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

2011–2010

STATE OF CALIFORNIA
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Lester A. Snow, Secretary for Natural Resources

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State Water Resources Development System

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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, 2011 and 2010, as listed in the table of contents. 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, 2011 and 2010, 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.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis as listed in the table of contents, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audit was conducted for the purpose of forming an opinion on the System's financial statements as a whole. The supplementary information as listed in the table of contents is presented for purposes of additional analysis and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

Macias Gini & O'Connell LLP

Sacramento, California
December 2, 2011

Management's Discussion and Analysis (Required Supplementary Information)

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 $65.8 million on total operating revenues of $1.1 billion. 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 November 2010, the System issued CVP Water System Revenue Bonds Series AH with a par amount of $97.6 million and a premium of $13.3 million with an average yield on the bonds of 3.33%. The bond proceeds along with System funds on hand in the amount of $.7 million were used to defease $29.8 million of outstanding bonds and fund $3.6 million of future interest on the defeased bonds by depositing $33.4 million in an irrevocable trust with an escrow agent, redeem commercial paper borrowings of $71.5 million, fund capitalized interest of $3.6 million, fund deposits to the debt service reserve account of $2.5 million and cover costs of issuance of $.6 million.

Overview of Financial Statements

Reports Included in Financial Statements

The System is accounted for as an enterprise fund. Enterprise funds account for the acquisition, operation, and maintenance of governmental facilities and services that are entirely or predominantly self-supported by user charges. This financial report consists of three financial statements, prepared on the accrual basis of accounting, with accompanying note disclosures. 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 certain information required by generally accepted accounting principles.

State Water Resources Development System
Management's Discussion and Analysis (Unaudited)
For the years ended June 30, 2011 and 2010

Condensed Statements of Net Assets

	2011	2010	2009	%Change 2011-2010	%Change 2010-2009
	(amounts in thousands)				
Total utility plant	$ 3,201,464	$ 3,215,188	$ 3,207,727	-0.4%	0.2%
Other assets	1,745,724	1,797,764	1,851,314	-2.9%	-2.9%
Total assets	$ 4,947,188	$ 5,012,952	$ 5,059,041	-1.3%	-0.9%
Capitalization:					
Net assets:					
Capital, net of related debt	$ 554,854	$ 486,347	$ 381,106	14.1%	27.6%
Restricted	650,577	719,084	824,325	-9.5%	-12.8%
Total net assets	1,205,431	1,205,431	1,205,431	0.0%	0.0%
Total long-term debt	2,913,479	2,975,096	3,055,642	-2.1%	-2.6%
Total capitalization	4,118,910	4,180,527	4,261,073	-1.5%	-1.9%
Other liabilities	828,278	832,425	797,968	-0.5%	4.3%
Total net assets and liabilities	$ 4,947,188	$ 5,012,952	$ 5,059,041	-1.3%	-0.9%

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

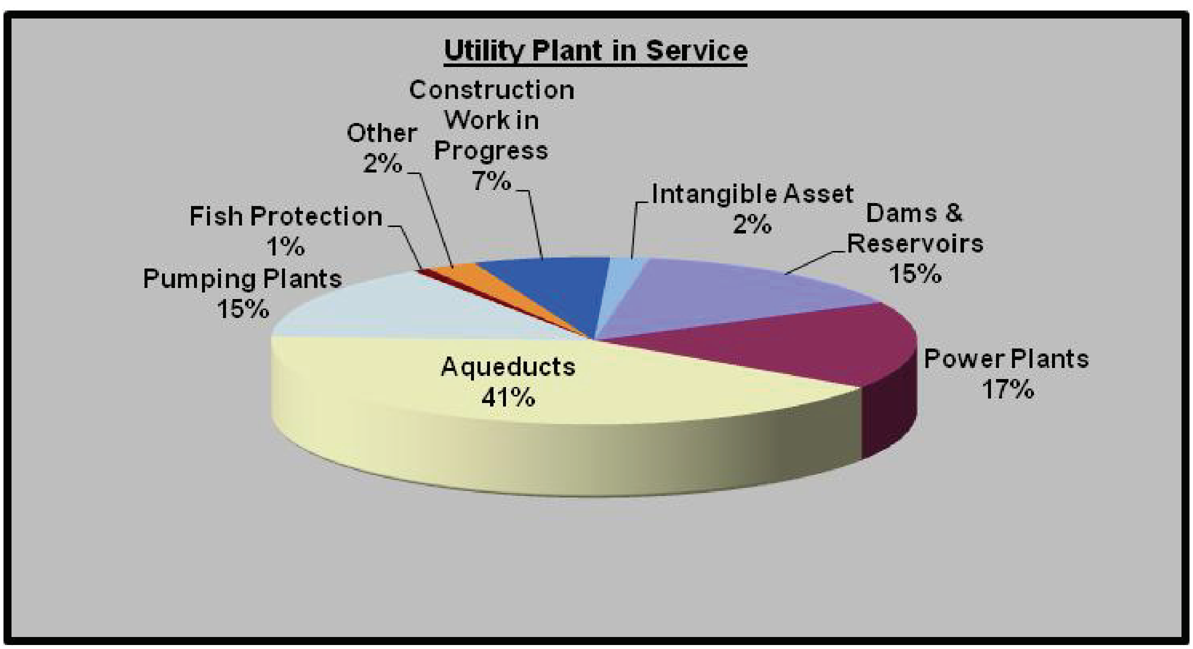
	2011	2010	2009	%Change 2011-2010	%Change 2010-2009
	(amounts in thousands)				
Water supply	$ 885,151	$ 853,158	$ 721,253	3.7%	18.3%
Power sales	193,154	165,664	175,318	16.6%	-5.5%
Federal reimbursements	17,891	24,021	18,266	-25.5%	31.5%
Total operating revenues	1,096,196	1,042,843	914,837	5.1%	14.0%
Operations and maintenance expense	428,559	435,801	466,708	-1.7%	-6.6%
Purchased power expense	342,446	212,658	206,632	61.0%	2.9%
Depreciation expense	100,257	80,813	79,632	24.1%	1.5%
Operating expenses recovered, net	109,535	189,000	21,257	-42.0%	789.1%
Total operating expenses	980,797	918,272	774,229	6.8%	18.6%
Income from operations	115,399	124,571	140,608	-7.4%	-11.4%
Capital revenues recovered	14,022	19,823	44,344	-29.3%	-55.3%
Interest expense	(134,996)	(151,390)	(131,481)	-10.8%	15.1%
Other (expense) income	5,575	6,996	(53,471)	-20.3%	-113.1%
Change 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 thirty-three storage facilities, twenty-three pumping plants, four generating plants, eight power plants, as well as fish protection facilities, aqueducts, and internally generated intangible assets.

Utility plant in service, net of accumulated depreciation (UPIS) increased by $19.5 million during fiscal 2011 to a balance of $2,834 million. Transfers were made from Construction Work in Progress to UPIS of $117.1 million including Facilities Repair and Improvement of $60.1 million, Arroyo Pasajero of $19.5 million, South Bay Aqueduct Del Valle Pipeline of $15.4 million, North Bay Aqueduct New Terminal of $13.6 million, and Delta Facilities of $8 million in fiscal 2011 in comparison to $144.7 million in fiscal 2010. While depreciation expense usually remains fairly constant each year, fiscal 2011 experienced an increase of $19.4 million in depreciation expense compared to fiscal 2010. Projects placed in service in fiscal 2010 which began depreciating in current year included Tehachapi East Afterbay which accounts for $6.3 million, Hyatt Pump-Turbine Refurbishment for $4 million, and Reid Gardner Pumping Plant for $10.4 million. The amount of additions and transfers to UPIS in the current year was $119.8 million compared to $149.3 million in 2010. Depreciation expense for fiscal 2011 was $100.3 million compared to 2010 of $80.8 million. There were certain projects placed into service in fiscal 2010 which should have been placed into service in prior years. This increased the depreciation expense for fiscal 2011 as the prior year's depreciation was also reflected in the depreciation expense for fiscal 2011. 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 generally range from 30 to 100 years.



Construction Work in Progress

Construction work in progress decreased by $33.3 million during the year, which represents a 8.3% decrease from fiscal 2010. In fiscal 2010, construction work in progress decreased by $60.9 million, or 13.2% from fiscal 2009. The current year decrease is attributable to the transfer of $117.1 million from Construction Work in Progress to UPIS for projects including Facilities Repair and Improvement of $60.1 million, Arroyo Pasajero of $19.5 million, South Bay Aqueduct Del Valle Pipeline of $15.4 million, North Bay Aqueduct New Terminal of $13.6 million, and Delta Facilities of $8 million. These transfers were offset by increases to new and ongoing projects including the East Branch Extension Phase II projects of $10.3 million, South Bay Aqueduct Enlargement projects of $27.5 million, South Bay Aqueduct Improvement projects of $14.1 million, Edmonston Pump Replacement project of $8.8 million, Fish Restoration Program Agreement - Battle Creek project of $5.3 million, Pearblossom Administration Building project of $2.3 million, Perris Dam Remediation project of $1.8 million, other Water Systems projects totaling $14.7 million, $1.9 million of Intangible Assets including the Federal Energy Regulatory Commission (FERC) re-licensing costs P2426 and internally generated computer software, and a decrease of $2.9 million for the Reid Gardner project. The increase in fiscal 2010 from fiscal 2009 was primarily due to additions made to new and on-going projects including the East Branch Extension Phase II projects of $9.7 million, Reid Gardner projects of $1.6 million, South Bay Aqueduct projects of $24.6 million, the Tehachapi East Afterbay project of $1.7 million and other Water Systems projects totaling $46.2 million. At June 30, 2011, total construction work in progress was comprised of $1.9 million of Intangible Assets, $45.8 million of East Branch Extension Phase II projects, $162.2 million for the South Bay Aqueduct, and $156.5 million of other Water Systems projects.

Restricted Cash and Investments

Restricted cash and cash equivalents increased by $2.5 million during fiscal 2011 to a total of $162 million. This compares to a balance of $159.5 million in fiscal 2010, and $162.6 million in fiscal 2009. The current year increase is attributed to a $2.5 million increase in the cash restricted for debt service due to the issuance of Series AH bonds.

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 $18.8 million remains outstanding at the end of fiscal 2011 compared to an outstanding balance of $20.4 million at the end of fiscal 2010. Additionally, $2.2 million remained outstanding in the Groundwater loan receivable previously presented as Restricted Cash. Advances to other State Funds represent the System's advance of $92 million to DWR's internal service fund, which functions as a revolving working capital facility for DWR.

Cash and Cash Equivalents

In fiscal 2011, cash and cash equivalents increased by $5.8 million to a balance of $465 million. The rise in the cash balance is primarily due to over collections from the Water Contractors for variable charges, which have not yet been returned.

Receivables

In fiscal 2011, water supply and power billings receivable decreased by $4.8 million as compared to fiscal 2010. The decrease is primarily due to a decrease of $6.4 million in power sales accruals, a decrease of $2.1 million for reduction of aged receivables for Angeles Tunnel billings, offset by an increase of $2.4 million in SWP Contractors receivables, and an increase of $1.3 million primarily for Highway 12 and 46 encasements receivables.

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 2011, the deferred charges decreased by $60 million to an ending balance of $871 million compared to $931 million for 2010, as the System defers expenses to be recovered from future revenues from the Water Contractors. In fiscal 2010, recoveries resulted in a decrease of deferred charges of $142.9 million.

Liabilities

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 $421 million remains outstanding at the end of fiscal 2011 compared to $477 million at fiscal 2010 and $532 million at fiscal 2009. The un-issued $168 million of the authorization is available only to provide funds for the construction of certain additional water conservation facilities.

Revenue Bonds

The System has issued 34 series of Water System Revenue Bonds totaling $6,658 million in the aggregate principal, of which $2,385 million remains outstanding at the end of fiscal 2011. This compares to outstanding balance of $2,418 million and $2,493 million at the end of fiscal year 2010 and 2009, respectively. During the year, the System completed the issuance of CVP Water Systems Revenue Bond Series AH of $97.7 million. The majority of the proceeds from the issuance were used to refund the Series W, X, and AC bonds, 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 AH Bonds, and pay costs of issuance of Series AH 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, $78 million is outstanding at the end of fiscal 2011, compared to $82 million at fiscal 2010 and $86 million at fiscal 2009.

Revenue Bonds (continued)

	2011	2010	2009
	(amounts in thousands)		
CVP revenue bonds par amount	$ 2,302,665	$ 2,339,310	$ 2,431,825
Unamortized bond issuance premiums/(discounts)	111,649	104,948	93,176
Deferred amount on refunding	(29,260)	(26,084)	(31,808)
Total CVP revenue bonds outstanding	2,385,054	2,418,174	2,493,193
Devil Canyon - Castaic revenue bond par amount	77,540	81,875	85,965
Total revenue bonds outstanding	2,462,594	2,500,049	2,579,158
Less current maturities	(116,150)	(108,870)	(97,359)
Total long-term portion	$ 2,346,444	$ 2,391,179	$ 2,481,799

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 defeased 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 2011, the outstanding long-term PMIA loan balance decreased from $21.1 million to $18.1 million due to $3 million of principal payments made during fiscal 2011. In fiscal 2010, the outstanding long-term PMIA loan balance decreased from $24.6 million to $21.1 million due to $3.4 million of principal payments made during fiscal 2010.

Postemployment Benefits Other than Pensions

The Post-Employment Benefits Other than Pensions (OPEB) increased by $26.4 million to a net OPEB obligation ending balance of $97.9 million in fiscal 2011 due to the difference between the Annual Required Contribution (ARC) to fully fund the obligation as calculated per GASB 45 requirements of $41.7 million and the actual contribution charged by the California Department of Finance through pro rata charges of $15.3 million. The $26.4 million increase for fiscal 2011 and $23.5 million increase in fiscal 2010 reflect the System's under funding of the ARC.

Accounts Payable and Other Current Liabilities

Accounts payable and other current liabilities totaled $299.2 million at June 30, 2011, compared to $303 million in fiscal 2010, and $284 million in fiscal 2009. The decrease of $3.8 million in the current year is due to increased production in payables invoice processing resulting in a decrease of $18.1 million in accounts payable vendor liabilities; a decrease of $4.2 million to the current liability portion of accrued vacation; an increase of $9.2 million for the current portion of long term bond principal; an increase of $600 thousand for the current portion of the System's pollution remediation obligations for the Delta Methylmercury Control Program; an increase of $8.3 million due to a timing difference in the transfer of cash settlements with DWR's Internal Service Fund; and an increase of $444 thousand attributable to slight increases in accrued bond interest current portions of loans payables.

In fiscal 2010, the increase of $18.9 million was due to a decrease of $8.1 million in accounts payable; a decrease of $800 thousand for accrued vacation, due to the reclassification of accrued vacation between current and long-term liabilities, whereas in prior years the accrued vacation time was reported as a lump sum in current liability; a decrease of $1.8 million in interest payable due to a decrease in accrual for the Capitalized Interest Fund; an increase of $13.1 million for the current portion of long term bond principal; a minor increase in accrued bond interest current portions of loans payables for $170 thousand; an increase of $400 thousand for the current portion of the System's pollution remediation obligation for the Reid Gardner Power Plant; and an increase of $16 million due to a timing difference in the transfer of cash settlements with DWR's Internal Service Fund.

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 decreased by $10 million during fiscal 2011 to an ending balance of $111 million. The decrease in fiscal 2011 can be primarily attributed to the abandonment of gas hedging activities of $10.8 million which has been returned to the Water Contractors, and a reduction in deferred operating revenue prepayments of $3.4 million for Off Aqueduct power refunds issued to the water contractors for fiscal 2009 to 2011. However, these decreases were offset by a $2.8 million increase in cover for various facilities and revenue collected but not yet recognized for delivery structures, and an increase of $1.3 million in interest as DWR has not returned the interest earnings which is pending re-allocation of the debt service reserve account.

In fiscal year 2010, Proceeds Due to Water Contractors increased from $120.4 million to $121 million, an increase of $600 thousand. The increase was due to advance funding of the North Bay Aqueduct Alternate Intake, an increase in cover for various facilities, an increase in interest refunds and an offsetting decrease in Off Aqueduct power facilities adjustments.

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 $1 million in fiscal 2011 to $153 million. This compares to a $4 million decrease in fiscal 2010. These decreases represent the recognition of revenue equal to the amount of depreciation recorded.

Deferred Capital Costs

The System had $25 million in deferred revenues for capital costs for 2011 compared to $41 million in deferred charges in fiscal 2010, an increase of $66 million. This is a result of principal recoveries of $159 million netted with capital costs of $93 million. Principal recovery of capital costs was $159 million in 2011 in comparison to $152.5 million in 2010, generally as a result of an increase in Reid Gardner capital recovery. Deferred capital costs for Transportation and Conservation facilities were $93 million in 2011 compared to $71.2 million in 2010. The increase was primarily due to Tehachapi Afterbay and Reid Gardner projects which began depreciating in the current year.

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 2011, the credits issued through the Delta Water Charge of $23.5 million were offset in part by the $14.7 million of revenue collected through the Variable charge for power generated at Hyatt-Thermalito for an $8.8 million decrease in the deferral for 2011 fiscal year. This compares to fiscal year 2010 where the credits issued through the Delta Water Charge were $21.2 million, offset in part by $14.7 million of revenue collected through the Variable charge for power generated at Hyatt-Thermalito for a $6.6 million decrease in the deferral.

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 decreased from $39.5 million in fiscal 2010 to a total of $36.5 million in fiscal 2011. The $3 million decrease in FY2011, is primarily due to revenue collection of $6.5 million that was offset by $9.8 million paid for replacements at Gianelli, Banks, Buena Vista, and Hyatt pumping plants.

Advances for plant replacements decreased from $42 million in fiscal 2009 to a total of $39.5 million in fiscal 2010. The $2.5 million decrease in FY2010, is primarily due to revenue collection of $10.3 million that was offset by $8 million paid for replacements at Gianelli, Buena Vista, and Pearblossom pumping plants.

Operating Revenues

Operating revenues for fiscal 2011 were $1.09 billion compared to $1.04 billion in fiscal 2010 and $914.8 million in fiscal 2009. The increase of $53.4 million in fiscal 2011 was primarily due to an increase in water supply revenue of $32 million, an increase in power sales revenue of $27.5 million offset by a decrease of $6.1 million in federal reimbursements. The increase of $128 million in fiscal 2010 was primarily due to an increase in water supply revenue of $131.9 million, a decrease in power sales revenue of $9.7 million, and an increase of $5.8 million in federal reimbursements.

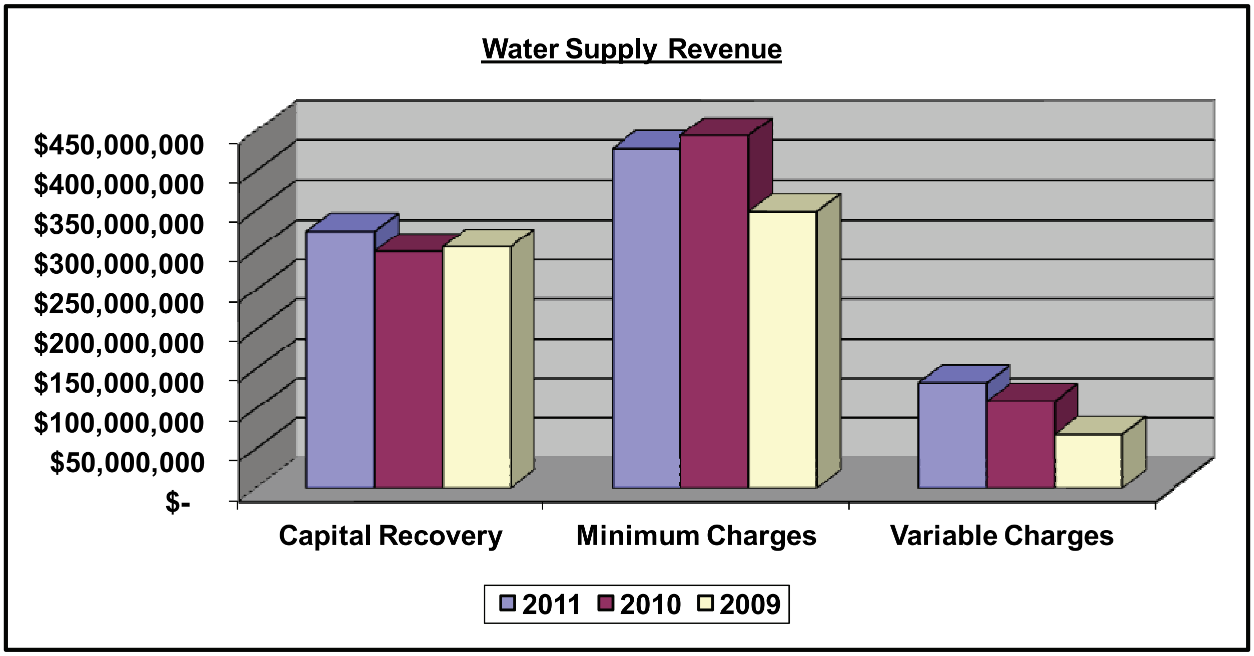
Water Supply Revenue

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

Water supply revenues consist of three main categories, as defined in the water supply contracts: Capital, Minimum and Variable. The Capital component of revenue enables the System to recover all the costs plus interest related to the construction of the System facilities, including its dams, aqueducts, pumping stations and power plants. Once a project is completed, its cost plus interest are amortized and recovered over the remaining term of the water supply contracts (through 2035). The Minimum component of revenue enables the System to recover the operating and maintenance costs associated with operating the System. These costs are generally recovered as they are incurred. Finally, the Variable component of revenue enables the System to recover the net cost of energy used to deliver water to the Water Contractors. Similar to 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 2011, the System generated $885.2 million in water supply revenue, compared to $853.2 million in fiscal 2010, and $721.2 million in fiscal 2009. The following table shows a comparative breakdown of the components of water supply revenue for fiscal years 2011, 2010 and 2009.



Water Supply Billings increased by $32 million in 2011 to a total of $885.2 million. This increase is due to a $25.4 million increase in Capital recovery, an increase of $23 million in Variable recovery, and an offsetting decrease of $16.4 million in Operating & Maintenance (O&M) recovery.

The Capital recovery revenues increase of $25.4 million is due in part to an increase of $12 million in Capital Transportation costs for completion of the Del Valle Surge Tank Pipeline repair and design. An additional increase of $8.8 million is due to increased Capital costs in the Delta.

The $23 million increase in Variable recovery revenues is due in part to the 54% increase in actual water deliveries. Deliveries in 2011 were 3.53 million acre-feet compared to 2.29 million acre-feet in fiscal 2010. Although the average mil rate decreased from 34.03 mills/kWh in fiscal 2010 to 29.84 mills/kWh in 2011, the increase in water deliveries occurred in the southern part of the state where the cost to deliver water is higher, resulting in additional recovery revenues. This was offset by a decrease in revenues of $24 million for prior year over collections which amounted to $53.8 million in fiscal 2011 compared to $29.8 million in fiscal 2010.

O&M recovery revenues for FY 2011 decreased by $16.4 million. The largest decrease of $25.9 million was in recovery revenues for the Delta Habitat Conservation and Conveyance Program (DHCCP). Funding agreements for DHCCP were not executed for the last half of the 2011 fiscal year. An additional $7.5 million decrease is for prior year over collections and $3.8 million for replacements. These decreases were offset by increases of $20.5 million in the Delta Water Charge recovery and $4.6 million increase in recovery for Reid Gardner Unit 4 separation costs.

In fiscal 2010, Water Supply Billings increased by $131.9 million to a total of $853.2 million. There were several contributing factors. A $95.6 million increase occurred as a result of O&M recovery, a $41.8 million increase was for Variable recovery, with an offsetting decrease of $5.5 million in Capital recovery. O&M recovery increased by $50.5 million for DHCCP revenues. Another $20.2 million increase was in the Minimum Delta Water Charge due to a change in methodology for escalating future conservation costs. There was also an increase of $13.9 million in Off-Aqueduct O&M due to reduced refunds to the Water Contractors. The Variable recovery increase of $41.8 million was due to increased water deliveries primarily in the southern part of the state where the cost to deliver water is higher, offset by a decrease in revenues for prior year over collections. The decrease in Capital recovery revenues of $5.5 million was primarily due to increased rate management credits given to the Water Contractors for Capital Transportation and Delta Water Charge Capital.

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 eight power plants with a total nameplate capacity of approximately 1,800 Mw and with total annual energy generation in recent years ranging between approximately 3,100 and 7,500 Gwh. The System also owns and operates 23 pumping plants with a total load, when operational, of approximately 2,000 Mw and total annual energy consumption in recent years ranging between 5,300 and 10,000 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. Operations continue 24 hours a day, seven days a week, with constant coordination with other utilities, water contractors, the California Independent System Operator (CAISO), and State Water Project pumping and generating plants. The power market controlled by CAISO can affect the bottom line cost or revenue from the System's hydro-electric facilities.

Each 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. Of the numerous events that occur throughout the year, the primary factor affecting operation of the SWP in fiscal year 2011 was the plentiful rainfall which allowed the replenishment of DWR reservoirs and increased allocation to the water contractors. This increased water availability and allocation increased the pumping demand. Unfortunately, another factor effecting power activities in fiscal 2011 was unavailability of units at DWR's Oroville complex.

During fiscal year 2011 California experienced significant amounts of rainfall. In Northern California the rainy season usually begins in October and ends near March. In fiscal 2011 rain fell from November 2010 and continued through June 2011. This increased rainfall allowed for unanticipated recovery of reservoirs throughout the SWP. As more units are made available at Oroville for generation and water remains available, DWR will be in a much better position to maximize the offset of pumping cost by submitting generation into the power market.

In April of 2011, the CAISO completed its second year under the implemented Market Redesign and Technology Upgrades (MRTU). The new MRTU market required DWR to implement a new scheduling software to conduct business in the new power market. The new CAISO market requires all SWP load and generation be submitted into the market and priced using Locational Marginal Pricing (LMP). The implementation of the new energy market by the CAISO has completely changed the way the SWP handles bi-lateral transactions. In prior years, the financial aspect of the bi-lateral market was handled between the counterparties. In today's market, the bi-lateral trades have financial impact with both the CAISO and the trading counterparty. In addition, the new market requires every megawatt of generation or load to have a price and therefore a financial impact to the scheduling party.

Power Sales

Energy sales from SWP hydro-electric generating plants allow some recovery of cost of the System's hydro-electric pumping plants. With low reservoir storages, the SWP's 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 2011, power sales increased by $27.5 million to a total of $193 million. Although, the system experienced a decrease in the quantity of energy sold there was a substantial increase in the MWh rate as well as a slight increase in Transmission sold. In Fiscal 2010, 1,850,294 MWh were sold compared to 1,338,296 MWh in fiscal 2011, a 27.67% decline from the prior year. The overall rate increased by 65.4%, from $72.19 in fiscal 2010 to $119.4 in fiscal 2011. The drop in sales was partially impacted by the new MRTU market's requirement of LMP.

The non-physical bi-lateral power sales transactions (financial only) when netted with the non-physical bi-lateral power purchase transactions between counterparties, resulted in less of a need to hedge the physical energy or generation to the CAISO. The MRTU market's LMP and market fluctuations contributed to the increase in MWh rate per unit sold. Water deliveries increased from 2,294,243 acre feet in fiscal 2010 to 3,531,739 acre feet in 2011, an increase of 1,237,496 acre feet or 54%. Increased rainfall in fiscal 2011 resulted in increased water deliveries however, generation revenue and load cost are netted by the CAISO under the new MRTU and only a slight increase in Transmission sold occurred.

In fiscal 2010, power sales decreased by $9.7 million to a total of $166 million. This is due to a decrease in the quantity of energy sold and a decrease in the MWh rate offset by an increase in the Transmission sold. In fiscal 2009, 2,111,027 MWh were sold compared to 1,850,294 MWh in fiscal 2010, a 12.35% decline from the prior year. The overall rate decreased by 1.5%, from $73.24 in fiscal 2009 to $72.19 in fiscal 2010. 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 $11.4 million in Transmission sold represents a combination of increases in water deliveries and an increase in transmission services provided through CAISO. Water deliveries increased from 2,129,268 acre feet in fiscal 2009 to 2,294,243 acre feet in 2010, an increase of 164,945 acre feet or 8%.

	Total Sold	Transmission Sold	Power Sold	MWh Sold	Rate/MWh
2010	$ 165,663,966	$ (32,091,514)	$ 133,572,452	1,850,294	$ 72.19
2011	193,153,799	(33,357,996)	159,795,803	1,338,296	119.40

Change in total MWh sold	(511,998)
Multiplied by 2010 rate/MWh	$ 72.19
Difference attributed to decreases sales	$ (36,961,000)
Change in MWh rate	$ 47.21
Multiplied by 2011 MWh sold	1,338,296
Difference attributed to rate change	$ 63,181,000
Total increase in power sales	$ 26,220,000

	Total Sold	Transmission Sold	Power Sold	MWh Sold	Rate/MWh
2009	$ 175,318,367	$ (20,696,756)	$ 154,621,611	2,111,027	$ 73.24
2010	165,663,966	(32,091,514)	133,572,452	1,850,294	72.19

Change in total MWh sold	(260,733)
Multiplied by 2009 rate/MWh	$ 73.24
Difference attributed to decreases sales	$ (19,096,000)
Change in MWh rate	$ (1.05)
Multiplied by 2010 MWh sold	1,850,294
Difference attributed to rate change	$ (1,952,000)
Total decrease in power sales	$ (21,048,000)

Federal Reimbursements Revenue

Federal reimbursements revenue for fiscal 2011 was $17.9 million, compared to $24 million and $18.3 million for fiscal years 2010 and 2009. The current year decrease of $6.1 million is primarily attributable to a $2.4 million decrease in expenses incurred at the Gianelli Pumping Plant, Dos Amigos Pumping Plant, and the San Luis Canal and Division. An additional $3 million decrease was due to the change in recreation allocation from 14% to 3.4% for the Suisun Marsh facilities. These facilities are located within the San Luis and Suisun Marsh facilities for which the System is reimbursed by the Federal government.

Operating Expenses

Total operating expenses increased by $62.5 million for 2011 to a total of $981 million. The increase is due to an increase in power purchases of $129.8 million, and an increase in depreciation expense of $19.4 million offset by a decrease in Operating expenses recovered, principally under long-term water supply contracts of $79.5 million, and a decrease of $7.2 million in operations and maintenance expense. The decrease in deferred expenses is represented by $110 million of recognized expense in 2011 compared to $189 million of recognized expense in 2010.

Total operating expenses for 2010 increased by $144 million to a total of $918 million. The increase was due to an increase in deferred expenses of $167.7 million, an increase in power purchases of $6 million, an increase in depreciation expense of $1.2 million offset by a decrease of $30.9 million in operations and maintenance expense.

Operations and Maintenance Expense

Total operations and maintenance expenses were $428.6 million for fiscal 2011, compared to $435.8 million for fiscal 2010 and $467 million for fiscal 2009. The decrease of $7.2 million in fiscal 2011 is mainly attributable to the following factors; a decrease of $3.7 million in the Pollution Remediation expense accrual; a decrease of $29.8 million related to the valuation of Easements and internally generated software that were classified as intangible assets last fiscal year; a decrease in Federal Cooperative contract of $3 million; a decrease in the repairs and replacement costs for South Bay of $1.3 million and Edmonston pumping plant of $2.1 million; and a decrease in the accruals of $7.2 million. These decreases are mitigated in part by increases of $5.3 million for the mitigation for SWP operations under the Federal Biological Opinion for salmon; a $9.4 million refund related to the Lodi Energy Center project in fiscal 2010; $5 million in condemnation proceedings; $4 million in labor cost; $1.7 million in right of way costs for the Del Valle Pipeline emergency repair; $3.4 million in bond issuance expense; and a normal $8 million increase in other operations and maintenance expenses.

The decrease of $30.9 million in fiscal 2010 is mainly attributable to the following: a decrease of $14.8 million for consulting fees, a decrease of $4.6 million for post employment benefits, a decrease of $5.1 million for general expense, and a $5.2 million decrease in coal and natural gas purchases. The decrease of $14.8 million for consulting fees is primarily due to the refund of $9.4 million 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 the Water Contractors. The System's sources of power include self-generated power by the eight 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.

Power purchases increased $130 million in fiscal 2011 to a total of $342 million. Of that increase, $67 million is attributable to increased MWh's purchased in fiscal 2011 of 1.1 million MWhs and $11 million is due to increases in transmission purchased. The average rate per MWh purchase increased from $46.31 in fiscal 2010 to $60.69 in fiscal 2011 resulting in an increase of $51.7 million in power purchases.

Power purchases are generally for off-peak pumping and are a reflection of water demand. One primary factor that contributed to increased purchases was the plentiful rainfall that occurred during fiscal 2011. The result of this increased water supply was an increase in water allocation and a subsequent increase in pumping demand. Under the new MRTU, which requires LMP, netted differences for every megawatt of generation or load cost have a financial impact to the scheduling party. In fiscal 2011 this impact was also a contributing factor in increased power purchases cost.

In fiscal 2010, purchased power increased $6 million from fiscal 2009 to a total of $213 million. Of that amount, $23 million is attributed to increased MWh purchased and $26.5 million is attributed to a decrease in the average rate per MWh purchased, while changes in transmission increased by $9.6 million.

The following tables show the relationship between volume and rate for fiscal 2011 compared to fiscal 2010, and fiscal 2010 compared to fiscal 2009.

	Total Purchased	Transmission Purchased	Power Purchased	MWh Purchased	Rate/MWh
2010	$ 212,658,256	$ (45,960,886)	$ 166,697,370	3,599,322	$ 46.31
2011	342,445,800	(56,971,668)	285,474,132	4,703,953	60.69
Change in MWh purchased					1,104,631
Multiplied by 2011 rate					$ 60.69
Difference attributed to increased purchases					$ 67,040,000
Change in MWh rate					$ 14.37
Multiplied by 2010 purchased					3,599,322
Difference attributed to rate change					$ 51,758,000
Total increase in power purchases					$ 118,798,000

	Total Purchased	Transmission Purchased	Power Purchased	MWh Purchased	Rate/MWh
2009	$ 206,632,303	$ (36,355,972)	$ 170,276,331	3,103,403	$ 54.87
2010	212,658,256	(45,960,886)	166,697,370	3,599,322	46.31
Change in MWh purchased					495,919
Multiplied by 2010 rate					46.31
Difference attributed to increased purchases					$ 22,968,000
Change in MWh rate					$ (8.55)
Multiplied by 2009 purchased					3,103,403
Difference attributed to rate change					$ (26,547,000)
Total decrease in power purchases					$ (3,579,000)

Operating Expenses Recovered

In fiscal 2011, $109.5 million in operating expenses were recognized, compared to fiscal 2010 in which the System recognized $189 million in operating expenses. The 2011 net change of $79.5 million is the result of a $14.6 million decrease in deferred depreciation due to Tehachapi East Afterbay, Hyatt Refurbishment, and Reid Gardner being placed into service; a $2.2 million decrease in the power sales credit; and a $92.8 million decrease in deferred operation and maintenance expense. These decreases are offset by an increase of $27.5 million in unbilled interest and $2.7 million in unamortized projects.

In fiscal 2010, $189 million in operating expenses were recognized, compared to fiscal 2009 in which the System recognized $21.3 million in operating expenses. The 2010 net change of

$167.7 million is the result of an increase of $148.3 million in deferred operation and maintenance expense, an increase in deferred depreciation of $19.9 million, an increase of $856 thousand in the power sales credit, and a decrease of $400 thousand in unamortized projects.

Capital Revenues Recovered

Capital revenues recovered represents the timing difference between net capital revenue recovered, and certain operating costs incurred. Capital revenues recovered decreased by $5.8 million in 2011 to a total of $14 million recovered compared to $19.8 million in capital revenues recovered from the Water Contractors in fiscal 2010.

Capital revenues recovered decreased by $24.5 million in 2010 to a total of $19.8 million recovered compared to $44.3 million in capital revenues recovered from the Water Contractors in fiscal 2009.

Interest Expense

Interest expense for fiscal 2011 was $135 million, which represents a decrease of $16.4 million from the prior year. This $16.4 million decrease is attributable to three major factors; a $7.4 million decrease in amortization of bond Premium and Discount, a $6 million decrease in amortization of Deferred Losses on defeased bonds, and a $3 million decrease in Interest Expense on debt service. The $7.4 million in the amortization of premium and discount variance occurred as a result of a larger amount of discount written off during fiscal 2010 than in fiscal 2011 and an adjustment relating to a change in the method of amortization to the straight line effective in fiscal 2010. The $6 million variance in amortization gain and loss is attributed to a larger amount of discount written off during fiscal 2010 than in fiscal 2011 and an adjustment relating to a change in the method for recording amortization of gain and loss from the effective interest to the straight line in FY 2010. The $3 million decrease in interest expense reflects the decrease in bonds outstanding and the savings resulting from the current year debt refunding.

Interest expense for fiscal 2010 was $151 million, which represents an increase of $19.9 million from the prior year. This $19.9 million increase is attributable to three major factors. First, an $8.3 million increase in bond amortization of premium and discount was due in part to a $11.1 million addition relating to the issuance of the Series AG bonds; a reduction of $7.7 million relating to the write off of the Series O & S bonds which were refunded by the Series AG bonds; and a $1.6 million adjustment related to a change in the amortization method from the effective interest rate method to the straight-line method. Second, a $7.8 million increase in amortization of the deferred amount on refunding is attributable to a $3.2 million loss relating to Series AG bonds, a $3.5 million write off of Series S bonds, which was refunded by Series AG, and a $2.5 million adjustment related to a change in the amortization method from the effective interest rate method to the straight-line method. Third, a $4.6 million increase of debt service was attributed to a $9.4 million adjustment relating to a prior period; interest expense, excluding this adjustment actually decreased by $4.6 million.

Other Revenues (Expenses)

Other revenues were $5.5 million in fiscal 2011, versus $7 million in fiscal 2010 and $53.5 million in expenditures in 2009. The $1.5 million decrease in 2011 is primarily the result of a $10 million decrease in unrealized gains and losses due to the abandonment of gas hedging activities, offset by a $500 thousand increase in investment income and $8.9 million increase in bond proceeds. The $8.9 million increase is primarily the result of a $5.8 million Springing

Amendment debt service reserves released in fiscal 2010, and a $3.8 million increase in bond proceeds for Series AH.

The $60.5 million increase in 2010 is primarily the result of a $41.5 million change in the fair value of the gas hedging account, $23.3 million change due to the release of debt service reserves in accordance with the Springing Amendment recorded in fiscal 2009 and $4.7 million change in the amounts refunded to the Water Contractors, offset by a decrease of $7.8 million in income from surplus money investments attributable to a decline in average interest rate for 2.2% in 2009 to 0.648% in 2010.

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State Water Resources Development System
Statements of Net Assets
June 30, 2011 and 2010 (in thousands)

	2011	2010
Assets		
Utility plant:		
Utility plant in service	$ 5,028,895	$ 4,909,265
Less accumulated depreciation	(2,194,406)	(2,094,306)
Net utility plant in service	2,834,489	2,814,959
Construction work in progress	366,975	400,229
Total utility plant	3,201,464	3,215,188
Long-term assets:		
Restricted assets:		
Cash and cash equivalents restricted for plant replacements	38,502	38,417
Cash and investments restricted for debt service	114,346	111,883
Cash and cash equivalents on deposit with revenue bond trustee	9,208	9,208
Loans receivable from local water agencies	21,040	22,610
Advance to other state funds	91,517	91,517
Total long-term assets	274,613	273,635
Current assets:		
Cash and cash equivalents	464,978	459,226
Receivables:		
Interest on investments	1,726	1,774
Water supply and power billings (net)	80,301	85,046
Due from federal government	19,625	24,314
Due from others	480	-
Inventories	32,984	23,081
Total current assets	600,094	593,441
Deferred charges:		
Amounts recoverable through future billings under long-term water supply contracts:		
Capital costs	-	41,487
Capital credit due from water contractors	49,087	35,065
Unamortized project costs	341,585	351,416
Unbilled interest incurred on capital costs	480,345	502,720
Total deferred charges	871,017	930,688
Total assets	$ 4,947,188	$ 5,012,952

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

State Water Resources Development System
Statements of Net Assets (continued)
June 30, 2011 and 2010 (in thousands)

	2011	2010
Capitalization and Liabilities		
Capitalization:		
Net assets:		
Capital, net of related debt	$ 554,854	$ 486,347
Restricted	650,577	719,084
Total net assets	1,205,431	1,205,431
Long-term liabilities		
General obligation bonds	362,375	420,540
Revenue bonds	2,346,444	2,391,179
Commercial paper	54,578	46,473
Other postemployment benefits	97,898	71,448
Pooled Money Investment Account (PMIA) Loan	18,052	21,055
Accrued vacation	29,052	19,921
Pollution remediation	5,080	4,480
Total long-term liabilities	2,913,479	2,975,096
Total capitalization	4,118,910	4,180,527
Current liabilities:		
Current maturities of bonds	174,315	165,245
Accounts payable	59,852	77,954
Accrued vacation	6,632	10,857
Pollution remediation	1,000	400
Accrued interest on long-term debt	17,845	17,401
Pooled Money Investment Account (PMIA) Loan	3,003	2,857
Due to other state funds	36,547	28,283
Proceeds due to water contractors	111,004	121,038
Total current liabilities	410,198	424,035
Deferred credits:		
Deferred revenue - State and Federal capital recovery	152,982	153,997
Operations and maintenance expense	25,281	27,860
Capital costs	25,123	-
Power sales credit due to water contractors	178,222	187,012
Advances for plant replacements	36,472	39,521
Total deferred credits	418,080	408,390
Total net assets and liabilities	$ 4,947,188	$ 5,012,952

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, 2011 and 2010 (in thousands)

	2011	2010
Operating revenues:		
Water supply	$ 885,151	$ 853,158
Power sales	193,154	165,664
Federal reimbursements	17,891	24,021
Total operating revenues	1,096,196	1,042,843
Operating expenses:		
Operations and maintenance	428,559	435,801
Purchased power	342,446	212,658
Depreciation expense	100,257	80,813
Operating expenses recovered, principally under long-term water supply contracts, net	109,535	189,000
Total operating expenses	980,797	918,272
Income from operations	115,399	124,571
Nonoperating revenue (expenses):		
Capital revenues recovered	14,022	19,823
Interest expense	(134,996)	(151,390)
Other revenues (expenses), net	5,575	6,996
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.

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State Water Resources Development System
Statements of Cash Flows
For the years ended June 30, 2011 and 2010 (in thousands)

	2011	2010
Cash flows from operating activities:		
Receipts from customers	$ 1,068,964	$ 1,037,401
Payments to employees for services	(232,016)	(228,070)
Payments to suppliers	(526,170)	(388,496)
Other expenses	(3,040)	(1,638)
Net cash provided by operating activities	307,738	419,197
Cash flows from capital and related financing activities:		
Proceeds from issuance of revenue obligation bonds including premium	81,268	11,781
Principal payments on long-term debt	(165,245)	(152,145)
Commercial paper notes issued	79,643	46,503
Principal payments on commercial paper notes	(71,538)	(9,927)
Principal payments on PMIA note	(2,857)	(3,376)
Interest payments on long-term debt	(144,406)	(146,770)
Additions to utility plant and CWIP	(86,537)	(88,274)
Net cash used by capital and related financing activities	(309,672)	(342,208)
Cash flows from investing activities:		
Cash received from investment earnings	8,944	9,425
Proceeds of investments matured	252,174	252,173
Purchases of investments	(252,174)	(252,173)
Loan payments from local water agencies	1,570	(250)
Net cash provided by investing activities	10,514	9,175
Net increase in cash and cash equivalents	8,580	86,164
Cash and cash equivalents, beginning of year, as restated	543,141	456,977
Cash and cash equivalents, end of year	$ 551,721	$ 543,141
Noncash capital and related financing activities:		
Principal retirements of long-term debt on proceeds received from issuance of Series AH and AG Water System Revenue Bonds	$ 29,785	$ 168,360

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, 2011 and 2010 (in thousands)

	2011	2010
Reconciliation to the statement of net assets:		
Cash and cash equivalents	$ 464,978	$ 459,226
Restricted assets:		
Cash and cash equivalents restricted for plant replacements	38,502	38,417
Cash and cash equivalents restricted for debt service (net of $75,313 and $75,593 of U.S. Agency securities for 2011 and 2010, respectively)	39,033	36,290
Cash and cash equivalents on deposit with revenue bond trustee	9,208	9,208
Cash and cash equivalents	$ 551,721	$ 543,141

	2011	2010
Reconciliation of income from operations to net cash provided by operating activities:		
Income from operations	$ 115,399	$ 124,571
Adjustment to reconcile income from operations to net cash provided by operating activities		
Depreciation expense	100,257	80,813
Other expenses	(3,040)	(1,638)
Decrease in deferred charges and credits, net	83,383	177,581
Changes in assets and liabilities:		
(Increase) decrease in receivables	4,266	(9,476)
(Increase) in inventories	(9,902)	(9,093)
Decrease in due from federal government	4,689	14,796
Increase in accounts payable, accrued vacation, pollution remediation and other postemployment benefits	14,456	24,926
Increase in due to other state funds	8,264	16,061
Increase (decrease) in current proceeds due to Water Contractors	(10,034)	656
Total adjustments	192,339	294,626
Net cash provided by operating activities	$ 307,738	$ 419,197

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

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For the years ended June 30, 2011 and 2010 (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	80 - 100 years
Dams and reservoirs	85 years
Environmental preservation and mitigation	50 years
Power plants	30 - 50 years
Pumping plants	30 - 40 years
Fish protection	35 - 36 years
Facilities	20 - 30 years
Machinery, equipment and vehicles	3 - 5 years
General	5 years

The System's intangible assets, consisting of software, land use and legal rights, and costs associated with the FERC licenses, are included in utility plant in service. Software costs are being amortized on a straight-line basis over a 10 year useful life. Easements are considered permanent with an indefinite useful life, reflected as land use rights, and are nondepreciable.

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 and restricted cash on deposit with revenue bond trustee. 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 maturities of more than three months.

Cash and cash equivalents for the year ended June 30, 2010, has been restated from the amount previously reported by a reduction of $2.3 million representing a groundwater loan that has been reclassified as loans receivable from local water agencies.

Restricted Cash and Investments

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

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

Investments

Cash not required for current use, including restricted cash, is invested in the Surplus Money Investment Fund (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, 2011 and 2010 had a balance of $68.2 billion and $69.4 billion, respectively. The weighted average to maturity of PMIA investments was 237 days and 203 days as of June 30, 2011 and 2010, respectively. The total amount of deposits in SMIF as of June 30, 2011 and 2010 was $35 billion and $37.4 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 $1.1 billion and $2.2 billion as of June 30, 2011 and $600 million and $3.1 billion as of June 30, 2010.

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, 2011, are of a similar nature as those held at June 30, 2010.

Advance to Other State Funds

Advance to Other State Funds represents the System's advance of $92 million to DWR's internal service fund, and functions as a revolving working capital facility for the System.

Receivables

Receivables include amounts due from the Water Contractors and organizations that purchase power from the System, totaling $80,301 and $85,046, net of the allowance for uncollectible amounts, at June 30, 2011 and 2010, respectively. Additionally, the Federal government owed the System $19,625 and $24,314 at June 30, 2011 and 2010, respectively, related to reimbursement for certain costs related to flood control and jointly owned facilities. The allowance for uncollectible amounts totaled $24,275 and $23,790 at June 30, 2011 and 2010, 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 FASB ASC 980, *Regulated Operations*, formerly known as SFAS 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 earned on unrecovered capital costs are classified as deferred charges until billed under the terms of the water supply contracts. Unbilled interest earned 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, 2011 and 2010.

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 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 to the reserve 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
Gains or 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 $16,788 and $31,727 during the years ended June 30, 2011 and 2010, 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 $55,542 and $53,257 for the years ended June 30, 2011 and 2010, respectively, are recorded as Proceeds due to water contractors in the financial statements. The System refunded $52,967 and $49,321 for the years ended June 30, 2011 and 2010, respectively, to the Water Contractors for the 25% bond cover 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 Pronouncement

<u>GASB 51</u>

Effective July 1, 2009, the System implemented 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 GASB 51 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 GASB 51 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). GASB 51 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—

For the years ended June 30, 2011 and 2010 (in thousands)

and of the periodic cost associated with the usage of such service capacity in governmental financial statements.

3. Interests in Jointly Owned Facilities

At June 30, 2011 and 2010, the System owned the following undivided interests in jointly owned facilities:

			System's Share			
	% Owned by System		Utility Plant in Service		Accumulated Depreciation	
	2011	2010	2011	2010	2011	2010
Reid Gardner Power Plant Unit No. 4	67.8%	67.8%	$ 360,539	$ 363,504	$ 323,859	$ 301,089
San Luis joint use facilities	55.0%	55.0%	281,140	255,932	120,960	117,654

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, 2011 and 2010 (in thousands)

4. Utility Plant

The summarized activity of the System's utility plant during 2011 is presented below:

	Beginning Balance June 30, 2010	Additions	Transfers and Deletions	Ending Balance June 30, 2011
Nondepreciable Utility Plant:				
Land	$ 136,129	$ -	$ -	$ 136,129
CWIP	400,229	83,880	(117,134)	366,975
Land use rights	10,925	80	-	11,005
Other intangible assets	81,976	-	-	81,976
Total nondepreciable utility plant	629,259	83,960	(117,134)	596,085
Depreciable Utility Plant:				
Aqueducts	2,029,898	27,539	-	2,057,437
Dams & reservoirs	765,246	15,864	-	781,110
Power plants	909,904	196	-	910,100
Pumping plants	784,247	2,761	-	787,008
Environmental preservation and mitigation	67,797	-	-	67,797
Fish protection	33,934	-	-	33,934
Facilities	-	64,810	-	64,810
Equipment and other depreciable assets	65,580	2,616	(200)	67,996
Computer software	23,629	-	-	23,629
General	-	5,964	-	5,964
	4,680,235	119,750	(200)	4,799,785
Less: accumulated depreciation	(2,084,854)	(97,894)	157	(2,182,591)
Less: accumulated amortization	(9,452)	(2,363)	-	(11,815)
	(2,094,306)	(100,257)	157	(2,194,406)
Total depreciable plant	2,585,929	19,493	(43)	2,605,379
Total Utility Plant - net	$ 3,215,188	$ 103,453	$ (117,177)	$ 3,201,464

For the years ended June 30, 2011 and 2010 (in thousands)

The summarized activity of the System's utility plant during 2010 is presented below:

	Beginning Balance June 30, 2009	Additions	Transfers and Deletions	Ending Balance June 30, 2010
Nondepreciable Utility Plant:				
Land	$ 136,129	$ -	$ -	$ 136,129
CWIP	461,208	83,776	(144,755)	400,229
Land use rights	10,925	-	-	10,925
Other intangible assets	80,659	1,317	-	81,976
Total nondepreciable utility plant	688,921	85,093	(144,755)	629,259
Depreciable Utility Plant:				
Aqueducts	1,949,071	80,827	-	2,029,898
Dams & reservoirs	765,246	-	-	765,246
Power plants	845,977	63,928	-	909,904
Pumping plants	784,247	-	-	784,247
Environmental preservation and mitigation	67,797	-	-	67,797
Fish protection	33,934	-	-	33,934
Equipment and other depreciable assets	64,515	3,182	(2,117)	65,580
Computer software	23,629	-	-	23,629
	4,534,416	147,937	(2,117)	4,680,235
Less: accumulated depreciation	(2,008,521)	(78,450)	2,117	(2,084,854)
Less: accumulated amortization	(7,089)	(2,363)	-	(9,452)
	(2,015,610)	(80,813)	2,117	(2,094,306)
Total depreciable plant	2,518,806	67,124	-	2,585,929
Total Utility Plant - net	$ 3,207,727	$ 152,217	$ (144,755)	$ 3,215,188

5. Investments

As of June 30, 2011, 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	$ 3	$ -	$ -	$ -	$ -	$ 3
PMIA	Not Rated	-	-	542,510	-	-	542,510
US Federal Agency Notes							
Federal National Mortgage Association	AAA	-	51,000	-	-	24,313	75,313
							617,826
Investment with Fiscal Agent							
Money Market Mutual Funds	AAA	9,208	-	-	-	-	9,208
Total Investments							$ 627,034

For the years ended June 30, 2011 and 2010 (in thousands)

As of June 30, 2010, 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	$ 15,849	$ -	$ -	$ -	$ -	$ 15,849
PMIA	Not Rated	-	-	518,084	-	-	518,084
US Federal Agency Notes							
Federal National Mortgage Association	AAA	-	51,136	-	-	24,457	75,593
							609,526
Investment with Fiscal Agent							
Money Market Mutual Funds	AAA	9,208	-	-	-	-	9,208
Total Investments							$ 618,734

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, 2011 and 2010, nearly 12% 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, 2011 and 2010, was as follows:

For the years ended June 30, 2011 and 2010 (in thousands)

	2011	2010
Federal National Mortgage Association	$ 75,313	$ 75,593

Interest on deposits in PMIA varies with the rate of return of the underlying portfolio and averaged 0.495% and 0.651% for the years ended June 30, 2011 and 2010, respectively. For the years ended June 30, 2011 and 2010, interest earned on the deposits with PMIA approximated $2,947 and $3,438, respectively and are included in the 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) is calculated as follows:

	2011	2010
Fair Value of Investments at the beginning of the fiscal year	$ 75,593	$ 75,477
Less: Proceeds of investments matured in fiscal year	(252,174)	(252,173)
Add: Purchase of investments in fiscal year	252,174	252,173
Add: Amortization of discounts	63	63
Change in fair value of investments during fiscal year	(343)	53
Fair value of investments at the end of the fiscal year	$ 75,313	$ 75,593

6. Long-term Debt

The following is a summary of changes in long-term debt for the years ended June 30, 2011 and 2010:

	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, 2009	$ 531,700	$ 2,517,790	$ 93,176	$ (31,808)	$ 2,579,158	$ 9,897	$ 27,288	$ 3,148,043
Additions	-	169,115	11,026	3,284	183,425	46,503	-	229,928
Payments/amortization	(54,785)	(265,720)	746	2,440	(262,534)	(9,927)	(3,376)	(330,622)
Balance at June 30, 2010	476,915	2,421,185	104,948	(26,084)	2,500,049	46,473	23,912	3,047,349
Additions	-	97,675	13,378	(4,809)	106,244	79,643	-	185,887
Payments/amortization	(56,375)	(138,655)	(6,677)	1,633	(143,699)	(71,538)	(2,857)	(274,469)
Balance at June 30, 2011	420,540	2,380,205	111,649	(29,260)	2,462,594	54,578	21,055	2,958,767
Less current portion	(58,165)	(116,150)	-	-	(116,150)	-	(3,003)	(177,318)
Total Long-term Debt	$ 362,375	$ 2,264,055	$ 111,649	$ (29,260)	$ 2,346,444	$ 54,578	$ 18,052	$ 2,781,449

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 Project 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 the bonds become 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.

As of June 30, 2011 the amount of the revenues pledged to repay the Burns-Porter Act WRD General Obligation Bonds debt service is $497,359 with payments through 2025. Principal and interest paid for the current year were $76,436 and Burns-Porter Act Water Supply operating revenues were $564,520. As of June 30 2010 the amount of the revenues pledged to repay the Burns-Porter Act WRD General Obligation Bonds debt service were $573,795 with payments through 2025. Principal and interest paid for 2010 were $77,259 and Burns-Porter Act Water Supply operating revenues were $547,435.

WRD General Obligation Bonds of $168 million are authorized but un-issued as of June 30, 2011 and 2010, 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.

For the years ended June 30, 2011 and 2010 (in thousands)

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 2011	Amounts Outstanding 2010
1964	A	0.1-3.6%	2014	$ 12,000	$ 16,000
1964	B&C	0.05-3.7%	2015	22,000	28,000
1965	D&E	3.0-3.8%	2016	38,600	46,500
1966	F&G	3.5-4.1%	2017	50,400	57,800
1967	H,J&K	3.0-4.8%	2018	83,000	93,900
1968	L&M	4.0-4.9%	2019	65,000	72,000
1970	N&P	5.0-5.8%	2020	72,000	78,600
1971	Q&R	4.8-5.2%	2021	58,950	63,750
1972	S	5.3-5.5%	2022	17,000	18,240
1991	W	10.0%	2012	450	900
1993	X	4.8%	2024	650	700
1994	Y	6.8-7.1%	2025	490	525
Total General Obligation bond debt outstanding at par				420,540	476,915
Less current maturities				(58,165)	(56,375)
Total long-term General Obligation bond debt outstanding				$ 362,375	$ 420,540

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.

As of June 30, 2011, the amount of the revenues pledged to repay the (CVP) Revenue Bonds debt service is $3,541,604 with payments through 2036. Principal and interest paid for the current year were $228,511 and Central Valley Project Act Water Supply operating revenues were $320,631. As of June 30, 2010, the amount of the revenues pledged to repay the (CVP) Revenue Bonds debt service were $3,649,000 with payments through 2033. Principal and interest paid for the year were $220,306 and Central Valley Project Act Water Supply operating revenues were $305,723.

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.

For the years ended June 30, 2011 and 2010 (in thousands)

Certain of the bonds are redeemable prior to maturity at redemption prices varying from 100% to 101%.

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 2011	Amounts Outstanding 2010
Devil Canyon-Castaic Facilities:						
1973	A&B	5.3-5.4%	2023	1983	$ 77,540	$ 81,875
CVP Water System:						
1992	J	5.5-7.0%	2013	2001	53,535	53,535
1997	Q	5.1-6.0%	2011	2007	-	8,955
1999	V	6.25%	2025	None	20,235	20,235
2001	W	4.6-5.5%	2030	2012	153,365	177,985
2002	X	4.0-5.5%	2030	2012	122,550	149,540
2003	Y	5.0-5.3%	2026	2013	251,975	268,270
2003	Z	3.0-5.0%	2020	2013	110,525	118,955
2003	AA	5.00%	2024	2013	107,215	107,215
2005	AC	3.0-5.0%	2030	2015	262,470	267,115
2006	AD	3.0-5.0%	2030	2015	109,520	109,955
2008	AE	3.0-5.0%	2030	2018	595,565	616,190
2009	AF	2.0-5.0%	2033	2019	248,920	272,245
2010	AG	2.0-5.0%	2033	2020	169,115	169,115
2011	AH	3.0-5.3%	2036	2021	97,675	-
	Total revenue bond debt outstanding at par				2,380,205	2,421,185
	Net Unamortized bond issuance premiums/discounts				111,649	104,948
	Net Deferred gain/loss on refunding				(29,260)	(26,084)
	Current fiscal maturities				(116,150)	(108,870)
	Total long-term bond debt outstanding				$ 2,346,444	$ 2,391,179

For the years ended June 30, 2011 and 2010 (in thousands)

Future Debt Service Requirements

Future principal and interest payment requirements on the bonds are as follows at June 30, 2011:

	General Obligation Bonds		Revenue Bonds		
Year	Principal	Interest	Principal	Interest	Total
2012	$ 58,165	$ 17,563	$ 116,150	$ 116,258	$ 308,136
2013	59,455	15,008	124,155	110,074	308,692
2014	61,085	12,503	115,905	104,111	293,604
2015	56,875	10,098	113,235	98,598	278,806
2016	49,915	7,742	118,665	92,870	269,192
2017-2021	132,955	13,779	628,475	370,585	1,145,794
2022-2026	2,090	125	649,105	208,313	859,633
2027-2031	-	-	488,065	57,390	545,455
2032-2036	-	-	26,450	3,200	29,650
	$ 420,540	$ 76,818	$ 2,380,205	$ 1,161,399	$ 4,038,962

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). 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.

For the years ended June 30, 2011 and 2010 (in thousands)

The minimum future principal and interest payment requirements on the PMIA loan are as follows at June 30, 2011:

Year	Principal	Interest	Total
2012	$ 3,003	$ 997	$ 4,000
2013	3,156	844	4,000
2014	3,317	683	4,000
2015	3,486	514	4,000
2016	3,663	337	4,000
2017 - 2018	4,430	157	4,587
	$ 21,055	$ 3,532	$ 24,587

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, 2011 and 2010, there were borrowings of $54,578 and $46,473, respectively, outstanding under this program. The weighted average for interest expense approximated 0.31% for both years ended June 30, 2011, and 2010, 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 the 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 November 2010, the System issued CVP Water System Revenue Bonds-Series AH in the amount of $97,675 plus the premium of $13,378, for a total of $111,053 with an average yield on the bonds of 3.33%. The bond proceeds along with System funds on hand in the amount of $684 were used to defease $29,785 of outstanding bonds, fund $3,641 of future interest on the defeased bonds, redeem commercial paper borrowings of $71,538, fund capitalized interest of $3,630, fund deposits to the debt service reserve account of $2,525, and cover costs of issuance of $618. The proceeds of the Series AH were used to advance refund CVP Water System Revenue Bonds Series W with a par amount of $2,905, and CVP Water System Revenue Bonds Series X with a par amount of $22,630, and CVP Water System Revenue Bonds Series AC with a par amount of $4,250. 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. As a result, the current refunded bonds are considered to be defeased and the related liabilities have been removed from the financial statements.

Revenue Bond debt service has increased by $121,365 over the life of the bonds when compared to debt service prior to the issuance of Series AH.

The refunding of Series W, Series X and Series AC bonds resulted in a total economic gain (Net Present Value) of approximately $272, $1,554 and $158 respectively. In addition, the refunding transactions resulted in cash flow savings of approximately $396 on Series W bonds, $2,139 on Series X bonds and $191 on Series AC bonds.

The total amount of bonds refunded in advance and still outstanding was $83,250 and $65,125 as of June 30, 2011 and 2010, 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. 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, 2011 and 2010 (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 year ended June 30, 2011, was 17.528% and 16.442% for State Miscellaneous Tier 1 and Tier 2, respectively. For the year ended June 30, 2010, the required employer contribution rate for Tiers 1 and 2 were 16.92% and 16.74%, 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, 2011 and 2010, the System's annual pension cost and actual contribution amounted to approximately $23 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, 2011 and 2010, approximated 1.1% for both years, of the total actuarially determined contribution requirements for the State Miscellaneous Category and approximately 16.12% and 14.28%, respectively, of the total System payroll. The required contribution for the year ended June 30, 2011 was determined as part of the June 30, 2009, 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
2009	$ 19,815	100%
2010	18,384	100%
2011	23,013	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, 2011 and 2010 (in thousands)

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

	2011	2010
Annual required contribution (ARC)	$ 41,382	$ 35,525
Interest on net OPEB obligation	3,248	1,922
Adjustment to the ARC	(2,849)	(1,686)
Annual OPEB cost	41,781	35,761
Contributions made	(15,331)	(12,210)
Increase in net OPEB obligation	26,450	23,551
Net OPEB obligation - beginning of year	71,448	47,897
Net OPEB obligation - end of year	$ 97,898	$ 71,448

The System's annual required contribution, percentage of the ARC contributed to the plan, and the net OPEB obligation for the fiscal year ended June 30, 2011, 2010 and 2009, were as follows:

Fiscal Year Ended	Annual Required Contribution	Percentage of ARC Contributed	Net OPEB Obligation
6/30/2009	$41,464	32%	$47,897
6/30/2010	$35,525	34%	$71,448
6/30/2011	$41,382	37%	$97,898

The annual OPEB cost (AOC) recorded by the System is calculated by the State and represents an allocation of the total ARC of the State, adjusted for interest and other adjustments. The allocation of retiree health benefit costs is based on the number of active employees funded by the System in relation to the total Department retiree health benefits costs.

The actuarial valuation report for OPEB may be obtained by writing to the Office of State Controller John Chiang, P.O. Box 942850, Sacramento, CA 94250 or by visiting the State Controller's Web site at www.SCO.ca.gov. The System's ARC, AOC and Net OPEB obligation will be calculated and adjusted for on an annual basis.

For the years ended June 30, 2011 and 2010 (in thousands)

10. Commitments and Contingencies

Commitments

Construction

The System has entered into long-term construction contract commitments for the State Water Project facilities. The remaining value of contracts in process as of June 30, 2011 and June 30, 2010, approximated $62,532 and $51,261, respectively.

Power Transmission and Purchase

The System has long-term power transmission service contracts requiring future payments of approximately $104,934 over periods ranging from one to 29 years. Payments made under these contracts approximated $14,885 and $5,348 for the years ended June 30, 2011 and 2010, respectively.

The System has also entered into long-term power purchase contracts requiring future payments of approximately $196,410 over periods ranging from one to 26 years. Payments made under these contracts, excluding payments to the Kings River Conservation District (District) to cover debt service, approximated $26,706 and $43,423 for the years ended June 30, 2011 and 2010, respectively.

The remaining amounts of fixed obligations under the long-term power purchase and transmission contracts as of June 30, 2011, are as follows:

For the year ended	Fixed Obligations
2012	$ 40,026
2013	40,026
2014	32,590
2015	26,029
2016	13,283
2017 - 2039	149,390
	$ 301,344

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 2019. Payments to the District totaled approximately $14,212 and $12,996 during the years ended June 30, 2011 and 2010, respectively.

The amounts of fixed obligations of the System related to future principal and interest payments of the District's bonds as of June 30, 2011 are as follows:

For the years ended June 30, 2011 and 2010 (in thousands)

For the year ended	Fixed Obligations	
2012	$	4,335
2013		4,310
2014		4,302
2015		4,272
2016		4,270
2017 - 2019		12,749
	$	34,238

DWR entered into a Power Sales Agreement with the Northern California Power Agency (NCPA) and other project participants on May 24, 2010 to participate in the Lodi Energy Center Project (LEC Project), which will consist of a 296 megawatt natural gas-fired combined cycle power plant constructed by NCPA in Lodi, California. The terms of the agreement provide that DWR will receive 33.5 percent of the output of the LEC Project. Participation in the LEC Project will assist DWR in meeting future State Water Project energy requirements, including the replacement of energy currently provided by the Reid Gardner Project. NCPA issued revenue bonds on June 24, 2010 for the DWR's share of construction costs. Construction of the LEC Project commenced in early August 2010 with scheduled operation beginning in June 2012. DWR anticipates that the LEC will be one of the most efficient thermal generating units in California and that it will be economically dispatched before other gas-fired units, resulting in power revenues that are sufficient to cover the operational costs and a portion of DWR’s debt service on the bonds.

The amounts of fixed obligations of the System related to future principal and interest payments of the LEC’s bonds as of June 30, 2011 are as follows:

For the year ended	Fixed Obligations	
2012	$	-
2013		6,173
2014		9,131
2015		9,207
2016		9,209
2017 - 2021		46,037
2021 - 2026		46,044
2026 - 2031		46,038
2032 - 2035		36,833
	$	208,672

Market value information for certain purchase power, sale and exchange contracts are disclosed at June 30, 2011, using forward market prices discounted at the prevailing risk-free interest rate. Except as discussed below, all energy sales and purchases expire before December 31, 2011. Twelve purchase and three sales contracts expire in 2011, six purchase contracts expire in 2012, three purchase contracts expire in 2013, and one purchase contract expires in 2015. 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 \$8.1 and \$5.9 million for the years ended June 30, 2011 and 2010, respectively.

For the years ended June 30, 2011 and 2010 (in thousands)

	Number of Contracts	Total Capacity (MWh)	Fair Value at June 30, 2011
Energy sales	27	875	$ (470)
Energy purchases	34	1050	(28,309)
Long-term energy purchases	3	450	211,512
Total			$ 182,733

The System entered into transactions to hedge the price of natural gas through bilateral arrangements, but has terminated and settled all contracts effectively as of June 30, 2010 and as a result, the System incurred a \$4.9 million loss. This loss was offset against the deposit held at the brokerage firm and was recorded as a deferred amount as of June 30, 2010. The amount of the loss was recognized in fiscal year 2010-11 when the service contracts relating to the loss expired. During fiscal year 2010-11, the System transferred the balance of \$15.8 million that remained from the deposit back to the State Treasury, leaving a minimal balance with the brokerage firm. The fair value of the Futures and Options was \$0 and \$15.8 million as of June 30, 2011 and 2010, respectively. The System recognized a loss of \$4.9 million in fiscal year 2011 and a deferred loss of \$4.9 million for fiscal 2010, 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 was required to prepare a new EIR. DWR completed the new Final EIR in February 2010 and filed its Notice of Determination in May 2010. In June 2010, two Delta water agencies and several environmental organizations and individuals filed a lawsuit in Sacramento Superior Court challenging the Department's California Environmental Quality Act (CEQA) compliance and the validity of the Monterey Amendment, including DWR's transfer of the Kern Fan Element to the KCWA. In July 2010, the same plaintiffs in the Sacramento Superior Court case filed a lawsuit in Kern County Superior Court challenging the transfer of the Kern Fan Element from KCWA to the Kern Water Bank Authority, a local joint powers agency which now has responsibility for the management of the Kern Fan Element and Kern Water Bank. In addition, in June 2010, two water districts in Kern County filed a separate lawsuit in Kern County Superior Court, primarily challenging DWR's CEQA compliance with respect to the Kern Fan Element transfer from the DWR to KCWA. The two lawsuits filed in Kern County Superior Court have been transferred to the Sacramento Superior Court. All three cases are in the pre-trial stage. The System, however, does not believe that there would be any material adverse impact on the System's financial position or results from operations, even if these lawsuits are successful.

2005 Contractor Lawsuit Regarding Oroville Power Credits

In April, 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 Delta Water 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 in December, 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 DWR and the Water Contractors which intervened in support of the DWR, finding that DWR's determinations and administration of the provisions regarding Oroville power credits were consistent with the water supply contracts. In May 2010, the Superior Court entered its judgment in favor of DWR and in July 2010, the Water Contractor plaintiffs appealed the lower 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, DWR 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. The System rectified the situation by restating past bills to provide appropriate credits back to the Water Contractors for the contested charges and taking 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. 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 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, 2012 the running of the time period and statute of limitations for filing by the Water Contractors of (1) protests regarding the System's bills to the Water Contractors for the years 2007 through 2013, (2) claims arising from the System'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 Agreements expire.

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. Trial of the consolidated cases began in August 2011 and is expected to conclude in December 2011. The trial Judge's decision is expected within 90 days after the conclusion of the trial. The System 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 from 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 System's financial position or results from operations. 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 February 29, 2012. 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.

Pollution Remediation

Reid Gardner Power Plant

The Reid Gardner (R-G) Power Plant, located near Moapa, Nevada, is operated by Nevada Energy (NVE) and consists of four coal-powered generators—Units 1 through 4. Units 1–3 are 100% owned by NVE, whereas the capital ownership of Unit 4 is shared between the DWR and NVE at 67.8% and 32.2%, respectively. Additionally, DWR has a 29.2% share of the R-G facilities necessary for and common to all four units.

In February 2008, NVE entered into an Administrative Order on Consent (AOC) with the Nevada Division of Environmental Protection (NDEP). Pursuant to the AOC, NVE agreed to undertake investigatory activities and also to remediate the groundwater contamination attributable to the R-G facility. Groundwater and soils have been affected by certain chemicals of interest associated with flue gas desulfurization effluent settlement and evaporation ponds. Since some of this contamination can be associated with the Unit 4 ponds, DWR, as co-owner of Unit 4, has voluntarily commenced participation in NVE's groundwater remediation activities. These activities are projected to continue through at least 2023.

Based on a review of NVE's planned remediation activities, it is estimated that DWR's equitable share of the current value of outlays could range between $2 million and $8.4 million, with the lower value considered to be a better estimate because it is based on a quantitative assessment of constituents of concern currently known to DWR. DWR calculated the potential financial liability by estimating a reasonable range of potential outlays and applying an estimated probability of occurrence to the potential outlays, yielding a current total expected liability of $4,880. DWR expects to pay $400 of the total expected liability during FY 2011/2012. The total remediation outlay estimate is expected to be refined, and adjusted accordingly, as additional site assessment information is available to DWR.

Delta Basin Plan: Mercury Control Program

In June 2011, the State Water Resources Control Board adopted an amendment to the Sacramento-San Joaquin Delta Basin Plan regarding the control in the Delta of methylmercury. The amendment, among other things, assigns certain responsibilities jointly to the Department (with regard to both the System and the Department's flood management programs), the Central Valley Flood Protection Board and the State Lands Commission to reduce methylmercury in the open waters of the Delta. In addition, the Department and others are assigned certain responsibilities regarding the discharge of methylmercury from wetland and other aquatic restoration and enhancement projects. The required actions are divided into two phases. Phase I, which lasts for up to nine years until June 2020, emphasizes studies and pilot projects to control methylmercury, along with some implementation, and Phase II requires implementation of measures to achieve required methylmercury levels by 2030. In July 2011, an organization representing twenty-seven System Water Contractors filed a lawsuit against the State Water Resources Control Board and the Central Valley Regional Water Quality Control Board challenging the portion of the Basin Plan amendment that requires the Department in its capacity as operator of the System to reduce methylmercury in the open waters of the Delta. The Department was named as a real party in interest in the lawsuit. The Contractors contend that since the System's water management activities do not add or introduce methylmercury into the Delta, there is no basis in law for assigning responsibility to the System to reduce the methylmercury that is present in the open waters of the Delta.

The Department estimates that during FY 2011/2012 and 2012/2013, the System may incur up to about $600 per year on Phase I activities. The ultimate amount to be expended by the System will depend, among other things, upon the results of the Phase I studies and pilot projects, the outcome of the Water Contractors' lawsuit challenging the inclusion of the System in the assignment of responsibility for reducing methylmercury in the open waters of the Delta and the distribution of costs among the parties ultimately determined to be responsible.

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.

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 55% and 57% of total System water supply revenue for the years ended June 30, 2011 and 2010, respectively, and Kern County Water Agency whose System billings constituted 10% and 9% of total System water supply revenue for the years ended June 30, 2011 and 2010, respectively.

For the years ended June 30, 2011 and 2010 (in thousands)

The System sold power to 13 power companies during the fiscal year ended June 30, 2011. 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 excluding power sold to the water contractors in the amount of $25.8 million.

	2011	% Total	2010	% Total
California Independent System Operator	$ 104,079	62.20%	$ 58,979	40.91%
BP Energy Company	19,012	11.36%	19,170	13.30%
Citigroup Energy Inc.	15,333	9.16%	19,153	13.29%
Morgan Stanley Capital Group Inc.	11,914	7.12%	-	-
Sempra Energy Trading Corp.	-	-	25,132	17.43%

Similarly, the System purchased power from 17 power suppliers during the fiscal year ended June 30, 2011 with the California Independent System Operator providing the highest percentage to the System at 48.95% of the total. The following table shows power purchases from suppliers which exceeded 5% of the total power purchased by the System.

	2011	% Total	2010	% Total
California Independent System Operator	$ 168,338	48.95%	$ 75,044	36.31%
Morgan Stanley Capital Group Inc.	55,199	16.05%	46,820	22.65%
Citigroup Energy Inc.	20,241	5.89%	-	-
Sempra Energy Trading Corp.	17,811	5.18%	21,147	10.23%
B P Energy Company	22,667	6.59%	-	-
Kings River Conservation District	17,950	5.22%	13,844	6.70%

For the years ended June 30, 2011 and 2010 (in thousands)

13. Segment Information

The table below presents the condensed statements of net assets, the statements of activities and the statements of cash flows for the System's two segments, as of and for the years ended June 30, 2011 and 2010.

	2011			2010		
	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	$ 882,579	$ 2,318,885	$ 3,201,464	$ 907,303	$ 2,307,885	$ 3,215,188
Other assets	793,817	351,813	1,145,630	1,086,846	117,477	1,204,323
Current assets	261,298	338,796	600,094	286,591	306,850	593,441
Total assets	$1,937,694	$ 3,009,494	$ 4,947,188	$2,280,740	$ 2,732,212	$ 5,012,952
Capitalization and Liabilities						
Capitalization:						
Net assets:						
Capital (deficit), net of related debt	$ 728,142	$ (173,288)	$ 554,854	$ 693,632	$ (207,285)	$ 486,347
Restricted	481,116	169,461	650,577	484,843	234,241	719,084
Total net assets	1,209,258	(3,827)	1,205,431	1,178,475	26,956	1,205,431
Long-term liabilities	507,979	2,405,500	2,913,479	532,966	2,442,130	2,975,096
Total capitalization	1,717,237	2,401,673	4,118,910	1,711,441	2,469,086	4,180,527
Current liabilities	145,319	264,879	410,198	178,011	246,024	424,035
Other liabilities	75,139	342,941	418,080	391,288	17,102	408,390
Total capitalization and liabilities	$1,937,695	$ 3,009,493	$ 4,947,188	$2,280,740	$ 2,732,212	$ 5,012,952
Condensed Statements of Revenues, Expenses and Changes in Net Assets:						
Operating revenues:						
Water supply	$ 564,520	$ 320,631	$ 885,151	$ 547,435	$ 305,723	$ 853,158
Power sales	190,993	2,161	193,154	158,427	7,237	165,664
Federal reimbursements	18,425	(534)	17,891	22,491	1,530	24,021
	773,938	322,258	1,096,196	728,353	314,490	1,042,843
Depreciation expense	(29,264)	(70,993)	(100,257)	(30,653)	(50,160)	(80,813)
Other operating expense	(707,463)	(173,077)	(880,540)	(654,613)	(182,846)	(837,459)
Income from operations	37,211	78,188	115,399	43,087	81,484	124,571
Capital expenses (deferred) recovered	(18,570)	32,592	14,022	(32,007)	51,830	19,823
Interest expense	(20,255)	(114,741)	(134,996)	(22,290)	(129,100)	(151,390)
Transfers In	(8,385)	(24,309)	(32,694)	(13,275)	(81,057)	(94,332)
Transfers Out	12,648	20,046	32,694	92,609	1,723	94,332
Other (expense) income	(2,649)	8,224	5,575	(68,124)	75,120	6,996
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	$ 73,429	$ 234,309	$ 307,738	$ 291,929	$ 127,268	$ 419,197
Capital and related financing activities	(88,894)	(220,778)	(309,672)	(164,815)	(177,393)	(342,208)
Investing activities	3,713	6,801	10,514	1,220	7,955	9,175
Net (decrease) increase in cash and cash equivalents	(11,752)	20,332	8,580	128,334	(42,170)	86,164
Cash and equivalents, beginning of year	255,880	287,261	543,141	127,546	329,431	456,977
Cash and equivalents, end of year	$ 244,128	$ 307,593	$ 551,721	$ 255,880	$ 287,261	$ 543,141

14. New Governmental Accounting Standards

GASB Statement No. 60

In November 2010, the GASB issued Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements.* This statement addresses how to account for and report service concession arrangements (SCAs), a type of public-private or public-public partnership that state and local governments are increasingly entering into. The requirements of GASB No. 60 are effective for fiscal year 2013 and thereafter. The System is currently evaluating the impact this statement will have, if any, on its financial statements.

GASB Statement No. 61

In November 2010, the GASB issued Statement No. 61, *The Financial Reporting Entity: Omnibus.* This statement amends GASB Statement No. 14 and GASB Statement No. 34, to modify certain requirements for inclusion of component units in the financial reporting entity, to amend the criteria for reporting component units as if they were part of the primary government in certain circumstances, and clarifies the reporting of equity interests in legally separate organizations. The requirements of GASB No. 61 are effective for fiscal year 2013 and thereafter. The System is currently evaluating the impact this statement will have, if any, on its financial statements.

GASB Statement No. 62

In December 2010, the GASB issued Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements.* The requirements in this Statement will improve financial reporting by contributing to the GASB's efforts to codify all sources of generally accepted accounting principles for state and local governments so that they derive from a single source. The requirements of Statement No. 62 are effective for the System beginning in fiscal 2013. The System is currently evaluating the impact this statement will have, if any, on its financial statements.

GASB Statement No. 63

In June 2011, the GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position.* This Statement provides financial reporting guidance which standardizes the presentation of deferred outflows of resources and deferred inflows of resources and their effects on a government's net position. The requirements of Statement No. 63 are effective for the System beginning in fiscal 2013. The System is currently evaluating the impact this statement will have, if any, on its financial statements.

GASB Statement No. 64

In June 2011, the GASB issued Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions an amendment of GASB Statement No. 53.* The objective of this Statement is to clarify whether an effective hedging relationship continues after the replacement of a swap counterparty or a swap counterparty's credit support provider. The requirements of Statement No. 64 are effective for the System beginning in fiscal 2013. The System does not expect this statement to have any impact on its financial statements.

15. Subsequent Events

The System delivered the CVP Water System Revenue Bonds Series AI on September 7, 2011 pursuant to a purchase agreement among the Department, the State Treasurer and the Underwriters executed on November 1, 2010. The delayed delivery of the Series AI Bonds was necessary in order to achieve a current refunding of the Series W Refunded Bonds for purposes of the Internal Revenue Code 1986, as amended. The CVP Water system Revenue Bonds Series AI were issued with a par amount of $92.3 million and a premium of $12.5 million, with an average yield on bonds of 3.06%. The bond proceeds, along with System funds on hand in the amount of $1.8 million were used to defease $103.2 million of outstanding bonds by depositing $105.9 million in an irrevocable escrow account, and to cover costs of issuance of $0.7 million.

In October 2011, the System issued CVP Water System Revenue Bonds Series AJ with a par amount of $216.9 million and a premium of $30.5 million with an average yield on the bonds of 3.13%. The bond proceeds along with System funds on hand in the amount of $3.1 million were used to defease $155.2 million of outstanding bonds by a tender refunding, fund redemption premium of $16 million, fund accrued interest of $3 million, redeem commercial paper borrowings of $69.3 million, fund capitalized interest of $3.7 million, fund deposits to the debt service reserve account of $1.6 million and cover costs of issuance of $1.7 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, 2011 and 2010 (in thousands)

	2011	2010
Water supply revenues, including $55,606 in 2011 and $54,085 in 2010 in refundable proceeds	$341,449	$333,746
Less: Operation and maintenance expense	(61,192)	(62,579)
Net revenues available for debt service	280,257	271,167
Principal and interest for revenue bonds	$219,974	$211,786
Debt service coverage	127.4%	128.0%

Note: Section 805 of the general bond resolution for the Central Valley Project (CVP) Water system Revenue Bonds states, "The total amount of Revenues receivable under all Water Supply Contracts in any Year shall be the sum of (A) 1.25 times the Annual Debt Service for such Year to be paid from the Revenue Fund, plus (B) the amount estimated by the Department, pursuant to Section 605, to be required from the Revenue Fund in such Year to provide for Water System Operating Expenses…"

The Supplementary Information, Calculation of Adequacy of Debt Service Coverage for the Central Valley Project Revenue Bonds does not include water supply revenues of $16,385 or principal and interest payments for the Devil Canyon Castaic Facilities Bonds (DCC) since the DCC General Bond resolution does not require cover to be collected for these bonds. In addition, the water supply revenues include projected current year minimum over/under collections of $28,069 less refunds and adjustments of $9,666 primarily related to operations and maintenance. The operations and maintenance expense consist of only the Off Aqueduct and East Branch Enlargements projects because they are funded under the Central Valley Project Act.

Edmund G. Brown Jr.
Governor, State of California

John Laird
Secretary of Resources,
The Natural Resources Agency

Mark Cowin
Director, Department of Water Resources