Attachment D
SMUD 2004 Annual Report

Sacramento Municipal Utility District

04|AR

ENERGIZING SACRAMENTO

2004 Statistics

567,176
Total Customers Served
(at year-end)

Total Operating Revenue:
$1.069 billion

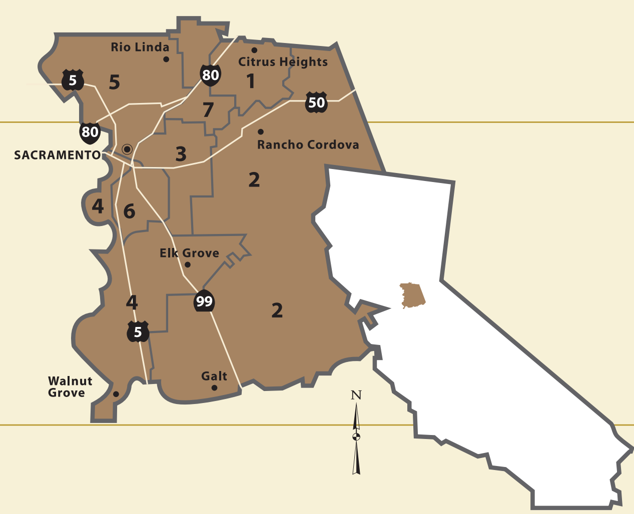
PEAK DEMAND:
2,672 megawatts
on Aug. 11, 2004
(all time peak demand:
2,809 megawatts on July 22, 2003)

Employees
2,149
(full-time)

SACRAMENTO MUNICIPAL UTILITY DISTRICT | 2004 ANNUAL REPORT

Since Dec. 31, 1946, SMUD has provided electrical service within Sacramento County. As of Dec. 31, 2004, SMUD delivered electric power to 1.4 million people in a 900-square-mile territory that includes California's capital city, Sacramento County and a small portion of Placer County. As a municipal utility, SMUD is governed by a seven-member Board of Directors elected by the voters for staggered four-year terms. The Board of Directors determines policy for the District and appoints the General Manager, who is responsible for the District's operations.

SMUD SERVICE AREA AND BOARD MEMBER WARDS



General Manager's message

At SMUD, the charge in 2004 was as simple as it was challenging: To continue building a more secure energy future for our customers. From installing solar roofs on zero-energy homes to building a new combined cycle power plant to hedging our natural gas contracts, we're always looking for better ways to meet our customers' electrical energy needs. They expect as much, and we took a number of significant steps in 2004 toward fulfilling that trust.

The federal Western Area Power Administration selected SMUD to host its control area operations in the Sierra Nevada region. We now have dependable access to our contract share of generating resources over a 230-kilovolt transmission system without the uncertainty of the state ISO. This will benefit our customers for many years to come. Despite rising natural gas prices and a below-average hydroelectric year, we maintained our strong financial footing. Our bond ratings are firm. And in one of the country's fastest-growing regions, SMUD provides a building block for economic development by supplying reliable and affordable power.

To further our commitment to renewable resources, we're expanding our wind farm near Rio Vista. Construction continued on the Cosumnes Power Plant, a 500-megawatt facility scheduled to open in 2006. While the new plant will be fueled by natural gas, we hedged the risk by purchasing natural gas reserves and locking in costs through long-term contracts. Nonetheless, the escalating cost of natural gas prompted me to recommend to our Board of Directors just our second rate increase in 15 years. The average rate increase of 6 percent will keep us on track to achieve our 20 percent equity target by 2007. Our rates remain significantly lower than those of California investor-owned utilities.

A desire for local control, along with SMUD's lower rates and history of providing reliable power, led the jurisdictions of Davis, West Sacramento, Woodland and Yolo County to approach SMUD about possibly annexing a portion of their county. The Board of Directors continues to assess the feasibility of the proposed annexation.

Other accomplishments are listed more fully in this report, but I'd like to mention a few in passing. SMUD moved closer to the full implementation of a new electronic outage management system that will provide more timely and accurate information to customers. In 2004, SMUD was the top-rated utility in California in overall customer satisfaction in a survey conducted by J.D. Power and Associates. Better yet, we're meeting these needs without increasing our overall labor costs per customer. The Board of Directors finalized a set of strategic directives that will set SMUD's course for the upcoming decade. Like other utilities, we're experiencing considerable employee turnover brought on by an aging work force. A variety of apprenticeship and experience transfer programs is helping us meet this challenge.

SMUD is a consumer-owned utility. Each and every one of our customers has a direct stake in the way we conduct business. Please take a few minutes to read about some of the ways in which we energized Sacramento in 2004.

Energizing Sacramento

1.

Reliable Power

Introduction

For the better part of six decades, SMUD has energized the Sacramento region with affordable, reliable electricity. Today, more than ever, SMUD's residential and commercial customers understand and appreciate the benefits provided by a locally owned and locally operated utility.

In 2004, SMUD was the top-rated electric utility in the state in terms of overall customer satisfaction. It marked the fourth time in five years that SMUD was the top-ranked California utility in the J.D. Power and Associates survey of residential and commercial customers.

But given uncertainties in the energy industry, it's imperative to look ahead. SMUD demonstrated in 2004 that it's taking the right steps to continue serving one of the fastest-growing regions in the country.

Construction of the 500-megawatt Cosumnes Power Plant should be completed before the summer peak season of 2006, increasing SMUD-owned generating capacity by more than 40 percent. In an ongoing effort to diversify its resource portfolio, SMUD also moved forward in 2004 with plans to expand its wind project near the city of Rio Vista in adjacent Solano County.

SMUD's Board of Directors finalized several strategic directives this past year that provide a roadmap for the nation's sixth-largest customer-owned utility. One of the key directives approved by the Board is to build customer equity in the electric system. The adopted target is to achieve 20 percent customer equity by the end of 2007. SMUD spent several years following the 1989 closure of the Rancho Seco nuclear plant paying off debt related to that project. Now, to sustain its valued "A" credit rating, SMUD is committed to increasing equity in its system, allowing the utility to continue financing capital projects at a reasonable cost.

Locally owned and operated

Top-rated electric utility in the state in customer satisfaction

20 percent equity goal by 2007

2.

Earning the public's confidence

In the J.D. Power commercial customer survey, SMUD ranked first in the state and second in the western United States.

Public power in general, and SMUD specifically, received a big vote of confidence when the Western Area Power Administration (WAPA) selected SMUD to host sub-control area operations for the Sierra Nevada region beginning Jan. 1, 2005. This gives SMUD greater flexibility and control over providing customers with affordable electricity. Plus, SMUD has improved access to contract rights for the Central Valley Project generating resources over a transmission system that's not subject to California Independent System Operator (Cal ISO) services and tariffs.

SMUD's control area now includes Western's 230-kilovolt California transmission system. The agreement allows for direct transactions between SMUD and Western and its direct-connect customers, such as Roseville and Redding, without triggering the need for services from the ISO.

With long-term contracts with PG&E expiring on Dec. 31, 2004, WAPA selected SMUD on the basis of five criteria — flexibility, durability, certainty, operating transparency and cost-effectiveness. By hosting sub-control areas for the Sierra Nevada region, SMUD should save significant fees that otherwise would have been paid to the ISO.

Western's Sierra Nevada region markets and transmits federal hydropower from the Central Valley Project to publicly owned nonprofit utilities in northern and central California. The Central Valley Project's hydro resources account for about 10 percent of SMUD's total energy supply.

Putting customers first

Customer Power

Customer satisfaction is a top priority at SMUD. For a locally owned utility, serving customer-owners is the primary reason for existence.

SMUD passed the test in 2004, ranking first in California among residential and commercial customers in a survey by J.D. Power and Associates.

In the J.D. Power commercial customer survey, SMUD ranked first in the state and second in the western United States.

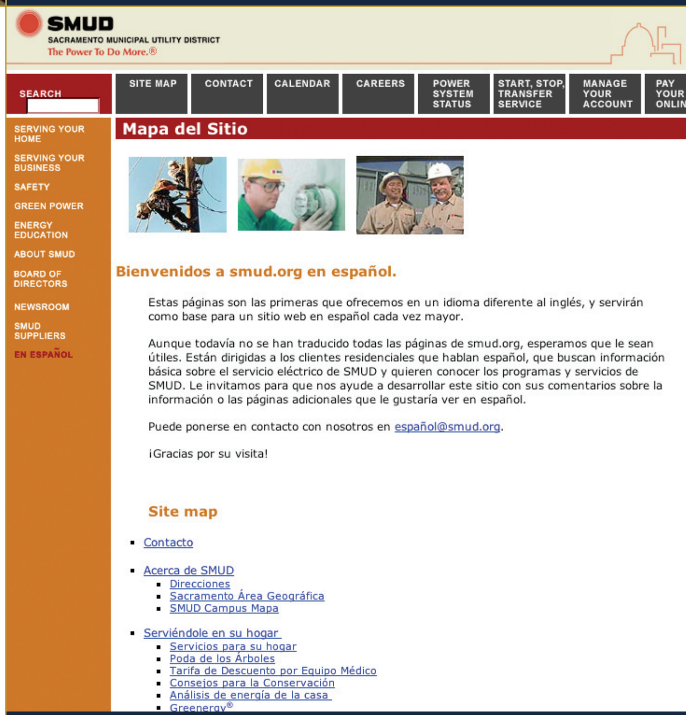
Customer perspectives on utility service are changing. Aside from receiving reliable power at competitive rates, customers expect to receive a level of service that meets or exceeds the standards set by other businesses.

SMUD established an overall customer satisfaction target of 95 percent on actual transactions with customers. Surveys indicate that SMUD customers are satisfied or very satisfied with new connects and transfers, energy audits, tree trimming, power quality, and design/construction services.

Upgrades to the SAP software system improved customer contacts and call center operations, resulting in reduced wait times for customers.

Customers are also taking advantage of expanded services available online at **www.smud.org**. More than 30,000 customers used SMUD's electronic "E-bill" service to view and pay their bills online.

Spanish Web pages



To better communicate with its residential customers, SMUD added 25 pages in Spanish to its Web site, www.smud.org. The Spanish pages include information on Greenergy[SM], conservation tips, free shade trees, online bill-payment and electrical safety tips.

3.

Reliability: count on it

SMUD is proud of its record in providing reliable, high-quality power at competitive rates, but outages do occur. Successful utilities such as SMUD work to reduce the chance of outages and respond quickly when they do occur.

Maintaining SMUD's system requires year-round work. That work continued to bear fruit in 2004. In years past, trees were the leading cause of outages. That's no longer the case. Thanks to the vegetation-management program, tree-related outages have gone down significantly. SMUD trimmed 66,871 trees and removed 5,782 trees in 2004, reducing the risk of branches falling on power lines.

More than 1,300 utility poles were replaced throughout SMUD's 900-square-mile service territory in 2004. SMUD also exceeded its goal in 2004 of replacing 100,000 feet of underground cable while staying within budget.

Additionally, SMUD used silicone injection to rehabilitate another 100,000 feet of underground cable. The rehabilitation process involves injecting a silicone fluid into cable strands. The fluid gradually seeps into the cable insulation layer and fills any voids in the insulation. This process can prolong the life of the cable by more than 20 years and is considerably less expensive than replacing the cable.

Keeping customers in the loop

SMUD moved closer to electronic outage management in November when a new system was implemented in the 21kV and 4kV system that serves downtown Sacramento. The outage management system is part of SMUD's broader Service Delivery Information Technology (SDIT) project.

When it's fully implemented throughout SMUD's service territory, outage management is expected to provide more timely and accurate information to customers. It should also streamline the management of repair crews and resources.

When a customer calls to report an outage, the outage-management system will combine information from customer calls and from systems monitoring SMUD substations to analyze within a matter of seconds where the problem originates.

A milestone in the SDIT project was the conversion of all of SMUD's paper maps to digital format using a Geographic Information System. GIS now contains more than 1.8 million features — poles, transformers, conductors, substations and customer locations.

SMUD now has computer terminals installed in 73 vehicles as part of the mobile data dispatch system. This allows troubleshooters, line supervisors and service crews to enter outage information from the field.

Meeting the needs of a growing community

The construction boom continued throughout the Sacramento region. SMUD designed 10,224 lots in 2004, close to the previous high of 11,388, set in 2003.

Commercial development also remained strong. SMUD reduced its backlog of projects and the average time it takes to do preliminary design work. The lead time for providing a commitment is now 12 weeks, down from 20 weeks in late 2003.

SMUD made numerous improvements in how new services work is handled and hired six additional designers in 2004.

Construction is expected to remain strong in the next two to three years. New development recently opened in the Sunrise/Douglas area south of Highway 50 and Laguna Ridge in Elk Grove.


611
SMUD
CA944

4.

Gearing up for the future

Cosumnes Power Plant pipeline completed

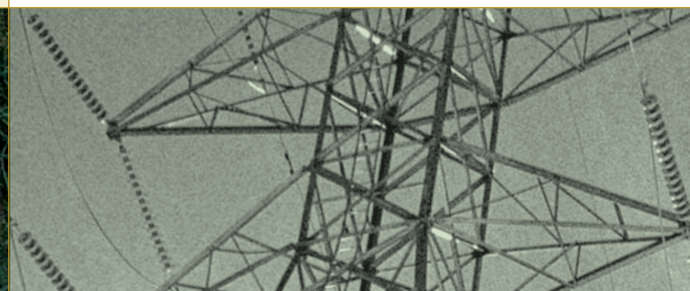
The Cosumnes Power Plant will supply the rapidly growing Sacramento region with a generating capacity of 500 megawatts — enough power to meet the annual needs of 450,000 households. Construction on the $380 million plant continued throughout 2004. The plant is due to be completed in time for the peak summer season of 2006.

The natural gas-fired plant is being built on SMUD's Rancho Seco property in southeastern Sacramento County. Construction of the 26-mile extension of SMUD's natural gas pipeline from Elk Grove to the Cosumnes Power Plant was completed in 2004. The $18.5 million pipeline project came in on time and within budget.

Power from the Cosumnes Power Plant will dramatically lower SMUD's dependence on imported power. And while the rising costs of natural gas in 2004 caused concern throughout the energy industry, the Cosumnes Power Plant is cost-effective compared to existing contracts and market purchases. Since the plant will be located within SMUD's service area, it will reduce SMUD's reliance on imported energy and the service charges attached to the delivery of imports.

In addition, the Cosumnes Power Plant is more efficient than many of the existing contract resources available, reducing risk from the volatile marketplace.

To meet long-term energy needs, SMUD has the option to construct additional natural gas generation at Rancho Seco, which the Board will consider as part of SMUD's long-term resource plan.



Relicensing

In a normal water year, the Upper American River Project (UARP) provides roughly 1.8 billion kilowatt-hours of electricity — enough energy to power about 180,000 homes. SMUD's federal license to operate the Upper American River Project, a series of 11 reservoirs and eight powerhouses in the Sierra Nevada, expires in 2007. SMUD is in the process of applying for a new license for the UARP that will enable the District to operate the project for a second license term — up to as many as 50 years into the future.

In addition to the existing UARP project, SMUD also seeks to license the Iowa Hill pumped storage development. If approved, Iowa Hill will provide additional capacity and flexibility to the UARP. To build the pumped storage system, SMUD would create a reservoir at the top of Iowa Hill, which is approximately 1,000 feet above the UARP's Slab Creek Reservoir. A powerhouse would be constructed in the mountainside next to Slab Creek Reservoir, and SMUD would excavate a vertical tunnel connecting the bottom of the Iowa Hill reservoir with the new powerhouse below.

Once the project is in operation, water would be pumped uphill from Slab Creek Reservoir to the new reservoir, where it would be held in storage. The new reservoir could add as much as 400 megawatts of generation for use during hours of peak energy demand.

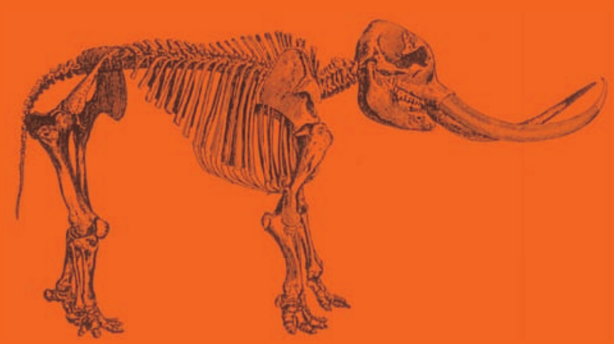
Relicensing typically involves input from a number of federal and state resource agencies. To enhance the likelihood of a successful relicensing, SMUD is encouraging all interested agencies, Native American tribes, local governments, non-governmental organizations, community groups, customer-owners and citizens to participate in SMUD's alternative relicensing process.

SMUD is committed to relicensing the Upper American River Project in a manner that optimizes operational flexibility, system reliability and economical generation while protecting the environment through a process that provides for active stakeholder participation.

A prehistoric discovery

Safeguards

… addressing these wide-ranging concerns — environmental, cultural and archeological — is a responsibility SMUD takes seriously.



Mammoths were vegetarian and devoted up to 20 hours a day to eating.

Construction of the gas pipeline made headlines around the state, but not because of any glitches or setbacks. A few feet beneath the surface of a sun-baked cornfield along the pipeline route, a pair of well-trained eyes unlocked a window to the prehistoric past.

A paleontologist working with SMUD during construction of the pipeline noticed white fragments in the heavy clay soil. The tiny fragments turned out to be the fossil remains of a Columbian mammoth that roamed the Sacramento Valley 130,000 to 450,000 years ago.

Excavation was halted immediately. Trenching was moved around the discovery site, allowing the project to continue without significant delay.

The discovery illustrates the attentiveness SMUD pays to environmental, cultural and archeological concerns on its projects. Paleontologists, archeologists and biologists accompanied construction crews along the 26-mile pipeline route. Biological monitors were on the lookout for giant garter snakes, fairy shrimp, California tiger salamanders, raptors and nesting birds such as the Swainson's hawk.

Earlier in the pipeline project, the routing was changed to avoid the sites of possible Native American villages and burial areas.

Similar safeguards are being taken on the northern end of SMUD's 900-square-mile service territory. The Elkhorn-Natomas neighborhood distribution project encompasses an area with numerous endangered or threatened species that need to be protected. In planning the Solano Wind Project near Rio Vista, SMUD enlisted experts to study the potential of raptors colliding with the wind turbines.

As these examples point out, addressing these wide-ranging concerns — environmental, cultural and archeological — is a responsibility SMUD takes seriously.

And sometimes, it yields a prehistoric treasure or two.

Paleontologists, archeologists and biologists accompanied construction crews along the 26-mile pipeline route.

mammoth

5.

Financial stability

Taking the long view

SMUD hedges natural gas costs to minimize the impact of volatile natural gas prices. "Hedging" means the utility signs fixed-price contracts to guard against fluctuations in the gas markets. For instance, SMUD plans to meet about 35 percent of its natural gas requirements with contracts that exceed five years in length.

Also, SMUD's purchase of natural gas reserves should meet about 15 percent of its long-term natural gas needs.

The largest portion of SMUD's annual budget is energy supply, which includes purchased power, fuel and transmission costs. This component is the most susceptible to market forces.

Just as consumers are seeing higher costs for gasoline, SMUD is feeling the effect of higher energy costs. A steep increase in natural gas prices increased SMUD's power generation costs and put pressure on wholesale prices for purchased power.

As a result, SMUD's general manager recommended in late 2004 an average rate increase of 6 percent. The Board of Directors voted in March 2005 on the recommendation to raise rates for just the second time in 15 years. The vote followed several weeks of community meetings, workshops and public hearings, all designed to receive input from SMUD's customer-owners. Without a rate increase, higher energy costs would have led to a 2005 reduction in cash flow of more than $60 million. In addition, SMUD would have fallen short of achieving its 20 percent equity goal by the end of 2007.

The equity goal is an essential element in SMUD's effort to maintain its solid credit rating. Lower ratings would trigger higher interest costs for borrowing and would hamper SMUD's ability to purchase energy through multi-year fixed price contracts and finance new power generation, transmission and distribution facilities.

In May, Moody's Investors Service boosted the District's credit rating a notch. Moody's raised SMUD's rating from A2 to A1 in connection with the spring sale of $129 million in bonds. Moody's also upgraded the credit rating on SMUD's outstanding bonds to A1.

As a community-owned utility, SMUD's vision is to be a leader in customer satisfaction and a positive force in promoting community benefits.

SMUD vision statement

SMUD's purpose is to provide solutions for meeting our customers' electrical energy needs.

SMUD purpose statement

Strategic Directives

6.

For the past two years, the Board of Directors worked to develop a set of strategic directives to guide SMUD operations for the next decade. The directives developed in 2004 established SMUD's set of core values.

Roadmap for the future

During the strategic planning process, the Board established priorities that define SMUD's strategic direction. Core values are essential in SMUD's strategic planning. A corresponding set of key values provides value added services to SMUD customers and ratepayers. Key values encompass resource planning and research and development.

SMUD'S CORE VALUES

- COMPETITIVE RATES
- ACCESS TO CREDIT MARKETS
- RELIABILITY
- CUSTOMER RELATIONS
- SAFETY
- ENVIRONMENTAL PROTECTION
- EMPLOYEE RELATIONS
- LOCAL CONTROL
- ETHICS

7. Supporting the business community

Public Power

Public power's lower rates, reliability and outstanding services provide competitive advantages for businesses. Business leaders know this. In many cases, they locate their facilities in public power communities for this very reason. SMUD serves Intel, Coca-Cola, Campbell's Soup, Procter & Gamble and several other large companies.

SMUD offers energy-efficiency and diagnostic service programs that enable commercial customers to maximize the cost of production and reduce operating costs while benefiting the environment.

Additionally, SMUD offers loans to small businesses to encourage start-ups and expansion. SMUD also contributes to a nonprofit organization that puts on workshops and seminars for entrepreneurs and investors. This group has helped Sacramento-area companies raise more than $700 million of equity investment.

SMUD's supplier-diversity program promotes inclusiveness in contracting activities with small, local and minority or woman-owned businesses. While the California appellate courts ruled in 2004 that SMUD's program must give up its race and gender preferences, SMUD will continue reaching out to these businesses. More than 95 percent of all contracts awarded to women and minority vendors did not benefit from preferences to be the successful bidder.

In 2004, SMUD exceeded its goals of 30 percent for women and minority contracts and 7.5 percent for rate-paying emerging business contracts in 2004.

Brightening Stockton Boulevard

Stockton Boulevard has long been known as one of Sacramento's most crime-ridden corridors. Prostitution and drug-dealing were widespread in the evening hours, exacerbated by poor lighting.

Through its work with the Stockton Boulevard Partnership, SMUD is literally helping bring light to the darkness.

The Stockton Boulevard Partnership was formed in 2001 to improve business fortunes on what used to be one of the region's most vibrant commercial thoroughfares. Increased lighting is making a world of difference, according to Scott Hall of the Sacramento Police Department.

"It's a simple solution, and one of the best solutions, in my experience," Hall said.

SMUD energy specialist Gil Razo works closely with law-enforcement officers and business owners to identify poorly lit areas and provide security lighting solutions.

"This has been a real dark boulevard," said Richard Greene, executive director of the Stockton Boulevard Partnership. "SMUD has helped our business owners improve our lighting, and better lighting provides a better environment for our customers. SMUD has helped us attack that crime issue, and we've seen an increase in our sales as a result."

Razo accompanies law enforcement on night-time ride-alongs, taking notes, recommending different types of lighting, pointing out SMUD utility poles that can help illuminate a dark area. For landlords and business owners, higher electric bills are a small price to pay for a safer business climate.

SMUD's Commercial Services also works closely with business partnerships along the Florin and Franklin corridors. In addition, SMUD has helped the Sacramento Public Library to improve lighting and security at the library system's 28 branches.

8. A dynamic work force

Employee Power

As the baby boom generation ages, SMUD and other utilities will need to replace a large percentage of employees. SMUD has increased its recruitment and training efforts for line workers and other skilled positions where experience is crucial. With about half of its work force nearing the traditional retirement age, SMUD has a work force plan that includes:

- Establishing new apprenticeship programs in various disciplines;
- Having employees shadow people who are about to retire; and
- Bringing back retired employees for training purposes.

Given these needs, SMUD has an opportunity to strengthen employee diversity and to hire employees with an appropriate mix of knowledge, skills and abilities to apply new technology.

In 2004, SMUD started or expanded apprentice programs for all of its skilled trades and developed technical curriculum for designers and engineers. These programs, which typically take four to five years to complete, will ensure that SMUD has qualified staff in key positions to offset expected attrition.

The Board of Directors' strategic directive on employee relations, coupled with SMUD's diversity commitment statement, will help SMUD prepare for the future. Given the expected employee turnover in the next five to seven years, a strategy to help retain and recruit a high-quality, diverse workforce will benefit one of the most racially and ethnically diverse communities in the country.

Cleaner ways to energize a community

9.

Renewable Power

SMUD has set a goal of supplying 20 percent of its energy from renewables by 2011, a more aggressive goal than the state target of 20 percent by 2017.

In addition to soliciting bids from suppliers of conventional renewables such as wind, small hydroelectric and landfill gas, SMUD is looking at emerging sources of renewable energy. This includes photovoltaic, biomass gasification, solid waste and solar thermal with and without gas. Emerging renewables are more expensive initially but should lead to lower cost energy in the future, once the technologies mature.

Expanding SMUD's renewable portfolio will improve environmental quality and diversify its energy supply, alleviating risks associated with other energy sources.

Energy efficiency

SMUD's energy efficiency programs removed the need for 54 gigawatt hours of fossil-fuel generation in 2004. That's enough to satisfy the annual energy needs of 6,000 homes while reducing more than 36,000 pounds of nitrous oxide emissions from generation needs.

One of SMUD's most successful energy efficiency programs is its Residential ENERGY STAR® Lighting Program. Marketing efforts in the spring and fall of 2004 increased the market penetration of high-efficiency light bulbs and fixtures in the Sacramento region. Compact fluorescent lights (CFLs) produce the same warm, bright light as traditional incandescent lights and don't hum or flicker like the older CFLs. The new CFLs use only one-third the energy and last seven to ten times longer than incandescent bulbs.

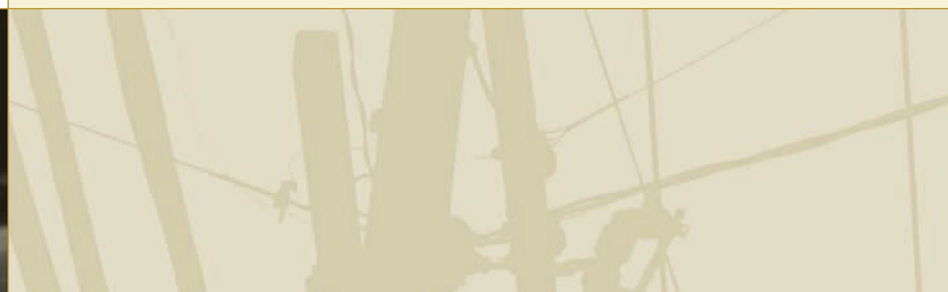
SMUD partnered with retailers and lighting product manufacturers to promote the purchase of CFLs. SMUD provided financial support to retailers, resulting in lower prices for customers. The sale of approximately 360,000 compact fluorescent light bulbs and 2,500 energy-efficient lighting fixtures in SMUD's service territory represented enough energy savings to meet the entire electrical energy needs of 2,300 homes each year.

The U.S. Environmental Protection Agency and the U.S. Department of Energy recognized SMUD by presenting the utility with a 2004 ENERGY STAR® Partner of the Year award.

energy
CHANGE FOR THE BETTER WITH ENERGY STAR

SMUD: A beacon of solar power

Clean Power



Decommissioning of the closed nuclear plant at Rancho Seco reached another milestone with the removal of two 73-foot-long steam generators. SMUD's Rancho Seco decommissioning team cut the generators in half and sealed in radioactive contamination before maneuvering the two 570-ton steam generators out of the reactor building and onto railcars for shipment to a disposal site.

Since 1997, SMUD has been dismantling the plant and removing radioactivity from the site. SMUD is about three-quarters of the way through decommissioning, which should be complete in 2008.

Creative thinking on managing costs and diligence on safety helps the decommissioning project stay in line with SMUD's Strategic Directives to keep rates competitive, protect the environment and work safely.

Twenty years ago, SMUD demonstrated long-range vision, tapping into an energy source 93 million miles away.

SMUD's installation in 1984 of what became known as PV1 at Rancho Seco was a historic moment in the annals of solar energy. PV1 was the world's first commercial central-station photovoltaic power plant built and operated by a utility.

Twenty years later, SMUD remains a leader in the field of solar energy. The 2004 dedication of PV6 — the sixth array of solar panels on the site of the decommissioned Rancho Seco nuclear power plant — brings the combined solar generating capacity at the site to 3.2 megawatts. Those 5,000 solar panels generate enough power to meet the average needs of more than 2,200 homes.

While large-scale solar facilities such as PV1 and PV6 provide clean and renewable energy to its energy mix, SMUD is now emphasizing customer-owned solar on Sacramento-area buildings, homes and parking structures. SMUD's PV Partners program offers customers the opportunity to buy their own rooftop panels at reduced prices.

Two Sacramento-area homebuilders are constructing SMUD Zero Energy Homes — homes that combine innovative construction and roof-integrated solar electric systems. Additionally, SMUD provides financial incentives to local businesses that install photovoltaic systems of 30 kilowatts or larger.

SMUD is one of the leading utilities in the United States in terms of solar power, with more than 9.3 megawatts of installed solar panels at Rancho Seco and on area buildings, homes and parking structures.

The benefits of solar power are far-reaching. Since solar technology doesn't use fossil fuels, the offset in power-plant emissions is equivalent to about 10,000 cars being removed from local roads.

Solar Power

Financial Report

SACRAMENTO MUNICIPAL UTILITY DISTRICT
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REPORT OF INDEPENDENT AUDITORS

PricewaterhouseCoopers LLP
400 Capitol Mall, Suite 600
Sacramento CA 95814-4602

To the Board of Directors of Sacramento Municipal Utility District:

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of revenues, expenses and changes in net assets and of cash flows present fairly, in all material respects, the financial position of Sacramento Municipal Utility District (the "District") and its subsidiaries at December 31, 2004 and December 31, 2003, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the District's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described in Note 2 to the consolidated financial statements, in 2003 the District adopted Statement of Financial Accounting Standards No. 143, *Accounting for Asset Retirement Obligations*, which changed the District's recognition and measurement of its decommissioning liabilities.

As described in Note 3 to the consolidated financial statements, the District restated its December 31, 2003 consolidated balance sheet to record the fair value of derivative financial instruments related to five power purchase agreements, to record related regulatory assets and liabilities and to present all derivatives assets and liabilities at gross on the consolidated balance sheet.

The management's discussion and analysis included on pages 25 through 33 is not a required part of the basic consolidated financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

PricewaterhouseCoopers LLP

March 10, 2005

SACRAMENTO MUNICIPAL UTILITY DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS

The following discussion and analysis of the Sacramento Municipal Utility District and its component units (District) financial performance provides an overview of the District's financial activities for the years ended December 31, 2004 and 2003. This discussion and analysis should be read in conjunction with the District's financial statements and accompanying notes, which follow this section.

BACKGROUND

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

Setting of Rates

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

On May 3, 2001, in response to market disruptions and the high costs of purchased power and natural gas (energy crisis) the Board unanimously approved the District's first rate increase in more than ten years. The rate action included a 16 percent average rate increase along with two temporary surcharges of three percent each, one to cover reduced hydroelectric production, resulting in increased power costs in 2001 and one intended to replenish the Rate Stabilization Fund. The first surcharge expired May 2, 2002 and the other expired May 2, 2004. The District is currently in the midst of a rate proceeding that will be completed early in 2005. The General Manager is recommending a rate increase that will result in an average system rate increase of approximately six percent and would be effective in rates beginning April 1, 2005.

Financial Reporting

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

In 2004, the District identified five power purchase agreements, in effect at December 31, 2003, that are derivative financial instruments which were improperly identified as a normal purchases and, as such, were not included at fair value in the December 31, 2003 consolidated balance sheet, as required by FAS 133 *"Accounting for Derivative Instruments and Hedging Activities."* In addition, the District was netting the fair value of contracts by commodity group and presenting the fair values net on the consolidated balance sheet when the right of set off did not exist as defined in FIN 39 *"Offsetting of Amounts Related to Certain Contracts."* The restatement of the December 31, 2003 consolidated balance sheet corrects the treatment of these contracts to reflect them as derivative financial instruments at that are recorded at their fair values and presents the fair values of derivative assets and liabilities gross on the balance sheet when it is appropriate to do so. The adjustment for these corrections resulted in an increase of, which totaled $35.7 million for derivative instrument assets and $170.5 million for derivative financial instrument liabilities at December 31, 2003. The District's Board defers the recognition of derivative financial instruments for rate-making purposes, and accordingly, regulatory assets and regulatory credits were restated by $87.5 and $47.3 million, respectively, at December 31, 2003. The restatement does not impact the 2003 statement of revenues, expenses and changes in net assets.

In accordance with Financial Accounting Standards (SFAS) No. 71, *"Accounting for the Effects of Certain Types of Regulation"*, the Board has taken various regulatory actions for ratemaking purposes that result in the deferral of expense or revenue recognition. As of December 31, 2004, the District had total regulatory costs for future recovery of $498 million, which is a net increase of $26 million from 2003. The increase is due primarily to the change in value of derivative financial instruments, an increase in the deferred decommissioning liability and the deferral of costs associated with the recognition of a liability to the U.S. Bureau of Reclamation (Bureau), partially offset by collection in rates of the deferred nuclear plant costs and reductions in deferred costs associated with wholesale receivables tentatively settled in 2004. The District also had regulatory credits of $382 million as of December 31, 2004, which is a net increase of $49 million over 2003. The increase is primarily due to the deferral of gains from contribution in aid of construction, the change in value of derivative financial instruments, and a settlement with El Paso Natural Gas, partially offset by the recognition of revenue from the Rate Stabilization Fund. The regulatory costs and regulatory credits will be recognized in the consolidated statement of revenues, expenses and changes in net assets in future periods as determined by the Board for ratemaking purposes.

For the last several years, the Board had a strategic directive to build up the Rate Stabilization Fund as a reserve against the need for future rate increases. As a result, the District would defer any net income or recoup any net loss through the use of the Rate Stabilization Fund as part of its rate policy. In 2004, the Board ceased this practice in connection with adoption of a strategic directive to increase customer equity to a targeted level of 20 percent by 2007.

Using This Financial Report

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

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

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

FINANCIAL HIGHLIGHTS

Summary of Consolidated Financial Position and Change in Net Assets
(millions)

	December 31,		
Assets	2004	2003 As Restated	2002
Electric Utility Plant — net	$ 2,494	$ 2,239	$ 1,919
Restricted and Designated Assets	238	271	228
Current Assets	642	750	762
Noncurrent Assets and Deferred Charges	527	501	417
	$ 3,901	$ 3,761	$ 3,326
Liabilities and Net Assets			
Long-Term Debt — net	$ 2,407	$ 2,359	$ 2,058
Current Liabilities and Deferred Credits	473	488	513
Noncurrent Liabilities and Deferred Credits	719	696	535
Net Assets	302	218	220
	$ 3,901	$ 3,761	$ 3,326

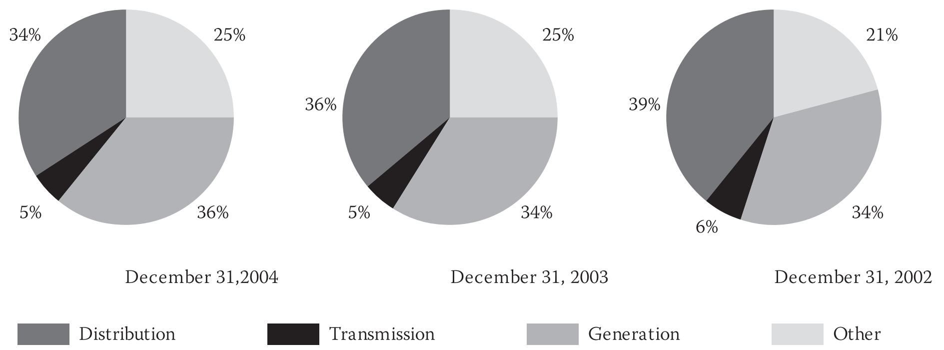
ASSETS

Utility Plant — Net
2004 Compared to 2003
The District has invested approximately $2.5 billion in utility plant assets and construction work in progress net of accumulated depreciation at December 31, 2004. Net utility plant makes up about 64 percent of the District's assets, approximately 4 percent greater than the previous year. During 2004, the District capitalized approximately $528 million of additions to utility plant, including additions to construction work in progress in the District's consolidated financial statements. The primary increase was due to the 2004 costs of approximately $161 million for the 500 MW, gas-fired Cosumnes Power Plant project (Project). The Project is currently planned to cost approximately $390 million and to be completed by April 2006.

The District has been negotiating with the Project's general contractor, Fru-Con Construction Corporation, to resolve disputes over cost and delays. Unable to resolve the disputes to the satisfaction of the District, the contract was terminated on February 11, 2005. See Note 17 for additional details.

2003 Compared to 2002
The District has invested approximately $2.2 billion in utility plant assets and construction work in progress net of accumulated depreciation at December 31, 2003. Net utility plant makes up about 60 percent of the District's assets, approximately 2 percent greater than the previous year. During 2003, the District capitalized approximately $371 million of additions to utility plant, including additions to construction work in progress in the District's consolidated financial statements. The primary increase was due to the purchase of the Rosa gas field natural gas reserves for $136 million, which is included in Other in the chart below. A second major increase was in generation plant, which includes the 2003 additional costs of approximately $118 million for the 500 MW, gas-fired Cosumnes Power Plant project (Project).

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



Restricted Assets

2004 Compared to 2003

The District's level of restricted assets (noncurrent) decreased by $36 million during 2004 reflecting a reduction of Revenue bond, debt service, and construction reserves, a reduction in the Rate Stabilization Fund, and a lower decommissioning trust fund balance as the District continues to decommission the Rancho Seco nuclear power plant.

2003 Compared to 2002

The District's level of restricted assets (noncurrent) increased by $43 million during 2003 reflecting a $56 million deposit into the Rate Stabilization Fund, higher decommissioning trust fund balance as the District continues to fund the decommissioning of the Rancho Seco nuclear power plant through rates, and higher securities lending, partially offset by a higher current portion of restricted assets.

Current Assets

2004 Compared to 2003 (As Restated)

Current assets decreased by $108 million in 2004 as a result of a lower level of unrestricted cash and investments reflecting significant expenditures for construction, a lower level of regulatory costs to be recovered in one year, reflecting the completion of recovering certain regulatory charges through rates, and a lower level of prepayments. These decreases were partially offset by higher receivables for wholesale energy sales.

2003 (As Restated) Compared to 2002

Current assets decreased by $12 million in 2003 as a result of a lower level of unrestricted cash and investments and a lower level of regulatory costs to be recovered in one year, reflecting the completion of recovering certain regulatory charges through rates. These decreases were partially offset by a higher current portion of restricted assets, higher receivables for wholesale and customer energy sales, and higher prepayments due to a credit from the energy contract with Western Area Power Administration.

Noncurrent Assets and Deferred Charges

2004 Compared to 2003 (As Restated)

Total noncurrent assets and deferred charges increased by $26 million. This increase reflects an increase in the amount of regulatory assets to be recovered in future periods as a result of a proposed settlement with the U.S. Bureau of Reclamation (Bureau), changes in the valuation of derivative financial instruments, which are deferred for rate-making purposes, and an increase in other noncurrent assets due to a credit from a settlement with El Paso Natural Gas.

2003 (As Restated) Compared to 2002

Total noncurrent assets and deferred charges increased by $84 million. This increase reflects changes in the valuation of derivative financial instruments, which are deferred for rate-making purposes, and higher unamortized debt issuance costs. The increases were partially offset by a reduction in the amount of regulatory assets to be recovered in future periods and the completion of recovering certain stranded costs in 2003. The long-term amount of conservation loans is also lower reflecting the continued normal collections and a low amount of new lending activity.

LIABILITIES

Long-term Debt

2004 Compared to 2003

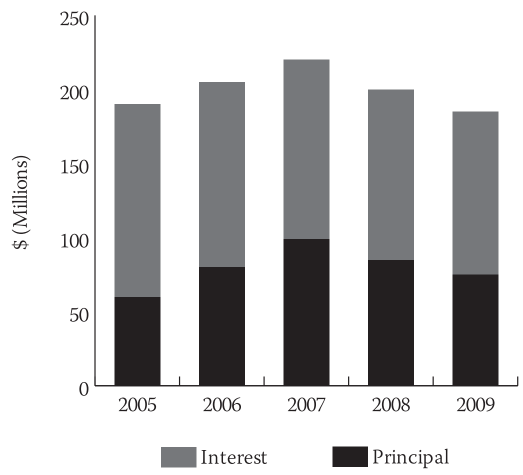
The District completed one debt issuance for a total of $131 million, which was used to refund $101 million of Commercial Paper Notes and $17 million of previously issued revenue bonds through legal defeasance. During 2004, the District called approximately $4 million of Central Valley Financing Authority (CVFA) bonds, a component unit of the District, reducing future debt service. In January 2005, the District called an additional $4 million of CVFA bonds.

2003 Compared to 2002

Long-term debt increased by over $300 million in 2003. The District completed four debt issuances for a total of $924 million. The 2003 Series R Electric Revenue Bonds were issued for $481 million and were used to refund $115 million of Commercial Paper Notes and $134 million of previously issued revenue bonds through legal defeasance. The 2003 Series S Electric Revenue Refunding Bonds were issued for $331 million and were used to refund $360 million of previously issued revenue bonds through a legal defeasance. The 2003 Subordinated Electric Revenue Bonds (2003 Series H and 2003 Series I) were issued for $112 million and were used to refund $106 million of previously issued revenue bonds.

The following table shows the District's future debt service requirements through 2009 as of December 31, 2004:

Debt Service Requirements



As of December 31, 2004, the District had an underlying rating of "A" from both Standard & Poor's and Fitch, and a higher rating of "A1" from Moody's. Most of the District's bonds are insured and are therefore rated "AAA" by the rating agencies.

Current Liabilities and Deferred Credits
2004 Compared to 2003 (As Restated)
Current liabilities and deferred credits decreased by approximately $15 million during 2004. As described in Long-Term Debt above, the District refunded $101 million of commercial paper notes through long-term senior debt after issuing $50 million during 2004. Additionally, accounts payable and accrued interest both decreased in 2004. The decreases were partially offset by an increase in the current portion of long-term debt, purchased power payable, and customer deposits and other. In January 2005, the District issued $50 million of commercial paper.

2003 (As Restated) Compared to 2002
Current liabilities and deferred credits decreased by approximately $25 million during 2003. As described in Long-term Debt above, the District refunded $115 million of commercial paper notes through long-term senior debt. The current portion of long-term debt also decreased by $6 million. The decreases were partially offset by increases in accounts payable, accrued decommissioning, accrued interest, and higher securities lending.

Noncurrent Liabilities and Deferred Credits
2004 Compared to 2003 (As Restated)
Noncurrent liabilities and deferred credits have increased by $23 million as a result of the increase in valuation of derivative financial instruments, which are deferred for rate-making purposes, an increase in regulatory credits and the recognition of a liability to the Bureau related to the tentative settlement of a billing dispute.

2003 (As Restated) Compared to 2002
Noncurrent liabilities and deferred credits have increased by $161 million as a result of the increase in the rate stabilization fund of $56 million and increases in other regulatory credits, and changes in the valuation of derivative financial instruments, which are deferred for rate-making purposes. The increases were partially offset by reductions in the accrued decommissioning and changes in the valuation of derivative financial instruments.

Summary of Revenues, Expenses and Changes in Net Assets
(millions)

	December 31, 2004	2003	2002
Operating revenues	$ 1,069	$ 1,033	$ 1,012
Operating expenses	(901)	(943)	(930)
Operating income	168	90	82
Interest and other income	25	30	40
Interest charges	(109)	(120)	(122)
Increase in net assets	$ 84	$ -0-	$ -0-

CHANGES IN NET ASSETS

Operating Revenues

2004 Compared to 2003

Operating revenues were $1,069 million in 2004, an increase from 2003 of $36 million after transferring approximately $12 million from the Rate Stabilization Fund in 2004 versus a $56 million transfer to the Rate Stabilization Fund in 2003. Sales to customers were $962 million in 2004, an increase of $9 million over 2003 sales. The District sold 3.2 percent more energy to its retail customers, which grew from 553,337 customers in 2003 to 567,176 customers in 2004, at average revenue per kilowatt hours that decreased by 2.1 percent, reflecting the end of a temporary rate surcharge in May 2004.

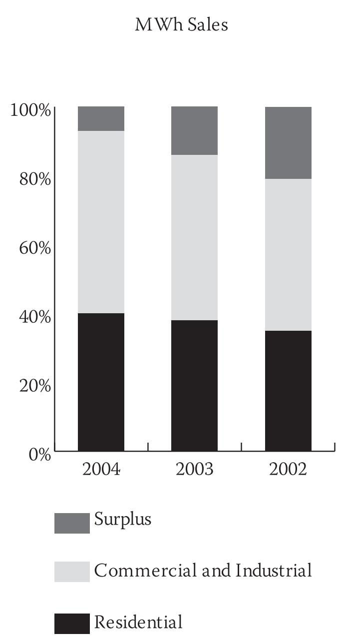
Wholesale revenues are comprised of both surplus energy and gas sales. In 2004, surplus gas sales were $62 million as compared to $65 million in 2003. The decrease was due to a lower amount sold (9 percent) although at higher average prices (4 percent) as compared to 2003. Surplus energy sales in 2004 were $39 million lower than in 2003. The decrease is due to lower volume (45 percent) and lower average prices (31 percent) than in 2003.

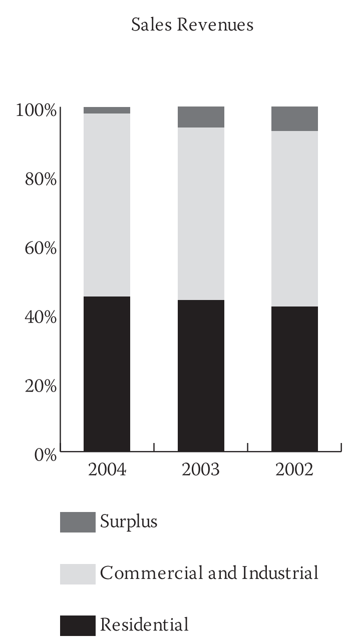
2003 Compared to 2002

Operating revenues were $1,033 million in 2003, an increase from 2002 of $21 million even after transferring approximately $56 million to the Rate Stabilization Fund versus a $2 million transfer in 2002. Sales to customers were $953 million in 2003, an increase of $39 million over 2002 sales. The District sold 4.3 percent more energy to its retail customers, which grew from 541,296 customers in 2002 to 553,337 customers in 2003, at average rates that remained the same as the previous year. Although average rates for the year remained stable, the three percent hydro surcharge was removed from rates in May 2003.

Wholesale revenues are comprised of both surplus energy and gas sales. In 2003, surplus gas sales exceeded surplus energy sales for the first time as a result of the investment in the Rosa gas field. The District had over $65 million of surplus gas sales in 2003 as compared to $29 million in 2002. The increase was due to both higher amounts sold (27 percent) and higher average prices (75 percent) as compared to 2002. Surplus energy sales in 2003 were $4 million lower than in 2002. The decrease is due to lower volume (28 percent) partially offset by higher average prices than in 2002.

The following charts show the percentage of megawatt hour (MWh) sales and sales revenue in 2004, 2003 and 2002 by surplus energy sales (surplus), commercial and industrial (C&I), and residential (Res) customers:





Operating Expenses
2004 Compared to 2003
Operating expenses were $901 million in 2004 as compared to $943 million in 2003. The District spent $15 million less for purchased power in 2004 than in 2003. Approximately 2.4 percent less energy was purchased in 2004 at average prices that were 1.4 percent lower than in 2003. In 2004, fuel costs, a component of production costs, were approximately $88 million, or $12 million higher than 2003. More fuel was used in 2004 (974 thousand decatherms) at average prices that were 10 percent higher than in 2003.

The District also had lower expenses for administrative and general due to lower property insurance premiums, lower A&G salaries, and lower expenditures for public good activities for research and development of photovoltaic generation and distributed technology.

Maintenance increased due to repairs at hydro facilities and preventative maintenance projects. Depreciation expense increased due to additions to plant in service, primarily for distribution plant.

Regulatory deferrals collected in rates significantly decreased due to the complete recovery through rates for deferred nuclear plant costs and other regulatory assets during 2003.

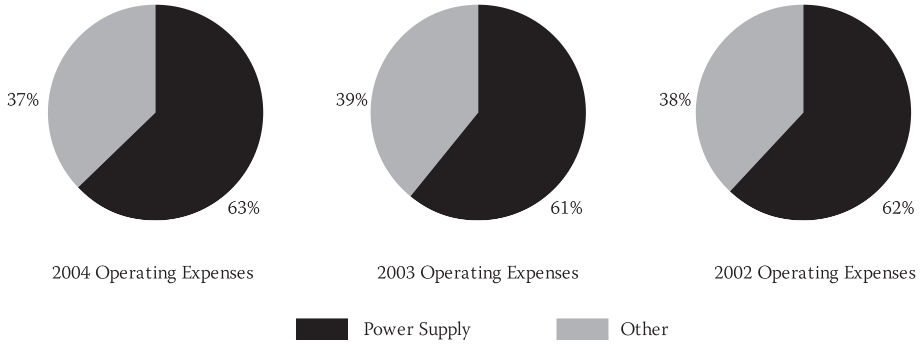
In 2004, power supply costs made up approximately 63 percent of total operating expenses as compared to 61 percent for 2003.

2003 Compared to 2002
Operating expenses were $943 million in 2003 as compared to $930 million in 2002. The District spent $25 million more for purchased power in 2003 than in 2002. Approximately two percent less energy was purchased in 2003 at average prices that were nine percent higher than in 2002. In 2003, fuel costs, a component of production costs, were approximately $93 million in 2003, or $56 million lower than 2002. Less fuel was used in 2003 (1.4 million decatherms) at average prices that were 33 percent lower than in 2002.

The District also had higher expenses for administrative and general due to higher property insurance, Service Delivery Information Technology project data conversion costs and renewable technology expenses not included in public good expense. Maintenance and depreciation expenses were also higher, all of which were partially offset by lower expenses for public good and decommissioning.

In both 2003 and 2002, power supply costs made up approximately 61 percent and 62 percent of total operating expenses, respectively.

The following charts compare the relative cost of purchased power, production expenses, and depletion of the Rosa gas field (power supply costs) to all other operating expenses in 2004, 2003 and 2002:



Interest and Other Income

2004 Compared to 2003

Interest and other income was lower by $5 million in 2004 as compared to 2003. Interest income was lower due to lower cash balances and lower interest rates in 2004 as compared to 2003. Other income was lower in 2004 primarily as a result of lower unrealized holding gains on investments.

2003 Compared to 2002

Interest and other income was lower by $10 million in 2003 as compared to 2002. This was primarily a result of lower interest rates in 2003 as compared to 2002.

Interest Charges

2004 Compared to 2003

Interest charges in 2004 were $11 million lower than in 2003, which is due primarily to higher allowance for funds used during construction as a result of the progress on the Cosumnes Power Plant project and due to lower amortization of debt issuance costs and discounts.

2003 Compared to 2002

Interest charges in 2003 were $2 million lower than in 2002, which is due primarily to higher allowance for funds used during construction as a result of the progress on the Cosumnes Power Plant project.

SACRAMENTO MUNICIPAL UTILITY DISTRICT
CONSOLIDATED BALANCE SHEETS

	DECEMBER 31, 2004	DECEMBER 31, 2003 (As Restated)
	(thousands of dollars)	
ASSETS		
Electric Utility Plant		
Plant in service	$ 2,945,909	$ 2,806,386
Less accumulated depreciation and depletion	(1,065,631)	(992,803)
Plant in service — net	1,880,278	1,813,583
Construction work in progress	613,507	425,490
Total electric utility plant — net	2,493,785	2,239,073
Restricted and Designated Assets		
Revenue bond, debt service and construction reserves	179,793	203,253
Nuclear decommissioning trust fund	87,968	91,346
Rate stabilization fund	75,000	87,317
Securities lending collateral	66,427	65,486
Other funds	6,072	3,625
Less current portion	(177,168)	(180,258)
Total restricted and designated assets	238,092	270,769
Current Assets		
Cash, cash equivalents and investments		
Unrestricted	123,322	226,965
Restricted and designated	177,168	180,258
Receivables — net:		
Retail customers	123,722	125,616
Wholesale	50,475	42,844
Conservation loans due within one year, accrued interest and other	16,508	19,776
Regulatory costs to be recovered within one year	72,836	76,790
Derivative financial instruments maturing within one year	32,309	24,731
Materials and supplies	33,631	29,848
Prepayments	11,837	23,302
Total current assets	641,808	750,130
Noncurrent Assets and Deferred Charges		
Regulatory costs for future recovery	289,373	301,310
Derivative financial instruments	150,971	120,998
Unamortized debt issuance costs	30,323	31,066
Conservation loans	33,730	31,276
Preliminary project studies and other	22,857	16,118
Total noncurrent assets and deferred charges	527,254	500,768
Total Assets	$ 3,900,939	$ 3,760,740

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

SACRAMENTO MUNICIPAL UTILITY DISTRICT
CONSOLIDATED BALANCE SHEETS

	DECEMBER 31, 2004	DECEMBER 31, 2003 (As Restated)
	(thousands of dollars)	
LIABILITIES		
Long-term Debt — net	$ 2,406,325	$ 2,358,710
Current Liabilities and Deferred Credits		
Commercial paper notes	-0-	51,000
Accounts payable	74,285	84,066
Purchased power payable	76,610	72,850
Long-term debt due within one year	67,165	44,245
Accrued decommissioning	41,500	39,081
Accrued interest	39,141	44,576
Accrued salaries and compensated absences	25,178	27,184
Derivative financial instruments maturing within one year	48,317	30,304
Regulatory credits to be recognized within one year	7,495	5,044
Securities lending collateral	66,427	65,486
Customer deposits and other	27,355	23,749
Total current liabilities and deferred credits	473,473	487,585
Noncurrent Liabilities and Deferred Credits		
Accrued decommissioning	283,758	283,866
Derivative financial instruments	155,523	147,722
Regulatory credits	238,497	233,763
Due to affiliated entity	14,863	16,960
Due to U.S. Bureau of Reclamation	12,485	-0-
Self insurance, deferred credits and other	13,699	13,679
Total noncurrent liabilities and deferred credits	718,825	695,990
Total Liabilities	3,598,623	3,542,285
NET ASSETS		
Invested in capital assets, net of related debt	152,809	(72,985)
Restricted	44,068	50,871
Unrestricted	105,439	240,569
Total Net Assets	302,316	218,455
COMMITMENTS AND CONTINGENCIES (Notes 17 And 18)		
Total Liabilities and Net Assets	$ 3,900,939	$ 3,760,740

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

SACRAMENTO MUNICIPAL UTILITY DISTRICT CONSOLIDATED STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

	Year Ended December 31, 2004	Year Ended December 31, 2003
	(thousands of dollars)	
Operating Revenues		
Residential	$ 442,704	$ 444,713
Commercial and industrial	514,670	503,668
Street lighting and other	13,158	12,894
Wholesale	85,878	127,661
Rate stabilization fund transfers	12,317	(56,069)
Total operating revenues	1,068,727	1 ,032,867
Operating Expenses		
Operations:		
Purchased power	373,362	387,985
Production	189,502	178,745
Transmission and distribution	32,553	32,965
Administrative, general and customer	93,609	97,998
Public good	22,933	25,421
Maintenance	54,834	46,353
Depreciation	98,614	92,578
Depletion	5,265	4,941
Decommissioning	29,166	29,708
Regulatory deferrals collected in rates	1,140	46,303
Total operating expenses	900,978	942,997
Operating Income	**167,749**	**89,870**
Nonoperating Revenues and Expenses		
Other revenues:		
Interest income	17,550	19,664
Other income — net	7,422	10,164
Total other revenues	24,972	29,828
Interest charges:		
Interest on debt	124,230	127,326
Allowance for funds used during construction	(15,370)	(7,628)
Total interest charges	108,860	119,698
Increase in Net Assets	**83,861**	**-0-**
Net assets — Beginning of year	218,455	219,652
Cumulative effect of change in accounting principle	-0-	(1,197)
Net assets — Beginning of year as adjusted	218,455	218,455
Increase in Net Assets During the Year	**83,861**	**-0-**
Net Assets — End of Year	$ 302,316	$ 218,455

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

SACRAMENTO MUNICIPAL UTILITY DISTRICT
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Year Ended December 31, 2004	Year Ended December 31, 2003
	(thousands of dollars)	
Cash Flows from Operating Activities		
Receipts from retail customers	$ 965,211	$ 949,397
Receipts from surplus power sales	32,942	66,548
Receipts from surplus gas sales	61,874	60,640
Receipts from federal and state grants	3,727	6,212
Receipts from steam sales	7,931	7,369
Issuance/repayment of conservation loans, net	2,102	15,989
Payments to employees — payroll and other	(176,518)	(159,199)
Payments for wholesale power	(354,050)	(390,867)
Payments for gas purchases	(149,712)	(143,213)
Payments to vendors	(63,005)	(81,969)
Payments for decommissioning	(32,249)	(26,320)
Payments for Rosa gas imbalance	-0-	(3,703)
Other payments — net	(6,047)	(4,190)
Net cash provided by operating activities	292,206	296,694
Cash Flows from Investing Activities		
Sales and maturities of securities	164,596	251,152
Purchases of securities	(257,582)	(251,201)
Interest and dividends received	13,937	15,019
Securities lending collateral — net	954	35,256
Net cash provided by (used in) investing activities	(78,095)	50,226
Cash Flows from Capital and Related Financing Activities		
Construction expenditures	(348,414)	(380,657)
Contributions in aid of construction	13,252	15,014
Net proceeds from bond issues	131,188	993,595
Repayment and defeasance of debt	(65,627)	(715,189)
Issuance/repayment of commercial paper — net	(51,000)	(115,300)
Interest on debt	(124,038)	(107,745)
Net cash used in capital and related financing activities	(444,639)	(310,282)
Net increase (decrease) in cash and cash equivalents	(230,528)	36,638
Cash and cash equivalents at the beginning of the year	551,926	515,288
Cash and cash equivalents at the end of the year	321,398	551,926
Cash and cash equivalents at the end of the year consist of:		
Unrestricted	123,322	226,965
Restricted and designated — current portion	177,168	180,258
Restricted and designated — noncurrent portion	20,908	144,703
	$ 321,398	$ 551,926

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

SACRAMENTO MUNICIPAL UTILITY DISTRICT
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. ORGANIZATION

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

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Method of Accounting

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

Use of Estimates

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

The Financial Reporting Entity

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

Component Units

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

Plant in Service

The cost of additions to Plant in Service and replacement property units is capitalized. Repair and maintenance costs are charged to expense when incurred. When the District retires portions of its Electric Utility Plant, retirements are recorded against Accumulated Depreciation and the retired portion of Electric Utility Plant is removed from Plant in Service. The costs of removal and the related salvage value, if any, are charged or credited as appropriate to Accumulated Depreciation. The District generally computes depreciation on Plant in Service on a straight-line, service-life basis. The consolidated average annual composite depreciation rates for 2004 and 2003 were 3.59 percent and 3.56 percent. Depreciation is calculated using the following estimated lives:

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

Investments in Joint Power Agency (JPA)

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

Investments in Gas Properties

In March 2003, the District acquired an approximate 23 percent non-operating ownership interest in the Rosa Unit gas properties in New Mexico for $136.6 million. The District transports the gas extracted from the Rosa Unit for use in its natural gas fired cogeneration power plants (see Note 5). The District uses the successful efforts method of accounting for its investment in gas producing properties. Costs to acquire mineral interests in gas properties, to drill and equip exploratory wells that find proved reserves, and to drill and equip development wells are capitalized as a component of Plant in Service on the consolidated balance sheets. Costs to drill exploratory wells that do not find proved reserves, geological and geophysical costs, and costs of carrying and retaining unproved properties are expensed. Capitalized costs of producing gas properties, after considering estimated residual salvage values, are depleted by the unit-of–production method based on the estimated future production of the proved developed producing wells.

Restricted Assets

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

Restricted Bond Funds

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

Nuclear Decommissioning Trust Fund

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

Interest earnings on the Trust Fund assets are recorded as Interest Income and are accumulated in the Trust Fund. Such interest is also included in Decommissioning Expense in the year earned.

Accrued Decommissioning

Effective January 1, 2003, the District implemented Statement of Financial Accounting Standards (SFAS) No. 143, *"Accounting for Asset Retirement Obligations (ARO)"*, which significantly changed the methodology for estimating the District's decommissioning liability. The District accrues decommissioning costs related to Utility Plant when an obligation to decommission facilities is legally required. Adjustments are made to such liabilities based on estimates by District staff in accordance with SFAS No. 143. For active plants, such costs are included in the Utility Plant's cost and included as a component of Depreciation expense over the Utility Plant's life. For Rancho Seco decommissioning changes there is no effect on net assets (see Note 13) because of the regulatory accounting applied to Rancho Seco decommissioning costs. Expenditures for decommissioning activities are recorded as reductions to Accrued Decommissioning liability. Changes in decommissioning liability estimates, arising from inflation, annual accretion and other changes to the cost assumptions are recorded directly to Accrued Decommissioning with a corresponding adjustment to the related regulatory deferral. The current portion of the accrued decommissioning liability represents the District's estimate of actual expenditures in the next year, generally as set forth in the annual budget.

At December 31, 2004 and 2003, the District's Accrued Decommissioning balance in the consolidated balance sheets relating to Rancho Seco was $320.5 million and $316.6 million, respectively (See Note 13). Other electricity generation and gas production facilities Accrued Decommissioning balance in the consolidated balance sheets totaled $4.8 million and $4.3 million as of December 31, 2004 and 2003, respectively.

Securities Lending Transactions

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

Cash Equivalents

Cash equivalents include all debt instruments purchased with an original maturity of three months or less and all investments in the Local Agency Investment Fund (LAIF) and money market mutual funds. The debt instruments and money market mutual funds are reported at amortized cost and the LAIF is reported at the value of its pool shares.

Investments

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

Unbilled Operating Revenues

The District records an estimate for unbilled revenues earned from the dates its retail customers were last billed to the end of the month. At December 31, 2004 and 2003, unbilled revenues were $59.9 million and $53.8 million, respectively.

Purchased Power Expenses

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

Advanced Capacity Payments

Some long-term agreements to purchase energy from other providers call for up-front payment. Such costs are generally recorded as an asset and amortized over the length of the contract. One advance capacity contract, with a fair value of $103.7 million at December 31, 2004, is accounted for as a derivative financial instrument (see Note 9).

Credit and Market Risk

The District enters into forward purchase and sales commitments for physical delivery of gas and electricity with utilities and power marketers. The District is exposed to credit risk related to nonperformance by its wholesale counterparties under the terms of these contractual agreements. In order to limit the risk of counterparty default, the District has a wholesale counterparty evaluation policy, which includes the assignment of internal credit ratings to the District's counterparties based on counterparty and/or debt ratings, the requirement for credit enhancements for counterparties that do not meet an acceptable risk level, and the use of standardized agreements that allow for the netting of positive and negative exposures associated with a single counterparty. The District is also subject to similar requirements for many of its gas and electricity purchase agreements.

Accounts Receivable and Allowance for Doubtful Accounts

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

The summarized activity of the changes in the allowance for doubtful accounts during 2004 and 2003 is presented below (thousands of dollars):

	Balance at beginning of Year	Additions	Write-offs and Recoveries	Balance at end of Year
California ISO/PX:				
December 31, 2004	$ 40,193	$ 457	$ 16,722	$ 23,928
December 31, 2003	39,619	574	-0-	40,193
Wholesale power and other:				
December 31, 2004	$ 3,674	$ 564	$ 343	$ 3,895
December 31, 2003	358	3,587	271	3,674
Retail Customers:				
December 31, 2004	$ 2,533	$ 6,410	$ 6,060	$ 2,883
December 31, 2003	2,406	5,056	4,929	2,533
Energy Efficiency Loans:				
December 31, 2004	$ 1,248	$ 1,164	$ 1,158	$ 1,254
December 31, 2003	1,786	674	1,212	1,248

Through December 31, 2003 the District's allowance for doubtful accounts for its receivables related to wholesale power sales for transactions executed through the California Independent System Operator (ISO) and Power Exchange (PX) were reserved at 100% of the outstanding balances due to collectibility issues and disputes over amounts billed from October 2000 through June 2001. In 2004, the District negotiated a reduced settlement of $5.5 million with the California ISO relating to $16.7 million of disputed amounts. District management believes collection of this amount is reasonably assured and, as a result, there is no allowance for this amount at December 31, 2004. Write-offs and recoveries of $16.7 million in 2004 in the above table reflect the $5.5 million settlement (recovery) and the associated $11.2 million write-off.

Regulatory Deferrals

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

Materials and Supplies

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

Unamortized Debt Issuance Costs

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

Compensated Absences

The District accrues vacation leave and compensatory time when the employees earn the rights to the benefits. The District does not record sick leave or other leave as a liability until it is taken by the employee, since there are no cash payments for sick leave or other leave made when employees terminate or retire. At December 31, 2004 and 2003, the total estimated liability for vacation and other compensated absences was $20.1 million and $19.3 million, respectively.

Public Good

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

Gains/Losses on Bond Refundings

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

Gains/Losses on Bond Defeasances

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

Allowance for Funds Used During Construction

The District capitalizes, as an additional cost of Construction Work In Progress (CWIP), an Allowance for Funds Used During Construction (AFUDC), which represents the cost of borrowed funds used for such purposes. The amount capitalized is determined by a formula prescribed by FERC. The AFUDC rates for 2004 and 2003 were 4.1 percent and 3.6 percent of eligible CWIP, respectively.

Derivative Financial Instruments (As Restated)

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

Interest Rate Swap Agreements

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

Gas and Electricity Price Swap and Option Agreements

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

Precipitation Hedge Agreements

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

Insurance Programs

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

Net Assets

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

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

Contributions in Aid of Construction

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

Grants

The District receives grant proceeds from federal and state assisted programs for its advanced and renewable technologies, electric vehicle, and energy efficiency programs. The District also periodically receives grant proceeds from federally assisted programs as partial reimbursements for costs it has incurred as a result of storm damages. When applicable, these programs may be subject to financial and compliance audits pursuant to regulatory requirements. The District considers the possibility of any material disallowances to be remote. During 2004 and 2003, the District recognized grant proceeds of $2.5 million and $6.5 million, respectively, as a component of Interest and Other Income, in the consolidated statements of revenues, expenses and changes in net assets.

Recent Accounting Pronouncements

In March 2003, GASB issued Statement of Governmental Accounting Standards (SGAS) No. 40, *"Deposit and Investment Risk Disclosures,"* which updates the custodial credit risk disclosure requirements of SGAS No. 3 and establishes additional disclosure requirements addressing other common risks of deposits and investments. This Statement is effective for the District beginning in 2005. The District is currently assessing the financial statement impact of adopting the new Statement.

In June 2004, GASB issued SGAS No. 45, *"Accounting and Financial Reporting by Employers for Postemployment Benefits other than Pensions (OPEB)",* which establishes standards of accounting and financial reporting for OPEB expense and related OPEB liabilities or assets. OPEB arises from an exchange of salaries and benefits for employee services rendered. It refers to postemployment benefits other than pension benefits such as postemployment healthcare benefits. This Statement is effective for the District beginning in 2007. The District's estimate of its OPEB obligation is approximately $321.1 million as of December 31, 2004.

Reclassifications

Certain amounts in the 2003 consolidated financial statements have been reclassified in order to conform with the 2004 presentation.

NOTE 3. RESTATEMENT

In 2004, the District identified five power purchase agreements, in effect at December 31, 2003, that are derivative financial instruments which were improperly identified as a normal purchases and, as such, were not included at fair value in the December 31, 2003 consolidated balance sheet, as required by FAS 133 "*Accounting for Derivative Instruments and Hedging Activities*". In addition, the District was netting the fair value of contracts by commodity group and presenting the fair values net on the consolidated balance sheet when the right of set off did not exist as defined in FIN 39 *"Offsetting of Amounts Related to Certain Contracts"*. The restatement of the December 31, 2003 consolidated balance sheet corrects the treatment of these contracts to reflect them as derivative financial instruments at that are recorded at their fair values and presents the fair values of derivative assets and liabilities gross on the balance sheet when it is appropriate to do so. The adjustment for these corrections resulted in an increase of, which totaled $35.7 million for derivative instrument assets and $170.5 million for derivative financial instrument liabilities at December 31, 2003. The District's Board defers the recognition of derivative financial instruments for rate-making purposes, and accordingly, regulatory assets and regulatory credits were restated by $87.5 and $47.3 million, respectively, at December 31, 2003. The restatement does not impact the 2003 statement of revenues, expenses and changes in net assets.

Balances presented in the 2003 consolidated balance sheet are restated as follows:

	2003 As Previously Reported	2003 As Restated
	(thousands of dollars)	
Assets:		
Regulatory costs for future recovery — current	$ 71,329	$ 76,790
Derivative financial instruments — current	3,448	24,731
Total current assets	723,386	750,130
Regulatory costs for future recovery — noncurrent	219,200	301,310
Derivative financial instruments — noncurrent	106,597	120,998
Total noncurrent assets and deferred charges	404,257	500,768
Total assets	3,637,485	3,760,740
Liabilities:		
Derivative financial instruments — current	580	30,304
Regulatory credits — current	7,912	5,044
Total current liabilities and deferred credits	460,729	487,585
Derivative financial instruments — noncurrent	6,949	147,722
Regulatory credits — noncurrent	278,137	233,763
Total current liabilities and deferred credits	599,591	695,990
Total liabilities	3,419,030	3,542,285
Total liabilities and net assets	$ 3,637,485	$ 3,760,740

NOTE 4. UTILITY PLANT

The summarized activity of the District's utility plant during 2004 is presented below (thousands of dollars):

	Balance December 31, 2003	Additions	Transfers and Deletions	Balance December 31, 2004
Nondepreciable Utility Plant:				
Land	$ 64,692	$ 1,153	$ -0-	$ 65,845
CWIP	425,490	357,929	(169,912)	613,507
Total nondepreciable utility plant	490,182	359,082	(169,912)	679,352
Depreciable Utility Plant:				
Generation	786,889	17,745	(872)	803,762
Transmission	173,906	13,805	(1,073)	186,638
Distribution	1,087,646	86,075	(4,483)	1,169,238
Investment in gas properties	136,975	-0-	-0-	136,975
General	556,277	49,410	(22,236)	583,451
	2,741,693	167,035	(28,664)	2,880,064
Less: accumulated depreciation and depletion	(992,802)	(103,789)	30,960	(1,065,631)
Total depreciable plant	1,748,891	63,246	2,296	1,814,433
Total Utility Plant — Net	$ 2,239,073	$ 422,328	$ (167,616)	$ 2,493,785

The summarized activity of the District's utility plant during 2003 is presented below (thousands of dollars):

	Balance December 31, 2002	Additions	Transfers and Deletions	Balance December 31, 2003
Nondepreciable Utility Plant:				
Land	$ 63,970	$ 736	$ (14)	$ 64,692
CWIP	285,843	283,134	(143,487)	425,490
Total nondepreciable utility plant	349,813	283,870	(143,501)	490,182
Depreciable Utility Plant:				
Generation	769,868	23,623	(6,602)	786,889
Transmission	155,105	19,139	(338)	173,906
Distribution	1,028,581	63,676	(4,611)	1,087,646
Investment in gas properties	-0-	136,975	-0-	136,975
General	557,835	35,075	(36,633)	556,277
	2,511,389	278,488	(48,184)	2,741,693
Less: accumulated depreciation and depletion	(942,236)	(97,529)	46,963	(992,802)
Total depreciable plant	1,569,153	180,959	(1,221)	1,748,891
Total Utility Plant — Net	$ 1,918,966	$ 464,829	$ (144,722)	$ 2,239,073

In 2002, the District began active development of the Cosumnes Power Plant (CPP Project), a 500 megawatts (MW) natural gas fueled generation facility located on the Rancho Seco site. The CPP Project is expected to be operational in 2006 (see note 18 relating to construction contract issues). Included in CWIP at December 31, 2004 and 2003, are cumulative capitalized costs of $356.4 million and $184.7 million, respectively, relating to the CPP Project's construction and development, including the related natural gas pipeline.

NOTE 5. INVESTMENT IN JOINT POWERS AGENCY

TANC

The District and fourteen other California municipal utilities are members of TANC, a JPA. TANC, along with the other California municipal utilities, own and operate the California-Oregon Transmission Project (COTP), a 500-kilovolt transmission line between central California and southern Oregon. The District is obligated to pay 27.1 percent of TANC's COTP debt service and operations costs in exchange for ownership of 339 MW of TANC's 1,269 MW transfer capability. Additionally, the District has a 46 MW share of TANC's 300 MW firm, bi-directional transmission over Pacific Gas and Electric's (PG&E) system between PG&E's Tesla and Midway substations. The District recorded transmission expenses related to TANC of $10.7 million and $11.5 million in 2004 and 2003, respectively.

Summary financial information for TANC is presented below:

	December 31,	
	2004 (Unaudited)	2003 (Unaudited)
	(thousands of dollars)	
Total assets	$ 473,754	$ 489,779
Total liabilities	$ 473,391	$ 489,424
Total net assets	363	355
Total liabilities and net assets	$ 473,754	$ 489,779
Revenues, Expenses and Changes in Net Assets	$ 5	$ 2

The long-term debt of TANC, which totals $407.7 million (unaudited) at December 31, 2004, is collateralized by a pledge and assignment of net revenues of TANC, supported by take-or-pay commitments of the District and other members. Should other members default on their obligations to TANC, the District would be required to make additional payments to cover a portion of such defaulted payments, up to 25 percent of its current obligation of 27.1%.

NOTE 6. COMPONENT UNITS

CVFA Carson Cogeneration Project

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

SCA Procter & Gamble Cogeneration Project

SCA is a JPA formed by the District and the Sacramento Municipal Utility District Financing Authority (SMUDFA). SMUDFA is a JPA formed by the District and the Modesto Irrigation District. SCA operates the Procter & Gamble Project, a 120 MW (net) natural gas-fired cogeneration facility and a 44 MW (net) natural gas-fired simple cycle peaking plant, which is financed primarily by SCA non-recourse revenue bonds.

SPA Campbell Soup Cogeneration Project

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

Copies of CVFA's, SCA's, and SPA's annual financial reports may be obtained from their Executive Office at 6201 S Street, P.O. Box 15930, Sacramento, California 95852.

NOTE 7. CASH, CASH EQUIVALENTS, AND INVESTMENTS

At December 31, 2004 and 2003, the District's cash, cash equivalents and investments consist of the following:

	December 31, 2004	December 31, 2003
	(thousands of dollars)	
Cash and cash equivalents:		
Investments:		
LAIF	$ 104,047	$ 292,204
United States (U.S.) government securities	79,055	102,066
Money market mutual funds	58,682	52,340
Securities lending transactions	66,427	65,486
Commercial paper	13,187	39,830
Total cash and cash equivalents	321,398	551,926
Investments:		
U.S. government securities	217,184	126,066
Total cash, cash equivalents and investments	$ 538,582	$ 677,992

At December 31, 2004 and 2003, the District reported its book overdraft of $2.7 million and $11.8 million, respectively, as a component of Accounts Payable on the consolidated balance sheets.

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

	December 31, 2004	December 31, 2003
	(thousands of dollars)	
Total cash, cash equivalents and investments:		
Revenue bond reserve, debt service and construction funds:		
Revenue bond reserve fund	$ 82,671	$ 89,624
Debt service fund	37,558	45,134
Component unit bond reserve and construction funds	59,564	68,495
Total revenue bond reserve, debt service and construction funds	179,793	203,253
Nuclear decommissioning trust fund	87,968	91,346
Rate stabilization fund	75,000	87,317
Securities lending collateral	66,427	65,486
Other restricted funds	6,072	3,625
Unrestricted funds	123,322	226,965
Total cash, cash equivalents and investments	$ 538,582	$ 677,992

Investment Risk Categories

Investments held by the District are classified as to credit risk by categories and summarized as follows: Category 1 includes investments that are insured or registered or for which securities are held by the District or its agent in the District's name and Category 2 includes uninsured and unregistered investments for which securities are held by the counterparty's trust department or agent in the District's name. At December 31, 2004 and 2003, investments in U.S government securities and Commercial Paper totaling $309.4 million and $268.0 million, respectively, are classified as Category 1 investments. At December 31, 2004 and 2003, the District had no investments in corporate securities that would be classified as Category 2 investments. All other investments, which comprise of LAIF, money market mutual funds and securities lending transactions are uncategorized.

Cash Equivalents and Investments

Cash deposits held in the District's name are fully insured by the Federal Deposit Insurance Corporation or are collateralized in accordance with the terms of the District's indentures and applicable federal and state laws. In accordance with state laws and the bond resolutions, the District is authorized to invest in the following types of instruments: obligations which are unconditionally guaranteed by the U.S. or its agencies or instrumentalities; direct and general obligations of the State of California (State) or any local district within the State; bankers' acceptances; certificates of deposit; repurchase agreements; reverse repurchase agreements; interest rate swap agreements; securities lending agreements; and corporate indebtedness, including commercial paper and medium-term notes with a maximum term of five years. Investments in corporate indebtedness must be rated "A-1" or its equivalent for commercial paper, and "A" or equivalent for medium-term notes by a nationally recognized rating agency. The component units' bond indentures allow investing in various other securities in addition to the ones described above. The District's custodial agent maintains records showing the securities are solely owned by the District, or by one of its component units, where applicable. A portion of these securities may be pledged as collateral or for other purposes. The District's investments in money market mutual funds are comprised of only non-derivative financial securities that are backed by federal or corporate issuers.

The LAIF is a component of the Pooled Money Investment Account Portfolio managed by the State Treasurer. At December 31, 2004 and 2003, the Pooled Money Investment Account Portfolio includes approximately 2.6 percent and 2.1 percent, respectively, in certain derivative-type products, which are in the form of structured notes and asset-backed securities.

Securities Lending Transactions

The District enters into securities lending agreements for up to 20 percent of its investment portfolio only with counterparties that are primary dealers of the Federal Reserve Bank of New York. At December 31, 2004, the District had no credit risk exposure to borrowers because the amount the District owes the borrowers exceeds the amounts the borrowers owe the District. The contract with the District's custodial bank requires it to indemnify the District if the borrowers fail to return the securities (and the collateral is inadequate to replace the securities lent) or fail to pay the District for income distributions by the securities' issuers while the securities were on loan.

NOTE 8. REGULATORY DEFERRALS

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

Regulatory Assets

Decommissioning

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

Wholesale Power Receivables

The District's regulatory asset relates to its wholesale receivables that were fully reserved as uncollectible in 2001. These wholesale receivable reserves relate to amounts due from the ISO and PX totaling $23.9 million and $40.2 million at December 31, 2004 and 2003, respectively. The ultimate recovery of these amounts is dependent on numerous factors and cannot be determined at this time. This regulatory asset will be reversed concurrent with the reasonable certainty of collections or by inclusion in rates in future periods. In connection with the tentative settlement of one of its receivable balances due from the California ISO in 2004 (See note 2), the District reduced the related regulatory asset by $16.7 million. Of this amount, $5.5 was recorded as an increase to net receivables (now determined to be collectable), and $11.2 million was recorded as a reduction to 2004 wholesale revenues.

TANC Operations Costs

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

U.S. Bureau of Reclamation

In December 2004, the District established a regulatory asset to defer recognizing the expense related to the settlement with the U.S. Bureau of Reclamation (Bureau) on a billing dispute. The District will make increased payments in future rates to settle the dispute (See Note 17). This regulatory asset will be collected in rates for future water service over the twenty-five year period the District is committed to making the increased rate payments to the Bureau.

Enrichment Facility Decommissioning Assessment

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

Derivative Financial Instruments

The District's regulatory asset relating to derivative financial instruments is intended to defer the net difference between the fair value of derivative instruments and their cost basis, if any. The balance is charged or credited into rates as the related asset or liability is utilized.

Precipitation Hedges

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

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

	December 31, 2004	December 31, 2003 (As Restated)
	(thousands of dollars)	
Regulatory costs for future recovery:		
Decommissioning	$ 233,345	$ 227,679
Wholesale power receivables	23,928	40,193
TANC operations costs	14,864	16,960
U.S. Bureau of Reclamation	12,485	-0-
Enrichment facility decommissioning assessment	4,651	5,697
Derivative financial instruments	71,234	87,571
Precipitation hedges	1,702	-0-
Total regulatory costs	362,209	378,100
Less: regulatory costs to be recovered within one year	(72,836)	(76,790)
Total regulatory costs for future recovery — net	$ 289,373	$ 301,310

Regulatory Liabilities

CIAC

In 2004 and 2003, the District capitalized CIAC totaling $18.2 million and $20.9 million, respectively, in Plant in Service in the consolidated balance sheets and recorded $5.8 million and $5.2 million, respectively, of depreciation expense in the consolidated statements of revenues, expenses and changes in net assets. The District's regulatory credit relating to CIAC is intended to offset the revenue and expense associated with this accounting treatment. Thus, this regulatory credit is being amortized into rates over the depreciable lives of the related contributed distribution plant assets in order to offset the earnings effect of these nonexchange transactions.

Rate Stabilization

The District's regulatory credit relating to Rate Stabilization is intended to defer the need for future rate increases when costs exceed existing rates. Each year, at the direction of the Board, amounts are either transferred into this fund (which reduces revenues) or amounts are transferred out of this fund (which increases revenues). For several years through 2003, the Board deferred all residual income or loss into this account, as part of its strategy to maintain break-even operations while building up the Rate Stabilization Fund. In 2004, the Board ceased this practice and adopted a practice of authorizing Rate Stabilization Fund transfers on an event driven basis. In 2004, the Board determined that $12.3 million should be withdrawn in connection with payments made to PG&E associated with the Scheduling Coordinator Services (SCS) Tariff issue as described in Note 17.

El Paso Settlement

In December 2004, the District established a regulatory credit relating to the settlement of a class action lawsuit with El Paso Natural Gas (El Paso), which is comprised of the present value of the amount the District will collect from El Paso over the twenty year repayment term. This regulatory deferral will be credited to revenue as payments from El Paso are realized.

Public Good

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

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

	December 31,	
	2004	2003 (As Restated)
	(thousands of dollars)	
Regulatory Credits for Future Revenue Recognition:		
CIAC	$ 163,197	$ 150,776
Rate stabilization	75,000	87,317
El Paso Settlement	6,900	-0-
Public good	895	714
Total regulatory credits for future revenue recognition	245,992	238,807
Less – regulatory credits to be recognized within one year	(7,495)	(5,044)
Total regulatory credits — net	$ 238,497	$ 233,763

NOTE 9. DERIVATIVE FINANCIAL INSTRUMENTS

The District enters into contracts for electricity and natural gas to meet the expected needs of its retail customers. The District sells excess capacity during periods when it is not needed to meet its retail requirements. The District's energy risk management program uses various physical and financial contracts to hedge exposure to fluctuating commodity prices. The District also enters into interest rate swap agreements to reduce interest rate risk or to enhance the relationship between the risk and return regarding the District's assets or debt obligations. During 2004 and 2003, the District executed numerous new gas related and power related purchase agreements, which are accounted as derivative financial instruments and are included in the table below.

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

	December 31, 2004	December 31, 2003 (As Restated)
	(thousands of dollars)	
Derivative Financial Instrument Assets:		
Gas related agreements	$ 41,371	$ 11,758
Electric related agreements	119,987	108,855
Treasury related agreements	21,922	25,116
Total derivative financial instruments	183,280	145,729
Less – derivative financial instruments maturing within one year	(32,309)	(24,731)
Total derivative financial instrument assets — net	$ 150,971	$ 120,998
Derivative Financial Instrument Liabilities:		
Gas related agreements	$ 3,515	$ 2,264
Electric related agreements	173,010	146,214
Treasury related agreements	27,315	29,548
Total derivative financial instruments	203,840	178,026
Less – derivative financial instruments maturing within one year	(48,317)	(30,304)
Total derivative financial instrument liabilities — net	$ 155,523	$ 147,722

The Board has deferred recognition of the effects of reporting the fair value of derivative financial instruments for rate-making purposes, and in 2001, established a regulatory account to defer the accounting impact of these accounting adjustments (see Note 8).

NOTE 10. LONG-TERM DEBT

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

	December 31, 2004	December 31, 2003
	(thousands of dollars)	
Electric revenue bonds:		
Electric revenue bonds, 2.5%-6.5%, 2005-2033	$ 1,727,090	$ 1,638,760
Subordinated electric revenue bonds, 1.45%-8.0%, 2005-2028	478,850	487,650
Total electric revenue bonds	2,205,940	2,126,410
Component unit cogeneration project revenue bonds, 5.0%-7.0%, 2005-2022	295,625	310,525
Total long-term debt outstanding	2,501,565	2,436,935
Bond premiums — net	78,614	84,881
Deferred losses on bond refundings — net	(106,689)	(118,861)
Total long-term debt	2,473,490	2,402,955
Less: amounts due within one year	(67,165)	(44,245)
Total long-term debt — net	$ 2,406,325	$ 2,358,710

The summarized activity of the District's long-term debt during 2004 is presented below (thousands of dollars):

	December 31, 2003	Additions	Payments or Amortization	December 31, 2004	Amounts Due Within One Year
Electric revenue bonds	$ 1,638,760	$ 130,950	$ (42,620)	$ 1,727,090	$ 57,840
Subordinate electric revenue bonds	487,650	-0-	(8,800)	478,850	425
Component unit cogeneration project revenue bonds	310,525	-0-	(14,900)	295,625	8,900
Total	2,436,935	130,950	(66,320)	2,501,565	$ 67,165
Unamortized premiums — net	84,881	2,412	(8,679)	78,614	
Deferred losses on bond refundings — net	(118,861)	(1,518)	13,690	(106,689)	
Total long-term debt	$ 2,402,955	$ 131,844	$ (61,309)	$ 2,473,490	

The summarized activity of the District's long-term debt during 2003 is presented below (thousands of dollars):

	December 31, 2002	Additions	Payments or Amortization	December 31, 2003	Amounts Due Within One Year
Electric revenue bonds	$ 1,486,455	$ 812,445	$ (660,140)	$ 1,638,760	$ 25,245
Subordinate electric revenue bonds	384,125	111,900	(8,375)	487,650	8,400
Component unit cogeneration project revenue bonds	332,590	-0-	(22,065)	310,525	10,600
Total	2,203,170	924,345	(690,580)	2,436,935	$ 44,245
Unamortized premiums — net	154	81,636	3,091	84,881	
Deferred losses on bond refundings — net	(94,674)	(33,972)	9,785	(118,861)	
Total long-term debt	$ 2,108,650	$ 972,009	$ (677,704)	$ 2,402,955	

At December 31, 2004, scheduled annual principal maturities and interest are as follows (thousands of dollars):

	Principal	Interest	Total
2005	$ 67,165	$ 123,151	$ 190,316
2006	85,160	119,299	204,459
2007	98,390	115,050	213,440
2008	88,225	110,407	198,632
2009	79,645	106,355	186,000
2010 – 2014	587,450	451,480	1,038,930
2015 – 2019	643,995	293,548	937,543
2020 – 2024	472,230	148,448	620,678
2025 – 2029	311,930	56,254	368,184
2030 – 2033	67,375	7,612	74,987
Total requirements	$ 2,501,565	$ 1,531,604	$ 4,033,169

Interest in the preceding table includes interest requirements for variable rate debt ranging from 2.4 percent to 4.5 percent using the debt interest rate in effect at December 31, 2004 for each issue.

2004 Electric Revenue Bonds

In May 2004, the District issued $130.9 million of 2004 Series T Electric Revenue Bonds at a premium of $2.4 million. Proceeds from the 2004 Series T Bonds and $1.4 million of available District funds were used to refund $101.0 million of Commercial Paper Notes (Notes) and $16.9 million of previously issued revenue bonds through a legal defeasance, and accordingly, the liability for the defeased bonds has been removed from Long-term Debt in the consolidated balance sheets. The refunding resulted in the recognition of a deferred accounting loss of $1.5 million, which is being amortized over the life of the refunding issue; and a current accounting loss of $0.5 million, which is included in Interest on Debt in the consolidated statements of revenues, expenses and changes in net assets. The 2004 refunding reduced future aggregate debt service payments by $3.3 million and resulted in a total economic gain of $1.3 million, the difference between the present value of the old and new debt service payments. Proceeds from the 2004 Series T Bonds were also used to fund $14.0 million of capital expenditures.

2003 Revenue Bonds Refundings and Defeasances

In 2003, the District issued $924.4 million of Electric Revenue and Subordinated Electric Revenue Bonds at a premium of $81.6 million. Proceeds from these bonds were used to refund $115.3 million of Notes and $600.3 million of previously issued revenue bonds. The refundings resulted in the recognition of deferred accounting losses of $65.1 million, which are being amortized over the lives of the refunding issues; and a current accounting loss of $2.0 million, which is included in Interest on Debt in the consolidated statements of revenues. The 2003 refundings reduced future aggregate debt service payments by $101.9 million and resulted in a total economic gain of $71.7 million, the difference between the present values of the old and new debt service payments.

Interest Rate Swap Agreements

The District has a fixed-to-variable interest rate swap agreement with a notional amount of $131.0 million, which is equivalent to the principal amount of the District's 1997 Series K Electric Revenue Bonds. Under this swap agreement, the District pays a variable rate equivalent to the Bond Market Association (BMA Index) (1.99 percent at December 31, 2004) and receives fixed rate payments of 5.15 percent. In connection with the swap agreement, the District has a put option agreement, also with a notional amount of $131.0 million which gives the counterparty the right to sell to the District, at par, either the 1997 Series K bonds, or a portfolio of securities sufficient to defease the 1997 Series K bonds. The exercise of the option terminates the swap at no cost to the District. The combination of these financial transactions brings the District's net cost of borrowing to the BMA Index less 8 basis points. The term of both the swap and the put is equal to the maturity of the 1997 Series K bonds.

Additionally, the District has three variable-to-fixed interest rate swap agreements with a combined notional amount of $407.8 million for the purpose of fixing the effective interest rate associated with certain of its Subordinated Bonds. Under these agreements, the District makes fixed payments of between 2.89 percent and 4.50 percent and receives variable payments from the counterparties of between 63 percent and 70 percent of the one-month London Interbank Offered Rate for U.S. dollar deposits (2.40 percent at December 31, 2004). The swap agreements expire in 2010 ($27.2 million notional value), 2018 ($269.1 million) and 2028 ($111.5 million). The notional values of all three swaps are amortized over the life of the respective swap agreements concurrently with scheduled principal payments. The District can terminate all swap agreements at any time, with payment or receipt of the fair market value of the swaps as of the date of termination.

Subordinated Electric Revenue Bonds

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

Variable Rate Bonds

The District's variable rate bonds bear interest at daily, weekly and monthly rates, ranging from 1.45 percent to 1.60 percent at December 31, 2004. The District can elect to change the interest rate period or fix the interest rate, with certain limitations. Certain variable rate bondholders have the right to tender the bonds to the tender agent. The District's variable rate bonds cannot be put to the District by the bondholders. Accordingly, the District has recorded such bonds as long-term debt, less amounts scheduled for redemption within one year.

Component Unit Cogeneration Bonds

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

Callable Bonds

The District has $24.6 million of fixed rate system revenue bonds that are currently callable and $921.3 million of bonds that become callable from 2006 through 2014. These bonds can be called until maturity. In addition, all $454.3 million of the District's variable rate subordinated bonds are currently callable.

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

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

NOTE 11. COMMERCIAL PAPER NOTES

The District issues Notes to finance or reimburse capital expenditures. At December 31, 2004, there were no Notes outstanding and as of December 31, 2003 Notes principal totaled $51.0 million. The effective interest rate for the Notes outstanding at December 31, 2003 was 0.98 percent and the average term was 37 days. The District maintains a $173.0 million letter of credit to support the sale of these outstanding Notes and incurs an annual fee of 0.50 percent. There has not been a term advance under the letter of credit agreement. In January 2005, the District issued $50.0 million of Notes.

NOTE 12. FAIR VALUE OF FINANCIAL INSTRUMENTS

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

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

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

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

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

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

	December 31, 2004	
	Recorded Value	Fair Value
	(thousands of dollars)	
Investments, including cash and cash equivalents	$ 583,582	$ 583,582
Long-term debt	(2,473,490)	(2,683,913)
Interest rate swap and put agreements	(5,393)	(5,393)
Gas and electricity related derivatives	(15,167)	(15,167)

	December 31, 2003	
	Recorded Value (As Restated)	Fair Value (As Restated)
	(thousands of dollars)	
Investments, including cash and cash equivalents	$ 677,992	$ 677,992
Long-term debt	(2,402,955)	(2,606,844)
Interest rate swap and put agreements	(4,432)	(4,432)
Gas and electricity related derivatives	(27,865)	(27,865)

NOTE 13. RANCHO SECO DECOMMISSIONING LIABILITY

Background

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

The Department of Energy (DOE), under the Nuclear Waste Policy Act of 1982, is responsible for permanent disposal of spent nuclear fuel and high-level radioactive waste. The District has a contract with the DOE for the removal and disposal of spent nuclear fuel and high-level (greater than class "C": GTCC) radioactive waste. However, the date when fuel and GTCC waste removal will be complete is uncertain. The DOE recently announced that it would not meet the projected 2010 opening date for the Yucca Mountain waste site. The rate at which DOE will remove fuel is also uncertain. The District has constructed and separately licensed an on-site independent spent fuel storage facility (Storage Facility) for dry storage of the fuel in sealed canisters and completed movement of the fuel into the facility in 2002. The District has applied for a license amendment to store the GTCC waste at the Storage Facility. The Storage Facility will remain under the regulation of NRC until such time as it is decommissioned after the DOE removes the nuclear fuel and GTCC radioactive waste.

Asset Retirement Obligations

Rancho Seco is one of the first large commercial nuclear power plants to be removed from service. Due to the substantial technical, regulatory and legal issues in connection with its nuclear decommissioning, the District cannot predict with certainty how long various decommissioning processes will take nor the eventual cost of decommissioning. These financial statements reflect the District's current estimate of its obligation for the cost of decommissioning under the requirements of SFAS No. 143 based on studies completed in 2004 and 2003. The 2004 study included an increase of $26.1 million, which related primarily to additional internal and outsourced staffing costs and other support costs related to spent fuel management from 2009 through the date of removal of spent nuclear fuel.

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

	December 31, 2004	December 31, 2003
Active decommissioning	$ 217,341	$ 249,332
Spent fuel management	103,208	67,208
Total ARO	320,549	316,540
Less: Current portion	41,500	39,081
Total non-current portion of ARO	$ 279,049	$ 277,459

The summarized activity of the Rancho Seco decommissioning liability during 2004 and 2003 are presented below (thousands of dollars):

	December 31, 2004	December 31, 2003
ARO at beginning of year	$ 316,540	$ 336,622
Accretion	16,158	17,488
Expenditures and annual adjustments	(38,221)	(37,570)
Additional decommissioning liability from 2004 study	26,072	-0-
Total ARO	$ 320,549	$ 316,540

The District contributed $27.0 million to the Trust Fund in 2004 and 2003, and plans the same contribution rate in 2005.

NOTE 14. PENSION PLANS

Defined Benefit Pension Plan

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

Funding Policy

Participants are required to contribute approximately 7.0 percent of their annual covered salary. The District makes either the full or partial contributions required of District employees on their behalf and for their account. The District is not currently required to contribute to the plan because of its current funding excess. The contribution requirements of plan members and the District are established and may be amended by PERS.

Annual Pension Cost

For 2004, 2003 and 2002, the District's annual pension cost for PERS was $0 since it was not required to make, and did not make, pension contributions. The lack of required contributions was determined by PERS as part of the annual actuarial valuation based on the entry age normal actuarial cost method. The actuarial assumptions included (a) a 7.75 percent investment rate of return (net of administrative expenses), (b) projected annual salary increases that vary by duration of service, and (c) 3.0 percent per year cost-of-living adjustments. Both (a) and (b) also included an inflation component of 3.0 percent. The actuarial value of PERS' assets was determined using techniques that smooth the effects of short-term volatility in the market value of investments over a four-year period (smoothed market value).

Three-year trend information for PERS is presented below:

Fiscal Year	Annual Pension Cost (APC)	Percentage of APC Contribution
6/30/02	$ -0-	100%
6/30/03	$ -0-	100%
6/30/04	$ -0-	100%

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

Actuarial Valuation Date	Entry Age Normal Liability	Actuarial Value of Assets	Funding Excess	Funded Status Percent	Annual Covered Payroll	Funding Excess as a Percent of Payroll
6/30/01	791,426	1,120,055	328,629	141.5	128,366	256.0
6/30/02	858,245	1,043,256	185,011	121.6	137,257	134.8
6/30/03	980,081	1,045,473	65,392	106.7	146,404	44.7

Other Plans

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

The District makes annual contributions to the 401(k) Plan on behalf of certain employees pursuant to a memorandum of understanding with one of its collective bargaining units. The District does not match employee contributions nor make contributions on behalf of its employees to the 457 Plan. Participating employees and the District made contributions into the Plans totaling $13.9 million and $0.3 million in 2004, respectively, and $12.1 million and $0.3 million in 2003, respectively.

NOTE 15. OTHER POST-EMPLOYMENT BENEFITS

The District provides post-employment health care benefits, in accordance with District policy and negotiated agreements with employee representation groups, to all employees who retire from the District, and their dependents, on or after attaining age 50 with at least 5 years of service. The District also provides post-employment health care benefits to covered employees who are eligible for disability retirement. The District contributes the full cost of coverage for employees hired before January 1, 1991, and a portion of the cost based on credited years of service for employees hired after January 1, 1991. The District also contributes a portion of the costs of coverage for these employees' dependents. Currently, 2,560 post-employment participants, including retirees, spouses of retirees, surviving spouses, and eligible dependents, participate in the District's health care benefits program.

The post-employment health care benefits are unfunded. The District records post-employment health care benefit expenses on a pay-as-you-go basis. During 2004 and 2003, post-employment health care benefit expenditures were $9.5 million and $7.9 million, respectively. At December 31, 2004 and 2003, the District estimates that the actuarially determined accumulated post-employment benefit obligation was approximately $321.1 million and $394.6 million, respectively. The significant decrease in this estimate in 2004 was caused primarily by decreased starting claims cost assumptions based on the most recent 2005 renewals related to Medicare Advantage plans, an increase in the discount rate (from 6.25 percent to 7.1 percent) due to a change from FASB reporting to GASB reporting, and an increase in the estimated value of additional governmental subsidies. The health care inflation rate assumption used to estimate the net present value of the post-employment benefit obligation for 2004 ranged between 5.0 percent and 13.0 percent compared to a range of 5.0 percent to 15.0 percent used in the 2003 study for various elements of the health care obligations. The decrease reflects most recent experience and expectations. The effect of a one percent change in these assumed health care cost trends would increase or decrease the District's total benefit obligation by approximately $48.6 million or $39.7 million, respectively.

NOTE 16. INSURANCE PROGRAMS AND CLAIMS

The District is exposed to various risks of loss related to torts, theft of and destruction to assets, errors and omissions, and natural disasters. In addition, the District is exposed to risks of loss due to injuries to, and illnesses of, its employees. The District carries commercial insurance coverage to cover most claims in excess of specific dollar thresholds, which range from $0.2 million to $1.0 million per claim with total excess liability insurance coverage for most claims of $100.0 million. District property insurance coverage is based on the replacement value of the asset. There have been no significant reductions in insurance coverage in 2004. In 2004 and 2003, the insurance policies in effect have adequately covered all settlements of the claims against the District. The claims liability is included as a component of Self Insurance, Deferred Credits and Other in the consolidated balance sheets.

The District's total claims liability at December 31, 2004 and 2003 is presented below:

	2004	2003
	(thousands of dollars)	
Workers' compensation claims	$ 6,429	$ 5,285
General and auto claims	3,069	3,055
Short- and long-term disability claims	2,501	2,233
Claims liability	$ 11,999	$ 10,573

Changes in the District's total claims liability during 2004 and 2003 is presented below:

	2004	2003
	(thousands of dollars)	
Claims liability, beginning of year	$ 10,573	$ 7,123
Add: provisions for claims	5,851	7,248
Less: payments on claims	(4,425)	(3,798)
Claims liability, end of year	$ 11,999	$ 10,573

NOTE 17. COMMITMENTS

Electric Power Purchase Agreements

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

At December 31, 2004, the approximate minimum obligations for these contracts over the next five years are as follows:

Year Ending:	Amount (thousands of dollars)
2005	$ 431,907
2006	318,817
2007	188,603
2008	149,546
2009	150,949

Contractual Commitments beyond 2009

Several of the District's purchase power contracts extend beyond the five-year summary presented above. These contracts expire between 2010 and 2024 and provide for power under various terms and conditions. The District estimates its annual minimum commitments under these contracts range between $152.6 million in 2010 and $49.6 million in 2024. The District's largest purchase power source is the Western Area Power Administration contract (Western), whereby the District can purchase up to 360 MW of capacity at cost-based rates, depending on the amount of energy available from Western in any given year. The Western contract expires in 2024.

Gas Supply Agreements

The District has numerous long-term natural gas supply agreements with Canadian and U.S. companies to supply a portion of the consumption needs of the District's natural gas fired cogeneration power plants, which expire through 2008.

Gas Transport Capacity Agreements

The District has numerous long-term gas transport capacity agreements with Canadian and U.S. companies to transport natural gas to the District's natural gas fired cogeneration power plants from the supply basins in Alberta to the California-Oregon border and from supply basins in the southwest and Rocky Mountains to the Southern California border. These gas transport capacity agreements provide for the delivery of gas into District owned pipeline capacity within California. The gas transport capacity agreements provide the District with 32,000 decatherms per day (Dth/d) of natural gas pipeline capacity to the Canadian Basins through 2023 and 40,000 Dth/d to the Southwest or Rocky Mountain Basins through at least 2018.

Gas Storage Agreements

The District also has an agreement for the storage of up to 1.5 million Dth of natural gas at a regional facility. The gas storage agreement expires in 2009.

At December 31, 2004, the approximate minimum obligations for these natural gas related contracts over the next five years are as follows:

Year Ending:	Amount (thousands of dollars)
2005	$ 98,000
2006	128,050
2007	122,563
2008	36,993
2009	6,302

Contractual Commitments Beyond 2009

Several of the District's gas transport and gas storage contracts extend beyond the five-year summary presented above. These contracts expire between 2009 and 2023 and provide for transportation and storage under various terms and conditions. The District estimates its annual minimum commitments under these contracts to be $5.8 million from 2010 through 2023.

Gas Price Swap Agreements

The District has entered into numerous variable to fixed rate swaps with notional amounts totaling 79,545,000 million British Thermal Units (mmbtu) for the purpose of fixing the rate on the District's natural gas purchases for its gas fueled power plants and gas indexed electric contracts. These gas price swap agreements result in the District paying fixed rates ranging from $3.60 to $7.47 per mmbtu. The swap agreements expire periodically from March 2005 through 2010.

Capital Expenditures

The District's 2005 budget for capital expenditures (excluding AFUDC) totals $276.0 million, of which approximately $165.3 million is for power supply projects (including $52.1 million for the Solano Wind Project and $46.0 million related to the construction of the 500 MW CPP Project), $66.8 million is for distribution projects and $43.9 million is for other capital projects.

NOTE 18. CLAIMS AND CONTINGENCIES

U.S. Bureau of Reclamation Water Service Contract Billing Dispute

The District entered into a 40-year water service contract with the Bureau, which expires in 2012, for the delivery of up to 75,000 acre-feet of water per year to originally meet the District's needs at Rancho Seco. This amount includes 60,000 acre-feet of municipal and industrial (M&I) water from the Central Valley Project (CVP). Over time, Bureau revenues have been insufficient to cover actual CVP operations and maintenance (O&M) costs; contractor payments have been insufficient to cover amortization of their respective shares of CVP capital costs and, in the case of M&I contractors, have been insufficient to cover interest on unpaid capital. Although the District's contract contains a specific rate methodology, the Bureau maintains that the District and other M&I contractors are running substantial O&M deficits which, by the Bureau's definition, includes as O&M costs both unpaid interest on capital and interest on the O&M deficit. The Bureau also claims interest has compounded on the O&M deficits.

In 2003 and 2004, the District worked with several M&I contractors, with similar contracts and significant deficits claimed by the Bureau, to resolve this matter with the Bureau. The District, in concert with the M&I contractors, filed their complaint against the Bureau in March 2003 in the U.S. District Court. Under the guidance of a federal magistrate, negotiations were held and a proposed settlement was reached.

In general, the settlement reduces each contractor's obligation based on a combination of lower interest rates and simple interest; and the contractors commit to repayment of under-recovered capital and O&M costs. The contractors can either pay off the obligation or retire it in rates. The District estimates that its obligation under this settlement is $12.5 million as of December 2004. In December 2004 the Board approved the settlement and deferred the $12.5 million obligation as a Regulatory item (See Note 7) to be recovered in future rates as the obligation is repaid to the Bureau. This amount is included in Due to U.S. Bureau of Reclamation in the balance sheet at December 31, 2004. Prior to completing the settlement, the Department of the Interior must give final approval so the Department of Justice can execute the settlement documents and obtain approval by the federal court. Management believes that such approvals are likely to occur.

California Energy Market Refund Dispute

In 2001, FERC issued an order establishing evidentiary hearings for the purpose of determining the amount of refunds, if any, due to customers of the California ISO and PX spot markets from market participants selling into those markets for the period October 2, 2000 through June 20, 2001. During this time period, the District was both a seller and a buyer in the California spot markets. The Administrative Law Judge (ALJ) assigned to the proceedings adopted hearing procedures for a three-phase hearing. Phase 1 of the hearing, held in March 2002, addressed the calculation of the price to be applied to sales into the California ISO and PX market retroactively. Phases 2 and 3 addressed the calculation of refunds and identification of the amount currently owed to each supplier (with separate quantities due from each entity) by the California ISO, the investor owned utilities, and the State. Hearings on Phases 2 and 3 concluded in August 2002. In December 2002, the ALJ issued his Certification of Proposed Findings (Findings) for all three phases. In March 2003, FERC issued an Order (March Order) accepting most of the Findings and adjusting the formula used |to calculate the mitigated market-clearing price (MMCP) to be used in retroactively resettling the markets during the refund period. In its March Order, FERC noted that any future FERC findings of energy market manipulation that results from its ongoing review of additional evidence filed would neither result in a resetting of the refund effective date for this proceeding, nor impact the just and reasonable MMCP developed for the refund period.

In April 2003, the District filed a request for rehearing of FERC's March Order and in October 2003, FERC issued an Order on Rehearing, where in relevant part (1) rejected the District's request for rehearing regarding the District's $4.1 million sleeve transaction, (2) rejected the District's request for rehearing regarding adjustments made by the California PX, (3) declined to address the issue of FERC's jurisdiction over municipal sellers and (4) determined that individual sellers, and not the California PX, should be subject to refund liability and refunds should be paid on a pro rata basis. The Order on Rehearing requires the California ISO and PX to submit compliance filings containing the results of their revised market reruns. Currently, the California ISO estimates that it will complete and file its revised market rerun with FERC in the summer of 2005. The District has filed a Petition for Review of the Order on Rehearing with the Court of Appeals for the Ninth Circuit, for the purposes of appealing the decision regarding the District's $4.1 million sleeve transaction. In November 2004, the Ninth Circuit Court issued an order severing the Petitions for Review of the jurisdictional issues and other transaction issues (which includes the District's sleeve transaction). The Ninth Circuit Court has scheduled oral arguments in April 2005 to consider the transaction issues (including the District's sleeve transaction); and the District anticipates a decision will be issued in the summer of 2005. Under the latest MMCP formula announced by FERC, the District estimated that its potential refund liability could be as high as $12.0 million. Throughout the process, the District has vigorously challenged FERC's jurisdiction over public power in these proceedings and believes it is likely to prevail in this matter; thus, removing any potential liability. If the District is found to be subject to FERC's authority in this matter, the District's liability would likely be partially offset by refunds it would eventually realize as a buyer in the California ISO and PX spot markets. However, since District management believes it is unlikely that it will be found to be subject to the jurisdiction of FERC's refund process, it has not accrued any liability in this matter.

Scheduling Coordinator Services Tariff Dispute

In January 2000, PG&E filed its proposed SCS Tariff with FERC. The proposed SCS Tariff is designed to charge the District and other existing wholesale contract customers for the various scheduling services that PG&E provides. PG&E claims that such services were new services that were due to the advent of industry restructuring in California and the California ISO. The District and others believe that their existing contracts require PG&E to provide such services under the terms of their existing contracts. Accordingly, the District and other utilities affected by the proposed SCS Tariff filing are rigorously opposing the proposed tariff action and have participated in numerous FERC proceedings in this regard. Although PG&E's tariff filing was made in 2000, PG&E is seeking to have the proposed SCS Tariff charges apply retroactively from April 1998 when the operations of the California ISO commenced and PG&E began incurring the ISO-related costs it is attempting to recover. In June 2002, the District commenced operations as a separate control area and, therefore, is not subject to the proposed SCS Tariff as of that date.

In January 2000, FERC accepted for filing PG&E's proposed SCS Tariff, suspended the filing for five months, and set the matter for hearing. In August 2003, the ALJ issued an Order Phasing Proceeding bifurcating the proceeding into two phases. In May 2004, the ALJ issued an initial decision in Phase 1 of the SCS Tariff Proceeding, in which the ALJ found extraordinary circumstances sufficient to grant waiver of the prior notice requirement for a March 31, 1998 effective date, thereby allowing PG&E to recover SCS Tariff charges retroactive to the effective date; and determined that PG&E provides a new service under the SCS Tariff. In October 2004, FERC issued its Phase 1 Opinion in which it found PG&E's SCS Tariff to be a new service, but reversed the ALJ's finding that extraordinary circumstances permitted waiver of the prior notice requirement. Accordingly, the FERC refused to allow PG&E to recover SCS Tariff charges retroactively from April 1998 through December 1999. The District filed a request for rehearing of the Phase 1 Opinion with respect to the new service issue in November 2004. FERC issued a tolling order in December 2004 and has not acted on any of the parties' requests for rehearing. The Phase 2 proceedings addressing cost allocation are underway with hearings scheduled to begin in May 2005.

In June 2004, PG&E issued the District an invoice in the amount of $19.2 million, which the District paid in full. While the District believes it will ultimately prevail in its arguments that PG&E improperly collected the SCS Tariff charges from the District and the District is entitled to a refund from PG&E of any amounts paid under the SCS Tariff, it recorded $16.4 million of this payment to expense in 2004; the amount is included in Purchased Power expense. At a minimum, District management believes that the FERC's October 2004 Order will stand which would result in the District receiving a refund from PG&E of $2.8 million plus interest for the retroactive charges that PG&E assessed the District. Accordingly, a receivable of $2.8 has been recorded at December 31, 2004.

The District's potential liability under the SCS Tariff is also potentially impacted by the settlement reruns that the California ISO is currently undertaking in the California refund case discussed above. The District will continue to vigorously contest any charges associated with the SCS Tariff at the FERC.

Replacement Reserves Dispute

In August 2003, PG&E issued invoices totaling $2.2 million for replacement reserve charges purportedly incurred by PG&E for energy scheduled through its Rancho Seco intertie point from July 2000 through June 2002. In September 2003, the District provided PG&E notice of dispute of the invoices due to the fact that the billing was inconsistent with the Restated Interim Agreement, the primary agreement between the parties governing such transactions and, therefore, there should never have been any Replacement Reserve charges incurred in connection with the power deliveries at issue. PG&E functioned as the Scheduling Coordinator on the District's behalf for transactions with the California ISO at this intertie point until June 2002, when the District became its own control area. These Replacement Reserve charges purportedly relate to power purchased by the California ISO to cover deviations between actual load and forecasted load. The District believes that, even if the charges were appropriate, PG&E's delay in billing within a reasonable timeframe compromised the District's ability to modify its operations or scheduling procedures to eliminate or mitigate the charges. Further, it is unclear whether PG&E has attempted to recover for these Replacement Reserve charges twice, once under the proposed SCS Tariff described above, and once through the Restated Interim Agreement.

Since October 2003 the parties have entered into a series of tolling agreements that hold this dispute in abeyance until the SCS Tariff Dispute described above is resolved.

District management believes that it is likely that it will not be found liable for any charges in this matter, and that in the event that a portion of these charges are ultimately upheld, any payment would be offset against the SCS liability described above for which the District has recorded an expense of $16.4 million in 2004.

COTP II Arbitration

The California ISO filed to pass through charges on transactions involving the COTP, the District and Western control area. The California ISO is seeking to pass through $9.0 million in new charges to PG&E as the COTP's and Western's control areas proxy scheduling coordinator. These charges include emissions costs, start-up costs, and minimum load costs. PG&E disputes the California ISO's authority to impose any charges on it as the Scheduling Coordinator for COTP and filed for arbitration in July 2004. The District filed its intervention in the arbitration in July 2004. The California ISO and Southern California Edison Company (Edison) filed motions for summary disposition in November 2004. The District, PG&E, and other aligned parties filed a joint reply to the California ISO's and Edison's motion for summary disposition in January 2005. Oral arguments on the California ISO's and Edison's summary disposition motions are being held in February 2005. The District believes that the California ISO will not prevail in its attempts to pass charges through to the COTP and the District and the Western control area. The District believes that previous COTP arbitration and subsequent FERC orders confirmed that such a pass through was in violation of the California ISO Tariff. Should the California ISO ultimately prevail, the District estimates that its share of the $9.0 million that the California ISO seeks to charge may be as much as $3.0 million. The District believes that it will prevail in this matter and, therefore, no liability has been recorded at December 31, 2004.

Fru-Con Construction Corporation Construction Matters

In August 2003, the District entered into a contract with Fru-Con Construction Corporation (Fru-Con) to construct the District's 500 MW CPP Project. Travelers Casualty and Surety Company of America (Travelers) is obligated, under a Performance Bond, to guarantee Fru-Con's performance under the contract. The original construction schedule for the CPP Project called for commercial operation in September 2005. As of mid-February 2005, the CPP Project is about 65 percent complete and the District estimates that the CPP Project is four to six months behind schedule.

Though Fru-Con has previously made claims for comparably smaller amounts that have been resolved through negotiation; in October 2004, Fru-Con asserted additional claims totaling $26.0 million. Beginning in October 2004 and continuing until early February 2005, the District and Fru-Con participated in negotiations to resolve disputes over both cost and delays in the CPP Project schedule. The parties were unable to resolve the disputes to the satisfaction of the District and on February 11, 2005, the District terminated its contract with Fru-Con on the basis of breach of contract by Fru-Con. On February 15, 2005 the District received notice from Fru-Con that Fru-Con claims the contract was wrongfully terminated. On February 28, 2005, the District filed suit in the Sacramento County Superior Court against Fru-Con and one of its sub-contractors alleging breach of contract. The District is currently engaged in negotiations with existing subcontractors and other potential construction vendors to execute new construction contracts and resume project construction activities. In the event the cost of completing the CPP Project exceeds the amount of the Fru-Con contract, the District expects to seek recovery of such amounts from Fru-Con and its surety, Travelers.

The District does not believe that this jeopardizes the CPP Project or that the District will incur material losses as a result of this matter.

Other Construction Matters

The District contracts with various other firms to design and construct facilities for the District. Currently, the District is party to various claims, legal actions and complaints on some of these construction projects. District management believes that it will be successful in refuting these allegations, and estimates that the ultimate resolution of these matters will not have a material adverse effect on the District's financial position. Accordingly, no liability has been recorded at December 31, 2004.

Environmental Matters

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

Other Matters

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

NOTE 19. SUPPLEMENTAL CASH FLOW INFORMATION

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

	Year Ended December 31, 2004	Year Ended December 31, 2003
	(thousands of dollars)	
Operating income	$ 167,749	$ 89,870
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	98,614	92,578
Depletion	5,265	4,941
Regulatory deferrals collected in rates, including decommissioning	30,306	76,011
Amortization of advance capacity	4,711	4,711
Revenue (recognized from) deferred to regulatory credits	(12,317)	56,069
Federal and State grants revenue	3,727	6,212
Interest income from energy efficiency loans	2,102	15,989
Other	945	2,406
Changes in operating assets and liabilities:		
Customer and wholesale receivables	7,003	(8,502)
Other assets	6,764	(14,370)
Payables and accruals	10,167	(2,481)
Decommissioning	(32,830)	(26,739)
Net cash provided by operating activities	$ 292,206	$ 296,694

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

	Year Ended December 31, 2004	Year Ended December 31, 2003 (As Restated)
	(thousands of dollars)	
Loss on defeasance of debt	$ (548)	$ (3,032)
Amortization of debt related costs	5,351	8,711
Unrealized holding loss	(1,868)	(2,548)
Change in valuation of derivative financial instruments	11,737	(125,420)
Assets contributed in aid of construction	4,975	5,867
Allowances for funds used during construction	15,370	7,628
Construction costs included in accounts payable	40,868	49,801
Increase in decommissioning liability relating to change in accounting principle	-0-	20,245

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