



Weaving Energy Partnerships in the West

2007 ANNUAL REPORT
WESTERN AREA POWER ADMINISTRATION



Partnering for reliability is
at the core of every job
Western crews undertake.



Background: Pierre Linemen *Frank Wellner*, sitting left front, and *Kevin Ripplinger*, right front, remove the static support from a tower.

Left: Fort Peck Electrician *Jake DeVries* works on the Dawson County Capacitor Bank addition.

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Right: Bismarck Lineman *Mark Dockter* prepares to install bird strike deflectors on the Audubon Causeway.

About Western

Western is a Federal agency under the Department of Energy that markets and transmits wholesale electrical power through an integrated 17,000-circuit mile, high-voltage transmission system across 15 western states.

Employees work around the clock to sell power, operate transmission and provide maintenance and engineering services to:

- Municipalities
- Cooperatives
- Public utility and irrigation districts
- Federal and state agencies
- Investor-owned utilities
(only one of which has an allocation of Federal hydropower from Western)
- Marketers
- Native American tribes

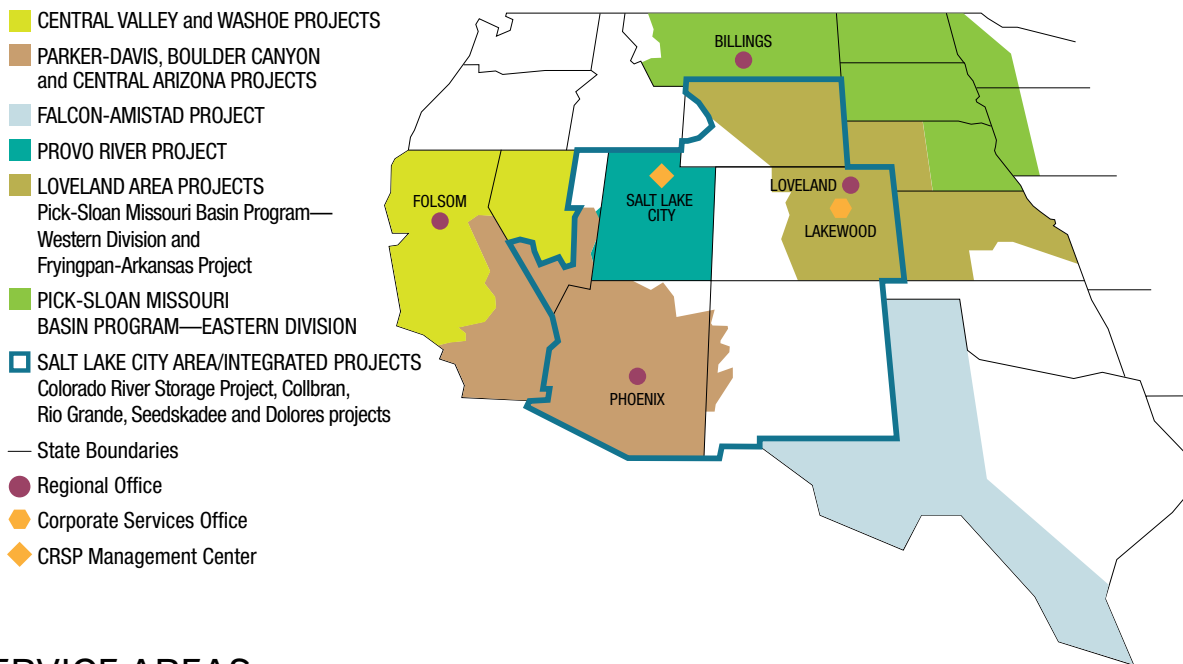
In turn, our customers provide electric service to millions of people from as far south as Texas all the way north to the Dakotas, and from the plains of Minnesota to the California coastline.

For 30 years, Western employees have been dedicated to providing public service, including promoting environmental stewardship, energy efficiency and renewable energy, as well as implementing new technologies to ensure our transmission system is the most reliable possible.

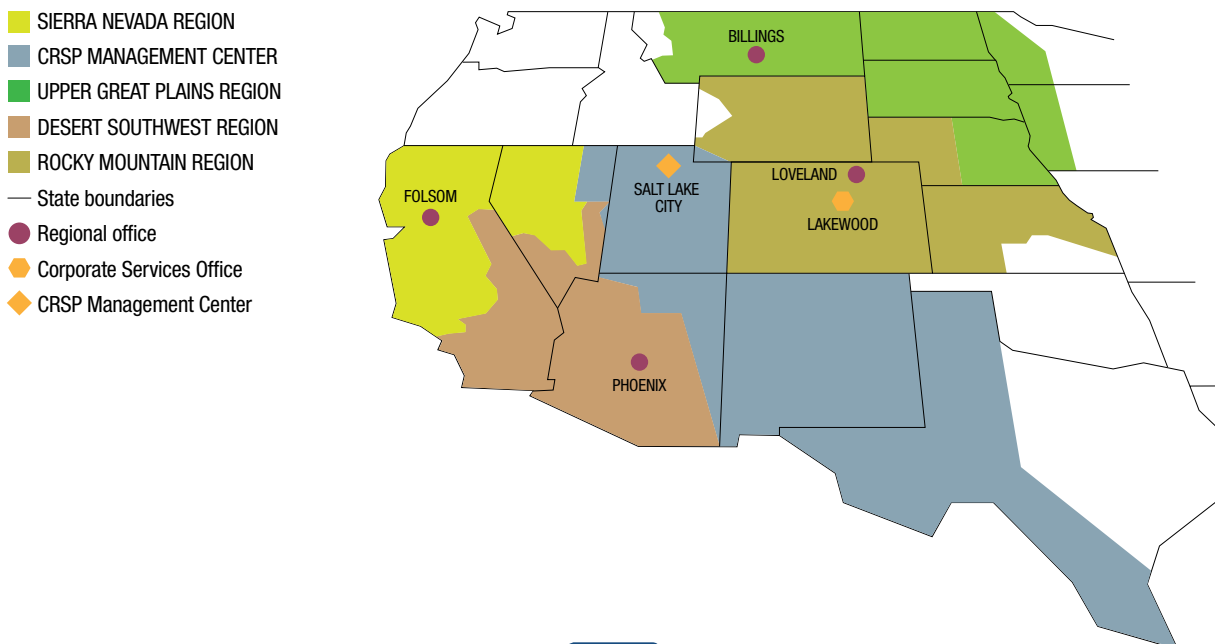
WESTERN'S MARKETING AND SERVICE AREAS

Western's role in delivering power includes managing 10 different rate-setting systems. These rate systems are made up of 14 multipurpose water resource projects and one transmission project. The systems include Western's transmission facilities along with power generation facilities owned and operated by the U.S. Bureau of Reclamation, the U.S. Army Corps of Engineers and the U.S. State Department's International Boundary and Water Commission. We set power rates to recover all costs associated with our activities, as well as the Federal investment in the power facilities (with interest) and certain costs assigned to power from repayment, such as aid to irrigation development.

MARKETING AREAS



SERVICE AREAS



WESTERN AT A GLANCE

Marketing profile

FY 2007

Long-term energy sales	33.1 billion kWh
Other energy sales	2.2 billion kWh
Total	35.3 billion kWh

Repayment profile

Principal repaid in FY 2007	\$31.6 million
Total repaid	\$3,047.2 million

Financial profile

Gross operating revenues	\$1,173.4 million
Sales of electric power	\$890.9 million
Total operating expenses	\$1,047.7 million
Purchased power and transmission expenses	\$598.8 million

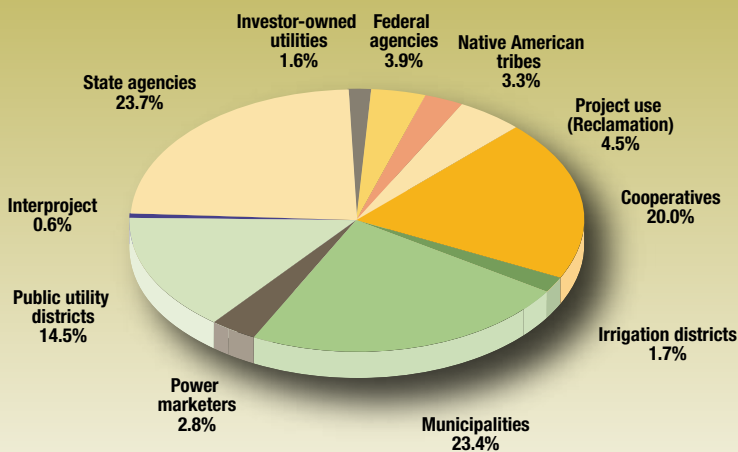
Assets

Substations	300
Transmission line miles	17,033

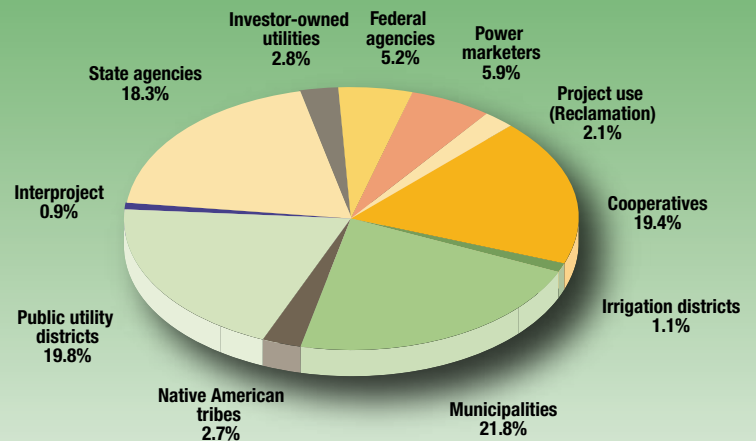
Our customers

Total	670
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WHERE OUR ENERGY GOES (MWh)



WHERE OUR POWER REVENUE COMES FROM (\$)



Administrator's letter

Marketing and delivering reliable, cost-based hydroelectric power and related services in 2007 has required Western to seek out partnerships in order to maintain the intricacies that make up the energy fabric in the West, from transmission infrastructure to energy diversity.

Operating in 2007 at 2006 funding. When Congress announced a year of continuing resolutions, our customers stepped in to help us fund nearly \$49 million of our Federal hydropower program in FY 2007. Together we created a strong financial balance using our alternative financing programs and our receipt funding authority, which allows us to fund purchase power expenses from power sale receipts. At the same time, we met our commitment to the U.S. Treasury by repaying more than \$31 million dollars.

This year, I spent a lot of time meeting with customers to find out what they value the most. Many told me that they appreciate Western's high level of customer service and our focus on providing reliable, cost-based energy and efficient transmission services. Several said they are interested in partnering—partnering to bring renewable energy into the mix (where economically justifiable) and partnering to support the utility industry as it adapts to change and grows in demand.

Of course, I'd love to see more rain, more snow pack and higher water levels in our reservoirs—that would mean resource stability for our customers. But the fact is the prolonged drought isn't ending anytime soon. So, at Western we're focusing on weaving energy partnerships in the West to serve three key areas:

1 Transmission expansion. Almost 40 percent of Western's 17,033 miles of transmission lines are 50 years or older. Every year, we focus on strengthening these vital energy threads through reliability centered maintenance and upgrades.

Yet the energy demands and interconnection requests continue to climb. The need to expand the transmission system while our workforce remains flat means that we need to fortify our partnerships to meet the ever-increasing power demands with a reliable energy infrastructure. Working with customers and other industry partners on transmission projects like TOT 3 in northeast Colorado and southeast Wyoming and the Palo Verde-Devers II Project in southern California open doors to alleviate transmission congestion.

2 Customer service building. I am grateful to our customers who continue to partner with us so that we can solve tomorrow's energy problems before they materialize. Our tightly knit relationships with customers have been the foundation for our growth and success with new programs, projects and initiatives.



We're continuing to work together with our long-standing, as well as our new customers, to meet consumers' ever-growing power needs. We're working with our tribal customers to find the potential for developing renewable energy on tribal lands. We hope that will allow tribes to spin that potential into self-sufficiency. In addition to explaining Western's role in getting tribal generation connected to the grid, in 2007 we partnered with Bonneville and Southwestern power administrations to craft the *Tribal Power Allocation Study* for Congress that explains the barriers that impede tribal access to Federal power and offers some potential solutions.

3 Renewable energy integration. With American eyes keenly set on climate change, we all share a common goal of interlacing the power grid with more renewable resources—particularly by adding solar and wind generation into the energy mix. The latter is the world's fastest-growing energy technology, and nine of the 10 windiest states are located in Western's footprint. Additionally, we're trying to make it easier to interconnect wind generation by helping prepare environmental reports, providing intermittent resource integration training at our Electric Power Training Center's facility and processing interconnection requests. For example, one interconnection at Hilken Substation in North Dakota provided the tie points for a new 50-MW wind farm. For years, we've helped integrate wind into the power tapestry and we will continue to do more in the future.

Forming strategy in 2008. In addition to my own travels, many Western employees have held deep and meaningful conversations with our customers. They are the energy and creativity behind many of our developing partnerships. Their dedication to training the next generation of craft workers (whether they are linemen, technicians or electricians) ensures our energy future by developing a safe, seasoned and dependable workforce. Their efforts also guarantee the safety of every employee, contractor and visitor on every job and at each facility.

This year we are focused on laying the groundwork for new partnerships. We will continue to work with our customers and industry partners to develop strategies that help secure clean, reliable and affordable energy, as well as the infrastructure. We will also maintain the high-quality and reliable service customers and consumers have come to depend on. Together we can create the fabric of America's energy future.



Tim Meeks
Administrator

“We're getting the work done together.”



Weaving energy partnerships in the West

Western has a long history of successfully working with customers to provide reliable service to millions of consumers threaded across the West.

The transmission system that Western owns and operates is an integral part of the nation's energy grid—the power that flows through Western's lines serves American consumers' ever-increasing demand for electricity. To ensure continued reliability to our customers, Western's crews upgraded the aging transmission system in fiscal year 2007, including:

In the Desert Southwest Region

- Mead Substation in Arizona
- Parker-to-Gila 161-kV line relocation in Arizona
- Perkins-to-Mead 500-kV transmission line
- Harry Allen Mead Project

In the Rocky Mountain Region

- Cheyenne-to-Miracle Mile and Ault-to-Cheyenne lines
- Beaver-to-Creek-to-Erie 230-kV in eastern Colorado
- Snowy Range Substation in Wyoming

In the Upper Great Plains Region

- Exira and Woonsocket substations in South Dakota
- Granby Pumping Plant-to-Windy Gap 69-kV line in Colorado
- Beaver Creek-to-Hoyt 230-kV in Colorado
- Hilken Switching Station in North Dakota
- Alternate Control Center in Watertown

In the Sierra Nevada Region

- Trinity Substation in northern California

The sun begins to rise behind a tower on the Mead-to-Davis, 230-kV transmission line.





Left: Havre Line Crew Foreman *Ron Barnett*, standing left, joins Havre Lineman *Ron Smith*, and Glendive Lineman *Ryan Staiger* in wrecking out a wooden structure on the Pickert-to-Grand Forks 230-kV transmission line, which was damaged by tornadoes July 15, 2007.

Below: After the July 15 storm mangled 28 steel structures on the Jamestown-to-Fargo, No. 1 230-kV transmission line, Western line crews installed 47 temporary wooden structures to get the line back in service.

Come wind, snow or ice

Additionally, Western routinely works with customers to help restore neighboring systems after devastating storm damage. In the winter of 2006/2007, Western's UGP crews repaired more than 69 structures damaged during storms, including assisting the Nebraska Public Power District to restore 100 distribution lines pummeled in an ice storm in December 2006. UGP crews also helped Lassen Municipal Utility District by dispatching maintenance staff and equipment to restore service from Woodland Substation until a replacement transformer could be purchased. Our crews in Sierra Nevada, Rocky Mountain and Desert Southwest regions also pitched in to help customers recover lines taken down by natural disasters.

Whether maintaining and upgrading our current infrastructure or partnering with customers to restore downed transmission lines, Western is dedicated to ensuring the lights come on every time someone flips a switch.

Stories of our partnerships with customers, the industry and our communities are woven throughout this FY 2007 Annual Report to showcase the interconnectedness of ensuring reliability in our energy landscape.





PARTNERING WITH CUSTOMERS



Clyde Spenser, regional director for the Bureau of Reclamation, speaks at the Trinity ground breaking ceremony, Oct. 17, 1955. (Courtesy of Bureau of Reclamation)

A connection 50 years in the making

Trinity Dam is just outside the town of Lewiston, Calif. Yet for more than half a century many of the town's residents and the Trinity County Public Utilities District have been unable to tap into the dam's hydroelectric power.

While Congress passed the act in 1955 that would give Trinity County up to 25 percent of the electricity supplied by the dam, they weren't getting it because the existing substation was outdated and unreliable by 21st century standards. The county had to secure the \$13.6 million in funding before Western could build a new substation that would reliably connect Trinity PUD to the Reclamation generation—as promised by Congress more than 50 years ago.



The Trinity Public Utilities Board stands in the Trinity Substation yard. Board member Rick Morris, far right, who has served on the board since the utility's inception, has waited to see the substation built since 1955.

The partnership was a success. Trinity PUD secured the funding in 2006 and Western constructed the substation in 2007. Now Lewiston and other Trinity PUD customers have a direct link to the Trinity and Carr powerplants, which are part of the Central Valley Project.

Dick Morris, a Trinity PUD Board member since the utility's inception added, "I have waited almost three decades for this moment, and I finally can now—with high confidence—believe that soon most citizens in Trinity County will be receiving the low-cost power mitigation promised by Congress in 1955."

Construction of the new substation ensures that the Bureau of Reclamation's hydro-power generators will be used more effectively, provides a backup power source should a black start event occur and allows Trinity PUD to begin serving customers directly from Reclamation hydropower generation facilities. Through partnerships, Western helps weave together the myriad energy threads and resources that serve customers and business owners throughout the West.

“It’s been a long journey, but I’m glad that we’ve finally arrived at our destination. The new substation will definitely improve the reliability of service to Trinity PUD customers.”

—Tom Boyko, Western’s Sierra Nevada regional manager



Left: An aerial view of Trinity Substation, September 2007.

Background: Aerial view of Trinity Dam nine miles from Lewiston along the Trinity River, October 2004. (Courtesy of Bureau of Reclamation)

TRINITY SUBSTATION

Project milestones	Date completed
Congress authorized construction	October 1955
Planning/design	December 2003
Environmental work/field collection activities	August 2005
Funding secured	Fiscal year 2006
Substation design	March 2006
Construction	August 2007
In-service	December 2007



PARTNERING WITH TRIBES

In FY 2007, Western provided Native Americans with a total of 1.2 million MWh of Federal hydropower.

Looking 7 generations forward

What legacy are we leaving for our great grandchildren's great grandchildren? Will there be enough water to continue generating hydropower? Will our natural and cultural resources still be there for them to enjoy? Will they have a community with a viable economy?

Some Native American tribes have asked these questions, and Western employees are listening and providing technical advice to support tribes' desire to secure the future for seven generations to come.

Our employees and our Administrator visited with more than 50 of our 87 Native American customers in FY 2007 to learn what is important to tribes and explain Western's role in getting tribal generation connected to the grid. We spend hundreds of hours per year partnering with our customers on energy issues, bill crediting and Western programs to help our customers, including tribes, get the most out of our energy resources.

Bill crediting—puts a credit on the tribe's utility bill, based on the tribe's Federal hydropower allocation displacing an equal amount of electricity that the utility would have acquired from its other sources.

Benefit crediting—tribes receive regular cash payments, from their utility, equal to the credited amount their Federal hydropower allocation would have saved them on their utility bills. The tribe then determines how the payment will be used to benefit its members.

Background: Aerial view of the area known by the Mohave Indian Tribe as the "Needles." (Courtesy of the Bureau of Reclamation)



Western often consults with tribes when upgrading its system, such as the Hoover Dam Bypass Project in 2003. Here Archaeological Monitor Suzy Eskenazi and Hualapai Tribe's Aaron Mapatis ensure Western preserves a spiritually significant site that was part of the project.

Studying possibilities for tribal wind

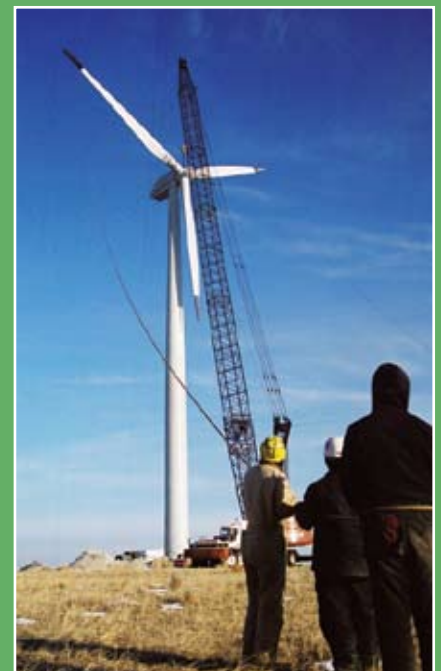
Western also partners with tribes to study opportunities for economic development. "Currently some tribes average a 30-percent unemployment rate, but that needs to change," stated Western's Native American Liaison Steve Tromly. Developing generation on a tribal land is one way to bring more jobs and economic stability to reservations.

The Inter Tribal Council on Utility Policy, or ICOUN, which represents nine tribes in the Upper Great Plains Region, plans to develop up to 400 megawatts of wind power on eight reservations.

Spurred by the Energy Policy Act of 2005, ICOUN, Western's Upper Great Plains staff and several other tribal customers—including Fort Peck, Blackfeet and Santee Sioux tribes—have been evaluating whether it is feasible to integrate tribal wind generation resources with hydro electric power generation to support Western's firm power contractual obligations.

It's the first comprehensive look at tribal wind development potential in the region and could involve developing, constructing and maintaining wind farms located on reservation lands.

So far, the study shows a promising outlook for integrating wind and hydropower and promising future partnerships between Western and its tribal customers.



Tribal members look on as the Rosebud turbine is installed, Feb. 23, 2003. The 750-kW turbine was installed and is owned and operated by the Rosebud Sioux tribe. The turbine is connected to the grid at the Rosebud Casino and Hotel complex.

"We're continuing to strengthen our relations with tribes and find ways to help tribes achieve economic self-sufficiency."

—Tim Meeks,
Western's administrator



PARTNERING FOR RENEWABLES

Renewable energy and construction of a clean energy infrastructure will play key roles in meeting an estimated 55-percent increase in world energy demand by 2030, according to the Department of Energy.

Transmitting 'green'

While the western United States has the fastest growing states in the country in terms of population and energy consumption, it is also the heart of the Nation's renewable energy potential.

Renewable energy options, including solar, look promising to Western's customers as solutions to increasing energy needs. In fall 2007, army officials at Fort Carson, Colo., teamed up with Western and private businesses to transform a 15-acre landfill into one of the largest onsite solar plants in the state and the largest solar array at a U.S. Army facility.



Fort Carson Major General Mark Graham, front, and Colorado Governor Bill Ritter cut the ribbon on the newly installed solar panels.

The 2-megawatt, ground-mounted solar photovoltaic array will generate 3,200 megawatt hours of clean renewable energy annually. "Reducing Fort Carson's reliance on fossil fuels helps us build a sustainable energy future that is good for our bottom line, the environment and national security," said Vince Guthrie, who oversees Fort Carson's utilities and electric bills.



A new 2-megawatt ground-mounted solar photovoltaic array occupies the site of a former landfill at Ft. Carson, Colo. Covering nearly 12 acres, the solar photovoltaic array is the largest solar array at a U.S. Army facility and one of the largest in Colorado.

Western employees *Linda Swails*, left, and *Melanie Reed* stand in front of the new solar panels.



Under Western's power marketing authority, Western's Rocky Mountain Region wrote two contracts to allow Fort Carson to buy power from the array as supplemental energy at a low fixed cost for 20 years. Colorado Springs Utilities provides services to Fort Carson and is monitoring the PV system, while 3 Phases Energy is selling the renewable energy certificates to Denver-based Xcel Energy under the investor-owned utility's Solar Rewards program.

"The Fort Carson solar project represents the collaboration of several major players, each of whom has played a decisive role in its success," said Erik Rothenberg, chief green officer at 3 Phases Energy.

The ground-mounted solar array consists of flat-plate, thin-film solar technology provided by First Solar, an Arizona company. The solar modules are warranted for 25 years, and the plant can be expected to efficiently produce energy for up to 40 years.

"We hope to use this collaboration as a model for other Federal customers who have expressed interest in similar types of projects," said Western Renewables Program Manager Randy Manion. "It is a great way to expand the use of renewable energy while meeting the needs of many different parties."





PARTNERING FOR RENEWABLES

Western's Electric Power Training Center, plus wind simulator, plus wind interconnection workshop equal success.

Trained for wind integration

Many developers are trying to capture the renewable resource sweeping the nation's plains and newspaper headlines—wind energy. But how do you interconnect wind generation to the grid? And how will it impact service reliability?

With about 70 interconnection requests from wind generators in 2007, Western sought hands-on experience of customers and industry partners to answer these and other questions.

To help power system operators, customers, wind developers and others understand how wind generation affects the grid, Western's Electric Power Training Center teamed up with the National Renewable Energy Laboratory to develop a 50-MW wind farm simulator.

Added in fall 2006, the wind farm is the first training simulator of its kind—providing class participants with controls that look like real wind plant controls. "Realism is the No. 1 priority," said EPTC Manager Stan Adcock. That realism will help to answer questions that arise with each new wind farm interconnected to the grid.

Wind developers are able to see how their facilities would interact with the grid, which will smooth the road to interconnection. "Too often in the industry, there's a disconnect between developers and utilities," said Adcock. "The simulator can help both parties understand the process from the other's point of view."

Western and DOE sponsor the Wind Powering America Program that highlights utilities' commitment to increasing wind energy use nationwide. Sacramento Municipal Utility District was honored with the 2007 Wind Power Pioneer Award for its leadership and demonstrated success with wind power technologies.

SMUD Superintendent of Renewable Generation Jon Bertolino stands with Wind Powering America Program Manager Phil Dougherty after receiving the 2007 award.

Workshop gives participants an overview

Every January, the EPTC partners with the National Rural Electric Cooperative Association and the American Public Power Association to host the Wind Interconnection Workshop. Designed to teach participants about wind generation technologies, state and regional renewable policies and economic evaluation for distributed wind applications, the workshop also educates consumer-owned utilities about the opportunities and challenges associated with wind energy technology.

“The EPTC is a first-class training facility interested in supporting wind integration training for our firm power customers and others; the EPTC also epitomizes who we are as an organization,” said Western’s Renewable Resource Program Manager Randy Manion.

EPTC offers one-of-a-kind training

Different than computer-based training, the Electric Power Training center gives participants hands-on experience with the wind farm simulator and the self-contained, fully operational miniature power system.

Live generators—including the wind farm—produce electricity, which is distributed over power lines to loads and substations that behave as if they are hundreds of miles apart and are monitored by real protection equipment. Every time a student operates a breaker, a physical contact is opened or closed.



EPTC Instructors *Kevin Privett*, front, and *Scott Labit* demonstrate how they simulate a fault for class participants in the miniature power system center.



PARTNERING FOR INDUSTRY SAFETY

“Exposure to radio frequency fields can be dangerous for workers and the public because RF heats tissue.”

Taking the heat out of radio frequency

Many Western employees team up with other industry leaders to develop regulations, policies, and even to address industry safety concerns.

The latter is what Western Electrical Engineer Stan Friskney focused on for the last few years. He led the way to a safer work environment by participating in Electric Power Research Institute’s research and testing of the performance of radio frequency, or RF, measurement devices and corona work suits—which protect employees from RF exposure—under various work conditions.

“Exposure to radio frequency fields can be dangerous for workers and the public because RF heats tissue,” explained Friskney. “I worked with the EPRI group to determine how effective personal protective equipment is in limiting RF exposure and to model antenna facilities to simulate the RF fields employees might come across on the job.”



The EPRI team, including Friskney, developed software that model’s RF exposure. The team also investigated potential problems in using RF measurement devices and corona work suits in environments for which they were not designed—particularly, such potential problems as operating RF meters in the strong electric fields of power lines. Exposure to electric fields can cause RF monitors to falsely interpret RF exposure levels.

The research also showed that the hood of an electric field corona suit acts as an RF resonance cavity that increases RF exposure to the head.

In the end, the EPRI team’s partnership led to increased safety for Western employees, industry workers and the public at large. “In both cases, this work will lead to improved worker safety and more reliable maintenance methods for transmission lines with RF antennas,” added EPRI EMF/RF Program Manager Mike Silva.

View of the Grouse Mountain communication tower, west of Granby, Colo. Because RF fields around communication towers and transmission lines can be dangerous to employees, Western continues to participate in a research study to determine how to limit RF exposure.



Structural Engineer
Matt Clark measures
the stabilizer on
Sunlight Peak
communication tower.

Communication systems upgraded

In FY 2007, Western's Rocky Mountain and Upper Great Plains regions continued to improve the communications backbone by upgrading our microwave radio system with digital technology—replacing our overhead ground wires with fiber optic cables. Our work is bringing the latest digital technology to our sister agencies, such as RM's work to provide bandwidth to the Bureau of Reclamation and Northern Colorado Water Conservancy District and install fiber optics from the Flatiron generator/pumping plant in northern Colorado. We further upgraded our communication system by completing a joint microwave project with Xcel Energy, Tri-State Generation and Transmission, Basin Electric Power Cooperative and Reclamation; partnering with the California-Oregon Transmission Project on Route 2 of a microwave replacement/fiber optic upgrade project; and upgrading the Supervisory Control and Data Acquisition system. RM also partnered with Sedgwick County, Colo., to build a new jointly owned communications building and provide channels for the county's Emergency Response System.



PARTNERING WITH COMMUNITIES

Furthering the future of kids and science

As the final minutes tick by, Poudre High School Senior Sam Sun turns to his teammates who are contemplating their final move. It's come down to this: The only thing that stands between them and the championship is a complex chemistry question about reaction order and rates. The Poudre team locks in its answer...the judges analyze it...it's correct! Poudre—winner of the Western-sponsored Rocky Mountain Regional Science Bowl—won the 2007 national title!

“The United States is really suffering from a shortage of engineers and scientists,” said Dennis Schaefer, Western’s Arizona Regional Science Bowl Coordinator. “But we at Western are committed to do something about it. Working with these students and encouraging them to continue in the sciences is great for the industry, our Nation and for our world’s existence.”

While not a physical sport, the National Science Bowl does cover physics, as well as mathematics, astronomy, biology, chemistry and more. And through these annual high-level scientific competitions, Western and its communities encourage high school students to become the future scientists, mathematicians and engineers.

“I’ve been involved with Science Bowl for a long time, but because of today’s win and my upcoming graduation from high school, I’m confident I’ll succeed in college,” said Sun, Poudre’s team captain. “The National Science Bowl is a premiere program that has made me more comfortable with science material.”

Poudre High School students (from left to right) Winston Gao, Sam Sun, Sam Elder and Logan Wright compete in the national championship match.



In April 2007, four champion Science Bowl teams from Western-sponsored regional competitions took home awards from the National Science Bowl. In addition to Poudre High School, from Fort Collins, Colo., three other high schools—Chaparral, from Scottsdale, Ariz., Mira Loma, from Sacramento, Calif., and Red River, from Grand Fork, ND—placed in the top sixteen teams in the country.

“These students displayed an acute knowledge of science and mathematics in many disciplines,” said Energy Secretary Samuel Bodman. “It is this level of knowledge, excitement and teamwork that will keep America at the forefront of innovation. With these students as our country’s next generation of scientists and engineers, I am confident the U.S. will remain the world’s leader in science, engineering and innovation.”



Above: Poudre High School students (from left to right) Wright, Elder, Gao and Sun compete in an early round-robin match.



Left: UGP Regional Manager *Bob Harris*, left, discusses the Science Bowl schedule with *Dirk Shulund*, center, and *Dan Belk*, two Western employee volunteers.



PARTNERING WITH COMMUNITIES

Bringing energy efficient lighting door to door

Western employees care about saving energy personally and professionally. In 2006 and 2007, several Western offices looked to cut down energy use by adding timed lighting in less frequently used office space, turning off building heaters and air conditioners during off-hours, and exchanging incandescent bulbs for more energy-efficient lighting.

Additionally, one Upper Great Plains employee and a local Boy Scout troop committed to change the world in Mandan, N.D., by giving the gift of free, energy-efficient bulbs to residents just two weeks before Christmas 2006.

Mandan Boy Scout Troop 54 gets ready to give away CFLs to town residents to earn their environmental merit badges. The troop was only the second in the country to participate in Energy Star's Change a Light campaign in October 2006.



If every home in America replaced just one incandescent light bulb with a CFL, it would save enough energy to light more than 3 million homes and prevent greenhouse gas emissions equivalent to those of more than 800,000 cars annually.

The idea, sparked by Western Environmental Protection Specialist Chad Bourgoïn, took off when the troop partnered with Mor-Gran-Sou Electric Cooperative, which provided a \$500 grant to purchase the energy-efficient lights. “We look for projects that focus on social, economic and environmental betterment in the co-op’s service territory,” explained Mor-Gran-Sou Member Services Manager Jackie Miller. “Without a doubt, the ‘Change a Light, Change the World’ program met those criteria.”

Walking door-to-door Dec. 9, 2006, the Scouts earned their environmental and conservation badges, while more than 400 local residents gained a better understanding of compact fluorescent lights, also known as CFLs, and the community saved more than 113,000 kWh of energy and prevented 90 tons of greenhouse gas emissions.

“Thank you for your commitment to the ‘Change a Light, Change the World’ campaign, and for answering the call by taking a small and easy step to save energy and heating costs,” wrote Secretary of Energy Samuel Bodman in a letter to the troop.



Above: Boy Scouts distribute the CFLs throughout their neighborhood.



Left: Door-to-door, a scout and his leader make a difference in their community.



PARTNERING FOR THE FUTURE

Western linemen climb a steel tower before replacing an outside phase suspension insulator with hot sticks. From top to bottom: DSW Linemen *Dave Richardson* and *Justin Swires* and Foreman *Ronnie Martinez*, UGP Apprentice *Scotty Schmaltz*, DSW Lineman *Jay Long* and an APS journeyman lineman.

Recruiting, training and retaining the future workforce

It's clear—the utility industry is facing a major workforce shortage. With more than 400 well-seasoned employees eligible to retire in the next five years, Western is focused on hiring and retaining the next generation of professionals to maintain and upgrade our nation's electrical infrastructure.

There are more than 35 apprentices and craft-in-training—including dispatchers, meter and relay mechanics, electricians and linemen—working at Western to become fully-qualified professionals who will maintain the energy tapestry infrastructure that threads through the West.

In fact, in 2007 Western's Rocky Mountain Region saw six of its apprentices "journey out" of the four-year training program. There was also an Upper Great Plains apprentice who reached Journeyman status before the year was out.

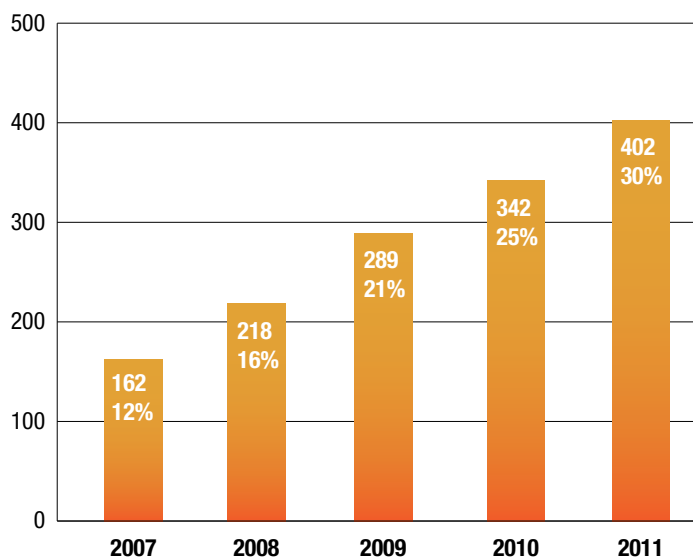
Cody Field Maintenance Manager Steve Upton said, "All six men finished the program with an overall grade point average well above 90 percent...that is remarkable! I believe it's a testament to the commitment and effort each made to achieve the goal."

Across the trades, the common theme is still "working together" to make Western's system run smoothly and efficiently. That is the unspoken element added to these former apprentices' training.

So what's on the horizon? Well, we still have 36 apprentices, with nine ready to journey out in 2008. By ensuring a well-trained supply of qualified workers, Western can provide the best service to customers and the community.

“It is recognized nationwide that there is a shortage of craftsmen in the industry, and it is expected to get worse,” said Dave Neumayer, a maintenance manager at Western. “It is vitally important that Western have a successful apprenticeship program and is capable of raising up the next generation of craft workers.”

Western retirement-eligible employees



The possibilities

For 30 years, we've built and sustained powerful and mutually beneficial partnerships with customers. Together we've brought comfort and security to small communities, universities, military bases, hospitals and rural electric cooperatives.

What lies ahead is up to us—all of us. Western will continue to focus on strategies that support our mission to market and transmit cost-based hydroelectric power. Working with other entities, we will continue to strengthen the power system throughout the Western and Central United States.

A contractor appears to be floating above the clouds as the helicopter above him is short hauling him to another structure on the Cheyenne-to-Miracle Mile line.



Partnering with customers

Rate adjustments ensure cost recovery

Western managed the impacts of the continuing drought in FY 2007 by working cooperatively with long-term power customers to notify them early on about rate adjustments. Because the drought has severely reduced reservoir levels, Western increased its purchase power budget more than 10 percent. Based on customer comments, several regions proposed adding drought adder components to their new rates, which became effective Jan. 1, 2008. The Pick-Sloan Missouri River Basin—Eastern Division and the Loveland Area Project rates now include these drought adders, which allows for the portion of the rate associated with drought costs to be adjusted up to 2 mills/kWh without a formal public process. Other projects have made adjustments for reduced generation due to the drought. While the Boulder Canyon Project did not contribute to purchase power costs, reduced reservoir levels and increased security costs at Hoover Dam led to a 22-percent increase in Boulder Canyon's composite rate in FY 2007.

Pseudo-tie increases resources

SN staff continued to work collaboratively with customers and Western's balancing area operator, the Sacramento Municipal Utility District, to improve the new types of services available from the Western-SMUD balancing area. On Dec. 1, 2006, the Western-SMUD balancing area implemented a "pseudo tie" for Reclamation's New Melones hydropower generators of the Central Valley Project. This pseudo tie allows the Western-SMUD balancing area to dynamically dispatch generation from these powerplants, which are physically located in the California Independent System Operator's balancing area, to allow these facilities to be electrically treated as if they were part of the Western-SMUD balancing area. The pseudo tie increases generation resources available to the Western-SMUD balancing area by up to 384 MW.

Rate case reduces transmission costs

Western saved its Salt Lake City Area/Integrated Project customers a bundle when it settled a case with Public Service Company of New Mexico in FY 2007 over transmission fees and losses. This settlement led to reduced transmission costs for Western, which depends on PNM for transmission service to deliver Federal power to customers in New Mexico, including Federal labs and Defense Department facilities. The settlement should save the Salt Lake City Area Integrated Project customers at least \$1 million a year in transmission expenses.

Partnering with industry

Budget requests coordinated

In FY 2007, Western successfully coordinated our FY 2008 budget request with DOE, the Office of Management and Budget and Congress. Western Administrator Tim Meeks testified before the House Subcommittee on Water and Power on March 7, 2007 in support of our \$706 million request, which included \$201 million in appropriations—approximately 28 percent of our mission requirement. The request also included \$259 million receipt authority for purchase power and wheeling. Congress ultimately passed an appropriation for Western's FY 2008 program of \$231 million, an increase of \$30 million which will reduce the reliance on customers for direct funding. Congress also increased the receipt authority for purchase power and wheeling to \$309 million, reflecting the ongoing drought conditions. To meet the remainder of the mission requirement, Western is partnering with customers to secure alternative financing sources. As Western continues to experience tighter appropriation levels, our reliance on customer advance funds and other alternative financing becomes more critical.

Western recognized for clean audit

Western's commitment to financial integrity earned an award from Energy Secretary Samuel Bodman, who recognized Western and 16 other field Chief Financial Offices for helping the Department earn a clean audit in FY 2007. DOE achieves that goal only if each field office records its own accurate and timely financial information. Western's Finance team not only rose to that challenge but also produced audited Western financial statements two weeks after the fiscal year end close to meet all mandated dates from DOE and the auditors to provide DOE with timely audited numbers from Western.

NERC audit revealed strengths

Commending Western for running one of the "tightest-run organizations" they had audited to date, the North American Electric Reliability Corporation, Midwest Reliability Organization and Western Electricity Coordinating Council's readiness reviews and compliance audit in 2007 showcased Western's commitment to reliability. The reviews and compliance audits of Western Area Upper Missouri—East and Western Area Upper Missouri—West revealed no compliance violations and revealed Western's strengths in meeting and exceeding industry reliability standards.



Glen Canyon Dam

Western coordinates on endangered fish recovery

As debate continues about how to protect endangered fish downstream of dams from which Western markets power, Western weaves power customers' interests into the discussions about the dam's future operations. Through the Adaptive Management Group and other venues, Western staff partnered with other agencies in FY 2007 to discuss how the Bureau of Reclamation's proposed long-term program of experimentation, which may include potential modifications to Glen Canyon Dam intake structures, could affect Western's ability to meet contract commitments. Western staff also participated in the Missouri River Natural Resources Committee to discuss how operational changes for ecosystem recovery will affect power generation on Missouri River mainstem dams.

International partnership established

Western extended its partnerships in FY 2007 to bring power into the United States from Mexico. DSW staff helped North Branch Resources move forward with its proposal to build a new powerplant in Mexico and

500-kV line by teaming up with other Federal agencies to study the project's environmental and system impacts. In its October 2007 Record of Decision, Western determined that the San Luis Rio Colorado line could interconnect to our system at Gila Substation in Arizona if it were constructed at 230-kV and substation modifications were made.

Tariff revised for wind, small generators

Western revised its Open Access Transmission Tariff, or OATT, in FY 2007 to standardize interconnection agreements for small generators (those less than 20 MW) and wind generators. These revisions not only comply with the Federal Energy Regulatory Commission's Order No. 2006 on Small Generator Interconnection and Order No. 661, technical requirements for wind interconnection, but allow Western to offer wind-friendly transmission service to accommodate wind generator interconnections. We are also studying how to improve our interconnection process to make it easier for requestors to interconnect to our system.

Interchange Tool simplifies scheduling

In another example of how Western is moving ahead with the latest technology, dispatchers began using the Western Electricity Coordinating Council's Western Interchange Tool for energy scheduling in FY 2007. With this new tool, Operations staff can manage some pre-scheduling tasks using a Web site shared with other utilities in the Western Interconnection. The WIT provides additional automatic e-Tag, or energy transaction, verifications based on North American Electric Reliability Corporation and WECC standards. This tool allows Western balancing authorities to better coordinate energy balancing activities with other balancing authorities across the interconnected system.

Partnering for reliability

Interconnection requests increase

To continue ensuring that the communities in which we live and work maintain reliability, Western managed about 30 transmission facility upgrades in FY 2007 and had about 35 interconnections in progress to be completed by 2017. Western staff continue to be challenged by the workload required by these interconnections and interconnection requests. Staff levels have remained flat while the number of interconnection study requests have increased 40 to 50 percent annually. For example, there were 112 tariff-related study requests in FY 2007 compared to 82 in FY 2006 and 53 in FY 2005.

Composite conductor installed

In cooperation with Mojave Electric, Western installed composite conductor in 2007 on a 20-mile segment of our Topock-Davis 230-kV line in Arizona that parallels the Colorado River and extends to Boulder Dam. The composite conductor increases the line's capacity 54 percent from 470 MW to 724 MW. Composite conductor is beneficial because it allows for increases in transmission capacity on existing lines without the need to build new towers.

Partnering for Renewables

Renewable Energy Credits promoted

We helped 17 Federal agencies and one city purchase more than 500,000 MWh of green tags, or renewable energy credits, in FY 2007. In acting as an agent for Federal agencies and cities in acquiring green tags, Western helps our customers and other utilities to promote the use of renewable energy in our service area and meet renewable energy goals outlined in the Energy Policy Act of 2005 and statewide renewable portfolio standards. We've purchased RECs on behalf of the Environmental Protection Agency, DOE, the Air Force, Army and City of Colorado Springs, among others.

Wind farm interconnected

Western continued to support efforts to add renewable energy onto the grid by interconnecting a new wind farm to Hilken Substation in North Dakota. Energized in March 2007, this new wind farm increases Western's wind interconnections to 305 MW—up from 278 MW in FY 2006. We also worked to prepare the Wessington Springs Substation in South Dakota for a 50-MW wind farm interconnection, a 200-MW interconnection request at our White Substation in South Dakota, and a 50 MW Valley County Wind Energy Project near Glasgow, Mont., scheduled to go online in 2008.

At the end of FY 2007, we had more than 69 additional requests in our study queue for additional wind generation, totaling 14,000 MW of renewable generation (average request is 200 MW) compared to 35 requests for 9,300 MW in FY 2006.

Western is a forerunner in the utility industry for accommodating the intermittent nature of wind generation. In FY 2007, Western was the only known entity within Western Electricity Coordinating Council that had implemented three FERC-identified ancillary services to address the unique characteristics of wind. For example, Western Rocky Mountain Region's Energy Imbalance Service Rate does not assess a penalty to a wind farm when forecasted generation is missed; the rate charges 100 percent of the cost without penalty, and credits the same back to the wind farm if it overgenerates.



Wind turbines generating power.

Wind Studies identify interest

Western supported a multi-state wind integration study program entitled, “Wind Integration Study Cost-Share Program with the National Renewable Energy Laboratory” in FY 2007 to identify consumer-owned utilities in Western’s service territory with a high level of interest in conducting wind integration studies. The effort examined potential impacts of wind integration to consumer-owned utility transmission and distribution systems and balancing area operators and the potential cost of service. NREL accepted cost-share applications from consumer-owned utilities within Western’s 15-state territory. A minimum of \$650,000 was available in FY 2007 under this program.

Partnering with tribes

Consultation and technical assistance support tribes



Colorado River Indian Tribal members look at the proposed siting of the Parker-to-Blythe No. 1 transmission line in Arizona. Western and the tribes consulted on the project to re-route the line away from the Black Point Mesa where cultural resources are located.

Western continued its efforts in FY 2007 to solidify relationships with Native American tribes by arranging about 50 tribal meetings concerning projects and activities Westernwide with possible environmental or cultural impacts to tribal lands. Western policy level staff, including the Administrator, conducted several government-to-government consultation meetings concerning Western’s support for tribal renewable and economic development. Last year, we also fostered our relationship with Gila River Indian Community by providing technical assistance and additional transmission to help

the tribe in establishing a tribal utility. We also continued to promote our bill crediting program (and benefit crediting), which allows tribes that have not formed their own utilities to still receive the benefit of cost-based Federal hydropower. Through bill crediting, Western delivers the tribe’s allocation to another utility in the area, which then passes along the benefit of the lower-cost power to the tribes.

Request for Interest in Tribal Wind issued

Western’s Upper Great Plains Region issued a Request for Interest in summer 2007 to customers in the service area that might be interested in purchasing energy and Renewable Energy Credits from tribal wind energy projects. We received four statements of interest and sent them to the Intertribal Council on Utility Policy for action. The project could consist of developing, constructing and maintaining wind farms located on tribal lands to enhance economic development through lease payments and construction and maintenance jobs. More than 20 large land-based Indian Reservations are located in the Upper Missouri River Basin. Tribal wind potential in this area exceeds 535 billion kWh annually.

Tribes consulted on Wind-Hydro study

Western staff consulted with tribes on the Wind/Hydro Feasibility Study to determine the feasibility of integrating wind with Missouri River hydropower generation. This joint study by Western, DOE, the U.S. Army Corps of Engineers and Department of the Interior analyzes the costs, benefits, including energy security, of a demonstration project that uses wind energy generated on tribal land and hydropower generated on the Missouri River to supply firming power to Western. Results from this study, which was called for in Section 2606 of EAct of 2005, will be reported to Congress.

Power allocated to tribes

In FY 2007, Western delivered Federal hydropower to 87 tribes and continued looking for ways to serve more tribal communities. For example, in December 2006, DSW also completed its Post-2008 Resource Pool allocation process for 17 MW of summer capacity and 13 MW of winter capacity. Thirteen entities received an allocation, including four new tribes and one existing tribe.

Partnering for safety and security

Western computers secured

Working together, Western employees ensured the integrity and protection of our computer systems and networks, the hub of our reliable system. Through our Cyber Security Program, we continually protect Western from ever-evolving threats attacking our networks and other computer systems, which keep our day-to-day marketing transactions and SCADA systems running 24/7. Western blocked more than 1.4 million computer viruses and SPAM e-mails in FY 2007.



Cyber Security Manager *Laurent Webber* monitors Western's network.

Western teamed up on safety with Arc Flash Policy

To comply with the National Electric Safety Code and National Fire Protection Association, Western's Engineering and Maintenance community developed a policy to prevent injuries from arc flashes, which are a type of electrical explosion. The policy requires employees working on or near energized parts to conduct an arc flash hazard analysis to determine the safest way to perform maintenance. Depending on the hazard level, employees may be required to either de-energize the equipment, wear Western-approved fire resistant protective clothing or modify the work procedure to remove the hazard. An estimated five to 10 arc flash incidents happen every year in the United States, often causing burns that require hospitalization. Staff updated the Power System Maintenance and Safety Manuals to ensure safety of crews and to prevent arc flash incidents. Also, through the Electric Power Research Institute, Western has partnered with nine other utilities to conduct a research project to determine the hazard levels for arc flash incidents on transmission level voltages.

FY 2007 IRP SUMMARY

Western's Integrated Resource Planning requirements outlined in Section 114 of the Energy Policy Act of 1992 gives customers several options to meet these requirements. The requirements, which were updated in 2000, recognize the changes occurring in the utility industry and our customer's varying size and structure. These changes also streamlined the reporting requirements without sacrificing the EAct's intent.

Customers must submit progress reports annually and new integrated resource plans every five years. They may submit them individually or cooperatively when they belong to member-based associations.

The IRP regulations allow customers to set action plan timelines (instead of a five-year minimum) to better correspond with their own situations. The regulations no longer require customers to provide a complete load forecast, only a brief summary verifying that one was conducted. It's not necessary for customers to provide detailed information validating predicted performance. Instead, they can submit a brief description of measurement strategies for the options identified in the IRP.

Western also accepts other IRP alternatives. Members of member-based associations and joint action agencies may now file a small customer plan if their sales/use is under 25 GWh per year.

Another alternative to the IRP is the minimum investment report. Customers required by a state, tribal or Federal regulation to make minimum financial/resource investment in demand-side management or renewable programs may file a minimum investment report consisting of an initial report and an annual letter.

With the Energy Efficiency/Renewable Energy Report option, state, tribal or Federal end-use customers required by state, tribal or Federal mandate to conduct energy efficiency or renewable energy programs can provide an initial report and an annual report on these activities to comply with Western's requirements.

All firm power customers have submitted one of these options. In FY 2007, Western received 82 IRPs from individual customers, 30 plans from cooperatives, 60 minimum investment reports and 96 small customer plans. These plans represent 784 long-term firm power customers and customer members.

Customer reported trends include:

- More investment in renewables, efficiency and basic conservation activities
- Increased influence of climate change issues
- Increased demand for renewable energy technologies in all (commercial, industrial, residential and institutional) market segments
- Increased requests for education and information transfer on energy efficiency and renewable energy technologies
- Water management issues including efficient use, conservation, irrigation and pumping efficiency
- Continued interest in demand-side management and efficiency activities/programs

The most frequent demand-side management activities cited by Western's customers are:

- Lighting technologies
- HVAC technologies with emphasis on cooling and ventilation
- Audits for residential, commercial and industrial facilities
- Domestic hot water technologies
- Irrigation system improvements

- Load management programs
- Weatherization
- Motor replacement

The top five renewable energy resource choices are:

- Hydro (large and small)
- Wind generation
- Solar—PV
- Geothermal
- Biomass/gas

IRPs are driven by customer need and requests. Cost and reliability used to be the major priorities and they still are, but climate change and environmental issues, national security, social issues, economic issues and political issues have joined the list. The potential for additional regulation on emissions is another factor that will certainly influence the results of many IRPs.

FY 2007 Customer IRP Accomplishments						
Item	CRSP	DSW	RM	SN	UGP	Total
DSM savings¹ (kW)	5,430	137,705	125,551	87,974	938,816	1,295,476
DSM savings (kWh)	51,509,297	1,295,181,476	100,695,890	214,592,811	68,782,087	1,730,761,561
DSM expenditure (\$)	13,141,798	40,930,879	4,996,936	60,230,362	42,859,151	\$162,159,126
DSM deviations² (\$)	10,149,517	(524,711)	619,970	811,852	7,548,295	\$18,604,923
Renewables (kW)	49,005	2,459,808	184,763	186,102	490,350	3,370,028
Renewables (kWh)	212,364,170	3,657,291,872	512,168,733	764,486,744	1,609,412,214	6,755,723,733
Renewable expenditure (\$)	3,269,607	99,770,110	12,585,077	37,410,796	40,472,250	\$193,507,840
Renewable program types	WTE, Solar, Wind, Small scale hydro	Solar, Wind, hydro	Small Hydro, Wind, Co-gen, Bio-mass, Solar	Small Hydro, Geothermal, Solar,	Medium/ Large wind, PV, WTE, Hydro	Solar, Hydro, Wind, Co-gen, Biomass/gas, Geothermal, WTE

¹ DSM refers to Demand-side management activities the utility conducts to change customer energy use.

² Deviations are any difference from their Integrated Resource Plan.

Management Discussion and Analysis

Federal Power Program Financial Highlights and Three-Year Financial Summary

The drought continued to impact Western's financial results and operations in FY 2007 in much the same way we experienced in FY 2006. Less power was generated, although revenue increased \$11.4 million to \$890.9 million, reflecting specific power system revenue requirements as supported by related marketing plans and rate adjustments.

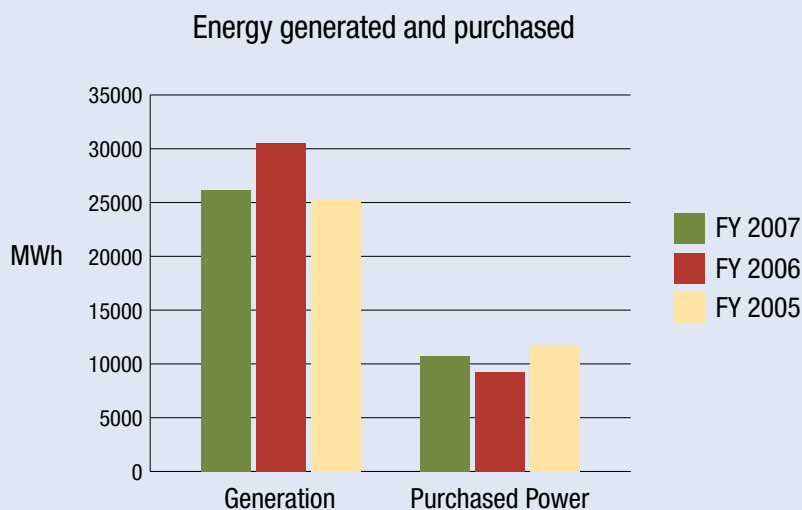
Other operating income decreased by \$6.9 million to \$282.5 million—offsetting increases in transmission revenues—as a result of settlement payments and reclassifications of timing and project use revenue attributed to FY 2006.


Drought conditions in specific power systems continued to impact hydropower generation and the need to purchase power to meet contractual requirements. Total systemwide hydropower generation decreased 16.4 percent in FY 2007, largely driven by reduced generation in California, which plummeted 40.5 percent when compared to FY 2006 output. In FY 2007, Western purchased 10.7 million MWh of power, an additional 1.4 million MWh from the FY 2006 level, resulting in a \$43.9 million or 8.9 percent increase to \$537.9 million.

Purchased Power

Improved policies to control purchase power costs were apparent in FY 2007. Western found lower rates by spreading purchases over more suppliers than we did in FY 2006. Specifically, Western paid on average \$51 per megawatt, or \$2 less per MWh, than in FY 2006, although this was still significantly higher than the FY 2005 price of \$43 MWh.

The following graph displays hydropower generation and corresponding purchase power activity to satisfy energy commitments.





Western continues exploring new energy contract strategies that include renewables in our existing Purchase Power Program, which is critical to meet contractual and customer demands.

Operations and Maintenance Costs

Operation and maintenance costs increased \$28.4 million, 8.6 percent, to \$359.5 million to ensure transmission reliability and protect related infrastructure. Higher costs resulted from increased vegetation management activities with continued focus on preventive maintenance to sustain or increase system reliability outlined in Western's Strategic Plan.

Repayment of Program investment in FY 2007 totaled \$31.6 million, compared to \$42.3 million in FY 2006. Specifically, repayment consisted of \$24.9 million of Federally-financed power investment, \$5.4 million of non-Federally-financed power investment, and \$1.3 million of non-power investment. Cumulative repayment of investment in program assets amounts to about \$3 billion through FY 2007 consisting of:

- \$2.9 billion or 51.7 percent of Federally-financed power
- \$76.5 million, or 33.3 percent, of non-Federally financed investment
- \$44.5 million, or 1.9 percent, of non-power investment

Additionally in FY 2007, the Federal Power Program paid the Treasury and taxpayers \$182.1 million in interest expense for a cumulative total of \$4.3 billion in interest expense on hydro-power investments to date.

Western and our generation partners continue to emphasize efforts to increase overall efficiency and effectiveness of generation and transmission assets for system reliability. At the end of FY 2007, the Federal Power Program plant account is about \$5.9 billion. Notable activities included \$64.6 million of construction work-in-progress being transferred to completed plant with a corresponding plant asset reduction of \$64.4 million. In addition, construction work-in-progress increased by \$159.1 million in FY 2007 to reflect new and continuing construction activities.

Federal Power Program officials are responsible for the contents of the 2007 power financial statements, which are prepared to conform to Generally Accepted Accounting Principles (GAAP). The power systems maintain a comprehensive accounting system containing controls that provide reasonable assurance about the integrity and reliability of the financial records and protection of assets. The FY 2007 Program financial statements again received an unqualified audit opinion (dating back to FY 1991), reflecting our continued success in recording and maintaining reliable financial information. In addition, internal audit staff regularly test and evaluate both internal controls and operating procedures related to major business processes and information systems to meet the requirements of OMB Circular A-123, Appendix A, "Internal Controls over Financial Reporting" for 2007.

Three-Year Financial Summary¹
Key Income Statement/Balance Sheet Accounts
(millions of dollars)

	FY 2007	FY 2006	FY 2005
Revenues			
Sales of Electric Power	890.9	879.5	806.6
Other Operating Income	282.5	289.4	260.1
Expenses			
Operation and Maintenance	359.5	331.1	318.2
Administrative and General	43.9	43.1	54.4
Purchased Power	537.9	494.1	479.0
Purchased Transmission Service	60.8	59.7	45.9
Interest on Federal Investment	179.3	179.8	169.6
	FY 2007	FY 2006	FY 2005
Assets			
Completed Plant	5,864.9	5,864.6	5,742.2
Construction work-in-progress	223.7	129.8	158.5
Cash	557.1	513.6	425.8
Accounts Receivable	144.2	129.5	116.7
Other Assets	209.6	190.3	195.2
Liabilities			
Accounts Payable	66.8	63.3	70.5
Other Liabilities	408.8	383.4	382.4

¹ The numbers above include inter-project sales (elimination entries) and Central Arizona Project activities.

Performance Perspective

Each year, the Program selects key performance targets that measure our continuing efforts to manage Federal resources and assets, which enhance the public's benefit by providing reliable, cost-effective, clean hydroelectric power. These targets illustrate the relationship of the various indicators to evaluate agency performance. The results of our efforts are:

1. Provide a Reliable Power Supply

Operate and maintain reliable power facilities

As hydropower infrastructure ages, it exhibits signs of deterioration and increased risk of impairment or failure, resulting in reduced capacity and availability and increased operation and maintenance costs/work.

Hydropower facilities are in fair to good condition as measured by the Facilities Reliability Rating:

U.S. Bureau of Reclamation: Goal was met. The annual target was 93 percent, with the actual performance reported at 98 percent. The targeting methodology predicted less than one power plant per region would be categorized as poor. However, as a result of a highly successful preventive maintenance program—only one facility, system-wide—was rated in poor condition.

U.S. Army Corps of Engineers: The measure was added at the end of FY 2007. The first year to report performance data will be FY 2008. This measure reflects the Corps' ongoing efforts to develop metrics for comparison with industry to include Federal and non-Federal entities.

Percent of time in forced outage: As measured against industry-wide forced outage average as reported by the North American Electric Reliability Corporation. The lower the forced outage rate, the more reliable and less expensive the electrical power provided to the customer.

Reclamation: Goal was not met. The annual target was 1.9 percent (annual industry average) with actual performance reported at 2.6 percent. These results reflect Reclamation's decisions to balance outages with the need to maintain and modernize system facilities.

Corps: Goal was not met. The hydropower program standard metric used for forced outages is 2.0 percent. The program's forced outage performance is 2.7 percentage points above the standard (4.7 percent) and 1.2 percentage points above the FY 2007 target of 3.5 percent.

The number and length of outages directly impacts the availability of the generating units, which, in turn, impacts costs, as noted below.

Improve power generation management to maximize supply

Percent of time that hydroelectric generating units are available to the interconnected Western electrical system during daily peak demand periods:

Reclamation: Goal was not met. The annual target was 91.6 percent, with the actual performance reported at 89.4 percent.

Corps: Goal was not met. The annual target was 89 percent, with actual performance reported as 84.3 percent. The significant decrease in appropriations for the program in FY 2007 affected performance and availability accordingly, which, in turn, caused system operation and maintenance costs to increase.

2. Provide Reliable Power Delivery

Control Area Performance Standards (CPS 1 & 2): NERC control performance standards for CPS1 greater than 100 and CPS2 greater than 90 respectively measures a generating system's performance at matching supply to changing demand requirements and in limiting the magnitude of generation and demand imbalances. Balanced supply and demand ensure wise and stable electric power grid operation.

Western: Goal was met. Actual system performance was 181.08 for CPS1 and 98.64 for CPS2. This reflects the ability of Western and the generating agencies to maintain the same high standards of performance in an increasingly complex operating environment due to industry restructuring.

Accountable outages

This measure reflects the Program's ambitious long-term goal to effectively operate and maintain the transmission system to ensure reliable operations. The operations support the integrated grid by reducing/eliminating outages resulting from improper or incorrect equipment operation, installation and maintenance.

Western: Goal was met. Transmission outages resulting from failure to effectively operate or maintain the transmission system "will not exceed" annual target of 26. Actual number of accountable outages recorded was 18. Achieving this target reflects Western's ability to operate and maintain the power system reliably, thus providing dependable service to customers.

3. Provide Cost Effective Power Services and Supply

Power Production Cost Goal: Operation and Maintenance (O&M) costs for power, expressed as \$/MW, will not increase annually beyond the five-year rolling average increase in cost, plus or minus 5 percent.

Reclamation: Goal was met. The annual target was 7.21 percent, with actual performance reported as 2.44, reflecting continued performance and cost containment.

Corps: Measure was added at the end of FY 2007. The first year this performance data is reported will be FY 2008.

Western: The power marketing administrations are currently developing an annual operating cost performance goal to contain operation and maintenance costs that impact power rates at levels below the national average for hydropower. FY 2008 will be the first year to report this measure.

We continue to evaluate and refine programs and processes to ensure our work is carried out effectively and meets applicable industry requirements and standards. We will continue to promote and use partnerships to create sustainable solutions, to leverage resources and learn from others in industry. This work will guide us in accomplishing our mission of managing resources and assets effectively, economically, and in an environmentally sound manner to benefit the American public.

Independent auditor's report

The Administrator

Western Area Power Administration

United States Department of Energy

We have audited the accompanying combined power system balance sheets of the Western Area Power Administration (Western), an agency of the U.S. Department of Energy, and the Western affiliated power generating functions of the U.S. Department of the Interior, Bureau of Reclamation; the U.S. Department of Defense, Army Corps of Engineers; and the U.S. Department of State, International Boundary and Water Commission (collectively, the generating agencies), as of September 30, 2007 and 2006, and the related combined power system statements of revenues and expenses, and accumulated net deficit, and cash flows for the years then ended. These combined power system financial statements are the responsibility of Western and the generating agencies' management. Our responsibility is to express opinions on these combined power system financial statements based on our audits. We did not audit the financial statements of the affiliated power generation function of the U.S. Department of the Interior, Bureau of Reclamation (Reclamation), which statements reflect total assets constituting 30% and 31% of combined total assets as of September 30, 2007 and 2006, respectively, and total revenues constituting 19% and 21%, respectively, of combined total revenues for the years then ended. Those statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for Reclamation, is based solely on the report of such other auditors.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*. Those standards and OMB Bulletin No. 07-04 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of Western and the generating agencies' internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits and the report of the other auditors provide a reasonable basis for our opinions.

In our opinion, based on our audits and the report of other auditors, the combined power system financial statements referred to above present fairly, in all material respects, the combined financial position of Western and its affiliated power generating agencies, as of September 30, 2007 and 2006, and their combined operations, changes in accumulated net deficit, and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated July 18, 2008 on our consideration of Western and the generating agencies' internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Deloitte & Touche LLP

July 18, 2008

Combined Power System Balance Sheets

As of September 30, 2007 and 2006 (in thousands)

	FY 2007	FY 2006
Assets		
Utility plant:		
Completed plant	\$ 5,864,912	\$ 5,864,569
Accumulated depreciation	<u>(2,778,029)</u>	<u>(2,671,840)</u>
Net completed plant	3,086,883	3,192,729
Construction work-in-progress	<u>223,746</u>	<u>129,764</u>
Net utility plant	3,310,629	3,322,493
Cash	557,092	513,586
Accounts receivable, net	144,156	129,546
Other assets	209,578	190,306
Total assets	\$ 4,221,455	\$ 4,155,931
Federal investment & liabilities		
Federal investment:		
Congressional appropriations	\$ 12,530,534	\$ 12,090,628
Interest on Federal investment	4,774,923	4,598,580
Transfer of property & services, net	<u>768,350</u>	<u>639,969</u>
Gross Federal investment	18,073,807	17,329,177
Funds returned to U.S. Treasury	<u>(13,475,420)</u>	<u>(13,015,516)</u>
Net outstanding Federal investment	4,598,387	4,313,661
Accumulated net deficit	(852,563)	(604,465)
Total Federal investment	\$ 3,745,824	\$ 3,709,196
Commitments and contingencies (notes 1, 6, 7 and 8)		
Liabilities:		
Accounts payable	66,849	63,346
Other liabilities	408,782	383,389
Total liabilities	475,631	446,735
Total Federal investment & liabilities	\$ 4,221,455	\$ 4,155,931

See accompanying notes to combined power system financial statements.

Combined Power System Statements of Revenues and Expenses, and Accumulated Net Deficit

For the Years Ended September 30, 2007 and 2006 (in thousands)

	2007	2006
Operating revenues:		
Sales of electric power	\$ 890,866	\$ 879,477
Other operating income	282,547	289,428
Gross operating revenues	1,173,413	1,168,905
Income transfers, net	(125,697)	(121,798)
Total operating revenues	1,047,716	1,047,107
Operating expenses:		
Operation and maintenance	359,494	331,114
Administration and general	43,855	43,118
Purchased power	537,949	494,079
Purchased transmission services	60,835	59,728
Depreciation	111,618	108,785
Total operating expenses	1,113,751	1,036,824
Net operating revenues (deficit)	(66,035)	10,283
Interest expenses:		
Interest on Federal investment	179,282	180,767
Interest on non-Federally financed funding	10,702	10,392
Allowance for funds used during construction	(7,921)	(7,767)
Net interest expenses	182,063	183,392
Net deficit	(248,098)	(173,109)
Accumulated net deficit, beginning of year	(604,465)	(429,091)
Irrigation assistance	0	(2,265)
Accumulated net deficit, end of year	\$ (852,563)	\$ (604,465)

See accompanying notes to combined power system financial statements.

Combined Power System Statements of Cash Flows

For the Years Ended September 30, 2007 and 2006 (in thousands)

	2007	2006
Cash flows from operating activities:		
Net deficit	\$ (248,098)	\$ (173,109)
Adjustments to reconcile net deficit to net cash (used in) provided by operating activities:		
Depreciation	111,618	108,785
Interest on Federal investment	175,232	179,819
Gain/Loss on disposition of assets	4,545	2,429
(Increase) decrease in assets:		
Accounts receivable	(14,610)	(12,850)
Other assets	(10,428)	(5,464)
Increase (decrease) in liabilities:		
Accounts payable	3,503	(7,128)
Other liabilities	22,229	(25,182)
Net cash (used in) provided by operating activities:	43,991	67,300
Cash flows from investing activities:		
Investment in utility plant	(139,260)	(86,811)
Cash flows from financing activities:		
Congressional appropriations, net	595,501	583,602
Funds returned to U.S. Treasury	(459,906)	(505,885)
Principal payments on non-federally financed funding	3,180	31,850
Irrigation assistance	0	(2,265)
Net cash (used in) provided by financing activities	138,775	107,302
Net (decrease) increase in cash	43,506	87,791
Cash, beginning of year	513,586	425,795
Cash, end of year	\$ 557,092	\$ 513,586
Supplemental schedule of noncash investing and financing activities		
Transfer of construction work-in-progress to completed plant	\$ 65,111	\$ 119,563
Capitalized interest during construction	\$ 7,979	\$ 7,769

See accompanying notes to combined power system financial statements.

Notes to Combined Power System Financial Statements

(As of and for the years ended September 30, 2007 and 2006)

(1) Basis of Presentation and Summary of Significant Accounting Policies

(a) Principles of Combination

The combined power system financial statements include the financial position, results of operations and cash flows of the Western Area Power Administration (Western), an agency of the U.S. Department of Energy (DOE), and the power generating function of the U.S. Department of the Interior, Bureau of Reclamation (Reclamation); the U.S. Department of Defense, U.S. Army Corps of Engineers (Corps); and the U.S. Department of State, International Boundary and Water Commission (IBWC) (collectively known as the generating agencies) for the individual power systems. The jointly owned power systems are separately managed and financed, and maintain separate accounting records. Western, a Federal power marketing administration, markets and transmits hydroelectric power generated from these power systems operated and maintained by the generating agencies throughout 15 western states. The power systems, with the exception of the Central Arizona Project (CAP) and the Pacific Northwest-Pacific Southwest Intertie (Intertie), are part of multipurpose water resource projects and include certain Western transmission facilities and certain generating agency facilities.

Operating expenses and net assets of multipurpose water resource projects are allocated among project activities, which are primarily power, irrigation, recreation, municipal and industrial water, navigation and flood control (see Note 4). The combined power system financial statements include only those expenses and net assets which are expected to be recovered through the sale of power and other related income.

Although Reclamation holds an entitlement to power from the coal-fired Navajo Generating Station and capacity from the CAP transmission facilities, the combined power system has no ownership in these facilities. As such, neither entitlements nor their associated assets are included in the combined power system financial statements.

Accounts are maintained in accordance with accounting principles generally accepted in the United States of America (GAAP) and the Federal Energy Regulatory Commission's (FERC) prescribed uniform system of accounts for electric utilities. Accounting policies also reflect specific legislation and executive directives issued by departments of the Federal government. The combined power system financial statements are presented in accordance with the provisions of Financial Accounting Standards Board (FASB) Statement No. 71, *Accounting for the Effect of Certain Types of Regulations*. The provisions of FASB Statement No. 71 require, among other things, that regulated enterprises reflect the regulator's rate actions in their financial statements, when appropriate. These rate actions can provide reasonable assurance of the existence of an asset, reduce or eliminate the value of an asset, or impose a liability on a regulated enterprise.

For purposes of financial reporting, the facilities and related operations of Western and the generating agencies are considered one entity. All intraentity balances and transactions have been eliminated from the combined power system financial statements.

The facilities and net revenues included in these combined power system financial statements are exempt from taxation.

(b) Confirmation and Approval of Rates

The Secretary of Energy (Secretary) has delegated authority to Western's Administrator to develop power and transmission rates for its controlled power systems. The Deputy Secretary of Energy has the authority to confirm, approve and place such rates in effect on an interim basis. The Secretary delegated to FERC the authority to confirm, approve and place such rates in effect on a final basis, to remand, or to disapprove such rates. Refunds with interest, as determined by the FERC, are authorized if rates finally approved are lower than rates approved on an interim basis. However, if at any time FERC determines that the administrative cost of a refund would exceed the amount to be refunded, no refunds will be required. No refunds are anticipated in connection with rates approved on an interim basis through September 30, 2007.

(c) Operating Revenues

Operating revenues are recognized when goods or services are provided to the public or another government agency. Except for power systems using revolving funds and customer advances, cash received from sales is deposited directly with the U.S. Department of the Treasury (U.S. Treasury) and is reflected as Funds Returned to U.S. Treasury in the Combined Power System Balance Sheet. As such, these funds are unavailable for power system operating needs. For power systems using revolving funds and customer advances, cash received is deposited in the U.S. Treasury and remains available to the power system. Cash collected into revolving funds in excess of operating requirements is used for repayment of Federal investment and interest.

Power and transmission rates are established under requirements of the power systems' authorizing legislation and related Federal statutes and are intended to provide sufficient revenue to recover all costs allocated to power and, in some power systems, a portion of irrigation-related costs (see Note 7). Costs allocated to power include repayment of Federal investment in power facilities and associated interest. Rates are structured to provide for repayment of Federal investment in power facilities, generally over 50 years, while operating expenses and interest on Federal investment are recovered annually. Replacements of utility plant are generally to be repaid over their expected service lives.

The power systems' legislation does not recognize annual depreciation based on actual service lives as a measure of the required repayment for investment in utility plant. This results in some assets being fully depreciated before costs are recovered; whereas, annual depreciation costs on other assets may continue after such costs have been recovered through revenues. Over the life of the combined power systems, accumulated net revenues represent timing differences between the recognition of expenses and related revenues. Because Western and the generating agencies are nonprofit Federal agencies, accumulated net revenues, to the extent that they are available, are committed to Federal investment repayment.

Other operating income represents the amount of funds collected from sources other than the sale of electric power. These revenues include rental of electric property, power wheeling and transmission services.

Net income transfers represent the amount of funds collected but subsequently transferred to Reclamation. This amount is primarily the surplus generation billed for the Navajo Generating Station by Western, on behalf of Reclamation's CAP.

(d) Cash

For purposes of the Combined Power System Financial Statements, cash consists principally of the undisbursed balance of funds authorized by Congress, customer advances and revolving fund balances at the U.S. Treasury.

(e) Accounts Receivable, Net

The estimate of the allowances is based on past experience in the collection of receivables and an analysis of the outstanding balances. The amounts due for receivables are stated net of an allowance of \$0.2 million for uncollectible accounts as of September 30, 2007 and 2006, from a gross amount of \$144.4 million and \$129.7 million, respectively.

Billing methods used by Western include net billing and bill crediting. Net billing is a two-way agreement between Western and a customer, whereby both buy and sell power to each other. Monthly sales and purchases, including any customer advances received, are netted between the two parties and the customer is provided either an invoice or a credit. Bill crediting involves a three-way net billing arrangement among Western, a customer and a third party. For example, Western purchases power from a third-party supplier, delivers it to the customer; the customer then pays the third-party supplier and receives a credit on its bill from Western.

(f) Stores Inventory

Inventory consists of hardware, tools, and maintenance parts and supplies. Inventory is valued using the average cost method.

(g) Utility Plant

Utility plant is stated at original cost, net of contributions in aid of construction by entities outside of the combined power system. Costs include direct labor and materials; payments to contractors; indirect charges for engineering, supervision and administrative and general expense; and interest during construction. The costs of additions, major replacements and betterments are capitalized; whereas, repairs are charged to operation and maintenance expense.

The cost of retired utility plant, net of accumulated depreciation, is charged to operation and maintenance expense as a gain (loss) and the net of removal costs and salvage credits is capitalized as part of the direct replacement asset. If there is not a replacement asset, the net of removal costs and salvage credits is charged to operation and maintenance expense. Plant assets of the combined power system are currently depreciated using the straight-line method over estimated service lives ranging from 8 to 50 years for transmission assets and 10 to 100 years for generation assets. Power rights are amortized over 40 years.

(h) Interest on Federal Investment

Interest is accrued annually on the Federal investment based on the Federal statute and power system legislation. Such interest is reflected as an expense in the Combined Power System Statement of Revenues

and Expenses. Western calculates interest annually based on the unpaid Federal investment owed to the U.S. Treasury using rates set by law, administrative orders pursuant to law or administrative policies.

All power systems recognize an annual interest credit for payments of interest on obligations that are due annually to the U.S. Treasury. Interest rates on unpaid Federal investments ranged from 2.5 to 12.4 percent for the years ended September 30, 2007 and 2006.

As provided by Federal law, interest is not assessed on Federal investment in irrigation facilities anticipated to be repaid through power sales (see Note 7).

(i) Allowance for Funds Used During Construction

Interest During Construction (IDC or Allowance for Funds Used During Construction) represents interest on funds borrowed from the U.S. Treasury during the construction of all generating and transmission facilities. Western calculates IDC based on the average annual outstanding balance of construction work-in-progress. Western and the generating agencies' policy is to capitalize IDC through the end of the fiscal year in which assets are placed in service. IDC is recovered over the repayment period of the related plant asset. Applicable interest rates ranged from 3.2 to 8.9 percent for the years ended September 30, 2007 and 2006, depending on the year in which construction on the transmission and generation facilities was initiated or the authorizing legislation.

(j) Pension and Other Retirement Benefits

Statement of Federal Financial Accounting Standards (SFFAS) No. 4, *Managerial Cost Accounting Concepts and Standards for the Federal Government*, and SFFAS Statement No. 5, *Accounting for Liabilities of the Federal Government*, direct the full cost reporting of employment benefits by an employing entity. These statements require Federal agencies to record the government's cost of providing pension, life and health insurance and other post-employment benefits (severance payment, counseling and training, workers' compensation benefits, etc.) regardless of the funding agency.

(k) Use of Estimates

Management of Western and the generating agencies have made many estimates and assumptions relating to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities to prepare these combined power system financial statements in conformity with GAAP. Actual results could differ significantly from those estimates.

(l) Derivative and Hedging Activities

Western analyzes derivative financial instruments in accordance with FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*. This statement requires that all derivative instruments, as defined by FASB Statement No. 133, be recorded on the balance sheet at fair value unless exempted. Changes in a derivative instrument's fair value must be recognized currently in earnings unless the derivative has been designated in a qualifying hedging relationship. The application of hedge accounting allows a derivative instrument's gains and losses to offset related results of the hedged item in the statement of operations, to the extent effective. FASB Statement No. 133 requires that the hedging relationship be highly effective and that a company formally designate a hedging relationship at the inception of the contract to apply hedge accounting.

Western enters into contracts for the purchase and sale of electricity for use in their business operations. FASB Statement No. 133 requires Western to evaluate these contracts to determine whether the contracts are derivatives. Certain contracts that literally meet the definition of a derivative may be exempted from FASB Statement No. 133 as normal purchases or normal sales. Normal purchases and normal sales are contracts that provide for the purchase or sale of something other than a financial instrument or derivative instrument that will be delivered in quantities expected to be used or sold over a reasonable period in the normal course of business. Contracts that meet the requirements of normal purchases or normal sales are documented and exempted from the accounting and reporting requirements of FASB Statement No. 133.

Western's policy is to fulfill all derivative and hedging contracts by either providing power to a third party or by taking delivery of power from a third party as provided for in each contract. Western's policy does not authorize the use of derivative or hedging instruments for speculative purposes such as hedging electricity pricing fluctuations beyond Western's estimated capacity to deliver or receive power. Accordingly, Western evaluates all of its contracts to determine if they are derivatives and, if applicable, to ensure that they qualify and meet the normal purchases and normal sales designation requirements under FASB Statement No. 133. Normal purchases and normal sales contracts are accounted for as executory contracts as required under generally accepted accounting principles.

(m) Concentrations of Credit Risks

General Credit Risk

Financial instruments, which potentially subject Western and the generating agencies to credit risk, include accounts receivable for customer purchases of power, transmission, or other products and services. These receivables are primarily with a group of diverse customers that are generally large, stable and established organizations which do not represent a significant credit risk. Although Western and the generating agencies are affected by the well-being of the utility industry, management does not believe a significant risk of loss from a concentration of credit exists.

(n) Moveable Equipment

Moveable equipment represents the acquisition cost of capitalized movable equipment having a unit cost of \$15,000 or more and an estimated useful life of two years or more. Examples of capitalized moveable equipment include computers, copiers, cranes, energy testing equipment, helicopters, trucks and wood chippers.

Western's internal use software is capitalized when the software has a service life of 3 years or more and a cost of \$150,000 or more upon the completion of the software development phase or upon purchase of commercial off-the-shelf software applications. Reclamation's internal use software is subject to a \$100,000 capitalization threshold with a service life of 2 years or more. No other generating agency has any capitalized internal use software.

(o) Abandoned Projects

In accordance with FERC regulations, Western's policy is to move capitalized costs into plant-in-service at the time the asset is placed in service. Occasionally, congressionally authorized projects originally planned for service are discontinued due to political and/or economic reasons. Western's policy is to classify these discontinued projects

based on congressional action as abandoned projects and amortize them into the power rates over a reasonable period.

(p) Interchange Energy

Western's power contracts may include a provision for energy transfers between Western and a supplier that result in deferred energy debits or credits. Deferred energy debits or credits represent the valuation of excess energy delivered or received under the interchange energy contract provisions. The interchange balance is posted either as a deferred debit (other asset) when Western is the net supplier, or as a deferred credit (other liabilities) when Western is the net user.

(q) Recovery Implementation Program (RIP)

Section 8 of the Colorado River Storage Project Act of 1956, as amended, mandates that the U.S. Department of the Interior establish and implement programs to conserve fish and wildlife. Under this act and other legislation, Reclamation has established programs to preserve the habitat and otherwise aid endangered fish and wildlife. The RIP is one such program and is managed by the U.S. Fish and Wildlife Service.

On October 30, 2000, Congress passed Public Law 106-392 that authorized additional funding to Reclamation to continue the RIP. The legislation specifies that a total of \$17.0 million is to be collected by Western from its power customers and provided to Reclamation to finance capital costs and up to \$6.0 million a year starting in FY 2001 for operating expenses, adjusted annually for inflation thereafter. Furthermore, the legislation states that operating expenses are considered non-reimbursable to the U.S. Treasury and a repayment of the Federal investment. Conversely, capital funded costs must be repaid to the U.S. Treasury through future power sales. Operating expenses were \$6.8 million and \$6.7 million for the years ended September 30, 2007 and 2006, respectively. There were no reimbursable capital costs for the years ended September 30, 2007 and 2006, respectively.

(r) Unused Annual Leave

Unused annual leave represents accrued benefits which would be payable to employees upon retirement or separation from employment with the government. The amount not funded by revolving funds has been deferred as an other asset in the Combined Power System Balance Sheet in accordance with FASB Statement No. 71.

(s) Transmission Termination Settlement

Western renegotiated certain CRSP long-term contractual obligations with third-party power providers. Under the terms of the settlement agreements, annual payments of \$0.6 million will be made through 2017 to PacifiCorp. The recognition of the expense associated with the settlements has been deferred as an 'other' asset in the Combined Power System Balance Sheet in accordance with FASB Statement No. 71 (see Note 2).

(t) Customer Advances

Customer advances represent the current balance of advance payments received from power and other customers under co-sponsoring agreements with entities for construction, operation and maintenance, or other furnished items. Subsidiary accounts are maintained by customer to reflect the status of each advance. Also included are revenue financing contracts that provide for customer funds to be advanced for construction, maintenance or purchase power expenses. For these contracts, the customer is provided revenue credits on future

power bills up to the amount of the advanced funds and, if applicable, any interest or fees.

(u) Workers' Compensation

Workers' compensation consists of two elements: a liability for expenses from actual claims incurred and paid by the Department of Labor (DOL) that Western and the generating agencies must reimburse; and an actuarial liability associated with cases incurred for which additional future claims may be made. In conjunction with SFFAS Statement Nos. 4 and 5, DOL determined the actuarial liability associated with future claims using historical benefit payment patterns discounted to present value (37 years) using economic assumptions for 10-year U.S. Treasury notes and bonds.

The recovery of future claims is deferred for rate-making purposes until such time the claims are submitted to and paid by the DOL.

Therefore, the recognition of the expense associated with the actuarially determined liability has been deferred as an other asset in the Combined Power System Balance Sheet in accordance with FASB Statement No. 71 (see Note 2) to reflect the effects of the rate-making process.

(v) Capital Credits

Capital credits represent the investment made in non-profit organizations that result in equity ownership (patronage credits) that will result in a cash collection refund at a later date, which sometimes can be as long as 30 years. These credits are reported as income and deferred asset at the time of notification until the actual cash collection is made.

(2) Other Assets

Other assets as of September 30, 2007 and 2006 consist of the following (in thousands):

	2007	2006
Regulatory Assets		
Workers' compensation actuarial (see Note 1(u))	\$ 52,333	\$ 45,980
Abandoned project costs, net (see Note 1(o))	20,933	12,652
Recovery Implementation Program (see Note 1(q))	12,788	12,252
Accrued annual leave (see Note 1(r))	10,920	14,430
Transmission termination settlement (see Note 1 (s))	5,800	1,000
Total Regulatory Assets	\$ 102,774	\$ 86,314
Other Assets		
Moveable equipment, net (see Note 1(n))	34,085	35,773
Deposit funds available	28,140	17,898
Stores inventory (see Note 1(f))	14,640	13,152
Energy banking deferral	11,033	12,636
Internal use software, net (see Note 1(n))	9,290	12,357
Interchange energy (see Note 1(p))	7,459	9,291
Other	1,642	2,370
Capital credits (see Note 1(v))	515	515
Total Other Assets	\$ 106,804	\$ 103,992
Total Regulatory and Other Assets	\$ 209,578	\$ 190,306

Abandoned project costs, net include the Celilo-Mead transmission line of \$11.8 million and \$12.7 million as of September 30, 2007 and 2006, respectively, which is being amortized over 23 years, through 2019. Also included in the abandoned project costs are \$9.1 million of various abandoned Reclamation projects of which the most significant are abandoned projects in the Colorado-Big Thompson Project for \$3.3 million and in the Yellowtail Unit for \$2.2 million as of September 30, 2007.

The energy banking deferral is an arrangement between Western and a customer whereby excess power and/or transmission capacity is banked with the customer until power is needed to meet contractual obligations. Banked power and/or transmission capacity is recorded at a contractually agreed-upon price. The net revenue associated with the banking activity is deferred and recorded as an 'other' liability.

(3) Utility Plant

Net Utility Plant as of September 30, 2007 consists of buildings, facilities, land and intangible power rights. Land costs for Western were \$74.0 million as of September 30, 2007 and 2006. Land costs for the generating agencies were \$90.6 million and \$94.5 million as of September 30, 2007 and 2006, respectively. Completed plant includes \$101.9 million and \$105.9 million of power rights, net of amortization of \$61.0 million and \$57.0 million as of September 30, 2007 and 2006, respectively.

(4) Federal Investment and Cost Allocation

(a) General

Federal investment consists of congressional appropriations, accumulated interest on unpaid Federal investment and the net transfers of property and services from other Federal agencies. Congressional appropriations is comprised of the cumulative appropriations received, net of expenses legislatively deemed non-reimbursable, and post-retirement benefits (see Note 8). Cumulative appropriations received, net of non-reimbursable expenses, totaled \$12.5 billion and \$12.1 billion as of September 30, 2007 and 2006, respectively. Postretirement benefits for the same time period totaled \$143.8 million and \$125.7 million, respectively. All power systems, except Dolores, Seedskaadee, Boulder Canyon (BC) and the operations and maintenance and purchased power programs of the CRSP, are primarily financed through congressional appropriations for operation and maintenance, construction and rehabilitation and purchased power expenditures. A portion of construction and rehabilitation, operation and maintenance, and purchased power expenditures are financed through other methods, such as advances from non-Federal entities; reimbursements from other Federal agencies; use of receipts authorization; and alternative methods such as net billing and bill crediting; or any combination of these methods.

Operating expenses (excluding depreciation expense) and interest on the unpaid Federal investment should be repaid annually. In cases where revenues are not available for repayment, such unpaid annual net deficits become payable from the future years' revenues. Interest is accrued on cumulative annual net deficits until paid. Deficits for operating expenses begin to accrue interest in the year they occur, while interest expense deficits begin to accrue interest in the following year they occur. As of September 30, 2007 and 2006, certain power systems have incurred operating and interest expense deficits aggregating approximately \$636.8 million and \$468.0 million, respectively. In cases where funds are available, unless otherwise

required by legislation, repayment of Federal investment is applied to the increment bearing the highest interest rate.

(b) Federal Investment in Multipurpose Facilities

The Federal investment in certain multipurpose facilities, primarily dams and structures integral to power generation, required to be repaid from the power sales, has been determined from preliminary cost allocation studies based on project evaluation standards approved by Congress. Allocations between power and non-power activities may be changed in future years; however, the project evaluation standards cannot be changed unless approved by Congress.

Final studies will be performed by Reclamation and the Corps, as appropriate, upon completion of each individual power project and are still pending for all but the Fryingpan-Arkansas Power System (FryArk). Reclamation completed the final FryArk study in 1993. The BC and Parker-Davis power systems are not subject to cost allocation studies since the power systems' enacting legislation require the total costs of the dams and appurtenant structures be repaid through power revenues.

With final cost allocation studies still pending for many of the individual power systems, the potential exists for significant future adjustment in the Federal investment for the cost of multi-purpose facilities allocated to power and the related accrued interest on the unpaid Federal investment. Such reallocations could affect the individual power system rates. For example, in 1997, Reclamation studied the implications of a cost reallocation of the Pick-Sloan Missouri Basin Program (Pick-Sloan) on existing water and power rates. The study resulted in additional costs, ranging from \$0 to \$416 million (depending on the assumptions of the cost methodologies used), which may be reallocated to power facilities.

(5) Other Liabilities

Other liabilities as of September 30, 2007 and 2006 consist of the following (in thousands):

	2007	2006
Long-term construction financing	\$ 158,843	\$ 156,200
Customer advances	87,502	80,801
Workers' compensation actuarial (see Note 1(u))	52,333	45,980
Deposit funds available	28,086	17,897
Custodial liability	14,884	14,089
Recovery Implementation Program (see Note 1(q))	12,788	12,252
Energy banking deferral	11,033	12,636
Accrued annual leave (see Note 1(r))	10,871	13,289
Workers' compensation accrual (see Note 1(u))	9,494	8,684
Accrued payroll benefits	8,276	8,264
Interchange energy (see Note 1(p))	7,459	9,291
Transmission termination settlement (see Note 1(s))	5,800	1,000
Other	1,413	3,006
Total	\$ 408,782	\$ 383,389

The majority of long-term construction financing consists of three significant contractual arrangements. The first significant arrangement provides customer financing for the Boulder Canyon power system to upgrade each of the generating units at Hoover Dam. The obligation to these customers is scheduled to be satisfied through issuing credits on power bills over a period through fiscal year 2017, at interest rates ranging between 5.5 and 8.2 percent. As of September 30, 2007 and 2006, the outstanding obligation was \$104.1 million and \$109.0 million, respectively.

The second significant arrangement consists of the principal payable to the State of Wyoming for providing partial financing for improvements at Buffalo Bill Dam (P-SMBP Power System) and associated power plants. This liability is being repaid over a period of 35 years, which began in 1996, at an approximate interest rate of 11.1 percent. The outstanding obligation amounted to \$20.5 million and \$20.7 million as of September 30, 2007 and 2006, respectively.

The third significant arrangement is principal due to Griffith Energy LLC for providing financing for the construction of the Griffith-McConnico and Griffith-Peacock transmission lines along with certain assets at Peacock Substation, and McConnico Switching Station. Repayment is through power bill credits beginning in 2001 and ending in 2018. The interest rate is 8.5 percent. As of September 30, 2007 and 2006, the outstanding obligation totaled \$21.2 million and \$22.4 million, respectively.

Additionally, the Mohave Electric Cooperative, Inc. has provided \$8.9 million in financing to Western to construct the network upgrades required for the Zorb Project. Repayment through crediting of transmission service bills will begin in December, 2008. The monthly amounts are unknown at this time, as the rates have yet to be established for that period. However, based on estimates, repayment should occur approximately over a 56-month period with an estimated monthly bill credit of \$162,000.

Western's Upper Great Plains region was provided with \$4 million in advanced customer financing. This financing is related to construction activity which does not have interest assessed. The obligation to these customers is scheduled to be satisfied through issuing credits on power bills in FY 2008.

Outstanding long-term construction financing as of September 30, 2007 is scheduled to be credited or repaid as follows (in thousands):

2008	\$ 13,772
2009	12,069
2010	13,184
2011	13,956
2012	14,652
Thereafter	91,210
Total	\$ 158,843

Custodial liabilities represent the amount of accrued revenue for the Central Arizona and Boulder Canyon power systems. The custodial revenue is transferred upon actual receipt of funds.

Western received a loan from the State of Colorado for \$5.5 million in December 2002 (fiscal year 2003) at an interest rate of 4.5 percent per year. Another \$5.9 million was received in December 2004 (fiscal year 2005) with an interest rate of 3.25 percent. The purpose of these loans was to fund Reclamation's endangered fish recovery implementation programs

(see note 1(q)). Interest began accruing at the time loans were granted, and is being capitalized. These balances, with capitalized interest and fees, total \$12.8 million. The original principal balances and the associated capitalized interest will be repaid through power revenues beginning in 2012.

(6) Lease Commitments

Western and the generating agencies have several cancelable operating leases, primarily for general purpose motor vehicles and office and warehouse space that expire over the next 15 years.

Western has a non-cancelable lease that expires in 2009 for Western's Corporate Service Office. This lease represents an annual expense of approximately \$2.2 million. The General Services Administration is the leaseholder for all locations with the exception of the Electric Power Training Center where Western is the leaseholder. The right to relinquish space on cancelable leases is available with 120-day notice to terminate.

These leases generally contain renewal options for periods ranging from three to five years and require the lessee to pay all costs such as maintenance, insurance and taxes. Rental expense for operating leases was approximately \$11.7 million and \$10.9 million for the years ended September 30, 2007 and 2006, respectively.

(7) Commitments and Contingencies

(a) General

Western and the generating agencies are involved in various claims, suits and complaints routine to the nature of their business. These Federal government organizations are self-insured for claims pertaining to litigation, unemployment, long-term disability and health and life insurance. Liabilities for these claims, as reported in the combined power system financial statements, are based on reported pending claims, estimates of claims incurred but not yet reported, actuarial reports and historical analysis. It is management's opinion that the ultimate disposition of these claims will not have a material adverse effect on the combined power system financial statements.

(b) Irrigation Assistance

Federal statute requires that certain individual power systems repay the U.S. Treasury that portion of Reclamation's project capital costs allocated to irrigation purposes determined by the Secretary of the Interior to be beyond the ability of the irrigation customers to repay. Although these repayments may be recovered through power sales, they do not represent an operating cost of the individual power systems and are treated as distributions from accumulated net revenues at the time of repayment.

Power repayment studies indicate that approximately \$2.3 billion of existing non-power Federal investment will be repaid from future power revenues over a period not to exceed 60 years. Reclamation made no irrigation assistance payments for the year ended September 30, 2007, but Reclamation made an irrigation assistance payment of \$2.4 million for the year ended September 30, 2006.

(c) Boulder Canyon Power System Improvements

In 1987, Reclamation initiated a project designed to increase (uprate) the generating capacity of the BC power system. Certain BC customers agreed to provide funding for these improvements, primarily through issuing long-term bonds. In some cases, proceeds from the bonds exceeded the amount required to fund the improvements.

For purposes of measuring the liability related to the Uprating Program (the Program), the total amount of the advances received from customers is reported in the Combined Power System Balance Sheet (see Note 5). Bond issuance costs are included in determining interest expense and are recognized over the term of debt repayment. Net proceeds from issuing the debt, in excess of the amount advanced to Reclamation, have similarly been excluded from the assets of the power system. Interest expense on the liability is measured based on the total outstanding bonded indebtedness. Interest income from excess proceeds reduces interest costs subject to arbitrage regulations. Until any remaining excess funds are applied against outstanding debt, the total interest cost of financing the Program will be subject to uncertainty.

(d) Colorado River Storage Project

In October 1992, Congress passed the Grand Canyon Protection Act of 1992 (the Act) to "protect...and improve the values for which the Grand Canyon National Park and Glen Canyon National Recreation Area were established."

The Act relieves CRSP power customers of repayment obligations for costs equivalent to certain expenses of environmental impact studies, associated purchased power, and other miscellaneous expenses related to Glen Canyon Dam. As of September 30, 2007 and 2006, Western and Reclamation combined incurred \$9.9 million and \$23.3 million, respectively, in environmental costs which were deemed non-reimbursable. Accordingly, such costs have been recognized as a reduction of congressional appropriations in the Combined Power System Balance Sheet.

(e) Power Contract Commitments

Western has entered into various agreements for power and transmission purchases that vary in length but generally do not exceed 20 years. Western's long-term commitments for these power and transmission contracts, subject to the availability of Federal funds and contingent upon annual appropriations from Congress, are as follows (in thousands):

Year ending Sept. 30:	Purchased power	Purchased transmission	Total
2008	\$ 16,076	\$ 5,239	\$ 21,315
2009	10,800	5,077	15,877
2010	2,605	3,805	6,410
2011	0	3,805	3,805
2012	0	3,805	3,805
Thereafter	0	21,608	21,608
Total	\$ 29,481	\$ 43,339	\$ 72,820

In addition to these contracts, Western maintains other long-term contracts which provide the ability to purchase unspecified quantities of transmission services within a contractually determined range and rate. To fulfill its contractual obligations to deliver power, Western has historically had to purchase a certain level of transmission services under these agreements. Western intends and anticipates it will be necessary to acquire resources under these contracts up to a maximum of \$54.1 million through the life of the current contracts.

(f) Pacific Gas & Electric Company Settlement

Under the terms of the integration contract 14-06-200-2948A (2948A) between Pacific Gas and Electric (PG&E) and Western, Western pays PG&E an estimated rate each year for energy purchases and records this amount as purchased power expense in the Combined Power System Statement of Revenues and Expenses. Provisions of the contract require the estimated rate to be adjusted to reflect PG&E's actual annual average thermal production costs, resulting in either Western paying an additional amount or receiving a refund for any overpayment. In the Combined Power System Statement of Revenues and Expense for fiscal year 2006, Western recorded purchased power expense of \$11.9 million related to calendar year 2004. During that time period, Western purchased approximately \$94.6 million in power from PG&E. Contract 2948A terminated on December 31, 2004.

There was no activity under this contract for fiscal year 2007 and no future activity will occur as the contract has terminated.

(g) Central Valley Project

Western is engaged in legal discussions with a customer/supplier regarding disputed grid management charges. There is a reasonable possibility that Western could be liable for additional charges estimated at \$5.5 million, receive a refund estimated at \$8.0 million, or settle at an amount between these numbers.

(8) Pension and Other Retirement Benefits

Western, Reclamation, the Corps and IBWC employees participate in one of the following contributory defined benefit plans: the Civil Service Retirement System (CSRS) or Federal Employees Retirement System (FERS). Agency

contributions are based on eligible employee compensation and total 7.0 percent for CSRS and up to 11.2 percent for FERS. These contributions are submitted to benefit program trust funds administered by the Office of Personnel Management (OPM). Western and the generating agencies' contributions for the two plans amounted to \$21.7 million and \$19.2 million for the years ended September 30, 2007 and 2006, respectively.

The contribution levels as legislatively mandated do not reflect the full cost requirements to fund the CSRS or FERS pension plans (approximately 25.0 and 12.0 percent of base salary, respectively). Other post-retirement benefits administered and partially funded by OPM are the Federal Employees Health and Benefits Program (FEHB) and the Federal Employee Group Life Insurance Program (FEGLI). FEHB is calculated at \$5,572 and \$5,229 per employee in fiscal year 2007 and 2006, respectively, and FEGLI is based on 0.02 percent of base salary for each employee enrolled in these programs. In addition to the amounts contributed to the CSRS and FERS as stated above, Western and the generating agencies recorded an expense for the pension and other retirement benefits in the Combined Power System Statement of Revenues and Expenses of \$18.2 million for the year ended September 30, 2007 and \$18.9 million for the year ended September 30, 2006. This amount reflects the contribution made on behalf of Western and the generating agencies by OPM to the benefit program trust funds.

As a Federal Agency, all postretirement activity is managed by OPM. Accordingly, disclosure requirements of FASB Statement No. 132, *Employers' Disclosures about Pensions and Other Post Retirement Benefits*, are accomplished by OPM.

WESTERN'S SENIOR MANAGEMENT TEAM

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Washington Liaison

Assistant Administrator
for Washington Liaison **Jack Dodd**

Regional Managers

Sierra Nevada Region **Tom Boyko**

Desert Southwest Region **Tyler Carlson**

Upper Great Plains Region **Bob Harris**

Rocky Mountain Region **Jim Keselburg**

Colorado River Storage Project
Management Center **Brad Warren**

Corporate Services Office Managers

General Counsel **Liova Juárez**

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Equal Employment **Charles Marquez, acting**

Chief Operating Officer **Tony Montoya**

Chief Information Officer **Eun Moredock**

Chief Financial Officer **Harry Pease**

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Contact Western

Call or write your local Western office or Corporate Communications at our Corporate Services Office in Lakewood, Colo., to share your comments or to find out more about Western. Our addresses and phone numbers are listed below.

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For no-cost energy-related technical assistance within Western's service territory, call 1-800-POWERLN (1-800-769-3756), or log on to www.wapa.gov/es.



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