Department of Water Resources
Electric Power Fund
Financial Statements
September 30, 2011

Index

USING THIS REPORT

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

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

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

STATEMENTS OF NET ASSETS

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

	September 30, 2011	June 30, 2011
Long-term restricted cash, equivalents and investments	$ 1,207	$ 1,207
Recoverable costs	4,911	4,809
Derivative instruments	3	7
Deferral of derivative cash outflows	17	30
Restricted cash and equivalents:		
Operating and priority contract accounts	870	1,133
Bond charge collection and bond charge payment accounts	842	618
Recoverable costs, current portion	226	220
Interest receivable	9	6
Other assets	68	79
Total assets	$ 8,153	$ 8,109
Net assets	$ -	$ -
Long-term debt, including current portion	7,830	7,836
Derivative instruments	23	36
Deferral of derivative cash inflows	1	3
Other current liabilities	299	234
Total capital and liabilities	$ 8,153	$ 8,109

ASSETS

Long-Term Restricted Cash and Investments

There is no change in the $288 million balance in the Operating Reserve Account at September 30, 2011 from June 30, 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 2010 as forecast in the DWR 2010 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. The $102 million net increase in long-term recoverable costs during the three month period ended September 30, 2011 is the net of 1) operating expenses exceeding operating revenues by $257 million, as power charges were lower due to lower remittance rates and the return of reserves to the IOUs and 2) bond charge revenue exceeding interest expense by $155 million.

Restricted Cash and Investments

The Operating and Priority Contract Accounts decreased by $263 million during the three month period ended September 30, 2011. DWR purposefully reduced cash balances while staying within indenture requirements as part of a planned return of cash reserves to ratepayers through lower power charge rates.

The Bond Charge Collection and Bond Charge Payment Accounts increased by $224 million in the period ended September 30, 2011 in anticipation of the semi-annual interest payment on fixed rate bonds due in November 1, 2011, with the next principal and interest payment due May 1, 2012.

From the dates of issuance of the revenue bonds through September 30, 2011, 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 is $226 million at September 30, 2011, increasing from $220 million at June 30, 2011. The higher amounts are as a result of higher volumes of power sold in the summer months to end use customers, and increased surplus sales from higher dispatch of contract power plant facilities.

Other Assets

DWR purchases natural gas as fuel for the production of power under the terms of certain power purchase contracts and maintains a brokerage account with a national brokerage firm in order to hedge natural gas costs. DWR invests funds to be used to meet realized losses as they occur, provide collateral for current positions, and enable future hedging activities that require margin or immediate payment. Assets in this account are classified as other assets on the Statements of Net Assets. At September 30, 2011, other assets consisted of money market obligations, US Treasury bills, and government bonds valued at $68 million.

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 statement of net assets for periods ended September 30, 2011 and June 30, 2011.

Derivative financial instrument assets decreased $4 million, and totaled $3 million and $7 million at September 30, 2011 and June 30, 2011, respectively. The lower fair value of derivative financial instruments is lower natural gas futures prices and lower volumes hedged as the Fund is no longer purchasing new natural gas hedge contracts.

Deferred outflows decreased by $13 million to $17 million at September 30, 2011 from $30 million at June 30, 2011, as derivative financial instrument liabilities decreased in value.

LIABILITIES

Long-Term Debt

Long-term debt decreased to $7,830 million as of September 30, 2011 from $7,836 million at June 30, 2011. The decrease is attributable to the amortization of premium and deferred loss on the Series 2011 N bonds. Net amortization of bond premium and deferred loss on defeasance was $3 million in quarter ended September 30, 2011.

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 September 30, 2011 accounts payable are $16 million lower than at June 30, 2011 as contract volumes decreased due to expiration of purchase power contracts.

The $81 million increase in accrued interest payable is anticipated as fixed rate bonds provide for semi-annual payments on May 1 and November 1.

Derivative Instruments- Liabilities

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

Derivative financial instrument liabilities decreased $13 million, and were valued at $23 million and $36 million at September 30, 2011 and June 30, 2011, respectively. Natural gas market prices declined reducing the fair value of existing natural gas hedges. In addition, the Fund is not purchasing natural gas hedges as the purchase power contracts expire and there is no longer a need to hedge future natural gas prices.

Deferred inflows decreased to $1 million at September 30, 2011 from $3 million at June 30, 2011, as derivative financial instrument assets decreased in value with the fall in natural gas prices and fewer open positions remain.

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

The Fund's activities for the three months ended September 30, 2011 and 2010 are summarized as follows (in millions):

	2011	2010
Revenues:		
Power charges	$ 196	$ 560
Surplus sales	11	44
Bond charges	230	239
Interest income	6	8
Total revenues	443	851
Expenses:		
Power purchases	469	726
Energy settlements	(10)	-
Interest expense	81	81
Investment Expense	(1)	10
Administrative expenses	6	5
Recovery of recoverable costs	(102)	29
Total expenses	443	851
Net increase in net assets	-	-
Net assets, beginning of year	-	-
Net assets, end of year	$ -	$ -

REVENUES

Power Charges

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

Power charges decreased by $364 million in the three months ended September 30, 2011 compared to the same three month period in 2010. The difference reflects a combination of lower volume of power sales to end use customers from the expiration of long term power purchase contracts and per unit remittance rates implemented in January 2011 with the 2011 revenue requirement that is substantially lower than rates that were in effect for 2010, as DWR purposefully lowered power charge rates to return cash reserves to customers..

Power charges during the first three months of fiscal 2012 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 the first three months of fiscal 2012, the Fund returned $121 million to ratepayers and will return a total of $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.

Surplus Sales

Surplus sales of energy and natural gas in the three month period ended September 30, 2011 were $33 million lower than in the same period in 2010. The primary factors were a decrease in volumes of surplus power sales from power plant dispatches by the California Independent System Operator's (CAISO) and lower natural gas sales revenue due to lower volumes and prices.

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 three months ended September 30, 2011 are $9 million lower than the same period in 2010 due to slightly lower delivered volumes. The amount collected is 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 of $6 million for the three months ended September 30, 2011 is $2 million lower than the interest income for the same period in 2010. The increase is as a result of an increase in interest earned on investments in the State of California Investment Pooled Money Investment Account-Surplus Investment Fund (SMIF).

EXPENSES

Power Purchases

Power costs are $257 million lower in the three months ended September 30, 2011 than in the same period in 2010. The decrease in costs is primarily due to the expiration of large power purchase contracts in fiscal 2011 and lower prices for natural gas in 2011 when compared to 2010 as commodities market prices continued to decline.

Energy Settlements

Energy settlements in the three month period ended September 30, 2011 were $10 million. The Fund received $6 and $3 million as part of the FERC refund settlement agreements signed by the California Parties (CPUC, the State Attorney General, California Department of Water Resources acting through the Fund, Southern California Edison, San Diego Gas and Electric Company, and Pacific Gas and Electric Company) and the City of Pasadena and the Modesto Irrigation District, respectively.

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 three months ended September 30, 2011 is unchanged from the same period in 2010.

Investment Expense

Due to changes in fair value of gas related hedges, the Fund realized investment $1 million of investment income from expiring ineffective gas hedges for the period ended September 30, 2011.

Other Expenses

Other expenses in the three months ended September 30, 2011 were $1 million higher than the same period in 2010, as a result of higher overhead and bond related expenses.

Recovery (Deferral) of Recoverable Costs

The individual components of the recovery (deferral) of recoverable costs are as follows for the three months ended September 30, 2011 and 2010 (in millions):

	2011	2010
Operations	$ (257)	$ (137)
Debt service and related costs	155	166
	$ (102)	$ 29

Operations
There was a deferral of recoverable costs of $257 million for the three months ended September 30, 2011, compared to the $137 million recovery in the same period in 2010. The deferral in the three months ended September 30, 2011 reflects lower power charges received than needed to pay power costs as DWR purposefully reduces cash balances through lower rates to ratepayers.

Debt Service and Related Costs
The recovery of debt service and bond related costs are $11 million lower for the three months ended September 30, 2011 compared to the same period in 2010. The recovery is comprised solely of the difference between bond charges and interest income less interest expense. The smaller recovery is primarily due to higher interest expense resulting from a greater outstanding amount of fixed rate debt due to prior bond refundings of variable rate debt with fixed rate debt.

LIQUIDITY

Prior to August 31, 2011, the Fund had $948 million in variable rate bonds outstanding and $605 million in credit enhancement facilities. Subsequent to the completion of the Series 2011 N bond issuance in August 2011, all variable rate bonds were refunded and all credit enhancement facilities were terminated.

At September 30, 2011, there are no outstanding amounts due under liquidity facilities. Prior to termination, the Fund paid fees of 0.37 to 0.70% per annum under the liquidity facilities.

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

	September 30, 2011	June 30, 2011
Assets		
Long-term assets:		
Restricted cash, equivalents and investments:		
Operating Reserve Account	$ 288	$ 288
Debt Service Reserve Account	919	919
Derivative instruments	-	-
Deferral of derivative cash outflows	-	-
Recoverable costs	4,911	4,809
Total long-term assets	6,118	6,016
Current assets:		
Restricted cash and equivalents:		
Operating and Priority Contract Accounts	870	1,133
Bond Charge Collection and Bond Charge Payment Accounts	842	618
Recoverable costs, current portion	226	220
Interest receivable	9	6
Derivative instruments, current portion	3	7
Deferral of derivative cash outflows, current portion	17	30
Other assets	68	79
Total current assets	2,035	2,093
Total assets	$ 8,153	$ 8,109
Capitalization and Liabilities		
Capitalization:		
Net assets	$ -	$ -
Long-term debt	7,253	7,275
Non-Current liabilities:		
Derivative instruments	2	3
Deferral of derivative cash inflows	-	-
Total capitalization and non-current liabilities	7,255	7,278
Current liabilities:		
Current portion of long-term debt	577	561
Derivative instruments, current portion	21	33
Deferral of derivative cash inflows, current portion	1	3
Accounts payable	162	178
Accrued interest payable	137	56
Total current liabilities	898	831
Commitments and Contingencies (Note 7)		
Total capitalization and liabilities	$ 8,153	$ 8,109

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 three months ended September 30, 2011 and 2010 (in millions)

	2011	2010
Operating revenues:		
Power charges	$ 196	$ 560
Surplus sales	11	44
Total operating revenues	207	604
Operating expenses:		
Power purchases	469	726
Energy settlements	(10)	-
Administrative expenses	6	5
Recovery (deferral) of recoverable operating costs	(257)	(137)
Total operating expenses	208	594
Income from operations	(1)	10
Bond charges	230	239
Interest income	6	8
Interest expense	(81)	(81)
Investment income (expense) from gas related derivatives	1	(10)
Recovery of recoverable debt service and related costs	(155)	(166)
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 three months ended September 30, 2011 and 2010 (in millions)

	2011	2010
Cash flows from operating activities:		
Receipts:		
Power charges	$ 181	$ 512
Surplus sales	20	45
Energy settlements	10	6
Payments for power purchases and other expenses	(480)	(733)
Net cash (used in) provided by operating activities	(269)	(170)
Cash flows from non-capital financing activities:		
Receipt of bond charges	230	227
Bond Payments	-	(3)
Interest payments	(3)	2
Proceeds from issuance of revenue bonds	1,116	-
Defeasance of revenue bonds	(1,119)	-
Net cash provided by non-capital financing activities	224	226
Cash flows from investing activities:		
Interest received on investments	3	5
Income received from derivative investments	3	1
Net cash provided by investing activities	6	6
Net increase (decrease) in cash and equivalents	(39)	62
Restricted cash and equivalents, beginning of period	2,658	3,077
Restricted cash and equivalents, end of period	$ 2,619	$ 3,139
Restricted cash and equivalents included in:		
Operating Reserve Account	$ 288	$ 549
Debt Service Reserve Account (a component of the total of $941 and $950 at September 30, 2010 and 2009, respectively)	619	641
Operating and Priority Contract Accounts	870	1,091
Bond Charge Collection and Bond Charge Payment Accounts	842	858
Restricted cash and equivalents, end of year	$ 2,619	$ 3,139
Reconciliation of operating income to net cash (used in) provided by operating activities:		
Income from operations	$ (1)	$ 10
Adjustments to reconcile operating income to net cash provided by (used in) operating activities:		
(Deferral) recovery of recoverable operating costs	(257)	(137)
	(258)	(127)
Changes in net assets and liabilities to reconcile operating income to net cash (used in) provided by operations:		
Recoverable costs	(6)	(55)
Other assets	11	7
Accounts payable	(16)	5
Net change in operating assets & liabilities:	(11)	(43)
Net cash (used in) provided by operating activities	$ (269)	$ (170)

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

1. Reporting Entity

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

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

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

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

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

2. Summary of Significant Accounting Policies

Basis of Presentation

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

The financial statements of the Fund are intended to present the financial position, and the changes in financial position and cash flows, where applicable, of only that portion of the business-type activities and major funds of the State of California that is attributable to the transactions of the Fund. They do not purport to, and do not, present fairly the financial position of the State of California as of September 30, 2011 and 2010, 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

DWR is required to at least annually establish a revenue requirement determination to recover all Fund costs, including debt service. The revenue requirement determination is submitted to the

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

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

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

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 September 30, 2011, 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, 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*. This Statement provides financial reporting guidance which standardizes the presentation of deferred outflows of resources and deferred inflows of resources and their effects on a government's net position. The requirements of Statement No. 62 are effective for the Fund beginning in fiscal 2012. The Fund is currently evaluating the impact this statement will have, if any, on its financial statements.

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*. 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.

3. Restricted Cash and Investments

As of September 30, 2011, the Fund had the following investments (in millions):

Investment	Maturity	September 30, 2011
State of California Pooled Money Investment Account - State Money Investment Fund	7.8 months avg.	$ 2,609
Cash		10
Total cash and equivalents		2,619
Guaranteed investment contracts	May 1, 2022	200
Forward purchase agreement	November 1, 2011	100
		$ 2,919
Reconciliation to Statement of Net Assets:		
Operating Reserve Account		$ 288
Debt Service Reserve Account		919
Operating and Priority Contract Accounts		870
Bond Charge Collection and Bond Charge Payment Accounts		842
		$ 2,919

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 September 30, 2011 $6 million of the Fund's cash balances were uninsured and uncollateralized.

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

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

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

Interest on deposits in the PMIA varies with the rate of return of the underlying portfolio and approximated 0.4% at September 30, 2011. For the three months ended September 30, 2011, interest earned on the deposit in the PMIA was $2 million.

Interest on the GICs is paid semi-annually at interest rates ranging from 5.3% to 5.5%. Interest earned on the GICs was $3 million for the three months ended September 30, 2011.

The FPA allows DWR to continuously reinvest funds in U.S. government or U.S. government agency securities through May 2022 to earn a minimum rate of return of 4.7%, as specified in the Reserve Fund Forward Purchase and Sale Agreement, dated May 1, 2004. The reinvested securities are to mature every six months. Interest earned on the FPA was $1 million for the three months ended September 30, 2011.

The Fund's investments in the guaranteed investment contracts and forward purchase agreement are rated as follows, by Standard & Poor's (S&P) and Moody's, respectively, at September 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

On September 21, 2011, Moody's Investor Service downgraded Merrill Lynch, the provider of the FPA, to Baa1 from A2. The rating of the FPA remains unchanged as the investment is fully collateralized by U.S. government or government agency securities.

4. Long-Term Debt

The following activity occurred in the long-term debt accounts during the three months ended September 30, 2011 (in millions):

	Revenue Bonds	Unamor-tized Premium	Deferred Loss on Defeasance	Total Revenue Bonds
Balance, June 30, 2011	$ 7,830	$ 467	$ (461)	$ 7,836
Refunding				
Issuance of Debt	960	156	-	1,116
Defeasance of Debt	(1,106)	-	(13)	(1,119)
Amortization	-	(27)	24	(3)
Balance, Sep 30, 2011	7,684	596	(450)	7,830
Less current portion	(556)	(118)	97	(577)
	$ 7,128	$ 478	$ (353)	$ 7,253

The tax exempt revenue bonds consist of the following at September 30, 2011 (in millions):

Series	Rates	Fiscal Year of Final maturity	Fiscal Year of First Call Date	Amount Outstanding 2011	
A	Fixed (3.8-5.5%)	2012	2012	$	314
F	Fixed (4.375-5.00%)	2022	Callable		348
G	Fixed (4.35-5.00%)	2018	Callable		173
H	Fixed (3.75-5.0%)	2022	2018		1,007
K	Fixed (4.0-5.0%)	2018	Non-callable		279
L	Fixed (2.0-5.0%)	2022	2020		2,919
M	Fixed (2.0-5.0%)	2020	Non-callable		1,684
N	Fixed (2.0-5.0%)	2021	Non-callable		960
Total bond debt outstanding at par				$	7,684
Plus unamortized bond premium					478
Less deferred loss on defeasance					(353)
Less current maturities					(556)
Total long-term bond debt outstanding				$	7,253

Bond refunding transactions

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

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

Key terms

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

The Series A bonds are callable May 1, 2012 at a redemption rate of 100%. The Series F and Series H bonds are callable in 2018 at a redemption rate of 100%. The Series L bonds are callable in 2020 at a redemption rate of 100%. All variable rate bonds have been refunded and their related credit enhancement facilities have been terminated on September 1, 2011.

Prior to being refunded, the payment of principal and interest for all $25 million Series B bonds, $947.6 million of Series C bonds, were paid under liquidity agreements with four different banks. The

Fund paid fees of 0.70% per annum on the stated amount of the liquidity agreements for the Series B and C bonds.

Remarketing, credit support and related uncertainties

Through August 31, 2011, the Fund bonds were remarketed by seven different broker-dealer remarketing agents, with credit enhancement provided by four 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. Letters of credit require the Fund to repay the bonds in eleven equal quarterly installments, while 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. There were no outstanding bank bonds as of September 30, 2011.

Effective September 1, 2011, all variable rate bonds were refunded by fixed rate bonds and all credit enhancement facilities were terminated. At September 30, 2011, there are no outstanding amounts due under liquidity facilities. Prior to termination, the Fund paid fees of 0.37 to 0.70% per annum under the liquidity facilities.

Maturities

As of September 1, 2011, the Fund executed a Series 2010 N refunding transaction that included refunding all remaining $948 million in variable rate bonds and terminating all the remaining credit enhancement facilities capacity.

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

Fiscal Year	Principal	Interest [1]	Total
2012	$ 556	$ 352	$ 908
2013	574	340	914
2014	611	314	925
2015	618	286	904
2016-20	3,603	962	4,565
2021-22	1,723	130	1,853
	$ 7,684	$ 2,384	$ 10,068

5. Derivative Financial Instruments

GASB 53 requires governments to record derivative instruments on the statement of net assets as either assets or liabilities depending on the underlying fair value of the derivative. The Fund is party to 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 September 30 and June 30, 2011.

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

As of September 30, 2011

		Business-type activities		Value	Notional	
Effective hedges						
Assets						
	Current	Gas Swaps	$	1	3,190,000	MMBtu
	Long Term	Gas Swaps	$	-	-	MMBtu
			$	1		
Liabilities						
	Current	Gas Swaps	$	(17)	7,542,500	MMBtu
	Long Term	Gas Swaps	$	-	-	MMBtu
			$	(17)		
Investment hedges						
Assets						
	Current	Gas Swaps	$	2	5,862,500	MMBtu
	Current	Gas Options	$	-	14,107,500	MMBtu
	Long Term	Gas Swaps	$	-	-	MMBtu
	Long Term	Gas Options	$	-	-	MMBtu
			$	2		
Liabilities						
	Current	Gas Swaps	$	(4)	2,067,500	MMBtu
	Current	Gas Options	$	-	-	MMBtu
	Long Term	Gas Swaps	$	(2)	530,000	MMBtu
			$	(6)		

As of June 30, 2011

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

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

Commodity contracts

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

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

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

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

Credit Risk: The Fund's open natural gas hedge positions at September 30, 2011 are with six different counterparties, all of which have credit ratings of at least A-/Baa1. At September 30, 2011, the Fund has credit risk exposure to three counterparties totaling $1 million, representing transactions with market values that are in the Fund's favor. There is no substantial credit exposure to the remaining three counterparties, as the low level of natural gas prices and the expiration of contracts have resulted in valuations in the counterparties' favor. The remaining gas hedge positions have been entered into through the Fund's brokerage accounts and the associated clearing accounts have collateral requirements that limit the Fund's counterparty credit risk.

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

6. Commitments and Contingencies

Litigation and Regulatory Proceedings

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

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

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

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

As to refunds owed, FERC has ruled that to the extent the Fund could demonstrate that payment of refunds would result in the Fund's costs exceeding its revenues remaining after payment of refunds, the Fund could request FERC to reduce the refunds. The Fund made a cost recovery filing that the Fund believes demonstrates that its costs related to sales to the CAISO exceeded its revenues, a demonstration that, if approved by FERC, would eliminate any refund amount the Fund might otherwise be required to pay. In January 2006, FERC deferred action on the Fund's cost filing on the basis that the Fund, as described above, likely will be a net refund recipient, and net refund recipients, according to FERC, cannot make cost filings. Certain parties to the litigation have sought rehearing of that order.

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

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

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

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

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

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

Other Contingencies

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

Commitments

DWR has power purchase contracts that have remaining lives of up to four years. Payments under these and gas purchase contracts approximated $469 million and $726 million for the three month period ended September 30, 2011 and 2010, respectively.

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

For the Year Ending June 30,	Fixed Obligation (in millions)
2012	212
2013	24
2014	13
2015	4
Thereafter	1
	$ 254

In addition to the fixed costs there are variable costs under several of the contracts. Management projects as of September 30, 2011 that the amount of future fixed and variable obligations associated with long-term power purchase contracts would approximate $350 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 quarter ended September 30, 2011, the Fund received $10 million in energy settlements. The Fund received $6 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 City of Pasadena. The Fund also received $3 million from the Modesto Irrigation District ("MID") as part of the FERC refund settlement agreement signed by the California Parties and MID.

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. Prior to the issuance of the Series 2011 N bonds, total commitment for liquidity facilities underlying the STRS' participation approximated $151 million. There are no outstanding amounts on the liquidity facilities at September 30 and June 30, 2011.

In August 2011, the Fund executed the 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.