State Water Resources Development System

Combined Financial Statements and Supplementary Information

For the years ended June 30, 2001 and 2000

State Water Resources Development System
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For the years ended June 30, 2001 and 2000

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Report of Independent Accountants

The Director of the State of California
Department of Water Resources

In our opinion, the accompanying combined balance sheets and the related combined statements of operations and retained earnings, and cash flows present fairly, in all material respects, the financial position of the State Water Resources Development System (System), a component unit of the State of California, as of June 30, 2001 and 2000, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the System's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States of America, which require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 7, 2001, on our consideration of the System’s internal control over financial reporting and on our tests of its compliance with laws and regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

PricewaterhouseCoopers LLP

December 7, 2001

State Water Resources Development System
Combined Balance Sheets
June 30, 2001 and 2000 (in thousands)

	2001	2000
Assets		
Utility plant:		
Utility plant in service	$ 4,495,092	$ 4,491,500
Less accumulated depreciation	1,386,313	1,310,893
Net utility plant in service	3,108,779	3,180,607
Construction work in progress	72,531	27,928
Total utility plant	3,181,310	3,208,535
Long-term assets:		
Restricted assets:		
Cash and cash equivalents restricted for plant replacements	23,496	20,700
Cash and investments restricted for debt service	164,290	150,313
Cash and cash equivalents on deposit with revenue bond trustee	9,183	9,183
Loans receivable from local water agencies	36,363	35,872
Advances to Pacific Gas & Electric Company	8,057	9,201
Due from other state funds	19,877	19,877
Total long-term assets	261,266	245,146
Current assets:		
Cash and cash equivalents	290,811	286,421
Receivables:		
Interest on investments	6,754	8,724
Water contractor and power billings	113,118	112,369
Advances to other state funds	71,640	71,640
Inventories	9,960	7,304
Other	14,821	6,119
Total current assets	507,104	492,577
Deferred charges:		
Amounts recoverable through future billings under long-term water supply contracts:		
Operations and maintenance expense	66,073	-
Unamortized project costs	455,638	462,058
Unbilled interest earnings on capital costs	493,263	496,566
Total deferred charges	1,014,974	958,624
Total assets	$ 4,964,654	$ 4,904,882

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

June 30, 2001 and 2000 (in thousands)

	2001	2000
Capitalization and Liabilities		
Capitalization:		
System equity:		
State contributions in aid of construction	$ 181,654	$ 181,654
Retained earnings	802,690	822,191
Total system equity	984,344	1,003,845
Long-term debt, less current maturities:		
General obligation bonds	864,380	905,420
Revenue bonds	2,371,215	2,359,872
Commercial paper notes	-	28,117
Total long-term debt	3,235,595	3,293,409
Total capitalization	4,219,939	4,297,254
Current liabilities:		
Current maturities of bonds	96,240	91,580
Accounts payable	89,362	41,790
Accrued vacation	18,746	11,994
Accrued interest on long-term debt	23,347	23,931
Due to other state funds	50,391	18,138
Proceeds due to water contractors	141,155	59,404
Other	4,408	311
Total current liabilities	423,649	247,148
Deferred credits:		
Deferred revenue - State and Federal capital recovery	188,980	192,552
Deferred depreciation	108,590	91,297
Operations and maintenance expense	-	55,931
Advances for plant replacements	23,496	20,700
Total deferred credits	321,066	360,480
Commitments and Contingencies (Note 8)		
Total capitalization and liabilities	$ 4,964,654	$ 4,904,882

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

State Water Resources Development System
Combined Statements of Operations and Retained Earnings
For the years ended June 30, 2001 and 2000 (in thousands)

	2001	2000
Operating revenues:		
Water supply	$ 506,900	$ 519,691
Power sales	563,993	154,416
Federal reimbursements	16,137	15,598
Advance recovery of current operating expenses, principally under long-term water supply contracts, net	-	(55,931)
Total operating revenues	1,087,030	633,774
Operating expenses:		
Operations and maintenance	339,122	243,128
Purchased power	625,903	126,615
Depreciation expense	75,388	75,352
Deferred operating expenses recovered, principally under long-term water supply contracts, net	(98,291)	23,272
Total operating expenses	942,122	468,367
Income from operations	144,908	165,407
Interest expense	(189,803)	(175,299)
Other income (expense)	25,394	(5,484)
Net loss	(19,501)	(15,376)
Retained earnings, beginning of year	822,191	837,567
Retained earnings, end of year	$ 802,690	$ 822,191

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

State Water Resources Development System
Combined Statements of Cash Flows
For the years ended June 30, 2001 and 2000 (in thousands)

	2001	2000
Cash flows from operating income:		
Receipts from customers	$ 1,163,427	$ 632,794
Payments to employees for services	(162,400)	(169,383)
Payments to suppliers	(716,177)	(211,696)
Net cash provided by operating activities	284,850	251,715
Cash flows from noncapital financing activities:		
Other income	-	3,747
Net cash provided by noncapital financing activities	-	3,747
Cash flows from capital and related financing activities:		
Proceeds from issuance of revenue obligation bonds, net of issuance discounts and premiums	270,207	-
Principal payments on long-term debt	(298,370)	(81,930)
Net change in commercial paper notes	(28,117)	13,753
Interest payments on long-term debt	(189,698)	(177,246)
Additions to utility plant	(45,726)	(23,965)
Net cash used in capital and related financing activities	(291,704)	(269,388)
Cash flows from investing activities:		
Cash received from investment earnings	24,051	5,419
Return of principal on matured investments	20,270	-
Net change loans receivable from local water agencies	(491)	411
Reduction of advance to PG&E	1,144	4,499
Net cash provided by investing activities	44,974	10,329
Net increase in cash and pooled investments	38,120	(3,597)
Cash and pooled investments at July 1, 2000	393,736	397,333
Cash and pooled investments at June 30, 2001	$ 431,856	$ 393,736
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	$ 144,908	$ 165,407
Adjustment to reconcile operating income to net cash provided by operations:		
Depreciation expense	75,388	75,352
(Increase) decrease in deferred charges and credits, net	(95,764)	77,405
Changes in assets and liabilities:		
Increase in receivables	(749)	(52,543)
(Increase) decrease in inventories	(2,656)	857
Increase in other assets	(8,702)	(648)
Decrease in advances to other state funds	-	147
Increase in accounts payable and accrued vacation	54,324	6,159
Increase (decrease) in due to other state funds	32,253	(16,560)
Increase (decrease) in current proceeds due to water contractors	81,751	(3,509)
Increase (decrease) in other liabilities	4,097	(352)
Total adjustments	139,942	86,308
Net cash provided by operating activities	$ 284,850	$ 251,715

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

1. Reporting Entity

The State Water Resources Development System (a component unit of the State of California) (System) includes the State Water Project Facilities (SWP), the Davis-Grunsky Act Program and the San Joaquin Drainage Facilities. The SWP is a complex of dams, water storage facilities, aqueducts, pumping stations and electric generation facilities which have been constructed for the purposes of developing firm water supply and conveying water to areas of need within the State and providing flood control, recreation, fish and wildlife enhancement and hydroelectric power. The System has entered into long-term water supply contracts with 29 customers, known as the "water contractors," in order to recover substantially all System costs. The 29 water contractors are principally located in the San Francisco Bay Area, the Central Valley and Southern California and their service areas encompass approximately 25% of the State's land area and 70% of its population.

The System is accounted for as an enterprise fund and is financed and operated in a manner similar to that of a private business enterprise. The System uses 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 System has elected not to apply statements and related interpretations issued by the Financial Accounting Standards Board after November 30, 1989. The System is administered by the State of California Department of Water Resources (Department) in three funds, including the California Water Resources Development Bond Fund, the Central Valley Water Project Construction Fund, and the Central Valley Water Project Revenue Fund. Each fund is accounted for with a set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues and expenses. The funds are combined to form the System's financial statements. All significant interfund activity is eliminated.

2. Summary of Significant Accounting Policies

Utility Plant

Utility plant is recorded at original cost. Cost includes labor, materials and indirect items such as engineering, supervision, transportation and interest on borrowed funds incurred during construction. Repairs, maintenance and minor purchases of equipment are charged to expense. During the years ended June 30, 2001 and 2000, interest expense of $2,437,000 and $1,338,000, respectively, was capitalized.

Depreciation

Depreciation is provided on a straight-line basis over the estimated useful lives (30 to 100 years) of the various classes of utility plant. Depreciation expense expressed as a percent of average depreciable utility plant approximated 1.66% and 1.67% for each of the years ended June 30, 2001 and 2000, respectively.

Cash and Cash Equivalents

Cash and cash equivalents, for purposes of the statement of cash flows, includes cash on hand and restricted cash on deposit with revenue bond trustee and amounts in short-term investments. Amounts in short-term investments include deposits in the State of California Pooled Money Investment Account-Surplus Money Investment Fund (SMIF) and instruments with original maturities of three months or less.

For the year ended June 30, 2001, the method of reporting cash flows was changed from the indirect method to the direct method, in anticipation of a requirement under Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis – for State and Local Governments*, effective for years beginning after June 15, 2001. This change in accounting principle was applied retroactively to the year ended June 30, 2000, and had no impact on net loss for the years ended June 30, 2001 or 2000, respectively.

Restricted Assets
Cash on deposit with revenue bond trustee consists of debt service reserve funds held with a major national bank for the Series 1973 Devil Canyon-Castaic Facilities bonds.

Cash and investments with the State Treasurer for plant replacements and debt service are restricted as required by the provisions of the water supply contracts and bond resolutions. Restricted funds consist of investments of the same type as those described below.

Investments and Marketable Securities
Cash not required for current use, including restricted cash, is invested in SMIF. SMIF has an equity interest in the State of California Pooled Money Investment Account (PMIA). The investments in PMIA are carried at fair value, which approximates amortized cost. Generally, the investments in PMIA are available for withdrawal on demand.

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 subject to limits of no more than 10% of PMIA. The PMIA does not invest in leveraged products or inverse floating rate securities. The PMIA cash and investments are recorded at amortized cost which approximates market.

The System is authorized by statute to invest in the same types of investment vehicles permitted by the State's Centralized Treasury System. U.S Treasury and agency debt securities are carried at fair value. Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties, and is determined from published data provided by the exchanges, computerized pricing sources, the National Association of Securities Dealers' National Market System, securities custodians, and other authoritative sources. Investments made by the System during the year ended June 30, 2001, are of a similar nature as those held at June 30, 2000.

Deferred Charges and Credits
The System records costs that are recoverable through future billings as a deferred charge and revenues that are in excess of total project costs from inception of the SWP as a deferred credit. These costs include capital costs (depreciation) and operations and maintenance.

Unamortized project costs represent abandoned utility plant and research and development expenditures that are recoverable through future billings to the water contractors under the terms of the water supply contracts.

Unbilled interest earnings on unrecovered capital costs are classified as deferred charges until billed under the terms of the water supply contracts. Unbilled interest earnings represent the System's unrecovered interest since inception, recalculated annually at the System's cumulative weighted average cost of borrowing (Project Interest Rate). The System's Project Interest Rate was 4.62% at June 30, 2001 and 2000, respectively.

Deferred revenue represents payments by the State and Federal governments for their share of the System's recreation and flood control capital costs in excess of the related depreciation expense recognized in the combined statement of operations.

Advances for plant replacements represent billings under the terms of water supply contracts for future replacement of certain System assets. These amounts are deferred in the reserve for replacements, and the assets received are restricted. Costs of replacements are charged to the reserve as incurred.

State Contributions in Aid of Construction

State contributions in aid of construction consist of capital contributed by the State and used to pay for State Water Project construction expenditures. These capital contributions were made from special appropriations from the Investment Fund, Water Fund and General Fund of the State. These amounts are not required to be repaid to the funds from which they were appropriated and are, therefore, reflected as equity contributions in the combined balance sheet.

Bond Issuance Discounts

Bond issuance discounts are reflected as a reduction of bonds outstanding and are amortized over the lives of the related debt instruments.

Revenues

The cost of providing services from the System is intended to be recovered through user charges and other reimbursements. Under the terms of the long-term water supply contracts, the System granted the water contractors rate management reductions of approximately $36,615,000 and $32,430,000 during the years ended June 30, 2001 and 2000, respectively.

Revenues under long-term water supply contracts are recognized when billings are due and payable. The billings cover debt service requirements, an additional 25% of revenue bond debt service to meet bond covenants, current operations and maintenance costs and past unrecovered operations and maintenance costs. The water supply contracts provide that the 25% portion of the billings collected for the purpose of meeting certain bond covenants be refunded in the subsequent year. These billings, which totaled $40,854,000 and $44,375,000 in 2001 and 2000, respectively, are recorded as a liability in the financial statements. The System refunded $35,281,000 and $43,275,000 in 2001 and 2000, respectively, to the water contractors for the 25% bond cover requirement.

The System's water supply revenue is derived from 29 water contractors, including Metropolitan Water District of Southern California, Kern County Water Agency, and Santa Barbara County Flood Control and Water Conservation District whose System billings constitute 60%, 10% and 5% of total System water supply revenue, respectively.

Revenues from the sale of surplus power are recognized as the power is delivered.

The State reimburses the System for operating and capital costs incurred by the System for recreation purposes. Costs incurred for flood control are reimbursed by the Federal government. In addition, the Federal government reimburses the State for its share of the operating costs of the San Luis joint use facilities and other water facilities. Revenue from the State and Federal government in excess of their share of the related depreciation expense is deferred.

Future Pronouncements
Effective for years beginning after June 15, 2001, the System will be required to implement Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements -- and Management's Discussion and Analysis – for State and Local Governments*. GASB 34 establishes new reporting requirements for the annual financial statements of state and local governments, including requirements for both a “management’s discussion and analysis” and other expanded “required supplementary information”.

3. Interests in Jointly Owned Facilities

At June 30, 2001, the System owned the following undivided interests in jointly owned facilities:

		System's Share (in thousands)	
	% Owned by System	Utility Plant in Service	Accumulated Depreciation
Reid Gardner Power Plant Unit No. 4	67.8 %	$ 325,047	$ 193,023
San Luis joint use facilities	55.0 %	$ 260,377	$ 88,225

The amounts above include the System's share of direct costs related to building the facilities. Each participant provides its own financing for the jointly owned facility.

The Department is the operator of the San Luis joint use facilities. All of the operating expenses related to these facilities are included as operating expenses in the combined statement of operations. The Federal government is billed for its share of the operating expenses, and these billings are included as operating revenues in the combined statement of operations.

The Department does not operate Reid Gardner Power Plant Unit No. 4. The portion of Reid Gardner Power Plant Unit No. 4 operations attributable to the System’s share is included in operations and maintenance expense in the combined statement of operations.

4. Cash and Investments

At June 30, 2001, the System's cash deposits, including interest-bearing deposits, included restricted cash and cash equivalents on deposit with a revenue bond trustee in the amount of $9,183,000. Of the bank balance, $100,000 is federally insured and $9,083,000 is uncollateralized.

The System's investments are categorized below to give an indication of the level of credit risk at June 30, 2001. Category 1 includes investments that are insured or registered or for which the securities are held by the System or its agent in the System's name. Category 2 includes uninsured and unregistered investments for which the securities are held by the counterparty's trust department or agent in the System's name. Category 3 includes uncollateralized deposits (including deposits that are collateralized with securities held by the pledging institution, or by its trust department or agent but not in the entity's name) and uninsured and unregistered investments for which the securities are held by counterparty or by its trust department or agent but not in the System's name. The investment in PMIA, an investment pool managed by the State of California, does not meet the criteria to require risk categorization.

	(in thousands)			
	Category 1	**Category 2**	**Category 3**	**Fair Value**
U.S. government and agency securities	$ -	$ 55,924	$ -	$ 55,924
Restricted cash in PMIA funds				131,862
Cash in PMIA funds				290,811
Total investments				$ 478,597

Reconciliation to combined balance sheet:	
Cash and cash equivalents restricted for plant replacements	$ 23,496
Cash and investments restricted for debt service	164,290
Cash and cash equivalents	290,811
Total investments	$ 478,597

Interest on deposits in PMIA varies with the rate of return of the underlying portfolio and approximated 5.73% at June 30, 2001. For the years ended June 30, 2001 and 2000, interest earned on the deposit with PMIF approximated $29,574,000 and $26,160,000, respectively.

Total interest and investment income is comprised of interest, dividends, realized gains and losses, and unrealized gains and losses due to changes in the fair value of investments held at year-end. The change in fair value of investments is calculated as follows:

	(in thousands) 2001	2000
Fair value of investments at the beginning of the fiscal year	$ 72,881	$ 74,031
Less: Proceeds of investments matured in fiscal year	(20,270)	-
Add: Amortization of discounts	1,359	1,237
Change in fair value of investments during fiscal year	1,954	(2,387)
Fair value of investments at the end of the fiscal year	$ 55,924	$ 72,881

5. Long-term Debt

General Obligation Bonds
The Burns-Porter Act authorized the issuance of State Water Resources Development (WRD) General Obligation Bonds in the amount of $1,750,000,000 for construction of the System. This amount included $130,000,000 to be set aside for financial assistance to local water agencies as provided in the Davis-Grunsky Act. The Burns-Porter Act also made a continuing appropriation of the Water Fund to supplement the bond authorization. To the extent Water Fund money was used for construction of the State water facilities in lieu of bond proceeds, an equal amount of bond authorization was set aside to be used only for the construction of additional facilities of the System that meet certain requirements set forth in the Burns-Porter Act.

WRD General Obligation Bonds of $167 million are authorized but unissued as of June 30, 2001, and may only be used for additional facilities meeting certain requirements of the Burns-Porter Act.

WRD General Obligation Bonds Series A through Series S may be called at any time for early redemption. If a series is called, the bonds of that series must be redeemed in reverse order of maturity, at a premium of 1/8 of one percent for each year until original maturity or 2003, whichever is earlier. WRD General Obligation Bonds Series W through Series Y do not have early redemption provisions.

WRD General Obligation Bonds consist of the following at June 30:

Fiscal Year of Issue	Series	Fixed Rates	Fiscal Year of Final Maturity	Amounts Outstanding (in thousands) 2001	2000
1964	A&B	.01-3.6%	2014	$ 70,950	$ 75,300
1964-65	C&D	3.0-3.7%	2015	101,700	107,400
1965	E	3.0-3.8%	2016	54,300	57,000
1966-67	F,G&H	3.0-4.1%	2017	171,000	178,800
1968	J&K	3.5-4.9%	2018	119,200	124,200
1968	L&M	4.0-5.0%	2019	124,200	129,000
1970	N&P	5.0-5.8%	2020	129,000	133,600
1971-72	Q,R&S	4.8-5.5%	2022	127,840	132,170
1992-95	W,X&Y	4.1-10.0%	2025	7,230	7,850
				905,420	945,320
Less current maturities				41,040	39,900
				$ 864,380	$ 905,420

Revenue Bonds
The Central Valley Project (CVP) Revenue Bonds have been issued for the acquisition or construction of projects to provide the water system and power for the State Water Project. Annual payments of principal and semi-annual interest payments are collateralized by payments to the System under the water supply contracts between the System and the water contractors. The System is subject to certain bond covenants, the most restrictive of which requires that the revenues in each year shall be at least equal to 1.25 times the debt service payable from revenues on all bonds outstanding in such year, plus operating costs, and the required funding of a debt service reserve account. The bonds are limited special obligations of the System; neither the principal nor any interest thereon constitutes a debt of the State. The bonds are callable at rates varying from 100% to 105%.

CVP Revenue Bonds consist of the following at June 30:

Fiscal Year of Issue	Series	Fixed Rates	Fiscal Year of Final Maturity	Fiscal Year of First Call Date	Amounts Outstanding (in thousands) 2001	2000
Devil Canyon-Castaic Facilities:						
1973		5.3-5.4%	2022	Callable	$ 111,365	$ 113,785
CVP Water System:						
1992	J	5.5-7.0%	2025	2001	263,505	482,630
1992	K	5.7-5.9%	2004	2002	4,565	5,915
1993	L	5.0-8.0%	2026	2003	494,260	505,415
1994	M	4.5-8.5%	2028	2004	175,785	178,495
1996	O	4.8-8.2%	2030	2006	303,520	308,160
1996	P	5.3-9.3%	2029	2006	76,665	78,810
1997	Q	4.4-6.0%	2028	2007	240,740	242,790
1998	S	4.0-5.0%	2030	2008	196,240	198,070
1998	T	5.0-5.4%	2013	2009	113,645	122,635
1999	U	4.0-5.1%	2030	2009	200,045	202,100
1999	V	6.25%	2025	None	20,580	20,580
2001	W	4.0-5.5%	2030	2012	260,995	-
					2,461,910	2,459,385
Less:	Unamortized bond issuance discounts / premiums				20,288	30,752
	Deferred loss on advanced refunding				15,207	17,081
	Current maturities				55,200	51,680
					$ 2,371,215	$ 2,359,872

Future Debt Service Requirements
Future principal payment requirements on bonds are as follows at June 30, 2001:

	(in thousands)		
Year	General Obligation Bonds	Revenue Bonds	Total
2002	$ 41,040	$ 55,200	$ 96,240
2003	42,290	58,555	100,845
2004	44,480	52,065	96,545
2005	46,320	54,660	100,980
2006	47,575	64,665	112,240
Thereafter	683,715	2,176,765	2,860,480
	$ 905,420	$ 2,461,910	$ 3,367,330

Commercial Paper Notes
The System has a commercial paper borrowing program of up to $100,000,000. Under this program, the System may issue commercial paper at prevailing interest rates for periods of not more than 270 days from the date of issuance. To provide liquidity for the program, the System entered into a revolving credit agreement with a commercial bank equal to the authorized amount of commercial paper. At June 30, 2001 and 2000, there were borrowings of $0 and $28,117,000, respectively, outstanding under this program. The proceeds from the issuance of commercial paper are restricted to construction costs of certain State water projects, reimbursement of construction costs of certain State water projects, and interest and issuance costs of the commercial paper notes. The liability has been classified as long-term as it is the System's policy to redeem the commercial paper outstanding by the issuance of CVP Revenue Bonds.

6. Advance Refunding of Debt

In May 2001, the System issued $260,995,000 in CVP Water System Revenue Bonds – Series W with an average interest rate of 5.0%, which was used to advance refund $206,790,000 of outstanding bonds and redeem commercial paper borrowings of $41,000,000.

The new proceeds of the advance refundings (after payment of underwriting refunding fees, other issuance costs and deposits to the Debt Service Reserve Accounts) were used to purchase securities that were deposited in an irrevocable trust with an escrow agent to provide for all future debt service payments on the advance refunded bonds. As a result, the advance refunded bonds are considered to be defeased and the related liabilities have been removed from the financial statements.

Although the fiscal year 2001 advance refunding resulted in the recognition of an accounting loss of approximately $6 million, the System effectively reduced its aggregate debt service payments by approximately $10.6 million over the next 20 years and obtained an economic gain (difference between the present values of the old and new debt service payments) of $8.3 million.

The total amount of bonds refunded in advance and still outstanding was approximately $496,310,000 at June 30, 2001.

7. Retirement Plan

Plan Description
The State is a member of the California Public Employees' Retirement System (PERS), an agent multiple-employer pension system which provides a contributory defined-benefit pension for substantially all State employees. The System is included in the State Miscellaneous Category (Tier 1 and Tier 2) within PERS, thereby limiting the availability of certain System pension data. PERS functions as an investment and administrative agent for participating public agencies within the State of California. Departments and agencies within the State of California, including the System, are in a cost-sharing arrangement in which all risks and costs are shared proportionately by participating State agencies. Copies of PERS' comprehensive annual financial report may be obtained from their executive office at 400 P Street, Sacramento, California 95814.

The pension plan provides retirement benefits, survivor benefits, and death and disability benefits based upon employee's years of credited service, age and final compensation. Vesting occurs after five years of credited service except for second tier benefits, which require ten years of credited service. Employees who retire at or after age 50 with five or more years of service are entitled to a retirement benefit, payable monthly for the remainder of their lives. Several survivor benefit options which reduce a retiree's unmodified benefit are available. Benefit provisions and all other requirements are established by state statute.

Funding Policy
Active members who participate in Social Security under the State Miscellaneous Tier 1 category are required to contribute 5% of their annual covered salary after excluding the first $513 of gross monthly pay. Active members who do not participate in Social Security under the State Miscellaneous Tier 1 category are required to contribute 6% of their annual covered salary after excluding the first $317 of gross monthly pay. Active members who participate in Social Security under the State Miscellaneous Tier 2 category are not required to make contributions to PERS.

The System is required to contribute the actuarially determined remaining amounts necessary to fund the benefits for its members. The actuarial methods and assumptions used are those adopted by the PERS Board of Administration. The required employer contribution rate for the fiscal year ended June 30, 2001, was 0% for State Miscellaneous Tier 1 and Tier 2. The contribution requirements of the plan members are established by State statute and the employer contribution rate is established and may be amended by PERS.

Annual Pension Cost

For the years ended June 30, 2001 and 2000, the System's annual pension cost and actual contribution amounted to approximately $0 million and $1.1 million, respectively. Annual covered payroll is not available for the System. However the actuarially determined contributions for the years ended June 30, 2001 and 2000, approximated 1% of the total actuarially determined contribution requirements for the State Miscellaneous Category and approximately 0% and 1.0%, respectively, of the total System payroll. The required contribution for the 2001 fiscal year was determined as part of the June 30, 1999, actuarial valuation using the entry age normal actuarial cost method with the contributions determined as a percent of pay. The actuarial assumptions included (a) 8.25% investment rate of return (net of administrative expenses), (b) projected salary increases of 3.75% for miscellaneous members, (c) 3.75% overall payroll growth, and (d) 3.5% inflation adjustment. The actuarial value of the System's assets was determined using a technique that smoothes the effect of short-term volatility in the market value of investments over a two to five year period depending on the size of investment gains and/or losses. The plan's unfunded actuarial accrued liability (or excess assets) is being amortized as a level percentage of projected payroll on a closed basis. The remaining amortization period at June 30, 2000, the date of the most recent actuarial valuation, was 17 years.

Trend Information

Trend information gives an indication of the progress made in accumulating sufficient assets to pay benefits when due. Information as to the Net Pension Obligation for the State Miscellaneous Category (first and second tier) determined in accordance with Governmental Accounting Standards Board Statement No. 27, *Accounting For Pensions by State and Local Governmental Employers*, for the three years ended June 30, 2000 (the most recent actuarial valuation date for which information is available), is as follows:

Three-Year Trend Information
(in thousands)

Fiscal Year Ended June 30	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation (NPO)
1998	$ 72,209	100 %	$ -
1999	$ -	100 %	$ -
2000	$ -	100 %	$ -

Analysis of Funding Progress
(in thousands)

	(A)	(B)	(C)	(D)	(E)	(F)
Actuarial Valuation Date June 30	Actuarial Asset Value	Entry Age Actuarial Accrued Liability	Unfunded Actuarial Accrued Liability (Excess Assets) [(B)-(A)]	Funded Ratio [(A)/(B)]	Covered Payroll	Unfunded Actuarial Liability (Excess Assets) as Percentage of Covered Payroll {[(B)-(A)]/(E)}
1996	$28,356,559	$31,742,109	$ 3,385,550	89 %	$6,881,124	49 %
1997	$32,362,806	$32,557,433	$ 194,627	99 %	$6,623,624	3 %
1998	$39,910,539	$34,169,378	$(5,741,161)	117 %	$6,592,210	(87)%
1999	$43,548,065	$35,771,215	$ 7,776,850	122 %	$6,811,654	114 %
2000	$46,841,738	$42,386,045	$ 4,455,693	111 %	$7,661,103	58 %

Post-employment Benefits Other Than Pension
In addition to the pension benefits provided by the State, the State also provides post-retirement health care benefits, in accordance with Section 22754(g) of the State Government Code, to all employees who retire from the State on or after attaining certain age and length of service requirements. The post-retirement health care benefits are funded by the State General Fund on a pay-as-you-go basis. Expenditures for health care benefits for the System's active employees and retirees for the years ended June 30, 2001 and 2000, were approximately $11,127,000 and $9,555,000, respectively. The System represents approximately 0.66% of the State of California's total expenditures for health care benefits. Post-retirement health care data for the System's retirees alone are not available and cannot be reasonably estimated.

8. Commitments and Contingencies

Commitments
The System has entered into long-term construction contract commitments for the State water facilities. The value of contracts in process as of June 30, 2001 and 2000, was $33,265,000 and $70,510,000, respectively.

The System has long-term power transmission service contracts requiring future payments of approximately $217,500,000 over periods ranging from three to 13 years. Payments made under these contracts approximated $21,334,000 and $20,000,000 for the years ended June 30, 2001 and 2000, respectively.

The System has also entered into long-term power purchase contracts requiring future payments of approximately $535,090,000 over periods ranging from three to 33 years. Payments made under these contracts, excluding payments to the Kings River Conservation District, were $39,253,000 and $38,710,000 for the years ended June 30, 2001 and 2000, respectively.

The System has a contract with the Kings River Conservation District (District) that provides that the System receive all power generated by the Pine Flat Powerplant Project (Project). Under the contract, the Department is obligated to pay fixed amounts each year to cover the debt service on bonds issued by the District to build the Project, operations and maintenance expenses, and a charge for power supplied. Such payments are to be made until all of the bonds issued by the District to finance the Project have been retired in 2020. Payments to the District totaled approximately $9,318,000 and $12,208,000 during the years ended June 30, 2001 and 2000, respectively.

The amounts of fixed obligations of the System related to future principal and interest payments of the District's bonds as of June 30, 2001, are as follows:

For the year ended	Fixed Obligati (in thousands
2001	$ 5,022
2002	4,948
2003	4,961
2004	4,959
2005	4,952
Thereafter	70,922
	$ 95,764

Contingencies

Litigation

Monterey Amendment
In fiscal year 1995, the System entered into a series of contract amendments, collectively known as the “Monterey Amendment” with the water contractors. Components of the Monterey Amendment included the transfer of land and related assets to the Kern County Water Agency (KCWA) (one of the water contractors), the creation of operating reserves, and the establishment of charges to contractors to meet, but not exceed operating expenses, debt service and financing costs and certain capital expenses.

In September 2000, the Third District Court of Appeal reversed an earlier trial court ruling on the Monterey Amendment environmental impact report (EIR). In 1995, the trial court had found that the designation of the Central Coast Water Authority (CCWA) (one of the water contractors), rather than the Department of Water Resources, as the lead agency for the EIR, violated the California Environmental Quality Act but that the EIR was adequate, and the lead agency error was harmless. As a result of the trial court’s ruling, the System proceeded to implement the Monterey Amendment, including the transfer of land and related assets to KCWA. The Court of Appeal found that the EIR was inadequate because it failed to address the deletion of a contract provision that would allow the System to declare a permanent water shortage on the SWP and reduce water contractor entitlements to water. The Court of Appeal remanded the case to the trial court to oversee the Department’s preparation of a new EIR and to consider whether the Monterey Agreement may continue to be implemented while the new EIR is being prepared. The Court of Appeal also reinstated a cause of action challenging the validity of the transfer of assets to KCWA.

In October 2000, the Department and CCWA filed a petition asking the California Supreme Court to review the appellate court decision. The Supreme Court declined to review the case. The continued implementation of the Monterey Amendment could be stayed in whole or in part by action of the Superior Court pending completion of the new EIR, or by an adverse ruling on the Kern Water Bank transfer. The Department does not expect the outcome of this litigation to have a materially adverse impact on the ability of the Department to meet its payment obligations.

General
The System, during the ordinary course of its operations, has been named in a number of additional suits and claims, several of which are still pending.

In the opinions of management and the Department's legal counsel, such legal actions, including the Monterey Amendment, will not have a material effect on the System's combined financial position or results of operations. If incurred, such costs would be recoverable from project beneficiaries.

Self-Insurance
The System is self-insured for all completed facilities of the State Water Project other than a portion of the Reid Gardner Project. The CVP Act and the related bond resolutions authorize the issuance of additional bonds, payable from available revenues or federal reimbursements under the National Disaster Act, for the purpose of providing funds for emergency repairs to power projects or Water System Projects necessitated by natural disasters, provided that certain conditions are met.

California Restructuring
California's electric utility industry has been in the process of active deregulation since the enactment of Assembly Bill 1890 in 1996 which was primarily designed to facilitate deregulation of electricity generation in California through a four year transition period. Among other structural changes, AB 1890 called for the creation of a Power Exchange (PX) responsible for managing the dispatch of generation from California's investor owned utilities, and an Independent System Operator (ISO) responsible for managing the transmission grid in California, both of which became operational in 1998. Over the ensuing years load growth in California and surrounding states has grown higher than anticipated. The increased demand for power coupled with generation facilities being taken off line for scheduled and unscheduled maintenance resulted in diminished reserve capacity margins. As a result, West Coast wholesale prices began to escalate dramatically during the summer of 2000. In December 2000, the Federal Energy Regulatory Commission (FERC) approved a number of changes to the market structure in California to try to bring long-term stability to the wholesale market.

At the same time, the price of natural gas, which fuels most of the thermal generation in California, increased dramatically. The immediate impact of the market shortages, higher natural gas prices and certain FERC changes was the closure of the PX's markets, higher wholesale prices and increased price volatility. As wholesale prices reached new highs, Pacific Gas & Electric Company (PG&E) and Southern California Edison (Edison) were unable to obtain additional credit to finance continuing energy purchases. Rate increases approved by the California Public Utilities Commission in early January 2001 were inadequate to cover cash flow requirements. By late January 2001, both PG&E and Edison had defaulted on power and debt payments. In January 2001, another fund of the Department, the Department of Water Resources Electric Power Fund (Power Fund), began purchasing power for delivery to the utilities' retail end use customers in order to provide a measure of financial stability to the markets. The Power Fund is not part of the System.

Because the System procures significant amounts of electric power to supply its operations in the short-term markets for power, the System has exposure to fluctuating short-term power costs. This exposure is mitigated by the fact that the bulk of the System's power needs are met through System-owned generation, long term power purchase contracts at prices lower than those prevailing on the short term markets and energy exchange arrangements. The System is able to recover the cost of power from the water contractors. The System does not expect the cost of power to have a material adverse effect on its ability to continue to operate.

PG&E Bankruptcy

In April 2001, PG&E voluntarily filed a petition which commenced federal bankruptcy proceedings under Chapter 11 of the U.S. bankruptcy code. PG&E is expected to continue to carry out its functions as the sole utility in its service area during the bankruptcy proceedings and upon their conclusion.

The System has a number of relationships with PG&E which may be affected by the bankruptcy, including joint ownership of certain transmission facilities and contracts for transmission. With respect to jointly owned facilities, it is possible that the bankruptcy and other developments related to the California energy situation could affect PG&E's ownership interests, but management of the System does not expect its ownership interests to be diminished, nor does management expect any material adverse effect on the operation of such facilities. The System does not have any material power purchase, energy exchange or similar arrangements which would be adversely affected by the bankruptcy.

Although the System's management cannot predict all of the possible consequences the PG&E bankruptcy may have on its operations and finances, management does not expect the bankruptcy to materially disrupt the operation of the System.

Edison

In 2001, the System derived approximately 9% of its electrical energy sources from on-peak/off-peak energy exchange contracts with Edison. In future years, projects will derive an even larger portion from those contracts. Beginning in July 2000 until May 2001, Edison failed to deliver certain off peak power to the System as required by the contracts. To compensate, the System has made up the net loss of electrical energy by purchasing energy on the short-term markets. From May 2, 2001 until December 1, 2001, Edison delivered energy to the Department pursuant to the on-peak/off-peak energy exchange contracts. The Department and Edison are currently in arbitration to reach agreement regarding contract disputes. It is projected that the arbitration decision will be made by June of 2002. The Department has entered into contracts to hedge its exposure to the short-term energy market. Management does not expect the cost of power to have a material adverse effect on its ability to continue to operate the System.

9. Related Party Transactions

During the year ended June 30, 2001, the System sold power approximating $80 million to the Department of Water Resources Electric Power Fund (Power Fund), another enterprise fund administered by DWR.

Supplementary Information

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Report of Independent Accountants
on Supplementary Information

The Director of the State of California
Department of Water Resources

Our report on the audit of the combined financial statements of the State Water Resources Development System (System) (a component unit of the State of California) as of June 30, 2001 and 2000, and for the years then ended appears on page 1. Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying schedule title " Calculation of Adequacy of Debt Service Coverage" is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

PricewaterhouseCoopers LLP

December 7, 2001

State Water Resources Development System
Calculation of Adequacy of Debt Service Coverage
For the years ended June 30, 2001 (dollars in thousands)

Water supply revenues, including $40,854 in refundable proceeds	$	280,780
Investment earnings		3,996
		284,776
Less: Operations and maintenance expense		54,627
Net revenues available for debt service	$	230,149
Principal and interest for revenue bonds	$	178,220
Debt service coverage		1.29

Note: The general bond resolution for the CVP Water System Revenue Bonds requires the System to collect revenues under the long-term water supply contracts equal to 1.25 times the annual debt service. The Schedule includes the amounts applicable to the CVP Water Project Revenue Fund. The Schedule excludes operations of the California Water Resources Development Bond Fund, which accounts for the operations of the facilities financed by general obligation bonds.