aggregate amount of allowance for funds used during construction ("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 placed in service. See Note 1e of Notes to Consolidated Financial Statements for changes in AFC rates.

The decrease in interest on long-term debt in 1987 as compared to 1986 and 1985 reflects the effect of refinancing high coupon debt with the proceeds of lower interest rate debt and redeeming high coupon debt with the proceeds of the sale and leaseback of a portion of the Company's interest in Palo Verde Unit 2 in 1986. See "Liquidity and Capital Resources" above and Note 6 of Notes to Consolidated Financial Statements.

Effective January 1, 1987, the Company changed its method of recording revenues to include revenue related to electricity delivered to customers but not yet billed at year end. The cumulative effect, as of January 1, 1987, of the change, net of income taxes, was $16.1 million ($0.2[illegible] per common share) and is reported as a separate component of 1987 net income. See Note 1d of Notes to Consolidated Financial Statements for further discussion.

Consolidated net income represents a composite of cash and non-cash items (see Consolidated Statements of Changes in Financial Position) and, in part, reflects 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," it is sometimes difficult, in the case of operation and maintenance expenses, to distinguish between effects of volume increases and rises in unit costs.

Certain inflationary effects, such as those on costs of generating fuel, are passed through to customers pursuant to rate adjustment procedures. Nevertheless, the Company attempts to minimize such effects by means that include increasing the availability of its nuclear and 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.

ARIZONA PUBLIC SERVICE COMPANY

CONSOLIDATED STATEMENTS OF INCOME

	Year Ended December 31,		
	1987	1986	1985
	(Dollars in Thousands, Except Per Share Amounts)		
Electric Operating Revenues	$ 1,313,438	$ 1,249,912	$ 1,174,502
Fuel Expenses:			
Fuel for electric generation	180,597	178,814	219,575
Purchased power and interchange - net	90,435	107,066	16,789
Total	271,032	285,880	236,364
Operating Revenues Less Fuel Expenses	1,042,406	964,032	938,138
Other Operating Expenses:			
Operations excluding fuel expenses	213,510	157,196	122,751
Maintenance	102,319	98,032	88,870
Depreciation and amortization	160,298	139,541	99,221
Income taxes (Note 10)	178,850	182,316	216,036
Other taxes (Note 13)	144,354	123,553	104,276
Palo Verde cost deferral (Note 3)	(84,289)	(25,526)	—
Total	715,042	675,152	631,154
Operating Income	327,364	288,880	306,984
Other Income (Deductions):			
Allowance for equity funds used during construction	59,015	93,764	143,612
Palo Verde cost deferral (Note 3)	71,961	38,262	—
Income taxes (Note 10)	(6,004)	25,496	50,757
Other - net	1,484	16,355	(4,322)
Total	126,456	173,847	190,047
Income Before Interest Deductions	453,820	462,727	497,031
Interest Deductions:			
Interest on long-term debt	190,587	214,029	209,220
Interest on short-term borrowings	5,122	6,973	6,951
Debt discount, premium and expense	6,781	5,851	3,613
Allowance for borrowed funds used during construction	(46,433)	(38,246)	(48,176)
Total	156,057	188,607	171,608
Income Before Cumulative Effect of Accounting Change	297,763	274,120	325,423
Cumulative Effect as of January 1, 1987 of Accruing Unbilled Revenues, Net of Income Taxes of $12,460,000 (Note 1)	16,110	—	—
Net Income	313,873	274,120	325,423
Preferred Stock Dividend Requirements	32,950	39,279	44,412
Earnings for Common Stock	$ 280,923	$ 234,841	$ 231,011
Average Common Shares Outstanding	71,264,947	71,264,947	72,031,228
Earnings per Average Share of Common Stock Outstanding:			
Before cumulative effect of accounting change	$ 3.71	$ 3.30	$ 3.96
Cumulative effect as of January 1, 1987 of accruing unbilled revenues (Note 1)	0.23	—	—
Total	$ 3.94	$ 3.30	$ 3.96
Dividends Declared per Share of Common Stock	$ 2.88	$ 2.94	$ 2.73

See Notes to Consolidated Financial Statements.

ARIZONA PUBLIC SERVICE COMPANY

CONSOLIDATED BALANCE SHEETS

ASSETS

	December 31, 1987	December 31, 1986
	(Thousands of Dollars)	
Utility Plant (Notes 6, 8 and 9):		
Electric plant in service and held for future use	$4,993,363	$4,807,226
Less accumulated depreciation and amortization	1,088,356	947,555
Total	3,905,007	3,859,671
Construction work in progress	1,154,829	979,733
Nuclear fuel, net of amortization of $48,055,000 and $28,555,000	33,199	64,921
Utility Plant—net	5,093,035	4,904,325
Investments and Other Assets (at cost)	46,430	40,692
Current Assets:		
Cash and marketable securities	13,643	6,770
Special deposits and working funds	3,942	167,212
Accounts receivable:		
Service customers	84,781	76,555
Other	34,365	35,143
Allowance for doubtful accounts	(2,518)	(2,060)
Accrued utility revenues (Note 1)	34,995	—
Materials and supplies (at average cost)	66,766	65,283
Fossil fuel (at average cost)	26,873	30,006
Deferred fuel	—	23,994
Other	9,868	8,060
Total Current Assets	272,715	410,963
Deferred Debits:		
Deferred income taxes	111,388	94,246
Palo Verde cost deferral (Note 3)	219,689	63,694
Unamortized costs of reacquired debt	29,301	31,002
Unamortized debt issue costs	17,643	17,563
Other	28,387	33,398
Total Deferred Debits	406,408	239,903
Total	$5,818,588	$5,595,883

See Notes to Consolidated Financial Statements.

ARIZONA PUBLIC SERVICE COMPANY

CONSOLIDATED BALANCE SHEETS

LIABILITIES

	December 31, 1987	December 31, 1986
	(Thousands of Dollars)	
Capitalization (Notes 2, 4, 5 and 6):		
Common stock	$ 178,162	$ 178,162
Premiums and expenses—net	1,034,364	1,040,084
Retained earnings	693,051	617,370
Common stock equity	1,905,577	1,835,616
Non-redeemable preferred stock	168,561	218,561
Redeemable preferred stock	221,978	178,728
Long-term debt less current maturities	[illegible]1,950	1,928,491
Total Capitalization	4,578,066	4,161,396
Current Liabilities:		
Commercial paper	—	37,000
Current maturities of long-term debt (Note 6)	17,796	312,554
Accounts payable	76,612	70,313
Accrued taxes	64,063	91,792
Accrued interest	52,162	52,498
Deferred fuel	33,601	—
Other	35,326	48,331
Total Current Liabilities	279,560	612,488
Deferred Credits and Other:		
Deferred income taxes	521,797	373,646
Deferred investment tax credit	201,242	203,066
Unamortized gain—sale of utility plant (Note 9)	131,659	141,786
Unamortized credit related to sale of tax benefits	40,270	41,958
Customers' advances for construction	26,077	23,852
Other	39,917	37,691
Total Deferred Credits and Other	960,962	821,9[illegible]
Commitments and Contingencies (Notes 3 and 12)		
Total	$5,818,588	$5,595,883

ARIZONA PUBLIC SERVICE COMPANY

CONSOLIDATED STATEMENTS OF RETAINED EARNINGS

	Year Ended December 31,		
	1987	1986	1985
	(Thousands of Dollars)		
Retained earnings at beginning of year	$617,370	$592,334	$505,414
Add—Net income	313,873	274,120	325,423
Total	931,243	866,454	830,837
Deduct—Dividends:			
Common stock (Notes 4, 5 and 6)	205,242	209,805	194,091
Preferred stock (see below)	32,950	39,279	44,412
Total	238,192	249,084	238,503
Retained earnings at end of year	$693,051	$617,370	$592,334
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
$3.50 Series G	—	—	96
$10.00 Series H	833	994	1,459
$10.70 Series I	—	942	2,300
$8.32 Series J	4,160	4,160	4,160
$8.80 Series K	2,686	3,033	3,407
$9.70 Series L	853	3,880	4,656
$11.95 Series M	—	426	1,235
$12.90 Series N	4,835	4,773	4,773
$3.58 Series O	2,983	7,160	7,160
Adjustable Rate Series P	315	1,250	1,250
Adjustable Rate Series Q	3,263	3,360	4,615
$11.50 Series R	5,824	5,750	5,750
$8.48 Series S	2,544	—	—
$8.50 Series T	1,098	—	—
Total	$ 32,950	$ 39,279	$ 44,412

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

See Notes to Consolidated Financial Statements.

ARIZONA PUBLIC SERVICE COMPANY

CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION

	Year Ended December 31, 1987	1986	1985
	(Thousands of Dollars)		
Source of Funds:			
Funds from operations:			
Income before cumulative effect of accounting change	$ 297,763	$ 274,120	$ 325,423
Principal non-fund charges (credits) to income:			
Depreciation and amortization	160,298	139,541	99,221
Nuclear fuel amortization	31,722	21,762	—
Allowance for equity funds used during construction	(59,015)	(93,734)	(143,612)
Deferred income taxes—net	131,009	62,420	106,158
Deferred investment tax credit—net	(1,824)	28,563	36,383
Palo Verde cost deferral	(156,250)	(63,788)	—
Other	(6,953)	(11,499)	31,361
Total	396,750	357,385	454,934
Cumulative effect of accounting change—net	16,110	—	—
Total funds from operations	412,860	357,385	454,934
Funds from external sources:			
Sale of utility plant	—	487,296	—
Common stock	—	—	28,562
Preferred stock	99,562	—	—
Long-term debt	383,318	521,738	745,030
Other items—net	23,704	21,416	(160)
Decrease in working capital*	137,078	—	—
Total funds from external sources	643,662	1,030,450	773,432
Total source of funds	$1,056,522	$1,387,835	$1,228,366
Application of Funds:			
Capital expenditures	$ 399,701	$ 552,991	$ 637,717
Allowance for equity funds used during construction	(59,015)	(93,734)	(143,612)
Funds used for capital expenditures	340,686	459,257	494,105
Investments and other assets	5,738	18,188	(44,777)
Short-term borrowings—net	37,000	(19,000)	141,800
Repayment and reacquisition of long-term debt	328,156	537,114	275,421
Redemption of preferred stock	106,750	40,693	63,319
Dividends on preferred and common stock	238,192	249,084	238,503
Increase in working capital*	—	102,499	59,995
Total application of funds	$1,056,522	$1,387,835	$1,228,366
Increase (Decrease) in Working Capital*:			
Cash, marketable securities, special deposits and working funds	$ (156,397)	$ 162,769	$ 309
Accounts receivable—net	6,990	(16,915)	22,098
Materials, supplies and fossil fuel	(1,650)	23,331	(1,147)
Accrued utility revenue, deferred fuel and other assets	12,809	(46,154)	71,245
Accounts payable and accrued liabilities	21,766	(1,377)	(38,846)
Deferred fuel and other liabilities	(20,596)	(19,155)	6,336
Net increase (decrease)	$ (137,078)	$ 102,499	$ 59,995

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

See Notes to Consolidated Financial Statements.

ARIZONA PUBLIC SERVICE COMPANY
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 its wholly-owned subsidiaries. All significant intercompany balances and transactions have been eliminated. Certain prior year items have been reclassified to conform to 1987 presentation.

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 6), 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 on utility property is provided on a straight-line basis at rates authorized by the Arizona Corporation Commission (the "ACC") annually. The applicable rates for 1985 through 1987 ranged from 0.68% to 9.86%.

d. Revenues and fuel costs—Effective January 1, 1987, the Company changed its method of recording revenues. Prior to that date, the Company recorded revenues as billed to its customers on a monthly cycle billing basis. The unbilled revenue for those kilowatt hours delivered to customers after meter reading dates became part of operating revenues in the following month. In order to better match revenues with expenses, the Company changed its method of accounting to accrue an estimate of revenue for sales unbilled at the end of each month. This change also serves to conform the Company's accounting treatment with the treatment of unbilled revenues as taxable under the Tax Reform Act of 1986. The cumulative effect as of January 1, 1987 of the change, net of income taxes, is $16.1 million ($0.23 per common share) and is reported as a separate component of 1987 net income. The pro forma effect of this change on the reported earnings and earnings per share of prior periods presented is not significant.

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 expense.

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 cost of borrowed funds and a reasonable rate of return on equity funds used during construction. The calculated amount is capitalized as a part of the cost of utility plant.

AFC has been calculated using composite rates of 12.75% from January 1985 through October 1986; 11.25% for November and December 1986; and 11.20% thereafter. The Company compounds AFC semi-annually and ceases to accrue AFC when construction is completed and the property is placed in service.

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 accordance with an ACC order, the Company defers amounts equal to the change in income taxes arising from substantially all other timing differences, which prior to October 1983 were reflected currently in income. At December 31, 1987 the Company had flowed through to income currently approximately $230 million of income tax benefits arising from income tax timing differences for which deferred taxes have not been provided.

In compliance with an ACC order, the Company defers amounts equal to the reduction in Federal income taxes arising from investment tax credits and amortizes these amounts to other income over the estimated life of the related assets.

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 sale as a deferred credit and is amortizing the amount of such proceeds on a straight-line basis over approximately 30 years.

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. Reacquired debt costs—In accordance with the regulatory accounting practices prescribed by the ACC, the Company defers the excess of the reaquisition price of reacquired debt over the net carrying amount and amortizes these amounts to expense over the remainder of the original life of the issues reacquired.

i. Nuclear fuel and decommissioning costs—Nuclear fuel is charged to fuel expense using the unit of production method under which the number of units of thermal energy produced in the current period is related to the total thermal units expected to be produced over the remaining life of the fuel.

Pursuant to the Nuclear Waste Policy Act of 1982 ("Act"), contracts have been entered into with the U.S. Department of Energy for disposal of spent nuclear fuel. The Act provides for an assessment of one mil per kilowatt-hour of nuclear generation. This amount is charged to nuclear fuel expense and recovered through the Company's fuel adjustment clauses.

The Company has made no provision for decommissioning costs for the Palo Verde Nuclear Generating Station ("Palo Verde") pending ACC action in its current rate case filing. Total decommissioning costs for all three Palo Verde units are currently estimated at approximately $615,000,000 (in 1986 dollars) of which the Company's share (29.1%) is approximately $179,000,000.

2. Corporate Restructuring.

On April 18, 1985, the Company's shareholders approved a plan for corporate restructuring to provide financial and organizational flexibility by separating regulated utility operations from other activities. Effective April 29, 1985, APS became a subsidiary of a holding company, AZP Group, Inc., which on April 24, 1987 changed its name to Pinnacle West Capital Corporation ("Pinnacle West").

As part of the restructuring, the Company sold to Pinnacle West, at book value of $34,703,000, the common stock of three of its previously wholly-owned subsidiaries, Malapai Resources Company, SunCor Development Company (formerly Energy Development Company) and El Dorado Investment Company.

The corporate restructuring had no effect on the ownership of preferred stock or on debt securities.

3. ACC and Related Matters.

Prudence Audit

On September 4, 1986, the ACC issued an order establishing the format for a prudence audit of Palo Verde costs. Ernst & Whinney, a national accounting firm, is overseeing the prudence audit and is expected to complete the audit sometime in 1988. Pursuant to the order, the Company submitted for review ten areas in which it believes its performance in the construction of Palo Verde exceeds the prudence audit standard of "reasonableness". Costs ultimately deemed by the ACC to have been imprudently incurred will be recognized as a loss by the Company at such time as it becomes probable that the costs will be disallowed for ratemaking purposes. Although the Company is unable to predict the ultimate outcome of this matter, management believes that overall Palo Verde was constructed and planned in a prudent manner.

Pursuant to an order issued by the ACC in October 1986, the Company estimates that up to $47 million in revenues attributable to the inclusion of $210 million of capital costs of Palo Verde Unit 1 ("Unit 1") collected through December 31, 1987 are to be deemed interim and temporary pending the outcome of the prudence audit.

Construction Cap

As an incentive to complete construction and commence operation of Palo Verde, in November 1984, the ACC issued an order that set a construction cost limit of $2.86 billion for the Company's share of Palo Verde. Amounts expended in excess of the construction cost limit are presumed to be imprudently incurred for ratemaking purposes (although no presumption of prudence will attach to expenditures made up to such limit). The Company considers Palo Verde Unit 3 ("Unit 3") to have commenced commercial operation on January 8, 1988, at which time the Company's share of total Palo Verde construction costs was estimated to be $2.77 billion.

Cost Deferrals

On October 9, 1986, the ACC issued an order allowing the Company, for ACC purposes, to defer substantially all costs relating to, and accrue a carrying charge on, that portion of common facilities associated with Palo Verde Unit 2 ("Unit 2") and Unit 3 from January 1, 1986 until the commercial operation dates of each unit. The Company considers Unit 2 and Unit 3 to have commenced commercial operation on September 19, 1986 and January 8, 1988, respectively.

On December 5, 1986, the ACC issued an accounting and ratemaking order allowing the Company, for ACC purposes, to defer substantially all costs relating to, and accrue a carrying charge on, its share of Unit 2 and associated common facilities, for the period of time between Unit 2 going into commercial operation and new retail electric rates going into effect to cover these costs. The Company has proposed that the costs of owning and operating Unit 2 be phased into its retail electric rates in 1988 and 1989. The hearing in the Unit 2 rate case was completed in June 1987 with a decision expected in early 1988.

On July 24, 1987, the Company filed an application with the ACC requesting an accounting and ratemaking order allowing the Company to defer expenses relating to, and accrue a carrying charge on, its ownership interest in Unit 3 and related common facilities for the period of time between the commercial operation date of Unit 3 and the effective date of new rates to cover the costs relating to Unit 3. Failure to grant such accounting and ratemaking order would adversely affect the Company's net income by approximately $7.5 million per month from the commercial operation date of Unit 3. A specific rate application designed for recovery of Unit 3 costs has not yet been filed with the ACC.

Financial Accounting Standards

In October 1987, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 92, Regulated Enterprises—Accounting for Phase-in Plans. SFAS No. 92 will preclude the Company from recording an equity return on cost deferrals. In accordance with an ACC order, the Company has been accruing a carrying charge, which includes an equity return, related to Unit 2 and its associated common facilities. Effective January 1, 1988, the Company will not be able to continue accruing an equity return for Unit 2, which will adversely affect net income by approximately $2.7 million per month. Such impact, however, should be short-term as a decision in the Unit 2 rate case is expected in early 1988. The Company will not be able to accrue an equity return for Unit 3, which will adversely affect net income by approximately $2.5 million per month.

Effective January 1, 1988, SFAS No. 90, Regulated Enterprises—Accounting for Abandonments and Disallowances of Plant Costs requires any disallowance, direct or indirect, of the cost of a recently completed plant to be recognized as a loss.

4. Common and Non-Redeemable Preferred Stock.

The balances at December 31, 1987 and 1986 of common stock and of preferred stock, which is not redeemable except pursuant to call by the Company at its option, are as follows.

	Number of Shares			Par Value			Call
		Outstanding at December 31,			Outstanding at December 31,		Price
	Authorized	1987	1986	Per Share	1987 (Thousands of Dollars)	1986	Per Share(a)
Common Stock	100,000,000	71,264,947(b)	71,264,947(b)	$ 2.50	$178,162	$178,162	—
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(c)						
$8.32 Series J		500,000	500,000	100.00	50,000	50,000	(d)
Adjustable rate Series Q		500,000	500,000	100.00	50,000	50,000	(e)
Serial preferred	10,000,000						
$3.58 Series O		—	2,000,000	25.00	—	50,000	(f)
Total		2,374,199	4,374,199		$168,561	$218,561	

(a) In each case plus accrued dividends.

(b) As a result of the 1985 corporate restructuring described in Note 2, these shares are now held by Pinnacle West.

(c) This authorization also covers outstanding redeemable preferred shares shown in Note 5, as well as the non-redeemable shares indicated above.

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

(e) 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.

(f) The $3.58 Series O was repurchased on June 1, 1987 at $27.39 per share plus accrued dividends.

The holders of preferred stock are entitled to one vote for each share held of record. 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 5.

Changes in common and non-redeemable preferred stock and premiums and expenses during each of the three years in the period ended December 31, 1987 are as follows (dollars in thousands):

	Common Stock		Non-Redeemable Preferred Stock (cumulative)		Premiums and Expenses Net*
Description	Number of Shares	Par Value Amount	Number of Shares	Par Value Amount	
Balance, December 31, 1984	70,128,329	$175,321	4,374,199	$218,561	$1,015,188
Common Stock	1,136,618	2,841	—	—	25,721
Balance, December 31, 1985	71,264,947	178,162	4,374,199	218,561	1,040,909
Premiums and Expenses - Net	—	—	—	—	(825)
Balance, December 31, 1986	71,264,947	178,162	4,374,199	218,561	1,040,084
$3.58 Series O	—	—	(2,000,000)	(50,000)	—
Premiums & Expenses - Net	—	—	—	—	(5,720)
Balance, December 31, 1987	71,264,947	$178,162	2,374,199	$168,561	$1,034,364

*Premiums and expenses — net also includes those of redeemable preferred stock issues (see Note 5).

5. **Redeemable Preferred Stock.**

The balances at December 31, 1987 and 1986 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 as follows.

	Number of Shares Outstanding at December 31,		Par Value			Call Price Per Share(a)
			Per Share	Outstanding at December 31,		
	1987	1986		1987	1986	
				(Thousands of Dollars)		
Redeemable Preferred Stock (cumulative)						
Serial preferred: (b)						
$10.00 Series H	72,677	88,677	$100.00	$ 7,268	$ 8,868	(c)
$8.80 Series K	277,100	344,600	100.00	27,710	34,460	(d)
$9.70 Series L	—	384,000	100.00	—	38,400	
$12.90 Series N	370,000	370,000	100.00	37,000	37,000	(e)
Adjustable Rate Series P	—	100,000	100.00	—	10,000	
$11.50 Series R	500,000	500,000	100.00	50,000	50,000	(f)
$8.48 Series S	500,000	—	100.00	50,000	—	(g)
$8.50 Series T	500,000	—	100.00	50,000	—	(h)
Total	2,219,777	1,787,277		$221,978	$178,728	

(a) In each case plus accrued dividends.

(b) See Note 4 for authorized number of shares.

(c) Redeemable at $105.40 through September 1, 1988, 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).

(d) 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 (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.

(e) 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, 2001. Applicable sinking fund provisions require the redemption at par value between 1988 and 2002 of all shares according to a predetermined schedule.

(f) 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 at par value between 1990 and 2004 of all shares according to a predetermined schedule.

(g) Not redeemable prior to June 1, 1992 with the proceeds of borrowed funds or stock issues having a lower cost of money than this Series' dividend rate. Otherwise, redeemable at the option of the Company at $108.48 per share prior to June 1, 1992, at $104.24 prior to June 1, 1993, at $102.12 prior to June 1, 1994 and at $100.00 per share thereafter. Applicable sinking fund provisions require the redemption at par of 100,000 shares annually beginning June 1, 1993.

(h) All outstanding shares to be redeemed at par on September 1, 1994.

ARIZONA PUBLIC SERVICE COMPANY

If there were to be any arrearage in dividends on any of its preferred stock or in the sinking fund 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 4 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 1992 are as follows: $6,440,000 in 1988; $6,440,000 in 1989; $9,873,000 in 1990; $9,873,000 in 1991; and $9,141,000 in 1992.

Redeemable preferred stock transactions during each of the three years in the period ended December 31, 1987 are as follows (dollars in thousands):

Description	Number of Shares	Par Value Amount
Balance, December 31, 1984	2,827,400	$282,740
Retirements:		
$8.50 Series G	(38,400)	(3,840)
$10.00 Series H	(199,323)	(19,932)
$10.70 Series I	(30,066)	(3,007)
$8.80 Series K	(255,400)	(25,540)
$11.95 Series M	(110,000)	(11,000)
Balance, December 31, 1985	2,194,211	219,421
Retirements:		
$10.00 Series H	(16,000)	(1,600)
$10.70 Series I	(209,934)	(20,993)
$9.70 Series L	(96,000)	(9,600)
$11.95 Series M	(85,000)	(8,500)
Balance, December 31, 1986	1,787,277	178,728
Issuances:		
$8.48 Series S	500,000	50,000
$8.50 Series T	500,000	50,000
Retirements:		
$10.00 Series H	(16,000)	(1,600)
$8.80 Series K	(67,500)	(6,750)
$9.70 Series L	(384,000)	(38,400)
$12.50 Series P	(100,000)	(10,000)
Balance, December 31, 1987	2,219,777	$221,978

ARIZONA PUBLIC SERVICE COMPANY
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (continued)

6. Long-Term Debt.

Details of long-term debt outstanding at December 31, 1987 and 1986 are as follows:

	December 31, 1987	December 31, 1986
	(Thousands of Dollars)	
First Mortgage Bonds:		
Maturing through 1992:		
5.125% due October 1, 1987	$ —	$ 15,000
4.7% due March 1, 1989	20,000	20,000
4.8% due November 1, 1991	35,000	35,000
4.45% due June 1, 1992	25,000	25,000
4.40% due December 1, 1992	25,000	25,000
Maturing 1993 through 1997 - 4.50% to 12%	515,000	390,000
Maturing 1998 through 2002 - 7.45% to 12.875%	249,645	277,311
Maturing 2003 through 2007 - 6.20% to 13.25%	218,000	218,000
Maturing 2008 through 2012 - 6%	34,000	34,000
Maturing 2013 through 2017 - 9% to 11.5%	450,000	350,000
Unamortized discount and premium	(4,598)	(1,487)
Total first mortgage bonds	1,567,047	1,387,824
Pollution Control Indebtedness:		
Maturing August 1, 2009 (a)	106,980	106,980
Maturing December 1, 2009 (c)	147,000	147,000
Maturing May 1, 2013 (c)	65,750	65,750
Maturing May 1, 2014 (d)	55,200	55,200
Maturing February 1, 2015 (a)	49,400	49,400
Less securities held by trustee (b)	(11,104)	(12,689)
Total pollution control indebtedness	413,226	411,641
Debentures:		
11.75% guaranteed due January 15, 1990 (e)	—	60,000
12.5% due February 15, 1992	75,000	75,000
Total debentures	75,000	135,000
Unsecured notes payable due 1987	—	70,000
Revolving credit agreements (f)	120,000	110,000
Term loan due June 1990 (LIBOR plus ¼%)	80,000	80,000
Capitalized lease obligation (g)	43,410	45,222
Other	1,063	1,536
Unamortized discount	—	(178)
Total long-term debt	2,299,746	2,241,045
Less current maturities:		
5.125% first mortgage bonds due October 1, 1987	—	15,000
11.50% first mortgage bonds due June 1, 2015	—	150,000
Unsecured notes payable due 1987	—	70,000
11.75% guaranteed debentures due January 15, 1990 (e)	—	60,000
Sinking fund requirements on first mortgage bonds	15,333	15,333
Capitalized lease obligation (g)	1,952	1,748
Other	511	473
Total current maturities	17,796	312,554
Total long-term debt less current maturities	$2,281,950	$1,928,491

(a) Adjustable-rate annual tender pollution control revenue refunding bonds supported by a long-term irrevocable letter of credit issued by a bank. The bonds bear an interest rate, determined annually, which will cause the bonds to have a market value which approximates, as nearly as possible, their par value.

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

(c) Consisting of borrowings 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.

(d) On May 15, 1985 the Company borrowed from a governmental authority the proceeds of a $55,200,000 issue of adjustable-rate annual tender pollution control revenue refunding bonds for the purpose of refunding $55,200,000 in aggregate principal amount of previously issued pollution control bonds due April 1, 1986. The new issue is supported by a long-term irrevocable letter of credit issued by a bank. The bonds bear an interest rate, determined annually, which will cause the bonds to have a market value which approximates, as nearly as possible, their par value.

(e) The 11.75% debentures due January 15, 1990 were redeemed on January 15, 1987 at 101½% plus accrued interest.

(f) Represents domestic commercial paper and borrowings under a $120,000,000 Eurocommercial paper program agreement among the company and various financial institutions that is supported by a revolving credit agreement which expires in 1991. At December 31, 1987 the outstanding balance consisted of $86,000,000 of Eurocommercial paper and $34,000,000 of domestic commercial paper. At December 31, 1986, the outstanding balance consisted of $100,000,000 of Eurocommercial paper and $10,000,000 on the revolving credit agreement. Interest rates are negotiated at the time of borrowing. Interest rates applicable to borrowings under the revolving credit agreement are LIBOR plus 0.30% to 0.45% with commitment fees of 0.15% on the unused credit line.

(g) 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 depreciation at December 31, 1987 was $25,892,000.

Aggregate annual payments due on long-term debt and for sinking fund requirements through 1992 are as follows: 1988, $17,796,000; 1989, $37,985,000; 1990, $98,193,000; 1991, $173,365,000 and 1992 $143,551,000. See Note 5 for sinking fund requirements and redemptions of redeemable preferred stock.

Substantially all utility plant, other than nuclear fuel, transportation equipment and 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, 1987.

7. Lines of Credit and Compensating Balances.

The Company's lines of credit at December 31, 1987 and 1986 are summarized below. No amounts were outstanding under the lines at December 31, 1987 and 1986.

	1987	1986
	(Thousands of Dollars)	
Commercial paper backup lines	$200,000	$175,000
Other domestic bank lines (a)	226,000	240,000
Total	$426,000	$415,000

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

The commitment fees for the commercial paper backup lines and virtually all of the other bank lines (exclusive of the credit agreement referred to in (a) above) were ⅜% per annum in 1987 and 1986. Compensating balances required (but which were not legally restricted) for a small portion of the other bank lines (exclusive of the credit agreement referred to in (a) above) were 5% of the lines plus 10% of borrowings in 1987, and generally 7½% of the lines plus 5% of borrowings in 1986.

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

8. Jointly-Owned Facilities.

At December 31, 1987, the Company-owned interests in jointly-owned electric generating and transmission facilities are as follows (dollars in thousands):

	Percent owned by Company	Plant in Service	Accumulated Depreciation	Net Plant in Service	Construction Work in Progress
Generating Facilities:					
Palo Verde Nuclear Generating Station - Units 1, 2 and 3	(a)	$1,600,463	$ 78,890	$1,521,573	$831,420
Four Corners Steam Generating Plant - Units 4 and 5	15.0%	127,496	25,473	102,023	815
Navajo Steam Generating Plant - Units 1, 2 and 3	14.0%	125,335	46,081	79,254	166
Transmission Facilities:					
ANPP Transmission System	35.8%(b)	61,470	4,009	57,461	4,922
Navajo Southern Transmission System	31.4%(c)	27,887	10,724	17,163	131
Palo Verde-Yuma 500KV System	23.9%(d)	15,376	1,450	13,926	—
Total		$1,958,027	$166,627	$1,791,400	$837,454

(a) The Company owns 29.1% of Units 1 and 3 and approximately 17% of Unit 2 (see Note 9).

(b) Weighted average of interests varying from 34.6% to 43.95%.

(c) Weighted average of interests varying from 14% to 100%.

(d) Weighted average of interests varying from 11% to 100%.

The foregoing dollar amounts correlate to the Company's percentage interest in each facility. The Company's share of related operating and maintenance expenses is included in Operating Expenses.

9. Leases

In 1986, the Company entered into sale and leaseback transactions under which it sold approximately 42% of its 29.1% share of Palo Verde Unit 2 resulting in net proceeds of $487,296,000. The resulting gain of approximately $140,220,000 has been deferred and is being amortized to operations expense over the original lease term. The leases require semi-annual payments of approximately $22,061,000 through December 1996, $23,605,000 through June 1997 and $26,963,000 through December 2015 and include options to renew the leases for two additional years and to purchase the property at fair market value at the end of the lease terms. The leases are being accounted for as operating leases. Lease expense for 1987 and 1986 amounted to $43,445,000 and $9,985,000, respectively, of which $39,421,000 and $9,060,000 was deferred as allowed by an order from the ACC (see Note 3).

10. Income Tax Expense.

The components of income tax expense for each of the three years in the period ended December 31, 1987 are as follows:

	Year Ended December 31, 1987	1986 (Thousands of Dollars)	1985
Currently payable:			
Federal	$ 50,073	$ 46,463	$ 10,095
State	3,428	17,951	10,664
Other	235	1,643	2,861
Total current	53,736	66,057	23,620
Deferred:			
Depreciation—net	86,128	62,347	57,273
Taxes, pension costs and other—net	59,274	84,550	48,003
Sale of utility plant	—	(84,697)	—
Investment tax credit—net	(1,824)	28,563	36,383
Total deferred	143,578	90,763	141,659
Total	$197,314	$156,820	$165,279

The difference between income tax expense and the amount obtained by multiplying income before income taxes by the statutory federal income tax rate for each of the three years in the period ended December 31, 1987 are as follows:

	Year Ended December 31, 1987	1986 (Thousands of Dollars)	1985
Federal income tax expense at statutory rate (40% in 1987 and 46% in 1986 and 1985)	$204,475	$198,232	$225,723
Increases (reductions) in tax expense resulting from:			
Tax under book depreciation	30,935	18,855	16,431
Allowance for funds used during construction	(27,430)	(60,711)	(88,222)
Palo Verde cost deferral	(20,965)	(11,505)	—
Investment tax credit amortization	(8,273)	(5,975)	(2,955)
State income tax—net of federal income tax benefit	18,481	13,239	11,815
Other	91	4,685	2,487
Total provision for federal and state income tax expense	$197,314	$156,820	$165,279

In December 1987, the FASB issued SFAS No. 96, Accounting for Income Taxes. SFAS No. 96 retains the concept of comprehensive interperiod tax allocation, however, the way in which deferred income taxes are computed has changed from the existing "deferred" method to a liability concept. The new statement will be effective beginning in 1989, although earlier adoption is encouraged. SFAS No. 96 will be implemented by recording a cumulative effect adjustment as of the beginning of the year in which SFAS No. 96 is first adopted. The Company expects adoption of SFAS No. 96 to have little impact on earnings and has not yet made a determination as to the timing of implementation.

11. Pension Plan and Other Benefits.

The Company's pension plan, a defined benefit plan, covers virtually all employees. The benefits are based on years of service and compensation utilizing the final average pay plan benefit formula. It is the Company's policy to fund the plan on a current basis to the extent deductible under existing tax regulations. Pension cost, including administrative cost, for 1987, 1986, and 1985 was approximately $1,484,000, $2,751,000, and $15,458,000, respectively, of which approximately $601,000, $6?2,000, and $5,081,000, respectively was charged to expense; the remainder was either capitalized as a component of construction costs or billed to participants of jointly-owned facilities. Plan assets consist primarily of common stocks, U.S. obligations and bonds.

In 1986, the Company adopted SFAS No. 87, Employers Accounting for Pensions. Net periodic pension cost under SFAS No. 87 is made up of the components listed below as determined using the projected unit credit actuarial cost method. For prior years, the Company's net periodic pension cost was normal cost as determined using the aggregate actuarial cost method.

Net periodic pension cost (income) included the following (thousands of dollars):

	1987	1986
Service cost-benefits earned during the period	$ 12,580	$10,253
Interest cost on projected benefit obligation	20,095	18,587
Return on plan assets	(17,634)	(54,441)
Net amortization and deferral	(15,790)	26,171
Net periodic pension cost (income)	$ (749)	$ 570

The following table sets forth the plan's funded status and amounts recognized in the Company's balance sheets (thousands of dollars):

	1987	1986
Actuarial present value of benefit obligation, including vested benefits of $137,857 and $152,884	$165,869	$173,825
Effect of projected future compensation increases	79,852	68,319
Projected benefit obligation	245,721	242,144
Plan assets, at fair value	299,073	294,934
Plan assets in excess of projected benefit obligation	53,352	52,790
Unrecognized net loss from past experience different from that assumed	989	4,241
Unrecognized prior service cost	90	—
Unrecognized net asset at January 1, 1986 being recognized over 20.2 years	(58,541)	(62,005)
Accrued pension liability included in other deferred credits	$ (4,110)	$ (4,974)

	1987	1986
Principal actuarial assumptions used were:		
Discount rate	9.0%	8.0%
Rate of increase in compensation levels	6.5%	5.5%
Expected long-term rate of return on assets	10.15%	10.15%

In addition to providing pension benefits, the Company provides certain health care and life insurance benefits for active and 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 both active and retired employees amounted to approximately $22,721,000, $18,591,000 and $14,509,000, of which approximately $8,922,000, $6,285,000 and $5,825,000 was charged to expense in 1987, 1986 and 1985, respectively. Remaining amounts were either capitalized as a component of construction costs or billed to participants of jointly-owned facilities. The cost of providing such benefits solely to retired employees is not significant.

12. Commitments and Contingencies.

Nuclear Insurance

The Palo Verde participants have insurance for public liability payments resulting from nuclear energy hazards to the full limit ($720 million as of January 1, 1988) of liability under federal law (such law being commonly referred to as the "Price-Anderson Act.") The maximum amount of insurance available from private carriers of $160 million has been purchased. The balance of the coverage ($560 million as of January 1, 1988) is provided through a secondary financial protection program using an industry retrospective rating plan, under which the Palo Verde participants could be assessed deferred premium charges of up to $5 million (of which the Company's share would be 29.1%) for each Palo Verde unit licensed by the NRC in the event the total liability arising from any nuclear incident involving any licensed facility in the nation exceeds $160 million. In the event of more than one incident, the potential $5 million assessment would apply to each incident, subject to a maximum annual assessment of $10 million (of which the Company's share would be 29.1%) for each Palo Verde unit for all incidents. The insureds under the liability insurance include the Palo Verde participants and "any other person or organization with respect to his legal responsibility for damage caused by the nuclear energy hazard."

The Palo Verde participants maintain "all risk" (including nuclear hazards) insurance for nuclear property damage to, and decontamination of, property at Palo Verde in the aggregate amount of $1.525 billion as of January 1, 1988, a substantial portion of which must first be applied to decontamination. The Company has also secured insurance against the increased cost of generation or purchased power resulting from the accidental outage of Units 1, 2, and 3 which, after a 26-week deductible period, will pay up to approximately $813,000 per week for Unit 1, approximately $851,000 per week for Unit 2, and approximately $662,000 per week for Unit 3 for 52 weeks and up to 50% of the respective amounts for an additional 52 weeks. In the event that the incident affects more than one unit, the indemnity is reduced by 20% for each additionally affected unit (i.e., two units simultaneously out of service result in 80% of single unit recovery for the second unit; three units simultaneously out of service result in 60% of single unit recovery for the third unit).

In addition to the above-described policies of insurance, the Palo Verde participants are parties to an indemnity agreement with the NRC containing an undertaking by the NRC to indemnify the Palo Verde participants and any other person who may be legally liable for public liability arising from nuclear incidents. The maximum aggregate indemnity for each nuclear incident is $500 million less the amount by which the amount of required financial protection exceeds $60 million. The indemnity agreement is not currently operative and will remain inoperative unless or until the level of financial protection (i.e., the aggregate amount of primary and secondary levels of liability protection) required of Palo Verde participants falls below $560 million.

The provisions of the Price-Anderson Act relating to the authority of the NRC to enter into new indemnity agreements with licensees of nuclear power plants expired on August 1, 1987. However, the Comptroller General of the United States has delivered an opinion stating that, until new legislation is adopted, the provisions of the Price-Anderson Act relating to the retrospective rating plan and the limitation of liability will continue to be applicable to nuclear power plants licensed for construction or operation prior to that date. The 100th Congress has considered extension of the expired provisions of the Price-Anderson Act as well as amendment or elimination of other provisions thereof. If the Price-Anderson Act is modified to increase or eliminate the limit of liability, the Company's potential assessment in the event of a nuclear incident would be significantly increased.

Litigation

The Company is a party to various claims, legal actions and complaints arising in the ordinary course of business, including a lawsuit seeking to invalidate the Company's contract with various municipalities for the purchase of effluent to be used as cooling water for Palo Verde. In the opinion of management, the ultimate disposition of these matters will not have a material adverse effect on the operations or financial position of the Company.

Purchase Commitments

The Company has significant purchase commitments in connection with its continuing construction program. Construction expenditures in 1988 have been estimated at $316,000,000.

13. Supplementary Income Statement Information.

Other taxes charged to operations during each of the three years in the period ended December 31, 1987 are as follows:

	Year Ended December 31,		
	1987	1986	1985
	(Thousands of Dollars)		
Ad valorem	$ 71,357	$ 55,798	$ 45,554
Sales	62,783	58,606	51,438
Other	10,214	9,189	7,284
Total other taxes	$144,354	$123,593	$104,276

14. Selected Quarterly Financial Data (Unaudited).

Quarter	Operating Revenues	Operating Income	Net Income	Earnings for Common Stock	Earnings Per Share of Common Stock
	(Dollars in Thousands, Except Per Share Amounts)				
1987					
First	$290,325	$ 65,171	$ 74,320(a)	$65,109(a)	$0.91(a)
Second	326,820	81,122	75,185	67,267	0.94
Third	392,792	108,539	101,453	94,068	1.32
Fourth	303,501	72,532	62,915	54,479	0.76
1986					
First	$274,530	$ 61,317	$ 59,263	$48,682	$0.68
Second	295,452	60,108	53,689	43,662	0.61
Third	391,738	99,942	102,223	92,874	1.30
Fourth	288,192	67,513	58,945	49,623	0.70

(a) Includes cumulative effect as of January 1, 1987 of accruing unbilled revenues, net of income taxes, of $16,110,000 ($0.23 per common share).

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, 1987 and 1986 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, 1987. 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, 1987 and 1986 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, 1987, in conformity with generally accepted accounting principles consistently applied during the period except for the change, with which we concur, in 1987 in the method of accounting for unbilled revenues as described in Note 1 to the consolidated financial statements.

Deloitte Haskins & Sells

Phoenix, Arizona
February 16, 1988

APS DIRECTORS

Joe Acosta, 64, Campbell, Sindlinger and Strassels, Ltd., C.P.A.s, P.A., Phoenix, Arizona

Dino DeConcini, 54, attorney at law, Phoenix, Arizona

[1] O. Mark De Michele, 54, president and chief executive officer of the Company, Phoenix, Arizona

[1] Karl Eller, 58, chairman of the board, The Circle K Corporation, Phoenix, Arizona

[2] Marianne Moody Jennings, 34, professor of business law, College of Business Administration, Arizona State University, Tempe, Arizona.

Jack M. Morgan, 64, attorney at law and state senator in New Mexico, Farmington, New Mexico

Marvin R. Morrison, 64, farmer, cattle feeder and dairyman, Morrison Brothers Ranch, Higley, Arizona

Jaron B. Norberg, 50, executive vice president and chief financial officer of the Company, Phoenix, Arizona

[1] John R. Norton III, 58, chairman and chief executive officer, J. R. Norton Company (agricultural production), Phoenix, Arizona

[3] Donald M. Riley, 44, president and general manager, Gilpin's Enterprises, Inc. (general contractor), Yuma, Arizona

Wilma W. Schwada, 61, civic leader and homemaker, Tempe, Arizona

[3] Verne D. Seidel, 62, managing partner of HMS Properties (property management), Flagstaff, Arizona

[1] Richard Snell, 57, chairman of the board and president, Ramada Inc., Phoenix, Arizona

[1] Keith L. Turley, 64, chairman of the board of the Company; chairman of the board and president of Pinnacle West Capital Corporation, Phoenix, Arizona

[1] Morrison F. Warren, 64, professor emeritus of education, Arizona State University, Tempe, Arizona

[1] Ben F. Williams, Jr., 58, mayor of the City of Douglas and attorney at law, Douglas, Arizona

Thomas G. Woods, Jr., 61, formerly executive vice president of the Company for the Arizona Nuclear Power Project (retired February 1985), Phoenix, Arizona

(Age on Annual Meeting date, April 21, 1988)

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[1] Member of the Executive Committee.

[2] Elected to the Board of Directors as of March 19, 1987.

[3] Elected to the Board of Directors as of June 16, 1987.

William T. Garland, Pamela Grant, John J. Rhodes, Donald N. Soldwedel, Maurice R. Tanner, and Douglas J. Wall served as directors to April 23, 1987.

SHAREHOLDER INFORMATION

Stock Listing

The adjustable rate cumulative preferred stock, Series Q (Symbol ARPQ) is listed for trading on the New York Stock Exchange. The common stock of the Company is wholly-owned by Pinnacle West and as a result is not listed for trading on any stock exchange. Prior to April 29, 1985 the Company's common stock was publicly held and was traded on the New York and Pacific Stock Exchanges. At the close of business on April 28, 1985 the Company's common stock was held by 123,776 shareholders.

The chart below sets forth the dividends per share paid on the Company's common stock for each of the four quarters of 1987 and 1986.

Common Stock Dividends Per Share

Quarter	1987	1986
1st Quarter	$0.72	$0.72
2nd Quarter	0.72	0.72
3rd Quarter	0.72	0.74
4th Quarter	0.72	0.76

Transfer Agent and Registrar

Pinnacle West Capital Corporation
Stock Transfer Department
P.O. Box 52134
Phoenix, Arizona 85072-2134
(602) 222-6951

General Counsel

Snell & Wilmer
Phoenix, Arizona

Auditors

Deloitte Haskins & Sells
Phoenix, Arizona

Pinnacle West Capital Corporation Stock Purchase and Dividend Reinvestment Plan

A Prospectus describing this plan is available upon request. Write: Office of the Secretary, Sta. 1930, 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, 1988, without charge, upon written request of shareholders. Write: Office of the Secretary, Sta. 1930, at the address below.

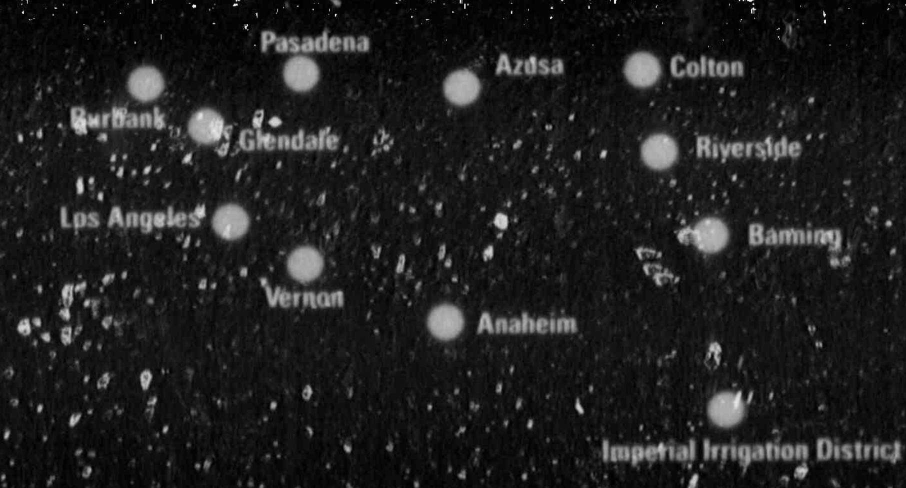
MAILING ADDRESS:

P.O. Box 53999
Phoenix, Arizona 85072-3999

SCPPA

SOUTHERN CALIFORNIA PUBLIC POWER AUTHORITY

1986-87 ANNUAL REPORT



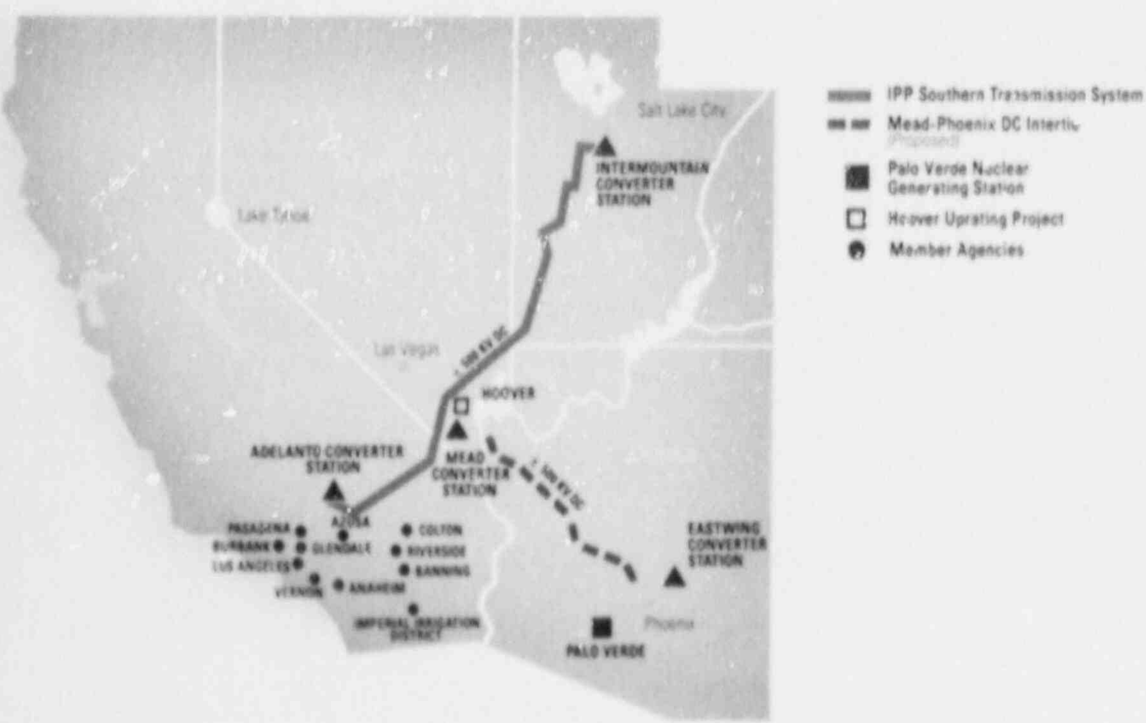
Introduction

The Southern California Public Power Authority (Authority) is comprised of all 11 public power agencies in Southern California. SCPPA has proved to be a reliable and economic source of energy for member communities by financing projects for the generation and transmission of electric energy for its member agencies.

The municipalities of Anaheim, Azusa, Banning, Burbank, Colton, Glendale, Los Angeles, Pasadena, Riverside and Vernon, as well as the Imperial Irrigation District comprise the vast area of the Authority. These member agencies serve more than 1.7 million customers—from the rural areas of Banning and the Imperial Irrigation District to metropolitan Los Angeles—and the growing, sprawling communities in between.

With combined sales of more than 32 million megawatt-hours—which had non-coincidental peak requirements of more than 7,500 megawatts—the member agencies of the Authority have received in excess of $1.9 billion in annual revenue.

Since initially going to market in 1982, the Authority has issued more than $5 billion in bonds and notes including refunding issues. This has been achieved due to the Authority's high level of acceptance in the financial community.



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Management

Gale A. Drews,
President

W. E. Cameron,
Vice President

Eldon A. Cotton
Secretary

Horace W. Rupp, Jr.
Assistant Secretary

Arthur T. Devine,
Executive Director

President
Gale A. Drews
Electrical Utility Director
City of Colton

Vice President
W. E. Cameron
Director of Public Services
City of Glendale

Secretary
Eldon A. Cotton
Assistant Chief Engineer – Power
Los Angeles Department of
Water and Power –
City of Los Angeles

Assistant Secretary
Horace W. Rupp, Jr.
Engineer of Power Contracts
Los Angeles Department of
Water and Power —
City of Los Angeles

Executive Director
Arthur T. Devine
Former Assistant City Attorney
City of Los Angeles
Former Electrical Engineer
Los Angeles Department of
Water and Power —
City of Los Angeles

President's Message

Since its formation in November 1981, the Southern California Public Power Authority (Authority) has efficiently served the needs of member agencies. SCPPA received a strong endorsement as one of the most effective joint action agencies in the nation with a financial rating upgrade to AA from an A+ rate in September 1987. This action translates into reduced borrowing costs for Authority funding due to lower interest rates. We are proud that the Authority is one of the few joint action agencies in the U.S. to carry an AA rating.

During the past fiscal year, the Authority completed funding for the Hoover Uprating Project in Nevada and the Palo Verde Nuclear Generating Station in Arizona. The Hoover Uprate, a project of the federal government scheduled for 1992 completion, is designed to increase the output rating of Hoover Power Plant generators and, in exchange, will provide capacity and energy allocations to Authority members, among others.

Unit 3 of the Palo Verde Station is expected to go online in early 1988. Ten Authority members are receiving electrical generation from Units 1 and 2 which were placed into commercial operation during 1986.

The Southern Transmission System (STS), placed into commercial operation last year, ahead of schedule, is being utilized to a greater extent with the operation of the second unit of the Intermountain Generating Station in Utah in May 1987. The STS provides six Authority members with transmission for additional energy and capacity, so members rely less on gas- and oil-fired generation in the Los Angeles Basin.

The Authority has borrowed funds for the Mead-Phoenix DC Intertie Project, and the feasibility study continued during the year.

During the past fiscal year, the Authority moved forward on all of its projects, and I have been pleased to be associated with these accomplishments. I want to especially thank the staff, Board of Directors, and all those responsible for the strength of this organization.

Gale A. D.
President

Anaheim

Located 25 miles southeast of Los Angeles, Anaheim is best known as the home of Disneyland and other popular tourist attractions. The tourism industry, including hundreds of hotels, motels, and restaurants, as well as the 685,000 gross square-foot Anaheim Convention Center, and a strong presence of high-tech defense businesses are the economic base for Anaheim.

The city's power needs are supplied by its ownership interest in San Onofre Nuclear Generating Station Units 2 and 3, non-firm sources, the Intermountain Generating Station and its entitlement in the Hoover Power Plant, in addition to power purchased from Southern California Edison Company (Edison). In fiscal 1987, power purchases and generation of 2,[illegible]99,[illegible]00 megawatt-hours met the needs of Anaheim's 94,000 customers, with a record system peak demand of 483 megawatts.

The city's population of 238,000 ranks it as the largest city in Orange County, one of the fastest growing population centers in the United States.

Azusa

Situated 20 miles east of Los Angeles near the Angeles National Forest, Azusa was incorporated in 1898. From its beginnings as a Shoshone Indian village, Azusa today has a population of 30,000 within its 11 square miles.

The city had been almost exclusively dependent on wholesale power from Edison until receiving its Palo Verde Generating Station and Hoover Power Plant entitlements which helped to displace a portion of the power being purchased from Edison. Last year, the utility sold approximately 167,000 megawatt-hours, with a peak demand of 43 megawatts.

Banning

"Stagecoach Town U.S.A.," as Banning is still known today, reveals the city's early roots. Located 85 miles east of Los Angeles, Banning is bordered north and south by mountain ranges — the San Gorgonio and San Jacinto, respectively. The city was incorporated in 1913 and now has a population of 14,000 living within its 17 square miles. Banning's economic foundation is built on agriculture, light manufacturing and recreation.

Banning is using its entitlements from Palo Verde Generating Station and Hoover Power Plant to offset some of its purchased power. It had relied exclusively on Edison, purchasing power at wholesale rates. Banning had a peak demand of 18.5 megawatts during the year, and sold approximately 70,000 megawatt-hours.

A tranquil setting near Banning typifies the rural flavor of the area 85 miles east of Los Angeles. Banning is using its entitlement from the Palo Verde Nuclear Generating Station to help offset its purchased power.

Burbank

The city of Burbank is at the base of the Verdugo Mountains, slightly northwest of Los Angeles. While the city had a population of 400 when it was incorporated in 1887, today Burbank has 85,000 residents.

This city serves as headquarters for Burbank Studios, Columbia Pictures, Walt Disney Productions, National Broadcasting Company, Warner Bros., and Lockheed Aircraft. Burbank industries employ more than 70,000 people.

Burbank supplies electricity to its customers through a combination of oil- and gas-fired generating facilities in the Los Angeles Basin, entitlements from Hoover Power Plant, Palo Verde Generating Station and the Intermountain Generating Station, and purchases from the Bonneville Power Administration and other utilities in the Pacific Northwest and the Southwest.

The city had a peak demand of 228 megawatts during the year while generating and purchasing 981,000 megawatt-hours of energy.

Colton

Colton quickly became established as the "Hub City" when one square mile of land was deeded to the Southern Pacific Railroad in 1875. Today the San Bernardino County community, 55 miles east of Los Angeles, is on the main line of three major railroads and the intersecting point for three major highways.

The city of Colton purchases the majority of its energy from Edison and additional energy requirements are met through its entitlements in the Palo Verde Generating Station and Hoover Power Plant. Colton had a peak demand of 39 megawatts and total energy requirements of 159,000 megawatt-hours.

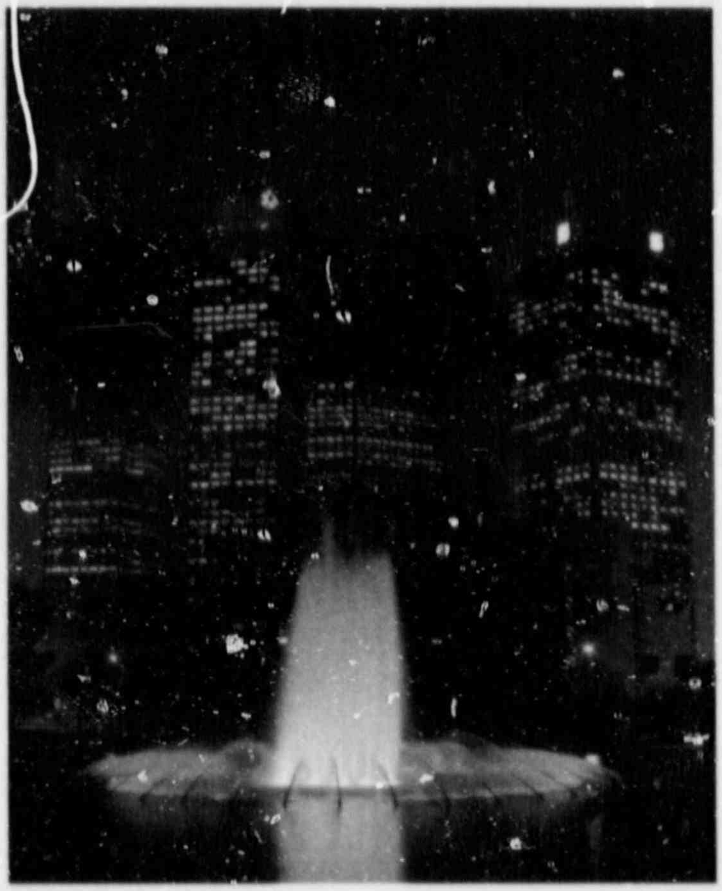
Glendale

The original 150-acre townsite of Glendale, formed in 1884, had grown almost ten times in size when it was incorporated in 1906. Today, this city just north of Los Angeles has grown to 30 square miles with a population of more than 154,000.

Glendale most recently began receiving its entitlements from the Intermountain Generating Station and the Palo Verde Generating Station. Glendale receives power from several different sources including oil- and gas-fired generation in the Los Angeles Basin, hydroelectric generation from Hoover Power Plant and purchases from the Bonneville Power Administration and other utilities.

Glendale purchased and generated a total of approximately 914,000 megawatt-hours in the fiscal year, serving almost 73,000 customers, and had a peak demand of 232 megawatts.

Industrialized Vernon supports a working population of about 55,000 within its 5 square miles. The city has been serving the needs of industry since 1905.



Los Angeles has established itself as an international city. Through its membership in the Authority, Los Angeles is receiving power from Utah via the Southern Transmission System and from the Palo Verde Nuclear Generating Station to meet its growing needs.

Los Angeles

A pueblo founded in 1781 along the Los Angeles river, the city of Los Angeles has grown to a population of 3.2 million, the nation's second largest city. Water and energy needs are served by the Los Angeles Department of Water and Power (Department), the largest U.S. municipal utility. The Department services about 1.3 million electric customers throughout Los Angeles' vast 465 square miles.

Los Angeles receives power from hydroelectric generating stations; coal, oil- and gas-fired facilities; a nuclear generating station; and purchases power from Pacific Northwest and Southwest utilities. During the fiscal year, Los Angeles experienced a peak demand of 4,713 megawatts while a total of 23 million megawatt-hours were generated. The Department provides a net dependable system capability of 7,254 megawatts.

Los Angeles is benefiting through its association with the Authority from two new power sources — the Intermountain Generating Station in Utah, completed in May 1987, and the Palo Verde Nuclear Generating Station in Arizona. Los Angeles has an entitlement in the Southern Transmission System which enables it to transmit power from the Intermountain Generating Station to its service territory and has an entitlement through the Authority of approximately 145 megawatts from the Palo Verde Nuclear Generating Station.

Pasadena

The home of the annual Tournament of Roses Parade and Rose Bowl college football competition each New Year's Day, Pasadena was founded in 1875 and incorporated the following year. Recognized as a major economic, cultural, residential and recreational center, the city is located northeast of Los Angeles at the base of the San Gabriel Mountains.

Among Pasadena's most prestigious employers are the California Institute of Technology, one of the world's major scientific research centers.

Pasadena supplies electricity through a combination of oil- and gas-fired generation in the Los Angeles Basin, hydroelectric generation from Hoover Power Plant and purchases from the Bonneville Power Administration, as well as receiving an entitlement from the Intermountain Generating Stations and Palo Verde.

Pasadena generated and purchased a total of approximately 1 million megawatt-hours for the year, and its peak demand was 232 megawatts.

Riverside

Riverside is located about 45 miles east of Los Angeles and is 72 square miles in area with a population of more than 175,000. It is the home of the University of California, Riverside.

The city was incorporated in 1883 in order to ensure an adequate water supply by annexing lands owned by an irrigation company. The present municipal utility, the oldest in California, had its beginning when a small hydroelectric plant was opened on a canal in 1888, and in 1896 the city started to distribute electric power from a more modern hydroelectric plant.

Riverside purchases power from Edison at wholesale rates, has ownership in Units 2 and 3 of the San Onofre Nuclear Generating Station, and receives power from an entitlement in the Palo Verde Generating Station, Hoover Power Plant and the Intermountain Generating Station.

Riverside has more than 1,600 circuit miles of subtransmission and distribution lines as well as 18 substations to meet the needs of its more than 75,000 customers. The city had a peak demand of 323 megawatts and total energy requirements of 1.2 million megawatt-hours.

Vernon

Vernon, a planned industrial city, has a small residential population which swells to more than 55,000 people during working hours. Four miles south of Los Angeles, the city, incorporated in 1905, provides a home for all types of industry within its five square miles.

More than 525 manufacturing plants and another 400 establishments engage in the wholesale-retail trade. It is served by four railroads operating 114 miles of line within the city. Every industry or business is on a direct transcontinental railway in Vernon, and 77 trucking lines have terminals in the city.

The Vernon Electrical System, established in 1931, receives most of its energy from Edison. The remainder is supplied from its entitlements in the Palo Verde Generating Station, Hoover Power Plant and a city operated diesel generating plant. During the year, Vernon had a peak demand of 193 megawatts and a total energy requirement of 1.15 million megawatt-hours.

Imperial Irrigation District

The Imperial Irrigation District (IID) provides power to 60,000 customers in Imperial and Riverside counties, one of the most productive agricultural areas in the country.

Formed in 1911, IID originally delivered water to 500,000 acres of farmland in Imperial County from distribution canals. Hydroelectric plants were developed along the waterways, and the properties of a private power company were purchased in 1943. Shortly afterward IID became the distributor of electric energy in Imperial County, and part of the Coachella Valley of Riverside County.

In addition to its hydroelectric plants, IID generates power from oil-fired units, gas turbines and diesel generators. It is receiving power from the Palo Verde Generating Station, has geothermal generation from the Heber Plant and purchases power from other utilities in the Southwest.

IID produced and purchased 1,393,000 megawatt-hours during the year, with a peak demand of 413 megawatts.

Palo Verde Generating Station

Unit 3 of the Palo Verde Nuclear Generating Station (Palo Verde) in Arizona is scheduled to go on-line in early 1988. Units 1 and 2 went into commercial operation during 1986. Each of the three generating units at the site, located 50 miles west of Phoenix, has a nominal capacity of 1,270 megawatts. The Authority has a 5.91 percent interest in Palo Verde and will receive about 216 megawatts (based on the licensed reactor thermal power level per unit of 1221 MW) when the facility is completed.

Ten member agencies have contracted with the Authority for entitlement in Palo Verde. This capacity will be used to meet growth, to replace more expensive purchased power, and to displace oil- or gas-fired generation.

The project is managed and operated by Arizona Public Service Company, with the switchyard portion operated by the Salt River Project. The Authority will use a certain portion of the project transmission system.

Palo Verde Project Participation

Participants	Project Entitlement	Generating Capability (Megawatts)
Los Angeles	67.0%	145.04
Imperial Irrigation District	6.5%	14.07
Riverside	5.4%	11.69
Vernon	4.9%	10.61
Burbank	4.4%	9.53
Glendale	4.4%	9.53
Pasadena	4.4%	9.53
Azusa	1.0%	2.16
Banning	1.0%	2.16
Colton	1.0%	2.16
Total	100.0%	216.48

Palo Verde is expected to have a net annual energy output of more than 22 million megawatt-hours by the early 1990s. The Authority's interest in the generating station is projected to deliver approximately 207 megawatts of capacity after allowing for transmission losses and 1,271,777 megawatt-hours of energy per year at the various points of delivery.

The Authority issued approximately $600 million in refunding bonds in 1985 and the first half of 1986, taking advantage of lower interest rates which resulted in a gross debt savings of $130 million to participating members over the life of the project. Total financing for the project amounted to $1 billion.

Southern Transmission Systems

With the completion of Unit 2 of the Intermountain Generating Station (IGS) during 1987, the ±500 kilovolt direct current Southern Transmission System (STS) has been officially rated at a 1920 megawatt capacity.

Six Authority members are receiving power over the STS, carried 488 miles across mountain and desert from the coal-fired IGS in Utah. Alternating current produced from the generating station is changed into direct current at an adjacent converter station. After transmission over the line, it is changed back to alternating current at the Adelanto Converter Station in Southern California and then delivered to project participants.

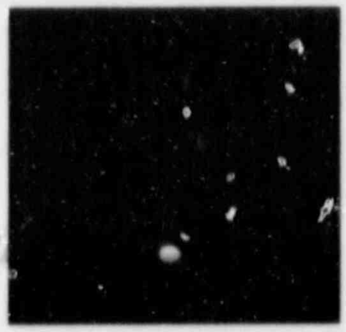
Los Angeles was appointed project manager and operating agent by the Intermountain Power Agency, a political subdivision of the State of Utah. A total of 36 utilities in California, Nevada and Utah are receiving power from the generating station.

Power transmitted by the project will be used by Authority participants to meet load growth, displace Los Angeles basin oil- and gas-fueled generation, and, for some, to reduce purchases from Edison.

Three refunding sales were completed by the Authority in 1985 and 1986 which totalled approximately $1 billion. This action translates into a gross debt service savings of approximately $7[illegible]5 million over the life of the project.

Hoover Uprating Project

The U.S. Bureau of Reclamation's (Bureau) plan to uprate the 17 original generators at the Hoover Power Plant is fully underway. Generator capacity is being increased by installing modern stator windings and upgrading various auxiliary equipment. Other modifications to the power plant to increase its efficiency include the replacement of existing transformer banks, consolidation of control rooms and



The ±500 kilovolt, direct current Southern Transmission System brings power from the Intermountain Generating Station in Utah to Southern California.

NEVADA

UTAH

NIA

Adelanto Converter Station on the edge of the Mojave Desert is the terminus of the Southern California Transmission System.

The capacity of the generators at Hoover Power Plant are being increased through an Uprating project which will benefit Authority members.

ARIZONA

Construction has been completed at the Palo Verde Nuclear Generating Station in Arizona.

modernization to provide for automatic and remote control. The Bureau determined that the nameplate capacity of the 50-year-old facility can be uprated to 1,951 megawatts at 498 feet of head, resulting in 503 megawatts of Uprate capacity.

Bonds were issued for approximately $34.5 million to advance the costs to the Bureau of the six Authority

Hoover Uprating Project Participation

Participants	Contingent Capacity		Associated Firm Energy
	MW	%	MWh
Anaheim	40.0	48.40	52,000
Riverside	30.0	36.30	39,000
Burbank	15.0	5.07	5,442
Azusa	4.0	4.65	5,000
Colton	3.0	3.72	4,000
Banning	2.0	1.86	2,000
Total	94.0	100.00	107,442

members participating in the Authority portion of the project. The members financing through the Authority will be allocated 94 megawatts of the additional output when the project is completed in 1992. The energy and capacity entitlements are now available to participants, and increasingly more amounts will be made available as the project advances until full entitlement is received in 1992.

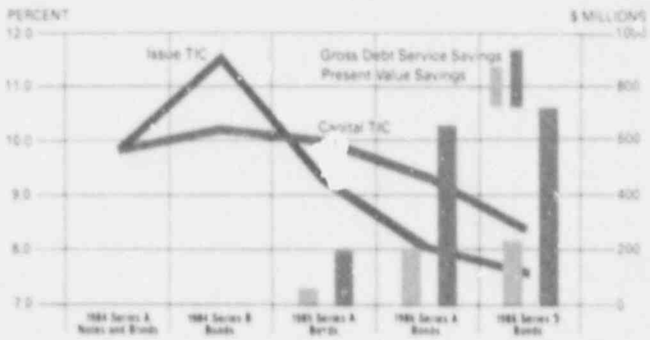
Mead-Phoenix DC Intertie Project

Studies continue by the Authority and other Southwest utilities as to the feasibility of constructing, owning and operating a ±500 kilovolt, direct current transmission line. The intertie between Phoenix, Arizona and Boulder City, Nevada, is a two-terminal 1,600 megawatts project which later could be expanded to 2,200 megawatts.

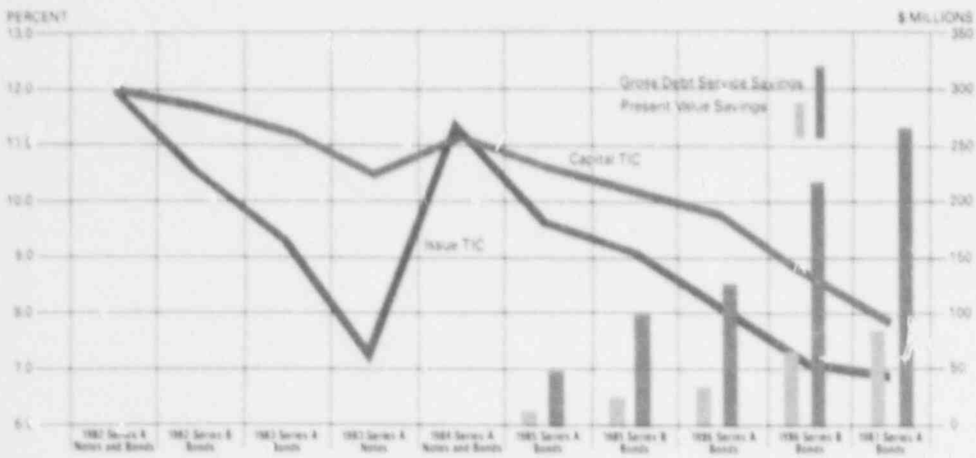
The intertie is currently scheduled for completion in the mid-1990s and would be used to transmit Palo Verde generation entitlements for the Authority participants and facilitate economy energy/capacity transactions with other utilities in the inland-Southwest. The other utilities participating in the studies are Salt River Project, M-S-R and the Western Area Power Administration.

If the participants elect to construct a two-terminal project, the Authority's participation would be 1500 megawatts with a potential increase to 2,062 megawatts if the project is expanded to 2200 megawatts.

Summary of Transmission Project Revenue Bond Program



Summary of Power Project Revenue Bond Program



September 30, 1987

To the Board of Directors of Southern California Public Power Authority

In our opinion, the accompanying combined balance sheet and the related combined statements of operations and of changes in financial position present fairly the financial position of the Southern California Public Power Authority (Authority) at June 30, 1987 and 1986, and the results of its operations and the changes in its financial position for the years then ended, in conformity with generally accepted accounting principles consistently applied. Our examinations of these statements 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, the accompanying separate balance sheets and the related separate statements of changes in financial position of the Authority's Palo Verde Project, Southern Transmission Project, Hoover Uprating Project and Mead-Phoenix Project, and the separate statements of operations of the Palo Verde Project, Southern Transmission Project and Hoover Uprating Project present fairly the financial position of each of the Projects at June 30, 1987, and the changes in each of their financial positions and the results of operations of the Palo Verde Project, Southern Transmission Project and Hoover Uprating Project for the year then ended, in conformity with generally accepted accounting principles consistently applied. Our examinations of these statements 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.

Our examinations were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplemental financial data and schedules, as listed in the accompanying index, are presented for purposes of additional analysis and are not a required part of the basic financial statements. Such supplemental financial data and schedules have been subjected to the auditing procedures applied in the examinations of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Price Waterhouse

Price Waterhouse

Southern California Public Power Authority
Combined Balance Sheet

(In thousands)

ASSETS	Palo Verde Project (June 30, 1987)	Southern Transmission Project (June 30, 1987)	Hoover Uprating Project (June 30, 1987)	Mead-Phoenix Project (June 30, 1987)	Total (June 30, 1987)	June 30, 1986 Total
Utility plant						
Production	$ 368,755				$ 368,755	$ 203,247
Transmission	3,512	$ 633,034			636,546	1,864
General	58	18,068			18,126	33
	372,325	651,102			1,023,427	205,144
Less—Accumulated Depreciation	15,983	18,089			34,072	3,340
	356,342	633,013			989,355	201,804
Construction work in progress	224,809		$ 3,064	$11,703	239,576	989,653
Nuclear fuel, at amortized cost	36,415				36,415	37,412
Net utility plant	617,566	633,013	3,064	11,703	1,265,346	1,228,869
Special funds (Notes C, D and E)						
Investments	222,229	156,446	30,962	2,910	412,547	497,788
Advance to Intermountain Power Agency		20,981			20,981	
Interest receivable	1,753	2,968	502		5,223	4,547
Cash	538			8	546	211
	224,520	180,395	31,464	2,918	439,297	502,546
Accounts receivable	2,859	2,662	66		5,587	5,442
Costs recoverable from future billings to participants (Note F)	26,069	58,241			84,310	7,340
Deferred costs						
Unamortized debt expenses, less accumulated amortization of $28,178 and $14,492 in 1987 and 1986	218,503	167,084	1,212	3	386,802	316,099
Other deferred costs	1,542				1,542	1,972
	220,045	167,084	1,212	3	388,544	318,071
	$1,091,059	$1,041,395	$35,806	$14,624	$2,182,884	$2,062,268
LIABILITIES						
Long-term debt (Notes C, D and E)	$1,039,335	$ 999,556	$34,293	$14,148	$2,087,332	$1,878,593
Current liabilities (Notes C and D)						
Bond anticipation notes						75,000
Accrued interest	37,454	38,611	689	426	77,180	91,762
Accounts payable and accrued expenses	14,270	3,228	824	50	18,372	16,913
	51,724	41,839	1,513	476	95,552	183,675
Commitments and contingencies						
	$1,091,059	$1,041,395	$35,806	$14,624	$2,182,884	$2,062,268

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

Southern California Public Power Authority
Combined Statement of Operations

(In thousands)

	Year ended June 30, 1987				
	Palo Verde Project	*Southern Transmission Project*	*Hoover Uprating Project*	*Total*	*Year ended June 30, 1986*
Operating revenues					
Sales of electric energy	$ 51,949		$66	$ 52,015	$ 10,042
Sales of transmission services		$ 40,617		40,617	
Total operating revenues	$ 51,949	$ 40,617	$66	$ 92,632	$ 10,042
Operating expenses					
Nuclear fuel expense	$ 7,259			$ 7,259	$ 2,022
Other operation	10,162	$ 7,036	$66	17,264	3,395
Maintenance	3,192	3,082		6,274	1,440
Depreciation	12,643	18,089		30,732	3,340
Expense charged to projects during construction	(370)			(370)	(1,056)
Total operating expenses	32,886	28,207	66	61,159	9,141
Debt expenses					
Interest on debt, net	78,290	70,651		148,941	84,294
Allowance for borrowed funds used during construction	(40,498)			(40,498)	(76,053)
Net debt expense	37,792	70,651		108,443	8,241
	70,678	98,858	66	169,602	17,382
Costs recoverable from future billings to participants (Note F)	(18,729)	(58,241)		(76,970)	(7,340)
Total expenses	$ 51,949	$ 40,617	$66	$ 92,632	$ 10,042

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

Southern California Public Power Authority
Combined Statement of Changes in Financial Position

(In thousands)

	Year ended June 30, 1987					
	Palo Verde Project	*Southern Transmission Project*	*Hoover Uprating Project*	*Mead-Phoenix Project*	*Total*	*Year ended June 30, 1986 Total*
Funds provided by (used for)						
Operations						
Revenues	$ 51,949	$ 40,617	$ 66		$ 92,632	$ 10,042
Expenses	(70,678)	(98,858)	(66)		(169,602)	(17,382)
Charges not involving funds:						
Depreciation and amortization	19,098	18,089			37,187	5,36_
Other, net	9,723	8,052			17,775	7,933
	10,092	(32,100)	0		(22,008)	5,955
Financing						
Sale of revenue bonds			34,293		34,293	
Sale of refunding bonds	679,434				679,434	1,343,525
Defeasance of revenue bonds	(508,703)				(508,703)	(1,130,929)
Defeasance of bond anticipation notes						(200,000)
Reduction in long-term debt						(75,000)
Bond issue costs	(106,289)		(1,260)		(107,549)	(232,270)
	64,442		33,033		97,475	(294,674)
Utility plant	(55,131)	(14,395)	(3,064)	$(1,073)	(73,663)	(191,950)
Other, net		23,157	48	12	23,217	(1,033)
	$ 19,403	$(23,338)	$30,017	$(1,061)	$ 25,021	$ (481,702)
Increase (Decrease in funds)						
Investments	$ (52,336)	$(63,100)	$30,962	$ (766)	$ (85,240)	$ (438,017)
Advance to Intermountain Power Agency		20,981			20,981	
Interest receivable	(515)	690	502		677	(21,910)
Cash	340		66	(5)	401	(56)
Accounts receivable	(2,560)	2,649		(10)	79	(1,233)
Bond anticipation notes	75,000				75,000	(75,000)
Accrued interest payable	4,529	11,107	(689)	(365)	14,582	6,266
Accounts payable and accrued expenses	(5,055)	4,335	(824)	85	(1,459)	48,248
	$ 19,403	$(23,338)	$30,017	$(1,061)	$ 25,021	$ (481,702)

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

NOTE A — **Organization and purpose:**

Southern California Public Power Authority (Authority), a public entity organized under the laws of the State of California, was formed by a Joint Powers Agreement dated as of November 1, 1980 pursuant to the Joint Exercise of Powers Act of the State of California. The Authority's participant membership consists of ten Southern California cities and one public district of the State of California. The Authority was formed for the purpose of planning, financing, developing, acquiring, constructing, operating and maintaining projects for the generation and transmission of electric energy for sale to its participants. The Joint Powers Agreement has a term of fifty years.

Palo Verde Project — The Authority, pursuant to an assignment agreement dated as of August 14, 1981 with the Salt River Project Agricultural Improvement and Power District (Salt River Project), has purchased a 5.91% interest in the Palo Verde Nuclear Generating Station (PVNGS), a 3,810 megawatt nuclear-fueled generating station being constructed near Phoenix, Arizona, and a 6.55% share of the right to use certain portions of the Arizona Nuclear Power Project Valley Transmission System (collectively, the Palo Verde Project). Units 1 and 2 of the Palo Verde Project began commercial operation in January and September 1986, respectively. Unit 3 is scheduled for commercial operation in January 1988.

Mead-Phoenix Project — The Authority is also studying the feasibility of constructing the proposed Mead-Phoenix DC Intertie Project (Mead-Phoenix Project), a transmission line from Arizona to Nevada. The Authority's present interest in the Mead-Phoenix Project is 93.75%.

Southern Transmission Project — The Authority, pursuant to an agreement dated as of May 1, 1983 with the Intermountain Power Agency (IPA), has agreed to make payments-in-aid of construction to IPA to defray all the costs of acquisition and construction of the Southern Transmission System Project (STS), a transmission line which will provide for the transmission of energy from the Intermountain Power Project in Utah to Southern California. The Authority entered into an agreement also dated as of May 1, 1983 with six of its members pursuant to which each member assigned its entitlement to capacity of the Southern Transmission Project to the Authority in return for the Authority's agreement to make payments-in-aid of construction to IPA. STS commenced commercial operations in July 1986.

Hoover Uprating Project — On August 13, 1986, six participant members of the Authority entered into an agreement with the Bureau of Reclamation of the United States of America (Bureau) to make advance payments toward the cost of uprating the Hoover Dam Facility's generating equipment. Construction is scheduled for completion by September 1992. The Authority will have an 18.68% interest in contingent capacity of the Hoover Uprating Project. Several "uprated" generators of the Hoover Uprating Project commenced commercial operations in June 1987.

NOTE B — **Summary of significant accounting policies:**

The Authority maintains its records substantially in accordance with accounting principles and methods prescribed by the Federal Energy Regulatory Commission and the California Public Utilities Commission. The Authority is not subject to regulation by such commissions.

Utility plant — All expenditures, including general administrative and other overhead expenses, payments-in-aid of construction, interest net of related investment income, deferred cost amortization and the fair value of test power generated and delivered to the participants are capitalized as utility plant construction work in progress until a facility begins commercial operation.

The Authority's share of costs associated with PVNGS Units 1 and 2 is included as Utility Plant in Service. Depreciation is provided using the straight-line method over the assets estimated useful lives of thirty-five years. Nuclear fuel is amortized and charged to expense on the basis of actual thermal energy produced relative to total thermal energy expected to be produced over the life of the fuel. A contract has been entered into with the United States Department of Energy for disposal of the spent fuel.

The costs associated with the STS project are included as Utility Plant in Service. Depreciation is provided using the straight-line method over the assets estimated useful lives of primarily thirty-five years.

Nuclear decommissioning — Decommissioning of PVNGS is projected to commence sometime after 2022. Estimated future decommissioning costs are provided over the commercial life of PVNGS through annual charges to expense.

Deferred costs — Deferred costs are shown net of accumulated amortization. Unamortized debt issue costs, including the cost of refunding, are amortized over the terms of the respective issues. Other deferred costs are amortized generally over five years.

Investments — Investments include United States Government and governmental agency securities and repurchase agreements which are collateralized by such securities. These investments are stated at amortized cost. As discussed in Notes C and D, all of the investments are restricted as to their use.

Investments, in thousands, were as follows:

	June 30,			
	1987		1986	
Project	Carrying Value	Market	Carrying Value	Market
Palo Verde	$222,229	$232,845	$274,565	$291,969
Southern Transmission	177,427	189,351	219,546	233,641
Hoover Uprating	30,962	30,651		
Mead-Phoenix	2,910	2,910	3,677	3,679
	$433,528	$455,757	$497,788	$529,289

Revenues — Revenues consist of billings to participants for the sales of electric energy and of transmission service in accordance with the participation agreements. Generally, revenues are fixed at a level to recover all operating and debt service costs over the commercial life of the plant. (See Note F).

Debt expenses — Debt expenses include interest on debt, the amortization of bond premiums and discounts, and debt issue and refunding costs. Income from investments is recorded as a reduction of debt expense.

NOTE C — **Long-term debt:**

Palo Verde Project — To finance the purchase and construction of the Authority's share of the Palo Verde Project, the Authority has issued Power Project Revenue Bonds and Power Project Bond Anticipation Notes pursuant to the Authority's Indenture of Trust dated as of July 1, 1981 (Bond Indenture), as amended and supplemented, and the Authority's Power Project Bond Anticipation Note Resolution (Note Resolution) adopted August 13, 1982, as amended and supplemented. Reference is made to the Combined Supplemental Schedule of Revenue and Refunding Bonds Payable at June 30, 1987 for details related to outstanding bonds.

The Bond Indenture provides that the Revenue Bonds shall be special limited obligations of the Authority payable solely from and secured solely by (1) proceeds from the sale of bonds, (2) all revenues, incomes, rents and receipts attributable to the Palo Verde Project (see Note E) and interest on all moneys or securities (other than in the Construction Fund) held pursuant to the Bond Indenture and (3) all funds established by the Bond Indenture (excluding the Decommissioning Account in the Reserve and Contingency Fund); subject to the provisions of the Palo Verde Project Bond Indenture providing for the application thereof. The Note Resolution provides that the Bond Anticipation Notes shall be special, limited obligations of the Authority payable from the proceeds of additional bonds, notes or loans obtained under the Revolving Credit Agreement. During fiscal 1987, the Bond Anticipation Notes were defeased and are considered extinguished for purposes of financial statement presentation.

All outstanding Power Project Revenue Term Bonds, at the option of the Authority, are subject to redemption prior to maturity.

The Bond Indenture requires mandatory sinking fund instalments to be made beginning in fiscal 1998 for the 1982 Series A Bonds, 1999 for the 1982 Series B Bonds and the 1983 Series A Bonds, 2001 for the 1984 Series A Bonds and 1985 Series A Bonds, 2005 for the 1985 Series B Bonds and 2003 for the 1986 Series A Bonds, the 1986 Series B Bonds and the 1987 Series A Bonds. Scheduled principal maturities for the Palo Verde Project during the five fiscal years succeeding June 30, 1987 are $13,095,000 in 1989, $13,870,000 in 1990, $14,745,000 in 1991 and $15,790,000 in 1992. No principal maturities of bonds outstanding at June 30, 1987 are scheduled for fiscal 1988. The effective interest rate on outstanding debt during 1987 was 8.4%.

The funds required by the Bond Indenture contain balances, in thousands, as follows:

	June 30,	
	1987	1986
Construction Fund — Initial Facilities Account	$ 38,454	$ 52,826
Debt Service Fund —		
Debt Service Account	67,711	105,473
Debt Service Reserve Account	90,235	98,299
Bond Anticipation Note Fund	30	6,080
Revenue Fund	1	2,720
Operating Fund	15,739	5,016
Reserve and Contingency Fund	8,169	6,272
General Reserve Fund	4,181	345
Total Special Funds	$224,520	$277,031

Southern Transmission Project — To finance payments-in-aid of construction to IPA for construction of the Southern Transmission Project, the Authority has issued Transmission Project Revenue Bonds pursuant to the Authority's Indenture of Trust dated as of May 1, 1983 (Bond Indenture). Reference is made to the Supplemental Schedule of Revenue and Refunding Bonds Payable at June 30, 1987 for details related to the outstanding bonds.

The Bond Indenture provides that the Revenue Bonds shall be special, limited obligations of the Authority payable solely from and secured solely by (1) proceeds from the sale of bonds, (2) all revenues, incomes, rents and receipts attributable to the Southern Transmission Project (see Note E) and interest on all moneys or securities (other than in the Construction Fund) held pursuant to the Bond Indenture and (3) all funds established by the Bond Indenture; subject to the provisions of the Bond Indenture providing for the application thereof.

All outstanding Transmission Project Revenue Term Bonds, at the option of the Authority, are subject to redemption prior to maturity.

The Bond Indenture requires mandatory sinking fund instalments to be made beginning in fiscal 2000 for the 1984 Series A Bonds, 2001 for the 1984 Series B Bonds and the 1985 Series A Bonds, 2003 for the 1986 Series A Bonds and 2002 for the 1986 Series B Bonds. Scheduled principal maturities for the Southern Transmission Project during the five fiscal years succeeding June 30, 1987 are $2,260,000 in 1989, $3,785,000 in 1990, $7,943,000 in 1991 and $8,485,000 in 1992. No principal maturities of bonds outstanding at June 30, 1987 are scheduled for fiscal 1988. The effective interest rate on outstanding debt during 1987 was 7.7%.

The special funds required by the Bond Indenture contain balances, in thousands, as follows:

	June 30,	
	1987	1986
Construction Fund — Initial Facilities Account	$ 18,638	$ 94,857
Debt Service Fund —		
Debt Service Account	38,623	35,705
Debt Service Reserve Account	91,192	91,262
Revenue Fund	1	
Operating Fund	6,249	
General Reserve Fund	4,711	
Total Special Funds	$159,414	$221,824

In addition, $20,981,000 has been advanced during fiscal year 1987 to IPA for SCPPA's share of the initial working capital for the Southern Transmission Project. The advance will be returned to SCPPA at the end of the project.

Hoover Uprating Project — Pursuant to the Authority's Indenture of Trust dated as of March 1, 1986 (Bond Indenture), the Authority issued $34,435,000 of Hydroelectric Power Project Revenue Bonds 1986 Series A to finance advance payments to the U.S. Bureau of Reclamation for application to the costs of the Hoover Uprating Project. The Bond Indenture provides that the Revenue Bonds shall be special, limited obligations of the Authority payable solely from and secured solely by (1) the proceeds of the sale of the bonds, (2) all revenues from sales of energy to project participants, (3) interest or other receipts derived from any moneys or securities held pursuant to the Bond Indenture, and (4) all funds established by the Indenture of Trust (except for the Interim Advance Payments Account in the Advance Payment Fund); subject to the provisions of the Bond Indenture providing for the application thereof.

All outstanding Hydroelectric Power Project Revenue Term Bonds, at the option of the Authority, are subject to redemption prior to maturity.

The Bond Indenture requires mandatory sinking fund instalments to be made beginning in fiscal 2002 for the 1986 Series A Bonds. No scheduled principal maturities of bonds outstanding at June 30, 1987 are scheduled for fiscal 1988 through fiscal 1992. The effective interest rate on outstanding debt during 1987 was 8.1%.

The funds required by the Bond Indenture contain balances, in thousands, as follows:

	June 30,
	1987
Advance Payments Fund	$27,277
Debt Service Fund	
Debt Service Account	932
Debt Service Reserve Account	3,255
Total Special Funds	$31,464

Summary of Special Funds — The Bond Indentures and Note Resolution for each of the three projects require the above listed special funds to be established to account for the Authority's receipts and disbursements. The moneys and investments held in these funds are restricted in use to the purposes stipulated in the bond indentures and note resolution. A summary of these funds follows.

Fund	Held by	Purpose
Construction	Trustee	To disburse funds for the acquisition and construction of the Project
Debt Service	Trustee	To pay interest and principal related to the Revenue Bonds
Bond Anticipation Note	Trustee	To pay interest related to the Bond Anticipation Note
Revenue	Trustee	To initially receive all revenues and disburse them to other funds
Operating	Trustee	To pay operating expenses
Reserve and Contingency	Trustee	To pay capital improvements and make up deficiencies in other funds and, in the case of the Palo Verde Project, accumulate funds for decommissioning
General Reserve	Trustee	To make up any deficiencies in other funds
Advance Payments	Trustee	To disburse funds for the cost of acquisition capacity of the project

Refunding bonds — During fiscal 1987 the proceeds from the sale of $707,275,000 of Power Project Refunding Bonds were used to advance refund $630,120,000 of previously issued bonds. In connection therewith, the net proceeds of the refunding bonds have been invested in securities of the United States Government, the principal and interest from which will be sufficient to fund the remaining principal, interest and call premium payments on all refunded bonds until the stated first call dates of the respective issues. Accordingly, all amounts related to the refunded bonds have been removed from the balance sheets and the cost of refunding the debt is included in unamortized debt expenses at June 30, 1987. At June 30, 1987 the aggregate amount of debt considered to be extinguished was $1,875,050,000.

NOTE D — Long-term bank loan payable:

At June 30, 1987, the Authority had borrowed $14,148,000 to finance the feasibility study and development costs of the Mead-Phoenix Project. This loan bears interest at approximately 67% of the prime rate; however, the interest rate cannot exceed 12%. The average interest rate on this loan was 5.2% and 6.1% during 1987 and 1986.

The proceeds of the loan were deposited in a Development Fund for which the lender is the trustee and can only be used for payment of Mead-Phoenix Project development costs, costs of issuance of the loan, including general and administrative expenses of the Authority related to the Mead-Phoenix Project, and loan principal and interest. At June 30, 1987 and 1986, the balance in the Development Fund was $2,918,000 and $3,690,000 of which substantially all were invested in securities of the United States Government.

If the Mead-Phoenix Project is terminated for any reason prior to the issuance of long-term bonds to refinance the loan, ten California cities, the Salt River Project and the United States Department of Energy, Western Area Power Administration, have contracted to make payments to the Authority based on their participation percentage sufficient to retire the loan and accrued interest thereon. The loan is secured solely by the restricted assets and the above mentioned contracts.

NOTE E — Power sales and transmission service contracts:

The Authority has sold its entitlement to the output of the Palo Verde Project pursuant to power sales contracts with ten member participants (see Note G). Under the terms of the power sales contracts, the purchasers are entitled to power output from the Palo Verde Nuclear Generating Station and are obligated to make payments on a "take or pay" basis for their proportionate share of operating and maintenance expenses and debt service on Power Project Revenue Bonds and other debt, whether or not the Palo Verde Project or any part thereof has been completed, is operating or operable, or its output is suspended, interfered with, reduced or curtailed or terminated. The contracts expire in 2030 and, as long as any Power Project Revenue Bonds are outstanding, cannot be terminated or amended in any manner which will impair or adversely affect the rights of the bondholders.

The Authority has entered into transmission service contracts with six member participants (see Note G). Under the terms of the transmission service contracts, the project participants are entitled to transmission service utilizing the Southern Transmission Project and are obligated to make payments on a "take or pay" basis for their proportionate share of operating and maintenance expenses and debt service on Transmission Project Revenue Bonds and other debt, whether or not the Southern Transmission Project or any part thereof has been completed, is operating or is operable, or its service is suspended, interfered with, reduced or curtailed or terminated. The contracts expire in 2027 and, as long as any Transmission Project Revenue Bonds are outstanding, cannot be terminated or amended in any manner which will impair or adversely affect the rights of the bondholders.

NOTE F — Costs recoverable from future billings to participants:

Billings to participants are designed to recover "costs" as defined by the power sales and transmission service agreements. The billings are structured to systematically provide for the debt requirements, operating funds and reserves in accordance with these agreements. Those expenses, according to generally accepted accounting principles, which are not included as "costs" are deferred to such periods as they are intended to be recovered through billings.

NOTE G — Related party transactions:

Under the terms of the various contracts, the Authority reimbursed the following entities for work performed on the respective projects. The Department of Water and Power of the City of Los Angeles has performed administrative and other work for the Authority totaling $469,000 and $310,000 for fiscal 1987 and 1986. The Arizona Public Service Company (APS), as project manager of the Palo Verde Project, billed the Authority for various construction, operating and maintenance costs totaling $36,005,000 and $50,101,000 for fiscal 1987 and 1986. The Intermountain Power Authority billed the Authority for payments-in-aid of construction, operating and maintenance costs relating to the Southern Transmission Project amounting to $25,267,000 and $62,561,000 for fiscal 1987 and 1986. The U.S. Bureau of Reclamation as project manager of the Hoover Uprating Project, billed the Authority for various construction costs totaling $2,448,000 for fiscal 1987. The Salt River Project, as development manager of the Mead-Phoenix Project, billed the Authority for various development costs amounting to $470,000 and $1,165,000 for fiscal 1987 and 1986.

Member participants have the following participation percentages in the Authority's interest in the four projects (see Note A):

	Project Participation Percentage			
Participant	Palo Verde	Southern Transmission	Hoover Uprating Project	Mead-Phoenix
City of Los Angeles	67.0%	59.5%		61.2%
City of Anaheim		17.6	42.6%	15.0
City of Riverside	5.4	10.2	31.9	6.0
Imperial Irrigation District	6.5			
City of Vernon	4.9			3.0
City of Azusa	1.0		4.2	.6
City of Banning	1.0		2.1	.6
City of Colton	1.0		3.2	.6
City of Burbank	4.4	4.5	16.0	5.0
City of Glendale	4.4	2.3		5.0
City of Pasadena	4.4	5.9		3.0
	100.0%	100.0%	100.0%	100.0%

NOTE H—Commitments and contingencies:

The Authority estimates that the total financing requirements for its interest in the Hoover Uprating Project will approximate $34 million, of which substantially all will be expended for payments for capacity and associated firm energy and the acquisition of entitlements to capability. Construction is scheduled for completion in September 1992.

The Authority is involved in various legal actions. In the opinion of management, the outcome of such litigation or claims will not have a material effect on the financial position of the Authority or the respective separate projects.

Southern California Public Power Authority Index to Supplemental Financial Data and Schedules

Souther.i California Public Power Authority
Combined Supplemental Schedule of Revenue and Refunding Bonds Payable
At June 30, 1987

(In thousands)

	Series	*Date of Sale*	*Effective Interest Rate*	*Maturity on July 1*	*Total*
Palo Verde Project Revenue and Refunding Bo ıds	1982A	8/13/82	10.9%	1988 to 2017	$ 26,325
	1982B	11/12/82	7.7%	1988 to 2017	44,445
	1983A	4/ 8/83	8.8%	1988 to 2017	36,015
	1984A	7/18/84	10.3%	1990 to 2004	24,090
	1985A	5/22/85	8.7%	1988 to 2014	12,515
	1985B	7/ 2/85	9.1%	1988 to 2017	101,815
	1986A	3/13/86	8.2%	1988 to 2015	157,645
	1986B	12/16/86	7.2%	1988 to 2017	354,630
	1987A	2/11/87	6.9%	1988 to 2017	352,645
					1,110,125
Southern Transmission Project Revenue and Refunding Bonds	1984A	2/ 9/84	9.3%	1990 to 2004	65,945
	1984B	10/17/84	10.2%	1990 to 2000	18,770
	1985A	8/15/85	8.9%	1989 to 2021	121,620
	1986A	3/18/86	8.0%	1988 to 2021	371,720
	1986B	4/29/86	7.5%	1988 to 2023	480,010
					1,058,065
Hoover Uprating Project Revenue Bonds	1986A	8/13/86	8.1%	1993 to 2017	34,435
Total Principal Amount					2,202,625
Less: Unamortized Bond Discount—					
Palo Verde Project Revenue and Refunding Bonds					70,790
Southern Transmission Project Revenue and Refunding Bonds					58,509
Hoover Uprating Power Project Revenue Bonds					142
Total Unamortized Bond Discount					129,441
Total Revenue and Refunding Bonds Less Amortized Bond Discount					$2,073,184

Long-term debt representing a bank loan of $14,148,000 for the Mead-Phoenix Project and bonds which have been refunded are excluded from this schedule.

Southern California Public Power Authority
Palo Verde Project
Supplemental Balance Sheet

(In thousands)

	June 30, 1987	June 30, 1986
ASSETS		
Utility plant		
Production	$ 368,755	$203,247
Transmission	3,512	1,864
General	58	33
	372,325	205,144
Less – Accumulated depreciation	15,983	3,340
	356,342	201,804
Construction work in progress	224,809	342,317
Nuclear fuel, at amortized cost	36,415	37,412
Net utility plant	617,566	581,533
Special funds		
Investments	222,229	274,565
Interest receivable	1,753	2,268
Cash	538	198
	224,520	277,031
Accounts receivable	2,859	5,419
Costs recoverable from future billings to participants	26,069	7,340
Deferred costs		
Unamortized debt expenses, less accumulated amortization of $13,698 and $6,949 in 1987 and 1986	218,503	118,963
Other deferred costs	1,542	1,972
	220,045	120,935
	$1,091,059	$992,258
LIABILITIES		
Long-term debt	$1,039,335	$866,060
Current liabilities		
Bond anticipation notes		75,000
Accrued interest payable	37,454	41,983
Accounts payable and accrued expenses	14,270	9,215
	51,724	126,198
Commitments and contingencies		
	$1,091,059	$992,258

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

Southern California Public Power Authority
Palo Verde Project
Supplemental Statement of Operations

(In thousands)

	Year ended June 30, 1987	1986
Operating revenues		
Sales of electric energy	$ 51,949	$ 10,042
Operating expenses		
Nuclear fuel expense	$ 7,259	$ 2,022
Other operation	10,162	3,395
Maintenance	3,192	1,440
Depreciation	12,643	3,340
Expense charged to projects during construction	(370)	(1,056)
Total operating expenses	32,886	9,141
Debt expenses		
Interest on debt, net	78,290	84,294
Allowance for borrowed funds used during construction	(40,498)	(76,053)
Net debt expense	37,792	8,241
	70,678	17,382
Costs recoverable from future billings to participants	(18,729)	(7,340)
Total expenses	$ 51,949	$ 10,042

Southern California Public Power Authority
Palo Verde Project
Supplemental Statement of Changes in Financial Position

(In thousands)

	Year ended June 30, 1987	1986
Funds provided by (used for)		
Operations		
Revenues	$ 51,949	$ 10,042
Expenses	(70,678)	(17,382)
Charges not involving funds:		
Depreciation and amortization	19,098	5,362
Other, net	9,723	7,933
	10,092	5,955
Financing		
Sale of refunding bonds	679,434	333,312
Defeasance of revenue bonds	(508,703)	(289,320)
Reduction of long-term debt		(75,000)
Bond issue costs	(106,289)	(57,653)
	64,442	(88,661)
Utility plant	(55,131)	(87,465)
Other, net		(1,972)
	$ 19,403	$(172,143)
Increase (Decrease) in funds		
Investments	$ (52,336)	$ (94,031)
Interest receivable	(515)	(12,308)
Cash	340	(56)
Accounts receivable	(2,560)	4,741
Bond anticipation notes	75,000	(75,000)
Accrued interest payable	4,529	6,725
Accounts payable and accrued expenses	(5,055)	(2,214)
	$ 19,403	$(172,143)

Southern California Public Power Authority
Palo Verde Project
Supplemental Schedule of Receipts and Disbursements in Funds Required by the Bond Indenture
Year Ended June 30, 1987

(In thousands)

	Construction Fund Initial Facilities Account	*Debt Service Fund*	*Bond Anticipation Note Fund*	*Revenue Fund*	*Operation Fund*	*Reserve & Contingency Note Fund*	*General Reserve Fund*	*Total*
Balance at June 30, 1986	$53,386	$201,277	$6,041	$ 2,719	$ 4,963	$6,456	$ 342	$275,184
Additions								
Bond and note proceeds	75,312							75,312
Bond and note interest received		4,561						4,561
Investment earnings	3,694	18,753	225	292	405	830	13	24,212
Sales—power	1,350			59,064	606			61,020
Other income	142				160			302
Transfer—bond closing	(7,893)	(22,841)						(30,734)
Transfer—note payment	(73,719)							(73,719)
Transfer—interest payment		67,803	(3,000)					64,803
Transfer—investments	3,600			(195)	1,460		(1,265)	3,600
Transfer—investment earnings	13,313	(21,865)	(237)	9,661	(361)	(459)	(51)	1
Transfer—power sales receipts		44,087		(61,374)	14,613	1,518	1,156	0
Transfer—other	622	304		(10,167)	6,178	132	3,983	1,052
Total	16,421	90,802	(3,012)	(2,719)	23,061	2,021	3,836	130,410
Deductions								
Construction expenditures	19,933							19,933
Operating expenditures	424				11,264			11,688
Fuel costs	6,189							6,189
Interest paid	54	133,658	3,000		61			136,773
Property tax paid	1,686				1,124			2,810
Financing costs	2,346							2,346
Interest paid on investment purchases	774	515						1,289
Premium paid on investment purchases	167							167
Total	31,573	134,173	3,000	0	12,449	0	0	181,195
Balance at June 30, 1987	$38,234	$157,906	$ 29	$ 0	$15,575	$8,477	$ 4,178	$224,399

This schedule summarizes the receipts and disbursements in funds required under the bond indenture and has been prepared from the trust statements. The balances in the funds consist of cash and investments at original cost. These balances do not include accrued interest receivable of $1,753 and $2,268 at June 30, 1987 and 1986, nor do they include total amortized net investment premiums of ($1,632) and ($421) at June 30, 1987 and 1986.

Southern California Public Power Authority
Southern Transmission Project
Supplemental Balance Sheet
(In thousands)

	June 30, 1987	June 30, 1986
ASSETS		
Utility plant		
Transmission	$ 633,034	
General	18,068	
	651,102	
Less — Accumulated depreciation	18,089	
	633,013	
Construction work in progress		$ 636,706
Net utility plant	633,013	636,706
Special funds		
Investments	156,446	219,546
Advance to Intermountain Power Agency	20,981	
Interest receivable	2,968	2,278
	180,395	221,824
Accounts receivable	2,662	13
Costs recoverable from future billings to participants	58,241	
Deferred costs		
Unamortized debt expenses, less accumulated amortization of $13,999 and $7,121 in 1987 and 1986	167,084	197,122
	$1,041,395	$1,055,665
LIABILITIES		
Long-term debt	$ 999,556	$ 998,385
Current liabilities		
Accrued interest	38,611	49,717
Accounts payable and accrued expenses	3,228	7,563
	41,839	57,280
Commitments and contingencies		
	$1,041,395	$1,055,665

Southern California Public Power Authority
Southern Transmission Project
Supplemental Statement of Operations

(In thousands)

	Year ended June 30, 1987
Operating revenues	
Sales of transmission services	$ 40,617
Operating expenses	
Other operation	7,036
Maintenance	3,082
Depreciation	18,089
Total operating expenses	28,207
Debt expenses	
Interest on debt, net	70,651
	98,858
Costs recoverable from future billings to participants	(58,241)
Total expenses	$ 40,617

Southern California Public Power Authority
Southern Transmission Project
Supplemental Statement of Changes in Financial Position

(In thousands)

	Year ended June 30, 1987	1986
Funds provided by (used for)		
Operations		
Revenues	$ 40,617	
Expenses	(98,858)	
Charges not involving funds		
Depreciation	18,089	
Other, net	8,052	
	(32,100)	
Financing		
Sale of refunding bonds		$ 1,010,213
Defeasance of bond anticipation notes		(200,000)
Defeasance of revenue bonds		(841,609)
Bond issue costs		(174,617)
		(206,013)
Utility plant	(14,395)	(102,530)
Other, net	23,157	903
	$(23,338)	$ (307,640)
Increase (Decrease) in funds		
Investments	$(63,100)	$ (342,128)
Advance to Intermountain Power Agency	20,981	
Interest receivable	690	(9,602)
Accounts receivable	2,649	(5,984)
Accrued interest	11,107	(472)
Accounts payable and accrued expenses	4,335	50,546
	$(23,338)	$ (307,640)

Southern California Public Power Authority
Southern Transmission Project
Supplemental Schedule of Receipts and Disbursements in Funds Required by the Bond Indenture
Year Ended June 30, 1987

(In thousands)

	Construction Fund-Initial Facilities Account	*Debt Service Fund*	*Revenue Fund*	*Operating Fund*	*General Reserve Fund*	*Total*
Balance at June 30, 1986	$ 93,836	$124,314	$ 0	$ 0	$ 0	$218,150
Additions						
Investment earnings	3,905	11,080	90	230	581	15,886
Sales			42,071			42,071
Transfer of interest payment		85,841				85,841
Transfer of funds	(38,534)	48,224	(9,751)	6,000	(5,939)	0
Transfer — transmission sales receipt		14,556	(38,201)	12,958	10,687	0
Other receipts			117			117
Total	(34,629)	159,701	(5,674)	19,188	5,329	143,915
Deductions						
Payments-in-aid of construction and administrative costs paid	19,255					19,255
Advance to Intermountain Power Agency	20,981					20,981
Operating expenditures				12,728		12,728
Interest paid	142	151,369				151,511
Interest paid on investment purchases	139	375			267	781
Financing costs paid	539					539
Transfer of investment earnings	(434)	5,407	(5,674)	223	478	0
Other	105					105
Total	40,727	157,151	(5,674)	12,951	745	205,900
Balance at June 30, 1987	$ 18,480	$126,864	$ 0	$ 6,237	$ 4,584	$156,165

This schedule summarizes the receipts and disbursements in funds required under the bond indenture and has been prepared from the trust statements. The balances in the funds consist of cash and investments at original cost. These balances do not include accrued interest receivable of $2,968 and $2,278 at June 30, 1987 and 1986, nor do they include total amortized net investment discounts and premiums of $281 and $1,396 at June 30, 1987 and 1986.

SOUTHERN CALIFORNIA PUBLIC POWER AUTHORITY