Department of Water Resources
Electric Power Fund
Financial Statements

March 31, 2005

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Department of Water Resources Electric Power Fund
Management's Discussion and Analysis

USING THIS REPORT

This discussion and analysis is designed to assist the reader in focusing on significant financial issues and activities and to identify any significant changes in financial position of the Department of Water Resources Electric Power Fund (Fund), which is administered by the California Department of Water Resources (DWR). Readers are encouraged to consider the information presented in conjunction with the financial statements as a whole, which follows *Management's Discussion and Analysis*. This discussion and analysis and the financial statements do not relate to DWR's other governmental and proprietary funds.

The basic financial statements include three required statements, which provide different views of the Fund. They are: the statement of net assets, the statement of revenues, expenses and changes in net assets and the statement of cash flows. These statements provide current and long-term information about the Fund and its activities. These financial statements report information using accounting methods similar (although not identical) to those used by private sector companies. The statement of net assets includes all assets and liabilities as of a specified date. The statement of revenues, expenses and changes in net assets presents all of the revenues and expenses for a specified time period. The final required statement is the statement of cash flows. This statement reports cash receipts, disbursements and the net change in cash resulting from three principal types of activities; operating activities, financing activities and investing activities. In order for the basic financial statements to be complete, they must be accompanied by a complete set of footnotes. The notes to the financial statements provide disclosures which are required to conform with generally accepted accounting principles. The Fund is required to follow accounting standards promulgated by the Governmental Accounting Standards Board.

This report should be read in conjunction with the Fund's June 30, 2004 audited financial statements.

BACKGROUND

The Fund was established in January 2001 through legislation to assist mitigation of the effects of a statewide energy supply emergency. DWR has the authority to secure and retain title to power for resale to end use customers of the State's investor owned utilities (IOUs) under power supply contracts entered into prior to January 1, 2003. On that date, DWR transitioned complete responsibility for the purchase of short-term power to the IOUs. DWR also transferred the scheduling, dispatch, and certain other administrative functions for the long-term contracts to the IOUs. However, DWR retains the legal and financial responsibility for the long-term contracts until such time as there is complete assignment of the contracts and release of DWR. DWR is entitled to recover its revenue requirements for authorized activities, including but not limited to debt service, the costs of power purchases, administrative costs and reserves.

STATEMENT OF NET ASSETS

The Fund's assets and liabilities as of March 31, 2005 and June 30, 2004 are summarized as follows (in millions):

	March 31, 2005		June 30, 2004	
Restricted cash and investments:				
Operating and priority contract accounts	$	1,277	$	1,320
Bond charge collection and bond charge payment accounts		954		539
Other investments		111		33
Recoverable costs, current portion		654		656
Interest receivable		31		15
Long-term restricted cash and investments		1,481		1,522
Note receivable, net of current portion		-		104
Recoverable costs, net of current portion		7,374		7,745
Total assets	$	11,882	$	11,934
Long-term debt, including current portion	$	11,381	$	11,414
Other current liabilities		501		520
Total capital and liabilities	$	11,882	$	11,934

Restricted Cash and Investments

The Operating and Priority Contract Accounts had a net decrease of $43 million in the nine months ended March 31, 2005. The June 30, 2004 balance was higher than expected because of the receipt in June 2004 of $215 million from an energy settlement with El Paso Corporation. The March 31, 2005 balance is approximately $64 million higher than the forecasted balance for that date in the 2005 Revenue Requirement.

The Bond Charge Collection and Bond Charge Payment Accounts increased by $415 million during the nine months ended March 31, 2005. The increase in the balances was expected in anticipation of the $338 million principal payment due in May 2005.

From the dates of issuance of the revenue bonds in 2002 through March 31, 2005, the balances in each of the restricted cash and investments accounts met or exceeded balances required by the Bond Indenture.

Other Investments

Other investments consists of a brokerage account with a national brokerage firm in order to hedge natural gas costs for fuel used in the production of power under the terms of certain power purchase contracts.

Other investments at March 31, 2005 increased by $78 million since June 30, 2004. Approximately $28 million of this increase is due to the increased value of the open positions as a result of the overall increase in natural gas prices. The remaining $50 million increase was due to additional money invested in the account. At March 31, 2005, the account consists of money market obligations and government bonds valued at $31 million and financial futures and options valued at $80 million. At March 31, 2005, DWR has open positions with an unrealized marked-to-market value increase of $36 million reflected in the account balance.

Long-Term Restricted Cash and Investments

The balances in the Operating Reserve Account at March 31, 2005 and June 30, 2004 are determined in accordance with the bond indenture and represents twelve percent of projected annual operating expenses of the Fund for calendar year 2005 and 2004, respectively. As a result of anticipated decreased expenditures in 2005, the March 31, 2005 balance in the Operating Reserve Account decreased by $41 million compared to the balance at June 30, 2004. There was no change in the $927 million balance of the Debt Service Reserve Account during the nine month period.

Recoverable Costs

The current portion of recoverable costs principally reflects billings to IOU customers that have not yet been collected. The current portion of recoverable costs decreased $2 million during the nine months ended March 31, 2005. The anticipated large decrease in the account balance resulting from the decreased sales of power in the winter months was offset by the reclassification of amounts due from the energy settlement with El Paso Corporation to a current receivable. In March 2005 El Paso Corporation announced its intention to prepay the $108 million discounted value of the series of semi annual payments due over a nineteen year period. The Fund received the $108 million in May 2005.

Long-term recoverable costs consist of costs that are recoverable through future billings. The majority of the $370 million recovery of costs during the nine month period ended March 31, 2005 is associated with the recognition of bond charge revenue at a level to meet both scheduled debt retirement and pay interest expense when due.

Long-Term Debt

Long-term debt decreased by $33 million in the nine month period ended March 31, 2005 due to amortization of the bond premium.

Other Current Liabilities

Accounts payable at March 31, 2005 and June 30, 2004 reflect one month's accrual for power purchases. The $121 million decrease as of March 31, 2005 reflects the cyclical reduction in power cost during March, 2005 as compared to the summer month of June, 2004, and the end of certain power contracts on December 31, 2004.

The $102 million increase in accrued interest payable is anticipated as the fixed rate bonds provide for semi-annual payments on May 1st and November 1st, while the variable rate bonds provide for more frequent payments.

STATEMENT OF ACTIVITIES

The Fund's activities for the three and nine months ended March 31 are summarized as follows (in millions):

	3 Months Ended March 31		9 Months Ended March 31	
	2005	2004	2005	2004
Revenues:				
Power charges and surplus sales	$ 1,108	$ 1,343	$ 3,768	$ 3,059
Bond charges	199	189	651	655
Interest income	28	59	82	87
Total revenues	1,335	1,591	4,501	3,801
Expenses:				
Power purchases	1,061	1,239	3,863	3,982
Energy settlements	(17)	-	(113)	-
Interest expense	115	117	339	327
Other expenses	15	20	42	46
Recovery (deferral) of recoverable costs	161	215	370	(554)
Total expenses	1,335	1,591	4,501	3,801
Net income	-	-	-	-

Power Charges and Surplus Sales

Revenues from Power Charges and surplus sales decreased by $235 million in the three month period ended March 31, 2005 compared to the same period in 2004. The volume of power sold in the three month period ended March 31, 2005 is within 5% of that sold in the same period in 2004. However, 2005 remittance rates, which are based on DWR's current revenue requirements, are lower than in 2004. This reduction in rates is attributable to the lower average cost per megawatt hour of power in the DWR contract portfolio in calendar 2005, the impact of energy settlements, and the ability of DWR to reduce cash balances and still remain in compliance with the Bond Indenture requirements. The revenues for the nine month period ended March 31, 2005 increased $709 million over the prior year. This reflects the recognition of the $1 billion bill credit to the ratepayers in September and October 2003 in addition to previously described changes for the three months ended March 31, 2005.

Bond Charges

Bond charges earned through March 31, 2005, were comparable to the same period in 2004. This was expected as the Fund has level annual debt service.

Interest Income

The $31 million decrease in interest income in the three months ended March 31, 2005 as compared to the same period in 2004 is primarily attributable to the receipt of $38 million in the three month period ended March 31, 2004 from PG&E for interest on past due remittances. The net $7 million increase is primarily attributable to the investment of $600 million of the Debt Service Reserve Account in higher yielding investments.

Power Purchases

DWR power costs are $178 million and $119 million less in the three and nine months ended March 31, 2005, respectively, than in the same periods in 2004. The decreases are due to a combination of a reduction in the amount of power purchased in the current periods, changes in the contract portfolio, and reduced costs for energy under the terms of the El Paso Corporation energy settlement, all of which offset higher fuel costs.

Interest Expense

Interest expense incurred during the three month period ended March 31, 2005 is comparable to the interest expense in the same period in 2004. The slight increase in the nine month period reflects higher interest rates for variable debt and a lower percentage of LIBOR being received in 2005 than in 2004 for the synthetic interest rate swaps.

Recovery (Deferral) of Recoverable Costs

The individual components of the recovery (deferral) of recoverable costs for the nine months ended March 31 are summarized as follows (in millions):

	2005	**2004**
Operations	$ (24)	$ (969)
Debt Service and related costs	394	415
	$ 370	$ (554)

Operations

The deferral of recoverable costs in the nine months ended March 31, 2004 is primarily attributable to the $1 billion bill credit. The $24 million deferral in the nine months ended March 31, 2005 recognizes that DWR has received revenues that approximate its operating costs during the nine month period.

Debt Service and Related Costs

The recovery of debt service and related costs are comparable between the nine month periods ended March 31, 2005 and 2004, and are comprised solely of the difference between bond charges and interest income less interest expense.

FUTURE OPERATIONS

On May 12, 2005, the Governor of the State of California submitted a reorganization plan to the Milton Marks "Little Hoover" Commission on California State Government Organization and Economy that would establish a Department of Energy through the consolidation of the functions of several departments, commissions and offices that currently implement state energy programs. If the plan were to be adopted by the Little Hoover Commission and approved by the Legislature, all of the powers, duties, responsibilities, rights, obligations, liabilities and jurisdiction of DWR under Division 27 of the California Water Code would be assumed by the Department of Energy.

DWR or its successor will administer the Fund until such time as the revenue bonds are completely retired. Revenue requirements for the repayment of the bonds will be determined at least annually and submitted to the CPUC for implementation. Under the terms of the rate agreement between the CPUC and DWR, the CPUC is required to set rates for the customers of the IOUs and ESPs such that the Fund will always have monies to pay the principal of and interest on the bonds and all other bond related costs when due.

DWR has the authority to administer all power supply contracts entered into before December 31, 2002, for the life of the contracts. The last of the contracts expires in 2015. Revenue requirements for the payment of energy purchased under the contracts will be determined at least annually and submitted to the CPUC. Under the terms of the rate agreement between the CPUC and DWR, the CPUC is required to implement power charges such that the Fund will receive necessary monies to meet its revenue requirements.

The financial responsibility for the contracts may be transferred to the IOUs as part of a complete assignment of the contracts and release of DWR or its successor. However, there are a number of issues to be addressed, including IOU creditworthiness and counterparty approval, before the contracts can be assigned.

Department of Water Resources Electric Power Fund
Statements of Net Assets
March 31, 2005 and June 30, 2004 (in millions)

	March 31, 2005	June 30, 2004
Assets		
Current assets:		
Restricted cash and investments:		
Operating and Priority Contract Accounts	$ 1,277	$ 1,320
Bond Charge Collection and Bond Charge Payment Accounts	954	539
Other investments	111	33
Recoverable costs, current portion	654	656
Interest receivable	31	15
Total current assets	3,027	2,563
Long-term assets:		
Restricted cash and investments:		
Operating Reserve Account	554	595
Debt Service Reserve Account	927	927
Note receivable, net of current portion	-	104
Recoverable costs, net of current portion	7,374	7,745
Total long-term assets	8,855	9,371
Total assets	$ 11,882	$ 11,934
Capitalization and Liabilities		
Capitalization:		
Long-term debt:		
Revenue bonds	$ 10,949	$ 10,982
Total capitalization	10,949	10,982
Current liabilities:		
Current portion of long-term debt	432	432
Accounts payable	331	452
Accrued interest payable	170	68
Total current liabilities	933	952
Commitments and Contingencies (Note 5)		
Total capitalization and liabilities	$ 11,882	$ 11,934

The accompanying notes are an integral part of these financial statements

Department of Water Resources Electric Power Fund
Statements of Revenues, Expenses and Changes in Net Assets
For three and nine months ended March 31, 2005 and 2004 (in millions)

	For 3 Months Ended March 31		For 9 Months Ended March 31	
	2005	2004	2005	2004
Operating revenues:				
Power charges	$ 946	$ 1,204	$ 3,446	$ 2,785
Surplus sales	162	139	322	274
Total operating revenues	1,108	1,343	3,768	3,059
Operating expenses:				
Power purchases	1,061	1,239	3,863	3,982
Administrative expenses	15	20	42	46
Energy settlements	(17)	-	(113)	-
Recovery (deferral) of recoverable operating costs	49	84	(24)	(969)
Total operating expenses	1,108	1,343	3,768	3,059
Income from operations	-	-	-	-
Bond charges	199	189	651	655
Interest income	28	59	82	87
Interest expense	(115)	(117)	(339)	(327)
Recovery of recoverable debt service and related costs	(112)	(131)	(394)	(415)
Net income	-	-	-	-
Net assets, beginning of the period	-	-	-	-
Net assets, end of the period	$ -	$ -	$ -	$ -

The accompanying notes are an integral part of these financial statements

Department of Water Resources Electric Power Fund
Statements of Cash Flows
For the nine months ended March 31, 2005 and 2004 (in millions)

	2005	2004
Cash flows from operating income:		
Receipts:		
Power charges	$ 3,539	$ 3,380
Surplus sales	335	274
Energy settlements	113	-
Payments for power purchases and other costs	(4,054)	(3,826)
Net cash used in operating activities	(67)	(172)
Cash flows from non-capital financing activities:		
Receipts from customers for bond charges	652	575
Interest payments	(270)	(330)
Net cash provided by non-capital financing activities	382	245
Cash flows from investing activities:		
Investments purchased	(50)	(20)
Interest received on investments	66	39
Net cash provided by investing activities	16	19
Net increase in restricted cash and investments	331	92
Restricted cash and investments, beginning of the period	3,381	3,350
Restricted cash and investments, end of the period	$ 3,712	$ 3,442
Reconciliation of operating income to net cash used in operating activities:		
Income from operations	$ -	$ -
Changes in net assets and liabilities to reconcile operating income to net cash used in operations:		
Recoverable costs	54	(146)
Due from other funds	-	21
Accounts payable	(121)	(47)
Total adjustments	(67)	(172)
Net cash used in operating activities	$ (67)	$ (172)

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

For the nine months ended March 31, 2005 and 2004 (in millions)

1. Reporting Entity

Background
In January 2001, the Governor of California issued an emergency proclamation directing the Department of Water Resources (DWR) to enter into contracts and arrangements for the purchase and sale of electric power to assist in mitigating the effect of a statewide energy supply emergency.

The Department of Water Resources Electric Power Fund (a component unit of the State of California) (Fund), administered by the Department of Water Resources (DWR), was established in January 2001 through legislation adding Division 27 to the California Water Code.

DWR began selling electricity to approximately ten million IOU retail customers in California in January 2001. DWR purchases power from wholesale suppliers under contracts entered into before January 1, 2003. DWR power is delivered to the customers through the transmission and distribution systems of the IOUs and payments from the customers are collected for DWR by the IOUs pursuant to servicing arrangements approved and/or ordered by the CPUC.

Basis of Presentation
The Fund is accounted for as an enterprise fund and is financed and operated in a manner similar to that of a private business enterprise. The Fund 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 Fund has elected not to apply statements and related interpretations issued by the Financial Accounting Standards Board after November 30, 1989. The Fund is accounted for with a set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues and expenses.

The financial statements of the Fund are intended to present the financial position, and the changes in financial position and cash flows, where applicable, of only that portion of the business-type activities and major funds of the State of California that is attributable to the transactions of the Fund. They do not purport to, and do not, present fairly the financial position and the changes in financial position and cash flows of the State of California in conformity with accounting principles generally accepted in the United States of America.

2. Restricted Cash and Investments

As of March 31, 2005, $38 million of the Fund's cash deposits of $60 million was exposed to custodial credit risk as follows:

Institution	Amount
Prime Value Obligation Fund	
Institutional Shares	$ 31
U.S. Bank	7
	$ 38

For the nine months ended March 31, 2005 and 2004 (in millions)

As of March 31, 2005, the Fund had the following investments:

Investment	Maturity	Fair Value
State of California Pooled Money Investment Account-State Money Investment Fund	6.5 months average	$ 3,082
Guaranteed investment contracts	May 1, 2022	500
Forward purchase agreements	May 1, 2005	100
Natural gas futures and options	3 months average	80
Other	5 year average	1
		$ 3,763

The Fund's investments in the guaranteed investment contracts (GIC) and forward purchase agreement (FPA) are rated as follows, Standard & Poors (S&P) and Moody's, respectively, at March 31, 2005:

Investment	Amount	S&P	Moody's
GIC Providers			
FSA	$ 100	AAA	Aaa
XL Capital	150	AAA	Aaa
Royal Bank of Canada	100	AA-	Aa2
Sun America	150	AAA	Aaa
	$ 500		
FPA Provider			
Merrill Lynch: FHLMC Discounted Notes	$ 100	AAA	Aaa

3. Long-Term Debt

The following activity occurred in the long-term debt accounts during the nine months ended March 31, 2005:

	Revenue Bonds	Unamor-tized Premium	Total Revenue Bonds
Balance, June 30, 2004	$ 11,084	$ 330	$ 11,414
Amortization of premium		(33)	(33)
Less current portion	(388)	(44)	(432)
Balance, March 31, 2005	$ 10,696	$ 253	$ 10,949

For the nine months ended March 31, 2005 and 2004 (in millions)

Total interest cost, including amortization of premium, for the nine months ended March 31, 2005 and March 31, 2004 for all revenue bonds was $339 million and $327 million, respectively. The interest rates for the variable debt for the nine months ended March 31, 2005 ranged from 1.05% to 2.45%.

Future payment requirements on the revenue bonds are as follows at March 31, 2005:

Fiscal Year	Principal	Interest [1]	Total
2005	388	112	500
2006	409	433	842
2007	427	416	843
2008	449	396	845
2009	471	374	845
2010-2014	2,750	1,536	4,286
2015-2019	3,580	831	4,411
2020-2022	2,610	164	2,774
	$ 11,084	$ 4,262	$ 15,346

[1] Variable portion of interest cost calculated using the March 31, 2005 Bond Market Association Municipal Swap Index (BMA).

4. Interest Rate Swaps

The terms, fair values, and credit ratings of counterparties for the various swap agreements at March 31, 2005 are summarized in the following table:

Outstanding Notional Amount	Fixed Rate Paid by Fund	Variable Rate [1] Received by Fund	Fair Value	Swap Termination Date	Counterparty Credit Rating S&P	Moody's	Fitch
$ 94	2.914%	67% of LIBOR	$ (2)	May 1, 2011	AAA	Aaa	AAA
234	3.024%	67% of LIBOR	(3)	May 1, 2012	AAA	Aaa	AAA
200	3.405%	BMA	(2)	May 1, 2013	A+	Aa3	A+
100	3.405%	BMA	(1)	May 1, 2013	A+	Aa3	AA-
30	3.405%	BMA	-	May 1, 2013	A+	Aa3	AA-
194	3.204%	67% of LIBOR	(1)	May 1, 2014	AA-	Aa1	AA-
174	3.280%	67% of LIBOR	(5)	May 1, 2015	AAA	Aaa	AAA
202	3.342%	67% of LIBOR	(2)	May 1, 2016	AA	Aa2	AA
202	3.389%	67% of LIBOR	(3)	May 1, 2017	A+	Aa3	AA-
$ 1,430			$ (19)				

[1] One month U.S. Dollar London Interbank Offered Rate or Bond Market Association Municipal Swap Index

The notional amounts of the swaps match the principal amounts of the associated debt. The swap agreements contain scheduled reductions in notional amounts that follow scheduled amortization of the associated debt.

For the nine months ended March 31, 2005 and 2004 (in millions)

Fair Value: The reported fair values from the table above were provided by the counterparties, using the par value, or marked-to-market, method.

Credit Risk: As of March 31, 2005, the Fund was not exposed to credit risk because the swaps had negative fair values.

Basis Risk: The Fund is exposed to basis risk on the swaps that have payments calculated on the basis of a percentage of LIBOR (a taxable rate index). As of March 31, 2005, the variable rate on DWR's hedged bonds ranged from 1.30% to 2.45%, while 67% of LIBOR received on the swap was equal to 1.92%.

Termination Risk: DWR's swap agreements do not contain any out-of-the-ordinary termination events that would expose it to significant termination risk.

Rollover Risk: Since the swap agreements have termination dates and notional amounts that are tied to equivalent maturity dates and principal amounts of amortizing debt, there is no rollover risk associated with the swap agreements, other than in the event of a termination.

Swap Payments and Associated Debt: As rates vary, variable-rate bond interest payments and net swap interest payments will vary. As of March 31, 2005, debt service requirements of the variable-rate debt and net swap payments, assuming current interest rates remain the same, for their term were as follows:

Fiscal Year Ending June 30	Variable Rate Bonds Principal	Variable Rate Bonds Interest	Interest Rate Swaps, Net	Total
2005	$ -	$ 8	$ 5	$ 13
2006	-	33	18	51
2007	-	33	18	51
2008	-	33	18	51
2009	-	33	18	51
2010-2014	852	137	78	1,067
2015-2017	578	27	17	622
	$ 1,430	$ 304	$ 172	$ 1,906

5. Commitments and Contingencies

Litigation and Regulatory Matters

DWR is involved in lawsuits and regulatory proceedings that could impact power costs and future revenue requirements.

DWR has paid all amounts billed by the California Independent System Operator (ISO). In May 2004, the Federal Energy Regulatory Commission (FERC) issued an order requiring DWR to pay approximately $270 million, the amount by which its sales to the ISO exceeded allowed mitigated market clearing prices, even though DWR sold the energy to the ISO at the same price DWR paid for the energy. In a separate proceeding, FERC has directed the ISO to rerun its markets to include adjustments for fuel, emissions, interest, and the separation of January 2001 into two separate periods to reflect the entering of DWR into the ISO market on January 17, 2001. DWR expects that any amount due under the May 2004 order or the ISO market rerun will be offset by FERC mandated refunds to DWR.

For the nine months ended March 31, 2005 and 2004 (in millions)

There are a number of lawsuits and regulatory proceedings in which DWR is not a party but may be affected by the result. In one case, California Power Exchange Corporation (CalPX), certain IOUs and others have brought suit against the State of California claiming that the State's commandeering of CalPX's block forward contracts after CalPX filed bankruptcy in early 2001 was unconstitutional. The plaintiffs argue that they are entitled to damages of $1.1 billion, which is their estimation of the fair value of the block forward contracts at the time of commandeering. Under the block forward contracts, which expired in December 2001, the Fund paid approximately $350 million for energy provided by the contracts.

Commitments

DWR has power purchase contracts that have remaining lives of up to ten years. Payments made under these contracts approximated $3.9 and $3.8 billion for the nine months ended March 31, 2005 and March 31, 2004, respectively.

The remaining amounts of fixed obligations under the contracts as of March 31, 2005, are as follows:

For the Year Ending June 30,	Fixed Obligation
2005	$ 645
2006	2,783
2007	2,525
2008	2,379
2009	2,238
Thereafter	3,443
	$ 14,013

In addition to the fixed costs there are variable costs under several of the contracts. Management projected as of March 31, 2005 that the amount of future fixed and variable obligations associated with long-term power purchase contracts would approximate $21 billion. The difference between the fixed costs and the expected total costs of the contracts are primarily due to the variable factors associated with dispatchable contracts and the cost of natural gas.

6. Energy Settlements

DWR and other parties have entered into settlement agreements with various energy suppliers which resolve potential and alleged causes of action against suppliers for their part in alleged manipulation of natural gas and electricity commodity and transportation markets during the 2000 - 2001 California energy crisis.

Settlements with Dynegy Inc. (Dynegy) and Duke Energy Corporation (Duke) became effective during the nine months ended March 31, 2005 Under the terms of the settlement agreements DWR has received $100 million and $13 million from Dynegy and Duke, respectively. Future revenues from the Dynegy and Duke settlements could approximate $25 million and $6 million, respectively, but are subject to conditions outlined in the settlement and allocation agreements.