KPMG

LOS ANGELES DEPARTMENT OF WATER AND POWER
POWER SYSTEM

Financial Statements and
Required Supplementary Information

June 30, 2007 and 2006

(With Independent Auditors' Report Thereon)

LOS ANGELES DEPARTMENT OF WATER AND POWER
POWER SYSTEM

Table of Contents

KPMG LLP
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Independent Auditors' Report

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

We have audited the accompanying balance sheets of the City of Los Angeles' Department of Water and Power's Power Revenue Fund (Power System), an enterprise fund of the City of Los Angeles, California, as of June 30, 2007 and 2006, and the related statements of revenues, expenses, and changes in fund net assets and cash flows for the years then ended. These financial statements are the responsibility of the Los Angeles Department of Water and Power's (the Department) management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Power System's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in note 1, the financial statements present only the Power System and do not purport to, and do not, present fairly the financial position of the City of Los Angeles, California, as of June 30, 2007 and 2006, the changes in its financial position or its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Power System as of June 30, 2007 and 2006 and the changes in its financial position and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards,* we have also issued our report dated November 14, 2007 on our consideration of the Power System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis included on pages 3 through 13 and the schedules of funding progress for the pension plan and postemployment healthcare plan on pages 51 note 12(c) and 59 are not a required part of the basic financial statements but are supplementary information required by U.S. generally accepted accounting principles. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

KPMG LLP

November 14, 2007

The following discussion and analysis of the financial performance of the City of Los Angeles' (the City) Department of Water and Power's (the Department) Power Revenue Fund (the Power System) provides an overview of the financial activities for the fiscal years ended June 30, 2007 and 2006. Descriptions and other details pertaining to the Power System are included in the notes to the financial statements. This discussion and analysis should be read in conjunction with the Power System's financial statements, which begin on page 14.

Using this Financial Report

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

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

The financial statements provide an indication of the Power System's financial health. The balance sheets include all of the Power System's assets and liabilities, using the accrual basis 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 and other commitments. The statements of revenues, expenses, and changes in fund net assets report all of the revenues and expenses during the time periods indicated. The statements of cash flows report the cash provided by and used in operating activities, as well as other cash sources and uses, such as investment income and cash payments for bond principal and capital additions and betterments.

(Continued)

The following table summarizes the financial condition and changes in fund net assets of the Power System as of and for the fiscal years ended June 30, 2007, 2006, and 2005:

Table 1 – Summary of Financial Condition and Changes in Fund Net Assets

(Amounts in millions)

		June 30		
Assets		**2007**	**2006**	**2005**
Utility plant, net	$	5,923	5,709	5,299
Restricted investments		669	955	1,036
Other noncurrent assets		1,843	1,362	1,307
Current assets		1,516	1,720	1,314
	$	9,951	9,746	8,956
Liabilities and Fund Net Assets				
Long-term debt, net of current portion	$	4,183	4,262	3,481
Other long-term liabilities		737	710	732
Current liabilities		763	662	681
		5,683	5,634	4,894
Fund net assets:				
Invested in capital assets, net of related debt		1,582	1,774	1,641
Restricted		1,244	1,159	1,482
Unrestricted		1,442	1,179	939
Total fund net assets		4,268	4,112	4,062
	$	9,951	9,746	8,956

Revenues, Expenses, and Changes in Fund Net Assets

(Amounts in millions)

	Year ended June 30		
	2007	**2006**	**2005**
Residential	$ 818	759	693
Commercial and industrial	1,643	1,545	1,421
Sales for resale	103	153	102
Other	36	39	39
Total operating revenues	2,600	2,496	2,255
Fuel for generation and purchased power	(1,245)	(1,283)	(1,113)
Maintenance and other operating expenses	(1,021)	(1,004)	(969)
Total operating expenses	(2,266)	(2,287)	(2,082)
Operating income	334	209	173
Nonoperating revenues (expenses):			
Investment income	153	123	113
Other nonoperating revenues and expenses, net	15	13	5
Debt expenses	(191)	(167)	(146)
Income before capital contributions and transfers	311	178	145
Capital contributions	20	30	26
Transfer to the reserve fund of the City of Los Angeles	(175)	(158)	(160)
Increase in fund net assets	156	50	11
Beginning balance of fund net assets	4,112	4,062	4,051
Ending balance of fund net assets	$ 4,268	4,112	4,062

(Continued)

Assets

Utility Plant

During fiscal years 2007 and 2006, the Power System capitalized $281 million and $331 million of additions, respectively, including transfers from construction work in progress to utility plant in service. Of the $281 million, $156 million, or 56%, related to distribution plant assets. In addition, during 2007, the Power System capitalized $53 million in transmission plant mostly related to the Pacific DC Intertie and Sylmar Converter Station, a jointly owned transmission facility that is approximately 846 miles and connects Southern California to the hydroelectric power of the Pacific Northwest. Of the $331 million, $186 million, or 56%, related to distribution plant assets. In addition, during 2006, the Power System capitalized $61 million related to generation assets. Furthermore, the Power System had capital improvements to its transmission and distribution utility plant assets to maintain and support normal load growth of the distribution and transmission systems.

Construction work in progress increased by $203 million in fiscal year 2007 and by $136 million in fiscal year 2006. The 2007 increases were mostly attributable to the Pinetree Wind Project and Distribution Control Systems. The increase in 2006 was mostly attributable to the Pinetree Wind Project and other generation improvements.

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

The Department's strategy is to have generating utility plant assets that can produce energy from a variety of fuel types. This is referred to as a hedged power supply. This is important in that if the costs related to a particular fuel type rise substantially in a short period of time, the Department can utilize its mix of generation assets to meet customer demand and to minimize increases in fuel expense. The Department has implemented a $2 billion, ten-year plan to upgrade its local power plants and to implement a program that includes demand side management, alternative energy sources, and distributed generation. Through June 30, 2007, the Department has incurred $1.3 billion related to such upgrades.

On July 1, 2005, the Power System and other members of the Southern California Public Power Authority (SCPPA) completed the acquisition of natural gas reserves and other real property located in Pinedale Wyoming. The transaction totaled in excess of $300 million of which the Power System contributed approximately $230 million. This is the first natural gas reserves acquisition for the Power System. Additional information regarding the natural gas field can be found in note 1 in the accompanying notes to the financial statements.

The tables below summarize the generating resources available to the Department as of June 30, 2007. These resources include those owned by the Department (either solely or jointly with other utilities) as well as resources available through long-term purchase agreements. Generating station capacity is measured in megawatts (MWs).

Table 2 – Department-Owned Generation Facilities

Type of fuel	Number of facilities	Number of units	Net maximum capability (MWs)	Net dependable capability (MWs)
Natural Gas	4 [(1)]	22	3,421	3,354
Large Hydro	1	6 [(2)]	1,175	1,075
Renewables	14	22 [(3)]	233 [(4)]	177
Subtotal	19	50	4,829	4,606
CDWR	—	—	(65) [(5)]	(65)
Total	19	50	4,764	4,541

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

[(2)] The Castaic Plant currently has six out of seven units available due to ongoing modernization work scheduled to be completed by 2011.

[(3)] The Department-owned renewable resources include the twenty-two Los Angeles Aqueduct, Owens Valley, and Owens Gorge small hydro units that qualify under the Department's renewable resource definition. This number does not include two of the Scattergood gas-fueled units that partially burn digester gas in which the output related to the digester gas also qualifies under the Department's renewable resource definition.

[(4)] Includes 22 MWs of renewable energy generated at the Scattergood Station by burning digester gas from the Hyperion Treatment Plant.

[(5)] Energy payable to the California Department of Water Resources for energy generated at the Castaic Plant.

Table 3 – Jointly Owned and Contracted Facilities

Type	Number of facilities	Net maximum capability (MWs)	Net dependable capability (MWs)
Large Hydro	1	491 [1]	389
Nuclear	1	380 [2]	374
Coal	3	1,515 [3]	1,515
Renewables/DG	112 [4]	108	108
Total[5]	117	2,494	2,386

(1) The Department's Hoover Plant contract entitlement is 25.16% of the Hoover total contingent capacity of 1,951 MWs. Current reduced lake level has reduced available capacity to 389 MWs.

(2) The Department's Palo Verde Station (PVNGS) entitlement is 9.66% of the maximum net plant capability of 3,938 MWs.

(3) The Department's current Intermountain Station (IPP) entitlement is 57.67% of the maximum net plant capability of 1,800 MW. A portion of the IPP entitlement is subject to recall. The Department's Navajo Station entitlement is 21.20% of the maximum net plant capability of 2,250 MWs. The Mohave Station generating units were removed from service at the end of 2005.

(4) The Department's contract renewable resources include energy generated from various landfills in the Los Angeles area, hydro from British Columbia, Canada, wind from Wyoming, variety of solar photovoltaic resources and fuel cell installations, also located in the Los Angeles area, and green energy purchases. Customer distributed generation (DG) units located in the city also provide energy resources.

(5) Previously, the Department categorized customer energy efficiency (EE) and demand side management (DSM) programs that result in customer energy savings as a resource rather than as a means of reducing future load growth. The Department currently views EE and DSM programs that result in customer energy savings as a means of reducing future load growth.

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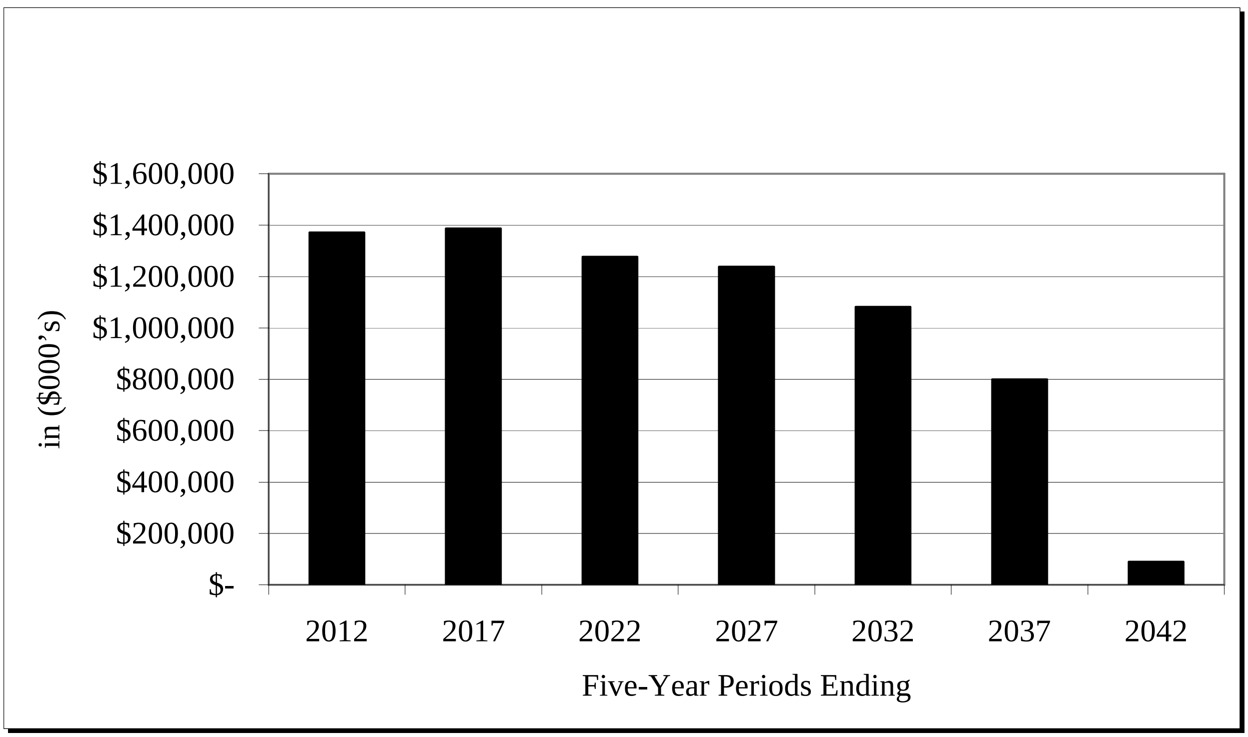
Liabilities and Fund Net Assets

Long-Term Debt

As of June 30, 2007, the Power System's total long-term debt balance was $4.3 billion. The decrease of $108 million over the prior year resulted from the scheduled maturities of $68.6 million and the cash defeasance of $39.8 million of Power System revenue bonds. Outstanding principal, plus scheduled interest as of June 30, 2007, is scheduled to mature as shown in the chart below:

Chart: Debt Service Requirements



As of June 30, 2007, $57 million principal amount of long-term debt is considered defeased and remains outstanding. This debt, together with trust funds set aside for its full repayment at scheduled maturity dates, is not reflected on the balance sheet.

In addition, the Power System had $503 million and $451 million on deposit in trust funds restricted for the use of debt reduction as of June 30, 2007 and 2006, respectively.

In September 2007, Standard & Poor's Rating Services, Moody's Investors Service, and Fitch Ratings affirmed the Power System's bond rating of AA-, Aa3, and AA-, respectively, due to the Power System's broad revenue stream, sound financial metrics, and the City Council authorizing the unfreezing of the energy cost adjustment factor, which allows the Power System to fully recover changes in purchased power costs, fuel costs, and renewable resource costs. Additional information regarding the Power System's long-term debt can be found in note 10 in the notes to the financial statements.

Changes in Fund Net Assets

Operating Revenues

The operating revenues of the Power System are generated from wholesale and retail customers. There are four major customer categories of retail revenue. These categories include residential, commercial, industrial, and other, which includes public street lighting. Table 4 summarizes the percentage contribution of retail revenues from each customer segment in fiscal years 2007 and 2006.

Table 4 – Revenue and Percentage of Revenue by Customer Class
(Amounts in thousands)

	Fiscal year 2007		Fiscal year 2006	
	Revenue	**Percentage**	**Revenue**	**Percentage**
Customer type:				
Residential	$ 817,642	33%	$ 758,932	32%
Commercial	1,428,282	57	1,320,870	56
Industrial	214,795	9	223,985	10
Other	36,353	1	39,122	2
Total retail revenue	$ 2,497,072	100%	$ 2,342,909	100%

While commercial customers consume the most electricity, residential customers represent the largest customer class. As of June 30, 2007 and 2006, the Power System had approximately 1.4 million customers. As shown in Table 5, 1.2 million, or 86%, of total customers were in the residential customer class.

Table 5 – Number of Customers and Percentage of Customers by Customer Class
(Amounts in thousands)

	Fiscal year 2007		Fiscal year 2006	
	Number	**Percentage**	**Number**	**Percentage**
Customer type:				
Residential	1,247	86%	1,242	86%
Commercial	185	13	186	13
Industrial	14	1	14	1
Other	2	—	3	—
	1,448	100%	1,445	100%

Fiscal Year 2007

Retail revenues increased $154.2 million while wholesale revenues decreased $50.5 million from fiscal year 2006. The increase in retail revenue is mostly due to the unfreezing of the energy cost adjustment factor and a 3.2% increase in retail consumption. The decrease in wholesale revenue is due to decreased sales activity.

Fiscal Year 2006

Retail revenues increased $189.6 million and wholesale revenues increased $51 million from fiscal year 2005. The increase in retail revenue is mostly due to discontinuing the deferral of revenue collected for out-of-market purchased power costs and beginning to recognize prior deferred amounts. The increase in wholesale revenue is due to increased sales activity in both the forward and real-time energy and capacity markets.

Operating Expenses

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

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

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

(Continued)

The table below summarizes the Power System's operating expenses during fiscal years 2007 and 2006:

Table 6 – Operating Expenses and Percentage of Expense by Type of Expense
(Amounts in thousands)

	Fiscal year 2007		Fiscal year 2006	
	Expense	**Percentage**	**Expense**	**Percentage**
Type of expense:				
Fuel for generation	$ 545,221	24%	$ 541,659	24%
Purchased power	699,841	31	741,810	32
Other operating costs	496,599	22	472,394	21
Maintenance	254,988	11	260,217	11
Depreciation and amortization	269,587	12	270,841	12
	$ 2,266,236	100%	$ 2,286,921	100%

Fiscal Year 2007

Fiscal year 2007 operating expenses were $21 million lower as compared to fiscal year 2006. Purchased power costs were $42 million lower as compared to fiscal year 2006. The decrease is attributable to lower sales for resale. This decrease was offset by a $4 million increase in fuel for generation expense related to natural gas run plants.

Other operating costs increased by $24 million and were offset in decreases in maintenance and depreciation expense of $5 million and $1 million, respectively. The increase in other operating costs was primarily due to $10 million in customer accounting and collection expenses and $8 million in other production expenses. The decrease in maintenance costs was mostly related to distribution plant.

Fiscal Year 2006

Fiscal year 2006 operating expenses were $205 million higher as compared to fiscal year 2005. Fuel for generation expense increased by $63 million due to higher cost of natural gas. Purchased power costs increased due to economic purchases being made. Economic purchases are purchases of energy on the open market where the Department has determined the cost of acquiring the energy is less expensive than using available generation resources to meet customer demand.

Maintenance and depreciation increased by $23 million and $24 million, respectively. The increase in maintenance was due to addition work being performed on transmission assets. The increase in depreciation was due to additional assets being placed in service. These increases were offset by a decrease in other operating costs related to distribution assets.

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Nonoperating Revenues and Expenses

Fiscal Year 2007

The major nonoperating activities of the Power System for fiscal year 2007 included the transfer of $174.7 million to the City's General Fund, interest income earned on investments of $153 million, and $191 million in debt expenses.

The transfer to the City is based on 7% of the previous year's operating revenues. Operating revenues for fiscal year 2006 were $2.5 billion, which generated a city transfer of $174.7 million.

Interest income increased $30 million due to more cash available for investing in fiscal year 2007 as compared to 2006.

The increase in debt expense is due to having a full year of interest expense on the 2005 series debt that was issued December 2005 offset by slightly lower interest rates on variable rate debt. The variable rate bonds' daily and weekly rate range increased from 3.94% to 3.95% as of June 30, 2006 to 3.70% to 3.76% as of June 30, 2007.

Fiscal Year 2006

The major nonoperating activities of the Power System for fiscal year 2006 included the transfer of $157.9 million to the City's General Fund, interest income earned on investments of $123 million, and $167.5 million in debt expenses.

The transfer to the City is based on 7% of the previous year's operating revenues. Operating revenues for fiscal year 2005 were $2.3 billion, which generated a city transfer of $157.9 million.

Interest income increased $10 million due to interest rates trending higher in fiscal year 2006 as compared to 2005.

The increase in debt expense is due to the issuance $932 million of revenue bonds and higher interest rates on variable rate debt. The variable rate bonds' daily and weekly rate range increased from 2.22% to 2.27% as of June 30, 2005 to 3.94% to 3.95% as of June 30, 2006.

Other Significant Matters

On October 2, 2007, the board of water and power commissioners approved an electric base rate increase of 2.9% effective January 1, 2008, 2.9% effective July 1, 2008, and 2.7% effective July 1, 2009. This increase is required to fund costs related to general inflation and Power System's reliability improvements. City Council's approval by ordinance is required.

LOS ANGELES DEPARTMENT OF WATER AND POWER
POWER SYSTEM

Balance Sheets

June 30, 2007 and 2006

(Amounts in thousands)

Assets		2007	2006
Noncurrent assets:			
Utility plant:			
Generation	$	3,479,754	3,444,102
Transmission		962,290	906,848
Distribution		4,443,792	4,288,601
General		979,960	948,407
		9,865,796	9,587,958
Accumulated depreciation		(4,969,876)	(4,701,006)
		4,895,920	4,886,952
Construction work in progress		773,694	570,418
Nuclear fuel, at amortized cost		18,311	14,578
Natural gas field, net		235,163	237,403
		5,923,088	5,709,351
Restricted investments		668,710	955,340
Long-term California wholesale energy receivable, net		116,339	116,367
Long-term notes and other receivables, net of current portion		1,117,142	1,144,941
Deferred debits		228,181	—
Net pension asset		84,710	99,793
Net postemployment asset		296,053	—
Total noncurrent assets		8,434,223	8,025,792
Current assets:			
Cash and cash equivalents – unrestricted		448,817	315,298
Cash and cash equivalents – restricted		196,959	731,205
Cash collateral received from securities lending transactions		237,946	73,509
Customer and other accounts receivable, net of $14,555 and $33,432 allowance for losses, respectively		282,897	280,723
Current portion of long-term notes receivable		31,778	32,887
Accrued unbilled revenue		147,335	140,386
Materials and fuel		118,349	112,107
Prepayments and other current assets		52,350	33,948
Total current assets		1,516,431	1,720,063
Total assets	$	9,950,654	9,745,855

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LOS ANGELES DEPARTMENT OF WATER AND POWER
POWER SYSTEM

Balance Sheets

June 30, 2007 and 2006

(Amounts in thousands)

Liabilities and Fund Net Assets		2007	2006
Fund net assets:			
Invested in capital assets, net of related debt	$	1,581,687	1,774,252
Restricted:			
Debt service		624,265	600,750
Capital projects		102,799	97,017
Other postemployment benefits		296,053	231,496
Pension benefits		84,710	99,793
Other purposes		136,487	129,304
Unrestricted		1,441,883	1,178,955
Total fund net assets		4,267,884	4,111,567
Long-term debt, net of current portion		4,183,127	4,261,748
Other noncurrent liabilities:			
Accrued liabilities		228,181	—
Deferred credits		480,296	564,164
Net other postemployment benefit obligation		—	110,823
Accrued workers' compensation claims		28,368	35,558
Total other noncurrent liabilities		736,845	710,545
Current liabilities:			
Current portion of long-term debt		158,756	188,821
Accounts payable and accrued expenses		198,836	223,434
Accrued interest		78,507	80,249
Accrued employee expenses		84,908	82,575
Due to Water System		3,845	13,407
Obligations under securities lending transactions		237,946	73,509
Total current liabilities		762,798	661,995
Total liabilities		5,682,770	5,634,288
Total liabilities and fund net assets	$	9,950,654	9,745,855

See accompanying notes to financial statements.

LOS ANGELES DEPARTMENT OF WATER AND POWER
POWER SYSTEM

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

Years ended June 30, 2007 and 2006

(Amounts in thousands)

		2007	2006
Operating revenues:			
Residential	$	817,642	758,932
Commercial and industrial		1,643,077	1,544,855
Sales for resale		102,983	153,480
Other		45,519	50,579
Uncollectible accounts		(9,166)	(11,457)
		2,600,055	2,496,389
Operating expenses:			
Fuel for generation		545,221	541,659
Purchased power		699,841	741,810
Maintenance and other operating expenses		751,587	732,611
Depreciation and amortization		269,587	270,841
		2,266,236	2,286,921
Operating income		333,819	209,468
Nonoperating revenues (expenses):			
Investment income		152,936	122,734
Other nonoperating income		20,556	17,394
		173,492	140,128
Other nonoperating expenses		(4,899)	(4,246)
		168,593	135,882
Debt expenses:			
Interest on debt		(201,840)	(170,839)
Allowance for funds used during construction		10,773	3,339
		(191,067)	(167,500)
Income before capital contributions, transfers, and extraordinary item		311,345	177,850
Capital contributions		19,719	29,925
Transfers to the reserve fund of the City of Los Angeles		(174,747)	(157,894)
Increase in fund net assets		156,317	49,881
Fund net assets:			
Beginning of year		4,111,567	4,061,686
End of year	$	4,267,884	4,111,567

See accompanying notes to financial statements.

LOS ANGELES DEPARTMENT OF WATER AND POWER
POWER SYSTEM

Statements of Cash Flows

Years ended June 30, 2007 and 2006

(Amounts in thousands)

		2007	2006
Cash flows from operating activities:			
Cash receipts:			
Cash receipts from customers	$	2,464,217	2,445,727
Cash receipts from customers for other agency services		379,152	349,767
Cash receipts from interfund services provided		308,898	286,947
Other cash receipts		17,074	32,810
Cash disbursements:			
Cash payments to employees		(473,496)	(431,114)
Cash payments to suppliers		(1,451,947)	(1,462,463)
Cash payments for interfund services used		(369,717)	(342,519)
Cash payments to other agencies for fees collected		(366,247)	(319,998)
		507,934	559,157
Cash flows from noncapital financing activities:			
Payments to the reserve fund of the City of Los Angeles		(174,747)	(157,894)
Transfer of assets to the Retiree Health Benefits Fund		(425,672)	—
Interest paid on noncapital revenue bonds		(20,014)	(17,060)
		(620,433)	(174,954)
Cash flows from capital and related financing activities:			
Additions to plant and equipment, net		(489,135)	(465,831)
Purchase of natural gas field		—	(230,190)
Capital contributions		22,937	12,186
Principal payments and maturities on long-term debt		(108,434)	(172,600)
Proceeds from issuance of bonds and revenue certificates		—	956,171
Debt interest payments		(182,981)	(133,831)
		(757,613)	(34,095)
Cash flows from investing activities:			
Purchases of investment securities		(1,839,545)	(2,122,855)
Sales and maturities of investment securities		2,126,176	2,214,078
Purchase of long-term notes receivable		—	(92,385)
Proceeds from notes receivable		32,887	44,999
Investment income		149,867	101,630
		469,385	145,467
Net increase (decrease)		(400,727)	495,575
Cash and cash equivalents:			
Cash and cash equivalents at July 1 (including $731,205 and $405,561 reported in restricted accounts, respectively)		1,046,503	550,928
Cash and cash equivalents at June 30 (including $196,959 and $731,205 reported in restricted accounts, respectively)	$	645,776	1,046,503

(Continued)

LOS ANGELES DEPARTMENT OF WATER AND POWER
POWER SYSTEM

Statements of Cash Flows

Years ended June 30, 2007 and 2006

(Amounts in thousands)

		2007	2006
Reconciliation of operating income to net cash provided by operating activities:			
Operating income	$	333,818	209,468
Adjustments to reconcile operating income to net cash provided by operating activities:			
Depreciation and amortization		269,587	270,841
Depletion expenses		6,358	5,200
Amortization of nuclear fuel		10,227	12,939
Provision for losses on customer and other accounts receivable		9,166	11,457
Provision for obsolete inventory		—	11,500
Changes in assets and liabilities:			
Customer and other accounts receivable		(15,441)	(25,843)
Accrued unbilled revenue		(6,949)	(15,108)
Materials and fuel		(6,242)	(6,405)
Deferred debits		(228,181)	—
Net pension asset		15,083	14,728
Accounts payable and accrued expenses		(24,598)	63,427
Accrued liabilities		228,181	—
Deferred credits		(83,868)	(61,391)
Due to Water System		(9,562)	(4,001)
Net other postemployment benefit liability		18,795	39,655
Workers' compensation liability and other		(8,440)	32,690
Net cash provided by operating activities	$	507,934	559,157

See accompanying notes to financial statements.

(1) Summary of Significant Accounting Policies

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

(a) Method of Accounting

The accounting records of the Power System are maintained in accordance with U.S. generally accepted accounting principles (GAAP) for governmental entities. The financial statements have been prepared using the economic resources measurement focus and the accrual basis of accounting. Prior to fiscal year 2003, the Department applied all statements issued by the Governmental Accounting Standards Board (GASB) and all statements and interpretations issued by the Financial Accounting Standards Board (FASB), which are not in conflict with statements issued by GASB. In fiscal year 2003, the Department changed its election under the guidance in GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting* (GASB No. 20), to follow all GASB statements and only FASB statements and interpretations issued on or before November 30, 1989.

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

(b) Use of Estimates

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

(c) Utility Plant

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

(d) Impairment of Long-Lived Assets

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

(e) Depreciation and Amortization

Depreciation expense is computed using the straight-line method based on service lives for all projects completed after July 1, 1973, and for all office and shop structures, related furniture and equipment, and transportation and construction equipment. Depreciation for facilities completed prior to July 1, 1973 is computed using the 5.0% sinking fund method based on estimated service lives. The Department uses the composite method of depreciation and, therefore, groups assets into composite groups for purposes of calculating depreciation expense. Estimated service lives range from 5 to 75 years. Amortization expense for computer software is computed using the straight-line method over 5 years. Depreciation and amortization expense as a percentage of average depreciable utility plant in service were 2.8% and 3.0% for fiscal years 2007 and 2006, respectively.

(f) Nuclear Decommissioning

The Department owns a 5.7% direct ownership interest in the Palo Verde Nuclear Generating Station (PVNGS). In addition, through its participation in the Southern California Public Power Authority (SCPPA), the Department is party to a contract for an additional 3.95% of the output of PVNGS. Nuclear decommissioning costs associated with the Power System's output entitlement are included in purchased power expense (see note 6).

Decommissioning of PVNGS is expected to commence subsequent to the year 2024. The total cost to decommission the Power System's direct ownership interest in PVNGS is estimated to be $130 million in 2004 dollars. This estimate is based on an updated site-specific study prepared by an independent consultant in 2004. As of June 30, 2007 and 2006, the Power System has recorded $122.4 million and $116.6 million, respectively, to accumulated depreciation to provide for the decommissioning liability.

Prior to December 1999, the Power System contributed $70.2 million to external trusts established in accordance with the PVNGS participation agreement and Nuclear Regulatory Commission requirements. During fiscal year 2000, the Department suspended contributing additional amounts to the trust funds, as management believes that contributions made, combined with reinvested earnings, will be sufficient to fully fund the Department's share of decommissioning costs. The Department will continue to reinvest its investment income into the decommissioning trusts. The Department reinvested $5.8 million and $1.3 million of investment income in fiscal years 2007 and 2006, respectively. Decommissioning funds, which are included in restricted investments, totaled $102.8 million and $97.0 million as of June 30, 2007 and 2006 (at fair value), respectively. The Department's current accounting policy recognizes any realized and unrealized investment earnings from nuclear decommissioning trust funds as a component of accumulated depreciation.

(g) Nuclear Fuel

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

(h) Natural Gas Field

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

Depletion expense related to the gas field is recorded as a component of fuel for generation expense. During fiscal year 2007 and 2006, the Power System recorded $10.2 million and $12.9 million of depletion expense, respectively.

(i) Cash and Cash Equivalents

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

At June 30, 2007 and 2006, restricted cash and cash equivalents include the following (amounts in thousands):

		June 30	
		2007	**2006**
Bond redemption and interest funds	$	120,044	149,308
Construction funds		483	515,471
Self-insurance fund		73,868	63,862
Other		2,564	2,564
	$	196,959	731,205

(j) Materials and Fuel

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

(k) Accrued Unbilled Revenue

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

(l) Restricted Investments

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

(m) Accrued Employee Expenses

Accrued employee expenses include accrued payroll and an estimated liability for vacation leave, sick leave, and compensatory time, which is accrued when employees earn the rights to the benefits. Below is a schedule of accrued employee expenses as of June 30, 2007 and 2006 (amounts in thousands):

		June 30	
		2007	**2006**
Type of expenses:			
Accrued payroll	$	29,352	31,178
Accrued vacation		37,704	35,125
Accrued sick time		8,727	8,399
Compensatory time		9,125	7,873
Total	$	84,908	82,575

(n) Debt Expenses

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

(o) Gas and Electricity Option and Location Swap Agreements

Gas and electricity option and location swap agreements were previously reported at fair value on the balance sheets. With the change in election under GASB No. 20, the Department now accounts for these contracts on a settlement basis (see note 9).

(p) Accrued Workers' Compensation Claims

Liabilities for unpaid workers' compensation claims are recorded at their present value when they are probable of occurrence and the amount can be reasonably estimated (see note 13).

(q) Customer Deposits

Customer deposits represent deposits collected from customers upon opening of new accounts. These deposits are obtained when the customer does not have a previously established credit history with the Department. Original deposits plus interest are paid to the customer once a satisfactory payment history is maintained, generally after one to three years. The Water System is responsible for collection, maintenance, and refunding of these deposits for all Department's customers, including those of the Power System. As such, the Water System's balance sheets include a deposit liability of $80.0 million and $67.9 million as of June 30, 2007 and 2006, respectively, for all customer deposits collected. In the event that the Water System defaults on refunds of such deposits, the Power System would be required to pay amounts owing to its customers.

(r) Revenues

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

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

(s) Capital Contributions

Capital contributions (formally referred to as contributions in aid of construction) and other grants received by the Department for constructing utility plant and other activities are recognized when all applicable eligibility requirements, including time requirements, are met.

(t) Allowance for Funds Used During Construction

An AFUDC represents the cost of borrowed funds used for the construction of utility plant. Capitalized AFUDC is included as part of the cost of utility plant and as a reduction of debt expenses. The average AFUDC rate was 4.6% for fiscal years 2007 and 2006.

(u) Use of Restricted and Unrestricted Resources

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

(v) Reclassifications

Certain financial statement items for 2006 have been reclassified to conform to the 2007 presentation.

(2) Recent Accounting Pronouncements

(a) GASB Statement No. 49

In November 2006, the GASB issued Governmental Accounting Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations* (GASB No. 49). This Statement addresses accounting and financial reporting standards for pollution (including contamination) remediation obligations, which are obligations to address the current or potential detrimental effects of existing pollution by participating in pollution remediation activities, such as site assessments and cleanups. The scope of the document excludes pollution prevention or control obligations with respect to current operations and future pollution remediation activities that are required upon retirement of an asset, such as landfill closure and postclosure care and nuclear power plant decommissioning. This statement is effective for the Department beginning in fiscal year 2009. The Department has not yet determined the financial statement impact of adopting this new statement.

(b) GASB Statement No. 50

In May 2007, the GASB issued Governmental Accounting Statement No. 50, *Pension Disclosures—an amendment to GASB Statement’s No. 25 and No. 27* (GASB No. 50). This statement more closely aligns the financial reporting requirements for pensions with those for other postemployment benefits (OPEB) and, in doing so, enhances information disclosed in notes to the financial statements or presented as required supplementary information (RSI) by pension plans and by employers that provide pension benefits. The reporting changes required by this statement amend applicable note disclosure and RSI requirements of GASB Statements No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans,* and No. 27*, Accounting for Pensions by State and Local Governmental Employers,* to conform to requirements of GASB Statements No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, and No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions.* This statement is effective for the Department beginning fiscal year 2008. The Department does not expect that there will be a material impact to the financial statement disclosures as a result of adopting this statement.

(c) GASB Statement No. 51

In June 2007, the GASB issued Governmental Accounting Statement No. 51, *Accounting and Financial Reporting for Intangible Assets* (GASB No. 51). This statement establishes accounting and financial reporting standards for intangible assets. Intangible assets include, but are not limited to, easements, water rights, timber rights, patents, trademarks, and computer software. This statement is effective for the Department beginning fiscal year 2010. The Department has not yet determined the financial statement impact of adopting this new statement.

(3) Regulatory Matters

(a) Federal Regulation of Transmission Access

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

FERC is encouraging the voluntary formation of regional transmission organizations (RTOs) independent from owners of generation and other market participants that will provide transmission access on a nondiscriminatory basis to buyers and sellers of power. Investor-Owned Utilities (IOUs) and publicly owned utilities are being encouraged to participate in the formation and operation of RTOs, but are not, at this time, being ordered by FERC to participate. FERC has adopted a “go slow” approach to the issue of RTO formation in the western United States; it is contemporaneously engaged in a wholesale overhaul of the California market design, referred to initially as the Market Design 2002 proceeding and more recently as the Market Redesign and Technology Update (MRTU) proceeding. These FERC proceedings will have potential impacts on every electric utility doing business in California. MRTU involves a comprehensive overhaul of the electricity markets administered by California Independent System Operator (CAISO), including the areas of transmission congestion management, trading and scheduling energy in the day ahead, or spot market, improved market power mitigation, and pricing transparency measures and system improvements to increase operational efficiency and enhance reliability, among other things. Currently, MRTU is scheduled to be implemented on March 31, 2008. It is not certain at this time what impact, if any, FERC’s final decision on MRTU will have on the Power System. In addition, CAISO has announced its intention to implement further market changes over the next five years.

(Continued)

(b) Federal Energy Legislation

On August 8, 2005, the Energy Policy Act of 2005 (the EP Act) was enacted, the first comprehensive energy legislation in over a decade. One of the most significant provisions of the EP Act repeals the Public Utility Holding Company Act of 1935 (PUHCA) six months after the effective date of the Act, on February 8, 2006. PUHCA prevented investment in the public utility sector by entities such as financial institutions and industrial companies and was a barrier to consolidation within the industry through its requirement that merged companies operate within a single region.

Another significant provision of the Act empowers FERC to certify an Electric Reliability Organization (ERO) to improve the reliability of the nation's "bulk-power system" through mandatory and enforceable electric reliability standards (in contrast to the current voluntary system). The definition of "bulk-power system" does not include facilities used in the local distribution of electric energy. The ERO will file any proposed reliability standard or modification with FERC. A "reliability standard" is a requirement that provides for reliable operation of the bulk-power system. Such a standard includes requirements for the operation of existing transmission facilities or the design of planned additions or modifications to the extent necessary to provide for reliable operation. It does not include, and the ERO may not impose, any requirement to enlarge existing facilities or to construct new transmission or generation. All users, owners, and operators of the bulk-power system are required to comply with the electric reliability standards. The ERO may impose a penalty on a user, owner, or operator for violating a reliability standard, and FERC may order compliance with such a standard and impose a penalty if it finds that a user, owner, or operator is about to engage in an act that would violate a reliability standard.

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

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

In addition, the EP Act prohibits any person from willfully and knowingly reporting false information to any federal agency on the price of wholesale electricity or availability of transmission capacity, or using (directly or indirectly) any manipulative device in contravention of any FERC rule. The EP Act increases civil and criminal penalties, modifies the procedures for review of FERC orders under the FPA, and changes the refund date under the FPA to be effective as of the date an applicable complaint is filed. The EP Act also establishes an entity's right to a refund if (i) it makes a short-term sale of electric energy through an organized market in which the rates for the sale are set by a FERC-approved tariff (not by a contract) and (ii) the sale violates the terms of the tariff or applicable FERC rule in effect at the time of the sale.

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

(4) Utility Plant

The Power System had the following activities in utility plant during fiscal year 2007 (amounts in thousands):

	Balance July 1, 2006	Additions	Retirements and disposals	Transfers	Balance June 30, 2007
Nondepreciable utility plant:					
Land and land rights	$ 144,621	126	(1,234)	—	143,513
Construction work in progress	570,418	247,773	—	(44,497)	773,694
Nuclear fuel	14,578	10,091	(6,358)	—	18,311
Natural gas field	237,403	7,987	(10,227)	—	235,163
Total nondepreciable utility plant	967,020	265,977	(17,819)	(44,497)	1,170,681
Depreciable utility plant:					
Generation	3,429,568	32,752	(972)	3,871	3,465,219
Transmission	829,496	52,434	—	656	882,586
Distribution	4,245,071	120,410	(998)	35,809	4,400,292
General	939,202	30,886	(63)	4,161	974,186
Total depreciable utility plant	9,443,337	236,482	(2,033)	44,497	9,722,283
Less accumulated depreciation:					
Generation	(1,934,917)	(115,268)	972	—	(2,049,213)
Transmission	(357,062)	(19,596)	—	—	(376,658)
Distribution	(1,784,373)	(110,416)	998	—	(1,893,791)
General	(624,654)	(25,623)	63	—	(650,214)
Total accumulated depreciation	(4,701,006)	(270,903)	2,033	—	(4,969,876)
Total utility plant, net	$ 5,709,351	231,556	(17,819)	—	5,923,088

Depreciation and amortization expense during fiscal 2007 was $269.6 million.

The Power System had the following activities in utility plant during fiscal year 2006 (amounts in thousands):

	Balance July 1, 2005	Additions	Retirements and disposals	Transfers	Balance June 30, 2006
Nondepreciable utility plant:					
Land and land rights	$ 148,568	6,619	(10,566)	—	144,621
Construction work in progress	434,105	324,694	—	(188,381)	570,418
Nuclear fuel	13,472	6,306	(5,200)	—	14,578
Natural gas field	—	250,342	(12,939)	—	237,403
Total nondepreciable utility plant	596,145	587,961	(28,705)	(188,381)	967,020
Depreciable utility plant:					
Generation	3,376,741	27,926	(8,666)	33,567	3,429,568
Transmission	792,262	797	(895)	37,332	829,496
Distribution	4,070,937	78,343	(11,733)	107,524	4,245,071
General	971,216	35,831	(77,803)	9,958	939,202
Total depreciable utility plant	9,211,156	142,897	(99,097)	188,381	9,443,337
Less accumulated depreciation:					
Generation	(1,835,185)	(107,409)	7,677	—	(1,934,917)
Transmission	(340,535)	(16,806)	183	96	(357,062)
Distribution	(1,676,710)	(109,044)	1,384	(3)	(1,784,373)
General	(655,900)	(35,537)	66,876	(93)	(624,654)
Total accumulated depreciation	(4,508,330)	(268,796)	76,120	—	(4,701,006)
Total utility plant, net	$ 5,298,971	462,062	(51,682)	—	5,709,351

Depreciation and amortization expense during fiscal 2006 was $270.8 million.

(5) Jointly Owned Utility Plant

The Power System has direct interests in several electric generating stations and transmission systems, which are jointly owned with other utilities. As of June 30, 2007 and 2006, utility plant includes the following amounts related to the Power System's ownership interest in each jointly owned utility plant (amounts in thousands, except as indicated):

	Ownership interest	Share of capacity (MWs)	Utility plant in service June 30, 2007 Cost	Utility plant in service June 30, 2007 Accumulated depreciation	Utility plant in service June 30, 2006 Cost	Utility plant in service June 30, 2006 Accumulated depreciation
Palo Verde Nuclear Generating Station	5.7%	224	$ 552,460	309,963	546,915	284,929
Navajo Generating Station	21.2	477	315,940	257,463	318,440	243,618
Mohave Generating Station	10.0	—	68,334	68,273	70,136	68,619
Pacific Intertie DC Transmission Line	40.0	1,240	261,908	71,326	211,709	66,690
Other transmission systems	—	Various	80,792	44,504	77,598	39,897
			$ 1,279,434	751,529	1,224,798	703,753

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

(6) Purchase Power Commitments

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

	Agency	Agency share	Power System's interest in agency's share: Interest	Capacity (MWs)	Outstanding principal
Intermountain Power Project	IPA	100.0%	62.2%	1,091	$ 1,343,535
Palo Verde Nuclear Generating Station	SCPPA	5.9	67.0	151	76,189
Mead-Adelanto Project	SCPPA	68.0	36.0	291	77,952
Mead-Phoenix Project	SCPPA	17.8 – 22.4	25.0	148	17,072
Southern Transmission System	SCPPA	100.0	60.0	1,142	520,399

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

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

The above agreements require the Power System to make certain minimum payments, which are based primarily upon debt service requirements. In addition to average annual fixed charges of approximately $309 million during each of the next five years, the Power System is required to pay for operating and maintenance costs related to actual deliveries of energy under these agreements (averaging approximately $342 million annually during each of the next five years). The Power System made total payments under these agreements of approximately $497 million and $433 million in fiscal years 2007 and 2006, respectively. These agreements are scheduled to expire from 2027 to 2030.

The Power System earned fees under the IPP project manager and operating agent agreements totaling $17.7 million and $16.9 million in fiscal years 2007 and 2006, respectively.

(a) Long-Term Notes Receivable

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

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

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

The IPA notes are subordinate to all of IPA's publicly held debt obligations. The Power System's future payments to IPA will be partially offset by interest payments and principal maturities from the subordinated notes receivable. The net IPA notes receivable balance totaled $1.14 billion and $1.17 billion as of June 30, 2007 and 2006, respectively.

(b) Energy Entitlement

The Department has a contract through 2017 with the U.S. Department of Energy for the purchase of available energy generated at the Hoover Power Plant. The Power System's share of capacity at Hoover is approximately 500 MWs. The cost of power purchased under this contract was $15 million and $13 million in fiscal years 2007 and 2006, respectively.

(7) Cash, Cash Equivalents, and Investments

(a) Restricted and Other Investments

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

		June 30	
		2007	**2006**
Restricted and other investments:			
Restricted investments:			
Debt reduction trust funds	$	503,292	450,561
Postretirement healthcare benefit trust		—	342,319
Nuclear decommissioning trust fund		102,799	97,017
Natural gas trust fund		25,050	25,043
SCPPA Palo Verde Investment		37,569	40,400
Total restricted investments		668,710	955,340
Other investments:			
Cash collateral received from securities lending transactions – Department Program only* (see note 8)		125,798	—
Total restricted and other investments	$	794,508	955,340

* The Power System also has $112,148 and $73,509 of cash collateral received from securities lending transactions in the City's securities lending program as of June 30, 2007 and 2006, respectively (see notes 7(b) and 8).

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

Debt Reduction Trust Funds

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

Postretirement Healthcare Benefit Trust Funds

The postretirement healthcare benefit trust fund was established to provide for the payment of the Department's postretirement healthcare benefits. In fiscal 2007, the Department transferred the balance to the Retiree Health Benefits Fund, a fiduciary fund (see note 12).

Nuclear Decommissioning Trust Funds

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

Natural Gas Trust Fund

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

SCPPA Palo Verde Investment

The SCPPA Palo Verde investment is a fixed rate investment held by SCPPA to be drawn down over the next 12 years to pay for purchased power obligations arising from the Department's participation in the SCPPA Palo Verde project.

As of June 30, 2007, the Power System's securities lending, cash collateral, and restricted investments and their maturities are as follows (in thousands):

		Investment maturities				
Type of investment	**Fair value**	**1 to 30 days**	**31 to 60 days**	**61 to 365 days**	**366 days to 5 years**	**Over 5 years**
U.S. agencies	$ 384,820	29,161	31,080	91,442	200,869	32,268
Medium-term notes	147,227	20,337	9,256	71,318	46,317	—
Commercial paper	54,027	19,789	9,935	24,302	—	—
Negotiable CDs	42,446	—	12,450	29,996	—	—
Money market funds	2,621	2,621	—	—	—	—
Securities lending cash collateral:						
Repurchase agreements	85,000	85,000	—	—	—	—
Commercial paper	39,927	37,937	1,990	—	—	—
Money market funds	871	871	—	—	—	—
SCPPA Palo Verde investment	37,569	37,569	—	—	—	—
	$ 794,508	233,285	64,711	217,058	247,186	32,268

As of June 30, 2006, the Power System's securities lending, cash collateral, and restricted investments and their maturities are as follows (in thousands):

		Investment maturities				
Type of investment	**Fair value**	**1 to 30 days**	**31 to 60 days**	**61 to 365 days**	**366 days to 5 years**	**Over 5 years**
U.S. agencies	$ 462,387	4,149	24,032	145,872	206,038	82,296
Medium-term notes	190,489	11,634	19,744	107,470	51,641	—
Commercial paper	158,070	121,009	27,168	9,893	—	—
Negotiable CDs	94,889	—	62,688	32,201	—	—
Money market funds	9,105	9,105	—	—	—	—
SCPPA Palo Verde investment	40,400	40,400	—	—	—	—
	$ 955,340	186,297	133,632	295,436	257,679	82,296

i *Interest Rate Risk*

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

ii. *Credit Risk*

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

The U.S. government agency securities in the portfolio consist of securities issued by government-sponsored enterprises, which are not explicitly guaranteed by the U.S. government. As of June 30, 2007 and 2006, the U.S. government agency securities in the portfolio carried the highest possible credit ratings by the Nationally Recognized Statistical Rating Organizations (NRSROs) that rated them.

The Department's investment policy specifies that medium-term corporate notes must be rated in a rating category of "A" or its equivalent or better by a NRSRO. Of the Power System's investments in corporate notes as of June 30, 2007, $24,409,663 (17%) was rated in the category of AAA, $93,307,449 (63%) was rated in the category of AA, and $29,510,044 (20%) was rated in the category of A by at least one NRSRO. Of the Power System's investments in corporate notes as of June 30, 2006, $3,385,560 (2%) was rated in the category of AAA, $129,933,595 (68%) was rated in the category of AA, and $57,170,056 (30%) was rated in the category of A by at least one NRSRO.

The Department's investment policy specifies that commercial paper must be of the highest ranking or of the highest letter and number rating as provided for by at least two NRSROs. As of June 30, 2007 and 2006, all of the Power System's investments in commercial paper were rated with at least the highest letter and number rating as provided by at least two NRSROs.

The Department's investment policy specifies that negotiable certificates of deposit must be of the highest ranking or letter and number rating as provided for by at least two NRSROs. As of June 30, 2007 and 2006, all of the Power System's investments in negotiable certificates of deposits were rated with at least the highest letter and number rating as provided by at least two NRSROs.

The Department's investment policy specifies that money market funds may be purchased as allowed under the Code, which requires that the fund must have either 1) attained the highest ranking or highest letter and numerical rating provided by not less than two NRSROs or 2) retained an investment advisor registered or exempt from registration with the Securities and Exchange Commission with not less than five years experience managing money market mutual funds with assets under management in excess of $500 million. As of June 30, 2007 and 2006, each of the money market funds in the portfolio had the highest possible ratings by three NRSROs, specifically AAAm by Standard and Poor's Corporation (S&P) and Aaa by Moody's Investors Service (Moody's), and AAA by Fitch Ratings (Fitch).

The Department's securities lending cash collateral investment policy specifies that repurchase agreement transactions shall be limited to broker/dealers or banks for which a securities lending line has been approved by the securities lending agent. Approved counterparties must be primary dealers in U.S. government securities that work directly with the Federal Reserve Bank of New York. Repurchase agreements must be adequately collateralized based on the margin requirements for the type of security listed in the investment policy. As of June 30, 2007, the counterparty to the repurchase agreement was an approved primary dealer rated with the highest short-term ratings as provided by two NRSROs. The collateral for the repurchase agreement consisted of mortgage-backed securities issued by U.S. government agencies that had minimum credit ratings of AAA with a margin of 102% of the repurchase agreements. As of June 30, 2006, the Power System did not have any securities on loan under securities lending transactions and, therefore, had no related reinvestments of cash collateral.

The Department's securities lending cash collateral investment policy specifies that commercial paper must be of the highest ranking or of the highest letter and number rating as provided for by at least two NRSROs. As of June 30, 2007, all of the commercial paper purchased with cash collateral had the highest rating provided by two NRSROs.

The Department's securities lending cash collateral investment policy specifies that money market funds may be purchased with cash collateral as allowed under the Code. As of June 30, 2007, the money market fund purchased with cash collateral was in compliance with the Code by having attained the highest possible ratings by three NRSROs, specifically AAAm by S&P, Aaa by Moody's, and AAA by Fitch.

iii. Concentration of Credit Risk

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

Of the Power System's total investments as of June 30, 2007, $151,897,853 (20%) was invested in securities issued by the Federal National Mortgage Association; $141,413,981 (19%) was invested in securities issued by the Federal Home Loan Bank; and $84,244,675 (11%) was invested in securities issued by the Federal Home Loan Mortgage Corporation.

Of the Power System's total investments as of June 30, 2006, $148,351,195 (16%) was invested in securities issued by the Federal Home Loan Bank; $144,048,527 (16%) was invested in securities issued by the Federal Home Loan Mortgage Corporation; and $129,360,590 (14%) was invested in securities issued by the Federal National Mortgage Association.

For overnight or open repurchase agreements, the Department's securities lending policy does not limit the percentage of cash collateral that may be invested with one particular counterparty. Of the Power System's total investments as of June 30, 2007, cash collateral received from securities lending transactions of $85,000,000 (11%) was invested in an overnight repurchase agreement with Morgan Stanley and $8,000,000 (1%) was invested in commercial paper issued by Morgan Stanley for a total investment of $93,000,000 (12%) in securities issued by Morgan Stanley.

(b) Pooled Investments

The Power System's cash, cash equivalents and its collateral value of the City's securities lending program are included within the City Treasury's General and Special Investment Pool (Pool). As of June 30, 2007 and 2006, the Power System's share of the Pool was $757,924,000 and $1,120,012,000, which represents approximately 10% and 15% of the Pool, respectively.

At June 30, 2007, the investments held in the City Treasury's General and Special Investment Pool Programs and their maturities are as follows (amounts in thousands):

		Investment maturities			
Type of investment	**Amount**	**1 to 30 days**	**31 to 60 days**	**61 to 365 days**	**366 days to 5 years**
U.S. Treasury notes	$ 1,651,432	—	—	100,394	1,551,038
U.S. government agencies	2,588,342	270,397	63,258	267,283	1,987,404
Medium-term notes	1,135,468	—	—	364,595	770,873
Commercial paper	900,606	811,138	54,758	34,710	—
Guaranteed investment contract	314,860	314,860	—	—	—
State of California LAIF	2,664	2,664	—	—	—
Short-term investment funds	7	7	—	—	—
Securities lending cash collateral:					
U.S. Treasury notes	898,087	—	—	5,386	892,701
U.S. government agencies	217,385	—	—	—	217,385
Total general and special pools	$ 7,708,851	1,399,066	118,016	772,368	5,419,401

At June 30, 2006, the investments held in the City Treasury's General and Special Investment Pool Programs and their maturities are as follows (amounts in thousands):

		Investment maturities			
Type of investment	**Amount**	**1 to 30 days**	**31 to 60 days**	**61 to 365 days**	**366 days to 5 years**
U.S. Treasury notes	$ 750,633	—	—	—	750,633
U.S. Treasury bills	7,193	7,193	—	—	—
U.S. government agencies	3,483,994	229,854	259,964	519,398	2,474,778
Medium-term notes	1,077,004	—	—	125,689	951,315
Commercial paper	1,298,356	1,173,459	52,464	72,433	—
State of California LAIF	2,204	2,204	—	—	—
Short-term investment funds	13	13	—	—	—
Securities lending cash collateral:					
U.S. Treasury notes	607,597	—	—	—	607,597
U.S. agencies	344,340	—	—	—	344,340
Total general and special pools	$ 7,571,334	1,412,723	312,428	717,520	5,128,663

i. Interest Rate Risk

The City's investment policy limits the maturity of its investments to a maximum of five years for U.S. Treasury and federal agency securities, medium-term corporate notes, and bonds issued by local agencies; 270 days for commercial paper; and 92 days for repurchase agreements.

ii. Credit Risk

As of June 30, 2007, the City's pooled investment policy requires that for all classes of investments, except linked banking program certificates of deposits, the issuers' minimum credit ratings shall be S&P A-1/A or Moody's P-1/A2; if available, Fitch IBCA F1/A. In addition, domestic banks are limited to those with a current Fitch Ratings BankWatch of "B/C" or better and an A-1 short-term rating. The City Treasurer is granted the authority to specify approved California banks with a Fitch Ratings BankWatch of "C" or better and an A-2 rating where appropriate. Foreign banks with domestic licensed offices must be rated AAA for country risk, "B" or better, and TBW-1 short-term rating by Fitch Ratings BankWatch. Domestic savings banks must be rated "B/C" or better and a TBW-1 short-term rating by Fitch Ratings BankWatch.

Medium-term notes must be issued by corporations operating within the United States and having total assets in excess of $500 million. Commercial paper issuers must meet the preceding requirement or must be issued by corporations organized in the United States as a special purpose corporation, trust, or limited liability company having program-wide credit enhancements.

The City's $2.59 billion investments in U.S. government agencies consist of securities issued by government-sponsored enterprises, which are not explicitly guaranteed by the U.S. government. As of June 30, 2007, these securities carried the highest ratings of AAA (S&P) and Aaa (Moody's).

The City's $1.14 billion investments in medium term notes consist of securities issued by banks and corporations that comply with the requirements discussed above and were rated "A" or better by S&P and "A2" or better by Moody's.

The City's $900.6 million investments in commercial paper comply with the requirements discussed above and were rated A-1+/A-1 by S&P and P-1 by Moody's.

The issuers of the guaranteed investment contracts and the State of California Local Agency Investment Fund (LAIF) are not rated.

As of June 30, 2006, the City's pooled investment policy requires that for all classes of investments, except linked banking program certificates of deposits, the issuers must have minimum credit ratings as follows: S&P A-1/A; Moody's P-1/A2; Fitch, if available, F-1/A. The City's investments in medium-term notes were rated A+ or better by S&P and A1 or better by Moody's, while investments in commercial paper were rated A-1+/A-1 by S&P and P-1 by Moody's. As further required by the City's investment policy, issurers of medium-term notes are corporations that have total assets in excess of $500 million and are operating within the United States. In addition, issuers of commercial paper notes are corporations organized in the United States as special purpose corporations, trust or limited liability companies having program-wide credit enhancements. The State of California Local Agency Investment Fund is not rated.

iii. Concentration of Credit Risk

The City's investment policy does not allow more than 10% of its investment portfolio, except U.S. Treasury and federal agencies, to be invested in securities of a single issuer, including its related entities. The City's investment policy further provides for a maximum concentration limit of 30% on any individual federal agency or government-sponsored entity. The City's pooled investments comply with these requirements. GAAP requires disclosure of certain investments in any one issuer that represents 5% or more of total investments, the City does not have such investment as of June 30, 2007 or 2006.

(8) Securities Lending Transactions

The Power System participates in two securities lending programs as follows (collateral amounts in thousands):

Program	June 30 2007	June 30 2006
Department Program	$ 125,798	—
City of Los Angeles Program	112,148	73,509
	$ 237,946	73,509

Department Program

In December 1999, the Department initiated a securities lending program managed by its custodial bank to increase interest income. The bank lends up to 20% of the investments held in the debt reduction trust funds, decommissioning trust funds, postretirement healthcare benefits trust for securities, cash collateral or letters of credit equal to 102% of the market value of the loaned securities, and interest, if any. The Department can sell securities received as collateral only in the event of borrower default. Both the investments purchased with the cash collateral received and the related liability to repay the cash collateral are reported on the balance sheets. A summary of the Power System's portion of the Department's securities lending program as of June 30, 2007 and 2006 is as follows (amounts in thousands):

	June 30			
	2007		2006	
Securities lent for cash collateral	Fair value of underlying securities	Collateral value	Fair value of underlying securities	Collateral value
U.S. government and agency securities	$ 123,228	125,798	—	—

Cash collateral received is reinvested by the lending agent in open repurchase agreements. As such, the maturities of reinvested cash collateral always match the maturities of the underlying securities lent. The lending agent provides indemnification for borrower default. There were no violations of legal or contractual provisions and no borrower or lending agent default losses during fiscal years 2007 and 2006.

General Investment Pool Program

The Power System also participates in the City's securities lending program through the pooled investment fund. The City's program has substantially the same terms as the Department's direct securities lending program. The Department recognizes its proportionate share of the cash collateral received for securities loaned and the related obligation for the general investment pool. As of June 30, 2007 and 2006, the Power System's attributed share of cash collateral and the related obligation from the City's program was $112.1 million and $73.5 million, respectively.

Management believes that participation in these securities lending programs increases interest earnings and results in minimal credit risk exposure to the Department because the amounts owed to the borrowers exceed the amounts that have been loaned.

(9) Derivative Instruments

In accordance with GASB Technical Bulletin 03-01, the Power System does not record its derivative instruments on the balance sheets, but instead discloses the derivatives in the financial statement footnotes and records the impact upon settlement of the derivatives. The Power System had three main types of derivative instruments as of June 30, 2007 and 2006: electricity swaps, forward contracts, and financial natural gas hedges. As of June 30, 2007 and 2006, the fair values of these outstanding derivative instruments were $36.8 million and $85.9 million, respectively.

(a) Objective of Electricity Swap and Options

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

A call option is the right, but not the obligation, to buy energy at a fixed price on or before a specific date. Because the Department has excess electric generation available at certain times during the year, it sells call options for a premium to other utilities. If the buyer calls the option, the Department is obligated to sell the energy for a specified dollar amount and deliver it to a specific delivery point. If the buyer does not call the option, the Department has no obligation to deliver energy, but does retain the premium collected. Premiums received are deferred and amortized to income over the period the option is outstanding and are recorded as part of sales for resale revenue. As of June 30, 2007 and 2006, the Power System had no deferred option revenue relating to options entered into prior to the fiscal year-end.

The Department does not enter into forward and option agreements for trading purposes. The Department is exposed to risk of nonperformance if the counterparties default or if the swap agreements are terminated.

(b) Objective of Forward Contracts

The Department enters into forward contracts in order to meet the electricity requirements to serve its customers.

(c) Objective of Financial Natural Gas Hedges

The Department enters into natural gas hedging contracts in order to stabilize the cost of gas needed to produce electricity to serve its customers.

As of June 30, 2007, the Power System had the following derivatives, which were not recorded on its balance sheet (amounts in thousands):

Derivative description	Total quantities	Contract price range $ per unit	First effective date	Last termination date	Fair value	Cash received at derivative inception
Electricity swaps:						
Purchases	123,200 MW	62.00	10/01/07	12/31/07	$ 83	—
Sales	123,200 MW	65.50	10/01/07	12/31/07	338	—
Electricity options	121,600MW	75.52 – 108.93	07/01/07	09/01/07	(67)	426
Forward contracts:						
Electricity	2,021,400 MW	75.25 – 84.75	07/01/07	12/31/11	(27)	—
Natural gas	310,000 MMBtu	3.43	07/01/07	07/31/07	166	—
Financial natural gas:						
Hedges*	77,610,500 MMBtu	4.30 – 7.50	07/01/07	06/01/11	36,348	—

* Financial hedges were variable to fixed rate swaps that serve to lock in a fixed cost of natural gas.

As of June 30, 2006, the Power System had the following derivatives, which were not recorded on its balance sheet (amounts in thousands):

Derivative description	Total quantities	Contract price range $ per unit	First effective date	Last termination date	Fair value	Cash received at derivative inception
Electricity swaps:						
Purchases	121,600 MW	63.00	10/01/06	12/31/06	$ (53)	—
Sales	121,600 MW	66.50	10/01/06	12/31/06	478	—
Electricity options	30,800 MW	75.50	07/01/06	09/30/06	(55)	346
Financial natural gas:						
Hedges*	91,336,000 MMBtu	4.30 – 7.49	10/01/05	06/01/10	85,521	—

* Financial hedges were variable to fixed rate swaps that serve to lock in a fixed cost of natural gas.

(d) Fair Value

All fair values were estimated using forward market prices available from broker quotes and exchanges.

(e) Credit Risk

The Power System is exposed to credit risk related to nonperformance by its wholesale counterparties under the terms of contractual agreements. In order to limit the risk of counterparty default, the Department has implemented a Wholesale Marketing Counterparty Evaluation Policy (the Policy). The Policy includes provisions to limit risk including: the assignment of internal credit ratings to all Department's counterparties based on counterparty and/or debt ratings; the requirement for credit enhancements (including irrevocable letters of credit, escrow trust accounts, and parent company guarantees) for counterparties that do not meet an acceptable level of risk; and the use of standardized agreements which allow for the netting of positive and negative exposures associated with a single counterparty.

As of June 30, 2007, the ten financial natural gas hedge counterparties were rated by Moody's as follows: two at Aaa, four at Aa1, three at Aa3, and one at A1. The counterparties were rated by S&P as follows: two at AA+, four at AA, three at AA-, and one at A. As of June 30, 2006, the eight financial natural gas hedge counterparties were rated by Moody's as follows: three at Aa1, two at Aaz and three at Aa3. The counterparties were rated by S&P as follows: two at AA+, one at AA, two at AA- and three at A+.

Based on the International Swap Dealers Association agreements, the Department obtains collateral to support derivatives subject to credit risk in the form of cash, negotiable debt instruments (other than interest only and principal-only securities) or eligible letters of credit. Collateral posted by a counter party is held by a custodian.

As discussed in note 14, during fiscal year 2001, the Power System experienced nonperformance and material counterparty default with the CAISO and the California Power Exchange (CPX). The Power System does not anticipate nonperformance by any other of its counterparties and has no reserves related to nonperformance at June 30, 2007 and 2006, respectively. Apart from the events discussed in note 14, the Power System did not experience any material counterparty default during fiscal years 2007 or 2006.

(f) Basis Risk

The Department mitigates basis risk through long-term physical transportation contracts.

(g) Termination Risk

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

(10) Long-Term Debt

Long-term debt outstanding as of June 30, 2007 and 2006 consists of revenue bonds and refunding revenue bonds due serially in varying annual amounts as follows (amounts in thousands):

Bond issues	Date of issue	Effective interest rate	Fiscal year of last scheduled maturity		Principal outstanding 2007	Principal outstanding 2006
Issue of 2001, Series A1	03/20/01	4.931%	2025	$	993,895	1,023,800
Issue of 2001, Series A2	11/06/01	5.109	2022		109,095	109,095
Issue of 2001, Series B	06/05/01	Variable	2035		580,800	620,600
Issue of 2001, Series C1	11/15/01	4.788	2017		3,211	4,543
Issue of 2002, Series A	08/22/02	Variable	2036		388,500	388,500
Issue of 2002, Series C2	11/22/02	4.375	2018		11,544	11,846
Issue of 2003, Series A1	07/31/03	3.409	2017		385,670	422,380
Issue of 2003, Series A2	08/19/03	4.662	2032		515,830	515,830
Issue of 2003, Series B	08/28/03	5.013	2036		200,000	200,000
Issue of 2004, Series C3	04/07/04	4.298	2020		11,899	12,192
Issue of 2005, Series A1	12/28/05	4.700	2041		616,895	616,895
Issue of 2005, Series A2	12/28/05	4.700	2031		315,195	315,195
Issue of 2006, Series C4	03/01/06	4.040	2017		8,526	8,618
Total principal amount					4,141,060	4,249,494
Revenue certificates					200,000	200,000
Unamortized premiums, discounts, and debt-related costs (including net loss on refundings), net					823	1,075
Debt due within one year (including current portion of variable rate debt)					(158,756)	(188,821)
				$	4,183,127	4,261,748

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

(a) Long-Term Debt Activity

The Power System had the following activity in long-term debt for the fiscal year ended June 30, 2007 and 2006 (amounts in thousands):

		Balance July 1, 2006	Additions	Reductions	Balance June 30, 2007	Current portion
Long-term debt:						
Bonds	$	4,250,569	—	(108,686)	4,141,883	138,756
Revenue certificates		200,000	—	—	200,000	20,000
Total	$	4,450,569	—	(108,686)	4,341,883	158,756

		Balance July 1, 2005	Additions	Reductions	Balance June 30, 2006	Current portion
Long-term debt:						
Bonds	$	3,457,583	966,155	(173,169)	4,250,569	168,821
Revenue certificates		200,000	—	—	200,000	20,000
Total	$	3,657,583	966,155	(173,169)	4,450,569	188,821

(b) New Issuances

Fiscal Year 2006

In December 2005, the Power System issued $932 million of Power System Revenue Bonds. Also, in March 2006, the Power System issued $8.9 million of Mini-Bonds. The net proceeds from both transactions were deposited into the construction fund to be used for capital improvements.

(c) Outstanding Debt Defeased

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

In July 2005, the Power System defeased the $116.3 million Power System Revenue Bonds, Series A, Sub series A-3 with a carrying amount of $115.3 million by utilizing $110.7 million from the debt reduction trust fund to purchase securities placed in an irrevocable trust to provide for all future debt service on the bonds. The transaction resulted in a realized gain of $4.6 million that was netted against interest on debt.

At June 30, 2007, the following revenue bonds outstanding are considered defeased (amounts in thousands):

Bond issues		Principal outstanding
Issue of 1992	$	495
Second Issue of 1993		8,855
Refunding Issue of 1994		41,365
Issue of 1994		5,950
	$	56,665

(d) Variable Rate Bonds and Revenue Certificates

The variable rate bonds currently bear interest at daily and weekly rates (ranging from 3.70% to 3.87% as of June 30, 2007). The Power System can elect to change the interest rate period of the bonds with certain limitations. The bondholders have the right to tender the bonds to the tender agent on any business day with seven days' prior notice. The revenue certificates bear interest at an average rate of 3.66%. The Power System has entered into standby and line-of-credit agreements with a syndicate of commercial banks in an initial amount of $580.8 million, $388.5 million, and $200 million to provide liquidity for the variable rate bonds and revenue certificates. The extended standby agreements expire in January 2010 for the $580.8 million issue and on July 11, 2008 for the $388.5 million issue. The $200 million line-of-credit agreement for the revenue certificates expires in September 2010.

On April 2, 2007, the Power System refunded $39.8 million of Power System Revenue Bonds 2001, Series B.

Bonds purchased under the agreements will bear interest that is payable quarterly at the greater of the Federal Funds Rate plus 0.50% or the bank's announced base rate, as defined. The unpaid principal of bonds purchased is payable in ten equal semiannual installments, commencing after the termination of the agreement. At its discretion, the Power System has the ability to convert the outstanding bonds to fixed rate obligations, which cannot be tendered by the bondholders. These bonds have been classified as long-term on the balance sheets as the liquidity facilities give the Power System the ability to refinance on a long-term basis and the Power System intends to either renew the facility or exercise its right to tender the debt as a long-term financing. The portion that would be due in the next fiscal year in the event that the outstanding variable rate bonds were tendered and purchased by the commercial banks under the standby agreements have been included in the current portion of long-term debt and was $116.9 million and $120.9 million at June 30, 2007 and 2006, respectively.

(e) Scheduled Principal Maturities and Interest

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

		Principal	Interest and amortization
Fiscal year(s) ending June 30:			
2008	$	41,826	192,632
2009		58,525	190,511
2010		98,952	186,528
2011		120,345	181,100
2012		127,309	178,417
2013 – 2017		613,854	775,206
2018 – 2022		648,694	625,928
2023 – 2027		797,695	437,091
2028 – 2032		821,430	258,982
2033 – 2037		728,945	70,819
2038 – 2042		83,485	5,458
Total requirements	$	4,141,060	3,102,672

The maturity schedule presented above reflects the scheduled debt service requirements for all of the Power System's long-term debt. The schedule is presented assuming that the tender options on the variable rate bonds, as discussed on the previous page, will not be exercised and that the full amount of the revenue certificates will be renewed. Should the bondholders exercise the tender options and the Power System convert all of the revenue certificates under the line of credit, the Power System would be required to redeem the $1,169.3 million in variable rate bonds outstanding over the next six years, as follows: $116.93 million in fiscal year 2008, $233.86 million in each of the fiscal years 2009 through 2012, and $116.93 million in fiscal year 2013. Accordingly, the balance sheets include the possibility of the exercise of the tender options and reflect the $116.93 million that could be due in fiscal year 2007 as a current portion of long-term debt payable. Interest and amortization include interest requirements for variable rate bonds, using the variable debt interest rate in effect at June 30, 2007 of 3.87%.

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

The Department has a funded contributory retirement, disability, and death benefit insurance plan covering substantially all of its employees. The Water and Power Employees' Retirement, Disability, and Death Benefit Insurance Plan (the Plan) operates as a single-employer defined benefit plan to provide pension benefits to eligible department employees and to provide disability and death benefits from the respective insurance funds. Plan benefits are generally based on years of service, age at retirement, and the employee's highest 12 consecutive months of salary before retirement. Active participants who joined the Plan on or after June 1, 1984 are required to contribute 6.00% of their annual covered payroll. Participants who joined the Plan prior to June 1, 1984 contribute an amount based upon an entry-age percentage rate. The Department contributes $1.10 for each $1.00 contributed by participants plus an actuarially determined annual required contribution (ARC) as determined by the Plan's independent actuary. The required contributions are allocated between the Power System and the Water System based on the current year labor costs.

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

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

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

		Year ended June 30	
		2007	2006
Annual required contribution	$	141,464	118,342
Interest on net pension asset		(11,883)	(13,023)
Adjustment to annual required contribution		17,707	19,405
APC (including $42.7 million and $36.2 million of amounts capitalized in fiscal years 2007 and 2006, respectively)		147,288	124,724
Department contributions		(129,057)	(101,630)
Change in NPO		18,231	23,094
NPO (asset) at beginning of year		(148,564)	(171,658)
NPO (asset) at end of year	$	(130,333)	(148,564)

(Continued)

The Power System's allocated share of APC and NPO consists of the following (amounts in thousands):

		Year ended June 30	
		2007	**2006**
Annual required contribution	$	96,195	78,106
Interest on net pension asset		(8,080)	(8,595)
Adjustment to annual required contribution		12,041	12,807
APC (including $26.3 million and $21.6 million of amounts capitalized in fiscal years 2007 and 2006, respectively)		100,156	82,318
Department contributions		(85,073)	(67,590)
Change in NPO		15,083	14,728
NPO (asset) at beginning of year		(99,793)	(114,521)
NPO (asset) at end of year	$	(84,710)	(99,793)

Annual required contributions are determined through actuarial valuations using the entry age normal actuarial cost method. The actuarial value of assets in excess of the Department's actuarial accrued liability (AAL) is being amortized by level contribution offsets over the period ended June 30, 2004. As a result of an April 2000 amendment to the Plan, the amortization period was changed to rolling 15-year periods effective July 1, 2000.

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

Actuarial valuation date July 1	**Normal cost**	**Surplus amortization**	**Contribution rate**
2006	10.82%	10.58%	22.25%
2005	10.77	7.69	19.20
2004	10.83	2.10	13.45

The significant actuarial assumptions include an investment rate of return of 8.0%, projected inflation-adjusted salary increases of 5.5%, and cost of living increases of 3.0%. The actuarial value of assets is determined using techniques that smooth the effects of short-term volatility in the market value of investments over a four-year period. Plan assets consist primarily of corporate and government bonds, common stocks, mortgage-backed securities, and short-term investments.

(Continued)

Trend information for fiscal years 2007, 2006, and 2005 for the Power System is as follows (amounts in thousands):

Year ended June 30	NPO (asset)	Percentage of APC contributed	APC
2007	$ (84,710)	85%	$ 100,156
2006	(99,793)	82	82,318
2005	(114,521)	86	56,777

Disability and Death Benefits

The Power System's allocated share of disability and death benefit plan costs and administrative expenses totaled $12 million and $9 million for fiscal years 2007 and 2006, respectively.

(12) Postretirement Healthcare Plan

(a) Plan Description

The Department provides certain healthcare benefits to active and retired employees and their dependents. The healthcare plan is administered by the Department. The Retirement Board and the Board have the authority to approve provisions and obligations. Eligibility for benefits for retired employees is dependent on a combination of age and service of the participants pursuant to a predetermined formula. Any changes to these provisions must be approved by the Boards. The total number of active and retired department participants entitled to receive benefits was approximately 16,750 and 16,450 at June 30, 2007 and 2006, respectively.

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

(b) Funding Policy

The Department pays a monthly maximum subsidy of $1,090 for medical and dental premiums depending on the employee's work location and benefits earned. Participants choosing plans with a cost in excess of the subsidy they are entitled to are required to pay the difference.

No funding policy has been established for the future benefits to be provided under this plan. However, in fiscal year 2007, the Department transferred $626,445,000 in investments and cash into the Retiree Health Benefits Fund and paid an additional $54,674,000 in retiree medical premiums. Power System's portion of these amounts was $425,672,000 and $36,740,000, respectively.

Prior to the creation of the Retiree Health Benefits Fund, the Department held assets in an irrevocable trust with the intent to transfer the funds into a fiduciary fund that met the requirements of GASB No. 45 once it was created and approved by both boards.

Annual OPEB Cost and Net OPEB Obligation

The annual other postemployment benefit (OPEB) cost (expense) is calculated based on the of the employer ARC, an amount actuarially determined in accordance with the parameters of GASB No. 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost under each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed 30 years.

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

		Year ended June 30	
		2007	**2006**
Annual required contribution	$	78,041	110,813
Interest on net OPEB obligation		13,496	7,094
Adjustment to annual required contribution		(9,867)	(5,353)
		81,670	112,554
Contributions made		(681,119)	(52,990)
Change in net OPEB obligation		(599,449)	59,564
Net OPEB obligation – beginning of year		168,704	109,140
Net OPEB obligation (asset) – end of year	$	(430,745)	168,704

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

		Year ended June 30	
		2007	**2006**
Annual required contribution	$	53,068	73,137
Interest on net OPEB obligation		9,177	4,682
Adjustment to annual required contribution		(6,709)	(3,533)
		55,536	74,286
Contributions made		(462,412)	(34,631)
Change in net OPEB obligation		(406,876)	39,655
Net OPEB obligation – beginning of year		110,823	71,168
Net other post employment benefit obligation/(asset) – end of year	$	(296,053)	110,823

The Department's annual OPEB cost, the percentage of annual required contribution contributed to the Plan, and the net postretirement obligation for fiscal years 2007 and 2006 were as follows (amounts in thousands):

		2007	**2006**	**2005**
Annual OPEB cost	$	81,670	112,554	103,204
Percentage of the ARC contributed		834%	47%	51%
Net postemployment obligation (asset)	$	(430,745)	168,704	109,140

The Power System's share in the annual OPEB cost, the percentage of annual required contribution contributed to the Plan, and the net retirement obligation for fiscal years 2007 and 2006 were as follows (amounts in thousands):

		2007	**2006**	**2005**
Annual OPEB cost	$	55,535	74,285	67,083
Percentage of the ARC contributed		833%	47%	51%
Net postemployment obligation (asset)	$	(296,053)	110,823	71,168

(Continued)

(c) Funded Status and Funding Progress (Unaudited)

As of July 1, 2006, the Department's AAL for benefits was $1.1 billion resulting in an unfunded actuarial accrued liability (UAAL) of $1.1 billion. The covered payroll (annual payroll of active employees covered by the Plan) was $635.7 million, and the ratio of the UAAL to the covered payroll was 166%.

As of July 1, 2005, the Department's AAL for benefits was $1.7 billion resulting in an UAAL of $1.7 billion. The covered payroll (annual payroll of active employees covered by the Plan) was $612.3 million, and the ratio of the UAAL to the covered payroll was 277%.

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

(d) Actuarial Methods and Assumptions

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

In the July 1, 2006 actuarial valuation, the entry-age normal cost method was used. The actuarial assumptions include 8.00% discount rate, which represents the expected long-term return on plan assets, an annual healthcare cost trend rate of 9.00% initially, reduced by decrements to an ultimate rate of 5.00% after eight years. Both rates include a 3.75% inflation assumption. The actuarial value of assets was determined using techniques that spread UAAL being amortized as a level percentage of projected payroll over a 29-year period.

In the July 1, 2005 actuarial valuation, the entry-age normal cost method was used. The actuarial assumptions include 6.5% discount rate, which represents the expected long-term return on plan assets, an annual healthcare cost trend rate of 11.0% initially, reduced by decrements to an ultimate rate of 5.0% after seven years. Both rates include a 4.0% inflation assumption. The actuarial value of assets was determined using techniques that spread UAAL being amortized as a level percentage of projected payroll over a 30-year period.

(Continued)

(13) Other Long-Term Liabilities

(a) Other Long-Term Liabilities

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

		Balance, July 1, 2006	Additions	Reductions	Balance, June 30, 2007
Accrued liabilities	$	—	228,181	—	228,181
Deferred credits:					
Purchased power	$	534,272	—	(76,643)	457,629
Public benefits		25,328	12,887	—	38,215
Over (under) recovered costs		—	—	(19,382)	(19,382)
Other		4,564	—	(730)	3,834
	$	564,164	12,887	(96,755)	480,296
Accrued workers' compensation claims	$	35,558	—	(7,190)	28,368

		Balance, July 1, 2005	Additions	Reductions	Balance, June 30, 2006
Deferred credits:					
Purchased power	$	612,828	—	(78,556)	534,272
Public benefits		12,727	12,601	—	25,328
Other		—	4,564	—	4,564
	$	625,555	17,165	(78,556)	564,164
Accrued workers' compensation claims	$	35,558	—	—	35,558

No portion of these liabilities is automatically due within one year.

(b) Accrued Liabilities

In June 2007, a tentative decision was awarded to certain public entities against the Department that claimed they were charged more than their proportional share of the Department's capital costs in violation of Section 54999 of the code. The Department has accrued a liability as of June 30, 2007 relative to the court's tentative decision, but intends to vigorously contest this matter. As of June 30, 2007, the Department has accrued $228.2 million related to this matter. In addition, in the event the Department is unsuccessful in defending this claim, a long-term deferred debit for the same amount has been accrued since these costs will need to be recovered in the future. (See note 14(d)ii)).

Effective January 1, 2007, the California Legislature has amended Section 54999 of the code, et seq. to clarify that, consistent with past practices, public agencies providing public utility service, such as the Department, may impose a reasonable fee, including a rate, charge, or other surcharge for any product, commodity, or service provided to a public agency and any public agency receiving service from such public agency providing public utility services will pay the imposed fee.

(c) Deferred Credits

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

Purchased Power Deferrals

During fiscal year 2006, the Board approved the suspension of deferring precollected purchased power costs and the reversal of the precollected purchased power costs recorded in prior years. The amount reversed is the cost of energy from IPP less the amount designated in rates for out-of-market purchased power costs. The reversal of the deferred credit is credited to retail sales. During fiscal years 2007 and 2006, the Power System reversed $76.6 million and $78.5 million, respectively, related to precollected purchase power costs. At June 30, 2007 and 2006, $457.6 million and $534.3 million, respectively, remain as part of deferred credits related to precollected purchased power costs.

Public Benefits

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

The Department defers public benefits revenue from customers in excess of costs incurred under qualifying programs and defers qualifying expenses in excess of collections pursuant to approval received from the Board. During fiscal years 2007 and 2006, the Department spent $52.0 million and $50.6 million, respectively, on public benefits programs. These programs include investments in electric buses and vehicles, photovoltaics or solar power and other alternative energy sources, and support for low-income and life support customers. As of June 30, 2007 and 2006, the Department has recorded a deferred credit in the amount of $38.2 million, and $25.3 million due to public benefit expenses below revenues. Regulatory liabilities are reduced when adequate public benefit expenses are incurred, and regulatory assets are recovered when the corresponding revenue is earned.

Over (Under) Recovered Costs

Effective October 1, 2006, the Energy Cost Adjustment Factor (ECAF), which is a billing factor defined in the electric rate ordinance was unfrozen. This change allows the Power System to increase or decrease the factor on a quarterly basis incompliance with the ordinance. While this change allows the Power System to fully recover fuel costs, purchased power costs, and other costs outlined in the ordinance, the difference between the amount billed to customers and the value of the costs allowed to be recovered through the factor create an over or under recovered amount. Costs that are under recovered will be recovered in future periods. Amounts over recovered will be factored into future quarterly rates. As of June 30, 2007, the amount of under recovered costs was $19.4 million.

(d) Accrued Workers' Compensation Claims

Liabilities for unpaid workers' compensation claims are recorded at their present value when they are probable of occurrence and the amount can be reasonably estimated. The liability is actuarially determined, based on an estimate of the present value of the claims outstanding and an amount for claim events incurred but not reported based upon the Department's loss experience, less the amount of claims and settlements paid to date. The discount rate used to calculate this liability at its present value was 4% at June 30, 2007. The Department has third-party insurance coverage for workers' compensation claims in excess of $1 million.

Changes in the Department's liability since June 30, 2005 are summarized as follows (amounts in thousands):

		June 30		
		2007	**2006**	**2005**
Balance at beginning of year	$	61,173	63,785	55,990
Current year claims and changes in estimates		7,409	12,646	15,166
Payments applied		(18,913)	(15,258)	(7,371)
Balance at end of year	$	49,669	61,173	63,785

The Power System's portion of the discounted reserves as of June 30, 2007 and 2006 are $28.4 million and $35.6 million, respectively.

(14) Commitments and Contingencies

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

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

The Department authorized total transfers of $174.7 million and $157.9 million in fiscal years 2007 and 2006, respectively, from the Power System to the reserve fund of the City.

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

As a joint project participant in PVNGS, the Department has certain commitments with respect to nuclear spent fuel and waste disposal. Under the Nuclear Policy Act, the Department of Energy (the DOE) is to develop facilities necessary for the storage and disposal of spent fuel and to have the first such facility in operation by 1998; however, the DOE has announced that such a repository cannot be completed before 2010. There is an ongoing litigation with respect to the DOE's ability to accept spent nuclear fuel; however, no permanent resolution has been reached. Capacity in existing fuel storage pools at PVNGS was exhausted in 2003. A Dry Cask Storage Facility (also called the Independent Spent Fuel Storage Facility) was built and completed in 2003 at a total cost of $33.9 million (about $3.3 million for the Department). The facility has the capacity to store all the spent fuel generated by the plant until the end of its life in 2026. The Department accrues for current nuclear fuel storage costs as a component of fuel expense as the fuel is burned. The Department's share of spent nuclear fuel costs related to its indirect interest in PVNGS is included in purchased power expense.

The Price-Anderson Act (the Act) requires that all utilities with nuclear generating facilities share in payment for claims resulting from a nuclear incident. Participants in PVNGS currently insure potential claims and liability through commercial insurance with a $300 million limit; the remainder of the potential liability is covered by the industry-wide retrospective assessment program provided under the Act. This program limits assessments to a maximum of $100.6 million for each licensee for each nuclear incident occurring at any nuclear reactor in the United States; payments under the program are limited to $10 million per incident, per year. Based on the Department's 5.70% direct interest and its 3.95% indirect investment interest through SCPPA, the Department would be responsible for a maximum assessment of $9 million per incident, limited to payments of $1 million per incident annually.

(c) Environmental Matters

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

Air Quality – Nitrogen Oxide (NOx) Emissions

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

In May 2001, SCAQMD adopted amendments to RECLAIM, with the intent of lowering and stabilizing RTC prices. One key element of the amendments is that existing power plants were bifurcated from the rest of the RECLAIM market and were required to install Best Available Retrofit Control Technology (BARCT). As required under SCAQMD rules, the Department met the BARCT compliance date of January 1, 2003. In January 1, 2007, power producers can reenter the RECLAIM market. As a result of the installation of NOx control equipment and the repowering of existing units, the Department has sufficient RTCs to meet its native load requirements for normal operations until 2010. For future years, the Department may need to acquire additional RTCs.

Air Quality – Greenhouse Gas Emissions

In September, Governor Schwarzenegger signed the California Global Warming Solutions Act of 2006 (AB32). The bill requires the California Air Resources Board to develop regulations and market mechanisms that will ultimately reduce California's greenhouse gas emissions by 25% by 2020. Mandatory caps will begin in 2012 for significant sources and be gradually reduced to meet the 2020 goals. As specified in the bill, all emissions from electricity that is consumed in the state, whether it is generated in California or in other states, will be subject to the cap. As a result, the Power System's share of emissions from IPP and other facilities outside California will be subject to this program.

It is uncertain at this time what impact this statute will have on the Power System's operations. If a cap and trade program is established, the primary issue will be how allowances will be allocated to the Department and other power producers. The target date for the Air Resources Board to adopt regulations is January 1, 2011. The goal of the regulations would be to "achieve the maximum technologically feasible and cost-effective reductions in greenhouse gas, including provisions for using both market mechanisms and alternative compliance mechanisms." The Department will be actively participating in the rule-making process.

Power Plant Once-Through Cooling Water Systems

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

In the past year, due to the Second Circuit Court's decision to remand most of Environmental Protection Agency's (EPA) new 316(b) Rule, EPA suspended its new 316(b) Rule. In the absence of EPA's 316(b) Rule, the California State Water Resources Control Board has decided to move forward and is in the process of developing their State-Wide Once Through Cooling Policy. In addition, other regulatory changes have been made that could significantly impact operations at the Haynes, Scattergood, and Harbor Generating Stations. The Regional Water Quality Control Board reclassified the body of water that the once-through cooling water is discharged to for the Harbor

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

(d) Litigation

i. California Receivables and Refund Hearings

During fiscal year 2001, the Power System made sales to two California agencies that were formed by Assembly Bill 1890 to facilitate the purchase and sale of energy and ancillary services in the State of California. Through June 30, 2007, these agencies, the CAISO, and the CPX, have made minimal payments since April 2001 on amounts outstanding to counterparties, including the Power System, for certain energy purchases in fiscal years 2000 and 2001. The CPX filed for protection under Chapter 11 of the Federal Bankruptcy Statute in January 2001. Two utilities with significant amounts due to these agencies have paid all amounts due to the CPX; however, the amounts remain in an escrow account pending the resolution of disbursement of the funds.

As of June 30, 2007 and 2006, a total of $166.5 million was due to the Power System from the CAISO and the CPX. Claims have been filed questioning whether amounts charged for energy sold to the CAISO and the CPX during 2000 and 2001 represent “unlawful profits” that should be subject to refund. The Courts have opined that FERC has no jurisdiction over the Department; however, the Courts have stated that the California parties seeking the refund may have a cause of action. As such, the litigation in this area is continuing.

The Power System has recorded a $50.0 million liability as of June 30, 2007 and 2006 against the $166.5 million receivable, for potential refunds pertaining to its wholesale sales during 2000 and 2001. Management believes that this is the most probable amount that will be refunded by the Power System and is based on the most recent formula disclosed by FERC. While management has recorded its estimate of the most probable amounts that will be refunded, management does believe that it is entitled to all amounts due from sales to counterparties in California, including those named above. Furthermore, management believes that interest may be due to it on those amounts but any potential receivable is not estimable at this time. In addition, management does not believe that the Power System’s exposure to any additional losses with respect to these receivable balances is currently estimable. If final settlement of these receivables results in an amount less than the recorded balance, net of the $50.0 million liability recorded, the Department will be required to record a loss in future periods.

(Continued)

ii. Capital Facilities Fee Claims

In June 2007, the Department received a tentative decision in favor of the state and a number of local government agencies that are electric customers of the Department that claimed that the Department has rates that include a capital facilities' charge that violates the state's statute. The Department intends to vigorously defend the claim. However, a long-term liability related to the tentative decision has been accrued in the event that the Department is not successful in defending this claim. Additionally, as permitted by SFAS No. 71, the Board approved to defer all potential costs associated with the resolution of this litigation and establish a corresponding long-term deferred debit to be recovered through future revenues over a period of up to ten years, if necessary. (See note 13b).

iii. Other

A number of claims and suits are also pending against the Department for alleged damages to persons and property and for other alleged liabilities arising out of its operations. In the opinion of management, any ultimate liability, which may arise from these actions, is not expected to materially impact the Power System's financial position, results of operations, or cash flows as of June 30, 2007.

(e) Risk Management

The Power System is subject to certain business risks common to the utility industry. The majority of these risks are mitigated by external insurance coverage obtained by the Power System. For other significant business risks, however, the Power System has elected to self-insure. Management believes that exposure to loss arising out of self-insured business risks will not materially impact the Power System's financial position, results of operations, or cash flows as of June 30, 2007.

(f) Credit Risk

Financial instruments, which potentially expose the Department to concentrations of credit risk, consist primarily of retail and wholesale receivables. The Department's retail customer base is concentrated among commercial, industrial, residential, and governmental customers located within the City. Although the Department is directly affected by the City's economy, management does not believe significant credit risk exists at June 30, 2007, except as provided in the allowance for losses. The Department manages its credit exposure by requiring credit enhancements from certain customers and through procedures designed to identify and monitor credit risk.

(15) Subsequent Event

On October 2, 2007, the Board approved an electric base rate increase of 2.9% effective January 1, 2008, 2.9% effective July 1, 2008, and 2.7% effective July 1, 2009. This increase is required to fund costs related to general inflation and Power System's reliability improvements. City Council's approval by ordinance is required.

LOS ANGELES DEPARTMENT OF WATER AND POWER
POWER SYSTEM

Required Supplementary Information

June 30, 2007

(Unaudited)

Pension Plan – Schedule of Funding Progress

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

Actuarial valuation date July 1		Actuarial value of assets	Actuarial accrued liability (AAL)	Unfunded AAL (UAAL)	Funded ratio		Covered payroll	UAAL as a percentage of covered payroll
2006	$	6,447,763	7,046,571	598,808	92%	$	635,728	94%
2005		6,331,048	6,763,080	432,032	94		616,270	70
2004		6,251,421	6,421,814	170,393	97		581,039	29

Postemployment Healthcare Plan – Schedule of Funding Progress

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

Actuarial valuation date July 1		Actuarial value of assets	Actuarial accrued liability (AAL)	Unfunded AAL (UAAL)	Funded ratio		Covered payroll	UAAL as a percentage of covered payroll
2006	$	—	1,053,853	1,053,853	—%	$	635,700	166%
2005		—	1,695,666	1,695,666	—		612,270	277
2004		—	1,597,835	1,597,835	—		628,898	254

See accompanying independent auditors' report.