**LOS ANGELES DEPARTMENT OF WATER AND POWER**
**POWER SYSTEM**

Financial Statements and
Required Supplementary Information

June 30, 2011 and 2010

(With Independent Auditors' Report Thereon)

**LOS ANGELES DEPARTMENT OF WATER AND POWER**
**POWER SYSTEM**

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# Independent Auditors' Report

The Board of Water and Power Commissioners
Department of Water and Power
City of Los Angeles:

We have audited the accompanying balance sheets of the City of Los Angeles' Department of Water and Power's Power Revenue Fund (Power System), an enterprise fund of the City of Los Angeles, California, as of June 30, 2011 and 2010, and the related statements of revenues, expenses, and changes in fund net assets and cash flows for the years then ended. These financial statements are the responsibility of the Los Angeles' Department of Water and Power'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 and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes 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 Power 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.

As discussed in note 1 to the financial statements, the financial statements of the Power System are intended to present the financial position, and the changes in financial position and, cash flows of only that portion of the business-type activities and each major fund of the City of Los Angeles, California that is attributable to the transactions of the Power System. They do not purport to, and do not, present fairly the financial position of the City of Los Angeles, California as of June 30, 2011 and 2010, the changes in its financial position or, where applicable, its cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Power 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 U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 30, 2011 on our consideration of the Power System's internal control on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting

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or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis included on pages 3 through 12 and the schedule of funding progress for the pension plan and postemployment healthcare plan on page 69 are not a required part of the basic financial statements but are supplementary information required by U.S. generally accepted accounting principles. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

KPMG LLP

November 30, 2011

The following discussion and analysis of the financial performance of the City of Los Angeles' (the City) Department of Water and Power's (the Department) Power Revenue Fund (the Power System) provides an overview of the financial activities for the fiscal years ended June 30, 2011 and 2010. Descriptions and other details pertaining to the Power System are included in the notes to the financial statements. This discussion and analysis should be read in conjunction with the Power System's financial statements, which begin on page 13.

## Using This Financial Report

This annual financial report consists of the Power System's financial statements and required supplementary information and reflects the self-supporting activities of the Power System that are funded primarily through the sale of energy, transmission, and distribution services to the public it serves.

## Balance Sheets, Statements of Revenues, Expenses, and Changes in Fund Net Assets, and Statements of Cash Flows

The financial statements provide an indication of the Power System's financial health. The balance sheets include all of the Power System's assets, deferred outflows, and liabilities, using the accrual basis of accounting, as well as an indication about which assets can be utilized for general purposes, and which net assets are restricted as a result of bond covenants and other commitments. The statements of revenues, expenses, and changes in fund net assets report all of the revenues and expenses during the time periods indicated. The statements of cash flows report the cash provided by and used in operating activities, as well as other cash sources and uses, such as investment income and cash payments for bond principal and capital additions and betterments.


(Continued)

The following table summarizes the financial condition and changes in fund net assets of the Power System as of and for the fiscal years ended June 30, 2011, 2010, and 2009:

**Table 1 – Condensed Schedule of Assets, Liabilities, and Fund Net Assets**

(Amounts in millions)

| | | As of June 30 | | |
|---|---|---|---|---|
| **Assets** | | **2011** | **2010** | **2009** |
| Utility plant, net | $ | 7,431 | 6,979 | 6,617 |
| Restricted investments | | 634 | 683 | 722 |
| Other noncurrent assets | | 2,515 | 2,364 | 2,107 |
| Current assets | | 1,866 | 1,623 | 1,545 |
| Deferred outflows on derivative instruments | | 74 | 84 | 113 |
| | $ | 12,520 | 11,733 | 11,104 |
| **Liabilities and Fund Net Assets** | | | | |
| Long-term debt, net of current portion | $ | 6,498 | 5,711 | 5,242 |
| Other long-term liabilities | | 248 | 355 | 557 |
| Current liabilities | | 838 | 788 | 748 |
| | | 7,584 | 6,854 | 6,547 |
| Fund net assets: | | | | |
| Invested in capital assets, net of related debt | | 1,307 | 1,387 | 1,251 |
| Restricted | | 1,417 | 1,507 | 1,461 |
| Unrestricted | | 2,212 | 1,985 | 1,845 |
| Total fund net assets | | 4,936 | 4,879 | 4,557 |
| | $ | 12,520 | 11,733 | 11,104 |

Certain prior year amounts have been reclassified to conform with the current year's presentation.

**Table 2 – Condensed Schedule of Revenues, Expenses, and Changes in Fund Net Assets**

(Amounts in millions)

| | | Year ended June 30 | | |
|---|---|---|---|---|
| | | **2011** | **2010** | **2009** |
| Operating revenues: | | | | |
| Residential | $ | 966 | 1,015 | 888 |
| Commercial and industrial | | 2,047 | 2,062 | 1,781 |
| Sales for resale | | 84 | 126 | 51 |
| Other | | 29 | 32 | 36 |
| Total operating revenues | | 3,126 | 3,235 | 2,756 |
| Operating expenses: | | | | |
| Fuel for generation and purchased power | | (1,290) | (1,310) | (1,149) |
| Maintenance and other operating expenses | | (1,405) | (1,315) | (1,187) |
| Total operating expenses | | (2,695) | (2,625) | (2,336) |
| Operating income | | 431 | 610 | 420 |
| Nonoperating revenues (expenses): | | | | |
| Investment income | | 82 | 106 | 115 |
| Federal bond subsidies | | 28 | — | — |
| Other nonoperating revenues and expenses, net | | 13 | 25 | 22 |
| Debt expenses | | (265) | (212) | (201) |
| Total nonoperating expenses | | (142) | (81) | (64) |
| Income before capital contributions and transfers | | 289 | 529 | 356 |
| Capital contributions | | 28 | 13 | 17 |
| Transfers to the reserve fund of the City of Los Angeles | | (259) | (220) | (223) |
| Increase in fund net assets | | 58 | 322 | 150 |
| Beginning balance of fund net assets | | 4,879 | 4,557 | 4,407 |
| Ending balance of fund net assets | $ | 4,937 | 4,879 | 4,557 |


(Continued)

## Assets

### *Utility Plant*

During fiscal years 2011 and 2010, the Power System capitalized $557 million and $848 million of additions, respectively, including transfers from construction work in progress to utility plant in service. Of the $557 million, $356 million, or 64%, is related to distribution plant assets and mostly attributable to the Power System's Power Reliability Program (PRP) to improve distribution system reliability including replacement of aging poles, crossarms, cables, station equipment, and transformers. Other major distribution system additions included installation of new business line facilities and meters related to the Automatic Meter Infrastructure (AMI). In addition, $90 million or 16% is mostly related to generation plant assets including station improvements at the in-basin generating stations. In addition, $88 million, or 16%, is related to general plant assets including a new joint service center, communication/mainframe hardware equipment, and general office building improvements. Of the $848 million during fiscal year 2010, $545 million, or 64%, is mostly related to distribution plant assets and mostly attributable to the Power System's PRP to improve distribution system reliability including replacement of aging poles, crossarms, cables, station equipment, and transformers. In addition, $165 million or 19% is related to generation plant assets and mostly attributable to the Department's commitment to green power including the expansion of Pine Tree Wind Farm.

Construction work in progress increased by $254 million in fiscal year 2011 and decreased by $178 million in fiscal year 2010. The 2011 increases were mostly attributable to generation system assets including work in progress for the repowering of Haynes Generating Station and station improvements at other in-basin generating stations. In addition, general plant has work in progress for the replacement of the Customer Information System (CIS). The 2010 decreases were mostly attributable to the capitalization of the Pine Tee Wind Project expansion, Station Equipment, Towers, Conductors, Conduits, and Meters.

Additional information regarding the Power System's utility plant assets can be found in note 4 to the accompanying financial statements.

The tables that follow summarize the generating resources available to the Department as of June 30, 2011. These resources include those owned by the Department (either solely or jointly with other utilities) as well as resources available through long-term purchase agreements. Generating station capacity is measured in megawatts (MWs).

**Table 3 – Department-Owned Generation Facilities**

| Type of fuel | Notional amount (Number of facilities) | Number of units | Net maximum capability (MWs) | Net dependable capability (MWs) |
|---|---|---|---|---|
| Natural gas | 4 [1] | 22 | 3,399 | 3,321 |
| Large hydro | 1 | 7 [2] | 1,247 | 1,175 |
| Renewables | 37 | 206 [3] | 413 [4] | 192 |
| Subtotal | 42 | 235 | 5,059 | 4,688 |
| CDWR | — | — | (120) [5] | (55) |
| Total | 42 | 235 | 4,939 | 4,633 |

(1) Consists of the following generating stations: Harbor Station, Haynes Station, Scattergood Station, and Valley Station.

(2) The Castaic Plant currently has six (1,075 MWs) out of seven units available due to ongoing modernization work scheduled to be completed by 2014.

(3) The Department-owned renewable resources in-service include the Los Angeles Aqueduct, Owens Valley, and Owens Gorge small hydro units that qualify under the Department's renewable resource definition. Also included are microturbine units at the Lopez Canyon Landfill and Department built photovoltaic solar installations, the Pine Tree Wind Project, Linden Wind Farm, and a local small hydro plant. This number does not include two of the Scattergood gas-fueled units that partially burn digester gas in which the output related to the digester gas also qualifies under the Department's renewable resource definition.

(4) Includes 16 MWs of renewable energy generated at the Scattergood Station by burning digester gas from the Hyperion Treatment Plant.

(5) Energy payable to the California Department of Water Resources (CDWR) for energy generated at the Castaic Plant. This amount varies weekly up to maximum of 120 MWs.

**Table 4 – Jointly Owned and Contracted Facilities**

| Type | Number of facilities | Net maximum capability (MWs) | Net dependable capability (MWs) |
|---|---|---|---|
| Large hydro | 1 | 491 (1) | 436 |
| Nuclear | 1 | 387 (2) | 380 |
| Coal | 3 | 1,569 (3) | 1,569 |
| Renewables/DG | 3,582 (4) | 921 | 277 |
| Total | 3,587 | 3,368 | 2,662 |

(1) The Department's Hoover Plant contract entitlement is 25.16% of the Hoover total contingent capacity of 1,951 MWs. Current reduced lake level has reduced available capacity to about 436 MWs annual average.

(2) The Department's Palo Verde Station (PVNGS) entitlement is 9.66% of the maximum net plant capability of 4,003 MWs.

(3) The Department's current Intermountain Station (IPP) entitlement is 66.79% of the maximum net plant capability of 1,800 MWs. A portion of the IPP entitlement is subject to variable recall. The Department's Navajo Station entitlement is 21.20% of the maximum net plant capability of 2,250 MWs. The Mohave Station generating units were removed from service at the end of 2005.

(4) The Department's contracted renewable resources in-service include landfill gas units at various landfills in the Los Angeles area, hydro units locally and in British Columbia, Canada, wind farms in Wyoming and Oregon, customer solar photovoltaic installations locally, and customer distributed generation (DG) units located in Los Angeles also provide energy resources.

## Liabilities and Fund Net Assets

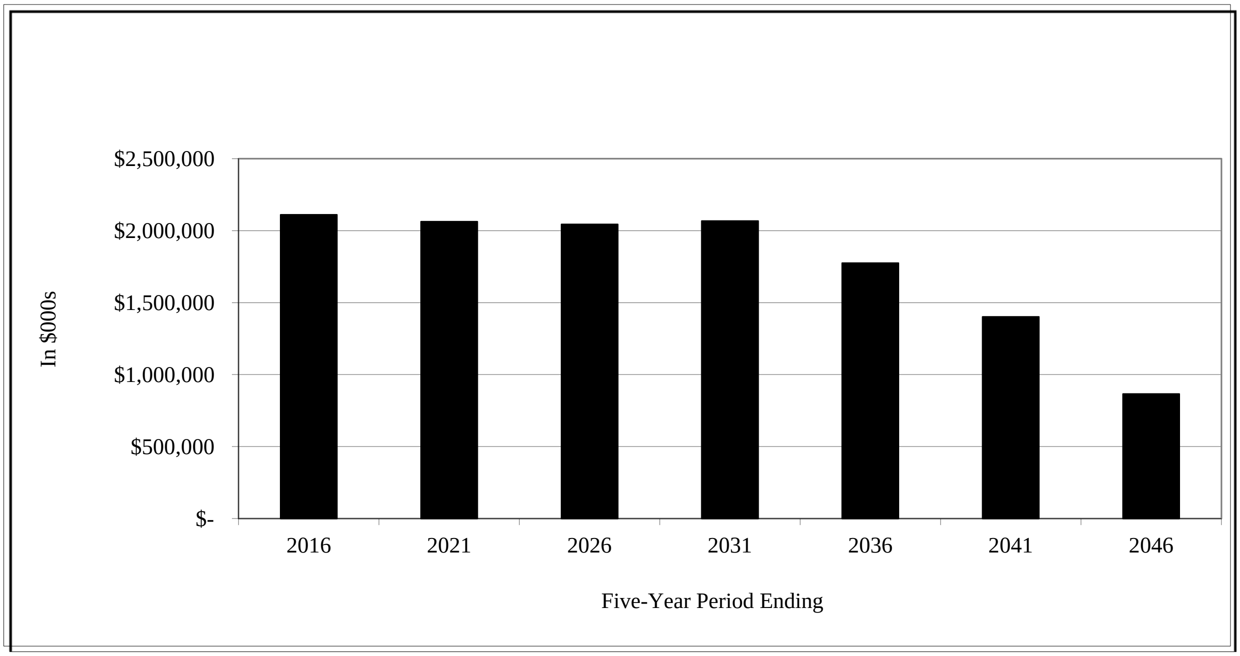
### *Long-Term Debt*

As of June 30, 2011, the Power System's total outstanding long-term debt balance was approximately $6.677 billion. The increase of $725 million over the prior year's balance resulted from the sale of $1.684 billion of the Power System revenue bonds less the refunding of $833 million revenue bonds and scheduled maturities of $126 million.

As of June 30, 2010, the Power System's total outstanding long-term debt balance was approximately $5.92 billion. The increase of $489 million over the prior year's balance resulted from the sale of $668 million of the Power System revenue bonds less the refunding of $77 million revenue bonds and scheduled maturities of $102 million.

Outstanding principal, plus scheduled interest as of June 30, 2011, is scheduled to mature as shown in the chart below:

**Chart: Debt Service Requirements**




In addition, the Power System had $486 million and $529 million on deposit in trust funds restricted for the use of debt reduction as of June 30, 2011 and 2010, respectively.

In June 2011, Standard & Poor's Rating Services, Moody's Investors Service, and Fitch Ratings affirmed the Power System's bond rating of AA-, Aa3, and AA-, respectively, due to the Power System's broad revenue stream and a competitive power supply portfolio that has historically provided competitive retail electricity rates and evident strategic focus on positioning the utility to improve system reliability while meeting state mandated greenhouse emission rules and renewable energy standards. Additional information regarding the Power System's long-term debt can be found in note 10 to the financial statements.

## Changes in Fund Net Assets

### *Operating Revenues*

The operating revenues of the Power System are generated from wholesale and retail customers. There are four major customer categories of retail revenue. These categories include residential, commercial, industrial, and other, which includes public street lighting. Table 5 summarizes the percentage contribution of retail revenues from each customer segment in fiscal years 2011 and 2010:

**Table 5 – Revenue and Percentage of Revenue by Customer Class**

(Amounts in thousands)

| | Fiscal year 2011 | | Fiscal year 2010 | |
|---|---|---|---|---|
| | **Revenue** | **Percentage** | **Revenue** | **Percentage** |
| Type of customer: | | | | |
| Residential | $ 966,436 | 32% | $ 1,014,610 | 33% |
| Commercial | 1,785,452 | 59 | 1,806,323 | 58 |
| Industrial | 261,398 | 8 | 256,092 | 8 |
| Other | 28,409 | 1 | 31,814 | 1 |
| | $ 3,041,695 | 100% | $ 3,108,839 | 100% |

While commercial customers consume the most electricity, residential customers represent the largest customer class. As of June 30, 2011 and 2010, the Power System had approximately 1.5 million customers. As shown in Table 6, 1.3 million, or 86% and 87%, of total customers were in the residential customer class in fiscal years 2011 and 2010, respectively.

**Table 6 – Number of Customers and Percentage of Customers by Customer Class**

(Amounts in thousands)

| | Fiscal year 2011 | | Fiscal year 2010 | |
|---|---|---|---|---|
| | **Number** | **Percentage** | **Number** | **Percentage** |
| Type of customer: | | | | |
| Residential | $ 1,263 | 86% | $ 1,252 | 87% |
| Commercial | 184 | 13 | 180 | 12 |
| Industrial | 12 | 1 | 13 | 1 |
| Other | 2 | — | 2 | — |
| | $ 1,461 | 100% | $ 1,447 | 100% |

### *Fiscal Year 2011*

Retail revenues decreased by $67 million and wholesale revenues decreased $42 million from fiscal year 2010. The decrease in revenue is mainly due to lower consumption despite a one-time increase of 0.6 cents/kWh in the

Energy Cost Adjustment Factor effective July 1, 2010. Retail consumption of energy decreased 255 million KWhs year over year while wholesale consumption decreased 256,967 MWhs.

***Fiscal Year 2010***

Retail revenues increased by $404 million while wholesale revenues increased by $75 million from fiscal year 2009. The increase in retail revenue is due to a series of automatic quarterly energy cost adjustment factor increases and the recognition of $177 million of deferred revenue that was earned. The energy cost adjustment factor increased due to rising fuel and renewable generation cost. Of the $75 million increase in wholesale revenue, $30 million came from the Cal-PX litigation settlement dating back to the 2000-01 energy crisis era, $13 million came from IPP litigation settlement sales to Utah municipalities and PacifiCorp. During fiscal years 2010 and 2009, the Power System deferred wholesale revenue of $2.2 million and $24.7 million, respectively, to the rate stabilization account.

***Operating Expenses***

Fuel for generation and purchased power are two of the largest expenses that the Power System incurs each fiscal year. Fuel for generation expense includes the cost of fuel that is used to generate energy. The majority of fuel costs include the cost of natural gas, coal, and nuclear fuel.

Purchased power expense includes the cost of buying power on the open market and paying the current portion of the Power System's purchased power contracts. Under these purchase power contracts, the Department has an entitlement to the energy that is produced at various generating stations and an entitlement to the use of various transmission facilities. Most of these contracts require the Department to pay for these services regardless of whether the energy or transmission is used. These types of contracts are referred to as "take-or-pay" contracts.

Depreciation expense is computed using the straight-line method based on service lives for all projects completed after July 1, 1973, and for all office and shop structures, related furniture and equipment, and transportation and construction equipment. Depreciation for facilities completed prior to July 1, 1973 is computed using the 5% sinking fund method based on estimated service lives. The Department uses the composite method of depreciation and, therefore, groups assets into composite groups for purposes of calculating depreciation expense. Estimated service lives range from 5 to 75 years. Amortization expense for computer software is computed using the straight-line method over 5 years.

The table below summarizes the Power System's operating expenses during fiscal years 2011 and 2010:

**Table 7 – Operating Expenses and Percentage of Expense by Type of Expense**

(Amounts in thousands)

| | Fiscal year 2011 | | Fiscal year 2010 | |
|---|---|---|---|---|
| | **Expense** | **Percentage** | **Expense** | **Percentage** |
| Type of expense: | | | | |
| Fuel for generation | $ 435,812 | 16% | $ 480,707 | 18% |
| Purchased power | 853,745 | 32 | 829,177 | 32 |
| Other operating expenses | 699,588 | 26 | 670,093 | 25 |
| Maintenance | 319,042 | 12 | 307,457 | 12 |
| Depreciation and amortization | 386,937 | 14 | 337,866 | 13 |
| | $ 2,695,124 | 100% | $ 2,625,300 | 100% |

***Fiscal Year 2011***

Fiscal year 2011 operating expenses were $69.8 million higher as compared to fiscal year 2010, driven primarily by a $49.1 million increase in depreciation expense. Fuel and Purchased Power expenses decreased $20.3 million due to lower retail sales and decreased wholesale generation activities despite a year-over-year increase of $114.2 million in renewable generation expenditures.

The $29.5 million increase in Other Operating costs can be primarily attributed to an increase of $18.8 million in overhead line and miscellaneous distribution expenses and a $10.4 million increase customer accounting and collection expenses. Maintenance expenses increased $11.6 million year over year, primarily due to higher transmission plant and distribution plant maintenance costs.

***Fiscal Year 2010***

Fiscal year 2010 operating expenses were $289 million higher as compared to fiscal year 2009. Purchased power expenses were $129 million higher in fiscal year 2010 due to a $60 million increase in renewable generation purchase as several long-term Renewable Portfolio Standard (RPS) purchase agreements came online, and by a $74 million increase in IPP purchased power expense due to increased coal cost and reduced recall sales.

Other operating costs increased by $54 million primarily in hydraulic station expenses, transmission expenses, distribution expenses, and settlements for injuries, and damages. Maintenance expense increased by $30 million as compared to fiscal year 2009 due to maintenance of distribution plant, hydraulic plant, and steam plant. Other increases include depreciation and amortization expense by $44.6 million, and fuel for generation increased by $31 million.

### Nonoperating Revenues and Expenses

***Fiscal Year 2011***

The major nonoperating activities of the Power System for fiscal year 2011 included the transfer of $259 million to the City's General Fund, interest income earned on investments of $82 million, $28 million in federal bond subsidies, and $265 million in debt expenses.

The transfer to the City is based on 8% of the previous year's operating revenues. Operating revenues for fiscal year 2010 were $3.2 billion, which generated a city transfer of $259 million.

The $25 million decrease in interest income is due to declining market interest rates coupled with decreases in funds held in the related restricted investments.

The $28 million increase in federal bond subsidies is directly related to interest payment subsidies that are received from the U.S. Treasury.

The increase in debt expense is mainly due to the interest expense related to the 2010 Series A, B, C, and D Bonds issued at end of fiscal year 2010 and during fiscal year 2011.

***Fiscal Year 2010***

The major nonoperating activities of the Power System for fiscal year 2010 included the transfer of $220 million to the City's General Fund, interest income earned on investments of $106 million, and $212 million in debt expenses.

The transfer to the City is based on 8% of the previous year's operating revenues. Operating revenues for fiscal year 2009 were $2.8 billion, which generated a city transfer of $220 million.

Interest income decreased by $9 million due to less cash available for investing and a decline in the interest rates in fiscal year 2010 as compared to 2009.

The increase in debt expense is due to having interest on the 2009 Series A and B debts that were issued in February 2009 and June 2009, respectively, offset by a slight lower interest rate on variable rate debt. The variable rate bonds' daily and weekly rate range decrease from 0.27% to 0.30% as of June 30, 2009 to 0.14% to 0.29% as of June 30, 2010.

**LOS ANGELES DEPARTMENT OF WATER AND POWER**
**POWER SYSTEM**

Balance Sheets

June 30, 2011 and 2010

(Amounts in thousands)

| Assets and Deferred Outflows | | 2011 | 2010 |
|---|---|---|---|
| Noncurrent assets: | | | |
| Utility plant: | | | |
| Generation | $ | 4,192,699 | 4,104,395 |
| Transmission | | 1,022,010 | 1,000,289 |
| Distribution | | 6,045,053 | 5,688,599 |
| General | | 1,271,714 | 1,193,556 |
| | | 12,531,476 | 11,986,839 |
| Accumulated depreciation | | (6,086,691) | (5,715,267) |
| | | 6,444,785 | 6,271,572 |
| Construction work in progress | | 685,485 | 431,491 |
| Nuclear fuel, at amortized cost | | 44,328 | 44,295 |
| Natural gas field, net | | 256,622 | 231,397 |
| | | 7,431,220 | 6,978,755 |
| Restricted investments | | 634,408 | 682,660 |
| Cash and cash equivalents – restricted | | 552,704 | 360,047 |
| Long-term notes and other receivables, net of current portion | | 903,055 | 1,006,680 |
| Underrecovered costs | | 294,226 | 250,381 |
| Deferred debits – long term | | 160,000 | 160,000 |
| Net pension asset | | 14,386 | 53,330 |
| Net postretirement asset | | 590,686 | 533,472 |
| Total noncurrent assets | | 10,580,685 | 10,025,325 |
| Current assets: | | | |
| Cash and cash equivalents – unrestricted | | 561,414 | 423,855 |
| Cash and cash equivalents – restricted | | 308,879 | 339,806 |
| Cash collateral received from securities lending transactions | | 69,534 | 13,581 |
| Customer and other accounts receivable, net of $20,000 and $18,000 allowance for losses for 2011 and 2010, respectively | | 340,518 | 349,858 |
| Current portion of long-term notes receivable | | 102,307 | 78,190 |
| Due from Water System | | 3,267 | 7,276 |
| Accrued unbilled revenue | | 156,079 | 158,837 |
| Materials and fuel | | 154,490 | 158,003 |
| Prepayments and other current assets | | 169,195 | 93,820 |
| Total current assets | | 1,865,683 | 1,623,226 |
| Total assets | | 12,446,368 | 11,648,551 |
| Deferred outflows on derivative instruments | | 73,770 | 84,268 |
| Total assets and deferred outflows | $ | 12,520,138 | 11,732,819 |



(Continued)

**LOS ANGELES DEPARTMENT OF WATER AND POWER**
**POWER SYSTEM**

Balance Sheets

June 30, 2011 and 2010

(Amounts in thousands)

| **Fund Net Assets and Liabilities** | | **2011** | **2010** |
|---|---|---|---|
| Fund net assets: | | | |
| Invested in capital assets, net of related debt | $ | 1,307,325 | 1,387,358 |
| Restricted: | | | |
| Debt service | | 549,511 | 658,444 |
| Capital projects | | 120,008 | 117,752 |
| Other postemployment benefits | | 590,686 | 533,472 |
| Pension benefits | | 14,386 | 53,330 |
| Other purposes | | 142,684 | 143,453 |
| Unrestricted | | 2,211,952 | 1,985,102 |
| Total fund net assets | | 4,936,552 | 4,878,911 |
| Long-term debt, net of current portion | | 6,497,714 | 5,711,209 |
| Other noncurrent liabilities: | | | |
| Accrued liabilities | | 10,487 | 12,040 |
| Deferred credits | | 123,160 | 218,218 |
| Accrued workers’ compensation claims | | 40,300 | 40,692 |
| Derivative instrument liabilities | | 73,770 | 84,268 |
| Total other noncurrent liabilities | | 247,717 | 355,218 |
| Current liabilities: | | | |
| Current portion of long-term debt | | 178,885 | 240,235 |
| Accounts payable and accrued expenses | | 266,692 | 246,150 |
| Accrued interest | | 129,874 | 101,607 |
| Accrued employee expenses | | 97,340 | 92,334 |
| Deferred credits | | 95,830 | 93,574 |
| Obligations under securities lending transactions | | 69,534 | 13,581 |
| Total current liabilities | | 838,155 | 787,481 |
| Total liabilities | | 7,583,586 | 6,853,908 |
| Total liabilities and fund net assets | $ | 12,520,138 | 11,732,819 |

See accompanying notes to financial statements.

**LOS ANGELES DEPARTMENT OF WATER AND POWER**
**POWER SYSTEM**

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

Years ended June 30, 2011 and 2010

(Amounts in thousands)

| | | 2011 | 2010 |
|---|---|---|---|
| Operating revenues: | | | |
| Residential | $ | 966,436 | 1,014,610 |
| Commercial and industrial | | 2,046,850 | 2,062,415 |
| Sales for resale | | 84,262 | 126,354 |
| Other | | 55,901 | 58,632 |
| Uncollectible accounts | | (27,492) | (26,818) |
| | | 3,125,957 | 3,235,193 |
| Operating expenses: | | | |
| Fuel for generation | | 435,812 | 480,707 |
| Purchased power | | 853,745 | 829,177 |
| Maintenance and other operating expenses | | 1,018,631 | 977,550 |
| Depreciation and amortization | | 386,937 | 337,866 |
| | | 2,695,125 | 2,625,300 |
| Operating income | | 430,832 | 609,893 |
| Nonoperating revenues (expenses): | | | |
| Investment income | | 81,847 | 106,446 |
| Federal bond subsidies | | 28,069 | — |
| Other nonoperating income | | 16,999 | 31,009 |
| | | 126,915 | 137,455 |
| Other nonoperating expenses | | (4,183) | (6,021) |
| | | 122,732 | 131,434 |
| Debt expenses: | | | |
| Interest on debt | | 276,897 | 219,986 |
| Allowance for funds used during construction | | (11,806) | (7,665) |
| | | 265,091 | 212,321 |
| Income before capital contributions and transfers | | 288,473 | 529,006 |
| Capital contributions | | 27,983 | 13,069 |
| Transfers to the reserve fund of the City of Los Angeles | | (258,815) | (220,475) |
| Increase in fund net assets | | 57,641 | 321,600 |
| Fund net assets: | | | |
| Beginning of year | | 4,878,911 | 4,557,311 |
| End of year | $ | 4,936,552 | 4,878,911 |

See accompanying notes to financial statements.

**LOS ANGELES DEPARTMENT OF WATER AND POWER**
**POWER SYSTEM**

Statements of Cash Flows
(Direct Method)

Years ended June 30, 2011 and 2010

(Amounts in thousands)

| | 2011 | 2010 |
|---|---|---|
| Cash flows from operating activities: | | |
| Cash receipts: | | |
| Cash receipts from retail customers | $ 3,021,564 | 2,817,546 |
| Cash receipts from retail customers for other agency services | 615,957 | 582,963 |
| Cash receipts from interfund services provided | 448,390 | 435,986 |
| Other cash receipts | — | 147,572 |
| Cash disbursements: | | |
| Cash payments to employees | (512,045) | (538,091) |
| Cash payments to suppliers | (1,642,853) | (1,569,197) |
| Cash payments for interfund services used | (571,847) | (502,607) |
| Cash payments to other agencies for fees collected | (585,948) | (558,025) |
| Other operating cash payments | (106,507) | (74,266) |
| Net cash provided by operating activities | 666,711 | 741,881 |
| Cash flows from noncapital financing activities: | | |
| Payments to the reserve fund of the City of Los Angeles | (258,815) | (220,475) |
| Interest paid on noncapital revenue bonds | (1,044) | (1,177) |
| Net cash used in noncapital financing activities | (259,859) | (221,652) |
| Cash flows from capital and related financing activities: | | |
| Additions to plant and equipment, net | (857,344) | (710,451) |
| Capital contributions | 32,129 | 21,034 |
| Principal payments and maturities on long-term debt | (173,820) | (126,954) |
| Proceeds from issuance of bonds and revenue certificates | 898,975 | 616,351 |
| Debt interest payments | (248,214) | (219,162) |
| Federal bond subsidies | 28,069 | — |
| Net cash used in capital and related financing activities | (320,205) | (419,182) |
| Cash flows from investing activities: | | |
| Purchases of investment securities | (1,680,327) | (1,607,082) |
| Sales and maturities of investment securities | 1,728,579 | 1,646,496 |
| Proceeds from notes receivable | 78,190 | 31,166 |
| Investment income | 86,199 | 97,542 |
| Net cash provided by investing activities | 212,641 | 168,122 |
| Net increase in cash and cash equivalents | 299,288 | 269,169 |
| Cash and cash equivalent: | | |
| Cash and cash equivalents at July 1 (including $699,853 and $409,863 reported in restricted accounts, respectively) | 1,123,708 | 854,539 |
| Cash and cash equivalents at June 30 (including $861,583 and $699,853 reported in restricted accounts, respectively) | $ 1,422,996 | 1,123,708 |



(Continued)

**LOS ANGELES DEPARTMENT OF WATER AND POWER**
**POWER SYSTEM**

Statements of Cash Flows
(Indirect Method)

Years ended June 30, 2011 and 2010

(Amounts in thousands)

| | | 2011 | 2010 |
|---|---|---|---|
| Reconciliation of operating income to net cash provided by operating activities: | | | |
| Operating income | $ | 430,832 | 609,893 |
| Adjustments to reconcile operating income to net cash provided by operating activities: | | | |
| Depreciation and amortization | | 386,937 | 337,866 |
| Depletion expense | | 14,398 | 5,074 |
| Amortization of nuclear fuel | | 11,974 | 8,709 |
| Provision for losses on customer and other accounts receivable | | 27,492 | 26,818 |
| Changes in assets and liabilities: | | | |
| Customer and other accounts receivable | | (25,331) | (69,833) |
| Accrued unbilled revenue | | 2,758 | (13,161) |
| Underrecovered costs | | (43,846) | (120,014) |
| Materials and fuel | | 3,513 | (4,785) |
| Due from Water System | | 4,009 | 2,627 |
| Long-term California wholesale energy receivable | | — | 116,333 |
| Net pension asset | | 38,944 | 17,314 |
| Accounts payable and accrued expenses | | 23,916 | 14,582 |
| Accrued liabilities | | (1,553) | (11,720) |
| Deferred credits | | (92,802) | (177,029) |
| Net other postemployment benefit liability | | (57,213) | (77,511) |
| Prepayments and other | | (57,317) | 76,718 |
| Net cash provided by operating activities | $ | 666,711 | 741,881 |

Supplemental disclosure of noncash capital and related financing activity:

The Power System issued capital bonds to refund previously issued debt. $776,420 in proceeds was deposited immediately into an irrevocable trust for defeasance of $826,420 of outstanding revenue bond principal. The remaining $50,000 was deposited directly from the Power System’s Debt Reduction Trust Fund.

See accompanying notes to financial statements.

## (1) Summary of Significant Accounting Policies

The Department of Water and Power of the City of Los Angeles (the Department) exists as a separate proprietary department of the City of Los Angeles (the City) under and by virtue of the City Charter enacted in 1925 and as revised effective July 2000. The Department's Power Revenue Fund (the Power System) is responsible for the generation, transmission, and distribution of electric power for sale in the City. The Power System is operated as an enterprise fund of the City.

### *(a) Method of Accounting*

The accounting records of the Power System are maintained in accordance with U.S. generally accepted accounting principles (GAAP) for governmental entities. The financial statements have been prepared using the economic resources measurement focus and the accrual basis of accounting. The Power System is accounted for as an enterprise fund and applies all applicable Governmental Standards Board (GASB) pronouncements in its accounting and reporting. In addition, the Power System follows Financial Accounting Standards Board (FASB) pronouncements issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements.

The financial statements of the Power System are intended to present the financial position, and the changes in the financial position, and cash flows of only that portion of the business-type activities and each major fund of the City of Los Angeles, California that is attributable to the transactions of the Power System. They do not purport to, and do not, present fairly the financial position of the City of Los Angeles, California as of June 30, 2011 and 2010, the changes in its financial position or, where applicable, its cash flows for the years then ended, in conformity with GAAP.

The Department's rates are determined by the Board of Water and Power Commissioners (the Board) and are subject to review and approval by the Los Angeles City Council (City Council). As a regulated enterprise, the Department utilizes Statement of Financial Accounting Standards (SFAS) No. 71, *Accounting for the Effects of Certain Types of Regulation*, which requires that the effects of the rate-making process be recorded in the financial statements. Such effects primarily concern the time at which various items enter into the determination of changes in fund net assets. Accordingly, the Power System records various regulatory assets and liabilities to reflect the Board's actions. Regulatory liabilities are recorded in deferred credits and regulatory assets are included as deferred debits and under recovered costs on the balance sheets. Management believes that the Power System meets the criteria for continued application of SFAS No. 71, but will continue to evaluate its applicability based on changes in the regulatory and competitive environment (see notes 3 and 14(d)i).

### *(b) Use of Estimates*

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

### (c) *Utility Plant*

The costs of additions to utility plant and replacements of retired units of property are capitalized. Costs include labor, materials, an allowance for funds used during construction (AFUDC), and allocated indirect charges, such as engineering, supervision, transportation and construction equipment, retirement plan contributions, healthcare costs, and certain administrative and general expenses. The costs of maintenance, repairs, and minor replacements are charged to the appropriate operations and maintenance expense accounts.

### (d) *Intangibles*

The Department follows GASB No. 51, *Accounting and Financial Reporting for Intangible Assets* (GASB No. 51), which requires that an intangible asset be recognized in the balance sheet only if it is considered identifiable. Additionally, it establishes a specified-conditions approach to recognize intangible assets that are internally generated. Effectively, outlays associated with the development of such assets are capitalized until certain criteria are met. Outlays incurred prior to meeting these criteria are expensed as incurred. The Power System capitalized internally generated software costs in 2011 and 2010. The capitalized amounts are included in construction work in progress on the balance sheets.

### (e) *Impairment of Long-Lived Assets*

The Department follows GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries* (GASB No. 42). Governments are required to evaluate prominent events or changes in circumstances affecting capital assets to determine whether impairment of a capital asset has occurred. A capital asset is considered impaired when its service utility has declined significantly and unexpectedly. Under GASB No. 42, impaired capital assets that will no longer be used by the government should be reported at the lower of carrying value or fair value. Impairment losses on capital assets that will continue to be used by the government should be measured using the method that best reflects the cause of the diminished service utility of the capital asset.

### (f) *Depreciation and Amortization*

Depreciation expense is computed using the straight-line method based on service lives for all projects completed after July 1, 1973, and for all office and shop structures, related furniture and equipment, and transportation and construction equipment. Depreciation for facilities completed prior to July 1, 1973 is computed using the 5.0% sinking fund method based on estimated service lives. The Department uses the composite method of depreciation and, therefore, groups assets into composite groups for purposes of calculating depreciation expense. Estimated service lives range from 5 to 75 years. Amortization expense for computer software is computed using the straight-line method over five years. Depreciation and amortization expense as a percentage of average depreciable utility plant in service was 3.2% and 3.0% for fiscal years 2011 and 2010, respectively.


(Continued)

### *(g) Nuclear Decommissioning*

The Department owns a 5.70% direct ownership interest in the Palo Verde Nuclear Generating Station (PVNGS). In addition, through its participation in the Southern California Public Power Authority (SCPPA), the Department is party to a contract for an additional 3.95% of the output of PVNGS. Nuclear decommissioning costs associated with the Power System's output entitlement are included in purchased power expense (see note 6).

Decommissioning of PVNGS is expected to commence subsequent to the year 2044, since the Nuclear Regulatory Commission (the NRC) approved a request for license extension in April 2011. The total cost to decommission the Power System's direct ownership interest in PVNGS is estimated to be $135 million in 2010 dollars. This estimate is based on an updated site-specific study prepared by an independent consultant in 2007. As of June 30, 2011 and 2010, the Power System has recorded $139.6 million and $137.3 million, respectively, to accumulated depreciation to provide for the decommissioning liability.

Prior to December 1999, the Power System contributed $70.2 million to external trusts established in accordance with the PVNGS participation agreement and NRC requirements. During fiscal year 2000, the Department suspended contributing additional amounts to the trust funds, as management believes that contributions made, combined with reinvested earnings, will be sufficient to fully fund the Department's share of decommissioning costs. The Department will continue to reinvest its investment income on the trust investments into the decommissioning trusts. The Department reinvested $2.2 million and $3.9 million of investment income in fiscal years 2011 and 2010, respectively. Decommissioning funds, which are included in restricted investments, totaled $120.0 million and $117.8 million as of June 30, 2011 and 2010 (at fair value), respectively. The Department's current accounting policy recognizes any realized and unrealized investment earnings from nuclear decommissioning trust funds as a component of accumulated depreciation.

### *(h) Nuclear Fuel*

Nuclear fuel is amortized and charged to fuel for generation on the basis of actual thermal energy produced relative to total thermal energy expected to be produced over the life of the fuel. Under the provisions of the Nuclear Waste Policy Act of 1982, the federal government assesses each utility with nuclear operations, including the Power System, $1 per megawatt hour of nuclear generation. The Power System includes this charge as a current year expense in fuel for generation. See note 14 for discussion of spent nuclear fuel disposal.

### *(i) Natural Gas Field*

In July 2005, the Power System acquired approximately a 74.5% ownership interest in gas properties located in Pinedale, Wyoming. The Power System uses the successful efforts method of accounting for its investment in gas producing properties. Costs to acquire the mineral interest in gas producing properties, to drill and equip exploratory wells that find proven reserves, and to drill and equip development wells are capitalized. Costs to drill exploratory wells that do not find proven reserves are expensed. Capitalized costs of gas producing properties are depleted by the unit-of-production method based on the estimated future production of the proved developed producing wells.

Depletion expense related to the gas field is recorded as a component of fuel for generation expense. During fiscal years 2011 and 2010, the Power System recorded $14.4 million and $5.1 million of depletion expense, respectively.

### *(j) Cash and Cash Equivalents*

As provided for by the State of California Government Code (the Code), the Power System's cash is deposited with the City Treasurer in the City's general investment pool for the purpose of maximizing interest earnings through pooled investment activities. Cash and cash equivalents in the City's general investment pool are reported at fair value and changes in unrealized gains and losses are recorded in the statements of revenues, expenses, and changes in fund net assets. Interest earned on such pooled investments is allocated to the participating funds based on each fund's average daily cash balance during the allocation period. The City Treasurer invests available funds of the City and its independent operating departments on a combined basis. The Power System classifies all cash and cash equivalents that are restricted either by creditors, the Board, or by law, as restricted cash and cash equivalents on the balance sheets. The Power System considers its portion of pooled investments in the City's pool to be cash and cash equivalents and the unspent construction funds as long-term restricted cash as cash equivalents.

At June 30, 2011 and 2010, restricted cash and cash equivalents include the following (amounts in thousands):

| | June 30 | |
|---|---|---|
| | **2011** | **2010** |
| Bond redemption and interest funds | $ 194,986 | 229,222 |
| Self-insurance fund | 113,893 | 107,884 |
| Other | — | 2,700 |
| Cash and cash equivalents – current portion | 308,879 | 339,806 |
| Construction funds – classified as long-term restricted cash | 552,704 | 360,047 |
| Total restricted cash and cash equivalents | $ 861,583 | 699,853 |

### *(k) Materials and Fuel*

Materials and supplies are recorded at average cost. Fuel is recorded at lower of cost or market, on an average cost basis.

### *(l) Accrued Unbilled Revenue*

Accrued unbilled revenue is the receivable for estimated energy sales during the period for which service has been provided but the customer has not been billed.

### *(m) Restricted Investments*

Restricted investments include primarily commercial paper, U.S. government and governmental agency securities, and corporate bonds. Investments are reported at fair value and changes in unrealized gains and losses are recorded in the statements of revenues, expenses, and changes in fund net assets except for Nuclear Decommissioning Trust Funds. The stated fair value of investments is generally based on published market prices or quotations from major investment dealers (see note 7).

### *(n) Accrued Employee Expenses*

Accrued employee expenses include accrued payroll and an estimated liability for vacation leave, sick leave, and compensatory time, which is accrued when employees earn the rights to the benefits. Below is a schedule of accrued employee expenses as of June 30, 2011 and 20 (amounts in thousands):

| | | 2011 | 2010 |
|---|---|---|---|
| Type of expenses: | | | |
| Accrued payroll | $ | 23,767 | 20,783 |
| Accrued vacation | | 47,649 | 47,006 |
| Accrued sick leave | | 11,534 | 11,253 |
| Compensatory time | | 14,390 | 13,292 |
| Total | $ | 97,340 | 92,334 |

### *(o) Debt Expenses*

Debt premium, discount, and issue expenses are deferred and amortized to debt expense using the effective-interest method over the lives of the related debt issues. Gains and losses on refundings related to bonds redeemed by proceeds from the issuance of new bonds are amortized to interest expense using the effective-interest over the shorter of the life of the new bonds or the remaining term of the bonds refunded.

### *(p) Accrued Workers' Compensation Claims*

Liabilities for unpaid workers' compensation claims are recorded at their net present value (see note 13).

### *(q) Customer Deposits*

Customer deposits represent deposits collected from customers upon opening of new accounts. These deposits are obtained when the customer does not have a previously established credit history with the Department. Original deposits plus interest are paid to the customer once a satisfactory payment history is maintained, generally after one to three years.

The Department's Water Revenue Fund (Water System) is responsible for collection, maintenance, and refunding of these deposits for all the Department customers, including those of the Power System. As such, the Water System's balance sheets include a deposit liability of $77 million and

$68 million as of June 30, 2011 and 2010, respectively, for all customer deposits collected. In the event that the Water System defaults on refunds of such deposits, the Power System would be required to pay amounts it owes its customers.

***(r) Revenues***

The Power System's rates are established by a rate ordinance, which is approved by the City Council. The Power System sells energy to the City's other departments at rates provided in the ordinance. The Power System recognizes energy costs in the period incurred and accrues for estimated energy sold but not yet billed.

Effective October 1, 2006, the Energy Cost Adjustment Factor (ECAF), which is a billing factor defined in the electric rate ordinance, was unfrozen. This change allows the Power System to increase or decrease the factor on a quarterly basis in compliance with the ordinance. While this change allows the Power System to fully recover fuel costs, purchased power costs, and other costs outlined in the ordinance, the difference between the amount billed to customers, and the value of the costs allowed to be recovered through the factor create an over/underrecovered amount. Costs that are underrecovered will be recovered in future periods. Amounts overrecovered will be factored into future quarterly rates. As of June 30, 2011 and 2010, the amount of underrecovered costs, including the ECAF and the Reliability Cost Adjustment Factor was $294.2 million and $250.4 million, respectively. These balances are recorded as noncurrent assets on the balance sheets.

Operating revenues are revenues derived from activities that are billable in accordance with the electric rate ordinance approved by the City Council.

***(s) Capital Contributions***

Capital contributions and other grants received by the Department for constructing utility plant and other activities are recognized when all applicable eligibility requirements, including time requirements, are met.

***(t) Allowance for Funds Used during Construction (AFUDC)***

An AFUDC charge represents the cost of borrowed funds used for the construction of utility plant. Capitalized AFUDC is included as part of the cost of utility plant and as a reduction of debt expenses. As of June 30, 2011 and 2010, the average AFUDC rates were 5.2% and 4.6%, respectively.

***(u) Use of Restricted and Unrestrictive Resources***

The Power System's policy is to use unrestricted resources prior to restricted resources to meet expenses to the extent that it is prudent from an operational perspective. Once it is not prudent, restricted resources will be utilized to meet intended obligations.

***(v) Reclassifications***

Certain prior year amounts have been reclassified to conform with the current year's presentation.

## (2) Recent Accounting Pronouncements

### *(a) GASB Statement No. 59*

In fiscal year 2011, the Department adopted GASB Statement No. 59, *Financial Instruments Omnibus* (GASB No. 59). This statement updates and improves existing standards regarding financial reporting and disclosure requirements of certain financial instruments and external investment pools for which significant issues have been identified in practice. The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2010. There was no impact to net assets as of July 1, 2010 as a result of implementation of this pronouncement.

### *(b) 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* (GASB No. 62). 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 this Statement are effective for financial statements for periods beginning after December 15, 2011, with retroactive application for all periods presented. The Power System has determined there will be no material impact of this pronouncement on the financial statements.

### *(c) 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* (GASB No. 63). The requirements of this Statement will improve financial reporting by standardizing the presentation of deferred outflows of resources and deferred inflows of resources and their effects on a government's net position. It alleviates uncertainty about reporting those financial statement elements by providing guidance where none previously existed. The provisions of this Statement are effective for financial statements for periods beginning after December 15, 2011. The Power System has determined there will be no material impact of this pronouncement on its deferred outflows that are reported on the balance sheets.

### *(d) 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* (GASB No. 64). 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. This Statement sets forth criteria that establish when the effective hedging relationship continues and hedge accounting should continue to be applied. The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2011. The Power System has determined there will be no material impact of this pronouncement on its hedging derivatives accounted for under GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments* (GASB No. 53).

## (3) Regulatory Matters

### *(a) Federal Regulation of Transmission Access*

The Energy Policy Act of 1992 made fundamental changes in the federal regulation of the electric utility industry, particularly in the area of transmission. As amended by the Energy Policy Act, Sections 211, 212, and 213 of the Federal Power Act (FPA) provide Federal Energy Regulatory Commission (FERC) authority, upon application by any electric utility, federal power marketing agency, or other person or entity generating electric energy for sale or resale, to require a transmitting utility to provide transmission services (including any enlargement of transmission capacity necessary to provide such services) to the applicant at rates, charges, terms, and conditions set by FERC based on standards and provisions in the FPA. Under the Energy Policy Act, electric utilities owned by municipalities and other public agencies, which own or operate electric power transmission facilities that are used for the sale of electric energy at wholesale rates are “transmitting utilities” subject to the requirements of Sections 211, 212, and 213.

FERC has encouraged in the past the voluntary formation of regional transmission organizations (RTOs) independent from owners of generation and other market participants that will provide transmission access on a nondiscriminatory basis to buyers and sellers of power. Investor-owned utilities (IOUs) and publicly-owned utilities (POUs) have been encouraged to participate in the formation and operation of RTOs, but POUs are not, at this time, being ordered by FERC to participate. FERC has adopted a “go slow” approach to the issue of RTO formation in the western United States; it is contemporaneously engaged in a wholesale overhaul of the California market design, referred to initially as the Market Design 2002 proceeding and lately as the Market Redesign and Technology Update (MRTU) proceeding. These FERC proceedings will have potential impacts on every electric utility doing business in California. MRTU involves a comprehensive overhaul of the electricity markets administered by California Independent System Operator (CAISO), including the areas of transmission congestion management, trading and scheduling energy in the day ahead, or spot market, improved market power mitigation, and pricing transparency measures and system improvements to increase operational efficiency and enhance reliability, among other things. MRTU was implemented on April 1, 2009. At this time there is no material impact on the Department. In addition, CAISO has announced its intention to implement further market changes over the next several years.

### *(b) Federal Energy Legislation of 2005*

On August 8, 2005, the Energy Policy Act of 2005 (EPAct) was enacted, the first comprehensive energy legislation in over a decade. One of the most significant provisions of EPAct empowers the Federal Energy Regulatory Commission (FERC) to certify an Electric Reliability Organization (ERO) to improve the reliability of the nation’s “bulk power system” through mandatory and enforceable electric reliability standards (in contrast to the long-standing voluntary system). The definition of “bulk power system” does not include facilities used in the local distribution of electric energy. The ERO will file any proposed reliability standard or modification with FERC. A “reliability standard” is a requirement that provides for reliable operation of the bulk-power system. Such a standard includes requirements for the operation of existing transmission facilities or the design of planned additions or modifications to the extent necessary to provide for reliable operation.

It does not include, and the ERO may not impose, any requirement to enlarge existing facilities or to construct new transmission or generation. All users, owners, and operators of the bulk-power system are required to comply with the electric reliability standards. The ERO may impose a penalty on a user, owner, or operator for violating a reliability standard, and FERC may order compliance with such a standard and impose a penalty if it finds that a user, owner, or operator is about to engage in an act that would violate a reliability standard.

Based on EPAct authority vested upon the FERC, the FERC approved the North American Electric Reliability Corporation (NERC) as the ERO, and last year made mandatory more than 80 NERC and Western Electricity Coordinating Council (WECC) reliability standards, all of which are subject to penalties ranging from $1,000 to $1,000,000, depending on the impact of the violation to reliability and other factors. The Department has implemented a NERC/WECC Reliability Standards Compliance Program to proactively prevent, monitor, and stop potential violations to these standards.

EPAct authorizes FERC to require nondiscriminatory access to transmission facilities owned by municipal, cooperative, and other transmission companies not currently regulated by FERC, unless exercising this authority would violate a private activity bond rule for purposes of Section 141 of the Internal Revenue Code of 1986. FERC is prohibited from requiring any such entities to join RTOs. EPAct also allows FERC to issue permits for the construction of new transmission facilities when states have been unable or unwilling to act and allows load-serving entities to use the firm transmission rights, or equivalent tradable or financial transmission rights, in order to deliver output or purchased energy to the extent required to meet its service obligations. EPAct does not relieve a load-serving entity from any obligation under state or local law to build transmission or distribution facilities adequate to meet its service obligations, or to abrogate preexisting firm transmission service contracts.

EPAct directs FERC to establish, by rule, incentive-based rates for transmission no later than August 2006 and requires FERC to establish market transparency rules for the electric wholesale market (entities that have a de minims market presence are exempt from the rules). EPAct instructs that the market transparency rules must provide for the timely dissemination of information about the availability and prices of wholesale electric energy and transmission service to FERC, state commission, buyers and sellers of wholesale electric energy, users of transmission services, and the public. Within 180 days of EPAct's enactment, FERC and the Commodity Futures Trading Commission are required to enter into a memorandum of understanding regarding information sharing pursuant to these rules.

In addition, EPAct prohibits any person from willfully and knowingly reporting false information to any federal agency on the price of wholesale electricity or availability of transmission capacity, or using (directly or indirectly) any manipulative device in contravention of any FERC rule. EPAct increases civil and criminal penalties, modifies the procedures for review of FERC orders under the FPA, and changes the refund date under the FPA to be effective as of the date an applicable complaint is filed. EPAct also establishes an entity's right to a refund if (i) it makes a short-term sale of electric energy through an organized market in which the rates for the sale are set by a

FERC-approved tariff (not by a contract) and (ii) the sale violates the terms of the tariff or applicable FERC rule in effect at the time of the sale.

The overall impact of EPAct on the Department cannot be predicted at this time.

***(c) Final Rule on Transmission and Cost Allocation – FERC Order No. 1000 (RM10-23-000)***

On July 21, 2011, the FERC issued its Final Rule on Transmission Planning and Cost Allocation by Transmission Owning and Operating Public Utilities, denominated Order No. 1000 (Docket No. RM10-23-000). The Final Rule, which largely mirrors FERC's proposed rule issued in June 2010, requires public utility transmission providers to: develop and participate in a regional planning process that produces a regional transmission plan; consider state and federal public policy requirements in transmission planning processes; eliminate, with certain exceptions, rights of first refusal contained in FERC-approved tariffs, or contracts that entitle an incumbent utility to build transmission facilities identified in the regional transmission planning processes; develop regional cost allocation methods for transmission projects selected in regional transmission plans; and coordinate with each neighboring planning region to develop procedures for coordination of planning and methods of cost allocation for interregional transmission projects.

The Final Rule reflects an ambitious effort by FERC to modify its policies in a manner that will result in more efficient and cost-effective transmission planning and support investment in transmission infrastructure. The Final Rule, however, leaves many of the critical details to be worked out at the regional and interregional levels, and subsequently, to be reviewed by FERC in the form of compliance filings.

The Final Rule urges, but does not require, government-owned utilities such as the Department and cooperative utilities to participate in regional transmission planning and cost allocation. FERC indicates that if "nonjurisdictional" transmission owners do not comply with Order No. 1000, they may not meet reciprocity requirements, and thus may have access to third-party transmission services limited.

***(d) Dodd-Frank Wall Street Reform and Consumer Protection Act***

On July 21, 2010, the "Dodd-Frank Wall Street Reform and Consumer Protection Act" (Dodd-Frank) was signed into law. Dodd-Frank was enacted to minimize systemic risk to the U.S. financial system, in part by establishing new rules related to swaps and other derivatives. First, Dodd-Frank generally requires that parties to swap transactions provide collateral for their swaps. This "margining" requirement means that a party to a swap must set aside cash or other collateral to secure its obligations under the swap. Second, Dodd-Frank generally requires that swap transactions be conducted or "cleared" through financial intermediaries. This clearing requirement means that parties generally cannot enter into a swap that is customized to the needs of the parties, as is typically the case for public power and other electric utilities. Dodd-Frank did, however, provide exceptions to both the margining and clearing requirements for "end users" that are using swaps to hedge commercial risks. A third requirement of Dodd-Frank is to impose reporting requirements on swap transactions, including additional reporting for end-user transactions. Finally, Dodd-Frank imposed additional limitations on swaps with "special entities," including public power and other governmental entities, to ensure that these special entities are being properly advised and dealt with fairly in consummating swap transactions. These rules require that a swap counterparty ensure that a special entity has an independent swap advisor and impose on the advisor a duty to act in the best interests of the special entity.

Under Dodd-Frank, the Department would be classified as a swap dealer instead of an end-user (which is exempt from the Dodd-Frank), impacting the Department’s transactions in the market. The economic impact is unknown at this time.

Dodd-Frank mandates that within one year the Commodities Futures Trading Commission (CFTC) is to issue a comprehensive system of regulations in order to implement the Act.

## (4) Utility Plant

The Power System had the following activities in utility plant during fiscal year 2011 (amounts in thousands):

| | | Balance July 1, 2010 | Additions | Retirements and disposals | Transfers | Balance June 30, 2011 |
|---|---|---|---|---|---|---|
| Nondepreciable utility plant: | | | | | | |
| Land and land rights | $ | 165,730 | 407 | — | — | 166,137 |
| Construction work in progress | | 431,491 | 434,434 | — | (180,440) | 685,485 |
| Nuclear fuel | | 44,295 | 12,007 | (11,974) | — | 44,328 |
| Natural gas field, net | | 231,397 | 39,623 | (14,398) | — | 256,622 |
| Total nondepreciable utility plant | | 872,913 | 486,471 | (26,372) | (180,440) | 1,152,572 |
| Depreciable utility plant: | | | | | | |
| Generation | | 4,067,327 | 40,911 | (2,382) | 49,395 | 4,155,251 |
| Transmission | | 920,584 | 8,138 | (10) | 13,566 | 942,278 |
| Distribution | | 5,645,415 | 277,681 | 134 | 78,639 | 6,001,869 |
| General | | 1,187,783 | 49,350 | (10,032) | 38,840 | 1,265,941 |
| Total depreciable utility plant | | 11,821,109 | 376,080 | (12,290) | 180,440 | 12,365,339 |
| Accumulated depreciation: | | | | | | |
| Generation | | (2,354,131) | (119,370) | 2,382 | — | (2,471,119) |
| Transmission | | (334,852) | (30,234) | 10 | — | (365,076) |
| Distribution | | (2,303,632) | (194,966) | (134) | — | (2,498,732) |
| General | | (722,652) | (39,144) | 10,032 | — | (751,764) |
| Total accumulated depreciation | | (5,715,267) | (383,714) | 12,290 | — | (6,086,691) |
| Total utility plant, net | $ | 6,978,755 | 478,837 | (26,372) | — | 7,431,220 |

Depreciation and amortization expense during fiscal year 2011 was $386.9 million.

Land and land rights are recorded on the balance sheet as utility plant in their functional category.

The Power System had the following activities in utility plant during fiscal year 2010 (amounts in thousands):

| | Balance July 1, 2009 | Additions | Retirements and disposals | Transfers | Balance June 30, 2010 |
|---|---|---|---|---|---|
| Nondepreciable utility plant: | | | | | |
| Land and land rights | $ 155,379 | 9,082 | — | 1,269 | 165,730 |
| Construction work in progress | 609,115 | 279,142 | — | (456,766) | 431,491 |
| Nuclear fuel | 36,904 | 16,100 | (8,709) | — | 44,295 |
| Natural gas field, net | 223,617 | 12,854 | (5,074) | — | 231,397 |
| Total nondepreciable utility plant | 1,025,015 | 317,178 | (13,783) | (455,497) | 872,913 |
| Depreciable utility plant: | | | | | |
| Generation | 3,908,768 | 30,023 | (6,129) | 134,665 | 4,067,327 |
| Transmission | 873,025 | 4,764 | (50) | 42,845 | 920,584 |
| Distribution | 5,103,216 | 293,498 | (2,730) | 251,431 | 5,645,415 |
| General | 1,106,781 | 64,029 | (9,583) | 26,556 | 1,187,783 |
| Total depreciable utility plant | 10,991,790 | 392,314 | (18,492) | 455,497 | 11,821,109 |
| Accumulated depreciation: | | | | | |
| Generation | (2,244,648) | (115,612) | 6,129 | — | (2,354,131) |
| Transmission | (312,584) | (22,318) | 50 | — | (334,852) |
| Distribution | (2,145,666) | (160,696) | 2,730 | — | (2,303,632) |
| General | (697,265) | (34,970) | 9,583 | — | (722,652) |
| Total accumulated depreciation | (5,400,163) | (333,596) | 18,492 | — | (5,715,267) |
| Total utility plant, net | $ 6,616,642 | 375,896 | (13,783) | — | 6,978,755 |

Depreciation and amortization expense during fiscal year 2010 was $337.9 million.

Land and land rights are recorded on the balance sheet as utility plant in their functional category.

## (5) Jointly Owned Utility Plant

The Power System has direct interests in several electric generating stations and transmission systems, which are jointly owned with other utilities. As of June 30, 2011 and 2010, utility plant includes the following amounts related to the Power System's ownership interest in each jointly owned utility plant (amounts in thousands, except as indicated):

| | Ownership interest | Share of capacity (MWs) | Utility plant in service June 30, 2011 Cost | Utility plant in service June 30, 2011 Accumulated depreciation | Utility plant in service June 30, 2010 Cost | Utility plant in service June 30, 2010 Accumulated depreciation |
|---|---|---|---|---|---|---|
| Palo Verde Nuclear Generating Station | 5.7% | 224 | $ 593,723 | 360,094 | 581,844 | 345,321 |
| Navajo Generating Station | 21.2 | 477 | 344,338 | 302,801 | 330,465 | 293,208 |
| Mohave Generating Station | 10.0 | — | 62,763 | 57,852 | 61,226 | 57,852 |
| Pacific Intertie DC Transmission Line | 40.0 | 1,240 | 183,531 | 52,941 | 182,363 | 48,589 |
| Other transmission systems | — | Various | 91,292 | 49,595 | 85,419 | 47,047 |
| | | | $ 1,275,647 | 823,283 | 1,241,317 | 792,017 |

The Power System will incur certain minimal operating costs related to the jointly owned facilities, regardless of the amount or its ability to take delivery of its share of energy generated. The Power System's proportionate share of the operating costs of the joint plants is included in the corresponding categories of operating expenses.

## (6) Purchase Power Commitments

As of June 30, 2011, the Power System has entered into a number of energy and transmission service contracts, which involve substantial commitments as follows (amounts in thousands, except as indicated):

| | Agency | Agency share | The Power System's interest in agency's share: Interest | Capacity (MWs) | Outstanding principal |
|---|---|---|---|---|---|
| Intermountain Power Project | IPA | 100.0% | 60.0% | 1,076 | $ 939,823 |
| Palo Verde Nuclear Generating Station | SCPPA | 5.9 | 67.0 | 151 | 53,225 |
| Mead-Adelanto Project | SCPPA | 68.0 | 36.0 | 313 | 63,182 |
| Mead-Phoenix Project | SCPPA | 17.8 – 22.4 | 25.0 | 148 | 13,862 |
| Southern Transmission System | SCPPA | 100.0 | 60.0 | 1,429 | 504,911 |
| Milford I Wind | SCPPA | 100.0 | 93.0 | 188 | 219,442 |
| Windy Point | SCPPA | 100.0 | 92.0 | 242 | 475,084 |
| Linden Wind Energy | SCPPA | 100.0 | 90.0 | 45* | 124,493 |

* For the first three years, Power System will receive 100% (50 MWs), unless City of Glendale exercises its option to take 10%.

**IPA** – The Intermountain Power Agency (IPA) is an agency of the State of Utah established to own, acquire, construct, operate, maintain, and repair the Intermountain Power Project (IPP). The Power System serves as the project manager and operating agent of IPP.

**SCPPA** – The Southern California Public Power Authority is a California Joint Powers Agency. SCPPA's interest in the Mead-Phoenix Project includes three components.

The above agreements require the Power System to make certain minimum payments, which are based primarily upon debt service requirements. In addition to average annual fixed charges of approximately $292 million during each of the next five years, the Power System is required to pay for operating and maintenance costs related to actual deliveries of energy under these agreements (averaging approximately $393 million annually during each of the next five years). The Power System made total payments under these agreements of approximately $678 million and $536 million in fiscal years 2011 and 2010, respectively. These agreements are scheduled to expire from 2027 to 2035.

The Power System earned fees under the IPP project manager and operating agent agreements totaling $20.8 million and $22.9 million in fiscal years 2011 and 2010, respectively.

***(a) Long-Term Notes Receivable***

Under the terms of its purchase power agreement with IPA, the Department is charged for its output entitlements based on its share of IPA's costs, including debt service. During fiscal year 2000, the Department restructured a portion of this obligation by transferring $1.11 billion to IPA in exchange for long-term notes receivable. The funds transferred were obtained from the debt reduction trust funds and through the issuance of new variable rate debentures (see notes 7 and 10). IPA used the proceeds from these transactions to defease and to tender bonds with par values of approximately $618 million and $611 million, respectively.

On September 7, 2000, the Department paid $187 million to IPA in exchange for additional long-term notes receivable. IPA used the proceeds to defease bonds with a face value of $198 million.

On July 20, 2005, the Department paid $97 million to IPA in exchange for additional long-term notes receivable. IPA used the proceeds to defease bonds with a face value of $92 million.

The IPA notes are subordinate to all of IPA's publicly held debt obligations. The Power System's future payments to IPA will be partially offset by interest payments and principal maturities from the subordinated notes receivable. The net IPA notes receivable balance totaled $1.005 billion and $1.08 billion as of June 30, 2011 and 2010, respectively.

The IPA notes pay interest and principal monthly and mature on July 1, 2023. The interest rates range from 0.4% to 14.4%, subject to adjustments related to IPA bond refundings.

### *(b) Energy Entitlement*

The Department has a contract through 2017 with the U.S. Department of Energy for the purchase of available energy generated at the Hoover Power Plant. The Department's contractual share of contingent capacity at Hoover is 491 MW (maximum rated capability). The cost of power (approximately 455 MW of capacity and 599,000 MWH of energy) purchased under this contract was approximately $17 million and $16 million as of June 30, 2011 and 2010, respectively.

On July 14, 2011, the Senate Energy and Natural Resources (ENR) Committee approved the Hoover Power Allocation Act (S.519), with Nonsubstantive technical amendments. The legislation reallocates for 50 years power from the Hoover Dam Power Plant to existing contractors while creating an additional pool of power for new entrants. The House companion bill (H.R. 470) was passed by the Natural Resources Committee on June 15, 2011.

The Department has a contract through 2026 with SCPPA for the purchase of available energy generated at the Pebble Springs Wind Project located in Gilliam County, Oregon. The Power System's share of capacity at Pebble Springs is approximately 69 MWs (maximum capacity). The cost of power purchased under this contract was $18 million and $11 million as of June 30, 2011 and 2010, respectively.

### *(c) Electricity Swap and Forward Contracts*

In order to obtain the highest market value on energy that is sold into the wholesale market, the Department monitors the sales price of energy, which varies based on which hub the energy is to be delivered. There are three primary hubs within the Department's transmission region: Palo Verde, California Oregon Border, and Mead. The Department enters into various locational swap transactions with other electric utilities in order to effectively utilize its transmission capacity and to achieve the most economical exchange of energy purchased and sold.

The Department procures renewable energy resources located remotely. These resources provide intermittent and limited source of energy and these resources are not directly connected to the Department's transmission system. In order to receive firm renewable energy, the Department entered into a green for green energy exchange with the same or different Renewable Energy Credit source.

The Department enters into power and natural gas forward contracts in order to meet the electricity requirements to serve its customers. To assist the Department in achieving its Renewable Portfolio Standards (RPS) goal of 20%, some of the forward purchases made are renewable energy and biomethane gas.

The Department does not enter into swap and forward transactions for trading purposes. All of these transactions are intended to be used in the Department's normal course of operations. The Department is exposed to risk of nonperformance if the counterparties default or if the swap agreements are terminated.

As of June 30, 2011, the Power System had the following Electricity Swap and Forward Contracts, which are not recorded in the Power System's financial statements based on the criteria in GASB No. 53 (amounts in thousands):

| Description | Notional amount (total contract quantities) | Contract price range dollar per unit | First effective date | Last termination date | Fair value | Cash paid at inception |
|---|---|---|---|---|---|---|
| Electricity swaps: | | | | | | |
| Purchases | 264,960 MW | $ 44.20 – 46.90 | 07/01/11 | 12/31/11 | $ (816) | — |
| Sales | 264,960 MW | 46.70 – 49.40 | 07/01/11 | 12/31/11 | 1,478 | — |
| Forward contracts: | | | | | | |
| Electricity | 600,160 MW | 9.52 – 75.67 | 07/01/11 | 12/31/11 | (2,328) | — |
| Natural gas | 26,782,400 MMBtu | 5.28 – 9.80 | 07/01/11 | 07/31/14 | (91,108) | — |

As of June 30, 2010, the Power System had the following Electricity Swap and Forward Contracts, which are not recorded in the Power System's financial statements (amounts in thousands):

| Description | Notional amount (total contract quantities) | Contract price range dollar per unit | First effective date | Last termination date | Fair value | Cash paid at inception |
|---|---|---|---|---|---|---|
| Electricity swaps: | | | | | | |
| Purchases | 1,563,264 MW | $ 36.00 – 71.52 | 07/01/10 | 12/31/10 | $ (80,258) | — |
| Sales | 1,562,996 MW | 8.05 – 53.70 | 07/01/10 | 12/31/10 | 62,819 | — |
| Forward contracts: | | | | | | |
| Electricity | 891,361 MW | 37.52 – 75.67 | 07/01/10 | 12/31/11 | (27,316) | — |
| Natural gas | 39,441,400 MMBtu | 5.28 – 9.80 | 07/01/10 | 01/31/14 | (108,884) | — |

## (7) Cash, Cash Equivalents, and Investments

### *(a) Restricted and Other Investments*

A summary of the Power System's restricted and other investments is as follows (amounts in thousands):

| | | June 30 | |
|---|---|---|---|
| | | **2011** | **2010** |
| Restricted and other investments: | | | |
| Restricted investments: | | | |
| Debt Reduction Trust Funds | $ | 485,609 | 529,338 |
| Nuclear Decommissioning Trust Funds | | 120,008 | 117,752 |
| Natural Gas Trust Fund | | 129 | 3,242 |
| Hazardous Waste Treatment Trust Fund | | 2,165 | 2,140 |
| SCPPA Palo Verde investment | | 26,497 | 30,188 |
| Total restricted investments | $ | 634,408 | 682,660 |

The Power System also has $69,534 and $13,581 of cash collateral received from securities lending transactions in the City's securities lending program as of June 30, 2011 and 2010, respectively (see notes 7(b) and 8).

All restricted and other investments are to be used for a specific purpose as follows:

**Debt Reduction Trust Funds**

The debt reduction trust funds were established during fiscal year 1997 to provide for the payment of principal and interest on long-term debt obligations and purchased power obligations arising from the Department's participation in IPP and SCPPA (see note 6). The Department has transferred funds from purchased power precollections into these trust funds. Funds from operations may also be transferred by management as funds become available.

**Nuclear Decommissioning Trust Funds**

Nuclear decommissioning trust funds will be used to pay the Department's share of decommissioning PVNGS at the end of its useful life (see note 1).

**Natural Gas Trust Fund**

The natural gas trust fund was established to serve as depository to pay for costs and to post margin or collateral in connection with contracts for the purchase and delivery of financial transactions for natural gas. These transactions are entered into to stabilize the natural gas portion of the Department's fuel for generation costs.

### Hazardous Waste Treatment Storage and Disposal Trust Fund

The hazardous waste treatment storage and disposal trust fund was established to provide financial assurance for closure of the Main Street treatment and disposal facility.

### SCPPA Palo Verde Investment

The SCPPA Palo Verde investment is a fixed rate investment held by SCPPA to be drawn down over the next six years to pay for purchased power obligations arising from the Department's participation in the SCPPA Palo Verde project. The fixed interest rate is 4.97% and the maturity date is June 25, 2017.

As of June 30, 2011, the Power System's securities lending cash collateral and restricted investments and their maturities are as follows (in thousands):

| | | Investment maturities | | | | |
|---|---|---|---|---|---|---|
| **Investment type** | **Fair value** | **1 to 30 days** | **31 to 60 days** | **61 to 365 days** | **366 days to 5 years** | **Over 5 years** |
| U.S. agencies | $ 393,849 | 5,005 | — | — | 313,479 | 75,365 |
| Medium-term notes | 43,335 | 5,484 | 5,546 | 10,931 | 21,374 | — |
| Commercial paper | 95,775 | 16,804 | 23,297 | 55,674 | — | — |
| Certificates of deposit | 27,005 | 12,000 | 10,001 | 5,004 | — | — |
| Municipal commercial paper | 5,000 | — | 5,000 | — | — | — |
| California local agency bonds | 23,543 | 12,775 | — | 6,686 | 4,082 | — |
| California state bonds | — | — | — | — | — | — |
| Bankers' acceptances | 500 | — | 500 | — | — | — |
| Money market funds | 18,904 | 18,904 | — | — | — | — |
| SCPPA Palo Verde investment | 26,497 | — | — | — | — | 26,497 |
| | $ 634,408 | 70,972 | 44,344 | 78,295 | 338,935 | 101,862 |

As of June 30, 2010, the Power System's securities lending cash collateral and restricted investments and their maturities are as follows (in thousands):

| | | Investment maturities | | | | |
|---|---|---|---|---|---|---|
| **Investment type** | **Fair value** | **1 to 30 days** | **31 to 60 days** | **61 to 365 days** | **366 days to 5 years** | **Over 5 years** |
| U.S. agencies | $ 501,537 | 15,011 | 5,030 | 5,036 | 407,404 | 69,056 |
| Medium-term notes | 33,274 | 359 | 1,556 | 13,780 | 17,579 | — |
| Commercial paper | 46,569 | 13,748 | 12,997 | 19,824 | — | — |
| Certificates of deposit | 26,008 | 6,000 | 4,999 | 15,009 | — | — |
| Municipal commercial paper | 7,200 | 2,200 | 5,000 | — | — | — |
| California local agency bonds | 23,412 | 18,412 | — | 5,000 | — | — |
| California state bonds | 5,680 | 5,680 | — | — | — | — |
| Bankers' acceptances | 5,494 | — | — | 5,494 | — | — |
| Money market funds | 3,298 | 3,298 | — | — | — | — |
| SCPPA Palo Verde investment | 30,188 | — | — | — | — | 30,188 |
| | $ 682,660 | 64,708 | 29,582 | 64,143 | 424,983 | 99,244 |

i. Interest Rate Risk

The Department's investment policy limits the maturity of its investments to a maximum of 30 years for U.S. government agency securities; 5 years for medium-term corporate notes, California local agency obligations, and California state obligations and municipal bonds; 270 days for commercial paper; 397 days for certificates of deposit; 180 days for bankers' acceptances; and 45 days for repurchase agreements purchased with cash collateral from securities lending agreements.

ii. Credit Risk

Under its investment policy and the Code, the Department is subject to the prudent investor standard of care in managing all aspects of its portfolios. The prudent investor standard requires that the Department "…shall act with care, skill, prudence, and diligence under the circumstances then prevailing, including, but not limited to, the general economic conditions and the anticipated needs of the agency, that a prudent person acting in a like capacity and in familiarity with those matters would use in the conduct of funds of a like character and with like aims, to safeguard the principal and maintain the liquidity needs of the agency."

The U.S. government agency securities in the portfolio consist of securities issued by government-sponsored enterprises, which are not explicitly guaranteed by the U.S. government. As of June 30, 2011 and 2010, the U.S. government agency securities in the portfolio carried the highest possible credit ratings by the Nationally Recognized Statistical Rating Organizations (NRSROs) that rated them.

The Department's investment policy specifies that medium-term corporate notes must be rated in a rating category of "A" or its equivalent or better by a NRSRO. Of the Power System's investments in corporate notes as of June 30, 2011, $38,748,005 (89%) was rated in the category of AA and $4,112,825 (10%) was rated in the category of A by at least one NRSRO. The remaining $474,169 (1%) of investments in corporate notes were not rated. Of the Power System's investments in corporate notes as of June 30, 2010, $24,221,621 (73%) was rated in the category of AA and $8,693,664 (26%) was rated in the category of A by at least one NRSRO. The remaining $358,463 (1%) of investments in corporate notes were not rated.

The Department's investment policy specifies that commercial paper must be of the highest ranking or of the highest letter and number rating as provided for by at least two NRSROs. As of June 30, 2011 and 2010, all of the Power System's investments in commercial paper were rated with at least the highest letter and number rating as provided by at least two NRSROs.

The Department's investment policy specifies that negotiable certificates of deposit must be of the highest ranking or letter and number rating as provided for by at least two NRSROs and that for nonnegotiable certificates of deposit, the full amount of principal and interest is insured by the Federal Deposit Insurance Corporation (FDIC) or National Credit Union Administration. As of June 30, 2011, the Power System's investments in certificates of deposits included $26,005,303 of negotiable certificates of deposit with at least the highest letter and number rating as provided by at least two NRSROs and $1,000,000 of nonnegotiable certificates of deposit fully insured by the FDIC. As of June 30, 2010, the Power System's investments in certificates of deposits included $25,008,335 of negotiable certificates of deposit with at least the highest letter and number rating as provided by at least two NRSROs and $1,000,000 of nonnegotiable certificates of deposit fully insured by the FDIC.

The Department's investment policy specifies that California local agency obligations, which include municipal commercial paper, must be rated in a rating category of "A" or its equivalent or better by a NRSRO. Of the Power System's investments in California municipal commercial paper as of June 30, 2011, $5,000,000 (100%) was rated with the highest short-term letter and number rating by two NRSROs. Of the Power System's investments in California local agency bonds as of June 30, 2011, $9,767,100 (41%) was rated in the category of AAA; $6,744,355 (29%) was rated in the category of AA; $2,026,557 (9%) was rated in the category of A; and $5,004,500 (21%) was rated with the highest short-term ranking as provided by at least one NRSRO. Of the Power System's investments in California municipal commercial paper as of June 30, 2010, $7,200,000 (100%) was rated with the highest short-term letter and number rating by two NRSROs. Of the Power System's investments in California local agency bonds as of June 30, 2010, $13,445,000 (57%) was rated in the category of AAA and $9,967,036 (43%) was rated with the highest short-term ranking as provided by at least one NRSRO.

The Department's investment policy specifies that State of California obligations must be rated in a rating category of "A" or its equivalent or better by a NRSRO. As of June 30, 2011 the Power System did not hold any investments in State of California obligations. As of June 30, 2010, the Power System's investments in State of California obligations were rated AAA by at least one NRSRO.

The Department's investment policy specifies that banker's acceptances must be of the highest ranking or letter and number rating as provided for by at least two NRSROs. As of June 30, 2011 and 2010, all of the Power System's investments in banker's acceptances were rated with the highest letter and number rating as provided by three NRSROs.

The Department's investment policy specifies that money market funds may be purchased as allowed under the Code, which requires that the fund must have either 1) attained the highest ranking or highest letter and numerical rating provided by not less than two NRSROs or 2) retained an investment advisor registered or exempt from registration with the Securities and Exchange Commission with not less than five years' experience in managing money market mutual funds with assets under management in excess of $500 million. As of June 30, 2011 and 2010, each of the money market funds in the portfolio had the highest possible ratings by three NRSROs, specifically AAAm by Standard and Poor's Corporation (S&P), Aaa by Moody's Investors Service (Moody's), and AAA by Fitch Ratings (Fitch).

iii. Concentration of Credit Risk

The Department's investment policy specifies that there is no percentage limitation on the amount that can be invested in U.S. government agency securities, except that a maximum of 30% of the cost value of the portfolio may be invested in the securities of any single U.S. government agency issuer.

Of the Power System's total investments as of June 30, 2011, $147,535,173 (23%) was invested in securities issued by the Federal National Mortgage Association; $128,982,034 (20%) was invested in securities issued by the Federal Home Loan Mortgage Corporation; and $101,033,649 (16%) was invested in securities issued by the Federal Home Loan Bank.

Of the Power System's total investments as of June 30, 2010, $167,214,799 (24%) was invested in securities issued by the Federal Home Loan Mortgage Corporation; $156,965,167 (23%) was invested in securities issued by the Federal National Mortgage Association; $120,082,514 (18%) was invested in securities issued by the Federal Home Loan Bank; and $51,254,063 (8%) was invested in securities issued by the Federal Farm Credit Bank.

***(b) Pooled Investments***

The Power System's cash, cash equivalents, and its collateral value of the City's securities lending program (SLP) are included within the City Treasury's General and Special Investment Pool (the Pool). As of June 30, 2011 and 2010, the Power System's share of the Pool was $1,492,530,000 and $1,137,289,000, which represents approximately 17% and 16% of the Pool, respectively.

The cash balances of substantially all funds on deposit in the City Treasury are pooled and invested by the City Treasurer for the purpose of maximizing interest earnings through pooled investment activities but safety and liquidity still take precedence over return. Interest earned on pooled investments is allocated to the participating funds based on each fund's average daily deposit balance during the allocation period with all remaining interest allocated to the General Fund. Investments in the City Treasury are stated at fair value based on quoted market prices except for commercial paper and money market investments that have remaining maturities of one year or less at time of purchase, which are reported at amortized cost.

Pursuant to California Government Code Section 53607 and the Los Angeles City Council File No. 94-2160, the City Treasury shall render to the City Council a statement of investment policy (the Policy) annually. City Council File No. 09-3050 was adopted on January 27, 2010 as the City's investment policy. This Policy shall remain in effect until the Los Angeles City Council and the Mayor approve a subsequent revision. The Policy governs the City's pooled investment practices. The Policy addresses soundness of financial institutions in which the City Treasurer will deposit funds and types of investment instruments permitted by California Government Code Sections 53600-53635 and 16429.1.

Examples of investments permitted by the Policy are obligations of the U.S. Treasury and government agencies, commercial paper notes, certificates of deposit (CD) placement service, bankers' acceptances, medium-term notes, mutual funds, money market mutual funds, and the State of California Local Agency Investment Fund.

At June 30, 2011, the investments held in the City Treasury's General and Special Investment Pool Programs and their maturities are as follows (in thousands):

| Type of investments | Amount | Investment maturities: 1 to 30 days | 31 to 60 days | 61 to 365 days | 366 days to 5 years | Over 5 years |
|---|---|---|---|---|---|---|
| U.S. Treasury notes | $ 3,541,794 | — | — | 38,482 | 3,490,201 | 13,111 |
| U.S. Treasury bills | 92,789 | 5,984 | 15,864 | 70,941 | — | — |
| U.S. Sponsored agency issues | 2,563,178 | 455,933 | 110,660 | 782,630 | 1,212,938 | 1,017 |
| Medium-term notes | 1,126,648 | — | — | 148,980 | 977,668 | — |
| Commercial paper | 607,177 | 388,945 | 130,749 | 87,483 | — | — |
| Certificates of deposit | 8,000 | — | — | 8,000 | — | — |
| Short-term investment funds | 22,425 | 22,425 | — | — | — | — |
| Securities lending cash collateral: | | | | | | |
| U.S. Treasury notes | 406,157 | — | — | — | 406,157 | — |
| U.S. Sponsored agency issues | 259,335 | — | — | — | 259,335 | — |
| Total general and special pools | $ 8,627,503 | 873,287 | 257,273 | 1,136,516 | 6,346,299 | 14,128 |

*Interest Rate Risk.* The Policy limits the maturity of its investments to five years for the U.S. Treasury and government agency securities, medium-term notes, CD placement service, collateralized bank deposits, mortgage pass-through securities, and bank/time deposits; one year for repurchase agreements; 270 days for commercial paper; 180 days for bankers' acceptances, and 92 days for reverse repurchase agreements. The Policy also allows City funds with longer-term investments horizons, to be invested in securities that at the time of the investment have a term remaining to maturity in excess of five years, but with a maximum final maturity of thirty years.

*Credit Risk*. The Policy establishes minimum credit ratings requirement for investments. There is no credit quality requirement for local agency bonds, U.S. Treasury Obligations, State of California Obligations, California Local Agency Obligations, and U.S. Sponsored Agencies (U.S. government sponsored enterprises) securities. The City's $2.6 billion investments in U.S. government sponsored enterprises consist of securities issued by the Federal Home Loan Bank – $866.0 million, Federal National Mortgage Association – $748.1 million, Federal Home Loan Mortgage Corporation – $738.9 million, Federal Farm Credit Bank – $164.4 million, Tennessee Valley Authority – $37.9 million, and Federal Agricultural Mortgage Corporation – $7.8 million. Of the City's $2.6 billion investments in U.S. Sponsored Agencies securities, $1,733.9 million are rated "AAA" by S&P and "Aaa" by Moody's; $821.5 million are not rated individually by S&P nor Moody's (issuers of these securities are rated "A-1+" by S&P and "P-1" by Moody's); and $7.8 million are not rated. In August 2011, Standard & Poor's lowered the long-term U.S. debt credit rating from "AAA" to "AA+." This downgrade affects the credit risk associated with the City's investments in certain U.S. Sponsored Agencies securities.

Medium-term notes must be issued by corporations organized and operating within the United States or by depository institutions licensed by the United States or any state and operating within the United States. Medium-term notes must have at least an "A" rating. The City's $1.1 billion investments in medium-term notes consist of securities issued by banks and corporations that comply with these requirements and were rated "A" or better by S&P and "A3" or better by Moody's.

Commercial paper issues must have a minimum of "A-1" or equivalent rating. If the issuer has issued long-term debt, it must be rated "A" without regard to modifiers. Issuing corporation must be organized and operating within the United States and have assets in excess of $500.0 million.

The City's $607.2 million investments in commercial paper comply with these requirements and were rated "A-1+/A-1" by S&P and "P-1" by Moody's.

The issuers of the certificates of deposit were not rated.

*Concentration of Credit Risk*. The Policy does not allow more than 40% of its investment portfolio be invested in commercial paper and bankers' acceptances, 30% in certificates of deposit and medium-term notes, 20% in mutual funds, money market mutual funds and mortgage pass-through securities. The Policy further provides for a maximum concentration limit of 10% in any one issuer of commercial paper as well as in any one mutual fund, and 30% in bankers' acceptances of any one commercial bank. There is no percentage limitation on the amount that can be invested in the U.S. government agencies. The City's pooled investments comply with these requirements. GAAP requires disclosure of certain investments in any one issuer that represent 5% or more of total investments. Of the City's total pooled investments as of June 30, 2011, $899.3 million (10%) was invested in securities issued by the Federal Home Loan Bank, $796.0 million (9%) was invested in securities issued by Federal Home Loan Mortgage Corporation, and $917.1 million (11%) was invested in securities issued by Federal National Mortgage Association.

At June 30, 2010, the investments held in the City Treasury's General and Special Investment Pool programs and their maturities are as follows (in thousands):

| Type of investments | Amount | Investment maturities: 1 to 30 days | 31 to 60 days | 61 to 365 days | 366 days to 5 years |
|---|---|---|---|---|---|
| U.S. Treasury notes | $ 1,977,346 | — | — | — | 1,977,346 |
| U.S. Treasury bills | 1,002,601 | 474,965 | 288,831 | 238,805 | — |
| U.S. Sponsored agency issues | 2,830,258 | 474,135 | 590,834 | 693,595 | 1,071,694 |
| Medium-term notes | 853,051 | — | 117,918 | 20,036 | 715,097 |
| Commercial paper | 476,263 | 322,519 | — | 153,744 | — |
| Certificates of deposit | 9,000 | — | — | 9,000 | — |
| Short-term investment funds | 41,770 | 41,770 | — | — | — |
| Securities lending cash collateral: | | | | | |
| U.S. Treasury notes | 54,031 | — | — | — | 54,031 |
| U.S. Sponsored agency issues | 111,068 | — | — | — | 111,068 |
| Total general and special pools | $ 7,355,388 | 1,313,389 | 997,583 | 1,115,180 | 3,929,236 |

*Interest Rate Risk*. The Policy limits the maturity of its investments to a maximum of five years for the U.S. Treasury and government agency securities, medium-term notes, CD placement service, collateralized bank deposits, mortgage pass-through securities, and bank/time deposits; one year for repurchase agreements; 270 days for commercial paper; 180 days for bankers' acceptances, and 92 days for reverse repurchase agreements.

*Credit Risk*. The Policy establishes minimum credit ratings requirement for investments. There is no credit quality requirement for local agency bonds, U.S. Treasury Obligations, State of California Obligations, California Local Agency Obligations, and U.S. Agencies (U.S. government-sponsored enterprises) securities in the Policy. The City's $2.83 billion investments in U.S. government-sponsored enterprises consist of securities issued by the Federal Home Loan Bank – $887.3 million, Federal National Mortgage Association – $763.7 million, Federal Home Loan Mortgage Corporation – $476.2 million, Federal Farm Credit Bank – $164.1 million, Tennessee Valley Authority – $38.5 million, and Freddie Mac – $500.5 million. Of the City's $2.83 billion investments in U.S. agencies securities, $1,041.8 million are rated "AAA" by S&P and "Aaa" by Moody's; $1,788.5 million are not rated by the NRSRO, but have an implied highest rating in the market.

Medium-term notes must be issued by corporations organized and operating within the United States or by depository institutions licensed by the United States or any state and operating within the United States. Medium-term notes must have at least an "A" rating. The City's $735.1 million investments in medium-term notes consist of securities issued by banks and corporations that comply with these requirements and were rated "A" or better by S&P and "A3" or better by Moody's.

Commercial paper issues must have a minimum of "A-1" or equivalent rating. If the issuer has issued long-term debt, it must be rated "A" without regard to modifiers. Issuing corporation must be organized and operating within the United States and have assets in excess of $500 million. The City's $594.2 million investments in commercial paper comply with these requirements and were rated A-1+/A-1 by S&P and P-1 by Moody's.

The issuers of the certificates of deposit were not rated.

*Concentration of Credit Risk*. The Policy does not allow more than 40% of its investment portfolio be invested in commercial paper and bankers' acceptances, 30% in certificates of deposit and medium-term notes, 20% in mutual funds and money market mutual funds, and mortgage pass-through securities. The Policy further provides for a maximum concentration limit of 10% in any one issuer of commercial paper as well as in any one mutual fund, and 30% in banker's acceptances of any one commercial bank. There is no percentage limitation on the amount that can be invested in the U.S. government agencies. The City's pooled investments comply with these requirements. GAAP requires disclosure of certain investments in any one issuer that represent 5% or more of total investments. Of the City's total pooled investments as of June 30, 2010, $887.3 million (12%) was invested in securities issued by the Federal Home Loan Bank, $476.2 million (6%) was invested in securities issued by Federal Home Loan Mortgage Corporation, $763.7 million (10%) was invested in securities issued by Federal National Mortgage Association, and $500.5 million (7%) was invested in securities issued by Freddie Mac.

## (8) Securities Lending Transactions

The Power System participates in a SLP as follows (collateral amounts in thousands):

| Program | | June 30 2011 | June 30 2010 |
|---|---|---|---|
| City of Los Angeles Program | $ | 69,534 | 13,581 |

### *General Investment Pool Program*

The Power System participates in the City's SLP through the pooled investment fund. The Department recognizes its proportionate share of the cash collateral received for securities loaned and the related obligation for the general investment pool.

Securities lending is permitted and limited under provisions of California Government Code Section 53601. The City Council approved the SLP on October 22, 1991 under Council File No. 91-1860, which complies with the California Government Code. The objectives of the SLP in priority order are: safety of loaned securities and prudent investment of cash collateral to enhance revenue from the investment program. The SLP is governed by a separate policy and guidelines.

The City's custodial bank acts as the securities lending agent. In the event a counterparty defaults by reason of an act of insolvency, the bank shall take all actions which it deems necessary or appropriate to liquidate permitted investment and collateral in connection with such transaction and shall make a reasonable effort for two business days (Replacement Period) to apply the proceeds thereof to the purchase of securities identical to the loaned securities not returned. If during the Replacement Period the collateral liquidation proceeds are insufficient to replace any of the loaned securities not returned, the bank shall, subject to payment by the City of the amount of any losses on any permitted investments, pay such additional amounts as necessary to make such replacement.

Under the provisions of the SLP, and in accordance with the California Government Code, no more than 20% of the market value of the General Investment Pool is available for lending. The City receives cash as collateral on loaned securities, which is reinvested in securities permitted under the Policy. In accordance with the California Government Code, the securities lending agent marks to market the value of both the collateral and the reinvestments daily. Except for open loans where either party can terminate a lending contract on demand, term loans have a maximum life of 92 days. Earnings from securities lending accrue to the Pool and are allocated on a pro rata basis to all Pool participants.

The City's SLP that was temporarily suspended in November 2008 due to the extreme volatility in the financial markets was resumed on April 22, 2010. At June 30, 2011 and 2010, the assets and liabilities arising from the reinvested cash collateral were recognized in the respective participants' financial statements. During the fiscal year, collateralizations on all loaned securities were within the required 102% of market value. The City can sell collateral securities only in the event of borrower default. The lending agent provides indemnification for borrower default. There were no violations of legal or contractual provisions and no borrower or lending agent default losses during the year. There was no credit risk exposure to the City as of June 30, 2011 because the amounts owed to the borrowers exceeded the amounts borrowed. Loaned securities are held by the City's agents in the City's name and are not subject to custodial credit risk.

## (9) Derivative Instruments

In June 2008, GASB issued GASB No. 53. The statement specifically requires governments to measure and report most derivative instruments at fair value in their financial statements that are prepared using the economic resources measurement focus and the accrual basis of accounting. The requirement of reporting the derivative instruments at fair value on the face of the basic financial statements gives the users of those statements a clearer look into the risks their governments are sometimes exposed to when they enter into these transactions and how those risks are managed. The statement also addresses hedge accounting requirements and improves disclosures, providing a summary of the government's derivative instrument activity, its objectives for entering into derivative instruments, and their significant terms and risks. The Power System implemented GASB No. 53 in the 2010 fiscal year.

In accordance with GASB No. 53, the Power System records the fair value of its hedging derivative instruments, financial natural gas hedges, on the balance sheets. As of June 30, 2011 and 2010, the fair values of the financial natural gas hedges were approximately $(73.8) million and approximately $(84.3) million, respectively.

### *(a) Financial Natural Gas Hedges*

The Department enters into natural gas hedging contracts in order to stabilize the cost of gas needed to produce electricity to serve its customers. It is designed to fix gas prices over a portion of the forecasted gas requirements.

The Department does not speculate when entering into financial transactions. Financial hedges are variable to fixed rate swaps and are layered by volumetric averaging. The Department is exposed to financial settlement risk if the counterparties default and/or the agreements are terminated.

As of June 30, 2011, the Power System's financial natural gas hedges by fiscal year are the following (amounts in thousands):

| Derivative description | Notional amount (Total contract quantities*) | Contract price range dollar per unit | First effective date | Last termination date | Fair value | Cash paid at derivative inception |
|---|---|---|---|---|---|---|
| Financial natural gas: | | | | | | |
| FY 2011-12 | $ 8,240,000 | 5.53 – 8.27 | 07/01/11 | 06/30/12 | $ (21,267) | — |
| FY 2012-13 | 6,387,500 | 5.96 – 8.31 | 07/01/12 | 06/30/13 | (14,355) | — |
| FY 2013-14 | 5,027,000 | 6.37 – 8.31 | 07/01/13 | 06/30/14 | (10,712) | — |
| FY 2014-15 | 5,384,500 | 6.37 – 9.38 | 07/01/14 | 06/30/15 | (11,357) | — |
| FY 2015-16 | 4,488,000 | 6.42 – 9.85 | 07/01/15 | 06/30/16 | (8,865) | — |
| FY 2016-17 | 3,197,500 | 6.61 – 9.83 | 07/01/16 | 06/30/17 | (5,320) | — |
| FY 2017-18 | 2,190,000 | 6.76 – 7.14 | 07/01/17 | 06/30/18 | (1,894) | — |
| Total | $ 34,914,500 | 5.53 – 9.85 | 07/01/11 | 06/30/18 | $ (73,770) | — |

* Contract quantities in MMBtu – Million British Thermal Units.

As of June 30, 2010, the Power System's financial natural gas hedges by fiscal year were the following (amounts in thousands):

| Derivative description | Notional amount (Total contract quantities*) | Contract price range dollar per unit | First effective date | Last termination date | Fair value | Cash paid at derivative inception |
|---|---|---|---|---|---|---|
| Financial natural gas: | | | | | | |
| FY 2010-11 | $ 14,928,000 | 5.07 – 7.70 | 07/01/10 | 06/30/11 | $ (32,809) | — |
| FY 2011-12 | 8,240,000 | 5.53 – 8.27 | 07/01/11 | 06/30/12 | (14,804) | — |
| FY 2012-13 | 6,387,500 | 5.96 – 8.31 | 07/01/12 | 06/30/13 | (10,458) | — |
| FY 2013-14 | 5,027,000 | 6.37 – 8.31 | 07/01/13 | 06/30/14 | (7,844) | — |
| FY 2014-15 | 5,384,500 | 6.37 – 9.38 | 07/01/14 | 06/30/15 | (8,152) | — |
| FY 2015-16 | 4,488,000 | 6.42 – 9.85 | 07/01/15 | 06/30/16 | (6,138) | — |
| FY 2016-17 | 3,197,500 | 6.61 – 9.83 | 07/01/16 | 06/30/17 | (3,415) | — |
| FY 2017-18 | 2,190,000 | 6.76 – 7.15 | 07/01/17 | 06/30/18 | (648) | — |
| Total | $ 49,842,500 | 5.07 – 9.85 | 07/01/10 | 06/30/18 | $ (84,268) | — |

* Contract quantities in MMBtu – Million British Thermal Units.

The fair value of the natural gas hedges increased by $10.5 million and is reported as a deferred outflow on the balance sheets. All fair values were estimated using forward market prices available from broker quotes and exchanges.

### *(b) Credit Risk*

The Power System is exposed to credit risk related to nonperformance by its wholesale counterparties under the terms of contractual agreements. In order to limit the risk of counterparty default, the Department has implemented a Wholesale Marketing Counterparty Evaluation Policy, which was amended and renamed as Counterparty Evaluation Credit Policy (the Counterparty Policy), and was approved by the Board on May 6, 2008. Under the new policy, the scope has been expanded beyond physical power to include transmission, physical natural gas, and financial natural gas. Also, the credit limit structure has been categorized into short-term and long-term structures where the short-term structure is applicable to transactions with terms of up to 18 months and the long-term structure to cover transactions beyond 18 months.

The Policy includes provisions to limit risk including: the assignment of internal credit ratings to all Department's counterparties based on counterparty and/or debt ratings; the use of expected default frequency equivalent credit rating for short-term transactions; the requirement for credit enhancements (including advance payments, irrevocable letters of credit, escrow trust accounts, and parent company guarantees) for counterparties that do not meet an acceptable level of risk; and the use of standardized agreements, which allow for the netting of positive and negative exposures associated with a single counterparty.

As of June 30, 2011, the 11 financial natural gas hedge counterparties were rated by Moody's as follows: two at Aa1, one at Aa2, two at Aa3, three at A1, and three at A2. The counterparties were rated by S&P as follows: one at AA, three at AA-, two at A+, and five at A. As of June 30, 2010, the 11 financial natural gas hedge counterparties were rated by Moody's as follows: one at Aaa, one at Aa1, one at Aa2, two at Aa3, three at A1, and three at A2. The counterparties were rated by S&P as follows: three at AA-, two at A+, and five at A, and one at NR.

Based on the International Swap Dealers Association agreements, the Department or the counterparty may be required to post collateral to support the financial natural gas hedges subject to credit risk in the form of cash, negotiable debt instruments (other than interest-only and principal-only securities), or eligible letters of credit. Collateral posted is held by a custodian. As of June 30, 2011 and 2010, the fair values of the financial natural gas hedges are within the credit limits and collateral posting was not required.

As of June 30, 2011 and 2010, the Power System was not exposed to credit risk on the outstanding pay-fixed, receive-variable natural gas swaps that had negative fair values. However, should natural gas prices change and the fair values of the swaps become positive, the Power System would be exposed to credit risk to each swap counterparty in the amount of the derivatives' fair value. Should the counterparties to the transactions fail to perform according to the terms of the swap contract, the Power System would face a maximum possible loss equal to the fair market value of these swaps.

***(c) Basis Risk***

The Department is exposed to basis risk between the financial natural gas hedges, which are settled monthly at NW Rocky Mountains Index, and the hedged gas deliveries, which are daily spot purchases at Kern River, Opal prices. However, these pricing points are in the same region and are highly correlated.

***(d) Termination Risk***

The Power System or its counterparties may terminate the contractual agreements if the other party fails to perform under the terms of the contract. No termination events have occurred and there are no out-of-the-ordinary termination events contained in contractual documents.

## (10) Long-Term Debt

Long-term debt outstanding as of June 30, 2011 and 2010 consists of revenue bonds and refunding revenue bonds due serially in varying annual amounts as follows (amounts in thousands):

| Bond issues | Date of issue | Effective-interest rate | Fiscal year of last scheduled maturity | | Principal outstanding 2011 | Principal outstanding 2010 |
|---|---|---|---|---|---|---|
| Issue of 2001, Series A1 | 03/20/01 | 4.931% | 2025 | $ | — | 771,280 |
| Issue of 2001, Series A2 | 11/06/01 | 5.109 | 2022 | | — | 62,840 |
| Issue of 2001, Series B | 06/05/01 | Variable | 2035 | | 580,800 | 580,800 |
| Issue of 2001, Series C1 | 11/15/01 | 4.788 | 2017 | | 2,976 | 3,003 |
| Issue of 2002, Series A | 08/22/02 | Variable | 2036 | | 388,500 | 388,500 |
| Issue of 2002, Series C2 | 11/22/02 | 4.375 | 2018 | | 8,208 | 8,399 |
| Issue of 2003, Series A1 | 07/31/03 | 3.409 | 2017 | | 224,150 | 266,435 |
| Issue of 2003, Series A2 | 08/19/03 | 4.662 | 2032 | | 515,830 | 515,830 |
| Issue of 2003, Series B | 08/28/03 | 5.013 | 2036 | | 128,225 | 192,860 |
| Issue of 2004, Series C3 | 04/07/04 | 4.298 | 2020 | | 7,369 | 7,540 |
| Issue of 2005, Series A1 | 12/28/05 | 4.700 | 2041 | | 556,170 | 561,895 |
| Issue of 2005, Series A2 | 12/28/05 | 4.700 | 2031 | | 315,195 | 315,195 |
| Issue of 2006, Series C4 | 03/01/06 | 4.040 | 2017 | | 6,339 | 6,465 |
| Issue of 2007, Series A1 | 10/18/07 | 4.659 | 2040 | | 334,630 | 335,630 |
| Issue of 2007, Series A2 | 10/18/07 | 4.638 | 2033 | | 191,125 | 191,125 |
| Issue of 2008, Series A1 | 11/25/08 | 5.583 | 2039 | | 200,000 | 200,000 |
| Issue of 2008, Series A1 | 11/25/08 | 5.039 | 2033 | | 350,000 | 350,000 |
| Issue of 2009, Series A | 02/19/09 | 4.773 | 2040 | | 122,260 | 123,120 |
| Issue of 2009, Series B | 06/02/09 | 4.563 | 2025 | | 172,125 | 172,125 |
| Issue of 2010, Series A | 06/02/10 | 3.898 | 2041 | | 616,000 | 616,000 |
| Issue of 2010, Series B | 06/02/10 | 3.015 | 2023 | | 51,030 | 52,130 |
| Issue of 2010, Series C | 08/25/10 | 2.188 | 2028 | | 139,775 | — |
| Issue of 2010, Series D | 12/02/10 | 4.342 | 2046 | | 760,200 | — |
| Issue of 2011, Series A | 06/30/11 | 2.715 | 2023 | | 694,130 | — |
| Total principal amount | | | | | 6,365,037 | 5,721,172 |
| Revenue certificates | | | | | 200,000 | 200,000 |
| Unamortized premiums, discounts, and debt-related costs (including net loss on refundings), net | | | | | 111,562 | 30,272 |
| Debt due within one year (including current portion of variable rate debt) | | | | | (178,885) | (240,235) |
| | | | | $ | 6,497,714 | 5,711,209 |

Revenue bonds generally are callable 10 years after issuance. The Department has agreed to certain covenants with respect to bonded indebtedness. Significant covenants include the requirement that the Power Systems' net income, as defined, will be sufficient to pay certain amounts of future annual bond interest and of future annual aggregate bond interest and principal maturities. Revenue bonds and refunding bonds are collateralized by the future revenues of the Power System.

### *(a) Long-Term Debt Activity*

The Power System had the following activity in long-term debt for the fiscal years ended June 30, 2011 and 2010 (amounts in thousands):

| | | Balance, July 1, 2010 | Additions | Reductions | Balance, June 30, 2011 | Current portion |
|---|---|---|---|---|---|---|
| Long-term debt: | | | | | | |
| Bonds | $ | 5,751,444 | 1,684,277 | (959,122) | 6,476,599 | 158,885 |
| Revenue certificates | | 200,000 | — | — | 200,000 | 20,000 |
| Total | $ | 5,951,444 | 1,684,277 | (959,122) | 6,676,599 | 178,885 |

| | | Balance, July 1, 2009 | Additions | Reductions | Balance, June 30, 2010 | Current portion |
|---|---|---|---|---|---|---|
| Long-term debt: | | | | | | |
| Bonds | $ | 5,259,735 | 672,673 | (180,964) | 5,751,444 | 220,235 |
| Revenue certificates | | 200,000 | — | — | 200,000 | 20,000 |
| Total | $ | 5,459,735 | 672,673 | (180,964) | 5,951,444 | 240,235 |

### *(b) New Issuances*

**Fiscal Year 2011**

In August 2010, the Power System issued $139.8 million of Power System Revenue Bonds, 2010 Series C. The net proceeds of $138.7 million, net of $1.1 million cost of issuance and underwriter's discount, were deposited into the construction fund to be used for renewable energy projects. The Power 2010 Series C Bonds, designated as direct payment new Clean Renewable Energy Bonds (CREBs) and Qualified Energy Conservation Bonds (QECBs), enabled the Department to receive subsidy payments from the U.S. Treasury equal to 3.37% representing 70% of the tax credit rate of 4.81% (the credit rate determined under Section 54(A)(b)(3) of the Internal Revenue Code of 1986). The financing provided a weighted average life of 16.9 years, an average coupon rate of 5.52% and an effective interest rate of 2.21% (net of the tax subsidy). The Power System received subsidy payments totaling $250,563 for the CREBs and $3,749,727 for the QECBs during the fiscal year ended June 30, 2011. These subsidies are recorded as federal bond subsidies on the Statements of Revenue, Expenses, and Changes in Fund Net Assets.

In December 2010, the Power System issued $760.2 million of Power System Revenue Bonds, 2010 Series D. The net proceeds of $755.7 million (net of underwriter's discount of $4.5 million) were deposited into the construction fund to be used for capital improvements.

Lastly, in June 2011, the Power System issued $694.13 million of Power System Revenue Bonds, 2011 Series A, the proceeds of which were used to refund $765.55 million of Power System Revenue Bonds, 2001 Series A, SubSeries A-1 and A-2 and $60.87 million of Power System Revenue Bonds, 2003 Series B. In addition to bond proceeds, the Department contributed $50 million to the financing. The refinancing resulted in $102.1 million in net present value savings (excluding Department contribution) over the next five years and a net loss for accounting purposes of $12.6 million, which was deferred and is being amortized over the life of the new bonds.

**Fiscal Year 2010**

In June 2010, the Power System issued $616 million of Power System Revenue Bonds, 2010 Series A. The net proceeds of $612 million (net of underwriter's discount of $3.95 million) from the 2010 Series A transaction were deposited into the construction fund to be used for capital improvements.

Power 2010, Series A Bonds, designated as "Build America Bonds" under the American Recovery and Reinvestment Act of 2009 has an average life of 28.61 years and an average coupon rate of 5.944%. The reported 3.898% effective interest rate is net of the underwriter's discount and the cash subsidy payments to be received by the Department directly from the U.S. Treasury equal to 35% of the interest payable on the bonds.

Also, in June 2010, the Power System issued $52.13 million of Power System Revenue Bonds, 2010 Series B. The net proceeds of $56.43 million, net of $4.3 million issue premium, costs of issuance and underwriter's discount, were used to refund certain outstanding Power System Revenue Bonds from 2001 Series A, SubSeries A-1, and Subseries A-2. The transaction resulted in a $5 million net present value savings and a net loss for accounting purposes of $3.6 million, which was deferred and is being amortized over the life on the new bonds.

***(c) Outstanding Debt Defeased***

The Power System defeased certain revenue bonds in prior years by placing cash or the proceeds of new revenue bonds in irrevocable trusts to provide for all future debt service payments on the old bonds. Accordingly, the trust account assets and the liability for the defeased bonds are not included in the Power System's financial statements.

At June 30, 2011, the following revenue bonds outstanding are considered defeased (amounts in thousands):

| Bond issues | | Principal outstanding |
|---|---|---|
| Second issue of 1993 | $ | 7,785 |
| Refunding issue of 1994 | | 22,185 |
| Issue of 1994 | | 5,215 |
| | $ | 35,185 |

### *(d) Variable Rate Bonds*

As of June 30, 2011 and 2010, the Power System had $969.3 million in variable rate bonds.

The variable rate bonds currently bear interest at weekly and daily rates ranging from 0.05% to 0.06% as of June 30, 2011 and 0.14% to 0.29% as of June 30, 2010. The Power System can elect to change the interest rate period of the bonds with certain limitations. The bondholders have the right to tender the bonds to the tender agent on any business day with seven days' prior notice. The Power System has entered into standby and line of credit agreements with a syndicate of commercial banks in an initial amount of $580.8 million and $388.5 million to provide liquidity for the variable rate bonds. The extended standby agreements expire in January 2012 for the $580.8 million and in June 2014 for the $388.5 million.

Under the agreements, the $580.8 million variable rate bonds will bear interest that is payable quarterly at the greatest of: (a) the Prime Rate plus 1.50%; (b) the Federal Funds Rate plus 3.00%; and (c) 8.50%, while the $388.5 million variable rate bonds will bear interest that is payable quarterly at the greatest of: (a) the Prime Rate plus 2.00%; (b) the Federal Funds Rate plus 2.00%; (c) the Daily One-Month LIBOR plus 0.5%; and (d) 7.50%. The unpaid principal of each liquidity advance made by the liquidity provider is payable in ten equal semi-annual installments ninety days immediately following the related liquidity advance. At its discretion, the Power System has the ability to convert the outstanding bonds to fixed rate obligations, which cannot be tendered by the bondholders.

The variable rate bonds have been classified as long-term on the balance sheets as the liquidity facilities give the Power System the ability to refinance on a long-term basis and the Power System intends to either renew the facility or exercise its right to tender the debt as a long-term financing. The portion that would be due in the next fiscal year in the event that the outstanding variable rate bonds were tendered and purchased by the commercial banks under the standby agreements has been included in the current portion of long-term debt and was $96.9 million at both June 30, 2011 and 2010.

***(e) Revenue Certificates***

As of June 30, 2011 and 2010, the Power System has outstanding $200 million of commercial paper bearing interest at an average rate of 0.25%. The commercial paper matures not more than 270 days from the date of issuance.

The Department entered into a letter of credit and reimbursement agreement (the Agreement) with a commercial bank in the amount of $200 million to provide liquidity and credit support for the Department's commercial paper program. The agreement secures the payment when due of the principal and interest on commercial paper issued on or after August 27, 2010. Drawings on the agreement will represent advances to the Department and will bear interest that is payable monthly at the highest of (i) the Prime Rate plus 1.00%, (ii) Federal Funds Rate plus 2.00%, (iii) the Daily One-Month LIBOR plus 3.00%, and (iv) 7.00%. The unpaid principal of each advance is payable in ten equal semiannual installments, commencing on the date six months after the advance. The Agreement terminates on August 26, 2013.

The revenue certificates have been classified as long-term debt on the balance sheets as the Agreement gives the Power System the ability to refinance on a long-term basis and the Power System intends to either renew the Agreement or exercise its option to draw on the Agreement. The portion that would be due in the next fiscal year in the event that the outstanding revenue certificates were advanced by the commercial bank under the Agreement has been included in the current portion of long-term debt and was $20 million at both June 30, 2011 and 2010.

***(f) Scheduled Principal Maturities and Interest***

Scheduled annual principal maturities and interest are as follows (amounts in thousands):

| | | Principal | Interest and amortization |
|---|---|---|---|
| Fiscal year(s) ending June 30: | | | |
| 2012 | $ | 61,955 | 297,635 |
| 2013 | | 129,651 | 293,565 |
| 2014 | | 131,575 | 289,177 |
| 2015 | | 142,578 | 283,548 |
| 2016 | | 145,865 | 277,472 |
| 2017 – 2021 | | 726,693 | 1,298,264 |
| 2022 – 2026 | | 912,360 | 1,121,287 |
| 2027 – 2031 | | 1,186,250 | 874,502 |
| 2032 – 2036 | | 1,143,050 | 628,816 |
| 2037 – 2041 | | 1,024,860 | 374,984 |
| 2042 – 2046 | | 760,200 | 104,312 |
| Total requirements | $ | 6,365,037 | 5,843,562 |

The maturity schedule presented above reflects the scheduled debt service requirements for all of the Power System's long-term debt. The schedule is presented assuming that the tender options on the variable rate bonds, as discussed on the previous page, will not be exercised and that the full amount of the revenue certificates will be renewed. Should the bondholders exercise the tender options and the Power System convert all of the revenue certificates under the line of credit, the Power System would be required to redeem the $1,169.3 million in variable rate bonds outstanding over the next six years, as follows: $116.93 million in fiscal year 2012, $233.86 million in each of the fiscal years 2013 through 2016, and $116.93 million in fiscal year 2017. Accordingly, the balance sheets recognize the possibility of the exercise of the tender options and reflect the $116.93 million that could be due in fiscal year 2012 as a current portion of long-term debt payable. Interest and amortization include interest requirements for variable rate bonds, using the variable debt interest rate in effect at June 30, 2011 of 0.076%.

## (11) Retirement, Disability, and Death Benefit Insurance Plan

The Department has a funded contributory retirement, disability, and death benefit insurance plan covering substantially all of its employees. The Water and Power Employees' Retirement, Disability, and Death Benefit Insurance Plan (the Plan) operates as a single-employer defined benefit plan to provide pension benefits to eligible department employees and to provide disability and death benefits from the respective insurance funds. Plan benefits are generally based on years of service, age at retirement, and the employee's highest 12 consecutive months of salary before retirement. Active participants who joined the Plan on or after June 1, 1984 are required to contribute 6% of their annual covered payroll. Participants who joined the Plan prior to June 1, 1984 contribute an amount based upon an entry-age percentage rate. The Department contributes $1.10 for each $1.00 contributed by participants plus an actuarially determined annual required contribution (ARC) as determined by the Plan's independent actuary, taking into consideration the amount of net pension asset or obligation currently recorded on the balance sheet. The required contributions are allocated between the Power System and the Water System based on the current year labor costs.

The Retirement Board of Administration (the Retirement Board) is the administrator of the Plan. The Plan is subject to provisions of the Charter of the City and the regulations and instructions of the Board. The Plan is an independent pension trust fund of the City.

Plan amendments must be approved by both the Retirement Board and the Board. The Plan issues separately available financial statements on an annual basis. Such financial statements can be obtained from the Department of Water and Power Retirement Office, 111 N. Hope, Room 357, Los Angeles, California 90012.

The annual pension cost (APC) and net pension asset for the Department's Plan consist of the following (amounts in thousands):

| | | Year ended June 30 | |
|---|---|---|---|
| | | **2011** | **2010** |
| Annual required contribution | $ | 329,178 | 210,341 |
| Interest on net pension asset | | (10,409) | (11,113) |
| Adjustment to annual required contribution | | 15,772 | 16,559 |
| APC (including $106.5 million and $68.0 million of amounts capitalized in fiscal years 2011 and 2010, respectively) | | 334,541 | 215,787 |
| Power System contributions | | (282,377) | (201,002) |
| Change in net pension asset | | 52,164 | 14,785 |
| Net pension asset at beginning of year | | (104,266) | (119,051) |
| Net pension asset at end of year | $ | (52,102) | (104,266) |

The Power System's allocated share of the Plan's APC and net pension asset consists of the following (amounts in thousands):

| | | Year ended June 30 | |
|---|---|---|---|
| | | **2011** | **2010** |
| Annual required contribution | $ | 223,841 | 143,032 |
| Interest on net pension asset | | (7,078) | (7,557) |
| Adjustment to annual required contribution | | 10,725 | 11,260 |
| APC (including $62.7 million and $40.6 million of amounts capitalized in fiscal years 2011 and 2010, respectively) | | 227,488 | 146,735 |
| Power System contributions | | (188,544) | (129,421) |
| Change in net pension asset | | 38,944 | 17,314 |
| Net pension asset at beginning of year | | (53,330) | (70,644) |
| Net pension asset at end of year | $ | (14,386) | (53,330) |

ARCs are determined through actuarial valuations using the entry-age normal actuarial cost method. The actuarial value of assets in excess of the Department's Actuarial Accrued Liability (AAL) is being amortized by level contribution offsets over rolling 15-year periods effective July 1, 2000.



(Continued)

In accordance with actuarial valuations, the Department's required contribution rates are as follows:

| Fiscal year | Normal cost | Deficit amortization | Contribution rate |
|---|---|---|---|
| 2011 | 14.68% | 22.34% | 38.45% |
| 2010 | 12.94 | 12.18 | 26.12 |

The significant actuarial assumptions include an investment rate of return of 7.75%, projected inflation adjusted salary increases of 4.25%, and cost-of-living increases of 3.00%. The actuarial value of assets is determined using techniques that smoothen the effects of short-term volatility in the market value of investments over a five-year period. Plan assets consist primarily of corporate and government bonds, common stocks, mortgage-backed securities, and short-term investments.

Trend information for fiscal years 2011, 2010, and 2009 for the Power System is as follows (amounts in thousands):

| Year ended June 30 | NPO asset | Percentage of APC contributed | APC |
|---|---|---|---|
| 2011 | $ (14,386) | 83% | $ 227,488 |
| 2010 | (53,330) | 88 | 146,735 |
| 2009 | (70,644) | 93 | 101,439 |

***(a) Disability and Death Benefits***

The Power System's allocated share of disability and death benefit plan costs and administrative expenses totaled $13 million and $17 million for fiscal years 2011 and 2010, respectively.

***(b) Funded Status and Funding Progress***

As of July 1, 2010, the Department's actuarial value of assets was $7.2 billion and AAL for benefits was $8.9 billion, resulting in an Unfunded Actuarial Accrued Liability (UAAL) of $1.65 billion. The covered payroll (annual payroll of active employees covered by the Plan) was $856.1 million, and the ratio of the UAAL to the covered payroll was 193%.

As of July 1, 2009, the Department's actuarial value of assets was $7.2 billion and AAL for benefits was $8.1 billion, resulting in a UAAL of $808.3 million. The covered payroll (annual payroll of active employees covered by the Plan) was $805.1 million, and the ratio of the UAAL to the covered payroll was 100%.

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the salary increases. Amounts determined regarding the funded status of the Plan and the ARCs of the Department are subject to continual revision as actual results are compared with past expectations and new estimates are made for the future. The schedule of funding progress, presented as required supplementary information, presents information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the AAL for benefits.

## (12) Other Postemployment Benefit (Healthcare) Plan

### *(a) Plan Description*

The Department provides certain other postemployment benefits (OPEB), such as medical and dental plans, to active and retired employees and their dependents. The healthcare plan is administered by the Department. The Retirement Board and the Board have the authority to approve provisions and obligations. Eligibility for benefits for retired employees is dependent on a combination of age and service of the participants pursuant to a predetermined formula. Any changes to these provisions must be approved by the Retirement Board and the Board. The total number of active and retired Department participants entitled to receive benefits was approximately 16,819 and 16,701 for the fiscal years ended June 30, 2011 and 2010, respectively.

The health plan is a single-employer defined benefit plan. During fiscal year 2007, the Retiree Health Benefits Fund (the Fund) was created to fund the postemployment benefits of the Department. The Fund is administered as a trust and has its own financial statements. Such financial statements can be obtained from the Department of Water and Power Retirement Office, 111 N Hope, Room 357, Los Angeles, California 90012.

### *(b) Funding Policy*

The Department pays a monthly maximum subsidy of $1,230 for medical and dental premiums depending on the employee's work location and benefits earned. Participants choosing plans with a cost in excess of the subsidy they are entitled to are required to pay the difference.

Although no formal funding policy has been established for the future benefits to be provided under this plan, the Department has made significant contributions into the Fund. In fiscal year 2011, the Department transferred $75 million into the Fund and paid an additional $65.6 million in retiree medical premiums. In fiscal year 2010, the Department transferred $100 million in cash into the Fund and paid an additional $60.5 million in retiree medical premiums. The Power System's portion of these amounts was $95.6 million and $109.1 million for 2011 and 2010, respectively.

### *(c) Annual OPEB Cost and Net OPEB Obligation*

The annual OPEB cost (expense) is calculated based on the employer ARC, an amount actuarially determined in accordance with the parameters of GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost under each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed 30 years.



(Continued)

The following table shows the components of the Department's annual OPEB cost for the year, the amount actually contributed to the Plan, and changes in the net OPEB asset (amounts in thousands):

| | | Year ended June 30 | |
|---|---|---|---|
| | | 2011 | 2010 |
| Annual required contribution | $ | 68,705 | 58,503 |
| Interest on net OPEB asset | | (62,322) | (54,996) |
| Adjustment to annual required contribution | | 50,081 | 42,893 |
| Annual OPEB costs | | 56,464 | 46,400 |
| Contributions made | | (140,590) | (160,460) |
| Change in net OPEB asset | | (84,126) | (114,060) |
| Net OPEB asset – beginning of year | | (779,758) | (665,698) |
| Net OPEB asset – end of year | $ | (863,884) | (779,758) |

The following table shows the components of the Power System's share in annual OPEB cost for the year, the amount actually contributed to the Plan, and changes in the net OPEB asset (amounts in thousands):

| | | Year ended June 30 | |
|---|---|---|---|
| | | 2011 | 2010 |
| Annual required contribution | $ | 46,720 | 39,782 |
| Interest on net OPEB asset | | (42,379) | (37,397) |
| Adjustment to annual required contribution | | 34,054 | 29,167 |
| Annual OPEB costs | | 38,395 | 31,552 |
| Contributions made | | (95,609) | (109,063) |
| Change in net OPEB asset | | (57,214) | (77,511) |
| Net OPEB asset – beginning of year | | (533,472) | (455,961) |
| Net OPEB asset – end of year | $ | (590,686) | (533,472) |



(Continued)

The Department’s annual OPEB cost, the percentage of ARC contributed to the Plan, and the net postemployment asset for fiscal years 2011, 2010, and 2009 were as follows (amounts in thousands):

| | | 2011 | 2010 | 2009 |
|---|---|---|---|---|
| Annual OPEB cost | $ | 56,464 | 46,400 | 50,038 |
| Percentage of OPEB costs contributed | | 249% | 346% | 319% |
| Net postemployment asset at end of year | $ | 863,884 | 779,758 | 665,698 |

The Power System’s share in the annual OPEB cost, the percentage of ARC contributed to the Plan, and the net retirement asset for fiscal years 2011, 2010, and 2009 were as follows (amounts in thousands):

| | | 2011 | 2010 | 2009 |
|---|---|---|---|---|
| Annual OPEB cost | $ | 38,395 | 31,552 | 34,026 |
| Percentage of OPEB costs contributed | | 249% | 346% | 319% |
| Net postemployment asset at end of year | $ | 590,686 | 533,472 | 455,961 |

### *(d) Funded Status and Funding Progress*

As of July 1, 2010, the Department’s actuarial value of assets was $987 million, and AAL for benefits was $1.6 billion, resulting in a UAAL of $644 million. The covered payroll (annual payroll of active employees covered by the Plan) was $856 million, and the ratio of the UAAL to the covered payroll was 75%.

As of July 1, 2009, the Department’s actuarial value of assets was $850 million, and AAL for benefits was $1.4 billion, resulting in a UAAL of $541 million. The covered payroll (annual payroll of active employees covered by the Plan) was $805.1 million, and the ratio of the UAAL to the covered payroll was 67%.

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the Plan and ARCs of the Department are subject to continual revision as actual results are compared with past expectations and new estimates are made for the future. The schedule of funding progress, presented as required supplementary information, presents information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the AAL for benefits.



(Continued)

### *(e) Actuarial Methods and Assumptions*

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan understood by the Department and the plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the Department and the plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in AAL and the actuarial value of assets, consistent with the long-term perspective of the calculations.

In the July 1, 2010 actuarial valuation, the entry-age normal cost method was used. The actuarial assumptions include 7.75% discount rate, which represents the expected long-term return on plan assets, an annual healthcare cost trend rate of 10.00% initially, reduced by decrements to an ultimate rate of 5.00% over 10 years. Both rates include a 3.75% inflation assumption. The actuarial value of assets was determined using techniques that spread UAAL being amortized as a level percentage of projected payroll over a closed 25-year period.

In the July 1, 2009 actuarial valuation, the entry-age normal cost method was used. The actuarial assumptions include 8.00% discount rate, which represents the expected long-term return on plan assets, an annual healthcare cost trend rate of 9.00% initially, reduced by decrements to an ultimate rate of 5.00% after 8 years. Both rates include a 3.75% inflation assumption. The actuarial value of assets was determined using techniques that spread UAAL being amortized as a level percentage of projected payroll over a closed 26-year period.

### *(f) Healthcare Reform Legislation*

The Patient Protection and Affordable Care Act (PPACA) was signed into law on March 23, 2010. One key provision of the PPACA is the assessment of the excise tax on high cost plans (Cadillac Plans) beginning in 2018. Under this act, a 40% excise tax applies to plans with costs exceeding certain annual thresholds ($11,850 for single; $30,950 for families for early retirees). Significant uncertainties exist regarding the impact of the excise tax on high cost plans without further regulatory guidance. Management estimated the potential impact of this tax on the liability is based on unadjusted thresholds and assuming the tax is shared between the Department and its participants in the same way that the current costs are shared. The estimated impact of the 40% excise tax provision on high cost plans beginning in 2018, under the healthcare reform, is not reflected in the actuarial valuation report as of July 1, 2010. It is estimated that the financial effect of reflecting the excise tax in the accrued liability will be an additional $38.1 million, which is approximately 2.3% of the total accrued liability of $1.63 billion as of July 1, 2010.


(Continued)

## (13) Other Long-Term Liabilities

### *(a) Other Long-Term Liabilities*

The Power System has the following other long-term liabilities:

| | Balance July 1, 2010 | Additions | Reductions | Balance June 30, 2011 | Current portion |
|---|---|---|---|---|---|
| Accrued liabilities | $ 12,040 | — | (1,553) | 10,487 | — |
| Deferred credits: | | | | | |
| Purchased power | $ 234,569 | — | (93,574) | 140,995 | 95,830 |
| Rate stabilization | 75,000 | — | — | 75,000 | — |
| Other | 2,223 | 772 | — | 2,995 | — |
| | $ 311,792 | 772 | (93,574) | 218,990 | 95,830 |
| Accrued workers' compensation claims | $ 40,692 | — | (392) | 40,300 | — |
| Derivative instrument liabilities | $ 84,268 | — | (10,498) | 73,770 | — |

| | Balance July 1, 2009 | Additions | Reductions | Balance June 30, 2010 | Current portion |
|---|---|---|---|---|---|
| Accrued liabilities | $ 23,760 | — | (11,720) | 12,040 | — |
| Deferred credits: | | | | | |
| Purchased power | $ 331,842 | — | (97,273) | 234,569 | 93,574 |
| Public benefits | 82,582 | — | (82,582) | — | — |
| Rate stabilization | 72,830 | 2,170 | — | 75,000 | — |
| Other | 1,567 | 656 | — | 2,223 | — |
| | $ 488,821 | 2,826 | (179,855) | 311,792 | 93,574 |
| Accrued workers' compensation claims | $ 29,128 | 11,564 | — | 40,692 | — |
| Derivative instrument liabilities | $ 112,586 | — | (28,318) | 84,268 | — |

### *(b) Deferred Credits*

The Department has deferred credits that are related to revenues collected from customers, but have not been earned. These funds are deferred and recognized as costs related to these deferrals are incurred.

**Purchased Power Deferrals**

During fiscal year 2006, the Board approved the suspension of deferring precollected purchased power costs and the reversal of the precollected purchased power costs recorded in prior years. The amount reversed is the cost of energy from IPP less the amount designated in rates for out-of-market purchased power costs. The reversal of the deferred credit is credited to retail sales. During fiscal years 2011 and 2010, the Power System reversed $93.6 million and $97.3 million, respectively, related to precollected purchase power costs. At June 30, 2011 and 2010, $140.9 million and $234.6 million, respectively, remain as part of deferred credits related to precollected purchased power costs.

**Public Benefits**

In accordance with Assembly Bill 1890, as amended by Assembly Bill 995 and pursuant to direction from the Board, a percentage of the Department's retail revenue is designated for use for qualifying public benefit programs. Qualifying programs include cost-effective demand side management services to promote energy efficiency and energy conservation, new investment in renewable energy resources and technologies, development and demonstration programs to advance science and technology, and services provided for low-income electricity customers. In accordance with current legislation and the Department's plans, the program is currently expected to cease on January 1, 2012.

As of June 30, 2010, the Department no longer defers public benefits revenue from customers in excess of costs incurred under qualifying programs and defers qualifying expenses in excess of collections. During fiscal years 2011 and 2010, the Department spent $65.8 million and $102.5 million, respectively, on qualified public benefits programs. These programs include energy efficiency programs, tree programs, investments in electric buses and vehicles, photovoltaics or solar power and other alternative energy sources, and support for low-income and life support customers. Regulatory liabilities are reduced when adequate public benefit expenses are incurred, and regulatory assets are recovered when the corresponding revenue is earned.

**Rate Stabilization Account**

In April 2008, the City Council approved an amendment to the electric rate ordinance, which required the balance of the Rate Stabilization Account to be maintained separately from the Energy Cost Adjustment Account. The ordinance also directed that the deferred amount within the Energy Cost Adjustment Account be the beginning balance of the Rate Stabilization Account. During fiscal year 2010, $2.2 million was deferred from current year sales for resale. As of June 30, 2011 and 2010, the balance in the Rate Stabilization Fund remained constant at $75.0 million.

***(c) Accrued Workers' Compensation Claims***

Liabilities for unpaid workers' compensation claims are recorded at their present value when they are probable of occurrence and the amount can be reasonably estimated. The liability is actuarially determined, based on an estimate of the present value of the claims outstanding and an amount for claim events incurred but not reported based upon the Department's loss experience, less the amount of claims and settlements paid to date. The discount rate used to calculate this liability at its present value was 4% at June 30, 2011 and 2010. The Department has third-party insurance coverage for workers' compensation claims in excess of $1 million.

Overall indicated reserves for workers' compensation claims, for both the Water System and the Power System, undiscounted, have decreased from $70 million as of June 30, 2010 to $69 million as of June 30, 2011. The decrease in the June 30, 2011 liability was due to a downward trend in the number of cases filed at the Department and the utility industry. As the claims typically take longer than one year to settle and close out, the entire discounted liability is shown as long-term on the balance sheets as of June 30, 2011 and 2010.

Changes in the Department's undiscounted liability since June 30, 2009 are summarized as follows (amounts in thousands):

| | June 30 | | |
|---|---|---|---|
| | **2011** | **2010** | **2009** |
| Balance at beginning of year | $ 69,692 | 53,037 | 57,757 |
| Current year claims and changes in estimates | 19,541 | 34,771 | 15,053 |
| Payments applied | (20,078) | (18,116) | (19,773) |
| Balance at end of year | $ 69,155 | 69,692 | 53,037 |

The Power System's portion of the discounted reserves as of June 30, 2011 and 2010 is $40.3 million and $40.7 million, respectively.

## (14) Commitments and Contingencies

### *(a) Transfers to the Reserve Fund of the City of Los Angeles*

Under the provisions of the City Charter, the Power System transfers funds at its discretion to the reserve fund of the City. Pursuant to covenants contained in the bond indentures, the transfers may not be in excess of the increase in fund net assets before transfers to the reserve fund of the City of the prior fiscal year. Such payments are not in lieu of taxes and are recorded as a transfer in the statements of revenues, expenses, and changes in fund net assets.

The Department authorized total transfers of $259 million and $220 million in fiscal years 2011 and 2010, respectively, from the Power System to the reserve fund of the City.

### *(b) Palo Verde Nuclear Generating Station (PVNGS) Matters*

As a joint project participant in PVNGS, the Department has certain commitments with respect to nuclear spent fuel and waste disposal. Under the Nuclear Policy Act, the Department of Energy (the DOE) is to develop facilities necessary for the storage and disposal of spent fuel and to have the first such facility in operation by 1998; however, the DOE has announced that such a repository cannot be completed before 2017. Capacity in existing fuel storage pools at PVNGS was exhausted in 2003. A Dry Cask Storage Facility (also called the Independent Spent Fuel Storage Facility) was built and completed in 2003 at a total cost of $33.9 million (about $3.3 million for the Department). The facility has the capacity to store all the spent fuel generated by the plant until the end of its life in 2026. The Department accrues for current nuclear fuel storage costs as a component of fuel expense as the fuel is burned. The Department's share of spent nuclear fuel costs related to its indirect interest in PVNGS is included in purchased power expense.

Because of the DOE's inability to provide a disposal site, the PVNGS operating agent filed damages actions against the DOE to recover costs incurred by the PVNGS participants. A settlement was reached in August 2010 in the amount of $30.2 million from DOE of which $1.7 million is the Department's share of the settlement which covers costs incurred up to 2006.

The Price-Anderson Act (the Act) requires that all utilities with nuclear generating facilities share in payment for claims resulting from a nuclear incident. Participants in PVNGS currently insure potential claims and liability through commercial insurance with a $375 million limit; the remainder of the potential liability is covered by the industrywide retrospective assessment program provided under the Act. This program limits assessments to a maximum of $118 million for each licensee for each nuclear incident occurring at any nuclear reactor in the United States; payments under the program are limited to $18 million per incident, per year. Based on the Department's 5.70% direct interest and its 3.96% indirect investment interest through SCPPA, the Department would be responsible for a maximum assessment of $11 million per incident, limited to payments of $2 million per incident annually.

The NRC guidelines require improved security in immediate areas surrounding the reactor buildings. PVNGS enlarged the protected area with inclusion of an outage support facility, a new warehouse, a minor vehicle maintenance facility, and a fuel depot to reduce vehicular traffic in and out of the protected area. The estimated cost for these facilities is approximately $6.3 million to the Department.

In response to the nuclear event in Fukushima, Japan, the NRC may require PVNGS to increase the redundancy in its power supply to emergency cooling systems and accelerate the transfer of spent fuel from the pool to the dry cask storage. The Department cannot predict what new requirements will be mandated by the NRC and the resulting costs to the Department.

### *(c) Environmental Matters*

Numerous environmental laws and regulations affect the Power System's facilities and operations. The Department monitors its compliance with laws and regulations and reviews its remediation obligations on an ongoing basis. The following topics highlight some of the major environmental compliance issues affecting the Power System:

#### Air Quality – Nitrogen Oxide (NOx) Emissions

The Power System's generating station facilities are subject to the Regional Clean Air Incentives Market (RECLAIM) NOx emission reduction program adopted by the South Coast Air Quality Management District (SCAQMD). In accordance with this program, SCAQMD established annual NOx allocations for NOx RECLAIM facilities based on historical emissions and type of emission sources operated. These allocations are in the form of RECLAIM trading emission credits (RTCs). Facilities that exceed their allocations may buy RTCs from other companies that have emissions below their allocations. The Department has a program of installing emission controls and purchasing RTCs, as necessary, to meet its emission requirements.

As a result of the installation of NOx control equipment and the repowering of existing units, the Department has sufficient RTCs to meet its native load requirements for normal operations.

**Air Quality – Greenhouse Gas Emissions**

In September 2006, Governor Schwarzenegger signed into law Assembly Bill 32, the California Global Warming Solutions Act of 2006 (Nunez, Chapter 488, Statutes of 2006). The bill requires the California Air Resources Board to develop regulations and market mechanisms that will ultimately reduce California's greenhouse gas emissions to 1990 levels by 2020, or approximately 30% from business-as-usual emission levels for 2020. Mandatory declining greenhouse gas emission caps will begin in 2012 for significant sources and be gradually reduced to meet the 2020 goals. As specified in the bill, all emissions from electricity that is consumed in the state, whether it is generated in California or in other states, will be subject to the cap. As a result, the Power System's share of emissions from IPP and other facilities outside California will be subject to this program. In December 2008, the California Air Resources Board adopted a Climate Change Scoping Plan, pursuant to AB 32. The Scoping Plan recommends a number of strategies that will apply to the electricity sector, including 1) California cap-and-trade program linked to the Western Climate Initiative, 2) energy efficiency, 3) renewable energy, and 4) combined heat and power.

It is uncertain at this time what impact a state program will have on the Power System's operations. The Air Resources Board adopted the regulations for the electricity and industrial sectors on October 20, 2011. Per AB 32, the goal of the regulations would be to "achieve the maximum technologically feasible and cost-effective greenhouse gas reductions." The Department is actively participating in the rule making process.

SB 1368 was signed into law on September 29, 2006 and requires the California Public Utilities Commission (CPUC) and the California Energy Commission (CEC) to establish a greenhouse gases emissions performance standard and implement regulations for all long-term financial commitments in base load generation made by LSEs and local publicly owned electric utilities publicly-owned utilities, respectively. The greenhouse gas emissions performance standard is not to exceed the rate of greenhouse gases emitted per MW hour associated with combined-cycle, gas turbine base load generation. The regulations have been adopted by the CPUC for investor-owned utilities and by the CEC for publicly owned utilities and establish an emissions performance standard of 1,100 pounds of carbon dioxide per MW hour of electricity.

At the federal level, several legislative bills have been proposed or introduced, but none have passed Congress. As such, a federal cap-and-trade program is unlikely to be established in the same time frame (2012) as a state cap-and-trade program, but may be considered in future years. However, the United States Environmental Protection Agency (EPA) adopted its Prevention of Significant Deterioration (PSD) and Title V Greenhouse Gas Tailoring Rule in June 2010. The Power System's in-basin repowering projects requiring PSD permits after January 2, 2011 would be impacted as they would be required to submit a GHG Best Available Control Technology (BACT) analysis. EPA is expected to issue its GHG BACT guidance for public review later this year. Also, the Power System's generating stations will need to amend their Title V operating permits to incorporate any GHG requirements when the permits are renewed.

**Power Plant Once-Through Cooling Water Systems**

Once-through cooling (OTC) is the process where water is drawn from a source, pumped through equipment to provide cooling, and then discharged. Some type of cooling process is necessary for nearly every type of traditional electrical generating station, and the OTC process is utilized by many electrical generating stations located next to large bodies of water. Typically, the water used for cooling is not chemically changed in the process although its temperature is increased.

Due to the Second Circuit Court's decision to remand most of Environmental Protection Agency (EPA's) 316(b) Rule finalized in July 2004, EPA suspended this Rule and is in the process of drafting a new rule. EPA's proposed new rule for existing facilities was recently released in the federal register for comments on April 19, 2011 for a 120-day comments period, and the targeted to finalize the Rule is 2011. In the absence of EPA's 316(b) Rule, the California State Water Resources Control Board (State Board) decided to move forward and adopted their own State wide 316 b Policy (Policy) on May 4, 2010. The Policy became effective on October 1, 2010. This policy requires the Department's coastal power plants to reduce OTC by 93% – equivalent to wet cooling towers using seawater. This is referred to as the Track 1 compliance path. If the Track 1 compliance path is found to be infeasible, with concurrence from the State Board, a Track 2 compliance path can be pursued, which requires that the cooling water intake structure (CWIS) achieve an impingement mortality and entrainment (IM/E) reduction level of 90% of the Track 1 compliance standard or 83.7% on a unit-by-unit basis. The Department has made a decision to pursue the Track 1 compliance path, in order to comply with the Policy and completely eliminate the use of OTC. Recently, the Department was successful in having the Policy amended to extend the compliance dates, for six out of the nine remaining OTC units, to 2024 for Scattergood, and 2029 for Haynes and Harbor. The other four OTC units are on schedule, due to an AQMD settlement, to be repowered with eliminating OTC by 2013 and 2015, respectively. The Amendment to the Policy was adopted on July 19, 2011. The Amendment requires the Department to submit additional information responsive to the Statewide Advisory Committee on Cooling Water Intake Structures (SACCWIS) resolution by December 31, 2012. Depending upon the information submitted by LADWP and no later than December 31, 2013, the State Board will consider modifications to the 2029 compliance dates. Furthermore, the Amendment requires implementation of interim measures, these measures include a proposal to study new and/or viable existing technologies to reduce impingement and entrainment. The proposal must be submitted to the State Board no later than December 31, 2015. Upon approval of the proposal, the interim measures must be in place no later than December 31, 2020. These interim measures will include the funding of a mitigation project or the use of screens or an equivalent alternative measure at each OTC unit or intake until the facility is in full compliance.

In addition, other regulatory changes have been made that could significantly impact operations at the Haynes and Harbor Generating Stations. The Regional Water Quality Control Board reclassified the body of water that the OTC water is discharged to an enclosed bay for the Harbor Generating

Station, and sent a letter of intent to reclassify the receiving water body of water as an estuary for the Haynes Generating Station discharge. Even though the Haynes Generating Station will be repowering existing units, should there be a reclassification for the water body discharges at the Haynes Generating Station, there will be requirements that cannot be met with its existing cooling or future repowered configuration. The Department is in the process of reviewing the regulations and conducting studies. Once the studies are reviewed, the Department will determine an appropriate course of action.

**Pollution and Remediation Obligations**

The Department follows GASB Statement No. 49, *Accounting and Financial Reporting for Pollution and Remediation Obligations* (GASB No. 49). This statement addresses accounting and financial reporting standards for pollution (including contamination) remediation obligations, which are obligations to address the current or potential detrimental effects of existing pollution by participating in pollution remediation activities such as site assessments and cleanups. The scope of the statement excludes pollution prevention or control obligations with respect to current operations, and future pollution remediation activities that are required upon retirement of an asset, such as landfill closure and postclosure care and nuclear power plant decommissioning. The Power System's obligations were approximately $20.9 million as of June 30, 2011 and 2010.

***(d) Litigation***

**i. Capital Facilities Fee Claims**

In June 2007, the Department received a tentative decision in favor of the state and a number of local government agencies that are electric customers of the Department that claimed that the Department has rates that include a capital facilities' charge that violates the state's statute. However, in October 2008, the Department settled the case and recorded the $160 million settlement amount. Additionally, as permitted by SFAS No. 71, *Accounting for the Effects of Certain Types of Regulation*, the Board approved to defer all potential costs associated with the resolution of this litigation and establish a corresponding long-term deferred debit to be recovered through future revenues over a period of up to 10 years, if necessary.

**ii. Other**

A number of claims and suits are also pending against the Department for alleged damages to persons and property and for other alleged liabilities arising out of its operations. In the opinion of management, any ultimate liability, which may arise from these actions, is not expected to materially impact the Power System's financial position, results of operations, or cash flows as of June 30, 2011.

### *(e) Risk Management*

The Power System is subject to certain business risks common to the utility industry. The majority of these risks are mitigated by external insurance coverage obtained by the Power System. For other significant business risks, however, the Power System has elected to self-insure. Management believes that exposure to loss arising out of self-insured business risks will not materially impact the Power System's financial position, results of operations, or cash flows as of June 30, 2011.

### *(f) Credit Risk*

Financial instruments, which potentially expose the Power System to concentrations of credit risk, consist primarily of retail and wholesale receivables. The Power System's retail customer base is concentrated among commercial, industrial, residential, and governmental customers located within the City. Although the Power System is directly affected by the City's economy, management does not believe significant credit risk exists at June 30, 2011, except as provided in the allowance for losses. The Power System manages its credit exposure by requiring credit enhancements from certain customers and through procedures designed to identify and monitor credit risk.

LOS ANGELES DEPARTMENT OF WATER AND POWER
POWER SYSTEM

Required Supplementary Information

(Unaudited)

June 30, 2011

## Pension Plan – Schedule of Funding Progress

The following schedule provides information about the Department's overall progress made in accumulating sufficient assets to pay benefits when due, prior to allocations to the Water System and the Power System (amounts in thousands):

| Actuarial valuation date July 1 | Actuarial value of assets | Actuarial accrued liability (AAL) | Unfunded AAL (UAAL) | Funded ratio | Covered payroll | UAAL as a percentage of covered payroll |
|---|---|---|---|---|---|---|
| 2011 | $ 7,465,184 | 9,297,204 | 1,832,020 | 80% | $ 870,203 | 211% |
| 2010 | 7,244,430 | 8,893,618 | 1,649,189 | 81 | 856,090 | 193 |
| 2009 | 7,248,721 | 8,057,061 | 808,340 | 90 | 805,138 | 100 |

## Postemployment Healthcare Plan – Schedule of Funding Progress

The following schedule provides information about the Department's overall progress made in accumulating sufficient assets to pay benefits when due, prior to allocations to the Water System and the Power System (amounts in thousands):

| Actuarial valuation date July 1 | Actuarial value of assets | Actuarial accrued liability (AAL) | Unfunded AAL (UAAL) | Funded ratio | Covered payroll | UAAL as a percentage of covered payroll |
|---|---|---|---|---|---|---|
| 2011 | $ 1,132,929 | 1,550,896 | 417,967 | 73% | $ 870,203 | 48% |
| 2010 | 987,476 | 1,631,916 | 644,440 | 61 | 856,090 | 75 |
| 2009 | 849,955 | 1,390,811 | 540,855 | 61 | 805,138 | 67 |

See accompanying independent auditors' report.