Department of Water Resources
Electric Power Fund
Financial Statements

September 30, 2013

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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 financial statements include three required statements, which provide different views of the Fund. They are: the Statements of Net Position, the Statements of Revenues, Expenses and Changes in Net Position, and the Statements of Cash Flows. These statements provide current and long-term information about the Fund and its activities. These financial statements report information using accounting methods similar (although not identical) to those used by private sector companies. The Statements of Net Position include all assets, liabilities and deferred outflows and inflows of resources as of the period ending date. The Statements of Revenues, Expenses and Changes in Net Position present all of the current year's revenues, expenses, and changes in net position. The Statements of Cash Flows reports cash receipts, disbursements and the net change in cash resulting from four principal types of activities: operating, capital financing, non-capital financing and investing. In order for the financial statements to be complete, they must be accompanied by a complete set of notes. The notes to financial statements provide disclosures which are required to conform to generally accepted accounting principles. The Fund is required to follow accounting standards promulgated by the Governmental Accounting Standards Board.

PURPOSE OF FUND

The Fund was established in January 2001 through legislation to assist 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 expired by June 30, 2013 and the last of the power supply contracts expires in September 2015.

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

This report should be read in conjunction with the Fund's June 30, 2013 audited financial statements.

CONDENSED STATEMENTS OF NET POSITION

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

	September 30, 2013	June 30, 2013
Long-term restricted cash, equivalents and investments	$ 937	$ 937
Recoverable costs	4,911	5,083
Derivative instruments	-	-
Restricted cash and equivalents:		
Operating and priority contract accounts	189	210
Bond charge collection and bond charge payment accounts	796	554
Recoverable costs, receivable	120	111
Interest receivable	7	4
Other assets	13	14
Total assets	6,973	6,913
Deferral of loss on defeasance cash outflows	98	104
Deferral of derivative cash outflows	1	2
Total deferred outflows of resources	99	106
Total assets and deferred outflows of resources	$ 7,072	$ 7,019
Long-term debt, including current portion	$ 6,928	$ 6,951
Derivative instruments	1	2
Other postretirement benefits and accrued vacation	5	5
Other current liabilities	138	61
Total liabilities	7,072	7,019
Deferral of derivative cash inflows	-	-
Total liabilities and deferred inflows of resources	$ 7,072	$ 7,019

Long-Term Restricted Cash and Investments

The Operating Reserve Account remained unchanged at $18 million at September 30, 2013 from June 30, 2013. The amount is determined in accordance with the Master Trust Indenture (the Indenture) and is equal to the maximum of one month priority contract cost amount under stress conditions for the calendar year 2013 as forecasted in the Fund's 2013 revenue requirement determination. The balance of the Debt Service Reserve Account remains at $919 million, and was also determined in accordance with the requirements of the Indenture.

Recoverable Costs

Long-term recoverable costs consist of costs that are recoverable through future billings. The $172 million net decrease in long-term recoverable costs during the three month period ended September 30, 2013 is the net of 1) operating expenses exceeding operating revenues by $19 million, as power charges were lower due to lower remittance rates and the return of excess amounts to the IOUs, 2) bond charge revenue exceeding interest expense by $192 million and 3) a $1 million change in the unrealized loss on open and ineffective natural gas futures contracts at period end.

Derivative Instruments – Assets

There are no outstanding derivative assets at September 30, 2013 and June 30, 2013. All remaining natural gas swap hedge contracts have negative fair value.

Deferral of derivative cash outflows decreased $1 million at September 30, 2013 and June 30, 2013 as the few remaining natural gas futures contracts expire.

Restricted Cash and Equivalents

The Operating and Priority Contract Accounts decreased by $21 million during the three month period ended September 30, 2013. The Fund purposefully reduced cash balances while staying within the requirements of the Indenture 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 $242 million in the period ended September 30, 2013 in anticipation of the semi-annual interest payment on fixed rate bonds due on November 1, 2012, with the next principal and interest payment due May 1, 2013.

From the dates of issuance of the revenue bonds through September 30, 2013, the balances in each of the restricted cash and investments accounts met or exceeded balances required by the Indenture.

Recoverable Costs Receivable

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 increased $9 million to $120 million at September 30, 2013 from $111 million at June 30, 2013 due to an increase in IOU power charge and power sales revenue receivables.

Other Assets

At September 30, 2013, other assets consisted of money market obligations and other derivative collateral balances valued at $13 million, a decrease of $1 million from June 30, 2013 as contracts expired and natural gas prices fell.

Long-Term Debt

Long-term debt decreased to $6,928 million as of September 30, 2013 from $6,951 million at June 30, 2013. The decrease is attributable to the net of amortization of premium.

Derivative Instruments- Liabilities

The Fund is party to natural gas hedging positions that are considered to be derivatives under the provisions of GASB 53 and included on the statement of Net Position for the periods ended September 30, 2013 and June 30, 2013.

Derivative financial instrument liabilities decreased $1 million, and were valued at $1 million and $2 million at September 30, 2013 and June 30, 2013, respectively. These liabilities increased as natural gas futures contracts expire and the Fund has not entered into new contracts.

There were no deferred inflows at September 30, 2013 or at June 30, 2013, as few open derivative financial instrument assets remain.

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, 2013 accounts payable are $2 million lower than at June 30, 2013 as contract volumes decreased due to lower dispatch by the system operator.

Accrued interest payable increased to $131 million at September 30, 2013 from $52 million at June 30, 2013 in anticipation of the next interest payment date on November 1, 2013.

CONDENSED STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION

The Fund's activities for the three months ended September 30, 2013 and 2012 are summarized as follows (in millions):

	2013	2012
Revenues:		
Power charges, net of refunds	$ (1)	$ (183)
Surplus sales	6	-
Bond charges	248	252
Interest income	5	7
Total revenues	258	76
Expenses:		
Power purchases	20	12
Energy settlements	-	-
Interest expense	61	81
Investment loss	-	-
Administrative expenses	4	4
Recovery of recoverable costs	173	(21)
Total expenses	258	76
Net increase in net position	-	-
Net position, beginning of year	-	-
Net position, 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 increased by $182 million in the three months ended September 30, 2013 compared to the same three month period in 2012. The difference primarily reflects a smaller return of excess amounts and previously received remittances to ratepayers in the Pacific Gas and Electric Company (PG&E) and Southern California Edison (SCE) service territories.

The return of excess amounts and previously received remittances are an allocation of prior year over-collections from ratepayers and reserves in excess of Indenture required levels. During the first three months of fiscal 2014, the Fund returned $29 million to ratepayers and will return a total of $58 million during the first six months of fiscal year 2014. This allocation of prior year over-collections and excess reserves was authorized by the CPUC in Decision 12-11-040. It is anticipated that the Fund will continue the return of excess amounts and previously received remittances to ratepayers in PG&E's and SCE's service territories during calendar year 2014. Amounts will be determined as part of the Fund's annual 2014 Revenue Requirement Determination.

In first three months of fiscal 2013, the Fund returned $195 million in excess amounts and previously received remittances to PG&E ratepayers in separate monthly payments. This allocation of prior year over-collections and excess reserves was authorized by the CPUC in Decision 11-12-005.

Surplus Sales

Surplus sales of energy and natural gas in the three month period ended September 30, 2013 were $6 million higher than in the same period in 2012. The primary factors were an increase in volume of power sales from power plant dispatches by the California Independent System Operator (CAISO).

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, 2013 are $4 million lower than the same period in 2012 due to lower bond revenue receivable. The amount collected is adequate to meet all debt service requirements and maintain Indenture required account balances in the Bond Charge Collection, Bond Charge Payment, and Debt Service Reserve Accounts.

Interest Income

Interest income of $5 million for the three months ended September 30, 2013 is $2 million lower than for the same period in 2012. The decrease is a result of lower interest rates on and lower balances in the State of California Surplus Money Investment Fund (SMIF).

Power Purchases

Power costs are $8 million higher in the three months ended September 30, 2013 than in the same period in 2012. The increase in costs is primarily due to the greater generator dispatch under the purchase power contracts.

Energy Settlements

In the quarters ended September 30, 2013 and 2012, there were no revenues received from energy settlements.

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, 2013 decreased $20 million from the same period in 2012 due to lower amounts of outstanding debt.

Investment Loss

The Fund realized no investment expenses from expiring ineffective natural gas futures contracts for the three months ended September 30, 2013 and September 30, 2012.

Administrative Expenses

Administrative expenses in the three months ended September 30, 2013 were unchanged from than the same period in 2012.

Recovery of Recoverable Costs

The individual components of the recovery (deferral) of recoverable costs are as follows for the three months ended September 30, 2013 and 2012 (in millions):

	2013	2012
Operations	$ (19)	$ (199)
Debt service and related costs	192	178
	$ 173	$ (21)

Operations
There was a deferral of recoverable costs of $19 million for the three months ended September 30, 2013, compared to the $199 million deferral of recovery in the same period in 2012. The deferral in the three months ended September 30, 2013 reflects less power charge revenue received than needed to pay power costs as the Fund purposefully reduces cash balances through lower rates to ratepayers.

Debt Service and Related Costs
The recovery of debt service and bond related costs are $14 million higher for the three months ended September 30, 2013 compared to the same period in 2012. The recovery is comprised solely of the difference between bond charges and interest income less interest expense. The larger recovery is due to higher revenues from the collection of bond charges.

LIQUIDITY

Various provisions of the Trust Indenture provide resources for the Fund to meet its cash requirements. In addition to its determination of revenue requirements, prepared annually or more frequently if necessary, to meet both operating and bond related expenditures, the Fund has an Operating Reserve and a Debt Service Reserve Fund in order to meet expenditures if revenue is impaired. The minimum balance in the Operating Reserve Account is set to be the greater of (i) the maximum seven-month difference between operating revenues and expenses as calculated under a high expense scenario, (ii) 12% of the Department's annual operating expenses and (iii) an amount equal to the maximum projected monthly power purchase contract cost. The minimum balance in the Debt Service Reserve Fund is set to be the maximum annual debt service over the remaining life of the Fund's bonds.

Under the Section 80130 of the California Water Code, the Fund has a total debt issuance limit of $13.4 billion, which does not include refunding debt issued: (i) to obtain a lower interest rate, (ii) to convert variable rate debt to fixed rate debt or (iii) to replace debt for which the credit rating of the insurer or credit facility provider has been or will be downgraded or withdrawn.

With the Series 2011 N refunding transaction done in fiscal 2012, the Fund has no variable rate bonds outstanding. The Fund terminated all of the outstanding credit enhancement facilities relating to those bonds.

There were no changes to bond ratings in the quarter ended September 30, 2013 or in fiscal 2013.

Department of Water Resources Electric Power Fund
Statements of Net Position
September 30, 2013 and June 30, 2013 (in millions)

	September 30, 2013	June 30, 2013
Assets		
Long-term assets:		
Restricted cash, equivalents and investments:		
Operating Reserve Account	$ 18	$ 18
Debt Service Reserve Account	919	919
Recoverable costs	4,911	5,083
Total long-term assets	5,848	6,020
Current assets:		
Restricted cash and equivalents:		
Operating and Priority Contract Accounts	189	210
Bond Charge Collection and Bond Charge Payment Accounts	796	554
Recoverable costs, receivable	120	111
Interest receivable	7	4
Other assets	13	14
Total current assets	1,125	893
Total assets	6,973	6,913
Deferred outflows of resources		
Deferral of loss on defeasance	98	104
Deferral of derivative cash outflows	1	2
Total deferred outflows of resources	99	106
Total assets and deferred outflows of resources	$ 7,072	$ 7,019
Liabilities		
Non-Current liabilities:		
Long-term debt	$ 6,229	$ 6,249
Derivative instruments	-	-
Other postemployment benefits and accrued vacation	5	5
Total non-current liabilities	6,234	6,254
Current liabilities:		
Current portion of long-term debt	699	702
Derivative instruments, current portion	1	2
Accounts payable	7	9
Accrued interest payable	131	52
Total current liabilities	838	765
Total liabilities	$ 7,072	$ 7,019

Commitments and Contingencies (Note 6)

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 Position
For the three months ended September 30, 2013 and 2012 (in millions)

	2013	2012
Operating revenues:		
Power charges, net of refunds	$ (1)	$ (183)
Surplus sales	6	-
Total operating revenues	5	(183)
Operating expenses:		
Power purchases	20	12
Energy settlements	-	-
Administrative expenses	4	4
Recovery of recoverable operating costs	(19)	(199)
Total operating expenses	5	(183)
Income from operations	-	-
Bond charges	248	252
Interest income	5	7
Interest expense	(61)	(81)
Investment income from debt related derivatives	-	-
Investment loss from gas related derivatives	-	-
Recovery of recoverable debt service and related costs	(192)	(178)
Net increase in net position	-	-
Net position, beginning of year	-	-
Net position, 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, 2013 and 2012 (in millions)

		2013		2012
Cash flows from operating activities:				
Receipts:				
Power charges, net of refunds	$	(3)	$	(152)
Surplus sales		5		2
Energy settlements		-		-
Payments to employees for services		(1)		-
Payments for power purchases and other expenses		(24)		(63)
Net cash used in operating activities		(23)		(213)
Cash flows from non-capital financing activities:				
Receipt of bond charges		241		242
Bond payments		-		-
Interest payments		1		-
Proceeds from issuance of revenue bonds		-		-
Defeasance of revenue bonds		-		-
Net cash used in non-capital financing activities		242		242
Cash flows from investing activities:				
Interest received on investments		2		1
Loss from derivative investments		-		(2)
Net cash provided by investing activities		2		(1)
Net decrease in cash and equivalents		221		28
Restricted cash and equivalents, beginning of period		1,401		1,865
Restricted cash and equivalents, end of period	$	1,622	$	1,893
Restricted cash and equivalents included in:				
Operating Reserve Account	$	18	$	68
Debt Service Reserve Account (a component of the total of $919 and $919 at September 30, 2013 and 2012, respectively)		619		619
Operating and Priority Contract Accounts		189		383
Bond Charge Collection and Bond Charge Payment Accounts		796		823
Restricted cash and equivalents, end of year	$	1,622	$	1,893
Reconciliation of operating income to net cash used in operating activities:				
Income from operations	$	-	$	-
Adjustments to reconcile operating income to net cash used in operating activities:				
Recovery of recoverable operating costs		(19)		(199)
		(19)		(199)
Changes in net assets and liabilities to reconcile operating income to net cash used in operations:				
Recoverable costs		(2)		31
Other assets		-		4
Other postemployment benefits and accrued vacation		-		-
Accounts payable		(2)		(49)
Net change in operating assets & liabilities:		(4)		(14)
Net cash used in operating activities	$	(23)	$	(213)

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 (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 the State's investor owned utilities (IOUs): Pacific Gas & Electric Company (PG&E), Southern California Edison Company (SCE), and San Diego Gas and Electric Company (SDG&E). 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's power is delivered to the customers through the transmission and distribution systems of the IOUs and payments from the customers are collected for the Fund by the IOUs pursuant to servicing arrangements approved and/or ordered by the California Public Utilities Commission (CPUC).

Under the Code, the Fund has the authority to establish a revenue requirement to recover all Fund costs, including debt service. At least annually, Fund management establishes a determination of the revenue requirement, which then is submitted to 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 end use customer rates that meet the Fund's revenue needs to assure the payment of debt service, power purchases, administrative expenses and maintenance of operating and debt service 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. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles, which considers the Fund a Regulated Operation under GASB codification Re10. The Fund is accounted for with a set of self-balancing accounts that comprise its assets, liabilities, net position, revenues and expenses.

The financial statements of the Fund are intended to present the financial position, and the changes in financial position and cash flow, 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, 2013 and 2012, 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.

Restricted Cash, Equivalents and Investments

Under the terms of the Trust Indenture among the State of California, Department of Water Resources, Treasurer of the State of California, as Trustee and U.S. Bank, N.A, as Co-Trustee (Trust 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 was initially funded with proceeds of the Series 2002 Bonds. The Operating Reserve Account must maintain a balance equal to the greater of (i) the maximum seven-month difference between operating revenues and expenses as calculated under a high expense scenario, (ii) 12% of the Department's annual operating expenses and (iii) an amount equal to the maximum projected monthly power purchase contract cost. If the Operating Reserve Account needed to be replenished, the funds would be transferred from the Operating Account.

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 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 and fees estimated to accrue or be payable for the next succeeding three months.
- Debt Service Reserve Account: The Debt Service Reserve Account was initially funded with proceeds of the Series 2002 Bonds. 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. If the Debt Service Reserve Account needed to be replenished, the funds would be transferred from either the Bond Charge Collection Account.

Restricted cash and equivalents, for purposes of the Statements of Cash Flows, include cash on hand and deposits in the Surplus Money Investment Fund (SMIF). The Operating Reserve Account and Debt Service Reserve Account (net of investments) are classified as long-term restricted cash due to requirements under the Trust Indenture to hold amounts in excess of anticipated current payments for operating and bond related expenses. Amounts required to be held in reserve are determined annually with the Fund's revenue requirement.

SMIF has an equity interest in the State of California Pooled Money Investment Account (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 fair value. 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.

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 (FPA). The GICs are carried at cost and the U.S. government backed agency security is carried at amortized cost and not at fair value because the investments are non-negotiable and non-transferable.

Net Position

The Fund does not record the difference between assets and liabilities as changes in net position. The difference between assets and deferred outflows of resources and liabilities on the Statements of Net Position is presented as recoverable costs such that there is no net position outstanding. The Fund anticipates that amounts in the recoverable costs will be recovered in subsequent years prior to program expiration.

Other Assets

The Fund entered into futures and option contracts for the purpose of hedging of the cost of natural gas used as fuel for power production. Collateral values, net trade equity and margin investments held in a brokerage account are accounted for as other assets on the Statements of Net Position. The brokerage firm that facilitates 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 September 30, 2013, other assets are valued at $13 million, and consisted of money market investments valued at $10 million and other collateral balances valued at $3 million. At June 30, 2013, other assets consist of money market investments valued at $10 million and other collateral balances valued at $4 million.

Revenues and Recoverable Costs

The Fund is required, at least annually, to establish a determination of the revenue requirement to be submitted to the CPUC, which then sets end use customer remittance rates. The Fund's financial statements are prepared in accordance with Section Re10 of the GASB Codification, “*Regulated Operations*”, which requires that the effects of the revenue requirement process be recorded in the financial statements. Accordingly, all expenses and credits, normally reflected in the change in net position as incurred, are recognized as recoverable costs in the Statements of Net Position and are recovered from IOU customers. Costs that are recoverable through future billings are recorded as long-term assets.

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 IOU customers. 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 sale of gas not needed for the generation of power and energy dispatched by the California Independent System Operator (CAISO) from the Fund’s power purchase agreements for grid reliability.

3. Restricted Cash and Investments

As of September 30, 2013, the Fund had the following investments (in millions):

Investment	Maturity	September 30, 2013	
State of California Pooled Money Investment Account - Surplus Money Investment Fund	7.9 months avg.	$	1,618
Cash			4
Total cash and equivalents			1,622
Guaranteed investment contracts	May 1, 2022		200
Forward purchase agreement	November 1, 2013		100
		$	1,922
Reconciliation to Statements of Net Position:			
Operating Reserve Account		$	18
Debt Service Reserve Account			919
Operating and Priority Contract Accounts			189
Bond Charge Collection and Bond Charge Payment Accounts			796
		$	1,922

Custodial Credit Risk: Under GASB Statement No. 40, custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of investment or collateral securities that are in the possession of an outside party. 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 held in the State's name. At June 30, 2013 and 2012, one of the guaranteed investment contracts in the amount of $100 million was uninsured and uncollateralized.

Interest Rate Risk: Under GASB Statement No. 40, 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 maturity, tend to be more sensitive to changes in interest rates and, therefore, more volatile than those with shorter maturities. 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: Under GASB Statement No. 40, credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. 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: Concentration of credit risk in SMIF 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 SMIF portfolio. At September 30, 2013, the Fund's investments in the forward purchase agreement (FPA) and two guaranteed investment contracts (GICs) individually exceed 5.0% of total investments. The ratings of the investments and their relative percentages of total investments is shown in the following table:

	Amount	Credit Rating	Percent of Total Investments September 30, 2013
FPA Provider			
Merrill Lynch: FHLMC Discounted Notes	$ 100	Not Rated	5.21%
GIC Providers			
FSA	$ 100	Not Rated	5.21%
Royal Bank of Canada	100	Not Rated	5.21%
	$ 200		

Interest on deposits in SMIF varies with the rate of return of the underlying portfolio and approximated 0.3% at September 30, 2013. For the three months ended September 30, 2013, interest earned on the deposit in the SMIF was $1 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, 2013.

The FPA allows the Fund to continuously reinvest funds in U.S. government or U.S. government agency securities through May 2022 to earn a minimum rate of return of 4.7%, as specified in the Reserve Fund Forward Purchase and Sale Agreement, dated May 1, 2004. The reinvested securities are to mature every six months. Interest earned on the FPA was $1 million for the three months ended September 30, 2013.

4. Long-Term Debt

The following activity occurred in the long-term debt accounts during the three months ended September 30, 2013 (in millions):

	Revenue Bonds	Unamortized Premium	Total
Balance, June 30, 2013	6,554	397	6,951
Amortization	-	(23)	(23)
Balance, September 30, 2013	6,554	374	6,928
Less current portion	611	88	699
	$ 5,943	$ 286	$ 6,252

The tax exempt revenue bonds consist of the following at September 30, 2013 (in millions):

Series	Rates	Fiscal Year of Final maturity	Fiscal Year of First Call Date	Amount Outstanding 2013	Current Portion
F	Fixed (4.38-5.00%)	2022	2018	$ 348	$ -
G	Fixed (4.35-5.00%)	2018	Non-callable	173	-
H	Fixed (3.75-5.00%)	2022	2018	1,007	-
K	Fixed (4.00-5.00%)	2018	Non-callable	279	-
L	Fixed (2.50-5.00%)	2022	2020	2,708	261
M	Fixed (2.00-5.00%)	2020	Non-callable	1,234	350
N	Fixed (2.00-5.00%)	2021	Non-callable	805	-
				6,554	611
Plus unamortized bond premium				374	88
				$ 6,928	$ 699

Bond refunding transactions

The Fund has issued revenue refunding bonds to advance refund various bonds that were previously issued. The net proceeds from these sales were used to purchase U.S. Treasury Securities that were deposited in irrevocable escrow trust accounts with the State Treasurer acting as an independent fiscal agent to provide for all future debt service on the bonds being refunded. As a result, those bonds are considered defeased and the related liabilities have been excluded from the Fund's financial statements. At June 30, 2013 and 2012, there was no outstanding debt that has been considered defeased.

With the Series 2011 N refunding transaction completed in August 2011, the Fund has no variable rate bonds outstanding. The Fund terminated all of the outstanding credit enhancement facilities relating to those bonds.

Key terms

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

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

Maturities

Future payment requirements on the revenue bonds are as follows at September 30, 2013 (in millions):

Fiscal Year	Principal	Interest	Total
2014	$ 611	$ 314	$ 925
2015	618	286	904
2016	669	258	927
2017	686	227	913
2018	714	194	908
2019-22	3,256	413	3,669
	$ 6,554	$ 1,692	$ 8,246

5. Derivative Financial Instruments

GASB Statement No. 53 requires governments to record derivative instruments on the Statements of Net Position as either assets or liabilities depending on the underlying fair value of the derivative. The Fund is party to natural gas hedging positions that are considered to be derivatives under the provisions of GASB Statement No. 53 and included on the Statements of Net Position as of September 30 and June 30, 2013.

The fair values, classification and notional amounts outstanding for the Fund's natural gas hedge derivatives accounted for as derivative financial instruments at September 30 and June 30, 2013 are summarized in the following tables:

As of September 30, 2013

		Business-type activities	Value	Notional
Effective hedges				
Liabilities				
	Current	**Gas Swaps**	$ (1)	230,000 MMBtu
			$ (1)	

As of June 30, 2013

		Business-type activities	Value (in mllions)	Notional
Effective hedges				
Liabilities				
	Current	Gas Swaps	$ (2)	460,000 MMBtu
			$ (2)	

All effective hedges in asset positions are included within the tables above and have been recorded in the Statements of Net Position as derivative instruments. Changes in fair value for effective hedges are recorded in the Statements of Net Position as deferral of derivative 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 position.

Commodity contracts

At September 30, 2013, the Fund no longer has any outstanding natural gas option contracts. In prior years, the Fund entered into natural gas hedge contracts, futures and options, to hedge the cost of natural gas. All natural gas options were treated as derivatives and were classified as investment derivatives since they do not meet GASB Statement No. 53 hedging criteria.

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

The Fund no longer has any forward natural gas purchase contracts. In prior years, the Fund's forward natural gas purchases were treated as Normal Purchase Normal Sale (NPNS) contracts and were therefore not required to be recorded prior to settlement.

Changes in fair value of derivatives that are classified as investment derivatives are included as investment loss on the Statement of Revenues, Expenses and Changes in Net Position.

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

Credit Risk: The Fund's open natural gas hedge positions at September 30, 2013 have been entered into through the Fund's brokerage accounts and the associated clearing accounts have collateral requirements that limit the Fund's counterparty credit risk.

Termination Risk: With regards to 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 (CalPX) markets during 2000 and 2001. FERC ruled that the Fund would not be entitled in that proceeding to approximately $3.5 billion in refunds associated with the Fund's approximately $5.0 billion of short-term purchases because the Fund made those purchases bilaterally, not in the CalPX or CAISO markets. The Ninth Circuit Court of Appeals affirmed FERC, but left open the possibility of refunds on the Fund's bilateral purchases in other FERC proceedings. In contrast, FERC ruled that the Fund is entitled to refunds on purchases made by the CAISO where the Fund actually paid the bill.

Of the Fund's $5.0 billion in short-term bilateral purchases, $2.9 billion 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. Refunds owed to the Fund for purchases it made in a given hour may, however, be offset by the amount of refunds owed by the Fund for its sales to the market during that same hour. Such offsets, however, will not change the Fund's status as a net refund recipient.

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

During fiscal year 2011, three of the Fund's power purchase contracts were novated. Management does not believe it is likely that there will be additional contract novations because only one power purchase contract will remain after December 31, 2013.

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 three fiscal years. Payments under these and gas purchase contracts approximated $20 million and $12 million for the three month periods ended September 30, 2013 and 2012, respectively.

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

The remaining amounts of fixed obligations under the contracts as of September 30, 2013, are as follows (in millions):

For the Year Ending June 30,	Fixed Obligation (in millions)	
2014	$	24
2015		27
2016		17
2017		15
2018		12
	$	95

In addition to the fixed costs there are variable costs under several of the contracts. Management projects as of September 30, 2013 that the amount of future fixed and variable obligations associated with long-term power purchase contracts would approximate $101 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 used as fuel.

All of the power 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.

7. Energy Settlements

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

In the quarters ended September 30, 2013 and 2012, there were no revenues received from energy settlements.

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.