Tennessee Valley Authority

(Wholly Owned Corporate Agency and Instrumentality of the United States of America)

Quarterly Report

For the quarterly period ended June 30, 2003

Tennessee Valley Authority

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For the quarterly period ended June 30, 2003

This document contains the Quarterly Report of TVA's Power Program and All Programs for the quarterly period ended June 30, 2003. TVA is not required to register securities under the Securities Act of 1933 or to make periodic reports to the Securities and Exchange Commission (SEC) under the Securities and Exchange Act of 1934. Accordingly, TVA does not intend to file this report with the SEC. In addition, several portions of this Quarterly Report contain forward-looking statements, and reference is made to page one for the location and character of such statements.

INDEX Page

Forward-Looking Statements

TVA's Quarterly Report for the quarterly period ended June 30, 2003, contains forward-looking statements relating to future events and future performance. Any statements regarding expectations, beliefs, plans, projections, estimates, objectives, intentions, assumptions or otherwise relating to future events or performance may be forward-looking.

In certain cases, forward-looking statements can be identified by the use of the words such as "may," "will," "should," "expect," "anticipate," "believe," "intend," "project," "plan," "predict," "assume," "estimate," "objective," "possible," "potential," or other similar expressions.

Some examples of forward-looking statements include statements regarding TVA's projections of future power and energy requirements; future costs related to environmental compliance; impacts of potential legislation on TVA and the likelihood of enactment of such legislation; strategic objectives; anticipated availability of nuclear waste storage facilities; projections of nuclear decommissioning costs; and impacts of pending litigation and various administrative orders which have been or may be issued.

Although TVA believes that the assumptions underlying the forward-looking statements are reasonable, TVA does not guarantee the accuracy of these statements. Numerous factors could cause actual results to differ materially from those in the forward-looking statements. These factors include, among other things, new laws, regulations and administrative orders, especially those related to restructuring of the electric power industry and various environmental matters; increased competition among electric utilities; legal and administrative proceedings affecting TVA; the financial and economic environment; performance of TVA's generation and transmission assets; fuel prices; demand for electricity; changes in technology; changes in the price of power; loss of any significant customers or suppliers; creditworthiness of counterparties; weather conditions and other natural phenomena; changes in accounting standards; and unforeseeable events. New factors emerge from time to time, and it is not possible for management to predict all such factors or to assess the extent to which any factor or combination of factors may impact TVA's business or cause results to differ materially from those contained in any forward-looking statement.

TVA undertakes no obligation to update any forward-looking statement to reflect developments that occur or come to TVA's attention after the statement is made.

FINANCIAL INFORMATION

STATEMENTS OF INCOME—POWER PROGRAM (unaudited)

	Three months ended June 30		Nine months ended June 30	
	2003	2002	2003	2002
	(in millions)		(in millions)	
Operating revenues				
Sales of electricity				
Municipalities and cooperatives	$ 1,396	$ 1,420	$ 4,368	$ 4,124
Industries directly served	194	186	597	538
Federal agencies and other	34	48	115	128
Other revenue	13	24	53	62
Total operating revenues	1,637	1,678	5,133	4,852
Operating expenses				
Fuel and purchased power	480	488	1,460	1,322
Operating and maintenance	488	422	1,452	1,286
Depreciation and accretion	265	258	792	765
Accelerated amortization	–	16	–	49
Tax-equivalents	80	82	243	245
Total operating expenses	1,313	1,266	3,947	3,667
Operating income	324	412	1,186	1,185
Other income, net	–	3	6	11
Loss on plant cancellation	–	–	–	(150)
Interest expense				
Interest on debt	347	367	1,047	1,103
Amortization of debt discount, issue, and reacquisition costs, net	7	6	21	17
Allowance for funds used during construction	(22)	(17)	(55)	(47)
Net interest expense	332	356	1,013	1,073
(Loss) income before cumulative effects of accounting changes	(8)	59	179	(27)
Cumulative effect of change in accounting for unbilled revenue	–	–	412	–
Cumulative effect of change in accounting for asset retirement obligations	–	–	(178)	–
Net (loss) income	$ (8)	$ 59	$ 413	$ (27)
Pro-forma net income assuming accounting changes are applied retroactively (note 1)		$ 70		$ 44

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

BALANCE SHEETS—POWER PROGRAM AND ALL PROGRAMS (unaudited)

	Power Program		All Programs	
	June 30 2003	September 30 2002	June 30 2003	September 30 2002
ASSETS	(in millions)		(in millions)	
Current assets				
Cash and cash equivalents	$ 358	$ 397	$ 360	$ 400
Accounts receivable	900	655	900	655
Inventories at average cost and other				
Fuel	220	173	220	173
Other	308	305	307	305
Total current assets	1,786	1,530	1,787	1,533
Property, plant, and equipment				
Completed plant	32,486	31,207	33,497	32,219
Less accumulated depreciation	(12,028)	(11,162)	(12,342)	(11,469)
Net completed plant	20,458	20,045	21,155	20,750
Construction in progress	1,328	1,040	1,328	1,040
Deferred nuclear generating units	4,115	4,113	4,115	4,113
Nuclear fuel and capital leases	553	481	553	481
Total property, plant, and equipment	26,454	25,679	27,151	26,384
Investment funds	613	659	613	659
Deferred charges and other assets				
Loans and other long-term receivables	155	138	179	161
Debt issue and reacquisition costs	193	193	193	193
Other deferred charges	2,307	1,959	2,307	1,959
Total deferred charges and other assets	2,655	2,290	2,679	2,313
Total assets	$ 31,508	$ 30,158	$ 32,230	$ 30,889
LIABILITIES AND PROPRIETARY CAPITAL				
Current liabilities				
Accounts payable	$ 722	$ 700	$ 724	$ 702
Accrued liabilities	162	220	162	220
Accrued interest	289	397	289	397
Short-term debt	2,512	3,492	2,512	3,492
Current maturities of long-term debt	1,336	–	1,336	–
Total current liabilities	5,021	4,809	5,023	4,811
Other liabilities				
Deferred liabilities	2,973	2,413	2,973	2,413
Asset retirement obligations	1,683	891	1,683	891
Total other liabilities	4,656	3,304	4,656	3,304
Long-term debt				
Public bonds	21,070	21,763	21,070	21,763
Unamortized discount and other adjustments	(306)	(405)	(306)	(405)
Total long-term debt	20,764	21,358	20,764	21,358
Commitments and contingencies (see note 5)				
Proprietary capital				
Appropriation investment	473	488	4,828	4,843
Retained earnings	746	349	746	349
Accumulated other comprehensive loss	(152)	(150)	(152)	(150)
Accumulated net expense of nonpower programs	–	–	(3,635)	(3,626)
Total proprietary capital	1,067	687	1,787	1,416
Total liabilities and proprietary capital	$ 31,508	$ 30,158	$ 32,230	$ 30,889

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

STATEMENTS OF CASH FLOWS—POWER PROGRAM (unaudited)

	Three months ended June 30		Nine months ended June 30	
	2003	2002	2003	2002
	(in millions)		(in millions)	
Cash flows from operating activities				
Net (loss) income	$ (8)	$ 59	$ 413	$ (27)
Items not requiring (providing) cash				
Depreciation and accretion	283	270	844	799
Accelerated amortization	–	16	–	49
Allowance for funds used during construction	(22)	(17)	(55)	(47)
Nuclear fuel amortization	30	31	94	106
Loss on plant cancellation	–	–	–	150
Cumulative effect of accounting changes	–	–	(234)	–
Other, net	26	(10)	59	(16)
Changes in current assets and liabilities				
Accounts receivable	(16)	(70)	167	147
Inventories and other	(33)	2	(59)	(38)
Accounts payable and accrued liabilities	100	112	(3)	(76)
Accrued interest	(113)	(89)	(108)	(75)
Other	(24)	(40)	(27)	(115)
Net cash provided by operating activities	223	264	1,091	857
Cash flows from investing activities				
Construction expenditures	(431)	(257)	(1,213)	(889)
Allowance for funds used during construction	22	17	55	47
Nuclear fuel	(66)	(6)	(174)	(137)
Other, net	(6)	1	136	121
Net cash used in investing activities	(481)	(245)	(1,196)	(858)
Cash flows from financing activities				
Long-term debt				
Issues	865	1,097	1,163	1,953
Redemptions	(146)	(936)	(528)	(1,355)
Short-term borrowings (redemptions), net	(757)	225	(980)	(769)
Proceeds from combustion turbine financing	162	–	325	320
Payments on lease/leaseback financing	(12)	(31)	(45)	(43)
Proceeds from call monetization	–	–	175	–
Financing costs, net	(6)	(2)	(13)	(36)
Payments to U.S. Treasury	(11)	(12)	(31)	(37)
Net cash provided by financing activities	95	341	66	33
Net change in cash and cash equivalents	(163)	360	(39)	32
Cash and cash equivalents at beginning of period	521	11	397	339
Cash and cash equivalents at end of period	$ 358	$ 371	$ 358	$ 371

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

STATEMENTS OF CASH FLOWS—ALL PROGRAMS (unaudited)

	Three months ended June 30		Nine months ended June 30	
	2003	2002	2003	2002
	(in millions)		(in millions)	
Cash flows from operating activities				
Net (loss) income	$ (8)	$ 59	$ 413	$ (27)
Net expense of nonpower programs	(4)	(2)	(9)	(7)
Items not requiring (providing) cash				
Depreciation and accretion	286	272	852	807
Accelerated amortization	–	16	–	49
Allowance for funds used during construction	(22)	(17)	(55)	(47)
Nuclear fuel amortization	30	31	94	106
Loss on plant cancellation	–	–	–	150
Cumulative effect of accounting changes	–	–	(234)	–
Other, net	26	(9)	61	(17)
Changes in current assets and liabilities				
Accounts receivable	(16)	(70)	167	147
Inventories and other	(33)	2	(60)	(38)
Accounts payable and accrued liabilities	100	111	(4)	(77)
Accrued interest	(113)	(89)	(108)	(75)
Other	(24)	(40)	(27)	(115)
Net cash provided by operating activities	222	264	1,090	856
Cash flows from investing activities				
Construction expenditures	(431)	(255)	(1,213)	(888)
Allowance for funds used during construction	22	17	55	47
Nuclear fuel	(66)	(7)	(174)	(137)
Other, net	(5)	–	136	121
Net cash used in investing activities	(480)	(245)	(1,196)	(857)
Cash flows from financing activities				
Long-term debt				
Issues	865	1,097	1,163	1,953
Redemptions	(146)	(936)	(528)	(1,355)
Short-term borrowings (redemptions), net	(757)	225	(980)	(769)
Proceeds from combustion turbine financing	162	–	325	320
Payments on lease/leaseback financing	(12)	(31)	(45)	(43)
Proceeds from call monetization	–	–	175	–
Financing costs, net	(6)	(2)	(13)	(36)
Payments to U.S. Treasury	(11)	(12)	(31)	(37)
Net cash provided by financing activities	95	341	66	33
Net change in cash and cash equivalents	(163)	360	(40)	32
Cash and cash equivalents at beginning of period	523	15	400	343
Cash and cash equivalents at end of period	$ 360	$ 375	$ 360	$ 375

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

STATEMENTS OF CHANGES IN PROPRIETARY CAPITAL—POWER PROGRAM
(unaudited)

	Three months ended June 30		Nine months ended June 30	
	2003	2002	2003	2002
	(in millions)		(in millions)	
Retained earnings reinvested at beginning of period	$ 760	$ 205	$ 349	$ 306
Net (loss) income	(8)	59	413	(27)
Return on appropriation investment	(6)	(7)	(16)	(22)
Retained earnings reinvested at end of period	746	257	746	257
Accumulated other comprehensive (loss) income	(152)	24	(152)	24
Appropriation investment at beginning of period	478	498	488	508
Return of appropriation investment	(5)	(5)	(15)	(15)
Appropriation investment at end of period	473	493	473	493
Proprietary capital at end of period	$ 1,067	$ 774	$ 1,067	$ 774

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

STATEMENTS OF CHANGES IN PROPRIETARY CAPITAL—NONPOWER PROGRAMS
(unaudited)

	Three months ended June 30		Nine months ended June 30	
	2003	2002	2003	2002
	(in millions)		(in millions)	
Proprietary capital at beginning of period	$ 724	$ 734	$ 729	$ 739
Net expense	(4)	(2)	(9)	(7)
Proprietary capital at end of period	$ 720	$ 732	$ 720	$ 732

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

STATEMENTS OF COMPREHENSIVE INCOME—POWER PROGRAM (unaudited)

	Three months ended June 30		Nine months ended June 30	
	2003	2002	2003	2002
	(in millions)		(in millions)	
Net (loss) income	$ (8)	$ 59	$ 413	$ (27)
Other comprehensive income (loss)				
Change in fair value of interest rate swap	(7)	5	2	6
Change in fair value of currency swap	86	(42)	(4)	124
	79	(37)	(2)	130
Comprehensive income	$ 71	$ 22	$ 411	$ 103

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

STATEMENTS OF NET EXPENSE AND COMPREHENSIVE INCOME (LOSS)—NONPOWER PROGRAMS (unaudited)

	Three months ended June 30		Nine months ended June 30	
	2003	2002	2003	2002
	(in millions)		(in millions)	
Water and land stewardship	$ (4)	$ (2)	$ (9)	$ (7)
Net expense and comprehensive (loss)	$ (4)	$ (2)	$ (9)	$ (7)

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

NOTES TO FINANCIAL STATEMENTS (unaudited)

1. Summary of Significant Accounting Policies

Organization

TVA is a wholly owned corporate agency and instrumentality of the United States. It was established by Congress in 1933 by the TVA Act with the objective of developing the resources of the Tennessee Valley region in order to strengthen the regional and national economy and the national defense by providing: (1) an ample supply of power within the region, (2) navigable channels and flood control for the Tennessee River System, and (3) agricultural and industrial development and improved forestry in the region. TVA carries out these regional and national responsibilities in a service area that centers on Tennessee and includes parts of Alabama, Georgia, Kentucky, Mississippi, North Carolina, and Virginia.

Substantially all TVA revenues and assets are attributable to its power program. The revenues and expenses of the power program have historically been segregated and distinct from TVA's nonpower programs. The power program is self-supporting from power revenues and proceeds from power program financings.

Power rates are established by the TVA Board of Directors (Board) as authorized by the TVA Act. The TVA Act requires TVA to charge rates for power that, among other things, will produce gross revenues sufficient to provide funds for operation, maintenance, and administration of its power system; payments to states and counties in lieu of taxes; debt service on outstanding indebtedness; and annual payments to the U.S. Treasury in repayment of and as a return on the government's appropriation investment in TVA's power facilities. Rates set by the Board are not subject to review or approval by any state or federal regulatory body. In a future restructured electric power industry, it is possible, however, that the ability of the Board to set TVA's rates as specified in the TVA Act could be adversely affected by legislative changes or by competitive pressures.

Basis of Presentation

TVA prepares its interim financial statements in conformity with accounting principles generally accepted in the United States of America for interim financial information. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. Because the accompanying interim financial statements do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements, they should be read in conjunction with the audited financial statements for the period ended September 30, 2002, and the notes thereto.

The amounts included in the interim financial statements are unaudited but, in the opinion of management, reflect all adjustments necessary to fairly present TVA's financial position and results of operations for the interim periods. Due to seasonal weather variations, the timing of planned and unanticipated maintenance and refueling outages of electric generating units and other factors, the results of operations for interim periods are not necessarily indicative of results for the entire year.

In preparing financial statements that conform with generally accepted accounting principles, management must make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and amounts of revenues and expenses reflected during the reporting period. Actual results could differ from those estimates.

Fiscal Year

TVA's fiscal year ends September 30. Unless otherwise indicated, years (2003, 2002, etc.) refer to TVA's fiscal years.

Accounts Receivable

Accounts receivable primarily consist of amounts due from customers for power sales. The table below summarizes the type and amount of receivables:

	At June 30, 2003 (in millions)	At September 30, 2002 (in millions)
Power receivables billed	$ 240	$ 315
Power receivables unbilled	625	309
Total power receivables	865	624
Other receivables	48	44
Allowance for uncollectible accounts	(13)	(13)
Net accounts receivable	$ 900	$ 655

Change in Accounting for Unbilled Revenue

Effective October 1, 2002, the Board approved a change in the methodology for estimating unbilled revenue from electricity sales. The change in calculating unbilled revenue was from a method using cumulative generation to a method that uses only generation for the current billing period. TVA was able to make this change based on improved metering technology that allows TVA to more accurately capture the number of days power has been generated and transferred to its customers but not yet billed to those customers. Changing to this more accurate estimating methodology has resulted in an increase in accounts receivable of $412 million.

Regulatory Assets

Regulatory assets, costs capitalized under the provisions of Statement of Financial Accounting Standards (SFAS) No. 71, *Accounting for the Effects of Certain Types of Regulation*, which are included in Other deferred charges, consisted of certain charges related to the closure and removal of nuclear generating units, losses related to mark-to-market valuation of purchase power options and an adjustment related to minimum pension liability.

	At June 30, 2003 (in millions)	At September 30, 2002 (in millions)
Decommissioning charges	$ 785	$ 556
Changes in fair value of option contracts	87	–
Adjustment to accrue minimum pension liability	896	896
Total Regulatory Assets	$ 1,768	$ 1,452

Asset Retirement Obligations

On October 1, 2002, TVA adopted SFAS No. 143, *Accounting for Asset Retirement Obligations*, which requires the recognition of a liability, and capitalization of the associated asset retirement cost as part of the carrying amount of the long-lived asset, for “legal obligations” associated with the retirement of long-lived assets that result from the acquisition, construction, development, and/or normal operation of long-lived assets. TVA identified and reviewed all relevant information in the determination of its potential asset retirement obligations (AROs). TVA identified four categories of AROs which represent legal obligations of TVA under the requirements set forth in the standard. Costs associated with retirement of coal-fired and gas/oil turbine generating plants and ash/waste ponds are being expensed as period costs while costs associated with retirement of nuclear generating plants are being deferred in accordance with SFAS No. 71, *Accounting for the Effects of Certain Types of Regulation*, because of the partially funded status of the obligation.

Nuclear Generating Plants. In prior years, TVA had recognized a decommissioning liability related to its nuclear generating plants in accordance with Nuclear Regulatory Commission requirements. This previously recorded liability represents the pre-SFAS No. 143 obligation for TVA’s nuclear plant AROs. The adoption of SFAS No. 143 resulted in a change in the methodology of quantifying this nuclear decommissioning obligation in accordance with the new standard. TVA has increased the nuclear decommissioning liability on the balance sheet to the new estimate, but has retained its regulatory accounting treatment of capturing all changes in the liability, investment funds, and regulatory asset as changes in the regulatory asset instead of recording these items on the income statement.

Coal-Fired Generating Plants. The activities associated with coal plant retirement include plant shutdown, securing the physical property, closure of storage and/or waste areas, maintenance of stack lights, security patrols, and measures to contain asbestos and other hazardous materials from release into the environment. The estimated costs of these activities have been included in the calculation of TVA’s coal plant AROs.

Gas/Oil Turbine Generating Plants. The activities associated with gas and oil turbine plant retirement include annual operating costs for site security, lighting, powerhouse and grounds maintenance, containment of asbestos, paint, and other materials, and groundwater monitoring. The estimated costs of these activities have been included in the calculation of TVA's combustion turbine plant AROs.

Ash/Waste Ponds. Most of the ARO components at TVA's coal plants have estimated useful lives that correspond to the overall estimated life of the plant, and these components were included in the coal plant AROs described above. However, certain ash ponds and waste areas have estimated useful lives that are independent of the lives of the coal plants themselves. Accordingly, these specific ash/waste pond areas were considered to be separate AROs and were quantified based on their specific estimated useful lives.

For each ARO identified, TVA calculated the net present value of the obligation as of October 1, 2002, the original and incremental cost of the long-lived asset at the time the assets were originally put in service, the cumulative effect of depreciation on the adjusted asset base and accretion of the liability from the date of initial operation to the current and pro-forma period. The following table summarizes for each ARO category the original asset retirement cost, the current and pro-forma ARO liability, the current fair market value of any assets legally restricted for purposes of settling the obligation (see Management's Discussion and Analysis of Financial Condition and Results of Operations-Financing Activities), and the estimated future liability at the time of closure.

ARO Category	Original Asset Retirement Cost	June 30, 2003 ARO Obligation	Pro-Forma September 30, 2002 ARO Obligation	Pro-Forma June 30, 2002 ARO Obligation	June 30, 2003 Fair Market Value of Assets	Estimated Future Liability
			(in millions)			
Nuclear Plants	$ 461	$ 1,490	$ 1,421	$ 1,402	$ 607	$ 10,446
Coal-Fired Plants	13	150	144	142	N/A	818
Gas/Oil Turbine Plants	1	1	1	1	N/A	42
Ash/Waste Ponds	4	42	40	40	N/A	85
Total	$ 479	$ 1,683	$ 1,606	$ 1,585	$ 607	$ 11,391

The effect of the adoption of SFAS No. 143 during the first quarter of 2003 included a cumulative effect charge to income of $178 million, a corresponding additional long-term liability of $717 million, an increase in assets of $745 million, and related accumulated depreciation of $206 million.

Pro-Forma Effects of Accounting Changes

Pro-forma net income amounts, assuming that the changes in accounting described above related to the change in methodology for estimating unbilled revenue and the adoption of SFAS No. 143 had been applied retroactively, are as follows:

	For the Three Months Ended June 30, 2002 (in millions)	For the Nine Months Ended June 30, 2002 (in millions)
Historical net income (loss)	$ 59	$ (27)
Accounting changes		
Unbilled revenue	14	79
Adoption of SFAS No. 143	(3)	(8)
Pro-Forma net income	$ 70	$ 44

New Accounting Pronouncements

Effective October 1, 2002, TVA adopted Emerging Issues Task Force (EITF) Issue 02-03, *Issues Related to Accounting for Contracts Involved in Energy Trading and Risk Management Activities.* EITF Issue 02-03 rescinded EITF Issue 98-10, *Accounting for Contracts Involved in Energy Trading and Risk Management Activities*, and reached two general conclusions:

- Energy trading contracts that do not meet the definition of a derivative under SFAS No. 133 should not be marked to fair market value, and
- Revenues should be shown in the income statement net of costs associated with trading activities, whether or not the trades are physically settled.

TVA's energy trading activities qualify as normal sales and purchases under SFAS No. 133, *Accounting for Certain Derivative Instruments and Certain Hedging Activities*, and accordingly, adoption of EITF Issue 02-03 had no impact on previously reported net income or proprietary capital.

In April 2003, the FASB issued SFAS No. 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities*. The statement clarifies under what circumstances a contract with an initial net investment meets the characteristic of a derivative as discussed in SFAS No. 133. In addition, it clarifies when a derivative contains a financing component that warrants special reporting in the statement of cash flows. The statement is effective for contracts entered into or modified after June 30, 2003 and should be applied prospectively. The adoption of SFAS No. 149 will have no effect on TVA as it currently reports these types of transactions in accordance with the standard.

In November 2002, the FASB published Interpretation No. 45, *Guarantor's Accounting and Disclosure requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*. The interpretation elaborates on the existing disclosure requirements for most guarantees, including standby letters of credit. It also clarifies that at the time a company issues a guarantee, the company must recognize an initial liability for the fair value, or market value, of the obligations it assumes under that guarantee and must disclose that information in its interim and annual financial statements. The initial recognition and initial measurement provisions apply on a prospective basis to guarantees issued or modified after December 31, 2002, regardless of the guarantor's fiscal year-end. At this time, TVA does not have any guarantees meeting the criteria of the interpretation.

In July 2003, the FASB published Interpretation No. 46, *Consolidation of Variable Interest Entities.* This interpretation explains how to identify variable interest entities and how an enterprise assesses its interests in a variable interest entity to decide whether to consolidate that entity. It also clarifies the application of Accounting Research Bulletin No. 51, *Consolidated Financial Statements*, to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. The interpretation applies to nonpublic enterprises in the first fiscal year beginning after June 15, 2003. At this time, TVA is in the process of evaluating the requirements of this statement.

Other

Certain reclassifications have been made to the 2002 financial statements to conform to the 2003 presentation.

2. Proprietary Capital

Accumulated Other Comprehensive Loss

SFAS No. 130, *Reporting Comprehensive Income*, requires the disclosure of comprehensive income to reflect changes in capital that result from transactions and economic events from nonowner sources. The losses for the nine months ended June 30, 2003, are due to market valuation adjustments for certain derivative instruments.

Total Other Comprehensive Income (Loss) Activity
(in millions)

Accumulated other comprehensive loss, September 30, 2002	$	(150)
Change in fair value of interest rate swap		2
Change in fair value of foreign currency swaps		(4)
Accumulated other comprehensive loss, June 30, 2003	$	(152)

3. Debt

From October 1, 2002 to June 30, 2003, TVA issued $418 million of electronotes® with an average interest rate of 4.31 percent. In June 2003, TVA also issued £150 million ($244.95 million) of 2003 Series A global power bonds with an interest rate of 4.625 percent (see note 4) and $500 million of 2003 Series B global power bonds with an interest rate of 4.70 percent. During the first nine months of 2003, TVA redeemed $163 million of electronotes® carrying an average interest rate of 5.20 percent. TVA also redeemed four other debt issues totaling $365 million with an average interest rate of 6.62 percent.

For the nine months ended June 30, 2003, the average balance and weighted average interest rate of short-term borrowings were $2.94 billion and 1.01 percent, respectively, as compared with $2.34 billion and 1.50 percent for the same period in 2002.

4. Risk Management Activities and Derivative Transactions

During the second quarter of 2003, TVA monetized the call provisions on a $1 billion public bond issue by entering into a swaption agreement with a third party in exchange for approximately $175 million. The swaption essentially grants the third party the right to exercise the embedded call provision of the bond while TVA continues to pay the holder of the swaption pursuant to the original bond issuance. The swaption is recorded in other liabilities on the balance sheet and is designated as a hedge of the future changes in the fair value of the original call provision. Under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, TVA will mark-to-market both the swaption and the embedded call. These values historically have been highly correlated; however, to the extent that the values do not perfectly offset, any differences will be recognized currently through earnings.

TVA is exposed to market risks, including changes in interest rates, foreign currency exchange rates, and volatility of certain commodity and equity market prices. To manage the volatility attributable to these exposures, TVA has entered into various nontrading derivative transactions, principally an interest rate swap agreement, foreign currency swap contracts, and option and swaption contracts.

When TVA issued its £150 million ($244.95 million) 2003 Series A Power Bonds on June 2, 2003, it entered into a swap transaction to hedge the exchange rate risk associated with these bonds. The overall effective cost to TVA of these bonds and the associated swap was 4.962 percent.

The recorded amounts of these derivative financial instruments are as follows:

Mark-to-Market Values of Derivative Transactions
At June 30, 2003 and September 30, 2002

	Asset/(Liability)	
	June 30, 2003 (in millions)	September 30, 2002 (in millions)
Interest rate swap	$ 32	$ 22
Currency swaps:		
Deutschemark	(349)	(148)
Sterling (GBP200 million)	(21)	(35)
Sterling (GBP250 million)	(23)	13
Sterling (GBP150 million)	5	–
Swaption on bond call	(257)	–
Debt-embedded call	77	–
Coal contracts-volume options	30	1
Purchase power contracts	(87)	–
	$ (593)	$ (147)

5. Commitments and Contingencies

<u>New Agreements</u>
During the summer of 2002, TVA completed construction of two sets of four combustion turbine units which were part of a series of new peaking combustion turbine units. Of the financing options available to TVA for these units, long-term lease and leaseback arrangements provided outcomes that were the most economically favorable to TVA. The lease/leaseback for the first set of four units was finalized during the first quarter of 2003 and provided about $163 million in lease proceeds. The cost of the first lease agreement approximated a full-term implicit rate just above four percent. The lease/leaseback of the second set of four units was finalized during the third quarter of 2003 and provided approximately $162 million in lease proceeds. The cost of the second lease agreement approximated a full-term implicit rate slightly more than three and one-half percent.

TVA accounted for the respective lease proceeds as financing obligations in accordance with SFAS No. 66, *Accounting for Sales of Real Estate*, and SFAS No. 98, *Accounting for Leases*. The outstanding financing obligations at September 30, 2002, of $559 million are included in Current liabilities ($16 million) and Other liabilities ($543 million), respectively, on TVA's 2002 year-end Balance Sheet. During the first and third quarters of 2003, TVA received a total of $325 million in lease proceeds which were recorded as additional financing obligations in accordance with SFAS Nos. 66 and 98. The outstanding financing obligations of $870 million are included in Current liabilities ($51 million) and Other liabilities ($819 million), respectively, on TVA's Balance Sheet at June 30, 2003.

The estimated commitments for TVA as of June 30, 2003 are as follows:

	2003*	2004	2005	2006	2007	Thereafter	Total
				(in millions)			
Debt maturities	$ 2,512	$ 2,336	$ 2,000	$ 2,621	$ 974	$ 14,475	$ 24,918
Leases	10	42	42	41	39	122	296
Lease/leaseback transactions	24	70	66	64	64	921	1,209
Power purchase obligations	55	132	155	155	143	2,859	3,499
Other obligations	15	27	12	7	–	–	61
Fuel purchase obligations	28	948	558	444	315	530	2,823
Total	$ 2,644	$ 3,555	$ 2,833	$ 3,332	$ 1,535	$ 18,907	$ 32,806

*Period July 1 - September 30, 2003

6. Benefit Plans

Other Postretirement Benefits

TVA sponsors an unfunded postretirement plan that provides for non-vested contributions toward the cost of certain retirees' medical coverage. This plan formerly covered all retirees participating in the TVA medical plan, and TVA's contributions were a flat dollar amount based on the participants' ages and years of service and certain payments toward the plan costs. This plan now operates on a much more limited basis, covering only certain retirees and surviving dependents who do not qualify for TVA Retirement System (TVARS) benefits.

During 2000, these postretirement benefits were enhanced to help covered retirees offset the cost of medical coverage resulting in approximately $16 million in additional postretirement benefit obligations.

Effective July 1, 2002 (applied retroactively to January 1, 2002), TVA changed its retiree medical plan to provide an enhanced benefit for certain retirees who retired with 20 or more years of service and are eligible for the original plan pension supplement from TVARS. The benefit is in the form of a credit provided by TVA to eligible retirees to help offset the cost of medical premiums. The additional benefit increased the accumulated postretirement benefit obligation approximately $199 million at the end of 2002. Pursuant to SFAS No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*, the increase in cost is combined with the existing net unrecognized prior service cost and amortized to expense over future periods. Expense for 2003 will increase approximately $34 million (from $19 million in 2002 to $53 million in 2003) due primarily to the additional prior service cost amortization and corresponding increases in service cost and interest cost coupled with changes in demographic information and actuarial assumptions.

7. Legal Proceedings

On February 20, 2003, the federal district court in Florence, Alabama, dismissed the Alabama Environmental Council and the Sierra Club's claim for civil penalties for alleged violations of Clean Air Act (CAA) opacity limits applicable to the Colbert Fossil Plant (Colbert). These groups are still seeking a court order (1) declaring TVA in violation of these opacity limits and (2) requiring TVA to bring Colbert into continuous compliance with these limits. These two claims are set for trial in the fall of 2003.

On August 31, 1999, Birmingham Steel Corporation filed a lawsuit in the U.S. District Court for the Northern District of Alabama challenging TVA's charges for economy surplus power (ESP) during the summer of 1998. The lawsuit purports to be a class action on behalf of industrial customers who participate in TVA's ESP program. Under ESP contracts, the hourly ESP energy price is calculated using TVA's actual incremental cost of supplying the ESP load in each hour. The plaintiff alleges that TVA overcharged for ESP during the summer of 1998 by including in the price of ESP in some hours certain costs that the plaintiff contended were not properly charged to ESP customers under the terms of the contracts. The plaintiff is seeking over $100,000,000 in damages on behalf of itself and the other proposed class members. In September 2002, the U.S. District Court for the Northern District of Alabama decertified the class action and then dismissed the lawsuit without prejudice on a jurisdictional issue, and the plaintiff appealed to the U.S. Court of Appeals for the Eleventh Circuit. Oral argument on the appeal occurred on June 5, 2003.

On June 24, 2003, the U.S. Circuit Court of Appeals for the Eleventh Circuit issued its decision in TVA's case challenging the Environmental Protection Agency's (EPA) administrative compliance order that held TVA liable for violating the Clean Air Act's New Source Review (NSR) provisions and required TVA to undertake substantial compliance activities. Although the Eleventh Circuit did not rule on the merits of the case, the court held that the procedure used by EPA against TVA was "unconstitutional" and that "TVA is free to ignore" EPA's administrative compliance order because it was "legally inconsequential" and did not constitute final agency action. Among other things, the court pointed out that EPA's Environmental Appeals Board and administrative law judge "manufactured the procedures they employed [against TVA] on the fly, entirely ignoring the concept of the rule of law." The Eleventh Circuit concluded that a part of the CAA is unconstitutional because it allows EPA to decide that a regulated party like TVA has violated the law and is liable for severe penalties without ever allowing the regulated party to present evidence on whether the law was in fact violated. The court said that EPA may sue TVA in district court to try to prove its case. EPA, through the Department of Justice, recently moved for reconsideration en banc by the Eleventh Circuit of the court's decision. In addition, the National Parks Conservation Association and the Sierra Club had filed cases in two federal district courts in 2001 raising the same NSR allegations at TVA's Bull Run Fossil Plant and Colbert Fossil Plant Unit 5 as were raised in the EPA proceeding found unconstitutional by the Eleventh Circuit. Both cases were stayed pending a decision from the Eleventh Circuit. We anticipate the stays will be lifted in the near future. See "Legal Proceedings" in Part I of the amended Information Statement.

On July 25, 2003, TVA received a notice of intent to sue from the Our Children's Earth Foundation (OCE). OCE alleges that TVA violated the NSR requirements of the CAA by undertaking major modifications at TVA's Allen Unit 3, Bull Run, Cumberland Units 1 and 2, Kingston Units 6 and 8, John Sevier Unit 3, Paradise Units 1, 2, and 3, Shawnee Units 1 and 4, Colbert Unit 5, and Widows Creek Unit 5. OCE also alleges the CAA new source performance standards at Colbert Unit 5 and the operations at TVA's Johnsonville Fossil Plant have not met the applicable opacity requirements. This notice does not allege a specific amount of damages. OCE's allegations about Bull Run and Colbert Unit 5 are already the subject of litigation in federal district courts initiated by the National Parks Conservation Association and the Sierra Club. Both of these cases were stayed pending a decision by the Eleventh Circuit in the NSR litigation discussed above. The plaintiffs in the Bull Run case recently moved to reactivate that case. OCE states in their notice that they intend to file suit anytime after 60 days from the date of their letter or after July 21, 2003.

8. Subsequent Events

On March 28, 2003, the Warren County Rural Electric Cooperative (Warren RECC) in Bowling Green, KY, informed TVA it plans to seek power from other sources to serve its load beginning in April 2008. On August 4, 2003, Duck River EMC gave notice to terminate its power contract with TVA effective August 4, 2008. During fiscal year 2002, sales to Warren RECC and Duck River EMC generated approximately two percent of TVA's total revenues.

During July 2003, TVA monetized the call provisions on a $476 million public bond issue by entering into a swaption agreement with a third party in exchange for approximately $81 million. The swaption essentially grants the third party the right to exercise the embedded call provision of the bond while TVA continues to pay the holder of the swaption pursuant to the original bond issuance.

TVA redeemed all of its 2002 5.375 percent electronotes® due July 15, 2012, with a par amount of $32 million, and its 2002 4.625 percent electronotes® due July 15, 2009, with a par amount of $30 million, on July 15, 2003. TVA also redeemed all of its 7.25 percent 1993 Series D Power Bonds due July 15, 2043, with a par amount of $617 million, on July 16, 2003.

On August 1, 2003, TVA issued a $1 billion, 10-year global power bond at a coupon rate of 4.75 percent. The bonds mature August 1, 2013, are noncallable and will pay interest semiannually.

On August 18, 2003, TVA will redeem all of its 2001 5.875 percent electronotes® due August 15, 2011, and its 2002 5.375 percent electronotes® due August 15, 2017. TVA issued about $41 million of the 2001 5.875 percent electronotes® and $38 million of the 2002 5.375 percent electronotes®. The bonds will be redeemed at 100 percent of their par value.

Management's Discussion and Analysis of Financial Condition and Results of Operations

Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) explains the results of operations and general financial condition of TVA. The MD&A should be read in conjunction with the accompanying Financial Statements and the Amended 2002 Information Statement dated as of January 13, 2003, except for certain new information described therein which is dated as of July 28, 2003.

Results of Operations. TVA had a net loss of $8 million for the third quarter of 2003 compared with net income of $59 million for the same period last year. The decrease resulted from a decrease in sales and overall operating income resulting from mild weather in the current year.

Year-to-date net income through June 30, 2003 increased to $413 million compared to a $27 million net loss through June 30, 2002, an improvement of $440 million. A significant portion of the increase relates to two non-cash accounting changes implemented during the first quarter of 2003. These included a $412 million gain related to a change in accounting for unbilled revenue and a $178 million charge related to a change in accounting for asset retirement obligations (see note 1 – Change in Accounting for Unbilled Revenue and Asset Retirement Obligations). In addition, TVA recognized a loss on project cancellation of $150 million in March 2002 which resulted in a net loss for the nine months ending June 30, 2002, not present in the current year.

Operating Revenues. Total sales decreased approximately 1.7 billion kilowatt-hours (or 4.3 percent) for the quarter ended June 30, 2003, from the same period last year. The decrease was primarily weather related with 23.5 percent fewer heating degree days and 31.6 percent fewer cooling degree days during the third quarter of 2003 as compared to the prior year. The increase in total sales for the nine month period ended June 30, 2003, over the same period of 2002 was approximately 3.8 billion kilowatt-hours (or 3.3 percent) and was also weather related. The TVA service territory experienced colder winter temperatures resulting in 17 percent more heating degree days for the nine month period ended June 30, 2003, over the same period last year. A detailed table of electricity sales for the three and nine month periods ended June 30, 2003 and 2002, is as follows:

	Three months ended June 30		Nine months ended June 30	
	2003	2002	2003	2002
Sales of electricity (millions of kWh)				
Municipalities and cooperatives	30,219	31,344	94,154	90,977
Industries directly served	6,786	6,671	21,962	20,219
Federal agencies and other utilities	860	1,556	3,110	4,204
Total sales of electricity	37,865	39,571	119,226	115,400

Total operating revenues were $1,637 million in the quarter ended June 30, 2003, compared to $1,678 million in the quarter ended June 30, 2002, for a reduction of 2.4 percent. The pro-forma effects of the change in accounting for unbilled revenue (see note 1-Change in Accounting for Unbilled Revenue and Pro-forma Effects of Accounting Changes), if applied retroactively, increased revenue from municipalities and cooperatives by $14 million for the three months ended June 30, 2002. Consequently, if total operating revenues of $1,637 million in the quarter ended June 30, 2003 are compared to pro-forma operating revenues of $1,692 million for the same period of 2002, the result is a reduction of operating revenues of 3.3 percent.

	Three months ended June 30 (in millions)		
	2003	2002	Percent change
Operating revenues			
Municipalities and cooperatives	$ 1,396	$ 1,420	(1.7%)
Industries directly served	194	186	4.3%
Federal agencies and other utilities	34	48	(29.2%)
Other revenue	13	24	(45.8%)
Total operating revenues	$ 1,637	$ 1,678	(2.4%)

The decrease in total operating revenues for the three month period ended June 30, 2003, over the same period in 2002 resulted mainly from decreased sales to municipalities and cooperatives and decreased sales to federal agencies and other utilities. Sales to municipalities and cooperatives decreased due to milder temperatures experienced across the valley, which resulted in lower sales to residential customers. Sales to federal agencies and other utilities also declined primarily due to lower interchange sales. Interchange sales have been lower due to reduced weather-related demand and TVA having less available capacity to take advantage of selling opportunities.

For the nine months ended June 30, 2003, revenues were $5,133 million, as compared to $4,852 million for the same period in 2002, an increase of $281 million or 5.8 percent. The pro-forma effects of the change in accounting for unbilled revenue (see note 1-Change in Accounting for Unbilled Revenue and Pro-forma Effects of Accounting Changes), if applied retroactively, increased revenue from municipalities and cooperatives by $79 million for the nine months ended June 30, 2002. Consequently, if total operating revenues of $5,133 million for the nine months ended June 30, 2003 are compared to pro-forma operating revenues of $4,931 million for the same period of 2002, the result is an increase of operating revenues of 4.1 percent.

	Nine months ended June 30		
	2003	2002	Percent change
	(in millions)		
Operating revenues			
Municipalities and cooperatives	$ 4,368	$ 4,124	5.9%
Industries directly served	597	538	11.0%
Federal agencies and other utilities	115	128	(10.2%)
Other revenue	53	62	(14.5%)
Total operating revenues	$ 5,133	$ 4,852	5.8%

The increase in total operating revenues for the nine month period ended June 30, 2003, over the same period in 2002 resulted from increased sales to municipalities and cooperatives and increased sales to industries directly served. Sales to municipalities and cooperatives increased mainly due to the colder temperatures over the winter months. The class of customers who are most affected by weather are residential customers who account for approximately 45 percent of the total municipality and cooperative sales. Sales to firm power customers who account for approximately 48 percent of directly served customers also increased. Sales of firm energy were higher as compared to last year primarily due to higher average prices and increased sales to paper, chlorine and ferroalloy industrial customers.

Fuel and Purchased Power. Fuel and purchased power expense was $480 million in the quarter ended June 30, 2003, compared to $488 million in the quarter ended June 30, 2002, a decrease of $8 million or 1.6 percent. Fuel and purchased power expense decreased in conjunction with reduced sales and generation. For the nine months ending June 30, 2003, fuel and purchased power expense was $1,460 million, compared to $1,322 million in the same period of the prior year, an increase of $138 million or 10.4 percent. Fuel and purchased power expense increased due to the impact of several forced outages combined with higher spot market prices.

Operating and Maintenance Expenses. Operating and maintenance expenses increased $66 million, or 15.6 percent, from $422 million to $488 million for the quarters ended June 30, 2002 and 2003, respectively. This increase was primarily due to lower pension income of $28 million, higher employee benefit costs of $6 million, and higher base O&M costs of $23 million due to forced unit outages. Base O&M costs include ongoing costs of operating and maintaining TVA's power facilities.

Operating and maintenance expenses increased $166 million, or 12.9 percent, from $1,286 million to $1,452 million for the nine month periods ending June 30, 2002 and 2003, respectively. O&M base costs were $89 million higher than the prior year due to several unplanned outages and higher generation expenses. O&M outage costs were $50 million lower in the current year due to the rescheduling of several planned outages as a result of system requirements due to forced outages. Other O&M costs were $96 million higher than the prior year primarily due to a lower pension income of $76 million and increased benefit costs of $18 million.

Depreciation and Accretion. Depreciation and accretion increased from $258 million to $265 million for the quarters ended June 30, 2002 and 2003, respectively. The increase resulted primarily from increased depreciation expense of $6 million for capital projects placed in service during the current quarter and accretion expense of $3 million related to the adoption of SFAS No. 143, *Accounting for Asset Retirement Obligations.*

Depreciation and accretion increased for the nine months ending June 30, 2003, from $765 million in the prior year to $792 million in 2003. The increase resulted from increased depreciation expense of $20 million for capital projects placed in service during the year and accretion expense of $7 million related to the adoption of SFAS No. 143, *Accounting for Asset Retirement Obligations.*

Loss on Plant Cancellation. Due to changes in the market forecast, TVA elected during 2002 not to complete a gas-fired combined-cycle plant that would have provided 510 megawatts of power in 2004. Accumulated costs of the project totaled approximately $150 million, which TVA recognized as a loss on plant cancellation during the second quarter of 2002 and is reflected in the results for the nine months ended June 30, 2002.

Interest Expense. Interest expense was $332 million in the quarter ended June 30, 2003, compared to $356 million in the quarter ended June 30, 2002. This reduction reflects lower average interest rates and a lower level of total outstanding debt during the third quarter of fiscal year 2003. Total outstanding indebtedness, excluding discount, as of June 30, 2003, was $24.9 billion with an average interest rate of 5.66 percent; as of June 30, 2002 total debt outstanding, excluding discount, was $25.3 billion with an average interest rate of 5.94 percent. The average long-term and short-term interest rates for the quarter ended June 30, 2003, were 6.26 percent and 1.21 percent, respectively, as compared with 6.35 percent and 1.78 percent for the quarter ended June 30, 2002.

Interest expense declined $60 million for the nine months ended June 30, 2003, from $1,073 million in the prior year to $1,013 million in 2003. This reduction reflects lower average interest rates on total outstanding debt during fiscal year 2003. Interest rates on debt averaged 5.82 percent for the first nine months of 2003 compared with 6.13 percent for the same period of 2002. The average long-term and short-term interest rates for the nine months ended June 30, 2003, were 6.45 percent and 1.34 percent, respectively, as compared with 6.59 percent and 1.99 percent for the quarter ended June 30, 2002.

Cumulative Effects of Accounting Changes. The net gain of $234 million from accounting changes during the first quarter of 2003 resulted from a gain related to a change in accounting for unbilled revenues of $412 million, partially offset by a change in accounting for asset retirement obligations of $178 million (see note 1-Impact of New Accounting Standards).

Material Changes in Liquidity and Capital Resources

Comparative Cash Flow Analysis - Power Program

Cash and cash equivalents decreased $163 million during the quarter ending June 30, 2003. Net cash provided by operating activities decreased $41 million from $264 million to $223 million for the three month periods ending June 30, 2002 and 2003, respectively. The decrease reflects lower operating revenues of $41 million due to milder weather during 2003. Other changes included higher cash operating and maintenance costs of $22 million, increased benefit costs of $5 million and increased worker's compensation costs of $7 million due to lump-sum settlement payments for hearing loss claims. Working capital requirements increased $17 million more during the third quarter of 2003 than during the third quarter of 2002 as a result of a $12 million smaller increase in accounts payable and accrued liabilities, a $24 million larger decrease in accrued interest, and a $33 million increase in inventories as compared to a $2 million decrease in inventories, offset by a $54 million smaller increase in accounts receivable. Cash outlays for interest declined $20 million, and other items requiring cash decreased $16 million due primarily to increased nuclear outage costs.

Cash and cash equivalents decreased $39 million for the nine months ended June 30, 2003. Net cash provided by operating activities increased $234 million from $857 million to $1,091 million for the nine month periods ended June 30, 2002 and 2003, respectively. The increase includes greater electricity sales of $281 million primarily to municipalities and cooperatives and industries directly served due to colder winter weather in the Valley and to contract term mix of industries directly served. Cash from the increase in sales was offset by a corresponding increase in fuel and purchased power expense of $138 million to meet the higher demand and an increase in cash operating and maintenance costs of $90 million as a result of several unplanned outages and higher generation expenses. Working capital requirements increased $39 million less during the first nine months of 2003 than during the first nine months of 2002 as a result of a $20 million larger decrease in accounts receivable and a $73 million smaller decrease in accounts payable and accrued liabilities, offset by a $21 million greater increase in inventory levels and a $33 million greater decrease in accrued interest. Other items requiring cash decreased $88 million due to decreased nuclear outage costs of $35 million and the receipt of distributor energy payments of $47 million.

Cash used in investing activities increased $236 million for the three month period ending June 30, 2003, compared to the same period of 2002. This included increased capital spending of $174 million primarily related to the Browns Ferry Unit 1 restart and clean air initiatives. The increase also included higher nuclear fuel expenditures of $60 million due to timing of enrichment services received.

Cash used in investing activities increased $338 million for the first nine months of 2003, compared to the same period of 2002. This increase included higher capital spending of $324 million primarily related to the Browns Ferry Unit 1 restart and clean air initiatives. The increase also included higher nuclear fuel expenditures of $37 million due to timing of enrichment services received. This was offset by a $15 million increase in proceeds from the sale of investments.

Net cash provided by financing activities decreased $246 million for the three month period ending June 30, 2003, compared to the same period of 2002. Issues of long-term debt decreased $232 million and redemptions of long-term debt decreased $790 million. Net short-term debt redemptions increased $982 million. Net proceeds received from combustion turbine financing in the current quarter were $162 million not present in the prior year. Additionally, payments on lease/leaseback obligations for the three months ending June 30, 2003 decreased $19 million in comparison with the the same period of the prior year.

Net cash provided by financing activities increased $33 million for the nine months ended June 30, 2003, compared to the same period of 2002. Long-term debt issues decreased $790 million and redemptions of long-term debt decreased $827 million. Net redemptions of short-term debt increased $211 million for the first nine months of 2003 compared with the same period of 2002 while financing costs were $23 million less in the first nine months of 2003 than the same period of 2002. Proceeds of $175 million from a bond call monetization were also received in 2003 which did not exist in the prior year.

Comparative Cash Flow Analysis - All Programs

The Statements of Cash Flows—All Programs are substantially the same as the Statements of Cash Flows—Power Program and should be viewed in conjunction with the Comparative Cash Flow Analysis—Power Program and the Statements of Cash Flows—Power Program.

Working Capital

At June 30, 2003, TVA's Power Program had negative working capital of approximately $3,235 million, largely attributable to $3,848 million in short-term indebtedness. The table below summarizes the components of working capital and short-term debt. It is TVA's cash management policy to use discount notes to meet current obligations and TVA plans to continue to use such financing instruments as long as short-term interest rates remain favorable and interest coverage levels are met.

	Power Program (in millions)		All Programs (in millions)	
	At June 30 2003	At September 30 2002	At June 30 2003	At September 30 2002
Current assets	$ 1,786	$ 1,530	$ 1,787	$ 1,533
Current liabilities	(5,021)	(4,809)	(5,023)	(4,811)
Working capital (deficit)	$ (3,235)	$ (3,279)	$ (3,236)	$ (3,278)
Discount notes <90 days	$ 2,512	$ 3,492	$ 2,512	$ 3,492
Current portion of long-term debt	1,336	–	1,336	–
Total short-term debt	$ 3,848	$ 3,492	$ 3,848	$ 3,492

Financing Activities

Capital Resources

From October 1, 2002 to June 30, 2003, TVA issued $418 million of electronotes® with an average interest rate of 4.31 percent. In addition, during June TVA issued £150 million ($244.95 million) of 2003 Series A global power bonds with an interest rate of 4.625 percent and $500 million of 2003 Series B global power bonds with an interest rate of 4.70 percent. During the first nine months of 2003, TVA redeemed $163 million of electronotes® carrying an average interest rate of 5.20 percent. TVA also redeemed four other debt issues totaling $365 million with an average interest rate of 6.62 percent (see Other Information-Debt Securities).

When TVA issued £150 million ($244.95 million) 2003 series A Power Bonds on June 2, 2003, it entered into a swap transaction to hedge the exchange rate risk associated with these bonds. The overall effective cost to TVA of these bonds and the associated swap was 4.962 percent.

TVA redeemed all of its 2002 5.375 percent electronotes® due July 15, 2012, with a par amount of $32 million, and its 2002 4.625 percent electronotes® due July 15, 2009, with a par amount of $30 million, on July 15, 2003. TVA also redeemed all of its 7.25 percent 1993 Series D Power Bonds due July 15, 2043, with a par amount of $617 million, on July 16, 2003.

On August 1, 2003, TVA issued a $1 billion, 10-year global power bond at a coupon rate of 4.75 percent. The bonds mature August 1, 2013, are noncallable and will pay interest semiannually.

On August 18, 2003, TVA will redeem all of its 2001 5.875 percent electronotes® due August 15, 2011, and its 2002 5.375 percent electronotes® due August 15, 2017. TVA issued about $41 million of the 2001 5.875 percent electronotes® and $38 million of the 2002 5.375 percent electronotes®. The bonds will be redeemed at 100 percent of their par value.

Discounted Energy Units

During October of 2002, TVA introduced the Discounted Energy Units (DEU) program to its customers. The goal of the program is to create a financial partnering between TVA and its customers to help finance TVA's power program. Annually for fiscal years 2003-2007, TVA customers may purchase DEU in $1 million increments. Each DEU entitles the customer to a 0.025 $/kWh discount on a specified quantity of firm load over a period of years (for example, 10, 15, or 20 years) for each kilowatt-hour in the prepaid block. The remainder of the price of the kilowatt-hours delivered is due upon billing. This program will allow customers to use the DEU to reduce their overall rates, lock in power supply without taking asset ownership risk and provide a higher return for available cash.

As of June 30, 2003, TVA had entered into sales agreements for 47.25 DEU totaling $47.25 million. TVA is accounting for the prepaid power as unearned revenue in Other liabilities on the June 30, 2003, Balance Sheet and is recognizing revenue as electricity is delivered to customers. As of June 30, 2003, nearly $3 million of the unearned revenue had been recognized as operating revenues.

Lease/Leaseback Transactions

During the summer of 2002, TVA completed construction of two sets of four combustion turbine units which were part of a series of new peaking combustion turbine units. Of the financing options available to TVA for these units, long-term lease and leaseback arrangements provided outcomes that were the most economically favorable to TVA. The lease/leaseback for the first set of four units was finalized during the first quarter of 2003 and provided about $163 million in lease proceeds. The cost of the first lease agreement approximated a full-term implicit rate just above four percent. The lease/leaseback of the second set of four units was finalized during the third quarter of 2003 and provided approximately $162 million in lease proceeds. The cost of the second lease agreement approximated a full-term implicit rate of slightly more than three and one-half percent.

TVA accounted for the respective lease proceeds as financing obligations in accordance with SFAS No. 66, *Accounting for Sales of Real Estate*, and SFAS No. 98, *Accounting for Leases*. The outstanding financing obligations at September 30, 2002, of $559 million are included in Current liabilities ($16 million) and Other liabilities ($543 million), respectively, on TVA's 2002 year-end Balance Sheet. During the first and third quarters of 2003, TVA received about $325 million in lease proceeds which were recorded as additional financing obligations in accordance with SFAS Nos. 66 and 98. The outstanding financing obligations of $870 million are included in Current liabilities ($51 million) and Other liabilities ($819 million), respectively, on TVA's Balance Sheet for the quarter ended June 30, 2003.

Cash Requirements and Contractual Obligations

The estimated commitments for TVA as of June 30, 2003 are as follows:

	2003*	2004	2005	2006	2007	Thereafter	Total
				(in millions)			
Debt maturities	$ 2,512	$ 2,336	$ 2,000	$ 2,621	$ 974	$ 14,475	$ 24,918
Leases	10	42	42	41	39	122	296
Lease/leaseback transactions	24	70	66	64	64	921	1,209
Power purchase obligations	55	132	155	155	143	2,859	3,499
Other obligations	15	27	12	7	–	–	61
Fuel purchase obligations	28	948	558	444	315	530	2,823
Total	$ 2,644	$ 3,555	$ 2,833	$ 3,332	$ 1,535	$ 18,907	$ 32,806

*Period July 1 - September 30, 2003

As of June 30, 2003, the nuclear decommissioning trust funds totaled approximately $607 million, which is approximately $307 million less than the present value of the estimated future decommissioning costs calculated in accordance with Nuclear Regulatory Commission (NRC) requirements. In March 2003, TVA submitted its biennial letter to the NRC on the funding status of the Nuclear Decommissioning Trust versus its liabilities. In the letter, TVA states that it is considering several alternatives to provide additional funding assurance methods and is assessing the need for future action on an ongoing basis. The current status of the fund has been primarily influenced by sizable declines in the stock market as well as increases in the projected decommissioning costs. Moderate market recovery along with the achievement of planned license renewal of Browns Ferry Nuclear Plant 1 within the near term will restore overall funding adequacy. These factors will have a significant impact on the status of the fund and prudent planning obligates TVA to take them into account.

New Accounting Pronouncements

Asset Retirement Obligations

On October 1, 2002, TVA adopted SFAS No. 143, *Accounting for Asset Retirement Obligations*, which requires the recognition of a liability, and capitalization of the associated asset retirement cost as part of the carrying amount of the long-lived asset, for “legal obligations” associated with the retirement of long-lived assets that result from the acquisition, construction, development, and/or normal operation of long-lived assets. TVA identified and reviewed all relevant information in the determination of its potential asset retirement obligations (AROs). TVA identified four categories of AROs which represent legal obligations of TVA under the requirements set forth in the standard. Costs associated with retirement of coal-fired and gas/oil turbine generating plants and ash/waste ponds are being expensed as period costs while costs associated with retirement of nuclear generating plants are being deferred in accordance with SFAS No. 71, *Accounting for the Effects of Certain Types of Regulation*, based on the partially funded status of the obligation.

Nuclear Generating Plants. In prior years, TVA had already recognized a decommissioning liability related to its nuclear generating plants in accordance with NRC requirements. This previously recorded liability represents the pre-SFAS No. 143 obligation for TVA’s nuclear plant AROs. The adoption of SFAS No. 143 resulted in a change in the methodology of quantifying this nuclear decommissioning obligation in accordance with the new standard. TVA has increased the nuclear decommissioning liability on the balance sheet to the new estimate, but has retained its regulatory accounting treatment of capturing all changes in the liability, investment funds, and regulatory asset as changes in the regulatory asset instead of recording these items on the income statement.

Coal-Fired Generating Plants. The activities associated with coal plant retirement include plant shutdown, securing the physical property, closure of storage and/or waste areas, maintenance of stack lights, security patrols, and measures to contain asbestos and other hazardous materials from release into the environment. The estimated costs of these activities have been included in the calculation of TVA’s coal plant AROs.

Gas/Oil Turbine Generating Plants. The activities associated with gas and oil turbine plant retirement include annual operating costs for site security, lighting, powerhouse and grounds maintenance, containment of asbestos, paint, and other materials, and groundwater monitoring. The estimated costs of these activities have been included in the calculation of TVA’s combustion turbine plant AROs.

Ash/Waste Ponds. Most of the ARO components at TVA’s coal plants have estimated useful lives that correspond to the overall estimated life of the plant, and these components were included in the coal plant AROs described above. However, certain ash ponds and waste areas have estimated useful lives that are independent of the lives of the coal plants themselves. Accordingly, these specific ash/waste pond areas were considered to be separate AROs and were quantified based on their specific estimated useful lives.

For each ARO identified, TVA calculated the net present value of the obligation as of October 1, 2002, the original and incremental cost of the long-lived asset at the time the assets were originally put in service, the cumulative effect of depreciation on the adjusted asset base and accretion of the liability from the date of initial operation to the current period.

The effect of the adoption of SFAS No. 143 during the first quarter of 2003 included a cumulative effect charge to income of $178 million, a corresponding additional long-term liability of $717 million, an increase in assets of $745 million, and related accumulated depreciation of $206 million.

<u>Other New Accounting Standards</u>
Effective October 1, 2002, TVA adopted Emerging Issues Task Force (EITF) Issue 02-03, *Issues Related to Accounting for Contracts Involved in Energy Trading and Risk Management Activities*. EITF Issue 02-03 rescinded EITF Issue 98-10, *Accounting for Contracts Involved in Energy Trading and Risk Management Activities*, and reached two general conclusions:

- Energy trading contracts that do not meet the definition of a derivative under SFAS No. 133 should not be marked to fair market value, and
- Revenues should be shown in the income statement net of costs associated with trading activities, whether or not the trades are physically settled.

TVA's energy trading activities qualify as normal sales and purchases under SFAS No. 133, *Accounting for Certain Derivative Instruments and Certain Hedging Activities*, and accordingly, adoption of EITF Issue 02-03 had no impact on previously reported net income or proprietary capital.

In April 2003, the FASB issued SFAS No. 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities*. The statement clarifies under what circumstances a contract with an initial net investment meets the characteristic of a derivative as discussed in SFAS No. 133. In addition, it clarifies when a derivative contains a financing component that warrants special reporting in the statement of cash flows. The statement is effective for contracts entered into or modified after June 30, 2003, and should be applied prospectively. The adoption of SFAS No. 149 will have no effect on TVA as it currently reports these types of transactions in accordance with the standard.

In November 2002, the FASB published Interpretation No. 45, *Guarantor's Accounting and Disclosure requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*. The interpretation elaborates on the existing disclosure requirements for most guarantees, including standby letters of credit. It also clarifies that at the time a company issues a guarantee, the company must recognize an initial liability for the fair value, or market value, of the obligations it assumes under that guarantee and must disclose that information in its interim and annual financial statements. The initial recognition and initial measurement provisions apply on a prospective basis to guarantees issued or modified after December 31, 2002, regardless of the guarantor's fiscal year-end. At this time, TVA does not have any guarantees meeting the criteria of the interpretation.

In July 2003, the FASB published Interpretation No. 46, *Consolidation of Variable Interest Entities*. This interpretation explains how to identify variable interest entities and how an enterprise assesses its interests in a variable interest entity to decide whether to consolidate that entity. It also clarifies the application of Accounting Research Bulletin No. 51, *Consolidated Financial Statements,* to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. The interpretation applies to nonpublic enterprises in the first fiscal year beginning after June 15, 2003. At this time, TVA is in the process of evaluating the requirements of this statement.

QUALITATIVE AND QUANTITATIVE DISCLOSURES ABOUT MARKET RISK

Value at Risk
TVA does not engage in wholesale trading operations for the purposes of speculation. Rather, when necessary, in order to supplement generation to meet its native load, TVA will engage in some aspects of physical trading. Further, TVA employs commodity-based instruments which include forwards and option contracts to manage risks associated with the market fluctuations in the price and transportation costs of certain commodities and fuels includ-

ing, but not limited to, coal, natural gas and electricity.

Mark-to-Market Valuation
TVA has not changed its valuation methodology from prior years. As of June 30, 2003, TVA's twelve-month forward position on a mark-to-market (MTM) basis for all energy assets for all hours is as follows:

Source of Fair Value	July 2003 - June 2004 (in millions)
Owned Assets	$ –
Actively Quoted	–
Prices Provided by External Sources	3,873
Modeled	–
Total	$ 3,873

Note that prices quoted by external sources reflect independent broker quotations and publicly posted prices on electronic media such as the Intercontinental Exchange.

Based on June 27, 2003, closing prices, the MTM value of TVA's energy portfolio for July 2003 to June 2004 is shown in the table above. The fair value calculation determines a profit or loss for each source of fair value, e.g. load, based on market prices. Since TVA is almost completely hedged, only a small portion of power is bought and sold in the market so the market price has little impact on TVA margins.

Cash Flow Hedges Included in Accumulated Other Comprehensive Loss on the Balance Sheet
June 30, 2003
(in millions)

	Accumulated Other Comprehensive Loss
Interest Rate	$ (16)
Foreign Currency	(136)
Total	$ (152)

CONTROLS AND PROCEDURES

TVA's management, including the Senior Vice President and Treasurer and the members of the Board of Directors (Board), have conducted an evaluation of the effectiveness of TVA's disclosure controls and procedures as of a date within 90 days prior to the date of this quarterly report. Based on that evaluation, the members of the Board and the Senior Vice President and Treasurer concluded that the disclosure controls and procedures are effective in ensuring that all material information necessary and appropriate in this quarterly report has been made known to them in a timely fashion. TVA's disclosure controls and procedures are effective in ensuring that information disclosed in TVA's periodic financial reports is accumulated and communicated to management, including the members of the Board and the Senior Vice President and Treasurer, as appropriate, to allow timely decisions regarding disclosure. TVA continues to develop and implement additional disclosure controls and procedures. There have been no significant changes in internal controls, or in factors that could significantly affect internal controls, subsequent to the date the members of the Board and the Senior Vice President and Treasurer completed their evaluation.

OTHER INFORMATION

Legal Proceedings

On February 20, 2003, the federal district court in Florence, Alabama, dismissed the Alabama Environmental Council and the Sierra Club's claim for civil penalties for alleged violations of Clean Air Act (CAA) opacity limits applicable to the Colbert Fossil Plant (Colbert). These groups are still seeking a court order (1) declaring TVA in violation of these opacity limits and (2) requiring TVA to bring Colbert into continuous compliance with these limits. These two claims are set for trial in the fall of 2003.

On August 31, 1999, Birmingham Steel Corporation filed a lawsuit in the U.S. District Court for the Northern District of Alabama challenging TVA's charges for economy surplus power (ESP) during the summer of 1998. The lawsuit purports to be a class action on behalf of industrial customers who participate in TVA's ESP program. Under ESP contracts, the hourly ESP energy price is calculated using TVA's actual incremental cost of supplying the ESP load in each hour. The plaintiff alleges that TVA overcharged for ESP during the summer of 1998 by including in the price of ESP in some hours certain costs that the plaintiff contended were not properly charged to ESP customers under the terms of the contracts. The plaintiff is seeking over $100,000,000 in damages on behalf of itself and the other proposed class members. In September 2002, the U.S. District Court for the Northern District of Alabama decertified the class action and then dismissed the lawsuit without prejudice on a jurisdictional issue, and the plaintiff appealed to the U.S. Court of Appeals for the Eleventh Circuit. Oral argument on the appeal occurred on June 5, 2003.

On June 24, 2003, the U.S. Circuit Court of Appeals for the Eleventh Circuit issued its decision in TVA's case challenging the Environmental Protection Agency's (EPA) administrative compliance order that held TVA liable for violating the Clean Air Act's New Source Review (NSR) provisions and required TVA to undertake substantial compliance activities. Although the Eleventh Circuit did not rule on the merits of the case, the court held that the procedure used by EPA against TVA was "unconstitutional" and that "TVA is free to ignore" EPA's administrative compliance order because it was "legally inconsequential" and did not constitute final agency action. Among other things, the court pointed out that EPA's Environmental Appeals Board and administrative law judge "manufactured the procedures they employed [against TVA] on the fly, entirely ignoring the concept of the rule of law." The Eleventh Circuit concluded that a part of the CAA is unconstitutional because it allows EPA to decide that a regulated party like TVA has violated the law and is liable for severe penalties without ever allowing the regulated party to present evidence on whether the law was in fact violated. The court said that EPA may sue TVA in district court to try to prove its case. EPA, through the Department of Justice, recently moved for reconsideration en banc by the Eleventh Circuit of the court's decision. In addition, the National Parks Conservation Association and the Sierra Club had filed cases in two federal district courts in 2001 raising the same NSR allegations at TVA's Bull Run Fossil Plant and Colbert Fossil Plant Unit 5 as were raised in the EPA proceeding found unconstitutional by the Eleventh Circuit. Both cases were stayed pending a decision from the Eleventh Circuit. We anticipate the stays will be lifted in the near future. See "Legal Proceedings" in Part I of the amended Information Statement.

On July 25, 2003, TVA received a notice of intent to sue from the Our Children's Earth Foundation (OCE). OCE alleges that TVA violated the NSR requirements of the CAA by undertaking major modifications at TVA's Allen Unit 3, Bull Run, Cumberland Units 1 and 2, Kingston Units 6 and 8, John Sevier Unit 3, Paradise Units 1, 2, and 3, Shawnee Units 1 and 4, Colbert Unit 5, and Widows Creek Unit 5. OCE also alleges the CAA new source performance standards at Colbert Unit 5 and the operations at TVA's Johnsonville Fossil Plant have not met the applicable opacity requirements. This notice does not allege a specific amount of damages. OCE's allegations about Bull Run and Colbert Unit 5 are already the subject of litigation in federal district courts initiated by the National Parks Conservation Association and the Sierra Club. Both of these cases were stayed pending a decision by the Eleventh Circuit in the NSR litigation discussed above. The plaintiffs in the Bull Run case recently moved to reactivate that case. OCE states in their notice that they intend to file suit anytime after 60 days from the date of their letter or after July 21, 2003.

Debt Securities

TVA issues power bonds pursuant to Section 15d of the TVA Act and pursuant to the Basic Tennessee Valley Authority Power Bond Resolution. Power bonds in each series must be further authorized by Supplemental Resolution. The table below summarizes TVA's debt securities activity for the period from October 1, 2002, to

June 30, 2003.

Activity October 1, 2002 to June 30, 2003
(in millions)

	Date	Amount	Coupon
Redemptions:			
1998 Series A	1/02/2003	$ 242	6.350%
2000 Series A	1/18/2003	65	7.150%
2000 Series B	1/18/2003	35	7.400%
1998 Series D	6/01/2003	23	6.750%
electronotes®	Second Quarter 2003	39	4.375% – 5.875%
	Third Quarter 2003	124	4.380% – 6.000%
		$ 528	
£ Issue:			
2003 Series A	6/02/2003	£ 150	4.625%
USD Issues:			
2003 Series B	6/23/2003	$ 500	4.700%
electronotes®	First Quarter 2003	156	4.600% – 5.050%
	Second Quarter 2003	142	3.050% – 5.000%
	Third Quarter 2003	120	2.450% – 5.125%
		$ 918	

From April 1, 2003, to June 30, 2003, TVA issued $120 million of electronotes with interest rates ranging from 2.45 percent to 5.13 percent. During the same period of 2003, TVA redeemed $124 million of electronotes with interest rates ranging from 4.38 percent to 6.00 percent.

TVA announced in early May 2003 that the coupon rate for the 1998 Series D PARRS (Putable Automatic Rate Reset Securities) would reset to 5.952 percent effective June 1, 2003, and will be reflected in the quarterly interest payments beginning on September 1, 2003. Bondholders had the option of retaining the bonds at the new rate or returning the bonds to TVA. Bondholders who held approximately $23 million in bonds chose to return the bonds and received the $25 par value for each bond returned.

On June 2, 2003, TVA issued £150 million ($244.95 million) of 2003 Series A global power bonds that have an interest rate of 4.625 percent and mature in 2043. The bonds are non-callable and pay interest annually. When TVA issued the 2003 Series A power bonds, it entered into a swap transaction to hedge the exchange rate risk associated with these bonds. The overall effective cost to TVA of these bonds and the associated swap was 4.96 percent.

On June 23, 2003, TVA issued a $500 million, 30-year global power bond with a coupon rate of 4.70 percent. The bonds mature July 15, 2003 and will pay interest semiannually.

TVA redeemed all of its 2002 5.375 percent electronotes® due July 15, 2012, with a par amount of $38 million, and its 2002 4.625 percent electronotes® due July 15, 2009, with a par amount of $30 million, on July 15, 2003. TVA also redeemed all of its 7.25 percent 1993 Series D Power Bonds due July 15, 2043, with a par amount of $617 million, on July 16, 2003.

On August 1, 2003, TVA issued a $1 billion, 10-year global power bond at a coupon rate of 4.75 percent. The bonds mature August 1, 2013, are noncallable and will pay interest semiannually.

On August 18, 2003, TVA will redeem all of its 2001 5.875 percent electronotes® due August 15, 2011, and its 2002 5.375 percent electronotes® due August 15, 2017. TVA issued about $41 million of the 2001 5.875 percent electronotes® and $38 million of the 2002 5.375 percent electronotes®. The bonds will be redeemed at 100 percent of their par value.

Board Actions

As of October 6, 2002, the Board approved such actions as may be necessary or desirable to effect the sale and leaseback or the lease and leaseback of eight combustion turbines, four for TVA's Lagoon Creek Combustion Turbine Plant and four for TVA's Kemper County, Mississippi site, and to enter into any agreements, to make such certifications, and to take such other actions as may be necessary or desirable to effect any such leasing arrangements.

As of January 10, 2003, the Board approved (1) regulatory accounting treatment of TVA's fiscal year 2002 minimum unfunded pension liability; (2) adoption of SFAS No. 143, *Accounting for Asset Retirement Obligations*; and (3) a change in methodology for estimating and recording unbilled revenue.

As of February 3, 2003, the TVA Board of Directors approved a Corporate Accountability and Disclosure Plan to establish additional policies and procedures to better ensure the accuracy and completeness of TVA's financial and non-financial disclosure and the integrity of its financial reporting. Additionally, the Board authorized a Disclosure Control Committee and delegated to the Disclosure Control Committee the authority to develop and implement the policies, controls, and procedures required to execute the Corporate Accountability and Disclosure Plan. In the same action, the Board approved the Disclosure and Financial Ethics Code.

As of February 6, 2003, the Board approved the sale of an option to enter into an interest rate swap associated with a call provision which TVA has on $1 billion of TVA power bonds.

As of March 18, 2003, the individual Board members sequentially approved the designation and selection by the TVA Retirement System (System) Board of INVESCO to serve as an investment manager for a portion of the System's funds, approved the investment management agreement between the investment manager and the System, and authorized and directed the Chief Financial Officer to signify such approval by signing the investment management agreement.

As of April 8, 2003, Board approved delegation of authority to the Chief Financial Officer, or a designee, to enter into agreements for the sale of accounts receivable that result from electric system projects for TVA's customers, administer such agreements, and amend such agreements as appropriate to protect TVA's interests.

At its July 30, 2003, Board meeting, the Board authorized TVA's chief financial officer to enter into a lease financing arrangement with respect to existing computers, software and other equipment. This financing arrangement is similar to other lease/leaseback agreements TVA has entered into with respect to its combustion turbine plants.

OTHER INFORMATION

Rates

Rate Adjustments

TVA has begun preliminary discussions with distributor representatives about the need for a rate adjustment and a change in the structure of TVA's rates beginning in fiscal year 2004. These rate actions would result in a 7.4 percent average wholesale increase to residential and commercial customers and a two percent decrease to about 2,500 manufacturing industries. The two percent decrease for large manufacturing industries is designed to help keep manufacturing jobs in the Valley. The increase could generate about $365 million in additional revenue annually for TVA. If approved by the Board, the adjustment would likely take effect in October 2003.

Products

Flat Price Interruptible

Flat Price Interruptible (FPI), a new five-minute interruptible product offering, was recently approved by the TVA Board and is now available for qualifying loads greater than one megawatt. FPI provides a credit to a customer's demand charge in exchange for interruption rights. The product offers an option for some manufacturers who previously have not had an opportunity to participate in TVA's interruptible programs and provides TVA with up to 300 megawatts of additional five-minute interruptible power to use as supplemental reserves.

Discounted Energy Unit Program

TVA has offered and plans to offer again a discounted energy unit (DEU) program whereby a distributor can prepay a portion of the price of a block of power to be taken and will subsequently receive credit on its power bill over a period of years (for example, 10, 15, or 20 years) for each kilowatt-hour in the prepaid block. As of June 30, 2003, DEUs totaling over $47 million have been sold, and nearly $3 million have been recognized in operating revenues during 2003. The DEUs are included in Other liabilities on the Balance Sheet.

Customers

Contract Termination Notice

On March 28, 2003, the Warren County Rural Electric Cooperative (Warren RECC) in Bowling Green, KY, informed TVA it plans to seek power from other sources to serve its load beginning in April 2008. On August 4, 2003, Duck River EMC gave notice to terminate its power contract with TVA effective August 4, 2008. During fiscal year 2002, sales to Warren RECC and Duck River EMC generated approximately two percent of TVA's total revenues. Since October 2002, a total of four distributors (including Warren RECC and Duck River EMC) have given notice to terminate their power contracts with TVA, the first becoming effective October 2007. Sales to these four distributors generated approximately three percent of TVA's total operating revenues in fiscal year 2002. Once a power contract is terminated, the terminating distributor would have neither the obligation nor the right to take power or obtain transmission from TVA, absent the negotiation of new arrangements. Moreover, under the Anti-Cherrypicking Provision of the Energy Policy Act of 1992, TVA is not required to provide its competitors access to its transmission system to transmit power for consumption within the area that TVA or the distributors of its power may serve.

Wholesale Power Contracts

The Board and the board of the Tennessee Valley Public Power Association (TVPPA), an organization representing almost all of the distributors of TVA power, have recently been in discussions to develop a common approach to energy legislation currently being considered in Congress. In connection with those discussions, TVPPA asked for, and TVA agreed to offer, additional flexibility under the wholesale power contract with respect to contract termination. Previously, if requested by a distributor, TVA would execute an amendment allowing the wholesale power contract to be terminated in its entirety upon five years' notice. The Board has sent all distributors a letter offering to enter into a wholesale power contract amendment under which, in the event the existing statutory provisions that restrict TVA's ability to make off-system sales and protect TVA from wholesale competition are repealed, each distributor would have the right at any time, upon five years' notice, to elect to take any amount of power that it chooses from another source. In the event of such a notice, TVA would remain obligated to supply only the remaining portion of the distributor's load, however large or small.

Operations

Outages

During the first and second quarters of 2003, TVA had approximately 2,000 megawatts of capacity at three different generating facilities in longer-term forced outage. TVA returned to service approximately 500 megawatts near the end of March, an additional 144 megawatts at the beginning of May, and the remaining megawatts in early June. TVA adjusted other outage schedules and budgets to accommodate the impacts of these forced outages.

During the planned refueling outage of Sequoyah Unit 1, plant personnel inspected the top of the reactor vessel and found the existence of boron residue which could be explained by a reactor coolant system leak. Following the completion of extensive inspections, TVA determined that there was no leak in the reactor vessel head and that there was no cracking in either the penetration tube or the weld in the area where a trace of boron residue was found. For added assurance, the Electric Power Research Institute independently analyzed TVA's inspection results and concurred with TVA's determination.

On July 23, 2003 Johnsonville Fossil Plant experienced a small fire resulting in a loss of power to units 8, 9 and 10, causing the units to trip. The fire was quickly contained but the power disruption resulted in loss of oil flow to the turbines. An assessment is currently under way on the extent of the damage.

Browns Ferry Unit 1

In May 2002, the Board initiated activities for the return of Browns Ferry Unit 1 to service in order to meet long-term energy needs in the Tennessee Valley. It is anticipated the Browns Ferry Unit 1 recovery project will add approximately 1,280 megawatts of generation at a cost of approximately $1.8 billion and will take five years to complete. When Unit 1 returns to service, it is expected its additional generation will help lower TVA's average cost of power. As of June 30, 2003, TVA had incurred approximately $237 million of costs on the Browns Ferry Unit 1 restart project, slightly under the planned amount for this period. The restart project was about 24 percent complete at that date and is on schedule.

Transmission

On April 16, 2003, TVA entered into a Memorandum of Understanding (MOU) with the Midwest Independent Transmission System Operator, Inc. (MISO), and the PJM Interconnection (PJM). The MOU is intended to serve as a framework for the development of a multiregional coordination agreement among TVA, MISO, and PJM designed to facilitate wholesale electricity competition and transmission services through a significant portion of the Eastern Interconnection. The Eastern Interconnection refers to North America's electric system east of the Rocky

Mountains, excluding most of Texas, and it includes 622,000 megawatts of peak electric load when fully developed. The scope of the area that encompasses TVA, MISO, and PJM would include about 270,000 megawatts of peak load (about 43 percent of the peak load in the Eastern Interconnection), about 295,000 megawatts of generating capacity, about 150,000 miles of transmission lines, and more than 57 million customers or end users.

Legislation

Debt Ceiling

On February 3, 2003, the Bush Administration released its fiscal year 2004 budget plan. Among other things, the plan charges TVA with developing a plan to significantly reduce its debt and proposes legislation that would include certain financial transactions, such as lease-leaseback obligations, that result in increasing TVA's long-term liabilities in the calculation of TVA's $30 billion debt ceiling.

Business Outlook and Strategic Plan

On February 5, 2003, Senator Trent Lott (R-MS) reintroduced a bill in the Senate that would require TVA to provide Congress and the Administration with a 10-year business outlook and strategic plan. Under the bill, restrictions would be placed on new generating capacity and debt issuances.

Energy Bill

On April 11, 2003, the House of Representatives passed an energy bill (H.R. 6) that, among other things would (1) authorize TVA to voluntarily join a regional transmission organization in a manner consistent with its statutory obligations and limitations, and (2) subject TVA and other nonjurisdictional utilities to FERC transmission service oversight to assure that such utilities provide transmission service to others at comparable rates and on comparable terms and conditions to those that apply when they provide transmission service to themselves.

On July 31, 2003, the Senate passed an energy bill that, among other things, would subject TVA and other nonjurisdictional utilities to FERC transmission service oversight but, unlike the House bill, would not specifically authorize TVA to voluntarily join a regional transmission organization. Neither the House bill nor the Senate bill would change restrictions on the TVA service area or affect TVA's ability to set its own rates. The two bills must now be considered in a Senate-House conference.

TVA Board of Directors

On June 26, 2003, Senator Bill Frist (R-TN) reintroduced a bill that calls for expanding and restructuring the TVA Board. This is the fourth consecutive Congress in which this bill has been introduced, and the language in this version is identical to the one introduced in 2001. Frist's proposal would create a nine-member part-time Board made up of experts in corporate management and strategic decision making who would appoint a Chief Executive Officer to manage the corporation full-time. The bill calls for the part-time Board to establish long-range goals and policies for TVA, as well as approve the annual budget, create a compensation plan for employees and the Chief Executive Officer, and conduct public hearings on the policies that have a major effect on ratepayers. Board members also will determine electricity rates and ensure that independent audits of the corporation's management are conducted.

Stewardship Responsibilities

During 2003, TVA continued to conduct certain nonpower programs including managing navigable river channels, providing flood control, and overseeing certain recreation facilities. TVA's responsibilities include general stewardship of land, water, and wildlife resources. Historically, Congressional appropriations provided most of the funding for TVA's nonpower programs, and TVA has obtained additional funds from revenues and user fees from the nonpower programs. In October 1997, Congress passed legislation that directed TVA to fund essential stewardship activities related to its management of the Tennessee River system and TVA properties with power funds in the event that there were insufficient appropriations or other available funds to pay for such activities in any year. Beginning in 2000, Congress stopped providing appropriations to TVA to fund essential stewardship activities. TVA primarily is using power funds (along with user fees and other forms of nonpower revenues) to continue to fund these stewardship activities. TVA spent a total of approximately $62 million on essential stewardship activities during the first nine months of 2003.

Management

On June 11, 2003, John M. Hoskins assumed the position of Acting Chief Financial Officer in addition to his position as Senior Vice President and Treasurer until assumption of duties by the new Chief Financial Officer on July 9, 2003.

SUBSEQUENT EVENTS

On July 9, 2003, Michael E. Rescoe assumed the position of TVA Chief Financial Officer and Executive Vice President, Financial Services. Mr. Rescoe most recently served as Senior Vice President of Finance & Planning and Chief Financial Officer with 3Com Corp. Prior to 3Com Corp, Mr. Rescoe served as Chief Financial Officer of Pacific Gas & Electric. He also has over twelve years experience as an investment banker serving utility and energy sectors with New York-based Bear Stearns and Kidder, Peabody.

Senator Lamar Alexander of Tennessee chaired a meeting of the Tennessee Valley Authority Congressional Caucus in Knoxville, Tennessee on July 21, 2003. In announcing this meeting, Senator Alexander stated that "it is crucial for Congress to provide strategic oversight on the Future of TVA-where it is today and where it should be in five to ten years, its overall financial condition and its debt level, how well it is serving the Valley with affordable and reliable power, and how well it is cleaning the air." The meeting included testimony from the Board, key stakeholders, and other experts on the future of TVA.

During July 2003, TVA monetized the call provisions on a $476 million public bond issue by entering into a swaption agreement with a third party in exchange for approximately $81 million. The swaption essentially grants the third party the right to exercise the embedded call provision of the bond while TVA continues to pay the holder of the swaption pursuant to the original bond issuance.

On July 31, 2003, U.S. Senator Bill Frist of Tennessee announced that the U.S. Treasury Department has issued final regulations that will facilitate a proposed deal for the prepayment of electricity between TVA and Memphis Light, Gas & Water (MLGW), a distributor of TVA power. Under the proposed deal, MLGW would make a prepayment to TVA for $1.5 billion worth of electricity capacity, which would be delivered to MLGW over the next 15 years at a discounted rate. Any prepayment arrangement upon which MLGW and TVA agree would have to be approved by MLGW management, TVA management, and the Memphis City Council.

The General Accounting Office (GAO) recently issued a report about the lease and leaseback transactions TVA has used with respect to 24 combustion turbine generators. GAO concluded that TVA reported the transactions in compliance with applicable standards and requirements for financial reporting but that current law does not clearly and unambiguously address whether the amount of the lease-leaseback arrangements should be counted against the debt cap. They also recommended that Congress might want to consider amending section 15d(a) of the TVA Act that establishes a ceiling of $30 billion on the amount of bonds, notes, and evidences of indebtedness that TVA can have outstanding at any one time to include in the calculation alternative sources of financing (such as lease/leaseback arrangements) that have the same impact on TVA's financial condition and competitive position as traditional debt financing.

TVA redeemed all of its 2002 5.375 percent electronotes® due July 15, 2012, with a par amount of $32 million, and its 2002 4.625 percent electronotes® due July 15, 2009, with a par amount of $30 million, on July 15, 2003. TVA also redeemed all of its 7.25 percent 1993 Series D Power Bonds due July 15, 2043, with a par amount of $617 million, on July 16, 2003.

On August 1, 2003, TVA issued a $1 billion, 10-year global power bond at a coupon rate of 4.75 percent. The bonds mature August 1, 2013, are noncallable and will pay interest semiannually.

On August 4, 2003, Duck River EMC gave notice to terminate its power contract with TVA effective August 4, 2008. During fiscal year 2002, sales to Duck River EMC generated approximately one percent of TVA's total revenues.

On August 18, 2003, TVA will redeem all of its 2001 5.875 percent electronotes® due August 15, 2011, and its 2002 5.375 percent electronotes® due August 15, 2017. TVA issued about $41 million of the 2001 5.875 percent electronotes® and $38 million of the 2002 5.375 percent electronotes®. The bonds will be redeemed at 100 percent of their par value.

On August 7, 2003, the United States District Court for the Southern District of Ohio issued a decision on the merits in EPA's New Source Review (NSR) enforcement action against Ohio Edison. The court held for EPA on all issues. The issues in this case are substantially the same as the issues in TVA's case against EPA before the Eleventh Circuit. The Eleventh Circuit recently decided that EPA's administrative compliance order was unconstitutional and could not be enforced against TVA. TVA is not a party in the Ohio Edison case, and the decision in that case has no direct effect on TVA. However, the decision may increase the pressure on utilities to settle their NSR cases. EPA, through the Department of Justice, also recently moved for reconsideration en banc by the Eleventh Circuit of the court's decision in TVA's case.

CERTIFICATIONS OF THE MEMBERS OF THE TVA BOARD OF DIRECTORS

Glenn L. McCullough, Jr., Skila Harris and Bill Baxter individually certify that:

1. I have reviewed the Tennessee Valley Authority Quarterly Report (Report) for the quarterly period ended June 30, 2003;
2. Based on my knowledge, the information in this Report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the periods covered by this Report;
3. Based on my knowledge, the unaudited financial statements and other financial information included in this Report fairly present in all material respects the financial condition, results of operations and cash flows of the Tennessee Valley Authority as of, and for, the periods presented in this Report;
4. I and the other certifiers are responsible for establishing and maintaining disclosure controls and procedures for the Tennessee Valley Authority and have:
    a. designed such disclosure controls and procedures or caused such disclosure controls and procedures to be designed under our supervision, to ensure that the financial statements and other financial information relating to the Tennessee Valley Authority are made known to us particularly during the period in which this Report is being prepared;
    b. evaluated the effectiveness of the Tennessee Valley Authority's disclosure controls and procedures and presented in this Report our conclusions about the effectiveness of the disclosure controls and procedures as of a date within 90 days prior to the date of this Report; and
    c. disclosed in this Report any change in the Tennessee Valley Authority’s internal control over financial reporting that occurred during the most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Tennessee Valley Authority’s internal control over financial reporting; and
5. I and the other certifiers have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Tennessee Valley Authority’s independent auditors and the Inspector General of the Tennessee Valley Authority:
    a. all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Tennessee Valley Authority's ability to record, process, summarize and report financial information; and
    b. any fraud, whether or not material, that involves management or other employees who have a significant role in the Tennessee Valley Authority's internal control over financial reporting.

Date: August 13, 2003

Glenn L. McCullough, Jr.
Chairman

Skila Harris
Director

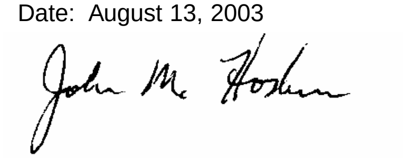
Bill Baxter
Director

CERTIFICATION OF THE SENIOR VICE PRESIDENT AND TREASURER

I, John M. Hoskins, certify that:

1. I have reviewed the Tennessee Valley Authority Quarterly Report (Report) for the quarterly period ended June 30, 2003;
2. Based on my knowledge, the information in this Report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the periods covered by this Report;
3. Based on my knowledge, the unaudited financial statements and other financial information included in this Report fairly present in all material respects the financial condition, results of operations and cash flows of the Tennessee Valley Authority as of, and for, the periods presented in this Report;
4. I and the other certifiers are responsible for establishing and maintaining disclosure controls and procedures for the Tennessee Valley Authority and have:
   a. designed such disclosure controls and procedures or caused such disclosure controls and procedures to be designed under our supervision, to ensure that the financial statements and other financial information relating to the Tennessee Valley Authority are made known to us particularly during the period in which this Report is being prepared;
   b. evaluated the effectiveness of the Tennessee Valley Authority's disclosure controls and procedures and presented in this Report our conclusions about the effectiveness of the disclosure controls and procedures as of a date within 90 days prior to the date of this Report; and
   c. disclosed in this Report any change in the Tennessee Valley Authority's internal control over financial reporting that occurred during the most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Tennessee Valley Authority's internal control over financial reporting; and
5. I and the other certifiers have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Tennessee Valley Authority's independent auditors and the Inspector General of the Tennessee Valley Authority:
   a. all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Tennessee Valley Authority's ability to record, process, summarize and report financial information; and
   b. any fraud, whether or not material, that involves management or other employees who have a significant role in the Tennessee Valley Authority's internal control over financial reporting.

Date: August 13, 2003



John M. Hoskins
Senior Vice President and Treasurer

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