Department of Water Resources
Electric Power Fund
Financial Statements

For the years ended June 30, 2011 and 2010

Department of Water Resources Electric Power Fund
Index

Report of Independent Auditors

The Director of the State of California
Department of Water Resources

In our opinion, the accompanying statements of net assets and the related statements of revenues, expenses and changes in net assets and of cash flows present fairly, in all material respects, the financial position of the Department of Water Resources Electric Power Fund (the Fund), a component unit of the State of California, at June 30, 2011 and 2010, and its changes in financial position and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 2, the financial statements present only the Fund and do not purport to, and do not, present fairly the financial position of the State of California at June 30, 2011 and 2010, or the changes in its financial position for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The accompanying Management's Discussion and Analysis on pages 2 through 12 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

PricewaterhouseCoopers LLP

November 8, 2011

PricewaterhouseCoopers LLP, 400 Capitol Mall, Suite 600, Sacramento, CA 95814
T: (916) 930 8100, F: (916) 930 8450, www.pwc.com/us

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 with 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 in 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 expires by December 31, 2011 and the last of the contracts expires in 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.

STATEMENTS OF NET ASSETS

The Fund’s assets, liabilities and net assets as of June 30 are summarized as follows (in millions):

	2011	2010	2009 (As Restated)
Long-term restricted cash, equivalents and investments	$ 1,207	$ 1,490	$ 1,493
Recoverable costs	4,809	4,881	5,653
Derivative instruments	7	25	90
Deferral of derivative cash outflows	30	195	434
Restricted cash and equivalents:			
Operating and priority contract accounts	1,133	1,257	964
Bond charge collection and bond charge payment accounts	618	630	629
Recoverable costs, current portion	220	339	468
Interest receivable	6	7	13
Other assets	79	92	47
Total assets	$ 8,109	$ 8,916	$ 9,791
Net assets	$ -	$ -	$ -
Long-term debt, including current portion	7,836	8,417	9,001
Derivative instruments	36	203	446
Deferral of derivative cash inflows	3	8	15
Other current liabilities	234	288	329
Total capital and liabilities	$ 8,109	$ 8,916	$ 9,791

In the year ended, June 30, 2010 the Fund adopted Government Accounting Standards Board Standard No. 53 (GASB 53) which changed their accounting for commodity and hedge transactions which are determined to be derivatives. In accordance with the transition provisions of GASB 53, the change in accounting was applied retrospectively for the year ended June 30, 2009. As such, financial information for fiscal 2011, 2010 and 2009 is presented in a consistent manner in both the accompanying financial statements and this management discussion and analysis (MD&A).

Long-Term Restricted Cash, Equivalents and Investments

The $283 million decrease in long-term restricted cash, equivalents and investments during fiscal 2011 is a combination of a $261 million decrease in the Operating Reserve Account and a $22 million decrease in the Debt Service Reserve Account.

The Operating Reserve Account decreased by $261 million to $288 million during fiscal 2011. The amount is 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 2011 as forecast in the Fund's 2011 revenue requirement determination. The decrease is caused by lower prospective power costs because of expiring contracts. The Debt Service Reserve Account decreased to $919 million due to decreased debt service cost assumptions resulting from a bond refunding transaction in October 2010, described below in the Long Term Debt section.

The $3 million decrease in long-term restricted cash, equivalents and investments during fiscal 2010 is a combination of a $6 million increase in the Operating Reserve Account and a $9 million decrease in the Debt Service Reserve Account.

The Operating Reserve Account increased by $6 million to $549 million during fiscal 2010. The amount is 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 2010 as forecast in the Fund's 2010 revenue requirement determination. The Debt Service Reserve Account decreased to $941 million due to decreased debt service cost assumptions resulting from a bond refunding transaction in May 2010, described below in the Long Term Debt section.

Recoverable Costs, Net of Current Portion

Long-term recoverable costs consist of costs that are recoverable through future billings. The $72 million decrease during fiscal 2011 is due to 1) operating expenses exceeding operating revenues by $485 million, as a result of the reductions in remittances due to lower required Operating Reserve Account balances offset by, 2) bond charges plus interest income exceeding interest and investment expense by $557 million. The surplus of bond charge collections over interest costs is primarily a result of the Fund's rate design which includes funding for annual debt service, including principal payments.

The $772 million decrease in long term recoverable costs during fiscal 2010 is due to 1) operating revenues exceeding operating expenses by $227 million, as a result of the collection of higher remittances than necessary to pay power costs due to the lower than projected prices for natural gas, combined with 2) bond charges plus interest income exceeding interest and investment expense by $544 million. The surplus of bond charge collections over interest costs is primarily a result of the Fund's rate design which includes funding for annual debt service, including principal payments.

Restricted Cash, Equivalents and Investments

The Operating and Priority Contract Accounts decreased by $124 million in 2011 due to lower account levels that resulted from reductions in expected expenses as power purchase contracts expire offset by $236 million in cash received from energy settlements. The $1,133 million balance in the Operating and Priority Contract Accounts at June 30, 2011 is $359 million higher than forecast in the Fund’s calendar year 2011 revenue requirement determination.

The Operating and Priority Contract Accounts increased by $293 million in 2010 due to lower than expected costs in the first six months of the fiscal year along with $48 million in cash received from energy settlements. The $1,257 million balance in the Operating and Priority Contract Accounts at June 30, 2010 is $195 million higher than forecast in the Fund’s calendar 2010 revenue requirement determination.

The Bond Charge Collection and Bond Charge Payment Accounts decreased by $12 million in 2011 due to increased interest expense from a higher proportion of fixed rate debt in 2011 that resulted from refunding of variable rate debt with fixed rate debt.

The Bond Charge Collection and Bond Charge Payment Accounts increased by $1 million in 2010 as debt service costs related to scheduled interest payments were similar with the lower than expected variable rates from declining interest rate markets offset higher fixed rate debt service costs during the fiscal year.

Recoverable Costs, Current Portion

The current portion of recoverable costs reflects power and bond charges to IOU customers that have not yet been collected and amounts due from surplus sales of energy and gas and litigation settlements. The $220 million current portion of recoverable costs at June 30, 2011 is $119 million lower than at June 30, 2010. The decrease is primarily due to lower expected remittances from the decline in delivered volumes after the expiration of several purchase power contracts during the year offset by higher surplus gas sales.

The $339 million current portion of recoverable costs at June 30, 2010 is $129 million lower than at June 30, 2009. The decrease is primarily due to lower expected remittances from the decline in delivered volumes after the expiration of a large fixed volume long term contract at the end of 2009 along with lower volumes and prices received for surplus gas sales.

Other Assets

The Fund 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. Until 2009 the Fund classified certain collateral assets in the brokerage account and certain bilateral hedge instruments as other assets on the statements of net assets.

As a result of implementing GASB 53, the Fund no longer classifies hedging instruments as other assets. The hedging instruments are now classified as derivative instruments and recorded as either an asset or liability according to the provisions of GASB 53.

At June 30, 2011, other assets were valued at $79 million, and consisted of money market investments, US Treasury bills and government bonds valued at $41 million and other derivative collateral balances including margin deposits valued at $38 million.

At June 30, 2010, other assets were valued at $92 million, and consisted of money market investments, US Treasury bills and government bonds valued at $16 million and other derivative collateral balances including margin deposits valued at $76 million. The amount decreased from a year earlier as hedge losses throughout the year lowered collateral values and money market instruments.

Derivative Instruments - Assets

Derivative assets decreased to $7 million at June 30, 2011 from $25 million at June 30, 2010 due primarily to the reduction in the total size of the natural gas hedging portfolio as purchase power contracts expired and as the Fund significantly reduced its hedge activities.

Derivative assets decreased to $25 million at June 30, 2010 from $90 million at June 30, 2009 primarily due to the Fund terminating $1,006 million notional amount of five-year constant maturity basis swaps in October 2009 combined with the decline in natural gas prices lowering the values of natural gas hedging instruments.

Deferral of derivative cash outflows decreased to $30 million at June 30, 2011 from $195 million at June 30, 2010 primarily due to the reduction in the total size of the natural gas hedging portfolio.

Deferral of derivative cash outflows decreased to $195 million at June 30, 2010 from $434 million at June 30, 2009, primarily because the Fund terminated $2,679 million notional value of interest rate swaps as part of a Series L refunding transaction in May 2010, highlighted in the Long-term debt section, as well as the lower price for natural gas decreasing the value of the deferred expenses related to natural gas hedges.

Long-Term Debt

Long-term debt decreased to $7,836 million as of June 30, 2011 from $8,417 million as of June 30, 2010. Revenue bond principal payments were $460 million and $518 million in fiscal 2011 and 2010, respectively. Net amortization of bond premium and deferred loss on defeasance were $4 million and $13 million in fiscal 2011 and 2010, respectively.

To address the upcoming expiration of letters of credit in fiscal 2011 and reduce the risk and dependency from credit support providers and interest rate swap counterparties, the Fund completed a refunding of existing debt in October 2010. The proceeds from the October issuance of Series 2010 M fixed rate debt were used to refund $1,054 million in variable rate debt, consisting of $5 million in Series 2002 B bonds, $423 million in Series 2002 C bonds, $409 million in Series 2005 G bonds and $217 million in Series 2008 J bonds. In addition, $813 million of the fixed rate debt Series 2002 A bonds were refunded to lower interest fixed rate bonds. Also, $102 million of the proceeds were used to terminate the remaining $1,053 million in notional value of interest rate swaps. The Series 2010 M bonds were issued with coupons ranging from 1.0% to 5.0%. The bonds were sold at a premium of $183 million and the Fund incurred an accounting loss of $172 million, which includes cost of issuance of $9 million.

With the Series M refunding transaction, the Fund reduced the amount of outstanding variable rate bonds to $948 million and lowered the amount of expiring credit enhancement capacity needing to be renewed during fiscal 2011 to $605 million. Subsequently, in November 2010, the Fund remarketed the $605 million variable rate bonds outstanding with expiring facilities, with replacement credit facilities and credit providers, all in weekly mode. The new facilities were signed with two year terms expiring by December 1, 2012.

In fiscal 2010, the Fund refunded $2,679 million of variable rate bonds and terminated associated interest rate swaps as part of a Series 2010 L fixed rate refunding transaction in May 2010. As part of this refunding, $970 million Series 2002 B bonds, $826 million Series 2002 C bonds, $409 Series 2005 F bonds, $213 million Series 2005 G bonds, $150 million Series 2008 I bonds and $112 million Series 2008 J bonds were refunded to fixed rate bonds. Additionally, as part of the Series L refunding transaction, the Fund refunded $430 million of existing 2002 Series A fixed rate bonds, issuing fixed rate bonds with lower debt service cost to provide savings to ratepayers. In total the Fund issued $2,992 million Series L fixed rate bonds with coupons ranging from 2.0% and 5.0%. The bonds were sold with a premium of $308 million and the Fund incurred an accounting loss of $226 million which includes cost of issuance of $16 million and interest rate swap termination fees of $188 million.

Other Current Liabilities

Other current liabilities consist of Accounts payable and Accrued interest payable.

Accounts payable at June 30, 2011 is $49 million lower than at June 30, 2010. The difference results from lower power costs after the expiration of several long term power contracts during the year along with lower costs for natural gas purchases as less fuel is needed to supply those long term power contracts. Accounts payable also includes $1 million in accrued leave time, which includes vested unpaid vacation, annual leave and other paid leave.

Accounts payable at June 30, 2010 is $39 million lower than at June 30, 2009. The difference results from lower power costs after the expiration of a large fixed volume long term power contract in December 2009, along with lower costs for natural gas as result of the decline in natural gas prices since the beginning of the fiscal year.

Accrued interest payable at June 30, 2011 is $5 million lower than at June 30, 2010 due to lower fixed interest costs that resulted from a refunding transaction in October 2010.

Accrued interest payable at June 30, 2010 is $2 million lower than at June 30, 2009 due to lower variable interest rates.

Derivative Instruments - Liabilities

The Fund has recorded derivative instruments on the balance sheet for the years ended June 30, 2011, 2010 and 2009 in accordance with GASB 53.

Derivative liability decreased to $36 million at June 30, 2011 from $203 million at June 30, 2010 due primarily to reductions in derivative values for both power related activities and interest rate swaps. Power related derivatives declined due to the reduction in the size of the natural gas hedge portfolio as less natural gas will need to be purchased after the expiration of several power purchase contracts and reductions in purchases of new hedges.

In October 2010, concurrent with the issuance of the Series 2010 M bonds, the Fund terminated all remaining interest rate swaps, paying $102 million in termination payments.

Derivative liabilities decreased to $203 million at June 30, 2010 from $446 million at June 30, 2009, primarily because the Fund terminated $2,679 million notional value of interest rate swaps as part of a Series L refunding transaction in May 2010, as well as the lower price for natural gas decreasing the value of the deferred expenses related to natural gas hedges.

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

The Fund's activities for the years ended June 30 are summarized as follows (in millions):

	2011	2010	2009 (As Restated)
Revenues:			
Power charges	$ 1,311	$ 2,915	$ 3,310
Surplus sales	132	108	294
Bond charges	860	864	873
Interest income	30	36	83
Total revenues	2,333	3,923	4,560
Expenses:			
Power purchases	2,122	2,805	3,807
Energy settlements	(236)	(62)	(30)
Interest expense	333	357	381
Investment Expense	16	15	110
Administrative expenses	26	37	36
Recovery of recoverable costs	72	771	256
Total expenses	2,333	3,923	4,560
Net increase in net assets	-	-	-
Net assets, beginning of year	-	-	-
Net assets, end of year	$ -	$ -	$ -

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 were $1,604 million lower in fiscal 2011 than in fiscal 2010. The difference is due to lower power sales to end use customers as a result of the expiration of several power purchase contracts, lower remittance rates implemented in January 2011 and the return of prior year overcollections and reserves as lower reserve levels are required with the expiration of power purchase contracts.

Power Charges during the last six months of fiscal 2011 also include the effect of the return of excess amounts and previously received remittances as separate monthly payments to ratepayers in Pacific Gas and Electric Company ("PG&E") service territory. These payments are the allocation of prior year over-collections from ratepayers and reserves in excess of indenture required levels. During fiscal 2011, the Fund returned $243 million to ratepayers and will return an additional $243 million during the first six months of fiscal year 2012. The allocation of prior year over-collections and excess reserves was authorized by the CPUC in D. 10-12-006. It is anticipated that the Fund will continue the return of excess amounts and previously received remittances to ratepayer in PG&E's service territory and also begin returning similar excess amounts to ratepayers in Southern California Edison's service territory during calendar year 2012. Amounts will be determined as part of the Fund's annual 2012 Revenue Requirement Determination.

Power Charges were $395 million lower in fiscal 2010 than in the prior year. The difference reflects the lower volume of power sales to end use customers as a result of the expiration of a large fixed volume contract in December 2009 along with lower per unit remittance rates implemented in January 2010 as part of the 2010 revenue requirement. Slightly lower volumes from falling demand across the state as a result of the softer economy also contributed to the decline in power sales.

Surplus Sales

The Fund receives revenue from the sale of excess natural gas and energy from counterparties. Surplus sales, primarily of surplus natural gas, for the year ended June 30, 2011 were $24 million higher than the same period in 2010. Higher surplus sales were due to higher volume of natural gas sold due to less gas being needed for generation of electricity.

Surplus sales of energy and natural gas for the year ended June 30, 2010 were $186 million lower than in the same period in 2009. The primary factor was the decline in volumes of surplus power sales occurring as a result of a change in remittance collection methodology adopted by the Fund and its IOU limited agents as part of implementing operational changes to adapt to the California Independent System Operator's (CAISO) Market Redesign Technology Upgrade (MRTU) launched on March 31, 2009. The Fund no longer receives a pro rata portion of surplus power sales to each IOU service area after the change. The Fund forecast this change in its 2010 revenue requirement and had implemented remittance rates to maintain required minimum balances in excess of bond indenture requirements. Lower gas sales volumes and lower prices received per unit of power and gas sold also contributed to the lower amounts during 2011 and 2010 periods as commodity market prices declined and have remained at low levels.

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 for the years ended June 30, 2011, 2010 and 2009 were $860 million, $864 million and $873 million, respectively, and 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. The $4 million decrease in 2011 is due to slightly lower total energy volumes sold to IOU customers as a result of the economic downturn and moderate summer temperatures.

Interest Income

Interest income for 2011 was $6 million lower than in 2010, due to continued low interest rates earned on investments in the State of California Investment Pooled Money Investment Account-Surplus Investment Fund (SMIF). The average yield earned on SMIF for the year ended June 30, 2011 was 0.50% compared to 0.65% for the year ended June 30, 2010.

Interest income for 2010 was $47 million lower than in 2009, due to the sharp decline in interest rates decreasing the interest earned on investments in the SMIF. The average effective yield earned on SMIF balances was 0.65% and 2.19% for the years ended June 30, 2010 and 2009, respectively.

Investment Income (Expense)

Under GASB 53, the Fund realizes investment income (expense) for the change in fair value of outstanding ineffective gas hedges. Due to changes in fair value of gas related hedges, the Fund realized net investment expense of ($16) million and ($15) million during the years ended June 30, 2011, and 2010, respectively.

During the year ended June 30, 2010, the Fund elected to terminate $1,006 million notional of five-year constant maturity basis swaps, receiving $42 million in termination payments. The basis swaps were deemed ineffective and accounted for as investment hedges after adopting GASB 53. The termination resulted in the Fund realizing investment income of $1 million for 2010 after realizing $41 million for fair value changes for prior years as a result of implementing GASB 53.

Power Purchases

Power costs were $683 million lower in fiscal 2011 than in fiscal 2010. The difference is primarily a result of lower volumes purchased after the expiration of several power purchase contracts.

Power costs were $1,002 million lower in fiscal 2010 than in fiscal 2009. The difference is primarily a result of lower volumes purchased after the expiration of a large fixed price contract in December 2009, along with lower costs for natural gas as prices were lower for fiscal year 2010 than in fiscal 2009. Volumes purchased were also lower as demand fell from the softer economy.

Energy Settlements

Energy settlements received, including those related to complex regulatory proceedings before the Federal Energy Regulatory Commission arising from events in California energy markets in 2001, are recorded as a decrease in operating expenses.

Energy settlements in 2011 totaled $236 million. The Fund received $233 million in proceeds in settlement of litigation with Sempra Generation to settle various claims involving Sempra and relating to the California energy crisis of 2000 and 2001. Under the terms of the settlement, in exchange for a cash payment by Sempra of approximately $410 million and certain other consideration, Sempra and certain of its affiliates exchanged mutual releases with the Fund, the CPUC, the State Attorney General, Southern California Edison and PG&E (the “Settling Parties”) except for a limited number of enumerated exceptions, the mutual releases cover all claims related to the long term power purchase agreement between the Fund and Sempra, and all claims related to the short-term energy or ancillary services transactions in the western energy markets during 2000 and 2001. The Fund’s proceeds of $233 million from the settlement amounts were allocated by the Settling Parties based on each party’s claims. Under the terms of the settlement the Fund and Sempra continue to perform their respective obligations under the power purchase agreement and the agreement costs will continue to be included in the Fund’s revenue requirement. This settlement was announced in fiscal 2010, but FERC approval was not obtained until late December 2010. The proceeds were received by the Fund in January and February 2011.

The Fund also received $2 million as part of the FERC refund settlement agreement signed by the California Parties (CPUC, the California 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 Sacramento Municipal Utility District.

Energy settlements in 2010 were $62 million. The Fund received $21 million in proceeds from the sale of gas turbines by the City and County of San Francisco (CCSF). The turbines were originally delivered to CCSF as part of a refund settlement with Williams Energy in 2004, which also resulted in the Fund entering into a contract with CCSF to purchase power output from the turbines. Since the power plant did not become operational by the contractually agreed upon operational date, terms of the contract allowed for termination and the turbines to be sold. The Fund received $11 million as part of the FERC refund settlement agreement signed by the California Parties and the Los Angeles Department of Water & Power for overcharges during the energy crisis in 2000 and 2001. The Fund also received $11 million as part of the FERC refund settlement agreement signed by the California Parties and the Public Service Company of New Mexico related to the energy crisis in 2000 and 2001. There were additional smaller settlements with other suppliers for $19 million.

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 not be recognized until if and when the contingencies are resolved.

Interest Expense

Interest expense was $24 million lower in 2011 when compared to 2010. The decrease is due primarily to lower interest rate payments as a result of the refunding transactions in 2010.

Interest expense was $24 million lower in 2010 when compared to 2009. The decrease is primarily due to the lower variable interest rates as rates remained at historic lows throughout the year. The lower costs from variable rate debt was partially offset by greater amounts of fixed rate debt outstanding in the portfolio as a result of the refunding transactions in 2010, 2009 and 2008.

Other Expenses

Other expenses decreased by $11 million in 2011 primarily as a result of lower staffing levels and fewer consultants due to lower workload in administering power purchase contracts as those contracts expired.

Other expenses increased by $1 million in 2010 as a result of increased legal expenditures for contract renegotiations and ongoing litigation services regarding the 2000-2001 California energy crisis and an increase in charges for services provided to the Power Supply program by other state agencies, offset by a decrease in amounts for postretirement health and dental liabilities incurred by the Fund.

Recovery (Deferral) of Recoverable Costs

The individual components of the recovery (deferral) of recoverable costs are as follows (in millions):

	2011	2010	2009
Operations	$ (485)	$ 227	$ (344)
Debt service and related costs	557	544	600
	$ 72	$ 771	$ 256

Operations
The $485 million deferral in the year ended June 30, 2011 resulted from lower net remittances as Operating Reserve Account levels are reduced. As power purchase contracts expire and fixed payments for purchased power fall, lower Operating Reserve Account balances are required.

The $227 million recovery in the year ended June 30, 2010 reflects the collection of higher remittances than necessary to pay power costs due to the lower than projected prices for natural gas.

Debt Service and Related Costs
The recovery of debt service and related costs in all three years is a result of bond charges and interest income providing funds to pay interest expense and retire debt. The recovery in 2011 was lower due to higher non-operating expenditures.

LIQUIDITY

With the Series M refunding transaction in October 2010, the Fund reduced the amount of outstanding variable rate bonds to $948 million, and lowered the amount of expiring credit enhancement capacity that needed to be renewed by December 1, 2010 to $605 million. On November 19, 2010 the Fund executed a remarketing of those bonds with replacement credit facilities, completing the renewal or replacement of all current outstanding facilities. After the remarketing, there are no facility expirations until December 1, 2012 - in fiscal year 2013.

Subsequent to June 30, 2011, the Fund executed a Series 2011N refunding transaction that included refunding all remaining $948 million in variable rate bonds and terminating all remaining credit enhancement facilities that would have expired by December 1, 2012.

Department of Water Resources Electric Power Fund
Statements of Net Assets
June 30, 2011 and 2010 (in millions)

	2011	2010
Assets		
Long-term assets:		
Restricted cash, equivalents and investments:		
Operating Reserve Account	$ 288	$ 549
Debt Service Reserve Account	919	941
Derivative instruments	-	6
Deferral of derivative cash outflows	-	112
Recoverable costs	4,809	4,881
Total long-term assets	$ 6,016	6,489
Current assets:		
Restricted cash and equivalents:		
Operating and Priority Contract Accounts	1,133	1,257
Bond Charge Collection and Bond Charge Payment Accounts	618	630
Recoverable costs, current portion	220	339
Interest receivable	6	7
Derivative instruments, current portion	7	19
Deferral of derivative cash outflows, current portion	30	83
Other assets	79	92
Total current assets	2,093	2,427
Total assets	$ 8,109	$ 8,916
Capitalization and Liabilities		
Capitalization:		
Net assets	$ -	$ -
Long-term debt	7,275	7,878
Non-Current liabilities:		
Derivative instruments	3	114
Deferral of derivative cash inflows	-	2
Total capitalization and non-current liabilities	7,278	7,994
Current liabilities:		
Current portion of long-term debt	561	539
Derivative instruments, current portion	33	89
Deferral of derivative cash inflows, current portion	3	6
Accounts payable	178	227
Accrued interest payable	56	61
Total current liabilities	831	922
Commitments and Contingencies (Note 7)		
Total capitalization and liabilities	$ 8,109	$ 8,916

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

Department of Water Resources Electric Power Fund
Statements of Revenues, Expenses and Changes in Net Assets
For the years ended June 30, 2011 and 2010 (in millions)

	2011	2010
Operating revenues:		
Power charges	$ 1,311	$ 2,915
Surplus sales	132	108
Total operating revenues	1,443	3,023
Operating expenses:		
Power purchases	2,122	2,805
Energy settlements	(236)	(62)
Administrative expenses	26	37
Recovery (deferral) of recoverable operating costs	(485)	227
Total operating expenses	1,427	3,007
Income from operations	16	16
Bond charges	860	864
Interest income	30	36
Interest expense	(333)	(357)
Investment income from debt related derivatives	-	1
Investment income (expense) from gas related derivatives	(16)	(16)
Recovery of recoverable debt service and related costs	(557)	(544)
Net increase in net assets	-	-
Net assets, beginning of year	-	-
Net assets, end of year	$ -	$ -

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

Department of Water Resources Electric Power Fund
Statements of Cash Flows
For the years ended June 30, 2011 and 2010 (in millions)

	2011	2010
Cash flows from operating activities:		
Receipts:		
Power charges	$ 1,410	$ 3,056
Surplus sales	136	109
Energy settlements	250	48
Payments for power purchases and other expenses	(2,182)	(2,925)
Net cash provided by (used in) operating activities	(386)	288
Cash flows from non-capital financing activities:		
Receipt of bond charges	862	866
Bond payments	(460)	(518)
Interest payments	(344)	(373)
Proceeds from issuance of revenue bonds	1,923	3,300
Defeasance of revenue bonds	(2,040)	(3,353)
Net cash used in non-capital financing activities	(59)	(78)
Cash flows from investing activities:		
Interest received on investments	31	42
Income (Expense) received from derivative investments	(5)	39
Net cash provided by investing activities	26	81
Net (decrease) increase in cash and equivalents	(419)	291
Restricted cash and equivalents, beginning of year	3,077	2,786
Restricted cash and equivalents, end of year	$ 2,658	$ 3,077
Restricted cash and equivalents included in:		
Operating Reserve Account	$ 288	$ 549
Debt Service Reserve Account (a component of the total of $919 and $941 at June 30, 2011 and 2010, respectively)	619	641
Operating and Priority Contract Accounts	1,133	1,257
Bond Charge Collection and Bond Charge Payment Accounts	618	630
Restricted cash and equivalents, end of year	$ 2,658	$ 3,077
Reconciliation of operating income to net cash provided by (used in) operating activities:		
Income from operations	$ 16	$ 16
Adjustments to reconcile operating income to net cash provided by (used in) operating activities:		
Recovery (deferral) of recoverable operating costs	(485)	227
	(469)	243
Changes in net assets and liabilities to reconcile operating income to net cash provided by (used in) operations:		
Recoverable costs, current portion	119	129
Other assets	13	(45)
Accounts payable	(49)	(39)
Net change in operating assets & liabilities:	83	45
Net cash provided by (used in) operating activities	$ (386)	$ 288

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 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 purchase agreements, but allows the Fund to enter into 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 (the CPUC).

Under the terms of a rate agreement between the Fund 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 assets, 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 June 30, 2011 and 2010, and the changes in its financial position and its cash flows, where applicable, for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Recent Accounting Pronouncements

GASB 54
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 as defined under GASB 54 which is unchanged from prior guidance

GASB 62
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*. The requirements in this Statement will improve financial reporting by contributing to the GASB's efforts to codify all sources of generally accepted accounting principles for state and local governments so that they derive from a single source. 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.

GASB 63
In June 2011, the GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. 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. 63 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.

GASB 64
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. 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.

At June 30, 2011, other assets were valued at $79 million, and consisted of money market investments valued at $41 million and other collateral balances valued at $38 million. At June 30, 2010, other assets consist of money market investments, US Treasury bills and government bonds valued at $92 million.

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 CPUC 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 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 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 as determined by the Fund's revenue requirement process.

Surplus sales represent the Fund's the sale of gas not needed for the generation of power and surplus energy dispatched by the CAISO from the Fund's power purchase agreements for grid reliability.

3. Restricted Cash and Investments

As of June 30, 2011 and 2010, the Fund had the following cash, equivalents and investments (in millions):

Investment	Maturity	2011	2010
State of California Pooled Money Investment Account - State Money Investment Fund	7.8 months average	$ 2,651	$ 3,065
Cash		7	12
Total cash and equivalents		2,658	3,077
Guaranteed investment contracts	May 1, 2022	200	200
Forward purchase agreement	November 1, 2011	100	100
		$ 2,958	$ 3,377
Reconciliation to Statement of Net Assets:			
Operating Reserve Account		$ 288	$ 549
Debt Service Reserve Account		919	941
Operating and Priority Contract Accounts		1,133	1,257
Bond Charge Collection and Bond Charge Payment Accounts		618	630
		$ 2,958	$ 3,377

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 June 30, 2011 and 2010, $3 million and $4 million, respectively, 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.

The Fund's investments in the GICs and the Forward Purchase Agreement (FPA) are rated as follows, by Standard & Poor's (S&P) and Moody's, respectively, at June 30, 2011 (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: FHLMC Discounted Notes	$ 100	AAA	Aa3

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 0.5% and 0.6% at June 30, 2011 and 2010, respectively. For the years ended June 30, 2011 and 2010, interest earned on the deposit in the PMIA was $15 million and $21 million, respectively.

Interest on the GICs is paid semi-annually at interest rates ranging from 5.3% to 5.5%. Interest earned on the GICs was $11 million and $11 million for the years ended June 30, 2011 and 2010, respectively.

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 years ended June 30, 2011 and 2010.

4. Long-Term Debt and Subsequent Event

The following activity occurred in the long-term debt accounts during the years ended June 30, 2011 and 2010 (in millions):

	Revenue Bonds	Unamortized Premium	Deferred Loss on Defeasance	Total
Balance, June 30, 2009	$ 9,030	$ 142	$ (171)	$ 9,001
Refunding				
Issuance of debt	2,992	308	-	3,300
Defeasance of debt	(3,109)	(18)	(226)	(3,353)
Payments	(518)	-	-	(518)
Amortization	-	(34)	21	(13)
Balance, June 30, 2010	8,395	398	(376)	8,417
Refunding				
Issuance of debt	1,763	183	-	1,946
Defeasance of debt	(1,868)	(23)	(172)	(2,063)
Payments	(460)	-	-	(460)
Amortization	-	(91)	87	(4)
Balance, June 30, 2011	7,830	467	(461)	7,836
Less current portion	556	98	(93)	561
	$ 7,274	$ 369	$ (368)	$ 7,275

Long-term debt consists of the following at June 30, 2011 and 2010, respectively (in millions):

Series	Rates	Fiscal Year of Final maturity	Fiscal Year of First Call Date	Amount Outstanding 2011	Amount Outstanding 2010
A	Fixed (3.8-5.5%)	2013	2012	$ 473	$ 1,590
B	Variable	2020	Callable	25	30
C	Variable	2022	Callable	923	1,346
F	Fixed (4.375-5.00%)	2022	Callable	348	348
G	Variable	2016	Callable	-	410
G	Fixed (4.35-5.00%)	2018	Callable	173	173
H	Fixed (3.75-5.0%)	2022	2018	1,007	1,007
J	Variable	2015	Callable	-	219
K	Fixed (4.0-5.0%)	2018	Non-callable	279	279
L	Fixed (2.0-5.0%)	2022	2020	2,919	2,993
M	Fixed (2.0-5.0%)	2020	Non-callable	1,683	-
				$ 7,830	$ 8,395
Plus unamortized bond premium				467	398
Less deferred loss on defeasance				(461)	(376)
Less current maturities				(561)	(539)
				$ 7,275	$ 7,878

Bond refunding transactions

To address the upcoming expiration of letters of credit in fiscal 2011 and reduce the risk and dependency from credit support providers and interest rate swap counterparties, the Fund completed a refunding of existing debt in October 2010. The proceeds from the October 2010 issuance of Series 2010 M fixed rate debt were used to refund $1,054 million in variable rate debt, consisting of $5 million in Series 2002 B bonds, $423 million in Series 2002 C bonds, $409 million in Series 2005 G bonds and $217 million in Series 2008 J bonds. In addition, $813 million of the fixed rate debt Series 2002 A bonds were refunded to lower interest fixed rate bonds. Also, $102 million of the proceeds were also used to terminate the remaining $1,053 million in notional value of interest rate. The Series 2010 M bonds were issued with coupons ranging from 1.0% to 5.0%. The bonds were sold at a premium of $183 million and the Fund incurred an accounting loss of $172 million, after adjusting for prior gains and losses from earlier refunding transactions extinguished as part of this transaction. The loss includes cost of issuance of $9 million. Such amounts will be amortized over the life of the Series M bonds since all defeased bonds had maturities that are similar to the maturities of the Series M bonds.

With the Series M refunding transaction, the Fund reduced the amount of outstanding variable rate bonds to $948 million and lowered the amount of expiring credit enhancement capacity needing to be renewed during fiscal 2011 to $605 million. Subsequently, in November 2010, the Fund remarketed the $605 million variable rate bonds outstanding with expiring facilities, with replacement credit facilities and credit providers, all in weekly mode. The new facilities were signed with two year terms expiring by December 1, 2012.

Subsequent to June 30, 2011, the Fund executed the Series 2010 N refunding transaction that included refunding all remaining $948 million in variable rate bonds and terminating all the remaining credit enhancement facilities that would have expired by December 1, 2012.

Subsequent to June 30, 2011, the Fund did not issue its audited financial statements within 120 days of the Fund's fiscal year end. This resulted in technical noncompliance with certain provisions of the Fund's bond indenture. This noncompliance is resolved with the issuance of these audited financial statements. Such noncompliance, as resolved, does not result in any acceleration clauses within the debt agreements and does not have an impact on long-term debt or other elements of the June 30, 2011 financial statements.

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 2002 A bonds are callable May 1, 2012 through October 31, 2012 at a redemption rate of 101%, from November 1, 2012 through April 30, 2013 at a redemption rate of 100.5% and thereafter, at 100%. The Series 2008 H bonds are callable in 2018 at a redemption rate of 100%. The Series 2010 L bonds are callable in 2020 at a redemption rate of 100%. All other callable bonds are redeemable at 100%.

The Fund's variable rate bonds have either daily or weekly rate reset modes. The variable rate bonds have a final stated maturity of 2022, but are scheduled to be retired in sinking fund installments from 2011 to 2022. The interest rates for the variable debt for the year ended June 30, 2011 and 2010, ranged from 0.04% to 2.75% and from 0.02% to 2.50%, respectively.

Remarketing, credit support and related uncertainties

The Fund bonds were remarketed by seven different broker-dealer remarketing agents, with credit enhancement provided by sixteen banks to spread its risk exposure among many firms. Remarketing agents can experience problems finding investors for certain bonds, including those with credit enhancement from banks and insurers that have perceived credit risk, as well as risk specific to their own company that carries negative perception with investors. Failed remarketings can result in the credit enhancing bank's required purchase of the bonds, and they become "bank bonds". If this occurs, the Fund is required to pay a stated fixed interest rate quarterly until the bonds are successfully remarketed. If the agreements expire or are terminated, the Fund is required to begin paying principal in quarterly installments at least six months after termination. Early repayment requirements vary with each type of credit facility. Liquidity facilities require repayment in nineteen or twenty seven equal quarterly installments depending on the provider.

In the past, negative credit market impacts increased borrowing costs on variable rate bonds that experienced interest rate resets at higher rates and on occasion caused the remarketing failure of bonds resulting in those bonds becoming bank bonds. The level of bank bonds can fluctuate daily as the bonds are successfully remarketed. At June 30, 2011, there were no outstanding bank bonds.

At June 30, 2011, $343 million of Series 2002 C bonds are credit enhanced by bond insurance for the timely payment of principal and interest. All insured bonds are enhanced by FSA bond insurance which was rated AA+/Aa3 by S&P and Moody's at June 30, 2011. Liquidity support for these variable rate bonds is provided by bank liquidity facilities. Any funds paid under the bond insurance facilities are immediately due and payable by the Fund. Bonds purchased under the initial liquidity facilities are required to be redeemed in equal quarterly installments over a five or seven year period beginning six months after the termination date of the liquidity facilities. There are no outstanding amounts due under liquidity facilities at June 30, 2011. The liquidity facilities backing the $343 million of Series 2002 C bonds and all $605 million other non insured Series 2002 B and 2002 C bonds expire in fiscal year 2013. The Fund pays fees of 0.37 to 0.70% per annum under the liquidity facilities.

Maturities

As of June 30, 2011, there were liquidity facilities enhancing $948 million of variable rate bonds that expire by December 1, 2012.

Subsequent to June 30, 2011, the Fund executed a Series 2010 N refunding transaction that included refunding all remaining $948 million in variable rate bonds and terminating the remaining $948 million in credit enhancement facilities capacity.

Future payment requirements on the revenue bonds are as follows at June 30, 2011 (in millions):

Fiscal Year	Principal	Interest [1]	Total
2012	$ 556	$ 321	$ 877
2013	583	294	877
2014	611	267	878
2015	639	239	878
2016	669	211	880
2017-2021	3,876	594	4,470
2022	896	31	927
	$ 7,830	$ 1,957	$ 9,787

[1] Variable portion of interest cost calculated using the June 30, 2011 Securities Industry and Financial Markets Association Swap Index (SIFMA).

5. Derivative Financial Instruments

The Fund implemented GASB 53 during the year ended June 30, 2010. 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 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 statements of net assets as of June 30, 2011 and 2010.

The Fund terminated all interest rate swap agreements in November 2010 using the proceeds of the Series 2010 M bonds to fund the termination payment of $102 million.

The fair values, classification and notional amounts outstanding for the Fund's natural gas hedge derivatives and interest rate swaps accounted for as derivative financial instruments at June 30, 2011 and 2010 are summarized in the following tables:

As of June 30, 2011

		Business-type activities	Value (in millions)		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		(3)	990,000	MMBtu
			$	(6)		

As of June 30, 2010

Business-type activities			Value (in mllions)	Notional
Effective hedges				
Assets				
	Current	Gas Swaps	$ 6	9,075,000 MMBtu
	Long Term	Gas Swaps	2	5,450,000 MMBtu
			$ 8	
Liabilities				
	Current	Gas Swaps	$ (83)	64,220,000 MMBtu
	Long Term	Gas Swaps	(20)	12,900,000 MMBtu
	Long Term	Interest Rate Swaps	(92)	$1,052,900,000
			$ (195)	
Investment hedges				
Assets				
	Current	Gas Swaps	$ 1	4,990,000 MMBtu
	Current	Gas Options	12	128,704,999 MMBtu
	Long Term	Gas Swaps	-	1,225,000 MMBtu
	Long Term	Gas Options	4	10,930,000 MMBtu
			$ 17	
Liabilities				
	Current	Gas Swaps	$ (2)	5,712,500 MMBtu
	Current	Gas Options	(4)	48,944,999 MMBtu
	Long Term	Gas Swaps	(2)	3,162,500 MMBtu
			$ (8)	

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.

Changes in fair value for ineffective interest rate swaps are recorded as investment expense from debt related contracts on the statement of revenues, expenses and changes in net assets. In fiscal 2010 the fair value of ineffective interest rate swaps was $92 million. In fiscal 2011, all interest rate swaps were terminated in connection with the Series 2010 M bond issuance.

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. 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 over 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.

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 June 30, 2011 are with nine different counterparties, all of which have credit ratings of at least A-/Baa1. At June 30, 2011, the Fund has credit risk exposure to three counterparties totaling $2 million, representing transactions with market values that are in the Fund's favor. There is no substantial credit exposure to the remaining six counterparties, as the decrease of natural gas prices has resulted in valuations in the counterparties' favor and fewer hedges are outstanding as the need for natural gas has decreased with the expiration of power purchase contracts. 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.

The Fund's open natural gas hedge positions at June 30, 2010 are with ten different counterparties, all of which have credit ratings of at least A-/Baa1. At June 30, 2010, the Fund has credit risk exposure to three counterparties totaling $3 million, representing transactions with market values that are in the Fund's favor.

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.

Interest Rate Swaps

As part of the Series 2010 M refunding transaction in October 2010, the Fund terminated all remaining interest rate swaps for $102 million to settle the negative fair market value of the swap agreements. The interest rate swap derivative values were removed from the statements of net assets and the loss incurred on termination is being deferred and amortized as part of the refunding transaction.

In prior years, the Fund entered into interest rate swap agreements with various counterparties to reduce variable interest rate risk. The pay-fixed swaps created a synthetic fixed rate for the Fund. The Fund had agreed to make fixed rate payments and receive floating rate payments on notional amounts equal to a portion of the principal amount of the Fund's variable rate debt.

As of June 30, 2010, all of the Fund's interest rate swaps were considered effective hedging derivatives under GASB 53, and had been recorded at fair value on the statements of net assets as long-term assets or liabilities.

The terms, fair values, and credit ratings of counterparties for the various swap agreements at June 30, 2010 are summarized in the following table (in millions):

Outstanding Notional Amount	Fixed Rate Paid by Fund	Variable Rate [1] Received by Fund	Fair Value [2]	Swap Termination Date	Counterparty Credit Rating S&P	Moody's	Fitch
$ 92	3.405%	SIFMA	$ (3)	May 1, 2013	A+	Aa3	AA-
46	3.405%	SIFMA	(2)	May 1, 2013	A	A2	A
14	3.405%	SIFMA	(1)	May 1, 2013	A	A2	A+
242	3.184%	66.5% of LIBOR	(19)	May 1, 2015	BBB	A3	A-
174	3.280%	67% of LIBOR	(17)	May 1, 2015	NR	A1	A+
485	3.228%	66.5% of LIBOR	(50)	May 1, 2016	AA	Aa2	AA-
$ 1,053			$ (92)				

[1] One month U.S. Dollar London Interbank Offered Rate or Securities Industry and Financial Markets Association (SIFMA)
[2] Fair value was determined based on quoted market prices for similar financial instruments.

The notional amounts of the swaps matched the principal amounts of the associated debt. The swap agreements contained scheduled reductions in notional amounts that follow scheduled amortization of the associated debt.

As of June 30, 2010, the variable rates on the Fund's hedged bonds ranged from 0.02% to 2.5%, while the variable rates received on the LIBOR-based swaps were 0.15% to 0.24% and the variable rate received on the SIFMA-based swaps was 0.15% to 0.43%.

Basis Risk: The Fund was exposed to basis risk on the swaps that have payments calculated on the basis of a percentage of LIBOR (a taxable rate index). The basis risk resulted from the fact that the Fund's floating interest payments payable on the underlying debt were determined in the tax-exempt market, while the Fund's floating receipts on the swaps were based on LIBOR, which is determined in the taxable market. When the relationship between LIBOR and the tax-exempt market change and move to convergence, or the Fund's bonds trade at levels higher in rate in relation to the tax-exempt market, the Fund's all-in costs would have increased.

Net amounts paid under all swaps amounted to $10 million and $98 million for the years ended June 30, 2011 and 2010, respectively.

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.

As of June 30, 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.

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 purchase contracts that have remaining lives of up to five years. Payments under these and gas purchase contracts approximated $2,122 million and $2,805 million for fiscal 2011 and 2010, respectively.

The remaining amounts of fixed obligations under the contracts as of June 30, 2011, are as follows (in millions):

Fiscal Year	Fixed Obligation
2012	$ 511
2013	24
2014	13
2015	4
Thereafter	1
	$ 553

In addition to the fixed costs there are variable costs under several of the contracts. Management projected as of June 30, 2011 that the amount of future fixed and variable obligations associated with long-term power purchase contracts would approximate $779 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.

All of the power and gas purchase contracts qualify under the normal purchases and normal sales exclusion under the provisions of GASB 53 since it is probable that the Fund will take delivery of the commodity and the Fund uses the commodity in its operations as in the normal course of business. As a result, market valuation and certain risk information are not required to be disclosed.

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.

Energy settlements in 2011 were $236 million. The Fund received $233 million in proceeds in settlement of litigation with Sempra Generation to settle various claims involving Sempra and relating to the California energy crisis of 2000 and 2001. Under the terms of the settlement, in exchange for a cash payment by Sempra of approximately $410 million and certain other consideration, Sempra and certain of its affiliates exchanged mutual releases with the Fund, the CPUC, the State Attorney General, Southern California Edison and PG&E (the "Settling Parties") except for a limited number of enumerated exceptions, the mutual releases cover all claims related to the long term power purchase agreement between the Fund and Sempra, and all claims related to the short-term energy or ancillary services transactions in the western energy markets during 2000 and 2001. The Fund's proceeds of $233 million of the settlement amounts were allocated by the Settling Parties based on each party's claims. Under the terms of the settlement the Fund and Sempra continue to perform their respective obligations under the power purchase agreement and the agreement costs will continue to be included in the Fund's revenue requirement. This settlement was announced in fiscal 2010, but FERC approval was not obtained until late December 2010. The Fund received the proceeds of the settlement in January and February 2011.

The Fund also received $2 million as part of the FERC refund settlement agreement 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 Sacramento Municipal Utility District.

In fiscal year 2010, the Fund received $62 million in energy settlements. The Fund received $21 million in proceeds from the sale of gas turbines by the City and County of San Francisco (CCSF). The turbines were originally delivered to CCSF as part of a refund settlement with Williams Energy in 2004, which also resulted in the Fund entering into a contract with CCSF to purchase power output from the turbines. Since the power plant did not become operational by the contractually agreed upon operational date, terms of the contract allowed for termination and the turbines to be sold.

Additionally, in fiscal year 2010, the Fund received $11 million as part of the FERC refund settlement agreement signed by the California Parties and the Los Angeles Department of Water & Power for overcharges during the energy crisis in 2000 and 2001. The Fund also received $11 million as part of the FERC refund settlement agreement signed by the California Parties and the Public Service Company of New Mexico related to the energy crisis in 2000 and 2001. There were additional smaller settlements with other suppliers for $19 million.

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 not be recognized until if and when the contingencies are resolved.

8. Related Party Transactions

The California State Teachers' Retirement System (STRS), which is part of the California state government, participates in the Fund's liquidity facilities with four financial institutions. The total commitment for liquidity facilities underlying the STRS' participation approximates $151 million and expires on November 19, 2012. There are no outstanding amounts on the liquidity facilities at June 30, 2011 or 2010.

Subsequent to year end, the Fund executed a Series 2010 N refunding transaction that included refunding all remaining $948 million in variable rate bonds and terminating the remaining $605 million in credit enhancement facilities capacity, which included the $151 million liquidity facility commitment by STRS.

9. Retirement Plan and Postretirement Benefits

Retirement Plan Description

The State of California is a member of the California Public Employees' Retirement System (PERS), an agent multiple-employer pension system that provides a contributory defined-benefit pension for substantially all State employees. The Fund is included in the State Miscellaneous Category (Tier 1 and Tier 2) within PERS, thereby limiting the availability of certain Fund pension data. PERS functions as an investment and administrative agent for participating public agencies within the State of California. Departments and agencies within the State of California, including the Fund, are in a cost-sharing arrangement in which all risks and costs are shared proportionately by participating State agencies. Copies of PERS' comprehensive annual financial report may be obtained from their executive office at 400 P Street, Sacramento, California 95814. The pension plan provides retirement benefits, survivor benefits, and death and disability benefits based upon an employee's years of credited service, age and final compensation. Vesting occurs after five years of credited service except for second tier benefits, which require ten years of credited service. Employees who retire at or after age 50 with five or more years of service are entitled to a retirement benefit, payable monthly for the remainder of their lives. Several survivor benefit options which reduce a retiree's unmodified benefit are available. Benefit provisions and all other requirements are established by state statute.

Annual Pension Cost

For the years ended June 30, 2011 and 2010, the Fund's annual pension cost payable from the Fund and actual contribution allocated to the Fund based on the Fund's payroll costs approximated $1 million per year.

Postretirement Benefits

In addition to the pension benefits, the State of California provides post-retirement health care benefits, in accordance with Section 22754(g) of the State Government Code, to all employees who retire on or after attaining certain age and length of service requirements. The State of California is funding postretirement benefits on a pay-as-you-go basis. The annual required contribution for the Fund amounted to $1.0 million for the years ended June 30, 2011 and 2010, respectively. The Fund's net OPEB obligation increased by $1 million at June 30, 2011 to $3 million. The Fund's annual required contribution represents 0.03% of the State's total annual required contribution for the year ended June 30, 2011. The State's unfunded actuarial accrued liability at July 1, 2010 attributable to all State employees is $59,900 million.