COMBINED BALANCE SHEETS

As of April 30, 2006 and 2005 (Thousands)

Assets	2006	2005
UTILITY PLANT		
Plant in service –		
Electric	$ 8,311,459	$ 7,899,197
Irrigation	274,029	267,928
Common	443,533	418,716
Total plant in service	9,029,021	8,585,841
Less – Accumulated depreciation on plant in service	(4,167,664)	(3,925,661)
	4,861,357	4,660,180
Plant held for future use	3,283	3,076
Construction work in progress	309,674	414,626
Nuclear fuel, net	42,156	39,834
	5,216,470	5,117,716
OTHER PROPERTY AND INVESTMENTS		
Non-utility property and other investments	121,313	112,326
Segregated funds, net of current portion	677,652	490,518
	798,965	602,844
CURRENT ASSETS		
Cash and cash equivalents	465,947	288,429
Rate Stabilization Fund	56,892	55,000
Temporary investments	152,604	135,081
Current portion of segregated funds	79,010	131,000
Receivables, net of allowance for doubtful accounts	189,013	220,820
Fuel stocks	28,540	34,583
Materials and supplies	92,543	80,278
Other current assets	62,668	78,659
	1,127,217	1,023,850
DEFERRED CHARGES AND OTHER ASSETS	306,321	322,273
	$ 7,448,973	$ 7,066,683

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

As of April 30, 2006 and 2005 (Thousands)

Capitalization and Liabilities	2006	2005
LONG-TERM DEBT	$ 2,893,017	$ 2,727,348
ACCUMULATED NET REVENUES AND OTHER COMPREHENSIVE INCOME	3,140,862	2,714,561
TOTAL CAPITALIZATION	6,033,879	5,441,909
CURRENT LIABILITIES		
Current portion of long-term debt	131,346	274,778
Accounts payable	162,804	172,001
Accrued taxes and tax equivalents	72,757	68,974
Accrued interest	45,407	44,000
Customers' deposits	65,522	53,547
Other current liabilities	217,409	171,400
	695,245	784,700
DEFERRED CREDITS AND OTHER NON-CURRENT LIABILITIES	719,849	840,074
COMMITMENTS AND CONTINGENCIES (Notes 5,7,8,9,10 and 11)		
	$ 7,448,973	$ 7,066,683

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

COMBINED STATEMENTS OF NET REVENUES AND COMPREHENSIVE INCOME (LOSS)

For the years ended April 30, 2006 and 2005 (Thousands)

	2006	2005
OPERATING REVENUES		
Retail electric	$ 1,885,912	$ 1,709,213
Water	12,036	12,786
Other	624,022	529,724
Total operating revenues	2,521,970	2,251,723
OPERATING EXPENSES		
Power purchased	453,549	358,697
Fuel used in electric generation	605,078	425,880
Other operating expenses	461,367	429,799
Maintenance	205,193	193,489
Depreciation and amortization	313,562	302,198
Taxes and tax equivalents	100,953	105,475
Total operating expenses	2,139,702	1,815,538
Net operating revenues	382,268	436,185
OTHER INCOME (EXPENSES)		
Interest income	53,807	25,241
Gain on sale of available-for-sale securities	97,041	–
Other income (expenses), net	8,118	6,661
Total other income (expenses), net	158,966	31,902
Net revenues before financing costs	541,234	468,087
FINANCING COSTS		
Interest on bonds	117,069	118,229
Capitalized interest	(11,971)	(24,189)
Amortization of bond discount/premium and issuance expenses	(7,932)	(9,642)
Interest on other obligations	28,668	21,239
Net financing costs	125,834	105,637
NET REVENUES	415,400	362,450
OTHER COMPREHENSIVE INCOME (LOSS)	10,901	(29,279)
COMPREHENSIVE INCOME	$ 426,301	$ 333,171

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

COMBINED STATEMENTS OF CASH FLOWS

For the years ended April 30, 2006 and 2005		(Thousands)
	2006	**2005**
CASH FLOWS FROM OPERATING ACTIVITIES		
Net revenues	$ 415,400	$ 362,450
Adjustments to reconcile net revenues to net cash provided by operating activities:		
Depreciation, amortization and accretion	325,274	313,727
Postretirement benefits expense	51,124	43,409
Amortization of provision for loss on long-term contracts	(13,280)	(13,280)
Amortization of net bond discount/premium and issuance expenses	(7,933)	(9,642)
Amortization of spent nuclear fuel storage	1,959	1,826
Loss (gain) on sale of capital assets	(8,124)	(7,610)
Decrease (increase) in:		
Fuel stocks and materials & supplies	(6,222)	(8,729)
Receivables, including unbilled revenues, net	31,807	(43,156)
Other assets	17,320	(50,497)
Increase (decrease) in:		
Accounts payable	(9,197)	45,350
Accrued taxes and tax equivalents	3,783	1,797
Accrued interest	1,407	(1,796)
Current liabilities	57,984	23,289
Deferred credits and other non-current liabilities	(51,098)	41,657
Net cash provided by operating activities	810,204	698,795
CASH FLOWS FROM INVESTING ACTIVITIES		
Additions to utility plant, net	(432,027)	(414,530)
Proceeds from disposition of assets	10,731	23,923
Purchases of investments	(391,162)	(336,822)
Sales and maturities of securities	304,404	202,636
Investment in Rate Stabilization Fund	(1,892)	(55,000)
Proceeds from sale of available-for-sale securities	97,041	–
Decrease (increase) in segregated funds	(262,697)	(80,807)
Net cash used for investing activities	(675,602)	(660,600)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from issuance of revenue bonds	343,844	–
Proceeds from issuance of commercial paper	–	100,000
Repayment of long-term debt, including refundings	(312,144)	(171,334)
Other proceeds from financing activities	11,216	40,606
Net cash used for financing activities	42,916	(30,728)
NET INCREASE IN CASH AND CASH EQUIVALENTS	177,518	7,467
BALANCE AT BEGINNING OF YEAR IN CASH AND CASH EQUIVALENTS	288,429	280,962
BALANCE AT END OF YEAR IN CASH AND CASH EQUIVALENTS	$ 465,947	$ 288,429
SUPPLEMENTAL INFORMATION		
Cash paid for interest (net of capitalized interest)	$ 132,359	$ 117,075
Non-cash financing activities:		
Loss on bond retirement	$ (1,951)	$ –

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

NOTES TO COMBINED FINANCIAL STATEMENTS

April 30, 2006 and 2005

(1) Basis of Presentation:

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

In 1997, the District established a wholly-owned, taxable subsidiary, New West Energy Corporation (New West Energy), to market, at retail, energy available to the District that was surplus to the needs of its retail customers, and energy that might have been rendered surplus in Arizona by retail competition in the supply of generation. However, as a result of the turmoil in the Western energy markets, New West Energy discontinued marketing excess energy in 2001, although it may resume this activity in the future.

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

Principles of Combination – The accompanying combined financial statements reflect the combined accounts of the Association and the District (together referred to as SRP). The District's financial statements are consolidated with its four wholly-owned taxable subsidiaries: New West Energy, SRP Captive Risk Solutions, Limited (CRS), Papago Park Center, Inc. (PPC) and Springerville Four, LLC (Springerville Four). PPC is a real estate management company. CRS is a domestic captive insurer incorporated in January 2004 primarily to access property/boiler and machinery insurance coverage under the Federal Terrorism Risk Insurance Act of 2002 for certified acts of terrorism. Springerville Four is a limited liability company that holds certain rights to construct a fourth unit at Springerville Generating Station. All material inter-company transactions and balances have been eliminated.

Regulation and Pricing Policies – Under Arizona law, the District's publicly elected Board of Directors (the Board) has the authority to establish electric prices. The District is required to follow certain public notice and special Board meeting procedures before implementing any changes in the standard electric price plans.

(2) Significant Accounting Policies:

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

By virtue of SRP operating a federal reclamation project under contract, with the federal government's pre-emptive rights, asset ownership and certain approval rights, SRP is considered for financial reporting purposes to follow accounting standards as set forth by the Federal Accounting Standards Advisory Board (FASAB). Entities reporting in accordance with the standards issued by the Financial Accounting Standards Board (FASB) prior to October 19, 1999 (the date the American Institute of Certified Public Accountants (AICPA) designated the FASAB as the accounting standard setting body for entities under the federal government) are permitted to continue to report in accordance with those standards. Consequently, SRP's financial statements are reported in accordance with FASB standards.

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

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

Composite rates of 4.51% and 4.42% were used in fiscal years 2006 and 2005 to calculate interest on funds used to finance construction work in progress, resulting in $12.0 million and $24.2 million of interest capitalized, respectively.

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

	2006	2005
Average electric depreciation rate	3.51%	3.49%
Average irrigation depreciation rate	2.07%	2.44%
Average common depreciation rate	5.36%	5.52%

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

Allowance for Doubtful Accounts – The District has provided for an allowance for doubtful accounts of $12.7 million and $16.7 million as of April 30, 2006 and 2005, respectively.

Nuclear Fuel – The District amortizes the cost of nuclear fuel using the units of production method. The nuclear fuel amortization and the disposal expense are components of fuel expense. Accumulated amortization of nuclear fuel at April 30, 2006 and 2005 was $389.1 million and $373.4 million, respectively.

Asset Retirement Obligation –The District adopted Statement of Financial Accounting Standards No. 143, "Accounting for Asset Retirement Obligations" (SFAS No. 143), on May 1, 2003. SFAS No. 143 requires the recognition and measurement of liabilities for legal obligations associated with the retirement of tangible long-lived assets. Under the standard, these liabilities are recognized at fair value as incurred and capitalized as part of the cost of the related tangible long-lived assets. Accretion of the liabilities, due to the passage of time, is an operating expense and the capitalized cost is depreciated over the useful life of the long-lived asset. Retirement obligations associated with long-lived assets included within the scope of SFAS No. 143 are those for which a legal obligation exists under enacted laws, statutes, and written or oral contracts, including obligations arising under the doctrine of promissory estoppel.

The District adopted FASB Interpretation No. 47 (FIN 47), on April 30, 2006. FIN 47 clarifies the meaning of conditional asset retirement obligations under SFAS No. 143, and provides further clarification of when sufficient information is available to provide a reasonable retirement obligation estimate. The District has evaluated existing asset retirement obligations as provided for under this new guidance and has determined that the liabilities recorded are sufficient at this time.

The District has identified retirement obligations for the Palo Verde Nuclear Generating Station (PVNGS), Navajo Generating Station (NGS), Four Corners Generating Station (Four Corners) and certain other assets. Amounts recorded under SFAS No. 143, are subject to various assumptions and determinations, such as determining whether an obligation exists to remove assets, estimating the fair value of the costs of removal, estimating when final removal will occur, and determining the credit-adjusted, risk-free interest rates to be utilized on discounting future liabilities. Changes that may arise over time with regard to these assumptions and determinations will change amounts recorded in the future as expense for asset retirement obligations.

A summary of the asset retirement obligation activity of the District for the year ended April 30, 2006, is included below (in millions):

Balance, May 1, 2005	$	198.5
Liabilities incurred		(26.2)
Accretion expense		11.7
Balance, April 30, 2006	$	184.0

In accordance with regulations of the Nuclear Regulatory Commission, the District maintains a trust for the decommissioning of PVNGS. Decommissioning funds of $172.8 million and $150.1 million, stated at market value, as of April 30, 2006 and 2005, respectively, are held in the trust and are classified as segregated funds in the accompanying Combined Balance Sheets. Unrealized gains on decommissioning fund assets of $5.6 million and $33.5 million at April 30, 2006 and 2005, respectively, are included in deferred credits and other non-current liabilities in the accompanying Combined Balance Sheets.

Accounting for Energy Risk Management Activities – The District has an energy risk management program to limit exposure to risks inherent in normal energy business operations. The goal of the energy risk management program is to measure and minimize exposure to market risks, credit risks and operational risks. Specific goals of the energy risk management program include reducing the impact of market fluctuations on energy commodity prices associated with customer energy requirements, excess generation and fuel expenses, in addition to meeting customer pricing needs, and maximizing the value of physical generating assets. The District employs established policies and procedures to meet the goals of the energy risk management program using various physical and financial instruments, including forward contracts, futures, swaps and options.

Certain of these transactions are accounted for under Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended (SFAS No. 133). Under SFAS No. 133, derivatives are recorded in the balance sheet as either an asset or liability measured at their fair value. The standard also requires changes in the fair value of the derivative be recognized each period in current earnings or other comprehensive income depending on the purpose for using the derivative and/or its qualification, designation and effectiveness as a hedging transaction. Many of the District's contractual agreements qualify for the normal purchases and sales exception allowed under SFAS No. 133 and are not recorded at market value. (For further explanation of the effects of SFAS No. 133 on the District's financial results, see Note (3) Accounting for Derivative Instruments and Hedging Activities.)

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

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

The District has four wholly-owned taxable subsidiaries: New West Energy, CRS, PPC and Springerville Four. The tax effect of these subsidiaries' operations on the Combined Financial Statements is immaterial.

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

Rate Stabilization Fund – In April 2005, the District transferred $55 million into the Rate Stabilization Fund (RSF) to be used in concert with the Fuel and Purchased Power Adjustment Mechanism (FPPAM) to cover fuel related expenses and to stabilize future prices related to fuel, as well as for any other purposes required or permitted by the Board's Supplemental Resolution dated September 10, 2001 authorizing an Amended and Restated Resolution Concerning Revenue Bonds (Bond Resolution), during fiscal years 2006 and 2007. A special Board

meeting was held on March 30, 2006, at which the Board approved the transfer of the $55 million, plus interest earnings back to the General Fund on May 1, 2006 to help cover undercollected fuel costs, thereby reducing the need for an upward increase in the FPPAM. (See Note (9) Regulatory Issues, The Changing Regulatory Environment, for additional information on the FPPAM.)

Revenue Recognition – The District recognizes revenue when billed and accrues estimated revenue for electricity delivered to customers that has not yet been billed. Other operating revenue consists primarily of revenue from marketing and trading electricity.

Materials and Supplies, and Fuel Stocks – Materials and supplies are stated at lower of market or average cost. Fuel stocks are stated at lower of market or weighted average cost.

Reclassifications – For comparative purposes, certain prior year amounts have been reclassified to conform to the current year presentation. The reclassifications had no impact on net revenues or cash flows.

Recently Issued Accounting Standards – FASB has issued the following Statement of Financial Accounting Standards (SFAS), Staff Positions (FSP), and Interpretations (FIN) that may have financial impacts on the District:

FIN No. 47, "Accounting for Conditional Asset Retirement Obligations," clarifies the meaning of conditional asset retirement obligations under SFAS No. 143, and provides further clarification of when sufficient information is available to provide a reasonable retirement obligation estimate. The District adopted FIN No. 47 on April 30, 2006, and has evaluated existing asset retirement obligations as provided for under this new guidance and determined that the liabilities recorded are sufficient.

(3) Accounting for Derivative Instruments and Hedging Activities:

The District follows SFAS No. 133, as amended, which requires that entities recognize all derivatives as either assets or liabilities in the balance sheet and measure those instruments at fair value. Changes in the fair value of derivative financial instruments are either recognized periodically in net revenues or accumulated net revenues (as a component of other comprehensive income), depending on whether or not the derivative meets specific hedge accounting criteria. The criteria include a requirement for hedge effectiveness, which is measured based on the relative changes in fair value between the derivative contract and the hedged item over time. Changes in the fair value resulting from ineffectiveness are recognized immediately in net revenues.

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

The District formally documents all relationships between hedging instruments and hedged items, as well as its risk-management objective and strategy for undertaking various hedge transactions. This process includes linking all derivatives to the forecasted transactions. The District also formally assesses (both at the hedge's inception and on an ongoing basis) whether the derivatives used in hedging transactions have been effective in offsetting changes in cash flow of hedged items and whether those derivatives may be expected to remain effective in future periods. When it is determined that a derivative is not (or has ceased to be) effective as a hedge, the District discontinues hedge accounting prospectively, as discussed below.

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

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

As of April 30, 2006 and 2005, the valuation of the District's energy risk-management contracts resulted in an increase (decrease) in electric revenues of $9.0 million and ($4.9) million, respectively, and an increase (decrease) in fuel expenses of $33.5 million and ($40.1) million, respectively. The impact to combined net revenues for fiscal years 2006 and 2005 was an unrealized gain (loss) of ($24.5) million and $35.2 million, respectively. Accumulated net revenues and other comprehensive income (as a component of other comprehensive income) were unchanged as of April 30, 2006 and April 30, 2005. The following table summarizes the District's derivative-related assets and liabilities at April 30 (in thousands):

	2006	2005
Other current assets	$ 45,901	$ 65,485
Deferred charges and other assets	50,323	65,915
Other current liabilities	(63,937)	(37,900)
Deferred credits and other non-current liabilities	(38,976)	(82,398)
Net asset	$ (6,689)	$ 11,102

The electric industry engages in an activity called "book-out," under which some energy purchases are netted against sales, and power does not actually flow in settlement of the contract. As a result of these transactions, the District nets the impacts of these financially settled contracts, which reduced revenues and purchase power expense by $290.5 million and $142.7 million for fiscal years 2006 and 2005, respectively, but which did not impact net revenues or cash flows.

(4) Accumulated Net Revenues and Other Comprehensive Income:

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

	Accumulated Net Revenues	Accumulated Other Comprehensive Income (Loss)	Accumulated Net Revenues And Other Comprehensive Income
BALANCE, April 30, 2004	$ 2,424,476	$ (43,086)	$ 2,381,390
Net revenues	362,450	–	362,450
Minimum pension liability	–	(35,300)	(35,300)
Net unrealized gain on available-for-sale securities	–	6,021	6,021
BALANCE, April 30, 2005	$ 2,786,926	$ (72,365)	$ 2,714,561
Net revenues	415,400	–	415,400
Minimum pension liability	–	41,400	41,400
Reclassification of realized gain to income	–	(55,162)	(55,162)
Net unrealized gain on available-for-sale securities	–	24,663	24,663
BALANCE, April 30, 2006	$ 3,202,326	$ (61,464)	$ 3,140,862

The majority of net unrealized gain on available-for-sale securities originates from segregated fund investments. Net unrealized gain on available-for-sale securities consists of gross unrealized gain on equity funds of $28.7 million and $6.0 million, and gross unrealized gain (loss) on debt funds of ($4.1) million and ($0.02) million, at April 30, 2006 and 2005, respectively. Accumulated Other Comprehensive Income (Loss) consists of minimum pension liability of ($73,300) and ($114,700), and net unrealized gain on available-for-sale securities of $11,836 and $42,335, at April 30, 2006 and 2005, respectively.

(5) Long-Term Debt:

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

	Interest Rate	2006	2005
Revenue bonds (mature through 2035)	4.0 - 6.0%	$ 2,213,584	$ 2,204,217
Unamortized bond (discount) premium		53,099	40,229
Total revenue bonds outstanding		2,266,683	2,244,446
Finance lease	2.0 - 5.3%	282,680	282,680
Commercial paper	3.1 - 3.8%	475,000	475,000
Total long term debt		3,024,363	3,002,126
Less current portion		(131,346)	(274,778)
Total long-term debt, net of current portion		$ 2,893,017	$ 2,727,348

The annual maturities of long-term debt (excluding commercial paper and unamortized bond discount/premium) as of April 30, 2006, due in fiscal years ending April 30, are as follows (in thousands):

Calendar Year	Revenue Bonds	Finance Lease
2006	$ –	$ 16,300
2007	115,046	16,015
2008	136,023	17,780
2009	153,205	16,790
2010	115,855	19,950
2011	108,480	17,455
Thereafter	1,584,975	178,390
	$ 2,213,584	$ 282,680

Revenue Bonds – Revenue bonds are secured by a pledge of, and a lien on, the revenues of the electric system, after deducting operating expenses, as defined in the Bond Resolution. Under the terms of the amended and restated Bond Resolution, effective in January 2003, the District is no longer required to make monthly deposits to an externally trusteed debt service fund for the payment of future principal and interest. However, the District is continuing to make debt service deposits to a non-trusteed segregated fund. Included in segregated funds in the accompanying Combined Balance Sheets are $146.7 million and $198.7 million of debt service related funds as of April 30, 2006 and 2005, respectively.

The District has $49.9 million of mini-revenue bonds outstanding, which are redeemable at the option of the bondholder under certain circumstances. Based on historical redemptions made on these bonds, management believes there are sufficient funds available to cover potential redemptions in any year.

The debt service coverage ratio, as defined in the Bond Resolution, is used by bond rating agencies to help evaluate the financial viability of the District. For the years ended April 30, 2006 and 2005, the debt service coverage ratio was 2.42 and 2.39, respectively.

Interest and the amortization of the bond discount, premium and issue expense on the various issues results in an effective rate of 4.95% over the remaining term of the bonds.

The District has authorization to issue additional Electric System Revenue Bonds totaling $722 million principal amount and Electric System Refunding Revenue Bonds totaling $2.9 billion principal amount.

In September 2005, the District issued $327.1 million Electric System Revenue Bonds. About $301.9 million of the net proceeds from these bonds are being used to fund distribution capital requirements and $43.7 million of the net proceeds were used to retire outstanding revenue bonds with an aggregate par amount of $41.0 million. The bond retirement is expected to reduce total debt payments over the life of the bonds by $5.2 million and is expected to result in present value savings of approximately $2.6 million. This transaction resulted in a net loss for accounting purposes of approximately $2.0 million, which was deferred and will be amortized over the life of the bonds to be refunded.

Finance Lease – In December 2003, the District entered into a lease-purchase agreement (Desert Basin Lease-Purchase Agreement) with Desert Basin Independent Trust (DBIT) to finance the acquisition of the Desert Basin Generating Station (Desert Basin) located in Central Arizona. In a concurrent transaction, $282.7 million in fixed-rate Certificates of Participation (COPs) were issued pursuant to a Trust Indenture, between Wilmington Trust Company, as trustee, and DBIT, to fund the acquisition of Desert Basin and other electric system assets of the District. Investors in the COPs obtained an interest in the lease payments made by the District to DBIT under the Desert Basin Lease-Purchase Agreement. Due to the nature of the Desert Basin Lease-Purchase Agreement, the District has recorded a lease-finance liability to DBIT with the same terms as the COPs.

In connection with the issuance of the COPs, the District entered into an interest rate swap transaction with Morgan Stanley Capital Services. This transaction consisted of a 6-year, $75 million fixed-to-floating swap (annual $25 million notional maturities expiring on December 1, 2007 through 2009, respectively) versus the Bond Market Association (BMA) Municipal Index. The fixed-receiver rate on the swap is 3.001%. Through the swap, the District was able to create synthetic variable rate debt and take advantage of the relationship between intermediate-term, tax-exempt borrowing costs and BMA-based, fixed-receiver swap rates. In addition, the swap to variable rate also enables the District to increase its short-term, variable rate debt portfolio. The interest rate swap is accounted for as a derivative and qualifies for hedge accounting. (For further explanation of the effects of SFAS No. 133 on the District's financial results see Note (3) Accounting for Derivative Instruments and Hedging Activities.)

Commercial Paper – The District has outstanding $475.0 million of commercial paper consisting of $375.0 million Series B Commercial Paper and $100.0 million Series C Commercial Paper. The issues have an average weighted interest rate to the District of 3.34%.

The commercial paper matures not more than 270 days from the date of issuance and is an unsecured obligation of the District. The District has the ability to refinance the outstanding commercial paper on a long-term basis in connection with its revolving line of credit that supports the commercial paper and is available through December 7, 2009. As such, the District has classified the commercial paper as long-term debt in the Combined Balance Sheets as of April 30, 2006.

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

Line-of-Credit Agreements – The District has a $475.0 million revolving line-of-credit agreement that supports the $475.0 million commercial paper program. The agreement has various covenants, with which management believes the District was in compliance at April 30, 2006.

(6) Fair Value of Financial Instruments:

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

Investments in Marketable Securities – The District invests in U.S. government obligations, certificates of deposit and other marketable investments. Such investments are classified as other investments, segregated funds, cash and cash equivalents or temporary investments in the accompanying Combined Balance Sheets depending on the purpose and duration of the investment. The fair value of marketable securities with original maturities greater than one year is based on published market data. The carrying amount of marketable securities with original maturities of one year or less approximates their fair value because of their short-term maturities.

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

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

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

	2006		2005	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Investments in marketable securities:				
Other investments	$ 45,000	$ 44,490	$ 35,765	$ 35,406
Segregated funds	$ 756,662	$ 755,957	$ 621,518	$ 622,100
Rate Stabilization Fund	$ 56,892	$ 56,892	$ 55,000	$ 55,000
Temporary investments	$ 152,604	$ 152,217	$ 135,081	$ 134,822
Long-term debt	$ 3,024,363	$ 3,054,834	$ 3,002,126	$ 3,143,934

Accounting for Debt and Equity Securities – The District's investments in debt securities are reported at amortized cost if the intent is to hold the security to maturity. At April 30, 2006, the District's investments in debt securities have maturity dates ranging from May 2, 2006 to February 28, 2012. Other debt and equity securities are reported at market, with unrealized gains or losses included as a separate component of Accumulated Net Revenues and Other Comprehensive Income. The District's investments in debt and equity securities are included in temporary investments, segregated funds and non-utility property and other investments in the accompanying Combined Balance Sheets.

(7) Employee Benefit Plans and Incentive Programs:

Defined Benefit Pension Plan and Other Postretirement Benefits – SRP's Employees' Retirement Plan (the Plan) covers substantially all employees. The Plan is funded entirely from SRP contributions and the income earned on invested Plan assets. The District made a contribution of $60.0 million and $75.0 million in fiscal years 2006 and 2005, respectively.

SRP provides a non-contributory defined benefit medical plan for retired employees and their eligible dependents (contributory for employees hired January 1, 2000 or later) and a non-contributory defined benefit life insurance plan for retired employees. Employees are eligible for coverage if they retire at age 65 or older with at least five years of vested service under the Plan (ten years for those hired January 1, 2000 or later), or any time after attainment of age 55 with a minimum of ten years of vested service under the Plan (20 years for those hired January 1, 2000 or later). The funding policy is discretionary and is based on actuarial determinations. The unrecognized transition obligation is being amortized over 20 years, beginning in 1994.

The following tables outline changes in benefit obligations, Plan assets, the funded status of the plans and amounts included in the Combined Financial Statements as of April 30, based on January 31 valuation dates (in thousands):

	Pension Benefits		Postretirement Benefits	
	2006	**2005**	**2006**	**2005**
Change in benefits obligation:				
Benefit obligation at beginning of year	$ 1,017,000	$ 889,000	$ 442,200	$ 392,700
Service cost	31,800	27,100	11,300	8,800
Interest cost	57,500	54,600	25,100	22,500
Amendments	–	–	200	–
Actuarial loss	24,500	82,200	45,600	30,400
Benefits paid	(34,100)	(35,900)	(13,700)	(12,200)
Benefit obligations at end of year	$ 1,096,700	$ 1,017,000	$ 510,700	$ 442,200

	Pension Benefits		Postretirement Benefits	
	2006	2005	2006	2005
Change in Plan assets:				
Fair value of Plan assets at beginning of year	$ 795,300	$ 670,000	$ –	$ –
Actual return on Plan assets	107,700	76,200	–	–
Employer contributions	60,000	85,000	13,600	12,200
Benefits paid	(34,100)	(35,900)	(13,600)	(12,200)
Fair value of Plan assets at end of year	$ 928,900	$ 795,300	$ –	$ –
Funded status	$ (167,800)	$ (221,700)	$ (510,700)	$ (442,200)
Unrecognized transition obligation	–	–	21,800	32,900
Unrecognized net actuarial loss	239,200	270,200	219,200	184,600
Unrecognized prior service cost	18,000	20,300	7,600	500
Post January 31 contributions	–	–	3,800	3,100
Net asset (liability) recognized	$ 89,400	$ 68,800	$ (258,300)	$ (221,100)
Amounts recognized in Combined Balance Sheets:				
Prepaid benefit cost	$ 89,400	$ 68,800	$ –	$ –
Additional minimum liability	(91,300)	(135,000)	–	–
Net additional minimum liability	(1,900)	(66,200)	–	–
Accrued benefit liability	–	–	(258,300)	(221,100)
Intangible asset	18,000	20,300	–	–
Accumulated other comprehensive income	73,300	114,700	–	–
Net asset (liability) recognized	$ 89,400	$ 68,800	$ (258,300)	$ (221,100)

The following table outlines the projected benefit obligation and accumulated benefit obligation in excess of Plan assets as of April 30, based on January 31 valuation dates (in thousands):

	2006	2005
Projected benefit obligation	$ 1,096,700	$ 1,017,000
Accumulated benefit obligation	$ 930,800	$ 861,500
Fair value of Plan assets	$ 928,900	$ 795,300

The District internally funds its other postretirement benefits obligation. At April 30, 2006 and 2005, $339.5 million and $253.9 million of segregated funds, respectively, were designated for this purpose.

The weighted average assumptions used to calculate actuarial present values of benefit obligations at April 30 were as follows:

	Pension Benefits		Postretirement Benefits	
	2006	2005	2006	2005
Discount rate	5.75%	5.75%	5.75%	5.75%
Rate of compensation increase	4.0%	4.0%	4.0%	4.0%

Weighted average assumptions used to calculate net periodic benefit costs were as follows:

	Pension Benefits		Postretirement Benefits	
	2006	2005	2006	2005
Discount rate	5.75%	6.25%	5.75%	6.25%
Expected return on Plan assets	8.25%	7.75%	N/A	N/A
Rate of compensation increase	4.0%	4.0%	4.0%	4.0%

For employees who retire at age 65 or younger, for measurement purposes, a 9% annual increase before attainment of age 65 and an 11% annual increase on and after attainment of age 65 in per capita costs of health care benefits were assumed during 2006; these rates were assumed to decrease uniformly until equaling 5.0% in all future years.

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

	Pension Benefits		Postretirement Benefits	
	2006	2005	2006	2005
Service cost	$ 31,800	$ 27,100	$ 11,300	$ 8,800
Interest cost	57,500	54,600	25,100	22,500
Expected return on Plan assets	(66,400)	(57,000)	–	–
Amortization of transition obligation	–	–	4,100	4,100
Recognized net actuarial loss	14,200	7,600	11,000	7,800
Amortization of prior service cost	2,300	2,500	100	100
Net periodic benefit cost	$ 39,400	$ 34,800	$ 51,600	$ 43,300

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

	One Percentage-Point Increase	One Percentage-Point Decrease
Effect on total service cost and interest cost components	$ 6,000	$ (5,300)
Effect on postretirement benefit obligation	$ 75,600	$ (67,000)

Plan Assets – The Board has established an investment policy for Plan assets and has delegated oversight of such assets to a compensation committee (the Committee). The investment policy sets forth the objective of providing for future pension benefits by targeting returns consistent with a stated tolerance of risk. The investment policy is based on analysis of the characteristics of the Plan sponsors, actuarial factors, current Plan condition, liquidity needs, and legal requirements. The primary investment strategies are diversification of assets, stated asset allocation targets and ranges, and external management of Plan assets. The Committee determines the overall target asset allocation ratio for the Plan and defines the target asset allocation ratio deemed most appropriate for the needs of the Plan and the risk tolerance of the District.

The Plan's weighted-average asset allocations at April 30, based on January 31 valuations, are as follows:

	Target Allocations	2006	2005
Equity securities	65.0%	66.0%	65.8%
Debt securities	25.0%	25.3%	25.2%
Real estate	10.0%	8.7%	9.0%
Total	100.0%	100.0%	100.0%

The investment policy allows for a tolerance range of plus or minus 5% from the stated target asset allocation.

Long-Term Rate of Return – The expected return on Plan assets is based on a review of the Plan asset allocations and consultations with a third-party investment consultant and the Plan actuary, considering market and economic indicators, historical market returns, correlations and volatility, and recent professional or academic research. As history has demonstrated, markets may decline and increase dramatically; however, the expected rate of return on the Plan assets is reasonable given its asset allocation in relation to historical and expected future performance.

Employer Contributions – The District expects to contribute $70 million to the Plan over the next valuation period.

Benefits Payments – The District expects to pay benefits in the amounts as follows (in thousands):

2007	$ 37,820
2008	$ 40,271
2009	$ 43,573
2010	$ 47,383
2011	$ 51,154
2012 through 2016	$ 315,556

Defined Contribution Plan – SRP's Employees' 401(k) Plan (the 401(k) Plan) covers substantially all employees. The 401(k) Plan receives employee pre-tax and post-tax contributions and partial employer matching contributions. Employer matching contributions to the 401(k) Plan were $11.2 million and $9.7 million during fiscal years 2006 and 2005, respectively.

Employee Incentive Compensation Program – SRP has an incentive compensation program covering substantially all regular employees. The incentive compensation amount is based on achievement of pre-established targets. An accrual of $28.6 million and $26.4 million for fiscal years ended April 30, 2006 and 2005, respectively, is included in other current liabilities in the accompanying Combined Balance Sheets. This liability is stated net of receivables from participants in jointly owned electric plants of $2.7 million and $2.7 million at April 30, 2006 and 2005, respectively.

(8) Interests in Jointly Owned Electric Utility Plants:

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

The following table reflects the District's ownership interest in jointly owned electric utility plants as of April 30, 2006 (in thousands):

Generating Station	Ownership Share	Plant in Service	Accumulated Depreciation	Construction Work In Progress
Four Corners (NM) (Units 4 & 5)	10.00%	$ 105,554	$ (94,064)	$ 4,694
Mohave (NV) (Units 1 & 2)	20.00%	131,804	(129,263)	–
NGS (AZ) (Units 1, 2 & 3)	21.70%	348,066	(271,056)	10,658
Hayden (CO) (Unit 2)	50.00%	116,089	(84,639)	1,059
Craig (CO) (Units 1 & 2)	29.00%	267,561	(163,919)	1,631
PVNGS (AZ) (Units 1, 2 & 3)	17.49%	1,252,081	(877,354)	28,714
		$ 2,221,155	$ (1,620,295)	$ 46,756

The Mohave Generating Station (Mohave) ceased operations on December 31, 2005, pending installation of new environmental controls and resolution of other operating issues. (See Note (9), Regulatory Issues, Mohave Generating Station, for a discussion of matters pertaining to Mohave.) There remains approximately $2.5 million in net plant value at Mohave for the Switchyard and Transmission Line still used to route power to other inter-tied systems.

(9) Regulatory Issues:

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

Similarly, in 1999, the Arizona Corporation Commission (the Commission), which regulates public service corporations, approved final rules for retail electric competition.

While retail competition was available to all customers by 2001, there were only a few customers who chose an alternative energy provider. Those customers have since returned to their incumbent utilities. At this time, there is no active retail competition within the District's service territory or, to the knowledge of the District, within the State of Arizona.

As provided for in the Act, the District assessed a temporary surcharge on electric distribution service prices to pay for all or a portion of unmitigated stranded costs of electric generation service incurred as a direct result of the onset of competition. The Act required that such costs, in order to be recovered, must have been incurred to serve customers in Arizona before December 26, 1996, and that the surcharge must not have caused prices to exceed the prices that were in effect on December 30, 1998. Effective June 1, 2004, the District ceased collection of this surcharge.

In January 2004, the Arizona Court of Appeals found numerous provisions of the Commission's retail electric competition rules to be invalid. Specifically, the court concluded that the Certificates of Convenience and Necessity awarded by the Commission to fifteen competitive electric service providers were invalid due to the Commission's failure to determine the fair value of the utility's Arizona property in setting rates. Other rules affected included the requirement to create an independent scheduling administrator and billing and collection practices. At this time, the Commission has taken no action to modify its electric competition rules to address the ruling of the Court of Appeals.

In 1996, the Federal Energy Regulatory Commission (FERC), which regulates the wholesale electric utility industry under the authority of various statutes, issued Orders 888 and 889 requiring transmitting "public utilities" (as defined in the Federal Power Act), to provide nondiscriminatory transmission services to entities seeking to effect wholesale power transactions, and to grant equal access to information concerning the pricing and availability of transmission services. The District is not a public utility under the Federal Power Act but historically has complied with these requirements voluntarily. The Energy Policy Act of 2005 (the "Energy Policy Act") expanded FERC jurisdiction by granting FERC discretionary authority to regulate the non-rate terms and conditions, and to a lesser extent, rates, under which unregulated transmitting utilities (including the District) provide wholesale transmission services. The Energy Policy Act explicitly prohibits FERC from requiring unregulated transmitting utilities to take actions that would violate a private activity bond rule. The extent to which FERC will exercise its authority over unregulated transmitting utilities is unknown at this time. However, FERC has initiated a number of regulatory actions that could affect the District's transmission and wholesale sales activities including a Notice of Proposed Rule-Making to revise and update Order 888. The District is monitoring these actions but does not expect them to result in significant adverse impacts on its operations.

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

The District's price plans have been unbundled since 1999. In May 2002, the District implemented a Fuel & Purchased Power Adjustment Mechanism (FPPAM) to allow for semi-annual rate adjustments to recover increases in actual fuel costs. The District has had several increases in the price of fuel and purchased power since the FPPAM was implemented. (See Note (2) Significant Accounting Policies, Rate Stabilization Fund, for additional information.) In June 2004, the District introduced a Transmission Cost Adjustment Factor (TCAF) to recover costs the District would incur if the District were required to participate in regional transmission organizations. To date, no costs have been incurred or recovered through the TCAF.

On October 3, 2005 the District Board approved a 2.9% system average price increase beginning November 1, 2005. The increase was needed to help fund a portion of the Capital Improvement Program. The increase is expected to generate annual revenues of $55.8 million.

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

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

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

Mohave Generating Station – The District and the other Participants in Mohave entered into a settlement with the Sierra Club, the Grand Canyon Trust, and the National Parks Conservation Association, that required the installation of certain pollution abatement equipment by the end of 2005 to continue operating as a coal-fired electric generating facility. (See Note (11) Contingencies, Air Quality, for additional information on air quality issues.) In addition, the initial term of the agreement with Peabody Western Coal Company (Peabody) to supply coal to Mohave expired at the end of 2005 and the Hopi Tribe demanded that the pumping of water from the Navajo Aquifer for the slurry pipeline serving Mohave cease. The Mohave Participants have refused to commit to install pollution abatement equipment without reasonable assurance that water will be available to enable the delivery of coal to the plant. Consequently, the plant suspended operations at the end of 2005. The Mohave Participants, the Navajo Nation, the Hopi Tribe and Peabody have been participating in mediation for the right to use an alternative source of water for the mine and the slurry pipeline and to resolve other pending issues. However, Southern California Edison Company (SCE), operating agent for Mohave, has advised the District that it does not intend to proceed with efforts to extend the life of Mohave. The District will evaluate the impact, if any, of SCE's recent decision on the District's effort to extend Mohave operations. (See Note (11), Contingencies, Black Mesa Litigation, for a discussion of other related issues.) The District has included approximately $211.3 million in its Capital Improvement

Program to cover the costs of such equipment or alternate resources, if necessary. Although the parties have been trying to reach a settlement, it is not certain if, and when, a resolution will be reached. The District has already replaced a portion of the energy and is considering several options for replacing the balance of the capacity if Mohave is not reopened.

If the negotiations are not successful and the Mohave Participants are unable to secure reasonable terms for the supply of coal and water, the Board authorized the recovery of the balance of the District's investment in Mohave in its revenue requirements prior to the closure of the plant. Consequently, it was determined that the plant's carrying value would not be realized through future revenues and a write-down of its carrying value of $66.2 million was recorded in fiscal year 2003, and an additional $5.2 million and $6.6 million of impairment was recorded in fiscal years 2005 and 2004, respectively. In accordance with accounting standards for rate-regulated enterprises (SFAS No. 71), a regulatory asset was established for $78.0 million, based on the District's expectation that any un-recovered book value at the end of 2005 would be recovered in future rates.

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

	2006	2005
Bond defeasance regulatory asset	$ 90,818	$ 93,023
Mohave Generating Station regulatory asset	75,406	78,006
Spent nuclear fuel storage regulatory asset	21,842	22,210
Derivatives market valuation	50,323	65,915
Pension intangible asset	18,001	20,300
Other	49,931	42,819
	$ 306,321	$ 322,273

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

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

	2006	2005
Asset retirement obligation	$ 183,965	$ 198,450
Accrued postretirement benefit liability	258,065	221,100
Additional pension minimum liability	1,890	66,200
Accrued decommissioning costs	5,597	33,527
Provision for contract losses	66,339	79,619
Derivatives market valuation	38,976	82,398
Accrued spent nuclear fuel storage	24,245	24,486
Accrued environmental issues	78,511	76,959
Other	62,261	57,335
	$ 719,849	$ 840,074

(10) Commitments:

Subsidiary Guarantees – The District acts as guarantor for New West Energy's contractual obligations as necessary to satisfy performance security requirements under agreements with utility distribution companies, brokers and counterparties for financial hedge transactions and power purchasers and sellers. No payments were made under these guarantees during fiscal years 2006 and 2005. Existing guarantees were terminated May 31, 2003, and New West Energy has not entered into any agreements since then.

Improvement Program – The Improvement Program represents the District's six-year plan for major construction projects and capital expenditures for existing generation, transmission, distribution and irrigation assets. For the 2007-2012 time period, the District estimates capital expenditures of approximately $5.0 billion. Major construction projects include construction of an additional unit at Springerville Generating Station, final completion of the Santan Generating Station, a new transmission line in the Southeast Valley, and other key generation, distribution and transmission projects.

Long-Term Power Contracts – The District entered into three contracts, collectively, with the United States Bureau of Reclamation (United States), the Western Area Power Administration and the Central Arizona Water Conservation District (CAWCD) for the long-term sale, through September 2011, of power and energy associated with the United States' entitlement to NGS. The amount of energy available to the District varies annually and is expected to decline over the life of the contracts. The District pays a fixed amount under the contracts, pays the cost of NGS generation and other related costs, and supplies energy at cost to CAWCD for Central Arizona Project facilities. The fixed portion of the District's payment obligations under the three contracts totals $47.0 million annually through fiscal year 2011, and $19.6 million thereafter. Of the total obligation, $25.2 million annually through fiscal year 2011 and $10.5 million thereafter are unconditionally payable regardless of the availability of power. Payments under these contracts totaled $91.5 million and $86.3 million in fiscal years 2006 and 2005, respectively.

The District entered into two other long-term power purchase agreements to obtain a portion of its projected load requirements through 2011. Minimum payments under these contracts are $38.2 million annually through fiscal year 2011 and $1.9 million thereafter. Total payments under these two contracts, including the minimum payments, were $68.4 million and $66.4 million in fiscal years 2006 and 2005, respectively. In conjunction with the impairment analysis performed on generation-related operations, the District has recorded provisions for losses on these contracts. The provisions recorded in August 1998, of $163.7 million, are being amortized over the life of the contracts, commencing January 1, 1999. Amortization of $13.3 million has been reflected as a reduction in purchased power expense in fiscal years 2006 and 2005. The remaining liability at April 30, 2006 of $66.3 million is included in deferred credits and other non-current liabilities in the Combined Balance Sheets.

In addition, beginning in the summer of 2006, the District will have 100 MW of capacity from Springerville Generating Station Unit 3, being developed by Tri-State Generation and Transmission Association, pursuant to a 30-year power purchase agreement.

Fuel Supply – At April 30, 2006, minimum payments under long-term coal supply contract commitments are estimated to be $173.2 million in fiscal year 2007, $161.3 million in fiscal year 2008, $161.3 million in fiscal year 2009, $161.3 million in fiscal year 2010, $162.3 million in fiscal year 2011 and $539.1 million thereafter.

Springerville Generating Station – In 2001 the District entered into an agreement with UniSource Energy Development Company (UniSource) for the joint development of two additional coal-fired generating units (Units 3 and 4), approximately 400 MW each in size, to be located at the existing Springerville (Arizona) Generating Station. Under an amendment to the agreement, dated October 20, 2003, the District entered into a 30-year power purchase agreement (the PPA) to purchase 100 MW of capacity from Unit 3, which is being developed by Tri-State Generation and Transmission Association, Inc. Unit 3 is anticipated to be placed in service in July 2006. In addition, the District received the right to construct the fourth unit (Unit 4) at any time during the term of the PPA. The District holds such rights in its wholly-owned subsidiary, Springerville Four. The District has determined to build Unit 4 and expects it to be in service by the end of calendar year 2009. Construction plans and financing have not been finalized yet. UniSource's affiliate, Tucson Electric Power Company, will operate both units.

(11) Contingencies:

Nuclear Insurance – Under existing law, public liability claims arising from a single nuclear incident are limited to $10.8 billion. PVNGS Participants insure for this potential liability through commercial insurance carriers to the maximum amount available ($300.0 million) with the balance covered by an industry-wide retrospective assessment program as required by the Price-Anderson Act. If losses at any nuclear power plant exceed available commercial insurance, the District could be assessed retrospective premium adjustments. The maximum assessment per reactor per nuclear incident under the retrospective program is $100.6 million including a 5% surcharge, applicable in certain circumstances, but not more than $15.0 million per reactor may be charged in any one year for each incident.

Based on the District's ownership share of PVNGS, the maximum potential assessment would be $52.8 million, including the 5% surcharge, but would be limited to $7.9 million per incident in any one year.

Spent Nuclear Fuel – Under the Nuclear Waste Policy Act of 1982, the District pays $0.001 per kWh on its share of net energy generation at PVNGS to the U. S. Department of Energy (DOE). The DOE was responsible for the selection and development of repositories for permanent storage and disposal of spent nuclear fuel not later than December 31, 1998. Because of the significant delays in the DOE's schedule, it cannot be determined when the DOE will accept waste from PVNGS or from the other owners of spent nuclear fuel. It is unlikely, due to PVNGS' position in DOE's queue for receiving spent fuel, that Arizona Public Service Company (APS), the operating agent of PVNGS, will be able to initiate shipments to DOE during the licensed life of PVNGS. Accordingly, APS has constructed an on-site dry cask storage facility to receive and store PVNGS spent fuel. The facility stored its first cask in March 2003. Forty-one casks are now stored on site.

The District's share of on-site interim storage at PVNGS is estimated to be $33.1 million for costs to store spent nuclear fuel from inception of the plant through fiscal year-end 2006, and $2.8 million per year going forward. These costs have been included in the District's regulated operations price plans for transmission and distribution.

Black Mesa Litigation – Navajo Nation v. Peabody (US Dist. Court, D.C. District) – In June 1999, the Navajo Nation filed a lawsuit in the United States District Court in Washington D.C. (the "U.S. District Court"), alleging that Peabody, Southern California Edison Company (operating agent for Mohave), the District (operating agent for NGS) and certain individual defendants, induced the United States to breach its fiduciary duty to the Navajo Nation, and violated federal racketeering statutes. The lawsuit arises out of negotiations culminating in 1987 with amendments to the coal leases and related agreements. The suit alleges $600.0 million in damages. The plaintiffs also seek treble damages against the defendants, measured by any amounts awarded under the racketeering statutes. In addition, the plaintiffs claim punitive damages of not less than $1.0 billion. In March 2001, the Hopi Tribe intervened in the suit. The claims of both the Navajo Nation and the Hopi Tribe were dismissed in their entirety with respect to the District, but the dismissal is appealable.

On February 9, 2005, the U.S. District Court granted a motion to stay the litigation until further order of the court. The parties are in mediation with respect to this litigation and related business issues.

Navajo Nation v. United States (Court of Federal Claims) – Previously, the Navajo Nation had filed a suit against the United States Government based on similar allegations. The lawsuit was dismissed, but on appeal, it was reinstated and the Court of Appeals, in August 2001, held that the United States had breached its fiduciary duty under certain specific statutes to the Navajo Nation, and that a claim for damages was within the jurisdiction of the Court of Federal Claims. In March 2003, the United States Supreme Court, reversed the decision of the Court of Appeals and remanded the case for further proceedings consistent with its opinion. Instead of dismissing the case, the Court of Appeals remanded the case to the Court of Federal Claims and ordered that court to determine whether other statutes and regulations impose enforceable fiduciary duties upon the United States in connection with Peabody's leases and, if so, whether the United States breached such duties.

Peabody Legal Fees Cases – Peabody claims it is entitled to reimbursement under both the NGS Coal Supply Agreement and the Mohave Coal Supply Agreement for its costs associated with the defense of the challenges by the Navajo Nation and Hopi Tribe to these coal leases (see above matters). Peabody has filed two separate lawsuits against the NGS and Mohave Participants, respectively, seeking recovery of these fees. The Mohave and NGS Participants dispute Peabody's attempt to recover its legal costs under the coal leases.

As for the Mohave fees, the District has been dismissed from the litigation and awarded its attorney's fees. On appeal, however, the case was remanded to determine whether the District should remain in the lawsuit.

The Mohave Participants and Peabody executed a settlement agreement pursuant to which Peabody granted the Mohave Participants a waiver for fees incurred prior to January 2006. However, as described above, the lawsuit for fees arising after December 2005 continues.

Peabody's claims against the NGS Participants were dismissed. Peabody has appealed this ruling.

Peabody v. SRP – Peabody has also filed suit in St. Louis, Missouri against the District and the other owners of NGS asserting claims against both the Participants and the District relating to liability issues associated with the Navajo Nation Lawsuit, alleged breach of the NGS Coal Supply Agreement, breach of indemnity obligations owed to Peabody as the alleged agent of the NGS Participants, and claims of tortuous interference with contracts and tortuous interference with business expectancies against the District. The claim seeks $500 million and unspecified compensatory damages, prejudgment interest, attorneys' fees and costs.

The District is unable to predict the likely outcome of these Black Mesa litigation matters at this time but does not believe that these disputes will have material adverse effects on its operations or financial condition.

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

In September 2003, the District received notice from the U.S. Environmental Protection Agency (EPA) that it is potentially liable under the Comprehensive Environmental Response, Compensation and Liability Act as an owner and operator of a facility (the 16th St. facility) within the Motorola 52nd Street Superfund Site. The District may be liable for past costs incurred and for future work to be conducted within the Superfund Site. Investigation and evaluation of this potential liability are in the preliminary stages, but initial soil vapor investigations indicate some contamination on site. Further soil and groundwater investigations will take place during 2006. The District is unable at this time to predict the outcome, but believes that it has adequate reserves for this potential liability.

The EPA is continuing its national enforcement initiative under the New Source Review (NSR) provisions of the Clean Air Act (CAA). This initiative is focused on determining whether companies had failed to disclose major repairs or alterations to facilities that would have required the installation of new pollution control equipment. As part of this initiative, the District received four (4) letters from Region IX of the EPA, under the authority of Section 114 of the CAA, requesting information on Coronado Generating Station (CGS) (the Section 114 Letters). In March 2004, the District entered into negotiations with the EPA regarding possible additional control technology to reduce emission levels from District generating units. To date, EPA Region IX has taken no enforcement action against the District for alleged violations of NSR regulations at CGS. The District is unable to predict the outcome of the Section 114 Letters or negotiations with EPA Region IX with respect to potential impacts on District generating units, but is optimistic that it will reach a mutually satisfactory agreement with the EPA regarding control technology and emission limits at District facilities.

Several species listed under the Endangered Species Act (ESA) have been discovered in and around Roosevelt and Horseshoe Dams. To obtain an Incidental Take Permit (ITP) under the ESA, the District entered into formal consultation with the United States Fish and Wildlife Service (USFWS), and developed a Habitat Conservation Plan (Plan), which allows full operation of Roosevelt Dam and Reservoir, provided the District mitigates for the "taking" of species by the establishment of habitat for the species in other areas or through other measures. The USFWS issued the District an ITP for operation of Roosevelt Dam in 2003. The District has reserved funds, that it believes will be sufficient to implement the Plan.

The District engaged in similar consultations with the USFWS to obtain an ITP for operation of Horseshoe and Bartlett Dams on the Verde River by December 2007.

The USFWS designated "critical habitat" for one of the species affected by SRP reservoir operations, the Southwestern Willow Flycatcher. The final designation does not encompass lands in or near the SRP reservoirs.

Air Quality – In December 1999, the participants in Mohave Generating Station settled a lawsuit alleging numerous and continuing violations of opacity and sulfur dioxide standards. Under the terms of the settlement, the participants were required to install by January 1, 2006, a sulfur dioxide scrubber and other pollution control equipment. Major plant modifications, including emissions controls, are required for continued operation as a coal-fired plant. Capital costs are estimated at $1 billion, of which the District's share would be $211.3 million. These costs are included in capital contingencies portion of the 2007-2012 Improvement Program. However, as discussed in Note (10) Regulatory Issues, Mohave Generating Station, the uncertainty in post-2005 coal and water supply have caused the Mohave Participants to be unwilling to make the necessary investments at this time.

Electric utilities are subject to continuing environmental regulation. Federal, state and local standards and procedures that regulate the environmental impact of electric utilities are subject to change. These changes may arise from continuing legislative, regulatory and judicial action regarding such standards and procedures. Consequently, there is no assurance that facilities owned by the District will remain subject to the regulations currently in effect, will always be in compliance with future regulations, or will always be able to obtain all required operating permits. An inability to comply with environmental standards could result in additional capital expenditures to comply, reduced operating levels, or the complete shutdown of individual electric generating units not in compliance. Although the prospect for new Clean Air Act legislation in 2006 is low, as a result of the legislative and regulatory initiatives, the District is planning emission reductions at its coal-fired power plants.

The EPA issued final regulations for the control of mercury emissions from coal-fired utility boilers in May 2005. The District is evaluating the impact of the final regulations, which could require the installation of new emission controls at some of its coal-fired power plants. Eleven states have filed a lawsuit challenging the EPA mercury rule claiming it is not protective enough of public health and contrary to the CAA. The District is monitoring developments associated with the lawsuit and its implications on the control requirements. The regulations give states until November 2006 to either adopt the federal programs, as described in the final EPA regulations, or establish an alternative regulatory program. Arizona has not yet decided whether to opt into the federal program or establish its own program under the CAA. The specific level of reduction and compliance cost will not be known until the state finalizes its regulatory program.

On June 15, 2005, the EPA issued final amendments to its July 1999 regional haze rule. These amendments apply to the provisions of the regional haze rule that require emissions controls known as Best Available Retrofit Technology (BART) for coal-fired power plants and other industrial facilities that emit air pollutants that reduce visibility. The amendments include final guidelines for states to use in determining which facilities must install controls and the types of controls that facilities must use. States must complete the BART determinations for eligible facilities by 2007. BART controls must be installed five years after the EPA approves a state's BART determination. The District has financial interests in several coal-fired power plants that may be subject to the new BART requirements.

The District is also closely monitoring global warming policy developments at both a federal and regional level. Federal legislation has been proposed which would cap emissions of carbon dioxide from fossil fuel power plants. There have also been several regional initiatives aimed at curbing utility carbon dioxide emission levels. The District is assessing the risk of these policy initiatives on its generation assets and is developing contingency plans to comply with any future laws and regulations restricting carbon dioxide emissions.

Coal Mine Reclamation – In management's opinion, there are sufficient accruals in the accompanying combined financial statements for the District's obligation to reimburse certain coal providers for amounts due for certain coal reclamation costs. However, the District is contesting certain other coal mine reclamation costs. Neither the District's responsibility nor the ultimate amount of liability, if any, can be determined at this time. Management does not believe that the outcome of these matters will have a material adverse effect on the District's financial position or results of operations.

Natural Gas Supply – The District had a contract with El Paso Natural Gas Company for the transportation of natural gas on a full-requirements basis. FERC converted the full requirements contract to a contract with monthly limits. A Phoenix area shipper, whose full-requirements contract was also converted, asked FERC to reallocate transportation costs among all of the Phoenix area shippers. FERC has denied this request. The shipper may appeal the decision and if successful, the approximate impact to the District could be as much as $20 million.

Proposition 200 – In November 2004, Arizona voters approved Proposition 200, Arizona Taxpayer and Citizen Protection Act (Prop. 200), which, among other things, requires state and local government employees to verify the immigration status of people applying for certain "public benefits" and to report violators to immigration authorities. The Arizona Attorney General issued an opinion in 2004 supporting a narrow interpretation of the public benefits subject to this requirement. In November 2004, a group called "Yes on Proposition 200" filed suit

against the State of Arizona (the State) in the Maricopa County Superior Court arguing that the covered benefits were much broader. The court ruled in favor of the State and the matter was appealed to the Arizona Court of Appeals where it has been under advisement since January 2006. As a non-tax supported agricultural improvement district, the District does not believe that it is subject to this aspect of Prop. 200. However, if it were found to apply to the District and if "Yes on Proposition 200" is successful in its appeal, the District employees could have to verify immigration status of electric customers prior to providing service.

Prop. 200 also required that voters provide identification at the polls. The District implemented this requirement effective with its April 2006 elections. Recently, Hispanic organizations filed a lawsuit seeking injunctions against implementation of voter identification requirements enacted pursuant to Prop. 200. The District has received the approval of the U.S. Department of Justice of its voter identification requirements as has the State. The District is not a party to the recent lawsuit and no one is seeking to enjoin application of the voter identification requirements in District elections.

Voluntary Contributions in Lieu of Taxes – The Arizona Department of Revenue (ADOR) challenged the District's exclusion of contributions in aid of construction (CIAC) in calculating the total value of District property for purposes of computing voluntary contributions in lieu of taxes (in lieu contributions) paid by the District. While the District obtained a favorable ruling from the Arizona State Board of Equalization, the Arizona Tax Court subsequently rendered a favorable decision to the ADOR on appeal. The District appealed the decision of the Arizona Tax Court to the Arizona Court of Appeals. The Court of Appeals ruled in the District's favor on January 19, 2006. The ADOR filed a petition for review of this decision with the Arizona Supreme Court. If the Arizona Supreme Court accepts the petition and overturns the Court of Appeals decision, the District would be liable for approximately $13.8 million plus interest for fiscal years 2003 (four months), 2004, and 2005 (eight months). The District believes it has adequate reserves for this potential liability. For calendar years 2005 and forward, legislation has been passed that removes the value of CIAC from the in lieu contribution formula. The legislation codifies the exclusion of CIAC from computing in lieu contributions that could have had approximately $7.3 million per year effect for the District.

The Arizona Legislature also passed legislation that reduces the assessment ratio for calculation of in lieu contributions in Arizona beginning in calendar year 2006. The rate of 25% that was in effect prior to calendar year 2006 will be reduced to 20% over a 10-year period. Because the tax year is based on a calendar year, the first reduction for in lieu contributions will affect only four months of the District's fiscal year 2006. Fiscal year 2007 will be the first full fiscal year for the District, with a continual reduction through fiscal year 2016, when the assessment ratio reaches 20%. The legislation reducing the assessment ratio to 20% is expected to produce a cumulative savings of approximately $1.5 million per year.

California Energy Market Issues – Numerous FERC proceedings are addressing various aspects of the California energy market "crisis" of 2000 through 2001. Several of these proceedings involve potential refunds. Because the District bought from and sold power to the California energy market, the District has been drawn into many of the proceedings. However, the District was a net buyer in the California market during the time periods being scrutinized, and believes it is entitled to refunds if any are ordered and, in fact, has received approximately $18.8 million in refunds to date.

On March 17, 2006, the three California public utilities and the California Energy Oversight Board (CA Parties) filed lawsuits in California federal court against numerous public power utilities, including the District, that made energy sales into the California market in 2000 and 2001. The CA Parties' Notice of Claim preceding this lawsuit alleged estimated damages of $62.3 million without consideration of offsets due to the District. Additionally, on December 30, 2005, the Project received a Notice of Claim from the California Attorney General and the California Department of Water Resources with similar allegations and alleged damages of $8.5 million without consideration of offsets due to the District. No lawsuit on this Notice was filed. The District believes it has offsets as a net buyer in the California Power Market which exceed the amount of the claims asserted against it. The CA Parties, as well as the California Attorney General and the California Department of Water Resources, have executed a stand-still agreement with the District that resulted in a dismissal of the claims against the District, without prejudice, and precludes filing of litigation by the California Attorney General and the California Department of Water Resources.

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

NOTES TO COMBINED FINANCIAL STATEMENTS

April 30, 2006 and 2005

Water Rights – The District and the Association are parties to a state water rights adjudication proceeding encompassing the entire Gila River System (the Gila River Adjudication). This proceeding is pending in the Superior Court for the State of Arizona, Maricopa County, and will eventually result in the determination of all conflicting rights to water from the Gila River and its tributaries, including the Salt and Verde Rivers. The District and the Association are unable to predict the ultimate outcome of this proceeding.

The United States, on behalf of the Gila River Indian Community (GRI Community), filed a lawsuit in 1982 in the Federal District Court, District of Arizona, to protect the water right claims of the GRI Community. The Association is among the many defendants named in this lawsuit. The lawsuit claims that the defendants' use of surface water and groundwater violates the GRI Community's rights to water in certain specified areas, and requests a decree specifying the GRI Community's rights, injunctive relief to stop the alleged illegal use of water by the defendants, and damages for increased costs to the GRI Community from, among other things, having to deepen its wells. This lawsuit has been stayed pending the outcome of the Gila River Adjudication.

In 2004, the U.S. Congress enacted the Arizona Water Rights Settlement Act of 2004, which, when fully implemented, will resolve the claims of the GRI Community listed above as well as many of the claims in the Gila River Adjudication. However, there are many conditions precedent to the full effectiveness and enforceability of the act and its associated agreements.

In 1978, a water rights adjudication was initiated in the Apache County Superior Court with regard to the Little Colorado River System. The District has filed its claim to water rights in this proceeding, which includes a claim for groundwater being used in the operation of CGS. The District is unable to predict the ultimate outcome of this proceeding, but believes an adequate water supply for CGS will remain available.

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

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

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

In our opinion, the accompanying combined balance sheets and the related combined statements of net revenues and comprehensive income (loss), and cash flows present fairly, in all material respects, the financial position of Salt River Project Agricultural Improvement and Power District and its subsidiaries and the Salt River Valley Water Users' Association (collectively, "SRP") at April 30, 2006 and 2005, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of SRP's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PricewaterhouseCoopers, LLP
Los Angeles, California
June 15, 2006