State Water Resources Development System

Combined Financial Statements and Supplementary Information

For the years ended June 30, 2002 and 2001

State Water Resources Development System
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For the years ended June 30, 2002 and 2001

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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 statements of net assets and the related combined statements of activities and of 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, 2002 and 2001, 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.

As explained in Note 2 to the financial statements, the financial statements for the year ended June 30, 2001 have been restated to reduce the deferred power sales credit for amounts previously credited through an offset to certain revenue charges.

As explained in Note 2 to the financial statements, the System has implemented the provisions of Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements – Management's Discussion and Analysis – for State and Local Governments,* as amended.

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

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Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplemental information on page 35 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.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 19, 2002, 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

November 19, 2002

This section presents management's discussion and analysis of the State Water Resources Development System's financial performance during the fiscal year ended June 30, 2002. The State Water Resources Development System (the System) includes the State Water Project (SWP), the Davis-Grunsky Act Program and the San Joaquin Drainage Implementation Program.

The SWP encompasses a complex of dams, reservoirs, pumping plants, power plants, aqueducts and pipelines owned and operated by the State of California. The SWP was developed in order to deliver water to areas of need throughout the State for domestic, industrial and agricultural purposes, as well as to provide flood control, recreation, fish and wildlife enhancement, hydroelectric power and other benefits. The California Department of Water Resources (DWR) is responsible for the planning, construction and operation of the SWP. The construction program commenced in 1957 and all 647 miles of the initially planned aqueduct system have been completed. The System has entered into long-term Water Supply Contracts with 29 customers, known as the "Contractors," in order to recover substantially all System costs. Through Water Supply Contracts presently in effect, the Contractors have maximum annual entitlements totaling 4,172,786 acre-feet of water from the SWP.

Portions of the SWP system consist of facilities developed and used jointly with the federal Central Valley Project (CVP) operated by the U.S. Bureau of Reclamation (Bureau). In addition, both projects have primary sources of water north of the Sacramento-San Joaquin Delta (Delta), transport water across the Delta and draw water from the southern edge of the Delta. The CVP, like the SWP, provides water for irrigation in the Central Valley, urban water supply, water quality, flood control, power, recreation, and fish and wildlife enhancement. Costs for the jointly developed facilities are shared approximately 55 percent State and 45 percent Federal. In 1986, the System and the Bureau entered into a Coordinated Operation Agreement (COA) under which the SWP and the CVP coordinate operations, including releases from upstream reservoirs and pumping from the Delta. The COA permits increased operational efficiency of both projects, ensures that each project receives an equitable share of available surplus water, and provides for sharing of responsibilities in meeting certain Delta water quality standards.

Financial Highlights

- The System recorded a decrease in net assets of $9.1 million on total operating revenues of $761 million. This result is in line with expectations, as the System incurs certain expenses it is not entitled to recover from the Contractors or other governmental entities.

- In May 2002, the issuance of Series X CVP Water System Revenue Bonds was completed. The majority of the $160 million bond issue was used to refund $114 million in revenue bonds and retire $41 million in commercial paper notes.

Overview of the Financial Statements

Proprietary /Enterprise Fund

An enterprise fund accounts for the acquisition, operation, and maintenance of governmental facilities and services that are entirely or predominantly self-supporting by user charges. Three public service enterprise funds are combined for financial reporting of the System. The three enterprise funds are as follows:

- California Water Resources Development Bond Fund (Bond Fund) - Accounts for the costs to build, operate and maintain the facilities financed by General Obligation bonds as authorized by the Burns-Porter Act. The Contractors’ transportation and conservation payments are recorded in the Bond Fund as well as power sales and reimbursements from Federal and State governments, and interest on investments. Disbursements are related to operations and maintenance of the SWP, power purchases, replacements and interest and principal on the General Obligation Bonds.

- Central Valley Water Project Construction Fund (Construction Fund) - Accounts for the activities financed by the CVP Revenue Bonds through construction and the first year of operation. Revenue bond proceeds, commercial paper sales, reimbursement from Federal and State governments for San Luis Dam and Reservoir, Suisun Marsh and recreation costs, and interest on investments are recorded in the Construction Fund. Disbursements are related to the construction of SWP facilities and first year of operation.

- Central Valley Water Project Revenue Fund (Revenue Fund) - Accounts for the activities of the facilities financed by CVP Revenue Bonds after the first year of operation. Receipts include Contractor payments for projects financed with Revenue bonds and interest on investments. Disbursements are related to the operations and maintenance of power facilities, and interest and principal payments.

Reports Included in Combined Financial Statements

This financial report consists of three combined financial statements, prepared on the accrual basis of accounting, with accompanying disclosure notes. The funds are combined to form the System's financial statements. All significant interfund activity is eliminated. The notes to the financial statements communicate information that is essential to understand the financial statements. The combined statements of net assets include all of the assets, liabilities, and the equity of the System. The combined statements of activities report all of the revenues and expenses incurred during the fiscal year. The combined statements of cash flows report the cash inflows and outflows classified by operating, investing, and financing activities during the reporting period.

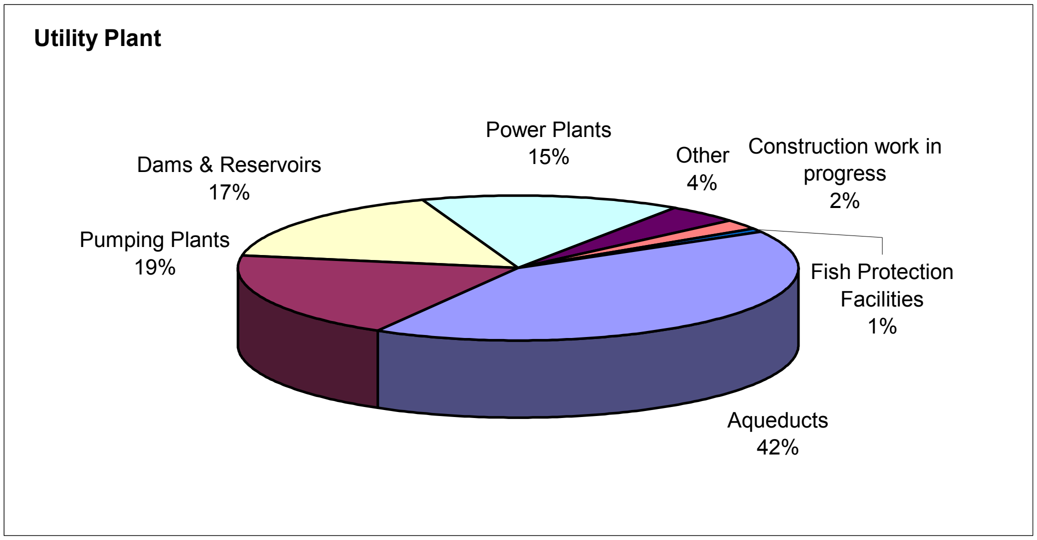
Summary of Financial Condition

	2002	2001	% Change
	(in thousands)		
Net Assets			
Capital assets, net	$ 3,126,827	$ 3,181,310	-1.71%
Other assets	2,075,014	2,173,535	-4.53%
Total assets	5,201,841	5,354,845	-2.86%
Long-term liabilities	3,182,135	3,235,595	-1.65%
Other liabilities	770,459	860,874	-10.50%
Total liabilities	3,952,594	4,096,469	-3.51%
Invested in capital, net of related debt	234,603	289,724	-19.03%
Restricted net assets	1,014,644	968,652	4.75%
Total net assets	$ 1,249,247	$ 1,258,376	-0.73%
Change in Net Assets			
Water supply	$ 642,728	$ 519,734	23.66%
Power sales	105,325	563,993	-81.33%
Federal reimbursements	13,169	16,137	-18.39%
Total operating revenues	761,222	1,099,864	-30.79%
Operations and maintenance expense	302,245	320,682	-5.75%
Purchased power	199,703	672,582	-70.31%
Depreciation expense	76,421	71,293	7.19%
Deferred operating expenses	14,048	(116,132)	112.10%
Total operating expenses	592,417	948,425	-37.54%
Income from operations	168,805	151,439	11.47%
Interest expense	(169,220)	(170,081)	-0.51%
Other (expense) income	(8,714)	16,982	-151.31%
Change in net assets	(9,129)	(1,660)	450.08%
Net assets, beginning of year	1,258,376	1,260,036	-0.13%
Net assets, end of year	$ 1,249,247	$ 1,258,376	-0.73%

Assets

Utility Plant

Utility Plant represents the accumulated original costs of labor, materials and indirect costs incurred during the construction of the project that are in service to provide water deliveries. The SWP utility includes 18 dams, 19 storage facilities, 17 pumping plants, 9 power plants, fish protection facilities and aqueducts.



The net utility plant in service (UPIS) decreased by $88.8 million or 2.86%. The change in the UPIS is relatively flat given that the majority of the System is complete and depreciation is on a straight-line basis over the estimated useful lives of the various classes of utility plant, ranging from 30 to 100 years. The cost of the UPIS has decreased by $62 million in fiscal 2002, attributable to retiring $49 million of fully depreciated items. Additionally, the System sold the Jibboom Street property that had a cost of $13 million.

Construction Work in Progress

Construction work in progress increased by $34 million or 47%. Construction on the East Branch Extension began in early 1999 and is expected to be complete in the fall of 2002. The East Branch Extension will enable the San Gorgonio Pass Water Agency to begin receiving deliveries of entitlement water.

Restricted Cash and Investments

Restricted cash and cash equivalents increased by $3.7 million or 1.89%, primarily due to the $2.1 million increase in debt service reserves associated with the issuance of CVP Water System Revenue Bonds – Series X.

Other Long-term Assets

The due from other state funds represents the System's advance of $91.5 million to the System's Internal Service Fund, which functions as a revolving working capital facility for the System.

The System also provides construction loans for local domestic water projects and agricultural water conservation projects as authorized by the Davis-Grunsky Act. No additional loans were funded during the fiscal year. The 2% reduction within the fiscal year is due to principal repayment.

Cash and Cash Equivalents
In fiscal 2002, cash decreased by $46 million to a balance of $245 million. Please refer to the Statements of Cash Flows for a summary of cash in-flows and out-flows.

Receivables
Water supply and power billings receivable declined from $113 million in fiscal 2001 to $89 million in fiscal 2002. This decrease relates mainly to the decreased volume of revenue experienced in fiscal 2002 compared to fiscal 2001. Please refer to the "Operating Revenue" section contained herein for a discussion of power revenue fluctuations.

Deferred Charges
Overall, deferred charges decreased in fiscal 2002 by $21 million. This amount represents the timing differences between expenditures incurred by the System and their ultimate recovery from the Contractors.

Liabilities

Revenue Bonds
The System has issued twenty-four series of Water System Revenue Bonds totaling $4,287 million in aggregate principal of which $2,344 million is outstanding as of June 30, 2002, compared to $2,351 million at June 30, 2001. This includes the issuance of Series X in May 2002. The principal amount of Series X was $160 million, and the proceeds were used primarily to refund existing series and retire commercial paper to take advantage of declining interest rates.

The System has also issued $1,526 million of revenue bonds secured by three separate bond resolutions to finance certain power facilities of which $109 million is outstanding as of June 30, 2002, compared to $111 million at June 30, 2001. Bonds issued under two of these resolutions have been fully retired.

General Obligation Bonds
In addition to the revenue bond obligations described above, a significant portion of the SWP construction was financed by the sale of General Obligation Bonds of the State pursuant to the provisions of the Burns-Porter Act which was adopted by the voters at the State's general election of November 8, 1960. The Burns-Porter Act authorized the issuance of $1,750 million of such bonds for the construction of the SWP, of which $1,582 million (including the entire amount available for construction of the initial components of the SWP) has been issued and $864 million remains outstanding at June 30, 2002. The unissued $168 million of the authorization is available only to provide funds for the construction of certain additional water conservation facilities.

Accounts Payable and Other Current Liabilities
Accounts payable and other current liabilities totaled $154 million in fiscal 2002, compared to $186 million in the prior year. The $32 million decrease is due primarily to a reduction in accounts payable, resulting from declining power purchase costs. Power costs were significantly higher in fiscal 2001 compared to fiscal 2002, as a result of the power crisis in California.

Proceeds Due to Water Contractors

Proceeds due to Water Contractors declined $58 million in fiscal 2002 to $83 million. This was due in part to certain Contractors prepaying $42 million of their July 2001 transportation charges in June 2001, which was recorded as a liability in fiscal 2001. Additionally, the System received $27 million for off-aqueduct power sales in fiscal 2001 that were subsequently refunded to the Contractors in fiscal 2002. These amounts were partially offset by additional cover charges collected.

Deferred Revenue – State and Federal Capital Recovery

Deferred revenue related to the capital recovery of State and Federal portions of projects decreased $2 million to a balance of $187 million at June 30, 2002. This decrease represents the amount of depreciation recorded for the portions of projects that relate to flood control and recreational use.

Deferred Power Sales Credit

The deferred power sales credit results from a timing difference of revenue collected from certain Water Contractors for power generated by the Oroville-Thermalito power plant and the corresponding credit that is issued to all Contractors through a reduced capital charge.

The financial statements for the year ended June 30, 2001 have been restated to reduce the deferred power sales credit by $274 million for amounts that had been repaid to the Contractors through a credit to certain revenue charges, but were not recorded as a reduction of the deferral. The cumulative effect of the restatement is a $256 million increase in net assets at July 1, 2000 and the impact on operations for the year ended June 30, 2001 was to decrease the net loss by $18 million.

Statement of Activities

Operating Revenues

Overall, operating revenues for the year of $761 million declined $339 million compared to the prior year. This is primarily attributable to the impact of the California energy crisis on fiscal year 2001 results. Due to the high cost of energy in fiscal 2001, revenues, as well as certain expenses, were inflated above their historical norms. Fiscal year 2002 reflects a return to more normal patterns.

Water Supply Revenue

Under the terms of the Water Supply Contracts, the System is required to collect from the Contractors all costs of the SWP allocated in proportion to each Contractors' maximum water entitlement. Generally, the System's costs, including the costs of gathering, storing, conveying and delivering water and interest, are billable to the Contractors whether or not water is delivered.

Water supply revenues consist of three main categories: Capital, Minimum, and Variable. The Capital component of revenue enables the System to recover all the costs plus interest related to the construction of the System facilities, including its dams, aqueducts, pumping stations, and power plants. Once a project is completed, its costs plus interest are amortized and recovered over the remaining term of the Water Supply Contracts (through 2035). The Minimum component of revenue enables the System to recover the operating and maintenance costs associated with operating the System. These costs are generally recovered as they are incurred. Finally, the Variable component of revenue enables the System to recover the cost of energy used to deliver water to the Contractors. Like Minimum, these costs are generally recovered as they are incurred.

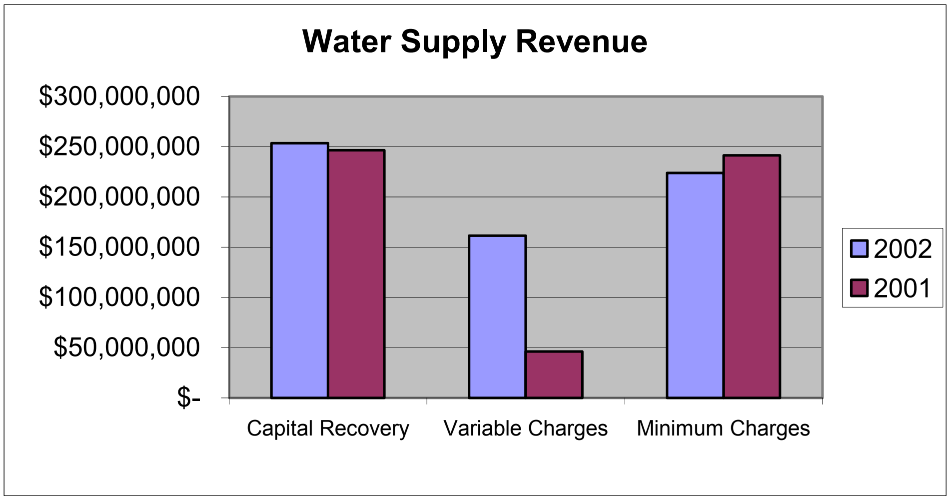


Table A

In fiscal 2002, the System generated $642 million in water supply revenue, compared to $520 million generated in fiscal 2001. Table A shows a comparative breakdown of the components of water supply revenue for fiscal years 2001 and 2002.

As shown in Table A, the primary reason for the variance in water supply revenue for the two years relates to the Variable component. Although total water deliveries declined 16% in fiscal 2002 compared to fiscal 2001, from 3,164,000 acre-feet to 2,657,000 acre-feet, issues relating to the California energy crisis caused the cost of electricity to rise dramatically between the two years. As a result, the calculated rate the System uses to determine the Variable charge to Contractors rose from an average in fiscal 2001 of $8.25 per acre-foot to over $32.00 for fiscal 2002. This increase in energy costs caused the Variable charge for fiscal 2002 to be $115 million higher than the previous year. Although the energy crisis occurred in the latter part of fiscal 2001, the timing of the billing cycle is such that the increased costs were reflected in billings to the Contractors in the first half of fiscal 2002. Because the Variable component of Water Supply Revenue is tied directly to energy costs, fluctuations in the energy market will directly effect the Variable charges to the Contractors.

Overview of the System's Power Activities
The SWP is one of the largest consumers and suppliers of electric power in the western United States. Since the commencement of the major facilities of the SWP in the 1960s, the System has been an active participant in the power markets of California and the western United States. The System has provided for the financing, construction and operation of a variety of power projects including hydroelectric, geothermal and coal-fired electric generating facilities and facilities to transmit electric energy. The System currently owns nine power plants with a total nameplate capacity of approximately 1,770 MW and with total annual generation of approximately 4,000 to 6,000 GWh. The System also owns approximately 17 pumping plants with a total load, when operational, of approximately 1,200 MW and total annual consumption of 4,000 to 9,000 GWh. The pumping plants, which are the SWP's major power-consuming components, can be operated principally during the off-peak portion of the daily electricity consumption cycle due to their large pumping capacity. Similarly, the designed capacity of most of the System's hydroelectric generation facilities permits those facilities to be operated at 100 percent of generation capacity during on-peak hours and generally held idle during off-peak hours. This

flexibility in the scheduling of the System's generation and load enables the System to sell relatively high value power during on-peak hours and buy less expensive power during off-peak hours.

Power Sales
As mentioned previously, the System employs a strategy to run its pumping plants during off-peak hours, when energy prices are generally lower, and generate energy during on-peak hours, when prices are generally higher. This enables the System to maximize its power generation capabilities by selling excess power to third parties at a higher rate. When economically rational, the System can also generate high-rate power to sell by re-circulating water through its power generation facilities back into its reservoirs. However, in any given year, a combination of factors, including hydrological production, energy market rates, energy market supply and demand, and the System's own energy requirements can affect the volume of power the System has available for sale.

In fiscal 2002, the System had gross power sales of $105 million, compared to $564 million in fiscal 2001. This difference between the two years is the result of a reduction in the amount of energy sold, combined with a reduction in prices. In fiscal 2001, the System sold 2,649,000 Mwh of energy at an average rate of $212.95 per Mwh. In fiscal 2002, the System sold 1,551,000 Mwh of energy at an average rate of $67.90 per Mwh. The table below describes the effect of these two reductions on the overall power sales revenue generated by the System.

	MWh Sold	$ Sold	Rate/MWh
Fiscal year 2001	2,648,531	$ 563,993,000	$ 212.95
Fiscal year 2002	1,551,102	$ 105,325,000	$ 67.90
Change in total MWh sold			(1,097,429)
Multiplied by fiscal year 2002 rate/MWh			$ 67.90
Difference attributed to decreased sales			$ (74,519,000)
Total MWh rate change			$ (145.05)
Multiplied by fiscal year 2001 MWh sold			2,648,531
Difference attributed to rate change			$ (384,149,000)
Total decrease in power sales			$ (458,668,000)

Federal Reimbursement Revenue
The System receives reimbursement from the Federal government for certain flood control projects and portions of projects in the Suisun Marsh, and the San Luis Reservoir. Federal reimbursement revenue for fiscal 2002 was $13 million, down slightly from the prior year.

Operating Expenses
As with revenues, total operating expenses for the year of $592 million were down considerably compared to the prior year amount of $948 million. Of the $356 million reduction, $473 million is attributable to a reduction of power purchases, which is reflective of the return to a more normal energy market in fiscal 2002. The remaining difference of $117 million increase is primarily attributable to the

deferral of operating expenses resulting from timing differences in the recovery of operating expenses from the Contractors.

Operations and Maintenance Expense
Total operations and maintenance expense was $302 million, which represents a six percent decrease compared to the prior year. This decline is attributable to reduced overhead charges, offset in part by certain operating costs for the Reid-Gardner power plant that pertained to fiscal 2001, as well as other timing differences.

Operations and maintenance expense for the year ended June 30, 2002 includes almost $15 million in expenditures related to recreational facilities for which it will not be reimbursed by the Contractors or other governmental entities, as well as over $2 million for projects that the System is not entitled to recover from the Contractors.

Power Purchases
As discussed above, the System uses a significant amount of power to operate its pumping stations in order to deliver water to the Contractors. Its sources of power include self-generated power by the nine power plants owned by the System, along with purchases of power from third party suppliers. As with power sales, in any given year, a combination of factors, including hydrological production, energy market rates, and energy market supply and demand, impact the System's energy requirements.

Consistent with power sales, power purchases in fiscal 2002 were down significantly compared to the prior year. The same factors that contributed to the reduction in power sales also contributed to the marked reduction in power purchases - a reduction in the amount of power purchased, combined with a reduction in the rate-per-MWh. In fiscal 2002, the System purchased 2,204,000 MWh of power at an average rate-per-MWh of $90.59 for a total of $200 million. In contrast, in fiscal 2001 the System purchased 4,084,000 MWh of power at an average rate-per-MWh of $164.67, for a total of $673 million. The table below describes the effect of these two reductions on the overall power sales revenue generated by the System.

	MWh Purchased	Power Purchased	Rate/MWh
Fiscal year 2001	4,084,394	$ 672,582,000	$ 164.67
Fiscal year 2002	2,204,383	$ 199,703,000	$ 90.59
Change in MWh purchased			(1,880,011)
Multiplied by fiscal year 2002 rate			$ 90.59
Difference attributed to decreased purchases			$(170,317,000)
Change in MWh rate			$ (74.08)
Multiplied by fiscal year 2001 purchased			4,084,394
Difference attributed to rate change			$(302,562,000)
Total decrease in power purchases			$(472,879,000)

Deferred Operating Expenses

Deferred operating expenses were $14 million. This amount represents timing differences between expenditures made by the System and their eventual recovery from the Contractors through the Minimum and Variable components of revenue.

Interest Expense

Interest expense for the year was $169 million, down slightly from the prior year amount of $170 million and relates to the normal principal pay-down of debt.

Other (Expense) Income

Other expense for the year was $8 million, compared to other income in fiscal 2001 of $17 million. This difference is comprised of a loss recorded in fiscal 2002 of $13 million relating to the sale of the System's Jibboom Street property in Sacramento, as well as reduced interest earnings in fiscal 2002 compared to fiscal 2001.

Change in Net Assets

Overall, the System recorded a net loss for the year of $9.1 million. This result is in line with expectations, as the System incurs certain expenses it is not entitled to recover from the Contractors or other governmental entities.

State Water Resources Development System
Combined Statements of Net Assets
June 30, 2002 and 2001 (in thousands)

	2002	Restated 2001
Assets		
Utility plant:		
Utility plant in service	$ 4,433,677	$ 4,495,092
Less accumulated depreciation	1,413,705	1,386,313
Net utility plant in service	3,019,972	3,108,779
Construction work in progress	106,855	72,531
Total utility plant	3,126,827	3,181,310
Long-term assets:		
Restricted assets:		
Cash and cash equivalents restricted for plant replacements	27,351	25,715
Cash and investments restricted for debt service	166,354	164,290
Cash and cash equivalents on deposit with revenue bond trustee	9,240	9,183
Loans receivable from local water agencies	33,295	34,145
Advances to Pacific Gas & Electric Company	5,112	8,057
Due from other state funds	91,516	91,516
Total long-term assets	332,868	332,906
Current assets:		
Cash and cash equivalents	244,689	290,811
Receivables:		
Interest on investments	3,554	6,754
Water supply and power billings	89,120	113,000
Inventories	8,225	9,960
Other	12,214	14,821
Total current assets	357,802	435,346
Deferred charges:		
Amounts recoverable through future billings under long-term water supply contracts:		
Operations and maintenance expense	136,633	66,073
Capital costs	352,895	390,309
Unamortized project costs	402,281	455,638
Unbilled interest earnings on capital costs	492,535	493,263
Total deferred charges	1,384,344	1,405,283
Total assets	$ 5,201,841	$ 5,354,845

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

June 30, 2002 and 2001 (in thousands)

	2002	Restated 2001
Capitalization and Liabilities		
Capitalization:		
Net assets:		
Capital, net of related debt	$ 234,603	$ 289,724
Restricted	1,014,644	968,652
Total net assets	1,249,247	1,258,376
Long-term debt, less current maturities:		
General obligation bonds	822,090	864,380
Revenue bonds	2,360,045	2,371,215
Total long-term debt	3,182,135	3,235,595
Total capitalization	4,431,382	4,493,971
Current liabilities:		
Current maturities of bonds	101,325	96,240
Accounts payable	60,831	89,362
Accrued vacation	12,189	18,746
Accrued interest on long-term debt	20,049	23,347
Due to other state funds	60,931	50,391
Proceeds due to Water Contractors	82,843	141,155
Other	172	4,408
Total current liabilities	338,340	423,649
Deferred credits:		
Deferred revenue - State and Federal capital recovery	186,640	188,862
Power sales credit due to Water Contractors	219,773	224,867
Advances for plant replacements	25,706	23,496
Total deferred credits	432,119	437,225
Commitments and Contingencies (Note 9)		
Total capitalization and liabilities	$ 5,201,841	$ 5,354,845

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

State Water Resources Development System
Combined Statements of Activities
For the years ended June 30, 2002 and 2001 (in thousands)

	2002	Restated 2001
Operating revenues:		
Water supply	$ 642,728	$ 519,734
Power sales	105,325	563,993
Federal reimbursements	13,169	16,137
Total operating revenues	761,222	1,099,864
Operating expenses:		
Operations and maintenance	302,245	320,682
Purchased power	199,703	672,582
Depreciation expense	76,421	71,293
Operating expenses recovered (deferred), principally under long-term water supply contracts, net	14,048	(116,132)
Total operating expenses	592,417	948,425
Income from operations	168,805	151,439
Interest expense	(169,220)	(170,081)
Other income (expense)	(8,714)	16,982
Decrease in net assets	(9,129)	(1,660)
Net assets, beginning of year as previously reported	1,258,376	1,003,845
Restatement (Note 2)	-	256,191
Net assets, beginning of year as restated	1,258,376	1,260,036
Net assets, end of year	$ 1,249,247	$ 1,258,376

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, 2002 and 2001 (in thousands)

	2002	Restated 2001
Cash flows from operating income:		
Receipts from customers	$ 725,161	$ 1,152,118
Payments to employees for services	(163,495)	(162,400)
Payments to suppliers	(361,366)	(716,177)
Net cash provided by operating activities	200,300	273,541
Cash flows from noncapital financing activities:		
Other income	2,954	-
Net cash provided by noncapital financing activities	2,954	-
Cash flows from capital and related financing activities:		
Proceeds from issuance of revenue obligation bonds, net of issuance discounts and premiums	163,462	270,207
Principal payments on long-term debt	(210,305)	(298,370)
Net change in commercial paper notes	-	(28,117)
Interest payments on long-term debt	(178,368)	(168,658)
Additions to utility plant	(30,947)	(45,726)
Net cash used in capital and related financing activities	(256,158)	(270,664)
Cash flows from investing activities:		
Cash received from investment earnings	2,318	14,321
Return of principal on matured investments	13,701	20,270
Net change loans receivable from local water agencies	1,907	1,727
Reduction of advance to PG&E	2,945	1,144
Net cash provided by investing activities	20,871	37,462
Net increase in cash and pooled investments	(32,033)	40,339
Cash and pooled investments at July 1, 2000	434,075	393,736
Cash and pooled investments at June 30, 2001	$ 402,042	$ 434,075
Reconciliation of operating income to net cash provided by operating activities:		
Income from operations	$ 168,805	$ 151,439
Adjustment to reconcile operating income to net cash provided by operations:		
Depreciation expense	76,421	75,388
(Increase) decrease in deferred charges and credits, net	14,048	(113,722)
Changes in assets and liabilities:		
Increase in receivables	23,880	(631)
(Increase) decrease in inventories	1,735	(2,656)
Increase in other assets	2,607	(8,702)
Increase in accounts payable and accrued vacation	(35,188)	54,324
Increase (decrease) in due to other state funds	10,540	32,253
Increase (decrease) in current proceeds due to Water Contractors	(58,312)	81,751
Increase (decrease) in other liabilities	(4,236)	4,097
Total adjustments	31,495	122,102
Net cash provided by operating activities	$ 200,300	$ 273,541

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, 2002 and 2001, interest expense of $4,318,000 and $2,437,000, 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 1.80% and 1.66% for each of the years ended June 30, 2002 and 2001, 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.

Restricted Cash and Investments
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, 2002, are of a similar nature as those held at June 30, 2001.

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 4.615% at June 30, 2002 and 2001.

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.

The deferred power sales credit arises from revenue collected for the power generated by the Oroville-Thermalito power plant which is decreased by a corresponding credit issued to the Water Contractors through a reduced capital charge.

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.

Net Assets
The System classifies its net assets into two components, invested in capital assets, net of related debt and restricted net assets. Net assets invested in capital assets, includes total utility plant, net of accumulated depreciation, related long-term debt and other assets and liabilities relating to the recovery of utility plant. The remaining net assets of the System are classified as restricted due to the requirements of legislation that created the System and authorized the construction of the SWP, to use the System's net assets solely in support of the SWP, the Davis-Grunsky Act Program and the San Joaquin Drainage Facilities.

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 $40,923,000 and $36,615,000 during the years ended June 30, 2002 and 2001, 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 $41,089,000 and $40,854,000 in 2002 and 2001, respectively, are recorded as a liability in the financial statements. The System refunded $38,049,000 and $35,281,000 in 2002 and 2001, 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 62%, 9% and 4% of total System water supply revenue, respectively.

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

The Federal government reimburses the System for operating and capital costs incurred by the System for flood control purposes. In addition, the Federal government reimburses the System 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.

Reclassifications
Certain reclassifications have been made to the prior year balances in order to conform to the current year presentation. These reclassifications have no effect on net assets or the change in net assets for the years ended June 30, 2002 or June 30, 2001.

Change in Accounting Principle
In 1999, the Governmental Accounting Standards Board (GASB) issued Statement No. 34, *Basic Financial Statements – Management's Discussion and Analysis – for State and Local Governments* (GASB 34). In 2001, the GASB issued Statement No. 37, *Basic Financial Statements – Management's Discussion and Analysis – for State and Local Governments: Omnibus* and Statement No. 38, *Certain Financial Statement Note Disclosures*, which amended certain provisions of GASB 34. The System has adopted the provisions of GASB 34, as amended, as required for the year ended June 30, 2002. The adoption of GASB 34 requires presentation of the System's Management Discussion and Analysis (MD&A) for each period presented. The MD&A is considered to be required supplementary information and precedes the financial statements. Additionally, the statement of cash flows has been prepared using the direct method, as required by GASB 34, rather than the indirect method. The other provisions of GASB 34 did not significantly impact presentation of the System's financial statements, except for the presentation of net assets. GASB 34 also requires the classification of net assets into three components – invested in capital assets, net of related debt; restricted; and unrestricted. These classifications are defined as follows:

- Invested in capital assets, net of related debt – This component of net assets consists of capital assets, net of accumulated depreciation reduced by the outstanding debt balances, net of unamortized debt expenses.

- Restricted – This component consists of net assets with constraints placed on their use, either externally imposed by creditors (such as through debt covenants), grants or laws and regulations of other governments, or by law through constitutional provisions or enabling legislation.

- Unrestricted – This component of net assets consists of net assets that do not meet the definition of "restricted" or "invested in capital, net of related debt."

Restatement
The financial statements for the year ended June 30, 2001 have been restated to correct an error. The correction reduces the previously reported deferred power sales credit due to Water Contractors in the statement of net assets for amounts previously credited to the Water Contractors through an offset to certain revenue charges. As a result, amounts previously reported as operating expenses recovered (deferred) in the statement of activities for the years ended June 30, 2001 and previous, have been increased.

The deferred power sales credit results from a timing difference of revenue collected for power generated by the Oroville-Thermalito power plant and the corresponding credit that is issued to the Water Contractors through a reduced capital charge.

The cumulative effect of the restatement is a $256,191 thousand increase in net assets at July 1, 2000 and a corresponding decrease to the deferred credit. The impact on operations for the year ended June 30, 2001 was to decrease the net loss by $17,841 thousand. The effect of the restatement is as follows for the year ended June 30, 2001:

	As Previously Reported (in thousands)	As Restated
Deferred credit - power sales credit due to Water Contractors	$ 498,899	$ 224,867
Net assets (equity at July 1, 2000)	1,003,845	1,260,036
Net assets (equity at June 30, 2001)	984,344	1,258,376
Operating expenses recovered (deferred), principally under long-term water supply contracts, net	(98,291)	(116,132)
Income from operations	133,598	151,439
Decrease in net assets (net loss)	(19,501)	(1,660)
Reconciliation of operating income to net cash provided by operating activities:		
Income from operations	133,958	151,439
(Increase) decrease in deferred charges and credits, net	(95,881)	(113,722)

3. Interests in Jointly Owned Facilities

At June 30, 2002, 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	$ 204,504
San Luis joint use facilities	55.0 %	$ 260,377	$ 88,431

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. Utility Plant

The following activity in utility plant occurred during the years ending June 30, 2002 and 2001 (in thousands):

	Utility Plant in Service	Accumulated Depreciation	Net Utility Plant in Service	Construct Work in Progress	Total Utility Plant
Beginning balance, June 30, 2000	$ 4,491,500	$ 1,310,893	$ 3,180,607	$ 27,928	$ 3,208,535
Additions	3,592	75,420	(71,828)	44,603	(27,225)
Retirements and disposals	-	-	-	-	-
Ending balance, June 30, 2001	4,495,092	1,386,313	3,108,779	72,531	3,181,310
Additions	941	76,421	(75,480)	34,324	(41,156)
Retirements and disposals	(62,356)	(48,929)	(13,427)	-	(13,427)
Ending balance, June 30, 2002	$ 4,433,677	$ 1,413,805	$ 3,019,872	$ 106,855	$ 3,126,727

5. Cash and Investments

At June 30, 2002, 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 $9,240,000. Of the bank balance, $100,000 is federally insured and $9,140,000 is uncollateralized.

The System's investments are categorized below to give an indication of the level of credit risk at June 30, 2002. 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 counter party'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 counter party 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	$ -	$ 45,592	$ -	$ 45,592
Restricted cash in PMIA funds				157,353
Cash in PMIA funds				244,689
Total investments				$ 447,634
Reconciliation to combined balance sheet:				
Cash and cash equivalents restricted for plant replacements				$ 27,351
Cash and investments restricted for debt service				175,594
Cash and cash equivalents				244,689
Total investments				$ 447,634

Interest on deposits in PMIA varies with the rate of return of the underlying portfolio and approximated 2.85% at June 30, 2002. For the years ended June 30, 2002 and 2001, interest earned on the deposit with PMIF approximated $15,179,000 and $29,574,000, 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:

	2002	2001
Fair value of investments at the beginning of the fiscal year	$ 55,924	$ 72,881
Less: Proceeds of investments matured in fiscal year	(13,701)	(20,270)
Add: Amortization of discounts	1,687	1,359
Change in fair value of investments during fiscal year	1,682	1,954
Fair value of investments at the end of the fiscal year	$ 45,592	$ 55,924

6. Long-term Debt

The following activity occurred in the long-term debt accounts during the years ended June 30, 2002 and 2001:

	General Obligation Bonds	Revenue Bonds	Unamortized (Discounts) and Premiums	Deferred Loss on Advanced Refunding	Total Revenue Bonds	Commercial Paper	Total Long-Term Debt
Balance at June 30, 2000	$ 945,320	$ 2,459,385	$ (30,752)	$ (17,081)	$ 2,411,552	$ 28,117	$ 3,384,989
Additions	-	260,995	6,535	-	267,530	12,883	280,413
Payments / amortization	(39,900)	(258,470)	3,929	1,874	(252,667)	(41,000)	(333,567)
Balance at June 30, 2001	905,420	2,461,910	(20,288)	(15,207)	2,426,415	-	3,331,835
Additions	-	160,225	3,237	(7,026)	156,436	41,332	197,768
Payments / amortization	(41,040)	(169,265)	3,515	1,979	(163,771)	(41,332)	(246,143)
Balance at June 30, 2002	$ 864,380	$ 2,452,870	$ (13,536)	$ (20,254)	$ 2,419,080	$ -	$ 3,283,460

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, 2002, 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 1% 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) 2002	2001
1964	A&B	.01-3.6%	2014	$ 66,600	$ 70,950
1964-65	C&D	3.0-3.7%	2015	95,900	101,700
1965	E	3.0-3.8%	2016	51,500	54,300
1966-67	F,G&H	3.0-4.1%	2017	162,900	171,000
1968	J&K	3.5-4.9%	2018	114,000	119,200
1968	L&M	4.0-5.0%	2019	119,200	124,200
1970	N&P	5.0-5.8%	2020	124,200	129,000
1971-72	Q,R&S	4.8-5.5%	2022	123,470	127,840
1992-95	W,X&Y	4.2-10.0%	2025	6,610	7,230
				864,380	905,420
Less current maturities				42,290	41,040
				$ 822,090	$ 864,380

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 SWP. 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) 2002	2001
Devil Canyon-Castaic Facilities:						
1973		5.3-5.4%	2022	Callable	$ 108,800	$ 111,365
CVP Water System:						
1992	J	5.6-7.0%	2025	2001	179,590	263,505
1992	K	5.8-5.9%	2004	2002	-	4,565
1993	L	5.0-5.9%	2026	2003	482,540	494,260
1994	M	4.5-8.5%	2028	2004	168,170	175,785
1996	O	4.8-8.3%	2030	2006	298,680	303,520
1996	P	5.3-9.3%	2029	2006	74,370	76,665
1997	Q	4.4-6.0%	2028	2007	219,645	240,740
1998	S	4.3-5.0%	2030	2008	194,335	196,240
1998	T	5.0-5.5%	2013	2009	104,110	113,645
1999	U	4.0-5.1%	2030	2009	194,680	200,045
1999	V	6.25%	2025	None	20,580	20,580
2001	W	4.0-5.5%	2030	2012	247,145	260,995
2002	X	2.5-5.5%	2029	2013	160,225	-
					2,452,870	2,461,910
Less: Unamortized bond issuance discounts / premiums					13,536	20,288
Deferred loss on advanced refunding					20,254	15,207
Current maturities					59,035	55,200
					$ 2,360,045	$ 2,371,215

Future Debt Service Requirements
Future principal payment requirements on bonds are as follows at June 30, 2002:

	(in thousands)				
	General Obligation Bonds		Revenue Bonds		
Year	Principal	Interest	Principal	Interest	Total
2003	$ 42,290	$ 1,840	$ 59,035	$ 129,787	$ 232,952
2004	44,480	1,930	51,745	125,868	224,023
2005	46,320	2,014	56,045	122,765	227,144
2006	47,575	2,073	66,080	119,292	235,020
2007	48,965	2,139	69,675	113,535	234,314
2008-2012	272,375	11,925	426,180	514,226	1,224,706
2013-2017	274,075	11,560	506,925	385,747	1,178,307
2018-2022	88,095	4,158	545,800	247,052	885,105
2023-2027	205	12	488,800	101,113	590,130
2028-2033	-	-	182,585	13,211	195,796
	$ 864,380	$ 37,651	$ 2,452,870	$ 1,872,596	$ 5,227,497

Commercial Paper Notes
The System has a commercial paper borrowing program of up to $100 million. 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, 2002 and 2001, there were no borrowings 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.

7. 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 million.

In May 2002, the System issued $160,225,000 in CVP Water System Revenue Bonds – Series X with an average interest rate of 4.4%, which was used to advance refund $114,065,000 of outstanding bonds and redeem commercial paper borrowings of $41,332,000.

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 years 2002 and 2001 advance refunding resulted in the recognition of an accounting loss of approximately $7 million and $6 million, respectively, the System effectively reduced its aggregate debt service payments by approximately $2.9 million and $10.6 million, respectively, over the next 20 years and obtained an economic gain (difference between the present values of the old and new debt service payments) of $3.7 million and $8.3 million, respectively.

The total amount of bonds refunded in advance and still outstanding was $221,745,000 at June 30, 2002.

8. 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, 2002, was 4.166% and 0.036% for State Miscellaneous Tier 1 and Tier 2, respectively. 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, 2002 and 2001, the System's annual pension cost and actual contribution amounted to approximately $5.8 million and $0, respectively. Annual covered payroll is not available for the System. However the actuarially determined contributions for the years ended June 30, 2002 and 2001, approximated .25% and 0%, respectively, of the total actuarially determined contribution requirements for the State Miscellaneous Category and approximately 3.5% and 0%, respectively, of the total System payroll. The required contribution for the 2002 fiscal year was determined as part of the June 30, 2000, 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 for miscellaneous members that vary by duration of service ranging from 3.75% to 8.45%, (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 three-year period. 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, 2001, the date of the most recent actuarial valuation, was 6 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 (Tier 1 and Tier 2) 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)
2000	$ -	100 %	$ -
2001	$ -	100 %	$ -
2002	$ 242,039	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 %
2001	$47,258,102	$45,261,495	$(1,996,607)	104 %	$8,190,102	(24)%

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 Department's active employees and retirees for the years ended June 30, 2002 and 2001, were approximately $10,561,000 and $11,127,000, respectively. The Department represents approximately 0.66% of the State of California's total expenditures for health care benefits. Post-retirement health care data for the Department's retirees alone are not available and cannot be reasonably estimated.

9. Commitments and Contingencies

Commitments
Construction
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, 2002 and 2001, approximated $51,936,000 and $33,265,000, respectively.

Power Transmission and Purchase
The System has long-term power transmission service contracts requiring future payments of approximately $161,696,000 over periods ranging from three to 12 years. Payments made under these contracts approximated $22,936,000 and $21,334,000 for the years ended June 30, 2002 and 2001, respectively.

The System has also entered into long-term power purchase contracts requiring future payments of approximately $413,651,000 over periods ranging from three to 25 years. Payments made under these contracts, excluding payments to the Kings River Conservation District (District), approximated $40,757,000 and $39,253,000 for the years ended June 30, 2002 and 2001, respectively.

The System has a contract with the District that provides that the System receive all power generated by the Pine Flat Power Plant 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 $9,608,000 and $9,318,000 during the years ended June 30, 2002 and 2001, 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, 2002, are as follows:

For the year ended	Fixed Obligation (in thousands)
2003	$ 4,948
2004	4,961
2005	4,959
2006	4,952
2007	4,948
Thereafter	65,974
	$ 90,742

Contingencies

Litigation

Monterey Amendment

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. However, the parties have engaged in settlement discussions through a mediation process during which the litigation has been stayed. The parties have reached an agreement in principle and are in the process of negotiating a final settlement agreement. If a final settlement is not achieved, the trial court could discontinue the implementation of the Monterey Amendment in whole or in part pending completion of the new EIR, and could invalidate the Kern Water Bank transfer. The Department does not expect the outcome of this litigation, either through settlement or trial 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 SWP 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. The System is also self-insured for workers' compensation, general liability and other risks.

Recent Developments in California Power Markets
California's 1998 electrical deregulation plan, massive shortages in the supply of electricity in the western United States, rapidly escalating natural gas prices and other factors combined to produce large increases in the wholesale price for electricity and substantial operating losses to the State's three major investor-owned utilities (the "Utilities") in 2000 and 2001. Ultimately, the Utilities' financial condition deteriorated until they could no longer purchase enough wholesale electricity to serve all of the needs of their retail customers. In December 2000, at the request of the California Independent System Operator (the operational manager of California's electricity grid) (the "ISO") and later pursuant to emergency proclamation of the Governor and subsequent legislation, the Department began purchasing wholesale electricity for delivery to the retail customers of the Utilities from sources unrelated to the System and the System's bonds. Subsequently, the Department created a separate energy division, the Department of Water Resources Electric Power Fund (Power Fund), to perform its function as supplier of energy to retail customers, and to distinguish and keep that function separate and distinct from its power activities in connection with 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.

Monies which have been or which may be appropriated to the Power Fund for the power purchase activities described above have not been and will not be derived from amounts or revenues pledged to the repayment of the System's general obligation and revenue Bonds. Furthermore, no indebtedness incurred by the Power Fund for such power purchase activities will be secured by amounts or revenues pledged to the repayment of the System's bonds.

Developments in the California energy market since mid-2000 have adversely impacted the financial condition of some market participants and have had the effect of increasing receivables for power sold by the SWP. The ISO, which, among other functions, acts as a clearinghouse for certain payments among market participants, currently owes the System approximately $26.0 million at June 30, 2002 for power supplied by System's power facilities to the California power grid. These amounts, if not collected, would increase the variable revenues imposed on Contractors under the Water Supply Contracts, but would not adversely affect the Department's ability to operate and maintain the System or to pay debt service.

As a supplier of energy, the System received increased market prices from energy sales in late 2000 and in 2001. Some of the proceeds of such sales may be subject to refund. See "Federal Energy Regulatory Commission Proceedings," below. Any such refunds will not have a materially adverse effect on the ability of the System to pay its obligations when due or to operate and maintain the System.

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.

Federal Energy Regulatory Commission Proceedings
There are a number of proceedings pending before FERC relating to the Department as operator of the System. Some of these proceedings address requests from the ISO, investor-owned utilities, and others to increase or adjust rates or allocate responsibility for costs for transmission and other services provided to the Department and other entities in California. The Department is participating in these proceedings, since the outcome of these proceedings has the potential to increase the Department's annual power costs. However, the Department does not believe that any increased charges arising from these proceedings will materially impact the Department's operations or ability to pay the System's debt service. Any increased charges will be passed through to the Water Contractors under the Water Supply Contracts in the form of higher operations charges.

FERC proceedings have also been instituted to address power purchaser requests for partial refunds from sellers of energy and related services in 2000 and 2001, including the Department. The Department believes that any additional amounts the Department is required to refund as a result of these proceedings will not have a material impact on the ability of the Department to pay debt service on the Bonds when due because the impact of any refunds would be passed through to the Water Contractors under the Water Supply Contracts in the form of higher operations charges.

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 made up the net loss of electrical energy by purchasing energy on the short-term markets, which did not have a material adverse effect on management's ability to continue to operate the System. Since May 2, 2001, Edison delivered energy to the System pursuant to the on-peak/off-peak energy exchange contracts. The System and Edison have been involved in an arbitration process to resolve contract disputes. Before the arbitration was completed, the System accepted an offer of settlement from Edison in October 2002, and the parties are in the process of preparing the settlement documents and amendments to the two energy contracts that were the subject of the dispute.

9. Related Party Transactions

During the years ended June 30, 2002 and 2001, the System sold power approximating $11 million and $80 million, respectively, to the Department of Water Resources Electric Power Fund (Power Fund), another enterprise fund administered by DWR.

10. Subsequent Events

In July 2002, the System issued CVP Water Systems Revenue Bonds Series Y, delayed delivery bonds in the amount of $329,885,000, which will be used to refund $316,080,000 of bonds, at a redemption price of 101.5%. In October 2002, the System issued CVP Water Systems Revenue Bonds Series Z, in the amount of $232,490,000, for the purposes of refunding $163,945,000, at redemption prices of 101% to 101.5%. Also in October 2002, the System issued CVP Water Systems Revenue Bonds Series AA, delayed delivery bonds in the amount of $108,705,000, which will be used to refund $117,260,000 of bonds, at a redemption price of 101.5%.

Supplementary Information

State Water Resources Development System
Calculation of Adequacy of Debt Service Coverage
For the years ended June 30, 2002 (dollars in thousands)

Water supply revenues, including $41, 089 in refundable proceeds	$	272,674
Investment earnings		2,079
		274,753
Less: Operations and maintenance expense		49,097
Net revenues available for debt service	$	225,656
Principal and interest for revenue bonds	$	179,009
Debt service coverage		126%

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.