State Water Resources Development System

Financial Statements and
Supplementary Information
For the years ended June 30, 2004 and 2003

State Water Resources Development System
Index

Page

Financial Statements:

Supplementary Information:

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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, 2004 and 2003, 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. Those standards 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 discussed in Note 1, the financial statements of the System are intended to present the financial position, and the changes in financial position and cash flows, where applicable, of only that portion of the business-type activities and major funds of the State of California that is attributable to the transactions of the System. They do not purport to, and do not, present fairly the financial position of the State of California as of June 30, 2004 and 2003, and the changes in its financial position and its cash flows, where applicable, for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 9, 2004, 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. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. 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.

The Management's Discussion and Analysis, presented on pages 3 through 16, 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 41 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.

PricewaterhouseCoopers LLP

December 9, 2004

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 the 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 follow *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; known as the "Water Contractors," in order to recover substantially all System costs. The Water Contractors may request up to maximum annual amounts totaling 4,172,786 acre-feet of water from the System. 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 (USBR). 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 USBR 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 $16 million on total operating revenues of $715 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.

- The Department completed the issuance of its $189,625,000 Water System Revenue Bonds, Series AB. The bonds were issued as auction rate securities, a form of variable rate debt. The financing included an advance refunding component and a current refunding of the Department's then outstanding Commercial Paper Notes. The Department realized the following benefits: 1) the Department was able to retire its outstanding Commercial Paper Notes and free up the commercial paper program's borrowing capacity for future capital projects; 2) the issuance of auction rate securities allowed the Department to access the short-term tax-exempt market and is expected to result in lower interest rates over the life of the bonds compared to traditional fixed rate bonds; and 3) the Department used the issuance of the Series AB bonds to provide debt service savings of more than $13.8 million from the date of issuance through December 1, 2005 and also to provide more level annual debt service obligations through 2029, the final maturity of the Department's bonds. This smoothing of the Department's debt service payments resulted in higher debt service payments in some years, but given the lower expected interest cost of the auction rate bonds (estimated at 4.0%), the financing is projected to generate present value savings of nearly $4 million.

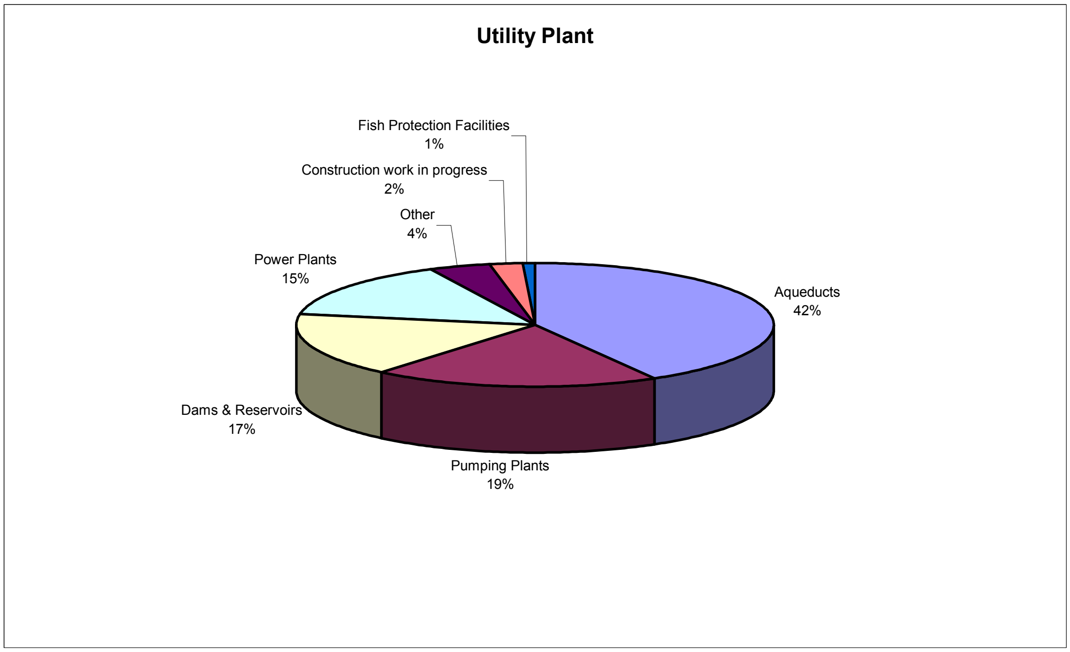
Overview of Financial Statements

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-supported 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.

	2004	2003 (in thousands)	2002	%Change 2004-2003	%Change 2003-2002
Condensed Statements of Net Assets					
Total utility plant	$ 3,030,356	$ 3,094,895	$ 3,126,827	-2.1%	-1.0%
Other assets	1,993,431	1,972,219	2,075,014	1.1%	-5.0%
Total assets	$ 5,023,787	$ 5,067,114	$ 5,201,841	-0.9%	-2.6%
Capitalization:					
Net assets:					
Capital, net of related debt	$ 185,676	$ 246,567	$ 234,603	-24.7%	5.1%
Restricted	1,000,866	956,427	1,014,644	4.6%	-5.7%
Total net assets	1,186,542	1,202,994	1,249,247	-1.4%	-3.7%
Total long-term debt	3,135,020	3,154,588	3,182,135	-0.6%	-0.9%
Total capitalization	4,321,562	4,357,582	4,431,382	-0.8%	-1.7%
Other liabilities	702,225	709,532	770,459	-1.0%	-7.9%
Total capitalization and liabilities	$ 5,023,787	$ 5,067,114	$ 5,201,841	-0.9%	-2.6%
Condensed Statements of Activities					
Water supply	$ 640,417	$ 587,624	$ 642,728	9.0%	-8.6%
Power sales	59,289	85,735	105,325	-30.8%	-18.6%
Federal reimbursements	14,941	16,072	13,169	-7.0%	22.0%
Total operating revenues	714,647	689,431	761,222	3.7%	-9.4%
Operations and maintenance expense	352,465	295,795	302,245	19.2%	-2.1%
Purchased power	143,151	82,617	199,703	73.3%	-58.6%
Depreciation expense	77,388	75,698	76,421	2.2%	-0.9%
Operating expenses (deferred) recovered, net	(14,423)	101,889	14,048	-114.2%	625.3%
Total operating expenses	558,581	555,999	592,417	0.5%	-6.1%
Income from operations	156,066	133,432	168,805	17.0%	-21.0%
Interest expense	(167,873)	(183,820)	(169,220)	-8.7%	8.6%
Other (expense) income	(4,645)	4,135	(8,714)	-212.3%	-147.5%
Decrease in net assets	(16,452)	(46,253)	(9,129)	-64.4%	406.7%
Net assets, beginning of year	1,202,994	1,249,247	1,258,376	-3.7%	-0.7%
Net assets, end of year	$ 1,186,542	$ 1,202,994	$ 1,249,247	-1.4%	-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 19 dams, 20 storage facilities, 20 pumping plants, three generating-pumping plants, ten power plants, as well as fish protection facilities and aqueducts.



The net utility plant in service (UPIS) increased by $41 million during the year to a balance of $2,993 million. This is compared to a net decrease in fiscal 2003 of $68 million. While depreciation expense remained relatively constant for the two years at $77 million and $76 million respectively, the amount of additions in the current year was $118 million compared to $8 million in fiscal 2003. The majority of this difference, or $102 million, relates to the transfer of the East Branch Extension project from construction work in progress. Other additions include improvements made at the Oroville dam, Devil Canyon power plant, South Bay aqueduct, Reid Gardner power plant and Mojave Siphon. Annual depreciation expense will remain 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 decreased by $106 million during the year, which represents a 74% decrease over 2003. Construction work in progress increased by $36 million for 2003 or 33% over 2002. The 2003/2004 decrease is primarily attributable to the completion of the East Branch Extension, which was transferred to UPIS during the year. Transfers to UPIS were offset in part by additional construction projects in the net amount of $12 million. The additions to the on-going projects included conservation projects in the amount of $2 million, the South Bay Aqueduct of $3.2 million, the Tehachapi Afterbay project of $4.8 million, and other transportation projects totaling $2 million. At June 30, 2004, construction work in progress was comprised of $15 million of conservation projects, $4 million for the South Bay aqueduct, and $18 million of transportation projects.

Restricted Cash and Investments

Restricted cash and cash equivalents decreased by $4 million during fiscal 2004. This change is in part the result of a net cash increase of $1 million for plant replacement reserves, which is due mainly to the timing differences between revenues collected, and the payment for expenditures incurred. This is offset by a net decrease of $5 million in debt service reserves primarily relating to the issuance of the CVP Water System Revenue bond – Series AB. This compares to a net increase in fiscal 2003 of $3 million consisting 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 $1 million remains outstanding at the end of fiscal 2004, compared to an outstanding balance of $3 million at the end of fiscal 2003, and $5 million at the end of fiscal 2002. The advance is reduced monthly by amounts owed by DWR to PG&E under transmission agreements. Lastly, the System made loans to local water agencies through the Davis-Grunsky Act of which a long-term portion of $32 million remains outstanding at the end of fiscal 2004 compared to an outstanding balance of $34 million at the end of fiscal 2003, and $36 million at the end of fiscal 2002.

Cash and Cash Equivalents

In fiscal 2004, cash and cash equivalents increased by $22 million to a balance of $270 million. The increase is due primarily to an increase in revenue over the prior year, plus payments received by the USBR on older outstanding amounts due. Refer to the Statements of Cash Flows for a detailed summary of cash in-flows and out-flows. By comparison, in fiscal 2003, cash and equivalents remained relatively flat at $248 million.

Receivables

Water supply and power billings receivable increased by $3 million during fiscal 2004. This increase is mainly attributable to increased operating revenues recorded compared to the prior year, offset in part by collection of older outstanding amounts from the USBR of approximately $10 million, and accruals made for power sales adjustments relating to the pending FERC pricing mitigation settlement and a transmission loss calculation adjustment from prior years totaling $23 million. In fiscal 2003, water supply and power billings receivable declined from $89 million to $83 million. That decrease is attributable to a reduction in revenue received in 2003 compared to 2002. Refer to "Operating Revenues" section for a discussion of revenue fluctuations.

Deferred Charges

Deferred charges represent timing differences between expenditures incurred by the System and their ultimate recovery from the Water Contractors. In total, deferred charges increased by $12 million to an ending balance of $1,290 million, as the System deferred expenditures not yet recovered from the Contractors. In fiscal 2003, recoveries resulted in a decrease of deferred charges of $107 million.

Liabilities

Revenue Bonds

The System has issued 28 series of Water System Revenue Bonds totaling $5,085 million in aggregate principal, of which $2,347 million remains outstanding at the end of fiscal 2004. This compares to outstanding balances of $2,291 million and $2,310 million at the end of fiscal years 2003 and 2002, respectively. During the year, the System completed the issuance of CVP Water System Revenue Bond, Series AB totaling $189 million. Approximately half of the proceeds from the issuance were used to refund and defease portions of the bonds of Series L, and all of Series M, while the other half was used to pay off all outstanding commercial paper as of the date of the issuance. The refundings are projected to provide a net present value savings to the System of $4 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, $103 million is outstanding as of fiscal 2004, compared to $106 million at fiscal 2003 and $109 million at fiscal 2002. Bonds issued under the other two bond resolutions have been fully retired.

	2004	2003	2002
CVP revenue bonds par amount	$ 2,343,880	$ 2,297,350	$ 2,344,070
Unamortized bond issuance premiums/(discounts)	23,071	20,813	(13,536)
Deferred loss on defeasance	(20,290)	(27,024)	(20,254)
Total CVP revenue bonds outstanding	2,346,661	2,291,139	2,310,280
Devil Canyon - castaic revenue bond par amount	103,195	106,080	108,800
Total revenue bonds outstanding	2,449,856	2,397,219	2,419,080
Less current maturities	(56,645)	(52,335)	(59,035)
Total long term portion	$ 2,393,211	$ 2,344,884	$ 2,360,045

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 $778 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 $106 million in fiscal 2004, compared to $123 million in 2003, and $154 million in fiscal 2002. The decrease of $17 million in the current year is due primarily to payments made to DWR's internal service fund for expenditures incurred, while in fiscal 2003, 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 revenue bond 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 increased by $15 million during the year to an ending balance of $90 million. This increase was comprised of $26 million for off-aqueduct power facilities cost adjustments that related to 2003 and 2002 plan-to-actual differences, which was offset in part by increased refunds made for interest and cover compared to the prior year. In fiscal 2003, the proceeds due declined by $8 million to $75 million. That decrease is attributed to a $20 million refund made in 2003 for off-aqueduct power, offset in part by the 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 $4 million in fiscal 2004 to $177 million. This compares to a $6 million decrease 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 fiscal 2004, the Delta Water Charge, which recovers the cost of conservation facilities, was reduced by $17 million for the principal portion of the power sales credit, which was offset in part by $14.65 million of revenue collected through the variable charge for power generated at Oroville. In 2003, the Delta Water Charge was reduced by $16 million for the principal portion of the power sales credit, which was offset in part by $14.65 million of revenue collected through the variable charge for power generated at Oroville.

Advances for Plant Replacements

Advances for Plant Replacements represents amounts collected in advance from the Water Contractors for future plant equipment replacements. As actual replacements have occurred more slowly than originally anticipated, advances collected from the Water Contractors have been reduced, allowing for a decline in the account. In fiscal 2004, expenditures for replacements exceeded revenue collected by $2 million. In fiscal 2003, expenditures exceeded revenues by $10 million.

Statement of Activities

Operating Revenues

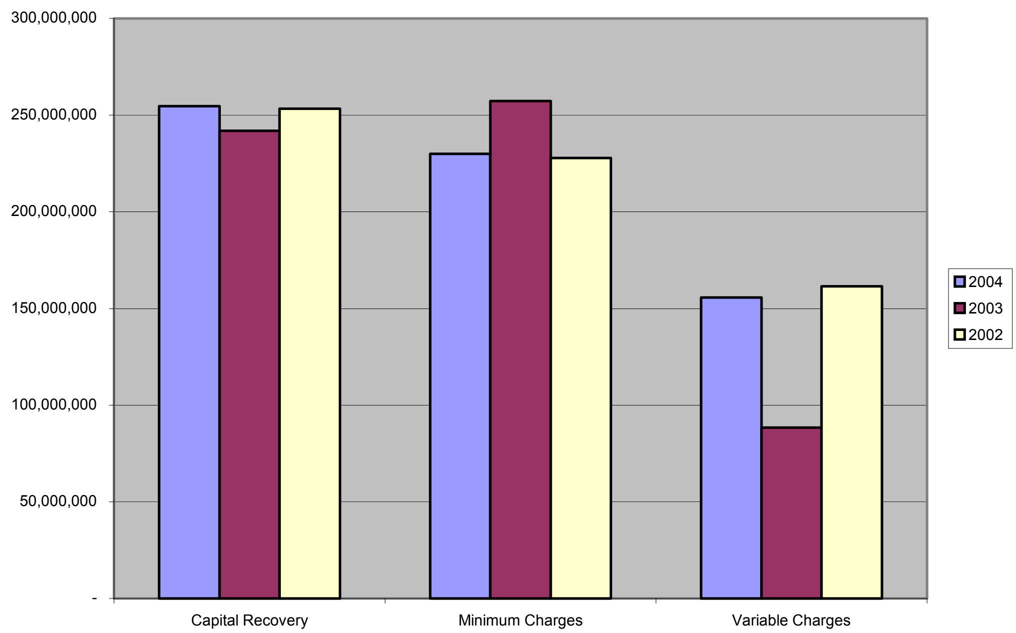
Operating revenues for the year were $715 million compared to $689 million in fiscal 2003 and $761 million in fiscal 2002. The increase in fiscal 2004 was due to increased water supply revenue of $53 million offset in part by a decrease in power sales revenue of $26 million. By comparison, the decrease in fiscal 2003 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 costs, 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.

Water Supply Revenue



In 2004, the System generated $640 million in water supply revenue, compared to $588 million in fiscal 2003, and $643 million in fiscal 2002. The table above shows a comparative breakdown of the components of water supply revenue for fiscal years 2004, 2003 and 2002.

As shown in the chart above, the primary reasons for the $53 million increase in water supply revenue for fiscal 2004 relates to an increase in the Variable and Capital components, offset in part by decreased Minimum revenue.

In fiscal 2004, the $67 million increase in Variable revenue is attributable to three items. First, in fiscal 2003, a settlement in the amount of $30 million was 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 for fiscal 2003. Second, total water deliveries for the year increased by 496,000 acre-feet, or 16% over fiscal 2003. As a result, $25 million of the fiscal 2004 increase is attributed to the increased water deliveries. Third, the average mill rate used to determine the Variable charge factor for each Contractor increased from $23.37 to $26.75 in 2004, which represents a 14.5% increase. When applied to 2003

Variable revenue, approximately $12 million of the 2004 change is attributed to this increase in the mill rate.

In fiscal 2003, the decrease in Variable revenue is attributable to two items. First, as mentioned above, a settlement in the amount of $30 million received from Southern California Edison (SCE) relating to prior year power purchase transactions, which resulted in a $30 million credit being issued to the Water Contractors through the Variable charge. Second, although total water deliveries increased slightly in 2003, the cost of power decreased. As a result, 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. Approximately $46 million of the 2003 change is attributed to the reduction in the mill rate.

The increase in Capital revenue is due mainly to a $17 million reduction in the Rate Management credits issued to the Water Contractors in fiscal 2004 as compared to fiscal 2003.

The $27 million decrease in Minimum revenue reflects billing decreases to account for differences between actual expenditures and estimated expenditures. Of these, approximately $18 million relates to information technology project costs that had been projected but were not incurred. The remainder of the variance is comprised of a one-time wheeling transfer that was billed to the USBR in fiscal 2003 for about $6 million and decreased replacement revenue of $3 million.

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. During the year, the System recorded adjustments to power sales that related to prior year activities. First, an adjustment was made to reduce power sales by $9.8 million which represents the estimated refunds the System will make relating to the FERC's Mitigated Market Clearing Prices (MMCP) settlement. Second, an adjustment was made to reduce power sales by $13 million for a transmission loss calculation adjustment that occurred in a prior year. When normalized to actual current year activity, power sales declined slightly in fiscal 2004 compared to fiscal 2003, yet they were $20 million less in 2003 than 2002. This is due largely to the fact that the rates per MWh were generally flat between fiscal 2004 and fiscal 2003, at $97.97 and $98.70, respectively, as were the MWh sold, at 838,000 MWh's and 869,000 MWh's, respectively. The first table below shows the effect of the rate and volume between the two years. This can be compared to the second table below for fiscal years 2003 and 2002, where the volume sold decreased and the rate increased.

	MWh Sold	$ Sold	Rate/MWh
2003	868,671	$ 85,735,000	$ 98.70
2004	837,911	$ 59,289,000	$ 97.97 *

Change in total MWh sold	(30,760)
Multiplied by 2004 rate/MWh	$ 97.97
Difference attributed to decreased sales (rounded to nearest thousand)	$ (3,014,000)
Change in MWh rate	$ (0.73)
Multiplied by 2003 MWh sold	868,671
Difference attributed to rate change (rounded to nearest thousand)	$ (632,000)
Less estimated settlement related to FERC settlements	$ (22,800,000)
Total decrease in power sales (rounded to nearest thousand)	$ (26,446,000)

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

	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 2004 rate/MWh	$ 98.70
Difference attributed to decreased sales (rounded to nearest thousand)	$ (67,356,000)
Change in MWh rate	$ 25.89
Multiplied by 2003 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 $15 million, which represents a $1 million decrease compared to fiscal 2003, and a $2 million increase over fiscal 2002. This decrease is attributable to the decreased expenditures incurred for the portion of the San Luis and Suisun Marsh facilities for which the System is reimbursed by the Federal government.

Operating Expenses
As with revenues, total operating expenses for fiscal 2004 of $559 million increased compared to fiscal 2003 by $3 million. Total operating expenses of $556 million for fiscal 2003 declined by $36 million from fiscal 2002. The change from last year is due to a number of items, including the $30 million settlement received from SCE in fiscal 2003, increased costs relating to information technology projects, and increased facilities repairs and maintenance costs. These cost increases are offset, in part, by a reduction of operating expenses recovered from previous years.

Operations and Maintenance Expense
Total operations and maintenance expense was $352 million, compared to $296 million last year, and $302 million in fiscal 2002. The increase from last year is attributable to several items. First, operating costs at the Reid-Gardner power plant were greater than last year by $5.8 million. Second, consulting services increased over last year by $11 million. This is due in part to increased costs associated with the information technology projects, as well as a resumption of services provided for IT support. Third, the System incurred costs for the implementation of a power management system that resulted in a $2.5 million cost increase over last year. Fourth, the System recorded one-time credits in fiscal 2003 relating to a comprehensive power transmission agreement with PG&E of approximately $15 million. Finally, facilities repairs and maintenance costs exceeded last year by $15 million. The increase over fiscal 2002 is due mainly to several of the items listed above.

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 $143 million in fiscal 2004, compared to $113 million in fiscal 2003 (adjusted for the $30 million SCE credit for comparability) and $200 million in fiscal 2002. The increase in the current year is due to an increased volume of power purchased, offset in part by a lower cost per MWh. The two tables below show the relationship between volume and rate for fiscal 2004 compared to fiscal 2003, and fiscal 2003 compared to fiscal 2002.

	MWh Purchased	**Power Purchased**	**Rate/MWh**
2003	1,947,000	$ 112,617,000	$ 57.84
2004	3,152,000	$ 143,151,000	$ 45.42
Change in MWh purchased			1,205,000
Multiplied by 2004 rate			$ 45.42
Difference attributed to decreased purchases (rounded to nearest thousand)			$ 54,731,000
Change in MWh rate			$ (12.43)
Multiplied by 2003 purchased			1,947,000
Difference attributed to rate change (rounded to nearest thousand)			$ (24,196,000)
Total increase in power purchases (rounded to nearest thousand)			$ 30,534,000

	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 2004 rate				$	57.84	
Difference attributed to decreased purchases (rounded to nearest thousand)				$	(14,884,000)	
Change in MWh rate				$	(11.24)	
Multiplied by 2003 purchased					2,204,383	
Difference attributed to rate change (rounded to nearest thousand)				$	(24,777,000)	
Plus retroactive adjustments to previous year sales and sale to related party				$	(47,425,000)	
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 deferred were $14 million, which represents a $116 million decrease compared to fiscal 2003. Operating expenses recovered for fiscal 2003 of $102 million increased $88 million compared to fiscal 2002. 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 fiscal year 2004 was $168 million and $16 million less than in fiscal 2003. Interest expense of $184 million for fiscal 2003 increased $15 million from fiscal 2002. The 2003/2004 decrease is due primarily to the difference of the losses recorded in conjunction with the issuances of Series Z, Y, and AA in fiscal 2003, and Series AB in fiscal 2004. The losses, including amortization of deferred amounts, recorded in fiscal 2003 were $25 million, compared to $9 million in fiscal 2004. When adjusted to exclude the charges related to debt issuance, actual interest expense has declined from $165 million in fiscal 2002 to $159 million in fiscal 2003 and to $156 million in fiscal 2004.

Other Income (Expense)

Other expense increased in 2004 by $9 million compared to fiscal 2003, and was roughly flat compared to fiscal 2002. The increase was due primarily to an increase in the market value decline on investment securities of approximately $9 million in fiscal 2004.

Change in Net Assets

Overall, the System recorded a net loss of $16 million. This is generally in line with expectations, as the System incurred certain expenses it has not recovered from the Water Contractors or other governmental entities.

The following table generally explains the sources of the change in net assets:

	2004	2003	2002
Increases:			
Investment income net of refunds to water contractors	$ 1,452,258	$ 10,915,320	$ 15,201,638
Capital revenue in excess of capital costs	7,392,815	(5,944,227)	39,928,444
Other miscellaneous income (expense)	1,835,787	1,519,121	(152,318)
Total increases	10,680,860	6,490,215	54,977,764
Decreases:			
Rate management credit	(23,235,084)	(40,470,168)	(40,923,000)
Recreation costs	(7,933,189)	(10,910,157)	(14,994,839)
Suspended costs	(1,163,355)	(1,363,251)	(2,248,925)
Total decreases	(32,331,628)	(52,743,576)	(58,166,764)
One time adjustments:			
Prior year suspended costs, retroactively adjusted	5,197,225	-	(3,419,724)
Other miscellaneous adjustments	-	-	(2,520,526)
Total one time adjustments	5,197,225	-	(5,940,250)
Change in net assets	$ (16,453,544)	$ (46,253,362)	$ (9,129,250)

State Water Resources Development System
Statements of Net Assets
June 30, 2004 and 2003 (in thousands)

	2004	2003
Assets		
Utility plant:		
Utility plant in service	$ 4,560,047	$ 4,441,688
Less accumulated depreciation	(1,566,792)	(1,489,403)
Net utility plant in service	2,993,255	2,952,285
Construction work in progress	37,101	142,610
Total utility plant	3,030,356	3,094,895
Long-term assets:		
Restricted assets:		
Cash and cash equivalents restricted for plant replacements	17,092	16,126
Cash and investments restricted for debt service	175,823	180,955
Cash and cash equivalents on deposit with revenue bond trustee	9,210	9,189
Loans receivable from local water agencies	31,959	34,178
Advances to Pacific Gas & Electric Company	1,022	3,067
Due from other state funds	91,516	91,516
Total long-term assets	326,622	335,031
Current assets:		
Cash and cash equivalents	269,996	247,843
Receivables:		
Interest on investments	1,761	1,993
Water supply and power billings	86,648	83,411
Due from federal government	7,978	16,884
Inventories	10,227	9,267
Other	66	110
Total current assets	376,676	359,508
Deferred charges:		
Amounts recoverable through future billings under long-term water supply contracts:		
Operations and maintenance expense	109,338	64,657
Capital costs	308,202	330,056
Unamortized project costs	384,841	393,561
Unbilled interest earnings on capital costs	487,752	489,406
Total deferred charges	1,290,133	1,277,680
Total assets	$ 5,023,787	$ 5,067,114

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

State Water Resources Development System
Statements of Net Assets, continued
For the years ended June 30, 2004 and 2003 (in thousands)

	2004	2003
Capitalization and Liabilities		
Capitalization:		
Net assets:		
Capital, net of related debt	$ 185,676	$ 246,567
Restricted	1,000,866	956,427
Total net assets	1,186,542	1,202,994
Long-term debt, less current maturities:		
General obligation bonds	731,290	777,610
Revenue bonds	2,393,211	2,344,884
Commercial paper	10,519	32,094
Total long-term debt	3,135,020	3,154,588
Total capitalization	4,321,562	4,357,582
Current liabilities:		
Current maturities of bonds	102,965	96,815
Accounts payable	39,156	34,767
Accrued vacation	11,430	10,816
Accrued interest on long-term debt	20,942	18,216
Due to other state funds	34,640	59,451
Proceeds due to water contractors	89,693	74,954
Total current liabilities	298,826	295,019
Deferred credits:		
Deferred revenue - State and Federal capital recovery	176,569	180,630
Power sales credit due to water contractors	213,224	218,234
Advances for plant replacements	13,606	15,649
Total deferred credits	403,399	414,513
Commitments and Contingencies (Note 9)		
Total capitalization and liabilities	$ 5,023,787	$ 5,067,114

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, 2004 and 2003 (in thousands)

	2004	2003
Operating revenues:		
Water supply	$ 640,417	$ 587,624
Power sales	59,289	85,735
Federal reimbursements	14,941	16,072
Total operating revenues	714,647	689,431
Operating expenses:		
Operations and maintenance	352,465	295,795
Purchased power	143,151	82,617
Depreciation expense	77,388	75,698
Operating expenses (deferred) recovered, principally under long-term water supply contracts, net	(14,423)	101,889
Total operating expenses	558,581	555,999
Income from operations	156,066	133,432
Interest expense	(167,873)	(183,820)
Other (expense) income	(4,645)	4,135
Decrease in net assets	(16,452)	(46,253)
Net assets, beginning of year	1,202,994	1,249,247
Net assets, end of year	$ 1,186,542	$ 1,202,994

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, 2004 and 2003 (in thousands)

	2004	2003
Cash flows from operating income:		
Receipts from customers	$ 728,995	$ 666,232
Payments to employees for services	(202,280)	(204,267)
Payments to suppliers	(309,985)	(203,401)
Net cash provided by operating activities	216,730	258,564
Cash flows from noncapital financing activities:		
Other expense	(12,772)	(6,833)
Net cash used in noncapital financing activities	(12,772)	(6,833)
Cash flows from capital and related financing activities:		
Proceeds from issuance of revenue obligation bonds, net of issuance discounts and premiums	186,898	643,779
Principal payments on long-term debt	(190,460)	(700,975)
Commercial paper notes issued	70,643	32,137
Commercial paper notes redeemed	(92,218)	(43)
Interest payments on long-term debt	(157,663)	(198,653)
Additions to utility plant	(15,772)	(37,721)
Net cash used in capital and related financing activities	(198,572)	(261,476)
Cash flows from investing activities:		
Cash received from investment earnings	11,240	6,409
Payments received on loans receivable from local water agencies	2,219	1,650
Reduction of advance to PG&E	2,045	2,045
Net cash provided by investing activities	15,504	10,104
Net increase in cash and pooled investments	20,890	359
Cash and pooled investments at beginning of year	402,401	402,042
Cash and pooled investments at end of year	$ 423,291	$ 402,401
Reconciliation of operating income to net cash provided by operating activities:		
Income from operations	$ 156,066	$ 133,432
Adjustment to reconcile operating income to net cash provided by operations:		
Depreciation expense	77,388	75,698
(Increase) Decrease in deferred charges and credits, net	(23,099)	85,822
Changes in assets and liabilities:		
(Increase) decrease in receivables	(3,237)	5,709
Increase in inventories	(1,467)	(339)
Decrease (increase) in other assets	8,950	(4,780)
Increase (decrease) in accounts payable and accrued vacation	12,201	(27,437)
Decrease in due to other state funds	(24,811)	(1,480)
Increase (decrease) in current proceeds due to Water Contractors	14,739	(7,889)
Decrease in other liabilities	-	(172)
Total adjustments	60,664	125,132
Net cash provided by operating activities	$ 216,730	$ 258,564

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

1. Reporting Entity

The State Water Resources Development System (System) (a component unit of the State of California) 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, 2004 and 2003, interest of $4,235 and $6,045, 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, 2004, are of a similar nature as those held at June 30, 2004.

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. Costs include capital costs (depreciation) and operations and maintenance charges.

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 recoverable by the System on unrecovered capital costs is 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 4.610% and 4.613% at June 30, 2004 and 2003, 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 billing for capital costs.

Advances for plant replacements represent billings under the terms of water supply contracts for future replacement of certain System assets. Cash received from such billings is restricted. Costs of plant replacements are charged to the advance account 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. Such losses are included as a component of long-term debt, revenue bonds.

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 water supply contracts, the System is required to collect from the Water Contractors all costs of the SWP allocated in proportion to each Water Contractor's contractual allocation of water. Generally, the System's costs, 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.

Under the terms of the long-term water supply contracts, the System granted the Water Contractors rate management reductions of approximately $23,235 and $40,470 during the years ended June 30, 2004 and 2003, 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 $40,710 and $40,206 in the years ended June 30, 2004 and 2003, respectively, are recorded as liabilities in the financial statements. The System refunded $46,021 and $38,221 in the years ended June 30, 2004 and 2003, 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 64% and 8% of total System water supply revenue for the year ended June 30, 2004, respectively.

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

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 held in this segment. Expenses are limited to operations and maintenance of the SWP constructed with general obligation bond proceeds, power purchases, replacements and interest 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 held in this segment. Expenses include the operation of SWP facilities constructed with revenue bond proceeds and power facilities and related interest payments.

Future Pronouncements
Effective not later than the year ending June 30, 2008, the System will be required to implement Governmental Accounting Standards Board Statement No. 45**,** *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions* (known as OPEBs). The System

offers postretirement medical and dental benefits. GASB 45 establishes standards for the measurement, recognition, and display of OPEB expense/expenditures and related liabilities (assets), note disclosures, and, if applicable, required supplementary information in the financial reports of state and local governmental employers. The cost of OPEB, like the cost of pension benefits, generally should be associated with the periods in which the exchange occurs, rather than with the periods (often many years later) when benefits are paid or provided. In current practice, most OPEB plans are financed on a pay-as-you-go basis, and financial statements generally do not report the financial effects of OPEB until the promised benefits are paid.

Upon implementation of GASB 45, the System will be required to record an annual OPEB cost based on the annual required contribution of the employer (ARC), an amount actuarially determined in accordance with the parameters of GASB 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize unfunded actuarial liabilities over a period not to exceed thirty years. The System has not completed the process of evaluating the impact that will result from adopting GASB 45.

3. Interests in Jointly Owned Facilities

At June 30, 2004, the System owned the following undivided interests in jointly owned facilities:

		System's Share (in thousands)	
	% Owned by System	**Ultility Plant in Service**	**Accumulated Depreciation**
Reid Gardner Power Plant Unit No. 4	67.8%	$ 327,069	$ 227,688
San Luis joint use facilities	55.0%	$ 255,931	$ 96,267

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 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.

For the years ended June 30, 2004 and 2003 (in thousands)

4. Utility Plant

The following activity in utility plant occurred during the years ending June 30, 2004 and 2003:

	Utility Plant in Service	Accumulated Depreciation	Net Utility Plant in Service	Construct Work in Progress	Total Utility Plant
Beginning balance, 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)	-
Ending balance, June 30, 2003	4,441,688	1,489,403	2,952,285	142,610	3,094,895
Additions	-	77,389	(77,389)	12,850	(64,539)
Transfers	118,359	-	118,359	(118,359)	-
Ending balance, June 30, 2004	$ 4,560,047	$ 1,566,792	$ 2,993,255	$ 37,101	$ 3,030,356

5. Cash and Investments

At June 30, 2004, 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 $9,210. Of the bank balance, $100 is federally insured and $9,110 is uncollateralized.

The System's investments are categorized below to give an indication of the level of credit risk at June 30, 2004. 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, 2004 and 2003 (in thousands)

	Category 1	Category 2	Category 3	Fair Value
U. S. Government and agency securities	$ -	$ 48,830	$ -	$ 48,830
Restricted cash in PMIA funds				144,085
Cash in PMIA funds				269,996
Cash and cash equivalents on deposit with revenue bond trustee				9,210
Total cash and investments				$ 472,121

Reconciliation to combined balance sheet:	
Cash and cash equivalents restricted for plant replacements	$ 17,092
Cash and investments restricted for debt service	175,823
Cash and cash equivalents on deposit with revenue bond trustee	9,210
Cash and cash equivalents	269,996
Total cash and investments	$ 472,121

Interest on deposits in PMIA varies with the rate of return of the underlying portfolio and averaged 1.53% and 2.17% for the years ended June 30, 2004 and 2003, respectively. For the years ended June 30, 2004 and 2003, interest earned on the deposit with PMIA approximated $7,101 and $10,292, respectively.

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:

For the years ended June 30, 2004 and 2003 (in thousands)

	2004	2003
Fair value of investments at the beginning of the fiscal year	$ 51,712	$ 45,592
Add: Amortization of discounts	1,721	1,585
Change in fair value of investments during fiscal year	(4,604)	4,535
Fair value of investments at the end of the fiscal year	$ 48,829	$ 51,712

6. Long-term Debt

The following activity occurred in the long-term debt accounts during the years ended June 30, 2004 and 2003:

	General Obligation Bonds	Revenue Bonds	Unamortized (Discounts) and Premium	Deferred Loss on Defeasance	Total Revenue Bonds	Commercial Paper	Total Long-Term Debt
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
Additions	-	189,625	(2,727)	(2,641)	184,257	70,643	254,900
Payments/Amortization	(44,480)	(145,980)	4,985	9,375	(131,620)	(92,218)	(268,318)
Balance at June 30, 2004	$ 777,610	$ 2,447,075	$ 23,071	$ (20,290)	$ 2,449,856	$ 10,519	$ 3,237,985
Less Current Portion	(46,320)	(56,645)	-	-	(56,645)	-	(102,965)
Total Long Term Debt	$ 731,290	$ 2,390,430	$ 23,071	$ (20,290)	$ 2,393,211	$ 10,519	$ 3,135,020

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 funds from the California Water Fund were 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 $168 million are authorized but unissued as of June 30, 2004, 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. 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) 2004	2003
1964	A	0.1-3.6%	2013	$ 38,000	$ 41,500
1964	B&C	.05-3.7%	2014	60,500	65,150
1965	D&E	3.0-3.8%	2015	88,100	94,200
1966	F&G	3.5-4.1%	2016	97,200	103,000
1967	H,J&K	3.0-4.9%	2017	151,600	160,100
1968	L&M	4.0-5.0%	2018	108,600	114,000
1970	N&P	5.0-5.8%	2020	114,000	119,200
1971	Q&R	4.8-5.2%	2021	89,400	93,150
1972	S	5.3-5.5%	2022	24,840	25,800
1991	W	6.0-10.0%	2011	3,600	4,050
1993	X	4.1-4.8%	2023	1,000	1,100
1994	Y	6.1-7.5%	2025	770	840
				777,610	822,090
Less current maturities				(46,320)	(44,480)
				$ 731,290	$ 777,610

Revenue Bonds
The Central Valley Project Water System (CVP) Revenue Bonds have been issued for the acquisition or construction of projects to provide water 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 103.5%.

Series AB bonds issued during fiscal year 2004 are variable rate bonds and have 35 day auction periods. The interest rate for Series AB averaged 4% for the year ended June 30, 2004.

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) 2004	2003
Devil Canyon - Castaic Facilities:						
1973	A&B	5.3-5.4%	2022	Callable	$ 103,195	$ 106,080
CVP Water System:						
1992	J	5.8-7.0%	2012	2001	151,345	165,855
1993	L	5.25%	2005	Callable	11,635	36,875
1993	M	4.5-8.4%	2027	Called	-	84,580
1996	O	4.8-8.3%	2030	2006	242,155	247,445
1996	P	5.3-9.3%	2029	2006	69,365	71,940
1997	Q	4.5-6.0%	2028	2007	199,965	202,315
1998	S	4.3-5.0%	2030	2008	183,165	185,235
1998	T	5.0-5.5%	2013	2009	93,330	94,195
1999	U	4.0-5.1%	2030	2009	175,120	177,435
1999	V	6.25%	2025	None	20,580	20,580
2001	W	4.0-5.5%	2030	2012	244,375	245,790
2002	X	2.5-5.5%	2029	2013	156,930	158,225
2003	Y	5.0-5.3%	2026	2013	329,885	329,885
2003	Z	2.0-5.0%	2020	2013	167,700	168,290
2003	AA	5.00%	2024	2013	108,705	108,705
2004	AB	Variable	2030	Callable	189,625	-
					2,447,075	2,403,430
	Unamortized bond issuance premiums, net				23,071	20,813
	Deferred loss on defeasance				(20,290)	(27,024)
	Current maturities				(56,645)	(52,335)
					$2,393,211	$2,344,884

For the years ended June 30, 2004 and 2003 (in thousands)

Future Debt Service Requirements
Future principal and interest payment requirements on bonds are as follows at June 30, 2004:

	General Obligation Bonds		Revenue Bonds		
Year	Principal	Interest	Principal	Interest	Total
2005	$ 46,320	$ 33,309	$ 56,645	$ 122,811	$ 259,085
2006	47,575	31,283	54,335	119,743	252,936
2007	48,965	29,195	70,475	116,405	265,040
2008	50,355	27,039	74,745	112,592	264,731
2009	52,695	24,806	78,910	108,619	265,030
2010-2014	289,865	87,610	469,600	473,758	1,320,833
2015-2019	213,745	29,707	519,455	343,750	1,106,657
2020-2024	28,055	2,036	555,235	205,700	791,026
2025-2029	35	1	470,265	75,847	546,148
2030	-	-	97,410	2,222	99,632
	$ 777,610	$ 264,986	$ 2,447,075	$ 1,681,447	$ 5,171,118

Commercial Paper Notes
The System has a commercial paper borrowing program of up to $141.5 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, 2004 and 2003, there were borrowings of $10,519 and $32,094, respectively, outstanding under this program. Interest expense approximated 1% and 2% for the years ended June 30, 2004 and 2003, respectively. 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 with 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 March 2004, the System issued $189,625 in CVP Water System Revenue Bonds – Series AB in a variable interest rate mode of 35-day auction periods. The interest rates for the variable debt from March 18, 2004 to June 30, 2004 ranged from 0.75% to 1.12%. These bonds, together with other monies, were used to refund $93,645 of outstanding bonds, redeem commercial paper borrowings of $92,210, fund capitalized interest $3,852 and cover costs of issuance of $1,865.

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.

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.

The proceeds of Series AB used for current refunding (after the payment of underwriting refunding fees, other issuance costs and deposits to the Debt Service Reserve Accounts) together with other available monies, were used to refund debt that was called. The current refunding resulted in the recognition of an accounting loss of approximately $2.6 million for fiscal year 2004.

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 proceeds of the Series 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 Series Z advance refunding resulted in an accounting loss of approximately $13 million for fiscal year 2003, which has 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 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.

The total amount of bonds refunded in advance and still outstanding was $246,250 at June 30, 2004.

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, 2004, was 14.843% and 10.265% for State Miscellaneous Tier 1 and Tier 2, respectively. For the fiscal year ended June 30, 2003, the required employer contribution rate for Tiers 1 and 2 were 7.413% and 2.813%, 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.

For the years ended June 30, 2004 and 2003 (in thousands)

Annual Pension Cost

For the years ended June 30, 2004 and 2003, the System's annual pension cost and actual contribution amounted to approximately $10.7 million and $5.4 million, respectively. Annual covered payroll is not available for the System. However the actuarially determined contributions for the years ended June 30, 2004 and 2003, approximated .8% and .9%, respectively, of the total actuarially determined contribution requirements for the State Miscellaneous Category and approximately 13.71% and 6.61%, respectively, of the total System payroll. The required contribution for the 2004 fiscal year was determined as part of the June 30, 2002, 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, 2003, the date of the most recent actuarial valuation, was 7 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, 2002 (date of the actuarial valuation used to determine the required contribution for the year ended June 30, 2004), is as follows:

Three-Year Trend Information

Fiscal Year Ended June 30	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation (NPO)
2002	$ 289,957	100%	$ -
2003	$ 607,631	100%	$ -
2004	$ 1,337,430	100%	$ -

For the years ended June 30, 2004 and 2003 (in thousands)

Analysis of Funding Progress

Actuarial Valuation Date June 30	(A) Actuarial Asset Value	(B) Actuarial Accrued Liability	(C) Unfunded Actuarial Accrued Liability (Excess Assets) [(B)-(A)]	(D) Funded Ratio [(A)/(B)]	(E) Covered Payroll	(F) 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	32,362,809	32,557,433	194,624	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%	7,332,110	-106%
2000	46,841,738	42,386,045	(4,455,693)	111%	8,246,460	-54%
2001	47,258,102	45,261,495	(1,996,607)	104%	8,190,102	-24%
2002	43,483,087	48,118,210	4,635,123	90%	8,582,663	54%
2003	43,256,806	51,558,913	8,302,107	84%	8,636,968	96%

Post-employment Benefits Other Than Pensions
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, 2004 and 2003 were approximately $15,457 and $12,278, 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 remaining value of contracts in process as of June 30, 2004 and June 30, 2003, $77,523 and $35,098 respectively.

Power Transmission and Purchase
The System has long-term power transmission service contracts requiring future payments of $229,863 over periods ranging from one to 35 years. Payments made under these contracts approximated $32,350 and $25,881 for the years ended June 30, 2004 and 2003, respectively.

The System has also entered into long-term power purchase contracts requiring future payments of $741,422 over periods ranging from one to 30 years. Payments made under these contracts, excluding payments to the Kings River Conservation District (District) to cover debt service, approximated $26,054 and $43,205 for the years ended June 30, 2004 and 2003, respectively.

For the years ended June 30, 2004 and 2003 (in thousands)

The remaining amounts of fixed obligations under the long-term power purchase and transmission contracts as of June 30, 2004, are as follows:

For the year ended:	Fixed Obligation
2005	$ 81,943
2006	81,943
2007	81,943
2008	81,943
2009	81,943
Thereafter	561,570
	$ 971,285

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 $10,300 and $10,289 during the years ended June 30, 2004 and 2003, 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, 2003, are as follows:

For the year ended	Fixed Obligation
2005	$ 4,910
2006	4,900
2007	4,894
2008	4,882
2009	4,884
Thereafter	55,062
	$ 79,532

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). The Monterey Amendment includes provisions related to 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 operation of certain System reservoirs, transfers of water allocations between contractors, establishment of certain operating reserves, and the revision of calculating certain Water Contractor billings.

The Monterey Amendment has been executed by the Department and 27 of the 29 Water Contractors, who receive approximately 99% of water delivered annually and who pay approximately 99% of annual water supply revenue. Certain parties have disputed the validity of the Monterey Amendment by challenging the validity of the related environmental impact report (EIR). While the courts have allowed the Department to proceed with the implementation of the Monterey Amendment, the Department has been required to prepare a new EIR, which remains in process. After the EIR process is completed, the plaintiffs involved could again challenge, on limited grounds, the EIR and certain provisions of the Monterey Amendment. 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. The Department estimates that the System will be required to refund approximately $9.8 million as a result of these proceedings.

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, 2004 and 2003 (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, 2004 and 2003:

	2004			2003		
	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	$ 905,686	$ 2,124,670	$ 3,030,356	$ 935,501	$ 2,159,394	$ 3,094,895
Other assets	1,109,547	507,208	1,616,755	1,069,330	543,381	1,612,711
Current assets	172,026	204,650	376,676	147,047	212,461	359,508
Total assets	$ 2,187,259	$ 2,836,528	$ 5,023,787	$ 2,151,878	$ 2,915,236	$ 5,067,114
Capitalization and Liabilities						
Capitalization:						
Net assets:						
Capital (deficit), net of related debt	$ 416,227	$ (230,551)	$ 185,676	$ 401,563	$ (154,996)	$ 246,567
Restricted	716,557	284,309	1,000,866	642,226	314,201	956,427
Total net assets	1,132,784	53,758	1,186,542	1,043,789	159,205	1,202,994
Long-term liabilities	731,290	2,403,730	3,135,020	777,610	2,376,978	3,154,588
Total capitalization	1,864,074	2,457,488	4,321,562	1,821,399	2,536,183	4,357,582
Current liabilities	96,356	202,470	298,826	97,269	197,750	295,019
Other liabilities	226,829	176,570	403,399	233,210	181,303	414,513
Total capitalization and liabilities	$ 2,187,259	$ 2,836,528	$ 5,023,787	$ 2,151,878	$ 2,915,236	$ 5,067,114
Condensed Statements of Activities:						
Operating revenues:						
Water supply	$ 447,980	$ 192,437	$ 640,417	$ 379,184	$ 208,440	$ 587,624
Power sales	39,674	19,615	59,289	56,821	28,914	85,735
Federal reimbursements	12,901	2,040	14,941	14,364	1,708	16,072
	500,555	214,092	714,647	450,369	239,062	689,431
Depreciation expense	(23,072)	(54,316)	(77,388)	(22,589)	(53,109)	(75,698)
Other operating expense	(351,237)	(129,956)	(481,193)	(377,863)	(102,438)	(480,301)
Income from operations	126,246	29,820	156,066	49,917	83,515	133,432
Interest expense	(34,790)	(133,083)	(167,873)	(27,753)	(156,067)	(183,820)
Other (expense) income	(2,461)	(2,184)	(4,645)	(5,315)	9,450	4,135
Increase (decrease) in net assets	88,995	(105,447)	(16,452)	16,849	(63,102)	(46,253)
Net assets, beginning of year	1,043,789	159,205	1,202,994	1,024,863	224,384	1,249,247
Net assets, end of year	$ 1,132,784	$ 53,758	$ 1,186,542	$ 1,043,789	$ 159,205	$ 1,202,994
Condensed Statements of Cash Flows:						
Net cash provided by (used in):						
Operating activities	$ 103,264	$ 113,466	$ 216,730	$ 60,674	$ 197,890	$ 258,564
Noncapital financing activities	(16,781)	4,009	(12,772)	(5,234)	(1,599)	(6,833)
Capital and related financing activities	(73,035)	(125,537)	(198,572)	(74,924)	(186,552)	(261,476)
Investing activities	14,425	1,079	15,504	5,837	4,267	10,104
Net increase (decrease) in cash and cash equivalents	27,873	(6,983)	20,890	(13,647)	14,006	359
Cash and equivalents, beginning of year	68,506	333,895	402,401	82,153	319,889	402,042
Cash and equivalents, end of year	$ 96,379	$ 326,912	$ 423,291	$ 68,506	$ 333,895	$ 402,401

11. Related Party Transactions

During fiscal 2004, the System had no related party transactions. During the years ended June 30, 2003, however, the System sold power amounting to $5,756 to, and purchased power amounting to $6,269 from, respectively, the Department of Water Resources Electric Power Fund (Power Fund), another enterprise fund administered by the Department. Net amounts owed to the Power Fund by the System for power purchases and sales were $2,985 at June 30, 2003.

Supplementary Information

State Water Resources Development System
Calculation of Adequacy of Debt Service Coverage

Water supply revenues, including $40,710 in refundable proceeds	$ 274,307
Investment earnings	4,780
	279,087
Less: Operations and maintenance expense	73,067
Net revenues available for debt service	$ 206,020
Principal and interest for revenue bonds	$ 164,393
Debt service coverage	125.3%

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.