Department of Water Resources
Electric Power Fund
Financial Statements

March 31, 2012

California Energy Resources Scheduling

Department of Water Resources

Index

USING THIS REPORT

This discussion and analysis is designed to assist the reader in focusing on significant financial issues and activities and to identify any significant changes in financial position of the Department of Water Resources Electric Power Fund (the Fund), which is administered by the California Department of Water Resources (DWR). Readers are encouraged to consider the information presented in conjunction with the financial statements as a whole, which follows *Management's Discussion and Analysis*. This discussion and analysis and the financial statements do not relate to DWR's other governmental and proprietary funds.

The basic financial statements include three required statements, which provide different views of the Fund. They are: the statement of net assets, the statement of revenues, expenses and changes in net assets, and the statement of cash flows. These statements provide current and long-term information about the Fund and its activities. These financial statements report information using accounting methods similar (although not identical) to those used by private sector companies. The statement of net assets includes all assets and liabilities as of the year-end date. The statement of revenues, expenses and changes in net assets presents all of the current year's revenues, expenses, and changes in net assets. The statement of cash flows reports cash receipts, disbursements and the net change in cash resulting from three principal types of activities: operating, financing and investing. In order for the basic financial statements to be complete, they must be accompanied by a complete set of footnotes. The notes to the financial statements provide disclosures which are required to conform to generally accepted accounting principles. The Fund is required to follow accounting standards promulgated by the Governmental Accounting Standards Board.

PURPOSE OF FUND

The Fund was established in January 2001 through legislation to assist mitigation of the effects of a statewide energy supply emergency.

DWR has the authority to secure and retain title to power for resale to end use customers of the State's investor owned utilities (IOUs) under power supply contracts entered into prior to January 1, 2003. The scheduling, dispatch, and certain other administrative functions for the long-term contracts are performed by the IOUs as agents for DWR. However, DWR retains the legal and financial responsibility for each contract for the life of the contract or until such time as there is complete assignment of the contract to an IOU and release of DWR. Most of the volume of power under contract expires by June 30, 2012 and the last of the contracts expires in fiscal 2016.

DWR is entitled to recover revenue requirements for authorized activities, including but not limited to debt service, the costs of power purchases, administrative expenses and reserves. Revenue requirements are determined at least annually and submitted to the California Public Utilities Commission (CPUC) for implementation. Under the terms of the rate agreement between the CPUC and DWR, the CPUC is required to set rates for the customers of the IOUs and "direct access" Electric Service Providers (ESPs) such that the Fund will always have monies to meet its revenue requirements.

This report should be read in conjunction with the Fund's June 30, 2011 audited financial statements.

STATEMENTS OF NET ASSETS

The Fund's assets, liabilities and net assets as of March 31, 2012 and June 30, 2011 are summarized as follows (in millions):

	March 31, 2012	June 30, 2011
Long-term restricted cash, equivalents and investments	$ 1,186	$ 1,207
Recoverable costs	4,944	4,809
Derivative instruments	-	7
Deferral of derivative cash outflows	23	30
Restricted cash and equivalents:		
Operating and priority contract accounts	577	1,133
Bond charge collection and bond charge payment accounts	1,110	618
Recoverable costs, current portion	138	220
Interest receivable	9	6
Other assets	52	79
Total assets	$ 8,039	$ 8,109
Net assets	$ -	$ -
Long-term debt, including current portion	7,819	7,836
Derivative instruments	30	36
Deferral of derivative cash inflows	-	3
Other current liabilities	190	234
Total capital and liabilities	$ 8,039	$ 8,109

ASSETS

Long-Term Restricted Cash and Investments

The balance in the Operating Reserve Account decreased $21 million to $267 million at March 31, 2012 from $288 million at June 30, 2011. The amount was determined in accordance with the bond indenture and is equal to the maximum one month priority contract cost amount under stress conditions for calendar year 2012 as forecast in the DWR 2012 revenue requirement determination. The balance of the Debt Service Reserve Account remains at $919 million, and was also determined in accordance with bond indenture requirements.

Recoverable Costs, Net of Current Portion

Long-term recoverable costs consist of costs that are recoverable through future billings. Long term recoverable costs increased $135 million to $4,944 million at March 31, 2012 from $4,809 million at June 30, 2011. This $135 million increase in long-term recoverable costs was the net of 1) operating expenses exceeding operating revenues by $556 million, as a result of reductions in remittances due to lower required Operating Reserve Account balances and 2) bond charge revenues exceeding interest expense by $417 million.

Derivative Instruments-Assets

The Fund is party to interest rate swap agreements and natural gas hedging positions that are considered to be derivatives under the provisions of GASB 53 and included on the statement of net assets for periods ended March 31, 2012 and June 30, 2011.

Derivative financial instrument assets decreased $7 million to zero at March 31, 2012 from $7 million at June 30, 2011. The lower fair value of derivative financial instruments was due to fewer outstanding natural gas hedge contracts as expiring hedges are not replaced because less natural gas was needed in the future as power contracts expire.

Deferral of Derivative Cash Outflows

Deferred outflows decreased by $7 million to $23 million at March 31, 2012 from $30 million at June 30, 2011 as a result of fewer outstanding natural gas hedge contracts needed to hedge future natural gas purchases.

Restricted Cash and Equivalents

The Operating and Priority Contract Accounts decreased by $556 million to $577 million at March 31, 2012 from $1,133 million at June 30, 2011. DWR purposefully reduced cash balances while staying within Indenture requirements as part of a planned return of cash reserves to ratepayers through lower power charge rates.

The Bond Charge Collection and Bond Charge Payment Accounts increased by $492 million to $1,110 million at March 31, 2012 from $618 million at June 30, 2011 in anticipation of the annual principal and semi-annual interest payment on fixed rate bonds due on May 1, 2012.

From the dates of issuance of the revenue bonds through March 31, 2012, the balances in each of the restricted cash and investments accounts met or exceeded balances required by the Bond Indenture.

Recoverable Costs, Current Portion

The current portion of recoverable costs reflects billings to IOU customers that have not yet been collected and amounts due for surplus sales of energy and gas. The current portion of recoverable costs decreased $82 million to $138 million at March 31, 2012 from $220 million at June 30, 2011. This decrease resulted from lower volumes of contracted purchased power generated and sold to end use customers, and decreased surplus energy sales as several contracts expired at the end of fiscal and calendar 2011.

Interest Receivable

Interest receivable consists of accrued interest on cash and equivalents and debt service reserve investments. Interest receivable increased $3 million to $9 million at March 31, 2012 from $6 million at June 30, 2011.

Other Assets

DWR purchases natural gas as fuel for the production of power under the terms of certain power purchase contracts and maintains a brokerage account with a national brokerage firm in order to hedge natural gas costs. DWR invests funds to be used to meet realized losses as they occur, provide collateral for current positions, and enable future hedging activities that require margin or immediate payment. Assets in this account are classified as other assets on the Statements of Net Assets. Other assets, consisting of money market obligations, US Treasury bills, and government bonds, decreased by $27 million to $52 million at March 31, 2012 from $79 million at June 30, 2011.

LIABILITIES

Long-Term Debt

Long-term debt decreased $17 million to $7,819 million at March 31, 2012 from $7,836 million at June 30, 2011.

Net amortization of bond premium and deferred loss on defeasance and the early redemption was $14 million in the nine month period ended March 31, 2012.

Derivative Instruments- Liabilities

The Fund is party to natural gas hedging positions that are considered to be derivatives under the provisions of GASB 53 and included on the statement of net assets for periods ended March 31, 2012 and June 30, 2011.

Derivative financial instrument liabilities decreased $6 million to $30 million at March 31, 2012 from $36 million at June 30, 2011. Total notional amounts of outstanding gas hedging derivatives also declined during the period.

Deferral of derivative cash inflows

There were no deferred inflows at March 31, 2012, a decrease of $3 million from June 30, 2011, as derivative financial instrument assets decreased in value with the reduction in notional amounts outstanding.

Accounts Payable

Accounts payable reflect one month's accrual for power and fuel purchases, as payments are normally made on the 20th of the month following purchase. Accounts payable decreased $141 million to $37 million at March 31, 2012 from $178 million at June 30, 2011 because contract energy costs have fallen as purchased power contracts have expired and also because natural gas prices were lower.

Accrued Interest Payable

Accrued interest payable increased $97 million to $153 million at March 31, 2012 from $56 million at June 30, 2011. This increase was anticipated as the fixed rate bonds provide for semi-annual payments on May 1st and November 1st. Interest costs have increased as a result of bond issues refunding all variable rate bonds with fixed rate bonds, which, in the current environment, are paid higher rates of interest.

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

The Fund’s activities for the nine months ended March 31, 2012 and 2011 are summarized as follows (in millions):

	Three months ended March 31		Nine months ended March 31	
	2012	2011	2012	2011
Revenues:				
Power charges	$ (98)	$ 68	$ 145	$ 1,125
Surplus sales	6	47	28	90
Bond charges	203	217	651	671
Interest income	6	8	19	23
Total revenues	117	340	843	1,909
Expenses:				
Power purchases	59	418	739	1,701
Energy settlements	(7)	-	(35)	(234)
Interest expense	86	(77)	253	154
Investment Expense	18	-	5	-
Administrative expenses	5	6	16	18
Recovery of recoverable costs	(44)	(7)	(135)	270
Total expenses	117	340	843	1,909
Net increase in net assets	-	-	-	-
Net assets, beginning of year	-	-	-	-
Net assets, end of year	$ -	$ -	$ -	$ -

REVENUES

Power Charges

The cost of providing energy is recoverable primarily through power charges to IOU customers and certain customers of ESPs. Charges are determined by applying a CPUC adopted rate for each IOU service area to the megawatt hours of power delivered by DWR to each IOU’s customers.

Power charges decreased by $980 million to $145 million in the nine months ended March 31, 2012 compared to $1,125 million for the nine months ended March 31, 2011. The difference reflects a combination of lower volume of power sales to end use customers from the expiration or novation of long term power purchase contracts since March 31, 2011 and per unit remittance rates implemented in January 2012 with the 2012 revenue requirement that were substantially lower than rates that were in effect for 2011, as DWR has purposefully lowered power charge rates to begin returning cash reserves to customers.

Power Charges during the nine months of fiscal 2012 also include the effect of the return of $442 million of excess amounts and previously received remittances as separate monthly payments to ratepayers in Pacific Gas and Electric Company ("PG&E") and Southern California Edison service territories. These payments were the allocation of prior year over-collections from ratepayers and reserves in excess of indenture required levels. The allocation of payments was authorized by the CPUC in D. 10-12-006 for calendar year 2011 and in D. 11-12-005 for calendar year 2012. Amounts were determined as part of the Fund's annual Revenue Requirement Determinations for 2011 and 2012.

Surplus Sales

Surplus sales of energy and natural gas decreased $62 million to $28 million in the nine month period ended March 31, 2012 from $90 million in the nine month period ended March 31, 2011 as the volume and prices of excess natural gas sales were significantly lower during the 2012 period.

Bond Charges

Bond charges provide revenue for the payment of debt service on the revenue bonds and are determined by applying a CPUC adopted rate to the total megawatt hours of power delivered to all IOU customers and certain ESP customers.

Bond charges decreased $20 million to $651 million for the nine months ended March 31, 2012 from $671 million for the nine months ended March 31, 2011 as delivered volumes were lower. The amount collected was adequate to meet all debt service requirements and maintain bond indenture required account balances in the Bond Charge Collection, Bond Charge Payment, and Debt Service Reserve Accounts.

Interest Income

Interest income decreased $4 million to $19 million for the nine months ended March 31, 2012 from $23 million for the nine months ended March 31, 2011. The decrease was as a result of lower interest earned on investments in the State of California Investment Pooled Money Investment Account-Surplus Investment Fund (SMIF) as there were lower cash balances outstanding.

EXPENSES

Power Purchases

Power costs decreased $962 million to $739 million in the nine months ended March 31, 2012 from $1,701 in the nine months ended March 31, 2011. The decrease in costs was primarily due to the expiration of a number of large power purchase contracts since the end of 2011 and lower prices for natural gas in 2012 when compared to 2011.

Energy Settlements

In the nine month period ended March 31, 2012, energy settlements were $35 million. The Fund received $9 million from the CAISO as a result of market re-runs for 2001. The Fund also received $9 million from the CalPX as a result of a FERC ordered and Bankruptcy Court approved distribution of funds related to the energy crisis. The Fund received $6, $3 and $3 million as part of the FERC refund settlement agreements signed by the California Parties (CPUC, the State Attorney General, California Department of Water Resources acting through the Fund, Southern California Edison, San Diego Gas and Electric Company, and Pacific Gas and Electric Company) and the City of Pasadena, the Modesto Irrigation District and Nevada Power, respectively. The Fund also received $3 million from a California litigation escrow account as the final payment from a settlement agreement reached with Sempra in 2010.

Future revenues under a number of settlements with larger suppliers including Mirant Corporation, Reliant Energy and Duke Energy Corporation, are subject to contingencies outlined in the underlying settlement and allocation agreements and will not be recognized until if and when the contingencies are resolved.

Interest Expense

Interest expense in the nine months ended March 31 increased $99 million to $253 million in 2012 from $154 million in 2011. The interest expenses were higher in the current period as a result of the refunding of variable bonds with higher rate fixed rate bonds as part of the 2010 Series M and 2011 Series N refunding transactions.

Investment Expense

The Fund realized investment income (expense) for the change in fair value of outstanding ineffective gas hedges, and any income (expense) related to expiration of ineffective gas hedges. Due to changes in fair value of gas related hedges, the Fund realized investment expense of $5 million for the nine month period ended March 31, 2012.

Administrative Expenses

Administrative expenses decreased $2 million to $16 million for the nine months ended March 31, 2012 from $18 million for the nine months ended March 31, 2011 as a result of a reduction in headcount of employees and consultants as DWR's power supply responsibilities continue to diminish.

Recovery (Deferral) of Recoverable Costs

The individual components of the recovery (deferral) of recoverable costs were as follows for the nine months ended March 31, 2012 and 2011 (in millions):

	Three months ended March 31		Nine months ended March 31	
	2012	2011	2012	2011
Operations	$ (167)	$ (231)	$ (552)	$ (270)
Debt service and related costs	123	302	417	540
	$ (44)	$ 71	$ (135)	$ 270

Operations
There was a deferral of $552 million for the nine months ended March 31, 2012. The deferral reflects lower net remittances as Operating Reserve Account balances are reduced. As power purchase contracts expire and fixed payments for purchased power fall, lower balances were required.

Debt Service and Related Costs
The $417 million recovery of debt service and bond related costs was due to higher interest expense and lower interest earnings on cash balances. The recovery was comprised solely of the difference between bond charges and interest income less interest expense.

LIQUIDITY

With the Series N refunding transaction in August 2011, the Fund refunded all outstanding variable rate bonds and terminated all credit enhancement facilities.

Department of Water Resources Electric Power Fund
Statements of Net Assets
March 31, 2012 and June 30, 2011 (in millions)

	March 31, 2012	June 30, 2011
Assets		
Long-term assets:		
Restricted cash, equivalents and investments:		
Operating Reserve Account	$ 267	$ 288
Debt Service Reserve Account	919	919
Derivative instruments	-	-
Deferral of derivative cash outflows	2	-
Recoverable costs	4,944	4,809
Total long-term assets	6,132	6,016
Current assets:		
Restricted cash and equivalents:		
Operating and Priority Contract Accounts	577	1,133
Bond Charge Collection and Bond Charge Payment Accounts	1,110	618
Recoverable costs, current portion	138	220
Interest receivable	9	6
Derivative instruments, current portion	-	7
Deferral of derivative cash outflows, current portion	21	30
Other assets	52	79
Total current assets	1,907	2,093
Total assets	$ 8,039	$ 8,109
Capitalization and Liabilities		
Capitalization:		
Net assets	$ -	$ -
Long-term debt	7,245	7,275
Non-Current liabilities:		
Derivative instruments	3	3
Deferral of derivative cash inflows	-	-
Total capitalization and non-current liabilities	7,248	7,278
Current liabilities:		
Current portion of long-term debt	574	561
Derivative instruments, current portion	27	33
Deferral of derivative cash inflows, current portion	-	3
Accounts payable	37	178
Accrued interest payable	153	56
Total current liabilities	791	831
Commitments and Contingencies (Note 6)		
Total capitalization and liabilities	$ 8,039	$ 8,109

Department of Water Resources Electric Power Fund
Statements of Revenues, Expenses and Changes in Net Assets
For the three and nine months ended March 31, 2012 and 2011 (in millions)

	Three months ended March 31		Nine months ended March 31	
	2012	2011	2012	2011
Operating revenues:				
Power charges	$ (98)	$ 68	$ 145	$ 1,125
Surplus sales	6	47	28	90
Total operating revenues	(92)	115	173	1,215
Operating expenses:				
Power purchases	59	418	739	1,701
Energy settlements	(7)	-	(35)	(234)
Administrative expenses	5	6	16	18
Recovery (deferral) of recoverable operating costs	(167)	(309)	(552)	(270)
Total operating expenses	(110)	115	168	1,215
Income (Expense) from operations	18	-	5	-
Bond charges	203	217	651	671
Interest income	6	8	19	23
Interest expense	(86)	77	(253)	(154)
Investment income (expense) from gas related derivatives	(18)	-	(5)	-
Recovery of recoverable debt service and related costs	(123)	(302)	(417)	(540)
Net increase in net assets	-	-	-	-
Net assets, beginning of year	-	-	-	-
Net assets, end of year	$ -	$ -	$ -	$ -

Department of Water Resources Electric Power Fund
Statements of Cash Flows
For the nine months ended March 31, 2012 and 2011 (in millions)

	2012	2011
Cash flows from operating activities:		
Receipts:		
Power charges	$ 223	$ 1,279
Surplus sales	40	107
Energy settlements	26	248
Payments for power purchases and other expenses	(868)	(1,804)
Net cash (used in) provided by operating activities	(579)	(170)
Cash flows from non-capital financing activities:		
Receipt of bond charges	652	661
Bond Payments	-	(3)
Interest payments	(171)	(223)
Proceeds from issuance of revenue bonds	1,115	1,946
Defeasance of revenue bonds	(1,118)	(1,997)
Net cash provided by non-capital financing activities	478	384
Cash flows from investing activities:		
Interest received on investments	16	19
Income received from derivative investments	-	8
Net cash provided by investing activities	16	27
Net increase (decrease) in cash and equivalents	(85)	241
Restricted cash and equivalents, beginning of period	2,658	3,077
Restricted cash and equivalents, end of period	$ 2,573	$ 3,318
Restricted cash and equivalents included in:		
Operating Reserve Account	$ 267	$ 288
Debt Service Reserve Account (a component of the total of $919 and $941 at December 31, 2011 and 2010, respectively)	619	619
Operating and Priority Contract Accounts	577	1,364
Bond Charge Collection and Bond Charge Payment Accounts	1,110	1,047
Restricted cash and equivalents, end of year	$ 2,573	$ 3,318
Reconciliation of operating income to net cash (used in) provided by operating activities:		
Income from operations	$ 5	$ -
Adjustments to reconcile operating income to net cash provided by (used in) operating activities:		
(Deferral) recovery of recoverable operating costs	(552)	39
	(547)	39
Changes in net assets and liabilities to reconcile operating income to net cash (used in) provided by operations:		
Recoverable costs	82	(119)
Other assets	27	(3)
Accounts payable	(141)	(87)
Net change in operating assets & liabilities:	(32)	(209)
Net cash (used in) provided by operating activities	$ (579)	$ (170)

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

1. Reporting Entity

In January 2001, the Governor of California issued an emergency proclamation directing the Department of Water Resources (DWR) to enter into contracts and arrangements for the purchase and sale of electric power to assist in mitigating the effect of a statewide energy supply emergency.

The Department of Water Resources Electric Power Fund (a component unit of the State of California) (the Fund), administered by DWR, was established in January 2001 through legislation adding Division 27 to the California Water Code (the Code).

DWR purchases power from wholesale suppliers under contracts entered into prior to January 1, 2003 for resale to ten million customers of Pacific Gas & Electric Company, Southern California Edison Company, and San Diego Gas & Electric Company (collectively referred to as the investor owned utilities or IOUs). The Code prohibits DWR from entering into new power purchase agreements, but allows DWR to enter into gas purchase contracts to provide fuel for power generation.

DWR power is delivered to the customers through the transmission and distribution systems of the IOUs and payments from the customers are collected for DWR by the IOUs pursuant to servicing arrangements approved and/or ordered by the California Public Utilities Commission (the CPUC).

Under the terms of a rate agreement between DWR and the CPUC, the CPUC implements DWR's determination of its revenue requirements by establishing customer rates that meet DWR's revenue needs to assure the payment of debt service, power purchases, administrative expenses and changes in reserves.

2. Summary of Significant Accounting Policies

Basis of Presentation

The Fund is accounted for as an enterprise fund and is financed and operated in a manner similar to that of a private business enterprise. The Fund uses the economic resources measurement focus and the accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred. As allowed by governmental accounting standards, the Fund has elected not to apply statements and related interpretations issued by the Financial Accounting Standards Board after November 30, 1989. The Fund is accounted for with a set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues and expenses.

The financial statements of the Fund are intended to present the financial position, and the changes in financial position and cash flows, where applicable, of only that portion of the business-type activities and major funds of the State of California that is attributable to the transactions of the Fund. They do not purport to, and do not, present fairly the financial position of the State of California as of March 31, 2012 and 2011, and the changes in its financial position and its cash flows, where applicable, for the periods then ended in conformity with accounting principles generally accepted in the United States of America.

Recent Accounting Pronouncements

<u>GASB 54</u>
Governmental Accounting Standards Board Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions* (GASB 54), establishes fund balance classifications based on the extent to which a governmental entity is bound to honor constraints imposed on the use of resources reported in governmental funds. GASB 54 fund balance classifications of are (1) Nonspendable; (2) Restricted; (3) Committed; (4) Assigned; and, (5) Unassigned. Fund balances are designated restricted when funds can only be spent for specific purposes stipulated by constitution, external resource providers or through enabling legislation. The Fund adopted GASB 54 during the

year ended June 30, 2011 with no effect, since all of the Fund's balances continue to be classified as restricted, which is unchanged from prior guidance.

<u>GASB 62</u>
In December 2010, the GASB issued Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. This Statement provides financial reporting guidance which standardizes the presentation of deferred outflows of resources and deferred inflows of resources and their effects on a government's net position. The requirements of Statement No. 62 are effective for the Fund beginning in fiscal 2012. The Fund is currently evaluating the impact this statement will have, if any, on its financial statements.

<u>GASB 63</u>
In June 2011, the GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. Statement No. 63 provides guidance for reporting deferred outflows of resources and deferred inflows of resources within the financial statements of governmental entities. Statement No. 63 renames the statement of net assets as the statement of net position. The statement of net position reports all assets, deferred outflows of resources, liabilities, deferred inflows of resources, and net position. This Statement is effective for periods beginning after December 15, 2011 and the Fund would begin reporting net position beginning in fiscal 2013.

<u>GASB 64</u>
In June, 2011, the GASB issued Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions an amendment of GASB Statement No. 53*. The objective of this Statement is to clarify whether an effective hedging relationship continues after the replacement of a swap counterparty or a swap counterparty's credit support provider. Statement No. 64 designates specific circumstances where hedge accounting may continue after the termination of the hedging derivative instrument. Under this Statement, a hedging derivative instrument is considered terminated unless an effective hedging relationship continues when all of the following criteria are met:

- Collectability of swap payments is considered to be probable.
- The swap counterparty of the interest rate swap or commodity swap, or the swap counterparty's credit support provider, is replaced with an assignment or in-substance assignment.
- The government enters into the assignment or in-substance assignment in response to the swap counterparty, or the swap counterparty's credit support provider, either committing or experiencing an act of default or a termination event as both are described in the swap agreement.

The requirements of Statement No. 64 are effective for the Fund beginning in fiscal 2012. The Fund is currently evaluating the impact this statement will have, if any, on its financial statements.

Restricted Cash, Equivalents and Investments

Under the terms of the Bond Indenture, separate restricted cash and investment accounts were established. The accounts and their purpose follow:

Power Charge Accounts:

- Operating Account: Power charges (see Revenues and Recoverable Costs) and miscellaneous revenue are deposited into the Operating Account. Monthly, funds are transferred to the Priority Contract Account as needed to make payments on priority contracts. Remaining monies are available for payment of all operating costs of the Fund other than priority contracts, debt service, and debt-related costs.
- Priority Contract Account: Priority contracts are those power purchase contracts that require monthly payment prior to any debt service payments. Monies in the Priority Contract Account are used to make scheduled payments on priority contracts. After the monthly transfer from the Operating Account on the fifth of the month, the Priority Contract Account is projected to have monies sufficient to make scheduled payments on priority contracts through the fifth of the following month.
- Operating Reserve Account: The Operating Reserve account must maintain a balance equal to the greater of (i) seven months of projected negative operating cash flows under a stress scenario, as defined, or (ii) twelve percent of projected annual operating expenses of the Fund, as defined.

Bond Charge Accounts:

- Bond Charge Collection Account: Bond charges (see Revenues and Recoverable Costs) are deposited into the Bond Charge Collection Account. Monthly, funds needed for debt service payments are transferred to the Bond Charge Payment Account.
- Bond Charge Payment Account: Monies in the Bond Charge Payment Account are used to pay debt service, swap payments and related fees for the revenue bonds. After receipt of the monthly transfer from the Bond Charge Collection Account, the balance in the Bond Charge Payment Account must at least equal debt service, swap payments and fees estimated to accrue or be payable for the next succeeding three months.
- Debt Service Reserve Account: The Debt Service Reserve account is to be funded at all times with the amount of maximum aggregate annual debt service on all outstanding debt, including net scheduled swap payments.

Restricted cash and equivalents, for purposes of the statements of cash flows, include cash on hand and deposits in the State of California Investment Pooled Money Investment Account-Surplus Money Investment Fund (SMIF).

SMIF has an equity interest in the State of California Pooled Money Investment Account (the PMIA). Generally, the investments in the PMIA are available for withdrawal on demand. The PMIA cash and investments are recorded at amortized cost, which approximates market. The PMIA funds are on deposit with the State's Centralized Treasury System and are managed in compliance with the California Government Code, described in Note 3 below.

Long-term investments are held solely in the Debt Service Reserve Account by the bond co-trustee and consist of guaranteed investment contracts (GICs) and a U.S. government backed agency security in accordance with a forward purchase agreement (the FPA). The GICs are carried at cost and the U.S. government backed agency security is carried at amortized cost.

Other Assets

The Fund enters into futures and option contracts for the purpose of hedging of natural gas fuel costs. Collateral values, net trade equity and reserve investments held in a brokerage account are accounted for as other assets on the balance sheet. The brokerage firm that facilitates certain of the Fund's hedging contracts requires that the Fund maintain a security deposit, which is invested in compliance with the California Government Code. These funds are invested in money market mutual funds and are carried at fair value.

Other assets decreased $27 million to $52 million at March 31, 2012 from $79 million at June 30, 2011. At March 31, 2012, other assets consisted of money market investments valued at $36 million and other collateral balances valued at $16 million.

Revenues and Recoverable Costs

DWR is required to at least annually establish a revenue requirement determination to recover all Fund costs, including debt service. The revenue requirement determination is submitted to the California Public Utilities Commission which then sets customer remittance rates. The Fund's financial statements are prepared in accordance with SFAS No. 71, "*Accounting for the Effects of Certain Types of Regulation*", which requires that the effects of the revenue requirement process be recorded in the financial statements. Accordingly, all expenses and credits, normally reflected in the change in net assets as incurred, are recognized when recovered from IOU customers. Costs that are recoverable through future billings are recorded as long-term assets.

Amounts that have been earned but not collected by DWR are recorded as the current portion of recoverable costs.

Customer charges are separated into two primary components, power charges and bond charges. Power charge revenues recover the cost of power purchases, other expenses and operating reserves and are recognized when energy provided by DWR is delivered to the IOU customers. Certain customers of "direct access" Electric Service Providers (ESPs) are assessed a "cost responsibility surcharge" that is used by DWR for the same purposes as power charge revenues. Bond charge revenues recover debt service, debt service reserves and other bond related costs and are recognized when energy provided by either DWR or the IOU, or an ESP, is delivered to IOU or ESP customers. Costs are recovered over the life of the bonds (2022) as determined by DWR's revenue requirement process.

3. Restricted Cash and Investments

As of March 31, 2012, the Fund had the following investments (in millions):

Investment	Maturity		March 31, 2012
State of California Pooled Money Investment Account - State Money Investment Fund	8.0 months avg.	$	2,567
Cash			6
Total cash and equivalents			2,573
Guaranteed investment contracts	May 1, 2022		200
Forward purchase agreement	November 1, 2012		100
		$	2,873
Reconciliation to Statement of Net Assets:			
Operating Reserve Account		$	267
Debt Service Reserve Account			919
Operating and Priority Contract Accounts			577
Bond Charge Collection and Bond Charge Payment Accounts			1,110
		$	2,873

Custodial Credit Risk: Custodial credit risk is the risk associated with a lack of diversification, such as having substantial unsecured deposits in a few individual financial institutions, thereby exposing the organization to greater risks resulting from adverse economic, political, regulatory, geographic or credit developments. The State of California has a deposit policy for custodial credit risk that requires deposits held by financial institutions to be insured by federal depository insurance or secured by collateral. As of March 31, 2012, $6 million of the Fund's cash balances were uninsured and uncollateralized.

Interest Rate Risk: Interest rate risk is the risk that the value of fixed income securities will decline because of changing interest rates. The prices of fixed income securities with a longer time to maturity, measured by effective duration, tend to be more sensitive to changes in interest rates and, therefore, more volatile than those with shorter durations. The State Treasurers Investment Policy, Pooled Money Investment Account, provides for spreading investments over various maturities to minimize the risk of portfolio depreciation due to a rise in interest rates. The State Treasurers Investment Policy limits investments to the following maximum maturities: U.S. Treasury securities, 5 years; federal agency securities, 5 years; bankers acceptances – domestic and foreign, 180 days; certificates of deposits, 5 years; commercial paper, 180 days; corporate bonds and notes, 5 years; repurchase agreements and reverse repurchase agreements, 1 year.

Credit Risk: The PMIA funds are on deposit with the State's Centralized Treasury System and are managed in compliance with the California Government Code, according to a statement of investment policy which sets forth permitted investment vehicles, liquidity parameters and maximum maturity of investments. These investments consist of U.S. government securities, securities of federally-sponsored agencies, U.S. corporate bonds, interest bearing time deposits in California banks, prime-rated commercial paper, bankers' acceptances, negotiable certificates of deposit, repurchase and reverse repurchase agreements. The PMIA policy limits the use of reverse repurchase agreements to limits of no more than 10% of the PMIA and commercial paper to limits not to exceed 30% of the

PMIA. The PMIA does not invest in leveraged products or inverse floating rate securities. The PMIA is not rated.

Concentration of Credit Risk: The PMIA's concentration of credit risk is limited by spreading the investment mix over different investment types and issuers to minimize the impact any one industry, investment class, or institution can have on the PMIA portfolio.

Interest on deposits in the PMIA varies with the rate of return of the underlying portfolio and approximated 0.4% at March 31, 2012. For the nine months ended March 31, 2012, interest earned on the deposit in the PMIA was $7 million.

Interest on the GICs is paid semi-annually at interest rates ranging from 5.3% to 5.5%. Interest earned on the GICs was $8 million for the nine months ended March 31, 2012.

The FPA allows DWR to continuously reinvest funds in U.S. government or U.S. government agency securities through May 2022 to earn a minimum rate of return of 4.7%, as specified in the Reserve Fund Forward Purchase and Sale Agreement, dated May 1, 2004. The reinvested securities are to mature every six months. Interest earned on the FPA was $4 million for the nine months ended March 31, 2012.

The Fund's investments in the guaranteed investment contracts and forward purchase agreement were rated as follows, by Standard & Poor's (S&P) and Moody's, respectively, at March 31, 2012 (in millions):

	Amount	S&P	Moody's
GIC Providers			
FSA	$ 100	AA-	Aa3
Royal Bank of Canada	100	AA-	Aa1
	$ 200		
FPA Provider			
Merrill Lynch: FNMA Discounted Notes	$ 100	AA+	Aaa

4. Long-Term Debt

The following activity occurred in the long-term debt accounts during the nine months ended March 31, 2012 (in millions):

	Revenue Bonds	Unamor-tized Premium	Deferred Loss on Defeasance	Total Revenue Bonds
Balance, June 30, 2011	$ 7,830	$ 467	$ (461)	$ 7,836
Refunding				
Issuance of Debt	959	156	-	1,115
Defeasance of Debt	(1,106)	-	(12)	(1,118)
Amortization	-	(88)	74	(14)
Balance, March 31, 2012	7,683	535	(399)	7,819
Less current portion	(556)	(113)	95	(574)
	$ 7,127	$ 422	$ (304)	$ 7,245

The tax exempt revenue bonds consist of the following at March 31, 2012 (in millions):

Series	Rates	Fiscal Year of Final maturity	Fiscal Year of First Call Date	Amount Outstanding 2012
A	Fixed (3.8-5.5%)	2012	Non-callable	$ 314
F	Fixed (4.375-5.00%)	2022	2018	348
G	Fixed (4.35-5.00%)	2018	Non-callable	173
H	Fixed (3.75-5.0%)	2022	2018	1,006
K	Fixed (4.0-5.0%)	2018	Non-callable	279
L	Fixed (2.0-5.0%)	2022	2020	2,919
M	Fixed (2.0-5.0%)	2020	Non-callable	1,684
N	Fixed (2.0-5.0%)	2021	Non-callable	960
Total bond debt outstanding at par				$ 7,683
Plus unamortized bond premium				422
Less deferred loss on defeasance				(304)
Less current maturities				(556)
Total long-term bond debt outstanding				$ 7,245

Bond refunding transactions

In August 2011, the Fund issued $960 million of revenue bonds. The proceeds from the August 2011 issuance of Series 2011 N fixed rate debt were used to refund $948 million in variable rate debt, consisting of $25 million in Series 2002 B bonds, and $923 million in Series 2002 C bonds. In addition, $159 million of the fixed rate debt Series 2002 A bonds were advance refunded to lower overall interest payments. The Series 2011 N bonds were issued with coupons ranging from 2.0% to 5.0%. The bonds were sold at a premium of $159 million and the Fund incurred an accounting loss of $12 million in the extinguishment of the old debt. The loss includes cost of issuance of $5 million. Such amounts will be amortized over the life of the Series N bonds since all defeased bonds had maturities that were similar to the maturities of the Series N bonds.

With the Series N refunding transaction, the Fund has no variable rate bonds outstanding. The Fund terminated all of the outstanding credit enhancement facilities relating to those bonds.

Key terms

Principal and interest payments are payable from bond charges. The Fund is subject to certain bond covenants, including establishing funding and expenditure requirements for several restricted cash and investment accounts. The bonds are limited special obligations of the Fund. Neither the principal nor any interest thereon constitutes a debt of the State of California.

The Series F, H, and L are callable at a redemption rate of 100 percent. The Series F and Series H are callable in 2018. The Series L bonds are callable in 2020. The Series A, G, K, M, and N are non-callable.

Maturities

Future payment requirements on the revenue bonds were as follows at March 31, 2012 (in millions):

Fiscal Year	Principal	Interest	Total
2012	$ 556	$ 183	$ 739
2013	574	340	914
2014	611	314	925
2015	618	286	904
2016	669	258	927
2017-21	3,758	791	4,549
2022	897	44	941
	$ 7,683	$ 2,216	$ 9,899

5. Derivative Financial Instruments

GASB 53 requires governments to record derivative instruments on the statement of net assets as either assets or liabilities depending on the underlying fair value of the derivative. The Fund is party to natural gas hedging positions that are considered to be derivatives under the provisions of GASB 53 and included on the statements of net assets as of March 31 and June 30, 2011.

The Fund had entered into interest rate swap agreements with various counterparties to reduce variable interest rate risk. These interest rate swap agreements were considered derivatives under GASB 53 and were included on the statements of net assets until they were terminated in October 2010 as a part of the Series 2010 M refunding transaction.

The fair values, classification and notional amounts outstanding for the Fund's natural gas hedge derivatives accounted for as derivative financial instruments at net assets as of March 31 and June 30, 2011 are summarized in the following tables:

As of March 31, 2012

	Business-type activities	Value	Notional	
Effective hedges				
Assets				
Current	Gas Swaps	$ -	762,500	MMBtu
Long Term	Gas Swaps	$ -	-	MMBtu
		$ -		
Liabilities				
Current	Gas Swaps	$ (8)	1,557,500	MMBtu
Long Term	Gas Swaps	$ (2)	612,500	MMBtu
		$ (10)		
Investment hedges				
Assets				
Current	Gas Swaps	$ -	915,000	MMBtu
Current	Gas Options	$ -	2,650,000	MMBtu
Long Term	Gas Swaps	$ -	-	MMBtu
Long Term	Gas Options	$ -	-	MMBtu
		$ -		
Liabilities				
Current	Gas Swaps	$ (6)	1,287,500	MMBtu
Current	Gas Options	$ -	305,000	MMBtu
Long Term	Gas Swaps	$ -	-	MMBtu
Long Term	Gas Options	$ -	-	MMBtu
		$ (6)		

As of June 30, 2011

		Business-type activities	Value (in mllions)		Notional	
Effective hedges						
Assets						
	Current	Gas Swaps	$	3	7,485,000	MMBtu
	Long Term	Gas Swaps	$	-	-	MMBtu
			$	3		
Liabilities						
	Current	Gas Swaps	$	(30)	16,925,000	MMBtu
	Long Term	Gas Swaps	$	-	-	MMBtu
			$	(30)		
Investment hedges						
Assets						
	Current	Gas Swaps	$	2	10,982,500	MMBtu
	Current	Gas Options	$	2	33,937,500	MMBtu
	Long Term	Gas Swaps	$	-	-	MMBtu
	Long Term	Gas Options	$	-	200,000	MMBtu
			$	4		
Liabilities						
	Current	Gas Swaps	$	(3)	3,250,000	MMBtu
	Current	Gas Options	$	-	(1,220,000)	MMBtu
	Long Term	Gas Swaps	$	-	-	MMBtu
	Long Term	Gas Options	$	(3)	990,000	MMBtu
			$	(6)		

All effective and ineffective hedges in asset and liability positions are included within the tables above and have been recorded in the statements of net assets as derivative instruments. Changes in fair value for effective hedges are recorded in the statement of net assets as deferred cash inflows or outflows.

Changes in fair value for ineffective gas hedges are recorded as investment expense from gas related contracts on the statement of revenues, expenses and changes in net assets. The fair value of investment hedges decreased $4 million to $(6) million at March 31, 2012 from $(2) million at June 30, 2011.

Commodity contracts

The Fund enters into forward gas futures and options contracts to hedge the cost of natural gas. Most of the Fund's forward gas futures are being treated as Normal Purchase Normal Sale (NPNS) contracts and are therefore not required to be recorded prior to settlement. Forward gas futures not qualifying as NPNS are recorded on the statements of net assets at fair value. Additionally, under GASB 53, all natural gas options are classified as derivatives. Prior to the adoption of GASB 53, these option contracts were recorded at fair value, but were previously reported as other assets. All natural gas options are treated as derivatives and are classified as investment derivatives since they do not meet GASB 53 hedging criteria.

For the Fund's gas hedging contracts that are effective hedges, unrealized gains and losses are deferred on the statement of net assets as current assets or liabilities for contracts with less than 12 months remaining until expiration, or as long-term assets or liabilities for contracts with more than 12 months remaining until expiration. The deferred amount recorded on the statements of net assets reflects the deferred inflow or outflow associated with the derivative financial instruments. Such amounts, adjusted for subsequent changes in fair value, will be recognized in the statements of revenues, expenses and changes in net assets.

Changes in fair value of derivatives that are classified as investment derivatives are included as investment income (expense) on the statement of revenues, expenses and changes in net assets.

Fair Value: The reported fair values from the table above were determined based on quoted market prices for similar financial instruments.

Credit Risk: The Fund's open natural gas hedge positions at March 31, 2012 were with four different counterparties, all of which have credit ratings of at least A-/A2. At March 31, 2012, the Fund does not have substantial credit exposure to these counterparties as continued lower natural gas prices and lowered hedged volumes have resulted in no exposure in the case of two counterparties and valuations in the favor of the other two counterparties. The remaining gas hedge positions have been entered into through the Fund's brokerage accounts and the associated clearing accounts have collateral requirements that limit the Fund's counterparty credit risk.

Termination Risk: With regards to gas hedge agreements, the Fund or the counterparty may terminate an agreement if the other party fails to perform under the terms of the contract. In addition, the agreements allow either party to terminate in the event of a significant loss of creditworthiness by the other party. If a termination were to occur, the Fund or the counterparty would owe the other a payment equal to the fair value of the open positions.

6. Commitments and Contingencies

Litigation and Regulatory Proceedings

Certain pending legal and administrative proceedings involving the Fund or affecting the Fund's power supply program are summarized below.

California Refund Proceedings: During 2001 and 2002, the Fund purchased power in bilateral transactions (both short term and long term), sold power to the CAISO, paid for power purchased by the CAISO and purchased power from the CAISO for sale to customers of the IOUs. In July 2001, the Federal Energy Regulatory Commission (FERC) initiated an administrative proceeding to calculate refunds for inflated prices in the CAISO and California Power Exchange (PX) markets during 2000 and 2001. FERC ruled that the Fund would not be entitled in that proceeding to approximately $3,500 million in refunds associated with the Fund's approximately $5,000 million of short term purchases because the Fund made those purchases bilaterally, not in the PX or CAISO markets. The Ninth Circuit Court of Appeals affirmed FERC, but left open the possibility of refunds on the Fund's bilateral purchases in other FERC proceedings. In contrast, FERC ruled that the Fund is entitled to refunds on purchases made by the CAISO where the Fund actually paid the bill.

Of the Fund's $5,000 million in short term bilateral purchases, $2,900 million was imbalance energy which the Fund sold to the CAISO at the Fund's cost in order to meet the CAISO's emergency needs during 2001. The Fund is treated in the FERC refund proceeding as a seller of that energy to CAISO, and in May 2004, FERC issued an order requiring the Fund to pay refunds on the sales to the CAISO. However, because the Fund would likely be the primary recipient of any refunds on energy it sold to the CAISO, the Fund's potential net liability associated with its sales to the CAISO would be substantially reduced. Settlements executed to date with various sellers have reduced that potential liability even further.

Under FERC's orders, therefore, the Fund both owes refunds (on the energy it sold to the CAISO) and is entitled to refunds (on the energy that the CAISO purchased but the Fund paid for); the effect of offsetting the two is likely to be that the Fund would receive refunds.

As to refunds owed, FERC has ruled that to the extent the Fund could demonstrate that payment of refunds would result in the Fund's costs exceeding its revenues remaining after payment of refunds, the Fund could request FERC to reduce the refunds. The Fund made a cost recovery filing that the

Fund believes demonstrates that its costs related to sales to the CAISO exceeded its revenues, a demonstration that, if approved by FERC, would eliminate any refund amount the Fund might otherwise be required to pay. In January 2006, FERC deferred action on the Fund's cost filing on the basis that the Fund, as described above, likely will be a net refund recipient, and net refund recipients, according to FERC, cannot make cost filings. Certain parties to the litigation have sought rehearing of that order.

In addition, in September 2005, the Ninth Circuit Court of Appeals ruled that FERC could not require governmental entities such as the Fund to pay refunds.

Accordingly, although subject to uncertainty, the Fund expects it likely will be a net refund recipient in the FERC proceedings. Pending litigation could increase or decrease the level of the refunds the Fund would be entitled to receive. The Fund does not expect that FERC will order it to pay more in refunds than it receives on a market-wide basis.

Direct Access Proceeding: On February 28, 2008, the CPUC approved a decision concluding that the suspension of direct access cannot be lifted at the present time because the Fund is still supplying power under the Act. However, the decision continued the proceeding to consider possible approaches to expediting the Fund's exit from its role of supplying power under the Act. On November 21, 2008, the CPUC adopted a plan with the goal of the early exit of the Fund from its role as supplier of power to retail electric customers. Under this plan, the Fund's power purchase contracts would be replaced by agreements between the IOUs and the Fund's power supplier counterparties that are not detrimental to ratepayers, through novation and/or negotiation.

During fiscal year 2011, three of the Fund's power purchase contracts were novated. Management does not believe it is likely that there will be additional contract novations because only three power purchase contracts will remain after June 30, 2012.

Senate Bill 695: On October 11, 2009, Senate Bill (SB) 695 was signed into law as an urgency statute. SB 695 allows individual retail nonresidential end-use customers to acquire electric service from other providers in each IOU service area, up to a maximum allowable limit. Except for this express authorization for increased direct access transactions under SB 695, the previously enacted suspension of direct access remains in effect. On March 15, 2010, the CPUC issued Decision 10-03-022 which authorizes increases in the maximum direct access load for each IOU service area, as specified in SB 695. The maximum load of allowable direct access volumes is established for each IOU as the maximum total kWh supplied by all other providers to distribution customers of that IOU during any sequential 12-month period between April 1, 1998 and the effective date of the section of the Public Utilities Code modified by SB 695, October 11, 2009.

Decision 10-03-022 phases in the additional load allowance over a four-year period beginning on April 11, 2010. The annual phase-in of the limits combined with the concurrent expiration of several long-term contracts should result in limited impacts to the Power Charges attributable to the increased limits. Regardless of the level of direct access participation within the IOU service areas, direct access customers will still be assessed Bond Charges and the Fund's revenue requirement will be recovered in the same manner as has been successfully implemented over the duration of the Power Supply Program.

Other contingencies

The Fund is self-insured for most risks, including general liability and workers' compensation. Management believes the Fund's exposure to loss is immaterial and that any costs associated with such potential losses are recoverable from customers as part of the Fund's revenue requirement.

Commitments

DWR has power purchase contracts that have remaining terms of up to four years. Payments under these and gas purchase contracts approximated $740 million and $1,701 million for the nine month periods ended March 31, 2012 and 2011, respectively.

The remaining amounts of fixed obligations under the contracts as of March 31, 2012, were as follows (in millions):

For the Year Ending June 30,	Fixed Obligation (in millions)
2012	50
2013	27
2014	19
2015	10
Thereafter	1
	$ 107

In addition to the fixed costs there are variable costs under several of the contracts. Management projected as of March 31, 2012 that the amount of future fixed and variable obligations associated with long-term power purchase contracts would approximate $160 million. The difference between the fixed costs and the expected total costs of the contracts are primarily due to the variable factors associated with dispatchable contracts and the cost of natural gas.

7. Energy Settlements

The Fund and other parties have entered into settlement agreements with various energy suppliers which resolve potential and alleged causes of action against suppliers for their part in alleged manipulation of natural gas and electricity commodity and transportation markets or overcharges during the 2000 - 2001 California energy crisis, and also have received settlements from other FERC actions.

In the nine month period ended March 31, 2012, energy settlements were $35 million. The Fund received $9 million from the CAISO as a result of market re-runs for 2001. The Fund also received $9 million from the CalPX as a result of a FERC ordered and Bankruptcy Court approved distribution of funds related to the energy crisis. The Fund received $6, $3 and $3 million as part of the FERC refund settlement agreements signed by the California Parties (CPUC, the State Attorney General, California Department of Water Resources acting through the Fund, Southern California Edison, San Diego Gas and Electric Company, and Pacific Gas and Electric Company) and the City of Pasadena, the Modesto Irrigation District and Nevada Power, respectively. The Fund also received $3 million from a California litigation escrow account as the final payment from a settlement agreement reached with Sempra in 2010.

Future revenues under a number of settlements with larger suppliers including Mirant Corporation, Reliant Energy and Duke Energy Corporation, are subject to contingencies outlined in the underlying settlement