ARIZONA POWER AUTHORITY

reliable affordable dynamic

2016 ANNUAL REPORT • NO. 58

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COMMISSION

Joe A. Albo
Chairman
10/01/15 - 09/16/16

Dalton H. Cole
Chairman
09/17/16 - 09/30/16
Vice Chairman
10/01/15 - 09/16/16

Stephen M. Brophy
10/01/15 - 09/30/16

Boyd W. Dunn
04/20/16 - 09/30/16

Russell L. Jones
10/01/15 - 09/30/16

Richard S. Walden
10/01/15 - 04/19/16

STAFF

Robert W. Johnson
Interim Executive Director

John T. Underhill, Jr.
Interim Deputy Director

July 2017

The Arizona Power Authority (Authority) presents the Operating Year 2016 Annual Report. This report accounts for the Authority's operational and financial activities for the operating year ending September 30, 2016. It also covers the Authority's administration of Arizona's hydroelectric power entitlement generated at Hoover Dam and Powerplant.

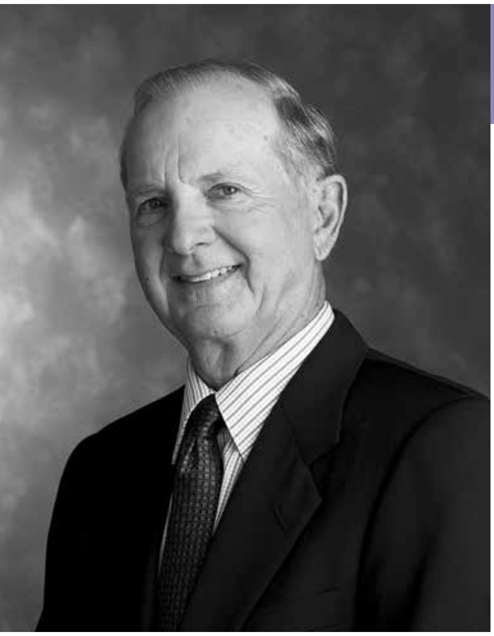
The Authority continues to support federal and state efforts to address and mitigate the significant, ongoing drought which impacts the Colorado River System. During Operating Year 2016, Lake Powell and Lake Mead again received below normal inflows. Despite challenging conditions, the Authority continued delivering Hoover power to its Arizona customers.

The Arizona Power Authority will remain focused on its mission to ensure that irrigation and electrical districts, cities, and towns located throughout the State of Arizona have access to low cost, dependable hydroelectric power.

Arizona Power Authority
1810 W. Adams St. Phoenix, AZ 85007
(602) 368-4265 | Fax (602) 253-7970

Joe A. Albo
Chairman

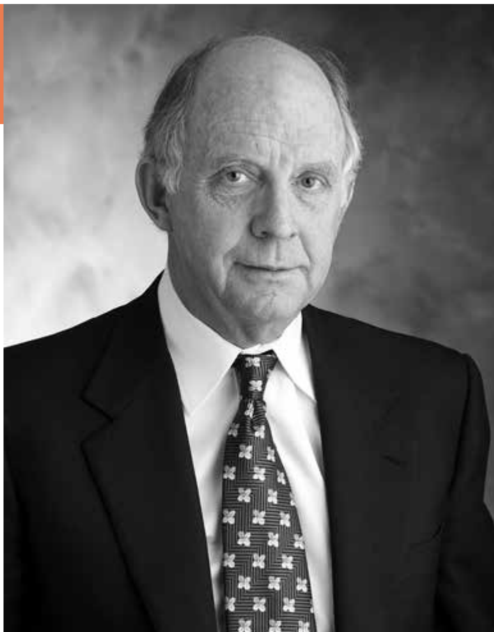
Appointed to the Commission in 2010 and re-appointed through his present term expiring in 2016, Joe retired from the Arizona Power Authority in September 2016. He served an earlier partial term as Commissioner on the Arizona Power Authority Commission from 1983 to 1984. Joe Albo is a fourth generation native Arizonan. He is a career public sector attorney. Mr. Albo is a graduate of Northern Arizona University and of the University of Arizona College of Law.



Dalton H. Cole
Vice Chairman

Appointed to the Commission in January 2002 and re-appointed through his present term expiring in 2020, Dalton assumed the Chairman's role in September 2016. He is a retired businessman and farmer. A past member of the Central Arizona Water Conservation District Board, Mr. Cole co-founded and chaired the HoHoKam Irrigation District. He also served on the board of Electrical District No. 2 in Pinal County for 18 years and is a past chairman. In addition, Mr. Cole is a past chairman of the State Board of Directors for Community Colleges. He has served on the Ground Water Management Committee for Pinal County, as well as advisory committees to the Arizona Legislature regarding water and power issues.

Stephen M. Brophy
Commissioner



Appointed to the Commission in 2009 and re-appointed though his present term expiring in 2020, Stephen M. Brophy is president of Page Land & Cattle Co, Aztec Land and Cattle Company, Ltd. and The Apache Railway Co., and a partner in Santa Lucia Farms. Among his affiliations, he is a member of the boards of the Arizona Cattle Growers Association, Mountain States Legal Foundation, The National Cowboy Museum and former Chairman and member of the Economic Advisory Counsel of the Federal Bank of San Francisco. He received a bachelor's degree from the University of Arizona and an M.B.A. from Stanford University.

Boyd Dunn

Commissioner - 04/20/16 - 09/30/16

Appointed to the Arizona Power Authority Commission in April 2016, Boyd Dunn was appointed upon the retirement of Richard S. Walden after 32 years of service to the APA. Boyd Dunn is a retired Maricopa County Superior Court judge who also served as an Assistant Attorney General. He was a trial attorney and a Judge Pro-Tem. He also served as the Chandler mayor from 2002-11, the Chandler vice mayor, a City Council member and he chaired the Chandler Planning & Zoning Commission. Boyd attended Arizona State University and received a Juris Doctorate, Sandra Day O'Connor College of Law 1978, a Bachelor of Science – Political Science, Highest Honors 1975, and was an intern for John J. Rhodes, Office of the Minority Leader. Boyd is a member of the Arizona Judges Association, The Arizona State Bar Association, and the Maricopa County Bar Association. Boyd has served as a member of numerous Board of Directors for valley community service organizations.

Russell L. Jones

Vice Chairman

Appointed to the Commission in January, 2014, upon the retirement of Lt. Gen. John I. Hudson, U.S.M.C. (Ret.), for a term expiring in 2018, Russ Jones assumed the role of Vice Chairman in September 2016. He is the Chairman of the Board of R.L. Jones Management Group and R.L. Jones Customs Brokers, with seven (7) offices, serving key Ports of Entry along the U.S./Mexican Border, established in 1938 by his Grandfather. Russ served three (3) terms in the Arizona House of Representatives, where he was the Chairman of the Agriculture and Water Committee. As well as holding a National Customs Broker license, he is a licensed Surplus Lines Insurance Broker, and sits on the Executive Committee and Boards of several organizations including the Arizona/Mexico Commission, Arizona Community Foundation of Yuma, the U.S./Mexico Border Philanthropy Partnership, is the Chairman of the Border Trade Alliance and sits on the Arizona-Sonora Desert Museum Board of Directors. An active Rotarian and pilot in the Civil Air Patrol, Russ is, also, a proud member of VFW Post 19 in Yuma.

Richard S. Walden

Commissioner - 10/01/15 - 04/19/16

Appointed to the Commission in 1984 and re-appointed through his present term expiring in 2016, Richard Walden is the President and CEO of Farmers Investment Co., a family-owned, pecan growing and processing company headquartered in Sahuarita, Arizona. He is a member of the Board of the International Tree Nut Council and in that capacity serves as the chairman of the Committee for Nutrition Research and Education associated with the Nutrition Research and Education Foundation. He is also a former member of the Advisory Council on Small Business and Agriculture for the Federal Reserve Bank of San Francisco and a past member of the Board of the National Pecan Shellers Association.

report of the executive director

Post-2017: The Future of Arizona Power

This is a significant and exciting time in the Arizona Power Authority's history. Contracts are in place and final touches are being made on a new power allocation that goes into effect October 1, 2017 for districts, cities, tribes and utilities throughout the state, helping spur the next 50 years of Arizona's agricultural and economic growth.

The new contracts are the result of a multi-year reallocation process completed in July 2016. The objective was to achieve a fair allocation of power for both new and existing customers, while conducting a transparent, public process that considered perspectives from a variety of communities, stakeholders and agents throughout Arizona. The updated 50-year agreements span from 2017 through 2067.

In March 2016, Hoover celebrated its 80th year of delivering clean, renewable energy to the southwest. During this time, we recognized two staff members whose collective service with the APA totaled the same time-span. James (Jim) Horton was honored for 48 years of service, mostly as legal counsel. We also honored Dick Walden, who had served on the commission for 32 years. Their work and dedication is greatly appreciated.

Also during 2016, the APA focused on transmission-related issues, held a Dynamic Signal workshop and finalized the Energy Services Contract with the Western Area Power Administration, while continuing to keep costs and overhead low.

In September, the commissioners held an important Strategic Planning Session designed to reflect on our history, assess current strengths and define both near-term and long-term opportunities heading into the post-2017 era. Leveraging our significant strengths of low-cost overhead, experienced staff and an iconic power facility, we discussed the challenges of serving such a geographically diverse customer base. We also identified opportunities to enhance our power operation services, lower costs and improve the value we deliver to our customers.

Some of the Authorities near-term initiatives involve holding regular education meetings with Arizona legislators, launching an educational program for energy resource management, and surveying our customers to learn more about their plans for regulation, ramping and reserves (the 3 R's).

Just as the Hoover Dam is a symbol of strength and solidity that has weathered more than 80 years of history, the APA symbolizes stability and consistency in meeting the ongoing power needs of Arizona customers. Post 2017, we look forward to continuing to deliver reliable, affordable and efficient energy that will support Arizona's ongoing prosperity.

Executive Director

operations & environments

On September 16, 2016 Commission Chairman Joe Albo signed 63 customer contracts and a 50-year contract with the Western Area Power Administration for the delivery of Hoover Dam power to Arizona entities beginning October 1, 2017.

OPERATIONS

The last low head turbine runner, N5, was delivered in May 2015. But due to some equipment breakdowns, and the need for an unplanned packing sleeve repair and contractor support issues, the scheduled completion date for the N5 Runner install was extended to August 1, 2017.

The generator life extension program is ongoing, maximizing the longevity of Hoover plant infrastructure. The typical generator life span is thirty years plus. The Bureau of Reclamation's objective is to extend time between unit rewinds by assessing the rotor and stator condition as well as inspecting the insulation degradation and mechanical fatigue. This work is being conducted on a regular basis, adding to the overall maintenance efficiency of the Hoover plant and Hoover power.

ENVIRONMENT

Low soil moisture in the fall resulted in below normal runoff. There was a strong El Nino weather effect, which typically produces greater rainfall. But the jet stream moved more northward than expected delivering less precipitation to the Colorado River Basin than average. The snow pack was 94% of average for the 2015-2016 winter season. The precipitation was 96% of average for the year. Inflow to Lake Powell was 89% of normal. Lake Mead elevation decreased 3 feet during the operating year.

The drought conditions continue to effect Hoover power. The drought in the basin extended throughout OY 2016, as a result energy production was reduced from previous years. Lake Powell operated in the Upper Elevation Balancing Tier which resulted in releases of 9 million acre feet. Close monitoring of water levels continues and policies to maximize power generation efficiency are in effect.

management's discussion & analysis

Introduction

The following is a discussion and analysis of the Arizona Power Authority's ("Authority") financial performance for the operating year ended September 30, 2016. This discussion is designed to:

(a) assist the reader in focusing on significant financial issues,
(b) provide an overview of the Authority's financial activity, and
(c) identify changes in the Authority's financial position.

The Management's Discussion and Analysis ("MD&A") focuses on the 2016 operating year's activities, resulting changes and known facts, and should be read in conjunction with the Authority's basic financial statements as of and for the year ended September 30, 2016.

This MD&A is an introduction to the basic financial statements of the Authority, which are comprised of two components.

(1) Fund Financial Statements
(2) Notes to the Financial Statements

The Fund Financial Statements begin on page 12 and provide detailed information about the individual funds. A fund is a operating and accounting entity with a self-balancing set of accounts that the Authority uses to keep track of specific sources of revenues and disbursements for specific purposes. The Authority's funds are treated as proprietary and are independent of each other. Most of the Authority's financial dealings are with contracts outside of state government. A separate fund is not maintained for government activities. The Authority does not act as a fiduciary.

Using This Financial Report

This financial report consists of a series of financial statements. The Statement of Net Position, the Statement of Revenues, Expenses and Changes in Net Position and the Statement of Cash Flows (on pages 16, 17, 18-19, respectively) provide information about the activities of the Authority as a whole and present a longer-term view of the Authority's finances. The Authority is a body, corporate and politic, of the State of Arizona and is a special-purpose government entity engaged only in business-type activities. Accordingly, the financial statements presented are the required basic financial statements in accordance with the provisions of Governmental Accounting Standards Board Statement No. 34, Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments, as amended.

The Authority Highlights

TRANSMISSION AGREEMENT

On January 24, 2003, the Authority and the Western Area Power Administration ("Western") entered into an agreement for the Advancement of Funds for Transmission Services. The Authority had an existing agreement with Western that provided for the delivery of power and energy. The agreement provides for the Authority to advance funds to Western on a monthly basis to fund operations, maintenance and replacement costs associated with Western's transmission services. For the years ended September 30, 2016 and 2015, the Authority advanced a net prepaid deposit of $634,855 and $613,373, respectively, which is included in the Statement of Net Position. This contract gives Western greater flexibility and allows them to work more effectively with the Authority and other customers.

EFFECTS OF DROUGHT ON HOOVER ENERGY

The Colorado River Basin has been experiencing severe drought conditions for the past seventeen years. This has resulted in a reduction in Lake Mead's storage and the power production at Hoover Dam. In response to customer requests, the Authority continues to purchase supplemental power to offset the reduced energy production at Hoover. The supplemental power costs are significantly higher than Hoover rates, and are passed directly to the requesting customers. These supplemental revenues and costs are reflected on the Authority's records, resulting in higher revenue and purchased power costs.

Revenues

INCREASE/DECREASE IN COMMISSION APPROVED POWER RATES

State statute requires the rates be set at levels to recover the cost of supplying services. In addition, contracts between the Authority and its customers provide specific details regarding rate determination. The Arizona Power Authority Commission is solely responsible for periodically adjusting rates, as appropriate.

MARKET IMPACTS ON INVESTMENT INCOME

During operating year 2016 market conditions have resulted in historic low investment returns.

ECONOMIC DROUGHT CONDITION

Although the drought condition in the Colorado River Basin continues, increased efficiency improvements at Hoover Dam have helped to offset the decreases resulting from reduced water levels.

Expenses

INTRODUCTION OF NEW PROGRAMS

There were no changes to existing programs during this operating year; however, individual programs may be added or deleted to meet changing Authority needs.

INCREASE/DECREASE IN AUTHORIZED PERSONNEL

Changes in the Authority's services may result in increasing/decreasing authorized staffing. Operating year 2016 staffing costs (salary and related benefits) represented 2.74% of the Authority's operating costs. For operating year 2015, staffing costs represented 2.88% of the Authority's operating costs.

SALARY STRUCTURE

The ability to attract and retain competent personnel requires the Authority to provide a competitive salary structure, which is reviewed annually, and is within State guidelines.

Financial Highlights

- The Authority's 2016 net position increased by $1,563,776 primarily due to a decrease in expenditures associated with the Advances for Hoover Uprating Program, as the deferred outflow of resources became fully amortized during the year.
- The Authority's 2015 net position decreased by $2,108,698 primarily due to GASB 68 pension liability reporting and amortization of future benefit of reduced power rates associated with the Power Resource Revenue Bonds, 2014 Series (Hoover Prepayment Project).
- The Authority's 2016 operating revenues increased by $355,410 or 1.20% due largely to an increase in the base charge and transmission costs, offset by reduced supplemental power sales.
- The Authority's 2015 operating revenues increased by $1,505,069 or 5.50% due largely to an increase in supplemental power sales, and is partially offset by reduced rates from refinancing of the Hoover Prepayment Project.

Statements Of Net Position

There are three normal transactions that will affect the comparability of the Statements of Net Position summary presentation:

Net Results of Activities which will impact (increase/decrease) current assets and unrestricted net position.

Principal Payment on Debt which will reduce current assets and reduce long-term debt, and impact restricted net position.

Reduction of Capital Assets through Depreciation which will reduce capital assets and net investment in capital assets.

> "If you don't know where you are going, you'll end up someplace else.
>
> -YOGI BERRA

Condensed Statements of Net Position

BUSINESS-TYPE ACTIVITIES		2016		2015		DIFFERENCE IN AMOUNT	DIFFERENCE IN %
Current Assets	$	16,263,264	$	15,824,860	$	438,404	2.8
Long-term assets		8,408,462		8,375,379		33,083	0.4
Capital assets, net		119,530		78,011		41,519	53.2
TOTAL ASSETS		**24,791,256**		**24,278,250**		**513,006**	**2.1**
DEFERRED OUTFLOWS OF RESOURCES		**21,332,831**		**25,959,115**		**(4,626,284)**	**(17.8)**
Current liabilities		9,233,095		8,857,741		375,354	4.2
Long-term bonds payable, net		33,721,812		39,632,776		(5,910,964)	(14.9)
TOTAL LIABILITIES		**42,954,907**		**48,490,517**		**(5,535,610)**	**(11.4)**
DEFERRED INFLOWS OF RESOURCES		**203,413**		**344,857**		**(141,444)**	**41.0**
Net investment in capital assets		119,530		78,011		41,519	53.2
Restricted for debt service		15,138,764		14,906,735		232,029	1.6
Unrestricted		(12,292,527)		(13,582,755)		1,290,228	(9.5)
TOTAL NET POSITION	**$**	**2,965,767**	**$**	**1,401,991**	**$**	**1,563,776**	**111.5**

Operating Year 2016 Condensed Statement of Net Position Discussion

Current Assets increased due to the timing of the payments of payables and an increase on the debt service reserve.

Long-Term Assets were flat.

Capital Assets, Net increased due to the purchases of a data server, copy machine, and air conditioning unit.

Deferred Outflows of Resources decreased primarily due to the full amortization of the Advances for Hoover Uprating Program.

Current Liabilities increased due to an increase in the 2001 Series Bonds current maturities and an increase in customer refunds payable.

Long-Term Liabilities decreased due to a pay down of the 2001 bond principal. See further explanation on page 10.

Deferred Inflows of Resources decreased due to the change in the pension liability accrual.

Net Position increased primarily due to a decrease in expenditures associated with the Advances for Hoover Uprating Program, as the deferred outflow of resources became fully amortized during the year.

Capital Assets

As of September 30, 2016, the Authority had $119,530 invested in a variety of capital assets, as reflected in the following schedule, which represents a net increase (additions less retirements and depreciation) of $41,519 during operating year 2016, and a net decrease of $10,677 during operating year 2015.

				BALANCES SEPTEMBER 30
		2016		**2015**
Distribution plant	$	1,728	$	4,031
General plant - office		117,802		73,980
NET INVESTMENT IN CAPITAL ASSETS, END OF YEAR	**$**	**119,530**	**$**	**78,011**

The following reconciliation summarizes the change in capital assets for the years ended September 30, 2016 and 2015, which is presented in detail in Note 4:

				BALANCES SEPTEMBER 30
		2016		**2015**
Beginning balance	$	78,011	$	88,688
Additions		55,904		3,187
Depreciation		(14,385)		(13,864)
ENDING BALANCE	**$**	**119,530**	**$**	**78,011**

Debt Outstanding

As of September 30, 2016, the Authority had $12,125,000 in debt outstanding for the 2001 Series Bonds, compared to $17,740,000 in the prior year, as a result of a principal payment of $5,615,000, which was paid on October 1, 2015. In addition, the Authority had $26,565,000 in debt outstanding for the 2014 Series Bonds, which were issued on March 27, 2014.

As of September 30, 2015, the Authority had $17,740,000 in debt outstanding for the 2001 Series Bonds, compared to $23,070,000 in the prior year, as a result of a principal payment of $5,330,000, which was paid on October 1, 2014. These payments were scheduled principal payments during the year. In addition, the Authority had $26,565,000 in debt outstanding for the 2014 Series Bonds, which were issued on March 27, 2014. See Note 6 to the Financial Statements for a detailed summary of debt activity during the year.

Liquidity

Pursuant to Arizona Revised Statutes (A.R.S.) Section 30-124, the Commission of the Authority shall establish electric rates to include such price components as are necessary to maintain the Authority, to provide and maintain reasonable working capital and depreciation and other necessary and proper reserves. Components that are necessary to maintain the Authority include employee payroll, occupancy costs, cost of purchases or construction of generation and transmission services, and any cost factors chargeable to the cost of providing service as the Commission deems necessary or advisable to establish and maintain the financial integrity of the Authority. Contracts for sale of electric power to the Authority's customers include rates which may be modified upon 24-hour notice when such action is necessary in the sole judgment of the Commission in order to achieve the purposes of A.R.S. Section 30-124. The Commission, on a monthly basis, reviews the financial status of the Authority, including expenses and revenues and the adequacy of the rates to maintain the Authority's financial integrity. During operating year 2016, the Commission did not change rates. During operating year 2015, the Commission increased rates by 4.35%.

Statements Of Revenues, Expenses, And Changes In Net Position

There are normal transactions that will affect the comparability of the Statements of Revenues, Expenses and Changes in Net Position summary presentation

Operating Revenues which increase/decrease as a result of economic conditions and power usage.

Operating Expenses which increase/decrease as a result of purchased power costs, transmission costs, and operating costs.

Other Income (Expenses) which increase/decrease as a result of investment market conditions.

> "Energy and persistence conquer all things.
>
> -BENJAMIN FRANKLIN

		2016		2015		DIFFERENCE IN AMOUNT	DIFFERENCE IN %
Operating revenues	$	29,449,935	$	29,094,525	$	355,410	1.2
Operating expenses							
Purchased power		18,508,108		18,071,042		437,066	2.4
Western credits		(8,969,179)		(6,575,745)		(2,393,434)	36.4
Amortization of Hoover Uprating Program costs		6,622,244		6,575,745		46,499	0.7
Transmission and distribution		7,460,166		7,303,644		156,522	2.1
Administrative and general		1,794,050		2,113,325		(319,275)	(15.1)
Depreciation		14,385		13,864		521	3.8
TOTAL OPERATING EXPENSES	**$**	**25,429,774**	**$**	**27,501,875**	**$**	**(2,072,101)**	**(7.5)**
OPERATING INCOME		**4,020,161**		**1,592,650**		**2,427,511**	**152.4**
OTHER INCOME (EXPENSES)							
Interest expense		(1,832,675)		(2,127,461)		294,786	(13.9)
Deferred interest expense		601,315		892,351		(291,036)	(32.6)
Amortization		(1,264,340)		(1,251,968)		(12,372)	1.0
Interest income		33,153		9,013		24,140	267.8
Other, net		6,162		–		6,162	100.0
NET OTHER INCOME (EXPENSES)	**$**	**(2,456,385)**	**$**	**(2,478,065)**	**$**	**21,680**	**(0.9)**
Changes in net position		1,563,776		(885,415)		2,449,191	(276.6)
Net Position, Beginning of Year		1,401,991		2,287,406		(885,415)	(38.7)
NET POSITION, END OF YEAR	**$**	**2,965,767**	**$**	**1,401,991**	**$**	**1,563,776**	**111.5**

Operating Year 2016 Changes in Net Position Discussion

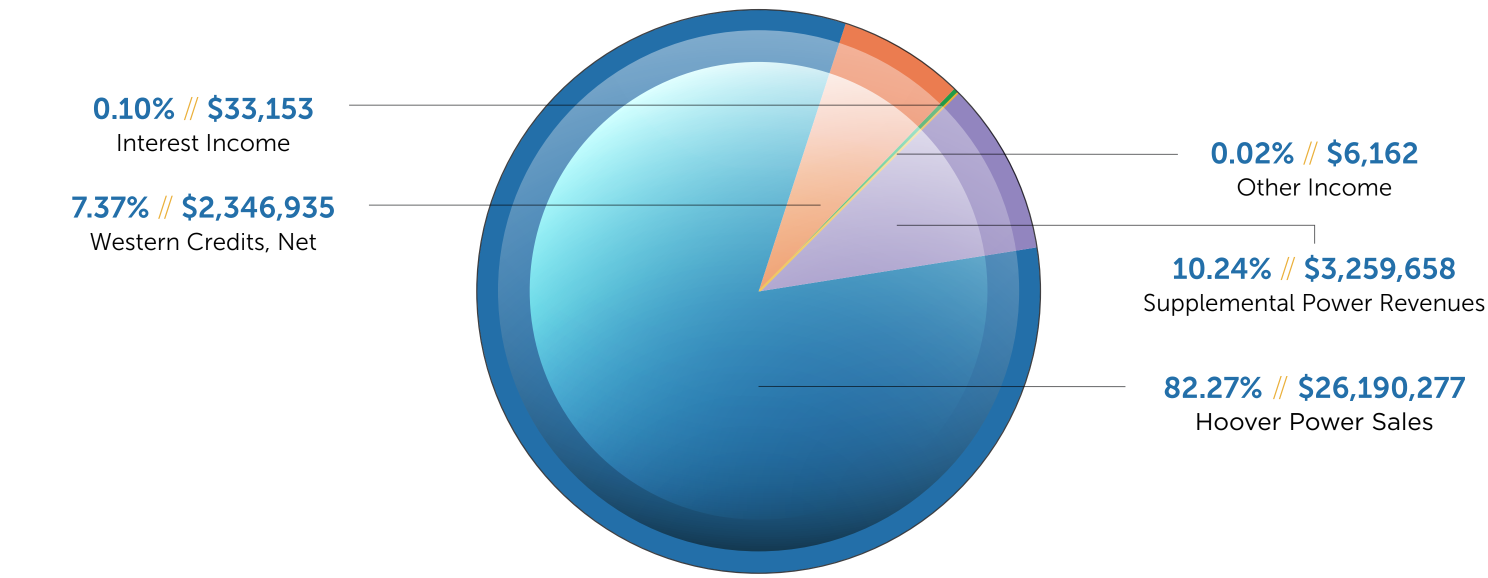
NET POSITION INCREASED OVERALL BECAUSE OF THE FOLLOWING:

- Operating Revenues increased due largely to an increase in the base charge and transmission costs offset by reduced supplemental power sales.
- Total Operating Expenses decreased primarily due to a decrease in expenditures associated with the Hoover Uprating Program, and decreased general and administrative expenses.
- Western Credits changed because of scheduled debt payments and associated costs related to the Uprating Program.
- Amortization of the Hoover Uprating Program costs changed because of the debt payments and associated costs related to the Uprating Program.
- Administrative and General Expenses decreased primarily due to reduced staffing costs and outside services related to the post 2017 allocation.
- Depreciation increased due to addition of capital assets.
- Net other income decreased during operating year 2016 due to amortization of the future benefit associated with the 2014 Series Bond.

BUSINESS TYPE ACTIVITIES

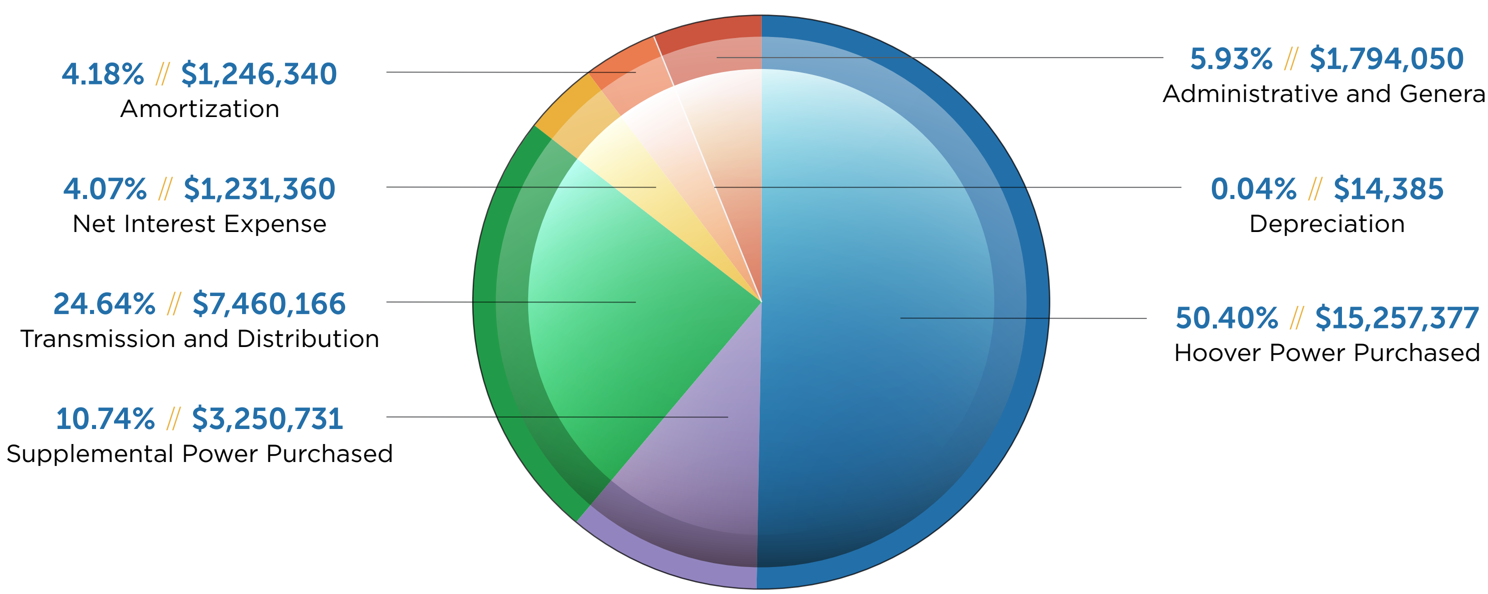
The following chart depicts the sources of revenues for the operating year 2016:

2016 Revenues



2016 Expenses

The following chart depicts the sources of expenses for the operating year 2016:



"In order to carry a positive action we must develop here a positive vision.

-DALAI LAMA

Request For Financial Information

The information contained in the Management's Discussion and Analysis is intended to provide a general overview of the Authority's finances. Questions concerning any of the information provided in this report, or requests for additional financial information should be addressed to the Accounting Department:

Arizona Power Authority, 1810 West Adams Street, Phoenix, Arizona, 85007

independent auditors report

CliftonLarsonAllen

Arizona Power Authority Commission
Phoenix, Arizona

REPORT ON THE FINANCIAL STATEMENTS

We have audited the accompanying financial statements of the Arizona Power Authority (A Body, Corporate and Politic, of the State of Arizona) (the Authority), which comprise the statement of net position as of September 30, 2016, and the related statements of revenues, expenses and changes in net position, and cash flows for the year then ended, and the related notes to the financial statements, which collectively comprise the Authority's basic financial statements as listed in the table of contents.

MANAGEMENT'S RESPONSIBILITY FOR THE FINANCIAL STATEMENTS

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

AUDITORS' RESPONSIBILITY

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

OPINION

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Arizona Power Authority as of September 30, 2016, and the changes in its financial position and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

OTHER MATTERS

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management discussion and analysis and schedule of the Authority's proportionate share of the net pension liability and contributions on pages 3 - 11 and pages 32 - 34 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board which considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

CliftonLarsonAllen LLP

Phoenix, Arizona
March 21, 2017

Statement of Net Position
September 30, 2016

ASSETS		APA GENERAL FUND		HOOVER UPRATING FUND		TOTAL
CURRENT ASSETS						
Cash and cash equivalents	$	3,442,555	$	3,118,241	$	6,560,796
Investments – short-term		–		7,365,157		7,365,157
Accounts receivable, Customer Power Purchases		2,676		2,334,635		2,337,311
TOTAL CURRENT ASSETS		**3,445,231**		**12,818,033**		**16,263,264**
NON CURRENT ASSETS						
Capital assets, net		119,530		–		119,530
Investments – long-term		–		7,773,607		7,773,607
Prepaid transmission		263,754		371,101		634,855
TOTAL NON CURRENT ASSETS		**383,284**		**8,144,708**		**8,527,992**
TOTAL ASSETS		**3,828,515**		**20,962,741**		**24,791,256**
DEFERRED OUTFLOWS OF RESOURCES						
Arizona State Retirement System		–		71,838		71,838
Advances for Hoover Uprating Program, net		–		–		–
Future benefit of reduced power rates, net		–		21,260,993		21,260,993
TOTAL DEFERRED OUTFLOWS OF RESOURCES		**–**		**21,332,831**		**21,332,831**
TOTAL ASSETS	**$**	**3,828,515**	**$**	**42,295,572**	**$**	**46,124,087**

LIABILITIES AND NET ASSETS		APA GENERAL FUND		HOOVER UPRATING FUND		TOTAL
CURRENT LIABILITIES						
Accounts payable and other	$	1,747	$	1,411,850	$	1,413,597
Customer refunds		–		998,158		998,158
Accrued interest payable		–		916,340		916,340
Bonds payable – short-term		–		5,905,000		5,905,000
TOTAL CURRENT LIABILITIES		**1,747**		**9,231,348**		**9,233,095**
LONG-TERM LIABILITIES						
Bonds payable – long-term		–		32,785,000		32,785,000
Premium on bonds payable, net of discounts		–		13,699		13,699
Pension liability		–		923,113		923,113
TOTAL LONG-TERM LIABILITIES		–		**33,721,812**		**33,721,812**
TOTAL LIABILITIES		**1,747**		**42,953,160**		**42,954,907**
DEFERRED INFLOWS OF RESOURCES						
Arizona State Retirement System		–		203,413		203,413
TOTAL DEFERRED INFLOWS OF RESOURCES		**–**		**203,413**		**203,413**
NET POSITION						
Net investment in capital assets		119,530		–		119,530
Restricted for debt service		–		15,138,764		15,138,764
Unrestricted		3,707,238		(15,999,765)		(12,292,527)
TOTAL NET POSITION		**3,826,768**		**(861,001)**		**2,965,767**
TOTAL LIABILITIES AND NET ASSETS	**$**	**3,828,515**	**$**	**42,295,572**	**$**	**46,124,087**

Statement of Revenues, Expenses, and Changes in Net Position

Year Ended September 30, 2016

	APA GENERAL FUND	HOOVER UPRATING FUND	TOTAL
OPERATING REVENUES	$ 3,259,658	$ 26,190,277	$ 29,449,935
OPERATING EXPENSES			
Purchased power	3,250,731	15,257,377	18,508,108
Western credits	–	(8,969,179)	(8,969,179)
Amortization of Hoover Uprating Program costs	–	6,622,244	6,622,244
Transmission and distribution	34,043	7,426,123	7,460,166
Administrative and general	–	1,794,050	1,794,050
Depreciation	14,385	–	14,385
Other	(12,082)	12,082	–
Total Operating Expenses	3,287,077	22,142,697	25,429,774
OPERATING INCOME (LOSS)	**(27,419)**	**4,047,580**	**4,020,161**
OTHER INCOME (EXPENSES)			
Interest expense	–	(1,832,675)	(1,832,675)
Deferred interest expense	–	601,315	601,315
Amortization	–	(1,264,340)	(1,264,340)
Interest Income	9,308	23,845	33,153
Other, net	–	6,162	6,162
Total Other Income (Expenses)	9,308	(2,465,693)	(2,456,385)
CHANGES IN NET POSITION	**(18,111)**	**1,581,887**	**1,563,776**
NET POSITION, BEGINNING OF YEAR	3,844,879	(2,442,888)	1,401,991
NET POSITION, END OF YEAR	**$ 3,826,768**	**$ (861,001)**	**$ 2,965,767**

See accompanying Notes to Financial Statements.

Statement of Cash Flows

	APA GENERAL FUND	HOOVER UPRATING FUND	TOTAL
CASH FLOWS FROM OPERATING ACTIVITIES			
Cash received from customers	$ 3,257,081	$ $26,379,267	$ $29,636,348
Cash payments to suppliers for goods or services	(3,012,104)	(21,803,591)	(24,815,695)
Cash payments to employees for services	–	(475,445)	(475,445)
NET CASH PROVIDED BY OPERATING ACTIVITIES	**244,977**	**4,100,231**	**4,345,208**
CASH FLOWS FROM INVESTING ACTIVITIES			
Interest on investments	9,308	23,845	33,153
Purchase of investments, net	–	(7,827,098)	(7,827,098)
Proceeds from sale and maturities of investments	–	7,595,069	7,595,069
NET CASH PROVIDED (USED) BY INVESTING ACTIVITIES	**9,308**	**(208,184)**	**(198,876)**
CASH FLOWS FROM CAPITAL AND RELATED FINANCIAL ACTIVITIES			
Interest payments on bonds payable	–	(1,980,067)	(1,980,067)
Payments on bonds payable	–	(5,615,000)	(5,615,000)
Acquisition of capital assets	(55,904)	–	(55,904)
Other costs related to Hoover Uprating Program	–	(357,078)	(357,078)
Reduction in advances for Hoover Uprating Program	–	4,266,107	4,266,107
NET CASH USED IN CAPITAL AND RELATED FINANCING ACTIVITIES	**(55,904)**	**(3,686,038)**	**(3,741,942)**
Net INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	198,381	206,009	404,390
Cash and Cash Equivalents, Beginning of Year	3,244,174	2,912,232	6,156,406
CASH AND CASH EQUIVALENTS, END OF YEAR	**$ 3,442,555**	**$ 3,118,241**	**$ 6,560,796**

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

DESCRIPTION OF BUSINESS

The Arizona Power Authority (the "Authority") is a body, corporate and politic, without taxing power, established by the Arizona Legislature on May 27, 1944 by the Power Authority Act. Under the Power Authority Act, the Authority is directed to obtain electric power developed from the mainstream of the Colorado River and sell such power to certain qualified purchasers. The Power Authority Act provides that the Authority must be a self-supporting agency and prohibits the Authority from incurring any obligation, which would be binding upon the State of Arizona.

The Authority supplies capacity and energy on a wholesale basis to certain power purchasers in the State of Arizona. The Authority's primary source of power and energy is the Hoover Powerplant at Hoover Dam, located approximately 25 miles from Las Vegas, Nevada. Hoover power is produced by the Boulder Canyon Project hydro-power plant owned by the Bureau

Statement of Cash Flows

	APA GENERAL FUND	HOOVER UPRATING FUND	TOTAL
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED BY OPERATING ACTIVITIES			
Operating income (loss)	$ (27,419)	$ 4,047,580	$ 4,020,161
Adjustments to reconcile operating income (loss) to net cash provided by operating activities:			
Depreciation	14,385	–	14,385
Adjustment to pension expense	–	(87,016)	(87,016)
Increase (decrease) in cash resulting from changes in:			
Accounts receivable	(2,576)	188,990	186,414
Prepaid transmission	263,753	(285,235)	(21,482)
Accounts payable and other	(3,166)	(39,658)	(42,824)
Customer refunds	–	201,902	201,902
Power contracts payable	–	73,668	73,668
TOTAL ADJUSTMENTS	**272,396**	**52,651**	**325,047**
NET CASH PROVIDED BY OPERATING ACTIVITIES	**$ 244,977**	**$ 4,100,231**	**$ 4,345,208**
SUPPLEMENTAL SCHEDULE OF NON-CASH CAPITAL AND RELATED FINANCING ACTIVITIES			
Deferred interest expense	–	601,315	601,315
Amortization of Future Benefit of Reduced Power Rates	$ –	$ 1,291,088	$ 1,291,088

of Reclamation. Hoover Dam is the highest and third largest concrete dam in the United States of America. Hoover Dam was dedicated in 1935 and the first generator of the Hoover Power Plant was in full operation in October 1936. The Hoover Power Plant has been in continuous operation since that time. Power and energy from the Hoover Power Plant is transmitted to load centers in Arizona, California and Nevada. The Authority first contracted for Arizona's share of Hoover power in 1952 and has continuously provided power and energy to its customers since that time.

The Authority is governed by a commission of five members appointed by the Governor and approved by the State Senate (the "Commission"). The term of office for each member is six years and the members select a chairman and vice-chairman from among its membership for two-year terms.

Pursuant to Arizona law, the Commission serves as the Authority's regulatory body with the exclusive authority to establish electric prices. The Authority is required to follow certain procedures, pertaining to public notice requirements and public meetings, before implementing changes in electric price schedules.

MEASUREMENT FOCUS

The Authority's funds are accounted for on a flow of economic resources measurement focus. All assets and liabilities, deferred outflows and inflows, (whether current or non-current) associated with their activity are included in the Statements of Net Position. The Statements of Revenues, Expenses and Changes in Net Position present increases (revenues) and decreases (expenses) in total net position. The Authority's reported total net position is segregated into net investment in capital assets, restricted and unrestricted components.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

BASIS OF ACCOUNTING

The accompanying financial statements are presented in conformity with accounting principles generally accepted in the United States of America ("GAAP") applicable to a governmental entity.

Basis of accounting refers to the time at which revenues and expenses are recognized in the accounts and reported in the financial statements, regardless of the measurement focus applied. The accrual basis of accounting is used by the Authority whereby revenues are recognized in the accounting period in which they are earned and become measurable, and expenses are recognized when incurred.

ACCOUNTING STANDARDS

For the year ended September 30, 2016, the financial statements include the impact, if any, of Governmental Accounting Standards Board Statement (GASBS) Number 72 – Fair Value Measurement and Application, GASBS Number 73 – Accounting and Financial Reporting for Pensions and Related Assets that are not within the Scope of GASBS Number 68 and Amendments to Certain Provisions of GASBS Numbers 67 and 68, GASBS Number 76 – the Hierarchy of Generally Accepted Accounting Principles for State and Local Governments, and GASBS Number 79 – Certain External Investment Pools and Pool Participants.

USE OF ESTIMATES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make a number of estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

REVENUE RECOGNITION

The Authority recognizes revenue when power is delivered to the customers.

CASH AND CASH EQUIVALENTS

The Authority treats short-term temporary cash investments with original maturities, when purchased, of three months or less as cash equivalents.

INVESTMENTS

The Authority's investments are U.S. Treasury obligations which are used to fund its debt service obligation. All such investments are stated at fair value based on quoted market prices.

CAPITAL ASSETS AND DEPRECIATION

Capital assets are initially stated at original cost less accumulated depreciation. Depreciation is provided on the straight-line method based on the estimated useful lives of the property items, which range from 3 to 20 years. The costs of additions and replacements are capitalized. Repairs and maintenance are charged to expense as incurred.

Retirements, sales and disposals are recorded by removing the cost and accumulated depreciation from the asset, with any resulting gain or loss reflected in other income or expense within the Statement of Revenues, Expenses and Changes in Net Position. Assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. If the fair value is less than the carrying amount of the asset, a loss is recognized for the difference.

PRESENTATION OF DEFERRED OUTFLOWS AND DEFERRED INFLOWS OF RESOURCES

Deferred outflows and inflows of resources are reported in the basic statements of net position in a separate section following assets and liabilities, respectively. The Authority elected the optional statement of net position presentation.

The Authority recognizes the consumption of net position that is applicable to a future reporting period as deferred outflows of resources. The deferred outflows of resources are related to the Authority's pension plan, the advance for the Hoover Uprating Program and the future benefit of reduced power rates associated with the 2014 Series Bonds (Hoover Prepayment Program).

The Authority recognizes the acquisition of net position that is applicable to a future reporting period as deferred inflows of resources. The deferred inflows of resources relate to the Authority's pension plan.

ADVANCES FOR HOOVER UPRATING PROGRAM

Proceeds from Hoover Uprating Bonds were advanced by the Authority to the Bureau of Reclamation for uprating the Hoover Power Plant and are recorded as advances. Such advances,

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

including debt issuance costs, plus most of net interest expense incurred by the Authority are reimbursed in the form of credits on the monthly power bills rendered by the Western Area Power Administration of the Department of Energy ("Western"). These credits are issued over the life of the bonds, which will mature October 1, 2017. Substantially all advances, net interest expense and other related costs on the 2001 Series Hoover Uprating Bonds are charged to the Uprating Program as amounts to be recovered from future credits. These amounts are included in the amortization of Hoover Uprating Program Costs in the Statement of Revenues, Expenses and Changes in Net Position

HOOVER PREPAYMENT PROGRAM

The Power Resource Revenue Bonds, 2014 Series Bonds (Hoover Prepayment Project) were issued to prepay the Authority's proportionate share of the obligations incurred by the United States Bureau of Reclamation for certain improvements at Hoover Dam. This prepayment of $23,843,169 will result in a reduction of future costs paid by the Authority for the power and energy from the Boulder Canyon Project. The Authority reports the future benefit of reduced power rates as a deferred outflow of resources in the Statement of Net Position. The future benefit of reduced power rates are amortized over the life of the bonds which will mature October 1, 2045. The amortization expense is reported in the Statement of Revenues, Expenses and Changes in Net Position. The unamortized balance of the prepayment was $ 21,260,993 as of September 30, 2016.

PENSION PLANS

For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions, and pension expense, information about the fiduciary net position of the Arizona State Retirement System (ASRS) and additions to/deductions from ASRS's fiduciary net position have been determined on the same basis as they are reported by ASRS. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value.

OPERATING REVENUES

Operating revenues are derived from the sale of power to customers and from other contractual agreements. Operating revenues include funds received as a result of a scheduling entity agreement between the Authority and the Salt River Project. These revenues amounted to $5,452,000 during the year ended September 30, 2016. These scheduling entity revenues reduce the overall revenue requirements to be paid by the Authority's customers through power rates. The current Scheduling Entity Agreement was approved and implemented as of October 1, 2013, and that Agreement will expire on September 30, 2017.

APPLICATION OF NET POSITION TO EXPENSES INCURRED

The Authority's restricted resources are funds held by the Trustee in the debt service and debt service reserve accounts. The Authority uses restricted resources solely for debt service associated with its outstanding bonds. The Authority would apply unrestricted, un-designated net position to expenses incurred which are not restricted. To the extent un-designated net position is unavailable, unrestricted, designated net position will be applied to expenses incurred.

CUSTOMER CREDITS

The Authority operates on a non-profit basis and reduces charges to its customers through credits on power bills or checks to customers during the subsequent operating year for any revenues collected in excess of expenses during the current operating year. The Authority is required under State statute to set the rates at levels sufficient to pay all expenses incurred during the operating year.

Refunds of $796,256 were paid to the customers during the year ended September 30, 2016.

INCOME TAXES

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

GEOGRAPHIC AND PRODUCT CONCENTRATION

The Authority's revenues are derived from the sale of electrical power and services to water districts, electrical and irrigation districts, and cities, which represent contracted customers in the State of Arizona. The Hoover Uprating Fund is used to purchase electric power solely from Western. The Authority's APA General Fund is used to purchase electric power from various providers.

NOTE 2 – FUND ACCOUNTING

HOOVER UPRATING FUND

The Hoover Power Plant Act of 1984 ("Hoover Act") authorized the U.S. government to increase the capacity of existing generating equipment at the Hoover Dam Power Plant ("Uprating Program"). Instead of appropriating further federal funds for the Uprating Program, Congress implemented an advancement of funds procedure whereby prospective non-federal purchasers of the uprated Hoover capacity and associated energy contribute to the financing of the Uprating Program. The Uprating Program was determined to be complete in September 1995. The Authority financed a portion of the total Uprating Program by issuing bonds.

The Hoover Uprating Fund accounts for advances by the Authority in connection with the Uprating Program. Effective June 1, 1987, the Authority executed new power contracts with Western and its customers which expire September 30, 2017. The revenues and expenditures applicable to the sale and transmission of power and energy received by the Authority from Western under these contracts are accounted for in the Hoover Uprating Fund.

APA GENERAL FUND

The Authority's operations other than those applicable to the Hoover Uprating Fund are accounted for in the APA General Fund. The purchase of supplemental power and the sale and transmission of such power to the Authority's customers comprise the majority of this fund's activity

NOTE 3 – CASH AND CASH EQUIVALENTS

All cash and cash equivalent balances except for bond funds held by the Trustee are maintained by the State of Arizona Treasurer within the Local Government Investment Pool ("LGIP"). The LGIP is not registered with the Securities and Exchange Commission and investments are not subject to custodial credit risk. The State Board of Investment conducts monthly reviews of investment activity and performance. LGIP amounts are carried at fair value. Participant shares are purchased and sold based on the Net Asset Value ("NAV") of the shares. The NAV is determined by dividing the fair value of the portfolio by the total shares outstanding. The Authority's LGIP investment balance represents its cash and cash equivalents as of September 30, 2016.

Note 4 – FAIR MARKET VALUE OF INSTRUMENTS

In determining fair value, the Authority uses various valuation approaches within the fair value measurement framework. Fair value measurements are determined based on the assumptions that market participants would use in pricing an asset or liability. Fair value measurements framework establishes a hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. Fair value measurements define levels within the hierarchy based on the reliability of inputs as follows:

- **Level 1** – Valuations based on unadjusted quoted prices for identical assets or liabilities in active markets;
- **Level 2** – Valuations based on quoted prices for similar assets or liabilities or identical assets or liabilities in less active markets, such as dealer or broker markets; and
- **Level 3** – Valuations derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable, such as pricing models, discounted cash flow models and similar techniques not based on market, exchange, dealer or broker-traded transactions.

The Authority's investments at September 30, 2016, categorized within the fair value hierarchy detailed above were as follows:

	FAIR VALUE MEASUREMENTS USING			
	TOTAL	(LEVEL 1)	(LEVEL 2)	(LEVEL 3)
Investments by Fair Value Level				
Direct U.S. Treasury obligations	$ 15,138,764	$ 15,138,764	$ –	$ –
TOTAL INVESTMENTS BY FAIR VALUE LEVEL	**15,138,764**	**15,138,764**	–	–
External investment pools measured at fair value				
State Treasurer's Investment Pool	6,560,796			
TOTAL INVESTMENTS MEASURED AT FAIR VALUE	**$ 21,699,560**			

NOTE 5 – CAPITAL ASSETS

Capital assets of the Authority at September 30, 2016 were as follows:

	BALANCES SEPTEMBER 30 2015	Additions	Deletions	BALANCES SEPTEMBER 30 2016
Transmission plant	$ 319,565	$ –	$ –	$ 319,565
Distribution plant	227,518	–	–	227,518
General plant - office	772,555	55,904	(38,474)	789,985
TOTAL DEPRECIABLE ASSETS	**1,319,638**	**55,904**	**(38,474)**	**1,337,068**
Less accumulated depreciation for:				
Transmission plant	319,565	–	–	319,565
Distribution plant	223,487	2,303	–	225,790
General plant - office	698,575	12,082	(38,474)	672,183
TOTAL ACCUMULATED DEPRECIATION	**1,241,627**	**14,385**	**(38,474)**	**1,217,538**
CAPITAL ASSETS, NET	**$ 78,011**	**$ 41,519**	**$ –**	**$ 119,530**

The Authority's depreciation expense was $14,385 for the year ended September 30, 2016.

The transmission and distribution plants are comprised of a substation and related equipment. Purchased power is delivered over transmission facilities owned by Western.

NOTE 6 – ADVANCES FOR HOOVER UPRATING PROGRAM

Advances for the Hoover Uprating Program were reimbursed by Western through credits on the Authority's power bills in the amount of $6,622,244 for the year ended September 30, 2016. Credits were received for the upraters' portion of principal and interest expense on the bonds and other costs associated with the Hoover Uprating Program.

“Pessimism leads to weakness, optimism to power.

-WILLIAM JAMES

NOTE 7 – ADVANCES FOR HOOVER UPRATING PROGRAM

The future benefit of reduced power rates reported as a deferred outflow of resources at September 30, 2016 was as follows:

Future benefit of reduced power rates	$ 23,843,169
Accumulated amortization	(2,582,176)
FUTURE BENEFIT OF REDUCED POWER RATES, NET	**$ 21,260,993**

The Authority's amortization of future benefit of reduced power rates was $1,264,340, for the year ended September 30, 2016.

NOTE 8 – BONDS PAYABLE

Bonds payable consists of the following:

		BALANCES SEPTEMBER 30 2015		Increases		Reductions		Transfers		BALANCES SEPTEMBER 30 2016
Bonds payable short-term	$	5,615,000	$	–	$	(5,615,000)	$	5,905,000	$	5,905,000
Bonds payable long-term		38,690,000		–		–		(5,905,000)		32,785,000
TOTAL BONDS PAYABLE	**$**	**44,305,000**	**$**	**–**	**$**	**(5,615,000)**	**$**	**–**	**$**	**38,690,000**
PREMIUM ON BONDS PAYABLE, NET DISCOUNTS	**$**	**40,447**	**$**	**–**	**$**	**(26,748)**	**$**	**–**	**$**	**13,699**

In prior years, the Authority defeased various issues of bonds by purchasing U.S. government securities which were deposited in an irrevocable trust with an escrow agent to provide for future debt service until the call dates. As a result, those bonds are considered to be defeased and the corresponding liability has been removed from the Hoover Uprating Fund.

The Authority's outstanding bonds, totaling $38,690,000, bear interest ranging from 1.799% to 5.25%, are due through Operating Year 2045, and are secured by the pledged property, as defined by the Resolution, which includes the proceeds from the sale of the bonds, rights and interest in various contracts and revenues. The Authority amortizes the bond premium (discount) using the interest method. Principal and interest amounts due over the next five operating years ending September 30 and thereafter are as shown in the chart at right.

CROSSOVER REFUNDING

On September 12, 2001, the Authority issued $57,520,000 of Special Obligation Crossover Refunding Bonds which refunded on October 1, 2003 $62,630,000 1993 Series Power Resource Revenue Refunding Bonds maturing on and after October 1, 2005. The 2001 Series Bonds bear interest at a rate of 5.00% and 5.25% payable on April 1 and October 1, respectively, of each year, commencing April 1, 2004 and maturing in 2017. In addition, the Authority recognized an economic gain (difference between the present value of the old and new debt service payments) of $2,095,648 in 2003 as a result of the cross-over.

The crossover refunding also resulted in the recognition of a deferred amount of $2,411,956 that has been reflected as a decrease in bonds payable and which will be amortized using the interest method as a component of interest expense over the life of the refunded bonds. The Authority amortized $57,348 for the year ended September 30, 2016, resulting in a net deferred amount of $29,437 in the Statement of Net Position. The Authority also recognized a premium of $3,536,652 on the crossover refunding which has been reflected as an increase in bonds payable and which will be amortized using the interest method. The Authority amortized $84,096 for the year ended September 30, 2016, resulting in a net premium of bonds payable of $43,136 in the Statement of Net Position.

Fiscal Year		Principal		Interest
2017	$	5,905,000	$	1,832,675
2018		6,220,000		1,522,662
2019		540,000		1,196,112
2020		550,000		1,186,398
2021		560,000		1,174,303
2022-2026		3,085,000		5,598,802
2027-2031		3,725,000		4,963,635
2032-2036		4,660,000		4,015,794
2037-2041		5,920,000		2,751,622
2042-2045		7,525,000		1,145,894
TOTAL	**$**	**38,690,000**	**$**	**25,387,897**

NOTE 9 – RETIREMENT PLANS

The Authority contributes to the Arizona Statement Retirement System plan described below. The plan is a component unit of the State of Arizona. September 30, 2016, the Authority reported the following amounts related to the pension plan to which it contributes:

Statement of Net Position and Statement of Activities		Business-Type Activities
Net Pension Liability	$	923,113
Deferred Outflows of Resources		71,838
Deferred Inflows of Resources		203,413
Pension Expense (Recovery)		(87,016)

ARIZONA STATE RETIREMENT SYSTEM

- **Plan Descriptions** – Authority employees participate in the Arizona State Retirement System (ASRS). The ASRS administers a cost-sharing, multiple-employer defined benefit pension plan; a cost-sharing, multiple-employer defined benefit health insurance premium benefit (OPEB); and a cost-sharing, multiple-employer defined benefit long-term disability (OPEB). The Arizona State Retirement System Board governs the ASRS according to the provisions of A.R.S. Title 38, Chapter 5, Articles 2 and 2.1. The ASRS issues a publicly available financial report that includes its financial statements and required supplementary information. The report is available on its Web site at www.azasrs.gov.

- **Benefits Provided** – The ASRS provides retirement, health insurance premium supplement, long-term disability, and survivor benefits. State statute establishes benefit terms. Retirement benefits are calculated on the basis of age, average monthly compensation, and service credit as follows:

	Before July 1, 2011	On or After July 1, 2011
Years of service/age required to receive benefit	Sum of years and age equals 80	30 years/age 55
	10 years/age 62	25 years/age 60
	5 years/age 50*	10 years/age 62
	Any years/age 65	5 years/age 50*
		Any years/age 65
		* With actuarially reduced benefits
FINAL AVERAGE SALARY IS BASED ON:	**Highest consecutive 36 months of last 120 months**	**Highest consecutive 60 months of last 120 months**
Benefit percentage per year of service	2.1% to 2.3%	2.1% to 2.3%

Retirement benefits for members who joined the ASRS prior to September 13, 2013, are subject to automatic cost-of-living adjustments based on excess investment earnings. Members with a membership date on or after September 13, 2013, are not eligible for cost-of-living adjustments. Survivor benefits are payable upon a member's death. For retired members, the survivor benefit is determined by the retirement benefit option chosen. For all other members, the beneficiary is entitled to the member's account balance that includes the member's contributions and employer's contributions, plus interest earned.

NOTE 9 – RETIREMENT PLANS (CONTINUED)

ARIZONA STATE RETIREMENT SYSTEM (CONTINUED)

- **Contributions** – In accordance with state statutes, annual actuarial valuations determine active member and employer contribution requirements. The combined active member and employer contribution rates are expected to finance the costs of benefits employees earn during the year, with an additional amount to finance any unfunded accrued liability. For the year ended September 30, 2016, active ASRS members were required by statute to contribute at the actuarially determined rate of 11.47 percent (11.35 percent for retirement and 0.12 percent for long-term disability) of the members' annual covered payroll, and the Authority was required by statute to contribute at the actuarially determined rate of 11.47 percent (10.85 percent for retirement, 0.50 percent for the health insurance premium benefit, and 0.12 percent for long-term disability) of the active members' annual covered payroll. In addition, the Authority was required by statute to contribute at the actuarially determined rate of 9.36 percent (9.17 percent for retirement, 0.13 percent for the health insurance premium benefit and 0.06 percent for long-term disability) of annual covered payroll of retired members who worked for the Authority in positions that would typically be filled by an employee who contributes to the ASRS. The Authority's contributions to the pension plan were $46,648 for the year ended September 30, 2016. The Authority's contributions for the current and two preceding years for OPEB, all of which were equal to the required contributions, were as follows:

Years Ended June 30	Health Benefit Supplement Fund	Long-Term Disability Fund
2016	$ 2,126	$ 510
2015	3,230	657
2014	3,298	660

During the operating year ended September 30, 2016, the Authority paid all ASRS pension and OPEB contributions out of the Hoover Uprating Fund.

- **Pension Liability** – At September 30, 2016, the Authority reported a liability of $923,113 for its proportionate share of the ASRS' net pension liability. The net pension liability was measured as of September 30, 2015. The total pension liability used to calculate the net pension liability was determined using update procedures to roll forward the total pension liability from an actuarial valuation as of June 30, 2014, to the measurement date of September 30, 2015.

  The Authority's reported liability at October 1, 2015 decreased from the Authority's initial liability because of the changes in ASRS' net pension liability and the Authority's proportionate share of that liability. The ASRS' publicly available financial report provides details on the change in the net pension liability.

  The Authority's proportion of the net pension liability was based on the Authority's FY 2015 contributions. The Authority's proportion measured as of June 30, 2015, was 0.0059263 percent, which was a decrease of 0.0001719 percent from its proportion measured of 0.0060982 percent as of June 30, 2014.

- **Pension Expense and Deferred Outflows/Inflows of Resources** – The Authority reported a pension expense adjustment of ($87,016) in administrative and general expense on its statement of revenues, expenses and changes in net position. The negative pension expense represents the net amount recognized after the amortization of deferred inflows and outflows, as well as the decrease in the Authority's proportionate share of the ASRS' net pension liability. For the year ended September 30, 2016, the Authority recognized pension expense for ASRS of ($40,548). At September 30, 2016, the Authority reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

NOTE 9 – RETIREMENT PLANS (CONTINUED)

ARIZONA STATE RETIREMENT SYSTEM (CONTINUED)

		Deferred Outflows of Resources		Deferred Inflows of Resources
Difference between expected and actual experience	$	25,190	$	48,372
Changes of assumptions or other inputs		–		–
Net difference between projected and actual earnings on pension plan investments		–		29,584
Changes in proportion and differences between Authority contributions and proportionate share of contributions		–		125,457
Contributions subsequent to the measurement date		46,648		–
TOTAL	**$**	**71,838**	**$**	**203,413**

The $46,648 reported as deferred outflows of resources related to ASRS pensions resulting from the Authority contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended September 30, 2017. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to ASRS pensions will be recognized in pension expense as shown in chart at right.

Year Ended June 30		Amount
2017	$	109,889
2018		66,520
2019		23,170
2020		(21,356)

- **Actuarial Assumptions** – The significant actuarial assumptions used to measure the total pension liability are shown at right.

Actuarial assumptions used in the June 30, 2014 valuation were based on the results of an actuarial study for the 5-year period ended June 30, 2013.

Actual Valuation Date	June 30, 2014
Actuarial Roll Forward Date	September 30, 2015
Actuarial Cost Method	Entry Age Normal
Investment Rate of Return	8%
Projected Salary Increases	3% - 6.75%
Inflation	3%
Permanent Benefit Increase	Included
Mortality Rates	1994 GAM Scale BB

> “Efficiency is doing better what is already being done. Effectiveness is deciding what to do better.
>
> -PETER F. DRUCKER

NOTE 9 – RETIREMENT PLANS (CONTINUED)

ARIZONA STATE RETIREMENT SYSTEM (CONTINUED)

The long-term expected rate of return on ASRS pension plan investments was determined to be 8.79% using a building block method in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. The target allocation and best estimates of arithmetic real rates of return for each major asset class are summarized in the following table:

Asset Class	Target Allocations	Long-Term Expected Portfolio Real Rate of Return
Equity	58%	3.94%
Fixed Income	25%	0.93%
Commodities	2%	0.08%
Real Estate	10%	0.42%
Multi-Asset Class	5%	.17%
Total	100%	5.54%
Inflation	0%	3.25%
TOTAL (INCLUDING INFLATION)	**100%**	**8.79%**

- **Discount Rate** – The discount rate used to measure the ASRS total pension liability was 8 percent, which is less than the long-term expected rate of return of 8.79%. The projection of cash flows used to determine the discount rate assumed that contributions from participating employers will be made based on the actuarially determined rates based on the ASRS Board's funding policy, which establishes the contractually required rate under Arizona statutes. Based on those assumptions, the pension plan's fiduciary net position was projected to be available to make all projected future benefit payments of current plan members. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

- **Sensitivity of the Authority's Proportionate Share of the ASRS Net Pension Liability to Changes in the Discount Rate** – The following table presents the Authority's proportionate share of the net pension liability calculated using the discount rate of 8 percent, as well as what the Authority's proportionate share of the net pension liability would be if it were calculated using a discount rate that is 1 percentage point lower (7%) or 1 percentage point higher (9%) than the current rate.

	1% Decrease (7%)	Current Discount Rate (8%)	1% Increase (9%)
Authority's proportionate share of the net pension liability	$ 1,209,593	$ 923,113	$ 726,780

- **Pension Plan Fiduciary Net Position** – Detailed information about the pension plan's fiduciary net position is available in the separately issued ASRS financial report

NOTE 10 – COMMITMENTS AND CONTINGENCIES

The Lower Colorado River Multi-Species Conservation Program (MSCP) is a cooperative effort between Federal and non-federal entities that will create more than 8,100 acres of riparian, marsh and backwater habitat for 31 species of fish, birds, mammals and plants. The program became effective on April 4, 2005 and expires April 30, 2055. As a party to this Agreement, the Arizona Power Authority's financial obligation is approximately $119,000 per year (in 2003 dollars, adjusted annually for inflation). For the year ended September 30, 2016, the Authority paid $165,232, for the MSCP.

The Authority is involved in various claims arising in the ordinary course of business, none of which, in the opinion of management, if determined adversely against the Authority, will have a material adverse effect on the financial condition or results of operations of the Authority.

NOTE 11 – INVESTMENTS HELD BY TRUSTEE

Certain funds of the Authority are secured under the Authority's bond resolution and held by the Authority's Trustee. The Authority has no formal policy concerning exposure to custodial credit risk, interest rate risk or credit risk. The Authority invests in U.S. Government securities collateralized with U.S. Government obligations held by the Authority's trustee. The fair value of the investment securities at September 30, 2016 is as follows:

U.S. Treasury obligations	$	15,138,764
TOTAL	**$**	**15,138,764**

These funds are invested in direct U.S. Treasury obligations, which mature on dates coinciding with the principal and interest payment dates for the Authority's outstanding bonds.

As of September 30, 2016, the investments held by the Trustee consist of U.S. Treasury obligations, which are direct obligations of the United States of America, as required by the Bond Resolution. The U.S. Treasury obligations are rated AA+ by Standard & Poor's Rating Services and AAA by Moody's Investors Service. There is minimal credit or interest rate risk.

NOTE 12 – ADDITIONAL BENEFITS

In addition to the pension benefits described above, ASRS offers health care benefits to retired and disabled members who are no longer eligible for health care benefits through their former member employer's group health plan. Retired is defined as actively receiving an annuity benefit and disabled is defined as receiving a long-term disability (LTD) benefit through the LTD program administered by ASRS. A premium benefit is applied to the member's health insurance cost. The following chart illustrates the maximum amount of the monthly available benefit supplement for eligible members and their dependents:

		MEMBER		MEMBER & DEPENDENT(S)	
Years of Credited Sevice	Percent of Premium Benefit	Not Medicare Eligible	Medicare Eligible	Not Medicare Eligible	Medicare Eligible
5.0 - 5.9	50%	$ 75.00	$ 50.00	$ 130.00	$ 85.00
6.0 - 6.9	60%	90.00	60.00	156.00	102.00
7.0 - 7.9	70%	105.00	70.00	182.00	119.00
8.0 - 8.9	80%	120.00	80.00	208.00	136.00
9.0 - 9.9	90%	135.00	90.00	234.00	153.00
10.0 +	100%	150.00	100.00	260.00	170.00

NOTE 13 – PURCHASED POWER, SALES AND TRANSMISSION COMMITMENTS

The Authority has sales contracts with its customers. Under these contracts, customers are obligated to pay for their proportionate share of Hoover power and transmission costs if delivered or made available for delivery. These sales contracts expire September 30, 2017, but some can be terminated by the Authority on June 1, 2007 or thereafter.

The Authority is party to a contract for electric service with Western which expires September 30, 2017. This requires the Authority to pay approximately 19% of Western's revenue requirements each operating year until the contract expires. During the year ended September 30, 2016, the Authority paid $15,257,377 for purchased power under this contract. The Authority is obligated to pay these costs under the contract even in the unlikely event that no power is supplied.

The Authority also has a contract with Western for transmission services. During the year ended September 30, 2016, the Authority paid $7,424,376, for transmission costs to Western. On January 24, 2003, the Authority entered into the Advancement of Funds for Transmission Services contract with Western. The contract provides for the Authority to advance funds to Western on a monthly basis to fund operations, maintenance and replacement costs associated with Western's transmission services. The advanced funds are then applied to the subsequent month's transmission invoice. As of September 30, 2016, the Authority recognized a prepayment of $634,855, which applies to the last payment upon termination of the contract.

The Authority has power contracts with SRP and the Southwest Public Power Agency, Inc. (SPPA) for the purchase and transmission of power to the Authority's customers. Under the transmission contract, the Authority must pay an annual transmission fee of $63,898 until September 30, 2017. The Authority has a power contract with SRP in which supplemental power purchases can be made by the Authority on behalf of its customers. There are no minimum quantities that the Authority is required to purchase. This agreement is applicable when supplemental power is necessary, during such times of low production of Hoover energy, and during summer months when customers require higher levels of energy. During the year ended September 30, 2016, the Authority paid $3,250,731, for purchased power under this contract for its customers.

NOTE 14 – SUBSEQUENT EVENTS

Management evaluated subsequent events through March 21, 2017, the date the financial statements were available to be issued.

SUPPLEMENTARY INFORMATION

Schedule of the Authority's Proportionate Share of the Net Pension Liability in the Arizona State Retirement System (ASRS) Plan September 30, 2016 and two years prior.

	OPERATING YEAR			
	2016 (2015)	2015 (2014)	2014 (2013)	2013 through 2007
Authority's proportion of the net pensions liability	0.005930%	0.006098%	0.007712%	Information not available
Authority's proportionate share of the net pension liability	$ 923,113	$ 902,329	$ 1,282,102	
Authority's covered-employee payroll	$ 429,939	$ 517,487	$ 491,323	
Authority's proportionate share of net pension liability as a percentage of it's covered-employee payroll	214.71%	174.37%	260.95%	
Plan fiduciary net position as a percentage of the total pension liability	68.35%	69.49%	Information not available	

Schedule of the Authority's Contributions to the Arizona State Retirement System (ASRS) Plan September 30, 2016 and nine years prior.

	2016	2015	2014	2013	2012	2011	2010	2009	2008	2007
Contractually required contribution	$ 46,648	$ 59,623	$ 58,819	$ 70,239	$ 71,733	$ 66,816	$ 60,860	$ 56,569	$ 56,730	$ 53,248
Contributions in relation to the contractually required contribution	46,648	59,623	58,819	70,239	71,733	66,816	60,860	56,569	56,730	53,248
Contribution Deficiency (Excess)	–	–	–	–	–	–	–	–	–	–
Authority's covered-employee payroll	$ 429,939	$ 517,487	$ 491,323	$ 683,359	$ 714,370	$ 695,896	$ 678,912	$ 650,423	$ 657,905	$ 687,770
Contributions as a percentage of covered-employee payroll	10.85%	11.52%	11.97%	10.28%	10.04%	9.60%	8.96%	8.70%	8.62%	7.74%

NOTES TO REQUIRED SUPPLEMENTARY INFORMATION

September 30, 2016

NOTE 1 – ACTUARIALLY DETERMINED CONTRIBUTION RATE

Actuarial determined contribution rates for ASRS are calculated as of September 30 one year prior to the end of the operating year in which contributions are made. The actuarial methods and assumptions used to establish the contribution requirements are as follows:

ASRS	
Actuarial valuation date	6/30/2014
Actuarial roll forward date	9/30/2015
Actuarial cost method	Entry age normal
AMORTIZATION METHOD:	
Plan amendments	Immediate
Investment gain/loss	5 years
Assumption gain/loss	Avg. Future service lives
Experience gain/loss	Avg. Future service lives
Asset valuation	Fair value
Discount rate	8%
Projected salary increases	3-6.75%
Inflation	3%
Permanent benefit increase	Included
Mortality Rates	1994 GAM Scale BB

"You cannot get through a single day without having an impact on the world around you. What you do makes a difference, and you have to decide what kind of difference you want to make.

-JANE GOODALL

DEBT SERVICE COVERAGE RATIO

UNAUDITED; NOT COVERED BY THE INDEPENDENT AUDITORS' REPORT

			OY 16
CHANGES IN NET POSITION		$	1,581,887
Add:	Interest Expense		1,832,675
	Amortization		57,348
	Depreciation		12,082
	Amortization of Hoover Uprating Program Costs		6,622,244
	Amortize Future Benefit of 2014 Refinancing		1,291,088
	Credits to Customers for Prior Years		998,158
TOTAL ADDITIONS		**$**	**12,395,482**
Deduct:	Pension Expense		(87,016)
	Deferred Interest Expenses		(601,315)
	Premium Amortization		(84,096)
TOTAL DEDUCTIONS		**$**	**(772,427)**
Income available for Debt Service		$	11,623,055
Debt Service			7,737,675
DEBT SERVICE COVERAGE RATIO			**1.50**

Note: Interest expense, depreciation expense, and amortization of costs are not expenses under the Bond Resolution. Debt Service is the total of principal payable and interest expense incurred between October 1, 2015 and September 30, 2016.

The "Amortize Future Benefit of 2014 Refinancing" and "Pension Expense" items are non-cash items included in the Changes in Net Position.

Arizona Power Authority

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