BONNEVILLE

POWER ADMINISTRATION

1997 ANNUAL REPORT

BONNEVILLE
POWER ADMINISTRATION

BPA employees are citizens of the Northwest.

While they climb transmission towers, string power lines, conduct economic analyses, and plan renewable energy projects, they also live and play along the Columbia River and its tributaries. Many have roots in the Northwest that go back generations.

For these employees, the Columbia and its tributaries are more than just a source of hydropower. The rivers are what brought a lot of their ancestors to the region and the reason the current generation stays in the Northwest. Devotion to the waters runs deep in BPA employees.

Throughout this report employees tell how they and their families are connected to the rivers of the Northwest.

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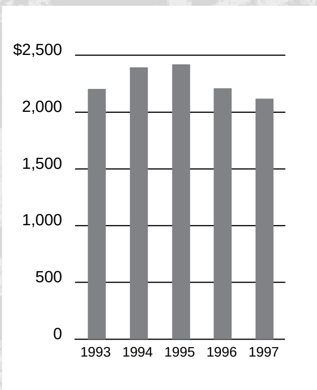
The illustrations used in this report are from a poster produced in 1997 for BPA's 60th anniversary.

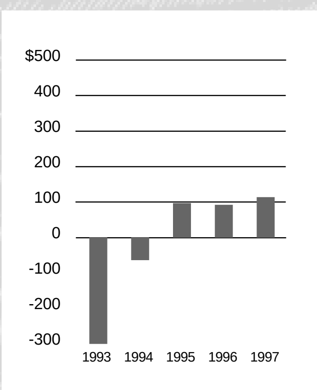
FINANCIAL HIGHLIGHTS

Federal Columbia River Power System
As of Sept. 30, 1997 & 1996

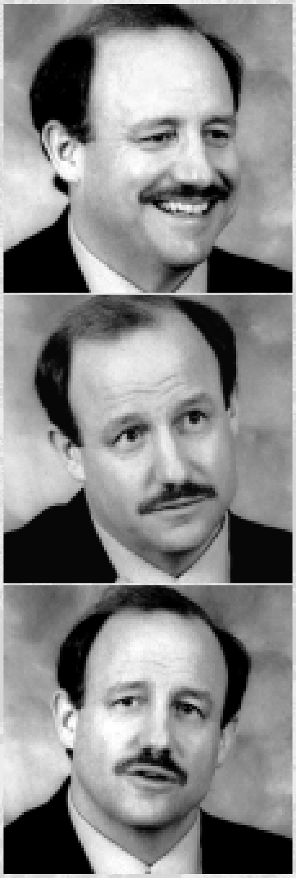
Total Operating Revenues
(millions of dollars)



Net Revenues *(Expenses)*
(millions of dollars)



	(thousands of dollars) 1997	1996
Operating Revenues		
Sales of electric power:		
Sales within the Northwest	**$ 1,677,090**	$ 1,896,047
Sales outside the Northwest	**373,295**	336,736
Wheeling and other sales	**221,652**	194,818
Total operating revenues	**2,272,037**	2,427,601
Total operating expenses	**1,780,005**	1,958,059
Net operating revenues	**492,032**	469,542
Net interest expense	**374,215**	373,685
Net revenues	**$ 117,817**	$ 95,857
End of Fiscal Year		
Total assets		
(Net of accumulated depreciation)	**$16,967,265**	$16,709,469
Total capitalization and liabilities:		
Accumulated net expenses	**$ (182,999)**	$ (275,673)
Federal appropriations	**4,452,161**	6,848,278
Capitalization adjustment	**2,525,786**	—
Long-term debt	**2,498,900**	2,456,100
Non-federal projects debt	**7,037,405**	7,105,674
Other	**636,012**	575,090
	$16,967,265	$ 16,709,469
Employees (staff years)	**2,929**	3,152



Dear Mr. President:

The Bonneville Power Administration's 60th anniversary year exceeded expectations.

Net revenues were the best since 1991, which demonstrates that earlier decisions to transform BPA into a smaller, cost-conscious, customer-focused organization were the correct decisions.

The region's evaluation of the agency's role in the Northwest was as gratifying as the positive financial position. Through the Comprehensive Review of the Northwest Energy System, the region concluded that BPA has been and must continue to be an important economic and environmental benefit to the Northwest.

BPA occupies a unique position in the region that is crystallized in the agency's new purpose statement: to meet our public responsibilities through commercially successful businesses.

The agency must be commercially successful to provide funding for public responsibilities such as its fish and wildlife program, conservation, and reliable power and transmission systems. But the heart and soul of the agency is providing benefits that reflect the public service orientation that inspired the agency's creation 60 years ago. BPA will provide the region with power at cost, provide preference to the region because the river on which the hydro system is based is a regional resource, and continue to see that its power flows to the "little guys." It is just as important that BPA deliver power to the region's residential and rural consumers now as it was when the agency brought electricity to rural areas for the first time.

On a personal note, we were sad to see the departure of Randy Hardy, who had served as BPA's administrator since 1991. His leadership was critical during one of the most turbulent eras in BPA's history, a period that continues as BPA makes the transition to a deregulated wholesale electricity market. But another legacy that Randy Hardy left was a strong management team and a clear sense of direction. We will continue the momentum both now and when a new administrator is named.

Respectfully,

Jack Robertson

Jack Robertson, Acting Administrator and Chief Executive Officer

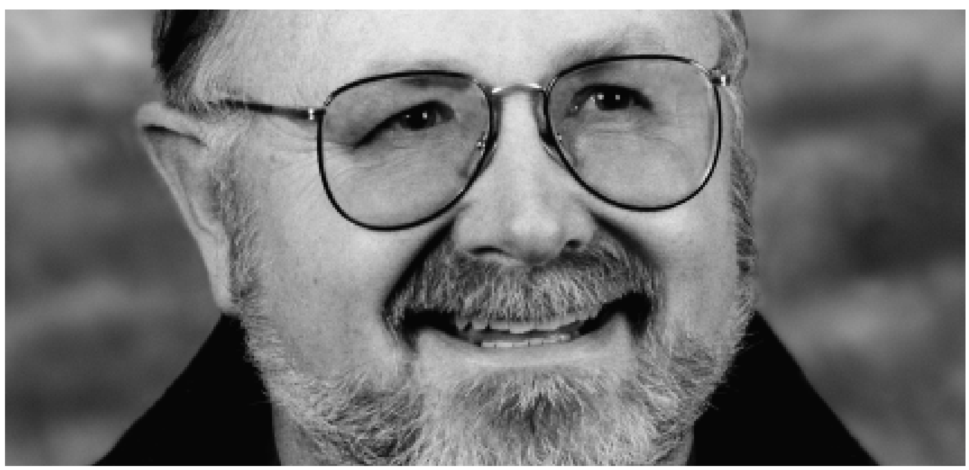
The 1997 fiscal year was a year of celebration and a year to celebrate.

Even though Administrator Randy Hardy stepped down to return to private life at the end of the fiscal year, the Bonneville Power Administration had much to be excited about. BPA celebrated its 60th anniversary on August 20. The agency had other notable milestones as well — BPA's financial performance was above expectations, and a regional panel convened by the Northwest's four governors reaffirmed the agency's value to the region as an economic and environmental resource.

BPA also made its annual payment to the U.S. Treasury on time and in full for the 14th year in a row. This year's payment was $775 million.

Net revenues of $118 million significantly exceeded the $70 million planned in the 1996 rate case. Gross revenues were slightly ahead of rate case projections at $2,272 million versus $2,269 million. Expenses of $2,154 million were below the rate case projection of $2,199 million and, reflecting the effectiveness of recent cost

THE RIVER PROVIDES



"In the 1950s my family moved to the basin, hearing promising stories of farmland and jobs, and that water from the Columbia River would make it flower without any shortage. Compared to the dust bowl years in Nebraska, it was wondrous news. We farmed land between Hanford and Coulee. A new canal system brought water from the Grand Coulee Project. Wherever the water flowed, the earth turned green."

•• Gerald Keenan
Lead Electrical
Engineering Technician

cutting as well as the good water year, were the lowest in five years. Capital investments were below rate case projections — $384 million versus $392 million. Agency financial reserves of $430 million are the best since 1992.

Wall Street also gave the agency a vote of confidence when all three bond rating agencies confirmed BPA's bonds as AA- or Aa1. The rating firms cited, among other strengths, BPA's cost-cutting efforts and improved financial position. The region anticipated Wall Street's confidence in the report prepared by the governors' Comprehensive Review of the Northwest Energy System (Regional Review). The report reaffirmed BPA's value to the region, but it also presented the agency and the region with the continuing challenge to implement the report's recommendations. Implementation is proceeding under the guidance of a Transition Board and with the bipartisan support of the Northwest's congressional delegation.

The Regional Review's report, BPA's improved financial condition, and the agency's long-term strategic plan combine to position the agency for the future. The goal BPA set for the 1996 rate case was to provide itself with five years of breathing room to position itself for the competitive future beginning in 2001. FY 1997 demonstrated the wisdom of that plan. Its legacy is the agency's present financial stability.

BPA is now taking advantage of that stability to plan for the future. The key date is October 2001. Most of BPA's current long-term power sales contracts expire on Sept. 30, 2001. The current agreement on financing salmon and steelhead recovery programs also expires in 2001. During the past year, BPA prepared its long-term strategic plan to position the agency for 2001 and beyond. The strategic plan lays out specific long-term goals and measurable annual targets that position BPA to meet its public responsibilities, attain its financial goals, achieve a high level of customer satisfaction, and continually improve as a high-performing organization. The goals and targets extend out through 2003 and provide clear direction toward which employees can focus their work.

BPA met all its FY 1997 targets even though they had been "stretch" targets that seemed extremely difficult to reach when they were set.

"In the early '70s, when the third powerhouse at Grand Coulee was under construction, I visited the dam. I remember standing on the crest, looking down. The huge dumptrucks looked like little matchbox cars from that viewpoint. In the 20-some succeeding years I was awestricken at the similarity between BPA and Grand Coulee Dam...both are quiet giants with a humble presence, providing immense benefits to the Northwest."

•• Kathy Hoffman
Assistant Manager
for the Eastern Power Business Area

REVENUES

The 1997 water year was very wet. The January-July runoff that flowed past The Dalles, Ore., was 159 million acre-feet (enough water to cover 159 million acres one-foot deep) — more than in any other year in the 69 years of continuous record keeping. The fact there was no disastrous flooding is partly the result of the timing of the spring runoff and partly a compliment to the coordination of the hydro system.

While the Columbia and Snake rivers were awash in water, BPA was not awash in money. After about 120 million acre-feet (normal is about 103 million acre-feet), revenues do not necessarily rise with increased volume.

Because the 1995 Biological Opinion calls for certain levels of flow for fish during the spring and summer, BPA has greater confidence in its summer energy supply. This increases the value of summer surplus energy. At the same time, customers were able to diversify their power sources, so not all the available firm power was sold at higher firm-power rates.

The 1997 water year volume was so great it exceeded the generating capacity of the system. As a result, water was spilled in excess of the spill levels required for fish passage. Generation was further constrained because the intertie to California was operating at a reduced rating. The constraint was due to conservative operation in response to the August 1996 outage.

COSTS

The agency has focused on cost cutting since it started its Competitiveness Project in 1993. When BPA submitted its FY 1995 Congressional Budget, it projected its budget to grow to over $3 billion by FY 2001. The current projection is $2.3 billion.

The difference is cost cutting. In the rate case, BPA set itself the target of reducing its expenses by $600 million a year over previous projections. Those cuts are now real; they have been implemented. And the agency is continuing to press on with more cost cutting. BPA continues to reduce staffing levels. Since 1994 the agency has reduced federal and contractor full-time equivalent positions by more than 1,700 from a base of about 5,700. The current staffing level is the lowest since 1965.

BPA has also continued to pursue its program of refinancing nongovernmental (Washington Public Power Supply System) debt whenever the bond market is receptive. This year the agency refinanced $462 million in WPPSS bonds, which will save Northwest ratepayers $18 million over the life of the bonds.

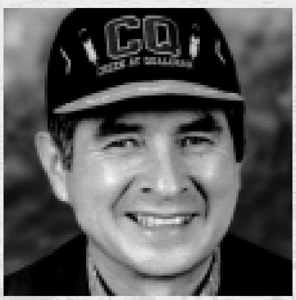
The agency also completed refinancing agreements with Congress and the executive branch over the agency's appropriated debt. Implementation of this newly enacted law resets BPA's interest rates to current Treasury rates, which removes the constant risk of significant increases in financing costs. BPA completed an arrangement

"I grew up on a 12,000-acre ranch along the Columbia River with about 10 miles of riverfront between Grand Coulee and Bridgeport. We all loved going to the river and took advantage of its many uses. We swam in it, our cattle drank from it, my grandfather operated a ferry across it at Barry, and we pumped irrigation water from it. The river gave us blessings, and we gave our blessings for it."
•• Matt Alling
Generation Dispatcher

with the Bureau of Reclamation so the agency can directly fund maintenance of Bureau-owned dams, which will save time and provide BPA with increased revenue. The agency worked with the U.S. Army Corps of Engineers to complete a similar agreement early in FY 1998. And, the agency is working with the Clinton administration, the Northwest congressional delegation, Northwest tribes, and other interested parties to explore fish and wildlife funding options for the post-2001 period.

Following direction it received in the 1996 federal appropriations legislation, BPA has reached agreements with all but one of the regional public and investor-owned utilities that participated in the residential exchange program. Concluding the program provides BPA with more predictable expenses while continuing to provide residential ratepayers access to cost-based federal hydropower. In addition to its current cost-cutting efforts, BPA and the Northwest Power Planning Council are jointly conducting a cost review. The effort responds to calls for cost reviews by the congressional delegation, the regional governors, and BPA's customers. A panel of five executives with cost-cutting and downsizing experience in large organizations is meeting to review BPA's business practices. The panel is expected to offer its recommendations for further cost management to the BPA administrator in early 1998.

The panel is examining the costs of the Federal Columbia River Power System (including dam operations and maintenance), of the BPA business lines, and of the BPA corporate functions for FYs 1998 through 2006. The group is focusing especially on the crucial FY 2002 through FY 2006 period. The goal is to help BPA manage its costs so its prices are competitive in the marketplace. BPA is eager to learn from the group so it can manage its costs even more effectively. The panel is consulting with all interested parties in the region.



"When dams were constructed on the Columbia River system blocking the passage of salmon, it had a major impact on the Native Americans that for thousands and thousands of years were dependent on the salmon for subsistence, religion, culture, and tradition. I am proud to be working with the tribes and BPA to rebuild the salmon. The effort is still not enough, but I am dedicated to helping in the effort to rebuild some of the great value of this river to Northwest tribes."

•• John Smith
Tribal Constituent
Account Executive

REGIONAL REVIEW

The 1997 fiscal year began with the agency under close scrutiny from a process conducted under the auspices of the governors of Idaho, Montana, Oregon, and Washington to review the region's electricity system. The process included representation from a broad cross section of BPA's stakeholders. When the Regional Review issued its report in December 1996, the region was prepared to respond to calls for the sale or privatization of the agency. Representatives of the region unanimously affirmed both the value of the Federal Columbia River Power System to the Northwest economy and ecology, and of BPA's role in maintaining and delivering those benefits to the people of the Northwest and to the nation's taxpayers.

The overall goal supported by the Regional Review and BPA focuses on retaining the benefits of the federal Columbia hydro system for the region while assuring that the U.S. Treasury is repaid in full and on time. The Regional Review also helped define BPA's role in the deregulated electricity market. BPA's role is to sell power at the wholesale level, to continue to sell power at cost, and to market power from its current resources rather than acquiring major new resources unless specific customers agree to pay the costs and take the risks of the new resources.

"I remember hunting for night crawlers in my grandparents' yard in Camas, Wash. Granddad would go fishing the next day at the end of his street and bring back a salmon. We'd have salmon steaks for dinner that night and salmon patties for breakfast the next day!"
•• Linda Palmer
Secretary

DEVIL IN THE DETAILS

While the vote of confidence by a group that had examined BPA for more than a year was gratifying, the report also presented the agency with the challenge of working out the details.

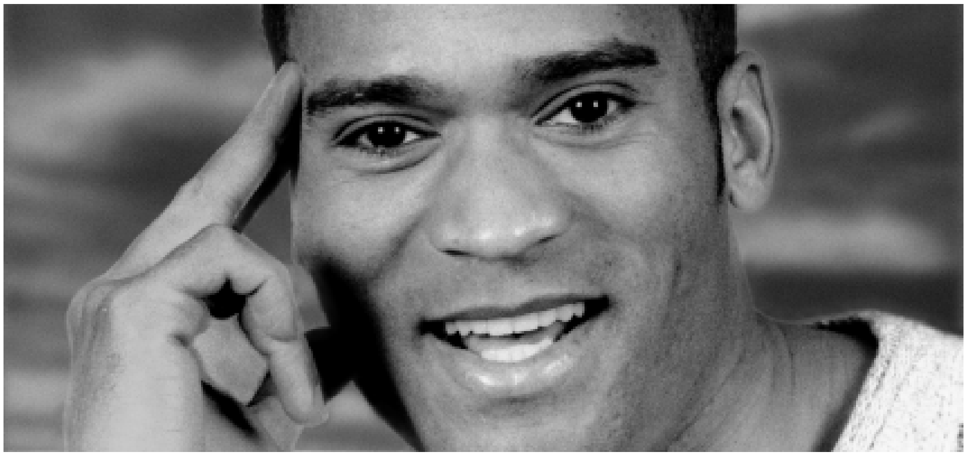
The governors appointed a four-person Northwest Energy Review Transition Board to supervise the regional effort to refine and accomplish the goals set out in the Regional Review report. BPA is a major supporter of the effort and is working closely with regional groups to implement the recommendations. For example, the agency participated in state legislative efforts to adopt Regional Review recommendations. It also participates in Transition Board working groups to deal with key transitional issues including the subscription process by which BPA's customers will sign up for power supplies after 2001, cost recovery mechanisms for potential stranded costs, and open access to BPA's transmission system.

SEPARATION OF THE POWER AND TRANSMISSION BUSINESS LINES

The Regional Review called for separation of BPA's two business lines. During Transition Board meetings, the dialogue has shifted from creating two legally separate agencies to placing BPA's Transmission Business Line under Federal Energy Regulatory Commission authority in a manner equivalent to the way investor-owned utilities are regulated. Either approach could achieve the goal of assuring that BPA's transmission system is open to all users and does not discriminate in favor of BPA's power business.

On Jan. 3, 1997, BPA filed its plan to comply with FERC Order 888 and to follow the rules of conduct outlined in Order 889. Both orders address open transmission access. The agency administratively separated its transmission function from its power marketing function in October 1996. Following FERC guidelines, BPA created an open-access same-time information system (OASIS) to provide equal information to all power suppliers, including BPA's Power Business Line. By the end of calendar year 1997, the agency's power and transmission staffs were well on their way to being housed in facilities separated by the Columbia River. BPA is also working with customers and constituents to implement FERC guidelines that require customers to pay for new facilities such as point-of-delivery substations that serve only one customer. The goal is to strike a balance that meets FERC requirements, minimizes BPA's new capital investments, and recognizes the unique historical relationship BPA has had with regional utilities.

THE RIVER INSPIRES



"Living in the Northwest means being outdoors. I spend as much time as I can being active outside, and a lot of that centers on the rivers — I sail, water ski, hike, and sometimes enjoy the challenge of climbing Rooster Rock, which gives a fantastic view of the Columbia River, if you aren't afraid to look down. At the end of a day of hard physical activity, nothing beats kicking back and just being there, outside in the Gorge or along a Columbia River beach. The preservation of the river's beauty is as important to me as the recreation."

•• *David Etherly*
Graphic Designer

TRANSMISSION RELIABILITY

It's not enough that BPA's transmission rates are the lowest in the region. The agency's transmission system must also be the most reliable. The outage of August 1996 was humbling. Since then, the agency has taken extraordinary steps to assure the system is reliable: patrolled all 15,012 miles of transmission lines by air and by foot; increased its vegetation management program from $3.2 million to $5.9 million a year; worked out coordination and communication agreements with Pacific Gas and Electric and Southern California Edison on operation of the Pacific Northwest-Pacific Southwest Intertie; and followed up with a comprehensive study of voltage support. The steps taken as a result of the study include installing shunt capacitor banks at John Day, Big Eddy, and Hanford substations; increasing the continuous current carrying capability of key transmission lines; adding protection schemes to take automatic remedial actions following the loss of key facilities; and identifying a more conservative level of reactive power margin to cope with unplanned outages.

The agency is successfully responding to other unforeseen challenges of deregulation. Before deregulation, schedulers dealt with dozens of transmission and power transactions from a handful of utilities. Now that wheeling has been opened up, schedulers are dealing with thousands of transactions each day from hundreds of utilities and marketers. The agency has created a computer system to handle the phenomenally increased complexity of transactions. The system is a model for the industry.

"My family came to the Oregon Territory in the 1840s via both the southern and northern routes. One branch of the family settled in the Rogue River valley, but my great-great-great-grandfather, Albert Stewart, came via the Columbia River and settled in what is now Clackamas County. During the mid-'80s, I started windsurfing in the Columbia River Gorge and since then have gotten to know the gorge on a personal basis. As a hobby, I created an Internet Web site that features the recreation and scenic opportunities of the gorge, including the 40 best windsurfing sites between Umatilla and Astoria."

•• Larry Stewart
Emerging Technology Manager

SUBSCRIPTION PROCESS FOR POST-2001 SALES

BPA is meeting with its customers to define a process by which they will subscribe to BPA power at cost for set periods of time of from five to 20 years after 2001. The regional parties to this are on course and have come to agreement on the nature of the products and services the agency will offer. Further discussions will center on the ability of customers to re-sell federal power, the conditions under which customers could leave BPA and then return, access for residential and small farm customers, option fees, and accelerated payments to the U.S. Treasury during good years.

PRE-SUBSCRIPTION, POST-2001 SALES

In a very encouraging turn of events, some regional customers have already come to the agency seeking to buy power in the post-2001 era or to make purchases that extend into that era. Some customers have a sense of urgency to act quickly to retain loads in the face of competition.

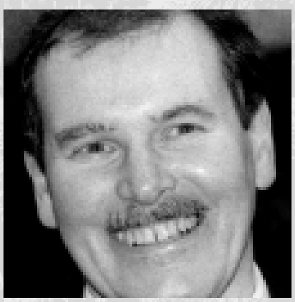
BPA conferred with the Transition Board about offering power for sale now for the post-2001 period. The board agreed with the agency's plan to offer up to 500 average megawatts of power to Northwest customers. BPA has signed agreements with utilities for approximately half of that power at rates that exceed the agency's target of selling power for two cents per kilowatt-hour. The agency has also been able to offer up to 800 megawatts of power to California customers in sales that can go beyond 2001 but not beyond 2006.

FISH AND WILDLIFE PROGRAM

FY 1997 began with an increase in independent scientific review of the region's fish and wildlife program. The Northwest Power Planning Council proposes a fish and wildlife program for BPA to fund as mitigation for the effects of the federal dams in the Columbia Basin. The council appointed the Scientific Review Panel, as called for in the 1996 "Gorton amendment" to the Northwest Power Act, to examine its program. The panel submitted its first annual report, which recommended improvements to the council's program.

BPA supports this re-evaluation and encourages the focus on results based on the best available science. At the same time, the agency is working with the Northwest congressional delegation, tribes, and states; the Clinton administration; and the agency's customers to discuss options for the agency's funding of fish recovery after the current funding agreement expires in 2001. The goal is to meet the needs of fish and wildlife while providing cost predictability for BPA customers. During the 1997 fish operations year, BPA worked diligently, and successfully, to meet all the requests of the National Marine Fisheries Service Biological Opinion on Snake River salmon and the U.S. Fish and Wildlife Biological Opinion on Kootenai River sturgeon. The agency met all the requirements despite the complexity of the record Columbia River volume. The agency worked with all involved agencies to balance spill requirements with the

"When my children were young, my family and I spent a day looking for petroglyphs along the Columbia Gorge near John Day Dam, shortly before it was flooded. One of the rubbings I did was from an Indian sunburst design. I have the rubbing at home, and a picture of my young son standing next to the huge rock where the petroglyph was etched."
•• Joan Dietz
Realty Specialist



"I have lived on the banks of the Columbia River for five years. The river is an ever changing setting that demands your attention. It has a character, if not an attitude, that can swing quickly from the tranquil reflection of evening lights to an angry torrent that threatens to spill over its banks."
•• Bob Mealey
Financial Economist

need to reduce the amount of dissolved nitrogen in the water resulting from high spill levels. This effort is to prevent gas bubble disease from affecting juvenile and adult salmon and steelhead. Some of the steps BPA took to reduce the excess spill included keeping all hydro generators operating, displacing thermal plants by providing hydropower to the generating utilities, spreading spill to areas away from migrating fish, and marketing as much power as possible within the limitations placed on the Pacific Northwest-Pacific Southwest Intertie. BPA is participating in the regional discussion on the advisability of removing four federal dams on the lower Snake River. The agency's role is to gather and provide all available information about the impacts on power production, on air quality, and on the economics of the proposals. Biological evaluations are provided by state and federal fish agencies.

THE RIVER CHALLENGES

"My grandfather, Fred Swain, provided chickens to the busy dining halls that served the thousands of construction workers building Grand Coulee Dam. However, like the chickens, his poultry business didn't survive the depression years. So he took a job with the Baker Ice Machine Company. Construction of Grand Coulee Dam depended on two cofferdams. Each diverted the Columbia River from half of the construction site. Construction on one of the cofferdams was held up when the hillside above it, loosened by natural springs, tumbled bit-by-bit down upon the work site. The Baker Ice Machine Company came up with a unique solution. My grandfather and his boss formed a huge set of refrigeration coils in the vacant lot behind my grandparents' house. The coils were taken by truck to Grand Coulee and embedded in the troublesome hillside. The refrigerant circulated and soon the soil was frozen, stabilizing the slope and allowing construction on the cofferdam to go ahead."

•• Martha Swain
Public Utilities Specialist

One hopeful sign is that the Columbia/Snake system is experiencing one of the best adult chinook runs in years. For example, the number of spring chinook passing Lower Granite Dam, the dam farthest upstream on the Snake River, was up 87 percent over last year while summer chinook returns were up 76 percent.

BPA joined the U.S. Forest Service, Bureau of Reclamation, U.S. Fish and Wildlife Service, Confederated Salish and Kootenai Tribes, and Montana Department of Fish, Wildlife and Parks in signing a five-year agreement expected to boost bull trout populations in Montana's Flathead River. Bull trout are a candidate for listing under the Endangered Species Act.

CONSERVATION

The Regional Review also endorsed BPA's continuing efforts to capture cost-effective energy conservation and promote the use of renewable energy sources. The Northwest Power Planning Council, in a report requested by Congress, complimented the BPA Energy Efficiency Group in the way it has followed the Regional Review guidelines and is taking an active role in becoming a market facilitator. BPA's Energy Efficiency Group continues to honor its long-term contracts to acquire energy efficiency, now called legacy programs. In other areas, the group is moving away from grant-based programs to focus on market transformation and programs that "grow the pie," that is, create more demand for private-sector energy services companies.

The Energy Efficiency Group is counseled by an advisory committee made up of representatives from public utilities, federal agencies, state agencies, the Northwest Power Planning Council, conservation organizations, Congress, and energy services firms. The legacy programs demonstrated their effectiveness when they doubled their FY 1996 target — saving 60 average megawatts, enough energy to serve the annual needs of about 30,000 Northwest homes.

GREEN POWER

Green power is much discussed in the Northwest. And BPA is in the middle of all the activity. BPA has entered into agreements to join PacifiCorp and the Eugene Water and Electric Board in purchasing power from the Wyoming Wind Project near Foote Creek Rim in Carbon County, Wyo. The project should be operational in late 1998 or early 1999. As well as furthering development of an alternative energy supply, the project is designed to evaluate state-of-the-art measures to protect birds and the ability

"My father remembers when electricity came through in the '40s. That was a big day for his family. Bonneville was responsible for that through the Kickitat County PUD. The wheat my father raised was sent by barge to Portland and from there overseas by the Columbia River. My grandfather worked for the Corps of Engineers and later for BPA. My great-grandfather, Capt. Stewart V. Winslow, was one of the early river pilots from the Snake River down to the Columbia and out to the Pacific. The river has always supported us. It seems right to take care of it in return."

•• Christine Seed
Library Technician

to operate in cold weather. On the broader green front, BPA is working with numerous public interest and environmental groups to define green power. The agency is working with marketers on how to segregate resources into supply pools based on environmental impact characteristics. The effort recognizes that hydropower is both renewable and reduces air pollution from thermal plants it supplants.

BPA has already teamed with the Environmental Resources Trust (ERT), a non-profit organization founded with the help of the Environmental Defense Fund. BPA and its partner will market environmentally beneficial power to reduce air pollution, help support development of renewable resources, and benefit fish and wildlife. The green power in the ERT arrangement includes additional hydropower produced as a result of operations for fish, BPA-supported renewable resources such as the Wyoming wind project, and surplus hydropower sold to displace thermal power plants. In return for marketing, ERT will receive a percentage of the sales and will invest at least 75 percent of all the funds it receives on fish and wildlife and other environmental projects in the Pacific Northwest. BPA is working with a number of environmental groups to expand this concept so that a percentage of revenues from some power sales will be devoted to an environmental trust.

POLLUTION PREVENTION AND ABATEMENT

During the year, the U.S. Environmental Protection Agency completed its review of BPA's environmental clean-up activities at the Eugene Starr Complex at The Dalles, Ore. The complex was under review primarily because of historical releases of mercury. Not only did the complex avoid listing on the National Priorities (Superfund) List, but EPA also concluded that no further remedial action is required. Avoiding a listing saves millions of dollars in procedural and remedial actions. Also during the year, BPA continued to focus efforts on pollution prevention through such actions as removing/replacing equipment containing polychlorinated biphenyls (PCBs) and installing spill prevention measures at its facilities.

INTERNATIONAL ISSUES

The BPA administrator and the division engineer of the North Pacific Division of the U.S. Army Corps of Engineers make up the U.S. Entity that negotiates with Canada under terms of the 1961 Columbia River Treaty. That treaty led to construction of three storage dams in Canada and one in the United States to maximize flood

"My grandfather worked as a cement mason on The Dalles and Libby dams. My grandparents lived in Idaho, and because of the construction of The Dalles Dam they moved to Oregon. Just a few years after grandpa died, while I was working for the Corps of Engineers, I found an old book in the office about the construction of The Dalles Dam. There was a photo in the book of a cement mason. It was my grandfather. I remember feeling really proud of him. Wouldn't he be surprised to know that his granddaughter works for the federal agency that markets the power he helped bring to the region."
•• Carlene Stenehjem
Public Affairs Specialist

control and power benefits in both countries. The Canadian portion of the power benefits from those dams was sold to a consortium of Northwest utilities under three agreements that expire in 1998, 1999, and 2003. In late 1996, agreement was reached to return the Canadian power benefit (the Canadian Entitlement) to Canada over existing transmission lines if a disposition in the U.S. cannot be agreed to. This is a modification to the original agreement that will save both parties millions of dollars in construction costs. During the summer of 1997, BPA also successfully led two regional efforts to renew agreements related to the Columbia River Treaty — the Canadian Entitlement Allocation Agreement (now the Canadian Entitlement Allocation Extension Agreement) and the Pacific Northwest Coordination Agreement. The entitlement agreement defines the mid-Columbia non-federal utilities' share of the Canadian Entitlement and prescribes how that share is delivered. The coordination agreement defines how power generation is to be coordinated on the Columbia River, in part to conform to terms of the Columbia River Treaty. The agreement allows the Columbia River to be operated as though it has one owner, which allows optimum use for power within the constraints of flood control, fish recovery efforts, and other uses.

"I started work at BPA on Sept. 13, 1938. At that time, BPA had one tiny substation tucked away in a cubicle by the original ship lock at Bonneville Dam, which served the city of Cascade Locks — BPA's first customer. When I retired in January 1972, BPA had about 300 substations and 11,000 miles of high-voltage transmission lines. To a greater or lesser degree, I had been involved with all of those substations. The Columbia River had been harnessed and BPA was marketing power from the Canadian border to Los Angeles. I am proud to have been a part of all of that."
•• Carleton "Bill" Waugh
BPA Retiree

TRIBAL RELATIONSHIPS

In 1996, BPA worked with affected Indian tribes to establish a formal policy for government-to-government relationships. The agency's primary tribal constituency is the 13 federally recognized Columbia Basin tribes that come under the 1980 Northwest Power Act. BPA also works on a variety of issues with 38 other Northwest tribes affected by BPA's and its customers' transmission lines. BPA and the tribes work especially closely on issues surrounding transmission rights-of-way, cultural resources, and fish and wildlife projects. BPA also co-sponsored an energy conference for the Northwest's tribes at Spokane in August. The tribes sought a better understanding of electric industry restructuring and learned about potential business opportunities in the industry.

In 1997, BPA provided the Nez Perce Tribe with the funds to purchase 10,300 acres of land in the Wallowa Valley in Oregon for a wildlife refuge. The Wallowa Valley is the ancestral homeland of the Nez Perce. The purchase was part of BPA's program to mitigate for loss of wildlife habitat related to the development of the federal hydroelectric facilities in the Columbia Basin. BPA also funds a significant number of other tribal fish and wildlife programs such as the Cle Elum Supplementation and

"*My grandfather and his father and brothers were commercial fishermen. While they primarily fished offshore, the Columbia River fishery, obviously, helped support them. Many times I recall as a child living here in Portland, the delivery to our home of a huge wooden box of freshly caught fish, mostly salmon, but sometimes tuna and halibut, too, on ice. Mother had a collection of fish recipes, and we canned what we didn't eat.*"
•• *Barbara Ballew*
Management Analyst

Research Facility that is testing a salmon recovery approach called supplementation. The Yakama Nation operates the facility in cooperation with the Washington Department of Fish and Wildlife.

The Washington Coalition Agreement, funded by BPA, enabled the Confederated Tribes of the Colville Reservation, the Yakama Indian Nation, and the Spokane Tribe of Indians to purchase land for wildlife habitat.

In the annual survey of tribal satisfaction with BPA, the agency showed great improvement in providing overall satisfaction to the tribes. According to the survey, the agency can improve its scores in the future by attending to the impacts of river operation on the tribes, including the tribes in the early stages of policy formation, and by meeting trust obligations effectively.

AND MORE

The 1996 Regional Review report was aimed at retaining the large-scale benefits BPA provides to the region — more than 15,000 miles of safe and reliable high-voltage transmission lines, cost-based rates, a massive fish and wildlife program, energy conservation, participation in international treaties, river coordination, and the like. The agency and its employees also make innumerable smaller contributions to the public good in the Northwest. BPA loaned a helicopter and pilot to the city of Ashland to ferry in help to save its water supply reservoir after severe flooding put it at risk. The agency has donated dozens of surplus computers to small school districts throughout its service region. BPA supports science and environmental education through sponsorship of the annual Science Bowls for junior high and high school students in Oregon and Washington, through sponsorship of the summer Hydromania programs for students in the Portland area, and through support of the Oregon Collaboration for Energy, Education and the Environment Grants.

And agency employees can be found volunteering at innumerable water-centered events such as Kids in the Creek environmental programs, Salmon Watch, and the Leavenworth Salmon Festival. In large and small ways, BPA brings the benefits of clean hydroelectric energy to the citizens of the Northwest.

FINANCIAL
SECTION

Results of Operations

Net revenues of the Federal Columbia River Power System were $118 million in 1997, an increase of $22 million over 1996. BPA was able to increase its net revenues despite a 13 percent reduction in its Priority Firm (PF) and Industrial Power (IP) rates and lower sales to public utility and Direct Service Industrial customers under those rate schedules, by refinancing Washington Public Power Supply System bonds, making a variety of cost cuts throughout the agency, and reselling the power freed up by lower PF and IP sales at favorable rates to other customers.

Expenses were reduced considerably not only because of cost-cutting efforts throughout the agency but also because 1996 expenses included a charge of $115 million for a settlement with Chase Manhattan Bank related to the cancellation of a gas-fired combustion turbine. BPA's year-end reserves, a combination of cash and deferred borrowing authority, were $430 million, an increase of $152 million over 1996.

Revenues

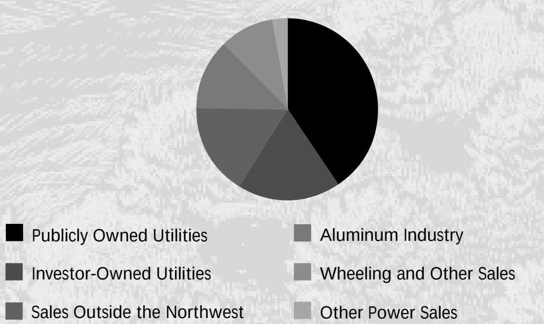
Total FCRPS operating revenues in 1997 dropped by $156 million to $2,272 million, a decrease of 6 percent. A 13 percent decline in firm power rates to publicly owned utilities and industrial customers contributed to the decrease in revenues. Continued high runoff allowed BPA to make surplus power sales outside the Northwest for much of the year. Increased surplus firm and nonfirm power sales offset some of the reduced firm power sales to publicly owned utilities and industrial customers.

1996 revenues had increased by 2 percent compared to 1995 primarily because of an increase in discretionary nonfirm power sales. Vastly improved water conditions allowed BPA to make surplus power sales outside the Northwest for much of the year, and a 4 percent across-the-board rate increase was in effect for 1996 only.

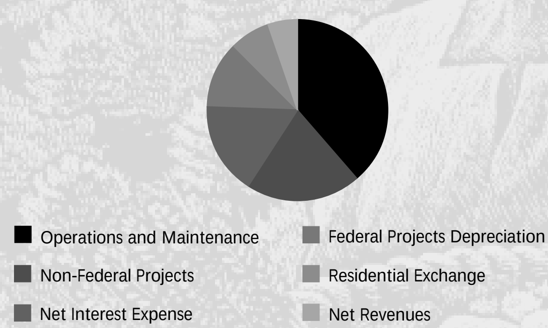
Revenues by customer class are described in the following narrative and charts.

Northwest Publicly Owned Utilities — Northwest publicly owned utilities, BPA's largest customer group, accounted for 41 percent of BPA's total 1997 revenues. This customer group includes municipalities, public utility districts, and cooperatives. Revenues from power sales

1997 Sources of Revenue



1997 Disposition of Revenue and Net Revenues



to public utilities were $925 million in 1997, $92 million less than in 1996. The difference from last year is due to lower rates and reduced sales. These revenues were down by $152 million in 1996 compared to 1995.

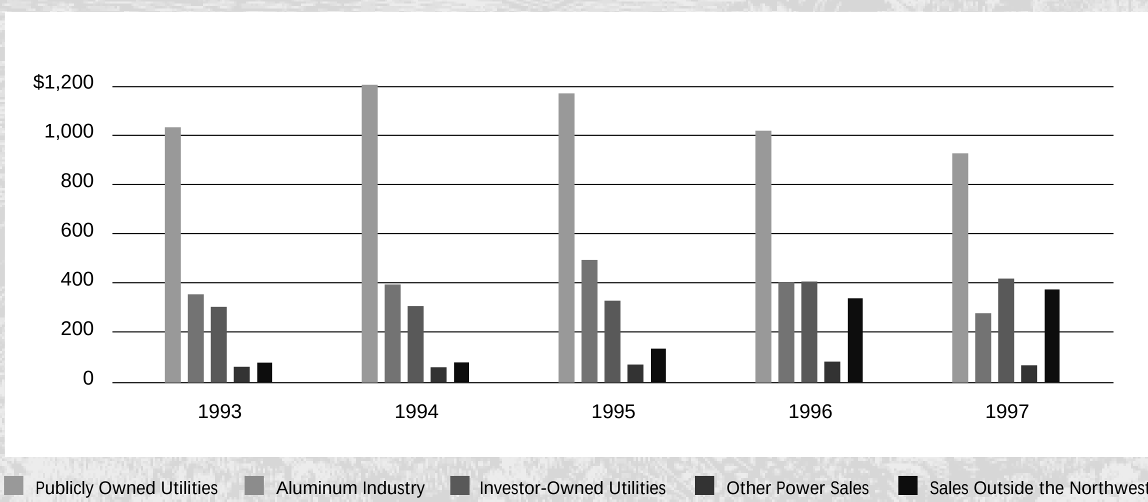
Aluminum Industry — Revenues from aluminum companies were $274 million in 1997, down $125 million, or 31 percent, from 1996 as aluminum companies decreased their dependence on BPA. Industrial customers purchased more of their power from other suppliers in 1997. Reduced power purchases, in addition to the rate reduction, were the reasons for the decrease in revenues. These revenues were down by $91 million in 1996 compared to 1995.

Northwest Investor-Owned Utilities — Revenues from power sales to Northwest investor-owned utilities increased $12 million, or 3 percent, to $415 million. These revenues increased $78 million in 1996 compared to 1995 due to greater nonfirm energy sales in the spot market, reflecting excellent water conditions. Investor-owned utilities buy power from BPA to supplement their own resources.

Other Northwest Power Sales — BPA sells directly to federal agencies such as the Department of Energy, the Navy, and the Air Force; to other governmental agencies; and to certain non-aluminum industries. Revenues from this group fell $15 million, or 19 percent, from 1996 levels. Revenues were down primarily due to the 13 percent reduction in the Priority Firm power rate. These revenues had increased $12 million in 1996 compared to 1995.

Sales Outside the Northwest — BPA's surplus energy revenues from sales outside the Northwest were $373 million in 1997, an increase of $37 million over 1996, due to higher prices for short-term firm power sales. 1996 revenues were up $205 million over 1995. 1997 and 1996 were both up as a result of two of the best water years in about

Electric Power Revenues by Customer Class
(millions of dollars)



Revenues *(continued)*

20 years. Also, power was freed up from Northwest customers who chose to buy power from suppliers other than BPA.

Customers outside the Northwest include public utilities, federal agencies, and investor-owned utilities.

Wheeling and Other Sales — Wheeling and other revenues combined were $222 million in 1997, a 14 percent and $27 million increase over 1996. The increase was due primarily to other services revenue. 1996 revenues were down $9 million from 1995.

Expenses

Total FCRPS operating and net interest expense dropped by $178 million, or 8 percent, in 1997. Total expenses are the lowest in five years. In 1996, overall expenses rose $45 million from 1995 levels.

FCRPS operations and maintenance cost decreased by $104 million, or 11 percent, to $882 million in 1997. In 1996, operations and maintenance cost increased by $35 million, or 4 percent. This 1996 increase included a $115-million settlement with Chase Manhattan Bank related to the cancellation of a gas-fired combustion turbine that increased operations and maintenance costs. As a result of the settlement, BPA has assumed Chase's position in ongoing litigation with the Tenaska partners. The Chase settlement will directly offset any monetary award Tenaska may obtain in arbitration, which is under way.

BPA continues to manage its costs by making cuts that are within its control. Debt service on non-federal projects decreased by $34 million, or 7 percent, to $464 million. Refinancing Washington Public Power Supply System bonds reduced debt service on non-federal projects after an increase of $13 million in 1996.

Federal projects depreciation decreased by $4 million to $273 million. Federal projects depreciation increased in 1996 by $22 million primarily because BPA wrote off some investments. Amortization of software costs accounted for the major increase in depreciation in 1996.

Comparative Electric Energy Sales *(Unaudited)*
(Megawatt-hours)

	1997	1996	1995
Priority Firm	**32,087,338**	33,272,958	43,499,630
Industrial	**12,358,725**	13,327,712	19,998,233
Surplus & Nonfirm	**53,827,652**	52,149,483	13,165,568
Other	**2,551,143**	3,556,830	3,727,204
	100,824,858	102,306,983	80,390,635

Expenses *(continued)*

Net residential exchange expense decreased by $35 million to $161 million in 1997. BPA has reached settlement with all residential exchange participants except Portland General Electric. Settlements establish payments to participants through June 30, 2001, when current residential exchange contracts expire. The net residential exchange expense was $196 million in 1996.

Net interest expense remained stable at $374 million in 1997. Net interest expense in 1996 was down $24 million from 1995.

Financial Condition

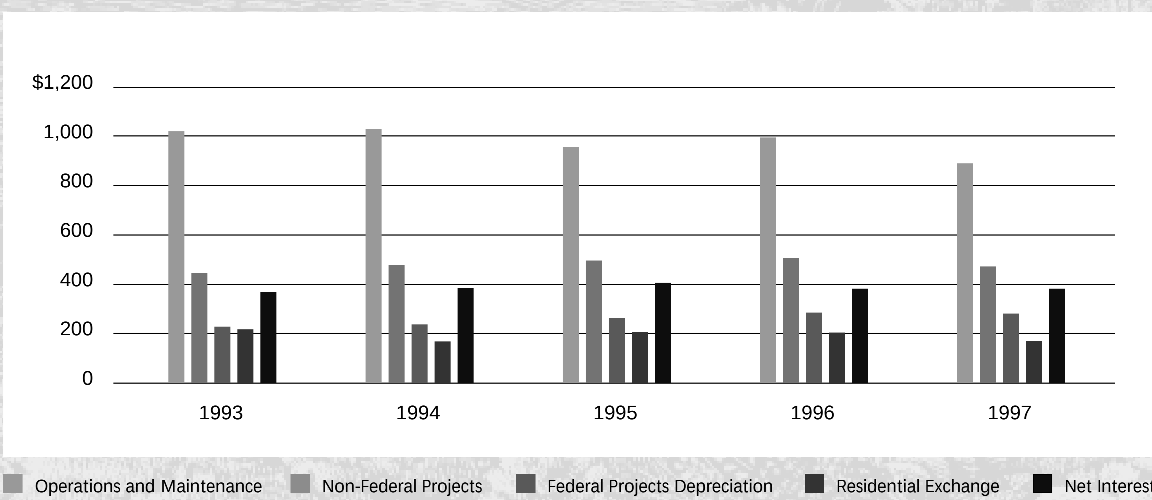
BPA ended 1997 with financial reserves — cash and deferred borrowing authority — of $430 million, 55 percent higher than financial reserves of $278 million at the end of 1996. The increased reserves of $152 million contrasts with $43 million projected in the rate design.

This year, BPA repaid $775 million to the U.S. Treasury, making it the fourteenth consecutive year in which BPA has made its payment on time and in full. Of this year's payment, $208 million went to principal, $447 million went to interest, and $95 million went to operations and maintenance on the federal dams operated by the U.S. Army Corps of Engineers and the Bureau of Reclamation. The irrigation assistance distribution was $25 million.

The funding plan of the administration and Congress for financing BPA's fish and wildlife obligations continues to provide stability to the largest growth area of BPA's expenses through 2001. Finally, new five-year contracts with publicly owned customers have stabilized revenues for BPA's largest customer class.

BPA ended the year in a solid financial position despite losing revenues from its public utility and industrial customers as they diversified their power supply. To make up for the lost revenues, BPA sold more surplus and nonfirm power and increased sales outside the Northwest.

Expenses by Category
(millions of dollars)



Financial Condition *(continued)*

Rates — In 1997, BPA's priority firm power rates dropped by an average of 13 percent from 1996 rate levels, the most significant rate decrease in the agency's history. This rate reduction was made possible primarily through internal cost reductions and cost stabilization actions taken by Congress, specifically BPA's fish and wildlife costs. To meet the rate target, BPA cut planned expenses for 1997-2001 by $600 million per year. The new rates were designed to maximize BPA revenues in an increasingly competitive wholesale power market.

Financing — To finance capital programs such as transmission system development, conservation, and fish and wildlife enhancement, BPA is authorized to borrow up to $3.75 billion from the U.S. Treasury. At the end of 1997, BPA's debt in this category totaled $2.5 billion, which is consistent with 1996.

The U.S. Army Corps of Engineers and Bureau of Reclamation use federal appropriations for new construction and replacement investments at the dams they operate. These appropriations, like BPA's borrowings, are to be repaid to the U.S. Treasury by BPA. The total remaining to be paid at the end of the year was $4.45 billion, or $2.4 billion less than last year. This reduction was due to the restructuring of the appropriated debt with an equitable amount of debt bearing current market rates of interest. The capitalization adjustment of $2.5 billion will be amortized, using the effective interest method, over the life of the appropriations.

BPA owes another $7 billion to non-federal sources for financing three Washington Public Power Supply System nuclear projects and several smaller generation and conservation investments. BPA backs bonds issued by others in the capital markets to finance these projects.

In 1997, the U.S. Treasury approved the BPA Appropriations Refinancing Act included in the Federal Omnibus Appropriations Act signed by President Clinton in April 1996. The net effect of the refinancing act returns about $100 million more to the U.S. Treasury in net present value than it would have received under BPA's old payment schedule. The act enhances BPA's long-term rate stability by mitigating the risk of higher interest costs that could have resulted from earlier repayment reform proposals.

Three rating agencies continued to maintain high credit ratings for BPA-backed Washington Public Power Supply System bonds. Moody's Investors Service issued a rating of Aa1, the second highest possible rating. Fitch Investors Service and Standard & Poor's maintained their AA- ratings. All three rating agencies cited BPA's strong financial position as a reason for the high ratings. They rated BPA's long-term outlook as "stable."

BPA's competitive success depends in part on its ability to manage financial risks. BPA is affected by changes in interest rates and by price risks associated with natural gas and electricity commodities. Flat-rate take-or-pay power sales contracts with aluminum and publicly owned utility customers expire in 2001. These contracts substantially reduce the risk to BPA of fluctuations in sales to those customers and lessen BPA's revenue risk associated with the price of aluminum.

Looking to the Future

BPA strategic planning is focused on two futures — the summer and fall of 1998, and October 2001 and beyond. Success in the near future should provide success in the longer term.

The summer 1998 activities are centered on the subscription process — the process the Regional Review suggested that the agency use to obtain new power contracts with customers long before the old ones expire. The majority of those contracts expire on or before the end of September 2001.

The goal of the subscription process is to obtain sufficient commitments from customers to ensure that BPA is able to meet all its financial and public responsibilities. The underpinning of the subscription process is BPA's aggressive cost management program. Beyond the cost management steps taken in FY 1997 and earlier, the agency received a draft report from an external cost management panel in January 1998 that provides new ideas for cost management that the agency will seriously weigh once the public comment period ends.

The twin efforts of subscription and cost management should position the agency to determine its own fate. Cost management will keep BPA's rate at or below market, which will assure a successful subscription process. A successful subscription process will assure BPA of sufficient revenue to meet all its responsibilities.

While the subscription process should resolve post-2001 revenue issues, an external cost issue remains to be resolved — the costs of endangered species recovery.

BPA's fish recovery spending is stable through FY 2001 because of previous agreements. The agency is working with representatives of tribal, state, regional, and federal interests to arrive at a stable and effective expenditure level for the years beyond 2001.

Balance Sheets

Federal Columbia River Power System
As of Sept. 30

Assets	1997 (thousands of dollars)	1996 (thousands of dollars)
Utility Plant (Notes 1 and 3)		
Completed plant	**$10,719,093**	$10,560,577
Accumulated depreciation	**(3,110,598)**	(3,056,092)
	7,608,495	7,504,485
Construction work in progress	**494,165**	437,328
Net utility plant	**8,102,660**	7,941,813
Non-Federal Projects (Note 4)		
Conservation	**63,818**	67,193
Hydro	**249,885**	253,550
Nuclear	**2,531,782**	2,543,386
Delayed construction/terminated projects	**4,191,920**	4,241,545
Total non-federal projects	**7,037,405**	7,105,674
Trojan Decommissioning Cost (Note 6)	**93,872**	91,300
Conservation, net of accumulated amortization of $528,040 in 1997 and $469,414 in 1996 (Notes 1 and 2)	**658,492**	696,782
Fish and Wildlife, net of accumulated amortization of $58,698 in 1997 and $46,020 in 1996 (Notes 1 and 2)	**141,385**	125,999
Current Assets		
Cash	**446,312**	246,501
Accounts receivable	**86,084**	66,032
Accrued unbilled revenues	**114,327**	133,970
Materials and supplies, at average cost	**78,793**	69,410
Prepaid expenses	**102,238**	149,624
Total current assets	**827,754**	665,537
Other Assets	**105,697**	82,364
	$16,967,265	$16,709,469

The accompanying notes are an integral part of these statements.

Capitalization and Liabilities	1997 (thousands of dollars)	1996
Accumulated Net Expense (Note 1)	**$ (182,999)**	$ (275,673)
Federal Appropriations (Note 3)	**4,417,006**	6,848,278
Capitalization Adjustment (Note 3)	**2,525,786**	—
Long-Term Debt (Note 2)	**2,371,200**	2,297,600
Non-Federal Projects Debt (Note 4)	**6,849,163**	6,937,954
Trojan Decommissioning Reserve (Note 6)	**73,072**	76,900
Total capitalization and long-term liabilities	**16,053,228**	15,885,059
Commitments and Contingencies (Notes 6 and 7)		
Current Liabilities		
Current portion of federal appropriations	**35,155**	—
Current portion of long-term debt	**127,700**	158,500
Current portion of non-federal projects debt	**188,242**	167,720
Current portion of Trojan decommissioning reserve	**20,800**	14,400
Accounts payable	**224,761**	231,675
Employees' accrued leave	**11,167**	14,938
Total current liabilities	**607,825**	587,233
Deferred Credits (Note 1)	**306,212**	237,177
	$16,967,265	$16,709,469

STATEMENTS OF REVENUES AND EXPENSES

Federal Columbia River Power System
For the Years Ended Sept. 30

(thousands of dollars)

	1997	1996	1995
Operating Revenues			
Sales of electric power:			
Publicly owned utilities	**$ 925,152**	$1,017,035	$1,168,661
Aluminum industry	**274,409**	399,359	490,684
Investor-owned utilities	**415,343**	402,962	325,233
Other regional power sales	**62,186**	76,691	64,898
Sales outside the Northwest	**373,295**	336,736	132,060
Total power sales	**2,050,385**	2,232,783	2,181,536
Wheeling and other sales	**221,652**	194,818	204,289
Total operating revenues	**2,272,037**	2,427,601	2,385,825
Operating Expenses			
Operations and maintenance	**882,383**	986,780	951,704
Non-federal projects (Note 4)	**463,922**	498,122	484,836
Residential exchange (Note 5)	**161,028**	196,074	198,186
Federal projects depreciation	**272,672**	277,083	254,738
Total operating expenses	**1,780,005**	1,958,059	1,889,464
Net operating revenues	**492,032**	469,542	496,361
Interest Expense			
Interest on federal investment:			
Appropriated funds (Note 3)	**244,425**	237,716	241,581
Long-term debt	**156,155**	163,644	180,215
Allowance for funds used during construction (AFUDC)	**(26,365)**	(27,675)	(24,202)
Net interest expense	**374,215**	373,685	397,594
Net revenues	**117,817**	95,857	98,767
Accumulated net expenses, Oct. 1	**(275,673)**	(371,530)	(470,297)
Irrigation assistance (Note 6)	**(25,143)**	—	—
Accumulated net expenses, Sept. 30	**$ (182,999)**	$ (275,673)	$ (371,530)

The accompanying notes are an integral part of these statements.

Statements of Changes in Capitalization and Long-term Liabilities

Federal Columbia River Power System

(thousands of dollars — including current portions)

	Accumulated Net Expenses	Federal Appropriations	Long-Term Debt	Non-Federal Project Debt	Other	Total
Balance at Sept. 30, 1994	$ (470,297)	$6,824,117	$2,616,500	$7,259,003	$ 108,488	$16,337,811
Increase in federal appropriations:						
Operations & maintenance	—	130,934	—	—	—	130,934
Construction	—	64,682	—	—	—	64,682
Repayment of federal appropriations:						
Operations & maintenance	—	(130,934)	—	—	—	(130,934)
Construction	—	(100,254)	—	—	—	(100,254)
Increase in long-term debt	—	—	325,000	—	—	325,000
Repayment of long-term debt	—	—	(378,100)	—	—	(378,100)
Net increase in non-federal projects debt	—	—	—	28,996	—	28,996
Repayment of non-federal projects debt	—	—	—	(93,486)	—	(93,486)
Trojan decommissioning reserve	—	—	—	—	(2,744)	(2,744)
Net revenues	98,767	—	—	—	—	98,767
Balance at Sept. 30, 1995	$ (371,530)	$6,788,545	$2,563,400	$7,194,513	$ 105,744	$16,280,672
Increase in federal appropriations:						
Operations & maintenance	—	134,089	—	—	—	134,089
Construction	—	82,443	—	—	—	82,443
Repayment of federal appropriations:						
Operations & maintenance	—	(134,089)	—	—	—	(134,089)
Construction	—	(22,710)	—	—	—	(22,710)
Increase in long-term debt	—	—	160,000	—	—	160,000
Repayment of long-term debt	—	—	(267,300)	—	—	(267,300)
Net increase in non-federal projects debt	—	—	—	16,589	—	16,589
Repayment of non-federal projects debt	—	—	—	(105,428)	—	(105,428)
Trojan decommissioning reserve	—	—	—	—	(14,444)	(14,444)
Net revenues	95,857	—	—	—	—	95,857
Balance at Sept. 30, 1996	$ (275,673)	$6,848,278	$2,456,100	$7,105,674	$ 91,300	$16,225,679
Increase in federal appropriations:						
Operations & maintenance	—	**144,883**	**—**	**—**	**—**	**144,883**
Construction	**—**	**190,675**	**—**	**—**	**—**	**190,675**
Repayment of federal appropriations:						
Operations & maintenance	**—**	**(139,277)**	**—**	**—**	**—**	**(139,277)**
Construction	**—**	**(2,771)**	**—**	**—**	**—**	**(2,771)**
Capitalization adjustment	**—**	**(2,589,627)**	**—**	**—**	**2,525,786**	**(63,841)**
Irrigation assistance	**(25,143)**	**—**	**—**	**—**	**—**	**(25,143)**
Increase in long-term debt	**—**	**—**	**351,300**	**—**	**—**	**351,300**
Repayment of long-term debt	**—**	**—**	**(205,200)**	**—**	**—**	**(205,200)**
Refinance of long-term debt	**—**	**—**	**(103,300)**	**—**	**—**	**(103,300)**
Net increase in non-federal projects debt	**—**	**—**	**—**	**33,596**	**—**	**33,596**
Repayment of non-federal projects debt	**—**	**—**	**—**	**(101,865)**	**—**	**(101,865)**
Trojan decommissioning reserve	**—**	**—**	**—**	**—**	**2,572**	**2,572**
Net revenues	**117,817**	**—**	**—**	**—**	**—**	**117,817**
Balance at Sept. 30, 1997	**$(182,999)**	**$4,452,161**	**$2,498,900**	**$7,037,405**	**$ 2,619,658**	**$16,425,125**

The accompanying notes are an integral part of these statements.

STATEMENTS OF CASH FLOWS

Federal Columbia River Power System
For the Years Ended Sept. 30

	(thousands of dollars)		
	1997	1996	1995
Cash from Operating Activities			
Net revenues	**$ 117,817**	$ 95,857	$ 98,767
Expenses (income) not requiring cash:			
Depreciation	**201,368**	209,783	192,443
Amortization of conservation and fish and wildlife	**71,304**	67,300	62,295
Amortization of non-federal projects	**101,865**	105,428	93,486
Amortization of capitalization adjustment	**(63,841)**	—	—
AFUDC	**(26,365)**	(27,675)	(24,202)
(Increase) decrease in:			
Receivables and unbilled revenues	**(409)**	(40,762)	(18,392)
Materials and supplies	**(9,383)**	5,523	(1,127)
Prepaid expenses	**47,386**	35,118	(3,907)
Increase (decrease) in:			
Accounts payable	**(6,914)**	(14,227)	19,597
Employees' accrued leave	**(3,771)**	(1,800)	2,185
Other	**45,702**	60,410	136,912
Cash provided by operating activities	**474,759**	494,955	558,057
Cash from Investment Activities			
Investment in:			
Utility plant	**(335,850)**	(258,304)	(280,899)
Conservation	**(20,336)**	(38,726)	(73,507)
Fish and wildlife	**(28,064)**	(26,046)	(32,486)
Cash used for investment activities	**(384,250)**	(323,076)	(386,892)
Cash from Borrowing and Appropriations			
Increase in federal appropriations:			
Operations and maintenance	**144,883**	134,089	130,934
Construction	**190,675**	82,443	64,682
Repayment of federal appropriations:			
Operations and maintenance	**(139,277)**	(134,089)	(130,934)
Construction	**(2,771)**	(22,710)	(100,254)
Irrigation assistance	**(25,143)**	—	—
Increase in long-term debt	**351,300**	160,000	325,000
Repayment of long-term debt	**(205,200)**	(267,300)	(378,100)
Refinance of long-term debt	**(103,300)**	—	—
Payment of non-federal debt	**(101,865)**	(105,428)	(93,486)
Cash provided by (used for) borrowing and appropriations	**109,302**	(152,995)	(182,158)
Increase (decrease) in cash	**199,811**	18,884	(10,993)
Beginning cash balance	**246,501**	227,617	238,610
Ending cash balance	**$ 446,312**	$ 246,501	$ 227,617

The accompanying notes are an integral part of these statements.

1. Summary of General Accounting Policies

Principles of Combination — The Federal Columbia River Power System (FCRPS) includes the accounts of the Bonneville Power Administration (BPA), which purchases, transmits, and markets power, and the accounts of the Pacific Northwest generating facilities of the U.S. Army Corps of Engineers (Corps) and the Bureau of Reclamation (Reclamation) for which BPA is the power marketing agency. Each entity is separately managed and financed, but the facilities are operated as an integrated power system with the financial results combined under the FCRPS title. Costs of multipurpose Corps and Reclamation projects are assigned to specific purposes through a cost allocation process. Only the portion of total project costs allocated to power is included in these statements.

FCRPS accounts are maintained in accordance with generally accepted accounting principles and the uniform system of accounts prescribed for electric utilities by the Federal Energy Regulatory Commission (FERC). FCRPS accounting policies also reflect specific legislation and executive directives issued by U.S. government departments. (BPA is a unit of the Department of Energy; Reclamation is part of the Department of the Interior; and the Corps is part of the Department of Defense.) FCRPS properties and income are tax-exempt. All material intercompany accounts and transactions have been eliminated from the combined financial statements.

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

Regulatory Authority — BPA's rates are established in accordance with several statutory directives. Rates proposed by BPA are subjected to an extensive formal review process, after which they are established by BPA and reviewed by FERC. FERC's review is limited to three standards set out in the Northwest Power Act and a standard set by the National Energy Policy Act. FERC reviews BPA's rates for all firm power, for nonfirm energy sold within the region, and for transmission service under such statutory standards that include a requirement that these rates be sufficient to assure repayment of the federal investment in the FCRPS over a reasonable number of years after first meeting BPA's other costs.

After final FERC approval, BPA's rates may be reviewed by the United States Court of Appeals for the Ninth Circuit. Action seeking such review must be filed within 90 days of the final FERC decision. FERC and the court of appeals may either confirm or reject a rate proposed by BPA. It is the opinion of BPA's general counsel that, if a rate were rejected, it would be remanded to BPA for reformulation. By contract, BPA has agreed that rates for the sale of power pursuant to its present contracts may not be revised on less than nine months' notice and may not be increased more than once in a 12-month period.

FERC has approved BPA's rates for fiscal years 1997 through 2001, which decreased average rates by approximately 13 percent from 1996 rate levels.

Because of the regulatory environment in which BPA established rates, certain costs may be deferred and expensed in future periods under Statement of Financial Accounting

1. Summary of General Accounting Policies *(continued)*

Standards No. 71 (SFAS 71), *Accounting for the Effects of Certain Types of Regulation.*

In order to defer incurred costs under SFAS 71, a regulated entity must have the statutory authority to establish rates that recover all costs and rates so established can be charged to and collected from customers.

Due to increasing competitive pressures, BPA may be required to seek alternative solutions in the future to avoid raising rates to a level that is no longer competitive.

If BPA should establish market rates, SFAS 71 would no longer be applicable, and any costs deferred under that standard would be expensed in the Statement of Revenues and Expenses.

The SFAS 71 assets of $5.15 billion, shown in the table below, reflect a decrease of $73 million from the prior year. Amortization of these costs aggregating $184 million in fiscal 1997, $184 million in 1996, and $156 million in fiscal 1995 is reflected in the Statements of Revenues and Expenses.

SFAS 71 assets are offset by liabilities that relate to future non-federal projects' debt service and operations and maintenance expense.

Revenues and Net Revenues — Operating revenues are recorded on the basis of service rendered, which includes estimated unbilled revenues. Because BPA is a U.S. government power marketing agency, net revenues over time are committed to repayment of the U.S. government investment in the FCRPS and the payment of certain irrigation costs as discussed in Note 6.

Utility Plant — Utility plant is stated at original cost. Cost includes direct labor and materials; payments to contractors; indirect charges for engineering, supervision, and similar overhead items; and an allowance for funds used during construction. The costs of additions, major replacements, and betterments are capitalized. Repairs and minor replacements are charged to operating expense. In accordance with FERC requirements the cost of utility plant retired, together with removal costs and less salvage, is charged to accumulated depreciation when it is removed from service.

Allowance for Funds Used During Construction — The allowance for funds used during construction (AFUDC) constitutes interest

SFAS 71 Assets
As of Sept. 30, 1997 & 1996

	(thousands of dollars)	
	1997	1996
Non-federal projects		
Conservation	**$ 63,818**	$ 67,193
Delayed construction/ terminated nuclear facilities	**4,191,920**	4,241,545
Trojan decommissioning cost	**93,872**	91,300
Conservation	**658,492**	696,782
Fish and wildlife	**141,385**	125,999
Total	**$5,149,487**	$5,222,819

on the funds used for utility plant under construction. AFUDC is capitalized as part of the cost of utility plant and results in a non-cash reduction of interest expense. While cash is not realized currently from this allowance, it is realized under the rate-making process over the service life of the related property through increased revenues resulting from higher plant in-service and higher depreciation expenses. AFUDC is based on the monthly construction work in progress (CWIP) balance. A portion of CWIP as stated on the balance sheets represents preliminary study and investigation costs to which AFUDC is not attributed.

AFUDC capitalization rates are stipulated in the congressional acts authorizing construction for certain generating projects (2.5 percent to 7.5 percent in 1997, 2.5 percent to 7.62 percent in 1996, and 2.5 percent to 7.57 percent in 1995). Capitalization rates for other construction approximate the cost of borrowing from the U.S. Treasury (7.13 percent in 1997, 7.625 percent in 1996, and 7.25 percent in 1995).

Depreciation and Amortization — Depreciation of utility plant is computed on the straight-line method based on estimated service lives of the various classes of property, which average 45 years for transmission and 75 years for generation. Engineering studies in 1995 resulted in revising generation lives from 85 years reported in prior years to the current estimate of 75 years. Amortization of conservation and fish and wildlife is computed on the straight-line method based on estimated service lives, which are 20 years for conservation and 15 years for fish and wildlife.

Retirement Benefits — FCRPS employees belong to either the Civil Service Retirement System (CSRS) or the Federal Employees' Retirement System (FERS). FCRPS and employees contribute to the systems. Based on the statutory contribution rates, retirement benefit expense under CSRS is equivalent to 7 percent of eligible employee compensation and under FERS is variable based upon options chosen by the participant but does not exceed 24.2 percent of eligible employee compensation. Retirement benefits are payable by the U.S. Treasury and not by the FCRPS.

Beginning in fiscal 1998, and for the remainder of the rate period ending in 2001, FCRPS may contribute additional amounts as a result of an underfunded status of the CSRS plan. These amounts will be calculated based on an estimate of FCRPS employees who participate in the plan as well as an estimate of FCRPS' share of the underfunded status. These contributions will be made over a period of years. The payments, if made, will be directly to the U.S. Treasury.

Cash — For purposes of reporting cash flows, cash includes cash in the BPA fund and unexpended appropriations of Reclamation and the Corps. Cash paid for interest was \$447 million in 1997, \$386 million in 1996, and \$397 million in 1995.

Non-cash transactions include changes in non-federal projects and non-federal projects' debt (other than amortization of non-federal projects and payment of non-federal projects' debt) of \$34 million in 1997, \$17 million in 1996, and \$29 million in 1995. In 1997, as discussed in Note 3, BPA refinanced federal appropriations resulting in a reduction in the amount outstanding of approximately \$2.5 billion. Additionally, in 1995 non-cash transactions included the establishment of a current liability of \$20 million and a long-term liability of \$60 million related to accruals for terminated construction on non-federal generation projects.

1. Summary of General Accounting Policies *(continued)*

Deferred Credits — Deferred credits consist of amounts paid to BPA from participants under various AC intertie capacity agreements and load diversification fees paid to BPA by various customers. Diversification fees are payments by customers to BPA in consideration for a reduction in their power purchases from BPA. These one-time payments cover the remaining term of the customer's existing contractual agreement. Deferred AC intertie capacity agreement amounts will be recognized over the 45 composite-year life of the assets. Deferred diversification fees will be recognized over the rate period ending on Sept. 30, 2001.

Hedging Activities — BPA policy allows the use of financial instruments such as commodity futures, options, and swaps to hedge the price of electricity and reduce BPA's exposure to market fluctuations.

In a pilot program started in fiscal 1996, BPA began using financial instruments in the form of Over-the-Counter (OTC) electricity swap agreements and NYMEX futures contracts to hedge anticipated production and marketing of hydroelectric energy. Under swap agreements, BPA makes or receives payments based on the differential between a specified fixed price and an index reference price of power. Under futures contracts, BPA either sells or buys NYMEX futures contracts to hedge anticipated future electricity sales. Recognition of gains or losses on the hedging instruments is deferred until the underlying physical transaction occurs. Both the swap and futures transactions have maturity dates that are less than one year.

At Sept. 30, 1997, BPA had swap agreements to exchange payments at various future dates that totaled less than 306,400 megawatt-hours at various fixed prices. Additionally, at this same date, BPA had open NYMEX futures and future options contracts totaling 171,488 MWh. Combined, at Sept. 30, 1997, the fair value of these electricity hedge transactions approximated $10 million. At and for the years ending Sept. 30, 1997 and 1996, the deferred and realized amounts from these transactions were not significant in relation to the consolidated FCRPS results.

Financial Instruments — All significant financial instruments of the FCRPS were recognized in the Balance Sheet as of Sept. 30, 1997 and 1996. The carrying value reflected in the Balance Sheet approximates fair value for the FCRPS's financial assets and current liabilities. The fair values of long-term liabilities are discussed in the respective footnotes.

2. Long-Term Debt

To finance its capital programs, BPA is authorized by the Federal Columbia River Transmission System Act to issue to the U.S. Treasury up to $3.75 billion of interest-bearing debt with terms and conditions comparable to debt issued by U.S. government corporations. A portion ($1.25 billion) of the $3.75 billion is reserved for conservation and renewable resource loans and grants. At Sept. 30, 1997, $588.7 million of this reserved amount and $1,910.2 million of other borrowings were outstanding. The average interest rate of BPA's borrowings from the U.S. Treasury exceeds the rate that could be obtained currently. As a result, the fair value of the BPA long-term debt, based upon discounting future cash flows using rates offered by the U.S. Treasury as of Sept. 30, 1997, for similar maturities exceeds carrying value by approximately $303 million, or 12.1 percent. BPA's policy is to refinance debt that is callable when associated benefits exceed costs. The table on page 33 reflects the terms and amounts of long-term debt.

Federal Columbia River Power System
Long-Term Debt (a)

(thousands of dollars)

Issue Date	First Call Date	Maturity Date	Interest Rate	Construction and Fish & Wildlife	Conservation	Cumulative Total
Bonds						
October 1992	none	1997	6.05%	$ 50,000	$ —	$ 50,000
May 1994	1995	1998	7.10%	—	37,700	87,700
May 1989	none	1999	8.95%	25,000	—	112,700
May 1989	none	1999	8.95%	75,000	—	187,700
August 1992	none	2000	6.60%	107,800	—	295,500
May 1997 (b)	none	2000	6.50%	50,000	—	345,500
September 1989	none	2002	8.65%	—	66,000	411,500
January 1996	none	2003	5.90%	60,000	—	471,500
January 1997	none	2004	6.80%	30,000	—	501,500
May 1997	none	2005	6.90%	80,000	—	581,500
August 1996	none	2006	7.05%	70,000	—	651,500
July 1992	1997	2007	7.14%	—	100,000	751,500
August 1992	1997	2007	7.25%	107,700	—	859,200
August 1997	none	2007	6.65%	111,300	—	970,500
February 1993	1998	2008	6.95%	20,000	—	990,500
July 1989	none	2009	8.55%	—	40,000	1,030,500
August 1995	2000	2010	7.20%	35,000	—	1,065,500
January 1996	2001	2011	6.7%	—	30,000	1,095,500
November 1996	2001	2011	6.95%	40,000	—	1,135,500
October 1992	1997	2012	8.05%	—	50,000	1,185,500
February 1993	1998	2013	7.40%	—	50,000	1,235,500
August 1993	1998	2013	6.75%	—	40,000	1,275,500
January 1994	1999	2014	6.75%	—	50,000	1,325,500
May 1995 (b)	2000	2015	7.50%	35,000	—	1,360,500
May 1995	2000	2015	7.50%	—	85,000	1,445,500
November 1996	2001	2016	7.20%	—	40,000	1,485,500
July 1995	2000	2025	7.70%	50,000	—	1,535,500
August 1995	2000	2025	7.70%	65,000	—	1,600,500
January 1990	2000	2030	9.25%	50,000	—	1,650,500
July 1992	1997	2032	8.13%	150,000	—	1,800,500
October 1992	1997	2032	8.35%	100,000	—	1,900,500
February 1993	1998	2033	7.80%	130,000	—	2,030,500
April 1993	1998	2033	7.50%	100,000	—	2,130,500
August 1993	1998	2033	6.95%	110,000	—	2,240,500
October 1993	1998	2033	6.85%	108,400	—	2,348,900
October 1993	1998	2033	6.85%	50,000	—	2,398,900
January 1994	1999	2034	7.05%	50,000	—	2,448,900
May 1994	1999	2034	8.20%	50,000	—	2,498,900
				$1,910,200	$588,700	$2,498,900
Less current portion						(127,700)
						$ 2,371,200

(a) *The weighted average interest rate was 7.4 percent on outstanding long-term debt as of Sept. 30, 1997. All construction, conservation, fish and wildlife, and Corps/Reclamation direct funding bonds are term bonds.*

(b) *Corps/Reclamation direct funding.*

3. Federal Appropriations

The BPA Appropriations Refinancing Act, 16 U.S.C. 8381, required that the outstanding balance of the FCRPS federal appropriations, which Bonneville is obligated to set rates to recover, be reset and assigned prevailing market rates as of Sept. 30, 1996. The new principal amount of appropriations is equal to the present value of the principal and interest that would have been paid to Treasury in the absence of the act, plus $100 million. The $100 million was capitalized as part of the appropriations balance and will be amortized over the period of repayment using the effective interest method.

The amount of appropriations refinanced was $6.6 billion. After refinancing, the appropriations outstanding was $4.1 billion. The difference between the appropriated debt before and after the refinancing is the capitalization adjustment. This adjustment will be amortized over the period of repayment so that, except for the amortization of the 100 million discussed above, interest expense is equal to that which would have been paid to the Treasury in the absence of the act.

Interest on appropriated funds for fiscal 1997 is net of $63.8 million amortization of the capitalization adjustment. The weighted average interest rate for fiscal 1997 was 5.5 percent prior to amortization of the capitalization adjustment. Construction and replacement of Corps and Reclamation generating facilities are financed through annual federal appropriations. Annual appropriations are also made for their operation and maintenance costs, although these are normally repaid by BPA to the U.S. Treasury by the end of each fiscal year. BPA transmission construction and operations and maintenance costs were also financed by appropriations before the Federal Columbia River Transmission System Act of 1974.

For fiscal 1996 and prior years, interest rates on the appropriated funds ranged from 2.5 percent to 8.5 percent. (The weighted average rate was 3.5 percent in 1996, and 3.6 percent in 1995.) The rates were set by law, administrative order pursuant to law, or administrative policies.

Federal appropriations relating to generating projects and the transmission system are repaid to the U.S. Treasury within 50 and 45 years, respectively, from the time each facility is placed in service.

If, in any given year, revenues are not sufficient to cover all cash needs, including interest, any deficiency becomes an unpaid annual expense. Interest is accrued on the unpaid annual expense until paid. This interest must be paid from subsequent years' revenues before any repayment of federal appropriations can be made.

The following table shows the term repayments on the remaining federal appropriations as of Sept. 30, 1997.

Federal Appropriations
Term repayments (a)

	(thousands of dollars)
1998	$ 35,155
1999	40,984
2000	21,543
2001	66,269
2002	23,913
2003+	4,264,297
	$ 4,452,161

(a) Includes payments on historic replacements but excludes planned future replacements and irrigation assistance.

4. Non-Federal Projects

BPA has acquired all or part of the generating capability of five nuclear power plants. The contracts to acquire the generating capability of the projects, referred to as "net-billing agreements," require BPA to pay all or part of the annual projects' budgets, including operating expense and debt service, whether or not the projects are completed or operating. BPA has also acquired all of the output of the Idaho Falls, Cowlitz Falls, and Wasco hydro projects. BPA has agreed to fund debt service on Eugene Water and Electric Board, Emerald, city of Tacoma, and Conservation and Renewable Energy System bonds issued to finance conservation programs sponsored by BPA.

BPA recognizes expenses for these projects based upon total project cash funding requirements reflected in project budgets that are adopted by BPA and the project's owners.

Operating expense of $208 million in fiscal 1997, $227 million in fiscal 1996, and $273 million in fiscal 1995 for the projects is included in operations and maintenance in the accompanying Statements of Revenues and Expenses. Following restoration of the Washington Public Power Supply System's bond rating in late 1988, BPA and the Supply System developed a refunding plan to refinance outstanding high-interest-rate net-billed bonds. By the end of fiscal year 1997, 17 advance refunding sales had been completed.

In total, $9.4 billion of refunding bonds was issued to refinance $7.9 billion of previously outstanding bonds. These advance refundings reduced the 1989 level cash requirements pursuant to the project budgets BPA is required to pay under the net-billing agreements by $140.9 million in fiscal 1997, $121.9 million in 1996, and $131.5 million in 1995. Additionally, the structure of the advance refundings allowed the release of cash reserves held by the bond trustee to further reduce the project budgets for fiscal 1997 and 1996. This resulted in $15.6 million and $4.2 million lower project budgets for fiscal 1997 and 1996, respectively. The release of cash reserves did not occur in fiscal 1995.

In summary, non-federal project expense included in the Statement of Revenues and Expenses was reduced by $156.5 million, $126.1 million, and $131.5 million for fiscal 1997, 1996, and 1995, respectively, relating to the above factors.

The recorded value of all Supply System debt exceeds fair value by $54.7 million or .8 percent based on discounting the future cash flows using interest rates for which similar debt could be issued at Sept. 30, 1997. All other non-federal projects' debt approximates fair value as stated.

The following table shows that future principal payments required for non-federal projects total approximately $7 billion.

Non-Federal Projects
Debt repayments

	(thousands of dollars)
1998	$ 188,242
1999	277,141
2000	296,969
2001	333,893
2002	257,320
2003+	5,683,840
	$7,037,405

5. Residential Exchange

As provided for in the Pacific Northwest Electric Power Planning and Conservation Act of 1980, Section 5(c), BPA entered into residential exchange contracts with several electric utilities. These contracts result in payments to each utility, which must be passed through to its qualified residential and irrigation loads, based on the difference between each utility's average cost and BPA's priority firm power rate.

Congress passed legislation in November 1995 that required BPA to pay $145 million in residential exchange benefits in fiscal 1997. The conference report prepared in connection with the legislation states that BPA and its customers, consistent with the Regional Review, should work together to gradually phase out the residential exchange program by Oct. 1, 2001. Termination agreements have been signed by all actively exchanging utilities except Portland General Electric, and Montana Power (which receives no benefits), whereby payments will be made by BPA for settlement of the period running from fiscal 1998 through June 30, 2001. Future benefits are fixed by the termination agreements except in the case of Portland General Electric. Without future legislation the residential exchange program will revert to the prior methodology on July 1, 2001.

6. Commitments and Contingencies

Irrigation Assistance — As directed by legislation, during fiscal 1997 BPA made a cash distribution of $25 million to the U.S. Treasury for original construction costs allocated to irrigation projects of certain Pacific Northwest irrigation projects that were determined to be beyond the irrigators' ability to pay. These irrigation distributions do not specifically relate to power generation and are required to be made only if doing so does not result in an increase to power rates. Accordingly, these distributions are not considered to be regular operating costs of the power program and have been treated as distributions from accumulated net expense in the fiscal 1997 Statement of Revenues & Expenses and in the fiscal 1997 Statement of Changes in Capitalization and Long-term Liabilities. The cumulative irrigation assistance payments ultimately could total $857 million and are scheduled to be made over the next 66 years. BPA is required by Public Law 89-448 to demonstrate that reimbursable costs of the FCRPS will be returned to the U.S. Treasury from BPA net revenues within the period prescribed by law. BPA is required to make a similar demonstration for the costs of irrigation projects which are beyond the ability of the 22 irrigation water users to repay. These requirements are met by conducting power repayment studies which produce schedules of payments at the proposed rates to demonstrate repayment of principal within the allowable repayment period.

The following table shows that future irrigation assistance distributions ultimately could total approximately $857 million.

Irrigation Assistance
Distributions

	(thousands of dollars)
1998	$ —
1999	—
2000	—
2001	10,103
2002	—
2003+	846,397
	$ 856,500

Net-Billing Agreements — BPA has agreed with the Supply System that, in the event any participant shall be unable for any reason, or shall refuse, to pay to the Supply System any amount due from such participant under its net-billing agreement for which a net-billing credit or cash payment to such participant has been provided by BPA, BPA will be obligated to pay the unpaid amount in cash directly to the Supply System, unless payment of such unpaid amount is made in a timely manner pursuant to the net-billing agreements.

Nuclear Insurance — BPA is a member of the Nuclear Electric Insurance Limited, established to provide insurance coverage for business interruption and/or extra expense resulting from an accidental outage at a member's nuclear site, and for excess property damage and decontamination liability. Under its business interruption and/or extra expense insurance coverage, BPA could be subject to a maximum assessment of $4.3 million in the event of a member's replacement power loss exceeding reserves and reinsurance. Under its property and decontamination coverage, BPA could be subject to a maximum assessment of $4.8 million in the event of a member-insured loss exceeding the reserves and reinsurance.

As a separate requirement, BPA is liable under the Nuclear Regulatory Commission's indemnity for public liability coverage under the Price-Anderson Act. In the event of a nuclear incident, BPA could be subject to a retrospective assessment of $79.3 million for WNP-2 limited to an annual maximum of $10 million.

Decommissioning and Restoration Costs — In March 1995, the Supply System submitted a site restoration plan to the state of Washington's Energy Facility Site Evaluation Committee (EFSEC) that complied with EFSEC's requirement to remove WNP-1 and -3 assets and restore the sites with minimal hazard to the public. EFSEC approved the Supply System's plan in June 1995. EFSEC's approval recognized that uncertainty still exists as to the exact details of the proposed plan; accordingly, EFSEC's conditional approval provided for additional reviews once the details of the plan are finalized. As part of submitting the restoration plan to EFSEC, the Supply System has obtained one outside estimate for site restoration that projected the cost of site restoration for WNP-1 at $46 million and for WNP-3 at $36 million. BPA is required to fund restoration of those projects. The Supply System expects to initiate a competitive bidding process before the final restoration plan is implemented. Recent Washington state legislation allows the transfer of the WNP-3 site to a county jurisdiction for redevelopment. The Supply System is working with Grays Harbor County agencies to negotiate a site transfer agreement that will reduce the cost of restoring the WNP-3 site.

The estimated obligation for restoration is reflected in the total non-federal projects debt liabilities and non-federal projects assets for WNP-1 and -3.

Decommissioning costs for WNP-2 are charged to operations over the operating life of the project. An external decommissioning sinking fund for costs is being funded monthly, as payments are made pursuant to the net-billing agreement, for WNP-2. The sinking fund is expected to provide for decommissioning at the end of the project's operating life in accordance with NRC requirements. Sinking fund requirements for WNP-2 are based on an estimate of decommissioning cost and assume a 40-year project life.

The estimated decommissioning sum of expenditures for WNP-2 is $357 million (1987 dollars). Payments to the sinking fund for the years ended Sept. 30, 1997, 1996, and 1995 were approximately $3 million per year. The sinking fund balance at Sept. 30, 1997, is $45 million.

6. Commitments and Contingencies *(continued)*

In January 1993, the Portland General Electric board of directors formally notified BPA of its intent to terminate the operation of the Trojan plant. PGE's rate filing in November 1993 with the Oregon Public Utility Commission included an estimated total decommissioning liability of $401 million (in 1993 dollars). The current remaining estimate of $368 million is based on site-specific studies less actual expenditures to date. As of Sept. 30, 1997, BPA's 30-percent share of this estimated remaining liability equals $110 million, which has been recorded net of the decommissioning trust fund balance of $16 million in the accompanying Balance Sheet. The Trojan Decommissioning Plan calls for prompt decontamination with delayed demolition of non-radiological structures. Funding requirements will be greater in the early years of decommissioning and then will decrease significantly. These greater early funding requirements have altered the decommissioning trust fund contributions for 1995, 1996, and 1997. For the period 1995 through 2000, funding for the Trojan decommissioning trust fund is being applied directly to the decommissioning expenses. Contributions to the decommissioning trust fund are made pursuant to the net-billing agreement for the plant through 2023. Once prompt decontamination is completed, funding of the trust will resume at a lower contribution level to pay for the delayed demolition. The decision to terminate the plant is not expected to result in the acceleration of debt-service payments. BPA will continue to recover its share of Trojan's costs through rates. Decommissioning costs are included in operations and maintenance expense in the Statements of Revenues and Expenses.

Environmental Cleanup — The Ross Complex in Vancouver, Wash., was removed from the Environmental Protection Agency's Superfund list in fiscal 1996. There are sites where BPA has been or may be identified as a potential responsible party. Costs associated with cleanup are not expected to be material to the FCRPS financial statements.

Endangered Species Act — Actions related to the Endangered Species Act are included in BPA's costs and recovered through current rates.

Purchase Commitments — BPA has commitments under billing credit agreements and other alternative energy programs whereby BPA provides a cost supplement to entities that are involved in alternative energy generation projects. BPA's aggregate cost of these commitments has approximated $17 million, $9 million, and $4 million for fiscal 1997, 1996, and 1995, respectively. BPA's continued cost of these commitments is expected to approximate $20 million per year over the next five years. These commitments expire at various periods over the next twenty years.

Technology Risk — Like all companies with business application software programs, BPA is affected by the year 2000 issue. Some of this software, which includes its operations and financial systems, was written using two digits to define the year rather than four. Any of BPA's software that is time-sensitive may recognize a date using "0" as the year 1900 rather than 2000. This could result in the computer shutting down or performing incorrect calculations.

BPA has identified the software programs that could be affected by the year 2000 issue and has developed plans to resolve the issue. BPA believes that, with the appropriate modifications, it will be able to operate its time-sensitive software programs beyond the turn of the century. The estimated cost of such modifications has been determined to not be material.

7. Litigation

Involving the Tenaska Washington Partners, II L.P. — In fiscal 1995 the Tenaska Washington Partners, II L.P. (Tenaska) and Chase Manhattan Bank (Chase) filed suit against BPA for breach of contract and lost revenues. In June 1996, BPA and Chase reached a settlement that resulted in a payment of $115 million by BPA to Chase. BPA settled with several subcontractors of Tenaska for $29 million in fiscal 1997. Currently, BPA and Tenaska are in binding arbitration to resolve Tenaska's suit. BPA believes that the factual and legal assertions by Tenaska in support of its $611 million claim are without merit. However, BPA believes that the arbitration could result in an award from the Tenaska case in excess of $115 million. There are defenses available to BPA that could result in a lesser net award. Any monetary award received by Tenaska in arbitration will be offset by the $115 million paid by BPA to Chase in settlement of Chase's claim, plus interest accruing on this amount. In the event that Tenaska obtains an award in arbitration that is less than the amount BPA paid Chase, Tenaska will owe BPA the difference. BPA's $115 million payment to Chase was reflected in the results of operations for the year ended Sept. 30, 1996. In 1997, BPA recorded additional settlements aggregating $29 million in its results of operations.

Subsequent Events — In October 1997, and January 1998, the Supply System issued a total of $821.1 million in refunding bonds, Series 1997B and 1998A, for WNP-1 ($352.6 million), WNP-2 ($310.7 million), and WNP-3 ($157.8 million). The proceeds of the bonds will be used to refund $326.9 million, $290.2 million, and $149.2 million of previously outstanding WNP-1, -2, and -3 bonds, respectively.

Selected Quarterly Information *(Unaudited)*
3 Months Ended

(thousands of dollars)

		Dec. 31	March 31	June 30	Sept. 30
1997	Operating revenues	**$584,099**	**$ 660,353**	**$ 479,624**	**$ 547,961**
	Operating expenses	**433,092**	**416,703**	**452,759**	**477,451**
	Net interest expenses	**95,401**	**93,385**	**91,401**	**94,028**
	Net revenues (expenses)	**$ 55,606**	**$ 150,265**	**$ (64,536)**	**$ (23,518)**
1996	Operating revenues	$ 688,764	$ 716,865	$ 516,610	$ 505,362
	Operating expenses	406,961	438,518	622,761	489,819
	Net interest expenses	100,193	98,510	88,787	86,195
	Net revenues (expenses)	$ 181,610	$ 179,837	$ (194,938)	$ (70,652)
1995	Operating revenues	$ 639,348	$ 624,629	$ 560,160	$ 561,688
	Operating expenses	497,132	418,433	473,166	500,733
	Net interest expenses	102,301	101,373	96,577	97,343
	Net revenues (expenses)	$ 39,915	$ 104,823	$ (9,583)	$ (36,388)

Note: *BPA's net revenues are normally higher in the first and second quarters of the fiscal year than in the third and fourth. In fall and winter, loads grow to serve Northwest heating needs. In warmer weather, loads decline and BPA spends more in yearly maintenance.*

Schedule of Amount and Allocation of Plant Investment

Federal Columbia River Power System
As of Sept. 30, 1997

Schedule A

		Commercial Power			Irrigation (unaudited)		
	Total Plant	Completed Plant	Construction Work in Progress	Total Commercial Power	Returnable from Power Commercial Revenues	Returnable from Other Sources	Total Irrigation
	(thousands of dollars)						
Bonneville Power Administration							
Transmission Facilities	$ 4,872,377	$ 4,647,729	$ 224,648	$ 4,872,377	$ —	$ —	$ —
Bureau of Reclamation							
Boise	98,597	14,805	—	14,805	25,143	41,509	66,652
Columbia Basin	1,923,927	1,087,580	10,872	1,098,452	592,993	172,433	765,426
Hungry Horse	141,770	111,791	2,565	114,356	—	—	—
Minidoka-Palisades	382,072	104,666	6	104,672	10,213	67,350	77,563
Yakima	209,160	5,294	442	5,736	12,631	134,313	146,944
Total Bureau Projects	2,755,526	1,324,136	13,885	1,338,021	640,980	415,605	1,056,585
Corps of Engineers							
Albeni Falls	42,332	38,404	1,022	39,426	—	—	—
Bonneville	1,270,688	824,069	44,047	868,116	—	—	—
Chief Joseph	599,294	558,800	558	559,358	—	172	172
Cougar	62,501	20,306	—	20,306	—	3,288	3,288
Detroit-Big Cliff	68,112	41,292	319	41,611	—	5,122	5,122
Dworshak	369,544	313,522	149	313,671	—	—	—
Green Peter-Foster	90,357	49,967	92	50,059	—	6,224	6,224
Hills Creek	49,253	17,521	121	17,642	—	4,607	4,607
Ice Harbor	197,229	140,575	226	140,801	—	—	—
John Day	632,024	466,369	18,287	484,656	—	—	—
Libby	572,555	427,924	4,507	432,431	—	—	—
Little Goose	253,134	211,454	24	211,478	—	—	—
Lookout Point-Dexter	104,505	47,428	5,246	52,674	—	1,487	1,487
Lost Creek	149,583	27,073	3	27,076	—	2,179	2,179
Lower Granite	405,687	332,421	38	332,459	—	—	—
Lower Monumental	270,723	227,812	66	227,878	—	—	—
McNary	355,695	280,857	871	281,728	—	—	—
The Dalles	354,814	296,223	9,294	305,517	—	—	—
Lower Snake	256,261	253,355	427	253,782	—	—	—
Columbia River Fish Bypass	366,419	171,856	170,335	342,191	—	—	—
Total Corps Projects	6,470,710	4,747,228	255,632	5,002,860	—	23,079	23,079
Irrigation Assistance at 12 Projects having no power generation	201,179	—	—	—	157,144	44,035	201,179
Total Plant Investment	14,299,792	10,719,093	494,165	11,213,258	798,124	482,719	1,280,843
Repayment Obligation Retained by Columbia Basin Project	4,639	2,836	—	2,836	1,803	—	1,803
Investment in Teton Project (b)	79,107	—	7,269	7,269	56,573	3,681	60,254
Total	**$14,383,538**	**$10,721,929**	**$ 501,434**	**$11,223,363**	**$ 856,500**	**$ 486,400**	**$1,342,900**

(a) Amount represents joint costs transferred to Bureau of Sports Fisheries and Wildlife. This is included in other assets in the accompanying balance sheets.

(b) The $7,269,000 commercial power portion of the Teton project is included in other assets in the accompanying balance sheets. Teton amounts exclude interest totalling approximately $2.2 million subsequent to June 1976 which was charged to expense.

	Non-reimbursable (unaudited)					
	Navigation	Flood Control	Fish and Wildlife	Recreation	Other	Percent Returnable from Commercial Power Revenues
	(thousands of dollars)					
Bonneville Power Administration						
Transmission Facilities	$ —	$ —	$ —	$ —	$ —	100%
Bureau of Reclamation						
Boise	—	17,140	—	—	—	40.52%
Columbia Basin	1,000	52,287	6,055	154	553	87.92%
Hungry Horse	—	27,414	—	—	—	80.66%
Minidoka-Palisades	—	64,571	2,566	10,276	122,424	30.07%
Yakima	—	1,103	48,771	—	6,606	8.78%
Total Bureau Projects	1,000	162,515	57,392	10,430	129,583	71.82%
Corps of Engineers						
Albeni Falls	168	253	—	2,485	—	93.14%
Bonneville	399,221	—	—	1,289	2,062	68.32%
Chief Joseph	—	—	5,502	5,262	29,000	93.34%
Cougar	548	38,359	—	—	—	32.49%
Detroit-Big Cliff	223	21,156	—	—	—	61.09%
Dworshak	9,703	31,386	—	14,784	—	84.88%
Green Peter-Foster	366	30,385	—	1,653	1,670	55.40%
Hills Creek	628	26,376	—	—	—	35.82%
Ice Harbor	53,419	—	—	3,009	—	71.39%
John Day	91,064	18,088	—	11,807	26,409	76.68%
Libby	—	95,803	870	12,814	30,637	75.53%
Little Goose	35,019	—	—	4,033	2,604	83.54%
Lookout Point-Dexter	744	49,089	—	511	—	50.40%
Lost Creek	—	52,852	24,279	29,592	13,605	18.10%
Lower Granite	52,638	—	—	12,748	7,842	81.95%
Lower Monumental	39,587	—	—	2,841	417	84.17%
McNary	69,180	—	—	4,787	—	79.20%
The Dalles	47,208	—	—	2,067	22	86.11%
Lower Snake	2,479	—	—	—	—	99.03%
Columbia River Fish Bypass	24,228	—	—	—	—	93.39%
Total Corps Projects	826,423	363,747	30,651	109,682	114,268	77.32%
Irrigation Assistance at 12 Projects having no power generation	—	—	—	—	—	78.11%
Total Plant Investment	827,423	526,262	88,043	120,112	243,851	84.00%
Repayment Obligation Retained by Columbia Basin Project	—	—	—	—	—	100.00%
Investment in Teton Project (b)	—	9,151		2,433	—	80.70%
Total	**$827,423**	**$535,413**	**$ 88,043**	**$122,545**	**$243,851**	**83.98%**

Price Waterhouse LLP

To the Administrator of
Bonneville Power Administration,
United States Department of Energy:

In our opinion, the accompanying balance sheets and the related statements of revenues and expenses, changes in capitalization and long-term liabilities, and cash flows present fairly, in all material respects, the financial position of the Federal Columbia River Power System (FCRPS) at September 30, 1997 and 1996, and the results of its operations, changes in its capitalization and long-term liabilities, and its cash flows for each of the three years in the period ended September 30, 1997, in conformity with generally accepted accounting principles. These financial statements are the responsibility of FCRPS' management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with generally accepted auditing standards which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

Our audit was made for the purpose of forming an opinion on the basic financial statements taken as a whole. The Schedule of Amount and Allocation of Plant Investment as of September 30, 1997 (Schedule A) is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information, except for that portion marked "unaudited," on which we express no opinion, has been subjected to the auditing procedures applied in the examination of the basic financial statements; and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Price Waterhouse LLP

Portland, Oregon
December 15, 1997

Revenue Requirement Study — The revenue requirement study demonstrates repayment of federal investment, and it reflects revenues and costs consistent with the 1996 Wholesale Power and Transmission Rate Filing. The Federal Energy Regulatory Commission granted final approval for proposed rates on April 4, 1997, for fiscal year 1997 (75 FERC 62,010).

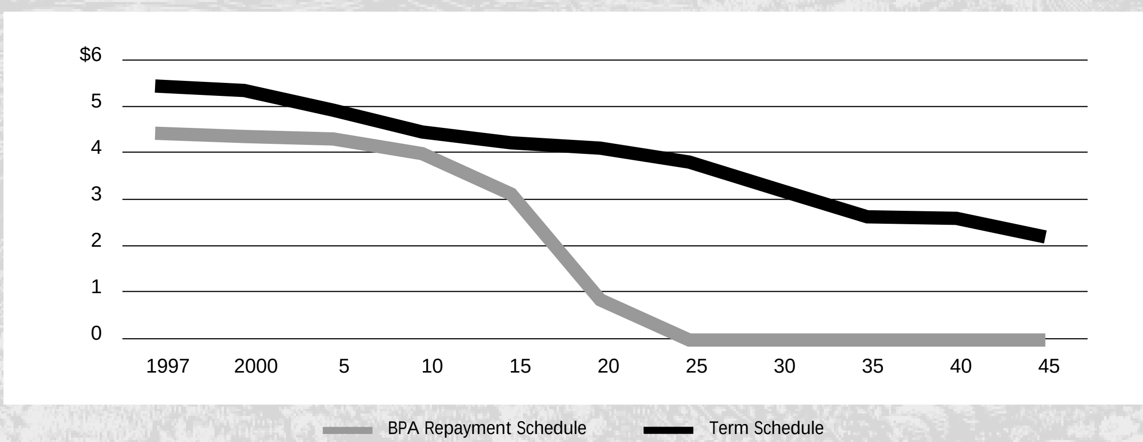
Repayment Demonstration — BPA is required by Public Law 89-448 to demonstrate that reimbursable costs of the FCRPS will be returned to the U.S. Treasury from BPA net revenues within the period prescribed by law. BPA is required to make a similar demonstration for the costs of irrigation projects that are beyond the ability of the 22 irrigation water users to repay. These requirements are met by conducting power repayment studies that produce schedules of payments at the proposed rates to demonstrate repayment of principal within the allowable repayment period.

Since 1985, BPA has prepared separate repayment demonstrations for generation and transmission in accordance with an order issued by the Commission on Jan. 27, 1984 (26 FERC 61,096).

Repayment Policy — BPA's repayment policy is reflected in its revenue requirements and rate levels. This policy requires that FCRPS revenues be sufficient to:

1. Pay the cost of obtaining power through purchase and exchange agreements (non-federal projects).
2. Pay the cost of operating and maintaining the power system.
3. Pay interest on and repay outstanding bonds issued to the Treasury to finance transmission system construction, conservation, and fish and wildlife projects.
4. Pay interest on the unrepaid investment in power facilities financed with appropriated funds. (Federal hydroelectric projects are all financed with appropriated funds, as were BPA transmission facilities constructed before 1978.)
5. Pay, with interest, any outstanding deferral.
6. Repay the power investment in each federal hydroelectric project within 50 years after going into service (except for the Chandler project, which has a legislated repayment period of 66 years).

Unrepaid Federal Generation Investment *(Includes future replacements)*
(billions of dollars)



7. Repay each increment of the investment in the BPA transmission system financed with appropriated funds within the average service life of the transmission facilities (45 years).
8. Repay the investment in each replacement at a federal hydroelectric project within its service life.
9. Repay construction costs at federal reclamation projects that are beyond the ability of the irrigators to pay and are assigned for payment from commercial power net revenues within the same period available to the water users for making payments. These periods range from 40 to 66 years, with 50 years being applicable to most of the irrigation payment assistance.

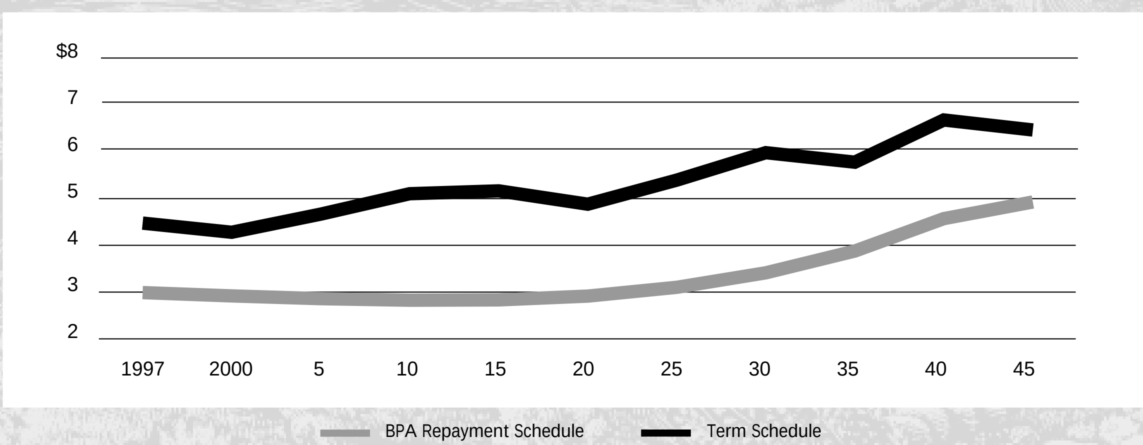
Investments bearing the highest interest rate will be repaid first, to the extent possible, while still completing repayment of each increment of investment within its prescribed repayment period.

Repayment Obligation — BPA's rates must be designed to collect sufficient revenues to return the reimbursable power costs of each FCRPS investment and each irrigation assistance obligation within the time prescribed by law. If existing rates are not likely to meet this requirement, BPA must reduce costs, adjust its rates, or both. However, total irrigation assistance payments cannot require an increase in the BPA power rate level. In the absence of a specific legislated period, the reimbursable power costs must be returned within 50 years from the date the investment is capable of producing revenue or within the investment's average service life, whichever is less.

By comparing the unrepaid investment resulting from BPA's repayment schedule with the allowable unrepaid investment resulting from a "term schedule" on a year-by-year basis it is demonstrated that the federal investment is repaid within the time allowed. A term schedule represents a repayment schedule whereby each investment would be repaid in total in the year it is due.

Reporting requirements of Public Law 89-448 are met so long as the unrepaid FCRPS investment and irrigation assistance resulting from BPA's repayment schedule are less than or equal to the allowable unrepaid investment in each year. While the comparison is illustrated

Unrepaid Federal Transmission Investment *(Includes future replacements)*
(billions of dollars)



by graphs representing total FCRPS generation and total FCRPS transmission investment, the actual comparison is performed on an investment-by-investment basis.

Repayment of FCRPS Investment — The graphs for Unrepaid Federal Generation and Transmission Investment on pages 43 and 44 illustrate that unrepaid investment resulting from BPA's generation and transmission repayment schedules is less than the allowable unrepaid investment. This demonstrates that BPA's rates are sufficient to recover all reimbursable costs of FCRPS investments on or before their due dates.

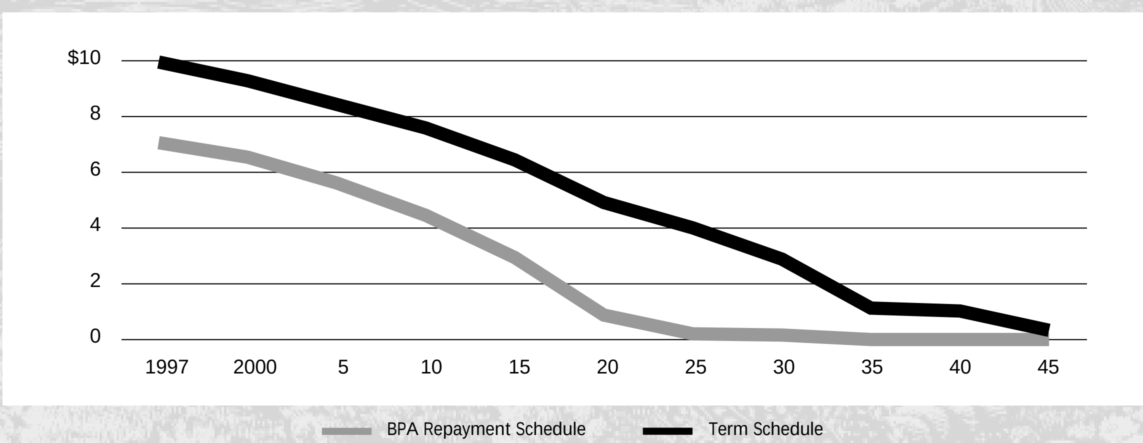
The term schedule lines in the graphs show how much of the investment can remain unpaid in accordance with the repayment period for the generation and transmission components of the FCRPS. The BPA repayment schedule lines show how much of the investment remains to be repaid according to BPA's repayment schedules. In each year, BPA's repayment schedule is ahead of the term schedule.

This occurs because BPA plans repayment both to comply with investment due dates and to minimize costs over the 45- or 50-year repayment period. Costs are minimized by repaying highest interest-bearing investments first, to the extent possible. Consequently, some investments are repaid before their due dates while assuring that all other investments are repaid by their due dates. These graphs include forecasts of future system replacements necessary to maintain the existing FCRPS generation and transmission facilities.

The Unrepaid Federal Investment graph below displays the total planned unrepaid FCRPS investment compared to allowable total unrepaid FCRPS investment omitting future system replacements. This demonstrates that the FCRPS investment expected through fiscal year 1997 is scheduled to be returned to the U.S. Treasury within the 45- or 50-year repayment period and ahead of due dates.

If, in any given year, revenues are not sufficient to cover all cash needs, including interest, any deficiency becomes an unpaid annual expense. Interest is accrued on the unpaid annual expense until paid. This must be paid from subsequent years' revenues before any repayment of federal appropriations can be made.

Unrepaid Federal Investment *(Excludes future replacements)*
(billions of dollars)



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BPA Profile

BPA markets power from 29 federal dams and one non-federal nuclear plant in the Pacific Northwest. BPA provides low-cost electricity to the region by offering cost-based rates for its power and transmission services.

BPA's service area includes Oregon, Washington, Idaho, western Montana, and small parts of Wyoming, Nevada, Utah, California, and eastern Montana. BPA sells wholesale power to publicly owned and investor-owned utilities, as well as to some large industries. BPA also sells or exchanges power with utilities in Canada and other parts of the western United States.

Today BPA fulfills its public responsibilities by operating and maintaining one of the largest and most reliable transmission systems in the United States assuring the Northwest of an efficient, economical, and reliable power supply. BPA also funds the region's efforts to protect and rebuild fish and wildlife populations in the Columbia River Basin, the largest such effort in the world.

BPA continues to fulfill its environmental obligations by working with others in the region to support new conservation and renewables projects.

Bonneville Power Administration

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DOE/BP-3034 January 1998 25C