State of California | The Natural Resources Agency | Department of Water Resources

ANNUAL REPORT

State Water Resources Development System

Financial Statements and Supplementary Information

YEARS ENDED JUNE 30

2009-2008

STATE OF CALIFORNIA
Arnold Schwarzenegger, Governor

THE NATURAL RESOURCES AGENCY
Michael J. Chrisman, Secretary for Natural Resources

DEPARTMENT OF WATER RESOURCES
Lester A. Snow, Director

Raphael A. Torres Deputy Director	Susan Sims Chief Deputy Director	James E. Libonati Deputy Director
Gerald E. Johns Deputy Director	John Pacheco Acting Deputy Director	Mark W. Cowin Deputy Director
David Sandino Chief Counsel	Kasey D. Schimke Assistant Director	

Division of Fiscal Services
Perla M. Netto-Brown, Chief

This document was prepared under the direction of:

Rita Sanko……………………………………………………………………………………Deputy Comptroller

Enterprise Accounting Branch

Robert Moeller.. Accounting Administrator II
Lisa Toms.. Accounting Administrator II
Mike Barentson... Accounting Administrator I
Antonio Perez………………………………………………………………………… Accounting Administrator I
Lori Lay………………………………………………………………………………... Accounting Administrator I
Eleanor De Anda…………………………………………………………………… . Accounting Administrator I
Kenneth Kwong.. Accounting Administrator I
Wendy Wheeler……………………………………………………………………… Accounting Administrator I
Ariel Gonzales……………………………………………………………………… Associate Accounting Analyst
Emmalynn Harvey…………………………………………………………………... Associate Accounting Analyst
Yolanda Lemence-Lantin.…………………………………………………………….Associate Accounting Analyst
Sisay Woldemichael ……………………………………………………................. Associate Accounting Analyst
Maria Vacaru………………………………………………………………………… Associate Accounting Analyst
Jesus Parrilla………………………………………………………………………… Associate Accounting Analyst
Wanda Cox.. Office Technician

State Water Resources Development System

Financial Statements and
Supplementary Information
For the years ended June 30, 2009 and 2008

State Water Resources Development System
Table of Contents

MACIAS GINI & O'CONNELL LLP
Certified Public Accountants & Management Consultants

SACRAMENTO
3000 S Street, Suite 300
Sacramento, CA 95816
916.928.4600

WALNUT CREEK

OAKLAND

LOS ANGELES

NEWPORT BEACH

SAN MARCOS

SAN DIEGO

The Director of the State of California
Department of Water Resources

Independent Auditor's Report

We have audited the accompanying basic financial statements of the State Water Resources Development System (System), a component unit of the State of California, as of and for the fiscal years ended June 30, 2009 and 2008. 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 in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control over financial reporting. Accordingly, we express no such opinion. An audit also 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, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the System as of June 30, 2009 and 2008, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As described in Note 2 to the financial statements, effective July 1, 2007, the System implemented Governmental Accounting Standards Board (GASB) Statements No. 45, Accounting *and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions* and No. 50, *Pension Disclosures*.

The management's discussion and analysis as listed in the table of contents is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the System's basic financial statements. The supplementary information is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Macias Gini & O'Connell LLP

Certified Public Accountants

Sacramento, California
January 16, 2010

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 approximately 700 miles of the System has 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 maximum 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 total assets of $112.9 million on total operating revenues of $914.8 million. This did not cause a decrease in net assets as a result of appropriately reflecting the timing differences in the deferral of expenses incurred and the deferral of capital recovery.

- In March 2009, the System issued CVP Water System Revenue Bonds Series AF with a par amount of $287.7 million and a premium of $15.0 million with an average yield on the bonds of 4.18%. The bond proceeds along with System funds on hand in the amount of $9.5 million were used to defease $266.7 million of outstanding bonds, redeem commercial paper borrowings of $33.3 million, fund capitalized interest of $1.3 million, fund deposits to the debt service reserve account of $2.4 million, and cover costs of issuance of $1.6 million.

- In March 2009, the Department of Water Resources entered into a cooperative agreement with the United States Bureau of Reclamation (USBR) for the Delta Habitat Conservation and Conveyance Program (DHCCP). The DHCCP is being conducted to complete general planning studies, preliminary engineering, and environmental analysis and documentation to evaluate the effectiveness of implementing measures that contribute to the conservation and rehabilitation of fish and wildlife species in the Sacramento-San Joaquin Delta. In accordance with the Memorandum of Agreement, 50% of the costs will be the Federal Share of the program costs. The Federal Share will be collected from the Delta Mendota Water Authority and as allowed under Federal appropriations law, via in-kind services and the Cooperative Agreement, from USBR.

- During fiscal 2009, the System was a party to certain power purchasing contracts with Morgan Stanley. These contracts require the System to pay market rates for the natural gas used to produce such power. As a result, the System established a natural gas hedging program designed to stabilize the cost of its natural gas. This hedging program causes the System to enter into contracts for the future purchase of natural gas at known costs to hedge against market swings in price. As of June 30, 2009, the System had 375 contracts outstanding, and realized a loss of $4.7 million for fiscal 2009. Losses are realized at the end of the contract service period, when contracts expire. This loss is recoverable through the Variable revenue collected by the System.

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 revenues, expenses, and changes in net assets 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, noncapital 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.

Condensed Statements of Net Assets

	2009	2008	2007	%Change 2009-2008	%Change 2008-2007
	(amounts in thousands)				
Total utility plant	$ 3,099,602	$ 3,074,755	$ 3,037,663	0.8%	1.2%
Other assets	1,959,439	2,097,223	2,156,502	-6.6%	-2.7%
Total assets	$ 5,059,041	$ 5,171,978	$ 5,194,165	-2.2%	-0.4%
Capitalization:					
Net assets:					
Capital, net of related debt	$ 272,984	$ 127,858	$ 98,490	113.5%	29.8%
Restricted	932,447	1,077,573	1,106,941	-13.5%	-2.7%
Total net assets	1,205,431	1,205,431	1,205,431	0.0%	0.0%
Total long-term debt	3,041,111	3,156,526	3,210,305	-3.7%	-1.7%
Total capitalization	4,246,542	4,361,957	4,415,736	-2.6%	-1.2%
Other liabilities	812,499	810,021	778,429	0.3%	4.1%
Total net assets and liabilities	$ 5,059,041	$ 5,171,978	$ 5,194,165	-2.2%	-0.4%

Condensed Statements of Revenues, Expenses, and Changes in Net Assets

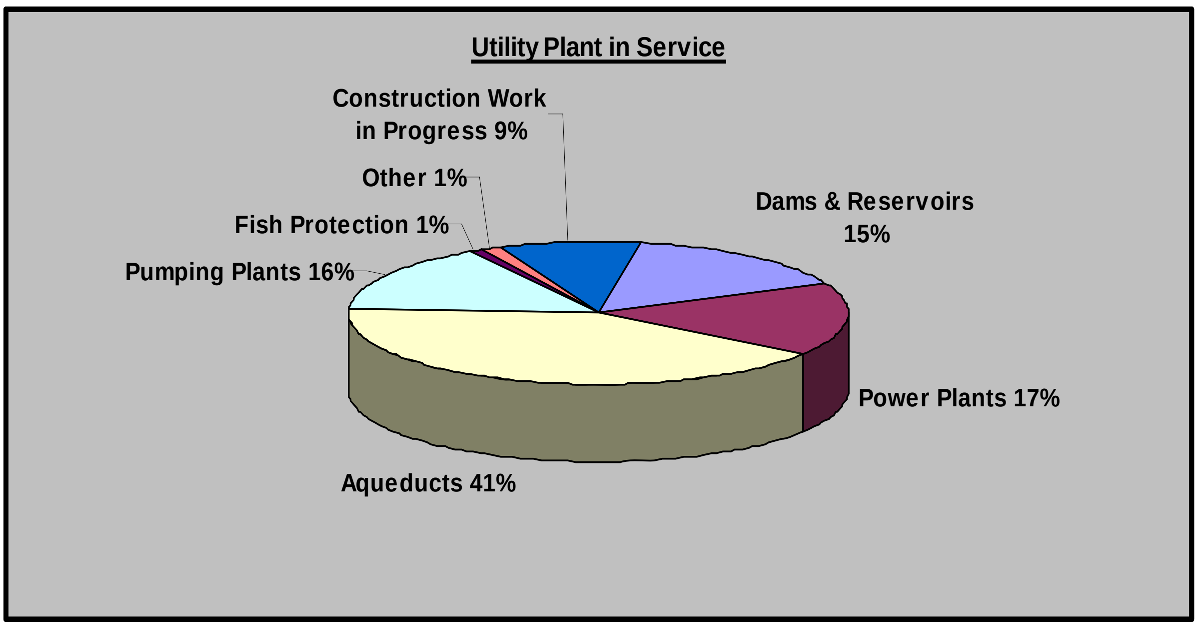
	2009	2008	2007	%Change 2009-2008	%Change 2008-2007
	(amounts in thousands)				
Water supply	$ 721,253	$ 752,853	$ 704,921	-4.2%	6.8%
Power sales	175,318	215,430	222,206	-18.6%	-3.0%
Federal reimbursements	18,266	20,992	24,463	-13.0%	-14.2%
Total operating revenues	914,837	989,275	951,590	-7.5%	4.0%
Operations and maintenance expense	469,667	409,150	344,464	14.8%	18.8%
Purchased power	206,632	323,236	374,568	-36.1%	-13.7%
Depreciation expense	77,269	79,136	78,065	-2.4%	1.4%
Operating expenses (deferred) recovered, n	18,299	40,976	(24,972)	-55.3%	-264.1%
Total operating expenses	771,867	852,498	772,125	-9.5%	10.4%
Income from operations	142,970	136,777	179,465	4.5%	-23.8%
Capital expenses (deferred) recovered	40,555	(20,595)	4,377	-296.9%	-570.5%
Interest expense	(130,054)	(156,716)	(151,746)	-17.0%	3.3%
Other (expense) income	(53,471)	40,534	(32,096)	-231.9%	-226.3%
Increase (decrease) in net assets	-	-	-	0.0%	0.0%
Net assets, beginning of year	1,205,431	1,205,431	1,205,431	0.0%	0.0%
Net assets, end of year	$ 1,205,431	$ 1,205,431	$ 1,205,431	0.0%	0.0%

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 33 storage facilities, 20 pumping plants, four generating plants, ten power plants, as well as fish protection facilities and aqueducts.

Utility plant in service, net of accumulated depreciation (UPIS) decreased by $71 million during fiscal 2009 to a balance of $2,638 million. This is compared to a net decrease in fiscal 2008 of $75 million. While depreciation expense remains fairly constant each year, fiscal 2009 experienced a decrease in depreciation expense of $1.8 million to $77.2 million for the current year due to several pumping plants and one fish hatchery being fully depreciated at the end of fiscal 2008. Depreciation expense for fiscal 2008 was $79.1 million, the amount of additions to UPIS in the current year was $6.2 million compared to a $4 million increase in 2008. 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 increased by $95.9 million during the year, which represents a 26.3% increase over fiscal 2008. In fiscal 2008, construction work in progress increased by $112 million, or 44.3% over fiscal 2007. The current year increase is attributable to additions made to new and on-going projects including East Branch Extension Phase II projects of $7.0 million, Reid Gardner projects in the amount of $9.1 million, South Bay Aqueduct projects of $25 million, the Tehachapi 2nd Afterbay project of $2.5 million and other Water Systems projects totaling $52.3 million. The increase in fiscal 2008 from fiscal 2007 was attributable to additions made to new and on-going projects including the East Branch Extension Phase II projects of $7.7 million, Reid Gardner projects of $11.9 million, South Bay Aqueduct projects of $45.8

million, the Tehachapi 2nd Afterbay project of $3.1 million and other Water Systems projects totaling $43.5 million. At June 30, 2009, total construction work in progress was comprised of $25.8 million of East Branch Extension Phase II projects, $29.7 million of Reid Gardner projects, $110.2 million for the South Bay aqueduct, $78.9 million of Tehachapi 2nd Afterbay projects, and $216.6 million of other Water Systems projects.

Restricted Cash and Investments
Restricted cash and cash equivalents increased by $21.3 million during fiscal 2009 to a total of $162.6 million. This compares to a balance of $141.3 million in fiscal 2008, and $220.7 million in fiscal 2007. The current year increase of $21.3 million is primarily due to $20 million from the reclassification of Hyatt-Thermalito power plant refurbishment costs. In fiscal 2007 a change was made for the collection of the costs for Hyatt-Thermalito power plant. It was determined that the costs would be collected through the Variable revenue component rather than the Replacement revenue. In fiscal 2008 the water contractors were given $17.6 million credit for amounts they had previously paid under the Replacement revenue component for the refurbishment costs, thereby reducing the amount of restricted cash. However, in fiscal 2009, the costs of $20 million were moved which increased the amount of cash restricted for replacements and decreased the unrestricted cash accounts.

Other Long-term Assets
As required by the Davis-Grunsky Act, the System has made loans to local water agencies of which a long-term portion of $22.4 million remains outstanding at the end of fiscal 2009 compared to an outstanding balance of $24.1 million at the end of fiscal 2008, and $25.9 million at the end of fiscal 2007. Advances to Other State Funds represents the System's advance of $92 million to DWR's internal service fund, this functions as a revolving working capital facility for DWR.

Cash and Cash Equivalents
In fiscal 2009, cash and cash equivalents decreased by $115 million to a balance of $370 million. The decrease is mainly due to the expenditure of $54 million on capital projects from the proceeds of the issuance of Bond Series AE that were unspent as of June 30, 2008, a reclass of $20 million of Hyatt-Thermalito expenses from restricted to unrestriced cash accounts, a $33 million decrease in fair market value for gas hedging program, and the maturity of the US Treasury Strip and other securities.

Receivables
In fiscal 2009, water supply and power billings receivable decreased from $110 million to $75.4 million as compared to fiscal 2008. The variable billings are due 30 days from the date of billing with a 30 day grace period. The fiscal 2009 decrease of $34.6 million is primarily attributable to decreases in variable water deliveries and variable rates for April through June 2009 as compared to April through June 2008 that were outstanding billings as of June 30.

Deferred Charges
Deferred charges represent timing differences between expenses incurred by the System and their ultimate recovery from the Water Contractors. Expense recognition is expected to match recovery from the Water Contractors in the future. In total, deferred charges decreased by $12 million to an ending balance of $1,182 million compared to $1,194 million for 2008, as the System defers expenses to be recovered from future revenues from the Water Contractors. In fiscal 2008, recoveries resulted in a decrease of deferred charges of $46 million.

Liabilities

Revenue Bonds

The System has issued 32 series of Water System Revenue Bonds totaling $6,391 million in the aggregate principal, of which $2,493 million remains outstanding at the end of fiscal 2009. This compares to outstanding balance of $2,547 million and $2,475 at the end of fiscal year 2008 and 2007, respectively. During the year, the System completed the issuance of CVP Water Systems Revenue Bond Series AF of $288 million. The majority of the proceeds from the issuance were used to refund portions of the bond of Series Q, T, U, and redeem the Bond Anticipation Bonds, while the remainder was used to pay off all outstanding commercial paper as of the date of issuance, make a deposit to the Debt Service Reserve Account, fund interest on a portion of the Series AF Bonds, and pay costs of issuance of Series AF Bonds.

The System has also issued $139 million of revenue bonds to finance the Devil Canyon-Castaic power facility. Under the Devil Canyon-Castaic bond resolution, $86 million is outstanding at the end of fiscal 2009, compared to $90 million at fiscal 2008 and $93 million at fiscal 2007.

	2009	2008	2007
CVP revenue bonds par amount	$ 2,431,825	$ 2,484,945	$ 2,449,735
Unamortized bond issuance premiums/(discounts)	93,176	85,674	46,025
Deferred amount on refunding	(31,808)	(23,675)	(21,142)
Total CVP revenue bonds outstanding	2,493,193	2,546,944	2,474,618
Devil Canyon - Castaic revenue bond par amount	85,965	89,825	93,465
Total revenue bonds outstanding	2,579,158	2,636,769	2,568,083
Less current maturities	(97,359)	(78,035)	(75,535)
Total long-term portion	$ 2,481,799	$ 2,558,734	$ 2,492,548

General Obligation Bonds

In addition to the revenue bond obligation 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 $532 million remains outstanding at the end of fiscal 2009 compared to $584 million at fiscal 2008 and $635 for fiscal 2007. The un-issued $168 million of the authorization is available only to provide funds for the construction of certain additional water conservation facilities.

Pooled Money Investment Loan

The System applied for and received a loan from the Pooled Money Investment Account pursuant to Government Code section 16313 for $29.6 million. The proceeds of the loan were used to establish escrow accounts that will defease certain Water System Revenue Bonds that financed recreation, fish, and wildlife enhancement related costs of the acquisition and construction of the System. The loan is to be repaid with surplus revenues of the System made available under Water Code section 12937(b)(4). The DWR executed the Pooled Money Investment Board Loan on March 26, 2008. The loan agreement requires minimum quarterly payments of $1 million on the first day of every March, June, September and December; the first payment was made on September 1, 2008. Interest is computed on the unpaid principal balance of the loan at the Variable Rate on the basis of a 360-day year or twelve 30-day months and the number of days elapsed. The Variable Rate means (a) for the period from the date of the Loan Agreement, March 26, 2008, through and including the day before the first Reset Date (March 25, 2009), five percent per annum, and (b) for each Renewal Period thereafter, the greater of (i) five percent per annum, or (ii) the last available daily rate of return by the PMIA on the day before the Reset Date on which such Renewal Period commences. In fiscal 2009, the outstanding long-term PMIA loan balance decreased from $27 million to $24.6 million due to $2.4 million of principal payments made during fiscal 2009.

Post-Employment Benefits Other than Pensions

The Post-Employment Benefits Other than Pensions (OPEB) liability increased by $28.2 million in fiscal 2009 due to a change in methodology for computing the OPEB liability and an increase in staffing levels for 2009. The fiscal 2008 OPEB liability of $19.7 million was previously based on a calculation of both labor hours and a percentage of total budget. For fiscal 2009, DWR revised the calculation method in order to more accurately base the OPEB liability solely on the allocation of labor. The $28.2 million increase for fiscal 2009 reflects the System's under funding of the annual required contribution.

Accounts Payable and Other Current Liabilities

Accounts payable and other current liabilities totaled $146.4 million at June 30, 2009, compared to $158.6 million in fiscal 2008, and $147.1 million in fiscal 2007. The decrease of $12.2 million in the current year is due to a decrease of $9.3 million in interest payable due in part to the issuance of Series AF Bonds; a decrease of $5 million in accounts payable; an increase of $4 million for accrued vacation due to the implementation of fuloughs requiring employees to use furlough time before accrued leave time; and a decrease of $1.8 million due to a timing difference in the transfer of cash settlements with DWR's Internal Service Fund. In fiscal 2008, the $11.5 million increase was due to the interest payable of $9 million from the issuance of Series AE Bonds, $2.5 million for the current portion of the PMIA loan.

Proceeds Due to Water Contractors

Proceeds Due to Water Contractors are comprised primarily of the additional 25% billing for revenue bond debt service in excess of debt service requirements (known as "cover"), plus 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 $1.4 million during fiscal 2009 to an ending balance of $120.4 million. This increase is primarily due to an increase in collateral deposits to be returned to the water contractors and an increase for interest refunds.

In fiscal 2008, Proceeds Due to Water Contractors increased from $99.4 million to $118.9 million, an increase of $19.5 million. The increase was due to a net $17.5 million off-aqueduct power facilities cost adjustment that updated plan to actuals and an increase of $1.7 million for interest refunds.

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. Those funds are deferred and then recognized as revenue as the projects are depreciated. Deferred revenue decreased $4 million in fiscal

2009 to $158 million. This compares to $4 million decrease in fiscal 2008. These decreases represent the recognition of revenue equal to the amount of depreciation recorded.

Deferred Capital Credits Due to Water Contractors

The System had no deferred revenues in fiscal 2009 compared to $29 million of deferred revenues in fiscal 2008. This represents excess capital revenues received that will be adjusted in future capital billings. The reduction in fiscal 2009 is due to the reduction in Fourth Priority funds available in fiscal 2009.

Deferred Power Sales Credit Due to Water Contractors

The deferred power sales credit results from a timing difference of revenue collected from certain Water Contractors for power generated by the Hyatt-Thermalito power plant and the corresponding credit that is issued to all Water Contractors through a reduced capital charge. In fiscal year 2009, the credits issued through the Delta Water Charge of $20.4 million were offset in part by the $14.7 million of revenue collected through the Variable charge for power generated at Hyatt-Thermalito for a $5.7 million decrease in the deferral for 2009 fiscal year.

Advances for Plant Replacements

Advances for plant replacements represents amounts collected in advance from the Water Contractors for future plant equipment replacements. Advances for plant replacements increased from $11.4 in 2008 fiscal to a total of $42 million in fiscal 2009. The $30.6 million increase is due to $13.2 million in revenue collections, $20 million for reclassification of Hyatt-Thermalito power plant costs, offset by costs of $2.6 million. It was determined that the Hyatt-Thermalio power costs would be collected through the Variable revenue component rather than the Replacement revenue component; therefore, costs for previous fiscal years were re-classed in the current year.

Operating Revenues

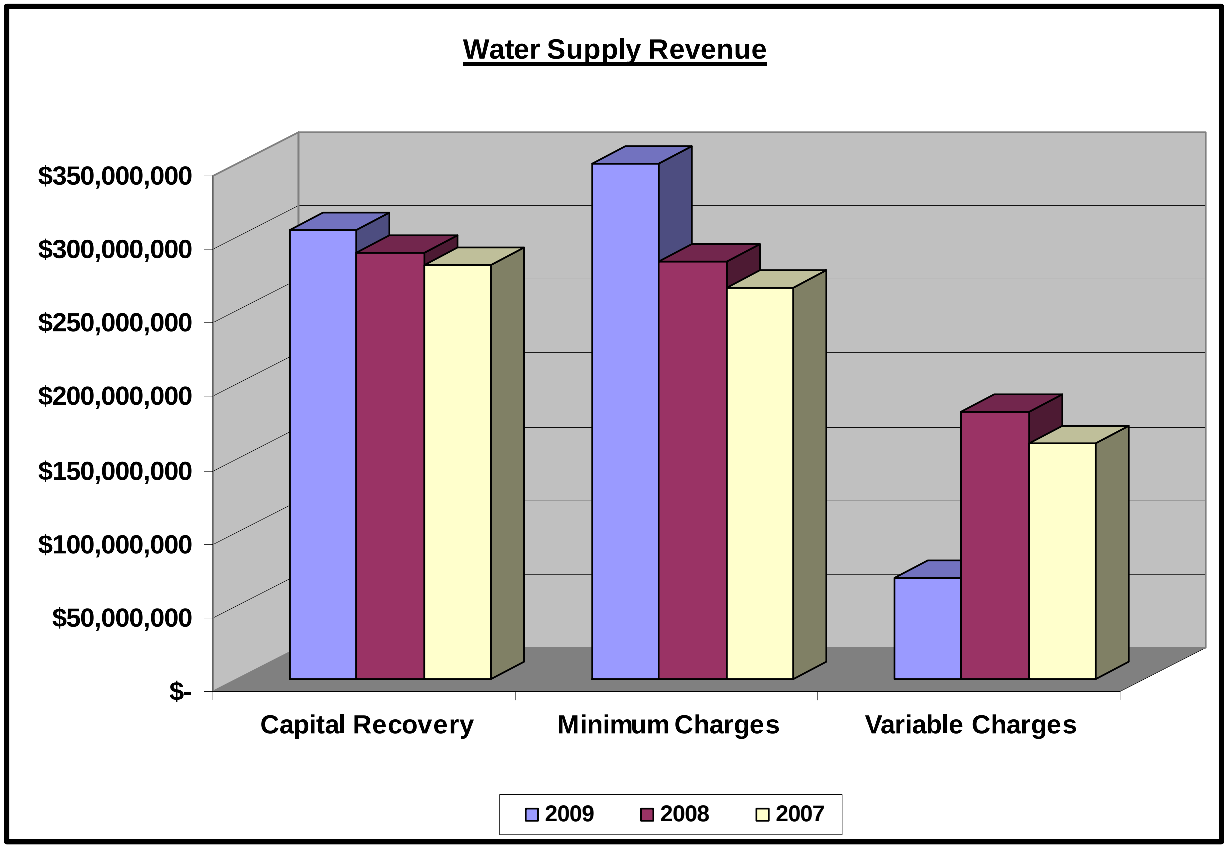
Operating revenues for fiscal 2009 were $914.8 million compared to $989 million in fiscal 2008 and $952 million in fiscal 2007. The decrease in fiscal 2009 was primarily due to a decrease in water supply revenue of $32 million, a decrease in power sales revenue of $40 million and a decrease of $2.7 million in federal reimbursements. The increase in fiscal 2008 was primarily due to an increase in water supply revenue of $48 million offset by decreases in power sales revenue of $6.8 million and $3.5 million in federal reimbursements

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 power sales, are generally recovered as they are incurred. On or before July 1 of each year, the System furnishes each Water Contractor with a statement of estimated charges for the Capital, Minimum, and Variable components for the following calendar year. The Capital components are due on January 1 and July 1 of the year following receipt of the statement of charges. The Minimum and Variable component payments are due in twelve monthly installments commencing on January 1 of the year following receipt of the statement of charges. On or about July 1 of each year, the System determines the rate (per acre-foot) to be charged to each Water Contractor in the following calendar year for the Variable components. The Variable components in such calendar year are calculated and billed monthly based on metered water deliveries for the preceding month and the rate determined on July 1st of each year. However, this rate can be modified over the course of the next year. On July 1 of each year, the System furnishes each Water Contractor with a statement showing the difference between the estimated water charges paid and the actual costs incurred in the prior calendar year. The difference is paid by or credited to each Water Contractor, as applicable, in equal monthly installments commencing on January 1 of the year following the "true-up" calculation. This process results in an approximately two-year delay in the reconciliation of estimated charges paid and actual costs reimbursed to the System.

In 2009, the System generated $721.2 million in water supply revenue, compared to $752.9 million in fiscal 2008, and $705 million in fiscal 2007. The table on the following page shows a comparative breakdown of the components of water supply revenue for fiscal years 2009, 2008 and 2007.



Water Supply Billings decreased by $31.6 million in 2009 to a total of $721.3 million. This decrease is due to a $15.5 million increase in Capital recovery, a $65.7 million increase in Operating & Maintenance (O&M) recovery, and an offsetting decrease of $112.8 in Variable recovery. The Capital recovery revenues increase of $15.5 million is due in part due to an increase of $13.1 million capital recovery in the Water Systems Revenue Bond Surcharge as a result of removing the debt service related to the recreation portion of certain systems facilities from the Water Contractor's bills in fiscal 2008. Capital recovery revenues for Off-Aqueduct facilities also rose by $8.7 million due to an increase in water deliveries. Capital Transportation recovery revenues increased by $4.5 million primarily due to a decrease in Rate Management adjustments in fiscal 2009 compared to fiscal 2008. These increases were offset by a decrease of $11.2 million for recovery of construction costs for the East Branch Enlargement Project. The O&M recovery revenues increased by $65.7 million in part due to recovery of $23.7 million for the Delta Habitat Conservation and Conveyance Program, an increase of $23.9 million for recovery of salary and overhead costs that occurred in 2007, and $5.9 million in over-collections for Off-Aqueduct facilities returned in fiscal 2008. Variable recovery revenue decreased by $112.8 million, primarily as a result of decreased rates, decreased water deliveries, and credit for the over-collection of revenues in fiscal 2008.

In fiscal 2008, Water Supply Billings increased by $47.9 million to a total of $752.9 million. There were several contributing factors. Increases occurred as a result of capital recovery revenues for construction costs on the East Branch Enlargement project of $6.8 million, and increases of $7.9 million for Transportation and Conservation Capital revenues. Capital recovery revenues for Off-Aqueduct facilities also rose by $6 million. These increases were offset by a decrease in capital recovery by $13.4 million in the Water Systems Revenue Bond Surcharge as a result of removing the debt service related to the recreation portion of certain system facilities from the Water Contractors' bills. In addition, O&M recovery revenues increased by $18.1 million. This is due in part to increases in Transportation and Conservation minimum costs of $26.2 million, offset by a decrease of $15.9 million in Off-Aqueduct facilities. Variable recovery revenue increased by $21.5 million, primarily as a result of increased rates and an additional billing for the under-collection of revenues in fiscal 2007.

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. Typically, the majority of generation is during the on-peak hours; however, ancillary services are provided in all hours of the day.

Every hour the SWP must enter the power market to facilitate the operation of the California aqueduct. The power market controlled by the California Independent System Operator (CAISO) can affect the bottom line cost or revenue from the System's hydro-electric facilities. Every year the DWR is confronted with factors that affect how the operation of the SWP is conducted. Some factors include plant or unit outages, environmental concerns, weather, fluctuation in natural gas prices, transmission line outages and wild fires. In July of 2008, California experienced numerous wild fires throughout the state causing transmission line outages and ultimately impacting the power grid. In April 2009, the CAISO implemented MRTU (Market Redesign and Technology Upgrades). The new MRTU market required the DWR to implement new scheduling tools to conduct business in the new power market. Of the numerous events that occur throughout the year, the primary factor affecting operation of the SWP in fiscal year 2009 continues to be low reservoir storages. The lack of any significant rainfall over the past couple of years has prevented reservoir recovery. These low storages influence the overall operation of the SWP.

In Northern California the rainy season usually begins in October and ends near March. While considerable rainfall occurred during December 2008 and February 2009, the other months remained unusually dry with no significant rainfall. Two rainy months out of a winter does not allow for much storage recovery in our local lakes and reservoirs. Not only was there minimal rainfall during the winter month, the weather in many cases was quite warm causing more evaporative affects on local lakes. The inability to recover SWP reservoir storage continues to affect SWP operation.

Power Sales

Energy sales from SWP hydro-electric generating plants allow some recovery of cost from the System's hydro-electric pumping plants. With low reservoir storages, the SWP ability to recover costs is greatly impacted. The Oroville complex is the largest SWP resource and required by

FERC to help mitigate negative environmental impacts. Mitigation could include controlling river temperatures to assisting with after-bay and fore-bay elevation control to help with nesting Grebe or Garter snake habitat. Mitigation can occur despite having minimal storage available at Oroville Lake.

In fiscal 2009, power sales decreased by $40 million to a total of $175 million. This is due to a decrease in the quantity of energy sold and a decrease in the MWh rate. In fiscal 2008, 2,213,122 units were sold compared to 2,111,027 units in fiscal 2009, a 4.6% decline from the prior year. The overall rate decreased by 17%, from $88.63 in fiscal 2008 to $73.26 in fiscal 2009. The decrease in revenue and energy is expected due to the fact that reservoir storages were quite low. Additionally, low natural gas prices helped to keep overall energy prices low. Elevated natural gas prices tend to keep off-peak energy prices high. An increase of $1 million in Transmission sold represents a combination of decreases in water deliveries and an increase in transmission services provided through The California Independent System Operator (CAISO). Water deliveries decreased from 3,272,732 acre feet in fiscal 2008 to 2,129,268 acre feet in 2009, a decline of 1,143,464 acre feet or 35%. While water deliveries went down, the average rate per acre foot increased by 4% or $0.24 from $5.44 in fiscal 2008 to $5.68 in fiscal 2009.

In fiscal 2008, power sales decreased by $6.8 million to a total of $215 million. Of that decrease, $15.5 million is attributable to decreased energy sales offset by an increase in the average MWh rate resulting in $17 million in increased power sales revenues while transmission decreased by $8.3 million. In energy sales, while the average rate per MWh sold increased by 9% from $81.49 to $88.63, the System sold 7% or .02 million less units in fiscal 2008 than fiscal 2007. The first table below shows the effect of the rate and volume between fiscal 2009 and fiscal 2008. This can be compared to the second table on the following page for fiscal years 2008 and 2007.

	Total Sold	Transmission Sold	Sold	MWh Sold	Rate/MWh
2008	$ 215,429,580	$ (19,289,231)	$ 196,140,349	2,213,122	$ 88.63
2009	175,357,081	(20,696,756)	154,660,325	2,111,027	73.26

Change in total MWh sold	(102,095)
Multiplied by 2008 rate/MWh	$ 88.63
Difference attributed to decreases sales	$ (9,049,000)
Change in MWh rate	$ (15.37)
Multiplied by 2009 MWh sold	2,111,027
Difference attributed to rate change	$ (32,446,000)
Total decrease in power sales	$ (41,495,000)

	Total Sold	Transmission Sold	Sold	MWh Sold	Rate/MWh
2007	$ 222,205,762	$ (27,619,792)	$ 194,585,970	2,387,758	$ 81.49
2008	215,429,580	(19,289,231)	196,140,349	2,213,122	88.63

Change in total MWh sold	(174,636)
Multiplied by 2008 rate/MWh	$ 88.63
Difference attributed to decreased sales	$ (15,477,000)
Change in MWh rate	$ 7.14
Multiplied by 2007 MWh sold	2,387,758
Difference attributed to rate change	$ 17,049,000
Total increase in power sales	$ 1,572,000

Federal Reimbursements Revenue

Federal reimbursements revenue for fiscal 2009 was $18.3 million, compared to $21 million and $24 million for fiscal years 2008 and 2007. The decrease in fiscal 2009 of $2.7 million is attributable to a decrease in expenses incurred for the portion of the San Luis and Suisun Marsh facilities for which the System is reimbursed by the Federal government.

Operating Expenses

Total operating expenses decreased by $80.6 million for 2009 to a total of $772 million. The decrease is due to a decrease in deferred expenses of $23 million and a decrease in power purchases of $117 million offset by an increase of $60 million in operations and maintenance expense. The decrease in deferred expenses is represented by $18 million of recognized expense in 2009 and a $41 million recognition of expense in 2008.

Operations and Maintenance Expense

Total operations and maintenance expenses were $470 million for fiscal 2009, compared to $409 million for fiscal 2008 and $344 million for fiscal 2007. The increase of $60 million in fiscal 2009 is mainly attributable to the following: an increase of $35.7 million for consulting fees, an increase of $8.5 million for post employment benefits due to increased staffing levels for fiscal 2009, an increase of $5.2 million for repairs, a $3.3 million increase for legal fees, and a $4.5 million increase in coal and natural gas purchases. Salaries increased in fiscal 2009 by $9.7 million due to increased staffing levels and structured pay increases with a corresponding overhead decrease of $5.7 million due to the implementation of furloughs effective in fiscal year 2009. The increase of $35.7 million for consulting fees is primarily due to $21.1 million in expenses for environmental and engineering services for the Delta Habitat Conservation and Conveyance Program (DHCCP) and $5.6 million for expenses related to the Lodi Energy Center project.

Power Purchases

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. With continuing low reservoir storage, the need to purchase power to pump water is considerably reduced.

Power purchases decreased $117 million in fiscal 2009 to a total of $207 million. Of that decrease, $76 million is attributable to a 1.4 million decrease in units purchased in fiscal 2009 of 3,103,403 compared to 4,480,357 units purchased in fiscal 2008, a decline of 30.7%. The average rate per MWh purchased decreased from $63.21 in fiscal 2008 to $54.87 in fiscal 2009 resulting in a decrease of $37 million in power purchases expense, while changes in transmission decreased by $3.7 million.

Power purchases are generally for off-peaking pumping and are a reflection of water demand. A six-month snapshot from January through June 2009 shows energy purchases of 989 GWh, while the same period in 2008 shows 1,783 GWh. The 2009 six-month snapshot showed a decrease in energy purchases by 794 GWh compared to 2008. The cost of energy during the period of January through June 2009 was $30 million, significantly below the cost in 2008 of $115 million.

In fiscal 2008, purchased power decreased $51 million over fiscal 2007 to a total of $323 million. Of that amount, $70 million is attributed to decreased power costs and $24 million is attributed to an increased in the average rate per MWh purchased, while changes in transmission decreased by $5.2 million.

The tables below and on the following page show the relationship between volume and rate for fiscal 2009 compared to fiscal 2008, and fiscal 2008 compared to fiscal 2007.

	Total Purchased	Transmission Purchased	Power Purchased	MWh Purchased	Rate/MWh
2008	$ 323,236,179	$ (40,048,849)	$ 283,187,330	4,480,357	$ 63.21
2009	206,632,303	(36,355,972)	170,276,331	3,103,403	54.87

Change in MWh purchased	(1,376,954)
Multiplied by 2009 rate	$ 54.87
Difference attributed to decreased purchases	$ (75,553,000)
Change in MWh rate	$ (8.34)
Multiplied by 2008 purchased	4,480,357
Difference attributed to rate change	$ (37,366,000)
Total decrease in power purchases	$ (112,919,000)

	Total Purchased	Transmission Purchased	Power Purchased	MWh Purchased	Rate/MWh
2007	$ 374,568,387	$ (45,244,343)	$ 329,324,044	5,582,482	$ 58.99
2008	323,236,179	(40,048,849)	283,187,330	4,480,357	63.21

Change in MWh purchased	(1,102,125)
Multiplied by 2008 rate	$ 63.21
Difference attributed to decreased purchases	$ (69,665,000)
Change in MWh rate	$ 4.22
Multiplied by 2007 purchased	5,582,482
Difference attributed to rate change	$ 23,558,000
Total decrease in power purchases	$ (46,107,000)

Operating Expenses Recovered (Deferred)
In fiscal 2009, $18.3 million in operating expenses were recognized, compared to fiscal 2008 in which the System recognized $41 million in operating expenses. The 2009 net change of $22.7 million is the result of an increase of $1.3 million in the power sales credit, an increase in deferred depreciation of $15.8 million, a decrease of $34.4 million in deferred operation and maintenance expense, and a decrease of $3.1 million in unamortized projects.

Capital Revenues Recovered (Deferred)
Capital revenues recovered (deferred) represents the timing difference between net capital revenue recovered, and certain operating costs incurred. Capital revenues recovered (deferred) increased by $61 million in 2009 to a total of $40.6 million recovered compared to $20.6 million in capital revenues deferred from the Water Contractors in fiscal 2008.

Interest Expense
Interest expense for fiscal 2009 was $130 million, which represents a decrease of $27 million from the prior year. The decrease of $27 million is due in part to a $11.4 million decrease in bond amortization of premium and discount due in part to a one time adjustment for the change to the effective interest rate method in fiscal 2008; $1.4 million write off for bonds refunded by bond Series AF; $8.7 million decrease in interest on the bonds and commercial paper notes due to the refunding of the Bond Anticipation Bonds (BAB) in fiscal 2008 and a reduction in outstanding commercial paper during the year; and a $3.4 million decrease in bond amortization of deferred amount on refundings due to a gain on the issuance of bond Series AF and related write offs.

Interest expense for fiscal 2008 was $157 million, which represents an increase of $5 million from the prior year. The increase of $5 million is due in part to a one time adjustment of $7.6 million needed as a result of a change in methodology to amortize the deferred amount on refundings and premium/discounts on bonds from the straight-line method to the effective interest rate method. The effective interest rate method better portrays the underlying economics of the Systems bond transactions. This adjustment is offset by a decrease of $3.3 million in interest for commercial paper.

Other Revenues (Expenses)

Other expenses were $53.5 million in fiscal 2009, versus $40.5 million in revenues in fiscal 2008 and $32 million in expenses in 2007. The $94 million decrease in 2009 is primarily the result of decreased refunds to the Water Contractor's by $6 million, a $12 million decrease in income from surplus money investments, a $55 million change in the fair value of the gas hedging account, and $30 million in expenses related to the release of debt service reserves due to the implementation of the Springing Amendment dated January 18, 2008.

Change in Net Assets

Overall, the System recorded no change in net assets. This is reflective of the System's operations where revenue is billed at a rate to be sufficient to recover all the costs of operating the System.

The table below explains the primary sources of the change in net assets.

	2009	2008	2007
Increases:			
Investment income/(loss) net of refunds to water contractors	$ (53,470,636)	$ 40,534,221	$ 12,193,924
Capital revenue in excess of capital costs	39,464,620	3,049,560	6,761,112
Total increases	(14,006,016)	43,583,781	18,955,036
Decreases:			
Rate management credit	(11,141,434)	(14,139,254)	(12,363,621)
Deferred capital recovery	40,554,511	(20,595,021)	4,376,971
Recreation costs	(14,000,828)	(8,069,998)	(10,564,898)
Suspended costs	(1,406,233)	(779,508)	(403,488)
Total decreases	14,006,016	(43,583,781)	(18,955,036)
Change in net assets	$ -	$ -	$ -

Economic Factors and Other Information

The DWR is negotiating with the Northern California Power Agency (NCPA) and other potential project participants regarding the DWR's possible participation in the Lodi Energy Center Project (LEC Project), which consists of a 255 megawatt gas-fired powerplant to be constructed by NCPA in Lodi, California. The DWR's participation in the LEC Project would be to assist the DWR in meeting future State Water Project energy requirements, including the replacement of energy currently provided by the Reid Gardner Project. The current terms being negotiated provide that the DWR would enter into a power purchase agreement with NCPA for 23.5% of the output of the LEC Project. If the LEC Project is approved by the California Energy Commission, the DWR expects construction of the LEC Project to begin in March 2010 with scheduled operation beginning in June 2012.

State Water Resources Development System
Statements of Net Assets
June 30, 2009 and 2008 (in thousands)

	2009	2008
Assets		
Utility plant:		
Utility plant in service	$ 4,646,914	$ 4,641,870
Less accumulated depreciation	(2,008,520)	(1,932,412)
Net utility plant in service	2,638,394	2,709,458
Construction work in progress	461,208	365,297
Total utility plant	3,099,602	3,074,755
Long-term assets:		
Restricted assets:		
Cash and cash equivalents restricted for plant replacements	38,242	15,066
Cash and investments restricted for debt service	111,652	110,426
Cash and cash equivalents on deposit with revenue bond trustee	9,207	9,463
Cash and cash equivalents on deposit with Wachovia Securities	3,533	6,301
Loans receivable from local water agencies	22,360	24,105
Advance to other state funds	91,517	91,517
Total long-term assets	276,511	256,878
Current assets:		
Cash and cash equivalents	369,820	485,283
Receivables:		
Interest on investments	2,680	5,016
Water supply and power billings	75,447	109,775
Due from federal government	39,110	26,968
Due from other state funds	123	-
Inventories	13,988	19,035
Total current assets	501,168	646,077
Deferred charges:		
Amounts recoverable through future billings under long-term water supply contracts:		
Operations and maintenance expense	191,448	139,609
Capital costs	122,742	184,098
Capital credit due from water contractors	11,452	-
Unamortized project costs	358,538	365,277
Unbilled interest incurred on capital costs	497,580	505,284
Total deferred charges	1,181,760	1,194,268
Total assets	$ 5,059,041	$ 5,171,978

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

State Water Resources Development System
Statements of Net Assets (continued)
June 30, 2009 and 2008 (in thousands)

	2009	2008
Capitalization and Liabilities		
Capitalization:		
Net assets:		
Capital, net of related debt	$ 272,984	$ 127,858
Restricted	932,447	1,077,573
Total net assets	1,205,431	1,205,431
Long-term liabilities		
General obligation bonds	476,915	531,700
Revenue bonds	2,481,799	2,558,734
Commercial paper	9,897	19,352
Other postemployment benefits	47,897	19,708
Pooled Money Investment Account Loan (PMIA) - long-term portion	24,603	27,032
Total long-term liabilities	3,041,111	3,156,526
Total capitalization	4,246,542	4,361,957
Current liabilities:		
Current maturities of bonds	152,144	130,730
Accounts payable	86,096	91,143
Accrued vacation	26,140	22,195
Accrued interest on long-term debt	19,251	28,581
Pooled Money Investment Account Loan (PMIA) - current portion	2,685	2,568
Due to other state funds	12,222	14,060
Proceeds due to water contractors	120,382	118,972
Total current liabilities	418,920	408,249
Deferred credits:		
Deferred revenue - State and Federal capital recovery	157,973	161,948
Capital credit due to water contractors	-	29,102
Power sales credit due to water contractors	193,573	199,279
Advances for plant replacements	42,033	11,443
Total deferred credits	393,579	401,772
Total net assets and liabilities	$ 5,059,041	$ 5,171,978

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

State Water Resources Development System
Statements of Revenues, Expenses, and Changes in Net Assets
For the years ended June 30, 2009 and 2008 (in thousands)

	2009	2008
Operating revenues:		
Water supply	$ 721,253	$ 752,853
Power sales	175,318	215,430
Federal reimbursements	18,266	20,992
Total operating revenues	914,837	989,275
Operating expenses:		
Operations and maintenance	469,667	409,150
Purchased power	206,632	323,236
Depreciation expense	77,269	79,136
Operating expenses recovered, principally under long-term water supply contracts, net	18,299	40,976
Total operating expenses	771,867	852,498
Income from operations	142,970	136,777
Nonoperating revenue/expenses:		
Capital revenues recovered (deferred)	40,555	(20,595)
Interest expense	(130,054)	(156,716)
Other revenues (expenses), net	(53,471)	40,534
Change in net assets	-	-
Net assets, beginning of year	1,205,431	1,205,431
Net assets, end of year	$ 1,205,431	$ 1,205,431

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, 2009 and 2008 (in thousands)

	2009	2008
Cash flows from operating activities:		
Receipts from customers	$ 964,880	$ 1,018,049
Payments to employees for services	(220,493)	(216,752)
Payments to suppliers	(425,510)	(502,787)
Other payments	(71,178)	5,522
Net cash provided by operating activities	247,699	304,032
Cash flows from capital and related financing activities:		
Proceeds from issuance of revenue obligation bonds including premium	36,064	668,604
Principal payments on long-term debt	(133,042)	(651,675)
Commercial paper notes issued	23,905	19,900
Principal payments on commercial paper notes	(33,360)	(133,910)
PMIA loan proceeds	-	29,600
Interest payments on long-term debt	(155,025)	(146,008)
Additions to utility plant and CWIP	(102,116)	(115,158)
Net cash used by capital and related financing activities	(363,574)	(328,647)
Cash flows from investing activities:		
Cash received from investment earnings	18,705	34,318
Proceeds of investments matured	201,739	179,961
Puchases of investments	(201,740)	(151,303)
Loan payments from local water agencies	1,744	1,823
Net cash provided by (used by) investing activities	20,448	64,799
Net increase (decrease) in cash and cash equivalents	(95,427)	40,184
Cash and cash equivalents, beginning of year	552,404	512,220
Cash and cash equivalents, end of year	$ 456,977	$ 552,404
Noncash capital and related financing activities:		
Principal retirements of long-term debt on proceeds received from issuance of Series AF Water System Revenue Bonds	$ 266,680	$ -

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

State Water Resources Development System
Statements of Cash Flows (continued)
For the years ended June 30, 2009 and 2008 (in thousands)

Reconciliation to the statement of net assets:	2009	2008
Cash and cash equivalents	$ 369,820	$ 485,283
Restricted assets:		
Cash and cash equivalents restricted for plant replacements	38,242	15,066
Cash and cash equivalents restricted for debt service (net of $75,477 and $74,135 of U.S. Agency and U.S. Treasury securities for 2009 and 2008, respectively)	36,175	36,291
Cash and cash equivalents on deposit with revenue bond trustee	9,207	9,463
Cash and cash equivalents on deposit with Wachovia Securities	3,533	6,301
Cash and cash equivalents	$ 456,977	$ 552,404

Reconciliation of income from operations to net cash provided by operating activities:	2009	2008
Income from operations	$ 142,970	$ 136,777
Adjustment to reconcile income from operations to net cash provided by operating activities		
Depreciation expense	77,269	79,136
Other expenses	(71,178)	5,522
Decrease in deferred charges and credits, net	44,870	20,591
Changes in assets and liabilities:		
Decrease in receivables	34,205	41,234
(Increase) decrease in inventories	5,047	(6,428)
Increase in due from federal government	(12,142)	(11,587)
Increase in accounts payable, accrued vacation and other postemployment benefits	27,086	5,217
Increase (decrease) in due to other state funds	(1,838)	14,060
Increase in current proceeds due to Water Contractors	1,410	19,510
Total adjustments	104,729	167,255
Net cash provided by operating activities	$ 247,699	$ 304,032

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

For the years ended June 30, 2009 and 2008 (in thousands)

1. Reporting Entity

The State Water Resources Development System (System), a component unit of the State of California (State), includes the State Water Project (SWP), the Davis-Grunsky Act Program and the San Joaquin Drainage Implementation Program, was constructed as the result of initial legislation in 1951 and subsequent legislation in the 1960s providing various financing mechanisms. The SWP is a complex of dams, water storage facilities, aqueducts, pumping stations and electric generation facilities which have been constructed for 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 (DWR).

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.

Depreciation

Depreciation is provided on a straight-line basis over the estimated useful lives of the various classes of utility plant, as follows:

Aqueducts	100 years
Dams and reservoirs	85 years
Power plants	30 - 50 years
Pumping plants	40 years

Cash and Cash Equivalents

Cash and cash equivalents, for purposes of the statement of cash flows, includes cash on hand, restricted cash for plant replacements, restricted cash for debt service, restricted cash on deposit with revenue bond trustee, and restricted cash on deposit with Wachovia Securities, formerly AG Edwards. Such amounts 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 with original maturities of more than three months.

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.

The System maintains deposits with Wachovia Securities, formerly AG Edwards, for natural gas hedging activities. The amount of deposits totaled $20.7 million and $20.5 million, as of June 30, 2009 and 2008, respectively. A portion of these deposits is restricted to cover margin requirements. The amounts restricted were $3.5 million and $6.3 million for June 30, 2009 and 2008, respectively. The amount of deposits, excluding the cash restricted for margin requirements totaled $17.2 million and $14.2 million as of June 30, 2009 and 2008, respectively.

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

Cash not required for current use, including restricted cash, is invested in SMIF, which is stated at fair value. SMIF is part of the State of California Pooled Money Investment Account (PMIA), which as of June 30, 2009 and 2008 had a balance of $50.7 billion and $69.9 billion, respectively. The weighted average to maturity of PMIA investments was 235 days and 212 days as of June 30, 2009 and 2008, respectively. The total amount of deposits in SMIF as of June 30, 2009 and 2008 was $35.7 billion and $33.9 billion, respectively. The Pooled Money Investment Board (PMIB) has oversight responsibility for SMIF. The Board consists of three members as designated by state statute. The value of the pool shares in SMIF which may be withdrawn is determined on an amortized cost basis, which is different than the fair value of the System's portion of the pool. PMIA funds are on deposit with the State's Centralized Treasury System and are not SEC registered, but 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. Included in PMIA's investment portfolio are structured notes and asset-backed securities totaling $5.1 billion and $2.3 billion as of June 30, 2009 and $6.1 billion and $4.2 billion as of June 30, 2008.

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, 2009, are of a similar nature as those held at June 30, 2008.

Advance to Other State Funds
Advance to Other State Funds represents the System's advance of $92 million to DWR's internal service fund.

Accounts Receivable
Accounts receivable include amounts due from the Water Contractors and organizations that purchase power from the System, totaling $75,447 and $109,775, net of the allowance for uncollectible amounts, at June 30, 2009 and 2008, respectively. Additionally, the Federal government owed the System $39,110 and $26,968 at June 30, 2009 and 2008, respectively, for reimbursement for certain costs related to flood control and jointly owned facilities. The allowance for uncollectible amounts totaled $369 and $403 at June 30, 2009 and 2008, respectively. Uncollectible amounts are generally recoverable from the Water Contractors.

Deferred Charges and Credits
The System has the authority to establish the level of rates to recover all System costs, including debt service. As a regulated entity, the System's financial statements are prepared in accordance with SFAS No. 71, "*Accounting for the Effects of Certain Types of Regulation*", which requires that the effects of the rate-making process be recorded in the financial statements. Accordingly, certain expenses and credits, normally reflected in the change in net assets, as incurred, are recognized when included in rates and recovered from, or refunded to customers and the state and federal governments. The System records various regulatory assets and credits to reflect rate-making actions of management. The System records costs that are recoverable through future billings as deferred charges and revenues that are in excess of total project costs from inception of the SWP as deferred credits. These costs include capital costs and operations and maintenance costs.

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

Unbilled interest incurred on unrecovered capital costs are classified as deferred charges until billed under the terms of the water supply contracts. Unbilled interest incurred represents 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 4.608% for the years ended June 30, 2009 and 2008.

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 revenues, expenses, and changes in net assets.

The deferred capital credit due from water contractors arises from differences between the Rate Management reductions granted to the Water Contractors from estimated available net revenues and actual net revenues. For fiscal 2009, this was a credit due from the water contractors in contrast to fiscal 2008 which showed a credit due to the water contractors.

The deferred power sales credit arises from revenue collected for the power generated by the Hyatt-Thermalito power plant. The deferred power sales credit is amortized over time by a credit issued to the Water Contractors through the Delta Water Capital Charge.

Advances for plant replacements represent billings under the terms of water supply contracts for future replacement of certain System assets. Assets from such billings are restricted. Costs of plant replacements are charged as incurred.

Bond Issuance Discounts and Premiums

Bond issuance discounts and premiums are reflected as a reduction/increase to the carrying value of the bonds outstanding and are amortized over the lives of the related debt instruments.

Deferred Amount on Refunding

Losses associated with the advance refunding of debt are deferred and amortized over the shorter of the weighted average lives of the new debt or the refunded debt.

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.

Revenues

The cost of providing services from the System is required to be recovered through user charges and other reimbursements. Under the terms of the long-term water supply contracts, the System granted the Water Contractors rate management reductions of approximately $11,141 and $14,139 during the years ended June 30, 2009 and 2008, 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 and current 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 $49,999 and $45,529 for the years ended June 30, 2009 and 2008, respectively, are recorded as liabilities in the financial statements. The System refunded $44,116 and $45,320 for the years ended June 30, 2009 and 2008, respectively, to the Water Contractors for the 25% bond coverage requirement.

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, which are 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. Transportation and conservation revenues from the Water Contractors are recorded in this segment as well as power sales and reimbursements from Federal and State governments, and interest on investments. Expenses are limited to operations and maintenance of the SWP constructed with general obligation bond proceeds, power purchases, replacements and debt service 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 System revenue bonds. Capital and operating revenues from the Water Contractors 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 the San Luis Dam and Reservoir, Suisun Marsh and recreation costs, and interest on investments. Expenses are limited to the construction and operation of SWP facilities constructed with revenue bond proceeds and power facilities, and debt service payments on the revenue bonds.

Reclassifications

Certain amounts presented in the prior year have been reclassified in order to be consistent with the current year's presentation.

New Accounting Pronouncements

GASB 45

Effective July 1, 2007, the System was required to implement Governmental Accounting Standards Board Statement (GASB) No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions,* known as OPEB. The System offers postretirement medical and dental benefits previously accounted for on a pay-as-you-go basis. GASB 45 establishes standards for the measurement, recognition, and reporting of OPEB expenses and related liabilities (assets), note disclosures, and, if applicable, required supplementary information in the financial reports of state and local governmental employers. Under GASB 45, the System is required to record an annual OPEB cost based on the annual required contribution of the employer (ARC), in 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 costs each year and amortize unfunded actuarial liabilities over a period not to exceed thirty years. DWR has elected to implement the requirements of GASB Statement No. 45 on a prospective basis. The System has recorded its net OPEB obligation and included the related financial statement disclosures in Note 9.

GASB 49

Effective July 1, 2008, the System implemented GASB 49, *Accounting and Financial Reporting for Pollution Remediation Obligations.* This Statement addresses accounting and financial reporting standards for pollution (including contamination) remediation obligations, which are obligations to address the current or potential detrimental effects of existing pollution by participating in pollution remediation activities such as site assessments and cleanups. The scope of GASB 49 excludes pollution prevention or control obligations with respect to current operations, and future pollution remediation activities that are required upon retirement of an asset, such as landfill closure and post-closure care and nuclear power plant decommissioning. If any one of five specified obligating events occurs, the System is required to estimate the components of expected pollution remediation outlays and determine whether outlays for those components should be accrued as a liability or, if appropriate, capitalized when goods and services are acquired. The implementation of GASB 49, during the current fiscal year did not have a material effect on the System's financial statements.

GASB 50

Effective July 1, 2007, the System implemented GASB 50, *Pension Disclosures, an amendment of GASB Statements No. 25 and No. 27.* This Statement more closely aligns the financial reporting requirements for pensions with those for other postemployment benefits (OPEB) and, in doing so, enhances information disclosed in the notes to financial statements or presented as required supplementary information (RSI) by pension plans and by employers that provide pension benefits. The reporting changes required by this Statement amend applicable note disclosure and RSI requirements of Statements No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, and No. 27, *Accounting for Pensions by State and Local Governmental Employers*, to conform with requirements of Statements No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, and No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*.

GASB 50 requires the System to disclose the current funded status of the pension plan as of the most recent actuarial valuation date in the notes to the financial statements. In addition, the System is required to disclose the funded status and present a multi-year schedule of funding progress using the entry age actuarial cost method. The System has included the related financial statement disclosures required by GASB Statement No. 50 in Note 8.

GASB 51

Effective not later than the year ending June 30, 2010, the System will be required to implement GASB 51, *Accounting and Financial Reporting for Intangible Assets.* The objective of this Statement is to establish accounting and financial reporting requirements for intangible assets to enhance the comparability of the accounting and financial reporting of such assets among state and local governments. The requirements of this Statement improve financial reporting by reducing inconsistencies that have developed in accounting and financial reporting for intangible assets. These inconsistencies will be reduced through the clarification that intangible assets subject to the provisions of this Statement should be classified as capital assets, and through the establishment of new authoritative guidance that addresses issues specific to these intangible assets given their nature (for example, recognition provisions for internally generated intangible assets, including computer software). This Statement also fosters greater comparability among state and local government financial statements and results in a more faithful representation of the service capacity of intangible assets - and therefore the financial position of governments - and of the periodic cost associated with the usage of such service capacity in governmental financial statements.

For the years ended June 30, 2009 and 2008 (in thousands)

GASB 53
Effective not later than the year ended June 30, 2010, the System will be required to implement GASB 53, *Accounting and Financial Reporting for Derivative Instruments*. GASB 53 requires governments to record most derivative instruments on the statement of net assets as either assets or liabilities depending on the underlying fair value of the derivative. The fair value of a derivative instrument is either the value of its future cash flows in current dollars or the price it would bring if it could be sold on an open market.

3. Interests in Jointly Owned Facilities

At June 30, 2009 and 2008, the System owned the following undivided interests in jointly owned facilities:

	% Owned by System		System's Share			
			Utility Plant in Service		Accumulated Depreciation	
	2009	2008	2009	2008	2009	2008
Reid Gardner Power Plant Unit No. 4	67.8%	67.8%	$ 332,209	$ 332,209	$ 288,751	$ 276,413
San Luis joint use facilities	55.0%	55.0%	255,932	255,932	114,348	111,042

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.

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

DWR does not operate the 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 revenues, expenses, and changes in net assets.

For the years ended June 30, 2009 and 2008 (in thousands)

4. Utility Plant

The following activity in utility plant occurred during the years ending June 30, 2009 and 2008:

	Utility Plant in Service			CWIP	Total
	Cost	Accumulated Depreciation	Net Value	Cost	
Beginning Balance, June 30, 2007	$ 4,639,051	$ (1,854,541)	**$ 2,784,510**	$ 253,152	**$ 3,037,662**
Additions	4,076	(79,136)	**(75,060)**	112,145	**37,085**
Disposals	(1,257)	1,265	**8**	-	**8**
Ending Balance, June 30, 2008	4,641,870	(1,932,412)	**2,709,458**	365,297	**3,074,755**
Additions	6,205	(77,269)	**(71,064)**	95,911	**24,847**
Disposals	(1,161)	1,161	**-**	-	**-**
Ending Balance, June 30, 2009	$ 4,646,914	$ (2,008,520)	**$ 2,638,394**	$ 461,208	**$ 3,099,602**

5. Investments

As of June 30, 2009 and 2008, the System's cash deposits consisted of restricted cash and cash equivalents maintained with a fiscal agent in the amount of $3,533 and $6,301, respectively.

As of June 30, 2009, the System's investments and credit ratings are as follows:

	Credit Rating (S&P)	Maturities: Under 30 Days	31-180 Days	181-365 Days	1-5 Years	Over 5 Years	Fair Value
Investments:							
Money Market Mutual Funds	Not Rated	$ 7,509	$ -	$ -	$ -	$ -	$ 7,509
State of California Pooled Money	Not Rated	-	-	436,728	-	-	436,728
US Federal Agency Notes							
Federal National Mortgage Association	AAA	-	-	-	-	23,697	23,697
Federal Home Loan Mortgage Corp	AAA	-	51,780	-	-	-	51,780
							519,714
Investment with Fiscal Agent							
Money Market Mutual Funds	AAA	9,207	-	-	-	-	9,207
Total Investments							$ 528,921

For the years ended June 30, 2009 and 2008 (in thousands)

As of June 30, 2008 the System's investments and credit ratings are as follows:

	Credit Rating (S&P)	Maturities: Under 30 Days	31-180 Days	181-365 Days	1-5 Years	Over 5 Years	Fair Value
Investments:							
Money Market Mutual Funds	Not Rated	$ 37,578	$ -	$ -	$ -	$ -	$ 37,578
State of California Pooled Money	Not Rated	-	-	499,062	-	-	499,062
US Federal Agency Notes							
Federal National Mortgage Association	AAA	-	50,941	-	-	22,993	73,934
Federal Home Loan Mortgage Corp.	AAA	-	201	-	-	-	201
							610,775
Investment with Fiscal Agent							
Money Market Mutual Funds	A-1+	9,463	-	-	-	-	9,463
Total Investments							$ 620,238

Interest Rate Risk: In accordance with its investment policy, the State of California manages its exposure to declines in fair value by spreading investments over the various maximum maturities: U.S. Treasury securities, 5 years; federal agency securities, 5 years; bankers acceptances – domestic and foreign, 180 days; certificates of deposits, 5 years; collateralized time deposits, 5 years; commercial paper, 180 days; corporate bonds and notes, 5 years; repurchase agreements and reverse repurchase agreements, 1 year.

Custodial Credit Risk: For deposits, custodial credit risk is that in the event of the failure of a depository financial institution, a government will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of its investment or collateral securities that are in the possession of another party. The California Government Code does not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits or investments, other than the following provision for deposits: The California Government Code requires that a financial institution secure deposits made by state or local governmental units by pledging securities in an undivided collateral pool held by depository regulated under stated law. The market value of the pledged securities in the collateral pool must equal at least 110% of the total amount deposited by the public agencies.

Credit Risk: 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 discussed in Note 2. The PMIA is not rated.

Concentration of Credit Risk: The PMIA's concentration of credit risk is limited by spreading the investment mix over different investment types, credit ratings and issuers to minimize the impact any one industry, investment class, or institution can have on the PMIA portfolio. As of June 30, 2009 and 2008, nearly 14% and 12%, respectively of the System's investments at year-end were in U.S. Agency Securities. There is no limitation on amounts invested in these types of issues. Investments in any one issuer (other than U.S. Treasury Notes, mutual funds and external investment pools) that represented 5% or more of the total investments of the System as of June 30, 2009 and 2008, were as follows:

For the years ended June 30, 2009 and 2008 (in thousands)

	2009	2008
Federal National Mortgage Association	$ 23,697	$ 73,934
Federal Home Loan Mortgage Corporation	51,780	-

Interest on deposits in PMIA varies with the rate of return of the underlying portfolio and averaged 2.224% and 4.325% for the years ended June 30, 2009 and 2008, respectively. For the years ended June 30, 2009 and 2008, interest earned on the deposits with PMIA approximated $12,441 and $24,789, respectively and are included in the other expenses line item on the statement of revenues, expenses and change in net assets.

interest earned on the deposits with PMIA approximated $12,441 and $24,789, respectively and are included in other expenses line item on the statement of revenues, expenses and change in net assets

Total interest and investment income is comprised of interest, dividends, realized gains and losses, and unrealized gains and losses due to changes in the fair value of investments held at year-end. The change in fair value of the System's investments (U.S. Federal Agency Securities and U.S. Treasury Securities) is calculated as follows:

	2009	2008
Fair Value of Investments at the beginning of the fiscal year	$ 74,135	$ 99,958
Less: Proceeds of investments matured in fiscal year	(201,739)	(179,961)
Add: Purchase of investments in fiscal year	201,739	151,303
Add: Amortization of Discounts	63	66
Change in fair value of investments during fiscal year	1,279	2,769
Fair value of investments at the end of the fiscal year	$ 75,477	$ 74,135

For the years ended June 30, 2009 and 2008 (in thousands)

6. Long-term Debt

The following is a summary of changes in long-term debt for the years ended June 30, 2009 and 2008:

	General Obligation Bonds	Revenue Bonds				Commercial Paper	PMIA Loan	Total Long Term Debt
	Par Amount	Par Amount	Unamortized (Discounts) and Premium	Deferred Amount on Refunding	Total Revenue Bonds	Par Amount		
Balance at June 30, 2007	$ 634,750	$ 2,543,200	$ 46,025	$ (21,142)	$ 2,568,083	$ 133,362	$ -	$ 3,336,195
Additions	-	632,890	45,069	(4,759)	673,200	19,900	29,600	722,700
Payments/amortization	(50,355)	(601,320)	(5,420)	2,226	(604,514)	(133,910)	-	(788,779)
Balance at June 30, 2008	584,395	2,574,770	85,674	(23,675)	2,636,769	19,352	29,600	3,270,116
Additions	-	287,735	15,009	(10,960)	291,784	23,905	-	315,689
Payments/amortization	(52,695)	(344,715)	(7,507)	2,827	(349,395)	(33,360)	(2,312)	(437,762)
Balance at June 30, 2009	531,700	2,517,790	93,176	(31,808)	2,579,158	9,897	27,288	3,148,043
Less current portion	(54,785)	(97,359)	-	-	(97,359)	-	(2,685)	(154,829)
Total Long-term Debt	$ 476,915	$ 2,420,431	$ 93,176	$ (31,808)	$ 2,481,799	$ 9,897	$ 24,603	$ 2,993,214

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. To the extent Water Fund money was used for construction of the State water facilities in lieu of bond proceeds, an equal amount of bond authorization was set aside to be used only for the construction of additional facilities of the System that meet certain requirements set forth in the Burns-Porter Act.

Under the Burns-Porter Act, revenues of the System, other than revenues attributable to facilities financed with Central Valley Project Water System (CVP) Revenue Bonds, are deposited in the California Water Resources Development Bond Fund and are to be used annually only for the following purposes and in the following order of priority:

(1) To pay the maintenance, operation and replacement costs of the System,
(2) To pay, or reimburse the General Fund of the State for, the principal of and interest on the WRD General Obligation Bonds issued for the System as it becomes due,
(3) To reimburse the California Water Fund for funds utilized from said fund for construction of the System (complete reimbursement has been made), and
(4) To pay additional costs of the acquisition and construction of the System.
All such revenues are pledged for those uses and purposes for the benefit of the owners of the WRD General Obligation Bonds.

The amount of the revenues pledged to repay the Burns-Porter Act WRD General Obligation Bonds debt service is $651,054 with payments through 2025. Principal and interest paid for the current year were $77,501 and Water supply operating revenues were $721,253.

For the years ended June 30, 2009 and 2008 (in thousands)

WRD General Obligation Bonds of $168 million are authorized but un-issued as of June 30, 2009 and 2008, 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. 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 2009	Amounts Outstanding 2008
1964	A	0.1-3.6%	2014	$ 20,000	$ 24,000
1964	B&C	0.05-3.7%	2015	34,000	39,500
1965	D&E	3.0-3.8%	2016	54,100	61,400
1966	F&G	3.5-4.1%	2017	65,000	72,000
1967	H,J&K	3.0-4.9%	2018	104,500	114,600
1968	L&M	4.0-4.9%	2019	78,600	85,000
1970	N&P	5.0-5.8%	2020	85,000	91,200
1971	Q&R	4.8-5.2%	2021	68,400	72,900
1972	S	5.3-5.5%	2022	19,440	20,600
1991	W	6.0-10.0%	2012	1,350	1,800
1993	X	4.8%	2024	750	800
1994	Y	6.8-7.1%	2025	560	595
Total General Obligation bond debt outstanding at par				531,700	584,395
Less current maturities				(54,785)	(52,695)
Total Long term General Obligation bond debt outstanding				$ 476,915	$ 531,700

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. Under the statute pursuant to which CVP Revenue Bonds are issued, principal of and interest on the bonds are secured by and payable solely from revenues attributable to the facilities financed by the bonds, primarily certain payments under the water supply contracts between the System and Water Contractors. The amount of the revenues pledged to repay the (CVP) Revenue Bonds debt service is $3,866,414 with payments through 2033. Principal and interest paid for the current year were $201,477 and Water supply operating revenues were $721,253. 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. Certain of the bonds are redeemable prior to maturity at redemption prices varying from 100% to 101%.

For the years ended June 30, 2009 and 2008 (in thousands)

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 2009	Amounts Outstanding 2008
Devil Canyon-Castaic Facilities:						
1973	A&B	5.3-5.4%	2023	1983	$ 85,965	$ 89,825
CVP Water System:						
1992	J	5.5-7.0%	2013	2001	53,535	53,535
1996	O	4.8-5.0%	2030	2006	125,595	125,595
1997	Q	5.1-6.0%	2011	2007	17,415	81,860
1998	S	4.6-5.0%	2030	2008	42,765	42,765
1998	T	5.0-5.5%	2013	2009	-	89,410
1999	U	4.1-5.1%	2030	2009	-	139,545
1999	V	6.25%	2025	None	20,235	20,235
2001	W	4.6-5.5%	2030	2012	198,625	218,255
2002	X	4.0-5.5%	2030	2012	149,540	149,540
2003	Y	5.0-5.3%	2026	2013	283,705	298,345
2003	Z	2.8-5.0%	2020	2013	134,920	147,095
2003	AA	5.00%	2024	2013	107,215	107,215
2005	AC	3.0-5.0%	2030	2015	267,500	267,875
2006	AD	3.0-5.0%	2030	2016	110,370	110,785
2008	AE	3.0-5.0%	2030	2018	632,670	632,890
2009	AF	2.0-5.0%	2033	2019	287,735	-
Total revenue bond debt outstanding at par					2,517,790	2,574,770
Net Unamortized bond issuance premiums/discounts					93,176	85,674
Net Deferred amount on refunding					(31,808)	(23,675)
Current fiscal maturities					(97,359)	(78,035)
Total long term bond debt outstanding					$ 2,481,799	$ 2,558,734

For the years ended June 30, 2009 and 2008 (in thousands)

Future Debt Service Requirements

Future principal and interest payment requirements on bonds are as follows at June 30, 2009:

	General Obligation Bonds		Revenue Bonds		
Year	Principal	Interest	Principal	Interest	Total
2010	$ 54,785	$ 22,474	$ 97,359	$ 122,893	$ 297,511
2011	56,375	20,061	108,871	118,317	303,624
2012	58,165	17,563	115,835	112,850	304,413
2013	59,455	15,008	122,170	106,704	303,337
2014	61,085	12,503	113,860	100,812	288,260
2015-2019	213,745	29,707	592,275	417,332	1,253,059
2020-2024	28,055	2,037	643,795	260,975	934,862
2025-2029	35	1	593,210	105,028	698,274
2030-2033	-	-	130,415	3,713	134,128
	$ 531,700	$ 119,354	$ 2,517,790	$ 1,348,624	$ 4,517,468

Pooled Money Investment Loan (PMIA)

The System applied for and received a loan from the Pooled Money Investment Account pursuant to Government Code section 16313 for $29.6 million. The proceeds of the loan were used to establish escrow accounts that defeased certain Water System Revenue Bonds that financed recreation, fish, and wildlife enhancement related cost of the acquisition and construction of the System. The loan is to be repaid with surplus revenues of the System made available under Water Code section 12937(b)(4). The DWR executed the Pooled Money Investment Board Loan on March 26, 2008. The loan agreement requires minimum quarterly payments of $1 million on the first day of every March, June, September and December; the first payment was made on September 1, 2008. Interest is computed on the unpaid principal balance of the loan at the Variable Rate on the basis of a 360-day year or twelve 30-day months and the number of days elapsed. The Variable Rate means (a) for the period from the date of the Loan Agreement, March 26, 2008, through and including the day before the first Reset Date (March 25, 2009), five percent per annum, and (b) for each Renewal Period thereafter, the greater of (i) five percent per annum, or (ii) the last available daily rate of return by the PMIA on the day before the annual Reset Date on which such Renewal Period commences.

For the years ended June 30, 2009 and 2008 (in thousands)

The minimum future principal and interest payment requirements on the PMIA loan are as follows at June 30, 2009:

Year	Principal	Interest	Total
2010	$ 2,685	$ 1,315	$ 4,000
2011	2,822	1,178	4,000
2012	2,966	1,034	4,000
2013	3,117	883	4,000
2014	3,276	724	4,000
2015 - 2018	12,422	1,155	13,577
	$ 27,288	$ 6,289	$ 33,577

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 programs, the System entered into a revolving credit agreement with a commercial bank equal to the authorized amount of commercial paper. At June 30, 2009 and 2008, there were borrowings of $9,897 and $19,352, respectively, outstanding under this program. The weighted average for interest expense approximated 1.70% and 2.95% for the years ended June 30, 2009, and 2008, respectively. The proceeds from the issuance of commercial paper are restricted to construction costs of certain State water projects, reimbursements 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 water supply contracts in their original form provide for two charges to the Water Contractors: (a) a Delta Water Charge and (b) a Transportation Charge. These charges are computed so as to return to the State the costs of the facilities necessary to deliver water to the Water Contractors, including capital costs (with interest) and operation and maintenance costs, and expressly including in the case of the facilities to be financed with commercial paper and the related Water System Revenue Bonds, debt service and 1.25 debt service coverage requirements to be satisfied from revenues. DWR expects to redeem its commercial paper liability with proceeds of additional commercial paper draws until DWR issues Water System Revenue Bonds to provide permanent financing for those Water System Projects financed with commercial paper.

7. Debt Refundings

In March 2009, the System issued CVP Water System Revenue Bonds-Series AF in the amount of $287,735 plus the premium of $15,009, for a total of $302,744 with an average yield on the bonds of 4.18%. The bond proceeds and System funds on hand in the amount of $9,530 were used to defease $266,680 of outstanding bonds, redeem commercial paper borrowings of $33,360, fund capitalized interest of $1,265, fund deposits to the debt service reserve account of $2,414, and cover costs of issuance of $1,632. The proceeds of the Series AF were used to advance refund CVP Water System Revenue Bonds Series Q with a par amount of $56,445 and CVP Water System Revenue Bonds Series T with a par amount of $73,365 and CVP Water System Revenue Bonds Series U with a par amount of $136,870. The proceeds (after payment of underwriting refunding fees, other issuance costs, redeeming commercial paper borrowings and deposits to the debt service reserve account) were deposited in an irrevocable trust with an escrow agent to provide for future debt service payments on the advance refunded bonds Series Q, T, and U. As a result the advance refunded bonds are considered to be defeased and the related liabilities have been removed from the financial statements.

Revenue Bond debt service increased by $23,000 over the life of the bonds when compared to debt service prior to the issuance of Series AF.

The refunding of Series Q, Series T, and Series U bonds resulted in a total economic gain (Net Present Value) of approximately $5,699, $4,054, and $6,109 respectively. In addition, the refunding transactions resulted in cash flow savings of approximately $8,370 on Series Q bonds, $5,345 on Series T, and $9,440 on Series U bonds.

The total amount of bonds refunded in advance and still outstanding was $76,340 and $124,640 as of June 30, 2009 and 2008, respectively.

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 that 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.

For the years ended June 30, 2009 and 2008 (in thousands)

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, 2009, was 16.57% and 16.47% for State Miscellaneous Tier 1 and Tier 2, respectively. For the fiscal year ended June 30, 2008, the required employer contribution rate for Tiers 1 and 2 were 16.63% and 16.57%, respectively. The contribution requirements of the plan members are established by State statute and the employer contribution rate is established and may be amended by PERS.

Annual Pension Cost

For the years ended June 30, 2009 and 2008, the System's annual pension cost and actual contribution amounted to approximately $19.8 million and $18.4 million, respectively. Annual covered payroll is not available for the System. However the actuarially determined contributions for the years ended June 30, 2009 and 2008, approximated 1.3% and 1.2%, respectively, of the total actuarially determined contribution requirements for the State Miscellaneous Category and approximately 14.39% and 14.51%, respectively, of the total System payroll. The required contribution for the 2009 fiscal year was determined as part of the June 30, 2007, actuarial valuation using the entry age normal actuarial cost method with the contributions determined as a percentage of covered payroll.

Trend information for the last three years regarding the System's required contributions and the percentage contributed, is as follows:

Three-year Trend Information

Year Ended June 30,	Required Contribution	Percentage of Required Contribution Contributed
2007	$ 19,500	100%
2008	18,400	100%
2009	19,800	100%

9. Postemployment Benefits Other Than Pensions

The State provides health care and dental benefits to annuitants of the retirement systems to which the State contributes as an employer. To be eligible for these benefits, first-tier plan annuitants must retire on or after age 50 with at least five years of service, and second-tier plan annuitants must retire on or after attaining age 55 with at least 10 years of service. In addition, annuitants must retire within 120 days of separation from employment to be eligible to receive these benefits. In accordance with the California Government Code, the State generally pays 100% of the health insurance cost for annuitants, plus 90% of the additional premium required for the enrollment of family members of annuitants. Although the California Government Code does not specify the State's contribution toward dental insurance costs, the State generally pays all or a portion of the dental insurance cost for annuitants, depending upon the completed years of credited state service at retirement and the dental coverage selected by the annuitant. The System participates in the State's plan on a cost sharing basis. The System recognizes the costs of providing health and dental insurance to annuitants based on the required contribution, which is actuarially determined, and is funded on a pay-as-you-go basis.

For the years ended June 30, 2009 and 2008 (in thousands)

The System's required contributions and resulting net OPEB obligation is as follows:

	2009	2008
Annual required contribution (ARC)	$ 41,464	$ 29,952
Interest on net OPEB obligation	1,046	-
Adj to the ARC	(918)	-
Annual OPEB cost	41,592	29,952
Contributions made	(13,403)	(10,244)
Increase in net OPEB obligation	28,189	19,708
Net OPEB obligation - beginning of year	19,708	-
Net OPEB obligation - end of year	$ 47,897	$ 19,708

The System's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for the fiscal year ended June 30, 2009 and 2008, were as follows:

Fiscal Year Ended	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation
6/30/2008	$29,952	34%	$19,708
6/30/2009	$36,913	36%	$47,897

The OPEB liability of the System is not evaluated at the fund level. Additional detail disclosures required by GASB Statement No. 45, regarding the State's postemployment benefit plan are presented in the financial statements of the State of California for the year ended June 30, 2009.

10. 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, 2009 and June 30, 2008, approximated $35,779 and $44,876 respectively.

Power Transmission and Purchase

The System has long-term power transmission service contracts requiring future payments of approximately $143,892 over periods ranging from one to 31 years. Payments made under these contracts approximated $13,343 and $15,671 for the years ended June 30, 2009 and 2008, respectively.

The System has also entered into long-term power purchase contracts requiring future payments of approximately $433,568 over periods ranging from one to 25 years. Payments made under these contracts, excluding payments to the Kings River Conservation District (District) to cover debt service, approximated $56,919 and $73,525 for the years ended June 30, 2009 and 2008, respectively.

For the years ended June 30, 2009 and 2008 (in thousands)

The remaining amounts of fixed obligations under the long-term power purchase and transmission contracts as of June 30, 2009, are as follows:

For the year ended	Fixed Obligations
2010	$ 77,623
2011	76,175
2012	55,307
2013	55,307
2014	55,307
Thereafter	257,741
	$ 577,460

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 $11,246 and $11,751 during the years ended June 30, 2009 and 2008, respectively.

The amount of fixed obligations of the System related to future principal and interest payments of the District's bonds as of June 30, 2009 are as follows:

For the year ended	Fixed Obligations
2010	$ 4,874
2011	4,862
2012	5,089
2013	5,077
2014	5,063
Thereafter	30,097
	$ 55,062

Market value information for certain power purchase, sale and exchange contracts is required to be disclosed under the provisions of Governmental Accounting Standards Board Technical Bulletin 2003-1, *Disclosure Requirements for Derivatives Not Reported at Fair Value on the Statement of Net Asset*. The fair value of these contracts as June 30, 2009 is disclosed below, using forward market prices discounted at the prevailing risk-free interest rate. Except as discussed below, all energy sales, purchase and exchange contracts expire before December 31, 2009. Four purchase contracts, one exchange contract and three sales contracts expire in 2009, three purchase contracts expire in 2010 and two purchase contracts expire in 2013 and 2015 respectively. The long-term energy purchase contracts involve energy delivered from the Reid Gardner and Pine Flat Power Plants which expire in 2013 and 2035, respectively, and a contract with Metropolitan Water District of Southern California (Metropolitan), one of the Water Contractors, which has no explicit termination date, although either party can terminate the contract with a ten-year notice. As such, the Metropolitan contract was valued out to ten years. Amounts paid to Metropolitan approximated $7.1 million and $8.6 million for the years ended June 30, 2009 and 2008, respectively.

For the years ended June 30, 2009 and 2008 (in thousands)

	Number of Contracts	Total Capacity (MWh)	Fair Value at June 30, 2008
Energy sales	17	565	$ 3,458
Energy purchases	32	1275	(16,327)
Energy exchanges	1	150 sales; 126 purchases	1,942
Long-term energy purchases	3	465	214,468
Total			$ 203,541

The System also has entered into transactions to hedge the price of natural gas through bilateral arrangements and has 375 contracts outstanding at June 30, 2009 with a total fair value approximating ($6.9) million, using forward market prices. The System has also purchased Options to hedge the market risk of these contracts. As of June 30, 2009 the fair value of the Options approximated ($2.8) million. The contracts expire at various times from December 2010 through October 2011. The System recognized a loss of $4.7 million and $4.3 million for fiscal 2009 and 2008, respectively.

Contingencies

Litigation and Claims

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 System 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 Monterey Amendment by challenging the validity of the related environmental impact report (EIR). While the courts have allowed the System to proceed with the implementation of the Monterey Amendment, the System has been required to prepare a new EIR. The Final EIR is expected to be completed in early 2010. After the EIR process is completed, the plaintiffs involved could again challenge, on limited grounds, the EIR and certain provisions of the Monterey Amendment. Other groups and/or individuals could also challenge the final EIR. The System, however, does not expect that there would be any material adverse impact on the ability of the System to meet its payment obligations, even if a challenge occurs and is successful.

2005 Contractor Lawsuit Regarding Oroville Power Credits

On April 25, 2005 the Kern County Water Agency and thirteen other Water Contractors filed a lawsuit against the System in Sacramento County Superior Court for declaratory relief and breach of contract. The complaint alleges that pursuant to the water supply contracts, the System is required, but has failed, to credit all revenues from power generated by certain project conservation facilities (primarily the Hyatt-Thermalito Power Plants) to the conservation facilities charge in the Water Contractor billings, and, as a result, has overcharged the Water Contractor plaintiffs. The complaint seeks a declaration that all "benefits" derived from the sale or other disposal of power from project conservation facilities be credited "in conformity with the terms of the water supply contracts," along with damages and costs in an unspecified amount. The Metropolitan Water District of Southern California and entities representing 12 other southern Water Contractors received court permission on December 12, 2005 to intervene in the lawsuit as defendants. Plaintiffs thereafter filed an amended complaint joining two additional contractors. A non-jury trial was held in November and December 2008. In October 2009, the Court issued its decision in favor of the System and the Water Contractors which intervened in support of the System, finding that the System's determinations and administration of the provisions regarding Oroville power credits were consistent with the water supply contracts. The next steps available to the plaintiffs, if they so choose, would be to ask the Court to reconsider its decision and to thereafter appeal the Superior Court's decision to the Court of Appeal. If the Water Contractor plaintiffs are ultimately successful in their efforts to reverse the Superior Court's decision, the System believes certain Water Contractors would pay more to the System under the Water Supply Contracts, while others would pay less and that this cost shifting would not materially adversely impact the System's financial position or results from operations.

Other Claims by Water Contractors, Including Claims Concerning Charges for Recreation and Fish and Wildlife Enhancement

In accordance with the water supply contracts, in December 2005, 27 Water Contractors and entities representing Water Contractors filed "Notices of Contest" with the System challenging the accuracy of various charges in the System's billings. One Water Contractor also filed a claim based on its Notice of Contest with the Victim Compensation and Government Claims Board. The System has been reviewing these Notices of Contest and investigating the items raised.

One item that has been determined to have merit, contested the System's practice of charging the Water Contractors for certain financing costs of the recreation and fish and wildlife enhancement portion of facilities financed with Water System Revenue Bonds. To rectify the situation, the System restated past bills to Water Contractors to credit back approximately $9.5 million, which the System has determined to be the amount of such charges, plus interest. The System also took other actions to pay for the costs of the recreation and fish and wildlife enhancement portion of System facilities with sources other than direct charges to the Water Contractors for such costs. Such actions included obtaining a loan from the State Pooled Money Investment Account (PMIA) in the amount of $29.6 million, which was used together with certain other available funds to retire or provide for the defeasance of approximately $28.2 million principal amount of revenue bonds and commercial paper notes, the proceeds of which had been used to pay costs allocated by the System to the development of recreation or fish and wildlife enhancement. The System has agreed to pay a minimum of $4 million per year beginning in September 2008 to repay the PMIA loan.

With the receipt of the PMIA loan and the waivers in the 2007 and 2008 Tolling and Waiver Agreement obtained from the 27 Water Contractors who signed the Monterey Amendment, the System sold revenue bonds in May 2008. The sale of System revenue bonds had been suspended pending the resolution of the recreation and fish and wildlife enhancement issue.

In addition to waivers included in the 2007 and 2008 Tolling and Waiver Agreements, which helped to facilitate the resumption of the sale of System revenue bonds, the Tolling and Waiver Agreements, as amended, also tolled (i.e. suspended) until December 31, 2010 the running of the time period and statute of limitations for filing by the Water Contractors of (1) protests regarding the DWR's bills to the Water Contractors for the years 2007 through 2011, (2) claims arising from the DWR's revisions to prior year invoices that were made to adjust for improper charges to the Water Contractors for recreation and fish and wildlife enhancement costs, and (3) certain other specified claims. The Tolling and Waiver Agreement also tolled the running of the time period for bringing an action on the Victim Compensation and Government Claims Board claim regarding the 2006 invoice that was filed by one of the Water Contractors. In the meantime, the System and Water Contractors are continuing their efforts to resolve issues that are covered by the Tolling and Waiver Agreement. However, no assurance can be given that the Water Contractors will not file additional Notices of Contest, claims and/or lawsuits with respect to the issues under discussion once the Tolling and Waiver Agreement expires.

Lawsuits Regarding 2004 Delta Levee Failure

Four lawsuits have been filed to recover damages caused when a Delta levee failed and flooded the Upper Jones Tract and Lower Jones Tract in June 2004. Three of the lawsuits name as defendants a local Delta reclamation district, the State Reclamation Board and the DWR. A cause of action in each of these three lawsuits alleges that the System's operations and activities in the Delta were a cause of the damage. All four lawsuits have been consolidated, although the fourth lawsuit does not involve the DWR or any other state agency. The consolidated cases are now in the pre-trial stage. The DWR does not believe that an adverse court decision in any of these consolidated cases would have a material adverse impact on the System's finances or operations because such costs would be recoverable under the long-term water supply contracts.

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 System'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 the Federal Energy Regulatory Commission (FERC) that may impact the cost of System operations. 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 System is participating in these proceedings, since the outcome of these proceedings has the potential to increase the System's annual power costs. However, the System does not believe that any increased charges arising from these proceedings will materially impact the SWP'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.

Claims for Partial Energy Purchase Refunds

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 System. However, in September 2005, the United States Ninth Circuit Court of Appeals ruled that FERC lacked jurisdiction under the Federal Power Act to order governmental entities, such as the System, to provide refunds in these types of proceedings. As a result of this Ninth Circuit Court of Appeals' ruling, a group of California entities filed similar claims for partial energy purchase refunds with the California Victim Compensation and Government Claims Board (Claims Board) against the governmental entity sellers, including the System. The claims were denied by the Claims Board in April, 2006, which allows the claimants to file lawsuits against the governmental entity sellers, including the System. However, DWR and a group of California entities have agreed to suspend the running of the statute of limitations for the filing of a lawsuit through March 1, 2010. The System believes that amounts, if any, that the System might be required to refund as a result of these claims would not have a material impact on the System's financial position or results from operations because the impact of any refunds would be passed through to the Water Contractors under the water supply contracts in the form of higher operating charges.

11. 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, 2009 and 2008 (in thousands)

12. Economic Dependency

The System's water supply revenue is derived from 29 Water Contractors, including the Metropolitan Water District of Southern California whose System billings constituted 58% and 62% of total System water supply revenue for the years ended June 30, 2009 and 2008, respectively, and Kern County Water Agency whose System billings constituted 10% and 7% of total System water supply revenue for the years ended June 30, 2009 and 2008, respectively.

The System sold power to 40 power companies during the fiscal year ended June 30, 2009. The highest percentage of power revenues came from the California Independent System Operator. The following table shows power sales to companies which exceeded 5% of the total power sold by the System.

	2009	% Total	2008	% Total
California Independent System Operator	$ 25,632	13.61%	$ 28,530	13.16%
Southern California Edison	21,186	11.25%	25,753	11.88%
Coral Power LLC	-	-	16,630	7.67%
Pacific Gas & Electric Company	13,318	7.07%	15,817	7.30%
San Diego Gas and Electric Company	11,524	6.12%	15,762	7.27%
Cargill Inc.	16,851	8.95%	15,058	6.95%
Citigroup Energy Inc.	10,085	5.36%	11,907	5.49%
Nevada Power Company	14,484	7.69%	11,662	5.38%
UBS Energy	9,639	5.12%	11,645	5.37%
Iberdrola Renewables Inc	9,723	5.16%	-	-
Sempra Energy Trading Corp	15,011	7.97%	-	-

Similarly, the System purchased power from 40 power suppliers during the fiscal year ended June 30, 2009 with Morgan Stanley Group, Inc. providing the highest percentage to the System at 26.37% of the total. The following table shows power purchases from suppliers which exceeded 5% of the total power purchased by the System.

	2009	% Total	2008	% Total
Morgan Stanley Capital Group Inc.	$ 61,160	26.37%	$ 85,928	25.01%
California Independent System Operator	38,834	16.75%	50,275	14.64%
Citigroup Energy Inc.	19,826	8.55%	-	-
Sempra Energy Trading Corp.	14,200	6.12%	-	-
Southern California Edison Co.	13,827	5.96%	17,410	5.07%
Metropolitan Water District of Southern California	12,094	5.21%	26,757	7.79%
Kings River Conservation District	11,813	5.09%	-	-
UBS Energy	-	-	28,141	8.19%

For the years ended June 30, 2009 and 2008 (in thousands)

13. Segment Information

The table below presents the condensed statements of net assets, the statements of revenues, expenses, and changes in net assets and the statements of cash flows for the System's two segments, as of and for the years ended June 30, 2009 and 2008.

	2009			2008		
	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	$ 825,390	$ 2,274,212	$ 3,099,602	$ 847,114	$ 2,227,641	$ 3,074,755
Other assets	1,147,906	310,365	1,458,271	1,086,361	364,785	1,451,146
Current assets	192,309	308,859	501,168	217,575	428,502	646,077
Total assets	$ 2,165,605	$ 2,893,436	$ 5,059,041	$ 2,151,050	$ 3,020,928	$ 5,171,978
Capitalization and Liabilities						
Capitalization:						
Net assets:						
Capital (deficit), net of related debt	$ 553,561	$ (280,577)	$ 272,984	$ 520,278	$ (392,420)	$ 127,858
Restricted	624,914	307,533	932,447	658,197	419,376	1,077,573
Total net assets	1,178,475	26,956	1,205,431	1,178,475	26,956	1,205,431
Long-term liabilities	549,415	2,491,696	3,041,111	578,440	2,578,086	3,156,526
Total capitalization	1,727,890	2,518,652	4,246,542	1,756,915	2,605,042	4,361,957
Current liabilities	202,109	216,811	418,920	154,310	253,939	408,249
Other liabilities	235,606	157,973	393,579	239,825	161,947	401,772
Total capitalization and liabilities	$ 2,165,605	$ 2,893,436	$ 5,059,041	$ 2,151,050	$ 3,020,928	$ 5,171,978
Condensed Statements of Revenues, Expenses, and Changes in Net Assets:						
Operating revenues:						
Water supply	$ 454,921	$ 266,332	$ 721,253	$ 467,291	$ 285,562	$ 752,853
Power sales	160,858	14,460	175,318	203,978	11,452	215,430
Federal reimbursements	16,234	2,032	18,266	20,209	783	20,992
	632,013	282,824	914,837	691,478	297,797	989,275
Depreciation expense	(27,119)	(50,150)	(77,269)	(28,806)	(50,330)	(79,136)
Other operating expense	(546,453)	(148,145)	(694,598)	(634,277)	(139,085)	(773,362)
Income from operations	58,441	84,529	142,970	28,395	108,382	136,777
Capital expenses (deferred) recovered	(5,064)	45,619	40,555	(20,595)	-	(20,595)
Interest expense	(23,780)	(106,274)	(130,054)	(27,178)	(129,538)	(156,716)
Transfers In	(6,798)	(155,775)	(162,573)	(6,064)	(144,792)	(150,856)
Transfers Out	82,987	79,586	162,573	118,390	32,466	150,856
Other (expense) income	(105,786)	52,315	(53,471)	(92,948)	133,482	40,534
Increase (decrease) in net assets	-	-	-	-	-	-
Net assets, beginning of year	1,178,475	26,956	1,205,431	1,178,475	26,956	1,205,431
Net assets, end of year	$ 1,178,475	$ 26,956	$ 1,205,431	$ 1,178,475	$ 26,956	$ 1,205,431
Condensed Statements of Cash Flows:						
Net cash provided by (used in):						
Operating activities	$ 146,773	$ 100,926	$ 247,699	$ 183,022	$ 121,010	$ 304,032
Capital and related financing activities	(160,941)	(202,633)	(363,574)	(162,749)	(165,898)	(328,647)
Investing activities	5,321	15,127	20,448	8,239	56,560	64,799
Net (decrease) increase in cash and cash equivalents	(8,847)	(86,580)	(95,427)	28,512	11,672	40,184
Cash and equivalents, beginning of year	136,392	416,012	552,404	107,880	404,340	512,220
Cash and equivalents, end of year	$ 127,545	$ 329,432	$ 456,977	$ 136,392	$ 416,012	$ 552,404

14. Subsequent Events

In December 2009, the System issued CVP Water System Revenue Bonds Series AG with a par amount of $169.1 million and a premium of $11.0 million with an average yield on the bonds of 4.41%. The bond proceeds along with System funds on hand in the amount of $.1 million were used to defease $168.3 million of outstanding bonds, redeem commercial paper borrowings of $9.9 million, fund capitalized interest of $.4 million, fund deposits to the debt service reserve account of $.4 million and cover costs of issuance of $1.1 million.

Supplementary Information

State Water Resources Development System
Calculation of Adequacy of Debt Service Coverage for the Central Valley Project Revenue Bonds
For the years ended June 30, 2009 and 2008 (in thousands)

	2009	2008
Water supply revenues, including $48,985 in 2009 and $45,264 in 2008 in refundable proceeds	$ 328,044	$ 328,655
Less: Operation and maintenance expense	(64,522)	(83,311)
Net revenues available for debt service	263,522	245,344
Principal and interest for revenue bonds	$ 192,973	$ 181,116
Debt service coverage	136.6%	135.5%

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 calculation above includes the amounts applicable to the CVP Water System Revenue Bonds and excludes amounts applicable to the State Water Resources Development General Obligation Bonds.

Arnold Schwarzenegger
Governor, State of California

Michael J. Chrisman
Secrectary of Resources,
The Natural Resources Agency

Lester A. Snow
Director, Department of Water Rersources