



**THE METROPOLITAN WATER DISTRICT
OF SOUTHERN CALIFORNIA**

Basic Financial Statements

Years ended June 30, 2010 and 2009

(With Independent Auditors' Report Thereon)

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June 30, 2010 and 2009

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KPMG LLP
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Independent Auditors' Report

The Board of Directors
The Metropolitan Water District of Southern California:

We have audited the accompanying basic financial statements of the Metropolitan Water District of Southern California (Metropolitan), as of and for the years ended June 30, 2010 and 2009, which collectively comprise Metropolitan's basic financial statements as listed in the table of contents. These financial statements are the responsibility of Metropolitan's management. Our responsibility is to express an opinion on these basic financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Metropolitan Water District of Southern California as of June 30, 2010 and 2009, and the changes in its financial position and its cash flows thereof for the years then ended in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 18, 2010 on our consideration of the Metropolitan's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

As discussed in note 1 to the basic financial statements, Metropolitan adopted Government Accounting Standards Board Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, effective July 1, 2008.

The accompanying management's discussion and analysis on pages 3 through 13 and the pension and other postemployment benefits supplementary information on page 72 are not a required part of the basic financial statements but are supplementary information required by U.S. generally accepted accounting principles. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

KPMG LLP

October 18, 2010

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MANAGEMENT'S DISCUSSION AND ANALYSIS

June 30, 2010 and 2009

The following discussion and analysis of The Metropolitan Water District of Southern California's (Metropolitan) financial performance provides an overview of the financial activities for the fiscal years ended June 30, 2010 and 2009. This discussion and analysis should be read in conjunction with the basic financial statements and accompanying notes, which follow this section.

DESCRIPTION OF BASIC FINANCIAL STATEMENTS

Metropolitan operates as a utility enterprise and maintains its accounting records in accordance with generally accepted accounting principles for proprietary funds as prescribed by the Governmental Accounting Standards Board (GASB). The basic financial statements include balance sheets, statements of revenues, expenses and changes in net assets, and statements of cash flows. The balance sheets include all of Metropolitan's assets and liabilities, with the difference between the two reported as net assets, some of which are restricted in accordance with bond covenants or other commitments. The statements of revenues, expenses and changes in net assets report all of Metropolitan's revenues and expenses during the periods indicated. The statements of cash flows show the amount of cash received and paid out for operating activities, as well as cash received from taxes, debt financing, and investment income, and cash used for construction projects and principal and interest payments on borrowed money.

CONDENSED FINANCIAL INFORMATION*Condensed Balance Sheet Information*

(Dollars in millions)	June 30,		
	2010	2009 Restated*	2008
Assets and deferred outflows			
Capital assets, net	\$ 8,464.2	\$ 8,209.7	\$ 7,844.5
Other assets and deferred outflows	3,060.1	3,057.2	2,981.0
Total assets and deferred outflows	11,524.3	11,266.9	10,825.5
Liabilities			
Long-term liabilities, net of current portion	4,907.7	4,900.0	4,640.6
Other liabilities	470.2	323.4	308.1
Total liabilities	5,377.9	5,223.4	4,948.7
Net Assets			
Invested in capital assets and State Water Project costs, net of related debt	5,243.8	5,079.1	4,839.7
Restricted	485.5	461.2	444.5
Unrestricted	417.1	503.2	592.6
Total net assets	\$ 6,146.4	\$ 6,043.5	\$ 5,876.8

*Related to the adoption of Government Accounting Standards Board Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments* (GASB53).

Note: Certain reclassifications have been made to the 2009 and 2008 condensed financial information to conform to the 2010 presentation.

Capital Assets, Net

Fiscal Year 2010 Compared to 2009. Net capital assets include plant, participation rights, and construction work in progress, net of accumulated depreciation and amortization. At June 30, 2010, net capital assets totaled \$8.5 billion, or 73.4 percent of total assets. This represents an increase of \$254.5 million, or 3.1 percent,

MANAGEMENT'S DISCUSSION AND ANALYSIS**(CONTINUED)**

June 30, 2010 and 2009

over the prior year due primarily to continued expenditures on the capital investment plan, partially offset by an increase in depreciation and amortization. Expenditures on the capital investment plan during fiscal year 2010 totaled \$284.7 million (including \$42.0 million of capitalized interest) and are described in the capital assets section below.

Fiscal Year 2009 Compared to 2008. Net capital assets include plant, participation rights, and construction work in progress, net of accumulated depreciation and amortization. At June 30, 2009, net capital assets totaled \$8.2 billion, or 71.7 percent of total assets. This represents an increase of \$365.2 million, or 4.7 percent, over the prior year due primarily to continued expenditures on the capital investment plan, partially offset by an increase in depreciation and amortization. Expenditures on the capital investment plan during fiscal year 2009 totaled \$392.4 million (including \$69.7 million of capitalized interest) and are described in the capital assets section below.

Other Assets and Deferred Outflows

Fiscal Year 2010 Compared to 2009. Other assets totaled \$3.1 billion at June 30, 2010, and were \$2.9 million higher than the prior year. Included in other assets was \$1.3 billion related to prepaid State Water Project costs and \$1.1 billion related to cash and investments. The remaining items in other assets consisted of accounts receivable, inventories, deferred charges, deferred outflow-fair value of effective interest rate swaps and other.

Fiscal Year 2009 Compared to 2008. Other assets totaled \$3.1 billion at June 30, 2009, and were \$76.2 million higher than the prior year. Included in other assets was \$1.3 billion related to prepaid State Water Project costs and \$1.1 billion related to cash and investments. The remaining items in other assets consisted of accounts receivable, inventories, deferred charges, deferred outflow-fair value of effective interest rate swaps and other. Included in the increase was a \$39.6 million increase in deferred outflow-fair value of effective interest rate swaps that resulted from the implementation of GASB 53 in fiscal 2009 along with \$40.0 million of other receivables related to Proposition 50 billings for grants from the state of California. Proposition 50 grants were provided for clean drinking water and coastal protection projects. Metropolitan applied the grants to its ozone disinfection projects. The funds were received in July 2009. (See Notes 1f and 9h of Notes to Basic Financial Statements.)

Long-term Liabilities, Net

Fiscal Year 2010 Compared to 2009. Long-term liabilities, net of current portion, totaled \$4.9 billion at June 30, 2010 and were \$7.7 million higher than the prior year due to the issuance of \$250 million of new debt, partially offset by maturities of existing debt. In addition, the \$128 million 2010 Series A Special Variable Rate Water Revenue Refunding Bonds are classified as current because they are not supported by a Standby Bond Purchase Agreement. (See Note 6h of Notes to Basic Financial Statements.) See the long-term debt section below for additional information.

Fiscal Year 2009 Compared to 2008. Long-term liabilities, net of current portion, totaled \$4.9 billion at June 30, 2009 and were \$259.4 million higher than the prior year due to the issuance of \$300 million of new debt, partially offset by maturities of existing debt. In addition, fair value of interest rate swaps of \$102 million was added to this balance as a result of implementation of GASB 53. See the long-term debt section below for additional information.

MANAGEMENT'S DISCUSSION AND ANALYSIS**(CONTINUED)**

June 30, 2010 and 2009

Other Liabilities

Fiscal Year 2010 Compared to 2009. Other liabilities represent current liabilities that are due within one year. They include accounts payable, accrued liabilities, and the current portion of long-term liabilities. At June 30, 2010, other liabilities totaled \$470.2 million, which was \$146.8 million more than the prior year. Included in the change from prior year was \$142.2 million increase in current portion of long-term debt due primarily to the issuance of \$128 million 2010 Series A Special Variable Rate Water Revenue Refunding Bonds discussed above. See long-term debt section below for additional information.

Fiscal Year 2009 Compared to 2008. Other liabilities represent current liabilities that are due within one year. they include accounts payable, accrued liabilities, and the current portion of long-term liabilities. At June 30, 2009, other liabilities totaled \$323.4 million, which was \$15.3 million higher than the prior year. Included in the change from prior year was \$10.2 million of higher obligations on the State Water Contract, which relates to an obligation to the state Department of Water Resources for its efforts in the delta habitat conservation and conveyance program.

Net Assets Invested in Capital Assets and State Water Project Costs, Net of Related Debt

Fiscal Year 2010 Compared to 2009. Investment in capital assets and State Water Project costs, net of related debt totaled \$5.2 billion and increased \$164.7 million over the prior year due to Metropolitan's continued investment in its capital investment plan (CIP). Current year CIP expenditures are described in the capital assets section below.

Fiscal Year 2009 Compared to 2008. Investment in capital assets and State Water Project costs, net of related debt totaled \$5.1 billion and increased \$239.4 million over the prior year due to Metropolitan's continued investment in its CIP. Current year CIP expenditures are described in the capital assets section below. The largest single component of the CIP was the Inland Feeder Project with a \$1.2 billion budget, which became operational in fiscal 2010. This project links the California Aqueduct and the Colorado River Aqueduct improving water quality and maximizing groundwater management programs by conveying and storing available water in Metropolitan's groundwater basins and surface reservoirs.

Restricted Net Assets

Fiscal Year 2010 Compared to 2009. Restricted net assets include amounts restricted for debt service payments and operating expenses, both of which are required by bond covenants. Restricted net assets totaled \$485.5 million at June 30, 2010, which was \$24.3 million higher than fiscal year 2009. The increase was due primarily to \$18.7 million more in amounts restricted for debt service payments.

Fiscal Year 2009 Compared to 2008. Restricted net assets include amounts restricted for debt service payments and operating expenses, both of which are required by bond covenants. Restricted net assets totaled \$461.2 million at June 30, 2009, which was \$16.7 million higher than fiscal year 2008. The increase was due primarily to \$25.1 million more in amounts restricted for debt service payments.

Unrestricted Net Assets

Fiscal Year 2010 Compared to 2009. Unrestricted net assets of \$434.1 million decreased \$2.2 million from the prior year. Unrestricted net assets consist of net assets that do not meet the definition of "restricted" or "invested in capital assets and State Water Project costs, net of related debt." Certain unrestricted net

MANAGEMENT'S DISCUSSION AND ANALYSIS**(CONTINUED)**

June 30, 2010 and 2009

assets have been designated for purposes authorized by the Board. These designated amounts totaled \$379 million and \$415.1 million at June 30, 2010 and 2009, respectively (see Note 13 of Notes to Basic Financial Statements).

Fiscal Year 2009 Compared to 2008. Unrestricted net assets of \$431.9 million decreased \$97.3 million from the prior year. Unrestricted net assets consist of net assets that do not meet the definition of "restricted" or "invested in capital assets and State Water Project costs, net of related debt." Certain unrestricted net assets have been designated for purposes authorized by the Board.

Certain reclassifications have been made to the 2009 and 2008 condensed financial information to conform to the 2010 financial information presentation. The changes were primarily related to the reclassification of certain amounts related to Prepaid State Water Project costs along with reclassification of amounts set aside for state water contract payments from Restricted to Unrestricted Net Assets. There was no impact on the previously reported changes in net assets or total net assets of Metropolitan.

Condensed Schedule of Revenues, Expenses, and Changes in Net Assets

(Dollars in millions)	June 30,		
	2010	2009 Restated*	2008
Water sales	\$ 1,044.3	\$ 1,032.1	\$ 991.3
Readiness-to-serve charges	103.0	87.0	82.1
Power recoveries	18.3	17.4	23.1
Operating revenues	1,165.6	1,136.5	1,096.5
Taxes, net	98.1	105.6	98.7
Investment income	40.6	27.3	65.9
Other, net	6.4	6.0	2.9
Nonoperating revenues	145.1	138.9	167.5
Total revenues	1,310.7	1,275.4	1,264.0
Power and water costs	(433.7)	(402.1)	(350.3)
Operations and maintenance	(395.6)	(440.0)	(405.0)
Depreciation and amortization	(246.4)	(226.1)	(228.9)
Operating expenses	(1,075.7)	(1,068.2)	(984.2)
Bond interest, net of amount capitalized	(133.3)	(103.4)	(120.0)
Interest and adjustments on off-aqueduct power facilities	(3.4)	(3.8)	(4.1)
Nonoperating expenses	(136.7)	(107.2)	(124.1)
Total expenses	(1,212.4)	(1,175.4)	(1,108.3)
Contributed capital	4.6	66.1	15.6
Cumulative effect of change in accounting principle	—	0.5	—
Change in net assets	\$ 102.9	\$ 166.6	\$ 171.3

*Related to the adoption of GASB 53.

MANAGEMENT’S DISCUSSION AND ANALYSIS

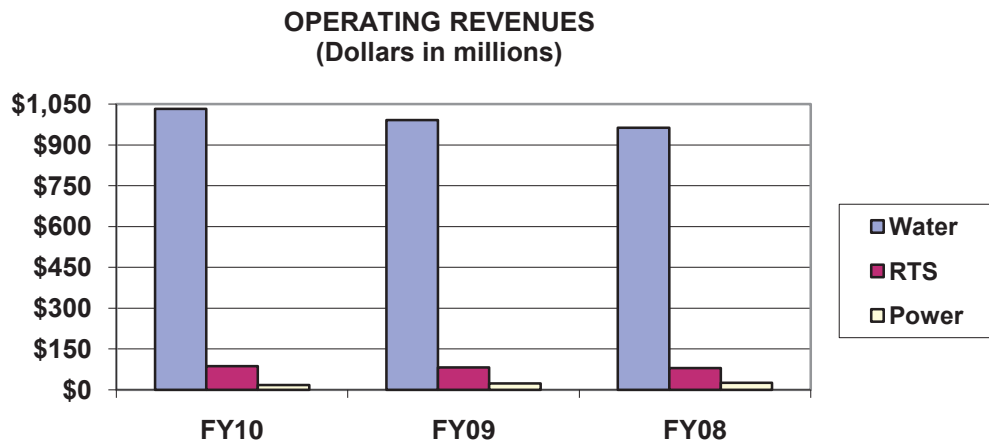
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June 30, 2010 and 2009

CHANGE IN NET ASSETS

Operating Revenues

Metropolitan’s principal source of revenue is from water sales, which typically account for approximately 90 percent of operating revenues. Metropolitan’s principal sources of water supply are the Colorado River and the State Water Project.



Analytical Review of Operating Revenues

Fiscal Year 2010 Compared to 2009. Fiscal year 2010 operating revenues were \$1.2 billion, or \$29.1 million higher than the prior year, due primarily to \$12.2 million of higher water sales and \$16.0 million of additional Readiness-to-serve (RTS) revenues. The higher water sales revenues reflect a Board-approved overall rate increase of 19.7%, partially offset by lower sales volumes in fiscal year 2010. The higher sales rates were effective September 1, 2009. RTS revenues were \$103.0 million or 8.8 percent of operating revenues, reflecting a Board-approved \$16 million increase over the prior year. Power sales totaled \$18.3 million and were \$0.9 million higher than the prior year.

Fiscal Year 2009 Compared to 2008. Fiscal year 2009 operating revenues were \$1.1 billion, or \$40.0 million higher than the prior year, due primarily to \$40.8 million of higher water sales. The higher water sales revenues reflect a Board-approved overall rate increase of 9.8% plus a \$25 surcharge per acre-foot sold, partially offset by lower sales volumes in fiscal year 2009. The higher sales rates were effective January 1, 2009. Readiness-to-serve (RTS) revenues were \$87.0 million or 7.7 percent of operating revenues, reflecting a Board-approved \$4.9 million increase over the prior year. Power sales totaled \$17.4 million and were \$5.7 million lower than prior year due to lower hydroelectric power generation as a result of less water moving through the system.

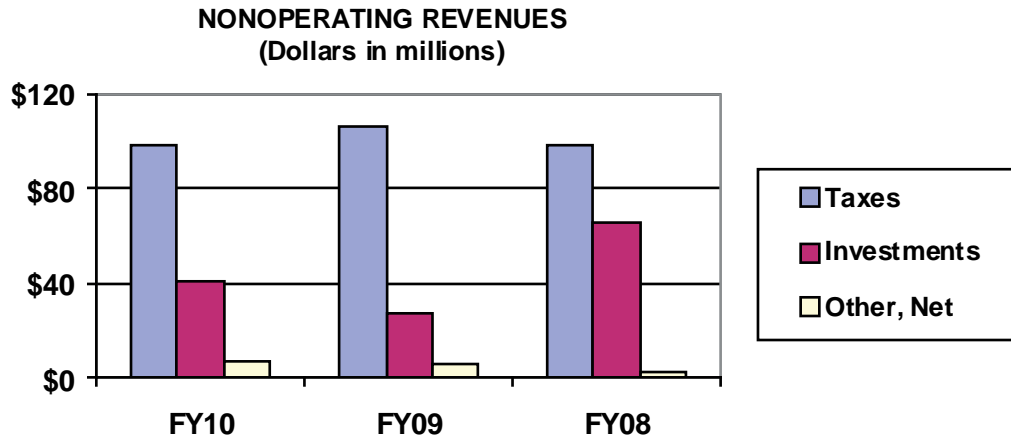
MANAGEMENT’S DISCUSSION AND ANALYSIS

(CONTINUED)

June 30, 2010 and 2009

Nonoperating Revenues

The primary sources of nonoperating revenues are taxes and investment income.



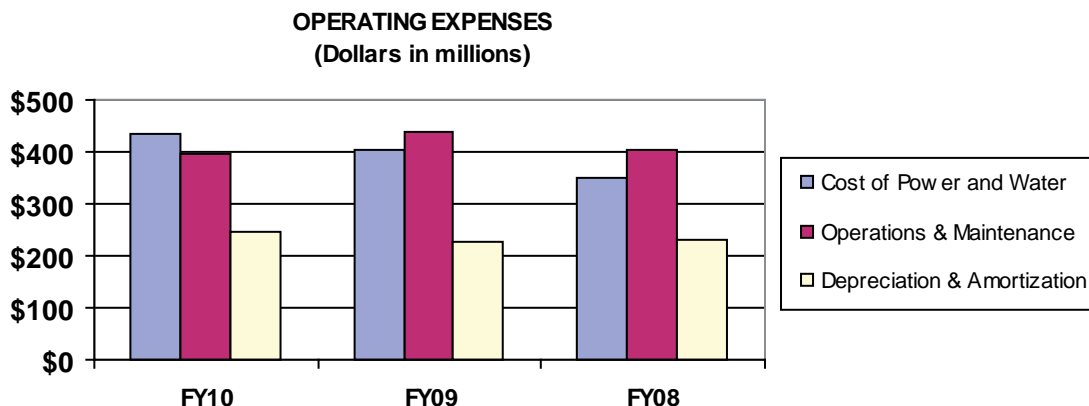
Analytical Review of Nonoperating Revenues

Fiscal Year 2010 Compared to 2009. Nonoperating revenues for fiscal year 2010 totaled \$145.1 million and were \$6.2 million higher than the prior year due primarily to \$13.3 million higher investment income, as portfolio balances and yields were higher than the prior year, partially offset by \$7.5 million in lower tax revenues due to a lower Board-approved rate.

Fiscal Year 2009 Compared to 2008. Nonoperating revenues for fiscal year 2009 totaled \$138.9 million and were \$28.6 million lower than the prior year due primarily to \$38.6 million lower investment income, as portfolio balances and yields were lower than the prior year, partially offset by \$6.9 million in higher tax revenues due to the collection of prior year taxes received from the sale of foreclosed properties.

Operating Expenses

Operating expenses fall into three primary cost areas: power and water, operations and maintenance (O&M), and depreciation and amortization.



MANAGEMENT’S DISCUSSION AND ANALYSIS

(CONTINUED)

June 30, 2010 and 2009

Analytical Review of Operating Expenses

Fiscal Year 2010 Compared to 2009. Fiscal year 2010 operating expenses of \$1,075.7 million were \$7.5 million more than prior year operating expenses and included \$31.6 million of higher power and water costs, \$44.4 million of lower O&M costs, and \$20.3 million more in depreciation and amortization.

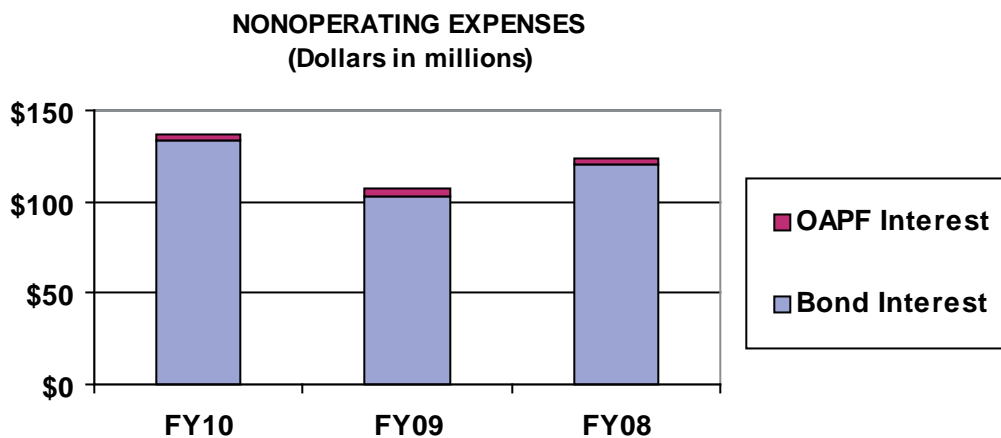
Power and water costs increased \$31.6 million over the prior year due primarily to higher average unit power costs. O&M costs were \$44.4 million lower than the prior year due primarily to a Board-approved action to reduce conservation-related spending of \$24.8 million along with a \$15 million decrease in risk-management-related expenses as a result of favorable settlements on previously established claims liabilities. The increase in depreciation and amortization relates to completion of the Inland Feeder capital project during fiscal 2010 which resulted in approximately \$10 million of depreciation expense. In addition, amortization of participation rights increased by approximately \$4 million as a result of four projects being completed near the end of fiscal 2009 that received a full year of amortization in 2010.

Fiscal Year 2009 Compared to 2008. Fiscal year 2009 operating expenses of \$1,068.2 million were \$84.0 million more than prior year operating expenses and included \$51.8 million of higher power and water costs, \$35.0 million of higher O&M costs, and \$2.8 million less in depreciation and amortization.

Power and water costs increased \$51.8 million over the prior year due primarily to higher average unit power costs. O&M costs were \$35.0 million higher than the prior year due primarily to \$31.5 million more in water management program costs due to more aggressive water conservation efforts including a new regional residential program.

Nonoperating Expenses

Nonoperating expenses include interest expense on both bonds and debt related to the off-aqueduct power facilities (OAPF) (see Note 9e of Notes to Basic Financial Statements).



MANAGEMENT’S DISCUSSION AND ANALYSIS

(CONTINUED)

June 30, 2010 and 2009

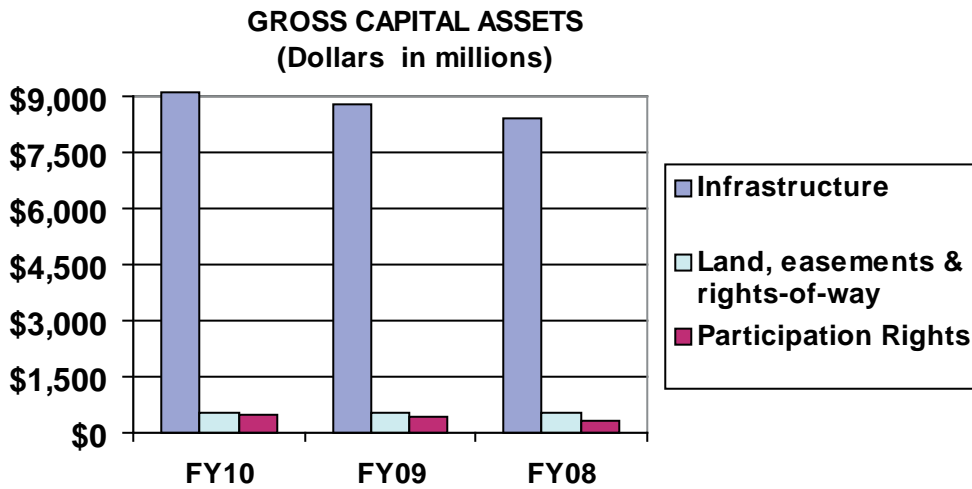
Analytical Review of Nonoperating Expenses

Fiscal Year 2010 Compared to 2009. Fiscal year 2010 nonoperating expenses of \$136.7 million were \$29.5 million higher than the prior year due primarily to a reduction in capitalized interest of \$30 million which was largely because the Inland Feeder Project became operational in September of 2009.

Fiscal Year 2009 Compared to 2008. Fiscal year 2009 nonoperating expenses of \$107.2 million were \$16.9 million lower than the prior year due primarily to lower variable interest rates on Metropolitan’s bonds.

Capital Assets and Debt Administration

Capital Assets. Capital assets include Metropolitan’s water infrastructure, land and buildings, as well as participation rights in various water programs.



MANAGEMENT'S DISCUSSION AND ANALYSIS**(CONTINUED)**

June 30, 2010 and 2009

Schedule of Capital Assets

(Dollars in millions)	June 30,		
	2010	2009	2008
Land, easements, and rights-of-way	\$ 553.9	\$ 537.5	\$ 536.9
Construction in progress	1,808.1	3,014.5	2,700.4
Parker power plant and dam	13.0	13.0	13.0
Power recovery plants	176.8	176.8	176.0
Other dams and reservoirs	1,430.5	1,430.5	1,430.3
Water transportation facilities	3,030.9	1,544.6	1,545.4
Pumping plants and facilities	227.8	227.5	227.5
Treatment plants and facilities	1,511.2	1,505.7	1,488.2
Other plant assets	833.7	803.8	790.7
Pre-operating expenses original aqueduct	44.6	44.6	44.6
Participation rights in other facilities	482.4	445.5	328.0
Gross capital assets	10,112.9	9,744.0	9,281.0
Less accumulated depreciation and amortization	(1,648.7)	(1,534.3)	(1,436.5)
Capital assets, net	\$ 8,464.2	\$ 8,209.7	\$ 7,844.5
Net increase from prior year	\$ 254.5	\$ 365.2	\$ 383.1
Percent increase	3.1%	4.7%	5.1%

Fiscal year 2010 Compared to 2009. Net capital assets totaled approximately \$8.5 billion and increased \$254.5 million over the prior year due primarily to \$284.7 million in new construction activity, partially offset by increased accumulated depreciation and amortization of \$114.4 million.

The major capital asset additions for the current year, excluding capitalized interest, included:

- \$96.1 million for the oxidation retrofit program at the water treatment plants; this program is designed to reduce the level of disinfection byproducts in the treated water supplied by these plants in order to meet state and federal standards.
- \$45.7 million on the Inland Feeder Project; this \$1.2 billion dollar project is designed to provide system reliability by linking together the State Water Project and the Colorado River systems and to improve water quality by blending State Water Project and Colorado River water.
- \$19.8 million for the Perris Valley pipeline, which will result in expanded service to member agencies.

Metropolitan's fiscal year 2011 capital budget includes plans to spend \$259.9 million principally for the oxidation retrofit program, the water treatment plants improvements program, the distribution system and rehabilitation projects, and the Colorado River Aqueduct reliability and containment programs. More detailed information about Metropolitan's capital assets is provided in Notes 2, 4, and 9f of the Notes to Basic Financial Statements.

Fiscal year 2009 Compared to 2008. Net capital assets totaled approximately \$8.2 billion and increased \$365.2

MANAGEMENT'S DISCUSSION AND ANALYSIS**(CONTINUED)**

June 30, 2010 and 2009

million over the prior year due primarily to \$392.4 million in new construction activity, partially offset by increased accumulated depreciation and amortization of \$97.8 million.

The major capital asset additions for the current year, excluding capitalized interest, included:

- \$93.5 million on the Inland Feeder Project; this \$1.2 billion dollar project is designed to provide system reliability by linking together the State Water Project and the Colorado River systems and to improve water quality by blending State Water Project and Colorado River water.
- \$73.1 million for the oxidation retrofit program at the water treatment plants; this program is designed to reduce the level of disinfection byproducts in the treated water supplied by these plants in order to meet state and federal standards.
- \$45.4 million for improvements/expansions at the water treatment plants; these projects will ensure reliability of equipment and facilities and ensure regulatory compliance.
- \$39.9 million for the Perris Valley pipeline, which will result in expanded service to member agencies.

LONG-TERM DEBT*Schedule of Long-term Debt*

(Dollars in millions)	June 30,		
	2010	2009 Restated (c)	2008
General obligation bonds (a)	\$ 255.1	\$ 293.4	\$ 327.2
Revenue bonds (a)	4,591.9	4,444.7	4,227.8
Other long-term debt	27.7	29.5	31.3
Other, net (b)	(105.0)	(96.0)	(51.5)
	<u>\$ 4,769.7</u>	<u>\$ 4,671.6</u>	<u>\$ 4,534.8</u>
Increase/(decrease) from prior year	\$ 98.1	\$ 136.8	\$ (81.6)
Percent change	2.1%	3.0%	(1.8%)

(a) Includes refunding bonds.

(b) Consists of unamortized bond discount, premiums, and deferred amounts on refunding debt.

(c) Related to the adoption of GASB 53.

Fiscal Year 2010 Compared to 2009. At June 30, 2010, there was \$4.8 billion in bonds outstanding, a net increase of \$98 million, or 2.1 percent over the prior year. This increase was due primarily to issuance of \$250 million of new debt, partially offset by maturities of existing debt and reclassification of \$128 million from long-term to current related to the 2010 Series A Special Variable Rate Water Revenue Refunding Bonds. (see Notes 5 and 6 of Notes to Basic Financial Statements).

MANAGEMENT’S DISCUSSION AND ANALYSIS

(CONTINUED)

June 30, 2010 and 2009

Fiscal Year 2009 Compared to 2008. At June 30, 2009, there was \$4.7 billion in bonds outstanding, a net increase of \$96 million, or 3.0 percent over the prior year. This increase was due primarily to issuance of \$300 million of new debt, partially offset by maturities of existing debt (see Notes 5 and 6 of Notes to Basic Financial Statements).

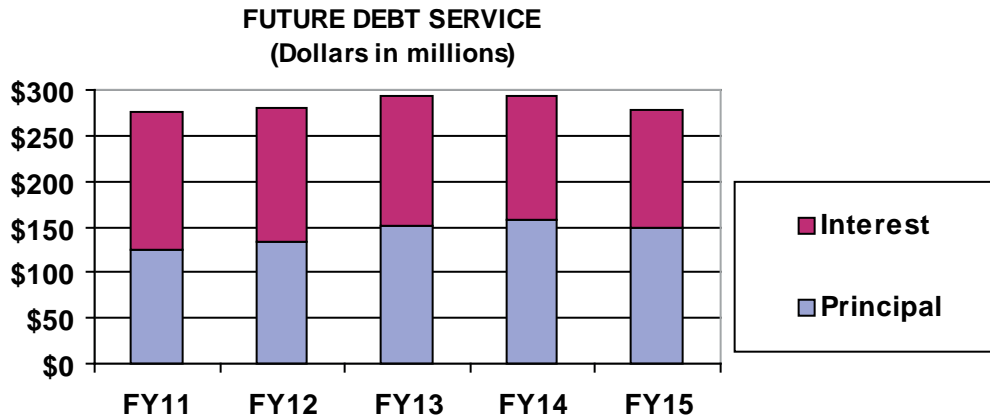
CREDIT RATINGS

Metropolitan’s credit ratings at June 30, 2010 are shown below.

	Moody’s Investors Service	Standard & Poor’s	Fitch Ratings
General obligation bonds	Aaa	AAA	AAA
Water revenue bonds-fixed rate	Aa1	AAA	AAA
Water revenue bonds-variable rate	VMIG1	A1+	F1+

FUTURE DEBT SERVICE

Metropolitan’s future debt service requirements through June 30, 2014 are shown on the following table.



BALANCE SHEETS

	Year Ended June 30,	
	2010	2009 Restated (Note 1q)
(Dollars in thousands)		
ASSETS AND DEFERRED OUTFLOWS		
Current Assets:		
Cash and investments, at fair value (Notes 1b and 3):		
Unrestricted (cost \$674 and \$1,765 for fiscal years 2010 and 2009, respectively)	\$ 674	\$ 1,765
Restricted (cost \$540,279 and \$464,999 for fiscal years 2010 and 2009, respectively)	544,515	462,677
Total cash and investments	545,189	464,442
Receivables, net:		
Water sales	186,175	186,248
Annexation charges-current portion (Note 1e)	864	902
Interest on investments	4,704	6,867
Other (Note 1f)	37,635	98,820
Total receivables	229,378	292,837
Inventories (Note 1g)	78,286	71,642
Prepaid State Water Project costs-current portion (Notes 1h and 10)	128,294	123,470
Deposits, deferred charges, and other-current portion (Note 11)	46,506	23,185
Total current assets	1,027,653	975,576
Noncurrent Assets:		
Cash and investments, at fair value (Notes 1b and 3):		
Unrestricted (cost \$445,604 and \$417,965 for fiscal years 2010 and 2009, respectively)	449,098	415,878
Restricted (cost \$100,394 and \$185,015 for fiscal years 2010 and 2009, respectively)	101,179	184,091
Total cash and investments	550,277	599,969
Capital Assets (Note 2):		
Plant and equipment (Notes 1i and 9f)	9,630,498	9,298,556
Participation rights (Notes 1j and 4)	482,432	445,457
Total capital assets	10,112,930	9,744,013
Less accumulated depreciation and amortization	(1,648,748)	(1,534,294)
Total capital assets, net	8,464,182	8,209,719
Other assets, net of current portion:		
Prepaid State Water Project costs, net (Notes 1h and 10)	1,283,185	1,276,341
Deposits, deferred charges, and other (Note 11)	132,667	160,931
Annexation charges, net (Note 1e)	4,794	4,777
Total other assets	1,420,646	1,442,049
Total noncurrent assets	10,435,105	10,251,737
Deferred Outflows		
Deferred outflow of effective swaps	61,523	39,575
Total Assets and Deferred Outflows	\$ 11,524,281	\$ 11,266,888

See accompanying notes to basic financial statements.

BALANCE SHEETS

	Year Ended June 30,	
	2010	2009 Restated (Note 1q)
(Dollars in thousands)		
LIABILITIES AND NET ASSETS		
Current Liabilities:		
Accounts payable and accrued expenses (Note 1k)	\$ 109,176	\$ 121,895
Current portion of long-term debt (Notes 5 and 6)	246,655	104,430
Current portion of obligations for off-aqueduct power facilities (Notes 6 and 9e)	6,032	7,123
Current portion of accrued compensated absences (Notes 11 and 6)	18,400	16,600
Current portion of customer deposits and trust funds (Note 6)	5,272	5,312
Current portion of workers' compensation and third party claims (Notes 6 and 14)	5,564	6,059
Current portion of other long-term debt obligations (Note 6)	40	60
Accrued bond interest	75,513	59,195
Matured bonds and coupons not presented for payment	1,931	1,206
Other	1,557	1,572
Total current liabilities	470,140	323,452
Noncurrent Liabilities (Note 6):		
Long-term debt, net of current portion (Note 5)	4,523,017	4,567,150
Obligations for off-aqueduct power facilities, net of current portion (Note 9e)	47,775	53,647
Accrued compensated absences, net of current portion (Note 11)	28,622	30,110
Customer deposits and trust funds, net of current portion	37,548	37,143
Postemployment benefits other than pensions (Note 8)	106,280	84,108
Worker's compensation and third party claims, net of current portion (Note 14)	11,120	20,638
Fair value of interest rate swaps	148,233	101,967
Other long-term debt obligations, net of current portion	5,144	5,219
Total noncurrent liabilities	4,907,739	4,899,982
Total liabilities	5,377,879	5,223,434
Commitments and Contingencies (Note 9)		
Net Assets (Note 13):		
Invested in capital assets and State Water Project costs, net of related debt	5,243,785	5,079,119
Restricted for:		
Debt Service	315,221	294,869
Other	170,262	166,315
Unrestricted	417,134	503,151
Total net assets	6,146,402	6,043,454
Total Liabilities and Net Assets	\$ 11,524,281	\$ 11,266,888

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**STATEMENTS OF REVENUES, EXPENSES AND
CHANGES IN NET ASSETS**

	Year Ended June 30,	
	2010	2009 Restated (Note 1q)
Dollars in thousands)		
Operating Revenues (Note 1c):		
Water Sales	\$ 1,044,302	\$ 1,032,131
Readiness-to-serve charges	103,000	87,000
Power recoveries	18,280	17,345
Total operating revenues	<u>1,165,582</u>	<u>1,136,476</u>
Operating Expenses:		
Power and water costs	433,684	402,106
Operations and maintenance	395,610	440,047
Total operating expenses	<u>829,294</u>	<u>842,153</u>
Operating income before depreciation and amortization	336,288	294,323
Less depreciation and amortization (Note 2)	<u>(246,431)</u>	<u>(226,059)</u>
Operating income	<u>89,857</u>	<u>68,264</u>
Nonoperating Revenues (Expenses):		
Taxes, net (Note 1d)	98,091	105,580
Bond interest, net of \$42,008 and \$69,741 of interest capitalized in fiscal years 2010 and 2009, respectively (Note 1i)	(133,277)	(103,354)
Investment income	40,620	27,348
Interest and adjustments on off-aqueduct power facilities obligations (Note 9e)	(3,429)	(3,831)
Other, net	6,429	5,978
Total nonoperating revenues, net	<u>8,434</u>	<u>31,721</u>
Income before Contributions	<u>98,291</u>	<u>99,985</u>
Capital contributions, net (Note 1m)	4,657	66,143
Change in net assets	102,948	166,128
Net assets, beginning of year	6,043,454	5,876,812
Cumulative effect of change in accounting principle (Note 1q)	—	514
Net Assets, End of Year	<u>\$ 6,146,402</u>	<u>\$ 6,043,454</u>

See accompanying notes to basic financial statements.

STATEMENTS OF CASH FLOWS

(Dollars in thousands)	Year Ended June 30,	
	2010	2009
Cash Flows from Operating Activities:		
Cash received from water sales	\$ 957,263	\$ 961,291
Cash received from readiness-to-serve charges	101,850	87,171
Cash received from capacity reservation charges	33,428	32,543
Cash received from power recoveries	18,820	22,499
Cash received from wheeling/exchange transactions	53,793	26,781
Cash paid for operating and maintenance expenses	(226,547)	(255,932)
Cash paid to employees	(172,356)	(162,062)
Cash paid for power and water costs	(431,859)	(352,423)
Other cash flows for operating activities	(3,328)	(1,672)
Net Cash Provided by Operating Activities	331,064	358,196
Cash Flows from Noncapital Financing Activities:		
Proceeds from other collections	4,341	—
Net Cash Provided by Noncapital Financing Activities	4,341	—
Cash Flows from Capital and Related Financing Activities:		
Acquisition and construction of capital assets	(286,902)	(385,912)
Payments for State Water Project costs	(164,493)	(144,132)
Payments for participation rights in other facilities	(4,246)	(6,027)
Proceeds from long-term debt	250,851	303,338
Proceeds from capital grants	59,958	3,048
Principal and interest paid on long-term debt	(287,026)	(273,862)
Proceeds from tax levy	97,260	105,205
Transfer to escrow trust accounts	(9,053)	(6,000)
Payment of rebatable arbitrage	-	(117)
Collection of notes receivable - land sales	139	139
Net Cash Used in Capital and Related Financing Activities	(343,512)	(404,320)
Cash Flows from Investing Activities:		
Purchase of investment securities	(12,770,005)	(10,615,547)
Proceeds from sales and maturities of investment securities	12,753,163	10,626,992
Interest on investments	23,858	36,444
Net Cash Provided by Investing Activities	7,016	47,889
Net change in Cash and Cash Equivalents	(1,091)	1,765
Cash and Cash Equivalents, Beginning of Year	1,765	—
Cash and Cash Equivalents, End of Year (Note 1b)	\$ 674	\$ 1,765

See accompanying notes to basic financial statements.

STATEMENTS OF CASH FLOWS

(Dollars in thousands)	Year Ended June 30,	
	2010	2009
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Operating Income	\$ 89,857	\$ 68,264
Adjustments to reconcile Operating Income to Net Cash Provided by Operating Activities:		
Depreciation and amortization expense	246,431	226,059
(Increase) decrease in accounts receivable	552	(11,532)
(Increase) decrease in inventories	(7,490)	12,677
Decrease in deferred charges	103,559	32,126
Increase (decrease) in accounts payable	(102,719)	26,565
Increase in other	874	4,037
Total adjustments	241,207	289,932
Net Cash Provided by Operating Activities	\$ 331,064	\$ 358,196
Significant Noncash Investing, Capital, and Financing Activities:		
Refunding bonds proceeds received in escrow trust fund	\$ 308,522	\$ 664,852
Debt defeased through escrow trust fund with refunding bonds	\$ (304,415)	\$ (630,305)
Recognition of capital grants to be received	\$ 7,794	\$ 63,094
Deferred loss on refunding debt	\$ (27,614)	\$ (73,580)
Change in fair value of investments	\$ 13,855	\$ (7,318)
RECONCILIATION OF CASH AND INVESTMENTS TO CASH AND CASH EQUIVALENTS		
Unrestricted cash and investments (at June 30, 2010 and 2009 include \$674 and \$1,765 of cash, respectively)	\$ 449,772	\$ 417,643
Restricted cash and investments	645,694	646,768
Total cash and investments, at fair value	1,095,466	1,064,411
Less: Carrying value of investments	(1,094,792)	(1,062,646)
Total Cash and Cash Equivalents	\$ 674	\$ 1,765

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NOTES TO BASIC FINANCIAL STATEMENTS

June 30, 2010 and 2009

I. REPORTING ENTITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**(a) Reporting Entity**

The Metropolitan Water District of Southern California (Metropolitan), a special district of the State of California, was organized in 1928 by vote of the electorates of several Southern California cities following adoption of the Metropolitan Water District Act (Act) by the California Legislature. Metropolitan's primary purposes under the Act are to develop, store and distribute water, at wholesale, to its member public agencies for domestic and municipal purposes. Surplus water is sold for other beneficial uses, including agricultural use. Metropolitan's service area comprises approximately 5,200 square miles and includes portions of the six counties of Los Angeles, Orange, Riverside, San Bernardino, San Diego, and Ventura. There are 26 independent member agencies of Metropolitan, consisting of 14 cities, 11 municipal water districts, and one county water authority. Metropolitan has no financial accountability for its member agencies. Metropolitan is governed by a 37-member Board of Directors (Board) comprised of representatives of the member agencies. Representation and voting rights are based on assessed valuations of property. Each member agency is entitled to have at least one representative on the Board plus an additional representative for each full five percent of its assessed valuation of property in Metropolitan's service area. Changes in relative assessed valuation do not terminate any director's term. Accordingly, the Board may, from time to time, have more than 37 directors. No single member agency has a voting majority.

The Metropolitan Water District Asset Financing Corporation (MWDAFC) was incorporated on June 19, 1996. The MWDAFC is a California nonprofit public benefit corporation formed to assist Metropolitan by acquiring, constructing, operating and maintaining facilities, equipment, or other property needed by Metropolitan and leasing or selling such property to Metropolitan. The MWDAFC is governed by a board of five directors, each of whom must be a member of Metropolitan's Board. MWDAFC had no financial operations during fiscal years 2010 or 2009. MWDAFC is a component unit of Metropolitan and its activities will be blended with those of Metropolitan for financial reporting purposes when it commences operations.

The Center for Water Education (Center), previously known as The Foundation for the Southern California Water Education Center, was incorporated on November 20, 2001 as a nonprofit public benefit corporation organized to construct a water education center in the vicinity of Metropolitan's Diamond Valley Lake for the purpose of facilitating water education. The Center's primary sources of revenues were grants, loans, and gifts. The Center was dissolved on December 1, 2008. All of the Center's assets became the property of Metropolitan upon dissolution of the Center.

(b) Principles of Presentation

Metropolitan operates as a utility enterprise and the accompanying basic financial statements reflect the flow of economic resources measurement focus and the full accrual basis of accounting. Under full accrual accounting, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred regardless of the timing of related cash flows.

Metropolitan is accounted for as an enterprise fund and applies all applicable Governmental Accounting Standards Board (GASB) pronouncements in its accounting and reporting. In addition, Metropolitan follows Financial Accounting Standards Board pronouncements issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements.

NOTES TO BASIC FINANCIAL STATEMENTS**(CONTINUED)**

June 30, 2010 and 2009

For purposes of the statements of cash flows, Metropolitan defines cash and cash equivalents as demand account balances, cash on hand, and non-negotiable time deposits. Metropolitan utilizes the direct method to present cash flows from operating activities. Due to investments of available demand account balances in overnight repurchase agreements at the respective balance sheet dates, cash and cash equivalents may be presented with zero balances at such dates on the statements.

All investments are stated at fair value, which is based on quoted market price or amortized cost, which approximates fair value.

Certain reclassifications of fiscal year 2009 amounts have been made to conform to the 2010 presentation.

(c) Revenue Policies

Metropolitan's principal source of revenue is from water sales, which include all revenues received from charges for the sale and availability of water, including water rates, a capacity charge, and wheeling/exchange transactions. Other sources of operating revenue include readiness-to-serve charges and hydroelectric power sales. Other revenues include ad valorem property taxes and investment income.

Water rates are established by the Board on an annual basis and are supported by an annual cost of service study. Water rates are not subject to regulation by the California Public Utilities Commission or by any other local, state, or federal agency. Water is delivered to the member agencies on demand and revenue is recognized at the time of delivery.

Metropolitan's rate structure includes separate rates for supply, treatment, conveyance and distribution, power, and demand management. The rate structure also includes tiered pricing for supply, a capacity charge, and a financial commitment from Metropolitan's member agencies in the form of a purchase order designed to improve regional water resources management and accommodate a water transfer market. Effective January 1, 2009, Metropolitan implemented a water supply surcharge to recover the costs of additional water transfers necessary to meet demands as a result of pumping restrictions in the Sacramento-San Joaquin River Delta.

Revenues from the capacity charge totaled \$32.6 million in fiscal years 2010 and 2009. Wheeling/exchange-type arrangements are transacted through Board-approved agreements. During fiscal years 2010 and 2009, wheeling/exchange revenues totaled \$53.8 million and \$28.0 million, respectively.

(d) Taxing Authority

Metropolitan is expressly empowered under the Act to levy and collect taxes on all taxable property within its boundaries for the purpose of carrying on its operations and paying its obligations, subject to certain limitations in the Act, the California Revenue and Taxation Code, and the California Constitution. Property taxes are levied annually by the Board as of July 1, using a lien date of March 1, and are payable by property owners in two equal installments that are due on November 1 and February 1, and become delinquent after December 10 and April 10, respectively. Property taxes levied by Metropolitan are billed and collected by the counties in its service area and are remitted to Metropolitan periodically throughout the year.

NOTES TO BASIC FINANCIAL STATEMENTS**(CONTINUED)**

June 30, 2010 and 2009

Property tax revenue is used to pay Metropolitan's general obligation bond debt service and a portion of its obligations under its contract with the state for a water supply (the State Water Contract). Special taxes collected pursuant to pre-1978 annexation proceedings are also used for payments under the State Water Contract. In developing the annual tax levy, Metropolitan takes into account potential delinquencies, tax allocations to redevelopment agencies, and supplemental tax collections. Metropolitan recognizes property taxes receivable on July 1 of each fiscal year and recognizes revenue over the following 12-month period beginning July 1 through June 30 (the period for which the tax is levied). The property tax receivable is included in the basic financial statements, net of an allowance for doubtful accounts.

As a result of legislation enacted in 1984, tax levies in fiscal year 1991 and subsequent years, other than special annexation taxes, are restricted to the amount needed to pay debt service on Metropolitan's general obligation bonds and Metropolitan's proportionate share of general obligation bond debt service of the state under the State Water Contract. However, under the terms of the 1984 legislation, tax levies may exceed the limitation prescribed therein during periods of financial necessity.

(e) Annexation Charges

Charges are collected for areas that annex to Metropolitan unless the areas annex to cities which are member agencies, in which case no charge is collected. Since fiscal year 1978, such charges have been paid in cash before completion of an annexation. Effective May 1996, the Board adopted regulations permitting payment of annexation fees in installments subject to Board approval. No annexations have yet been completed utilizing this payment method.

Prior to fiscal year 1978, annexation charges were primarily collected in installments, including interest on unpaid balances, through the levy of special ad valorem taxes. It is Metropolitan's policy to record an allowance for uncollectible receivables on pre-1978 annexations when the principal and interest thereon cannot be collected within 50 years following the date of annexation. Accordingly at June 30, 2010 and 2009, annexation receivables of \$5,658,000 and \$5,679,000, respectively, were reflected in the accompanying basic financial statements, net of allowance of \$12,395,000 and \$12,509,000, respectively.

(f) Other Receivables

Other receivables include amounts for taxes, hydroelectric power sales, the capacity and readiness-to-serve charges, and other billings. The June 30, 2009 balance included \$40 million of Proposition 50 state grant funds. The passage of Proposition 50, "The Water Security Clean Drinking Water, Coastal and Beach Protection Act of 2002," resulted in the availability of \$260 million in grants for water quality projects that will reduce reliance on Colorado River supplies. Metropolitan applied and received a letter of commitment for \$60 million of the Proposition 50 funds. As of June 30, 2009, \$40 million of the funds were requested from the state and recorded in other receivables. The grant funds were received in fiscal year 2010.

NOTES TO BASIC FINANCIAL STATEMENTS**(CONTINUED)**

June 30, 2010 and 2009

(g) Inventories

Metropolitan's inventories are valued based on a moving-average cost. Expenditures are recorded when inventories are used. Components of inventories at June 30, 2010 and 2009 were as follows:

(Dollars in thousands)	June 30,	
	2010	2009
Water in storage	\$ 65,882	\$ 59,678
Operating supplies	12,404	11,964
Total inventories	\$ 78,286	\$ 71,642

(h) Prepaid State Water Project Costs

Metropolitan participates in the State Water Project through cash payments, which provide Metropolitan prepaid capacity rights. Certain amounts of these cash payments are required to be made through 2035, but provide capacity rights through 2052. These payments are recorded as prepaid State Water Project costs and are amortized through June 30, 2052. Maintenance costs are expensed as incurred (see Note 10).

(i) Plant and Equipment

Metropolitan's capital assets include plant and equipment, which are recorded at cost. In fiscal year 2009 the capitalization threshold was increased to \$50,000 from \$25,000. Construction costs are capitalized if the costs meet the threshold limits and the asset has a useful life of at least five years. The cost of constructed assets includes labor, materials, certain general and administrative expenses, and interest incurred during construction periods. Depreciation is calculated using the straight-line method based on the estimated average useful lives of the assets, which are 80 years for storage and distribution facilities, 50 years for treatment plants and hydroelectric power recovery facilities, and 10, 25 or 50 years for assets acquired from the Center for Water Education. Improvements or overhauls with aggregated costs that meet capitalization thresholds and that extend the useful life of an existing asset by at least five years are capitalized.

Major computer systems software, whether purchased or internally developed, is capitalized if the cost equals or exceeds \$250,000 and the useful life is at least three years. Vehicles and operating equipment are capitalized if the cost equals or exceeds \$5,000 and the useful life is at least four years. Depreciation is calculated using the straight-line method based on the estimated useful lives and ranges from four to ten years.

(j) Participation Rights

Metropolitan participates in various storage and water management programs entitling it to certain water rights. Metropolitan's participation in these projects is through cash payments. Monies used for the construction of capital assets, such as pipelines, pumping facilities, storage facilities, etc., are recorded as participation rights, included in capital assets, and amortized over the life of the agreements. Certain projects also require payments for ongoing maintenance; those payments are charged to expense as incurred. (See Note 4.)

NOTES TO BASIC FINANCIAL STATEMENTS*(CONTINUED)*

June 30, 2010 and 2009

(k) Disaggregation of Payable Balances

Accounts payable and accrued expenses at June 30, 2010 and 2009 were as follows:

(Dollars in thousands)	June 30,	
	2010	2009
Department of Water Resources (State Water Project):		
Capital, operating, maintenance, power, replacement	\$ 28,114	\$ 24,225
Variable power	25,112	20,049
Vendors	43,140	65,782
Accrued power costs	3,229	4,252
Accrued salaries	2,269	1,505
Readiness-to-serve overcollection	1,100	841
Conservation credits	6,212	5,241
Total accounts payable and accrued expenses	\$ 109,176	\$ 121,895

(l) Compensated Absences

Metropolitan's employees earn vacation, sick, and compensatory leave in varying amounts depending primarily on length of service. Upon termination from Metropolitan service, employees are entitled to full payment for accrued vacation and compensatory leave at their final pay rates, and are entitled to payment for approximately one-half of their accrued sick leave at such rates. Metropolitan records its obligations for vacation, sick, and compensatory leave when earned by eligible employees based on current pay rates at the time. The allocations to the current and long-term portions of these vested obligations were based on experience and projections of turnover.

(m) Capital Contributions

Capital contributions are comprised of federal, state, and private grants. These grants are typically of a reimbursable nature: Metropolitan first pays for the project and then the granting agency reimburses Metropolitan for its eligible expenses. The portion of the grants used for capital purposes are reflected as capital contributions in the statements of revenues, expenses and changes in net assets when they are earned, irrespective of the timing of the receipts. Examples of capital projects where grants are received include water treatment plant improvements, such as fluoridation, and water storage programs.

(n) Operating and Nonoperating Revenues and Expenses

Metropolitan's primary purpose is to provide a supplemental supply of water for domestic and municipal uses. Accordingly, Metropolitan defines operating revenues as water sales, readiness-to-serve charges, and hydroelectric power recovery sales. Operating expenses include the cost of sales and services, administrative expenses, and depreciation and amortization on capital assets.

Revenues from property taxes and investment income, as well as interest expense on outstanding debt, are related to capital and financial activities and are defined as nonoperating revenues and expenses.

NOTES TO BASIC FINANCIAL STATEMENTS

(CONTINUED)

June 30, 2010 and 2009

(o) Restricted and Unrestricted Resources

When both restricted and unrestricted resources are available for use, it is Metropolitan's practice to use restricted resources first, then unrestricted resources as they are needed.

(p) Use of Estimates

The preparation of basic financial statements in conformity with U.S. generally accepted accounting principles 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 basic financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(q) Interest Rate Swaps and Implementation of Accounting Principle

Metropolitan enters into interest rate swap agreements to manage interest rate risk and reduce debt service costs on debt. During fiscal year 2002, the Board established a policy governing the use of interest rate swaps. The policy defines the parameters under which the program will operate. (see Note 5f).

In June 2008, GASB issued Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments* (GASB 53). The statement specifically requires governments to measure and report most derivative instruments at fair value in their financial statements that are prepared using the economic resources measurement focus and the accrual basis of accounting. The requirement of reporting the derivative instruments at fair value on the face of financial statements gives the users of financial statements a clearer look into the risks their governments are sometimes exposed to when they enter into these transactions and how those risks are managed. The statement also addresses hedge accounting requirements and improves disclosures, providing a summary of the government's derivative instrument activity, its objectives for entering into derivative instruments, and their significant terms and risks. Metropolitan implemented GASB 53 in fiscal 2010 and restated its fiscal 2009 financial statements. The cumulative impact of implementation of GASB 53 was an increase of \$514,000 on beginning net assets for fiscal 2009.

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NOTES TO BASIC FINANCIAL STATEMENTS*(CONTINUED)*

June 30, 2010 and 2009

2. CAPITAL ASSETS

Capital asset activity for the fiscal years ended June 30, 2010 and 2009 was as follows:

(Dollars in thousands)	June 30, 2008	Additions
Capital assets not being depreciated:		
Land, easements and rights-of-way	\$ 536,948	\$ 915
Construction in progress	2,700,431	392,368
Total capital assets not being depreciated	3,237,379	393,283
Other capital assets:		
Parker power plant and dam	13,009	—
Power recovery plants	175,981	771
Other dams and reservoirs	1,430,337	117
Water transportation facilities	1,545,407	111
Pumping plants and facilities	227,455	43
Treatment plants and facilities	1,488,230	17,515
Power lines and communication facilities	33,192	107
Computer systems software	72,750	5,896
Miscellaneous	609,104	3,699
Major equipment	75,554	8,791
Pre-operating interest and other expenses of original aqueduct	44,595	—
Participation rights in other facilities (Note 4)	328,039	117,418
Total other capital assets at historical cost	6,043,653	154,468
Accumulated depreciation and amortization:		
Parker power plant and dam	(9,890)	(163)
Power recovery plants	(64,136)	(3,529)
Other dams and reservoirs	(177,035)	(17,831)
Water transportation facilities	(508,721)	(19,188)
Pumping plants and facilities	(56,608)	(2,854)
Treatment plants and facilities	(316,345)	(29,898)
Power lines and communication facilities	(7,186)	(409)
Computer systems software	(63,345)	(3,365)
Miscellaneous	(71,306)	(8,193)
Major equipment	(56,294)	(6,733)
Pre-operating interest and other expenses of original aqueduct	(31,135)	(1,035)
Participation rights in other facilities (Note 4)	(74,569)	(8,662)
Total accumulated depreciation and amortization	(1,436,570)	(101,860)
Other capital assets, net	4,607,083	52,608
Total capital assets, net	\$ 7,844,462	\$ 445,891

Depreciation and amortization was charged as follows:

Depreciation of water related assets

Amortization of participation rights

Depreciation and amortization expense related to capital assets

Amortization of State Water Project capacity costs

Plus: Net retirements adjusted to expense

Total depreciation and amortization expense

NOTES TO BASIC FINANCIAL STATEMENTS*(CONTINUED)*

June 30, 2010 and 2009

Reductions	June 30, 2009	Additions	Reductions	June 30, 2010
\$ (323)	\$ 537,540	\$ 16,425	\$ (17)	\$ 553,948
(78,318)	3,014,481	284,652	(1,491,132)	1,808,001
(78,641)	3,552,021	301,077	(1,491,149)	2,361,949
—	13,009	—	—	13,009
—	176,752	—	—	176,752
—	1,430,454	—	—	1,430,454
(919)	1,544,599	1,486,480	(161)	3,030,918
—	227,498	387	(12)	227,873
(7)	1,505,738	5,664	(190)	1,511,212
—	33,299	237	(19)	33,517
—	78,646	8,776	—	87,422
(10)	612,793	18,813	(35)	631,571
(5,193)	79,152	5,109	(3,035)	81,226
—	44,595	—	—	44,595
—	445,457	36,975	—	482,432
(6,129)	6,191,992	1,562,441	(3,452)	7,750,981
—	(10,053)	(163)	—	(10,216)
—	(67,665)	(3,532)	—	(71,197)
—	(194,866)	(17,833)	—	(212,699)
200	(527,709)	(29,700)	80	(557,329)
—	(59,462)	(2,856)	9	(62,309)
7	(346,236)	(30,016)	89	(376,163)
—	(7,595)	(411)	13	(7,993)
—	(66,710)	(4,491)	—	(71,201)
3	(79,496)	(8,511)	12	(87,995)
3,926	(59,101)	(6,836)	3,266	(62,671)
—	(32,170)	(1,035)	—	(33,205)
—	(83,231)	(12,539)	—	(95,770)
4,136	(1,534,294)	(117,923)	3,469	(1,648,748)
(1,993)	4,657,698	1,444,518	17	6,102,233
(80,634)	\$ 8,209,719	\$ 1,745,595	\$ (1,491,132)	\$ 8,464,182
	\$ 93,198			\$ 105,384
	8,662			12,539
	101,860			117,923
	123,470			128,294
	729			214
	\$ 226,059			\$ 246,431

NOTES TO BASIC FINANCIAL STATEMENTS*(CONTINUED)*

June 30, 2010 and 2009

3. CASH AND INVESTMENTS

As a public agency, Metropolitan's investment practices are prescribed by various provisions of the California Government Code and the Act, as well as by administrative policies. Metropolitan's statement of investment policy is approved annually by the Board and describes the Treasurer's investment authority, practices, and limitations. The basic investment policy objectives, in order of importance, are safety of principal, liquidity, and return on investment.

Cash and investments may or may not be restricted as to use, depending on the specific purposes for which such assets are held (see Notes 3d and 13).

A summary of Metropolitan's deposit and investment policies, information on interest and credit risks, and restricted cash and investments is provided below.

(a) Deposits

The California Government Code requires California banks and savings and loan associations to secure a local government agency's deposits by pledging government securities as collateral. Cash deposits were \$674,000 and \$1,765,000 at June 30, 2010 and 2009, respectively.

(b) Investments

Metropolitan is permitted by State law and Board policy to invest in a variety of instruments including U.S. Treasury securities, federal agencies, repurchase agreements, negotiable certificates of deposit, bankers' acceptances, prime commercial paper, asset- and mortgage-backed securities, municipal bonds, and corporate notes. As of June 30, 2010 and 2009, Metropolitan had the following investments at fair value:

(Dollars in thousands)	June 30,	
	2010	2009
U.S. Treasury notes	\$ 165,494	\$ 107,585
U.S. Treasury strips	43,513	36,260
U.S. Guarantees—GNMAs	404	22
Federal agency securities	251,506	250,389
Bankers' acceptances	33,332	6,092
Prime commercial paper	180,986	219,266
Corporate notes	78,040	95,924
Negotiable certificates of deposit	69,500	—
Shares of beneficial interest	329	1,822
Asset- and mortgaged-backed securities	35,020	46,541
Municipal bonds	186,668	258,745
Local Agency Investment Fund	50,000	40,000
Total investments	\$ 1,094,792	\$ 1,062,646

NOTES TO BASIC FINANCIAL STATEMENTS**(CONTINUED)**

June 30, 2010 and 2009

Interest rate risk. In accordance with Metropolitan's investment policy, interest rate risk was managed by limiting the duration of the various portfolio segments, which have limitations on the amount of duration exposure for each segment (see the following for specific durations).

Internally Managed Segment

This component of the portfolio was managed against the Merrill Lynch 3-Month Treasury Bill index. For fiscal years 2010 and 2009, the benchmark was 0.23 and the portfolio was permitted to vary from the duration by plus or minus 0.20. As of June 30, 2010 and 2009, the investments and durations for this segment were as follows:

(Dollars in thousands)	June 30,			
	2010		2009	
	Fair Value	Duration	Fair Value	Duration
U.S. Treasury notes	\$ 15,100	0.44	\$ 15,000	0.09
U.S. Treasury strips	\$ 7,774	11.18	\$ 2,563	12.11
Federal agency securities	\$ 181,722	0.12	\$ 169,874	0.17
Bankers' acceptances	\$ 33,332	0.05	\$ 6,092	0.06
Prime commercial paper	\$ 180,466	0.00	\$ 219,046	0.01
Corporate notes	\$ 40,662	1.05	\$ 38,827	0.54
Negotiable certificates of deposit	\$ 69,500	0.02	\$ —	—
Municipal bonds	\$ 78,130	0.23	\$ 143,841	0.01
Local Agency Investment Fund	\$ 50,000	—	\$ 40,000	—
Weighted average duration		0.27		0.14

Externally Managed Segment

This component of the portfolio was managed against the Merrill Lynch U.S. Corporate and Government, one to five years, A-Rated and above index. For fiscal years 2010 and 2009, the benchmarks were 2.61 and 2.46, respectively, and the portfolio was permitted to vary from the duration by plus or minus 1.50. As of June 30, 2010 and 2009, Metropolitan's investments and durations for this segment were as follows:

(Dollars in thousands)	June 30,			
	2010		2009	
	Fair Value	Duration	Fair Value	Duration
U.S. Treasury notes	\$ 150,394	0.86	\$ 92,585	1.09
U.S. Treasury strips	\$ 13,552	11.89	\$ 10,286	12.14
U.S. Guarantees-GNMAs	\$ 404	6.01	\$ 22	5.35
Federal agency securities	\$ 66,986	4.06	\$ 76,608	5.22
Corporate notes	\$ 36,895	2.83	\$ 56,752	3.29
Shares of beneficial interest	\$ 329	—	\$ 1,822	—
Asset- and mortgaged-backed securities	\$ 35,020	0.95	\$ 46,541	1.57
Weighted average duration		2.31		3.11

NOTES TO BASIC FINANCIAL STATEMENTS**(CONTINUED)**

June 30, 2010 and 2009

Bond Reserves Segment

Investments in the bond reserves were managed based on the requirements of each of the bond issues. Per Board authorization, the Treasurer was authorized to invest these monies in excess of five years. As of June 30, 2010 and 2009, Metropolitan's bond reserves investments and durations for this segment were as follows:

(Dollars in thousands)	June 30,			
	2010		2009	
	Fair Value	Duration	Fair Value	Duration
U.S. Treasury strips	\$ 22,187	11.18	\$ 23,411	12.11
Federal agency securities	\$ 2,798	0.11	\$ 3,907	0.67
Prime commercial paper	\$ 520	—	\$ 220	—
Corporate notes	\$ 483	1.24	\$ 345	2.20
Municipal bonds	\$ 108,538	7.80	\$ 114,904	10.63
Weighted average duration		8.14		10.56

Credit risk. Credit risk was managed by purchasing investments with the nationally recognized credit ratings specified in Metropolitan's investment policy. Additionally, the policy required monitoring the credit ratings of securities held in the portfolio, and if the securities' credit ratings were downgraded, evaluating for potential sale. For certain securities, additional requirements included consideration of net worth, length of time in business, and specified market values.

Presented below is the minimum rating required, if applicable, by investment type pursuant to Metropolitan's investing policy.

U.S. Government and Agencies – not applicable.

Bankers' Acceptances – prime quality of the highest ranking or highest letter and numerical rating (A1, P1 or higher) as provided by Moody's Investors Service, Inc (Moody's), or Standard and Poor's Ratings Services, and Fitch Ratings.

Negotiable Certificates of Deposits – prime quality of the highest ranking or highest letter and numerical rating (A1, P1 or higher) as provided by Moody's, or Standard and Poor's Ratings Services, and Fitch Ratings.

Commercial Paper – prime quality of the highest ranking or highest letter and numerical rating (A1, P1 or higher) as provided by Moody's, or Standard and Poor's Ratings Services, and Fitch Ratings.

Corporate Notes – rating category of at least A or its equivalent or better by a nationally recognized rating service.

Mortgage Obligations and Asset-Backed Securities – issued by an issuer having an A or higher rating for the issuer's debt as provided by a nationally recognized rating service and rated in a category of AAA by a nationally recognized rating service.

NOTES TO BASIC FINANCIAL STATEMENTS**(CONTINUED)**

June 30, 2010 and 2009

Local Agency Investment Fund – not applicable.

Shares of Beneficial Interest – highest ranking of the highest letter and numerical rating provided by not less than two nationally recognized rating agencies.

At June 30, 2010 and 2009, Metropolitan's portfolio was invested in the following securities by rating:

(Dollars in thousands)	Rating	June 30,	
		2010	2009
		Fair Value	Fair Value
U.S. Treasury notes and strips	AAA	\$ 209,007	\$ 143,845
U.S. Guarantees - GNMA's	AAA	404	22
Federal agency securities	AAA	251,506	250,389
Shares of beneficial interest	AAA	329	1,822
Asset- and mortgaged-backed securities	AAA	35,020	46,541
Corporate notes	A ⁽¹⁾⁽²⁾	78,040	95,924
Prime commercial paper	A1/P1 ⁽¹⁾	180,986	219,266
Negotiable certificates of deposit	F1	69,500	—
Bankers' acceptances	F1 ⁽¹⁾	33,332	6,092
Municipal bonds	⁽¹⁾	186,668	258,745
Local Agency Investment Fund	⁽³⁾	50,000	40,000
Total Portfolio		\$ 1,094,792	\$ 1,062,646

⁽¹⁾ A or better e.g. F1+, A1+, AA, or AAA.

⁽²⁾ Included are defaulted, unrated Lehman notes with an original cost of \$5.268 million, and a fair value of \$1.044 million and \$780,000 at June 30, 2010 and 2009, respectively. Also included are two corporate notes with fair values and original cost of \$1.754 million and \$1.854 million and \$2.119 million and \$1.872 million, respectively at June 30, 2009. The corporate notes were rated A3/Baa1 and BB+/A- with Moody's Investor Service and Standard & Poor's, respectively and were sold in fiscal 2010.

⁽³⁾ Securities are not rated.

NOTES TO BASIC FINANCIAL STATEMENTS**(CONTINUED)**

June 30, 2010 and 2009

Concentration of credit risk. In accordance with Metropolitan's investment policy, the minimum requirements for limiting concentration of credit risk defined the maximum percent allowable for investment in each security type as well as the percent allowable for investment by issuer per type. Generally, the maximum allowable for investment by security type varied from 20 percent, for asset-and mortgage-backed securities, to 100 percent for U.S. Treasury and agency securities. The percentages of investments that can be purchased by a single issuer, within each security type, ranged from 5 percent, for asset-backed securities, to 10 percent for bankers' acceptances.

	Investment Policy Limits	Percent of Portfolio	
		2010	2009
U.S. Treasury notes and strips	100%	19.1%	13.5%
U.S. Guarantees - GNMA's	100%	.1%	—%
Federal agency securities	100%	22.9%	23.6%
Shares of beneficial interest	20%	.1%	0.2%
Asset- and mortgaged-backed securities	20%	3.2%	4.4%
Corporate notes	30%	7.1%	9.0%
Prime commercial paper	25%	16.5%	20.6%
Negotiable certificates of deposit	30%	6.3%	—%
Bankers' acceptances	40%	3.0%	0.6%
Municipal bonds	30%	17.1%	24.3%
Local Agency Investment Fund	N/A	4.6%	3.8%
Total Portfolio		100.0%	100.0%

At June 30, 2010 and 2009, Metropolitan had the following investments (obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government not listed) representing five percent or more of its net investments:

(Dollars in thousands)	June 30,			
	2010		2009	
California State Economic Recovery Bonds	\$ —	—	\$ 57,243	5.39%
Federal Home Loan Bank	\$ 68,755	6.28%	\$ 66,214	6.23%
Federal National Mortgage Association	\$ 100,799	9.21%	\$ 100,395	9.44%
Federal Home Loan Mortgage Association	\$ 63,960	5.84%	\$ —	—

Custodial credit risk. At June 30, 2010 and 2009, Metropolitan's investments were insured or registered or were held, in Metropolitan's name, in safekeeping at Metropolitan's bank, which was not a counterparty to the investment transactions. Exceptions were \$50.0 million and \$40.0 million in deposits in the California State managed Local Agency Investment Fund (LAIF) as of June 30, 2010 and 2009, respectively and \$12.04 and \$1.3 million in collateral posted with Morgan Stanley as of June 30, 2010 and 2009, respectively. The LAIF, created by California statute, is part of a pooled money investment account. The LAIF has oversight by the Local Investment Advisory Board, which consists of five members designated by statute. The Chairman is the State Treasurer, or his designated representative. Securities held with Morgan Stanley are required pursuant to various swap agreements.

NOTES TO BASIC FINANCIAL STATEMENTS

(CONTINUED)

June 30, 2010 and 2009

(c) Reverse Repurchase Agreements

Metropolitan was permitted, subject to conditions imposed by State law, to sell securities owned under written agreements and to buy back the securities on or before a specified date for a specified amount. No such reverse repurchase agreements were entered into during the fiscal years ended June 30, 2010 and 2009.

(d) Restricted Cash and Investments

Metropolitan has established a number of separate accounts, also referred to as funds, to provide for specific activities in accordance with special regulations, bond covenants, and trust arrangements. The accounts were classified as "restricted." Most restricted accounts had minimum cash and investment balance requirements and all were nondiscretionary in terms of the use of assets. Among other things, the restricted amounts provided for payments of debt service on Metropolitan's bonds; reserves for principal and interest on outstanding bonds; payments for arbitrage tax rebate; construction of capital assets; payment of Metropolitan's operations and maintenance expenses; and payment of the costs related to the closure and postclosure maintenance of Metropolitan's solid waste landfill facility.

NOTES TO BASIC FINANCIAL STATEMENTS*(CONTINUED)*

June 30, 2010 and 2009

4. PARTICIPATION RIGHTS

Participation rights activity for the fiscal years ended June 30, 2010 and 2009 was as follows:

(Dollars in thousands)	June 30, 2008	Additions
Participation rights:		
Imperial Irrigation District	\$ 112,313	\$ —
Palo Verde Irrigation District	82,215	590
Kern Water District	—	—
South County Pipeline	72,371	—
Semitropic Water Storage District	31,319	—
Arvin-Edison Water Storage District	29,821	17,366
Calleguas Municipal Water District	—	28,354
Chino Basin	—	27,500
Orange County	—	23,000
Conjunctive Use Programs	—	20,608
Total	328,039	117,418
Accumulated amortization:		
Imperial Irrigation District	(36,260)	(2,270)
Palo Verde Irrigation District	(7,662)	(2,329)
Kern Water District	—	—
South County Pipeline	(13,985)	(912)
Semitropic Water Storage District	(9,089)	(814)
Arvin-Edison Water Storage District	(7,573)	(977)
Calleguas Municipal Water District	—	(442)
Chino Basin	—	(363)
Orange County	—	(299)
Conjunctive Use Programs	—	(256)
Total	(74,569)	(8,662)
Participation rights, net	\$ 253,470	\$ 108,756

NOTES TO BASIC FINANCIAL STATEMENTS

(CONTINUED)

June 30, 2010 and 2009

Reductions	June 30, 2009	Additions	Reductions	June 30, 2010
\$ —	\$ 112,313	\$ —	\$ —	\$ 112,313
—	82,805	—	—	82,805
—	—	36,975	—	36,975
—	72,371	—	—	72,371
—	31,319	—	—	31,319
—	47,187	—	—	47,187
—	28,354	—	—	28,354
—	27,500	—	—	27,500
—	23,000	—	—	23,000
—	20,608	—	—	20,608
—	445,457	36,975	—	482,432
—	(38,530)	(2,270)	—	(40,800)
—	(9,991)	(2,342)	—	(12,333)
—	—	—	—	—
—	(14,897)	(912)	—	(15,809)
—	(9,903)	(814)	—	(10,717)
—	(8,550)	(1,467)	—	(10,017)
—	(442)	(1,060)	—	(1,502)
—	(363)	(1,454)	—	(1,817)
—	(299)	(1,195)	—	(1,494)
—	(256)	(1,025)	—	(1,281)
—	(83,231)	(12,539)	—	(95,770)
\$ —	\$ 362,226	\$ 24,436	\$ —	\$ 386,662

NOTES TO BASIC FINANCIAL STATEMENTS**(CONTINUED)**

June 30, 2010 and 2009

(a) Imperial Irrigation District

In December 1988, Metropolitan and the Imperial Irrigation District (IID) entered into a water conservation agreement that became effective in December 1989. Under the terms of the conservation agreement, Metropolitan paid for capital costs and continues to pay annual costs for specific conservation projects within IID. From 1998 to 2003, Metropolitan diverted from the Colorado River a quantity of water equal to the amount of water conserved by the conservation projects, which totaled between 104,940 and 109,460 acre-feet annually (see Note 9b). Under the October 2003 amendment to an agreement and at the request of the Coachella Valley Water District (CVWD), 20,000 acre-feet of the total conserved volume was made available to CVWD. As a result, annually, between 81,160 and 81,940 acre-feet of water was made available to Metropolitan from 2004 through 2006. Under the May 2007 amendment to the agreement, 85,000 and at least 93,000 acre-feet will be/was available in calendar years 2010 and 2009, respectively. The water must be used in the calendar year the water is conserved, unless stored in a Colorado River reservoir pursuant to a separate agreement.

As capital projects were completed, the costs contributed by Metropolitan were capitalized as participation rights in Metropolitan's accounting records. The construction phase of this program was completed as of September 30, 1998, and the operation and maintenance phase commenced on October 1, 1998. The October 2003 amendment to the agreement extended the term through December 31, 2041 or 270 days beyond the termination of the Quantification Settlement Agreement plus any extension applicable over the agreement (see Note 9d). Participation rights for this project totaled \$112,313,000 as of June 30, 2010 and 2009, and are amortized using the straight-line method over the remaining life of the agreement. Amortization expense totaled \$2,270,000 in fiscal years 2010 and 2009.

(b) Palo Verde Irrigation District

In August 2004, Metropolitan entered into an agreement with Palo Verde Irrigation District (PVID) to implement a 35-year land management, crop rotation, and water supply program. This following program commenced in January 2005 and will extend through July 2040 and will make available up to 130,000 acre-feet of water in certain years for transfer to Metropolitan from PVID.

Under the terms of the agreement, Metropolitan paid for all program start-up costs that have been capitalized as participation rights. These costs included sign-up payments to individual landowners, funding for a community improvement program and program setup costs.

Participation rights for this program totaled \$82,805,000 as of June 30, 2010 and 2009, and are being amortized using the straight-line method over 35 years. Amortization expense totaled \$2,342,000 and \$2,329,000 in fiscal years 2010 and 2009, respectively.

(c) Kern Water District

Metropolitan entered into an agreement with the Kern Water District for the development of a water management program. The agreement includes a Regulation Program and a Transportation Program. Under the terms of the Regulation Program, Kern Delta will regulate the storage and delivery for Metropolitan of up to 250,000 acre-feet of water and currently has 9,872 acre-feet in the program. The program is intended to provide a minimum recharge and return capability of 50,000 acre-feet annually. Construction of infrastructure is required in order to meet the program's dry year minimum return. The transportation program provides

NOTES TO BASIC FINANCIAL STATEMENTS**(CONTINUED)**

June 30, 2010 and 2009

Metropolitan with priority rights to convey water acquired by Metropolitan from third parties through the Kern-Delta facilities to the California Aqueduct for ultimate delivery to Metropolitan. This program terminates on December 31, 2029. Metropolitan is currently negotiating an amendment to the program that will extend the term to November 4, 2035. The facilities became operational in June of 2010.

Participation rights for the Kern Delta totaled \$36,975,000 as of June 30, 2010 and are being amortized using the straight-line method over the remaining life of the agreement. Amortization will begin in fiscal 2011.

(d) South County Pipeline

In 1989, Metropolitan entered into an agreement with two member agencies and one of their subagencies to participate in the construction of an upsized version of a 26-mile long pipeline serving the south Orange County portion of its service area. Participation in this project provides Metropolitan capacity to transport its water in the central part of its service area. Participation rights for this project totaled \$72,371,000 as of June 30, 2010 and 2009. These participation rights are amortized using the straight-line method over 80 years. Amortization expense totaled \$912,000 in fiscal years 2010 and 2009.

(e) Semitropic Water Storage District

In December 1994, Metropolitan entered into a water banking and exchange program with Semitropic Water Storage District and its improvement districts that entitles it to storage, withdrawal, and exchange rights for its State Water Project supplies. The agreement terminates in November 2035.

In 1999, Metropolitan became fully vested for 35 percent of the 1 million acre-foot banking project. Metropolitan has a storage allocation of 350,000 acre-feet and currently has 43,914 acre-feet in the program. Metropolitan is entitled to a minimum of 31,500 acre-feet per year of pump back capacity. In addition, assuming a 100 percent State Water Project allocation, Metropolitan is entitled to a minimum of 46,550 acre-feet per year of entitlement exchange rights. Finally, Metropolitan has the ability to use other banking partners' rights when they are not being used. As a result, the potential minimum return capability for Metropolitan is estimated at 107,000 acre-feet per year.

Participation rights for this program totaled \$31,319,000 as of June 30, 2010 and 2009. These participation rights are amortized using the straight-line method over the remaining life of the agreement. Amortization expense totaled \$814,000 in fiscal years 2010 and 2009.

(f) Arvin-Edison Water Storage District

In December 1997, Metropolitan entered into an agreement for a water management program with Arvin-Edison Water Storage District (Arvin-Edison). The agreement includes a regulation program, a transportation program, and a water quality exchange program. Under the terms of the regulation program, Arvin-Edison will regulate the storage and delivery for Metropolitan of up to 350,000 acre-feet of water and currently has 39,695 acre-feet in the program. The minimum estimated return capability for the Arvin-Edison program varies from 40,000 acre-feet per year to 75,000 acre-feet per year depending on hydrologic/groundwater conditions. Return water will be delivered to Metropolitan upon request through a new intertie pipeline to the California Aqueduct and by exchange of existing Arvin-Edison supplies in the California Aqueduct. In 2008, Metropolitan amended the agreement to construct the south canal improvement project that will improve the operational flexibility of the program as well as increase the ability to return high quality water to the California Aqueduct. The project was completed in early 2009. The agreement terminates on November 4, 2035 with provisions for automatic extension if all stored water has not been returned.

NOTES TO BASIC FINANCIAL STATEMENTS**(CONTINUED)**

June 30, 2010 and 2009

The agreement also provides a transportation program whereby Metropolitan is provided priority rights to convey water acquired by Metropolitan from third parties through the Arvin-Edison facilities to the California Aqueduct for ultimate delivery to Metropolitan. This program terminates on November 4, 2035.

Participation rights for the Arvin-Edison program totaled \$47,187,000 as of June 30, 2010 and 2009, respectively. These participation rights are amortized using the straight-line method over the longer life of the transportation program. Amortization expense totaled \$1,467,000 and \$977,000 in fiscal years 2010 and 2009, respectively.

(g) Calleguas Municipal Water District

In June 1995, and as amended in 2000 and 2008, Metropolitan entered into a storage agreement with the Calleguas Municipal Water District to store up to 210,000 acre-feet of water in the North Los Posas groundwater basin in Ventura County. The facilities became operational in January 2009 and Metropolitan currently has 39,316 acre-feet stored. The program is intended to improve Metropolitan's ability to reliably serve Calleguas by establishing facilities which will allow Metropolitan to store water in the Calleguas service area in advance of need by Calleguas and to establish a second point of delivery to Calleguas for Metropolitan water. The program consists of construction of storage and recovery wells and pipelines and related facilities connecting the wells to Calleguas' water distribution system. This agreement terminates in November 2035.

Participation rights for the North Los Posas storage program totaled \$28,354,000 as of June 30, 2010 and 2009 respectively and are being amortized using the straight-line method over the remaining life of the agreement. Amortization expense totaled \$1,060,000 and \$442,000 in fiscal years 2010 and 2009, respectively.

(h) Chino Basin

In June 2003, Metropolitan entered into a groundwater storage agreement with Inland Empire Utilities Agency, Three Valleys Municipal Water District, and the Chino Basin Watermaster. Under the terms of the agreement, Metropolitan may store up to 25,000 acre-feet per year to a maximum of 100,000 acre-feet and may withdraw up to 33,000 acre-feet per year. The facilities became operational during fiscal year 2009 and Metropolitan currently has 16,029 acre-feet in the Chino Basin. The agreement terminates on March 1, 2028, unless the parties agree to extend for an additional maximum period of 25 years.

Participation rights in the Chino groundwater storage program totaled \$27,500,000 as of June 30, 2010 and 2009, respectively. These participation rights are amortized using the straight-line method over the remaining life of the agreement. Amortization expense totaled \$1,454,000 and \$363,000 in fiscal years 2010 and 2009, respectively.

(i) Orange County

In 2003, Metropolitan entered into a groundwater storage agreement with Orange County Water District and the Municipal Water District of Orange County to allow Metropolitan to store 66,000 acre-feet in the Orange County basin. Metropolitan may store up to 16,500 acre-feet per year and withdraw up to 22,000 acre-feet for overlying demand during dry, drought, and emergency conditions. The facilities became operational during fiscal year 2009 and Metropolitan currently has 517 acre-feet in storage. The program included the construction of wells and barrier improvements for protection of groundwater supplies from seawater intrusion. The agreement terminates in June 2028.

NOTES TO BASIC FINANCIAL STATEMENTS**(CONTINUED)**

June 30, 2010 and 2009

Participation rights in the Orange County groundwater storage program totaled \$23,000,000 as of June 30, 2010 and 2009, respectively. These participation rights are amortized using the straight-line method over the remaining life of the agreement. Amortization expense totaled \$1,195,000 and \$299,000 in fiscal years 2010 and 2009, respectively.

(j) Conjunctive Use Programs

Conjunctive use is the operation of a groundwater basin in coordination with a surface water system to increase total water supply availability, thus improving the overall reliability of supplies. Metropolitan has entered into seven agreements with its member agencies for conjunctive use programs whereby Metropolitan provides funding for construction of water storage and related facilities in exchange for water storage and withdrawal rights. The conjunctive use programs were funded with State Proposition 13 grant dollars. The seven projects are with Long Beach, Long Beach-Lakewood, Compton, Three Valleys MWD-La Verne, Foothill MWD, and Western MWD-Elsinore Valley MWD. Collectively, these seven projects allow Metropolitan to store up to 45,889 acre-feet with storage of 11,472 acre-feet per year and withdrawal of 15,296 acre-feet per year. At the close of fiscal year 2010, Metropolitan had a total of 8,540 acre-feet in storage in these seven accounts.

The programs became operational during fiscal year 2009. Participation rights in these projects totaled \$20,608,000 at June 30, 2010 and 2009, respectively. These participation rights are amortized using the straight-line method over the remaining lives of the agreements. Amortization expense totaled \$1,025,000 and \$256,000 in fiscal years 2010 and 2009, respectively.

5. Short-term and Long-term Debt

Metropolitan's enabling Act specifies that its indebtedness shall be limited to 15 percent of the assessed value of all taxable property within Metropolitan's service area. Existing outstanding debt of \$4.875 billion and \$4.768 billion at June 30, 2010 and 2009, respectively, represents less than one percent of the 2010-11 and 2009-10 total taxable assessed valuation of \$2,049 billion and \$2,082 billion, respectively.

Metropolitan's long-term debt consists of general obligation and revenue bond issues as well as other obligations. The general obligation bonds are secured by Metropolitan's authority to levy ad valorem property taxes in an unlimited amount for such purposes. The revenue bond obligations are special limited obligations of Metropolitan and are secured by a pledge of Metropolitan's net operating revenues. Such obligations contain certain restrictive covenants, with which Metropolitan has complied. All of the bond issues contain call provisions. Substantially all of the debt proceeds have been, and are expected to continue to be, utilized to fund new facilities, improvements and betterments, and to refund outstanding bonds.

(a) Short-term Debt

Metropolitan may issue up to \$400 million in commercial paper to fund a portion of its capital plan. At June 30, 2010 and 2009, there were no commercial paper notes outstanding. Metropolitan may also issue other forms of short-term debt such as variable rate water revenue bonds (see Note 5c).

(b) General Obligation Bonds

In 1966, voters authorized Metropolitan to incur up to \$850.0 million of general obligation bond indebtedness to finance a portion of Metropolitan's capital plan. The original amounts, issued as Series A through H

NOTES TO BASIC FINANCIAL STATEMENTS**(CONTINUED)**

June 30, 2010 and 2009

under the 1966 authorization, totaled \$850.0 million at June 30, 2010 and 2009. Metropolitan has advance refunded some of these general obligation bond issues through the issuance of refunding bonds. A total of \$255.1 million and \$293.4 million in general obligation bonds and general obligation refunding bonds was outstanding at June 30, 2010 and 2009, respectively.

The general obligation bond issues include of both serial and term bonds that mature in varying amounts through March 2037 at interest rates ranging from 2.0 percent to 5.0 percent. The term bonds are subject to mandatory redemption prior to maturity. All general obligation bonds maturing on or after the earliest applicable call date are subject to optional redemption prior to maturity, callable on interest payment dates, and subject to early redemption premiums.

No general obligation bonds were issued during the fiscal years ended June 30, 2010 or 2009.

(c) Revenue Bonds

Pursuant to a 1974 voter authorization, additional funds, primarily for funding the capital investment plan, are obtained through the sale of water revenue bonds. Revenue bonds may be issued subject to certain conditions, including a requirement that the total of revenue bonds outstanding does not exceed the equity (net assets) of Metropolitan as of the fiscal year-end prior to such issuance. Metropolitan has advance refunded some of these revenue bonds through the issuance of refunding bonds. A total of \$4.592 billion and \$4.445 billion of revenue bonds and revenue refunding bonds was outstanding at June 30, 2010 and 2009, respectively.

Each fixed rate revenue bond issue consists of both serial and term bonds that mature in varying amounts through July 2039 at interest rates ranging from 2.00 percent to 6.538 percent. The term bonds are subject to mandatory redemption prior to maturity. All revenue bonds maturing on or after the earliest applicable call date are subject to optional redemption prior to maturity, callable on interest payment dates, and subject to early redemption premiums.

Revenue bonds issued during fiscal 2010 were as follows:

- On August 11, 2009, Metropolitan issued \$250,000,000 of Water Revenue Bonds, 2008 Authorization Series D, Taxable Build America Bonds, at a true interest cost of 4.03 percent, to finance a portion of the capital investment plan. The maturities extend to July 1, 2039 and are subject to mandatory and optional redemption provisions. Build America Bonds are taxable securities that are subject to a semi-annual subsidy payment from the United States Treasury equal to 35 percent of interest payable on the Build America Bonds.

Revenue bonds issued during fiscal 2009 were as follows:

- On January 27, 2009, Metropolitan issued \$200 million of Water Revenue Bonds, 2008 Authorization Series A, at a true interest cost of 4.534 percent, to finance a portion of the capital investment plan. The maturities extend to January 1, 2039 and are subject to mandatory and optional redemption provisions.
- On June 25, 2009, Metropolitan issued \$21,615,000 of Water Revenue Bonds, 2008 Authorization Series B at a true interest cost of 2.810 percent, to finance a portion of the capital investment plan. The maturities extend to July 1, 2020 and are subject to mandatory and optional redemption provisions.

NOTES TO BASIC FINANCIAL STATEMENTS**(CONTINUED)**

June 30, 2010 and 2009

- On June 25, 2009, Metropolitan issued \$78,385,000 of Water Revenue Bonds, 2008 Authorization Series C, Taxable Build America Bonds, at a true interest cost of 4.1586 percent, to finance a portion of the capital investment plan. The maturities extend to July 1, 2039 and are subject to mandatory and optional redemption provisions. Build America Bonds are taxable securities that are subject to a semi-annual subsidy payment from the United States Treasury equal to 35 percent of interest payable on the Build America Bonds.

(d) Bond Refundings and Defeasances

Metropolitan has issued Waterworks General Obligation Refunding Bonds and Water Revenue Refunding Bonds to advance refund various issues of Waterworks General Obligation Bonds, Waterworks General Obligation Refunding Bonds, Water Revenue Bonds, and Water Revenue Refunding Bonds previously issued. The net proceeds from these sales were used to purchase U.S. Treasury securities that were deposited in irrevocable escrow trust accounts with a bank acting as an independent fiscal agent to provide for all future debt service on the bonds being refunded. As a result, those bonds are considered defeased and the related liabilities have been excluded from Metropolitan's basic financial statements. At June 30, 2010 and 2009, outstanding general obligation bonds and revenue bonds (including prior year's refundings) of \$150,850,000 and \$222,980,000, respectively, are considered to be defeased.

Refunding and defeasance transactions during fiscal 2010 were as follows:

- On August 11, 2009, Metropolitan issued \$81,065,000 of Water Revenue Refunding Bonds, 2009 Series D at a true interest cost of 3.07 percent, to refund \$88,675,000 of Water Revenue Refunding Bonds, 2002 Series A. Their maturities extend to July 1, 2021 and are subject to mandatory and optional redemption provisions.
- On December 10, 2009, Metropolitan issued \$26,050,000 of Water Revenue Refunding Bonds, 2009 Series E at a true interest cost of 2.59 percent, to refund \$34,700,000 of Water Revenue Refunding Bonds, 2002 Series B. Their maturities extend to July 1, 2020 and are subject to optional redemption provisions.
- On December 22, 2009, Metropolitan issued \$45,515,000 of Waterworks General Obligation Refunding Bonds, 2009 Series A at a true interest cost of 3.23 percent, to refund \$10,260,000 of Waterworks General Obligation Refunding Bonds, 1998 Series A, \$19,325,000 Waterworks General Obligation Bonds, Election 1966, Series H, \$9,145,000 Waterworks General Obligation Refunding Bonds, 2001 Series A and \$9,545,000 of Waterworks General Obligation Refunding Bonds, 2001 Series B. Their maturities extend to July 1, 2028 and are subject to optional redemption provisions.
- On June 24, 2010, Metropolitan issued \$128,005,000 of Special Variable Rate Water Revenue Refunding Bonds, 2010 Series A at variable interest rates, to refund \$132,765,000 of Water Revenue Refunding Bonds, 2004 Series C. Their maturities extend to October 1, 2029 and are subject to mandatory and optional redemption provisions

NOTES TO BASIC FINANCIAL STATEMENTS**(CONTINUED)**

June 30, 2010 and 2009

Refunding and defeasance transactions during fiscal 2009 were as follows:

- On July 1, 2008, Metropolitan issued \$133,430,000 of Water Revenue Refunding Bonds, 2008 Series B at a true interest cost of 4.11 percent, to refund \$10,195,000 of Water Revenue Refunding Bonds, 1996 Series B and \$128,215,000 of Water Revenue Refunding Bonds, 1998 Series A. Their maturities extend to July 1, 2022 and are subject to mandatory and optional redemption provisions.
- On July 31, 2008, Metropolitan issued \$79,045,000 of Water Revenue Refunding Bonds, 2008 Series C at a true interest cost of 5.51 percent to refund \$70,140,000 of Water Revenue Refunding Bonds, 1996 Series A and to fund a \$7,989,566 termination payment on an interest rate swap associated with the 1996 Series A bonds. The true interest cost without the termination payment would be 3.77 percent. Their maturities extend to July 1, 2023 and are subject to mandatory and optional redemption provisions.
- On May 20, 2009, Metropolitan issued \$208,365,000 of Water Revenue Refunding Bonds, 2009 Series A-1 and A-2, (Index Mode), at variable rates, to refund \$221,970,000 of Water Revenue Refunding Bonds, 2003 Series C-1 and C-2. Their maturities extend to July 1, 2030. The 2009 Series A-1 and A-2 Bonds are subject to an unscheduled mandatory tender and a scheduled mandatory tender. The unscheduled mandatory tender, which is at Metropolitan's discretion, may be on any business day at least six-months after the prior unscheduled or scheduled mandatory tender date. The scheduled mandatory tender is twelve months from the prior unscheduled or scheduled mandatory tender date.
- On June 25, 2009, Metropolitan issued \$106,690,000 of Water Revenue Refunding Bonds, 2009 Series B, at a true interest cost of 4.44 percent to refund \$110,985,000 of Water Revenue Refunding Bonds, 2003 Series C-3. Their maturities extend to July 1, 2030 and are subject to mandatory and optional redemption provisions.
- On June 25, 2009, Metropolitan issued \$91,165,000 of Water Revenue Refunding Bonds, 2009 Series C, at a true interest cost of 4.97 percent to refund \$88.8 million of Water Revenue Bonds, 2000 Series B-1. Their maturities extend to July 1, 2035 and are subject to mandatory and optional redemption provisions.

These refundings and defeasances were accomplished to take advantage of lower interest rates. The transactions resulted in cash flow savings of \$19.4 million and \$13.9 million and economic gains (difference between the present values of the debt service payments on the old debt and new debt) of \$7.3 million and \$19.9 million for fiscal years 2010 and 2009, respectively. The difference between the book value of the old debt and the amount required to retire the debt is deferred and amortized over the original remaining life of the old debt or the life of the new debt, whichever is less. Bonds payable are reported net of these deferred costs. In fiscal years 2010 and 2009, approximately \$1,599,000 and \$12,180,000 of costs were deferred. Amortization of all deferred refunding costs was approximately \$9,530,000 and \$10,404,000 in fiscal years 2010 and 2009, respectively.

NOTES TO BASIC FINANCIAL STATEMENTS

(CONTINUED)

June 30, 2010 and 2009

(e) Other Long-term Debt

Other long-term debt includes two loans from the State Revolving Fund.

Metropolitan has received two loans from the State Revolving Fund as follows:

- In November 2003, Metropolitan received \$20 million through the state Department of Water Resources for oxidation retrofit facilities at the Mills Water Treatment Plant in Riverside County. This 20-year loan carries interest at 2.39 percent with the final payment due July 1, 2024. At June 30, 2010 and 2009, the outstanding balance was \$15,410,000 and \$16,290,000, respectively.
- During fiscal years 2002 and 2001, Metropolitan received funds totaling \$20 million through the State Water Resources Control Board for development and implementation of nonpoint source pollution control projects and programs. This 20-year loan carries interest at 2.8 percent with the final payment due February 1, 2020. At June 30, 2010 and 2009, the outstanding balance was \$12,266,000 and \$13,207,000, respectively.

(f) Interest Rate Swaps

Metropolitan has entered into 22 separate interest rate swap agreements of which 17 were outstanding as of June 30, 2010. Fifteen of the agreements require that Metropolitan pay fixed interest rates and receive interest at variable interest rates, and two require that Metropolitan pay a variable rate based on a tax-exempt index and receive a variable rate payment based on a taxable index.

The table on the following page summarizes Metropolitan's interest rate swap portfolio as of June 30, 2010, 2009 and 2008.

NOTES TO BASIC FINANCIAL STATEMENTS

(CONTINUED)

June 30, 2010 and 2009

Summary: The terms, fair values, and credit ratings of the outstanding swaps as of June 30, 2010 and 2009 were as follows:

(Dollars in thousands)

Associated Bond Issue	Notional Amount	Effective Date	Variable Rate Paid	Variable Rate Received	Counterparty Credit Rating ¹
2001 Payor ²	\$ 109,900	09/06/01	4.219%	SIFMA ³ less 35 basis points	Aa3/A+/A+
2001 Payor ²	109,900	09/06/01	4.219%	SIFMA less 35 basis points	Aa1/AA-/AA-
WRRB ⁴ 2002 A	89,786	09/12/02	3.300%	57.74% of 1MoLIBOR ⁵	A2/A/A
WRRB 2002 B	33,589	09/12/02	3.300%	57.74% of 1MoLIBOR	Aa1/AA-/AA-
WRRB 2003 C-1 - C-3	165,882	12/18/03	3.257%	61.20% of 1 MoLIBOR	Aa2/A+/A+
WRRB 2003 C-1 - C-3	165,882	12/18/03	3.257%	61.20% of 1 MoLIBOR	Aa1/AA-/AA-
WRRB 2004 A-1 - A-2	157,960	02/19/04	2.917%	61.20% of 1 MoLIBOR	A2/A/A
WRRB 2004 C	73,021	11/16/04	2.980%	61.55% of 1 MoLIBOR	A2/A/A
WRRB 2004 C	59,744	11/16/04	2.980%	61.55% of 1 MoLIBOR	A3/A/A+
2005 Payor ²	58,547	07/06/05	3.360%	70.00% of 3 MoLIBOR	Aa1/AA-/AA-
2005 Payor ²	58,547	07/06/05	3.360%	70.00% of 3 MoLIBOR	A3/A/A+
2006 Payor ²	31,078	04/04/06	3.210%	63.00% of 3 MoLIBOR	Aa3/A+/A+
2006 Payor ²	31,078	04/04/06	3.210%	63.00% of 3 MoLIBOR	Aa1/AA-/AA-
2006 Payor ²	6,028	04/04/06	2.911%	63.00% of 3 MoLIBOR	Aa3/A+/A+
2006 Payor ²	6,028	04/04/06	2.911%	63.00% of 3 MoLIBOR	Aa1/AA-/AA-
Sub-total pay-fixed receive-variable	1,156,970				
2004 Basis	125,000	05/19/04	SIFMA	70% of 1MoLIBOR +31.5 basis points	Aa1/AA-/AA-
2004 Re-Amended basis	125,000	05/19/04	SIFMA	70% of 1MoLIBOR +31.5 basis points	Aa1/AA-/AA-
Sub-total pay variable, receive-variable	250,000				
Total swaps	\$ 1,406,970				

¹ Includes accrued interest.

² Credit Ratings—Moody's Investors Service, Standard & Poor's, and Fitch Ratings, respectively.

³ These swaps lock in a fixed rate for an equivalent amount of variable rate debt.

⁴ The Securities Industry and Financial Markets Municipal Swap Index, previously known as Bond Marketing Index.

⁵ Water Revenue Refunding Bonds.

⁶ London Interbank Offered Rate.

NOTES TO BASIC FINANCIAL STATEMENTS**(CONTINUED)**

June 30, 2010 and 2009

Swap Termination	Fair Value as of 6/30			Change in Fair Value in FY	
	2010	2009	2008	2010	2009
07/01/20	\$ (16,376)	\$ (12,260)	\$ (11,989)	\$ (4,116)	\$ (271)
07/01/20	(16,376)	(12,260)	(11,989)	(4,116)	(271)
07/01/25	(13,359)	(9,833)	(5,334)	(3,526)	(4,499)
07/01/25	(5,000)	(3,672)	(1,966)	(1,328)	(1,706)
07/01/30	(24,220)	(16,590)	(18,711)	(7,630)	2,121
07/01/30	(24,219)	(16,589)	(18,711)	(7,630)	2,122
07/01/23	(15,190)	(9,075)	(1,354)	(6,115)	(7,721)
10/01/29	(7,467)	(4,582)	(930)	(2,885)	(3,652)
10/01/29	(6,120)	(3,730)	(777)	(2,390)	(2,953)
07/01/30	(6,651)	(3,763)	(75)	(2,888)	(3,688)
07/01/30	(6,651)	(3,763)	(75)	(2,888)	(3,688)
07/01/21	(3,287)	(2,164)	(724)	(1,123)	(1,440)
07/01/21	(3,287)	(2,164)	(724)	(1,123)	(1,440)
07/01/12	(271)	(265)	(73)	(6)	(192)
07/01/12	(271)	(265)	(73)	(6)	(192)
	(148,745)	(100,975)	(73,505)	(47,770)	(27,470)
07/01/14	256	(496)	858	752	(1,354)
07/01/14	256	(496)	791	752	(1,287)
	512	(992)	1,649	1,504	(2,641)
	\$ (148,233)	\$ (101,967)	\$ (71,856)	\$ (46,266)	\$ (30,111)

NOTES TO BASIC FINANCIAL STATEMENTS**(CONTINUED)**

June 30, 2010 and 2009

Pay-Fixed, Receive-Variable

Objective of the Swaps: In order to take advantage of low interest rates in the marketplace, Metropolitan entered into 15 separate pay-fixed, receive-variable interest rate swaps at costs that were less than what Metropolitan otherwise would have paid to issue fixed rate debt in the tax-exempt municipal bond market.

Terms: The notional amounts of the swaps match the principal amounts of the associated debt in total. Metropolitan's swap agreements contain scheduled reductions to outstanding notional amounts that are expected to approximately follow scheduled or anticipated reductions in the associated long-term debt (see Note 5g).

Fair Values: At June 30, 2010, all pay-fixed, receive-variable swaps had a negative fair value. Because the coupons on Metropolitan's variable rate bonds adjust to changing interest rates, the bonds do not have corresponding fair value changes. The fair values of the swaps were estimated using the zero-coupon method and include accrued interest. This method calculates the future net settlement payments required by the swap, assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These payments are then discounted using spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the date of each future net settlement on the swaps.

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

All swap agreements contain specific collateral requirements that are in effect for Metropolitan and the counterparties. The swaps require different collateral levels based on credit ratings and the fair value of the swap. Generally, the fair value threshold levels are also reduced as the credit ratings are reduced. Collateral on all swaps is to be in the form of U.S. government securities that may be held by the party posting the collateral. On June 30, 2010, Metropolitan had posted collateral of \$12.0 million with one counterparty.

Each swap contains cross-default provisions that allow the nondefaulting party to accelerate and terminate all outstanding transactions and to net the transactions' fair values into a single sum to be owed by, or owed to, the nondefaulting party.

As of June 30, 2010, Metropolitan has pay-fixed, receive-variable swap transactions with one counterparty in the amount of \$655 million or 46.6 percent of the notional amount of Metropolitan's outstanding swap transactions. The swap transactions comprise \$405 million of pay-fixed, receive-variable swaps. This counterparty is rated Aa1/AA-/AA- by Moody's, Standard & Poor's, and Fitch Ratings, respectively.

NOTES TO BASIC FINANCIAL STATEMENTS**(CONTINUED)**

June 30, 2010 and 2009

On July 10, 2008, Metropolitan terminated a \$70,140,000 pay-fixed, receive-variable interest rate swap effective August 1, 2008. On August 1, 2008, Metropolitan paid AIG Financial Products Corp., the swap counterparty, a termination payment of \$7,989,566, which was funded from a portion of the proceeds of Metropolitan's Water Revenue Refunding Bonds, 2008 Series C. The swap termination was done in conjunction with the refunding of Metropolitan's Water Refunding Bonds, 1996 Series A, which were associated with the swap transaction.

Basis Risk: The interest rates on Metropolitan's variable rate bonds are expected to be equivalent, but not necessarily equal to the variable rate payments received from counterparties on pay-fixed, receive-variable interest rate swaps. To the extent these variable payments differ, Metropolitan is exposed to basis risk. When the rates received from the counterparties are less than the rates on variable rate bonds associated with the respective swap transactions there is a basis loss. When the rates received from the counterparties are greater than the rates on variable rate bonds associated with the respective swap transactions there is a basis gain. As of June 30, 2010, the interest rates of the variable rate debt associated with these swap transactions were 0.28 percent, 0.25 percent, 0.24 percent, 0.22 percent, 0.24 percent, 0.28 percent, and 0.28 percent. However, Metropolitan's variable rate payments received from the counterparties of these swaps were (0.04) percent, 0.20 percent, 0.21 percent, 0.21 percent, 0.21 percent, 0.42 percent, and 0.38 percent, respectively.

Termination Risk: Metropolitan may terminate any of the swaps if the other party fails to perform under the terms of the swap agreements. If any of the swaps are terminated, the associated variable rate bonds would no longer carry a synthetic fixed interest rate. Also, if at the time of termination the swap has a negative fair value, Metropolitan would be liable to the counterparty for a payment equal to the swap's fair value.

Tax Risk: As with other forms of variable rate exposure and the relationship between the taxable and tax-exempt markets, Metropolitan is exposed to tax risk should tax-exempt interest rates on variable rate debt issued in conjunction with the swaps rise faster than taxable interest rates received by the swap counterparties, due particularly to reduced federal or state income tax rates, over the term of the swap agreement.

Pay-Variable, Receive-Variable

Objective of the Swaps: The low interest rate environment during fiscal years 2004 through 2006 enabled Metropolitan to reduce the cost of Metropolitan's debt obligations by taking advantage of the relationship between taxable and tax-exempt market indices. To take advantage of the market opportunity, Metropolitan entered into four SIFMA-to-LIBOR basis swap transactions to generate additional cash flow savings while preserving the call option value of its existing bonds. Metropolitan pays a variable rate based on the SIFMA or tax-exempt index and receives a variable rate based on a percentage of the LIBOR or taxable index. In addition, Metropolitan entered into two basis swaps and modified one of the existing 2004 basis swaps, where Metropolitan received a percentage of the five-year LIBOR index and paid a percentage of either a tax-exempt or taxable index. These transactions are called constant maturity swaps. The objective of the constant maturity swap is to take advantage of the favorable differential between short-term and medium-term rates in order to reduce debt service costs; reduce tax risk; mitigate the impact of rate compression in low interest rate environments; and to diversify Metropolitan's interest rate risk.

NOTES TO BASIC FINANCIAL STATEMENTS**(CONTINUED)**

June 30, 2010 and 2009

Terms: On May 17, 2004, Metropolitan entered into two basis swap transactions (2004 Basis Swaps) with two counterparties. The terms of both swaps are 10 years and terminate in July 2014. The notional amount of each swap is \$125.0 million. Under the original terms of the swaps, Metropolitan pays a variable rate equal to the SIFMA Index and receives a variable rate based on 70.0 percent of the one-month LIBOR plus 31.5 basis points. On May 5, 2006, one of the \$125.0 million 2004 Basis Swaps was amended to change the rate that Metropolitan receives to 64.54 percent of the five-year LIBOR index plus 31.5 basis points from 70.0 percent of the one-month LIBOR rate. The amended swap was effective on July 3, 2006. The terms of the other 2004 Basis Swap remained unchanged. On December 19, 2007, Metropolitan took advantage of market conditions and amended the amended swap to change the rate Metropolitan receives to 70.0 percent of one-month LIBOR plus 31.5 basis points. The two basis swaps now have identical terms. The amendment was effective on January 2, 2008. As a result of the amendment, Metropolitan received a payment of \$1.05 million on January 2, 2008, from the swap counterparties. Effective May 26, 2009, the two counterparties merged, so there is now one counterparty for the two pay-variable, receive-variable swaps.

Fair Value: As of June 30, 2010, each basis swap had a positive fair value of \$256,000. The fair values were estimated using the zero-coupon method and include accrued interest. This method calculates the future net settlement payments required by the swap, assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These payments are then discounted using spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the date of each future net settlement on the swaps.

Credit Risk: The swap's fair value represents Metropolitan's credit exposure to one counterparty as of June 30, 2010. Should the counterparty to this transaction fail to perform according to the terms of the swap contract, Metropolitan would face a maximum possible loss equivalent to the swap's fair value. As of June 30, 2010, the swap counterparty was rated Aa1/AA-/AA- by Moody's, Standard & Poor's, and Fitch Ratings, respectively.

Basis Risk: Since the payments received by Metropolitan for the basis swap transactions are based on a percentage of a taxable index and the payments made by Metropolitan are based on a tax-exempt index, the trading relationship exposes Metropolitan to basis risk as payments received by Metropolitan could be less than payments made by Metropolitan to the counterparties.

Tax Risk: As with other forms of variable rate exposure and the relationship between the taxable and tax-exempt markets, Metropolitan is exposed to tax risk should tax-exempt interest rates rise faster than taxable interest rates thereby resulting in narrower spreads between taxable and tax-exempt indices over the term of the swap agreement.

NOTES TO BASIC FINANCIAL STATEMENTS*(CONTINUED)*

June 30, 2010 and 2009

(g) Swap Payments and Associated Debt

Using rates as of June 30, 2010, debt service requirements on Metropolitan's swap-related variable rate debt and net swap payments are as follows. As rates vary, variable rate bond interest payments and net swap payments will vary.

(Dollars in thousands)	Variable Rate Bonds		Interest Rate	Total
	Principal	Interest	Swaps, Net	
Year ending June 30:				
2011	\$ 4,495	\$ 2,904	\$ 36,721	\$ 44,120
2012	7,430	2,888	36,514	46,832
2013	19,690	2,838	35,956	58,484
2014	12,850	2,803	35,521	51,174
2015	40,075	2,728	34,503	77,306
2016-2020	393,405	11,046	137,695	542,146
2021-2025	406,155	5,260	64,834	476,249
2026-2030	242,035	1,211	15,765	259,011
2031	30,835	45	544	31,424
Total	\$ 1,156,970	\$ 31,723	\$ 398,053	\$ 1,586,746

(h) Variable Rate Bonds

The variable rate bonds bear interest at daily and weekly rates ranging from 0.14% to 0.40% as of June 30, 2010 and 0.10% to 0.75% as of June 30, 2009. Metropolitan can elect to change the interest rate period of the bonds with certain limitations. The bondholders have the right to tender bonds to the paying agent on any business day with either same day or seven days' prior notice. Metropolitan has entered into standby bond purchase agreements (SBPA's) with several commercial banks to provide liquidity for twenty separate variable rate bond issues in the amount of \$1.758 billion as of June 30, 2009 and for seventeen separate variable rate bond issues in the amount of \$1.498 billion as of June 30, 2010. In addition, Metropolitan has two series of variable rate bonds in the amount of \$208.365 million as of June 30, 2009 and has three series of variable rate bonds in the amount of \$336.370 million as of June 30, 2010, that are not supported by an SBPA.

NOTES TO BASIC FINANCIAL STATEMENTS**(CONTINUED)**

June 30, 2010 and 2009

The Bank Bonds that would be issued under the SBPA's would bear interest that is payable semi-annually at a rate, depending on the agreement, that is the higher of the "base rate" which is defined as the higher of 12.0% or the Banks Prime Rate plus up to 3.0%; or the Federal Funds rate plus 0.5% to 3.0%; or the Libor Index Rate plus 3.0%. The base rate is then adjusted upwards by between 2.0% and 8.0%. The principal would be payable, depending on the agreement, from between six to ten equal semi-annual installments commencing between 180 days and one year after purchase by the bank. For two series of variable rate bonds not supported by SBPA's in the amount of \$208.365 million there are take-out provisions for the conversion of these variable rate bonds to fixed rate bonds payable at a rate equal to the lower of (i) 12.0% and (ii) the higher of 8.0% or Prime Rate plus 3.0%. The principal amount of these bonds would be payable in three equal installments at 18 month increments from the conversion of the bonds to a fixed rate. Metropolitan also has one series of variable rate bonds, the 2010 Series A Special Variable Rate Water Revenue Refunding bonds, that is not supported by a SBPA and has no long-term take out provisions. The entire principal amount of \$128.005 million may be due and payable upon one week's notice from bondholders and, as a result, these bonds have been classified as current liabilities.

Except for the 2010 Series A Special Variable Rate Water Revenue Refunding bonds, the variable rate bonds have been classified as long-term obligations on the balance sheet as the SBPA or the terms of other variable rate bonds not supported by an SBPA, give Metropolitan the ability to refinance on a long-term basis under the terms of the SBPA or other agreements and Metropolitan intends to either renew the SBPA's or maintain the existing provisions of non-SBPA supported bonds or exercise its right to tender the variable rate debt as a long-term financing.

NOTES TO BASIC FINANCIAL STATEMENTS*(CONTINUED)*

June 30, 2010 and 2009

(i) Long-term Debt Obligation Summary

Interest rates on all outstanding fixed-rate obligations range from 2 percent to 6.538 percent. Interest on the variable rate debt is reset either daily or weekly based upon market conditions. Future principal and interest payments as of June 30, 2010 are as follows:

(Dollars in thousands)	Principal	Interest	Total
Year ending June 30:			
2011	\$ 123,863	\$ 152,804	\$ 276,667
2012	133,827	147,460	281,287
2013	151,027	141,714	292,741
2014	157,869	135,486	293,355
2015	147,957	129,228	277,185
2016-2020	812,871	574,617	1,387,488
2021-2025	784,862	472,835	1,257,697
2026-2030	885,625	353,172	1,238,797
2031-2035	1,001,030	201,141	1,202,171
2036-2040	675,730	36,539	712,269
	4,874,661	<u>\$ 2,344,996</u>	<u>\$ 7,219,657</u>
Unamortized bond discount, premium, and deferred amount on refundings, net	<u>(104,989)</u>		
Total debt	4,769,672		
Less current portion	<u>(246,655)</u>		
Long-term portion of debt	<u>\$ 4,523,017</u>		

6. Long-term Liabilities

Long-term liability activity for the fiscal years ended June 30, 2010 and 2009 is shown on the following table. Payments on the bonds are made from the restricted debt service funds; other long-term debt, the off-aqueduct power facilities obligation, and the compensated absences liability will be liquidated primarily with water revenues.

NOTES TO BASIC FINANCIAL STATEMENTS

(CONTINUED)

June 30, 2010 and 2009

(Dollars in thousands)	Maturity Dates	Range of Interest Rates	June 30, 2008 Restated	Additions
Waterworks general obligation bonds (Note 5):				
1966 Series H	3/1/08—3/1/37	4.60%—5.25%	\$ 40,370	\$ —
Waterworks general obligation refunding bonds:				
1993 Series A1-A2	3/1/09	8.00%	20,205	—
1998 Series A	3/1/08-1/1/14	5.20%	11,980	—
2001 Series A-B	3/1/08-3/1/22	3.625%-5.000%	38,715	—
2002 Series A	3/1/08-3/1/17	3.00%-4.25%	36,115	—
2003 Series A	3/1/08-3/1/12	3.00%-4.00%	47,150	—
2004 Series A	3/1/09-3/1/15	3.00%-5.00%	68,345	—
2005 Series A	3/1/12-3/1/21	4.125%-5.000%	64,335	—
2009 Series A	03/1/10-3/1/28	2.00%-5.00%	—	—
Total general obligation and general obligation refunding bonds			327,215	—
Water revenue bonds (Note 5):				
1992	7/1/09	5.75%	17,635	—
1997 Series A	7/1/07-7/1/08	4.60%-5.00%	13,200	—
1997 Series B-C	7/1/28	Variable	100,000	—
1999 Series A	7/1/07-7/1/09	4.700%-4.875%	4,305	—
1999 Series B-C	7/1/23-7/1/27	Variable	100,000	—
2000 Series B-1-B-4	7/1/29-7/1/35	Variable	355,200	—
2001 Series C-1-C-2	7/1/29-7/1/36	Variable	200,000	—
2003 Series B-1-B-2	10/1/23-10/1/36	5.00%	200,000	—
2003 Series B-3-B-4	10/1/07-10/1/31	2.50%-5.00%	283,935	—
2005 Series A	7/1/09-7/1/35	3.00%-5.00%	100,000	—
2005 Series B-1-B-2	7/1/14-7/1/28	Variable	100,000	—
2005 Series C	7/1/08-7/1/35	4.00%-5.00%	200,000	—
2005 Series D-1-D-2	7/1/27	Variable	—	—
2006 Series A	7/1/10-7/1/37	4.00%-5.00%	400,000	—
2006 Series B	7/1/37	Variable	—	—
2008 Series A	1/01/12-1/01/39	2.00%-5.00%	—	200,000
2008 Series B	7/1/12-7/1/20	2.00%-4.00%	—	21,615
2008 Series C	7/1/26-7/1/39	5.752%-6.250%	—	78,385
2008 Series D	7/1/21-7/1/39	5.906%-6.538%	—	—
Water revenue refunding bonds:				
1993 Series A-B	7/1/07-7/1/21	5.70%-5.80%	111,085	—
1996 Series A	6/1/08-6/1/23	Variable	70,140	—
1996 Series B	7/1/07-7/1/11	4.625%-5.000%	14,220	—
1998 Series A	7/1/07-7/1/22	4.10%-5.25%	128,750	—
2001 Series A	7/1/08-7/1/29	3.750%-5.375%	148,330	—
2002 Series A-B	7/1/07-7/1/25	Variable	128,830	—
2003 Series A	7/1/08-7/1/14	3.25%-5.00%	36,215	—
2003 Series C-1-C-3	7/1/07-7/1/30	Variable	334,070	—
2004 Series A-1-A-2	7/1/07-7/1/23	Variable	159,850	—
2004 Series B	7/1/07-7/1/16	2.00%-5.00%	266,410	—
2004 Series C	10/1/07-10/1/29	Variable	134,130	—
2006 Series A-1-A-2	7/1/07-7/1/21	Variable	74,085	—
2006 Series B	7/1/10-7/1/37	4.00%-5.00%	45,875	—
2007 Series A-1-A-2	7/1/20	Variable	—	—
2007 Series B	7/1/31-7/1/37	Variable	—	—
2008 Series A-1-A-2	7/1/08-7/1/37	Variable	501,575	—
2008 Series B	7/1/09-7/1/22	3.00%-5.00%	—	133,430
2008 Series C	7/1/09-7/1/23	3.00%-5.00%	—	79,045
2009 Series A-1-A-2	7/1/20-7/1/30	Variable	—	208,365
2009 Series B	7/1/20-7/1/30	4.00%-5.00%	—	106,690
2009 Series C	7/1/29-7/1/35	5.00%	—	91,165
2009 Series D	7/1/12-7/1/21	2.00%-5.00%	—	—
2009 Series E	7/1/12-7/1/20	3.75%-5.00%	—	—
2010 Series A	10/1/2010-10/1/2029	Variable	—	—
Total water revenue and water revenue refunding bonds			4,227,840	918,695
Other long-term debt (Note 5e):				
State revolving fund loans	7/1/08—7/1/24	2.39%—2.80%	31,271	—
Unamortized bond discount, premiums, and deferred amount on refundings, net			(50,346)	(49,843)
Total long-term debt			4,535,980	868,852
Other long-term liabilities (See table next page)			261,166	68,159
Total long-term liabilities			\$ 4,797,146	\$ 937,011

NOTES TO BASIC FINANCIAL STATEMENTS*(CONTINUED)*

June 30, 2010 and 2009

Reductions	June 30, 2009 Restated	Additions	Reductions	June 30, 2010	Amounts Due Within One Year
\$ (215)	\$ 40,155	\$ —	\$ (19,555)	\$ 20,600	\$ —
(20,205)	—	—	—	—	—
(840)	11,140	—	(11,140)	—	—
(6,435)	32,280	—	(25,345)	6,935	6,935
(3,585)	32,530	—	(3,645)	28,885	3,770
—	47,150	—	(21,035)	26,115	12,760
(2,510)	65,835	—	(2,635)	63,200	2,720
—	64,335	—	—	64,335	—
—	—	45,515	(510)	45,005	1,220
(33,790)	293,425	45,515	(83,865)	255,075	27,405
—	17,635	—	(17,635)	—	—
(13,200)	—	—	—	—	—
—	100,000	—	—	100,000	—
(2,100)	2,205	—	(2,205)	—	—
—	100,000	—	—	100,000	—
(88,800)	266,400	—	—	266,400	—
—	200,000	—	—	200,000	—
—	200,000	—	—	200,000	—
(10,120)	273,815	—	(7,430)	266,385	7,280
—	100,000	—	(4,565)	95,435	4,700
—	100,000	—	—	100,000	—
(5,885)	194,115	—	(6,125)	187,990	6,370
—	—	—	—	—	—
—	400,000	—	—	400,000	3,705
—	—	—	—	—	—
—	200,000	—	—	200,000	—
—	21,615	—	—	21,615	—
—	78,385	—	—	78,385	—
—	—	250,000	—	250,000	—
(5,900)	105,185	—	—	105,185	—
(70,140)	—	—	—	—	—
(14,220)	—	—	—	—	—
(128,750)	—	—	—	—	—
(2,230)	146,100	—	—	146,100	20,385
(4,985)	123,845	—	(123,845)	—	—
(7,855)	28,360	—	—	28,360	—
(334,070)	—	—	—	—	—
(920)	158,930	—	(970)	157,960	995
(11,315)	255,095	—	(29,685)	225,410	33,265
(680)	133,450	—	(133,450)	—	—
(60)	74,025	—	(65)	73,960	65
—	45,875	—	—	45,875	10,685
—	—	—	—	—	—
—	—	—	—	—	—
(600)	500,975	—	(925)	500,050	925
—	133,430	—	(5,185)	128,245	175
—	79,045	—	(5,830)	73,215	5,805
—	208,365	—	—	208,365	—
—	106,690	—	—	106,690	—
—	91,165	—	—	91,165	—
—	—	81,065	—	81,065	—
—	—	26,050	—	26,050	—
—	—	128,005	—	128,005	128,005
(701,830)	4,444,705	485,120	(337,915)	4,591,910	222,360
(1,774)	29,497	—	(1,821)	27,676	1,868
4,142	(96,047)	(13,973)	5,031	(104,989)	(4,978)
(733,252)	4,671,580	516,662	(418,570)	4,769,672	246,655
(63,306)	266,019	57,002	(51,224)	271,797	(35,308)
\$ (796,558)	\$ 4,937,599	\$ 573,664	\$ (469,794)	\$ 5,041,469	\$ 211,347

NOTES TO BASIC FINANCIAL STATEMENTS**(CONTINUED)**

June 30, 2010 and 2009

(Dollars in thousands)	June 30, 2008	Additions	Reductions	June 30, 2009	Additions	Reductions	June 30, 2010	Amounts Due Within One Year
Off-aqueduct power facilities (Note 9e)	\$ 66,659	\$ —	\$ (5,889)	\$ 60,770	\$ —	\$ (6,963)	\$ 53,807	\$ 6,032
Compensated absences	44,914	19,657	(17,861)	46,710	18,852	(18,540)	47,022	18,400
Customer deposits and trust funds	50,168	20,474	(28,187)	42,455	13,971	(13,606)	42,820	5,272
Other postemployment benefits (Note 8)	62,933	21,175	—	84,108	22,172	—	106,280	—
Workers' Compensation and third-party claims (Note 14)	31,079	6,819	(11,201)	26,697	1,962	(11,975)	16,684	5,564
Other long-term liabilities	5,413	34	(168)	5,279	45	(140)	5,184	40
Total other long-term liabilities	\$ 261,166	\$ 68,159	\$ (63,306)	\$ 266,019	\$ 57,002	\$ (51,224)	\$ 271,797	\$ 35,308

7. PENSION PLAN**(a) Plan Description**

Metropolitan contributes to the California Public Employees' Retirement System (CalPERS), an agent multiple-employer public employee defined benefit pension plan. All full-time Metropolitan employees are required to participate in CalPERS. CalPERS provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. CalPERS acts as a common investment and administrative agent for participating public entities within the State of California. A menu of benefit provisions as well as other requirements is established by State statutes within the Public Employee's Retirement Law. Metropolitan selects optional benefit provisions from the benefit menu by contract with CalPERS and adopts those benefits through Board approval. CalPERS issues a separate comprehensive annual report. Copies of CalPERS' annual financial report may be obtained from its Executive Office, 400 Q Street, Sacramento, CA 95811.

(b) Funding Policy

Active plan members are required to contribute 7.0 percent of their annual covered salary. Effective July 1, 2001, Metropolitan contributes the full 7.0 percent for all active plan members. In addition, Metropolitan is required to contribute the actuarially determined remaining amount necessary to fund the benefits for its members. The actuarial methods and assumptions used are those adopted by the CalPERS Board of Administration. The required employer contribution rate for fiscal year 2010 and 2009 was 11.708 percent and 11.432 percent, respectively. The contribution requirements of the plan members are established by State statute and the employer contribution rate is established and may be amended by CalPERS.

NOTES TO BASIC FINANCIAL STATEMENTS**(CONTINUED)**

June 30, 2010 and 2009

(c) Annual Pension Cost and Net Pension Obligation

Metropolitan's annual pension cost and net pension obligation (asset) to CalPERS for fiscal year 2010 and the two preceding fiscal years were as follows:

(Dollars in thousands)	June 30,		
	2010	2009	2008
Annual required contribution	\$ 36,754	\$ 35,970	\$ 34,334
Interest on net pension obligation (asset)	—	—	—
Adjustment to annual required contribution	—	—	—
Annual pension cost	36,754	35,970	34,334
Contributions made	36,754	(35,970)	(34,334)
Increase in net pension obligation (asset)	—	—	—
Net pension obligation (asset), beginning of year	—	—	—
Net pension obligation (asset), end of year	\$ —	\$ —	\$ —

For fiscal year 2010, Metropolitan's annual pension cost and contribution made was \$36,754,000. The annual pension cost includes \$13,760,000 for Metropolitan's pickup of the employee's 7.0 percent share. The required contribution was based on CalPERS June 30, 2007 actuarial valuation using the entry-age-normal actuarial cost method with the contributions determined as a percent of pay. This is the latest information available from CalPERS relating to the current fiscal year. 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 age and duration of service, and (c) an inflation component of 3.0 percent. Metropolitan's net pension obligation (asset) was being amortized as a level percentage of payroll on a closed basis. The actuarial value of CalPERS assets was determined using techniques that smooth the effect of short-term volatility in the market value of investments over a fifteen-year period (smoothed market value).

Three-Year Trend Information for CalPERS

(Dollars in millions)	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation (Asset)
Year ended June 30:			
2008	\$ 34,334	100%	\$ —
2009	\$ 35,970	100%	\$ —
2010	\$ 36,754	100%	\$ —

NOTES TO BASIC FINANCIAL STATEMENTS**(CONTINUED)**

June 30, 2010 and 2009

(d) Funded Status and Funding Progress

As of June 30, 2008, the most recent actuarial valuation date, the plan was 92.3 percent funded. The actuarial accrued liability for benefits was \$1,334.2 million, and the actuarial value of assets was \$1,231.7 million, resulting in an unfunded actuarial accrued liability (UAAL) of \$102.5 million. The covered payroll (annual payroll of active employees covered by the plan) was \$187.4 million, and the ratio of the UAAL to the covered payroll was 54.7 percent.

The schedule of funding progress, presented as required supplementary information (RSI) following the notes to the basic financial statements, presents multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

8. POSTEMPLOYMENT BENEFITS OTHER THAN PENSIONS**(a) Plan Description**

Through CalPERS, Metropolitan offers medical insurance to active and retired employees, as well as their qualified dependents. The CalPERS plan is an agent multiple-employer plan governed by the Public Employees' Medical & Hospital Care Act (PEMHCA). Under PEMHCA, health coverage for the employee continues into retirement. Current plans offered are PERS Care PPO, PERS Choice PPO, Blue Shield HMO, and Kaiser HMO. Benefit provisions are established through negotiations between Metropolitan and its various bargaining units, which also apply to retirees. This benefit was provided to 1,331 and 1,310 retired Metropolitan employees at June 30, 2010 and 2009, respectively. CalPERS issues a separate comprehensive annual report that includes financial statements for its Health Care Fund. Copies of CalPERS' annual financial report may be obtained from its Executive Office, 400 Q Street, Sacramento, CA 95811.

(b) Funding Policy

Contribution requirements are negotiated between Metropolitan and its various bargaining units. During fiscal year 2010, Metropolitan contributed up to 90% of the PERS Care PPO Los Angeles regional basic plan rate towards all plans. Funding was on a pay-as-you-go basis for fiscal year 2010 and 2009. During fiscal year 2010 and 2009, Metropolitan contributed, net of participant contributions as determined by CalPERS, \$9,839,000 and \$10,600,000, respectively.

(c) Annual OPEB Cost and Net OPEB Obligation

Metropolitan's annual other postemployment benefit (OPEB) cost is calculated based on the annual required contribution of the employer (ARC), an amount actuarially determined in accordance with the parameters of GASB Statement 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities over a defined period. In fiscal 2008, a 30-year fresh start amortization replaced the previous fiscal year's 20-year amortization period.

NOTES TO BASIC FINANCIAL STATEMENTS**(CONTINUED)**

June 30, 2010 and 2009

The annual OPEB cost and net OPEB obligation at June 30, 2010, and the two preceding fiscal years, was as follows:

(Dollars in thousands)	June 30,		
	2010	2009	2008
Annual required contribution	\$ 34,096	\$ 31,101	\$ 29,905
Interest on net OPEB obligation	4,205	3,147	2,145
Adjustment to annual required contribution	(6,290)	(2,473)	(2,083)
Annual OPEB cost	32,011	31,775	29,967
Contributions made	(9,839)	(10,600)	(10,152)
Increase in net OPEB obligation	22,172	21,175	19,815
Net OPEB obligation, beginning of year	84,108	62,933	43,118
Net OPEB obligation, end of year	\$ 106,280	\$ 84,108	\$ 62,933

For fiscal year 2010, Metropolitan's annual OPEB cost was \$32,011,000. Contributions made of \$9,839,000 were equal to the pay-as-you-go amount and represented 31 percent of the annual OPEB cost. The required contribution was based on January 1, 2009 actuarial valuation using the entry-age-normal actuarial cost method with contributions determined as a level percent of pay. The actuarial assumptions included (a) a 5.0 percent investment rate of return, (b) a 3.0 percent inflation component, and (c) healthcare cost trend rates as follows: (i) HMO - starting at 9.7 percent, grading down to 4.5 percent over nine years, (ii) PPO - starting at 10.3 percent, grading down to 4.5 percent over nine years. The assumptions used in the actuarial valuation are subject to future revisions as actual results are compared to past expectations and new assumptions are made about the future.

(d) Funded Status and Funding Progress

The funded status of the plan at January 1, 2009, was as follows:

(Dollars in thousands)	
Actuarial accrued liability (AAL)	\$ 404,172
Actuarial value of plan assets	—
Unfunded actuarial accrued liability (UAAL)	\$ 404,172
Funded ratio (actuarial value of plan assets / AAL)	0.0%
Covered payroll (active plan members)	\$ 185,400
UAAL as a percentage of covered payroll	218.0%

Actuarial valuations of the ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend.

The schedule of funding progress, presented as RSI following the notes to basic financial statements, presents multiyear trend information that shows whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

NOTES TO BASIC FINANCIAL STATEMENTS**(CONTINUED)**

June 30, 2010 and 2009

9. COMMITMENTS AND CONTINGENCIES**(a) State Water Contract (see Note 10)**

Estimates of Metropolitan's share of the projected fixed costs of the State Water Project (SWP) are provided annually by the State. The estimates are subject to future increases or decreases resulting from changes in planned facilities, refinements in cost estimates, and inflation. During the next five years, payments under the State Water Contract, exclusive of variable power costs, are currently estimated by the State to be as follows:

(Dollars in thousands)	State Water Contract Payments
Year ending June 30:	
2011	\$ 428,567
2012	\$ 435,521
2013	\$ 424,367
2014	\$ 408,777
2015	\$ 372,262

According to the State's latest estimates, Metropolitan's long-term commitments under the contract, for capital and minimum operations and maintenance costs, including interest to the year 2035, are as follows:

(Dollars in thousands)	State Water Contract Long-Term Commitments
Transportation facilities	\$ 4,481,555
Conservation facilities	1,984,210
Off-aqueduct power facilities (see Note 9e)	315,806
East Branch enlargement	643,818
Revenue bond surcharge	687,877
Total long-term SWP contract commitments	\$ 8,113,266

Metropolitan intends to exercise its option to extend its agreement with the State through 2052, which will result in annual minimum operations and maintenance costs through 2052. In addition, the amounts shown above do not contain any escalation for inflation, are subject to significant variation over time because the amounts are based on a number of assumptions, and are contingent on future events. None of the estimated long-term commitments, other than the \$53.8 million obligation related to loss accruals on certain off-aqueduct power facilities (see Note 9e), are recorded as liabilities in the accompanying basic financial statements.

Bay/Delta Regulatory and Planning Activities. The State Water Resources Control Board (State Board) is the agency responsible for setting water quality standards and administering water rights throughout California. Decisions of the State Board can affect the availability of water to Metropolitan and other water users throughout California. The State Board exercises its regulatory authority over Bay/Delta watershed supplies by means of public proceedings leading to regulations and decisions.

In September 2006, Governor Schwarzenegger established a Delta Vision Process to identify a strategy for managing the Delta as a sustainable resource. The process is tied to legislation that created a Blue Ribbon Task Force (BRTF) and cabinet-level committee (Delta Vision Committee) tasked with developing a durable vision for sustainable management of the Delta over the long term. The Delta Vision is anticipated to broaden the

NOTES TO BASIC FINANCIAL STATEMENTS**(CONTINUED)**

June 30, 2010 and 2009

focus of past efforts and recommend actions that will address the full array of natural resource, infrastructure, land use, and governance issues necessary to achieve a sustainable Delta. The BRTF released its final Delta Vision Strategic Plan in October 2008. The Delta Vision Committee considered the BRTF's final strategic plan and submitted its final implementation report to the Governor in January 2009.

The Bay Delta Conservation Plan (BDCP), which began in 2007, is a voluntary collaboration of state, federal, and local water agencies, state and federal fish agencies, environmental organizations, and other interested parties to provide a comprehensive habitat conservation and restoration program for the Delta. In addition, the BDCP will provide the basis for permits under federal and state endangered species laws for activities covered by the plan based on the best available science, identify sources of funding, provide for an adaptive management and monitoring program, and streamline the permitting process for projects covered by the plan. It is expected that the BDCP will be approved, and a permit decision will be made by mid 2012.

Other issues such as the recent decline of some fisheries in the Delta and surrounding regions and certain operational actions in the Delta have significantly impacted Metropolitan's water supply from the Delta. While the impact on future revenues of such potential actions is not known at this time, pumping restrictions in the Delta are in place to protect certain endangered species.

(b) Imperial Irrigation District

As of June 30, 2010, Metropolitan had advanced to the Imperial Irrigation District (IID) a total of \$244.7 million for construction costs, operations and maintenance costs, and indirect costs of the conservation projects. Metropolitan remains obligated to pay IID approximately \$10.1 million per year (2010 dollars) for actual operation and maintenance costs for the remainder of this agreement through at least 2041. In return, Metropolitan will receive between 85,000–105,000 acre-feet of water annually depending upon the amount used by Coachella Valley Water District. A total of at least 85,000 and 93,000 acre-feet will be/was available in calendar years 2010 and 2009, respectively, for diversion by Metropolitan (see Note 4a).

(c) Sale of Water by the Imperial Irrigation District to San Diego County Water Authority

In April 1998, the San Diego County Water Authority (SDCWA) and IID executed an agreement (Transfer Agreement) for SDCWA's purchase from IID of Colorado River water currently delivered to IID. SDCWA is a Metropolitan member agency and the largest water purchaser from Metropolitan. In October 2003 the Transfer Agreement was revised as part of the Quantification Settlement Agreement (QSA) and sets the transfer amount at 200,000 acre-feet per year, with transfers ramping up to that amount over an approximate 20-year period (see Note 9d).

No facilities presently exist to provide for delivery of water directly from IID to SDCWA. The Transfer Agreement provides that IID water be delivered to SDCWA through existing facilities owned by Metropolitan. On November 10, 1998, the boards of directors of Metropolitan and SDCWA authorized execution of an exchange contract, which provides for transfer to Metropolitan of conserved water that SDCWA receives from IID pursuant to the Transfer Agreement and delivery of a like quantity of water by Metropolitan to SDCWA. The exchange contract was amended and restated pursuant to the QSA. The price payable by SDCWA for conveyance of these deliveries will be the charges set by Metropolitan's Board from time to time that are applicable to the conveyance (or wheeling/exchange) of water by Metropolitan on behalf of its member agencies (see Note 1c).

NOTES TO BASIC FINANCIAL STATEMENTS**(CONTINUED)**

June 30, 2010 and 2009

(d) Quantification Settlement Agreement

The Quantification Settlement Agreement (QSA) is part of the California Plan, which is a plan to reduce California's use of Colorado River water to its basic apportionment of 4.4 million acre-feet per year when necessary through water conservation, transfers from higher priority agricultural users to Metropolitan's service area, and storage programs. The QSA was executed in October 2003 and establishes Colorado River water use limits for IID, the Coachella Valley Water District (CVWD), and Metropolitan. It also provides for specific acquisitions of conserved water and water supply arrangements for up to 75 years and restores the opportunity for Metropolitan to receive any special surplus water.

On February 11, 2010, the Sacramento Superior Court issued its judgment in consolidated cases filed to determine or challenge the validity of the QSA and associated agreements. The court ruled that the QSA Joint Powers Agreement (pursuant to which IID, CVWD and SDCWA agreed to commit \$163 million toward certain mitigation and restoration costs associated with implementation of the OSA and related agreements, and the State agreed to be responsible for any costs exceeding this amount) was invalid because the State's commitment was unconditional in nature and, as such, violated the State's debt limitation under the California Constitution. The court also invalidated eleven other agreements, including the QSA, because they were inextricably interrelated with the QSA Joint Powers Agreement. Metropolitan, IID, CVWD, SDCWA, the State and others have appealed various aspects of the court's ruling, which has been stayed pending outcome of the appeal. If the ruling stands, it could delay the implementation of programs authorized under the QSA or result in increased costs or other adverse impacts. The impact, if any, that the ruling might have on Metropolitan's water supplies cannot be determined at this time.

(e) Abandoned Off-Aqueduct Power Facilities

The state Department of Water Resources (DWR) has financed the construction of certain off-aqueduct power facilities in order to provide power for water transportation purposes for the State Water Project system. Two geothermal facilities have been abandoned by DWR due to insufficient steam supply to operate the plants at their planned capacities. As a result of these actions by DWR, Metropolitan recorded losses of \$204.1 million in prior fiscal years. Metropolitan's estimated remaining long-term contractual obligations for these facilities as of June 30, 2010, which are based on the State's latest estimates, including average interest of 5.5 percent through the year 2024, are shown in the following table (see Note 6):

(Dollars in thousands)	Principal	Interest	Total
Year ending June 30:			
2011	\$ 6,032	\$ 3,071	\$ 9,103
2012	6,460	2,653	9,113
2013	10,348	2,200	12,548
2014	8,314	1,465	9,779
2015	4,142	1,196	5,338
2016-2020	10,768	3,420	14,188
2022-2027	7,743	1,031	8,774
Total obligations	53,807	<u>\$ 15,036</u>	<u>\$ 68,843</u>
Less current portion	<u>(6,032)</u>		
Long-term portion of obligations	<u>\$ 47,775</u>		

NOTES TO BASIC FINANCIAL STATEMENTS**(CONTINUED)**

June 30, 2010 and 2009

(f) Construction Programs and Contracts

At June 30, 2010, the estimated cost, excluding contingencies, of Metropolitan's capital program through fiscal year 2015 totals approximately \$1.794 billion, includes escalation of 2.77 percent per year for unfunded components of capital programs.

Over the next three years, approximately \$1 billion dollars is budgeted in the capital program, with over \$280 million planned for the Diemer and Weymouth ORP, Solids Handling Facilities at the Jensen and Mills treatment plants, and the electrical upgrades at the Weymouth water treatment plant.

The capital program also includes \$417.7 million of estimated costs for facilities that may be required to meet current water quality standards (see Note 9h) and \$366.8 million for San Diego Pipeline No. 6.

Metropolitan had commitments under construction contracts in force as follows:

(Dollars in thousands)	June 30,	
	2010	2009
Inland Feeder Project	\$ 5,399	\$ 37,513
Filtration plants and oxidation retrofit project	91,315	153,901
Weymouth treatment plant coagulant tank farm modification	3,022	5,418
Distribution system-air release and vacuum valve replacements	2,617	1,215
Weymouth plant Power System Upgrade	22,896	—
Weymouth Plant Inlet Conduit Relocation and Rapid Mix	20,776	—
Perris Valley pipeline	8,895	17,609
Diemer Plant North Access Road	7,330	—
Jensen water treatment plant solids thickeners 5 & 6	—	3,334
Other	2,778	4,194
Total	\$ 165,028	\$ 223,184

These commitments are being financed primarily with revenue bonds secured by Metropolitan's net operating revenues.

(g) Claims and Litigation

In July 1998, a case entitled *Dewayne Cargill et al. v. Metropolitan Water District of Southern California et al.* was filed against Metropolitan. This case is a class action lawsuit brought by various categories of temporary workers against Metropolitan and certain temporary agencies, claiming that Metropolitan misclassified them as temporary workers to avoid providing them the same rights and benefits given to regular employees, and seeking the full benefits of public employment, including membership in the California Public Employees' Retirement System (PERS) on a retroactive basis.

The parties initially litigated the legal standard of eligibility for PERS benefits. PERS intervened in support of plaintiffs' position that the common law standard of employment governs. On February 26, 2004, in a case of first impression, the California Supreme Court ruled that Metropolitan is required to enroll in PERS all temporary workers who would be considered Metropolitan employees under California common law. The Supreme Court did not decide whether plaintiffs are in fact common law employees of Metropolitan, whether plaintiffs (if they are determined to be Metropolitan employees for PERS purposes) are entitled to enrollment

NOTES TO BASIC FINANCIAL STATEMENTS**(CONTINUED)**

June 30, 2010 and 2009

in PERS as of the dates they were first employed, whether plaintiffs are Metropolitan's employees for any purpose other than PERS enrollment, or whether they are entitled to any benefits as employees under other provisions of law.

The legal issue heard by the California Supreme Court was limited to the standard of eligibility for PERS benefits and did not address plaintiffs' claims for rights and benefits under Metropolitan's Administrative Code. The parties reached a court-approved settlement of the Administrative Code claim. Pursuant to the settlement, Metropolitan paid \$35.0 million to a settlement fund. The remaining portion of the case concerns implementing the Supreme Court's ruling establishing common law eligibility for PERS benefits. That effort involves enrolling eligible temporary workers, resolving eligibility disputes, and addressing the potential penalties associated with late PERS enrollment. The parties agreed to address eligibility disputes by submitting test cases before administrative judges covering different categories of temporary worker services. Metropolitan received an adverse determination from PERS on the penalty issue. While Metropolitan continues to maintain that PERS should not apply any penalty provision, the parties have entered into a settlement agreement that fully resolves plaintiffs' PERS claim. The settlement provides for a claims process which Metropolitan estimates will result in approximately 1,500 claims for PERS benefits. The estimated potential liability is in the range of \$15.0 million to \$30.0 million.

On April 25, 2005, a group of 14 State Water Project contractors filed suit against the Department of Water Resources challenging the manner in which it allocates certain energy costs and revenues related to operation of the State Water Project. Among other things, these contractors allege that the Department of Water Resources has been and is administering certain provisions of State Water Contract incorrectly, depriving them of "all benefits" derived from the sale or other disposal of electrical energy generated at the Hyatt-Thermalito power facility. The plaintiffs have not alleged specific amounts for damages. Metropolitan and 12 other State Water Project contractors have intervened in the litigation. Metropolitan believes that Hyatt-Thermalito energy costs and revenues have been and are being allocated by the Department of Water Resources in a manner that is both legal and equitable. However, if plaintiffs are successful, tens of millions of dollars in annual costs could be shifted from State Water Project contractors located north of the Tehachapi Mountains to State Water Project contractors located south of the Tehachapi Mountains and on the Central Coast, including Metropolitan. In November 2006, the trial court divided the litigation into two phases, liability and damages. In March 2007, the court further divided the liability phase into a contract interpretation phase and an affirmative defenses phase. After a trial limited to contract interpretation issues, on September 14, 2009, the court rejected all of the plaintiffs' assertions and on April 19, 2010, the court dismissed all remaining claims without leave to amend. The court entered its final statement of decision and final judgment in favor of defendants on May 3, 2010. Plaintiffs filed a notice of appeal on July 1, 2010.

A number of other suits and claims arising in the normal course of business are pending against Metropolitan. In the opinion of Metropolitan's General Counsel, the adverse results, if any, of such legal actions on these suits and claims will not have a material effect on Metropolitan's financial position.

(h) Drinking Water Quality Standards

Under the Safe Drinking Water Act Amendments of 1996, Congress required the United States Environmental Protection Agency to set new drinking water quality standards. New standards to control microbial pathogens and disinfection byproducts (DBPs) became effective in 2002. These rules are known as the Interim Enhanced Surface Water Treatment Rule and the Stage 1 Disinfectants/Disinfection By-Product Rule. These standards

NOTES TO BASIC FINANCIAL STATEMENTS**(CONTINUED)**

June 30, 2010 and 2009

became more stringent in a second set of regulations effective 2006. The second set of regulations (the Stage 2 Disinfectants/Disinfection Byproducts Rule and the Long-Term 2 Enhanced Surface Water Treatment Rule) did not require additional capital investment by Metropolitan.

Metropolitan identified ozone disinfection as the most cost-effective option to minimize the production of DBPs and achieve other water quality objectives. Ozone is being installed as the primary disinfectant at all five of Metropolitan's treatment plants. Ozone is in various stages of implementation. It is operational at the Mills and Jensen plants, is under construction at the Skinner and Diemer plants, and is in design at the Weymouth plant. It will be operational at these three remaining plants between 2012 and 2014. The estimated cost of implementing ozone treatment at all five plants is approximately \$1.30 billion.

(i) Arbitrage Rebate Obligation

At June 30, 2010 and 2009, Metropolitan had general obligation and revenue bonds outstanding which are subject to arbitrage limitations. The term arbitrage rebate refers to the required payment to the U.S. Treasury of excess earnings received on applicable tax-exempt bond proceeds that are invested at a higher yield than the yield of the tax-exempt bond issue. Metropolitan's ultimate rebate of arbitrage earnings on these issues is contingent on various factors, including future yields on invested proceeds.

As of June 30, 2010 and 2009, Metropolitan's recorded arbitrage rebate liability was \$66,000 and \$55,000, respectively. The rebate obligations are generally computed and adjusted, as applicable, on an annual basis in accordance with regulations promulgated by the U.S. Treasury Department. Required rebates are generally due and payable in five-year intervals during the life of debt issues, with final rebates due upon the retirement of the debt issues.

(j) Landfill Obligation

Federal and State laws and regulations require that Metropolitan perform certain maintenance and monitoring functions at its sole landfill site for 30 years after closure. They further require that a separate funding mechanism be established to ensure that sufficient funds are available for closure and postclosure costs. In October 1995, the landfill was closed and management's estimate of closure and postclosure costs for this site totaled approximately \$2.0 million. The required thirty-year postclosure maintenance and monitoring of the landfill officially started in January 1998, after the installation of the landfill's final cover was completed. During fiscal year 2010 and 2009, \$50,000 and \$48,000, respectively was expended for postclosure maintenance and monitoring activities.

The actual cost of postclosure care may be higher due to inflation, changes in technology, or changes in landfill laws or regulations. Funding of these costs has been derived from a separate trust account that has been established for closure and postclosure costs. The balance of the trust account is sufficient to cover the landfill liability. At June 30, 2010 and 2009, approximately \$919,000 and \$969,000 net of interest receipts and disbursements were available, respectively, in this account.

(k) Purchase Commitments

Metropolitan has firm obligations in the forward power markets. These obligations were entered into to mitigate energy price volatility. Metropolitan's forward purchase obligations at June 30, 2010 are \$22.9 million for fiscal year 2011 and \$11.8 million for fiscal year 2012.

NOTES TO BASIC FINANCIAL STATEMENTS**(CONTINUED)**

June 30, 2010 and 2009

10. PREPAID STATE WATER PROJECT COSTS

State Water Project activity for the fiscal year ended June 30, 2010 and 2009 was as follows:

(Dollars in thousands)	June 30, 2008	Additions	Reductions	June 30, 2009	Additions	Reductions	June 30, 2010
State Water Project costs	\$ 3,974,016	\$ 83,286	\$ (47,801)	\$ 4,009,501	\$ 177,333	\$ (37,371)	\$ 4,149,463
Accumulated amortization	(2,486,220)	(123,470)	—	(2,609,690)	(128,294)	—	(2,737,984)
State Water Project costs, net	\$ 1,487,796	\$ (40,184)	\$ (47,801)	1,399,811	\$ 49,039	\$ (37,371)	1,411,479
Less current portion				123,470			128,294
Noncurrent portion				\$ 1,276,341			\$ 1,283,185

Metropolitan is one of 29 water suppliers contracting with the State of California for a system to provide water throughout much of California. Under the terms of the State Water Contract, as amended, Metropolitan is obligated to pay allocable portions of the cost of construction of the system and ongoing operations and maintenance costs through at least the year 2035, regardless of the quantities of water available from the project (see Note 9a). Metropolitan and the other contractors may also be responsible to the State for certain obligations of any contractor who defaults on its payments to the State.

Approximately 27 percent and 24 percent of Metropolitan's total expenditures during fiscal years 2010 and 2009, respectively, pertained to its net payment obligations for the State Water Project. These payments were primarily based on contractual water delivery entitlements, the requested and actual deliveries received, and the cost of power required for such deliveries, offset by credits received from the project.

Management's present intention is to exercise Metropolitan's option to extend the contractual period to at least 2052, under substantially comparable terms. This corresponds to an estimated 80-year service life for the original facilities. The State is obligated to provide specified quantities of water throughout the life of the contract, subject to certain conditions.

The State has power generation facilities associated with its reservoirs and aqueducts. In addition to these power facilities, the State has, either on its own or through joint venture, financed certain off-aqueduct power facilities (OAPF). The power generated is utilized by the system for water transportation purposes. Power generated in excess of system needs is marketed to various utilities and California's power market. The revenues resulting from sales of excess power reduce the costs of pumping. Metropolitan and the other water contractors are responsible for repaying the capital and operating costs of the OAPF regardless of the amount of power generated (see Note 9e).

Metropolitan defers its share of system construction costs as prepaid State Water Project costs when such costs are billed by the State (see Note 9a). Unamortized prepaid State Water Project costs essentially represent a prepayment for future water deliveries through the State system. Metropolitan's share of system operations and maintenance costs is charged to expense.

Metropolitan amortizes a portion of prepaid State Water Project costs each month using a formula that considers the total estimated cost of the project, the estimated useful life, and estimated production capacity of the assets based upon information provided by the State of California. In fiscal year 2006, the formula was modified to use entitlements in place of deliveries as the production capacity estimate. Amortization expense totaled \$128.3 million and \$123.5 million in fiscal years 2010 and 2009, respectively.

NOTES TO BASIC FINANCIAL STATEMENTS**(CONTINUED)**

June 30, 2010 and 2009

II. DEPOSITS, DEFERRED CHARGES, AND OTHER

Balances at June 30, 2010 and 2009 were as follows:

(Dollars in thousands)	June 30,	
	2010	2009
Deferred water rights	\$ 85,938	\$ 83,183
Deferred charges-Kern Delta	—	32,729
Deferred charges-Delta Habitat	25,124	8,057
Deferred charges-Bay/Delta	4,771	7,397
Prepaid expenses	27,128	27,525
Feasibility studies	19,365	20,274
Other	16,847	4,951
Total deposits, deferred charges and other	179,173	184,116
Less current portion	(46,506)	(23,185)
Noncurrent portion	\$ 132,667	\$ 160,931

(a) Deferred Water Rights

Metropolitan has entered into several water exchange and storage agreements with other agencies. These agreements provide Metropolitan with additional reliable water supplies to supplement deliveries of Colorado River and State Water Project water. Metropolitan is also actively pursuing other agreements, both within and outside its service area, to provide additional water supplies. The exchange and storage agreements generally provide for advance delivery of water during periods when water is available. At a later time when water is needed, these programs can then return water to improve Metropolitan's reliability. Expenditures associated with these agreements have been recorded as deferred charges and are charged to cost of water as the rights are exercised. At June 30, 2010 and 2009, deferred water rights totaled approximately \$85.9 million and \$83.2 million, respectively, based on volumes of 400,000 acre-feet and 552,000 acre-feet, as of such dates.

(b) Deferred Charges—Kern Delta

Metropolitan entered into an agreement with the Kern Delta Water District for the development of a water management program. The agreement includes a Regulation Program and a Transportation Program. Under the terms of the Regulation Program, Kern Delta will regulate the storage and delivery for Metropolitan of up to 250,000 acre-feet of water and currently has 14,821 acre-feet in the program. The program is intended to provide a minimum recharge and return capability of 50,000 acre-feet annually. Construction of infrastructure is required in order to meet the program's dry year minimum return. These costs were recorded as deferred charges until construction was completed in June of 2010. This project is recorded as a participation right at June 30, 2010 (See Note 4c).

The transportation program provides Metropolitan with priority rights to convey water acquired by Metropolitan from third parties through the Kern-Delta facilities to the California Aqueduct for ultimate delivery to Metropolitan. This program terminates on December 31, 2029. Metropolitan is currently negotiating an amendment to the program that will extend the term to November 4, 2035.

(c) Delta Habitat Conservation and Conveyance

In March 2009, Metropolitan, other State Water Project contractors, federal Central Valley Project contractors, and the U.S. Department of Interior's Bureau of Reclamation entered into funding agreements with the California Department of Water Resources. The agreements are known collectively as the Delta

NOTES TO BASIC FINANCIAL STATEMENTS**(CONTINUED)**

June 30, 2010 and 2009

Habitat Conservation and Conveyance Program (DHCCP) Funding Agreement. Metropolitan's three-year agreement provides funding of approximately \$35 million for Metropolitan's share (24 percent) of the costs for environmental analysis, planning and design of Delta conservation measures including Delta conveyance options. The DHCCP agreement is intended to support and complement certain activities of the Bay Delta Conservation Plan for restoration of the California Delta. If the DHCCP is approved for construction, DWR intends to issue revenue bonds in an amount sufficient to reimburse Metropolitan for all funding. If the DHCCP is not approved to proceed with construction, no reimbursement will occur.

(d) Deferred Charges—Bay/Delta

In December 1994, representatives from state and federal resource agencies, and urban, agricultural, and environmental agencies agreed to a set of principles to implement a protection plan for the San Francisco Bay/Delta Estuary. Among the principles was a commitment by agricultural and urban water agencies to fund \$60.0 million to help initiate a comprehensive program to address nonoutflow-related impacts to the Bay/Delta environment. The Secretary of the Interior requested Metropolitan to guarantee \$10.0 million annually for three years, for a total of \$30.0 million, to be made available for the restoration fund created by the principles. Metropolitan's final payment of its \$30.0 million commitment was made in June 1998. Metropolitan's contributions are accounted for as deferred charges that are charged to expense based on expenses by the restoration fund. The amount charged to expense totaled \$2.6 million and \$69,000 for fiscal years ended June 30, 2010 and 2009, respectively. During fiscal year 2001, Metropolitan became trustee for the unspent funds, which totaled \$4.8 and \$7.4 million at June 30, 2010 and 2009, respectively.

(e) Feasibility Studies/Reimbursable Projects

Metropolitan conducts studies to determine if construction projects are feasible. The costs of these studies are recorded as deferred charges until the study has been completed. If the study shows that the project is feasible, the study costs are capitalized as project costs. Otherwise, the study costs are charged to operating expense.

Reimbursable projects include work Metropolitan is contracted to perform for outside, non-related parties, and is subsequently billed for reimbursement.

12. DEFERRED COMPENSATION AND SAVINGS PLANS

For the benefit of its employees, Metropolitan has adopted a deferred compensation plan in accordance with Section 457 of the Internal Revenue Code. Generally, eligible employees may defer receipt of a portion of their salary until termination, retirement, death, or unforeseeable emergency. Until the funds are paid or otherwise made available to the employee, the employee is not obligated to report the deferred salary for income tax purposes. Metropolitan's Treasurer serves as trustee for the plan.

Prior to November 2003, Metropolitan managed the investment of the funds. The plan assets, together with the corresponding liability, were included in the basic financial statements. In November 2003, the plan assets were transferred to a third-party administrator. Accordingly, at June 30, 2010 and 2009, neither the plan assets nor the related liability were included in the accompanying basic financial statements.

NOTES TO BASIC FINANCIAL STATEMENTS**(CONTINUED)**

June 30, 2010 and 2009

Metropolitan has established another compensation deferral arrangement in accordance with Section 401(k) of the Internal Revenue Code. The 401(k) Savings Plan is available to substantially all employees. At June 30, 2010 and 2009, 1,816 and 1,841 employees participated in the combined 401(k) plan. Amounts deferred by participants, Metropolitan matching contributions, and accumulated earnings thereon are fully vested. Deferred amounts and matching contributions are transferred by Metropolitan each pay period to a third-party administrator who coordinates the investment of such proceeds in a variety of investment vehicles in accordance with the instructions of each participant. The Treasurer serves as Trustee for each plan. Metropolitan is not liable to its employees for any losses that may be incurred in connection with their participation in such plans.

Metropolitan has established a matching contribution program on behalf of each participating employee in the savings plan. Metropolitan's contribution is subject to a maximum of 4.5 percent of the employee's total cash compensation.

Contributions to the savings plans were as follows:

(Dollars in thousands)	June 30,	
	2010	2009
Employees	\$ 18,351	\$ 17,695
Metropolitan	7,648	7,537
	<u>\$ 25,999</u>	<u>\$ 25,232</u>
Eligible payroll	\$ 198,866	\$ 195,755
Employee contributions as percent of eligible payroll	<u>9.2%</u>	<u>9.0%</u>

13. NET ASSETS

GASB 34 requires that the difference between assets and liabilities be reported as net assets. Net assets are classified as either restricted, unrestricted, or invested in capital assets and State Water Project Costs, net of related debt.

Net assets that are invested in capital assets and State Water Project costs, net of related debt consist of capital assets, net of accumulated depreciation and amortization, and reduced by the outstanding balances of any bonds, notes, or other borrowings attributable to the acquisition or construction of those assets. Metropolitan's capital assets and State Water Project costs include plant and equipment, and participation rights (see Note 2) and prepaid State Water Project costs (Notes 1h and 10). Approximately \$5.2 billion and \$5.1 billion were invested in capital assets and State Water Project costs, net of related debt at June 30, 2010 and 2009, respectively.

Restricted net assets are those net assets that have external constraints placed on them by creditors, grantors, contributors, or laws or regulations of other governments, or imposed by law through constitutional provisions of enabling legislation. Restricted net assets totaled \$468.5 million and \$461.2 million at June 30, 2010 and 2009, respectively, of which \$76.6 million and \$80.0 million were restricted by enabling legislation at June 30, 2010 and 2009, respectively.

NOTES TO BASIC FINANCIAL STATEMENTS**(CONTINUED)**

June 30, 2010 and 2009

Unrestricted net assets consist of net assets that do not meet the definition of “restricted” or “invested in capital assets and State Water Project costs, net of related debt.” Unlike the restricted net assets, the Board has discretion in determining the use and establishing minimum/maximum balance requirements for the unrestricted cash and investment portion of net assets. The Board may at any time change or eliminate amounts established for these purposes. Unrestricted net assets totaled \$434.1 million and \$503.2 million at June 30, 2010 and 2009, respectively.

Certain of the unrestricted amounts have been designated. The designated balances at June 30, 2010 and 2009 were as follows:

(Dollars in thousands)	June 30,	
	2010	2009
Water rate stabilization	\$ 80,926	\$ 110,411
Working capital	219,810	215,321
State water contract	68,865	71,303
Water transfer	—	12,045
Self-insurance retention	25,386	24,875
Replacement and refurbishment	34,024	33,799
Desalination	18,854	18,601
Total designated balances	\$ 447,865	\$ 486,355

Metropolitan established the water rate stabilization account for the purpose of identifying amounts available at the end of the year to mitigate future water rate increases. The maximum level authorized in this account is based on two years of revenue shortfall estimates. The working capital account was established for general purposes to be used in the event that revenues are insufficient to pay current costs. The amount in the account is based on an 18-month revenue shortfall estimate—this is the minimum balance. The water transfer account was established to set monies aside for the purchase of water through transfers or similar arrangements, and for the costs of filling Diamond Valley Lake. The water stewardship account was established to pay costs, including administrative costs, associated with recycling, seawater and brackish water desalination, conservation, or other demand management programs. The self-insurance retention account was established for emergency repairs and claims against Metropolitan. The replacement and refurbishment account was established to pay for certain capital expenditures on a current basis in lieu of using bond funds. Finally, the Board designated certain monies in the general account for future desalination facilities.

14. RISK MANAGEMENT

Metropolitan is exposed to various risks of loss related to design, construction, treatment, and delivery of water resources. Metropolitan self-insures most Metropolitan property losses, the first \$25 million for general liability and \$5 million for workers' compensation. Metropolitan supplements its self-insurance program with \$75 million excess general liability coverage and \$50 million excess workers' compensation insurance. Excess liability policies also purchased include \$60 million for fiduciary liability and \$65 million for directors' and officers' liability. Specialty insurance policies purchased include aircraft hull and liability, crime insurance, and travel accident coverage. Coverage types and limits for fiscal year 2010 were unchanged from fiscal year 2009. Settlement amounts did not exceed the self-insurance or insurance coverage limits in any of the past three years.

NOTES TO BASIC FINANCIAL STATEMENTS**(CONTINUED)**

June 30, 2010 and 2009

Metropolitan has had, and recently concluded owner-controlled insurance programs (OCIP) to cover all work on the Diamond Valley Lake project and the Inland Feeder project. These owner-controlled insurance programs (OCIP's) provided coverage for all contractors, subcontractors, and construction managers on the project. Funds totaling \$41.9 million have been approved for the Diamond Valley Lake OCIP. As of June 30, 2010, \$40.0 million had been expended. Funds totaling \$18.7 million have been approved for the Inland Feeder OCIP. As of June 30, 2010, \$16.0 million had been expended. Though the OCIP's have been concluded, workers' compensation and liability coverages remain in place for open claims and those incurred but not reported.

Liabilities are reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. Liabilities include an estimated amount for claims that have been incurred but not reported (IBNR). Claims liabilities are calculated considering the effects of inflation, recent claim settlement trends including frequency and amount of payouts, and other economic and social factors. Changes in the balances of claims liabilities during the past two fiscal years were as follows:

(Dollars in thousands)	June 30,		
	2010	2009	2008
Unpaid claims, beginning of fiscal year	\$ 26,697	\$ 31,079	\$ 36,593
Incurred claims (including IBNR)	1,962	6,819	22,010
Claim payments and adjustments	(11,975)	(11,201)	(27,524)
Unpaid claims, end of fiscal year	16,684	26,697	31,079
Less current portion	(5,564)	(6,059)	(9,413)
Noncurrent portion	\$ 11,120	\$ 20,638	\$ 21,666

15. SUBSEQUENT EVENTS

On July 22, 2010, Metropolitan issued \$88,845,000 of Water Revenue Refunding Bonds, 2010 Series B at a true interest cost of 3.246 percent, to refund \$50,000,000 of Water Revenue Bonds, 2005 Authorization Series B-1 and \$50,000,000 of Water Revenue Bonds, 2005 Authorization Series B-2. Their maturities extend to July 1, 2027 and are subject to optional redemption provisions.

On July 22, 2010 the obligations under four interest rate swap agreements were assigned by UBS AG to Deutsche Bank AG pursuant to novation transactions dated July 22, 2010. The swaps have a notional amount outstanding of \$311,735,000 and a market value of \$(18,677,367) and are considered terminated as of July 22, 2010. As a result of this transaction, a loss of 18,677,367 may be recognized in Metropolitan's fiscal 2011 financial statements. GASB is currently preparing a Technical Bulletin that will address novation of derivative instruments. The Technical Bulletin is expected to be issued in January of 2011 and, as such, its impact on the accounting for this transaction is currently unknown.

On October 13, 2010, Metropolitan issued \$39,430,000 of Waterworks General Obligation Refunding Bonds, 2010 Series A at a true interest cost of 3.745 percent, to refund \$21,220,000 of Waterworks General Obligation Refunding Bonds, 2002 Series A and \$20,600,000 of Waterworks General Obligation Bonds, Election 1966, Series H. Their maturities extend to March 1, 2037 and are subject to optional redemption provisions.

REQUIRED SUPPLEMENTARY INFORMATION—UNAUDITED

June 30, 2010 and 2009

Funding Progress of Pension Plan

The table below provides a three-year history of the funded status of Metropolitan's pension plan. The information reflects the most recent actuarial valuation and the two preceding valuations from CalPERS.

(Dollars in thousands)

Actuarial Valuation Date	Entry Age Normal Accrued Liability	Actuarial Asset Value	Unfunded Liability/ (Excess Assets)	Funded Ratio	Covered Payroll	Unfunded Actuarial Liability/ (Excess Assets) as Percentage of Covered Payroll
June 30:						
2006	\$ 1,140,159	\$ 1,062,646	\$ 77,513	93.2%	\$ 163,111	47.5%
2007	\$ 1,247,881	\$ 1,153,108	\$ 94,773	92.4%	\$ 180,022	52.6%
2008*	\$ 1,334,233	\$ 1,231,714	\$ 102,519	92.3%	\$ 187,367	54.7%

Funding Progress of Other Postemployment Benefits

The table below provides a history of the funded status of Metropolitan's OPEB obligation. The information reflects the most recent biennial actuarial valuation and the preceding biennial valuations.

(Dollars in thousands)

Actuarial Valuation Date	Accrued Liability	Actuarial Asset Value	Unfunded Liability	Funded Ratio	Covered Payroll	Unfunded Actuarial Liability as Percentage of Covered Payroll
1/1/05	\$ 310,461	\$ —	\$ 310,461	0.00%	\$ 161,990	191.6%
6/30/07	\$ 393,476	\$ —	\$ 393,476	0.00%	\$ 170,059	231.4%
1/1/09*	\$ 404,172	\$ —	\$ 404,172	0.00%	\$ 185,400	218.0%

See accompanying independent auditors' report.

*Most recent actuarial valuation date.