

# COMPARATIVE STATISTICS

(In Thousands Of Dollars)	2006	2005	2004	2003	2002
<b>Electric Revenues</b>					
Retail Revenues					
Residential	\$111,989	\$99,938	\$89,767	\$82,272	\$70,677
Commercial	76,020	67,857	62,520	55,736	49,165
Industrial	52,706	47,606	41,694	37,806	35,864
Other	9,842	9,126	8,398	7,813	6,594
Total Retail Revenue	250,557	224,527	202,379	183,627	162,300
Wholesale Revenue	28,380	40,867	29,851	20,757	12,572
Total Electric Revenue	<b>\$278,937</b>	<b>\$265,394</b>	<b>\$232,230</b>	<b>\$204,384</b>	<b>\$174,872</b>
<b>Electric kWh Sales (000) <sup>1</sup></b>					
Retail Kwh					
Residential	914,665	875,238	861,273	847,031	792,809
Commercial	754,447	735,351	725,387	697,419	675,996
Industrial	801,578	792,027	766,018	741,435	749,756
Other	94,540	105,156	106,910	107,968	99,302
Total Retail Sales	2,565,230	2,507,772	2,459,588	2,393,853	2,317,863
Wholesale Sales	1,050,037	744,538	526,572	505,733	477,800
Total Electric Sales	<b>3,615,267</b>	<b>3,252,310</b>	<b>2,986,160</b>	<b>2,899,586</b>	<b>2,795,663</b>
<b>Retail Customers At Year End</b>					
Residential	93,372	91,061	88,741	86,650	84,381
Commercial	12,671	11,682	11,319	10,995	10,378
Industrial	188	173	155	150	136
Other	6,135	5,608	5,488	5,428	5,356
Total Retail Customers	<b>112,366</b>	<b>108,524</b>	<b>105,703</b>	<b>103,223</b>	<b>100,251</b>
<b>Retail Revenue Per kWh Sold (Cents)</b>					
Residential	12.2	11.4	10.4	9.7	8.9
Commercial	10.1	9.2	8.6	8.0	7.3
Industrial	6.6	6.0	5.4	5.1	4.8
Other	10.4	8.7	7.9	7.2	6.6
System Average	9.8	9.0	8.2	7.7	7.0
<b>Wholesale Revenue Per kWh Sold (Cents)</b>	2.7	5.5	5.7	4.1	2.6
<b>Financial Ratios</b>					
Operating Ratio	0.80	0.81	0.88	0.96	1.00
Current Ratio	1.62	1.1	1.27	0.85	0.97
Quick Ratio	1.14	0.69	0.91	0.48	1.02
Debt Service Coverage - Sr. Lien Debt	7.35	4.91	3.44	1.81	1.42
Debt Service Coverage - Jr. Lien Debt	2.31	1.91	1.55	1.50	1.56
<b>Power Supply (GWh)</b>					
Power Purchased	3,008.3	2,638.5	2,594.6	2,537.5	2,607.5
Power Generated	755.4	674.2	459.2	475.5	293.9
Total System Requirements	<b>3,763.7</b>	<b>3,312.7</b>	<b>3,053.8</b>	<b>3,013.0</b>	<b>2,901.4</b>
<b>Annual System Peak Load (MWh)</b>	697.3	632.5	606.4	624.2	599.9

<sup>1</sup> (kWh=kilowatthours; MWh=megawatthours; GWh=gigawatthours)

# LONG TERM DEBT SUMMARY

(In Thousands Of Dollars)

	2006	2005	2004	2003	2002
<b>Outstanding Debt At Year End</b>					
<b>Modesto Irrigation District Debt</b>					
<i>Electric Debt</i>					
1967 Don Pedro G. O. Bonds	\$ -	\$ -	\$ 985	\$ 1,930	\$ 2,835
1996A Geysers Refunding Revenue Bonds	80,335	87,060	93,445	99,520	105,305
1996 Certificates of Participation	-	-	-	-	32,800
1999A Certificates of Participation	47,222	49,523	51,936	55,656	59,226
1999B Certificates of Participation	41,285	42,900	44,440	45,895	47,280
2001A Certificates of Participation	91,245	93,180	95,050	96,855	98,600
2003A Certificates of Participation	87,330	89,515	91,650	93,225	-
2004A Certificates of Participation	50,000	50,000	50,000	-	-
2004B Certificates of Participation	66,025	66,025	66,025	-	-
2006A Certificates of Participation	146,960	-	-	-	-
	<b>\$610,402</b>	<b>\$478,203</b>	<b>\$493,531</b>	<b>\$393,081</b>	<b>\$346,046</b>
<i>Domestic Water Debt</i>					
1998 D Refunding Revenue Bonds - Domestic Water	73,780	76,710	79,490	82,145	84,660
	<b>\$73,780</b>	<b>\$76,710</b>	<b>\$79,490</b>	<b>\$82,145</b>	<b>\$84,660</b>
<b>Total Outstanding MID Debt</b>	<b>\$684,182</b>	<b>\$554,913</b>	<b>\$573,021</b>	<b>\$475,226</b>	<b>\$430,706</b>
<b>MID Share Of Joint Power Agency Debt</b>					
<i>MSR Public Power Agency - 50%</i>					
1993 Series F Refunding San Juan A Bonds	10,205	10,205	10,205	10,205	40,433
1997 Series G Refunding San Juan C Bonds	27,560	28,263	28,810	29,333	29,830
1997 Series H Refunding San Juan D Bonds	-	-	-	40,860	41,338
2001 Series I Refunding San Juan E Bonds	28,743	30,783	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
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	21,513	23,490	25,380	27,188	-
2004 Series J Refunding San Juan H Bonds	16,110	19,633	23,095	-	-
	<b>\$217,631</b>	<b>\$225,874</b>	<b>\$233,105</b>	<b>\$255,101</b>	<b>\$259,116</b>
<i>Transmission Agency Of Northern California - 21.12%</i>					
1990 Series A Revenue Bonds	\$6,011	\$6,011	\$6,470	\$6,966	\$7,503
1993 Series A Revenue Bonds	7,574	9,243	9,564	9,870	48,866
2002 Series A Revenue Refunding Bonds	19,702	20,307	20,879	21,419	21,928
2003 Series A&B Revenue Refunding Bonds	39,758	39,954	40,143	40,329	-
2003 Series C Revenue Refunding Bonds	8,400	8,733	9,055	9,361	-
Commercial Paper	7,307	7,307	7,307	6,839	15,287
	<b>\$88,752</b>	<b>\$91,555</b>	<b>\$93,418</b>	<b>\$94,784</b>	<b>\$93,584</b>
<b>Total MID Share Of JPA Debt</b>	<b>\$306,383</b>	<b>\$317,429</b>	<b>\$326,523</b>	<b>\$349,885</b>	<b>\$352,700</b>
<b>Total Outstanding MID &amp; JPA Debt</b>	<b>\$990,565</b>	<b>\$872,342</b>	<b>\$899,544</b>	<b>\$825,111</b>	<b>\$783,406</b>

# REPORT OF INDEPENDENT AUDITORS

## 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 the enterprise funds of the Modesto Irrigation District and its component unit (the District) at December 31, 2006 and 2005, and their changes in financial position and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the District's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 2, the District consists of both enterprise funds, as reported in these consolidated financial statements, and fiduciary funds, which are excluded from these financial statements. Such fiduciary funds comprise pension plans disclosed in Note 7 which are managed for the benefit of the District's employees, retirees and related beneficiaries. Because of the exclusion of these pension fiduciary funds, these financial statements do not purport to, and do not, present fairly the financial position of the District as a whole inclusive of the fiduciary funds as of December 31, 2006 and 2005, and the changes in its financial position and its cash flows, for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis presented on pages 16 through 19 is not a required part of the basic 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.

The image shows a handwritten signature in black ink that reads "PricewaterhouseCoopers LLP". The signature is written in a cursive, flowing style.

May 21, 2007

# MANAGEMENT DISCUSSION AND ANALYSIS

December 31, 2006 and 2005

## 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 2006 and 2005 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.

## Background

The District is responsible for the acquisition, generation, transmission, and distribution of electric power to its service area, which includes a 160 square mile service area in Stanislaus County and in the Don Pedro Reservoir area of Tuolumne County. The District also provides electric power to portions of the 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.

## 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.

## Overview of Financial Statements

The District's 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		
	2006	2005	2004
<b>Assets</b>			
Utility plant, net	\$527.8	\$520.2	\$475.6
Other noncurrent assets and investments	211.3	184.8	220.3
Current assets	107.4	82.1	88.2
	<u>\$846.5</u>	<u>\$787.1</u>	<u>\$784.1</u>
<b>Liabilities and Net Assets</b>			
Long-term debt	\$583.2	\$532.0	\$547.6
Noncurrent liabilities	131.1	141.9	141.9
Current liabilities	66.3	73.7	69.8
Net assets			
Invested in capital assets, net	18.0	22.9	23.7
Restricted	10.2	9.6	12.4
Unrestricted	37.7	7.0	(11.3)
	<u>\$846.5</u>	<u>\$787.1</u>	<u>\$784.1</u>

(\$ in millions)	December 31		
	2006	2005	2004
<b>Revenues, Expenses and Changes in Net Assets</b>			
Operating revenues	\$307.4	\$291.6	\$253.9
Operating expenses	(270.7)	(259.7)	(245.3)
Operating income (loss)	36.7	31.9	8.6
Investment income, net	8.0	4.0	9.4
Other non-operating income, net	8.9	3.7	(3.9)
Interest expense	(27.2)	(25.0)	(26.2)
Change in net assets	26.4	14.6	(12.1)
Net assets, beginning of year	39.5	24.9	37.0
Net assets, end of year	<u>\$65.9</u>	<u>\$39.5</u>	<u>\$24.9</u>

## **Assets**

### ***Utility Plant***

Utility plant increased \$7.6 million in 2006 when compared to 2005 and \$44.6 million in 2005 when compared to 2004. The increases were 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 increases are partially offset by depreciation expense of \$25.8 million in 2006 and \$22.3 million in 2005.

Additionally, in both 2006 and 2005, construction of new distribution system infrastructure continued as the District installed approximately 3,800 and 3,200 new meters, respectively and began service to these customers. The District also continued to build infrastructure in the Mountain House area of the District's service territory, acquired in 1998.

### ***Other Non-current Assets and Investments***

Other non-current assets and investments increased by \$26.5 million in 2006 when compared to 2005. The increase was attributable to a \$30.9 million increase in long-term investments as a result of the issuance of \$147.0 million in Series 2006A Certificates of Participation (COPs) offset by construction expenditures for the Ripon Generation Station, the Westley Rosemore Transmission Line and the McClure Generation Station environmental upgrade. The increase was partially offset by a \$5.1 million decrease in long-term derivative financial instruments.

Other non-current assets and investments decreased by \$35.5 million in 2005 when compared to 2004. The decrease was a result of construction expenditures for the Ripon Generation Station, the Westley Rosemore Transmission Line and the McClure Generation Station environmental upgrade. Monies paid by the trustee from the construction fund and other project funds caused the decrease in other assets. The decrease was partially offset by an increase in long-term derivative financial instruments of \$5.6 million.

### ***Current Assets***

Current assets increased in 2006 by \$25.3 million when compared to 2005. The increase was attributable to an increase in cash and cash equivalents as a result of the issuance of \$147.0 million in Series 2006A COPs and a \$6.8 million increase in materials, supplies and other. These increases were primarily offset by a decrease in derivative financial instruments maturing within one year of \$7.2 million.

Current assets decreased in 2005 by \$6.1 million when compared to 2004. The decrease was attributable to a \$20.0 million decrease in cash and cash equivalents that was primarily due to capital expenditure for the Ripon Generation Station and other capital projects, and a decrease in materials, supplies and other of \$2.1 million. These decreases were primarily offset by an increase in customer accounts receivable of \$5.8 million, an increase in wholesale power receivables of \$2.8 million and an increase to the derivative financial instruments maturing within one year of \$6.7 million.

## **Liabilities and Net Assets**

### ***Long-term Debt***

Long-term debt increased by \$51.2 million in 2006 when compared to 2005 primarily due to the issuance of \$147.0 million in Series 2006A Certificates of Participation (COPs), issued with a net premium of \$3.5 million. This increase was primarily offset by the defeasance of \$80.4 million of the 1996 Refunding and Capital Improvements Certificates of Participation and \$17.6 million normal debt service payments and \$0.8 million interest paid on Capital Appreciation Certificates.

Long-term debt decreased by \$15.6 million in 2005 when compared to 2004 due to \$18.1 million normal debt service payments and \$0.7 million interest paid on Capital Appreciation Certificates. The decrease was offset by a \$1.8 million decrease in unamortized debt defeasance charges, which are amortized over the life of the related debt and \$1.6 million increase in accrued bond interest related to the Capital Appreciation Certificates, which is included as a component of Long-term debt.

### ***Current Liabilities***

Current liabilities decreased by \$7.4 million in 2006 when compared to 2005 primarily due to a decrease in trade accounts payable and reduction in construction retention liabilities associated with the completion of the Ripon Generation station, completed in June 2006.

Current liabilities increased by \$3.9 million in 2005 when compared to 2004 primarily due to a \$1.9 million increase in derivative financial instruments maturing within one year and a \$2.5 million increase in accounts payable and other accruals.

### ***Non-current Liabilities***

Non-current liabilities decreased \$10.8 million in 2006 when compared to 2005. This decrease is due primarily to the \$8.3 million net change in the District's investment in other joint power agencies and the related liabilities owed to those agencies. This decrease was offset by a \$2.6 million decrease in derivative financial instruments with maturities greater than one year and other non-current liabilities.

Non-current liabilities remained relatively unchanged in 2005 when compared to 2004. This is primarily due to \$2.4 million increase in the District's estimated refund liability for amounts owed for power purchases made in 2000 and 2001 currently in dispute under the California market refund disputes. This increase is offset by decreases due primarily to the net change in the District's investment in other joint power agencies and the related liabilities owed to those agencies.

## Net Assets

In 2006, the District's net assets invested in capital assets decreased by \$4.9 million when compared to 2005. A \$45.0 million decrease in capital assets net of related debt is primarily the result of the issuance of the Series 2006A COPs. This decrease is offset by the \$39.3 million change in reserve funds resulting from the Series 2006A COPs and the continued construction of financed capital projects. The District's net assets invested in capital assets remained fairly constant in 2005 when compared to 2004. Net assets were \$22.9 million and \$23.7 million in 2005 and 2004 respectively.

Restricted assets remained fairly constant in 2006 when compared to 2005 at \$10.2 million and \$9.6 million, respectively; however, in 2005, restricted assets decreased by \$2.8 million when compared to 2004. The decrease is primarily due to the use of debt proceeds for construction.

Unrestricted net assets changed primarily as a result of the changes above and the change in net assets in 2006 and 2005.

## Changes in Net Assets

### Operating Revenues

Retail electric revenue in 2006 increased by \$25.8 million compared to 2005, as a result of a 9.5% electric revenue increase effective January 10, 2006, and a 3.7% increase in the number of customers. In 2005, retail electric revenue increased by \$21.5 million compared to 2004, as a result of a 9% electric revenue increase effective January 1, 2005, and a 3.0% increase in the number of customers.

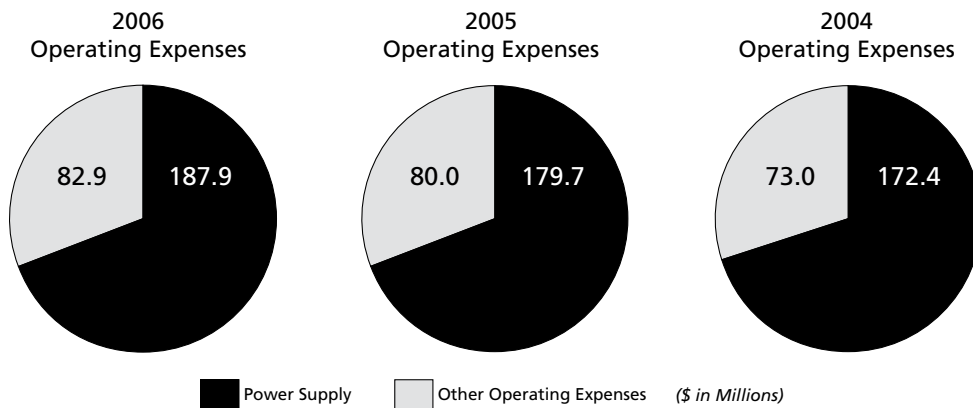
Wholesale electric revenue decreased by \$11.6 million in 2006 when compared to 2005 and increased by \$11.1 million in 2005 when compared to 2004. The decrease in 2006 was due to reductions in natural gas prices that resulted in lower market prices for wholesale power and a \$1.4 million write-off of 2000 and 2001 emergency power sales as a result of a settlement agreement with Pacific Gas and Electric. The increase in 2005 was the result of improved hydro generation conditions and available excess power supply when compared to 2004.

Over the last three fiscal years, water revenues from agricultural water and wholesale treated water remained relatively constant with revenues that totaled \$14.4 million, \$14.5 million and \$14.7 million for fiscal years 2006, 2005, and 2004 respectively.

Other operating income, which includes equity in net income of public power agencies, increased \$1.7 million in 2006 when compared to 2005. The increase is due primarily to an increase in net income from MSR Public Power Agency (the Agency) of \$3.0 million offset by a \$1.3 million decline in other operating. In 2005, as compared to 2004, other operating income, which includes equity in net income of public power agencies, increased \$5.2 million in 2005 when compared to 2004. The increase is due primarily to an increase in net income from MSR Public Power Agency (the Agency) of \$2.6 million and a realized gain of \$1.0 million for Central California Power Agency No. 1. The remaining increase is primarily due to sales of excess turbine fuel as well as increased infrastructure work requested by District customers.

### Operating Expenses

Purchased power and power generation costs for 2006 increased by \$8.2 million when compared to 2005. The increase was primarily due to a combination of \$19.0 million increase in power generation expenses offset by a \$10.8 million decrease in purchased power costs. The District's power generation cost increase of \$19.0 million was due to increased generation at District owned generation facilities, including the addition of the Ripon Generation Station which began commercial operation in June 2006, and hedging losses on natural gas purchases. The purchased power cost decreased as a result of a \$15.6 million purchased power litigation settlement and reduced power purchases due to increased generation from District owned facilities. These decreases were offset by losses from hedging activities.



Purchased power and power generation costs for 2005 increased by \$7.3 million when compared to 2004. The increase was primarily due to a combination of a \$7.5 million increase in purchased power costs offset by a \$0.2 million decrease in power generation expenses. Purchased power costs increased due to combination of price increases, which were partially offset by a 3.6% decrease in MWh purchases and gains from hedging activities. While the District's gas purchases for its natural gas generation facilities increased by 19%, the costs per MWh of production were not significantly higher than in prior years because the District hedged their natural gas costs thus offsetting increased market prices from natural gas. As a result, production expenses remained relatively flat in the current year. The District's gas purchases increased due to 16% increase in MWh generation in its gas generation facilities.

Other operating expenses increased by \$2.9 million in 2006 when compared to 2005. The increase is primarily the result of increased depreciation expense for the Ripon Generation Station which began commercial operation in June 2006.

Other operating expenses increased by \$7.0 million in 2005 when compared to 2004. The increase is primarily the result of a new labor contract negotiated early in 2005, which provided increased pension benefits and a 3.0% cost of living increase. Additionally there were increased costs for warehouse sales and jobbing of \$1.9 million.

#### ***Investment and Other Income***

Investment and other income increased in 2006 when compared to 2005 by \$9.3 million. The increase is the result of an increase of \$4.1 million in net investment income due to increased investments earning interest due to the issuance of the Series 2006A COPs and an increase in unrealized gains on investments. Additionally, other non-operating income increased \$5.3 million primarily due to \$2.6 Mirant settlement for breach of contract, \$1.5 million of interest on the PG&E settlement and the realized gain of \$1.5 million on the termination of an interest rate swap.

Investment and other income increased in 2005 when compared to 2004 by \$2.1 million. The increase is primarily due to increased realized gains and losses.

#### ***Interest Expense***

Interest expense for 2006 increased \$2.2 million when compared to 2005 primarily as a result of higher debt balances after the issuance of the Series 2006A COPs.

Interest expense for 2005 decreased \$1.2 million when compared to 2004 primarily as a result of lower debt balances from normal debt service payments.

# CONSOLIDATED BALANCE SHEETS

December 31, 2006 and 2005

(Dollars in Thousands)

	2006	2005
<b>Asset</b>		
Utility plant, net	\$527,852	\$520,215
Other assets and investments:		
Long-term investments	203,111	172,253
Deferred debt issuance costs	7,160	6,626
Derivative financial instruments	810	5,894
Equity interest in TANC	198	61
	<u>211,279</u>	<u>184,834</u>
Current assets:		
Cash and cash equivalents	45,477	19,380
Customer accounts receivable, net	31,821	29,914
Wholesale power receivables, net	3,736	6,655
Interest receivable	2,306	1,642
Derivative financial instruments maturing within one year	34	7,233
Materials, supplies and other	24,002	17,249
	<u>107,376</u>	<u>82,073</u>
	<u>\$846,507</u>	<u>\$787,122</u>
<b>Liabilities and Net Assets</b>		
Net assets:		
Invested in capital assets, net of related debt	\$18,005	\$22,947
Restricted	10,189	9,615
Unrestricted	37,754	6,921
Total net assets	<u>65,948</u>	<u>39,483</u>
Noncurrent liabilities:		
Long-term debt, net of current portion	583,226	532,037
Unearned revenue and other liabilities	24,815	28,258
Derivative financial instruments	1,641	799
Equity interest in M-S-R	104,605	112,859
	<u>714,287</u>	<u>673,953</u>
Current liabilities:		
Accounts payable and other accruals	34,468	42,321
Derivative financial instruments maturing within one year	2,099	3,050
Interest payable	10,070	9,785
Current portion of long-term debt	19,635	18,530
	<u>66,272</u>	<u>73,686</u>
Commitments and contingencies (Notes 8 and 9)	<u>\$846,507</u>	<u>\$787,122</u>

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

# CONSOLIDATED STATEMENTS *of Revenues, Expenses and Changes in Net Assets*

*December 31, 2006 and 2005*

<i>(Dollars in Thousands)</i>	2006	2005
Operating revenues:		
Residential, commercial and industrial electric	\$248,876	\$223,114
Wholesale electric	29,283	40,867
Domestic water	11,275	11,502
Irrigation water	3,143	2,968
Equity in net income of public power agencies	8,459	5,501
Other operating income, net	6,351	7,637
Total operating revenues	307,387	291,589
Operating expenses:		
Purchased power	148,413	159,282
Power generation	39,440	20,421
Electric resources	7,614	7,077
Electric transmission and distribution	10,131	10,836
Irrigation operations	6,937	6,864
Domestic water operations	4,775	4,297
Customer account service	5,197	4,888
Administrative and general	22,410	23,738
Depreciation and amortization	25,787	22,259
Total operating expenses	270,704	259,662
Total operating income	36,683	31,927
Other income (expense):		
Net investment income	8,060	4,010
Interest expense	(27,225)	(24,989)
Other non-operating income, net	8,947	3,650
Total other income (expense)	(10,218)	(17,329)
Net increase in net assets	26,465	14,598
Net assets, beginning of year	39,483	24,885
Net assets, end of year	\$65,948	\$39,483

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

# CONSOLIDATED STATEMENTS OF CASH FLOWS

December 31, 2006 and 2005

<i>(Dollars in Thousands)</i>	2006	2005
<b>Cash flows from operating activities:</b>		
Receipts from electric customers	\$279,171	\$255,381
Receipts from domestic water and irrigation operations	10,975	17,532
Payments for purchased power	(143,883)	(166,890)
Payments for all other operational activities	(103,257)	(77,955)
Other receipts	11,609	9,527
Net cash provided by operating activities	54,615	37,595
<b>Cash flows from capital financing activities:</b>		
Net proceeds from issuance of long-term debt obligations	60,481	-
Repayment of long-term debt	(10,966)	(18,835)
Construction expenditures	(29,581)	(62,921)
Interest paid	(26,971)	(25,556)
Net cash used in capital financing activities	(7,037)	(107,312)
<b>Cash flows from investing activities:</b>		
(Purchases) sales of investments, net	(29,875)	37,858
Interest received	7,076	8,487
Proceeds from termination of interest rate swap agreement	1,318	-
Distributions from public power agencies	-	1,523
Net cash (used in) provided by investing activities	(21,481)	47,868
Increase (decrease) in cash and cash equivalents	26,097	(21,849)
Cash and cash equivalents, beginning of year	17,490	39,339
Cash and cash equivalents, end of year	\$43,587	\$17,490
<b>Cash flows from operating activities:</b>		
Operating income	\$36,683	\$31,927
Adjustments to reconcile operating income to net cash provided by operating activities:		
Other income	5,190	-
Depreciation and amortization	25,787	22,259
Undistributed income from public power agencies	(8,391)	(5,501)
Change in value of derivative financial instruments	12,383	(10,177)
Change in operating assets and liabilities:		
Customer accounts receivable, net	(1,907)	(5,820)
Wholesale power receivables, net	2,919	(2,780)
Materials, supplies and other	(6,753)	2,056
Accounts payable and other accruals	(7,853)	2,569
Unearned revenue and other liabilities	(3,443)	3,062
Net cash provided by operating activities	\$54,615	\$37,595

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

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Years ended December 31, 2006 and 2005 (Dollars in Thousands)

## 1. 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 of Tuolumne County. The District also provides electric power to 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 establish 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 activities as described above are accounted for as an enterprise fund and are financed and operated in a manner similar to that of a private business enterprise. The District uses the economic resources measurement focus and the accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred. 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).

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.

These consolidated financial statements present only the enterprise funds of the District and exclude the fiduciary funds of the District. The District's fiduciary funds comprise the pension plans disclosed in Note 7.

### Cash and Cash Equivalents

Cash equivalents include all debt instruments with maturity dates of 90 days or less from the date of purchase and all investments in the Local Agency Investment Fund (LAIF), and money market mutual funds. LAIF has an equity interest in the State of California Pooled Money Investment Account (PMIA). PMIA funds are on deposit with the State's Centralized Treasury System and are managed in compliance with the California Government Code, according to a statement of investment policy which sets forth permitted investment vehicles, liquidity parameters and maximum maturity of investments. The PMIA cash and investments are recorded at amortized cost which approximates market. The District's deposits with LAIF are generally available for withdrawal on demand.

	2006	2005
<b>Supplemental disclosure of noncash capital financing and investing activities:</b>		
Contributions in aid of construction	\$2,230	\$1,706

### Investments

Generally, all investments are carried at their fair market value, except for guaranteed investment contracts (GICs), which are carried at cost.

### 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 2006 and 2005, the District capitalized interest totaling \$1,613 and \$2,269, 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 unspent project and debt service funds.
- *Restricted* - This component consists of net assets with constraints placed on their use. Constraints include those imposed by debt trust indentures, grants or laws and regulations of other governments, or by law through constitutional provisions or enabling legislation.
- *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 non-operating 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**

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, 2006 and 2005 for these assets.

The District has identified retirement obligations for transformers that are known to contain PCB oil and has estimated a liability for the disposal of these transformers at retirement at the fair value of the obligation. The District has recorded a liability in 2006 for this obligation in the amount of \$131.

The District has no other potential asset retirement obligations that represent a material asset retirement obligation (ARO). The District accrues costs related to utility plant when an obligation to decommission facilities or other liability is legally required. Additionally, the District recognizes the ARO as an increase in the capitalized carrying amount of the related long-lived asset. Annual accretions of ARO liabilities are recorded as operating expenses and the capitalized costs are depreciated over the useful life of the related long-lived assets.

#### **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, 2006 and 2005 amounted to \$551 and \$568, respectively.

#### **Derivative Financial Instruments**

The District has gas price swap agreements and positions on natural gas commodity futures that 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 and power generation expenses 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 gas price swap agreements and natural gas commodity futures positions, net at December 31, 2006 and 2005 are (\$2,896) and \$9,487.

Additionally, during 2005 the District had entered into a variable-to-fixed interest rate forward swap agreement (the swap) that met the definition of a derivative financial instrument and was recorded on the balance sheet at fair value at December 31, 2005. The swap agreement had a notional amount of \$83,275. The total fair value of the District's interest rate swap agreement at December 31, 2005 was a liability of \$209. In 2006, the District terminated the interest rate swap in connection with the Series 2006A Certificates of Participation debt issuance that refunded the 1996 Refunding and Capital Improvements debt issue, because the COPs were issued at fixed rates. As a result of the termination, the District recognized a realized gain of \$1,521, included in other non-operating income in the statements of revenues, expenses and changes in net assets.

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, 2006 and 2005, unbilled revenues of \$14,400 and \$12,800, respectively, are included in customer accounts receivable in the consolidated balance sheet.

Irrigation revenues are recognized when billed based on annual assessments, payable with installment payments due in June and December.

#### ***Allowance for Doubtful Accounts***

The District recognizes an estimate of uncollectible accounts for its retail customer accounts receivable related to electric service based upon its historical experience with collections. At December 31, 2006 and 2005, the District maintained an allowance for doubtful accounts for its retail customers for electric services of \$1,900 and \$600, respectively. For its wholesale power receivables, the District maintained an allowance for doubtful accounts at December 31, 2006 and 2005 of \$200 and \$800, respectively, due to collection issues resulting from the uncertain California wholesale energy markets. The District's net expense relating to doubtful accounts for all accounts receivable was \$2,968 and \$1,412 in 2006 and 2005, respectively, which is included as an offset to operating revenues 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 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***

***GASB 45*** – 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 liability is approximately \$46,147 as of December 31, 2006 which, upon adoption of SGAS 45, will be amortized to expense over the transition period which has yet to be determined by District management.

***GASB 49*** – Effective for the year ending December 31, 2008, the District will be required to implement Governmental Accounting Standards Board Statement No. 49 (GASB 49), Accounting and Financial Reporting for Pollution Remediation Obligations. This Statement addresses accounting and financial reporting standards for pollution (including contamination) remediation obligations, which are obligations to address the current or potential detrimental effects of existing pollution by participating in pollution remediation activities such as site assessments and cleanups. The scope of the document excludes pollution prevention or control obligations with respect to current operations, and future pollution remediation activities that are required upon retirement of an asset, such as landfill closure and postclosure care and nuclear power plant decommissioning. If any one of five specified obligating events occurs, the District will be required to estimate the components of expected pollution remediation outlays and determine whether outlays for those components should be accrued as a liability or, if appropriate, capitalized when goods and services are acquired. The District is currently assessing the new Statement.

#### ***Reclassifications***

Certain amounts in the 2005 financial statements have been reclassified to conform to the 2006 financial statement presentation.

### 3. Cash and Investments

The District's investment policies are governed by the California Government Codes and its bond Indenture, which restricts the District's investment securities to obligations which are unconditionally guaranteed by the United States (U.S.) Government or its agencies or instrumentalities; direct and general obligations of the State of California (State) or any local agency within the State; bankers' acceptances; commercial paper; certificates of deposit; time certificates of deposit; repurchase agreements; reverse repurchase agreements or securities lending agreements; medium-term corporate notes; shares of beneficial interest; mortgage pass-through securities; financial futures and financial option contracts; and deposits with the Local Agency Investment Fund (LAIF). 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 in LAIF approximates the value of its pool shares.

The District's investment policy includes restrictions for investments relating to maximum amounts invested as a percentage of total portfolio and with a single issuer, maximum maturities, and minimum credit ratings.

#### Credit Risk

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

The following schedules present the credit risk at December 31, 2006 and 2005. The credit ratings listed are from Standard and Poor's. NR means not rated. At December 31, 2006 and 2005, the District's cash, cash equivalents and investments consist of the following:

	Credit Rating	2006	2005
<b>Cash and cash equivalents:</b>			
Deposits	NR	\$17	\$35
Money market mutual funds	AAA	29,131	7,965
Local Agency Investment Fund	NR	13,022	8,070
Commercial paper	A1/P1	3,307	3,310
		<u>45,477</u>	<u>19,380</u>
<b>Long-term investments:</b>			
Guaranteed investment contracts	NR	60,205	34,184
Federal Home Loan Bank bonds	AAA	48,704	52,542
Fannie Mae	AAA	33,233	29,479
Freddie Mac	AAA	30,799	23,426
Corporate medium term notes	A+	24,235	19,725
Federal Farm Credit Bank notes	AAA	5,935	10,894
Student loan marketing bonds	AAA	-	2,003
		<u>203,111</u>	<u>172,253</u>
		<u>\$248,588</u>	<u>\$191,633</u>
		<b>2006</b>	<b>2005</b>
<b>General operating funds:</b>			
Operating accounts		\$98,794	\$81,595
Funds designated for rate stabilization fund		53,750	53,750
		<u>152,544</u>	<u>135,345</u>
<b>Restricted funds:</b>			
Project funds		70,431	35,770
Revenue bond and COP reserve funds		15,423	10,903
Debt service fund		9,216	9,115
Other		974	500
		<u>96,044</u>	<u>56,288</u>
		<u>\$248,588</u>	<u>\$191,633</u>

At December 31, 2006 and December 31, 2005, the District reported book overdrafts of \$682 and \$338 respectively, as a component of Accounts payable and other accruals on the consolidated balance sheets.

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 2006 and 2005.

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.

**Custodial Credit Risk**

This is the risk that in the event of the failure of a depository financial institution or counterparty to a transaction, the District's deposits may not be returned or the District will not be able to recover the value of its deposits, investments or collateral securities that are in the possession of another party. The District does not have a deposit policy for custodial credit risk. As of December 31, 2006 and 2005, \$2,110 and \$1,143, respectively, of the District's deposits were uninsured and uncollateralized.

**Concentration of Credit Risk**

This is the risk of loss attributed to the magnitude of an entity's investment in a single issuer. The District places no limit on the amounts invested in any one issuer for federal agency securities. The following are the concentrations of risk greater than 5% in either year:

Investment type	2006	2005
Guaranteed investment contracts:		
IXIS Funding	22%	0%
Transamerica Occidental Insurance Co.	0%	15%
Federal Home Loan Bank bonds	20%	27%
Fannie Mae	13%	15%
Freddie Mac	12%	12%
Corporate medium term notes	10%	10%
LAIF	5%	4%
Federal Farm Credit Bank notes	2%	6%

**Interest Rate Risk**

Though the District has restrictions as to the maturities of some of the investments, it does not have a formal policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increases in interest rates. Of the District's total portfolio at December 31, 2006 and 2005, all of the District's cash and cash equivalents have maturities of 90 days or less. The remaining investments mature between one to five years.

**4. Utility Plant**

Utility plant consists of the following at December 31:

	Balance December 31, 2005	Additions	Transfers and Deletions	Balance December 31, 2006
<b>Nondepreciable utility plant</b>				
Land	\$19,797	\$ -	\$1,597	\$21,394
Construction in progress	99,639	31,111	(113,176)	17,574
	<u>119,436</u>	<u>31,111</u>	<u>(111,579)</u>	<u>38,968</u>
<b>Depreciable utility plant</b>				
Electric system	\$476,780	\$2,268	\$110,013	\$589,061
Domestic water plant	104,710	-	7	104,717
Irrigation system	46,352	-	148	46,500
General and administrative facilities	54,006	-	1,252	55,258
	<u>681,848</u>	<u>2,268</u>	<u>111,420</u>	<u>795,536</u>
Less: accumulated depreciation	281,069	25,694	(111)	306,652
Total depreciable plant	<u>400,779</u>	<u>(23,426)</u>	<u>111,531</u>	<u>488,884</u>
<b>Total utility plant, net</b>	<u>\$520,215</u>	<u>\$7,685</u>	<u>\$(48)</u>	<u>\$527,852</u>

	Balance December 31, 2004	Additions	Transfers and Deletions	Balance December 31, 2005
<b>Nondepreciable utility plant</b>				
Land	\$18,307	\$1,490	\$ -	\$19,797
Construction in progress	60,461	63,720	(24,542)	99,639
	<u>78,768</u>	<u>65,210</u>	<u>(24,542)</u>	<u>119,436</u>
<b>Depreciable utility plant</b>				
Electric system	\$452,940	\$1,706	\$22,134	\$476,780
Domestic water plant	104,696	-	14	104,710
Irrigation system	46,242	-	110	46,352
General and administrative facilities	52,413	-	1,593	54,006
	<u>656,291</u>	<u>1,706</u>	<u>23,851</u>	<u>681,848</u>
Less: accumulated depreciation	259,471	22,259	(661)	281,069
Total depreciable plant	<u>396,820</u>	<u>(20,553)</u>	<u>24,512</u>	<u>400,779</u>
<b>Total utility plant, net</b>	<u>\$475,588</u>	<u>\$44,657</u>	<u>\$(30)</u>	<u>\$520,215</u>

## 5. 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:

	2006	2005
M-S-R Public Power Agency (M-S-R)	\$(104,605)	\$(112,859)
Transmission Agency of Northern California (TANC)	\$ 198	\$ 62
Central California Power Agency No. 1 (CCPA No. 1)	\$ -	\$ 1,125

### 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 generation assets owned by M-S-R. The District's deficit investment derives from its proportionate interest in M-S-R's deficit and the District's commitment to repay its share of M-S-R's debt, among other costs and obligations, through its take-or pay commitment. The generation activities of M-S-R consist 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 generation and transmission 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. In 2006 M-S-R entered into agreements with PPM Energy, Inc. to purchase renewable energy from the Big Horn wind project. The District's share of the Big Horn output is 12.5% and the District is obligated to make payments commensurate with its share of the project. During 2006 and 2005, the District incurred purchased power costs of \$41,295 and \$45,679, respectively, in connection with these M-S-R resources. At December 31, 2006 and 2005, the District had a payable of \$5,065 and \$2,883, 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 1,600 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. In July 2006 TANC changed the method used to invoice members for transmission costs. TANC began invoicing its members at the monthly TANC Open Access Transmission Tariff (OATT) rate. The OATT rate is charged to the member based on their entitlement share of kWhs. During 2006 and 2005, the District incurred transmission costs of \$5,109 and \$9,975, 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, 2006 and 2005, the District has a long-term payable of \$7,207 and \$12,253, 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 consolidated balance sheets. In 2006, the District began selling excess transmission capabilities from the COTP transmission lines through TANC, as agent of the District. The District recognized \$912 in revenues from transmission sales in the current year.

**CCPA No. 1**

The District owned a 40% undivided interest in CCPA No. 1 (CCPA), a joint power agency, formed for the purpose of participating in the exploration, development and production of electricity from geothermal resources. In June 1996, CCPA ceased operations and placed its power plant and steam field in a lay-up condition, and at that time, the District wrote-off its investment. The California Energy Commission approved the CCPA No. 1 closure plan in 1998. Decommissioning efforts commenced in October 1999. At December 31, 2005, the plant-dismantling project and the site restoration were complete. In May 2006 CCPA received \$1,145 in settlement of the property tax litigation and in June 2006, CCPA was officially dissolved.

**Summary**

Summarized audited financial information for M-S-R and unaudited information for CCPA No. 1, and TANC is as follows at December 31:

	2006	2005
Total assets	\$713,371	\$716,095
Total liabilities	\$921,249	\$939,187
Total net assets	(207,878)	(223,092)
	<u>\$713,371</u>	<u>\$716,095</u>
Changes in net assets during the year	<u>\$17,460</u>	<u>\$9,021</u>

The long-term debt of M-S-R and TANC, which totals approximately \$855,485 and \$885,240 at December 31, 2006 and 2005, 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 revenues and expenses of the Authority are eliminated upon consolidation with the District. The Authority's summary financial information as of December 31, 2006 and 2005 and for the years then ended is as follows:

	2006	2005
<b>Assets</b>		
Current assets	\$4,316	\$12,195
Debt service installment receivable, less current portion	65,690	147,891
	<u>\$70,006</u>	<u>\$160,086</u>
<b>Liabilities</b>		
Current liabilities	\$4,316	\$12,195
Long-term debt	65,690	147,891
Net assets	-	-
	<u>\$70,006</u>	<u>\$160,086</u>
<b>Revenues and Expenses</b>		
Revenues:		
Debt service contributions	\$7,576	\$9,735
Interest income	17	20
	7,593	9,755
Interest expense	(7,593)	(9,755)
Change in net assets	-	-
Net assets, beginning of year	-	-
Net assets, end of year	<u>\$ -</u>	<u>\$ -</u>

## 6. Long-term Debt

The District's total long-term debt is presented below as of December 31, 2006 and 2005:

	2006	2005
Domestic Water Revenue Bonds, fixed interest rates of 4.75% to 5.50% with maturities through 2022	\$73,780	\$76,710
Certificates of Participation (COPs): Fixed interest rates of 2.50% to 5.30% with maturities through 2036	443,165	301,940
Variable interest rate of 3.65% at December 31, 2005, with maturities through 2035	66,025	66,025
Capital appreciation certificates with fixed interest rates of 4.25% to 5.30% with maturities through 2021.	20,877	23,178
Revenue Bonds defeased in the current year with COPs issued in 2006	-	87,060
	<u>603,847</u>	<u>554,913</u>
Accreted interest on Capital Appreciation Certificates	9,787	9,118
Unamortized debt defeasance charges	(16,796)	(15,756)
Unamortized net premium	6,023	2,292
Total long-term debt	<u>602,861</u>	<u>550,567</u>
Less: Amount due within one year	<u>(19,635)</u>	<u>(18,530)</u>
Total long-term debt, net	<u>\$583,226</u>	<u>\$532,037</u>

The summarized activity of the District's long-term debt during 2006 and 2005 are presented below:

	December 31, 2005	Additions	Payments, amortization and refundings	December 31, 2006
Domestic Water				
Revenue Bonds	\$76,710	\$ -	\$(2,930)	\$73,780
Revenue Bonds	87,060	-	(87,060)	-
Certificates of Participation	391,143	146,960	(8,036)	530,067
Total	<u>554,913</u>	<u>146,960</u>	<u>(98,026)</u>	<u>603,847</u>
Accreted interest on				
Capital Appreciation Certificates	9,118	1,508	(839)	9,787
Unamortized net premium	2,292	3,558	173	6,023
Unamortized debt				
defeasance charges	(15,756)	(4,177)	3,137	(16,796)
Total long-term debt	<u>\$550,567</u>	<u>\$147,849</u>	<u>\$(95,555)</u>	<u>\$602,861</u>

	December 31, 2004	Additions	Payments, amortization and refundings	December 31, 2005
Domestic Water				
Revenue Bonds	\$79,490	\$ -	\$(2,780)	\$76,710
Revenue Bonds	93,445	-	(6,385)	87,060
Certificates of Participation	399,101	-	(7,958)	391,143
General Obligation Bonds	985	-	(985)	-
Total	<u>573,021</u>	<u>-</u>	<u>(18,108)</u>	<u>554,913</u>
Accreted interest on				
Capital Appreciation Certificates	8,282	1,563	(727)	9,118
Unamortized net premium	2,695	-	(403)	2,292
Unamortized debt				
defeasance charges	(17,506)	-	1,750	(15,756)
Total long-term debt	<u>\$566,492</u>	<u>\$1,563</u>	<u>\$(17,488)</u>	<u>\$550,567</u>

**2006 Certificates of Participation**

In July 2006, the District issued \$146,960 of 2006 Series A fixed rate Certificates of Participation (Series 2006A), at a premium of \$3,558. The proceeds are being used to defease \$80,335 of outstanding Senior Lien Obligations of the District (except for the October 2007 principal and interest payments which were paid from debt service reserves) and fund the acquisition and construction of certain improvements to the electric generation, transmission, distribution and other electric system facilities. The current refunding of the Senior Lien Obligations resulted in an accounting loss of approximately \$4,177 for fiscal year 2006, which has been deferred and is being amortized over the shorter of the remaining life of the defeased debt or COPs, which is ten years. However, the District effectively reduced its aggregate debt service payments by approximately \$7,641 over the next 9 years and obtained an economic gain (difference between the present values of the old and new debt service payments) of \$2,977.

**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 that 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 as of December 31, 2006:

	Principal	Interest	Total
2007	\$18,694	\$28,012	\$46,706
2008	19,274	27,428	46,702
2009	20,727	26,802	47,529
2010	22,665	24,844	47,509
2011	22,749	24,787	47,536
2012-2016	119,176	113,098	232,274
2017-2021	122,702	88,209	210,911
2022-2026	102,640	48,892	151,532
2027-2031	94,110	26,284	120,394
2032-2036	61,110	6,951	68,061
Total requirements	<u>\$603,847</u>	<u>\$415,307</u>	<u>\$1,019,154</u>

Interest payments for variable rate debt are computed using the rate in effect at December 31, 2006.

The District has outstanding debt obligations totaling \$67,812 and \$73,842 at December 31, 2006 and 2005, 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:

	2006	2005
Carrying amount	\$603,847	\$554,913
Fair value	\$637,743	\$582,676

**7. Employee Benefit Plans**

The District maintains two retirement plans and a retiree medical 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 performs plan administrative functions. Plan investments are managed by the District Treasury Department and third-party investment managers. 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 publicly available financial statements and required supplementary information of the Plan.

*Annual Pension Cost*

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, 2006, the most recently completed actuarial valuation, include the following, all reflecting annual compounding:

- Rate of return on the investment of present and future assets of 7.75% per year;
- Discount rate applied to the pension benefit obligation of 7.75% per year;
- Salary increases of 4% per year; and
- Cost of living increases to retirees of 2.5% per year.

The District's annual pension cost and net pension obligation for 2006 and 2005 were as follows:

	(a)	(b)
	2006	2005
Annual required contribution	\$8,267	\$7,540
Interest on net pension (prepaid) obligation	136	138
Adjustment to annual required contribution	(116)	(117)
Annual pension cost	<u>8,287</u>	<u>7,561</u>
Contributions made	<u>8,267</u>	<u>7,540</u>
Increase in net pension obligation	20	21
Net pension obligation, beginning of period	1,751	1,730
Net pension obligation, end of period	<u>\$1,771</u>	<u>\$1,751</u>

*Funding Policy*

The Board of Directors has established, and may amend, the contribution requirements for Plan members and the District set forth in the terms of the Plan. The terms of the Plan empower the Retirement Committee of the District (the Committee) to make, at reasonable intervals, an analysis of the funding requirements of the Plan for the payment of retirement benefits and expenses, based on reasonable actuarial assumptions and methods which take into account the experience of the Plan and reasonable expectations, and on the basis of this analysis, to establish a funding policy for the Plan. The terms of the Plan state that, subject to the Board of Directors' right to suspend or reduce contributions to the Plan at any time, the District shall contribute to the Plan at least once a year, the amounts necessary to maintain the Plan on a sound actuarial basis, in a manner consistent with the funding policy established by the Committee.

The funding policy currently established by the Committee requires the District to contribute an amount set forth in the Recommendation Regarding Total Contributions presented in the Plan actuary's 2006 Actuarial Report. The Required Annual Contribution set forth in the Recommendation regarding Total Contributions presented in the Plan actuary's 2006 Actuarial Report is \$8,267, which was contributed July 1, 2006.

The District is the sole contributing entity. Prior to 1989, participants were allowed to make voluntary contributions and prior to 1977, participant contributions were required.

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 Obligation /(Prepaid)
12/31/06	\$8,287	100%	\$1,771
12/31/05	\$7,561	100%	\$1,751
12/31/04	\$4,147	24%	\$1,730

The schedule of funding progress is presented below:

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ([b-a]/c)
01/01/06	\$120,922	\$151,878	\$30,956	79.6%	\$29,616	104.5%
01/01/05	\$109,124	\$133,933	\$24,809	81.5%	\$28,948	85.7%
01/01/04	\$101,354	\$104,584	\$3,230	96.9%	\$27,808	11.6%

**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 \$1,597 and \$1,554 for 2006 and 2005, respectively.

**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 233 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 a portion of the monthly premium 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 and vision care for retirees only to age 65.

These other post-employment benefits are charged to expense on a pay-as-you-go basis. During 2006 and 2005, the District’s post-retirement health care benefit expenses were \$1,587 and \$1,318, respectively. As discussed in Note 2, the District plans to adopt GASB 45 during the year ended December 31, 2007.

**8. Commitments**

The District purchases most of its purchased power from M-S-R (Note 5) 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) was amended in 2005 and is titled “Amended and Restated Long Term Power Sales Agreement between the City and County of San Francisco and the Modesto Irrigation District (ARLTSA). The ARLTSA provides for the delivery of power at volumes that are dependent upon available levels of power generated from CCSF’s Hetch Hetchy Hydroelectric System. Such power is priced based on formulas in the agreement which are based on numerous factors including the level of demonstrated Class One (for defined public entities) uses of MID’s take. The ARLTSA guarantees Class One power for the District with a minimum schedule of 30% of the capacity for the month, and expires in 2007. The District’s purchases in 2006 and 2005 totaled \$13,688 and \$13,302, respectively. Total commitments under this agreement over the next five years is as follows as of December 31, 2006:

2007	\$11,215
2008	1,624
2009	1,699
2010	1,778
2011	1,861

### **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 over the next five years are as follows as of December 31, 2006:

2007	\$101,640
2008	81,894
2009	73,896
2010	53,669
2011	38,215

## **9. Contingencies and Settlements**

### **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. This matter has been the subject of various proceedings with FERC and court filings with the Ninth District since 2001. The Administrative Law Judge (ALJ) assigned to the proceedings adopted hearing procedures that, among other issues, 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, and 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, FERC noted that any future FERC findings of energy market manipulation that result 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 challenged the FERC's jurisdictional authority to order refunds against the District, as a municipal utility.

In September 2005, the Ninth Circuit found that FERC does not have refund authority over wholesale power sales made by governmental entities and other non-public utilities, including the District. On March 7, 2007, the Ninth Circuit denied the California Parties' petition for rehearing and rehearing en banc as to the September 2005 decision. The California Parties have indicated that they intend to file a petition for writ of certiorari to the U.S. Supreme Court. The mandate has issued for the September 2005 decision and proceedings have begun at FERC to determine how the Ninth Circuit's decision should be implemented.

In August 2006, the Ninth Circuit issued a decision, as amended, which could have expanded the scope of transactions for which the District would have been required to pay refunds, but for the September 2005 decision addressing jurisdiction. The August 2006 decision requires FERC to review certain evidence in considering whether to open up the time period for refunds back to May 2000. The decision also requires FERC to review multi-day transactions, but denies refunds for bilateral sales, including to the California Energy Resources Scheduling ("CERS") division of the California Department of Water Resources ("CDWR"). If the California Parties prevail at the U.S. Supreme Court on their jurisdictional arguments, the California Parties may attempt to apply this ruling against the District at FERC. The California Parties may also use such ruling to support their cases in the civil proceedings discussed below. The mandate for the Ninth Circuit's August 2006 decision has not yet issued. Even if the Ninth Circuit's decision stands, the District must still defend several civil actions filed by the California Parties and the State of California as described below. 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.

### **Claims for 2000 and 2001 Power Sales**

Following the Ninth Circuit's jurisdictional ruling in September 2005, the California Parties began to seek refunds through other jurisdictions. In December 2005, the California Parties presented a claim for damages pursuant to California Government Code §905 et seq. ("Tort Claims Act"). The California Parties' claim arises from the District's power sales from May 1, 2000 through June 20, 2001 in the wholesale electricity markets operated by the California ISO and the California PX. The California Parties allege that the District is contractually obligated under the California PX Participation Agreement and/or the ISO Scheduling Coordinator Agreement to reimburse the California Parties for any amounts that FERC might find were unjust under the California Refund Proceedings. The District returned the claim without action as untimely filed. In March 2006, the California Parties filed lawsuits in the Federal District Court for the Eastern District of California, Sacramento Division. The District, in conjunction with other municipal entities, filed motions to dismiss for failure to state a claim, raising defenses such as expiration of the statute of limitations and lack of standing. Other entities argued that the U.S. District Court had no jurisdiction to hear the claims. On October 24, 2006, the Federal District Court heard oral argument on the issue concerning subject matter jurisdiction. The judge deferred oral argument on the issue of failure to state a

claim. On March 16, 2007, the judge issued an order dismissing both complaints before him for lack of subject matter jurisdiction. The judge's order has been appealed by the California Parties to the Ninth Circuit. On April 9, 2007, the California Parties filed a Complaint in state Superior Court in Los Angeles against the District and other entities, seeking substantively similar relief as they did in the U.S. District Court, Eastern District. The California Parties have served their Complaint on the District, and the District intends on vigorously defending against this Complaint.

On January 3, 2006 the Attorney General of the State of California and the California Department of Water Resources (collectively, the State) presented a claim for damages pursuant to the Tort Claims Act. The State's claim arises out of the District's power sales into the California ISO/ California PX from October 2, 2000 through June 20, 2001. Similar to the California Parties' claim, discussed above, the State alleges that the District is contractually obligated under the California PX Participation Agreement and the ISO Scheduling Coordinator Agreement to reimburse the State for any amounts that FERC might find were unjust under the California Refund Proceedings. The District returned the claim without action as untimely. On June 14, 2006, the State filed a lawsuit against the District. On February 23, 2007, the Plaintiffs served their Complaint on the District, triggering the time period for the District to answer. On February 28, 2007, the District and other entities entered into tolling agreements with the State. As an outcome of the tolling agreement, on March 1, 2007, the State moved to dismiss its Complaint against the District without prejudice.

Although the California Parties' lawsuits and the State's claims do not specify the amount of damages that the California Parties seek, the District expects that the amounts would parallel the refund that the District would owe to the market if it were subject to the FERC-based refund liability. Under the latest MMCP formula prescribed in the FERC proceedings, the District estimates its potential refund exposure to be in the range of \$4,900 to \$7,700.

As such the District has maintained an accrued liability of \$4,900 related to their contingent refund obligations at both December 31, 2006 and 2005.

#### ***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 or results of operations of the District.

#### ***Settlements***

##### ***SCS Tariff Settlement***

Through the Scheduling Coordinator Services (SCS) Tariff, PG&E proposed to charge the District, as a wholesale existing contract customer, various charges for the scheduling services that PG&E provided. Based on orders issued by FERC, PG&E issued the District an invoice in the amount of \$15,600 and which the District began paying in 2004. The District paid \$7,600 in 2004 and the remaining balance in 2005. All of the above amounts were included in purchased power expense on the statement of revenues, expenses and changes in net assets in 2004 and 2005. In May 2006, FERC issued an order terminating the SCS Tariff proceeding and ordered PG&E to refund all amounts paid under the SCS Tariff. As a result of the order, in June 2006, the District received \$17,100 (original \$15,600 plus interest) from PG&E which is included as an offset to purchase power expense on the statement of revenues, expenses and changes in net assets for the year ended December 31, 2006.

##### ***PG&E Boundary Claims Settlement***

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 another matter involving PG&E, the District had been pursuing collection of emergency power sales made to PG&E during 2000 and 2001 through PG&E's bankruptcy proceedings.

In March 2007, the District completed a settlement with PG&E involving both of these matters and others, as part of which PG&E dismissed the boundary dispute and the District dismissed its bankruptcy claims related to the 2000/2001 emergency power sales. As this settlement agreement clarifies the lack of collectability of the District's receivables from PG&E at December 31, 2006, the District wrote off wholesale power receivables totaling \$1,389 at December 31, 2006, recording the charges as an offset to wholesale power revenues on the District's statements of revenues, expenses and changes in net assets.

##### ***Mirant Settlement***

In 2004, the District filed claims in bankruptcy proceedings involving Mirant Americas Energy Marketing citing damages for rejection of a purchase power agreement in which the District would purchase firm energy starting in 2003 and continue through and include 2010. In May 2006, the District received \$2,575, which is included in other non-operating income on the statement of revenues, expenses and changes in net assets for the year ended December 31, 2006.