SMUD
SACRAMENTO MUNICIPAL UTILITY DISTRICT
The Power To Do More.®

P.O. Box 15830, Sacramento, CA 95852-1830; 1-888-742-SMUD (7683)

NQA 07-027

May 17, 2007

U.S. Nuclear Regulatory Commission
Document Control Desk
Washington, DC 20555

Docket No. 50-312
Rancho Seco Nuclear Generating Station
License No. DPR-54

Docket No. 72-11
Rancho Seco Independent Spent Fuel Storage Installation
License No. SNM-2510

ANNUAL FINANCIAL REPORT

Attention: John Hickman and Randy Hall

In accordance with 10 CFR 50.71(b) and 10 CFR 72.80(b), we are submitting the 2006 annual financial report for the Sacramento Municipal Utility District. If you or members of your staff have questions requiring additional information or clarification, please contact me at (916) 732-4843.

Sincerely,

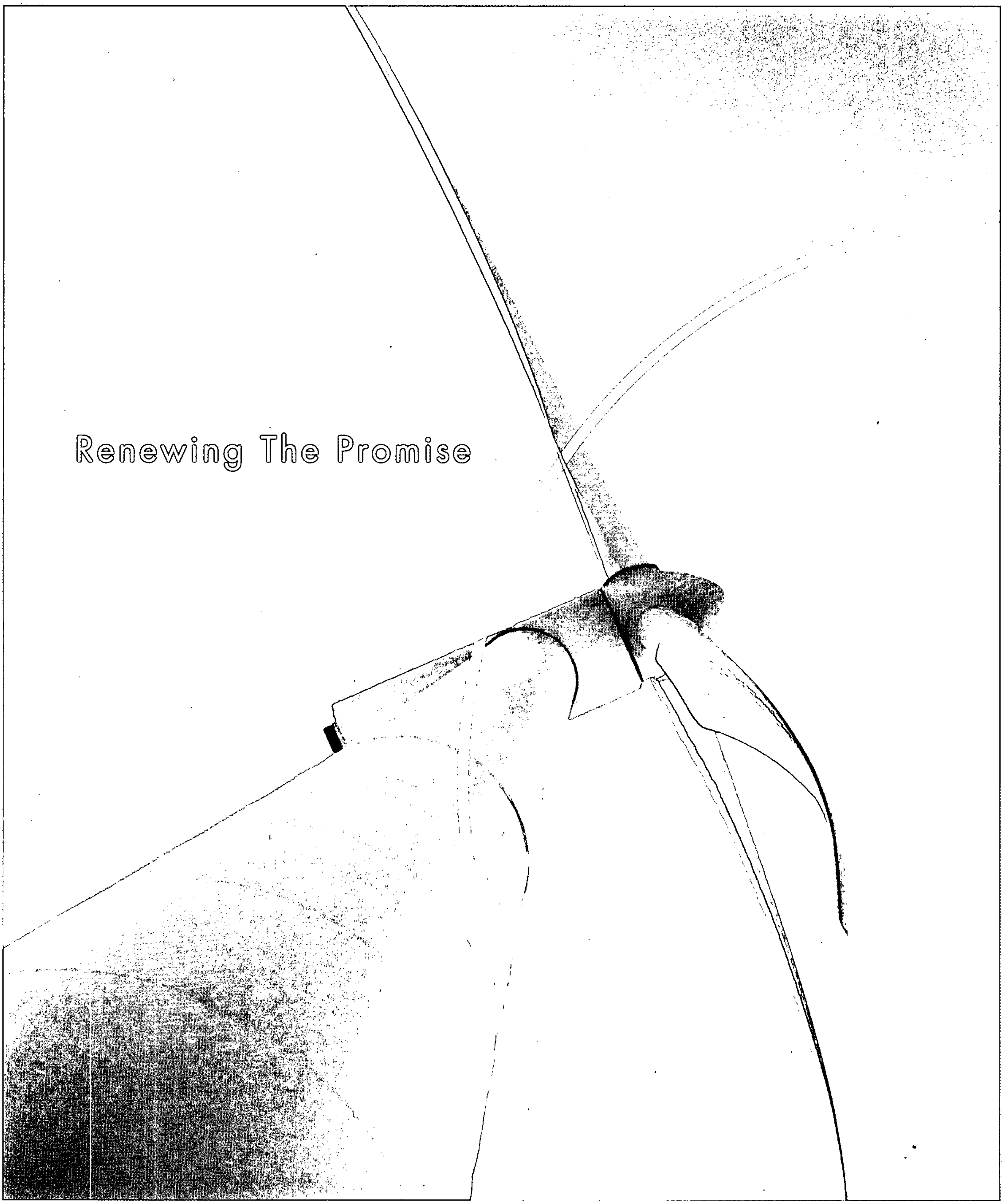
Robert E. Jones
Supervising Quality Engineer

Cc: NRC, Region VI

NMSS01
M004

SMUD
SACRAMENTO MUNICIPAL UTILITY DISTRICT

2006 Annual Report



STATISTICS 2006

Service area population:
1.4 million

Total operating revenue:
$1.39 billion

Employees:
2,213

Record peak demand:
3,299 megawatts
July 24, 2006

Number of customers (year end):
585,221

Credit Rating:
A Standard & Poor's
A1 Moody's
A Fitch

Executive Management

Jan E. Schori
General Manager and
Chief Executive Officer

James R. Shetler
Assistant General Manager,
Energy Supply

John DiStasio
Assistant General Manager,
Energy Delivery & Customer Services

Betty Masuoka
Assistant General Manager,
Administrative Services

Arlen Orchard
General Counsel and Secretary

James A. Tracy
Chief Financial Officer

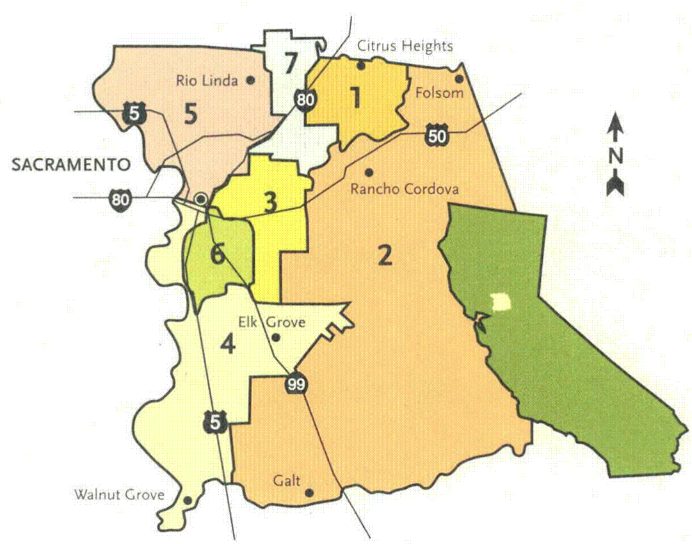
Noreen Roche-Carter
Treasurer

Cary M. Nethaway
Controller

Linda Carey Johnson
Director of Business Technology &
Change Management

SMUD Service Area and Board Member Wards

SMUD generates, transmits and distributes electric power to a 900-square-mile territory that includes California's capital city, Sacramento County and a small portion of Placer County. As a municipal utility, SMUD is governed by a seven-member board of directors elected by the voters to staggered four-year terms. The SMUD Board of Directors determines policy for the District and appoints the general manager, who is responsible for the District's operations.



SMUD Board of Directors

- **Linda M. Anderson Davis**
  Ward 1
- **Susan Patterson**
  Ward 2
  President 2007
  Vice President 2006
- **Howard Posner**
  Ward 3
  Vice President 2007
- **Genevieve Shiroma**
  Ward 4
  President 2006
- **Peter R. Keat**
  Ward 5
- **Larry Carr**
  Ward 6
- **Bill Slaton**
  Ward 7

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Produced by: Communication & Advertising Services
Monica Siewert, Manager | ©2007 SMUD

Meeting the challenge of climate change will not be easy, but it is the right thing to do for today's customers and for future generations.

Having just completed our 60th year of operations, we believe the promise of public power has been realized in Sacramento. Our rates are 30 percent lower than those of neighboring Pacific Gas & Electric Co. We are on sound financial footing. And our long-standing commitment to environmental protection has positioned us well to meet the challenges of the future.

Our net income of $107.4 million in 2006 was more than double the amount anticipated in our budget. As a result, we increased our equity level by more than 3 percentage points. That moves us significantly closer to our year-end 2007 equity target, which the board established in 2003 to protect our strong credit rating.

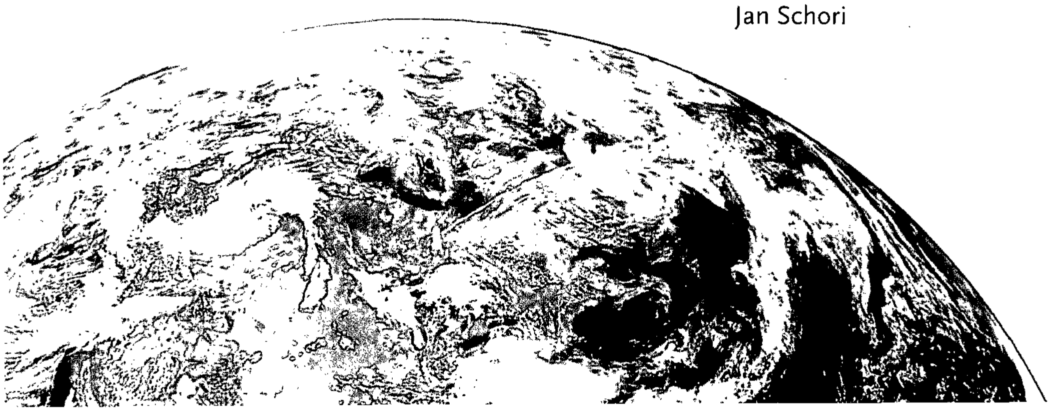
Our efforts to maintain quality service have been rewarded again. A few weeks before this report went to press, J.D. Power and Associates released study results showing SMUD ranked "Highest Customer Satisfaction With Business Electric Service in the Western U.S." and scored highest in the nation.

As we renew the promise of public power in Sacramento, our board of directors has pledged to reduce our emissions of carbon dioxide and other greenhouse gases. We are working diligently to increase our renewable energy supplies. The board has put great effort into studying what it will take to help customers curb peak energy demand in preparation for adoption of a new 10-year demand reduction and energy efficiency goal in 2007, and we have increased both funding and programs for an expanded energy efficiency partnership with our customers. Meeting the challenge of climate change will not be easy, but it is the right thing to do for today's customers and for future generations.

We respect the November 2006 election decision of our current customers rejecting the proposal to expand to provide electric service in Yolo County. In the months ahead, we will be stepping up interaction with our customers and the communities we serve to build even stronger relationships and assure that we continue to provide cost-effective and environmentally sensitive energy solutions which meet their needs. I hope you will take a few minutes to read on and learn more about how we are renewing and redefining the promise of public power.

Jan Schori

RENEWING THE PROMISE OF PUBLIC POWER



A YEAR IN REVIEW

SACRAMENTO MUNICIPAL UTILITY DISTRICT
60 YEARS OF PUBLIC POWER
1946 - 2006
SMUD

JANUARY

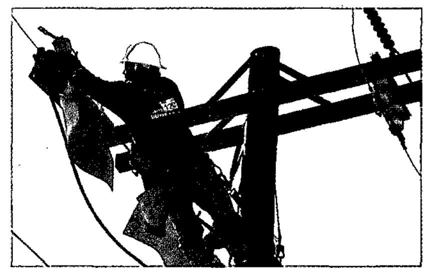
- SMUD begins its 60th year of operation as a community utility owned by its customers.
- SMUD becomes the first utility in the country to initiate a program offering residential customers rebates for installation of reflective, energy-saving "cool roofs."

FEBRUARY

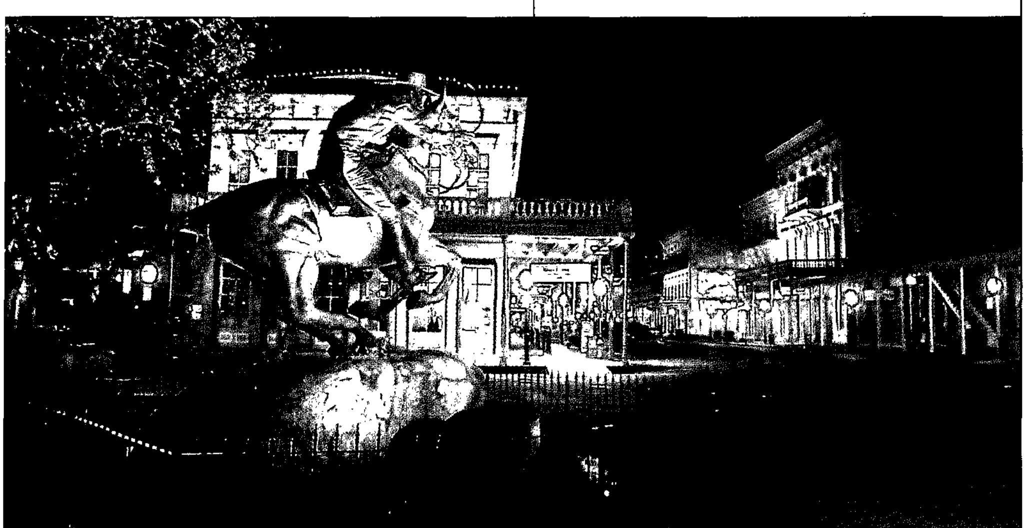
- Following months of testing, the 500-megawatt Cosumnes Power Plant officially begins commercial operation on Feb. 24. The highly efficient natural gas-fired plant produces enough power to serve 450,000 households.

MARCH

- A national survey of commercial customers shows SMUD is the top-rated utility in California, second highest in the West and fifth highest in the nation.



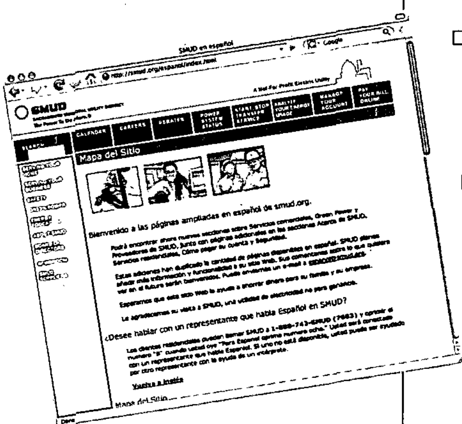
- SMUD's Greenergy® is the only green program ranked in the top five nationally by the National Renewable Energy Laboratory in three separate categories – kilowatt-hours sold, number of participants, and participation rate. Greenergy is a voluntary program in which SMUD matches up to 100 percent of participants' electricity needs with purchases of renewable resources for use on the SMUD power system.



As part of its 60th anniversary celebration, SMUD provided lighting for the historic Pony Express statue in Old Sacramento.

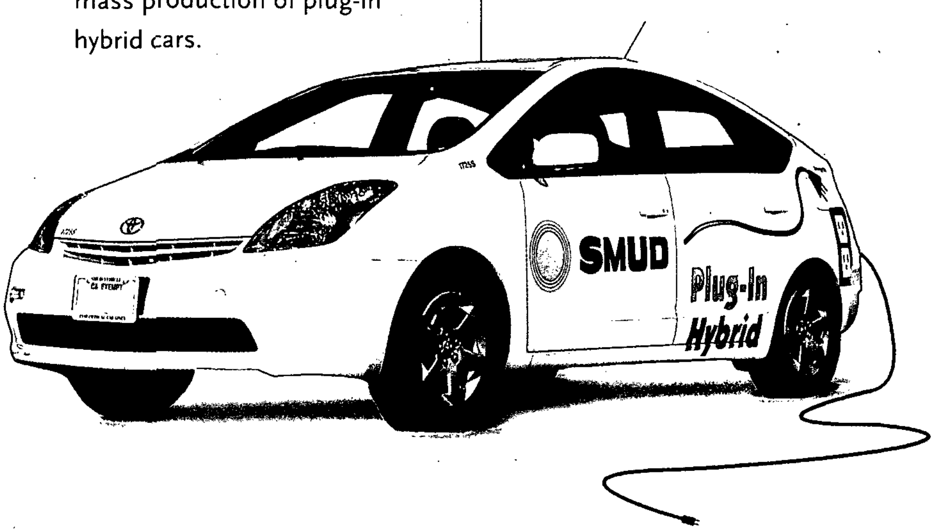
SMUD's Greenergy® was the only green program ranked in the top five nationally by the National Renewable Energy Laboratory in three separate categories.

SMUD and The Nature Conservancy open a 7-mile trail that meanders from riparian and marsh habitat on rural SMUD land to the neighboring Howard Ranch.



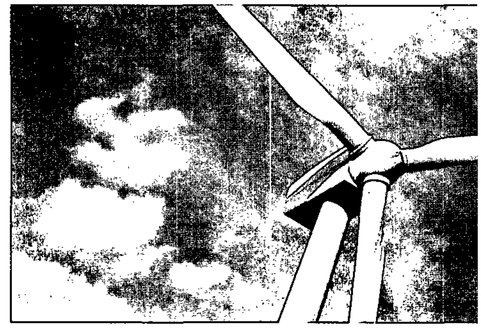
APRIL

- SMUD takes delivery of a prototype plug-in hybrid vehicle that gets 100 miles to the gallon. SMUD is compiling operating data in hopes of encouraging mass production of plug-in hybrid cars.



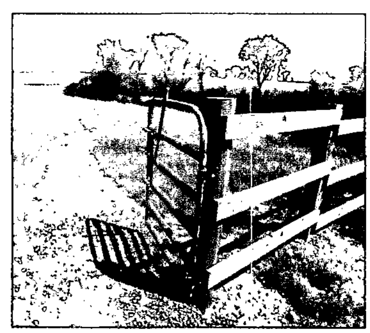
MAY

- SMUD more than doubles the Spanish-language content on its Web site, smud.org.
- SMUD's Zero Energy Homes program is featured on NBC's *Today Show* in a report on global warming.
- SMUD directors present the first Community Energy Awards to honor commercial customers who worked with SMUD on projects that reflect a shared commitment to environmental stewardship and efficiency.



JUNE

- SMUD dedicates new wind turbine generators that add 24 megawatts of production capacity at the utility's Solano Wind Project. The new turbines are the largest in commercial operation in North America.
- SMUD and The Nature Conservancy open a 7-mile trail that meanders from riparian and marsh habitat on rural SMUD land to the neighboring Howard Ranch in southeast Sacramento County. The opening culminates a four-year effort to protect vernal pools that support threatened and endangered species.



JULY

- A national survey of residential customers shows SMUD to be the top-rated electric utility in California for the sixth time in seven years.
- An unprecedented heat wave blankets California in the second half of the month. Electricity use hits record levels in the SMUD service area on four days in little more than a week. Energy use tops out at 3,299 megawatts on July 24. SMUD replaces 150 transformers in three days, but has enough power to meet customer demand, plus adequate reserves to meet reliability standards.
- SMUD directors adopt principles for reducing greenhouse gas emissions, as developed by SMUD and other members of the California Municipal Utilities Association in response to global warming.
- SMUD becomes the first electric utility to support Assembly Bill 32, the California Global Warming Solutions Act.

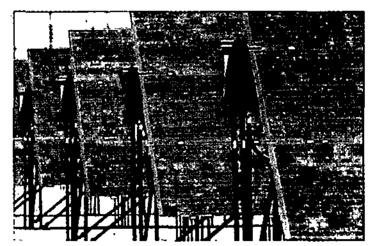
SMUD adds a new dimension to its longtime solar energy commitment with the launch of a program that awards $30,000 in grants for student solar projects.

AUGUST

- SMUD hosts a special exhibit at the California State Fair to celebrate its 60th anniversary: Side-by-side displays of a 1950s kitchen and an ultra-modern kitchen showcase improvements in energy efficiency; professional actors regale fairgoers with a humorous presentation that teaches the value of energy conservation during the hours of peak demand.

SEPTEMBER

- SMUD adds a new dimension to its longtime solar energy commitment with the launch of a program that awards $30,000 in grants for student solar projects.



The new Cosumnes Power Plant helped SMUD meet record demands for electricity during the summer heat wave.

OCTOBER

- SMUD sets aside nearly half its land holdings in southeast Sacramento County to create the SMUD Nature Preserve, a 1,200-acre expanse at Rancho Seco. The utility worked with The Nature Conservancy and the Sacramento Valley Conservancy on an agreement to protect agricultural land and important ecological resources.

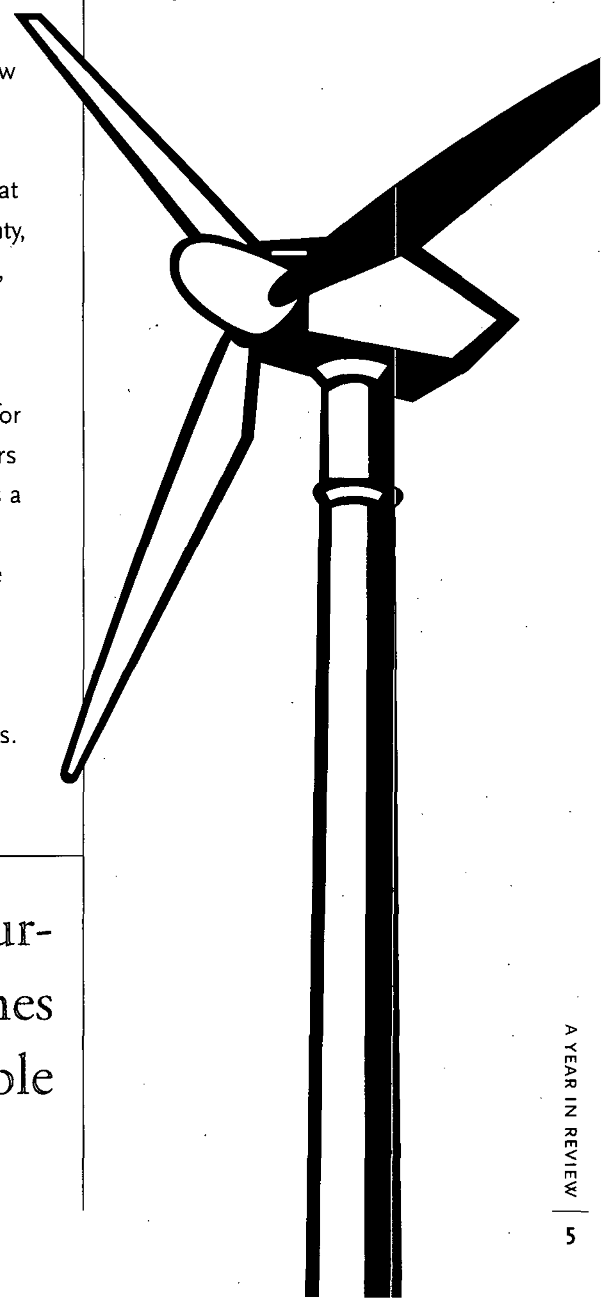
COSUMNES RIVER PRESERVE

NOVEMBER

- SMUD and 15 other parties reach a breakthrough agreement in principle on how SMUD should operate its hydroelectric system, the Upper American River Project, for decades to come. The settlement is expected to pave the way for regulators to grant SMUD a new, long-term operating license for the project, which is SMUD's most economical and second largest energy resource.
- SMUD customers vote not to extend the SMUD service territory into Yolo County areas served by PG&E. SMUD by law could not campaign for the expansion, and PG&E spent more than $11 million to defeat it. Elected officials in Yolo County, who requested the expansion, express disappointment.
- SMUD installs an improved automated answering system for customers and adds a Spanish-language version. The new system is simpler to use and gives customers more options.

DECEMBER

- Directors approve a $1.36 billion no-rate-increase budget for SMUD in 2007.
- Directors approve contracts for the purchase and installation of new wind turbines that will add 63 megawatts of renewable generation by the end of 2007.



Directors approve contracts for the purchase and installation of new wind turbines that will add 63 megawatts of renewable generation by the end of 2007.

A legacy of care

THE UTILITY'S ENTITYWIDE EMISSIONS OF CARBON DIOXIDE WERE LOWER IN 2006 THAN THEY WERE IN 1990.

Since 1990, SMUD's retail sales have increased by approximately 30 percent. But due to investment in clean generation and energy efficiency, SMUD's emissions of greenhouse gases have not increased. Year-to-year fluctuations in emissions are driven primarily by the availability of hydroelectricity.

Early to recognize the global warming problem, SMUD first analyzed its own operations to measure emissions of carbon dioxide and other greenhouse gases in 1990.

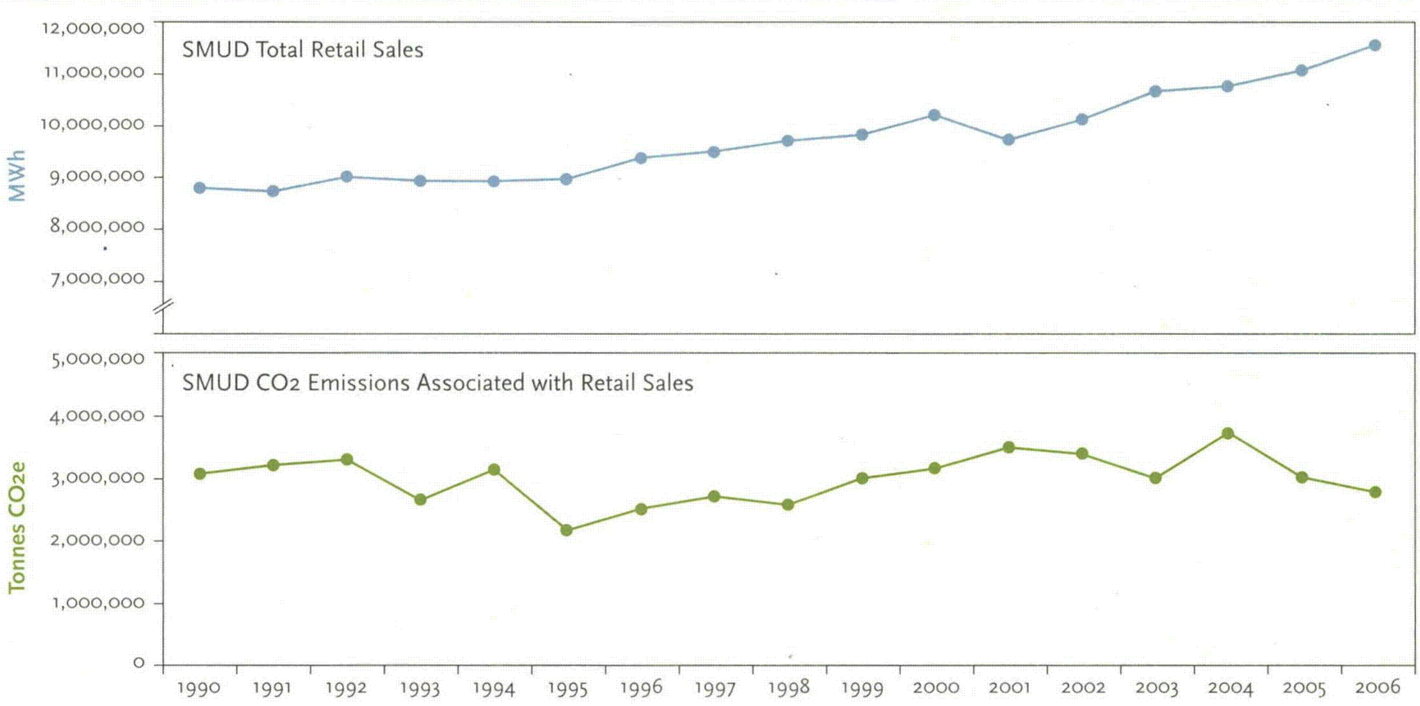
Rooted in its commitment to customers and the community, SMUD has developed an environmental culture and an array of programs that have positioned it to tackle the challenge of global warming.

Sacramento's not-for-profit utility has embraced renewable energy since its earliest days of operation and has a highly successful renewable energy subscription program. It has broad and deep experience in promoting energy efficiency to help its customer-owners save money while sparing the environment. And it has done extensive work on electric vehicles and other alternative modes of transportation.

Early to recognize the global warming problem, SMUD first analyzed its own operations to measure emissions of carbon dioxide and other greenhouse gases in 1990. In 1995, SMUD became a charter signatory to the U.S. Department of Energy's Climate Challenge and pledged to reduce its greenhouse-gas emissions. The utility's entitywide emissions of carbon dioxide were lower in 2006 than they were in 1990.

SMUD became a founding member of the voluntary California Climate Action Registry in 2002. And it was the first registry member to present a certified inventory of its greenhouse gas emissions.

SMUD Retail Electricity Sales vs. Total Emissions

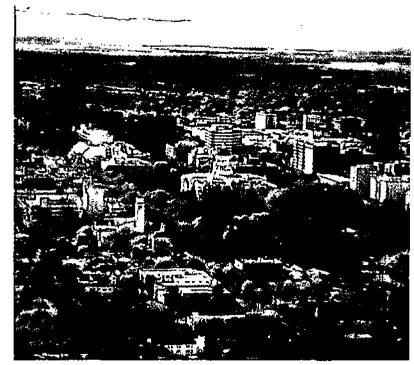


In its 60 years of service, the Sacramento Municipal Utility District has taken its environmental stewardship seriously.

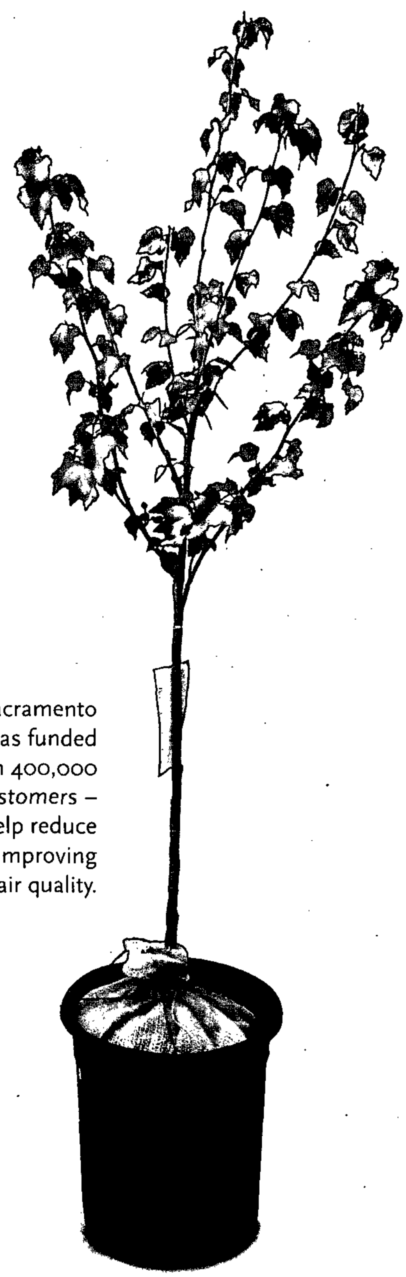
In the United States, and particularly in California, 2006 may be remembered as the year global warming took center stage. The Golden State became the first in the nation to mandate regulation of greenhouse gas emissions from power plants and other industrial operations.

In its 60 years of service, the Sacramento Municipal Utility District has taken its environmental stewardship seriously.

Sacramento's public utility has planted hundreds of thousands of shade trees. It was a pioneer in the development of solar energy. And it was the first utility to endorse the California Global Warming Solutions Act of 2006.

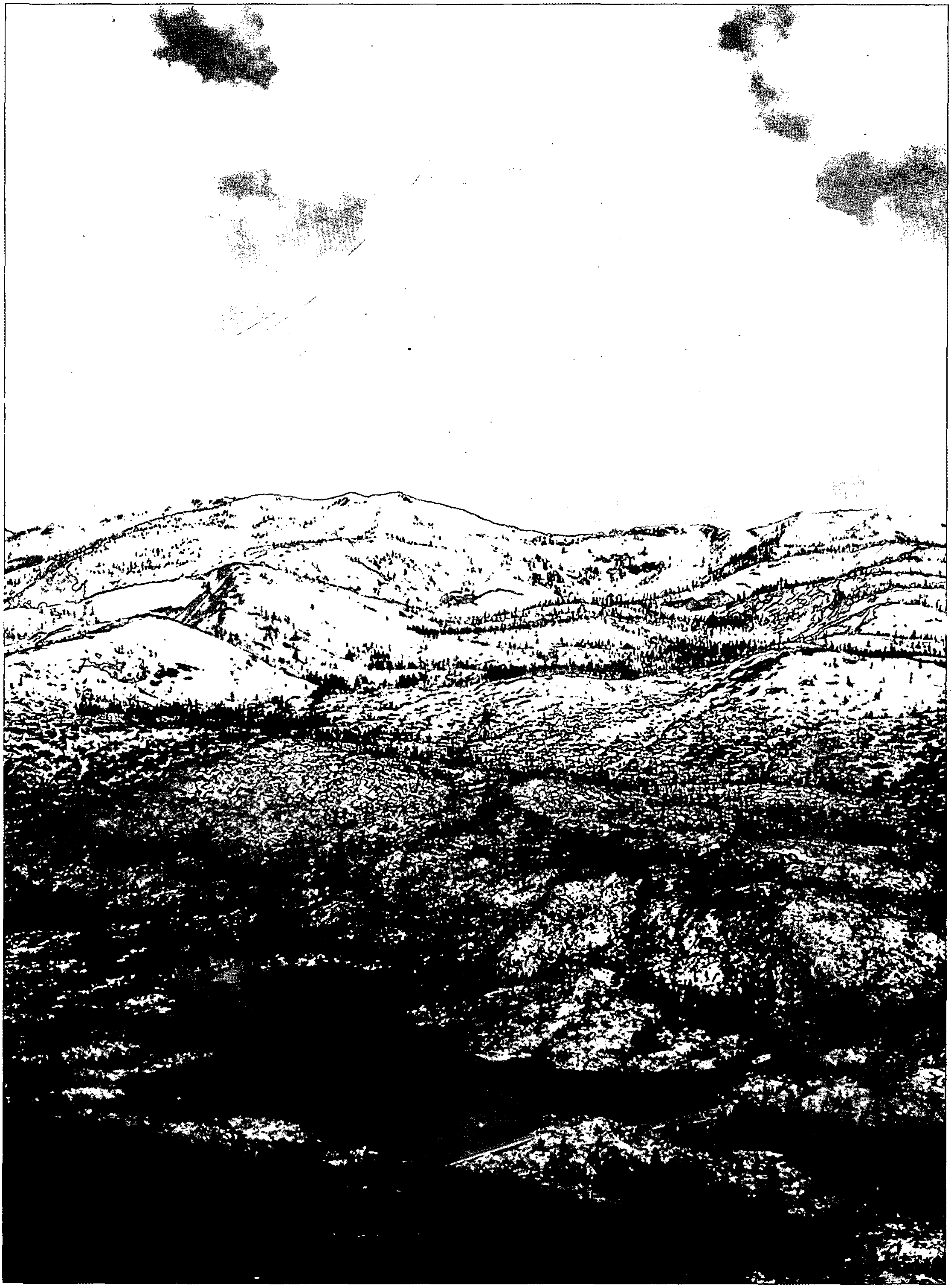


Sacramento is known as the "City of Trees" for good reason.



In collaboration with the Sacramento Tree Foundation, SMUD has funded the planting of more than 400,000 shade trees – *free to customers* – since 1990. Shade trees help reduce home cooling costs while improving the region's air quality.

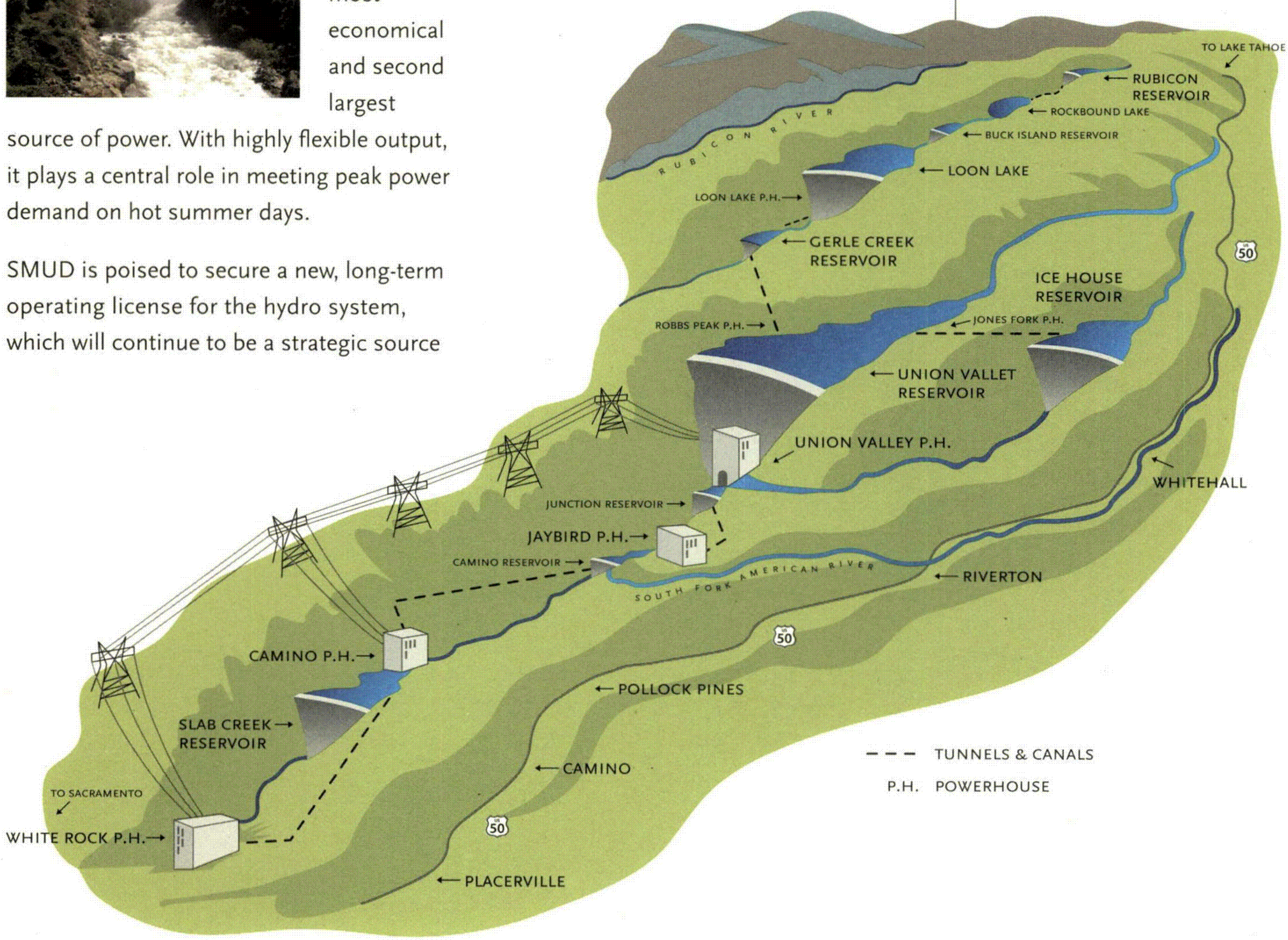
The U.S. Environmental Protection Agency named SMUD one of the nation's "Best Workplaces for Commuters" for encouraging its employees to use alternative forms of transportation to and from work.



SMUD's focus on renewable energy dates back to the 1950s, when it tapped snowmelt and gravity in the Sierra Nevada mountains east of Sacramento. Today, SMUD's hydroelectric system is the capital's most economical and second largest source of power.

SMUD's focus on renewable energy dates back to the 1950s, when it tapped snowmelt and gravity in the Sierra Nevada mountains east of Sacramento. Today, SMUD's hydroelectric system is the capital's most economical and second largest source of power. With highly flexible output, it plays a central role in meeting peak power demand on hot summer days.

SMUD is poised to secure a new, long-term operating license for the hydro system, which will continue to be a strategic source of clean power as SMUD strives to reduce its carbon footprint. Along with a new operating license, SMUD expects to get permission to consider building an off-stream reservoir that could add 400 megawatts of production capacity through a water-recycling concept known as pumped storage.



Leading the way

A decade ago, SMUD launched Greenergy®, which has evolved into one of the nation's largest and most successful subscription programs for clean, renewable energy.

THE AIM IS FOR RENEWABLES TO ACCOUNT FOR 23 PERCENT OF ENERGY SUPPLY BY 2011.

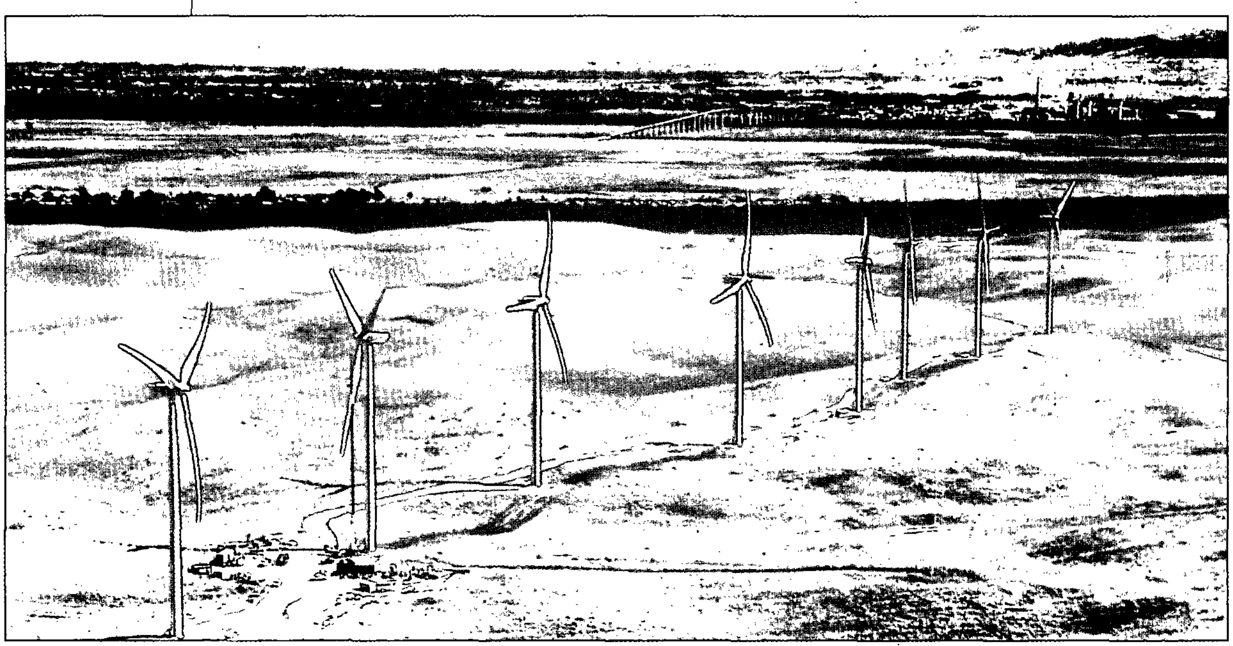
In the early 1980s, SMUD undertook pioneering work with photovoltaics to harness the sun's energy. A decade later, the utility was among the first to foresee the promise of large-scale wind generation. By the mid-1990s, SMUD was producing energy from geothermal, solar and wind sources.

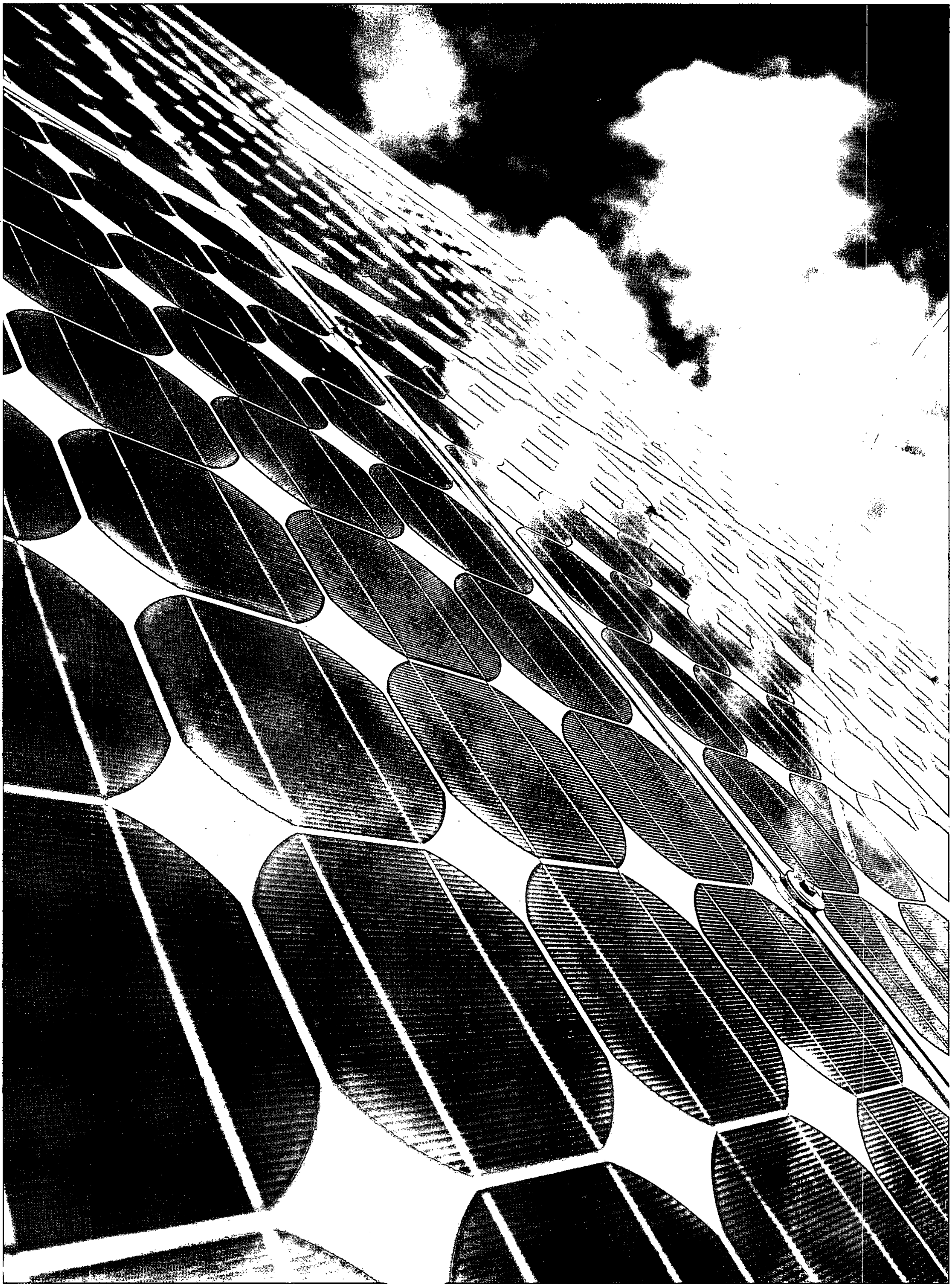
A decade ago, SMUD launched Greenergy®, which has evolved into one of the nation's largest and most successful subscription programs for clean, renewable energy. Today, more than 35,000 SMUD customers voluntarily pay a monthly premium to purchase renewable energy and fund development of new sources of renewable generation.

In 2001, SMUD became the first utility in California to commit to ambitious targets for expanding its renewable-energy portfolio. In 2006, SMUD surpassed its first renewable-portfolio target. The utility's supply of renewable energy was nearly triple what it was in 2003, measured in megawatt hours delivered to customers. Not counting its large hydroelectric system, approximately 13 percent of SMUD's total energy supply came from renewable sources.

SMUD owns or has power purchase contracts for generation produced by wind, biomass, geothermal, small hydroelectric and photovoltaic resources. The utility is working on solar thermal and biogas-to-electricity projects. The aim is for renewables to account for 23 percent of energy supply by 2011.

Wind power is just one of the renewable resources contributing to the Greenergy® power mix.

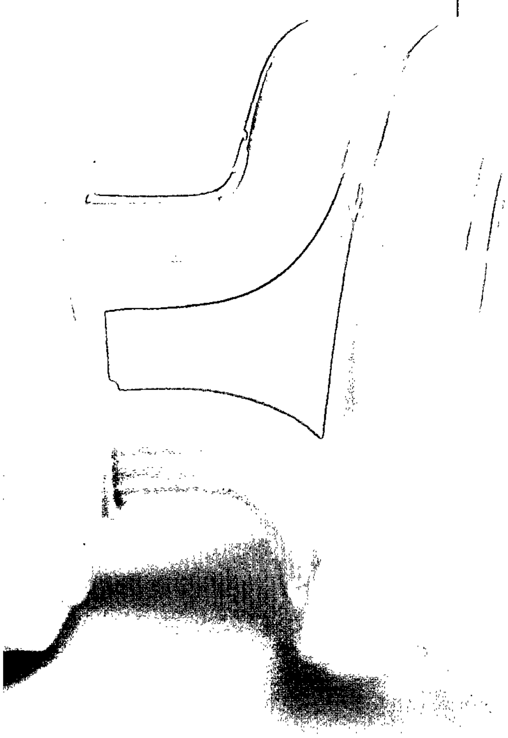




Using energy wisely

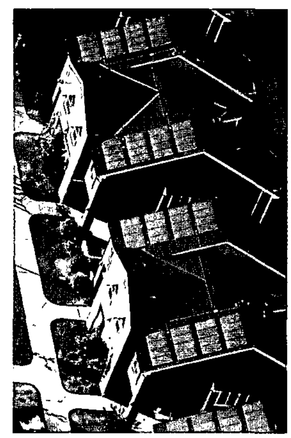
As the new millennium began, the utility joined with builders to push reflective "cool roofs" to help reduce peak energy demand in the hot summer months.

Compact fluorescent bulbs (CFLs) last longer and are better for the environment.



SMUD redoubled its efforts to spread energy efficiency after closing its nuclear power plant in 1989. The not-for-profit utility urged the public to visualize and support the concept of a "conservation power plant."

In the 1990s, SMUD introduced financial incentives to promote compact fluorescent lights and light emitting diode (LED) technology. The utility prodded customers to trade in gas-powered lawn mowers for clean electric mowers. It offered rebates for the purchase of energy-efficient appliances and low-interest loans for dual-pane windows. It paid customers to recycle old energy-guzzling refrigerators. Its program to fund the planting of shade trees to reduce air conditioning needs became a model for utilities nationwide. And as the new millennium began, the utility joined with builders to push reflective "cool roofs" to help reduce peak energy demand in the hot summer months.



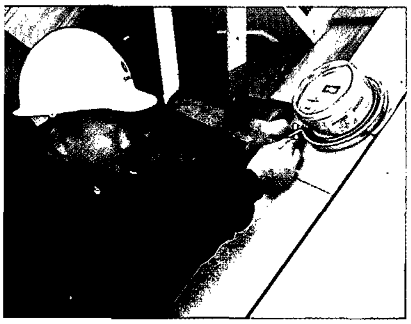
Get customers more involved in managing their energy use and make them partners with SMUD in understanding the environmental consequences of their decisions.

The directors of SMUD are committed to the more efficient use of energy as part of ongoing efforts to determine how best to meet customers' energy needs through the year 2050. Having studied the issue in depth in 2006, directors will decide in the months ahead how best to meet growing demand for electricity while reducing emissions of greenhouse gases and balancing environmental goals with the desire to keep rates affordable.

The aim is to develop new policies and programs that form a "compact with the customer." This compact will give customers choices, get customers more involved in managing their energy use and make them partners with SMUD in understanding the environmental consequences of their decisions.

Monica and Eddie Ortiz took advantage of SMUD's Customer Advanced Technologies program to reduce energy consumption and lower their utility bills at the Grocery Outlet in Rancho Cordova.

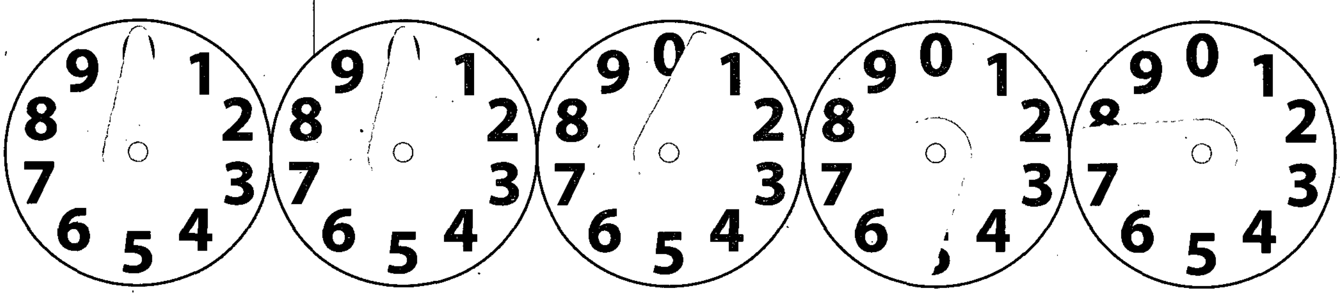
Strategic focus



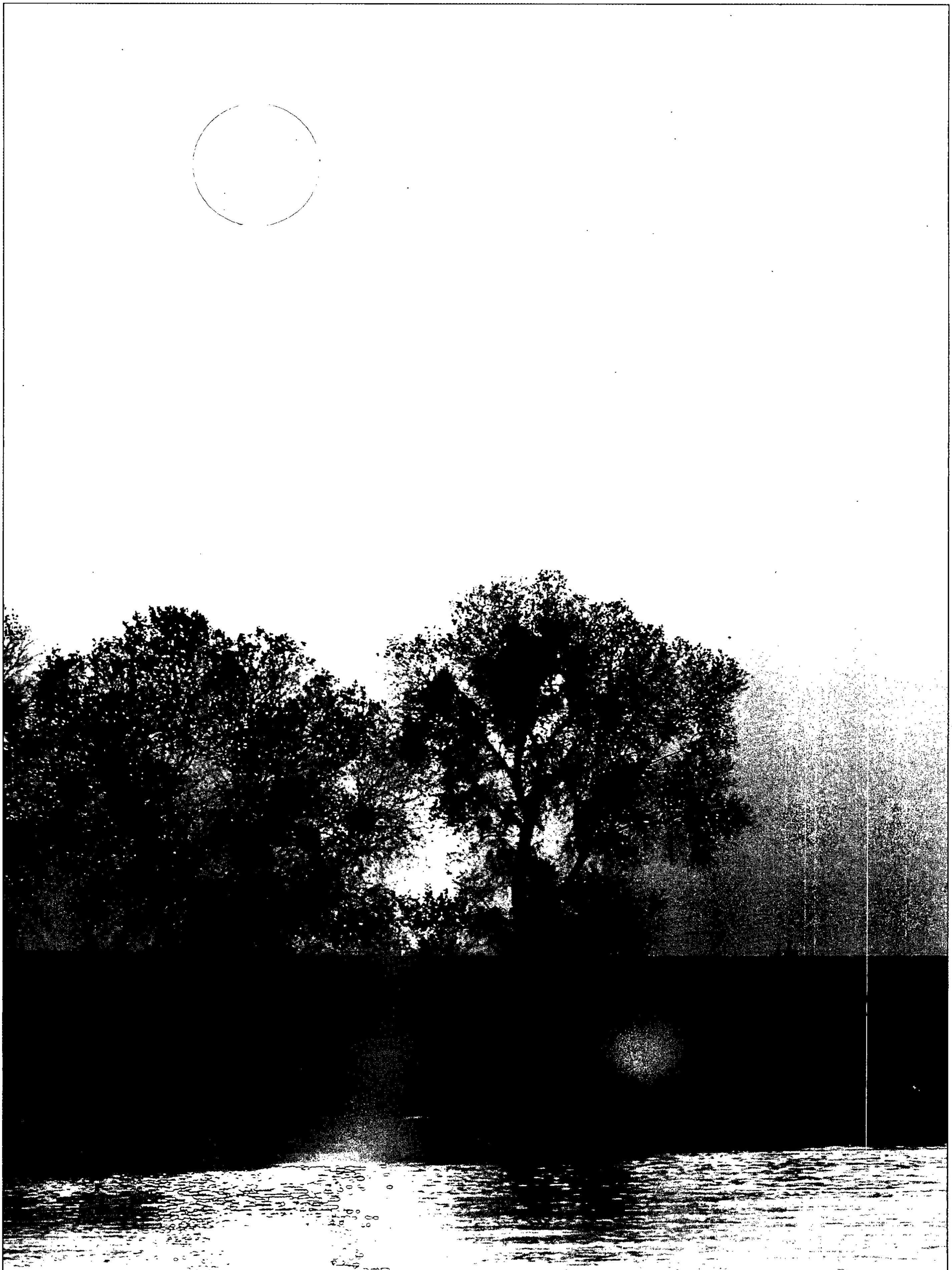
The extra electricity needed to meet spikes in peak energy demand is extremely expensive per kilowatt-hour, and is costly from an environmental perspective as well.

In planning for the future, SMUD will be focusing on reining in peak energy use, which in Sacramento occurs during the hottest hours of summer, when air conditioners are running full tilt. The extra electricity needed to meet spikes in peak energy demand is extremely expensive per kilowatt-hour, and is costly from an environmental perspective as well.

SMUD is looking for solutions that will encourage customers to shift energy use away from the hours of peak demand yet allow them to remain comfortable during Sacramento's hot summers. The utility has begun pilot programs to evaluate how customers will respond to rates that vary with the time of day to more accurately reflect variable energy costs. Results of these studies will help SMUD determine how to get the most mileage out of major investments in the evolving technology of advanced meters.

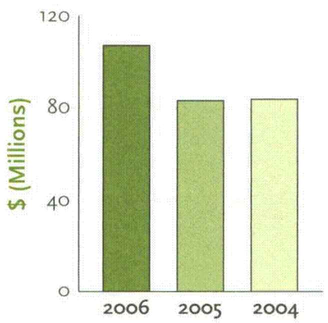


KILOWATT-HOURS



In the black

Net Income



Higher than normal hydroelectric generation and a significant increase in revenues from hot summer weather contributed to an increase in net assets.

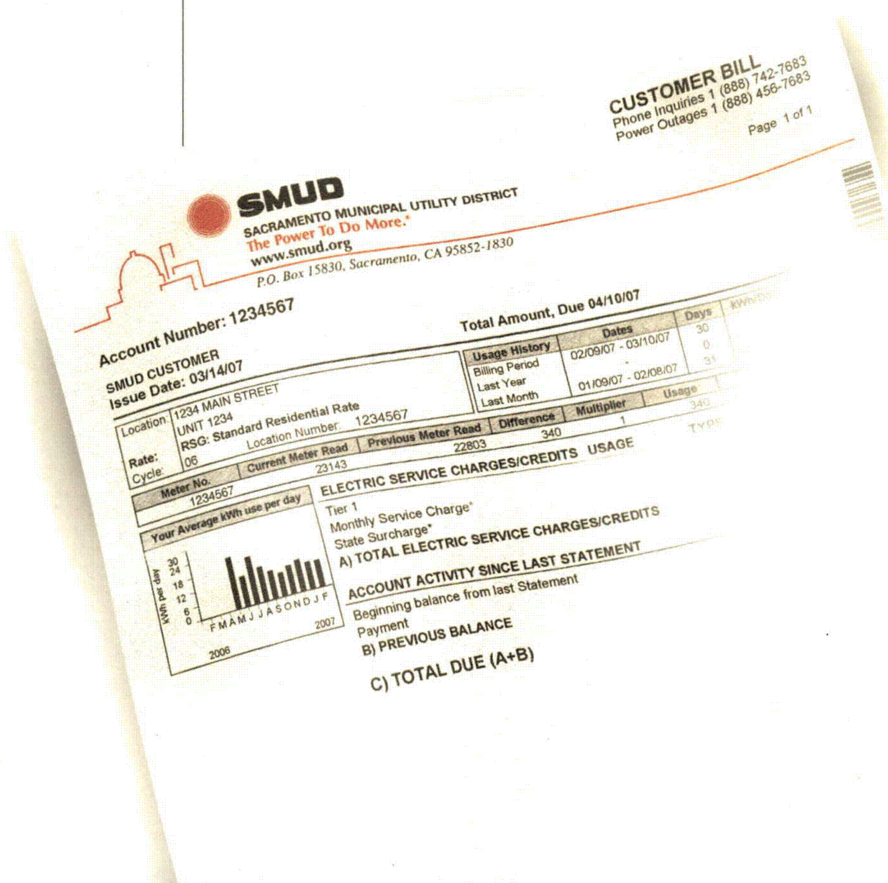
Financially, 2006 was a strong year for Sacramento's customer-owned electric utility.

Higher than normal hydroelectric generation and a significant increase in revenues from hot summer weather contributed to an increase in net assets (net income) of $107.4 million, roughly $58 million more than anticipated.

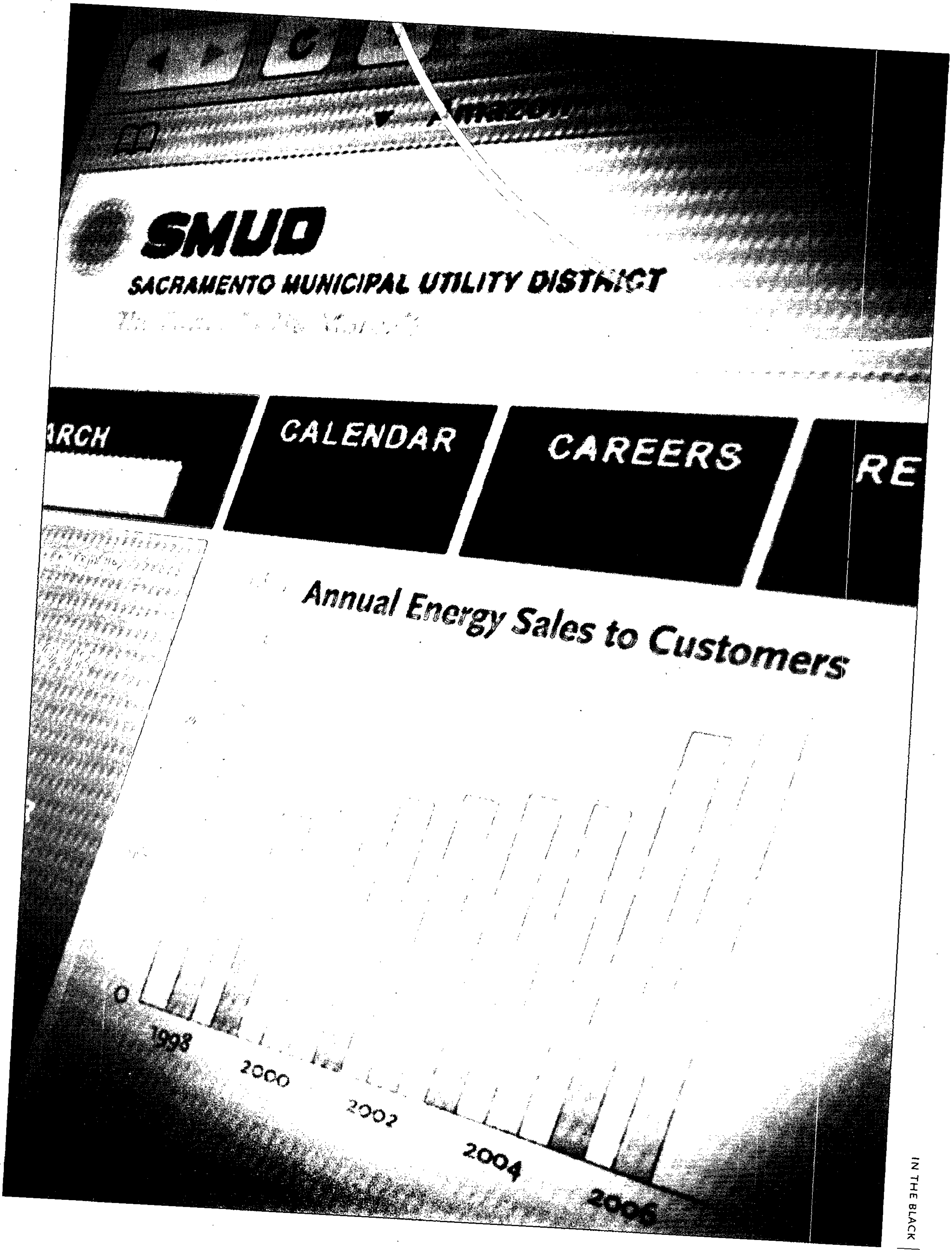
That boosted SMUD's equity level by more than 3 percentage points and moved the utility closer to the equity target the board established in 2003 for year-end 2007.

This bodes well for the utility's credit rating and its continuing ability to borrow money at reasonable rates.

The utility's strategy of purchasing natural gas in advance to hedge the risks associated with volatile prices enabled SMUD to avoid a rate increase in 2006 and adopt a no-rate-increase budget for 2007. Natural gas prices remain stubbornly high, and SMUD will be re-evaluating its revenue needs for 2008 and beyond.



SMUD's strategy of purchasing natural gas in advance has helped keep customers' bills low.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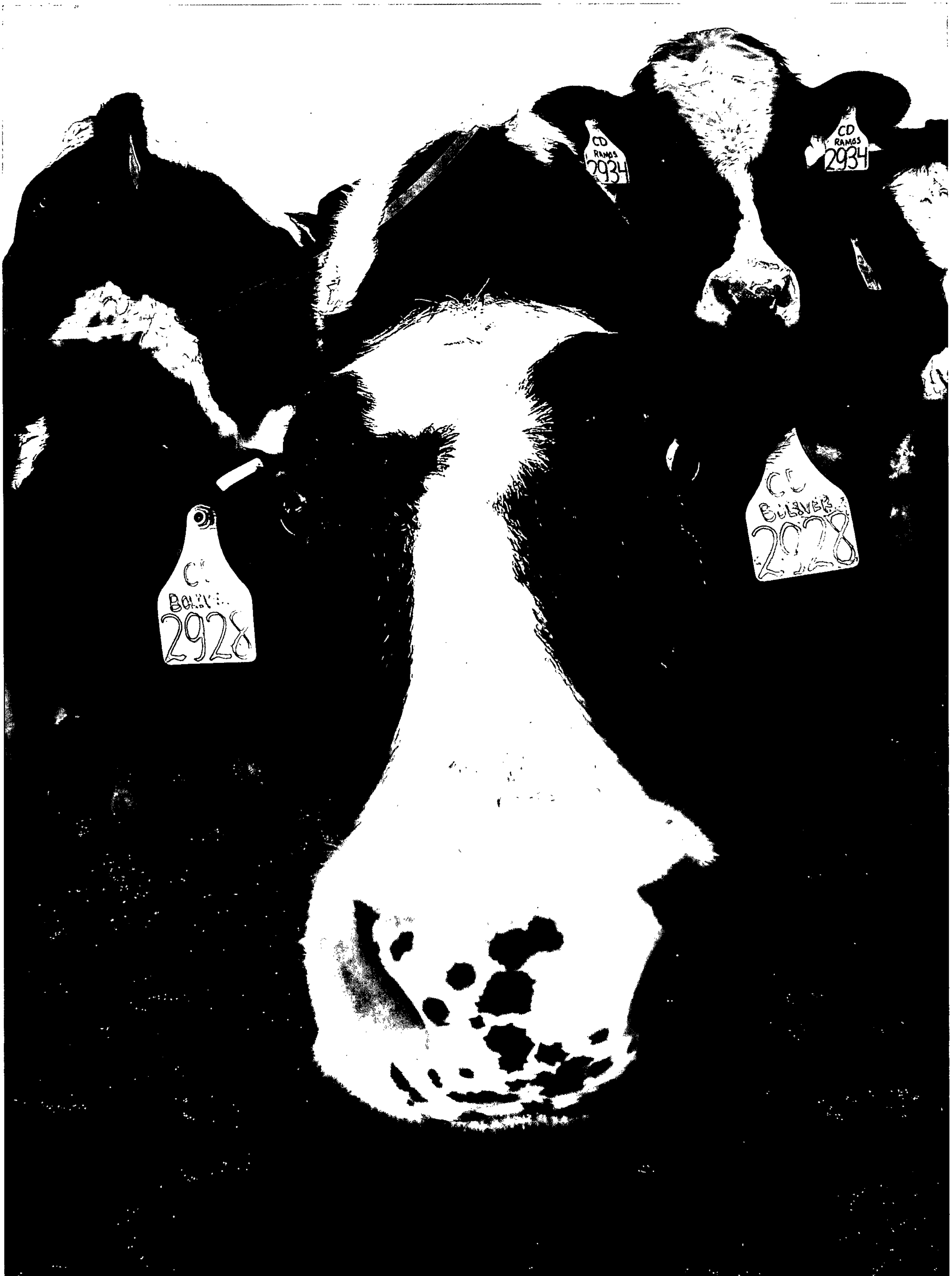
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SMUD will purchase an estimated 3.3 gigawatt-hours of electricity generated annually by the three Sacramento County dairy farms.

Most people are familiar with the benefits of solar and wind power. But renewable energy can be unearthed in less likely places.

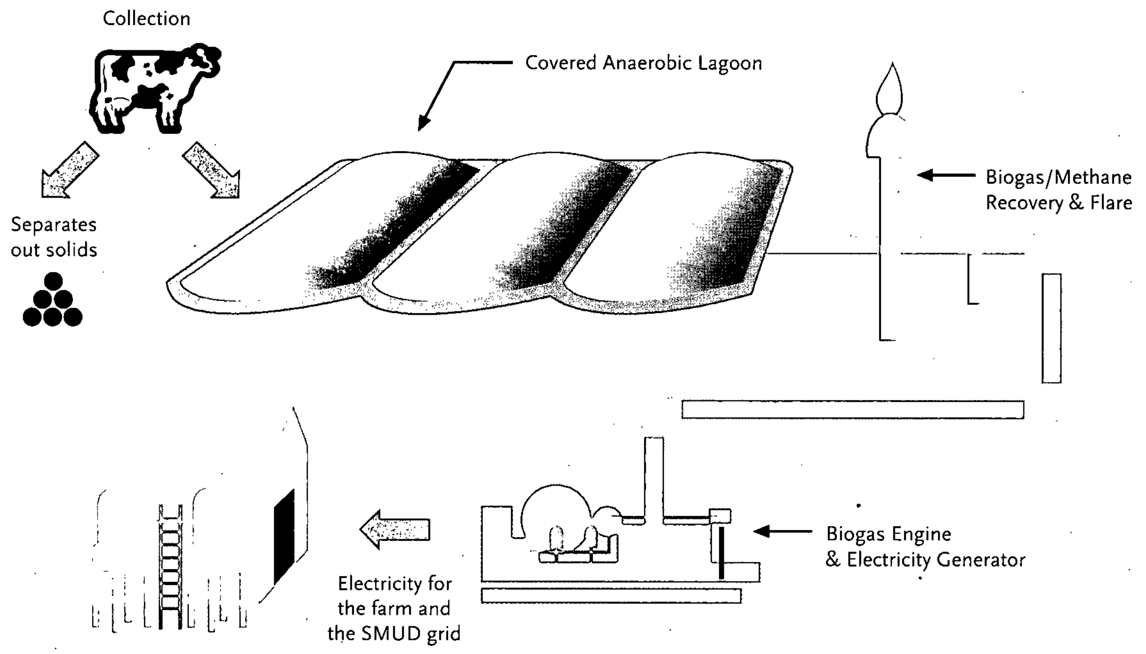
SMUD's Advanced Renewables and Distributed Generation Technology group is working with three Sacramento County dairy farms to tap into a pungent energy supply – cow manure.

Dairy digesters capture methane from cow manure. The digester is an airtight container that uses bacteria to break down manure. The methane from the manure is converted into biogas, which is then combusted in an adjacent generator.

The U.S. Department of Agriculture and the California Energy Commission provide financial incentives for dairy farmers to install methane digesters. To further encourage the advance of this emerging technology, SMUD will purchase an estimated 3.3 gigawatt-hours of electricity generated annually by the three Sacramento County dairy farms beginning in 2007.

This is one example of how SMUD can provide local environmental solutions. And the benefits are global: By capturing this greenhouse gas before it escapes to the atmosphere, dairy digesters make the air cleaner while also producing electricity.

SMUD Dairy Digesters



Dairy digesters capture methane from cow manure and convert it into clean, renewable energy.

The Curtis Park Partnership promotes energy efficiency and renewable resources by helping residents track their energy use. The partnership's goal is to reduce home energy use by 20 percent.

In central Sacramento, Curtis Park residents are fighting global warming one household at a time in a special partnership with SMUD.

The Curtis Park Partnership promotes energy efficiency and renewable resources by helping residents track their energy use. The partnership's goal is to reduce energy usage by 20 percent.

SMUD distributed free DVDs showing how to identify energy waste at home. Participants adjusted their thermostats, installed compact fluorescent lights, washed their clothes in cold water, and discovered myriad other ways to trim energy use. Folks are finding that the little things add up. Together they are making a difference.

The Easterling family is an enthusiastic supporter of the Curtis Park Partnership.

5 Year Summary (Unaudited)

Operating Statistics (i)

	2006	2005	2004	2003	2002
Customers at year-end	585,221	577,946	567,176	553,337	541,296
KWH Sales (thousands)					
Sales to customers —					
Residential	4,760,391	4,534,276	4,446,117	4,372,111	4,093,714
Commercial, industrial & other	6,038,839	5,951,447	5,790,984	5,547,617	5,413,730
Subtotal	10,799,230	10,485,723	10,237,101	9,919,728	9,507,444
Sales of surplus power	3,964,326	1,496,569	858,234	1,547,595	2,502,646
Total	14,763,556	11,982,292	11,095,335	11,467,323	12,010,090
Revenues (thousands of dollars)					
Sales to customers —					
Residential	$ 515,025	$ 480,100	$ 442,704	$ 444,713	$ 411,993
Commercial, industrial & other	566,851	557,305	527,828	516,562	506,613
Subtotal	1,081,876	1,037,405	970,532	961,275	918,606
Sales of surplus power	191,931	73,475	23,856	62,382	66,521
Sales of surplus gas	112,719	114,313	62,022	65,279	29,413
Total (ii)	$ 1,386,526	$ 1,225,193	$ 1,056,410	$ 1,088,936	$ 1,014,540
Average kWh sales per residential customer	9,202	8,909	8,927	8,998	8,629
Average revenue per residential kWh sold (cents)	10.60	10.41	9.91	10.11	10.03
Power supply (thousands of kWh)					
Hydroelectric	2,804,704	2,236,818	1,259,570	1,575,534	1,409,537
Cogeneration	4,775,933	2,196,055	2,417,533	2,292,179	2,482,552
Windpower	73,887	36,828	41,644	27,376	4,521
Photovoltaic	2,323	2,341	2,201	2,380	2,834
Gas turbine	7,918	2,225	13,445	2,568	19,710
Purchases	7,679,518	7,968,762	7,853,322	8,067,294	8,566,718
Net system peak demand — 1 hour (kW)	3,280,000	2,959,000	2,672,000	2,809,000	2,779,000
Equivalent Full Time Employees at year-end	2,213	2,279	2,209	2,219	2,191
Financial Statistics (thousands of dollars)					
Operating revenues	$ 1,354,427	$ 1,225,193	$ 1,068,727	$ 1,032,867	$ 1,012,073
Operating expenses —					
Purchased and interchanged power	388,714	463,710	373,362	387,985	363,338
Operation and maintenance	620,002	461,229	398,696	386,423	400,026
Depreciation and amortization	125,937	107,751	99,754	138,881	134,958
Decommissioning	30,894	29,408	29,166	29,708	31,552
Total operating expenses	1,165,547	1,062,098	900,978	942,997	929,874
Operating income	188,880	163,095	167,749	89,870	82,199
Other income	47,421	26,591	24,972	29,828	39,555
Income before interest charges	236,301	189,686	192,721	119,698	121,754
Interest charges	128,895	106,414	108,860	119,698	121,754
Net increase in net assets	$ 107,406	$ 83,272	$ 83,861	$ -0-	$ -0-
Funds available for revenue bond debt service	$ 345,293	$ 310,257	$ 310,739	$ 254,036	$ 256,413
Revenue bond debt service	$ 174,121	$ 160,036	$ 136,929	$ 119,238	$ 127,487
Revenue bond debt service coverage ratio	1.98	1.94	2.27	2.13	2.01
Electric utility plant — net	$ 2,734,776	$ 2,662,311	$ 2,493,785	$ 2,239,073	$ 1,918,966
Capitalization					
Long-term debt, net of current portion	$ 2,518,309	$ 2,303,188	$ 2,406,325	$ 2,358,710	$ 2,058,280
Customers' equity	$ 492,994	$ 385,588	$ 302,316	$ 218,455	$ 219,652

i Financial information is consolidated (except the debt service information).

ii Prior to the net deferral/transfer of revenues to/from the Rate Stabilization Fund and deferral of Public Good revenue.

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INDEPENDENT AUDITORS' REPORT

Virchow Krause & company

To the Board of Directors of Sacramento Municipal Utility District, Sacramento, California

We have audited the accompanying consolidated balance sheet of Sacramento Municipal Utility District and its blended component units as of December 31, 2006, and the related consolidated statements of revenues, expenses, and changes in net assets and cash flows for the year then ended. These consolidated financial statements are the responsibility of Sacramento Municipal Utility District's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit. The consolidated financial statements of Sacramento Municipal Utility District as of and for the year ended December 31, 2005 were audited by other auditors whose report, dated April 3, 2006, expressed an unqualified opinion on those consolidated financial statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Governmental Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Sacramento Municipal Utility District and its blended component units at December 31, 2006, and the results of their operations and their cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we will also issue a report on our consideration of the overall internal control over financial reporting and on our tests of compliance with certain provisions of laws, regulations, contracts and grants, applicable to Sacramento Municipal Utility District and its blended component units. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audits.

The management's discussion and analysis on pages 28 through 35 is not a required part of the consolidated financial statements, but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Virchow, Krause & Company, LLP

Madison, Wisconsin
February 16, 2007

The following discussion and analysis of the Sacramento Municipal Utility District and its component units (District) financial performance provides an overview of the District's financial activities for the years ended December 31, 2006 and 2005. This discussion and analysis should be read in conjunction with the District's financial statements and accompanying notes, which follow this section.

BACKGROUND

The District was formed by a vote of the electors in 1923, under provisions of the State of California Municipal Utility District Act, and began electric operations in 1947. The District is governed by an elected Board of Directors and has the rights and powers to fix rates and charges for commodities or services furnished, to incur indebtedness and issue bonds or other obligations, and, under certain circumstances, to levy and collect ad valorem property taxes. The District is responsible for the acquisition, generation, transmission, and distribution of electric power to its service area, which includes most of Sacramento County and a small adjoining portion of Placer County.

Setting of Rates

The District's Board of Directors (Board) has autonomous authority to establish the rates charged for all District services. Changes in such rates require formal action, after public hearing, by the Board.

In March 2005, the Board approved an average system rate increase of approximately six percent that was effective in rates beginning April 1, 2005.

Financial Reporting

The District's accounting records are maintained in accordance with generally accepted accounting principles for proprietary funds as prescribed by the Governmental Accounting Standards Board (GASB) and, where not in conflict with GASB pronouncements, accounting principles prescribed by the Financial Accounting Standards Board. The District's accounting records generally follow the Uniform System of Accounts for Public Licensees prescribed by the Federal Energy Regulatory Commission, except as it relates to the accounting for contributions of utility property in aid of construction.

In accordance with Statement of Financial Accounting Standards No. 71, "Accounting for the Effects of Certain Types of Regulation", the Board has taken various regulatory actions for ratemaking purposes that result in the deferral of expense or revenue recognition. As of December 31, 2006, the District had total regulatory costs for future recovery of $212 million, which is a net decrease of $68 million from 2005. The decrease is due primarily to a decrease in the deferred decommissioning liability due to continued decommissioning progress, a decrease the liability to the U.S. Bureau of Reclamation (Bureau) due to the partial assignment of water rights to the Sacramento County Water Agency, a decrease in the deferred liability related to the year-end valuation of precipitation hedges, and a decrease in deferred operation costs for the Transmission Agency of Northern California (TANC). The District also had regulatory credits of $335 million as of December 31, 2006, which is a net decrease of $132 million from 2005. The decrease is primarily due to the change in value of derivative financial instruments. In 2006, certain energy contracts that had previously been classified as derivatives and had been marked to fair market value were reclassified as normal purchases and sales and are not reported as derivatives in the 2006 results. This decrease is partially offset by an increase in the deferral of gains from contribution in aid of construction and an increase of deferred revenues into the Rate Stabilization Fund. The regulatory costs and regulatory credits will be recognized in the consolidated statement of revenues, expenses and changes in net assets in future periods as determined by the Board for ratemaking purposes.

Using This Financial Report

This financial annual report consists of management's discussion and analysis and the consolidated financial statements, including notes to the consolidated financial statements. The financial annual report reflects the activities of the District primarily funded through the sale of energy, transmission, and distribution services to its customer-owners.

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

The consolidated financial statements provide both short-term and long-term information about the District's financial status. The consolidated Balance Sheets include all of the District's assets and liabilities, using the accrual method of accounting, as well as an indication about which assets can be utilized for general purposes, and which assets are restricted as a result of bond covenants, Board action and other commitments. The consolidated Balance Sheets provide information about the nature and amount of resources and obligations at a specific point in time. The consolidated Statements of Revenues, Expenses and Changes in Net Assets report all of the District's revenues and expenses during the periods indicated. The consolidated Statements of Cash Flows report the cash provided and used by operating activities, as well as other cash sources such as investment income and debt financing, and other cash uses such as payments for bond principal and capital additions and betterments.

FINANCIAL HIGHLIGHTS

Condensed Consolidated Balance Sheets
(millions)

	December 31, 2006	2005	2004
Assets			
Electric Utility Plant — net	$ 2,735	$ 2,662	$ 2,494
Restricted and Designated Assets	286	243	251
Current Assets	781	950	629
Noncurrent Assets and Deferred Charges	331	577	527
	$ 4,133	$ 4,432	$ 3,901
Liabilities and Net Assets			
Long-Term Debt — net	$ 2,518	$ 2,303	$ 2,407
Current Liabilities and Deferred Credits	542	877	473
Noncurrent Liabilities and Deferred Credits	580	866	719
Net Assets:			
Invested in capital, net of related debt	252	200	153
Restricted	89	53	44
Unrestricted	152	133	105
	$ 4,133	$ 4,432	$ 3,901

ASSETS

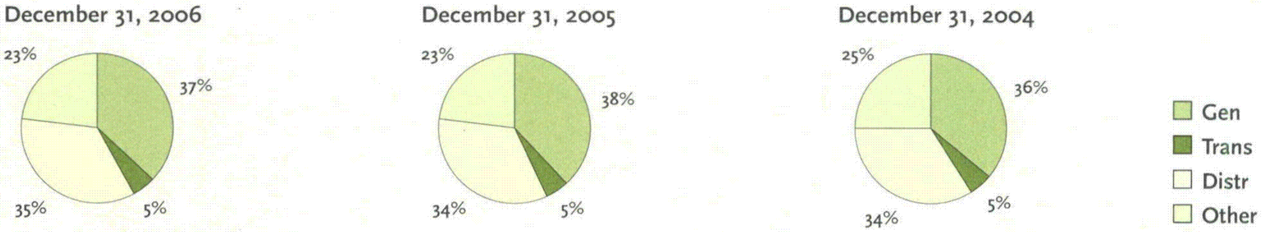
Utility Plant — net

2006 Compared to 2005 The District has invested approximately $2.7 billion in utility plant assets and construction work in progress net of accumulated depreciation at December 31, 2006. Net utility plant makes up about 66 percent of the District's assets, approximately 6 percent more than the previous year. During 2006, the District capitalized approximately $203 million of additions to utility plant, including additions to construction work in progress in the District's consolidated financial statements. This was a result of routine capital additions for generation, transmission, distribution, and general plant.

2005 Compared to 2004 The District has invested approximately $2.7 billion in utility plant assets and construction work in progress net of accumulated depreciation at December 31, 2005. Net utility plant makes up about 60 percent of the District's assets, approximately 4 percent less than the previous year. During 2005, the District capitalized approximately $278 million of additions to utility plant, including additions to construction work in progress in the District's consolidated financial statements. The primary increase was due to the 2005 costs of approximately $101 million for the 500 MW, gas-fired Cosumnes Power Plant project.

The District entered into a contract with Fru-Con Construction Corporation (Fru-Con) to construct the Cosumnes Power Plant project. Unable to resolve the disputes over costs and delays to the satisfaction of the District, the contract was terminated in February 2005. The District is currently in litigation with Fru-Con to resolve these disputes. The District assumed the construction management responsibilities for the completion of the Cosumnes Power Plant project. See Note 18 for additional details.

The following charts show the breakdown of net utility plant by major plant category — Generation (Gen), Transmission (Trans), Distribution (Distr), and Other:



Restricted and Designated Assets

2006 Compared to 2005 The District's level of restricted and designated assets increased by $43 million during 2006 primarily due to an increase in reserve bond funds as a result of the Sacramento Municipal Utility District Financing Authority (SFA) financing, deposits into the Rate Stabilization Fund, and an increased level of collateral for securities lending, partially offset by an increase in the current portion of restricted and designated assets.

2005 Compared to 2004 The District's level of restricted assets decreased by $8 million during 2005 primarily due to a reduction in the decommissioning trust fund balance as the District continues with decommissioning of the Rancho Seco nuclear power plant.

Current Assets

2006 Compared to 2005 Current assets decreased by $169 million in 2006 due to a decrease in unrestricted cash, a decrease in wholesale receivables, a decrease in the deferred precipitation hedge liability, and a decrease in the value of the current portion of derivative financial instruments mainly due to more energy contracts being excluded as normal purchases and sales contracts and lower gas prices. These decreases were partially offset by an increase in restricted and designated cash and cash equivalents, an increase in restricted and designated investments, an increase in retail receivables, and an increase in materials and supplies.

2005 Compared to 2004 Current assets increased by $321 million in 2005 partially due to an increase in credit support collateral of $149 million for energy purchase contracts. The District has begun to employ credit support agreements with which to mitigate large credit exposures with certain energy trading partners. The agreements outline certain specific criteria and requirements for the timely posting of collateral to limit the unsecured portions of the contracts. The increase is also due to the value of derivative financial instruments maturing within one year, an increase in the current portion of restricted and designated assets, a higher level of unrestricted cash, and higher receivables for wholesale energy and gas sales. These increases were partially offset by lower materials and supplies and lower prepayments.

Noncurrent Assets and Deferred Charges

2006 Compared to 2005 Total noncurrent assets and deferred charges decreased by $246 million. This reflects the exclusion of more energy contracts as normal purchases and sales contracts and lower gas prices, the continued decommissioning of the Rancho Seco nuclear power plant, and the assignment of a portion of the liability to the Bureau.

2005 Compared to 2004 Total noncurrent assets and deferred charges increased by $50 million. This reflects an increase in the value of derivative financial instruments and higher conservation loans, partially offset by a decrease in regulatory costs for future recovery reflecting changes in the valuation of derivative financial instruments, which are deferred for ratemaking purposes, the continued decommissioning of the Rancho Seco nuclear power plant and a revised estimate for the liability to the Bureau.

LIABILITIES

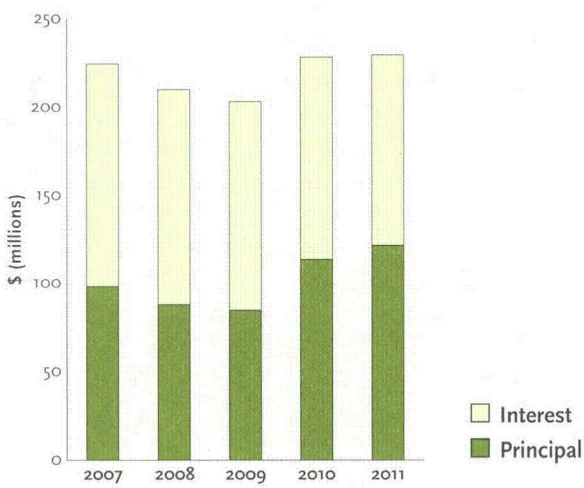
Long-Term Debt

2006 Compared to 2005 In January 2006, the District issued $300 million of 2006 Series SFA Cosumnes Project Revenue Bonds, a component unit of the District. In July 2006, Central Valley Financing Authority (CVFA) redeemed $1.9 million of CVFA Bonds, a component unit of the District, reducing future debt service.

2005 Compared to 2004 During 2005, the District issued $123 million of 2005 Series Sacramento Power Authority (SPA) Revenue Refunding Bonds, a component unit of the District, the proceeds of which plus cash were used to refund $124 million of previously issued SPA bonds. During 2005, the District also redeemed approximately $9 million of CVFA Bonds, and approximately $14 million of Sacramento Cogeneration Authority (SCA) Bonds, both component units of the District, reducing future debt service.

The following table shows the District's future debt service requirements through 2011 as of December 31, 2006:

Debt Service Requirements



As of December 31, 2006, the District had an underlying rating of "A" from both Standard & Poor's and Fitch, and a higher rating of "A1" from Moody's. Most of the District's bonds are insured and are therefore rated "AAA" by the rating agencies.

Current Liabilities and Deferred Credits

2006 Compared to 2005 Current liabilities and deferred credits decreased by approximately $335 million during 2006. In 2005, the District had issued $200 million of Commercial Paper Notes primarily to provide short-term financing for the construction of the Cosumnes Power Plant. During 2006, the District sold the Cosumnes Power Plant to SFA and redeemed the Notes with a portion of the proceeds. Purchased power payable decreased significantly from 2005 reflecting lower power costs. The current portion of credit support collateral for energy purchases decreased to $10 million. Additionally, the current portion of regulatory credits decreased as a result of excluding more energy contracts as normal purchases and sales contracts.

2005 Compared to 2004 Current liabilities and deferred credits increased by approximately $404 million during 2005. The District issued $200 million of Commercial Paper Notes primarily to provide short-term financing for the construction of the Cosumnes Power Plant. Regulatory credits to be recovered in one year increased by approximately $99 million reflecting changes in the valuation of derivative financial instruments. The current portion of credit support collateral for energy purchases, which was implemented in 2005, grew to $58 million. Additionally, purchased power payable increased by approximately $34 million reflecting higher power costs for 2005.

Noncurrent Liabilities and Deferred Credits

2006 Compared to 2005 Noncurrent liabilities and deferred credits decreased by $286 million as a result of excluding more energy contracts as normal purchases and sales contracts, a decrease in the non-current portion of credit support collateral for energy purchases, and a decrease in the decommissioning liability as the District continues with decommissioning of the Rancho Seco nuclear power plant.

2005 Compared to 2004 Noncurrent liabilities and deferred credits have increased by $147 million as a result of the increase in valuation of derivative financial instruments, which are deferred for ratemaking purposes and the non-current portion of credit support collateral for energy purchases, partially offset by a decrease in the decommissioning liability as the District continues with decommissioning of the Rancho Seco nuclear power plant.

Condensed Statement of Consolidated Revenues, Expenses and Changes in Net Assets
(millions)

	December 31, 2006	December 31, 2005	December 31, 2004
Operating revenues	$ 1,354	$ 1,225	$ 1,069
Operating expenses	(1,165)	(1,062)	(901)
Operating income	189	163	168
Interest and other income	47	26	25
Interest charges	(129)	(106)	(109)
Increase in net assets	$ 107	$ 83	$ 84

CHANGES IN NET ASSETS

Operating Revenues

2006 Compared to 2005 Operating revenues were $1,354 million in 2006, an increase from 2005 of $129 million even though $32 million was transferred to the Rate Stabilization Fund in 2006 versus no transfer to or from the Rate Stabilization Fund in 2005. Sales to retail customers were $1,084 million in 2006, an increase of $56 million over 2005 sales. The District sold 3.0 percent more energy to its retail customers, which grew from 577,946 customers in 2005 to 585,221 customers in 2006, at average revenue per kilowatt hour that increased by 2.4 percent, reflecting a full year of the April 2005 rate increase.

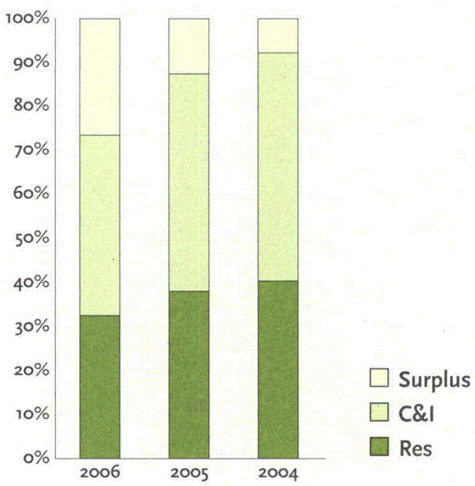
Wholesale revenues are comprised of both surplus energy and gas sales. In 2006, surplus gas sales were $113 million as compared to $114 million in 2005. The amount of surplus gas sold was higher, although at significantly lower average prices. Surplus energy sales in 2006 were $118 million higher than in 2005. The increase is due to higher volume (160 percent) and slightly higher average prices (0.6 percent) than in 2005. Higher surplus energy sales are a result of a number of factors, including higher hydro generation and the timing of hydro generation for reservoir management.

2005 Compared to 2004 Operating revenues were $1,225 million in 2005, an increase from 2004 of $156 million even though no funds were transferred to or from the Rate Stabilization Fund in 2005 versus a $12 million transfer from the Rate Stabilization Fund in 2004. Sales to customers were $1,028 million in 2005, an increase of $65 million over 2004 sales. The District sold 2.4 percent more energy to its retail customers, which grew from 567,176 customers in 2004 to 577,946 customers in 2005, at average revenue per kilowatt hour that increased by 4.3 percent, reflecting the rate increase in 2005.

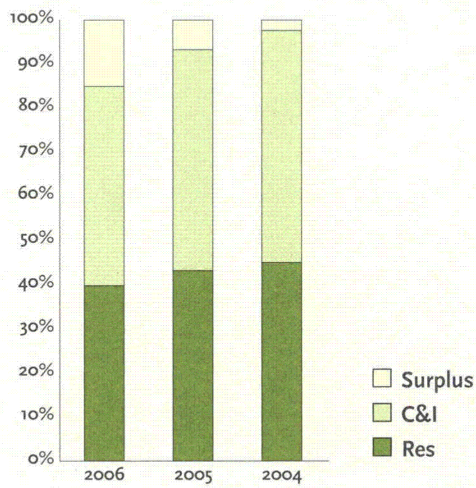
Wholesale revenues are comprised of both surplus energy and gas sales. In 2005, surplus gas sales were $114 million as compared to $62 million in 2004. The increase was primarily due to a higher amount sold (36 percent) as a result of the delayed start-up of the Cosumnes Power Plant. Additionally, the surplus gas sales were at higher average prices (35 percent) as compared to 2004. Surplus energy sales in 2005 were $50 million higher than in 2004. The increase is due to higher volume (74 percent) and higher average prices (77 percent) than in 2004. Higher surplus energy sales are a result of a number of factors, including higher hydro generation, the timing of hydro generation for reservoir management, and test energy from the Cosumnes Power Plant project.

The following charts show the percentage of megawatt hour (MWh) sales and sales revenue in 2006, 2005 and 2004 by surplus energy sales (Surplus), commercial and industrial (C&I), and residential (Res) customers:

MWh Sales



Sales Revenues



Operating Expenses

2006 Compared to 2005 Operating expenses were $1,165 million in 2006 as compared to $1,062 million in 2005. The District's purchased power expense was $75 million lower in 2006 than in 2005. The District spent $87 million less for power purchases in 2006 mainly due to lower market prices and less energy purchased as compared to 2005. The District also reduced purchased power expense by $17 million for a judgment in the Scheduling Coordinator Service (SCS) dispute with PG&E. This was partially offset by an increase to expense of $28 million for precipitation hedge payments in 2006 as a result of the excellent hydro conditions. Approximately 4.6 percent less energy was purchased in 2006 at average prices that were 12.1 percent lower than in 2005. In 2006, fuel costs for generation, a component of production costs, were approximately $182 million, or $104 million higher than 2005. More fuel was used in 2006 (18.6 million decatherms), primarily due to the addition of the Cosumnes Power Plant, at average prices that were 19.0 percent higher than in 2005.

Transmission and distribution operations expense was $3 million higher in 2006 as compared to 2005 due to higher transmission costs relating to the District performing its own control area and scheduling coordinator functions.

The District had higher expenses for administrative and general due to litigation expenses related to the contract disputes with Fru-Con, higher costs due to improvements to customer service, and higher expenditures for public good activities, primarily for energy efficiency.

Depreciation expense increased due to the completion of the Cosumnes Power Plant and additions to plant in service, primarily for general and distribution plant.

In 2006, power supply costs made up approximately 64 percent of total operating expenses as compared to 66 percent for 2005.

2005 Compared to 2004 Operating expenses were $1,062 million in 2005 as compared to $901 million in 2004. The District's purchased power expense was $90 million higher in 2005 than in 2004. The District spent $105 million more for power purchases in 2005 mainly due to higher market prices and some additional energy as compared to 2004. This was partially offset by revenue recognition for the advance payment of the settlement with El Paso Natural Gas in 2005. Approximately 1.5 percent more energy was purchased in 2005 at average prices that were 18 percent higher than in 2004. In 2005, fuel costs for generation, a component of production costs, were approximately $77 million, or $11 million lower than 2004. Less fuel was used in 2005 due to lower JPA generation (1.8 million decatherms) at average prices that were 3.6 percent lower than in 2004.

Transmission and distribution operations expense was $9 million higher in 2005 as compared to 2004 due to higher transmission expenses for the Western Area Power Administration, both for a new transmission contract and higher rates on an existing contract, and the California Independent System Operator.

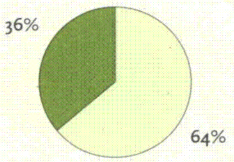
The District had higher expenses for administrative and general due to litigation expenses related to the contract disputes with Fru-Con, and higher expenditures for public good activities primarily for energy efficiency lighting programs.

Depreciation expense increased due to additions to plant in service, primarily for general and distribution plant.

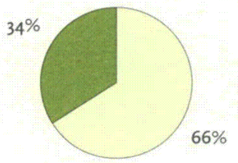
In 2005, power supply costs made up approximately 66 percent of total operating expenses as compared to 63 percent for 2004.

The following charts compare the relative cost of purchased power, production expenses, and depletion of the Rosa gas field (power supply costs) to all other operating expenses in 2006, 2005 and 2004:

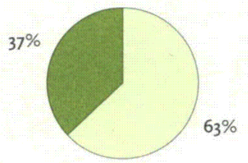
2006 Operating Expenses



2005 Operating Expenses



2004 Operating Expenses



Interest and Other Income

2006 Compared to 2005 Interest and other income was higher by $21 million in 2006 as compared to 2005. Interest income was higher due to higher cash balances and higher interest rates in 2006 as compared to 2005, and interest on the SCS tariff settlement in 2006. Other income was approximately the same in 2006 as in 2005.

2005 Compared to 2004 Interest and other income was higher by $2 million in 2005 as compared to 2004. Interest income was higher due to higher cash balances and higher interest rates in 2005 as compared to 2004. Other income was lower in 2005 primarily as a result of lower JPA earnings and grant revenues, partially offset by lower unrealized holding losses on investments. JPA earnings were lower due to funds being used for debt reduction as opposed to being distributed to the member.

Interest Charges

2006 Compared to 2005 Interest charges in 2006 were $23 million higher than in 2005, which is due primarily to higher allowance for funds used during construction in 2005 as a result of the progress on the Cosumnes Power Plant project and by higher interest on long-term debt as a result of the SFA financing for the Cosumnes Power Plant.

2005 Compared to 2004 Interest charges in 2005 were $2 million lower than in 2004, which is due primarily to higher allowance for funds used during construction as a result of the progress on the Cosumnes Power Plant project, partially offset by higher interest on long-term debt and commercial paper.

Consolidated Balance Sheets

Assets	December 31, 2006	December 31, 2005
	(thousands of dollars)	
Electric Utility Plant		
Plant in service	$ 3,774,843	$ 3,133,248
Less accumulated depreciation and depletion	(1,264,646)	(1,153,096)
Plant in service — net	2,510,197	1,980,152
Construction work in progress	224,579	682,159
Total electric utility plant — net	2,734,776	2,662,311
Restricted and Designated Assets		
Revenue bond, debt service and construction reserves	231,943	178,016
Nuclear decommissioning trust fund	82,315	83,177
Rate stabilization fund	107,100	75,000
Securities lending collateral	76,086	66,136
Other funds	1,181	6,310
Less current portion	(213,065)	(165,124)
Total restricted and designated assets	285,560	243,515
Current Assets		
Unrestricted cash and cash equivalents	202,944	329,457
Restricted and designated cash and cash equivalents	103,118	84,735
Unrestricted investments	11,792	-0-
Restricted and designated investments	109,947	80,389
Receivables — net:		
Retail customers	142,178	128,703
Wholesale	41,799	58,280
Conservation loans due within one year, accrued interest and other	23,204	18,353
Regulatory costs to be recovered within one year	57,763	77,818
Derivative financial instruments maturing within one year	35,503	136,412
Materials and supplies	40,983	28,531
Prepayments	12,155	6,874
Total current assets	781,386	949,552
Noncurrent Assets and Deferred Charges		
Regulatory costs for future recovery	154,134	202,501
Advance capacity payments	36,467	3,701
Derivative financial instruments	48,126	287,512
Unamortized debt issuance costs	33,231	29,645
Conservation loans	45,541	37,573
Preliminary project studies and other	13,444	16,081
Total noncurrent assets and deferred charges	330,943	577,013
Total assets	$ 4,132,665	$ 4,432,391

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

CONSOLIDATED BALANCE SHEETS

Liabilities	December 31, 2006	2005
	(thousands of dollars)	
Long-Term Debt — net	$ 2,518,309	$ 2,303,188
Current Liabilities and Deferred Credits		
Commercial paper notes	-0-	200,000
Accounts payable	88,775	88,584
Purchased power payable	70,562	110,158
Credit support collateral obligation	9,650	57,628
Long-term debt due within one year	98,080	82,340
Accrued decommissioning	54,839	41,514
Accrued interest	43,082	37,097
Accrued salaries and compensated absences	28,836	27,499
Derivative financial instruments maturing within one year	25,725	33,829
Regulatory credits to be recognized within one year	18,879	105,351
Securities lending collateral obligation	76,086	66,136
Customer deposits and other	27,364	27,357
Total current liabilities and deferred credits	541,878	877,493
Noncurrent Liabilities and Deferred Credits		
Accrued decommissioning	197,939	248,479
Derivative financial instruments	22,054	128,860
Regulatory credits	316,198	362,067
Credit support collateral obligation	18,100	90,972
Due to affiliated entity	8,856	15,425
Due to U.S. Bureau of Reclamation	5,790	9,732
Self insurance, deferred credits and other	10,547	10,587
Total noncurrent liabilities and deferred credits	579,484	866,122
Total liabilities	3,639,671	4,046,803
Net Assets		
Invested in capital assets, net of related debt	251,988	200,218
Restricted	89,119	52,827
Unrestricted	151,887	132,543
Total net assets	492,994	385,588
Commitments and Contingencies (Notes 17 and 18)		
Total liabilities and net assets	$ 4,132,665	$ 4,432,391

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

CONSOLIDATED STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

	Year Ended December 31, 2006	2005
	(thousands of dollars)	
Operating Revenues		
Residential	$ 515,025	$ 480,100
Commercial and industrial	572,018	548,113
Street lighting and other	8,611	9,995
Wholesale	304,651	187,788
Test Power	(13,778)	(803)
Rate stabilization fund transfers	(32,100)	-0-
Total operating revenues	1,354,427	1,225,193
Operating Expenses		
Operations:		
Purchased power	388,714	463,710
Production	346,586	234,626
Transmission and distribution	45,424	41,952
Administrative, general and customer	125,498	97,574
Public good	29,009	26,690
Maintenance	65,118	54,146
Depreciation	124,745	106,588
Depletion	8,367	6,241
Decommissioning	30,894	29,408
Regulatory deferrals collected in rates	1,192	1,163
Total operating expenses	1,165,547	1,062,098
Operating Income	188,880	163,095
Nonoperating Revenues and Expenses		
Other revenues		
Interest income	42,773	22,146
Other income — net	4,648	4,445
Total other revenues	47,421	26,591
Interest charges		
Interest on debt	132,198	126,923
Allowance for funds used during construction	(3,303)	(20,509)
Total interest charges	128,895	106,414
Increase in Net Assets	107,406	83,272
Net Assets — Beginning of Year	385,588	302,316
Net Assets — End of Year	$ 492,994	$ 385,588

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended December 31, 2006	2005
	(thousands of dollars)	
Cash Flows from Operating Activities		
Receipts from retail customers	$ 1,075,824	$ 1,025,925
Receipts from surplus power sales	196,271	71,193
Receipts from surplus gas sales	120,451	110,605
Receipts from federal and state grants	2,648	1,355
Receipts from steam sales	9,427	8,555
Other receipts	1,286	4,208
Repayment/receipts for credit support collateral, net	(120,850)	148,600
Issuance/repayment of conservation loans, net	(9,218)	(2,829)
Payments to employees — payroll and other	(206,564)	(174,906)
Payments for wholesale power	(369,869)	(437,517)
Payments for gas purchases	(285,486)	(185,055)
Payments to vendors/others	(116,182)	(72,982)
Payments for weather hedge/insurance	(26,879)	(14,955)
Payments for decommissioning	(35,987)	(37,252)
Net cash provided by operating activities	234,872	444,945
Cash Flows from Investing Activities		
Sales and maturities of securities	337,853	331,378
Purchases of securities	(428,729)	(286,969)
Interest and dividends received	41,007	15,429
Securities lending collateral — net	9,950	(260)
Net cash provided by (used in) investing activities	(39,919)	59,578
Cash Flows from Capital and Related Financing Activities		
Construction expenditures	(236,178)	(258,469)
Contributions in aid of construction	23,706	13,742
Net proceeds from bond issues	306,482	125,722
Repayment and defeasance of debt	(84,240)	(219,645)
Issuance of commercial paper	-0-	200,000
Repayment of commercial paper	(200,000)	-0-
Interest on debt	(120,787)	(121,936)
Net cash used in capital and related financing activities	(311,017)	(260,586)
Net increase (decrease) in cash and cash equivalents	(116,064)	243,937
Cash and cash equivalents at the beginning of the year	470,088	226,151
Cash and cash equivalents at the end of the year	$ 354,024	$ 470,088
Cash and cash equivalents included in:		
Unrestricted cash and cash equivalents	$ 202,944	$ 329,457
Restricted and designated cash and cash equivalents	103,118	84,735
Revenue bond, debt service and construction reserves (a component of the total of $231,943 and $178,016 at December 31, 2006 and 2005, respectively)	47,962	55,896
Cash and cash equivalents at the end of the year	$ 354,024	$ 470,088

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

SUPPLEMENTAL CASH FLOW INFORMATION

A reconciliation of the consolidated statements of cash flows operating activities to operating income is as follows:

	Year Ended December 31, 2006	2005
	(thousands of dollars)	
Operating income	$ 188,880	$ 163,095
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	124,745	106,588
Depletion	8,367	6,241
Regulatory deferrals collected in rates, including decommissioning	32,086	30,571
Amortization of advance capacity	4,711	4,711
Revenue (recognized from) deferred to regulatory credits	33,685	866
Test power revenue capitalized	13,778	804
Federal and State grants revenue	2,648	1,355
Other	(909)	(4,086)
Changes in operating assets and liabilities:		
Customer and wholesale receivables	3,392	(1,327)
Conservation loans	(9,218)	(2,829)
Other assets	(7,223)	6,502
Payables and accruals	(124,083)	169,706
Decommissioning	(35,987)	(37,252)
Net cash provided by operating activities	$ 234,872	$ 444,945

The supplemental disclosure of noncash financing and investing activities is as follows:

	Year Ended December 31, 2006	2005
	(thousands of dollars)	
Loss on defeasance of debt	$ (12)	$ (706)
Amortization of debt related costs	(5,336)	6,115
Unrealized holding loss	778	(14)
Change in valuation of derivative financial instruments	(182,990)	281,795
Assets contributed in aid of construction	6,950	4,591
Allowances for funds used during construction	3,303	20,509
Construction costs included in accounts payable	27,305	39,837

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. ORGANIZATION

The Sacramento Municipal Utility District (District) was formed and operates under the State of California Municipal Utility District Act (Act). The Act confers upon the District the rights and powers to fix rates and charges for commodities or services furnished, to incur indebtedness and issue bonds or other obligations and, under certain circumstances, to levy and collect ad valorem property taxes. As a public utility, the District is not subject to regulation or oversight by the California Public Utilities Commission. The District is responsible for the acquisition, generation, transmission, and distribution of electric power to its service area, which includes most of Sacramento County and a small adjoining portion of Placer County. The Board of Directors (Board) determines the District's rates. The District is exempt from payment of federal and state income taxes and real and personal property taxes.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Method of Accounting. The District's accounting records are maintained in accordance with generally accepted accounting principles for proprietary funds as prescribed by the Governmental Accounting Standards Board (GASB) and, where not in conflict with GASB pronouncements, accounting principles prescribed by the Financial Accounting Standards Board. The District's accounting records generally follow the Uniform System of Accounts for Public Utilities and Licensees prescribed by the Federal Energy Regulatory Commission (FERC), except as it relates to the accounting for contributions of utility property in aid of construction (CIAC). The District's consolidated financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of the related cash flows. Electric revenues and costs that are directly related to generation, purchase, transmission, and distribution of electricity are reported as operating revenues and expenses. All other revenues and expenses are reported as non-operating revenues and expenses.

Use of Estimates. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

The Financial Reporting Entity. These consolidated financial statements include the District and its component units. Although the component units are legally separate from the District, they are blended into and reported as part of the District because of the extent of their operational and financial relationships with the District. All significant inter-component transactions have been eliminated in consolidation.

Component Units. The component units include the Central Valley Financing Authority (CVFA), the Sacramento Cogeneration Authority (SCA), the Sacramento Power Authority (SPA) and the Sacramento Municipal Utility District Financing Authority (SFA). The primary purpose of the component units is to own and operate electric utility plants that supply power to the District. The District's Board comprises the Commissions that govern these entities.

Plant in Service. The cost of additions to Plant in Service and replacement property units is capitalized. Repair and maintenance costs are charged to expense when incurred. When the District retires portions of its Electric Utility Plant, retirements are recorded against Accumulated Depreciation and the retired portion of Electric Utility Plant is removed from Plant in Service. The costs of removal and the related salvage value, if any, are charged or credited as appropriate to

Accumulated Depreciation. The District generally computes depreciation on Plant in Service on a straight-line, service-life basis. The consolidated average annual composite depreciation rates for 2006 and 2005 were 3.54 percent and 3.66 percent. Depreciation is calculated using the following estimated lives:

Generation	5 to 74 years
Transmission and Distribution	5 to 50 years
General	2 to 45 years

Investments in Joint Power Agency (JPA). The District's investment in the Transmission Agency of Northern California (TANC) is accounted for under the equity method of accounting and is reported as a component of Plant in Service. The District's share of the TANC debt service costs and operations and maintenance expense, inclusive of depreciation, are included in Transmission and Distribution expense in the consolidated statements of revenues, expenses and changes in net assets.

Investments in Gas Properties. The District has an approximate 23 percent non-operating ownership interest in the Rosa Unit gas properties in New Mexico of which, the District's portion of the extracted gas is transported for use in its natural gas-fired power plants (see Note 6). The District uses the successful efforts method of accounting for its investment in gas producing properties. Costs to acquire mineral interests in gas properties, to drill and equip exploratory wells that find proved reserves, and to drill and equip development wells are capitalized as a component of Plant in Service on the consolidated balance sheets. Costs to drill exploratory wells that do not find proved reserves, geological and geophysical costs, and costs of carrying and retaining unproved properties are expensed. Capitalized costs of producing gas properties, after considering estimated residual salvage values, are depleted by the unit-of-production method based on the estimated future production of the proved developed producing wells. The District's investment in gas properties is reported as a component of Plant in Service.

Restricted and Designated Assets. Cash, cash equivalents and investments, which are restricted under terms of certain agreements for payments to third parties or Board actions limiting the use of such funds are included as restricted assets.

Restricted Bond Funds. The District's Indenture Agreements and Bond Resolutions require the maintenance of minimum levels of reserves for debt service and certain construction costs intended by the related debt offerings.

Nuclear Decommissioning Trust Fund. The District makes annual contributions to its Nuclear Decommissioning Trust Fund (Trust Fund) to cover the cost of its primary decommissioning activities associated with the Rancho Seco facility. Primary decommissioning excludes activities associated with the spent fuel storage facility after 2008 and most non-radiological decommissioning tasks. The District annually evaluates its contribution rate to ensure the Trust Fund will fully fund primary decommissioning by the end of 2008, the same year in which active decommissioning is planned to be complete (see Note 13). The annual contribution rate is determined in advance of each year, during the budget process, based on calculation of the planned expenditure rate over the remaining number of years estimated to complete the primary decommissioning activities. Changes in the estimate of the decommissioning liability serve to increase the contribution rate in future years (not in the year the estimate is updated, if changed).

Interest earnings on the Trust Fund assets are recorded as Interest Income and are accumulated in the Trust Fund. Annual Decommissioning expense comprises the district's annual contribution to the Trust Fund and the interest earnings on Trust Fund assets during the year.

Accrued Decommissioning. The District accrues decommissioning costs related to Utility Plant when an obligation to decommission facilities is legally required. Adjustments are made to such liabilities based on estimates by District staff in accordance with Statement of Financial Accounting Standards (SFAS) No. 143, *"Accounting for Asset Retirement Obligations" (ARO)*. For active plants, such costs are included in the Utility Plant's cost and included as a component of Depreciation expense over the Utility Plant's life. Expenditures for decommissioning activities are recorded as reductions to Accrued Decommissioning liability. Changes in Rancho Seco decommissioning liability estimates, arising from inflation, annual accretion and other changes to the cost assumptions are recorded directly to Accrued Decommissioning with a corresponding adjustment to the related regulatory deferral. The current portion of the accrued decommissioning liability represents the District's estimate of actual expenditures in the next year, generally as set forth in the annual budget.

The District has identified potential retirement obligations related to certain generation, distribution and transmission facilities. The District's non-perpetual leased land rights generally are renewed continuously because the District intends to utilize these facilities indefinitely. Since the timing and extent of any potential asset retirements are unknown, the fair value of any obligations associated with these facilities cannot be reasonably estimated. Accordingly, a liability has not been recorded.

At December 31, 2006 and 2005, the District's Accrued Decommissioning balance in the consolidated balance sheets relating to Rancho Seco was $247.5 million and $284.9 million, respectively (See Note 13). The Accrued Decommissioning balance in the consolidated balance sheets relating to other electricity generation and gas production facilities totaled $5.3 million and $5.1 million as of December 31, 2006 and 2005, respectively.

Securities Lending Transactions. The District lends its securities to broker-dealers and other entities for collateral with a simultaneous agreement to return the collateral for the same securities in the future. District policy requires cash collateral of 102 percent of the market value of the loaned securities. Both the investments purchased, with the collateral received, and the related liability to repay the collateral are included in the consolidated balance sheets.

Cash and Cash Equivalents. Cash and cash equivalents include all debt instruments purchased with an original maturity of 90 days or less and all investments in the Local Agency Investment Fund (LAIF), and money market mutual funds. LAIF has an equity interest in the State of California (State) Pooled Money Investment Account (PMIA). PMIA funds are on deposit with the State's Centralized Treasury System and are managed in compliance with the California Government Code, according to a statement of investment policy which sets forth permitted investment vehicles, liquidity parameters and maximum maturity of investments. The District's deposits with LAIF comprise cash representing demand deposits up to $40.0 million maximum and cash equivalents representing amounts above $40.0 million which are able to be withdrawn after a thirty day period. The debt instruments and money market mutual funds are reported at amortized cost which approximates fair value and the LAIF is reported at the value of its pool shares.

Investments. The District's investments are reported at fair value. Realized and unrealized gains and losses are included in Interest and Other Income in the consolidated statements of revenues, expenses and changes in net assets. Premiums and discounts on zero coupon bonds are amortized using the effective interest method. Premium and discounts on other securities are amortized using the straight-line method, which approximates the effective interest method.

Electric Operating Revenues. Electric revenues are billed on the basis of monthly cycle bills and are recorded as revenue when the electricity is delivered. The District records an estimate for unbilled revenues earned from the dates its retail customers were last billed to the end of the month. At December 31, 2006 and 2005, unbilled revenues were $65.1 million and $56.3 million, respectively.

Purchased Power Expenses. A portion of the District's power needs are provided through power purchase agreements. Expenses from such agreements, along with associated transmission costs paid to other utilities, are charged to Purchased Power expense, on the consolidated statements of revenues, expenses and changes in net assets, in the period the power is received. The costs, or credits, associated with energy swap agreements (gas and electricity) or other arrangements that affect the net cost of Purchased Power, are recognized in the period in which the underlying power delivery occurs. Contract termination payments and adjustments to prior billings are included in Purchased Power expense once the payments or adjustments can be reasonably estimated.

Advanced Capacity Payments. Some long-term agreements to purchase energy from other providers call for up-front payment. Such costs are generally recorded as an asset and amortized over the length of the contract. One advance capacity contract, with a fair value of $103.4 million at December 31, 2005, was accounted for as a derivative financial instrument. In 2006 it was reassessed and determined to be within normal purchases and normal sales and has been reclassified to Advanced Capacity Contracts on the Consolidated Balance Sheets. (see Note 9).

Credit and Market Risk. The District enters into forward purchase and sales commitments for physical delivery of gas and electricity with utilities and power marketers. The District is exposed to credit risk related to nonperformance by its wholesale counterparties under the terms of these contractual agreements. In order to limit the risk of counterparty default, the District has a wholesale counterparty evaluation policy, which includes the assignment of internal credit ratings to the District's counterparties based on counterparty and/or debt ratings, the requirement for credit enhancements for counterparties that do not meet an acceptable risk level, and the use of standardized agreements that allow for the netting of positive and negative exposures associated with a single counterparty. The District is also subject to similar requirements for many of its gas and electricity purchase agreements. As of December 31, 2006 and 2005, the District held $27.8 million and $148.6, respectively, on deposit by counterparties. The amount is recorded as unrestricted cash with an associated short-term and long-term liability. On January 23, 2007, the District entered into a $50 million letter of credit facility to support collateral requirements under the District's various energy and natural gas purchase, sale and swap agreements.

Accounts Receivable and Allowance for Doubtful Accounts. Accounts Receivable are recorded at the invoiced amount and do not bear interest except for accounts related to energy loans. The District recognizes an estimate of uncollectible accounts for its receivables related to electric service, wholesale activities and conservation loans based upon its historical experience with collections, and current energy market conditions. For large wholesale receivable balances, the District determines its bad debt reserves based on the specific credit issues for each account. The District records bad debts for its estimated uncollectible accounts related to electric service and wholesale activities as a reduction to the related operating revenues in the consolidated statements of revenues, expenses and changes in net assets. The District records bad debts for its estimated uncollectible accounts related to energy loans in Administrative, General and Customer expense in the consolidated statements of revenues, expenses and changes in net assets.

The summarized activity of the changes in the allowance for doubtful accounts during 2006 and 2005 is presented below (thousand of dollars):

	Balance at beginning of Year	Additions	Write-offs and Recoveries	Balance at end of Year
California ISO and PX:				
December 31, 2006	$ 24,274	$ 303	$ -0-	$ 24,577
December 31, 2005	23,928	346	-0-	24,274
Wholesale power and other:				
December 31, 2006	$ 913	$ 484	$ 92	$ 1,305
December 31, 2005	3,895	1,006	3,988	913
Retail Customers:				
December 31, 2006	$ 2,556	$ 5,320	$ 4,887	$ 2,989
December 31, 2005	2,883	4,089	4,416	2,556
Conservation Loans:				
December 31, 2006	$ 1,113	$ 396	$ 139	$ 1,370
December 31, 2005	1,254	-0-	141	1,113

Regulatory Deferrals. The Board has the authority to establish the level of rates charged for all District services. As a regulated entity, the District's financial statements are prepared in accordance with SFAS No. 71, *"Accounting for the Effects of Certain Types of Regulation"*, which requires that the effects of the rate-making process be recorded in the financial statements. Accordingly, certain expenses and credits, normally reflected in Net Increase (Decrease) in Net Assets as incurred, are recognized when included in rates and recovered from, or refunded to customers. The District records various regulatory assets and credits to reflect rate-making actions of the Board.

Materials and Supplies. Materials and supplies are stated at average cost, which approximates the first-in, first-out method.

Unamortized Debt Issuance Costs. The costs incurred in connection with the issuance of debt obligations, principally underwriter's fees and legal costs, are recorded as Unamortized Debt Issuance Costs in the consolidated balance sheets and are amortized over the terms of the related obligations using the bonds outstanding method, which approximates the effective interest method.

Compensated Absences. The District accrues vacation leave and compensatory time when the employees earn the rights to the benefits. The District does not record sick leave or other leave as a liability until it is taken by the employee, since there are no cash payments for sick leave or other leave made when employees terminate or retire. At December 31, 2006 and 2005, the total estimated liability for vacation and other compensated absences was $21.1 million and $20.5 million, respectively.

Public Good. Public Good expenses consist of non-capital expenditures for energy efficiency programs, renewable energy resources and technologies research.

Gains/Losses on Bond Refundings. Gains and losses resulting from bond refundings are included as a component of Long-Term Debt on the consolidated balance sheets and amortized as a component of Interest on Debt in the consolidated statements of revenues, expenses and changes in net assets, over the shorter of the life of the refunded debt or the new debt using the bonds outstanding method, which approximates the effective interest method.

Gains/Losses on Bond Defeasances. Gains and losses resulting from bond defeasances that were not financed with the issuance of new debt are included as a component of Interest on Debt in the consolidated statements of revenues, expenses and changes in net assets.

Allowance for Funds Used During Construction. The District capitalizes, as an additional cost of Construction Work In Progress (CWIP), an Allowance for Funds Used During Construction (AFUDC), which represents the cost of borrowed funds used for such purposes. The amount capitalized is determined by a formula prescribed by FERC. The AFUDC rates for 2006 and 2005 were 4.0 percent and 4.1 percent of eligible CWIP, respectively.

Derivative Financial Instruments. The District records derivative financial instruments (interest rate swap and gas price swap agreements, certain wholesale sales agreements, certain electricity purchase agreements and option agreements) at fair value on its consolidated balance sheets. The District generally does not enter into agreements for trading purposes. However, the District does not elect hedge accounting. Fair market value is estimated by comparing contract prices to forward market prices quoted by third party market participants and/or provided in relevant industry publications. The Board defers recognition of the unrealized gains or losses from such instruments for rate-making purposes. The District is exposed to risk of nonperformance if the counterparties default or if the swap agreements are terminated. The District reports derivative financial instruments with remaining maturities of one year or less and the next twelve months portion of long-term contracts as current on the consolidated balance sheets.

Interest Rate Swap Agreements. The District enters into interest rate swap agreements to modify the effective interest rates on outstanding debt. Interest expense is reported net of the swap payments received or paid as a component of Interest on Debt in the consolidated statements of revenues, expenses and changes in net assets.

Gas and Electricity Price Swap and Option Agreements. The District uses forward contracts to hedge the impact of market volatility on gas commodity prices for its gas-fueled power plants and for energy prices on purchased power for the District's retail load. Net cash payments or receipts incurred under the price swap and option agreements are reported as a component of Production for fuel related contracts and Purchased Power for electricity contracts in the consolidated statements of revenues, expenses and changes in net assets over the periods of the agreements.

Precipitation Hedge Agreements. The District enters into non-exchange traded precipation hedge agreements to hedge the increased cost of power caused by low precipitation years (Precipitation Agreements). The District records the intrinsic value of the Precipitation Agreements on the consolidated balance sheets. Settlement of the Precipitation Agreements is not performed until the end of the period covered (water year ended September 30). The intrinsic value of a Precipitation Agreement is the difference between the expected results from a monthly allocation of the cumulative rainfall amounts, in a normal rainfall year, and the actual rainfall during the same period.

Insurance Programs. The District records liabilities for unpaid claims at their present value when they are probable of occurrence and the amount can be reasonably estimated. The District records a liability for unpaid claims associated with general, auto, workers' compensation, and short-term and long-term disability, based upon estimates derived by the District's claims administrator or District staff. The liability comprises the present value of the claims outstanding, and includes an amount for claim-events incurred but not reported based upon the District's experience.

Net Assets. The District classifies its net assets into three components as follows:

- **Invested in capital assets, net of related debt** — This component of net assets consists of capital assets, net of accumulated depreciation reduced by the outstanding debt balances, net of unamortized debt expenses.
- **Restricted** — This component consists of net assets with constraints placed on their use, either externally or internally. Constraints include those imposed by Debt Indentures (excluding amounts considered in net capital, above), grants or laws and regulations of other governments, or by law through constitutional provisions or enabling legislation or by the Board.
- **Unrestricted** — This component of net assets consists of net assets that do not meet the definition of "invested in capital, net of related debt" or "restricted."

Contributions in Aid of Construction. The District records CIAC from customer contributions, primarily relating to expansions to the District's distribution facilitates, as Nonoperating Revenues in the consolidated statements of revenues, expenses and changes in net assets. Contributions of capital are valued at estimated market cost. For rate-making purposes, the Board does not recognize such revenues when received; rather CIAC is included in revenues as such costs are amortized over the estimated useful lives of the related distribution facilities.

Grants. The District receives grant proceeds from federal and state assisted programs for its advanced and renewable technologies, electric vehicle, and energy efficiency programs. The District also periodically receives grant proceeds from federally assisted programs as partial reimbursements for costs it has incurred as a result of storm damages. When applicable, these programs may be subject to financial and compliance audits pursuant to regulatory requirements. The District considers the possibility of any material disallowances to be remote. During 2006 and 2005, the District recognized grant proceeds of $2.8 million and $1.0 million, respectively, as a component of Interest and Other Income, in the consolidated statements of revenues, expenses and changes in net assets.

Implementation of GASB Statement No. 40. In 2005, the District implemented GASB Statement (SGAS) No. 40, *"Deposit and Investment Risk Disclosures — an amendment of GASB Statement No. 3"*. SGAS No. 40 requires disclosure of credit risk, concentration of credit risk, interest rate risk, and foreign currency risk and modifies previous custodial credit risk disclosure requirements.

Recent Accounting Pronouncements. In June 2004, GASB issued SGAS No. 45, *"Accounting and Financial Reporting by Employers for Postemployment Benefits other than Pensions" (OPEB)*, which establishes standards of accounting and financial reporting for OPEB expense and related OPEB liabilities or assets. OPEB arises from an exchange of salaries and benefits for employee services rendered. It refers to postemployment benefits other than pension benefits such as postemployment healthcare benefits. This Statement is effective for the District beginning in 2007. The District's estimate of its OPEB obligation is approximately $262.5 million as of December 31, 2006.

Reclassifications. Certain amounts in the 2005 consolidated financial statements have been reclassified in order to conform with the 2006 presentation.

NOTE 3. ACCOUNTING CHANGE

GASB 47. Effective January 1, 2006, the District adopted SGAS No. 47, *"Accounting for Termination Benefits"*. GASB No. 47 establishes standards of accounting and financial reporting for termination benefits. Termination benefits are benefits provided to employees as an incentive to hasten the termination of services, as a result of a voluntary early termination, or as a consequence of involuntary early termination. Under the standard, all termination benefits, including voluntary and involuntary benefits, must be recorded as a liability and expense. Upon initial recognition, a liability is recorded for voluntary termination benefits when the employees accept the offer and amounts can be estimated. Involuntary termination benefits should be recognized when the plan has been communicated to employees and amounts can be estimated. Measurement of the liability should be updated over future service periods.

The District has identified a termination benefit liability related to certain employees at the Rancho Seco Decommissioning site, which will complete non-radiological decommissioning in 2010. There are voluntary separation programs and retention agreements for certain employees, and if required reductions have not been achieved, an involuntary separation program will be instituted. Benefits provided include up to six months of paid COBRA medical benefits, outplacement services and severance, based on length of service and type of termination agreement. As of December 31, 2006, 24 employees had retention agreements totaling $1.6 million, recorded as a component of Customer Deposits and Other on the Consolidated Balance Sheets. Prior to the new standard, the District has recorded termination benefits, therefore, no initial amount was reported as an adjustment to net assets.

NOTE 4. UTILITY PLANT

The summarized activity of the District's utility plant during 2006 is presented below (thousands of dollars):

	Balance December 31, 2005	Additions	Transfers and Deletions	Balance December 31, 2006
Nondepreciable Utility Plant:				
Land	$ 73,477	$ 13,645	$ -0-	$ 87,122
CWIP	682,160	189,238	(646,819)	224,579
Total nondepreciable utility plant	755,637	202,883	(646,819)	311,701
Depreciable Utility Plant:				
Generation	811,072	465,705	(1,638)	1,275,139
Transmission	188,169	11,566	(4,923)	194,812
Distribution	1,241,704	90,477	(6,178)	1,326,003
Investment in gas properties	144,777	15,254	-0-	160,031
Investment in JPAs	9,649	336	-0-	9,985
General	664,399	64,055	(6,703)	721,751
	3,059,770	647,393	(19,442)	3,687,721
Less: accumulated depreciation and depletion	(1,150,513)	(132,873)	21,636	(1,261,750)
Less: accumulated amortization on JPAs	(2,583)	(313)	-0-	(2,896)
	(1,153,096)	(133,186)	21,636	(1,264,646)
Total depreciable plant	1,906,674	514,207	2,194	2,423,075
Total Utility Plant — net	$ 2,662,311	$ 717,090	$ (644,625)	$ 2,734,776

The summarized activity of the District's utility plant during 2005 is presented below (thousands of dollars):

	Balance December 31, 2004	Additions	Transfers and Deletions	Balance December 31, 2005
Nondepreciable Utility Plant:				
Land	$ 65,845	$ 7,632	$ -0-	$ 73,477
CWIP	607,936	271,942	(197,718)	682,160
Total nondepreciable utility plant	673,781	279,574	(197,718)	755,637
Depreciable Utility Plant:				
Generation	803,762	10,957	(3,647)	811,072
Transmission	184,834	3,597	(262)	188,169
Distribution	1,169,238	80,912	(8,446)	1,241,704
Investment in gas properties	136,975	7,802	-0-	144,777
Investment in JPAs	9,645	4	-0-	9,649
General	583,451	93,236	(12,288)	664,399
	2,887,905	196,508	(24,643)	3,059,770
Less: accumulated depreciation and depletion	(1,065,631)	(112,643)	27,761	(1,150,513)
Less: accumulated amortization on JPAs	(2,270)	(313)	-0-	(2,583)
	(1,067,901)	(112,956)	27,761	(1,153,096)
Total depreciable plant	1,820,004	83,552	3,118	1,906,674
Total Utility Plant — net	$ 2,493,785	$ 363,126	$ (194,600)	$ 2,662,311

In 2002, the District began active development of the Cosumnes Power Plant (CPP Project), a 500 megawatts (MW) natural gas-fueled generation facility located on the Rancho Seco site. The CPP Project became operational on February 24, 2006 (see note 6 for component unit information and note 18 relating to construction contract issues). Included in Utility Plant and CWIP at December 31, 2006 and 2005, are cumulative capitalized costs of $469.3 million and $459.6 million, respectively, relating to the CPP Project's construction and development, including the related natural gas pipeline.

NOTE 5. INVESTMENT IN JOINT POWERS AGENCY

TANC. The District and fourteen other California municipal utilities are members of TANC, a JPA. TANC, along with the other California municipal utilities, own and operate the California-Oregon Transmission Project (COTP), a 500-kilovolt transmission line between central California and southern Oregon. The District is obligated to pay 27.1 percent of TANC's COTP debt service and operations costs in exchange for ownership of 339 MW of TANC's 1,269 MW transfer capability. Additionally, the District has a 46 MW share of TANC's 300 MW firm, bi-directional transmission over Pacific Gas and Electric's (PG&E) system between PG&E's Tesla and Midway substations. The District recorded transmission expenses related to TANC of $11.4 million and $11.0 million in 2006 and 2005, respectively.

Summary financial information for TANC is presented below:

	December 31,	
	2006 (Unaudited)	2005 (Unaudited)
	(thousands of dollars)	
Total assets	$ 437,963	$ 466,741
Total liabilities	$ 436,631	$ 466,360
Total net assets	1,332	381
Total liabilities and net assets	$ 437,963	$ 466,741
Changes in net assets for the year ended December 31	$ 951	$ 18

The long-term debt of TANC, which totals $385.6 million (unaudited) at December 31, 2006, is collateralized by a pledge and assignment of net revenues of TANC, supported by take-or-pay commitments of the District and other members. Should other members default on their obligations to TANC, the District would be required to make additional payments to cover a portion of such defaulted payments, up to 25 percent of its current obligation of 27.1 percent.

Copies of the TANC annual financial reports may be obtained from the District at 6201 S Street, P.O. Box 15830, Sacramento, California 95852.

NOTE 6. COMPONENT UNITS

CVFA Carson Cogeneration Project. CVFA is a JPA formed by the District and the Sacramento Regional County Sanitation District. CVFA operates the Carson Project, a 57 MW (net) natural gas-fired cogeneration facility and a 43 MW (net) natural gas-fired simple cycle peaking plant, which is financed primarily by CVFA non-recourse revenue bonds.

SFA Cosumnes Power Plant Project. SFA is a JPA formed by the District and the Modesto Irrigation District. SFA operates the CPP Project, a 500 MW (net) natural gas-fired, combined cycle facility, which is financed primarily by SFA non-recourse revenue bonds.

SCA Procter & Gamble Cogeneration Project. SCA is a JPA formed by the District and the SFA. SCA operates the Procter & Gamble Project, a 120 MW (net) natural gas-fired cogeneration facility and a 44 MW (net) natural gas-fired simple cycle peaking plant, which is financed primarily by SCA non-recourse revenue bonds.

SPA Campbell Soup Cogeneration Project. SPA is a JPA formed by the District and SFA. SPA operates the Campbell Soup Project, a 160 MW (net) natural gas-fired cogeneration facility, which is financed primarily by SPA non-recourse revenue bonds.

As described in Note 2, all of the activities and balances of the component units are blended into and reported as part of the District because of the extent of their operational and financial relationships with the District. Copies of CVFA's, SCA's, SPA's and SFA's annual financial reports may be obtained from their Executive Office at 6201 S Street, P.O. Box 15830, Sacramento, California 95852.

NOTE 7. CASH, CASH EQUIVALENTS, AND INVESTMENTS

Cash Equivalents and Investments. The District's investment policies are governed by the California State and Municipal Codes and its Indenture, which restricts District investment securities to obligations which are unconditionally guaranteed by the United States (U.S.) Government or its agencies or instrumentalities; direct and general obligations of the State or any local agency within the State; bankers' acceptances; certificates of deposit; repurchase agreements; and taxable government and tax-exempt money market portfolios. The District's investment policy includes restrictions for investments relating to maximum amounts invested as a percentage of total portfolio and with a single issuer, maximum maturities, and minimum credit ratings.

Credit Risk. To mitigate the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment, the District limits investments to those rated by a nationally recognized rating agency of "A-1" (or equivalent) or better for commercial paper and "A" (or equivalent) or better for medium-term notes.

Custodial Credit Risk. This is the risk that in the event of the failure of a depository financial institution or counterparty to a transaction, the District's deposits may not be returned or the District will not be able to recover the value of its deposits, investments or collateral securities that are in the possession of another party. The District does not have a deposit policy for custodial credit risk. As of December 31, 2006, $2.9 million in deposits was uninsured. Additionally, at December 31, 2006 and 2005, $76.1 million and $66.1 million, respectively, in commercial paper and repurchase agreements were held by a counterparty that was acting as the District's agent in securities lending transactions.

Concentration of Credit Risk. This is the risk of loss attributed to the magnitude of an entity's investment in a single issuer. At December 31, 2006, more than 5 percent of the District's portfolio is invested in Federal National Mortgage Association (Fannie Mae) (16 percent), Federal Home Loan Banks (15 percent), Federal Home Loan Mortgage Corporation (Freddie Mac) (10 percent), and Morgan Stanley Repurchase Agreements (7 percent). At December 31, 2005, more than 5 percent of the District's portfolio is invested in Wells Fargo Repurchase Agreements (17 percent); Federal Home Loan Banks (11 percent); Freddie Mac (10 percent); Morgan Stanley Repurchase Agreements (8 percent); and Fannie Mae (8 percent). The District places no limit on the amounts invested in any one issuer for repurchase agreements and federal agency securities.

Interest Rate Risk. This is the risk of loss due to the fair value of an investment falling due to interest rates rising. The table below details investments by security type and maturity. Though the District has restrictions as to the maturities of some of the investments, it does not have a formal policy that limits investment maturities as means of managing its exposure to fair value losses arising from increasing interest rates.

Securities Lending Transactions. The District is authorized by its investment policy and by California Government Code to enter into securities lending agreements for up to 20 percent of its investment portfolio, not to exceed $75.0 million, only with counterparties that are primary dealers of the Federal Reserve Bank of New York. There have been no violations of the provisions of the authorization during 2006 or 2005. The maturities of the investments made, which are repurchase agreements and commercial paper, match the maturities of the securities loaned, which are U.S. Treasuries and Agencies. At December 31, 2006 and 2005, the District had no credit risk exposure to borrowers because the amount the District owes the borrowers exceeds the amounts the borrowers owe the District. The contract with the District's custodial bank requires it to indemnify the District if the borrowers fail to return the securities (and the collateral is inadequate to replace the securities lent) or fail to pay the District for income distributions by the securities' issuers while the securities were on loan. The District cannot pledge or sell collateral securities without borrower default. The District receives cash collateral and invests in both Repurchase Agreements and Commercial Paper, in the amount of $73.1 million and $3.0 million, respectively, as of December 31, 2006. The fair market value equals the carrying amount for both the Repurchase Agreements and Commercial Paper.

Interest Rate Swap Agreement. The District has a variable-to-variable rate swap agreement with an initial notional amount of $100.0 million for the purpose of exchanging earnings on short-term assets in the investment portfolio for earnings based on a longer term investment rate without sacrificing liquidity. The swap agreement expires in June 2016. Under the terms of the swap agreement, the District pays a variable rate equal to the 90-day LIBOR rate and receives a variable rate of the 10-year LIBOR minus .347 percent. The Standard and Poor's (S&P) credit rating of the counterparty is AA-.

The following schedules indicate the credit and interest rate risk at December 31, 2006 and 2005. The credit ratings listed are from S&P.

At December 31, 2006, the District's cash, cash equivalents and investments consist of the following:

		Remaining Maturities (in years)			
Description	**Credit Rating**	**Less Than 1**	**1–5**	**More than 5**	**Total Fair Value**
Cash and Cash Equivalents:					
LAIF	Not Rated	$ 470	$ -0-	$ -0-	$ 470
Money market mutual funds	AAAm	113,571	-0-	-0-	113,571
Certificates of Deposits	A-1/AA+/A-1+	125,000	-0-	-0-	125,000
Commercial paper	A-1/A-1+	41,897	-0-	-0-	41,897
Repurchase agreements	Aaa	73,086	-0-	-0-	73,086
Total cash and cash equivalents		354,024	-0-	-0-	354,024
Investments:					
Fannie Mae	AAA	53,815	55,450	4,859	114,124
Federal Farm Credit Bonds	AAA	-0-	2,232	-0-	2,232
Federal Home Loan Banks	AAA	44,865	61,069	-0-	105,934
Freddie Mac	AAA	31,935	40,046	-0-	71,981
Guaranteed Investment Contract	Not Rated	-0-	-0-	10,698	10,698
United States Treasuries	N/A	10,845	22,524	-0-	33,369
Corporate Note	A+/AA-/AAA	-0-	14,034	4,992	19,026
Commercial paper	A-1/A-1+	1,973	-0-	-0-	1,973
Total investments		143,433	195,355	20,549	359,337
Total cash, cash equivalents and investments		$ 497,457	$ 195,355	$ 20,549	$ 713,361

At December 31, 2005, the District's cash, cash equivalents and investments consist of the following:

Description	Credit Rating	Remaining Maturities (in years) Less Than 1	1–5	More than 5	Total Fair Value
Cash and Cash Equivalents:					
LAIF	Not Rated	$ 5,645	$ -0-	$ -0-	$ 5,645
Money market mutual funds	AA-/AA/AAAm	85,443	-0-	-0-	85,443
Certificates of Deposits	A-1/A-1+	115,000	-0-	-0-	115,000
Fannie Mae	A-1+	3,004	-0-	-0-	3,004
Federal Home Loan Banks	A-1+	19,897	-0-	-0-	19,897
Freddie Mac	A-1+	9,966	-0-	-0-	9,966
Commercial paper	A-1	39,952	-0-	-0-	39,952
Repurchase agreements	Not Rated	191,181	-0-	-0-	191,181
Total cash and cash equivalents		470,088	-0-	-0-	470,088
Investments:					
Fannie Mae	A-1+/AAA	45,841	7,167	4,820	57,828
Federal Farm Credit Bonds	AAA	-0-	14,920	-0-	14,920
Federal Home Loan Banks	A-1+/AAA	26,782	36,628	-0-	63,410
Freddie Mac	A-1+/AAA	26,884	38,500	-0-	65,384
Federal Agricultural Mortgage Corporation	Not Rated	2,400	-0-	-0-	2,400
United States Treasuries	Not Rated	-0-	20,819	-0-	20,819
Corporate Note	A+/AA	13,858	7,748	-0-	21,606
Commercial paper	A-1+	21,641	-0-	-0-	21,641
Total investments		137,406	125,782	4,820	268,008
Total cash, cash equivalents and investments		$ 607,494	$ 125,782	$ 4,820	$ 738,096

At December 31, 2006 and 2005, the District reported its book overdraft of $0.8 million and $3.7 million, respectively, as a component of Accounts Payable on the consolidated balance sheets.

The District's cash, cash equivalents, investments and securities lending collateral are classified in the consolidated balance sheets as follows:

	December 31, 2006	December 31, 2005
	(thousands of dollars)	
Total Cash, Cash Equivalents and Investments:		
Revenue bond reserve, debt service and construction funds:		
Revenue bond reserve fund	$ 76,551	$ 79,477
Debt service fund	58,901	40,281
Component unit bond reserve and construction funds	96,491	58,258
Total revenue bond reserve, debt service and construction funds	231,943	178,016
Nuclear decommissioning trust fund	82,315	83,177
Rate stabilization fund	107,100	75,000
Securities lending collateral	76,086	66,136
Other restricted funds	1,181	6,310
Unrestricted funds	214,736	329,457
Total cash, cash equivalents and investments	$ 713,361	$ 738,096

NOTE 8. REGULATORY DEFERRALS

The Board has taken various regulatory actions that result in differences between the recognition of revenues and expenses for rate-making purposes and their treatment under generally accepted accounting principles for non-regulated entities. These actions result in regulatory assets and liabilities, which are summarized in the tables below. Changes to these balances, and their inclusion in rates, occur only at the direction of the Board.

Regulatory Assets

Decommissioning. The District's regulatory asset relating to the unfunded portion of its decommissioning liability is being collected in rates and through interest earnings on the Trust Fund, through 2008 when radiological decommissioning is expected to be complete. Subsequently, nuclear fuel storage costs and non-radiological decommissioning costs are to be collected in rates commencing in 2009.

Wholesale Power Receivables. The District's regulatory asset relates to its wholesale receivables that were fully reserved as uncollectible in 2001. These wholesale receivable reserves relate to amounts due from the California PX totaling $24.6 million and $24.3 million at December 31, 2006 and 2005, respectively. The ultimate recovery of these amounts is dependent on numerous factors and cannot be determined at this time. This regulatory asset will be reversed concurrent with the reasonable certainty of collections or by inclusion in rates in future periods.

TANC Operations Costs. The District's regulatory asset relating to deferred TANC costs comprises the difference between its cash payments made to TANC and its share of TANC's accrual-based costs of operations. This regulatory asset is being collected in rates over the life of TANC's assets during the period that cash payments to TANC exceed TANC's accrual-based costs.

U.S. Bureau of Reclamation. In December 2004, the District established a regulatory asset to defer recognizing the expense related to the settlement with the U.S. Bureau of Reclamation (Bureau) on a billing dispute. The District will make increased payments in future rates to settle the dispute (See Note 18). This regulatory asset will be collected in rates for future water service over the twenty-five year period the District is committed to making the increased rate payments to the Bureau.

Enrichment Facility Decommissioning Assessment. The District's regulatory asset relating to obligations associated with the federal nuclear fuel enrichment program is being collected in rates, based on cash payments made, through 2008.

Precipitation Hedges. Settlements of Precipitation Agreements are included in rates in the year settled, and accordingly the intrinsic value of open precipitation hedges is deferred as regulatory assets or liabilities.

The District's total regulatory costs for future recovery are presented below:

	December 31, 2006	December 31, 2005
	(thousands of dollars)	
Regulatory Costs for Future Recovery:		
Decommissioning	$ 170,243	$ 205,196
Wholesale power receivables	24,577	24,274
TANC operations costs	8,856	15,425
U.S. Bureau of Reclamation	5,790	9,732
Enrichment facility decommissioning assessment	2,431	3,576
Precipitation hedges	-0-	22,116
Total regulatory costs	211,897	280,319
Less: regulatory costs to be recovered within one year	(57,763)	(77,818)
Total regulatory costs for future recovery — net	$ 154,134	$ 202,501

Regulatory Liabilities

CIAC. In 2006 and 2005, the District capitalized CIAC totaling $23.7 million and $18.3 million, respectively, in Plant in Service in the consolidated balance sheets and recorded $7.0 million and $6.3 million, respectively, of depreciation expense in the consolidated statements of revenues, expenses and changes in net assets. The District's regulatory credit relating to CIAC is intended to offset the revenue and expense associated with this accounting treatment. Thus, this regulatory credit is being amortized into rates over the depreciable lives of the related contributed distribution plant assets in order to offset the earnings effect of these nonexchange transactions.

Derivative Financial Instruments. The District's regulatory asset relating to derivative financial instruments is intended to defer the net difference between the fair value of derivative instruments and their cost basis, if any. Derivatives are reflected in rates at contract cost and as such, the balance is charged or credited into rates as the related asset or liability is utilized.

Rate Stabilization. The District's regulatory credit relating to Rate Stabilization is intended to defer the need for future rate increases when costs exceed existing rates. At the direction of the Board, amounts may be either transferred into this fund (which reduces revenues) or amounts are transferred out of this fund (which increases revenues). For several years through 2003, the Board deferred all residual income or loss into this account, as part of its strategy to maintain break-even operations while building up the Rate Stabilization Fund. In 2004, the Board ceased this practice and adopted a practice of authorizing Rate Stabilization Fund transfers on an event driven basis.

Public Good. The District's regulatory credit relating to Public Good comprises the amounts collected in rates for specifically identified Public Good programs that have not been fully expended. These regulatory deferrals are credited to revenue in the period when the expenditures on identified projects occur.

The District's total regulatory credits for future revenue recognition are presented below:

	December 31, 2006	December 31, 2005
	(thousands of dollars)	
Regulatory Credits for Future Revenue Recognition:		
CIAC	$ 191,949	$ 175,204
Derivative financial instruments	32,645	215,453
Rate stabilization	107,100	75,000
Precipitation hedges	36	-0-
Public good	3,347	1,761
Total regulatory credits for future revenue recognition	335,077	467,418
Less — regulatory credits to be recognized within one year	(18,879)	(105,351)
Total regulatory credits — net	$ 316,198	$ 362,067

NOTE 9. DERIVATIVE FINANCIAL INSTRUMENTS

The District enters into contracts for electricity and natural gas to meet the expected needs of its retail customers. The District sells excess capacity during periods when it is not needed to meet its retail requirements. The District's energy risk management program uses various physical and financial contracts to hedge exposure to fluctuating commodity prices. The District also enters into interest rate swap agreements to reduce interest rate risk or to enhance the relationship between the risk and return regarding the District's assets or debt obligations. During 2006 and 2005, the District executed numerous new gas related and power related purchase agreements, some of which are recorded as derivative financial instruments and are included in the table below. In 2006, certain energy contracts that had previously been classified as derivatives and had been marked to fair value were reclassified as normal purchases and sales and are not reported as derivatives in the 2006 results. This change in methodology had no impact on the increase in net assets, as all adjustments are deferred under SFAS No. 71. (Note 8)

The fair value of the District's derivative financial instruments are as follows:

	December 31, 2006	December 31, 2005
	(thousands of dollars)	
Derivative Financial Instrument Assets:		
Gas related agreements	$ 59,897	$ 228,736
Electric related agreements	-0-	172,398
Treasury related agreements	23,732	22,790
Total derivative financial instrument assets	83,629	423,924
Less — derivative financial instruments maturing within one year	(35,503)	(136,412)
Total derivative financial instrument assets — net	$ 48,126	$ 287,512
Derivative Financial Instrument Liabilities:		
Gas related agreements	$ 34,122	$ 7,575
Electric related agreements	-0-	136,963
Treasury related agreements	13,657	18,151
Total derivative financial instruments liabilities	47,779	162,689
Less — derivative financial instruments maturing within one year	(25,725)	(33,829)
Total derivative financial instrument liabilities — net	$ 22,054	$ 128,860

The Board has deferred recognition of the effects of reporting the fair value of derivative financial instruments for rate-making purposes, and maintains regulatory accounts to defer the accounting impact of these accounting adjustments (see Note 8).

NOTE 10. LONG-TERM DEBT

The District's total long-term debt is presented below:

	December 31, 2006	December 31, 2005
	(thousands of dollars)	
Electric Revenue Bonds:		
Electric revenue bonds, 2.5%–6.5%, 2007–2033	$ 1,603,590	$ 1,669,250
Subordinated electric revenue bonds, 3.5%–8.0%, 2007–2028	469,425	478,425
Total electric revenue bonds	2,073,015	2,147,675
Component unit project revenue bonds, 3.0%–5.5%, 2007–2030	554,280	263,485
Total long-term debt outstanding	2,627,295	2,411,160
Bond premiums — net	79,221	75,813
Deferred losses on bond refundings — net	(90,127)	(101,445)
Total long-term debt	2,616,389	2,385,528
Less: amounts due within one year	(98,080)	(82,340)
Total long-term debt — net	$ 2,518,309	$ 2,303,188

The summarized activity of the District's long-term debt during 2006 is presented below (thousands of dollars):

	December 31, 2005	Additions	Payments or Amortization	December 31, 2006	Amounts Due Within One Year
Electric revenue bonds	$ 1,669,250	$ -0-	$ (65,660)	$ 1,603,590	$ 59,165
Subordinate electric revenue bonds	478,425	-0-	(9,000)	469,425	26,025
Component unit project revenue bonds	263,485	300,375	(9,580)	554,280	12,890
Total	2,411,160	300,375	(84,240)	2,627,295	$ 98,080
Unamortized premiums — net	75,813	13,129	(9,721)	79,221	
Deferred losses on bond refundings — net	(101,445)	-0-	11,318	(90,127)	
Total long-term debt	$ 2,385,528	$ 313,504	$ (82,643)	$ 2,616,389	

The summarized activity of the District's long-term debt during 2005 is presented below (thousands of dollars):

	December 31, 2004	Additions	Payments or Amortization	December 31, 2005	Amounts Due Within One Year
Electric revenue bonds	$ 1,727,090	$ -0-	$ (57,840)	$ 1,669,250	$ 65,660
Subordinate electric revenue bonds	478,850	-0-	(425)	478,425	9,000
Component unit project revenue bonds	295,625	122,960	(155,100)	263,485	7,680
Total	2,501,565	122,960	(213,365)	2,411,160	$ 82,340
Unamortized premiums — net	78,614	6,224	(9,025)	75,813	
Deferred losses on bond refundings — net	(106,689)	(7,282)	12,526	(101,445)	
Total long-term debt	$ 2,473,490	$ 121,902	$ (209,864)	$ 2,385,528	

At December 31, 2006, scheduled annual principal maturities and interest are as follows (thousands of dollars):

	Principal	Interest	Total
2007	98,080	126,396	224,476
2008	87,700	122,269	209,969
2009	84,520	118,833	203,353
2010	113,685	114,649	228,334
2011	121,600	107,990	229,590
2012 – 2016	689,290	446,382	1,135,672
2017 – 2021	660,240	277,412	937,652
2022 – 2026	455,395	137,114	592,509
2027 – 2031	286,620	38,870	325,490
2032 – 2033	30,165	2,281	32,446
Total Requirements	$ 2,627,295	$ 1,492,196	$ 4,119,491

Interest in the preceding table includes interest requirements for variable rate debt using the debt interest rate of 4.3 percent in effect at December 31, 2006 for the issue.

2006 Revenue Bonds. On January 19, 2006, SFA issued $300.4 million of 2006 Series SFA Revenue Bonds. The proceeds of the offering were used to purchase the CPP Project from the District.

2006 Revenue Bonds Refunding and Redemptions. In July 2006, CVFA redeemed $1.9 million of CVFA Bonds 1993 Series due in July 2009 at a cost of $1.9 million. This bond redemption resulted in a current accounting loss of $12 thousand, which is included in Interest on Debt in the consolidated statements of revenues, expenses and changes in net assets. Redeeming the bonds will reduce the aggregate future debt service payments by $2.2 million.

2005 Revenue Bonds Refunding and Redemptions. In April 2005, the District issued $123.0 million of 2005 Series SPA Revenue Refunding Bonds at a premium of $6.2 million. Proceeds from the 2005 Series bonds and $5.6 million of available funds were used to refund $123.5 million of previously issued SPA Revenue Bonds and accordingly the liability for the defeased bonds has been removed from Long-term Debt in the consolidated balance sheets. The refunding resulted in the recognition of a deferred accounting loss of $7.3 million, which is being amortized over the life of the refunding issue; and a current accounting loss of $0.3 million, which is included in Interest on Debt in the consolidated statements of revenues, expenses and changes in net assets. The 2005 refunding reduced future aggregate debt service payments by $19.1 million and resulted in a total economic gain of $13.6 million, the difference between the present value of the old and new debt service payments.

In January and July 2005, the District redeemed $9.0 million of CVFA Bonds 1993 Series due from 2006 to 2009 at a cost of $9.0 million. In July 2005, the District redeemed $13.7 million of SCA Revenue Bonds 1995 Series due from 2006 to 2008 at a cost of $14.0 million. These bond redemptions resulted in a current accounting loss of $0.4 million, which is included in Interest on Debt in the consolidated statements of revenues, expenses and changes in net assets. Redeeming the bonds will reduce the aggregate future debt service payments by $26.2 million.

Interest Rate Swap Agreements. A summary of the District's four swap agreements are as follows:

Initial Notional Amount (000's)	District Pays	Fixed Rate	Floating Rate	Termination Date	Counterparty Credit Rating (S&P)
$ 269,095	Fixed	4.345%	70% of LIBOR	08/15/18	AAA
131,030	Variable	5.154%	BMA	07/01/24	AA-
111,900	Fixed	2.894%	63% of LIBOR	08/15/28	A+
39,470	Fixed	4.500%	65% of LIBOR	07/01/10	AA-

The District has a fixed-to-variable interest rate swap agreement with an initial notional amount of $131.0 million, which is equivalent to the principal amount of the District's 1997 Series K Electric Revenue Bonds. Under this swap agreement, the District pays a variable rate equivalent to the Bond Market Association (BMA) Index (3.91 percent at December 31, 2006) and receives fixed rate payments of 5.154 percent. In connection with the swap agreement, the District has a put option agreement, also with an initial notional amount of $131.0 million which gives the counterparty the right to sell to the District, at par, either the 1997 Series K Bonds, or a portfolio of securities sufficient to defease the 1997 Series K Bonds. The exercise of the option terminates the swap at no cost to the District. The term of both the swap and the put is equal to the maturity of the 1997 Series K Bonds.

Additionally, the District has three variable-to-fixed interest rate swap agreements with a combined initial notional amount of $420.5 million for the purpose of fixing the effective interest rate associated with certain of its Subordinated Bonds. The notional values of all three swaps are amortized over the life of the respective swap agreements. The District can terminate all swap agreements at any time, with payment or receipt of the fair market value of the swaps as of the date of termination.

In September 2005, the District entered into a variable-to-fixed swap agreement with a counterparty to hedge interest rate risk on the CPP Project financing, which subsequently funded on January 19, 2006. The swap had a notional amount of $257.0 million and was scheduled to amortize through 2030. Although the agreement was scheduled to become effective March 1, 2006, the intent was to terminate and cash settle the swap upon funding of the CPP Project. Consequently, on January 19, 2006 the swap cash settled with a $2.0 million payment from the counterparty.

Subordinated Electric Revenue Bonds. Payment of and interest on the Subordinated Electric Revenue Bonds is subordinate to the payment of the principal and interest on the District's Electric Revenue Bonds.

Variable Rate Bonds. The District's variable rate bonds bear interest at daily, weekly and monthly rates, ranging from 3.21 percent to 3.70 percent at December 31, 2006. The District can elect to change the interest rate period or fix the interest rate, with certain limitations. Certain variable rate bondholders have the right to tender the bonds to the tender agent. The District's variable rate bonds cannot be put to the District by the bondholders. Accordingly, the District has recorded such bonds as long-term debt, less amounts scheduled for redemption within one year.

Component Unit Bonds. The component units of the District have each issued bonds to finance their respective projects. These bonds have limited-recourse to the District. Principal and interest associated with these bonds are paid solely from the component units' revenues and receipts collected in connection with the operation of the projects. Most operating revenues earned by the component units are collected from the District in connection with the sale of electricity to the District. The ability of the component units to service the debt is dependent upon the successful operation of the respective projects (see Note 6).

Callable Bonds. The District has $30.8 million of fixed rate electric system revenue bonds that are currently callable and $911.3 million of bonds that become callable from 2007 through 2014. These bonds can be called until maturity. In addition, all $444.9 million of the District's variable rate subordinated bonds are currently callable.

Collateral. The principal and interest on the District's bonds are payable exclusively from, and are collateralized by a pledge of, the net revenues of the electric system of the District. Neither the credit nor the taxing power of the District is pledged to the payment of the bonds and the general fund of the District is not liable for the payment thereof.

Covenants. The District's bond resolutions contain various covenants that include requirements to maintain minimum debt service coverage ratios, certain other financial ratios, stipulated minimum funding of revenue bond reserves, and various other requirements.

NOTE 11. COMMERCIAL PAPER NOTES

The District issues Commercial Paper Notes (Notes) to finance or reimburse capital expenditures. At December 31, 2006, there were no Notes outstanding and as of December 31, 2005, Notes outstanding totaled $200.0 million. The effective interest rate for the Notes outstanding at December 31, 2005 was 3.18 percent and the average term was 39 days. The District currently maintains a $204.9 million letter of credit to support the sale of these outstanding Notes and incurs an annual fee of 0.2 percent on undrawn balances and 0.4 percent on drawn balances. There has not been a term advance under the letter of credit agreement. On January 23, 2007, a new $204.9 million letter of credit goes into effect with fees of 0.1 percent on undrawn balances and 0.16 percent on drawn balances.

The summarized activity of the District's Notes during 2006 and 2005 is presented below (thousands of dollars):

	Balance at beginning of Year	Additions	Reductions	Balance at end of Year
December 31, 2006	$ 200,000	$ -0-	$ 200,000	$ -0-
December 31, 2005	-0-	200,000	-0-	200,000

NOTE 12. FAIR VALUE OF FINANCIAL INSTRUMENTS

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate the value:

Investments. The fair values of investments, including cash equivalents, are based upon quoted market prices.

Long-term Debt. The fair value of Long-Term Debt, which includes the short-term portion, was calculated by determining the value of each individual series using a standard bond pricing formula and market yields from representative yield curves. For debt with a stepped interest rate, the fair market value of debt was calculated by discounting future interest and principal payments using a market yield from a representative yield curve. The District's electric revenue bonds, including subordinated bonds, were priced using the fair market curve for insured municipal revenue bonds. A similar fair value calculation was performed for the component units' bonds, except that all uninsured component unit debt was priced using the yield curve for "BBB" rated municipal power bonds and insured component debt was calculated using the yield curve for "A" rated municipal power bonds. All yield curves were obtained from Bloomberg L.P.

Interest Rate Swap and Put Agreements. The fair values of interest rate swap and put agreements are based on quoted market prices.

Gas and Electricity Related Derivatives. The fair values of gas and electricity price swap agreements and electricity option agreements are based on forward prices from established indexes for the applicable regions. The fair values of gas and electricity purchase agreements are based on forward prices from established indexes from applicable regions and discounted using established interest rate indexes. Additionally, for electricity purchase contracts that include options and/or exchanges, the fair values of such contracts are based on models prepared by District staff that include forecasted future usage and/or exchanges and electricity pricing based on price curves as described above for the periods covered by the agreements.

The estimated fair values of the District's financial instruments are presented below:

	December 31, 2006	
	Recorded Value	Fair Value
	(thousands of dollars)	
Investments, including cash and cash equivalents	$ 713,361	$ 713,361
Long-term debt	(2,616,389)	(2,803,466)
Interest rate swap and put agreements	10,075	10,075
Gas and electricity related derivatives, net	25,775	25,775

	December 31, 2005	
	Recorded Value	Fair Value
	(thousands of dollars)	
Investments, including cash and cash equivalents	$ 738,096	$ 738,096
Long-term debt	(2,385,528)	(2,559,789)
Interest rate swap and put agreements	4,639	4,639
Gas and electricity related derivatives, net	256,596	256,596

NOTE 13. RANCHO SECO DECOMMISSIONING LIABILITY

Background. The Rancho Seco decommissioning liability relates to the nuclear decommissioning of the former 913 MW nuclear power plant, which terminated commercial operations in 1989. Nuclear decommissioning is the process of safely removing nuclear facilities from service and reducing residual radioactivity to a level that permits termination of the Nuclear Regulatory Commission (NRC) license and release of the property for unrestricted use. The NRC has approved the District's decommissioning plan, which provides for removing low-level radioactive material beginning in 1997 and completing active decommissioning in 2008. The plant license will be terminated in phases. The license for the main areas of the Rancho Seco power plant site will be terminated in 2008 after removal of waste, most of which will be sent to licensed disposal sites or licensed radioactive waste processors. The remaining waste will be stored on site for an unspecified period after 2008 pending availability of appropriate disposal sites. The license for the storage facilities will be terminated after the waste is removed.

The Department of Energy (DOE), under the Nuclear Waste Policy Act of 1982, is responsible for permanent disposal of spent nuclear fuel and high-level radioactive waste. The District has a contract with the DOE for the removal and disposal of spent nuclear fuel and high-level (greater than class "C": GTCC) radioactive waste. However, the date when fuel and GTCC waste removal will be complete is uncertain. The DOE has announced that 2017 is the most optimistic opening date for the Yucca Mountain nuclear fuel waste site. The rate at which DOE will remove fuel is also uncertain. The District maintains a separately licensed on-site independent spent fuel storage facility (Storage Facility) which stores all of the District's spent fuel and GTCC waste in sealed canisters. The Storage Facility will remain under the regulation of NRC until such time as it is decommissioned after the DOE removes the nuclear fuel and GTCC radioactive waste.

Asset Retirement Obligations. Rancho Seco is one of the first large commercial nuclear power plants to be removed from service. Due to the substantial technical, regulatory and legal issues in connection with its nuclear decommissioning, the District cannot predict with certainty how long various decommissioning processes will take nor the eventual cost of decommissioning. These financial statements reflect the District's current estimate of its obligation for the cost of decommissioning under the requirements of SFAS No. 143 based on studies completed each year. Each year the District evaluates the estimate of costs of decommissioning and there was no increase in cost in the 2006 study.

Rancho Seco's decommissioning liability is presented below (thousands of dollars):

	December 31, 2006	December 31, 2005
Active decommissioning	$ 134,620	$ 176,523
Spent fuel management	112,859	108,419
Total ARO	247,479	$ 284,942
Less: Current portion	(54,839)	(41,500)
Total Non-current portion of ARO	192,640	$ 243,442

The summarized activity of the Rancho Seco decommissioning liability during 2006 and 2005 are presented below (thousands of dollars). The annual adjustments include a savings computed as the difference between the fair value of the obligation as if the decommissioning activities were performed by a third party and the amount actually incurred by the District performing the decommissioning activities.

	December 31, 2006	December 31, 2005
ARO at beginning of year	$ 284,942	$ 320,549
Accretion	13,790	16,185
Expenditures and annual adjustments	(33,398)	(36,872)
Annual adjustments	(17,855)	(14,920)
Total ARO	$ 247,479	$ 284,942

The District contributed $27.0 million to the Trust Fund in 2006 and 2005.

NOTE 14. PENSION PLANS

Defined Benefit Pension Plan. The District participates in the California Public Employee's Retirement System (PERS), an agent multiple-employer public employee defined benefit pension plan. PERS provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. PERS acts as a common investment and administrative agent for participating public entities within the State. Benefit provisions and all other requirements are established by State statute and District policies. The pension plan provides retirement benefits, survivor benefits, and death and disability benefits based upon employee's years of credited service, age and final compensation. Copies of PERS' annual financial report may be obtained from their Executive Office at 400 Q Street, Sacramento, California 95814.

Funding Policy. Participants are required to contribute approximately 7.0 percent of their annual covered salary. The District makes either the full or partial contributions required of District employees on their behalf and for their account. The District is currently required to contribute 6.8 percent of payroll to the plan. The contribution requirements of plan members and the District are established and may be amended by PERS.

Annual Pension Cost. PERS payments made by the District in 2006 were $21.6 million. The Annual Pension Cost for 2006 was $20.8 million, and $0.8 million was paid by employees for purchase of additional service credits. Overall, the District paid $19.9 million and employees paid $1.7 million. PERS payments made by the District in 2005 were $9.0 million. The Annual Pension Cost for 2005 was $8.2 million, and $0.8 million was paid by employees for purchase of additional service credits. Overall, the District paid $7.3 million and employees paid $1.8 million. Contributions are determined by actuarial valuations which are performed based on the entry age normal actuarial cost method. The contribution for the first half of 2006 was determined by PERS as part of the annual actuarial valuation as of June 30, 2003; the contribution for the second half of 2006 was determined by PERS as part of the annual actuarial valuation as of June 30, 2004. The actuarial assumptions included (a) a 7.75 percent investment rate of return (net of administrative expenses), (b) projected annual salary increases that vary by duration of service, and (c) 3.0 percent per year cost-of-living adjustments. Both (a) and (b) also included an inflation component of 3.0 percent. The actuarial value of PERS' assets was determined using techniques that smooth the effects of short-term volatility in the market value of investments over a three-year period (smoothed market value).

Three-year trend information for PERS is presented below (dollars in thousands):

Fiscal Year	Annual Pension Cost (APC)	Percentage of APC Contribution
6/30/04	$ -0-	100%
6/30/05	8,209	100
6/30/06	20,825	100

Required supplementary information for PERS is presented below for the three most recent years for which the District has available data (dollars in thousands):

Actuarial Valuation Date	Entry Age Normal Liability	Actuarial Value of Assets	Funding Excess	Funded Status Percent	Annual Covered Payroll	Funding Excess as a Percent of Payroll
6/30/03	$ 980,081	$ 1,045,473	$ 65,392	106.7	$ 146,404	44.7
6/30/04	1,054,410	1,087,532	33,122	103.1	155,289	21.3
6/30/05	1,141,187	1,143,666	2,478	100.2	158,557	1.6

Other Plans. The District provides its employees with two cash deferred compensation plans, one pursuant to Internal Revenue Code (IRC) Section 401(k) [401(k) Plan] and one pursuant to IRC Section 457 (457 Plan) (collectively, the Plans). The Plans are contributory plans in which the District's employees contribute the funds. Each of the District's eligible full-time or permanent part-time employees may participate in either or both Plans and amounts contributed are vested immediately. Such funds are held by a Trustee in trust for the employees upon retirement from District service and, accordingly, are not subject to the general claims of the District's creditors. The District is responsible for ensuring compliance with IRC requirements concerning the Plans and has the duty of reasonable care in the selection of investment alternatives, but neither the District nor its Board or officers have any liability for market variations in the Plans' asset values. District employees are responsible for determining how their funds are to be invested and pay all ongoing fees related to the Plans. The Plans are currently not subject to discrimination testing or the requirements of the Employee Retirement Income Security Act of 1974. The District employees participating in the Plans are allowed to contribute a portion of their gross income not to exceed the annual dollar limits prescribed by the IRC.

The District makes annual contributions to the 401(k) Plan on behalf of certain employees pursuant to a memorandum of understanding with both of its collective bargaining units. The District does not match employee contributions nor make contributions on behalf of its employees to the 457 Plan. Participating employees and the District made contributions into the Plans totaling $15.5 million and $0.8 million in 2006, respectively, and $14.7 million and $0.3 million in 2005, respectively.

NOTE 15. OTHER POSTEMPLOYMENT BENEFITS

The District provides postemployment health care benefits, in accordance with District policy and negotiated agreements with employee representation groups, to all employees who retire from the District, and their dependents, on or after attaining age 50 with at least 5 years of service. The District also provides postemployment health care benefits to covered employees who are eligible for disability retirement. The District contributes the full cost of coverage for employees hired before January 1, 1991, and a portion of the cost based on credited years of service for employees hired after January 1, 1991. The District also contributes a portion of the costs of coverage for these employees' dependents. At December 31, 2006, 2,394 postemployment participants, including retirees, spouses of retirees, surviving spouses, and eligible dependents, participate in the District's healthcare benefits program.

The postemployment healthcare benefits are unfunded. The District records postemployment health care benefit expenses on a pay-as-you-go basis. During 2006 and 2005, postemployment health care benefit expenditures were $11.5 million and $10.8 million, respectively. At December 31, 2006 and 2005, the District estimates that the actuarially determined accumulated postemployment benefit obligation was approximately $262.5 million and $327.0 million, respectively. The decrease in 2006 was primarily due to updated starting claims costs caused by changing medical vendors, and a change in the attribution period due to GASB requirements, partially offset by updated trend and future participation rates. The health care inflation rate assumption used to estimate the net present value of the postemployment benefit obligation for 2006 ranged between 5.0 percent and 12.0 percent compared to a range of 5.0 percent to 11.5 percent used in the 2005 study for various elements of the health care obligations. The increase reflects most recent experience and expectations. The effect of a one percent change in these assumed health care cost trends would increase or decrease the District's total benefit obligation at December 31, 2006 by approximately $34.6 million or $28.6 million, respectively.

NOTE 16. INSURANCE PROGRAMS AND CLAIMS

The District is exposed to various risks of loss related to torts, theft of and destruction to assets, errors and omissions, and natural disasters. In addition, the District is exposed to risks of loss due to injuries to, and illnesses of, its employees. The District carries commercial insurance coverage to cover most claims in excess of specific dollar thresholds, which range from $0.2 million to $1.0 million per claim with total excess liability insurance coverage for most claims of $100.0 million. District property insurance coverage is based on the replacement value of the asset. There have been no significant reductions in insurance coverage in 2006. In 2006, 2005, and 2004, the insurance policies in effect have adequately covered all settlements of the claims against the District. No claims have exceeded the limits of property or liability insurance in any of the past three years. In 2006, earthquake and terrorism insurance limits decreased from the 2005 limits, but no other property and related insurance limits had significant reductions in coverage compared to the prior year. The claims liability is included as a component of Self Insurance, Deferred Credits and Other in the consolidated balance sheets.

The District's total claims liability, comprising claims received and claims incurred but not reported, at December 31, 2006, 2005, and 2004 is presented below:

	2006	2005 (thousands of dollars)	2004
Workers' compensation claims	$ 5,862	$ 4,741	$ 6,429
General and auto claims	2,004	2,940	3,069
Short- and long-term disability claims	1,247	1,691	2,501
Claims liability	$ 9,113	$ 9,372	$ 11,999

Changes in the District's total claims liability during 2006, 2005 and 2004 is presented below:

	2006	2005 (thousands of dollars)	2004
Claims liability, beginning of year	$ 9,372	$ 11,999	$ 10,573
Add: Provision for claims, current year	2,180	3,690	2,723
Increase/(Decrease) in provision for claims in prior years	2,032	(882)	3,128
Less: payments on claims attributable to current & prior years	(4,471)	(5,435)	(4,425)
Claims liability, end of year	$ 9,113	$ 9,372	$ 11,999

NOTE 17. COMMITMENTS

Electric Power Purchase Agreements. The District has numerous power purchase agreements with other power producers to purchase capacity and associated energy to supply a portion of its load requirements. The District has minimum take-or-pay commitments for energy on most contracts. Certain contracts allow for the District to exchange energy, received primarily in the summer months, when the District most needs the energy and to return energy during the winter months, or other subsequent periods.

At December 31, 2006, the approximate minimum obligations for these contracts over the next five years are as follows:

Year ending:	Amount (thousands of dollars)
2007	$ 216,934
2008	204,554
2009	186,444
2010	156,757
2011	116,784

Contractual Commitments beyond 2011. Several of the District's purchase power contracts extend beyond the five-year summary presented above. These contracts expire between 2012 and 2026 and provide for power under various terms and conditions. The District estimates its annual minimum commitments under these contracts range between $97.9 million in 2012 and $0.7 million in 2026. The District's largest purchase power source is the Western Area Power Administration (Western) Base Resource contract, whereby the District receives 31.25 percent of the amount of energy made available by Western, after meeting Central Valley Project (CVP) use requirements, in any given year at a 31.25 percent share of their revenue requirement. On January 1, 2015, the District's percentage share changes to approximately 25 percent. The Western contract expires on December 31, 2024.

Gas Supply Agreements. The District has numerous long-term natural gas supply agreements with Canadian and U.S. companies to supply a portion of the consumption needs of the District's natural gas-fired power plants, which expire through 2015.

Gas Transport Capacity Agreements. The District has numerous long-term natural gas transport capacity agreements with Canadian and U.S. companies to transport natural gas to the District's natural gas-fired power plants from the supply basins in Alberta to the California-Oregon border and from supply basins in the southwest and Rocky Mountains to the Southern California border. These gas transport capacity agreements provide for the delivery of gas into District-owned pipeline capacity within California. The gas transport capacity agreements provide the District with 64,000 dekatherms (Dth) per day (Dth/d) of natural gas pipeline capacity to the Canadian Basins through 2023 and 66,000 Dth/d to the Southwest or Rocky Mountain Basins through at least 2018.

Gas Storage Agreements. The District also has an agreement for the storage of up to 2.25 million Dth of natural gas at a regional facility. The gas storage agreement expires in 2009.

At December 31, 2006, the approximate minimum obligations for these natural gas related contracts over the next five years are as follows:

Year ending:	Amount (thousands of dollars)
2007	$ 168,271
2008	81,289
2009	52,542
2010	32,960
2011	27,686

Contractual Commitments beyond 2011. Several of the District's gas transport and gas storage contracts extend beyond the five-year summary presented above. These contracts expire between 2012 and 2023 and provide for transportation and storage under various terms and conditions. The District estimates its annual minimum commitments under these contracts to be between $27.7 million in 2012 and $8.9 million in 2023.

Gas Price Swap Agreements. The District has entered into numerous variable to fixed rate swaps with notional amounts totaling 173,845,000 million British Thermal Units (mmbtu) for the purpose of fixing the rate on the District's natural gas purchases for its gas-fueled power plants and gas indexed electric contracts. These gas price swap agreements result in the District paying fixed rates ranging from $4.60 to $9.86 per mmbtu. The swap agreements expire periodically from January 2007 through December 2022.

NOTE 18. CLAIMS AND CONTINGENCIES

U.S. Bureau of Reclamation Water Service Contract Billing Dispute. The District entered into a 40-year water service contract with the Bureau, which expires in 2012, for the delivery of up to 75,000 acre-feet of water per year to originally meet the District's needs at Rancho Seco. This amount includes 60,000 acre-feet of municipal and industrial (M&I) water from the CVP. Over time, Bureau revenues have been insufficient to cover actual CVP operations and maintenance (O&M) costs; CVP contractor payments have been insufficient to cover amortization of their respective shares of CVP capital costs and, in the case of M&I contractors, have been insufficient to cover interest on unpaid capital. Although the District's contract contains a specific rate methodology, the Bureau maintained that the District and other M&I contractors are running substantial O&M deficits which, by the Bureau's definition, includes as O&M costs both unpaid interest on capital and interest on the O&M deficit. The District, in concert with the M&I contractors, filed their complaint against the Bureau in March 2003 in the U.S. District Court. Under the guidance of a federal magistrate, negotiations were held and a settlement was reached with the Department of the Interior in March 2005.

In general, the settlement reduces each contractor's obligation based on a combination of lower interest rates and simple interest; and the contractors commit to repayment of under-recovered capital and O&M costs. The contractors can either pay off the obligation or retire it in rates. In December 2004 the Board approved the settlement and deferred the obligation as a Regulatory item (See Note 8) to be recovered in future rates as the obligation is repaid to the Bureau. This amount is included in Due to U.S. Bureau of Reclamation in the balance sheet. In July 2006, the District entered into an agreement with the Sacramento County Water Agency (SCWA) to assign 30,000 acre feet of CVP water. SCWA paid the District $3.0 million and SCWA agrees to pay one half of the District's M&I deficit at September 30, 2006. The District estimates that its obligation is $5.8 million and $9.7 million at December 31, 2006 and 2005.

California Energy Market Refund Dispute. In 2001, FERC issued an order establishing evidentiary hearings for the purpose of determining the amount of refunds, if any, due to customers of the California ISO (ISO) and California PX (PX) spot markets from market participants selling into those markets for the period October 2, 2000 through June 20, 2001. During this time period, the District was both a seller and a buyer in the California spot markets. This matter has been the subject of various proceedings with FERC and court filings with the Ninth District since 2001.

In March 2003, FERC issued an Order adjusting the formula used to calculate the mitigated market-clearing price (MMCP) to be used in retroactively resettling the markets during the refund period. In October 2003, FERC issued an Order on Rehearing, where in relevant part (1) rejected the District's request for rehearing regarding the District's $4.1 million sleeve transaction, (2) rejected the District's request for rehearing regarding adjustments made by the PX, (3) declined to address the issue of FERC's jurisdiction over municipal sellers and (4) determined that individual sellers, and not the PX, should be subject to refund liability and refunds should be paid on a pro rata basis. The District filed a Petition for Review of the Order on Rehearing with the Court of Appeals for the Ninth Circuit, for the purposes of appealing the decision regarding the District's $4.1 million sleeve transaction. In November 2004, the Ninth Circuit Court issued an order severing the Petitions for Review of the jurisdictional issues and other transaction issues (which includes the District's sleeve transaction). The Ninth Circuit Court heard oral arguments in April 2005 to consider the transaction issues.

In August 2005, FERC issued an opinion that involved how entities may demonstrate that their overall costs of selling power to the ISO and PX exceeded their overall revenue received under the MMCP. In the Order, the Commission approved the District's proposed methodology for determining its actual costs, but denied the District's request to use its replacement costs for hydro sales, noting only that the District did not justify the use of replacement costs. The District filed for rehearing of the August Order on September 7, 2005. In the meantime, FERC required parties to submit cost showings on an expedited basis.

On September 6, 2005, the Ninth Circuit found that FERC does not have refund authority over wholesale power sales made by governmental entities and other non-public utilities, including the District. On October 3, 2005, PG&E, Southern California Edison Company (Edison), San Diego Gas & Electric Company and the Electricity Oversight Board (EOB) (collectively "the California Parties") filed a motion with the Ninth Circuit requesting that the timeline for filing for rehearing of the September 2005 decision be extended for forty-five days after the Ninth Circuit Court issues a decision in the pending appeal related to the scope/transactions issues. The motion also sought a delay in the issuance of the mandate in the jurisdictional case until after the extended deadline to seek rehearing and/or rehearing *en banc* has passed. The Ninth Court granted the California Parties motion on October 17, 2005. On August 2, 2006, the Ninth Circuit issued its decision of the scope/transaction issues. Of particular significance to the District, the Ninth Circuit upheld the FERC's decision that bilateral transactions between the California Energy Resource Scheduler (CERS) and other entities that occurred outside of the ISO and PX markets should not be mitigated. Other conclusions reached by the Court include: (1) the FERC properly established October 2, 2000 as the refund effective date for the Section 206 proceeding; (2) the FERC erred in excluding Section 309 relief for tariff violations that occurred prior to October 2, 2000; (3) the FERC erred in limiting refund liability to spot market sales i.e. the 24-hour sales period, as opposed to forward sales (day-ahead, multi-day sales, etc.) in the ISO and PX markets; and (4) the FERC erred in excluding energy exchange transactions in the ISO and PX markets. The likely result of the Court's expansion of the refund proceedings is that the District will receive a greater amount of refunds for purchases made during this timeframe. It remains unclear, however, whether this decision will necessarily result in an indefinite delay in the refund calculations currently ongoing at the FERC.

In a separate order to facilitate settlement, the FERC extended the time to seek rehearing/rehearing *en banc* of both jurisdictional and scope/transaction decisions until 90 days from the issuance of the scope/transaction order; i.e. October 31, 2006. In response to a motion filed by the California Parties to further extend the deadline for filing rehearing of the jurisdictional and scope/transaction issues, the Court extended the deadline to file rehearing of the jurisdictional decision to November 13, 2006, and extended the deadline to file rehearing of the scope/transaction decision to February 28, 2007. The California Parties filed for rehearing of the jurisdictional decision on November 13, 2006.

If the Ninth Circuit's decision stands, the District will have no refund liability. Under the latest MMCP formula as of August 2006, the District estimated that its potential refund liability could be as high as $13.5 million plus interest. Even if the Ninth Circuit's decision is reversed, and the District is required to pay refunds, the District's liability would likely be partially offset by refunds it would eventually realize as a buyer in the ISO and PX spot markets. Moreover, the District's refund liability may be further reduced to the extent the District's underlying costs of making the energy sales exceed its revenues as determined under the MMCP. Finally, staff expects that the District's refund liability will be completely offset by the amount of receivables owed to the District from sales made to the ISO and PX spot markets during this timeframe. Since District management believes it is unlikely that the Ninth Circuit will be reversed and that it will be found to be subject to the jurisdiction of FERC's refund process, it has not accrued any liability in this matter.

Replacement Reserves Dispute. In August 2003, PG&E issued invoices totaling $2.2 million for replacement reserve charges purportedly incurred by PG&E for energy scheduled through its Rancho Seco intertie point from July 2000 through June 2002. In September 2003, the District provided PG&E notice of dispute of the invoices due to the fact that the billing was inconsistent with the Restated Interim Agreement, the primary agreement between the parties governing such transactions and, therefore, there should never have been any Replacement Reserve charges incurred in connection with the power deliveries at issue. PG&E functioned as the Scheduling Coordinator on the District's behalf for transactions with the ISO at this intertie point until June 2002, when the District became its own control area. These Replacement Reserve charges purportedly relate to power purchased by the ISO to cover deviations between actual load and forecasted load. The District believes that, even if the charges were appropriate, PG&E's delay in billing within a reasonable timeframe compromised the District's ability to modify its operations or scheduling procedures to eliminate or mitigate the charges. District management believes that it is likely that it will not be found liable for any charges in this matter, and therefore no liability has been recorded.

COTP II Arbitration. The ISO filed to pass through charges on transactions involving the COTP, the District and Western control area. The ISO is seeking to pass through $14.0 million in new charges to PG&E as the COTP's and Western's control areas proxy scheduling coordinator. These charges include emissions costs, start-up costs, and minimum load costs. PG&E disputes the ISO's authority to impose any charges on it as the Scheduling Coordinator for COTP and filed for arbitration in July 2004. The District filed its intervention in the arbitration in July 2004. The ISO and Edison filed motions for summary disposition in November 2004. The District, PG&E, and other aligned parties filed a joint reply to the ISO's and Edison's motion for summary disposition in January 2005. In March 2005, the arbitrator issued an order denying the summary disposition motions of the ISO and Edison.

Arbitration hearings were conducted in July 2005. In September 2005, the arbitrator issued an award finding that the ISO improperly assessed PG&E the Must Offer Charges related to the COTP and related transactions involving municipal utilities within California. Accordingly, the arbitrator ordered the ISO to adjust the billings to reflect a full refund of all Must Offer Charges for transactions on the COTP and Western transactions through the close of the record. However, the arbitrator's order did not award PG&E interest on the refunded amount based on his belief that PG&E did not request interest. In October 2005, the ISO filed a petition for review of the arbitrator's award with FERC. PG&E filed a petition for review on that same day raising as its sole issue the arbitrator's failure to provide PG&E with interest on the refunded amount. In November 2005, the District and the other Joint Interveners filed a motion to intervene, motion to reject the ISO's petition for review, and, in the alternative, motion to consolidate PG&E's petition for review with that of the ISO's. On January 12, 2006, the FERC issued an order denying the motion to reject, consolidating the proceedings, and establishing a procedural schedule. The parties completed briefing in April 2006 and are awaiting the commission's decision.

The District believes that the ISO will not prevail in its attempts to pass charges through to the COTP and the District and the Western control area. The District believes that previous COTP arbitration and subsequent FERC orders confirmed that such a pass through was in violation of the ISO Tariff. Should the ISO ultimately prevail, the District estimates that its share of the $14.0 million that the ISO seeks to charge may be as much as $3.0 million. The District believes that it will prevail in this matter and, therefore, no liability has been recorded at December 31, 2006.

Claims for 2000 and 2001 Power Sales. On December 6, 2005, the California Parties filed a claim for damages pursuant to California Government Code § 910.4 ("Tort Claims Act") and in March 2006 filed complaints against the District and other governmental entities for damages and/or restitution and declaratory relief in Federal District Court in the eastern District of California. The California Parties' claim arises from the District's power sales from May 1, 2000 through June 20, 2001 in the wholesale electricity markets operated by the ISO and the PX under tariffs filed with FERC. The California Parties allege that the District is contractually obligated under the PX Participation Agreement to reimburse the California Parties for any amounts that FERC might find were unjust under the California Refund Proceedings. On May 26, 2006, the District and other governmental entities filed motions to dismiss for failure to state a claim upon which relieve could be granted, and other governmental entities also filed based on lack of subject matter jurisdiction. On October 24, 2006, the District Court heard oral arguments on the subject matter jurisdiction matter issue; if it retains jurisdiction, it will likely schedule oral argument on the remaining motions to dismiss shortly thereafter. While the District has not fully analyzed the complaint, the District believes that as to the non-governmental California Parties, the claim is untimely filed under the one-year statute of limitations under the Tort Claims Act and as to the EOB is untimely filed under the four-year statute of limitations for contract claims. In addition, the District is analyzing the impact of the Ninth Circuit Court of Appeals recent decision that FERC lacks refund authority over wholesale power sales made by governmental entities, like the District, may have on the claim (see related discussion in *California Energy Market Refund Dispute* above).

Although the California Parties' claim and complaint does not specify the amount of damages that the California Parties seek, the District expects that this amount would parallel the refund that the District would owe to the market if it were subject to refund liability. Accordingly, the District estimates that its potential refund liability ranges between no liability and approximately $14.0 million plus interest. Ultimately, the District does not believe that the California Parties will be successful in pursuing the claim.

On January 3, 2006, the Attorney General of the State of California and the California Department of Water Resources (collectively, the State) filed a claim for damages pursuant to the Tort Claims Act. The State's claim arises out of the District's power sales into the ISO/ PX markets from May 1, 2000 through June 20, 2001, as well as the District's bilateral power sales to the Department of Water Resources (DWR) through the CERS. The District returned the claim as untimely in mid-January 2006.

On June 14, 2006, the State filed a complaint for damages in the Sacramento Superior Court of California. Similar to the California Parties' claim, discussed above, the State alleges that the District is contractually obligated under the PX Participation Agreement to reimburse the State for any amounts that FERC might find were unjust under the California Refund Proceedings. With respect to the District's bilateral sales to CERS, the State claims that the District is contractually obligated to reimburse the State for the difference between the rates received for any sales made under the Western Systems Power Pool (WSPP) Agreement and a lawful rate as determined by FERC.

The District believes that the claim is untimely filed under the one-year statute of limitations under the Tort Claims Act, if applicable, and the four-year statute of limitations for contract claims. With respect to the District's bilateral sales to the DWR, FERC has already refused to mitigate bilateral power sales to CERS, which has been upheld by the Ninth Circuit Court of Appeals. In addition, the Ninth Circuit Court of Appeals' recent decision that FERC lacks refund authority over wholesale power sales made by governmental entities, like the District, imposes further obstacles that the State must overcome to prevail in litigation. On December 19, 2006, the State filed a request for dismissal without prejudice with respect to the cause of action and related allegations that pertain to the bilateral purchases of energy by DWR.

On January 11, 2007, the State filed its amended complaint and served it on the District on January 18, 2007. The amended complaint, similar to the original complaint, attempts to recover damages for breach of contract, unjust enrichment, and money received. It further states that it arises out of the District's voluntary power sales to DWR and the ISO, for which DWR paid, from May 1, 2000 through June 20, 2001. The complaint further provides that the sales transactions occurred in wholesale markets governed by the ISO and PX and the tariffs those entities filed with the FERC. Significantly, the amended complaint does not state that it seeks recovery for the District's bilateral sales to CERS that were made pursuant to the WSPP Agreement. The amended complaint suggests, however, that DWR intends to recover those monies by now characterizing those sales as having been made pursuant to the ISO Tariff. A case management conference is schedule for March 8, 2007. Case Management Statements are due no later than 15 days prior to the hearing. The District will respond to the complaint no later than February 20, 2007.

Similar to the California Parties', the State seeks the difference between the market price paid to the District and the FERC-mitigated price. Accordingly, the District estimates that its liability for these market sales ranges between no liability and $13.5 million. Further, while the State does not specify the amount of damages that it seeks for the sales, the District estimates that this amount is approximately $72.0 million based on the FERC-mitigated price as of July 2004. Ultimately, the District does not believe that either party will be successful in pursuing the claims. Consequently, District management believes that the outcome of these matters will not have a material adverse impact on the District's financial position or results of operations.

Fru-Con Construction Corporation Construction Matters. In August 2003, the District entered into a contract with Fru-Con Construction Corporation (Fru-Con) to construct the District's 500 MW CPP Project. St. Paul Travelers Casualty Company (Travelers) is obligated, under a Performance Bond, to guarantee Fru-Con's performance under the contract. The original construction schedule for the CPP Project called for commercial operation in September 2005. The CPP Project became operational on February 24, 2006.

Though Fru-Con has previously made claims for comparably smaller amounts that have been resolved through negotiation, in October 2004, Fru-Con asserted additional claims totaling $26.0 million. Beginning in October 2004 and continuing until early February 2005, the District and Fru-Con participated in negotiations to resolve disputes over both cost and delays in the CPP Project schedule. The parties were unable to resolve the disputes to the satisfaction of the District and in February 2005, the District terminated its contract with Fru-Con on the basis of breach of contract by Fru-Con.

On February 28, 2005, the District filed suit in the Sacramento County Superior Court against Fru-Con and one of its sub-contractors alleging breach of contract and violation of the California False Claims Act.

On March 24, 2005, Fru-Con filed its complaint against the District in federal court, alleging breach of contract. Then, on March 29, 2005, Fru-Con attempted to remove the State Court Action to federal court. On May 23, 2005, the federal court granted the District's motion to remand, and transferred the State Court Action back to the Sacramento County Superior Court. On August 10, 2005, the federal court denied without prejudice the District's motion to stay the Federal Court Action. Upon remand to state court, Fru-Con moved to stay the State Court Action in favor of its later-filed federal court action. On August 19, 2005, the Superior Court denied Fru-Con's motion to stay the State Court Action. Both parties have filed estimates of damages, with the District estimating its claims at $60.0 million or more. Fru-Con estimates that its claims will be roughly $22.0 million, plus fees.

Since January 2005, the District has also been pursuing a claim against Travelers under the performance bond. On September 28, 2005, Travelers denied the District's claim and filed a declaratory relief action in the same federal court as the Fru-Con Federal Court Action. The District filed a counterclaim in response to Travelers' lawsuit. In general, the District is seeking to recover from Travelers all of the damages it claims against Fru-Con plus attorneys' fees related to the Travelers suit.

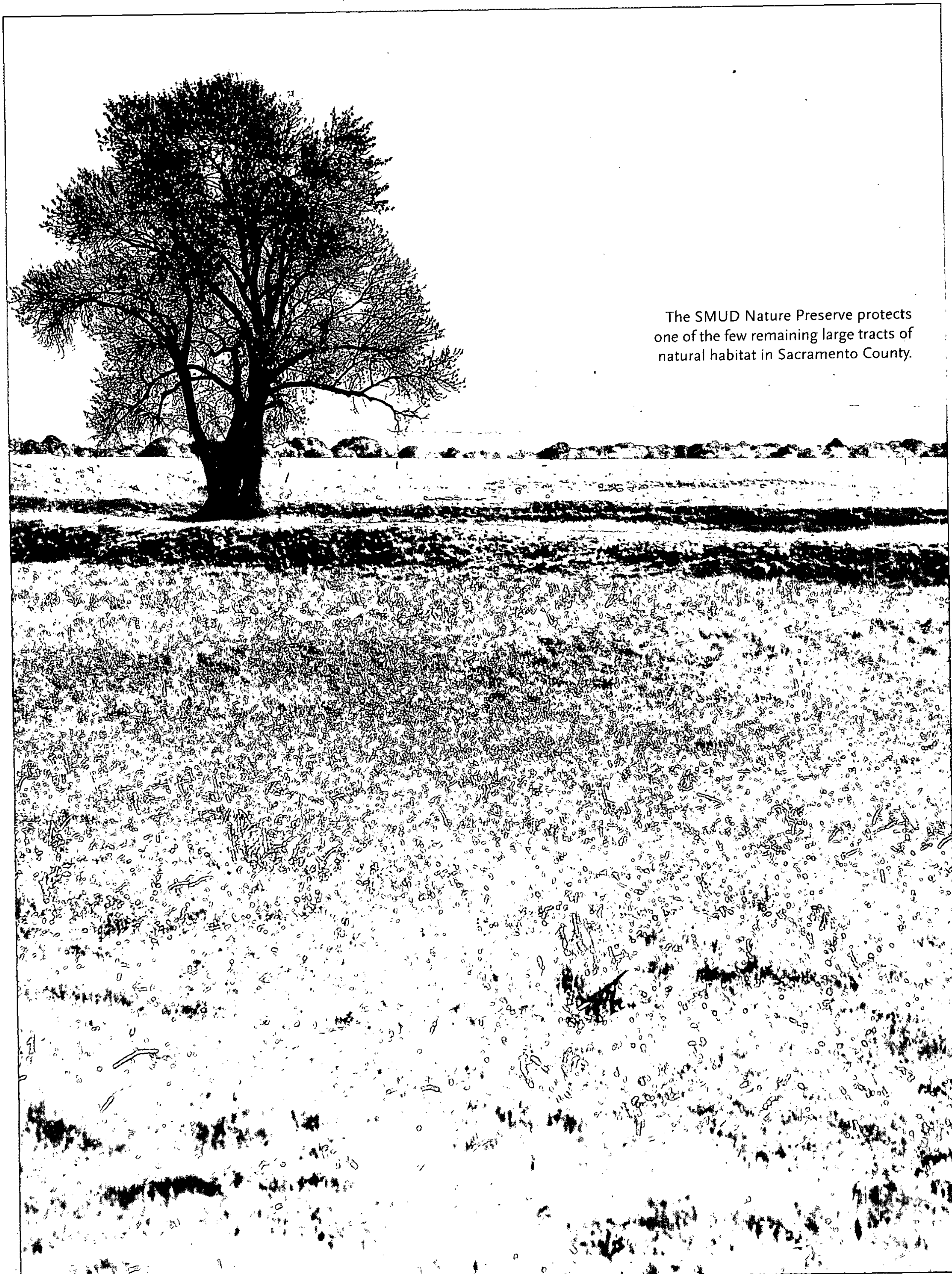
On December 15, 2006, the federal court granted the District's Motion to Amend its Counterclaim to add Fru-Con's parent companies, Fru-Con Holding Corporation and Bilfinger Berger AG, a German corporation. A state pre-trial conference is scheduled for February 2007.

District management believes it is reasonably likely to be successful in refuting, at a minimum, a majority of Fru-Con's claims and it is reasonably likely to prevail in a majority of its claims against Fru-Con and Travelers. District management also believes that the outcome of this matter will not have a material adverse impact on the District's financial position or results of operations. No liability or receivable has been recorded by the district in connection with these disputes.

Other Construction Matters. The District contracts with various other firms to design and construct facilities for the District. Currently, the District is party to various claims, legal actions and complaints on some of these construction projects. District management believes that it will be successful in refuting these allegations, and estimates that the ultimate resolution of these matters will not have a material adverse effect on the District's financial position.

Environmental Matters. The District is one of many potentially responsible parties that have been named in a number of actions relating to environmental claims and/or complaints. Due to the nature of these claims, legal actions or complaints, the District is unable to predict the range of costs for resolution of these actions and intends to take all actions necessary to defend its position. Some of these matters name the District along with other electric utilities as potentially responsible parties. The District has estimated its exposure to such costs based on its proportionate share of the potential claim and recorded its share as a liability; in most instances this is a relatively small percentage. However, should other named responsible parties become insolvent and unable to pay their share of the claims, the District's share of these contingent liabilities would increase and could be material. District management does not believe this will occur, and accordingly, management believes that the outcome of these environmental claims will not have a material adverse impact on the District's financial position or results of operations.

Other Matters. In the normal operation of business, the District is party to various claims, legal actions and complaints. Management and the District's legal counsel believe that there are no other material loss contingencies that would have a material adverse impact on the District's financial position or results of operations.



The SMUD Nature Preserve protects one of the few remaining large tracts of natural habitat in Sacramento County.

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