

COMPARATIVE STATISTICS

(Dollars in Thousands)

	2004	2003	2002	2001	2000
ELECTRIC REVENUES (1)					
Retail Revenues					
Residential	\$ 89,767	\$ 82,272	\$ 70,677	\$ 64,073	\$ 59,335
Commercial	62,520	55,736	49,165	45,991	45,202
Industrial	41,694	37,806	35,864	34,368	33,823
Other	8,398	7,813	6,594	6,704	6,426
Total Retail Revenue	202,379	183,627	162,300	151,136	144,786
Wholesale Revenue	28,351	20,757	12,572	210,825	70,784
Total Electric Revenue	\$ 230,730	\$ 204,384	\$ 174,872	\$ 361,961	\$ 215,570
ELECTRIC KWH SALES (000) (1)					
Retail kWh					
Residential	861,273	847,031	792,809	758,886	772,252
Commercial	725,387	697,419	675,996	648,883	653,715
Industrial	766,018	741,435	749,756	731,484	756,283
Other	106,910	107,968	99,302	91,326	75,185
Total Retail Sales	2,459,588	2,393,853	2,317,863	2,230,579	2,257,435
Wholesale Sales	526,572	505,733	477,800	1,047,171	426,228
Total Electric Sales	2,986,160	2,899,586	2,795,663	3,277,750	2,683,663
RETAIL CUSTOMERS AT YEAR END					
Residential	88,741	86,650	84,381	82,833	80,326
Commercial	11,319	10,995	10,378	10,250	9,719
Industrial	155	150	136	129	108
Other	5,488	5,428	5,356	5,252	5,077
Total Retail Customers	105,703	103,223	100,251	98,464	95,230
RETAIL REVENUE PER KWH SOLD (CENTS)					
Residential	10.4	9.7	8.9	8.4	7.7
Commercial	8.6	8.0	7.3	7.1	6.9
Industrial	5.4	5.1	4.8	4.7	4.5
Other	7.9	7.2	6.6	7.3	8.5
System Average	8.2	7.7	7.0	6.8	6.4
WHOLESALE REVENUE PER KWH SOLD (CENTS)					
	5.4	4.1	2.6	20.1	16.6
FINANCIAL RATIOS					
Operating Ratio	0.88	0.96	1.00	0.99	0.91
Current Ratio	1.27	0.85	0.97	1.41	0.87
Quick Ratio	0.92	0.48	1.02	1.19	0.65
Debt Ratio	0.86	0.83	0.83	0.84	0.93
Debt Service Coverage - Sr. Lien Debt	3.23	1.81	1.42	1.44	2.37
Debt Service Coverage - Jr. Lien Debt	1.51	1.50	1.56	1.71	2.29
POWER SUPPLY (GWH)					
Power Purchased	2,594.6	2,537.5	2,607.5	3,224.6	2,331.2
Power Generated	459.2	475.5	293.9	415.6	492.5
Total System Requirements	3,053.8	3,013.0	2,901.4	3,640.2	2,823.7
ANNUAL SYSTEM PEAK LOAD (MWH)					
	606.4	624.2	599.9	568.7	570.5

(1) Amounts for 2004, 2003 & 2002 include unbilled revenue and consumption reflecting an implemented accounting change.
kWh = kilowatthours; MWh = megawatthours; GWh = gigawatthours

LONG TERM DEBT SUMMARY

(Dollars in Thousands)

	2004	2003	2002	2001	2000
OUTSTANDING DEBT AT YEAR END					
MODESTO IRRIGATION DISTRICT DEBT					
ELECTRIC DEBT					
1967 Don Pedro G. O. Bonds	\$ 985	\$ 1,930	\$ 2,835	\$ 3,705	\$ 4,535
1991 Series A Refunding of 1989 C.O.P.S	-	-	-	-	715
1992 Series A Woodland Station Bonds	-	-	-	1,050	2,040
1996A Geysers Refunding Revenue Bonds	93,445	99,520	105,305	110,815	116,075
1996 Certificates of Participation	-	-	32,800	32,800	32,800
1999A Certificates of Participation	51,936	55,656	59,226	62,651	65,211
1999B Certificates of Participation	44,440	45,895	47,280	47,540	47,785
2001A Certificates of Participation	95,050	96,855	98,600	98,600	-
2003A Certificates of Participation	91,650	93,225	-	-	-
2004A Certificates of Participation	50,000	-	-	-	-
2004B Certificates of Participation	66,025	-	-	-	-
	\$ 493,531	\$ 393,081	\$ 346,046	\$ 357,161	\$ 269,161

DOMESTIC WATER DEBT

1992 Series B Domestic Water Mini Bonds	-	-	-	5,058	5,058
1998 D Refunding Revenue Bonds – Domestic Water	79,490	82,145	84,660	87,070	89,385
	\$ 79,490	\$ 82,145	\$ 84,660	\$ 92,128	\$ 94,443

Total Outstanding MID Debt

	\$ 573,021	\$ 475,226	\$ 430,706	\$ 449,289	\$ 363,604
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MID SHARE OF JOINT POWER AGENCY (JPA) DEBT MSR PUBLIC POWER AGENCY - 50%

1991 Series E Southwest Transmission Bonds	\$ -	\$ -	\$ -	\$ -	\$ 39,453
1993 Series F Refunding San Juan A Bonds	10,205	10,205	40,433	42,510	44,480
1997 Series G Refunding San Juan C Bonds	28,810	29,333	29,830	30,308	35,273
1997 Series H Refunding San Juan D Bonds	-	40,860	41,338	41,788	42,213
2001 Series I Refunding San Juan E Bonds	32,115	32,115	32,115	32,115	-
1995 Series B Refunding San Juan B Bonds	8,750	8,750	8,750	8,750	8,750
1995 Series C Refunding San Juan B Bonds	-	1,900	1,900	1,900	1,900
1997 Series D Refunding San Juan C Bonds	32,500	32,500	32,500	32,500	32,500
1997 Series E Refunding San Juan C Bonds	32,500	32,500	32,500	32,500	32,500
1998 Series F Refunding San Juan A&C Bonds	31,250	31,250	31,250	31,250	31,250
1998 Series G Refunding San Juan A&C Bonds	8,500	8,500	8,500	8,500	8,500
2003 Series I Refunding San Juan F Bonds	25,380	27,188	-	-	-
2004 Series J Refunding San Juan H Bonds	23,095	-	-	-	-
	\$ 233,105	\$ 255,101	\$ 259,116	\$ 262,121	\$ 276,819

TRANSMISSION AGENCY OF NORTHERN CALIFORNIA - 21.12%

1990 Series A Revenue Bonds	\$ 6,470	\$ 6,966	\$ 7,503	\$ 8,081	\$ 9,327
1992 Series A Revenue Bonds	-	-	-	21,998	22,424
1993 Series A Revenue Bonds	9,564	9,870	48,866	49,145	49,412
2002 Series A Revenue Refunding Bonds	20,879	21,419	21,928	-	-
2003 Series A & B Revenue Refunding Bonds	40,143	40,329	-	-	-
2003 Series C Revenue Refunding Bonds	9,055	9,361	-	-	-
Commercial Paper	7,307	6,839	15,287	14,337	12,647
	\$ 93,418	\$ 94,874	\$ 93,584	\$ 93,561	\$ 93,810

Total MID Share of JPA Debt

	\$ 326,523	\$ 349,885	\$ 352,700	\$ 355,682	\$ 370,629
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Total Outstanding MID & JPA Debt

	\$ 899,544	\$ 825,111	\$ 783,406	\$ 804,971	\$ 734,233
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REPORT OF INDEPENDENT AUDITORS

MODESTO IRRIGATION DISTRICT CONSOLIDATED FINANCIAL STATEMENTS DECEMBER 31, 2004 AND 2003


TO THE MEMBERS OF THE BOARD OF DIRECTORS OF MODESTO IRRIGATION DISTRICT

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

As described in Note 3 to the consolidated financial statements, the financial statements as of and for the year ended December 31, 2003 have been restated.

As described in Note 2 to the consolidated financial statements, in 2003, the District adopted Statement of Financial Accounting Standards No. 143, *Accounting for Asset Retirement Obligations*, which changed the District's recognition and measurement of its asset retirement obligations. The adoption of this accounting change had no direct financial impact to the District's assets and liabilities. However, the District's financial position was affected by the adoption of this change by M-S-R Public Power Agency, which is 50% owned by the District.

The management discussion and analysis included on pages 15 through 19 is not a required part of the basic consolidated financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.



Sacramento, CA

June 7, 2005

MANAGEMENT DISCUSSION AND ANALYSIS

December 31, 2004 and 2003

OVERVIEW

The following management discussion and analysis of Modesto Irrigation District (the District) provides an overview of the financial activities and transactions for fiscal year 2004 and 2003 in the context of the requirements of the Statement of Governmental Accounting Standards (SGAS) Statement No. 34, Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments, as amended. This discussion and analysis should be read in conjunction with the District's audited financial statements and accompanying notes.

FINANCIAL REPORTING

The District's accounting records are maintained in accordance with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (GASB) and, where not in conflict with GASB pronouncements, accounting principles prescribed by the Financial Accounting Standards Board.

EXPLANATION OF FINANCIAL STATEMENTS

District financial statements include consolidated balance sheets, statements of revenues, expenses and changes in net assets and statements of cash flows. The balance sheets provide information about assets and obligations of the District at a specific point in time. The statements of revenues, expenses and changes in net assets provide information regarding the District's operations during the fiscal years indicated. The statements of cash flows report cash sources and cash uses for operations, capital financing and investing activities.

FINANCIAL SUMMARY

(\$ in millions)	December 31		
	2004	2003 (As Restated See Note 3)	2002 (As Restated See Note 3)
ASSETS			
Utility plant, net	\$ 475.6	\$ 453.4	\$ 429.8
Other noncurrent assets and investments	220.0	178.7	171.3
Current assets	87.7	48.0	52.1
	\$ 783.3	\$ 680.1	\$ 653.2
LIABILITIES AND NET ASSETS			
Long-term debt	\$ 547.7	\$ 444.5	\$ 396.7
Current liabilities	69.2	56.7	53.6
Noncurrent liabilities	141.6	141.9	130.0
Net assets			
Invested in capital assets, net	23.7	53.0	36.6
Restricted	11.9	9.9	7.5
Unrestricted	(10.8)	(25.9)	28.8
	\$ 783.3	\$ 680.1	\$ 653.2
REVENUES, EXPENSES AND CHANGES IN NET ASSETS			
Operating revenues	\$ 253.9	\$ 222.3	\$ 191.8
Operating expenses	(245.4)	(231.7)	(206.3)
Operating income (loss)	8.5	(9.4)	(14.5)
Interest and other income	8.9	10.2	10.3
Interest expense	(25.7)	(23.8)	(20.6)
(Losses)/gains on investments, net	(3.9)	(3.0)	3.4
Change in net assets	\$ (12.2)	\$ (26.0)	\$ (21.4)
Net assets, beginning of year	\$ 37.0	\$ 72.9	\$ 90.5
Restatement (see Note 3) ¹	-	-	(4.0)
Cumulative effect of change in accounting principle	-	(9.9)	7.8
Net assets, beginning of year, as adjusted	37.0	63.0	94.3
Net assets, end of year	\$ 24.8	\$ 37.0	\$ 72.9

MANAGEMENT DISCUSSION AND ANALYSIS

December 31, 2004 and 2003

¹As described in Note 3 to the financial statements, net assets and interest expense have been restated in 2003, the earliest period presented in the financial statements. For the purposes of this management discussion and analysis, the restatement is recorded in 2002, the earliest period presented. Accordingly, the above table includes an adjustment to beginning net assets at January 1, 2002 of \$4.0 million and an adjustment to interest expense for the year ended December 31, 2002 of \$1.3 million.

ASSETS

UTILITY PLANT

Utility plant increased \$22.2 million in 2004 when compared to 2003. The increase was primarily a result of continued construction work on the Ripon Generation Station, the Westley Rosemore Transmission Line and associated substations, and the environmental upgrade of the McClure Generation Station. The increase is partially offset by depreciation expense of \$21.9 million in 2004.

Utility plant increased in 2003 by \$23.6 million when compared to 2002. The increase in 2003 occurred primarily due to the construction of several major capital projects that include the Ripon Generation Station, an environmental equipment upgrade at the McClure Generation Station, and a new customer billing system. The increase is partially offset by depreciation expense of \$19.0 million in 2003. The construction of the Woodland Generation station Unit #2, which accounted for most of the increase in utility plant in 2002, went into service in the second quarter of 2003.

Additionally, in both 2004 and 2003, construction of new distribution system infrastructure continued as the District installed approximately 2,500 and 3,000 new meters, in 2004 and 2003, respectively and began service to these customers. The District also continued to build infrastructure in the Mountain House service area, acquired in 1998, and in the traditional service area of the District.

OTHER ASSETS AND INVESTMENTS

Other assets and investments increased in 2004 by \$41.3 million when compared to 2003. The increase is a result of unspent debt proceeds from a 2004 debt issuance to finance the construction of the Ripon Generation Station, the Westley Rosemore Transmission Line and the McClure Generation Station environmental upgrade.

Other assets and investments increased in 2003 by \$7.4 million when compared to 2002. The increase in 2003 is a result of unspent debt proceeds from a 2003 debt issuance held in project funds.

CURRENT ASSETS

Current assets increased in 2004 by \$39.7 million when compared to 2003. The increase was primarily attributable to a \$27.8 million increase in unrestricted cash due to a 2004 debt issuance, a portion of which was used to reimburse the District's unrestricted cash funds for capital expenditures made from general funds in 2003. In addition, accounts receivable increased by \$7.7 million due to a combination of an 8% rate increase for customer electricity sales and increased wholesale energy receivables from increased sales. The remaining \$4.2 million is primarily attributable to increased deposits.

Current assets decreased in 2003 by \$4.1 million when compared to 2002. The decrease was primarily attributable to a \$7.0 million decrease in unrestricted cash which was used to fund capital for the Ripon Generation Station and other projects. The decrease in cash is partially offset by a \$2.4 million increase in accounts receivables due to a combination of a 10% rate increase for customer electricity sales and increased wholesale energy receivables from increased sales.

LIABILITIES AND NET ASSETS

LONG-TERM DEBT

Long-term debt increased in 2004, when compared to 2003, by \$103.2 million. The increase was the result of the issuance of \$116.0 million of debt to finance the construction of the Ripon Generation Station, the Westley Rosemore Transmission Line and an environmental upgrade of the McClure Generation Station. The increase was partially offset by scheduled debt service payments totaling \$18.2 million.

Long-term debt increased by \$47.8 million in 2003 when compared to 2002. The increase is primarily attributable to the issuance of \$93.2 million in new debt, the proceeds of which were used to refund \$32.8 million in variable-rate debt and finance the costs of improvements to the District's electric infrastructure, partially offset by scheduled debt service payments totaling \$15.9 million during 2003. (See also 2003 restatement discussion below and in Note 3 to the financial statements).

MANAGEMENT DISCUSSION AND ANALYSIS

December 31, 2004 and 2003

CURRENT LIABILITIES

Current liabilities increased by \$12.5 million in 2004 when compared to 2003. The increase is primarily attributable to a \$9.1 million increase in trade accounts payable due to increased purchased power and scheduling coordinator charges and a \$1.7 million liability related to the difference between the actuarially determined contribution to the District's pension plan and actual contributions. The remaining increase is primarily due to increase in the current portion of long term debt for amounts scheduled to mature in 2005.

Current liabilities increased by \$3.1 million in 2003, when compared to 2002. The increase is due to a combination of a \$4.6 million increase in current portion of long-term debt and an increase interest payable due to the 2003 debt issuance. This increase is partially offset by a \$1.4 million decrease in trade accounts payable and other current liabilities, due mainly to decreases in contractor retention amounts as the construction of the Woodland Generation Station Unit # 2 was completed in mid-2003.

NONCURRENT LIABILITIES

Non-current liabilities decreased by \$0.3 million in 2004 when compared to 2003. The decrease is due to a \$1.4 million decrease in the District's investment in joint power agencies and payables due to those agencies and a \$1.0 million decrease in unearned revenue related to the operations of the District's domestic water operations project. The decreases were partially offset by a \$1.5 million increase in the District's liability related to the California energy market refund dispute and a \$0.6 million increase in liabilities related to derivative financial instruments.

The District's other non-current liabilities increased by \$11.9 million in 2003 primarily due to the District's equity investment in MSR Public Power Agency (the Agency), a joint powers agency accounted for by the District using the equity method of accounting. During 2003 the Agency adopted Statement of Financial Accounting Standard (SFAS) No. 143, and recognized a charge to beginning net assets. The District's share of this charge was \$9.9 million.

NET ASSETS

The District's net assets invested in capital assets decreased in 2004 by \$29.3 million due to the related debt increasing more, as a result of the new debt in 2004, than the related utility plant, net of depreciation. In 2003, the District's net assets invested in capital assets increased by \$16.4 million as generation assets and routine distribution capital were constructed.

Restricted assets increased in 2004 and 2003 by \$2.0 and \$2.4 million, respectively, due to increased restrictions on cash for future interest payments related to the 2004 and 2003 debt issuances.

Unrestricted net assets changed primarily as a result of the changes above and the overall decrease in net assets resulting from net operating losses incurred in both 2004 and 2003.

CHANGES IN NET ASSETS

OPERATING REVENUES

Retail electric revenue in 2004 increased by \$18.9 million when compared to 2003, as a result of an 8% electric rate increase, effective January 1, 2004, and a 2.4% increase in the number of customers. In 2003, retail revenue increased from \$161.4 million in 2002 to \$182.8 million. The 2003 increase is a result of a combination of a 10% increase in electric rates, effective January 1, 2003, and a 3% increase in consumption per customer. Retail electric revenues are expected to further increase in 2005 due to a 9% electric rate increase effective January 1, 2005.

Wholesale electric revenue increased by \$10.0 million in 2004 when compared to 2003 and \$7.0 million in 2003 when compared to 2002. These increases were the result of improved market conditions and available excess power supply for the District due to the completion of construction of the Woodland Generation Station Unit #2, which began commercial operations in May 2003.

Over the last three years, water revenues from agricultural water and wholesale treated water remained relatively constant with slight increases in total revenues that totaled \$14.7 million, \$14.1 million, and \$13.9 million in 2004, 2003, and 2002 respectively.

Other operating income increased \$2.2 million in 2004 when compared to 2003. The increase is due to a change from net income recognized by the District in 2004 of \$1.4 related to the District's investment in MSR Public Power Agency (the Agency) as compared to a \$1.7 million loss in 2003.

Other operating income increased \$2.0 million in 2003. The increased was primarily due to lower losses recognized by the District in 2003, as compared to 2002, for their share of the income or loss from public power agencies.

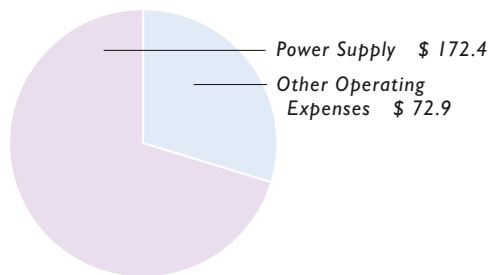
MANAGEMENT DISCUSSION AND ANALYSIS

December 31, 2004 and 2003

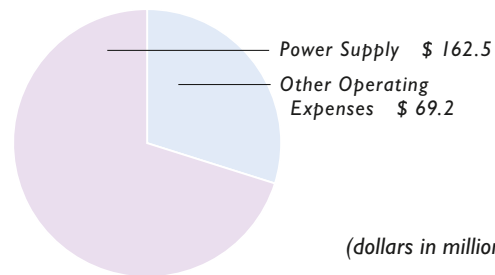
OPERATING EXPENSES

Purchased power and power generation costs for 2004 increased by \$9.9 million when compared to 2003. The increase was primarily due to a combination of a \$12.5 million increase in purchased power costs offset by a \$2.6 million decrease in power generation expenses. Purchased power increased in 2004 due to a combination of an 8% increase in MWh purchases, increased scheduling coordinator charges as a result of a FERC order to pay Pacific Gas and Electric Company (PG&E) \$15.3 million offset by a \$2.0 million settlement from El Paso. Power generation costs decreased due to a 6% decrease in gas purchases. In 2003, the District experienced a \$17.5 million increase in purchased power and power generation costs as compared to 2002. The increase was a result of higher natural gas prices for fuel used in power generators owned by the District as well as fuel used by others to generate power purchased by the District. The District also had operating costs for the Woodland Generation Station Unit #2 that went into operation in the spring of 2003. This unit was in the process of being constructed in fiscal year 2002 and as a result, was not operational in the prior year. The charts below depict operating expense compositions for the previous two years.

2004 OPERATING EXPENSES



2003 OPERATING EXPENSES



(dollars in millions)

Other operating expenses increased by \$3.8 million in 2004 when compared to 2003 due to a combination of \$2.9 million increase in depreciation expense and a \$0.8 million increase in other operating expenses. The increase in depreciation expense is due to completion of the Woodland Generation Station Unit #2 in May 2003. In 2003, other operating expenses increased as labor and benefit costs increased due to an additional \$2.3 million contribution above the 2002 contribution amount related to pension costs. Maintenance costs for overhead lines increased by approximately \$0.9 million in 2003 above 2002 cost levels because of increased activity to comply with general order safety requirements.

INTEREST AND OTHER INCOME

Interest income and other income decreased in 2004 when compared to 2003. The decrease of \$1.3 million was attributable to a decrease in interest income due to lower interest rates.

Interest and other income for 2003 decreased \$0.1 million as compared to 2002. The decrease is primarily the result of lower cash balances in 2003 when compared to 2002.

INTEREST EXPENSE

Interest expense for 2004 increased \$1.9 million when compared to 2003. This was a result of interest for the Series 2003A bonds being a full years of interest in 2004 as compared to only a partial year in 2003. Interest expense for the remaining debt issues outstanding remained relatively unchanged from 2003. The interest for the 2004 debt issue was capitalized to the related projects under construction.

Interest expense for 2003 increased \$3.2 million when compared to 2002. Prior to 2003, the District capitalized interest related to the 2001 Certificates of Participation, issued for the construction of the Woodland Generation Station Unit #2, which became commercially operational in May 2003. When the plant became operational, the District stopped capitalizing interest and began expensing interest. The remaining increase is due to interest expense associated with the new debt issued in 2003 to finance the costs of certain improvements in the District's electric infrastructure. (See 2003 restatement discussion below and in Note 3 to the financial statements).

MANAGEMENT DISCUSSION AND ANALYSIS

December 31, 2004 and 2003

RESTATEMENT OF PRIOR YEARS' FINANCIAL STATEMENTS

In 2004, the District determined that interest related to approximately \$25 million of Capital Appreciation Certificates (CACs) issued in 1999 had not been recognized as of December 31, 2003. The restatement of the 2003 consolidated balance sheet and the statement of revenues, expenses and changes in net assets corrects the consolidated financial statements to record interest that had accreted since 1999 on the CACs, a component of the District's 1999 Certificates of Participation. The adjustment for this correction resulted in an increase to long-term debt of \$6.7 million as of December 31, 2003, an increase to interest expense of \$1.4 million for the year ended December 31, 2003 and an adjustment to beginning net assets at January 1, 2003 of \$5.3 million. See also Note 3 to the financial statements.

CUMULATIVE EFFECT OF CHANGES IN ACCOUNTING PRINCIPLE

In 2003, the District adopted Statement of Financial Accounting Standard No. 143, *Accounting for Asset Retirement Obligations*, which changed the District's recognition and measurement of its asset retirement obligations. The adoption of this accounting change had no direct financial impact to the District; however, the District's financial position was affected by the adoption of this change by the Agency. The change resulted in an increase in the District's portion of asset retirement obligations of \$9.9 million, recorded as a cumulative effect of a change in accounting principle.

CONSOLIDATED BALANCE SHEETS

December 31, 2004 and 2003 (Dollars in Thousands)

	2004	2003 (As Restated See Note 3)
ASSETS		
Utility plant, net	\$ 475,588	\$ 453,438
Other assets and investments:		
Long-term investments	212,711	172,887
Deferred debt issuance costs	7,194	5,740
Equity interest in TANC	57	55
	<u>219,962</u>	<u>178,682</u>
Current assets:		
Cash and cash equivalents	39,339	11,554
Customer accounts receivable, net	24,094	20,776
Wholesale power receivables, net	3,875	1,426
Interest receivable	2,234	2,148
Materials, supplies and other	18,179	12,099
	<u>87,721</u>	<u>48,003</u>
	<u>\$ 783,271</u>	<u>\$ 680,123</u>
LIABILITIES AND NET ASSETS		
Net assets:		
Invested in capital assets, net of related debt	\$ 23,735	\$ 52,996
Restricted	11,931	9,917
Unrestricted	(10,781)	(25,877)
Total net assets	<u>24,885</u>	<u>37,036</u>
Noncurrent liabilities:		
Long-term debt, net of current portion	547,656	444,460
Unearned revenue and other liabilities	25,816	27,091
Equity interest in M-S-R	115,707	114,785
	<u>689,179</u>	<u>586,336</u>
Current liabilities:		
Accounts payable and other accruals	40,372	28,933
Interest payable	9,999	9,588
Current portion of long-term debt	18,836	18,230
	<u>69,207</u>	<u>56,751</u>
	<u>\$ 783,271</u>	<u>\$ 680,123</u>

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

CONSOLIDATED STATEMENTS of Revenues, Expenses and Changes in Net Assets

Years ended December 31, 2004 and 2003 (Dollars in Thousands)

	2004	2003 (As Restated See Note 3)
OPERATING REVENUES:		
Residential, commercial and industrial electric	\$ 201,644	\$ 182,754
Wholesale electric	29,740	19,757
Domestic water	11,753	11,517
Irrigation water	2,909	2,602
Equity in net income (loss) of public power agencies	1,786	(497)
Other operating income, net	6,109	6,175
Total operating revenues	<u>253,941</u>	<u>222,308</u>
OPERATING EXPENSES:		
Purchased power	151,800	139,294
Power generation	20,624	23,246
Electric resources	6,037	5,899
Electric transmission and distribution	9,332	9,456
Irrigation operations	6,341	6,335
Domestic water operations	4,415	4,083
Customer account service	4,409	4,303
Administrative and general	20,481	20,112
Depreciation and amortization	21,939	19,008
Total operating expenses	<u>245,378</u>	<u>231,736</u>
Total operating income (loss)	<u>8,563</u>	<u>(9,428)</u>
OTHER INCOME (EXPENSE):		
Interest and other income	9,440	10,195
Losses on investments, net	(3,929)	(2,976)
Interest expense	(25,675)	(23,799)
Change in value of interest rate swap	(550)	-
Total other income (expense)	<u>(20,714)</u>	<u>(16,580)</u>
Net decrease in net assets	<u>(12,151)</u>	<u>(26,008)</u>
Net assets, beginning of year, as previously reported	37,036	78,170
Restatement (Note 3)	-	(5,250)
Cumulative effect of change in accounting principle	-	(9,876)
Net assets, beginning of year, as restated	<u>37,036</u>	<u>63,044</u>
Net assets, end of year	<u>\$ 24,885</u>	<u>\$ 37,036</u>

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

CONSOLIDATED STATEMENTS of Cash Flows

Years ended December 31, 2004 and 2003 (Dollars in Thousands)

	2004	2003
CASH FLOWS FROM OPERATING ACTIVITIES:		
Receipts from electric customers	\$ 225,617	\$ 190,249
Receipts from domestic water and irrigation operations	13,387	15,831
Payments for purchased power	(140,912)	(139,571)
Payments for all other operational activities	(77,719)	(74,292)
Receipts from public power agencies, net	333	8,710
Other receipts	6,109	6,175
Net cash provided by operating activities	<u>26,815</u>	<u>7,102</u>
CASH FLOWS FROM CAPITAL FINANCING ACTIVITIES:		
Net proceeds from issuance of long term debt obligations	117,074	94,220
Repayment of long-term debt	(18,230)	(48,329)
Construction expenditures	(40,369)	(39,382)
Interest paid	(24,313)	(19,234)
Net cash provided by (used in) capital financing activities	<u>34,162</u>	<u>(12,725)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of investments, net	(43,753)	(9,994)
Interest received	8,188	8,589
Distributions from public power agencies	2,373	-
Net cash used in investing activities	<u>(33,192)</u>	<u>(1,405)</u>
Increase (decrease) in cash and cash equivalents	27,785	(7,028)
Cash and cash equivalents, beginning of year	11,554	18,582
Cash and cash equivalents, end of year	<u>\$ 39,339</u>	<u>\$ 11,554</u>
SUPPLEMENTAL DISCLOSURE OF NONCASH CAPITAL FINANCING AND INVESTING ACTIVITIES:		
Contributions in aid of construction	<u>\$ 2,232</u>	<u>\$ 2,013</u>

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

SUPPLEMENTAL CASH FLOW INFORMATION

Years ended December 31, 2004 and 2003 (Dollars in Thousands)

	2004	2003
CASH FLOWS FROM OPERATING ACTIVITIES:		
Operating income (loss)	\$ 8,563	\$ (9,428)
Adjustments to reconcile operating income (loss) to net cash provided by operating activities:		
Depreciation	21,939	19,008
Undistributed loss from public power agencies	(1,453)	496
Change in operating assets and liabilities:		
Customer accounts receivable, net	(3,318)	(1,880)
Wholesale power receivables, net	(2,449)	(506)
Materials, supplies and other	(6,080)	(858)
Accounts payable and other accruals	11,439	(1,442)
Unearned revenue and other liabilities	(1,826)	1,712
Net cash provided by operating activities	<u>\$ 26,815</u>	<u>\$ 7,102</u>

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Years ended December 31, 2004 and 2003 (Dollars in Thousands)

I. ORGANIZATION AND DESCRIPTION OF BUSINESS

The Modesto Irrigation District (the "District") was formed in 1887 and operates as a nonregulated special district of the State of California. The District provides electric power on an exclusive basis within a 160 square mile service area in Stanislaus County and in the Don Pedro Reservoir area in Tuolumne County. The District also provides electric power in portions of southern San Joaquin County. The District provides irrigation water to an area of California's Central Valley that lies between the Tuolumne and Stanislaus rivers. The District also operates a surface water treatment plant that provides water for the City of Modesto's (the "City") domestic water supply.

The District's Board of Directors has the authority to fix rates and charges for the District's commodities and services. As a public power utility, the District is not subject to regulation or oversight by the California Public Utilities Commission (CPUC). The District may also incur indebtedness including issuing bonds. The District is exempt from payment of federal and state income taxes.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

METHOD OF ACCOUNTING

The District maintains its accounts in accordance with accounting principles generally accepted in the United States of America for proprietary funds as prescribed by the Governmental Accounting Standards Board (GASB), and where not in conflict with GASB pronouncements, accounting principles prescribed by the Financial Accounting Standards Board (FASB). The District's accounting records generally follow the Uniform System of Accounts for public utilities and licensees prescribed by the Federal Energy Regulatory Commission (FERC) except as it relates to the accounting for contributions in aid of construction (CIAC).

COMPONENT UNIT

The Modesto Irrigation District Financing Authority (the "Authority"), a joint power authority composed of the District and the City of Redding provides financing for public improvements of the District. The District's Board of Directors serves as the Authority's Board, and District employees provide all of the Authority's administrative and management functions. All of the Authority's financial transactions, except the payment of debt service, are transacted with the District. Accordingly, all operations of the Authority are consolidated into the District's financial statements.

CASH AND CASH EQUIVALENTS

Cash equivalents include all debt instruments with maturity dates of three months or less from the date of purchase and all investments in the Local Agency Investment Fund (LAIF).

INVESTMENTS

All investments are carried at their fair market value. Interest income includes interest earned on the District's investments. Gains and losses on investments are reported separately. Net unrealized losses and realized gains during 2004 were \$4,117 and \$188, respectively and net unrealized losses and realized gains during 2003 were \$3,170 and \$194, respectively.

UTILITY PLANT

Utility plant is stated at cost. Costs and related accumulated depreciation of assets sold or otherwise disposed of are eliminated from the accounts and related gains or losses are included in operations. The costs of replacement are charged to utility plant. Repair and maintenance costs are charged to expense in the period incurred. Interest costs incurred, plus amortization of deferred debt issue costs and related bond discounts/premiums, less any related interest earned during periods of construction of utility plant assets are capitalized at a rate based on the District's borrowings related to that construction. In 2004 and 2003, the District capitalized interest totaling \$1,448 and \$1,246, respectively.

Depreciation is computed using the straight-line method over the useful lives of the assets, which generally range from twenty to fifty years for electric and domestic water plant assets and ten to one hundred years for irrigation system assets. The estimated useful lives of furniture, fixtures, equipment and other assets range from five to twenty years.

NET ASSETS

The District classifies its net assets into three components – invested in capital assets, net of related debt; restricted; and unrestricted. These classifications are defined as follows:

- Invested in capital assets, net of related debt – This component of net assets consists of capital assets, net of accumulated depreciation reduced by the outstanding debt balances, net of unamortized debt expenses and related project funds.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Years ended December 31, 2004 and 2003 (Dollars in Thousands)

- Restricted—This component consists of net assets with constraints placed on their use, either externally or internally.
- Unrestricted—This component of net assets consists of net assets that do not meet the definition of “restricted” or “invested in capital assets, net of related debt.”

CONTRIBUTIONS IN AID OF CONSTRUCTION (CIAC)

The District reports CIAC, primarily relating to expansions to the District’s distribution facilities, as nonoperating revenues, a component of interest and other income, in the statements of revenues, expenses and changes in net assets.

UNEARNED REVENUE

Billings to the City in connection with the Domestic Water Project (the “Project”) in advance of the operation of the facility were recorded as deferred revenues. The deferred revenues are being amortized over the life of the facility. Annual differences between billings to the City and the District’s annual Project costs are charged or credited to deferred revenues. Accordingly, the District’s financial statements reflect Domestic Water operations on a break-even basis, consistent with the operating agreements between the District and the City.

ASSET RETIREMENT OBLIGATIONS

Effective January 1, 2003, the District implemented Statement of Financial Accounting Standards (SFAS) No. 143, “Accounting for Asset Retirement Obligations,” which significantly changed the methodology for estimating the District’s asset retirement obligations. The District accrues costs related to utility plant when an obligation to decommission facilities or other liability is legally required.

The District has identified potential retirement obligations related to certain transmission, distribution and irrigation canal facilities located on properties that do not have perpetual lease rights. The District’s nonperpetual leased land rights generally are renewed continuously because the District intends to utilize these facilities indefinitely. Since the timing and extent of any potential asset retirements are unknown, the fair value of any obligations associated with these facilities cannot be reasonably estimated. Accordingly, a liability has not been recorded at December 31, 2004 and 2003. The District has no other potential asset retirement obligations that represent a material ARO. The implementation of SFAS No. 143 had no direct effect on the District’s assets and liabilities. However, as described below, the District’s financial position was affected by the adoption of the change in accounting principle by M-S-R Public Power Agency (the “Agency”).

As described in Note 6, the District has an ownership interest in the Agency. As of January 1, 2003, the District recorded its portion of the Agency’s cumulative effect of change in accounting principle related to SFAS No. 143. The asset retirement obligations of the Agency are related to the Agency’s ownership interest in a power plant, and contractual obligations relating to coal mines that provide fuel for the plant, resulting in a cumulative effect reduction of net assets of the District of \$9,876.

LONG-TERM DEBT

Long-term debt is recorded at the stated principal amounts of the obligations adjusted for original issue discounts and premiums. The discounts and premiums are amortized over the lives of the obligations using the effective interest method.

Debt defeasance charges result from debt refunding transactions and represent the difference between the reacquisition costs and the net carrying amount of the defeased debt. Such charges are included in long-term debt and amortized as a part of interest expense, over the shorter of the life of the refunded debt or the new debt using the effective interest method.

DEFERRED DEBT ISSUANCE COSTS

Costs incurred in connection with the issuance of debt obligations, principally underwriters’ fees and legal fees, are deferred and amortized over the terms of the related obligations using the effective interest method. Amortization of deferred debt issuance costs charged to interest expense for the years ended December 31, 2004 and 2003, amounted to \$566 and \$486, respectively.

DERIVATIVE FINANCIAL INSTRUMENTS

Certain of the energy purchase agreements and gas price swap agreements meet the definition of derivative financial instruments and are therefore recorded on the balance sheet at fair market value with a corresponding charge to purchase power expense in the statements of revenues, expenses and changes in net assets. Fair market value is estimated by comparing contract prices to forward market prices quoted by third party market participants or provided in relevant industry publications. The total fair value of the District’s energy purchase and gas price swap agreements at December 31, 2004 and 2003 are (\$690) and \$85.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Years ended December 31, 2004 and 2003 (Dollars in Thousands)

Additionally, the District has an interest rate swap agreement that meets the definition of a derivative financial instrument and is therefore recorded on the balance sheet at fair value with the offsetting entry to the change in value of interest rate swap on the statements of revenues, expenses and changes in net assets. The total fair value of the District's interest rate swap agreement at December 31, 2004 was a liability of \$550. There was no such liability at December 31, 2003.

The total fair value of the District's derivative financial instruments at December 31, 2004 and 2003 was a liability of \$1,240 and an asset of \$85, respectively. The District is exposed to risk of nonperformance if the counterparties default or if the agreements are terminated. The District monitors the risk, and does not anticipate nonperformance.

ELECTRIC AND IRRIGATION REVENUES

Retail and wholesale electric revenues are billed on the basis of monthly cycle bills and are recorded as revenue when the electricity is delivered. The District records an estimate for unbilled revenues earned from the dates its retail customers were last billed to the end of the month. At December 31, 2004 and 2003, unbilled revenues of \$11,500 and \$10,000, respectively, are included in customer accounts receivable in the balance sheet.

Irrigation revenues are billed monthly and recorded as revenue when customers are billed.

ALLOWANCE FOR DOUBTFUL ACCOUNTS

The District recognizes an estimate of uncollectible accounts for its customer accounts receivables related to electric service based upon its historical experience with collections. There was no allowance for doubtful accounts maintained by the District relating to retail customers for electric services at December 31, 2004 and 2003. At December 31, 2004 and 2003, the District maintained an allowance for doubtful accounts for its wholesale power receivables of \$3,283 and \$4,820, respectively, due to collectibility issues resulting from the uncertain California wholesale energy markets. The District's net expenses (or income) relating to doubtful accounts for all accounts receivable were (\$653) and \$873 in 2004 and 2003, respectively, which are included in administrative and general expenses in the accompanying statements of revenues, expenses, and changes in net assets.

PURCHASED POWER

The majority of the District's power needs are provided by power purchases. These power purchases are principally made under long-term agreements with the M-S-R Public Power Agency and the Hetch Hetchy System, owned and operated by the City and County of San Francisco. Additionally, the District purchases power from the Western Area Power Administration and others under various power purchase agreements. Gains or losses on power purchase and sale transactions that are settled without physical delivery are recorded as net additions or reductions to purchased power expense.

RECENT ACCOUNTING PRONOUNCEMENTS

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

In November 2003, the GASB issued SGAS No. 42 "Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries," which establishes accounting and financial reporting standards for impairment of capital assets and accounting requirements for insurance recoveries. This Statement is effective for the District beginning in 2005. The District is currently assessing the new Statement.

In June 2004, the GASB issued SGAS No. 45, "Accounting and Financial Reporting by Employers for Postemployment Benefits other than Pensions (OPEB)", which establishes standards of accounting and financial reporting for OPEB expenses and related OPEB liabilities or assets. OPEB arises from an exchange of salaries and benefits for employee services rendered. It refers to postemployment benefits other than pension benefits such as postemployment healthcare benefits. This Statement is effective for the District beginning in 2007. The District's estimate of its OPEB obligation is approximately \$38,000 as of December 31, 2004.

In March 2005, the FASB issued Interpretation No. 47, *Accounting for Unconditional Asset Retirement Obligations* (FIN 47), which generally clarifies guidance related to conditional asset retirement obligations, as provided in SFAS No. 143, *Accounting for Asset Retirement Obligations*. The District adopted SFAS No. 143 in 2003. FIN 47 is effective for the District in 2005. The District is currently assessing the new statement.

RECLASSIFICATIONS

Certain amounts in the 2003 financial statements have been reclassified to conform to the 2004 financial statement presentation.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Years ended December 31, 2004 and 2003 (Dollars in Thousands)

3. RESTATEMENT OF PRIOR YEARS' FINANCIAL STATEMENTS

In 2004, the District determined that interest related to approximately \$25,000 of Capital Appreciation Certificates (CACs) issued in 1999 had not been recognized as of December 31, 2003. The restatement of the 2003 consolidated balance sheet and the statement of revenues, expenses and changes in net assets corrects the consolidated financial statements to record interest that had accreted since 1999 on the CACs, a component of the District's 1999 Certificates of Participation. The adjustment for this correction resulted in an increase to long-term debt of \$6,730 as of December 31, 2003, an increase to interest expense of \$1,480 for the year ended December 31, 2003 and a decrease to beginning net assets of \$5,250 as of January 1, 2003.

The following balances presented in the 2003 consolidated financial statements are restated:

	As Previously Reported	As Restated
<i>Consolidated Balance Sheet at December 31, 2003:</i>		
Long-term debt	\$ 437,730	\$ 444,460
Total noncurrent liabilities	\$ 579,606	\$ 586,336
Net assets invested in capital assets, net of related debt	\$ 59,726	\$ 52,996
Total net assets	\$ 43,766	\$ 37,036
<i>Consolidated Statement of Revenues, Expenses and Changes in Net Assets for the year ended December 31, 2003:</i>		
Interest expense	\$ 22,319	\$ 23,799
Total other income (expense)	\$ (17,113)	\$ (16,580)
Net decrease in net assets	\$ (24,528)	\$ (26,008)
Net assets beginning of year	\$ 78,170	\$ 72,920
Net assets beginning of year as adjusted	\$ 68,294	\$ 63,044

4. CASH AND INVESTMENTS

A summary of the District's cash and investments at December 31 is presented below:

	2004	2003
Cash and cash equivalents:		
Insured deposits	\$ 100	\$ 100
Uninsured deposits	819	316
Local Agency Investment Fund	3,479	3,101
Managed pool and commercial paper	34,941	8,037
	39,339	11,554
Long-term investments:		
U.S. government securities	191,348	131,966
Corporate notes	21,363	37,693
Other	-	3,228
	\$ 252,050	\$ 184,441
General operating funds:		
Operating accounts	\$ 79,910	\$ 66,094
Funds designated for rate stabilization fund	53,750	53,750
	133,660	119,844
Restricted funds:		
Project funds	95,746	48,312
Debt service funds	12,213	7,766
Other	10,431	8,519
	118,390	64,597
	\$ 252,050	\$ 184,441

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Years ended December 31, 2004 and 2003 (Dollars in Thousands)

The District's cash deposits are held in institutions insured by the Federal Deposit Insurance Corporation (subject to limitations) and, as required by its bond resolutions, in a bank, savings and loan association or trust company of the U.S. or national banking association. The District is authorized to invest its cash in various financial instruments pursuant to Section 53607 of the California Government Code. All investments in U.S. government securities are registered in the District's name. Investments in managed pool and commercial paper are held by its agent and in the District's name.

Investments in LAIF are unregistered, pooled funds. LAIF is a component of the Pooled Money Investment Account Portfolio managed by the State Treasurer, in accordance with Government Code Sections 16430 and 16480. The fair value of the District's investments approximates the value of its pool shares. The LAIF portfolio includes approximately 2.6% and 2.1%, as of December 31, 2004 and 2003, respectively, in certain derivative-type products. Investments in LAIF, managed pool accounts and commercial paper are not insured or collateralized. However, due to the stringent investment policies of these funds, management considers the risk of loss of principal to be remote.

The District maintains a rate stabilization fund to protect District customers from extreme rate increases that would otherwise be necessitated by dramatic short-term changes in purchased power or other operating costs. Annual transfers into and out of the fund are determined by the District's Board of Directors (Board), which may utilize these unrestricted funds for any lawful purpose. The rate stabilization fund consists of an undivided portion of the District's general operating funds. No transfers occurred during fiscal year 2004 and 2003.

In accordance with provisions of the credit agreements relating to certain of the District's long-term debt obligations, restricted funds are maintained at levels set forth in the agreements to provide for debt service reserve and project funding requirements. These funds are held by trustees and are invested in U.S. Government securities and related instruments with maturities no later than the expected date of the use of the funds.

5. UTILITY PLANT

Utility plant consists of the following at December 31:

	Balance December 31, 2003	Additions	Transfers and Deletions	Balance December 31, 2004
NONDEPRECIABLE UTILITY PLANT				
Construction in progress	\$ 44,519	\$ 41,884	\$ (25,942)	\$ 60,461
DEPRECIABLE UTILITY PLANT				
Electric system	\$ 440,584	\$ 2,232	\$ 23,572	\$ 466,388
Domestic water plant	105,233	-	13	105,246
Irrigation system	46,499	-	386	46,885
General and administrative facilities	54,238	-	1,841	56,079
	646,554	2,232	25,812	674,598
Less: accumulated depreciation	237,635	21,939	(103)	259,471
Total depreciable plant	408,919	(19,707)	25,915	415,127
TOTAL UTILITY PLANT, NET	\$ 453,438	\$ 22,177	\$ (27)	\$ 475,588
	Balance December 31, 2002	Additions	Transfers and Deletions	Balance December 31, 2003
NONDEPRECIABLE UTILITY PLANT				
Construction in progress	\$ 89,538	\$ 41,122	\$ (86,141)	\$ 44,519
DEPRECIABLE UTILITY PLANT				
Electric system	\$ 355,740	\$ 1,556	\$ 83,288	\$ 440,584
Domestic water plant	105,229	-	4	105,233
Irrigation system	46,467	-	32	46,499
General and administrative facilities	51,868	-	2,370	54,238
	559,304	1,556	85,694	646,554
Less: accumulated depreciation	219,033	19,008	(406)	237,635
Total depreciable plant	340,271	(17,452)	86,100	408,919
TOTAL UTILITY PLANT, NET	\$ 429,809	\$ 23,670	\$ (41)	\$ 453,438

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Years ended December 31, 2004 and 2003 (Dollars in Thousands)

6. INVESTMENT IN PUBLIC POWER AGENCIES

The District's investments in public power agencies are accounted for using the equity method of accounting and consist of the following at December 31:

	2004	2003
M-S-R Public Power Agency (M-S-R)	\$ (115,707)	\$ (114,785)
Transmission Agency of Northern California (TANC)	\$ 57	\$ 55

M-S-R

The District, Silicon Valley Power and the City of Redding formed M-S-R for the principal purpose of acquiring electric power resources for the electric systems of its members. The District owns a 50% interest in M-S-R. The activities of M-S-R consist principally of a 28.8% ownership interest in a 507-megawatt (MW) unit of a coal-fired electricity generating plant located in New Mexico (the San Juan Plant). M-S-R is also a participant in the Southwest Transmission Project, a 500-kilovolt alternating current transmission line between Central Arizona and Southern California that provides a firm transmission path for the transmission of electric power from the San Juan plant. The District is obligated to make interest and other project related payments to M-S-R commensurate with its 50% interest in M-S-R, and receives 50% of the electrical power generated by M-S-R. During 2004 and 2003, the District incurred purchased power costs of \$45,431 and \$46,664, respectively, in connection with these M-S-R resources. At December 31, 2004 and 2003, the District had a payable of \$4,136 and \$4,452, respectively, to M-S-R for its proportionate share of project related expenditures.

TANC

TANC is a joint power agency that owns a portion of the California Oregon Transmission Project (COTP), a transmission line between central California and southern Oregon. The District has a 21.1% ownership interest in TANC. TANC is entitled to approximately 80% of the 1600 MW transmission capacity of the COTP. In addition, the District has a 34% share of TANC's transmission entitlement under the South of Tesla transmission agreements with Pacific Gas & Electric Company (PG&E) that provides the District with 102 MW of transmission between Tesla and Midway. The District is responsible for 34% of the South of Tesla operating costs. During 2004 and 2003, the District incurred transmission costs of \$9,386 and \$9,887, respectively, relating to these projects, which are included in purchased power expense in the accompanying statements of revenues, expenses and changes in net assets. At December 31, 2004 and 2003, the District has a long-term payable of \$11,858 and \$13,789, respectively, to TANC relating primarily to certain non-cash expenses of TANC. This liability is included in unearned revenue and other liabilities in the accompanying balance sheets.

SUMMARY

Summarized unaudited financial information of M-S-R and TANC is as follows at December 31:

	2004	2003
Total assets	\$ 731,375	\$ 791,994
Total liabilities	\$ 962,427	\$ 1,021,248
Total net assets	(231,052)	(229,254)
	\$ 731,375	\$ 791,994
Changes in net assets during the year	\$ 2,907	\$ 4,644

The long-term debt of M-S-R and TANC, which totals approximately \$908,495 and \$966,400 at December 31, 2004 and 2003, respectively, is collateralized by a pledge and assignment of net revenues of each agency, supported by take-or-pay commitments of the District and the other members. Should other members of these agencies default on their obligations to the agencies, the District would be required to make "step up" payments to cover a portion of the defaulted payments.

MODESTO IRRIGATION DISTRICT FINANCING AUTHORITY

The Authority is a joint power authority that provides financing for public improvements of the District, and is accounted for as a component unit of the District. The Authority's summary financial information is as follows:

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Years ended December 31, 2004 and 2003 (Dollars in Thousands)

	2004	2003
Assets		
Current assets	\$ 11,747	\$ 11,525
Debt service installment receivable, less current portion	157,019	165,657
	<u>\$ 168,766</u>	<u>\$ 177,182</u>
Liabilities		
Current liabilities	\$ 11,747	\$ 11,525
Long-term debt	157,019	165,657
	<u>\$ 168,766</u>	<u>\$ 177,182</u>
Revenues and Expenses		
Revenues:		
Debt service contributions	\$ 10,208	\$ 10,635
Interest income	3	1
	<u>10,211</u>	<u>10,636</u>
Interest expense	(10,211)	(10,636)
	<u>\$ -</u>	<u>\$ -</u>

7. LONG-TERM DEBT

The District's total long-term debt is presented below as of December 31, 2004 and 2003:

	2004	2003 (As Restated See Note 3)
Domestic Water Revenue Bonds, stated interest rates of 3.65% to 6.30% with maturities through 2022	\$ 79,490	\$ 82,145
Revenue Bonds, stated interest rates of 3.75% to 6.60% with maturities through 2022	93,445	99,520
Certificates of Participation (COPs)		
Stated interest rates of 2.95% to 7.25% with maturities through 2035	307,485	266,040
Variable interest rate of 1.71% at December 31, 2004, with maturities through 2035	66,025	-
Capital Appreciation Certificates, stated interest rates of 4.10% to 5.30% with maturities through 2021	25,591	25,591
General Obligation Bonds, stated interest rate of 4.25% with annual maturities through 2005	985	1,930
	<u>573,021</u>	<u>475,226</u>
Accreted interest on Capital Appreciation Certificates	8,282	6,730
Unamortized debt defeasance charges	(17,506)	(19,321)
Unamortized net premium	2,695	55
Total long-term debt	<u>566,492</u>	<u>462,690</u>
Less: Amount due within one year	(18,836)	(18,230)
Total long-term debt, net	<u>\$ 547,656</u>	<u>\$ 444,460</u>

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Years ended December 31, 2004 and 2003 (Dollars in Thousands)

The summarized activity of the District's long-term debt during 2004 and 2003 are presented below:

	December 31, 2003	Additions	Payments, amortization and refundings	December 31, 2004	Amounts due within one year
Domestic Water					
Revenue Bonds	\$ 82,145	\$ -	\$ (2,655)	\$ 79,490	\$ 2,780
Revenue Bonds	99,520	-	(6,075)	93,445	6,385
Certificates of Participation	291,631	116,025	(8,555)	399,101	7,959
General Obligation Bonds	1,930	-	(945)	985	985
Total	475,226	116,025	(18,230)	573,021	18,109
Accreted interest on					
Capital Appreciation Certificates	6,730	1,552	-	8,282	727
Unamortized net premium	55	3,056	(416)	2,695	-
Unamortized debt defeasance charge	(19,321)	-	1,815	(17,506)	-
Total long-term debt	\$ 462,690	\$ 120,633	\$ (16,831)	\$ 566,492	\$ 18,836

	December 31, 2002	Additions	Payments, amortization and refundings	December 31, 2003	Amounts due within one year
Domestic Water					
Revenue Bonds	\$ 84,660	\$ -	\$ (2,515)	\$ 82,145	\$ 2,655
Revenue Bonds	105,305	-	(5,785)	99,520	6,075
Certificates of Participation	237,906	93,225	(39,500)	291,631	8,555
General Obligation Bonds	2,835	-	(905)	1,930	945
Total	430,706	93,225	(48,705)	475,226	18,230
Accreted interest on					
Capital Appreciation Certificates (As restated see Note 3)	5,250	1,480	-	6,730	-
Unamortized net (discount) premium	(2,585)	2,897	(257)	55	-
Unamortized debt defeasance charge	(20,838)	(375)	1,892	(19,321)	-
Total long-term debt	\$ 412,533	\$ 97,227	\$ (47,070)	\$ 462,690	\$ 18,230

2004 CERTIFICATES OF PARTICIPATION

In February 2004, the District issued \$50,000 of 2004 Series A fixed rate Certificates of Participation (2004 Series A), at a premium of \$3,056, and \$66,025 of 2004 Series B variable rate Certificates of Participation (2004 Series B). The proceeds are being used to finance the costs of construction related to the Ripon Generation Station (the "Project"), a 95 MW power plant. In addition, the proceeds will finance other costs associated with the Project as well as capital improvements to the electric transmission, distribution, and other electric system facilities of the District.

The 2004 Series B bondholders have the right to tender the bonds to the tender agent; however, the bonds cannot be put to the District by the bondholders. Accordingly, the District has recorded such COPs as long-term debt, less amounts scheduled for redemption within one year.

2003 CERTIFICATES OF PARTICIPATION REFUNDING AND DEFEASANCE

In July 2003, the District issued \$93,225 of 2003 Series A fixed rate Certificates of Participation (2003 Series A). Proceeds from the 2003 Series A were used to refund \$32,800 of previously issued Certificates of Participation through a legal defeasance, and accordingly, the liability for the defeased Certificates of Participation has been removed from long-term debt. The remaining net proceeds are being used to finance the costs of improvements to the electric transmission and distribution and other electric system facilities of the District. The refunding resulted in the recognition of a deferred accounting loss of \$375, which is being amortized over the life of the refunding issues.

INTEREST RATE SWAP AGREEMENT

In December 2004, the District entered into a variable-to-fixed interest rate forward swap agreement (the swap) with a notional amount of \$83,275. Under the terms of the agreement, beginning September 2006, the District will pay a fixed rate of 3.23%. In return, the counterparty pays the District variable interest, calculated at 65 percent of LIBOR. The

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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swap terms extend through 2015. At December 31, 2004, the fair market value of the swap is a liability of \$550, and is recorded on the consolidated balance sheet as a component of financial derivative instruments, with the offsetting entry recorded in change in derivative financial instruments on the statement of revenues, expenses and changes in net assets.

GENERAL DEBT TERMS

The net revenue of the District's electric system is pledged for repayment of COPs and Revenue Bonds. The Domestic Water Revenue Bonds are collateralized by a pledge of payments made by the City of Modesto relating to domestic water services. Interest on certificates and revenue bonds is generally payable semi-annually, except for interest on certain COPs which is payable on the last day of each interest rate reset period and, interest on capital appreciation certificates (a component of COPs), which are paid at the date of maturity.

Future scheduled debt service payments for the District's long-term debt are as follows:

	Principal	Interest	Total
2005	\$ 18,109	\$ 25,873	\$ 43,982
2006	17,691	25,275	42,966
2007	18,304	24,653	42,957
2008	18,969	23,981	42,950
2009	20,526	23,252	43,778
2010-2014	118,033	100,828	218,861
2015-2019	110,261	76,163	186,424
2020-2024	102,518	44,352	146,870
2025-2029	77,630	18,883	96,513
2030-2034	62,705	5,282	67,987
2035	8,275	141	8,416
Total requirements	\$ 573,021	\$ 368,683	\$ 941,704

The District has outstanding debt obligations totaling \$96,260 at December 31, 2004, which are defeased and excluded from the District's long-term debt.

FAIR VALUE

The estimated fair values of the District's long-term debt, calculated using the value of each individual series based on quoted market prices for the same or similar issues at December 31, are as follows:

	2004	2003
Carrying amount	\$ 573,021	\$ 475,226
Fair value	\$ 606,003	\$ 507,627

8. EMPLOYEE BENEFIT PLANS

The District maintains two retirement plans and a healthcare benefits plan for its eligible employees. The Retirement Committee of the District's Board of Directors oversees the plans. The District has a Retirement Department that manages plan investments and performs plan administrative functions. All funds of the plans are separate assets of the retirement plans, and are not assets of the District.

BASIC RETIREMENT PLAN

Plan Description. The Basic Retirement Plan (the Plan) is a single-employer noncontributory defined benefit pension plan for eligible employees. The Plan provides retirement, disability and death benefits to plan members and beneficiaries. The District issues a publicly available comprehensive annual financial report that includes financial statements and required supplementary information of the Plan.

The District contributes at an actuarially determined rate. The annual required contribution was determined in accordance with the projected unit credit actuarial cost method. The actuarial value of assets is based on fair market valuations prepared by an appraisal service. Significant assumptions used to determine the actuarial accrued liabilities as of January 1, 2004, the most recently completed actuarial valuation, include the following, all reflecting annual compounding:

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- Rate of return on the investment of present and future assets of 8% per year;
- Discount rate applied to the pension benefit obligation of 8% per year;
- Salary increases of 4.25% per year; and
- Cost of living increases to retirees of 3% per year.

The District's annual pension cost and net pension obligation or prepaid for 2004 and 2003, were as follows:

	2004	2003
Annual required contribution	\$ 4,187	\$ 5,275
Interest on net pension (prepaid) obligation	(113)	(75)
Adjustment to annual required contribution	73	100
Annual pension cost	4,147	5,300
Contributions made	1,000	5,765
Increase (decrease) in net pension obligation (prepaid)	3,147	(465)
Net pension prepaid, beginning of period	(1,417)	(952)
Net pension obligation (prepaid), end of period	\$ 1,730	\$ (1,417)

Certain historical trend information is summarized as follows:

THREE-YEAR TREND INFORMATION

Fiscal Year Ending	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension (Prepaid)/Obligation
12/31/04	\$ 4,147	24%	\$ 1,730
12/31/03	\$ 5,300	109%	\$ (1,417)
12/31/02	\$ 2,043	181%	\$ (952)

The schedule of funding progress is presented below:

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Liability (AAL) Entry Age (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ([b-a]/c)
01/01/04	\$ 101,354	\$ 104,584	\$ 3,230	96.9%	\$ 27,808	11.6%
01/01/03	\$ 81,653	\$ 95,409	\$ 13,756	85.6%	\$ 25,878	53.2%
01/01/02	\$ 88,040	\$ 87,484	\$ -	100.6%	\$ 23,932	n/a

SUPPLEMENTAL RETIREMENT PLAN

Eligible employees of the District also participate in the District's supplemental retirement plan (the Supplemental Plan). The Supplemental Plan is a defined contribution plan and serves as partial or full replacement of social security for participants, depending upon date of employment. Participants are required to contribute 5% of their compensation on a pre-tax basis. The District wholly matches the contributions. Participants become fully vested in the District's portion of their account after six months of employment. Covered payroll of Participants is the same as under the Basic Retirement Plan. Participants have two investment options, a fund comprised of short-term fixed income money market securities, managed by the District's Treasury Department, and a fund comprised primarily of equities, managed by third party investment managers. The District made contributions to the Supplemental Plan of \$1,543 and \$1,406 for 2004 and 2003, respectively.

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HEALTH CARE BENEFITS

The District provides health care benefits, in accordance with District policy, to qualified retirees and their spouses. The qualification requirements for these benefits are similar to those under the District's retirement plans. Currently 361 employees and surviving spouses meet those eligibility requirements. The District contributes the full cost of coverage for employees who retired before 1992; employees who retire in 1992 and thereafter pay the monthly contribution rate that was in effect for the insurance plan selected during the year of retirement for eligible dependent coverage, and the District pays the remainder of the cost of the plan. Covered retirees are also responsible for personal deductibles and co-payments. The District pays for post-retirement dental care for retirees only to age 65.

These other post-employment benefits are charged to expense on a pay-as-you-go basis. During 2004 and 2003, the District's post-retirement health care benefit expenses were \$839 and \$926, respectively. In addition, in 2004, the District made a contribution of \$500 to fund the OPEB obligation, which has been charged to expense.

9. COMMITMENTS

The District purchases most of its purchased power from M-S-R (Note 6) and through the following long-term agreements:

THE CITY AND COUNTY OF SAN FRANCISCO POWER PURCHASE AGREEMENT

The City and County of San Francisco (CCSF) Power Purchase Agreement (Agreement) provides for a 90 MW take-or-pay obligation for capacity on a monthly basis. The District may schedule up to 85 MWh during any half-hour period and may schedule monthly energy take between a 60% and 70% capacity factor, with an annual capacity factor of 65%. The energy rates escalate annually. The agreement expires in 2007. The District's purchases in 2004 and 2003 totaled \$18,369 and \$17,635, respectively.

OTHER ENERGY PURCHASE COMMITMENTS

The District has a number of other power and natural gas purchase agreements with various entities, which provide for power and fuel deliveries, under various terms and conditions through 2016. Total commitments under these agreements are \$67,857; \$48,860; \$34,657; \$23,022 and \$23,014 for 2005, 2006, 2007, 2008 and 2009, respectively.

10. CONTINGENCIES

FLOOD CLAIMS

During January 1997, Northern California experienced a series of extreme storms resulting in significant flooding in certain areas, including areas within the service area of the District. No significant damage to any of the District's facilities occurred as a result of such flooding. Actions have been filed against the District as well as Turlock Irrigation District and the City and County of San Francisco, on behalf of multiple individual claimants who lease or own real and personal property along the Tuolumne River and one class action representing claimants who are owners and/or occupants of dwellings located within areas of flooding in Stanislaus County. The actions assert that the flood damage was caused in part by the operation of the Don Pedro Dam facilities, which are jointly owned by the District and the Turlock Irrigation District. The total amount of damages sought has not been specified. In October 2003, the District's motion for summary judgment in the consolidated flood cases was granted; judgment was entered in February 2004. The claimants did not appeal within the court ordered deadline and the cases have been concluded without payment by the District. To that effect, only one remaining claim, relating to damages to one residential property, remains outstanding as of December 31, 2004. Management believes an adverse outcome is unlikely and therefore has not recorded a liability.

CALIFORNIA ENERGY MARKET REFUND DISPUTE

In 2001, FERC issued an order establishing evidentiary hearings for the purpose of determining the amount of refunds, if any, due to customers of the California ISO and PX spot markets from market participants selling into those markets for the period October 2, 2000 through June 20, 2001 (the refund period). During this time period, the District was both a seller and a buyer in the California spot markets. The Administrative Law Judge (ALJ) assigned to the proceedings adopted hearing procedures for a three-phase hearing. Phase 1 of the hearing, held in March 2002, addressed the calculation of the price to be applied retroactively to sales into the California ISO and PX market. Phases 2 and 3 addressed the calculation of refunds and identification of the amount currently owed to each supplier (with separate quantities due from each entity) by the California ISO, the investor owned utilities, and the State of California.

In December 2002, the ALJ issued his Certification of Proposed Findings (Findings) for all three phases. In March 2003, FERC issued an Order (the March Order) accepting most of the Findings and adjusting the formula used to calculate the mitigated market-clearing price (MMCP) to be used in resettling the markets during the refund period. In its March Order,

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FERC noted that any future FERC findings of energy market manipulation that results from its ongoing review of additional evidence filed would neither result in a resetting of the refund effective date for this proceeding, nor impact the just and reasonable MMCP developed for the refund period. Throughout the process, the District has continued to challenge the FERC's jurisdictional authority to order refunds against the District, as a municipal utility. If the District is found to be subject to FERC's authority in this matter, the District's liability would likely be partially offset by refunds it would eventually realize as a buyer in the California ISO and PX spot markets.

Under the latest MMCP formula announced by FERC, the District estimates its potential refund exposure to be in the range of \$4,900 to \$7,700. The District expects this refund would likely be partially offset by the \$2,400 net receivable from the ISO markets during the same period. As of December 31, 2004 and 2003, the District has fully reserved the receivable. Therefore, the District increased the related liability on its balance sheet to \$2,500 in 2004, with a corresponding charge to wholesale sales revenues in 2004 of \$1,500. In 2003, the District had previously recorded a liability of \$1,000, based on their estimated potential refund liability at that time.

SCHEDULING COORDINATOR SERVICES (SCS) TARIFF

In January 2000, PG&E filed its proposed SCS Tariff with FERC. The proposed SCS Tariff is designed to charge the District and other existing wholesale contract customers for the various scheduling services that PG&E provides. PG&E claims that such services were new services that were due to the advent of industry restructuring in California and the ISO. The District and others believe that their existing contracts require PG&E to provide such services under the terms of their existing contracts (or require the customer to self-provide such services). In August 2003, the ALJ issued an Order Phasing Proceeding bifurcating the proceeding into two phases. In May 2004, the ALJ issued an initial decision on Phase I of the SCS Tariff Proceeding, in which the ALJ found extraordinary circumstances sufficient to grant waiver of the prior notice requirement for a March 31, 1998 effective date, thereby allowing PG&E to recover SCS Tariff charges retroactive to the effective date; and determined that PG&E provides a new service under the SCS Tariff.

In October 2004, the Commission issued an Opinion in which it found PG&E's SCS Tariff to be a new service, but reversed the ALJ's finding that extraordinary circumstances permitted waiver of the prior notice requirement and that PG&E did not have the right to recover charges prior to the rate order which commenced in January 2000. Accordingly, FERC refused to allow PG&E to recover SCS Tariff charges retroactively for 1998 and 1999.

Based on an order issued by FERC, in 2004, PG&E issued the District an invoice in the amount of \$15,300, which includes approximately \$400 related to the retroactive charges described above, and which the District began paying in installments. During 2004, the District paid \$7,600 and accrued the remaining amount of \$7,700 in accounts payable and other accruals on the balance at December 31, 2004, with a corresponding charge to purchased power expense on the statement of revenues, expenses and changes in net assets.

The District continues to believe that PG&E has no legal or factual basis for its proposed tariff and intends to vigorously contest any charges associated with the proposed SCS Tariff at FERC.

PG&E BOUNDARIES CLAIM

In April 1999, PG&E filed a petition in Stanislaus County Superior Court that claimed the District illegally provided retail electrical service outside its boundaries to customers in and around the cities of Ripon, Escalon, Riverbank, and Oakdale. In February 2001, the Court issued its decision, ruling that the District was required to seek and obtain permission from the Local Agency Formation Commission prior to providing electric service to customers outside the District's traditional electric service boundaries. The District appealed, and in January 2003, the Court of Appeals reversed the judgment in full, and ordered the trial court to dismiss PG&E's complaint. PG&E has also presented two claims to the District's Board of Directors, claiming that it has been damaged by the District's provision of electrical service outside its boundaries. PG&E filed suit in June 2003. PG&E claims it was damaged in an amount of approximately \$5,000. In November 2004, the superior court granted the District's demurrer to PG&E's complaint. However, in March 2005, the court reversed its position, and allowed the suit to proceed. The District will continue to vigorously contest this matter. However, if PG&E is successful in this litigation, the District could be liable for as much as \$5,000. While the District's management and legal counsel cannot reasonably predict the outcome of this matter, management does not believe it is probable that the ultimate resolution will result in a material liability to the District. Accordingly, the District has not recorded a liability.

GENERAL CONTINGENCIES

In the normal course of operations, the District is party to various claims, legal actions and complaints. However, the District's counsel and management believe that the ultimate resolution of these matters will not have a significant adverse effect on the financial position of the District.

MODESTO IRRIGATION DISTRICT MANAGEMENT

BOARD OF DIRECTORS

- Division 1:* CECIL O. HENSLEY
Division 2: CHARLES J. BILLINGTON (2004 Board Vice President)
Division 3: TOM VAN GRONINGEN
Division 4: PAUL WARDA (2004 Board President)
Division 5: JOHN E. KIDD
Secretary to the Board: VICKIE EHRLER


STAFF

- General Manager:* ALLEN SHORT
- Assistant General Managers*
- Customer Services:* RON MONTWID
Electric Resources: ROGER VANHOY
Finance & General Services: ROBERT DELACRUZ (*acting*)
Human Resources: JOHN GRONHOLT
Information Technology: CINDY MINTER
Planning & Marketing: CHRIS MAYER
Transmission & Distribution: TOM KIMBALL
Water Operations: WALTER WARD
- General Counsel:* JOEL MOSKOWITZ
Assistant General Counsel: SCOTT STEFFEN
- Government Relations Advisors:* THE GUALCO GROUP, INC., SACRAMENTO
THE FERGUSON GROUP, LLC, WASHINGTON, D.C.
- Paying Agents:* BANK OF AMERICA, SAN FRANCISCO
WELLS FARGO BANK, SAN FRANCISCO
- Independent Accountants:* PRICEWATERHOUSECOOPERS LLP, SACRAMENTO
- Bond Counsel:* ORRICK, HERRINGTON & SUTCLIFFE, SAN FRANCISCO
- Financial Advisor:* FIRST SOUTHWEST COMPANY, DALLAS, TEXAS

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