State Water Resources Development System

Financial Statements and
Supplementary Information
For the years ended June 30, 2003 and 2002

State Water Resources Development System
Index

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Report of Independent Auditors

The Director of the State of California
Department of Water Resources

In our opinion, the accompanying statements of net assets and the related statements of 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, 2003 and 2002, 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.

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.

Our audits were 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 audits 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 24, 2003, 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 audits.

PricewaterhouseCoopers LLP

November 24, 2003

Management's Discussion and Analysis

This discussion and analysis is designed to assist the reader in focusing on significant financial issues and activities and to identify any significant changes in financial position of the State Water Resources Development System (the System), which is administered by the California Department of Water Resources (DWR). Readers are encouraged to consider the information presented in conjunction with the financial statements as a whole, which follows *Management's Discussion and Analysis*. This discussion and analysis and the financial statements do not relate to DWR's other governmental and proprietary funds. The 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. 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; know as the "Water Contractors," in order to recover substantially all System costs. The Water Contractors have a contractual entitlement to request 4,172,786 acre-feet of SWP water on an annual basis. This entitlement does not assure delivery of that amount of water, but rather provides the basis for proportional allocation of available supplies among the Water Contractors.

Portions of the SWP system consist of facilities developed and used jointly with the Federal Central Valley Water 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 $46 million on total operating revenues of $719 million. This result is in line with expectations as the System has incurred certain expenses it has not recovered from the Water Contractors or other governmental entities.

- During the year, the System completed the issuance of three CVP Water System Revenue Bonds, Series Y, Z and AA. These bond issuances totaled $609 million. The majority of the proceeds from the issuances were used to refund and defease portions of the bonds of Series L, M, O, Q, S and U. The refundings are projected to provide a net present value savings to the System of $36 million.

Overview of Financial Statements

Reports Included in Financial Statements

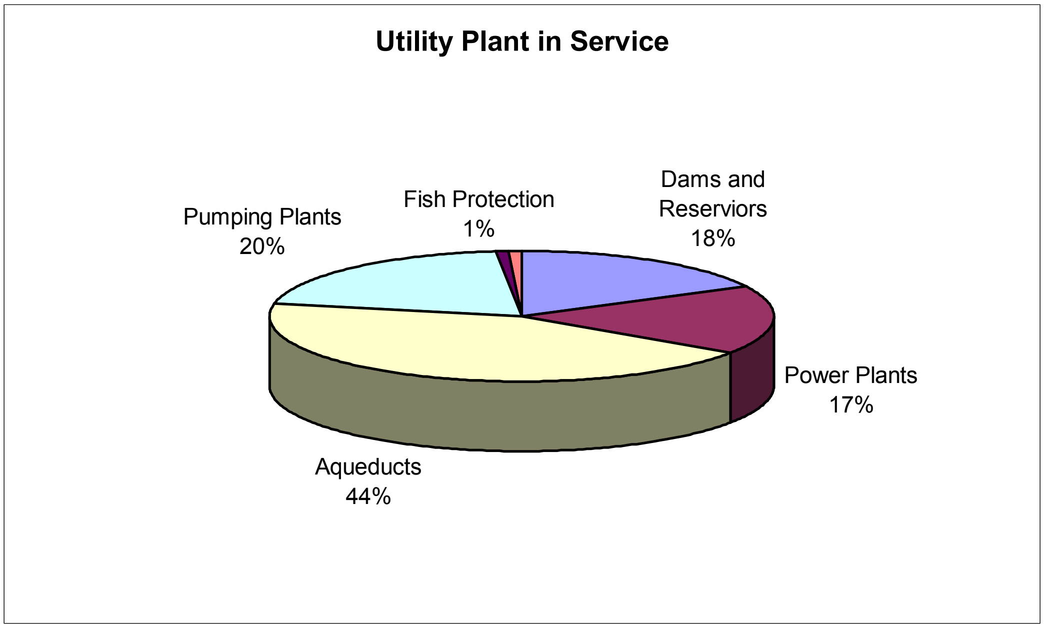
The System is accounted for as an enterprise fund. Enterprise funds account for the acquisition, operation and maintenance of governmental facilities and services that are entirely or predominantly self-supporting by user charges. This financial report consists of three financial statements, prepared on the accrual basis of accounting, with accompanying disclosure notes. These financial statements report information using accounting methods similar (although not identical) to those used by private sector companies. The statements of net assets include all the assets, liabilities and the net assets of the System. The statements of activities report all of the revenues and expenses incurred during the fiscal years presented. The statements of cash flows report the cash inflows and outflows classified by operating, investing, non-capital financing, and capital and related financing activities during the reporting periods presented. The notes to the financial statements communicate information that is required by generally accepted accounting principles.

	2003	2002	% Change
	(in thousands)		
Condensed Statements of Net Assets			
Total utility plant	$ 3,094,895	$ 3,126,827	-1.0%
Other assets	1,972,219	2,075,014	-5.0%
Total assets	5,067,114	5,201,841	-2.6%
Capitalization:			
Net assets:			
Capital, net of releated debt	246,567	234,603	5.1%
Restricted	956,427	1,014,644	-5.7%
Total net assets	1,202,994	1,249,247	-3.7%
Total long-term debt	3,154,588	3,182,135	-0.9%
Total capitalization	4,357,582	4,431,382	-1.7%
Other liabilities	709,532	770,459	-7.9%
Total capitalization and liabilities	$ 5,067,114	$ 5,201,841	-2.6%
Statements of Activities			
Water supply	$ 587,624	$ 642,728	-8.6%
Power sales	85,735	105,325	-18.6%
Federal reimbursements	16,072	13,169	22.0%
Total operating revenues	689,431	761,222	-9.4%
Operations and maintenance expense	295,795	302,245	-2.1%
Purchased power	82,617	199,703	-58.6%
Depreciation expense	75,698	76,421	-0.9%
Operating expenses recovered, net	101,889	14,048	625.3%
Total operating expenses	555,999	592,417	-6.1%
Income from operations	133,432	168,805	-21.0%
Interest expense	(183,820)	(169,220)	8.6%
Other income (expense)	4,135	(8,714)	-147.5%
Decrease in net assets	(46,253)	(9,129)	406.7%
Net assets, beginning of year	1,249,247	1,258,376	-0.7%
Net assets, end of year	$ 1,202,994	$ 1,249,247	-3.7%

Assets

Utility Plant

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



The net utility plant in service (UPIS) decreased by $68 million during the year. This is due to depreciation recorded in the amount of $76 million, offset in part by the addition of certain projects completed during the year that totaled $7 million and other additions of $1 million. The completed projects include work done at the Thermalito Diversion Dam and aqueduct work done at the Devil Canyon power plant. The depreciation amount remains relatively constant, as the majority of the System is complete and depreciation is recorded on a straight-line basis over the estimated useful life of the assets, which range from 30 to 100 years.

Construction Work in Progress

Construction work in progress increased by $36 million for 2003 or 33% over 2002. This increase was due to additions to on-going construction projects that totaled $43 million, offset in part by $7 million of projects that were completed during the year and subsequently transferred to utility plant in service, as discussed above. The additions to the on-going projects included conservation projects in the amount of $10 million, East Branch Extension projects of $18 million, transportation projects of $14 million and off-aqueduct power projects of $1 million. At June 30, 2003, construction work in progress was comprised of $20 million of conservation projects, $103 million of East Branch Extension projects, and $20 million of transportation projects.

Restricted Cash and Investments
Restricted cash and cash equivalents increased by $3 million during the year. This change consists of a $14 million increase in debt service reserves associated with the issuance of CVP Water System Revenue Bonds – Series Y, Z, and AA, offset by the usage of $11 million of plant replacements reserves.

Other Long-term Assets
The due from other state funds represents the System's advance of $92 million to DWR's internal service fund, which functions as a revolving working capital facility for DWR. Additionally, the System made an advance to Pacific Gas & Electric Company for transmission line reinforcements, of which $3 million remains outstanding as of June 30, 2003. Lastly, the System made loans to local water agencies through the Davis-Grunsky Act of which a long-term portion of $34 million remains outstanding at June 30, 2003.

Cash and Cash Equivalents
In fiscal 2003, cash increased by $3 million to a balance of $248 million. Refer to the Statements of Cash Flows for a detailed summary of cash in-flows and out-flows. The System generated cash flows of $248 million provided by operating activities, $7 million used in noncapital financing activities, $248 million used in capital and related financing activities, and $10 million provided by investing activities.

Receivables
Water supply and power billings receivable declined from $89 million in 2002 to $83 million in 2003. The decrease is attributed to a reduction in revenue received in 2003 compared to 2002. Refer to "Operating Revenues" section for a discussion of power revenue fluctuations.

Deferred Charges
Deferred charges represent timing differences between expenditures incurred by the System and their ultimate recovery from the Water Contractors. Overall, deferred charges decreased in fiscal 2003, by $107 million because the System recognized previously deferred expenditures to match revenues received.

Liabilities

Revenue Bonds
The System has issued 27 series of Water System Revenue Bonds totaling $4,896 million in aggregate principal, of which $2,297 million remains outstanding as of June 30, 2003, compared to $2,344 million at June 30, 2002. This includes the issuance of Series Y, Z and AA, issued in an aggregate amount of $609 million. The proceeds of these Series were used to refund existing debt to take advantage of declining interest rates. The net present value savings of these issuances is projected to be $36 million.

The System has also issued $1,526 million of revenue bonds under three separate bond resolutions to finance certain power facilities. Under the Devil Canyon – Castaic bond resolution, $106 million is outstanding as of June 30, 2003, compared to $109 million at June 30, 2002. Bonds issued under the other two bond resolutions have been fully retired.

General Obligation Bonds
In addition to the revenue bond obligations described above, a large portion of the SWP was financed by the sale of general obligation bonds of the State pursuant to the provisions of the Burns-Porter Act, which authorized the issuance of $1,750 million of such bonds for the construction of the SWP. The Burns-

Porter Act was adopted by the voters at the State's general election of November 1960. Of that authorization, $1,582 million (including the entire amount available for construction of the initial components of the SWP) has been issued, of which $822 million is outstanding. The un-issued $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 $123 million in 2003, compared to $154 million in fiscal 2002. The $31 million decrease is attributed primarily to a reduction in power purchases.

Proceeds Due to Water Contractors
Proceeds due to Water Contractors is comprised of the additional 25% billing for debt service in excess of debt service requirements, certain investment income and off-aqueduct power sales, all defined as refundable to the Water Contractors under terms of the water supply contracts. Proceeds due to Water Contractors declined by $8 million in 2003 to $75 million. This decrease can be attributed to a $20 million refund made in 2003 for off-aqueduct power, offset in part by an accrual made in fiscal 2003 for additional off-aqueduct power refunds due.

Deferred Revenue – State and Federal Capital Recovery
The System received funds from the State and Federal governments to build certain projects that relate to recreational use and flood control. That revenue has been deferred until those projects are depreciated. Deferred revenue decreased $6 million to $181 million in fiscal 2003. This decrease represents the recognition of revenue equal to the amount of depreciation recorded.

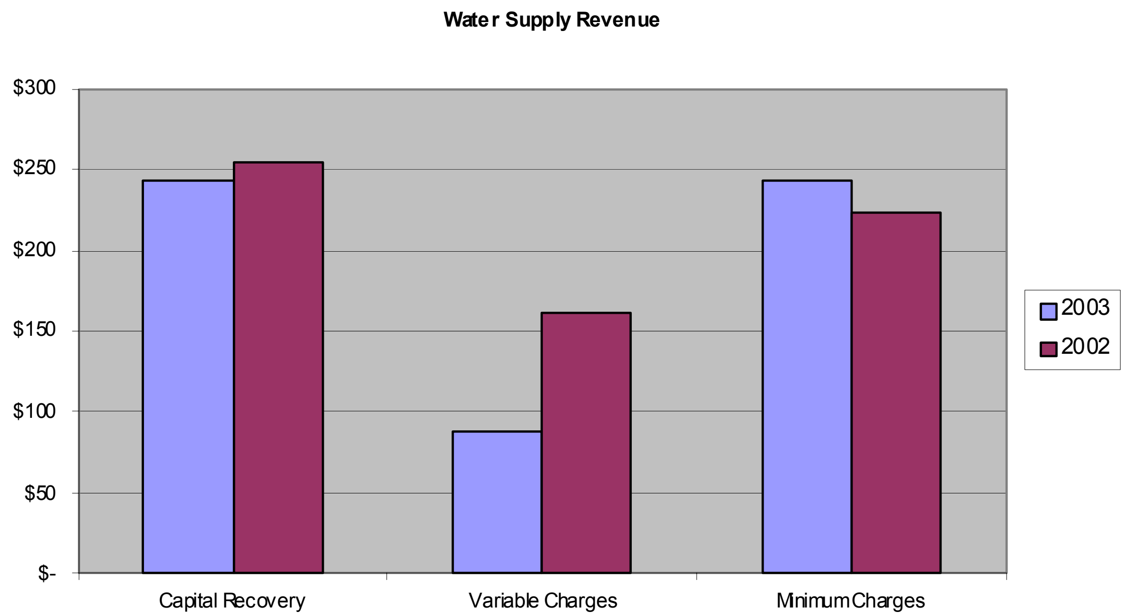
Deferred Power Sales Credit
The deferred power sales credit results from a timing difference of revenue collected from certain Water Contractors for power generated by the Oroville-Thermalito power plant and the corresponding credit that is issued to all Water Contractors through a reduced capital charge. In 2003, capital charges (Delta Water Charge) included credits for the principal portion of the power sales credit in the amount of $16 million, which was offset in part by $15 million of revenue recovering the net cost of energy.

Statement of Activities

Operating Revenues
Operating revenues declined $72 million in fiscal year 2003 to $689 million. This was due in part to a decrease in water supply revenue of $55 million a decrease in power sales of $20 million and an increase in Federal reimbursements of $3 million.

Water Supply Revenue
Under the terms of the water supply contracts, the System is required to collect from the Water Contractors all costs of the SWP allocated in proportion to each Contractor's contractual allocation of water. Generally, the System's cost, including the costs of gathering, storing, conveying and delivering water, and interest, are billable to Water Contractors whether or not water is delivered.

Water supply revenues consist of three main categories, as defined in the water supply contracts: 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 cost 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 net cost of energy used to deliver water to the Water Contractors. Like Minimum, these costs, net of on-aqueduct power sales, are generally recovered as they are incurred.



In 2003, the System generated $588 million in water supply revenue, compared to $643 million generated in 2002. The table above shows a comparative breakdown of the components of water supply revenue for 2003 and 2002.

As shown in the chart above, the primary reasons for the $55 million decrease in water supply revenue for the two years relates to a decrease in the Variable component, offset in part by increased Minimum revenue.

The decrease in Variable revenue is attributable to two items. First, a settlement in the amount of $30 million received from Southern California Edison (SCE) relating to prior year power purchase transactions. SCE paid DWR $30 million that DWR recorded as an offset to power purchases in 2003. In turn, DWR gave the Water Contractors credit for the settlement through the Variable charge, thus decreasing the Variable charge on a comparative basis by $30 million. Second, although total water deliveries increased slightly in 2003, the cost of power has decreased, and hence the average mill rate used to determine the Variable charge factor for each Contractor decreased from $32.65 to $23.37 in 2003, which represents a 28% reduction. When applied to 2002 Variable revenue, approximately $46 million of the 2003 change can be attributed to this reduction in the mill rate.

The increased Minimum revenue reflects billing increases to recover differences between actual expenditures and estimated expenditures.

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 with 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. 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. Also, during California's recent energy crisis, the variance between off-peak and on-peak prices significantly narrowed. Power sales as reported were $20 million less in 2003 than 2002. This difference is attributable to a decrease in the volume of power sold offset in part by an increased price per MWh. The table on the following page explains the change attributable to each factor at June 30:

	MWh Sold	$ Sold	Rate/MWh	
2002	1,551,102	$ 105,325,000	$ 72.81	*
2003	868,671	$ 85,735,000	$ 98.70	

Change in total MWh sold	(682,431)
Multiplied by 2003 rate/MWh	$ 98.70
Difference attributed to decreased sales (rounded to nearest thousand)	$ (67,356,000)
Total MWh rate change	$ 25.89
Multiplied by 2002 MWh sold	1,551,102
Difference attributed to rate change (rounded to nearest thousand)	$ 40,158,000
Plus retroactive adjustments to previous year sales	$ 7,608,000
Total decrease in power sales (rounded to nearest thousand)	$ (19,590,000)

* The rate/MWh has been adjusted to eliminate the effect of retroactive adjustments to the previous year's sales.

Federal Reimbursement Revenue
Federal Reimbursements revenue for the year was $16 million, which represents a $3 million increase over 2002. This increase is attributable to the increased expenditures incurred for the portion of the San Luis and Suisun Marsh facilities relating to flood control, for which the System is reimbursed by the Federal government.

Operating Expenses
As with revenues, total operating expenses for the year of $556 million were down $30 million compared to the prior year amount of $592 million. This difference is primarily the result of the $30 million settlement received from SCE discussed previously. The remaining $6 million decrease results from a reduction in power purchases and an increase in operating expenses recovered.

Operations and Maintenance Expense
Total operations and maintenance expense was $296 million, which represents a two percent decrease compared to the prior year.

Power Purchases
As discussed above, the System uses a significant amount of power to operate its pumping stations in order to deliver water to Water 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. Purchased power was $117 million less in 2003 compared to 2002. When adjusted for the settlement from Southern California Edison for $30 million discussed previously, power purchases were actually down $87 million from 2002 on a comparable basis. This decrease is due to a decline in the volume

purchased and a decline in the cost per MWh. The following table shows the amount attributable to each factor at June 30:

	MWh Purchased	Power Purchased	Rate/MWh
2002	2,204,383	$ 199,703,000	$ 69.08 *
2003	1,947,061	$ 112,617,000	$ 57.84
Change in MWh purchased			(257,322)
Multiplied by 2003 rate			$ 57.84
Difference attributed to decreased purchases (rounded to nearest thousand)			$ (14,884,000)
Change in MWh rate			$ (11.24)
Multiplied by 2002 purchased			2,204,383
Difference attributed to rate change (rounded to nearest thousand)			$ (24,779,000)
Plus retroactive adjustments to previous year sales and sale to related party			$ (47,423,000)
Total decrease in power purchases (rounded to nearest thousand)			$ (87,086,000)

* The rate/MWh has been adjusted to eliminate the effect of retroactive adjustments to the previous year's purchases.

Operating Expenses Recovered

Operating expenses recovered increased by $88 million. This amount represents timing differences between expenditures made by the System and their eventual recovery from the Water Contractors through the Minimum and Variable components of revenue.

Interest Expense

Interest expense for the year was $184 million, an increase of $15 million over the prior year amount of $169 million. This is primarily due to the loss recorded on the issuance of Series Y and AA Revenue Bonds.

Other Income (Expense)

Other income increased in 2003 by $13 million. This is due primarily to the loss recorded in 2002 for the sale of the Jibboom Street project in the amount of $13 million.

Change in Net Assets

Overall, the System recorded a net loss of $46 million. The System incurred certain expenses it has not recovered from the Water Contractors or other governmental entities.

State Water Resources Development System
Statements of Net Assets
June 30, 2003 and 2002 (in thousands)

	2003	2002
Assets		
Utility plant:		
Utility plant in service	$ 4,441,688	$ 4,433,677
Less accumulated depreciation	(1,489,403)	(1,413,705)
Net utility plant in service	2,952,285	3,019,972
Construction work in progress	142,610	106,855
Total utility plant	3,094,895	3,126,827
Long-term assets:		
Restricted assets:		
Cash and cash equivalents restricted for plant replacements	16,126	27,351
Cash and investments restricted for debt service	180,955	166,354
Cash and cash equivalents on deposit with revenue bond trustee	9,189	9,240
Loans receivable from local water agencies	34,178	33,295
Advances to Pacific Gas & Electric Company	3,067	5,112
Due from other state funds	91,516	91,516
Total long-term assets	335,031	332,868
Current assets:		
Cash and cash equivalents	247,843	244,689
Receivables:		
Interest on investments	1,993	3,554
Water supply and power billings	83,411	89,120
Due from federal government	16,884	12,119
Inventories	9,267	8,225
Other	110	95
Total current assets	359,508	357,802
Deferred charges:		
Amounts recoverable through future billings under long-term water supply contracts:		
Operations and maintenance expense	64,657	136,633
Capital costs	330,056	352,895
Unamortized project costs	393,561	402,281
Unbilled interest earnings on capital costs	489,406	492,535
Total deferred charges	1,277,680	1,384,344
Total assets	$ 5,067,114	$ 5,201,841

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

State Water Resources Development System
Statements of Net Assets, continued
June 30, 2003 and 2002 (in thousands)

	2003	2002
Capitalization and Liabilities		
Capitalization:		
Net assets:		
Capital, net of related debt	$ 246,567	$ 234,603
Restricted	956,427	1,014,644
Total net assets	1,202,994	1,249,247
Long-term debt, less current maturities:		
General obligation bonds	777,610	822,090
Revenue bonds	2,344,884	2,360,045
Commercial paper	32,094	-
Total long-term debt	3,154,588	3,182,135
Total capitalization	4,357,582	4,431,382
Current liabilities:		
Current maturities of bonds	96,815	101,325
Accounts payable	34,767	60,831
Accrued vacation	10,816	12,189
Accrued interest on long-term debt	18,216	20,049
Due to other state funds	59,451	60,931
Proceeds due to Water Contractors	74,954	82,843
Other	-	172
Total current liabilities	295,019	338,340
Deferred credits:		
Deferred revenue - State and Federal capital recovery	180,630	186,640
Power sales credit due to Water Contractors	218,234	219,773
Advances for plant replacements	15,649	25,706
Total deferred credits	414,513	432,119
Commitments and Contingencies (Note 9)		
Total capitalization and liabilities	$ 5,067,114	$ 5,201,841

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

State Water Resources Development System
Statements of Activities
For the years ended June 30, 2003 and 2002 (in thousands)

	2003	2002
Operating revenues:		
Water supply	$ 587,624	$ 642,728
Power sales	85,735	105,325
Federal reimbursements	16,072	13,169
Total operating revenues	689,431	761,222
Operating expenses:		
Operations and maintenance	295,795	302,245
Purchased power	82,617	199,703
Depreciation expense	75,698	76,421
Operating expenses recovered, principally under long-term water supply contracts, net	101,889	14,048
Total operating expenses	555,999	592,417
Income from operations	133,432	168,805
Interest expense	(183,820)	(169,220)
Other income (expense)	4,135	(8,714)
Decrease in net assets	(46,253)	(9,129)
Net assets, beginning of year	1,249,247	1,258,376
Net assets, end of year	$ 1,202,994	$ 1,249,247

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

State Water Resources Development System
Statements of Cash Flows
For the years ended June 30, 2003 and 2002 (in thousands)

	2003	2002
Cash flows from operating income:		
Receipts from customers	$ 666,232	$ 725,161
Payments to employees for services	(204,267)	(163,495)
Payments to suppliers	(203,401)	(361,366)
Net cash provided by operating activities	258,564	200,300
Cash flows from noncapital financing activities:		
Other (expense) income	(6,833)	2,954
Net cash (used in) provided by noncapital financing activities	(6,833)	2,954
Cash flows from capital and related financing activities:		
Proceeds from issuance of revenue bonds, net of issuance discounts and premiums	643,779	163,462
Principal payments on long-term debt	(700,975)	(210,305)
Proceeds from issuance of commercial paper notes	32,094	-
Interest payments on long-term debt	(198,653)	(178,368)
Additions to utility plant	(37,721)	(30,947)
Net cash used in capital and related financing activities	(261,476)	(256,158)
Cash flows from investing activities:		
Cash received from investment earnings	6,409	2,318
Return of principal on matured investments	-	13,701
Payments received from local water agencies on loans receivable	1,650	1,907
Reduction of advances to Pacific Gas & Electric Company	2,045	2,945
Net cash provided by investing activities	10,104	20,871
Net increase (decrease) in cash and cash equivalents	359	(32,033)
Cash and cash equivalents, beginning of year	402,042	434,075
Cash and cash equivalents, end of year	$ 402,401	$ 402,042
Reconciliation of operating income to net cash provided by operating activities:		
Income from operations	$ 133,432	$ 168,805
Adjustment to reconcile operating income to net cash provided by operating activities:		
Depreciation expense	75,698	76,421
Decrease in deferred charges and credits, net	85,822	14,048
Changes in operating assets and liabilities:		
Decrease in receivables	944	26,537
(Increase) decrease in inventories	(339)	1,735
Increase in other assets	(15)	(50)
Decrease in accounts payable and accrued vacation	(27,437)	(35,188)
(Decrease) increase in due to other state funds	(1,480)	10,540
Decrease in current proceeds due to Water Contractors	(7,889)	(58,312)
Decrease in other liabilities	(172)	(4,236)
Total adjustments	125,132	31,495
Net cash provided by operating activities	$ 258,564	$ 200,300

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 (SWP), the Davis-Grunsky Act Program and the San Joaquin Drainage Implementation Program. 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 (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 economic resources measurement focus and the accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred. As allowed by governmental accounting standards, the 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).

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 as incurred. During the years ended June 30, 2003 and 2002, interest expense of $6,045 and $4,318, 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.

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. Cash and cash equivalents do not include U.S. Government and agency securities.

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). 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, 2003, are of a similar nature as those held at June 30, 2002.

Deferred Charges and Credits
The System records costs that are recoverable through future billings as deferred charges and revenues that are in excess of total project costs from inception of the SWP as deferred credits. 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 charged and recoverable by the System 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 4.613% and 4.615% at June 30, 2003 and 2002, 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 statements of operations.

The deferred power sales credit arises from revenue collected for the power generated by the Oroville-Thermalito power plant. The deferred power sales credit is ratably decreased over time 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. Assets received from such billings are restricted. Costs of plant 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 Implementation Program.

Bond Issuance Discounts and Premiums
Bond issuance discounts and premiums are reflected as a reduction / increase of bonds outstanding and are amortized over the lives of the related debt instruments.

Deferred Loss on Advanced Refunding
Losses associated with the advance refunding of debt are deferred and amortized over the shorter of the life of the new debt or the refunded debt.

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 $40,470 and $40,923 during the years ended June 30, 2003 and 2002, respectively. Rate management reductions are permanent reductions in capital related billings to the Water Contractors.

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 satisfy certain 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 satisfying certain bond covenants be refunded in the subsequent year. These billings, which totaled $40,206 and $41,089 in the years ended June 30, 2003 and 2002, respectively, are recorded as liabilities in the financial statements. The System refunded $38,221 and $38,049 in the years ended June 30, 2003 and 2002, 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 and Kern County Water Agency whose System billings constitute 63% and 8% of total System water supply revenue for the year ended June 30, 2003, respectively.

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

For the years ended June 30, 2003 and 2002 (in thousands)

The Federal government reimburses the System for certain operating and capital costs incurred by the System for flood control purposes. In addition, the Federal government reimburses the System for the Federal government's 45% 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 until the related depreciation expense is recognized.

Segments
The System has two segments, defined under governmental accounting standards as an identifiable activity for which one or more revenue bonds or other revenue-backed debt instruments are outstanding:

1) Activities Allowed Under the Burns-Porter Act – This segment accounts for the costs to build, operate and maintain the facilities financed by general obligation bonds as authorized by the Burns-Porter Act. The Water Contractors' transportation and conservation revenues are recorded in this segment as well as power sales and reimbursements from Federal and State governments, and interest on investments. Expenses are limited to operations and maintenance of the SWP constructed with general obligation bond proceeds, power purchases, replacements and interest and principal on the General Obligation Bonds.

2) Activities Allowed Under the Central Valley Project Act – This segment accounts for the costs to build, operate and maintain the facilities financed by the Central Valley Project Water Systems revenue bonds. The Water Contractors' capital and operations revenues for projects financed by revenue bond proceeds are recorded in this segment as well as commercial paper sales, reimbursements from Federal and State governments for San Luis Dam and Reservoir, Suisun Marsh and recreation costs, and interest on investments. Expenses are related to the construction and operation of SWP facilities constructed with revenue bond proceeds and power facilities, and interest and principal payments.

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, 2003 or 2002, respectively.

3. Interests in Jointly Owned Facilities

At June 30, 2003, the System owned the following undivided interests in jointly owned facilities:

		System's Share	
	% 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%	$ 255,932	$ 121,588

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.

For the years ended June 30, 2003 and 2002 (in thousands)

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 statement of activities. The Federal government is billed for its share of the operating expenses, and these billings are included as operating revenues in the statement of activities.

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 statement of activities.

4. Utility Plant

The following activity in utility plant occurred during the years ending June 30, 2003 and 2002:

	Utility Plant in Service	Accumulated Depreciation	Net Utility Plant in Service	Construction Work in Progress	Total Utility Plant
Balance at 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)	(49,029)	(13,327)	-	(13,327)
Balance at June 30, 2002	4,433,677	1,413,705	3,019,972	106,855	3,126,827
Additions	536	75,698	(75,162)	43,230	(31,932)
Transfers	7,475	-	7,475	(7,475)	-
Balance at June 30, 2003	$ 4,441,688	$ 1,489,403	$ 2,952,285	$ 142,610	$ 3,094,895

5. Cash and Investments

At June 30, 2003, 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 $9,189. Of the bank balance, $100 is federally insured and $9,089 is uncollateralized.

The System's investments are categorized below to give an indication of the level of credit risk at June 30, 2003. 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.

For the years ended June 30, 2003 and 2002 (in thousands)

	Category 1	Category 2	Category 3	Fair Value
U. S. Government and Agency Securities	$ -	$ 51,712	$ -	$ 51,712
Restricted cash in PMIA funds				145,369
Cash in PMIA funds				247,843
Cash and cash equivalents on deposit with revenue bond trustee				9,189
Total investments				$ 454,113

Reconciliation to combined balance sheet:	
Cash and cash equivalents restricted for plant replacements	$ 16,126
Cash and investments restricted for debt service	180,955
Cash and cash equivalents on deposit with revenue bond trustee	9,189
Cash and cash equivalents	247,843
Total investments	$ 454,113

Interest on deposits in PMIA varies with the rate of return of the underlying portfolio and averaged 2.16% and 3.42% for the years ended June 30, 2003 and 2002, respectively. For the years ended June 30, 2003 and 2002, interest earned on the deposit with PMIA approximated $10,292 and $15,179, respectively.

For the years ended June 30, 2003 and 2002 (in thousands)

Total 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:

	2003	2002
Fair value of investments at the beginning of the fiscal year	$ 45,592	$ 55,924
Less: Proceeds of investments matured in fiscal year	-	(13,701)
Add: Amortization of discounts	1,585	1,687
Change in fair value of investments during fiscal year	4,535	1,682
Fair value of investments at the end of the fiscal year	$ 51,712	$ 45,592

6. Long-term Debt

The following activity occurred in the long-term debt accounts during the years ended June 30, 2003 and 2002:

	General Obligation Bonds	Revenue Bonds	Unamortized (Discounts) and Premium	Deferred Loss on Advanced Refunding	Total Revenue Bonds	Commercial Paper	Total Long-Term Debt
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
Additions	-	609,245	34,534	(13,179)	630,600	32,137	662,737
Payments/amortization	(42,290)	(658,685)	(185)	6,409	(652,461)	(43)	(694,794)
Balance at June 30, 2003	822,090	2,403,430	20,813	(27,024)	2,397,219	32,094	3,251,403
Less current portion	(44,480)	(52,335)	-	-	(52,335)	-	(96,815)
Long-term debt, net of current portion	$ 777,610	$ 2,351,095	$ 20,813	$ (27,024)	$ 2,344,884	$ 32,094	$ 3,154,588

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 for construction of the System. This amount included $130,000 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 California Water Fund, a fund unrelated to the System, to supplement the bond authorization. Certain revenues from the Water Contractors have been pledged for the payment of the WRD General Obligation Bonds. 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.

For the years ended June 30, 2003 and 2002 (in thousands)

WRD General Obligation Bonds of $168 million are authorized but unissued as of June 30, 2003, 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 2003	Amounts Outstanding 2002
1964	A	0.1-3.6%	2013	$ 41,500	$ 44,400
1964	B&C	0.1-3.7%	2014	65,150	69,500
1965	D&E	3.0-3.8%	2015	94,200	100,100
1966	F&G	3.5-4.1%	2016	103,000	108,600
1967	H,J&K	3.0-4.9%	2017	160,100	168,300
1968	L&M	4.0-5.0%	2018	114,000	119,200
1970	N&P	5.0-5.8%	2020	119,200	124,200
1971	Q&R	4.8-5.2%	2021	93,150	96,750
1972	S	5.3-5.5%	2022	25,800	26,720
1991	W	6.0-10.0%	2011	4,050	4,500
1993	X	4.3-4.8%	2023	1,100	1,200
1994	Y	6.4-7.5%	2024	840	910
				822,090	864,380
Less current maturities				(44,480)	(42,290)
				$ 777,610	$ 822,090

For the years ended June 30, 2003 and 2002 (in thousands)

Revenue Bonds

The Central Valley Project Water System (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 solely by certain 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 2003	Amounts Outstanding 2002
Devil Canyon - Castaic Facilities:						
1973	A&B	5.3-5.4%	2022	Callable	$ 106,080	$ 108,800
CVP Water System:						
1992	J	5.7-7.0%	2012	Callable	165,855	179,590
1993	L	5.1-5.3%	2005	Callable	36,875	482,540
1993	M	4.8-8.4%	2027	2004	84,580	168,170
1995	O	4.8-8.3%	2029	2006	247,445	298,680
1996	P	5.3-9.3%	2028	2006	71,940	74,370
1996	Q	4.5-6.0%	2027	2007	202,315	219,645
1997	S	4.3-5.0%	2029	2008	185,235	194,335
1998	T	5.0-5.5%	2012	2012	94,195	104,110
1998	U	4.0-5.1%	2029	2009	177,435	194,680
1998	V	6.25%	2024	None	20,580	20,580
2001	W	4.0-5.5%	2029	2012	245,790	247,145
2002	X	2.5-5.5%	2029	2013	158,225	160,225
2003	Y	5.0-5.3%	2025	2013	329,885	-
2003	Z	1.5-2.5%	2019	2013	168,290	-
2003	AA	5.00%	2023	2013	108,705	-
					2,403,430	2,452,870
Unamortized bond issuance premiums / (discounts)					20,813	(13,536)
Deferred loss on advanced refunding					(27,024)	(20,254)
Current maturities					(52,335)	(59,035)
					$ 2,344,884	$ 2,360,045

For the years ended June 30, 2003 and 2002 (in thousands)

Future Debt Service Requirements
Future principal and interest payment requirements on bonds are as follows at June 30, 2003:

	General Obligation Bonds		Revenue Bonds	
Year	**Principal**	**Interest**	**Principal**	**Interest**
2004	$ 44,480	$ 35,267	$ 52,335	$ 122,768
2005	46,320	33,309	56,645	119,697
2006	47,575	31,283	66,605	116,301
2007	48,965	29,195	70,475	110,636
2008	50,355	27,039	74,745	108,818
2009-2013	281,475	99,912	455,845	479,594
2014-2018	248,855	39,796	514,140	352,375
2019-2023	53,945	4,446	551,970	214,004
2024-2028	120	6	444,250	78,726
2029-2033	-	-	116,420	5,810
	$ 822,090	$ 300,253	$ 2,403,430	$ 1,708,729

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, 2003 and 2002, there were borrowings of $32,094 and $0, respectively, outstanding under this program. Interest expense approximated 2% for the year ended June 30, 2003. 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. The System’s obligation to make debt service payments on the commercial paper notes is subordinate to its payment obligations under the resolutions for the CVP Revenue Bonds and WRD General Obligation Bonds. The same revenues from the Water Contractors that collateralize the CVP Revenue Bonds also collateralize the commercial paper notes. Under the terms of the related commercial paper agreements, the System is to meet the same 1.25 debt service coverage requirement as is required by the CVP Revenue Bonds.

7. Debt Refundings

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

In October 2002, the System issued $170,655 in CVP Water System Revenue Bonds – Series Z, with an average interest rate of 4.1%, which were used to advance refund $163,945 of outstanding bonds.

In May 2003, the System issued $438,590 in CVP Water System Revenue Bonds – Series Y and AA, with an average interest rate of 5.1%, which were used to refund $433,340 of outstanding bonds.

The proceeds of the Series X and Z 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. The advance refundings resulted in the recognition of an accounting loss of approximately $13 million and $7 million, for fiscal year 2003 and 2002, respectively, which have been deferred over the shorter of the life of new or advance refunded debt. However, the System effectively reduced its aggregate debt service payments by approximately $15 million and $3 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 $8 million and $4 million, respectively.

The proceeds of the Series Y and AA current refundings (after payment of underwriting refunding fees, other issuance costs and deposits to the Debt Service Reserve Accounts) were used to refund debt that was called. Although the current refundings resulted in the recognition of an accounting loss of approximately $18 million for fiscal year 2003, the System effectively reduced its aggregate debt service payments by approximately $45 million over the next 22 years and obtained an economic gain (difference between the present values of the old and new debt service payments) of $28 million.

The total amount of bonds refunded in advance and still outstanding was $331,550 at June 30, 2003.

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, 2003, was 7.413% and 2.813% 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, 2003 and 2002, the System's annual pension cost and actual contribution amounted to approximately $5.4 million and $5.8 million, respectively. Annual covered payroll is not available for the System. However the actuarially determined contributions for the years ended June 30, 2003 and 2002, approximated .9% and 2.4%, respectively, of the total actuarially determined contribution requirements for the State Miscellaneous Category and approximately 6.61% and 3.5%, respectively, of the total System payroll. The required contribution for the 2003 fiscal year was determined as part of the June 30, 2001, 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, 2002, the date of the most recent actuarial valuation, was 5 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, 2001 (date of the actuarial valuation used to determine the required contribution for the year ended June 30, 2003), is as follows:

For the years ended June 30, 2003 and 2002 (in thousands)

Three-Year Trend Information

Fiscal Year Ended June 30	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation (NPO)
2001	$ -	100 %	$ -
2002	$ 242,039	100 %	$ -
2003	$ 607,162	100 %	$ -

Analysis of Funding Progress

	(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%
2002	43,843,087	48,118,210	4,275,123	91%	8,582,663	50%

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, 2003 and 2002 were approximately $12,278 and $10,561, 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.

For the years ended June 30, 2003 and 2002 (in thousands)

9. Commitments and Contingencies

Commitments

Construction
The System has entered into long-term construction contract commitments for the State water facilities. The remaining value of contracts in process as of June 30, 2003, approximated $35,098.

Power Transmission and Purchase
The System has long-term power transmission service contracts requiring future payments of approximately $226,000 over periods ranging from one to 36 years. Payments made under these contracts approximated $25,881 and $22,936 for the years ended June 30, 2003 and 2002, respectively.

The System has also entered into long-term power purchase contracts requiring future payments of approximately $258,676 over periods ranging from one to 31 years. Payments made under these contracts, excluding payments to the Kings River Conservation District (District) to cover debt service, approximated $43,205 and $40,757 for the years ended June 30, 2003 and 2002, respectively.

The remaining amounts of fixed obligations under the long-term power purchase and transmission contracts as of June 30, 2003, are as follows:

Fiscal year ended	Fixed Obligation
2004	$ 70,994
2005	24,794
2006	24,794
2007	24,794
2008	24,794
Thereafter	314,506
	$ 484,676

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 System 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 $10,289 and $9,608 during the years ended June 30, 2003 and 2002, respectively.

For the years ended June 30, 2003 and 2002 (in thousands)

The amounts of fixed obligations of the System related to future principal and interest payments of the District's bonds as of June 30, 2003, are as follows:

Fiscal year ended	Fixed Obligation
2004	$ 4,915
2005	4,910
2006	4,900
2007	4,894
2008	4,882
Thereafter	59,947
	$ 84,448

Contingencies

Litigation

Monterey Amendment
In 1994, the System and certain Water Contractors adopted a set of principles pursuant to which additional amendments to the water supply contracts have since been negotiated (Monterey Amendment). Components of the Monterey Amendment included the transfer of land and related assets, known as the Kern Water Bank, to the Kern County Water Agency (KCWA) (one of the Water Contractors), the creation of operating reserves, and the establishment of charges to Water Contractors to meet, but not exceed operating expenses, debt service and financing costs and certain capital expenses.

In 1995, a trial court had found that the designation of the Central Coast Water Authority (CCWA), one of the Water Contractors, rather than the Department, as the lead agency for the Environmental Impact Report (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 the Kern Water Bank to KCWA. The Third District Court of Appeal, in September 2000, reversed the earlier trial court ruling on the Monterey Amendment EIR. 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 System and reduce Water Contractor contractual allocations of water. The Court of Appeal remanded the case to the trial court to oversee the Department's preparation of a new EIR. The Court of Appeal also reinstated a cause of action challenging the validity of the transfer of assets to KCWA.

In May 2003, the trial court approved a settlement agreement among the Department and the other parties in *Planning and Conservation League, et al, vs. Department of Water Resources and Central Coast Water Authority*, which lawsuit involved a challenge to the Monterey Amendment. Under the settlement agreements, the Department agreed, among other things, to act as lead agency in the preparation of a new EIR for the Monterey Amendment. During the preparation and processing of the new EIR, the Department will be permitted under the settlement agreement to continue to operate the System in accordance with the provisions of the Monterey Amendment, including the provisions pertaining to the transfer of land and related assets (Kern Water Bank) to the KCWA. The Department also agreed to pay for certain amounts for use in implementing the settlement agreement.

The plaintiffs agreed to limit the grounds upon which they could challenge the new EIR after it is completed.

The Department is preparing a new EIR. After the EIR process is completed, the plaintiffs could again challenge, on limited grounds, the EIR and the Kern Water Bank transfer. The Department, however, does not expect that there would be any material adverse impact on the ability of the Department to meet its payment obligations, even if such a challenge occurs and is successful.

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 financial position or results of operations. If incurred, such costs would be recoverable from project beneficiaries under the long-term water supply contracts.

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 California Independent System Operator, investor-owned utilities, and others to increase or adjust rates or allocate responsibility for costs for transmission and other services provided to the System and other entities in California. The Department is participating in these proceedings, since the outcome of these proceedings has the potential to increase the System’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 System is required to refund as a result of these proceedings will not have a material impact on the ability of the System 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.

Self-Insurance
The System is self-insured for all completed facilities of the SWP other than a portion of the Reid Gardner Project. The System is also self-insured for workers’ compensation, general liability and other risks. All workers’ compensation claims and other losses are on a “pay as you go” basis. The long-term water supply contracts provide for recovery of such losses from the Water Contractors. Additionally, 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.

For the years ended June 30, 2003 and 2002 (in thousands)

10. Segment Information

The table below presents the condensed statements of net assets, the statements of activities and the statements of cash flows for the System's two segments, as of and for the years ended June 30, 2003 and 2002:

	2003			2002		
	Activities Allowed Under			Activities Allowed Under		
	Burns-Porter Act	Central Valley Project Act	Total	Burns-Porter Act	Central Valley Project Act	Total
Condensed Statements of Net Assets:						
Assets						
Capital assets	$ 935,501	$ 2,159,394	$ 3,094,895	$ 953,628	$ 2,173,199	$ 3,126,827
Other assets	1,069,330	543,381	1,612,711	1,154,688	562,524	1,717,212
Current assets	147,047	212,461	359,508	152,525	205,277	357,802
Total assets	$ 2,151,878	$ 2,915,236	$ 5,067,114	$ 2,260,841	$ 2,941,000	$ 5,201,841
Capitalization and Liabilities						
Capitalization:						
Net assets:						
Capital (deficit), net of related debt	$ 401,563	$ (154,996)	$ 246,567	$ 377,400	$ (142,797)	$ 234,603
Restricted	642,226	314,201	956,427	647,463	367,181	1,014,644
Total net assets	1,043,789	159,205	1,202,994	1,024,863	224,384	1,249,247
Long-term liabilities	777,610	2,376,978	3,154,588	822,090	2,360,045	3,182,135
Total capitalization	1,821,399	2,536,183	4,357,582	1,846,953	2,584,429	4,431,382
Current liabilities	97,269	197,750	295,019	169,083	169,257	338,340
Other liabilities	233,210	181,303	414,513	244,805	187,314	432,119
Total capitalization and liabilities	$ 2,151,878	$ 2,915,236	$ 5,067,114	$ 2,260,841	$ 2,941,000	$ 5,201,841
Condensed Statements of Activities:						
Operating revenues:						
Water supply	$ 379,184	$ 208,440	$ 587,624	$ 470,558	$ 172,170	$ 642,728
Power sales	56,821	28,914	85,735	67,316	38,009	105,325
Federal reimbursements	14,364	1,708	16,072	9,334	3,835	13,169
	450,369	239,062	689,431	547,208	214,014	761,222
Depreciation expense	(22,589)	(53,109)	(75,698)	(22,874)	(53,547)	(76,421)
Other operating expense	(377,863)	(102,438)	(480,301)	(344,912)	(171,084)	(515,996)
Income from operations	49,917	83,515	133,432	179,422	(10,617)	168,805
Interest expense	(27,753)	(156,067)	(183,820)	(37,405)	(131,815)	(169,220)
Other (expense) income	(5,315)	9,450	4,135	(511)	(8,203)	(8,714)
Decrease in net assets	16,849	(63,102)	(46,253)	141,506	(150,635)	(9,129)
Net assets, beginning of year	1,024,863	224,384	1,249,247	994,173	264,203	1,258,376
Net assets, end of year	$ 1,043,789	$ 159,205	$ 1,202,994	$ 1,024,863	$ 224,384	$ 1,249,247

For the years ended June 30, 2003 and 2002 (in thousands)

	2003			2002		
	Activities Allowed Under			Activities Allowed Under		
	Burns-Porter Act	Central Valley Project Act	Total	Burns-Porter Act	Central Valley Project Act	Total
Condensed Statements of Cash Flows:						
Net cash provided by (used in):						
Operating activities	$ 60,674	$ 197,890	$ 258,564	$ 67,566	$ 132,734	$ 200,300
Noncapital financing activities	(5,234)	(1,599)	(6,833)	5,793	(2,839)	2,954
Capital and related financing activities	(74,924)	(186,552)	(261,476)	(82,904)	(173,254)	(256,158)
Investing activities	5,837	4,267	10,104	12,219	8,652	20,871
Net increase (decrease) in cash and cash equivalents	(13,647)	14,006	359	2,674	(34,707)	(32,033)
Cash and equivalents, beginning of year	82,153	319,889	402,042	79,479	354,596	434,075
Cash and equivalents, end of year	$ 68,506	$ 333,895	$ 402,401	$ 82,153	$ 319,889	$ 402,042

11. Related Party Transactions

During the years ended June 30, 2003 and 2002, the System sold power amounting to $5,756 and $10,606 to, and purchased power amounting to $6,269 and $506 from, respectively, the Department of Water Resources Electric Power Fund (Power Fund), another enterprise fund administered by the Department. Net amounts (owed to) due from the Power Fund by the System for power purchases and sales were ($2,985) and $1,031 at June 30, 2003 and 2002, respectively.

Supplementary Information

State Water Resources Development System
Calculation of Adequacy of Debt Service Coverage
For the year ended June 30, 2003 (dollars in thousands)

Water supply revenues, including $40,206 in refundable proceeds	$	253,335
Investment earnings		6,803
		260,138
Less: Operations and maintenance expense		55,427
Net revenues available for debt service	$	204,711
Principal and interest for revenue bonds	$	162,523
Debt service coverage		126%

Note: The general bond resolution for the Central Valley Project (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 Revenue Bonds and excludes amounts applicable to the Water Resources Development General Obligation Bonds.