Department of Water Resources
Electric Power Fund
Financial Statements

March 31, 2013

Department of Water Resources Electric Power Fund
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 Statements of Net Position, the Statements of Revenues, Expenses and Changes in Net Position, and the Statements 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 Statements of Net Position include all assets, liabilities and deferral of cash outflows and inflows as of the period ending date. The Statements of Revenues, Expenses and Changes in Net Position present all of the current year's revenues, expenses, and changes in net position. The Statements 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.

The Fund 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 the Fund. However, the Fund 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 the Fund. Most of the volume of power under contract expired by June 30, 2012 and the last of the power supply contracts expires in September 2015.

The Fund 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 the Fund, 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, 2012 audited financial statements.

STATEMENTS OF NET POSITION

The Fund's assets, liabilities and net position as of March 31, 2013 and June 30, 2012 are summarized as follows (in millions):

	March 31, 2013	June 30, 2012
Long-term restricted cash, equivalents and investments	$ 937	$ 1,186
Recoverable costs	5,006	5,038
Restricted cash and equivalents:		
Operating and priority contract accounts	242	398
Bond charge collection and bond charge payment accounts	1,095	581
Recoverable costs, current portion	97	132
Interest receivable	8	4
Other assets	15	45
Total assets	$ 7,400	$ 7,384
Deferral of derivative cash outflows	$ 2	$ 2
Long-term debt, including current portion	7,246	7,259
Derivative instruments	2	7
Other current liabilities	154	120
Total capital and liabilities	$ 7,402	$ 7,386
Deferral of derivative cash inflows	$ -	$ -
Net Position	$ -	$ -

ASSETS

Long-Term Restricted Cash and Investments

The balance in the Operating Reserve Account decreased $249 million to $18 million at March 31, 2013 from $267 million at June 30, 2012. 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 2013 as forecast in the Fund's 2013 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 decreased $32 million to $5,006 million at March 31, 2013 from $5,038 million at June 30, 2012. This $32 million decrease in long-term recoverable costs was the net of 1) operating expenses exceeding operating revenues by $418 million, as a result of reductions in remittances due to lower required Operating Reserve Account balances; 2) bond charge revenues exceeding interest expense by $445 million; and 3) a $5 million change in the unrealized gain on open and ineffective natural gas futures contracts at period end.

Restricted Cash, Equivalents and Investments

The Operating and Priority Contract Accounts decreased by $156 million to $242 million at March 31, 2013 from $398 million at June 30, 2012. The Fund 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 $514 million to $1,095 million at March 31, 2013 from $581 million at June 30, 2012 in anticipation of the annual principal and semi-annual interest payment on fixed rate bonds due on May 1, 2013.

From the dates of issuance of the revenue bonds through March 31, 2013, 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 $35 million to $97 million at March 31, 2013 from $132 million at June 30, 2012. This decrease resulted from lower volumes of contracted power purchased and sold to end use customers, and decreased surplus energy sales as all but three purchase power contracts expired at the end of calendar 2012.

Interest Receivable

Interest receivable consists of accrued interest on cash and equivalents and debt service reserve investments. Interest receivable increased $4 million to $8 million at March 31, 2013 from $4 million at June 30, 2012 due to accrued interest on debt service reserve investments which will be paid to the Fund on May 1, 2013.

Other Assets

The Fund purchases natural gas as fuel for the production of power under the terms of certain power supply contracts and maintains a brokerage account with a national brokerage firm in order to hedge natural gas costs. The Fund invests funds to be used to meet realized losses as they occur, to provide collateral for current positions and to enable future hedging activities that require margin or immediate payment. Assets in this account are classified as other assets on the Statements of Net Position. Other assets, consisting of money market obligations, US Treasury bills, and government bonds, decreased by $30 million to $15 million at March 31, 2013 from $45 million at June 30, 2012 as the Fund reduced these positions by moving funds to the State of California Pooled Money Investment Account/Surplus Money Investment Fund (PMIA/SMIF).

Derivative Instruments-Assets

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 Position for periods ended March 31, 2013 and June 30, 2012.

There were no derivative financial instrument assets at March 31, 2013 and June 30, 2012, respectively. All remaining natural gas futures contracts have negative net value.

DEFERRAL OF CASH OUTFLOWS

Deferred outflows were unchanged at $2 million at March 31, 2013 and at June 30, 2012.

LIABILITIES

Long-Term Debt

Long-term debt decreased $13 million to $7,246 million at March 31, 2013 from $7,259 million at June 30, 2012.

Net amortization of bond premium and deferred loss on defeasance and the early redemption was $13 million in the nine month period ended March 31, 2013.

Other Current Liabilities

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. At March 31, 2013 accounts payable are $51 million lower than at June 30, 2012 due to lower purchased power costs as a result of fewer and smaller capacity purchase power contracts remaining.

Accrued interest payable at March 31, 2013 increased to $142 million, an increase of $85 from June 30, 2012 due to the approaching bond interest payment date of May 1, 2013.

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 position for periods ended March 31, 2013 and June 30, 2012.

Derivative financial instrument liabilities decreased $5 million to $2 million at March 31, 2013 from $7 million at June 30, 2012. Total notional amounts of outstanding natural gas hedge contracts also declined during the period as existing contracts expire and the Fund has not entered into new contracts.

DEFERRAL OF CASH INFLOWS

There are no deferred inflows at March 31, 2013 and June 30, 2012, as there are few remaining derivative financial instruments outstanding.

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

The Fund's activities for the three and nine months ended March 31, 2013 and 2012 are summarized as follows (in millions):

	Three months ended March 31		Nine months ended March 31	
	2013	**2012**	**2013**	**2012**
Revenues:				
Power charges	$ (20)	$ (98)	$ (392)	$ 145
Surplus sales	1	6	2	28
Bond charges	206	203	671	651
Interest income	5	6	16	19
Total revenues	192	117	297	843
Expenses:				
Power purchases	13	59	36	739
Energy settlements	(1)	(7)	(21)	(35)
Interest expense	81	86	242	253
Investment Expense	-	18	-	5
Administrative expenses	4	5	13	16
Recovery of recoverable costs	95	(44)	27	(135)
Total expenses	192	117	297	843
Net increase in net position	-	-	-	-
Net position, beginning of year	-	-	-	-
Net position, 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 the Fund to each IOU's customers.

Power charges decreased by $537 million to $(392) million in the nine months ended March 31, 2013 compared to $145 million for the nine months ended March 31, 2012. The difference reflects a lower volume of power sales to end use customers from the expiration of long term power supply contracts since March 31, 2012, lowered power charge rates in order to return excess cash reserves to customers and the return of $420 million of excess amounts and previously received remittances to ratepayers in Pacific Gas and Electric Company (PG&E) and Southern California Edison (SCE) service territories. These payments to PG&E and SCE 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. 11-12-005 for calendar year 2012 and in D. 12-11-040 for calendar year 2013. The amounts were determined as part of the Fund's annual Revenue Requirement Determinations for 2012 and 2013.

Surplus Sales

Surplus sales of energy and natural gas decreased $27 million to $1 million in the nine month period ended March 31, 2013 from $28 million in the nine month period ended March 31, 2012 as the volume and prices of surplus natural gas sales were lower in fiscal 2013.

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 increased $20 million to $671 million for the nine months ended March 31, 2013 from $651 million for the nine months ended March 31, 2012 as delivered volumes were higher and include an expected $8 million refund of previously paid arbitrage earnings rebate on the Fund's 2002 Series B, C and D bonds to the Internal Revenue Service. Bond charges were 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 $3 million to $16 million for the nine months ended March 31, 2013 from $19 million for the nine months ended March 31, 2012. The decrease was as a result of lower interest earned on investments in the SMIF as there were lower cash balances outstanding and the interest rate earned was lower.

EXPENSES

Power Purchases

Power costs decreased $703 million to $36 million in the nine months ended March 31, 2013 from $739 in the nine months ended March 31, 2012. The decrease in costs was primarily due to the expiration of all but three power supply contracts since the end of 2012 and lower prices for natural gas in 2013 when compared to 2012.

Energy Settlements

In the nine month period ended March 31, 2013, revenues from energy settlements were $21 million. The Fund received $20 million as a result of a Federal Energy Regulatory Commission (FERC) approved settlement agreement resolving energy crisis related litigation between the State of California, represented by the CPUC, and NRG Energy. The Fund also received a total of $1 million from the California Independent System Operator (CAISO) and Cal Polar as the final distribution for market re-runs for 2001 and a FERC approved settlement, respectively.

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 California Power Exchange (CalPX) as a result of a FERC ordered and Bankruptcy Court approved distribution of funds related to the energy crisis. The Fund received $14 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, SCE, San Diego Gas and Electric Company, and PG&E) and the Cities of Santa Clara, Seattle, Pasadena, Glendale and Burbank, the Modesto Irrigation District, the Turlock Irrigation District, PPL Montana, AEP and Nevada Power. 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 decreased $11 million to $242 million in 2013 from $253 million in 2012. The interest expenses were lower in the current period as a result of the maturing of a portion of the Series 2002A and Series 2010L bonds on May 1, 2012.

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. There was no investment expense recorded for the nine month period ended March 31, 2013.

Administrative Expenses

Administrative expenses decreased $3 million to $13 million for the nine months ended March 31, 2013 from $16 million for the nine months ended March 31, 2012 as a result of lower administrative costs due to the expiration of all but three power supply contracts.

Recovery (Deferral) of Recoverable Costs

The individual components of the recovery (deferral) of recoverable costs were as follows for the three and nine months ended March 31, 2013 and 2012 (in millions):

	Three months ended March 31		Nine months ended March 31	
	2013	2012	2013	2012
Operations	$ (35)	$ (167)	$ (418)	$ (552)
Debt service and related costs	130	123	445	417
	$ 95	$ (44)	$ 27	$ (135)

<u>Operations</u>
There was a deferral of $418 million for the nine months ended March 31, 2013. The deferral reflects lower net remittances as Operating Reserve Account balances were reduced. As power supply contracts expire and fixed payments for purchased power fall, lower balances were required.

<u>Debt Service and Related Costs</u>
The $445 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 Revenues, Expenses and Changes in Net Position
For the three and nine months ended March 31, 2013 and 2012 (in millions)

	March 31, 2013	June 30, 2012
Assets		
Long-term assets:		
Restricted cash, equivalents and investments:		
Operating Reserve Account	$ 18	$ 267
Debt Service Reserve Account	919	919
Recoverable costs	5,006	5,038
Total long-term assets	5,943	6,224
Current assets:		
Restricted cash and equivalents:		
Operating and Priority Contract Accounts	242	398
Bond Charge Collection and Bond Charge Payment Accounts	1,095	581
Recoverable costs, current portion	97	132
Interest receivable	8	4
Other assets	15	45
Total current assets	1,457	1,160
Total assets	$ 7,400	$ 7,384
Deferral of cash outflows		
Deferral of derivative cash outflows, long term	-	1
Deferral of derivative cash outflows, current portion	2	1
Total deferral of cash outflows	2	2
Total assets and deferral of outflows	$ 7,402	$ 7,386
Capitalization and Liabilities		
Capitalization:		
Net position	$ -	$ -
Long-term debt	6,652	6,667
Non-Current liabilities:		
Derivative instruments	-	1
Total capitalization and non-current liabilities	6,652	6,668
Current liabilities:		
Current portion of long-term debt	594	592
Derivative instruments, current portion	2	6
Accounts payable	12	63
Accrued interest payable	142	57
Total current liabilities	750	718
Total capitalization and liabilities	7,402	7,386
Deferral of cash inflows		
Total deferral of cash inflows	-	-
Commitments and Contingencies (Note 6)		
Total capitalization, liabilities and deferral of cash inflows	7,402	7,386

Department of Water Resources Electric Power Fund
Statements of Revenues, Expenses and Changes in Net Position
For the three and nine months ended March 31, 2013 and 2012 (in millions)

	Three months ended March 31		Nine months ended March 31	
	2013	2012	2013	2012
Operating revenues:				
Power charges	$ (20)	$ (98)	$ (392)	$ 145
Surplus sales	1	6	2	28
Total operating revenues	(19)	(92)	(390)	173
Operating expenses:				
Power purchases	$ 13	$ 59	$ 36	$ 739
Energy settlements	(1)	(7)	(21)	(35)
Administrative expenses	4	5	13	16
Recovery (deferral) of recoverable operating costs	(35)	(167)	(418)	(552)
Total operating expenses	(19)	(110)	(390)	168
Income from operations	-	18	-	5
Bond charges	$ 206	$ 203	$ 671	$ 651
Interest income	5	6	16	19
Interest expense	(81)	(86)	(242)	(253)
Investment income (expense) from gas related derivatives	-	(18)	-	(5)
Recovery of recoverable debt service and related costs	(130)	(123)	(445)	(417)
Net increase in net position	-	-	-	-
Net position, beginning of year	-	-	-	-
Net position, end of year	$ -	$ -	$ -	$ -

Department of Water Resources Electric Power Fund
Statements of Cash Flows
For the nine months ended March 31, 2013 and 2012 (in millions)

	2013	2012
Cash flows from operating activities:		
Receipts:		
Power charges	$ (361)	$ 223
Surplus sales	4	40
Energy settlements	21	26
Payments for power purchases and other expenses	(70)	(868)
Net cash (used in) provided by operating activities	(406)	(579)
Cash flows from non-capital financing activities:		
Receipt of bond charges	676	652
Bond Payments	-	-
Interest payments	(170)	(171)
Proceeds from issuance of revenue bonds	-	1,115
Defeasance of revenue bonds	-	(1,118)
Net cash provided by non-capital financing activities	506	478
Cash flows from investing activities:		
Interest received on investments	13	16
Income received from derivative investments	(4)	-
Net cash provided by investing activities	9	16
Net increase (decrease) in cash and equivalents	109	(85)
Restricted cash and equivalents, beginning of period	1,865	2,658
Restricted cash and equivalents, end of period	$ 1,974	$ 2,573
Restricted cash and equivalents included in:		
Operating Reserve Account	$ 18	$ 267
Debt Service Reserve Account (a component of the total of $919 and $919 at December 31, 2012 and 2012, respectively)	619	619
Operating and Priority Contract Accounts	242	577
Bond Charge Collection and Bond Charge Payment Accounts	1,095	1,110
Restricted cash and equivalents, end of year	$ 1,974	$ 2,573
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	(418)	(552)
	(418)	(547)
Changes in net assets and liabilities to reconcile operating income to net cash (used in) provided by operations:		
Recoverable costs	29	82
Other assets	34	27
Accounts payable	(51)	(141)
Net change in operating assets & liabilities:	12	(32)
Net cash (used in) provided by operating activities	$ (406)	$ (579)

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).

The Fund 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 the Fund from entering into new power supply agreements, but allows the Fund to enter into natural gas purchase contracts to provide fuel for power generation.

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

Under the terms of a rate agreement between DWR and the CPUC, the CPUC implements the Fund's determination of its revenue requirements by establishing customer rates that meet the Fund'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, net position, 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, 2013 and 2012, 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.

Revenues and Recoverable Costs

The Fund 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 Topic 980 of the Financial Accounting Standards Board Codification "*Regulated Operations*", 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 position 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 the Fund 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 the Fund 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 the Fund 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 the Fund, the IOU or an ESP is delivered to IOU or ESP customers. Costs are recovered over the life of the bonds (final maturity 2022) as determined by the Fund’s revenue requirement process.

Surplus sales represent the Fund’s sale of natural gas not needed for the generation of power and surplus energy dispatched by the California Independent System Operator (CAISO) from the Fund’s power supply agreements for grid reliability.

3. Restricted Cash and Investments

As of March 31, 2013, the Fund had the following investments (in millions):

Investment	Maturity		March 31, 2013
State of California Pooled Money Investment Account - Surplus Money Investment Fund	7.0 months avg.	$	1,972
Cash			2
Total cash and equivalents			1,974
Guaranteed investment contracts	May 1, 2022		200
Forward purchase agreement	May 1, 2013		100
		$	2,274
Reconciliation to Statements of Net Position:			
Operating Reserve Account		$	18
Debt Service Reserve Account			919
Operating and Priority Contract Accounts			242
Bond Charge Collection and Bond Charge Payment Accounts			1,095
		$	2,274

The Fund's investments with the State of California are maintained in the Surplus Money Investment Fund (SMIF), which is invested through the Pooled Money Investment Account (PMIA). Investments in the SMIF earn interest at the same daily rate as investments in the PMIA.

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, 2013, none 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 Treasurer's Investment Policy (the Investment Policy) for the PMIA provides for spreading investments over various maturities to minimize the risk of portfolio depreciation due to a rise in interest rates. The 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: PMIA funds are on deposit with the State's Centralized Treasury System and are managed in compliance with the California Government Code, according to the 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 Investment 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 0.3% at March 31, 2013. For the nine months ended March 31, 2013, interest earned on the deposit in the PMIA was $4 million.

Interest on the guaranteed investment contracts (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, 2013.

The FPA allows the Fund 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, 2013.

The Fund's investments in the GICs and FPA were rated as follows, by Standard & Poor's (S&P) and Moody's, respectively, at March 31, 2013 (in millions):

	Amount	S&P	Moody's
GIC Providers			
FSA	$ 100	AA-	A2
Royal Bank of Canada	100	AA-	Aa3
	$ 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, 2013 (in millions):

	Revenue Bonds	Unamortized Premium	Deferred Loss on Defeasance	Deferred Cost of Issuance	Total
Balance, June 30, 2012	$ 7,128	$ 506	$ (135)	$ (240)	$ 7,259
Amortization	-	(84)	24	47	$ (13)
Balance, March 31, 2013	7,128	422	(111)	(193)	$ 7,246
Less current portion	574	96	(25)	(51)	$ 594
	$ 6,554	$ 326	$ (86)	$ (142)	$ 6,652

The tax exempt revenue bonds consist of the following at March 31, 2013 (in millions):

Series	Rates	Fiscal Year of Final maturity	Fiscal Year of First Call Date	2013	Current Portion
F	Fixed (4.38-5.00%)	2022	2018	$ 348	$ -
G	Fixed (4.35-5.00%)	2018	Non-callable	173	-
H	Fixed (3.75-5.0%)	2022	2018	1,007	-
K	Fixed (4.0-5.0%)	2018	Non-callable	279	-
L	Fixed (2.5-5.0%)	2022	2020	2,708	-
M	Fixed (2.0-5.0%)	2020	Non-callable	1,653	419
N	Fixed (2.0-5.0%)	2021	Non-callable	960	155
				$ 7,128	$ 574
Plus unamortized bond premium				422	96
Less deferred loss on defeasance				(111)	(25)
Less costs of issuance				(193)	(51)
				$ 7,246	$ 594

Bond refunding transactions

The Fund has issued revenue refunding bonds to advance refund various bonds that were previously issued. The net proceeds from these sales were used to purchase U.S. Treasury Securities that were deposited in irrevocable escrow trust accounts with the State Treasurer acting as an independent fiscal agent to provide for all future debt service on the bonds being refunded. As a result, those bonds are considered defeased and the related liabilities have been excluded from the Fund's basic financial statements. At March 31, 2013, there was no outstanding debt related to these defeased bonds.

On August 31, 2011, the Fund issued $960 million of revenue bonds at a true interest cost of 2.42% to refund $948 million of variable rate debt, consisting of $25 million of Series 2002 B bonds, and $923 million of Series 2002 C bonds. In addition, $159 million of the fixed rate debt Series 2002 A bonds were advance refunded to take advantage of lower interest rates. The Series 2011 N bonds were issued at a premium of $158 million with coupons ranging from 2.0% to 5.0%. The transaction resulted in a net cash flow savings of $7.8 million and an economic gain (difference between the present values of the debt service payments on the old debt and the new debt) of $4.9 million. The difference between the book value of the old debt and the amount required to retire the debt is deferred and amortized over the original remaining life of the old debt or the life of the new debt, whichever is less. The Fund incurred an accounting loss of $12 million, which included cost of issuance of $5 million. Bonds payable are reported net of these deferred costs. Such amounts will be amortized over the life of the Series 2011 N bonds since all defeased bonds had maturities that were similar to the maturities of the Series 2011 N bonds.

With the Series 2011 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 G, K, M, and N are non-callable.

Maturities

Future payment requirements on the revenue bonds were as follows at March 31, 2013 (in millions):

Fiscal Year	Principal	Interest	Total
2013	$ 574	$ 170	$ 744
2014	611	314	925
2015	618	286	904
2016	669	258	927
2017	686	227	913
2018-22	3,970	607	4,577
	$ 7,128	$ 1,862	$ 8,990

5. Derivative Financial Instruments

GASB 53 requires governments to record derivative instruments on the Statements of Net Position 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 Position as of March 31, 2013 and June 30, 2012.

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 Position 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 as of March 31, 2013 and June 30, 2012 are summarized in the following tables:

As of March 31, 2013

		Business-type activities	Value		Notional	
Effective hedges						
Assets						
	Current	Gas Swaps	$	-	-	MMBtu
	Long Term	Gas Swaps		-	-	MMBtu
			$	-		
Liabilities						
	Current	Gas Swaps	$	(2)	612,500	MMBtu
	Long Term	Gas Swaps		-	-	MMBtu
			$	(2)		
Investment hedges						
Assets						
	Current	Gas Swaps	$	-	-	MMBtu
	Current	Gas Options		-	-	MMBtu
	Long Term	Gas Swaps		-	-	MMBtu
	Long Term	Gas Options		-	-	MMBtu
			$	-		
Liabilities						
	Current	Gas Swaps	$	-	-	MMBtu
	Current	Gas Options		-	-	MMBtu
	Long Term	Gas Swaps		-	-	MMBtu
			$	-		

As of June 30, 2012

		Business-type activities	Value (in mllions)		Notional	
Effective hedges						
Assets						
	Current	Gas Swaps	$	-	-	MMBtu
	Long Term	Gas Swaps		-	-	MMBtu
			$	-		
Liabilities						
	Current	Gas Swaps	$	(1)	305,000	MMBtu
	Long Term	Gas Swaps		(1)	382,500	MMBtu
			$	(2)		
Investment hedges						
Assets						
	Current	Gas Swaps	$	-	-	MMBtu
	Current	Gas Options		-	200,000	MMBtu
	Long Term	Gas Swaps		-	-	MMBtu
	Long Term	Gas Options		-	-	MMBtu
			$	-		
Liabilities						
	Current	Gas Swaps	$	(5)	990,000	MMBtu
	Current	Gas Options		-	-	MMBtu
	Long Term	Gas Swaps		-	-	MMBtu
			$	(5)		

Note: The Fund holds certain natural gas options in assets that have little value but still offer some price protection.

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 Position as derivative instruments. Changes in fair value for effective hedges are recorded in the Statements of Net Position 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 Statements of Revenues, Expenses and Changes in Net Position. The fair value of investment hedges increased $5 million at March 31, 2013 from June 30, 2012 as losses were realized as the ineffective hedges expired.

Commodity contracts

The Fund had entered into natural gas hedge contracts, futures and options, to hedge the cost of natural gas. At March 31, 2013, the Fund no longer has any outstanding natural gas option contracts. In prior years, all natural gas options were treated as derivatives and were classified as investment derivatives since they do not meet GASB 53 hedging criteria.

For the Fund’s natural gas futures contracts that are effective hedges, unrealized gains and losses are deferred on the Statements of Net Position as deferral of cash outflows or cash inflows. The deferred amount recorded on the Statements of Net Position reflects the deferred inflow or outflow associated with the derivative financial instruments.

In fiscal 2013, the Fund no longer has any forward natural gas purchase contracts. In prior years, most of the Fund's forward natural gas purchases were treated as Normal Purchase Normal Sale

(NPNS) contracts and were therefore not required to be recorded prior to settlement. Natural gas futures not qualifying as NPNS are recorded on the Statements of Net Position at fair value.

Changes in fair value of derivatives that are classified as investment derivatives are included as investment income (expense) on the Statements of Revenues, Expenses and Changes in Net Position.

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, 2013 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 natural gas futures 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 (CalPX) 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 CalPX 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 supply 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 supply contracts were novated. Management does not believe it is likely that there will be additional contract novations because only three power supply 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

The Fund has power supply contracts that have remaining terms of up to three years. Payments under these and gas purchase contracts approximated $36 million and $739 million for the nine month periods ended March 31, 2013 and 2012, respectively.

In addition to the remaining purchased power contracts, the remaining fixed obligations include a natural gas transmission capacity contract that expires in fiscal 2018. There are no associated natural gas purchase requirements with this contract.

The remaining amounts of fixed obligations under the contracts as of March 31, 2013, were as follows (in millions):

For the Year Ending June 30,	Fixed Obligation (in millions)
2013	$ 4
2014	35
2015	27
2016	17
2017	15
2018	12
	$ 110

In addition to the fixed costs there are variable costs under several of the contracts. Management projected as of March 31, 2013 that the amount of future fixed and variable obligations associated with long-term power supply contracts would approximate $119 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 during the 2000 - 2001 California energy crisis, and also received settlements from other FERC actions.

In the six month period ended March 31, 2013, revenues from energy settlements were $21 million. The Fund received $20 million as a result of a FERC approved settlement agreement resolving energy crisis related litigation between the State of California, represented by the CPUC, and NRG Energy. The Fund also received a total of $1 million from the CAISO and Cal Polar as the final distribution for market re-runs for 2001 and a FERC approved settlement, respectively.

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 $14 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 Cities of Santa Clara, Seattle, Pasadena, Glendale and Burbank, the Modesto Irrigation District, the Turlock Irrigation District, PPL

Montana, AEP and Nevada Power. 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 associated with pending settlements with Mirant Corporation, Reliant Energy, and Duke Energy Corporation are subject to contingencies outlined in the underlying settlements and allocation agreements and will be recognized when and if the contingencies are resolved.