AUDITED FINANCIAL STATEMENTS

TABLE OF CONTENTS

KPMG LLP
Suite 2000
355 South Grand Avenue
Los Angeles, CA 90071-1568

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

We have audited the accompanying basic financial statements of The Metropolitan Water District of Southern California (Metropolitan) as of and for the years ended June 30, 2007 and 2006, as listed in the table of contents. These financial statements are the responsibility of Metropolitan's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

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

In accordance with *Government Auditing Standards*, we have also issued our report dated October 4, 2007, on our consideration of Metropolitan's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

The information in the Management Discussion and Analysis on pages 2 through 12 and the pension and other postemployment benefits supplementary information on page 60 are not a required part of the basic financial statements, but are supplementary information required by U.S. generally accepted accounting principles. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit this information and express no opinion on it.

KPMG LLP

October 4, 2007

This page intentionally left blank.

The following discussion and analysis of The Metropolitan Water District of Southern California's (Metropolitan) financial performance provides an overview of the financial activities for the fiscal years ended June 30, 2007 and 2006. This discussion and analysis should be read in conjunction with the basic financial statements and accompanying notes, which follow this section.

DESCRIPTION OF BASIC FINANCIAL STATEMENTS

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

Metropolitan implemented GASB Statement No. 45 in fiscal year 2006. This statement provides accounting and reporting rules for postemployment benefits other than pensions (OPEB), which for Metropolitan consists of retiree medical benefits (see Notes 1b and 8 of Notes to Basic Financial Statements).

CONDENSED FINANCIAL INFORMATION

Condensed Balance Sheet Information

	June 30,		
(Dollars in millions)	**2007**	2006	2005
Assets			
Capital assets, net	**$ 7,461.4**	$ 6,967.3	$ 6,523.8
Other assets	**3,480.3**	2,996.4	3,237.2
Total assets	**10,941.7**	9,963.7	9,761.0
Liabilities			
Long-term liabilities, net of current portions	**4,703.5**	3,972.1	3,803.9
Other liabilities	**532.7**	490.0	524.8
Total liabilities	**5,236.2**	4,462.1	4,328.7
Net Assets			
Invested in capital assets and State Water Project costs, net of related debt	**4,692.3**	4,574.9	4,443.4
Restricted	**471.5**	411.6	380.2
Unrestricted	**541.7**	515.1	608.7
Total net assets	**$ 5,705.5**	$ 5,501.6	$ 5,432.3

Capital Assets, Net

Fiscal Year 2007 Compared to 2006. Net capital assets include plant, participation rights, and construction work in progress, net of accumulated depreciation and amortization. At June 30, 2007, net capital assets totaled $7.5 billion, or 68 percent of total assets. This represents an increase of $494.1 million, or 7 percent, over the prior year due primarily to continued expenditures on the capital investment plan, partially offset by an increase in depreciation and amortization. Expenditures on the capital investment plan during fiscal year 2007 totaled $528.9 million (including $56.7 million of capitalized interest) and are described in the capital assets section below.

Fiscal Year 2006 Compared to 2005. At June 30, 2006, Metropolitan had invested $7.0 billion in net capital assets. These assets, which made up 70 percent of Metropolitan's total assets, increased by $443.5 million, or 7 percent, over fiscal year 2005 due to continued expenditures on the capital investment plan, partially offset by an increase in depreciation and amortization. Expenditures on the capital investment plan during fiscal year 2006 totaled $504.8 million (including $58.7 million of capitalized interest) and are described in the capital assets section below.

Other Assets

Fiscal Year 2007 Compared to 2006. Other assets totaled $3.5 billion at June 30, 2007, and were $483.9 million higher than the prior year. Included in other assets was $1.5 billion related to prepaid State Water Project costs and $1.4 billion related to cash and investments. The remaining items in other assets consisted of accounts receivable, inventories, deferred charges, and other. Cash and investments were $450.7 million higher than the prior year due to the issuance of new bonds during the year. Receivables were $48.4 million higher than the prior year due primarily to $39.4 million higher water sales and $4.8 million increased annexation charges.

Fiscal Year 2006 Compared to 2005. Other assets totaled $3.0 billion at June 30, 2006, and were $240.8 million lower than at June 30, 2005. Included in other assets was $1.5 billion related to prepaid State Water Project costs and $977.2 million related to cash and investments. In fiscal year 2006, costs related to the State Water Project costs were reclassified from capital assets to prepaid assets (see Note Ib of Notes to Basic Financial Statements). Prepaid State Water Project costs were $49.4 million less than the prior year due primarily to the expensing of $56.4 million net operating and maintenance costs, previously capitalized. The remaining items in other assets consisted of cash and investments, accounts receivable, inventories, deferred charges, and other. Cash and investments were $243.9 million lower than the prior year due to higher expenditures on the capital investment plan in fiscal year 2006. Receivables were $27.5 million higher than the prior year due primarily to $18.6 million higher water sales and taxes receivable and $7.2 million of grant reimbursables. Water transfers and exchange programs increased by $13.5 million as Metropolitan was able to take advantage of available water supplies from these programs during the year.

Long-term Liabilities

Fiscal Year 2007 Compared to 2006. Long-term liabilities totaled $4.7 billion at June 30, 2007 and increased $731.4 million over the prior year due primarily to the issuance of $800.0 million in new debt, partially offset by maturities and defeasance of debt. See the long-term debt section below for additional information.

Fiscal Year 2006 Compared to 2005. Long-term liabilities totaled $4.0 billion at June 30, 2006 and were $168.2 million higher than at June 30, 2005 due primarily to the issuance of $200.0 million in new debt, partially offset by maturities and defeasance of debt. See the long-term debt section below for additional information.

Other Liabilities

Fiscal Year 2007 Compared to 2006. Other liabilities represent current liabilities that are due within one year. They include accounts payable, accrued liabilities, and the current portion of long-term liabilities. At June 30, 2007, other liabilities totaled $532.7 million, which was $42.7 million higher than the prior year. Included in the change from prior year were $32.1 million of higher State Water Project accruals, primarily variable costs and $21.4 million of additional OPEB costs; partially offsetting these charges was $11.7 million of lower accounts payable.

Fiscal Year 2006 Compared to 2005. Other liabilities totaled $490.0 million at June 30, 2006, which was $34.8 million lower than at June 30, 2005. Included in the change was $53.2 million in payments for the land fallowing program with Palo Verde Irrigation District and a $35.0 million payment related to the Cargill lawsuit (see Note 9g of Notes to Basic Financial Statements); partially offsetting these payments were higher accruals of $18.4 million for the State Water Project and $39.5 million for vendor and contractor payments.

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

Fiscal Year 2007 Compared to 2006. Investment in capital assets and State Water Project costs, net of related debt totaled $4.7 billion and increased $117.4 million over the prior year due to Metropolitan's continued investment in its capital investment plan (CIP), partially offset by an increase in debt to finance the CIP. Current year CIP expenditures are described in the capital assets section below. The largest single component of the CIP was the Inland Feeder Project with a $1.2 billion budget, currently estimated to be completed in fiscal year 2011.

Fiscal Year 2006 Compared to 2005. Investment in capital assets and State Water Project costs, net of related debt totaled $4.6 billion and was $131.5 million greater than at June 30, 2005 due to Metropolitan's continued investment in its CIP, partially offset by an increase in debt to finance the plan. Fiscal year 2006 CIP expenditures are described in the capital assets section below.

Restricted Net Assets

Fiscal Year 2007 Compared to 2006. Restricted net assets include amounts restricted for debt service payments and operating expenses, both of which are required by bond covenants. Restricted net assets totaled $471.5 million at June 30, 2007, which was $59.9 million higher than fiscal year 2006. The increase was due to $32.9 million more in amounts restricted for debt service payments and $27.0 million more restricted for operating expenses.

Fiscal Year 2006 Compared to 2005. Restricted net assets totaled $411.6 million at June 30, 2006, which was $31.4 million higher than fiscal year 2005. The increase was due primarily to $25.7 million more in the amounts restricted for debt service payments.

Unrestricted Net Assets

Fiscal Year 2007 Compared to 2006. Unrestricted net assets of $541.7 million increased $26.6 million from the prior year. Unrestricted net assets consisted of net assets that did not meet the definition of "restricted" or "invested in capital assets and State Water Project costs, net of related debt". Certain unrestricted net assets have been designated for purposes authorized by the Board. These designated amounts totaled $457.6 million and $458.4 million at June 30, 2007 and 2006, respectively (see Note 13 of Notes to Basic Financial Statements).

Fiscal Year 2006 Compared to 2005. Unrestricted net assets of $515.1 million were $93.6 million lower than at June 30, 2005. Unrestricted net assets consisted of net assets that did not meet the definition of "restricted" or "invested in capital assets and State Water Project costs, net of related debt". Certain of the unrestricted net assets have been designated for purposes authorized by the Board.

Condensed Schedule of Revenues, Expenses and Changes in Net Assets

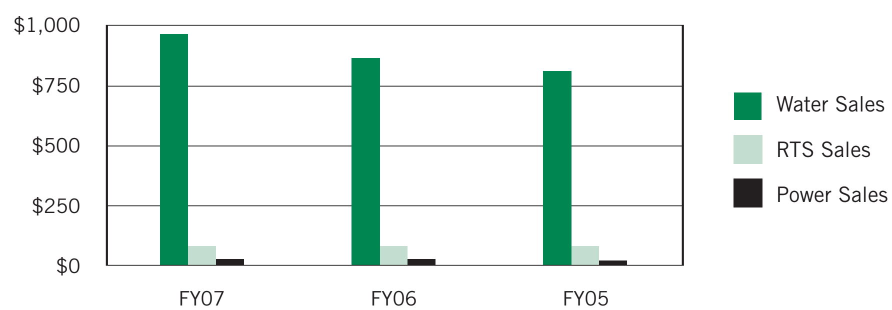
	Year Ended June 30,		
(Dollars in millions)	**2007**	2006	2005
Water sales	**$ 963.2**	$ 864.2	$ 810.2
Readiness-to-serve charges	**80.0**	80.0	80.0
Power recoveries	**26.1**	26.8	20.9
Operating revenues	**1,069.3**	971.0	911.1
Taxes, net	**96.4**	102.7	91.8
Investment income	**55.3**	32.5	47.2
Other, net	**10.1**	4.6	7.2
Nonoperating revenues	**161.8**	139.8	146.2
Total revenues	**1,231.1**	1,110.8	1,057.3
Power and water costs	**(335.4)**	(366.2)	(278.5)
Operations and maintenance	**(368.4)**	(370.4)	(321.2)
Depreciation and amortization	**(214.4)**	(205.3)	(210.5)
Operating expenses	**(918.2)**	(941.9)	(810.2)
Bond interest, net of amount capitalized	**(118.9)**	(110.0)	(100.3)
Interest and adjustments on off-aqueduct power facilities	**(4.5)**	(4.9)	(5.4)
Nonoperating expenses	**(123.4)**	(114.9)	(105.7)
Total expenses	**(1,041.6)**	(1,056.8)	(915.9)
Contributed capital	**14.5**	15.2	7.7
Change in net assets	**$ 204.0**	$ 69.2	$ 149.1

CHANGE IN NET ASSETS

Operating Revenues

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

OPERATING REVENUES
(Dollars in millions)



Analytical Review of Operating Revenues

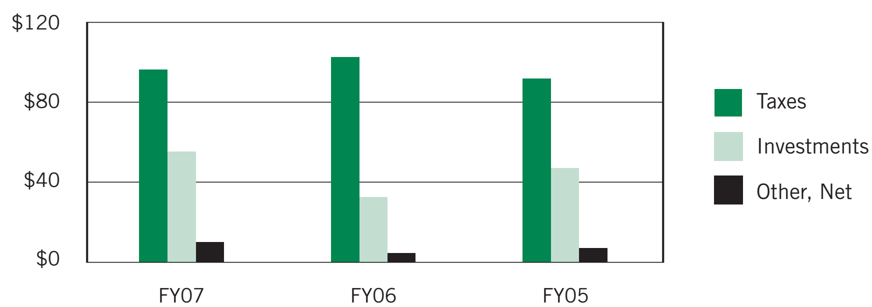
Fiscal Year 2007 Compared to 2006. Fiscal year 2007 operating revenues were $1.1 billion or $98.3 million higher than the prior year due primarily to higher water sales. Water sales vary with the amount of rainfall. During dry periods, Metropolitan's water sales are higher than during wet periods. Southern California is in its eighth year of drought and fiscal year 2007 was the driest year in recorded history. Readiness-to-serve (RTS) revenues remained at $80.0 million or 8 percent of operating revenues, while power sales totaled $26.1 million, or 2 percent of operating revenues.

Fiscal Year 2006 Compared to 2005. Fiscal year 2006 operating revenues were $971.0 million, or $59.9 million higher than fiscal year 2005 due primarily to higher water sales. Water sales vary with the amount of rainfall. During dry periods Metropolitan's water sales are higher than during wet periods. RTS revenues remained at $80.0 million, or 8 percent of operating revenues, while power sales totaled $26.8 million, or 3 percent of operating revenues.

Nonoperating Revenues

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

NONOPERATING REVENUES
(Dollars in millions)



Analytical Review of Nonoperating Revenues

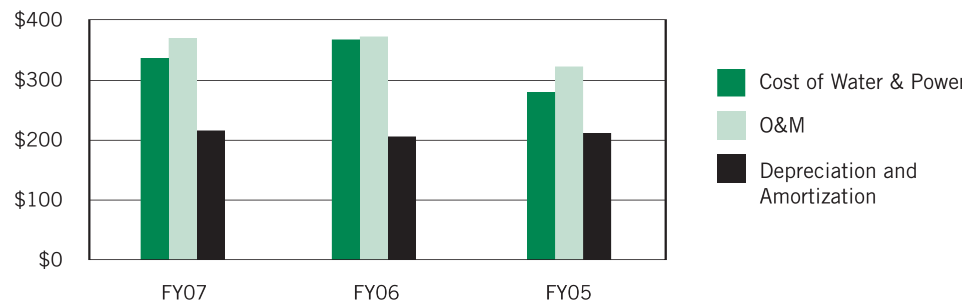
Fiscal Year 2007 Compared to 2006. Nonoperating revenues for fiscal year 2007 totaled $161.8 million and were $22.0 million higher than the prior year due primarily to the change in fair value adjustment on investments of $19.8 million.

Fiscal Year 2006 Compared to 2005. Nonoperating revenues for fiscal year 2006 totaled $139.8 million and were $6.4 million lower than fiscal year 2005. The primary reason for the decrease was lower investment income due to a lower average portfolio balance compared to the prior year; partially offset by higher tax revenues.

Operating Expenses

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

OPERATING EXPENSES
(Dollars in millions)



Analytical Review of Operating Expenses

Fiscal Year 2007 Compared to 2006. Fiscal year 2007 operating expenses of $918.2 million were $23.7 million lower than prior year operating expenses due primarily to lower power and water costs partially offset by higher depreciation and amortization expense.

Power and water costs decreased $30.8 million from the prior year due primarily to a lower average unit cost of water reflecting lower power costs and the expensing of $56.4 million of State Water Project O&M costs in fiscal year 2006, partially offset by higher depreciation and amortization costs of $9.1 million.

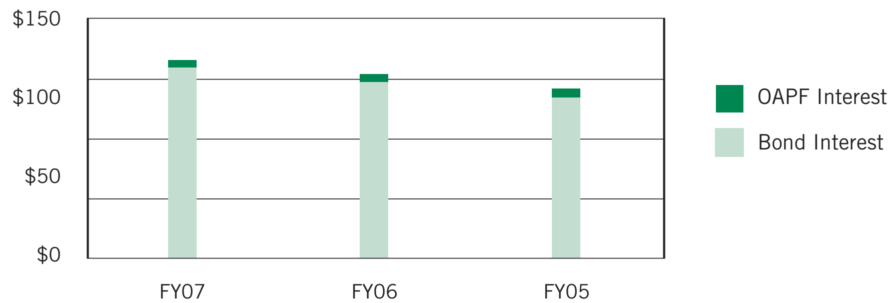
Fiscal Year 2006 Compared to 2005. Fiscal year 2006 operating expenses of $941.9 million were $131.7 million higher than fiscal year 2005 operating expenses due primarily to higher power and water costs and O&M costs.

Power and water costs were $87.7 million higher than in fiscal year 2005 due primarily to higher water sales, higher State Water Project energy costs, and the expensing of previously capitalized State Water Project O&M costs totaling $56.4 million. O&M costs increased $49.2 million over fiscal year 2005 due primarily to higher labor costs of $46.0 million, of which $18.2 million was due to the implementation of GASB 45, a new accounting pronouncement relating to accounting and reporting for postemployment benefits other than pensions. About $27.6 million of the higher labor costs related to higher salary and benefit costs.

Nonoperating Expenses

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

NONOPERATING EXPENSES
(Dollars in millions)



Analytical Review of Nonoperating Expenses

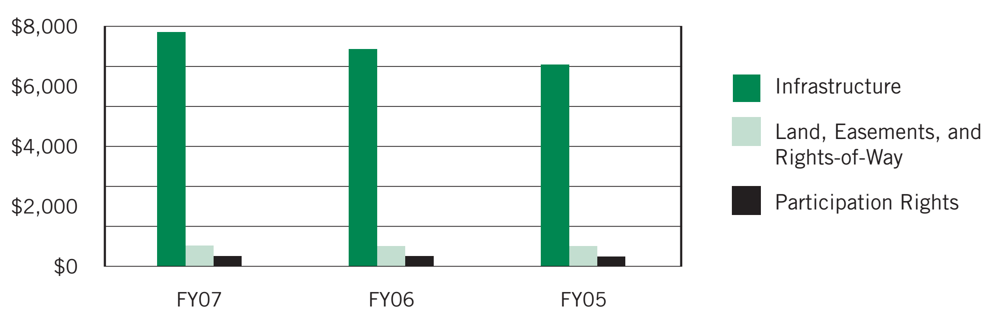
Fiscal Year 2007 Compared to 2006. Fiscal year 2007 net interest expense of $123.4 million was $8.5 million higher than the prior year due primarily to Metropolitan's issuance of $300.0 million of new debt in August 2007. An additional $500.0 million of new debt was issued in the May/June 2007 timeframe and had little impact on the current year's interest expense.

Fiscal Year 2006 Compared to 2005. Fiscal year 2006 net interest expense of $114.9 million was $9.2 million higher than fiscal year 2005 due primarily to Metropolitan's issuance of $200.0 million in new debt.

Capital Assets and Debt Administration

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

GROSS CAPITAL ASSETS
(Dollars in millions)



Schedule of Capital Assets

	June 30,		
(Dollars in millions)	**2007**	2006	2005
Land, easements, and rights-of-way	**$ 537.2**	$ 534.5	$ 539.5
Construction in progress	**2,313.9**	2,036.1	1,782.7
Parker power plant and dam	**13.0**	13.0	13.0
Power recovery plants	**175.9**	175.9	176.1
Other dams and reservoirs	**1,430.0**	1,430.5	1,429.9
Water transportation facilities	**1,536.3**	1,519.5	1,516.0
Pumping plants and facilities	**227.2**	226.8	226.7
Treatment plants and facilities	**1,440.5**	1,249.7	995.3
Other plant assets	**752.0**	657.6	652.7
Pre-operating expenses original aqueduct	**44.6**	44.6	44.6
Participation rights in other facilities	**328.2**	326.0	314.3
Gross capital assets	**8,798.8**	8,214.2	7,690.8
Less accumulated depreciation and amortization	**(1,337.4)**	(1,246.9)	(1,167.0)
Capital assets, net	**$ 7,461.4**	$ 6,967.3	$ 6,523.8
Net increase from prior year	**$ 494.1**	$ 443.5	$ 355.5
Percent increase	**7.1%**	6.8%	5.8%

Fiscal year 2007 Compared to 2006. Net capital assets totaled approximately $7.5 billion and increased $494.1 million over the prior year due primarily to $528.9 million in new construction activity, partially offset by increased accumulated depreciation and amortization, net of $90.5 million. The major capital asset additions for the current year, excluding capitalized interest, included:

- $139.0 million for the oxidation retrofit program at the filtration plants; this program is designed to reduce the level of disinfection by-products in the treated water supplied by these plants in order to meet state and federal standards.

- $99.8 million for improvements/expansions at the filtration plants; these projects will ensure reliability of equipment and facilities and ensure regulatory compliance.

- $67.9 million on the Inland Feeder Project; this $1.2 billion dollar project is designed to provide system reliability by linking together the State Water Project and the Colorado River systems and to improve water quality by blending State Water Project and Colorado River water.

- $46.7 million on chlorine containment and handling facilities; this project will reduce the potential exposure to treatment plant personnel or the public from a release of chlorine, and ensure compliance with current Uniform Fire Code requirements.

- $45.7 million on Skinner Filtration Plant, Expansion No. 4; this project will assure regulatory compliance at the treatment plant, as well as, achieve 100 percent compliance with all primary drinking water standards.

Metropolitan's fiscal year 2008 capital budget includes plans to spend $498.4 million principally for the oxidation retrofit program, the filtration plants improvements program, the Inland Feeder and Perris Valley pipeline projects, the chlorine containment and handling facilities project, and the distribution system and rehabilitation projects. More detailed information about Metropolitan's capital assets is provided in Notes 2, 4, and 9f of the Notes to Basic Financial Statements.

Fiscal year 2006 Compared to 2005. Net capital assets totaled approximately $7.0 billion and increased $443.5 million over fiscal year 2005 due primarily to $504.8 million in new construction activity and a net increase of $11.8 million in participation rights in various water programs, partially offset by increased accumulated depreciation and amortization, net of $79.9 million. The major capital asset additions for the current year, excluding capitalized interest, included:

- $122.6 million for improvements/expansions at the filtration plants; these projects will ensure reliability of equipment and facilities and ensure regulatory compliance.
- $100.9 million for the oxidation retrofit program at the filtration plants; this program is designed to reduce the level of disinfection by-products in the treated water supplied by these plants in order to meet state and federal standards.
- $67.9 million on the Inland Feeder Project; this $1.2 billion dollar project is designed to provide system reliability by linking together the State Water Project and Colorado River systems and to improve water quality by blending State Water Project and Colorado River water.
- $57.1 million on San Diego Pipeline No. 6; this is a joint project with the San Diego County Water Authority that includes construction of a 30-mile pipeline and tunnel conveyance system to meet supplemental water needs in southern Riverside County and San Diego County.
- $22.7 million for the Diamond Valley Lake recreation program; this project includes the design and construction of a marina and trails in the Diamond Valley Lake area, and includes construction of a water education center.

LONG-TERM DEBT

Schedule of Long-term Debt

	June 30,		
(Dollars in millions)	**2007**	2006	2005
General obligation bonds (a)	**$ 359.1**	$ 389.6	$ 419.4
Revenue bonds (a)	**4,279.2**	3,531.3	3,360.5
Other long-term debt	**33.0**	34.7	40.3
Other, net (b)	**(54.9)**	(89.3)	(97.1)
	$ 4,616.4	$ 3,866.3	$ 3,723.1
Increase from prior year	**$ 750.1**	$ 143.2	$ 199.8
Percent change	**19.4%**	3.8%	5.7%

(a) Includes refunding bonds.

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

Fiscal Year 2007 Compared to 2006. At June 30, 2007, there was $4.6 billion in bonds outstanding, a net increase of $750.1 million or 19.4 percent from the prior year. This increase was due to the issuance of $800.0 million in new debt partially offset by maturities and defeasance of debt. In addition, Metropolitan refinanced $269.4 million of bonds with $264.3 million of refunding bonds taking advantage of lower interest rates during the year (see Notes 5 and 6 of Notes to Basic Financial Statements).

Fiscal Year 2006 Compared to 2005. At June 30, 2006, there was $3.9 billion in bonds outstanding, a net increase of $143.2 million, or 3.8 percent, from fiscal year 2005. This increase was due to the issuance of $200.0 million in new debt partially offset by maturities and defeasance of debt. In addition, Metropolitan refinanced $73.4 million of bonds with $74.1 million of refunding bonds taking advantage of lower interest rates during the year. (See Notes 5 and 6 of Notes to Basic Financial Statements.)

CREDIT RATINGS

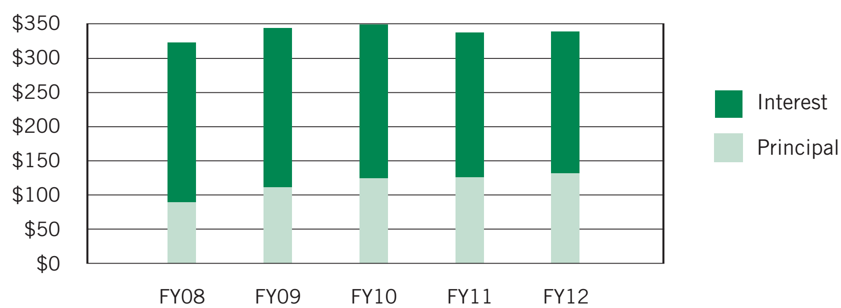
Metropolitan's credit ratings at June 30, 2007 and 2006 are shown below.

	Moody's Investors Service	Standard & Poor's	Fitch Ratings
General obligation bonds	Aaa	AAA	AAA
Water revenue bonds—fixed rate	Aa2	AAA	AA+
Water revenue bonds—variable rate	VMIG1	A1+	F1+

FUTURE DEBT SERVICE

Metropolitan's future debt service requirements through June 30, 2012 are shown on the following table.

FUTURE DEBT SERVICE
(Dollars in millions)



This page intentionally left blank.

(Dollars in thousands)	June 30, 2007	2006
ASSETS		
Current Assets:		
Cash and investments, at fair value (Notes 1b and 3):		
Unrestricted (cost $180,831 and $195,251 for fiscal years 2007 and 2006, respectively)	**$ 180,723**	$ 193,528
Restricted (cost $808,308 and $304,017 for fiscal years 2007 and 2006, respectively)	**807,840**	301,501
Total cash and investments	**988,563**	495,029
Receivables, net:		
Water sales	**184,610**	145,169
Annexation charges—current portion (Note 1e)	**1,688**	1,719
Interest on investments	**13,416**	13,315
Other	**42,360**	38,342
Total receivables	**242,074**	198,545
Inventories (Note 1n)	**74,170**	84,970
Prepaid State Water Project costs—current portion (Notes 1h and 10)	**116,425**	113,778
Deposits, deferred charges, and other—current portion (Note 11)	**77,897**	84,109
Total current assets	**1,499,129**	976,431
Noncurrent Assets:		
Cash and investments, at fair value (Notes 1b and 3):		
Unrestricted (cost $284,378 and $275,318 for fiscal years 2007 and 2006, respectively)	**284,220**	273,214
Restricted (cost $155,147 and $210,699 for fiscal years 2007 and 2006, respectively)	**155,057**	208,956
Total cash and investments	**439,277**	482,170
Capital assets (Note 2):		
Plant and equipment (Notes 1f and 9f)	**8,470,615**	7,888,179
Participation rights (Notes 1g and 4)	**328,213**	326,065
Total capital assets	**8,798,828**	8,214,244
Less accumulated depreciation and amortization	**(1,337,385)**	(1,246,915)
Total capital assets, net	**7,461,443**	6,967,329
Other assets, net of current portion:		
Prepaid State Water Project costs, net (Notes 1h and 10)	**1,361,385**	1,374,338
Deposits, deferred charges, and other (Note 11)	**175,608**	163,411
Annexation charges, net (Note 1e)	**4,871**	—
Total other assets	**1,541,864**	1,537,749
Total noncurrent assets	**9,442,584**	8,987,248
Total Assets	**$ 10,941,713**	$ 9,963,679

See accompanying notes to basic financial statements.

(Dollars in thousands)	June 30, 2007	2006
LIABILITIES AND NET ASSETS		
Current Liabilities:		
Accounts payable and accrued expenses (Note 1l)	**$ 326,836**	$ 322,978
Current portion of long-term debt (Notes 5 and 6)	**87,499**	74,884
Current portion of obligations for off-aqueduct power facilities (Notes 6 and 9e)	**6,047**	6,361
Current portion of accrued compensated absences (Notes 1i and 6)	**14,200**	13,700
Current portion of customer deposits and trust funds (Note 6)	**19,922**	13,371
Current portion of workers' compensation and third-party claims (Notes 6 and 14)	**24,614**	6,316
Current portion of other long-term obligations	**50**	30
Accrued bond interest	**49,685**	49,028
Matured bonds and coupons not presented for payment	**1,240**	1,251
Other	**2,586**	2,095
Total current liabilities	**532,679**	490,014
Noncurrent Liabilities (Note 6):		
Long-term debt, net of current portion (Note 5)	**4,528,869**	3,791,451
Obligations for off-aqueduct power facilities, net of current portion (Note 9e)	**66,476**	73,376
Accrued compensated absences, net of current portion (Note 1i)	**26,296**	26,064
Customer deposits and trust funds, net of current portion	**21,469**	24,996
Postemployment benefits other than pensions (Note 8)	**43,118**	21,718
Workers' compensation and third-party claims, net of current portion (Note 14)	**11,979**	29,222
Other long-term obligations, net of current portion	**5,327**	5,290
Total noncurrent liabilities	**4,703,534**	3,972,117
Total liabilities	**5,236,213**	4,462,131
Commitments and Contingencies (Note 9)		
Net Assets (Note 13):		
Invested in capital assets and State Water Project costs, net of related debt	**4,692,307**	4,574,882
Restricted for:		
Debt service	**313,823**	280,927
Other	**157,659**	130,642
Unrestricted	**541,711**	515,097
Total net assets	**5,705,500**	5,501,548
Total Liabilities and Net Assets	**$ 10,941,713**	$ 9,963,679

This page intentionally left blank.

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

	Year Ended June 30,	
(Dollars in thousands)	**2007**	2006
Operating Revenues (Note 1c):		
Water sales	**$ 963,182**	$ 864,213
Readiness-to-serve charges	**80,001**	80,002
Power recoveries	**26,129**	26,795
Total operating revenues	**1,069,312**	971,010
Operating Expenses:		
Power and water costs	**335,401**	366,240
Operations and maintenance	**368,400**	370,335
Total operating expenses	**703,801**	736,575
Operating income before depreciation and amortization	**365,511**	234,435
Less depreciation and amortization (Notes 2 and 10)	**(214,395)**	(205,297)
Operating income	**151,116**	29,138
Nonoperating Revenues (Expenses):		
Taxes, net (Note 1d)	**96,371**	102,705
Bond interest, net of $56,728 and $58,731 of interest capitalized in fiscal years 2007 and 2006, respectively (Note 1f)	**(118,942)**	(109,978)
Investment income	**55,254**	32,510
Interest and adjustments on off-aqueduct power facilities obligations (Note 9e)	**(4,506)**	(4,919)
Other, net	**10,119**	4,558
Total nonoperating revenues, net	**38,296**	24,876
Income before Contributions	**189,412**	54,014
Capital contributions, net (Note 1p)	**14,540**	15,165
Change in net assets	**203,952**	69,179
Net assets, beginning of year	**5,501,548**	5,432,369
Net Assets, End of Year	**$ 5,705,500**	$ 5,501,548

See accompanying notes to basic financial statements.

STATEMENTS OF CASH FLOWS

(Dollars in thousands)	Year Ended June 30, 2007	2006
Cash Flows from Operating Activities:		
Cash received from water sales	**$ 878,401**	$ 813,814
Cash received from readiness-to-serve charges	**80,869**	79,631
Cash received from capacity charges	**32,251**	31,747
Cash received from power recoveries	**44,940**	29,892
Cash received from wheeling/exchange transactions	**13,069**	8,654
Cash paid for operations and maintenance expenses	**(194,854)**	(212,763)
Cash paid to employees	**(146,801)**	(138,513)
Cash paid for power and water costs	**(306,358)**	(336,668)
Cash paid for member agency refund	**—**	(8,982)
Cash flow from (for) other operating activities	**(175)**	2,045
Net Cash Provided by Operating Activities	**401,342**	268,857
Cash Flows from Capital and Related Financing Activities:		
Acquisition and construction of capital assets	**(550,305)**	(439,400)
Payments for State Water Project costs	**(114,359)**	(128,894)
Payments for participation rights in other facilities	**(9,210)**	(65,369)
Proceeds from long-term debt	**795,346**	198,284
Proceeds from short-term debt	**500**	—
Proceeds from capital grants	**2,027**	948
Principal and interest paid on long-term debt	**(253,932)**	(233,337)
Proceeds from tax levy	**101,084**	97,825
Transfers (to) from escrow trust accounts	**(9,215)**	2,180
Transfer from revenue bond reserve fund	**36,026**	6,345
Payment of rebatable arbitrage	**(193)**	(1)
Proceeds from real estate sales	**654**	13,061
Collection of notes receivable	**83**	7,506
Net Cash Used in Capital and Related Financing Activities	**(1,494)**	(540,852)
Cash Flows from Investing Activities:		
Purchase of investment securities	**(17,039,562)**	(12,586,450)
Proceeds from sales and maturities of investment securities	**16,599,259**	12,819,461
Interest on investments	**39,491**	34,794
Net Cash Provided by (Used in) Investing Activities	**(400,812)**	267,805
Net Change in Cash and Cash Equivalents	**(964)**	(4,190)
Cash and Cash Equivalents, Beginning of Year	**964**	5,154
Cash and Cash Equivalents, End of Year (Note 1b)	**$ —**	$ 964

See accompanying notes to basic financial statements.

(Dollars in thousands)	Year Ended June 30, 2007	2006
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES		
Operating Income	$ 151,116	$ 29,138
Adjustments to reconcile Operating Income to Net Cash Provided by Operating Activities:		
Depreciation and amortization expense	214,395	205,297
Increase in accounts receivable	(44,304)	(9,359)
Decrease (increase) in inventories	10,801	(4,319)
Decrease in prepaid expenses	5,787	33,494
Increase in accounts payable	58,701	17,767
Increase (decrease) in other	4,846	(3,161)
Total adjustments	250,226	239,719
Net Cash Provided by Operating Activities	$ 401,342	$ 268,857
Significant Noncash Investing, Capital, and Financing Activities:		
Refunding bonds proceeds received in escrow trust fund	$ 259,448	$ 74,008
Debt defeased through escrow trust fund with refunding bonds	$ (269,390)	$ (73,365)
Deferred loss on refunding debt	$ (1,742)	$ (712)
Change in fair value of investments	$ 7,261	$ (12,549)
RECONCILIATION OF CASH AND INVESTMENTS TO CASH AND CASH EQUIVALENTS		
Unrestricted cash and investments (includes cash of $877 for fiscal year 2006)	$ 464,943	$ 466,742
Restricted cash and investments (includes cash of $87 for fiscal year 2006)	962,897	510,457
Total cash and investments, at fair value	1,427,840	977,199
Less carrying value of investments (Note 3b)	(1,427,840)	(976,235)
Total Cash and Cash Equivalents (Note 1b)	$ —	$ 964

This page intentionally left blank.

1. REPORTING ENTITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Reporting Entity

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

The Metropolitan Water District Asset Financing Corporation (MWDAFC) was incorporated on June 19, 1996. The MWDAFC is a California nonprofit public benefit corporation formed to assist Metropolitan by acquiring, constructing, operating and maintaining facilities, equipment, or other property needed by Metropolitan and leasing or selling such property to Metropolitan. The MWDAFC is governed by a board of five directors, each of whom must be a member of Metropolitan's Board. MWDAFC had no financial operations during fiscal years 2007 or 2006. MWDAFC is a component unit of Metropolitan and its activities will be blended with those of Metropolitan for financial reporting purposes when it commences operations.

The Center for Water Education (Center), previously known as The Foundation for the Southern California Water Education Center, was incorporated on November 20, 2001 as a nonprofit public benefit corporation organized to construct a water education center in the vicinity of Metropolitan's Diamond Valley Lake for the purpose of facilitating water education. The Center's primary sources of revenues are grants, loans, and gifts. Upon liquidation or dissolution of the Center, all assets become the property of Metropolitan. The number of Center directors can range from five to fifteen. As of June 30, 2007, there were eleven directors; one Center director is also a member of Metropolitan's Board of Directors. The Center is a component unit of Metropolitan and its financial activity is reflected as a blended component unit in Metropolitan's financial reports.

There was no significant revenue to the Center for fiscal years 2006 and 2007. Grants totaling $22.5 million have been received and used by the Center for design and construction of the water education center. As of June 30, 2007, $500,000 remains on a State grant that is available through December 31, 2007. In February 2007, Metropolitan's Board voted to terminate the ground lease with the Center and appropriated $4.67 million to complete construction, temporarily maintain the facility, and assist the Center in paying the reasonable and appropriate value of its debts. Metropolitan took possession of the facility on March 16, 2007. Metropolitan is considering the possibility of partnering with other educational entities to develop a self-sustaining facility. Separate financial statements for the Center may be obtained from Metropolitan's headquarters in Los Angeles, California.

(b) Principles of Presentation

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

Metropolitan's basic financial statements are presented in conformance with the provisions of Governmental Accounting Standards Board (GASB) Statement No. 34, "Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments" (GASB 34).

For purposes of the statements of cash flows, Metropolitan defines cash and cash equivalents as demand account balances, cash on hand, and non-negotiable time deposits. In accordance with GASB 34, Metropolitan has utilized the direct method to present cash flows from operating activities. Due to investments of available demand account balances in overnight repurchase agreements at the respective balance sheet dates, cash and cash equivalents may be presented with zero balances at such dates on the statements.

Under GASB 20, "Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting", enterprise funds, such as Metropolitan, have the option of consistently following or not following pronouncements issued by the Financial Accounting Standards Board (FASB) subsequent to November 30, 1989. Metropolitan has elected not to follow FASB standards issued after that date, unless such standards are specifically adopted by the GASB.

Metropolitan is required to apply GASB Statement No. 45, "Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions" (GASB 45) for periods beginning after December 15, 2006. GASB encourages early application and Metropolitan has elected to implement GASB 45 for the fiscal year ended June 30, 2006. Implementation was on a prospective basis using a zero net obligation at the beginning of the fiscal year. GASB 45 establishes standards for the measurement and recognition of other postemployment benefits, which for Metropolitan consists of medical coverage (see Note 8).

All investments are stated at fair value as required by GASB Statement No. 31, "Accounting and Financial Reporting for Certain Investments and for External Investment Pools" (GASB 31). Fair value is based on market price or amortized cost.

GASB 34 requires that limitations on the use of net assets imposed by enabling legislation be reported as restricted net assets. GASB 46 "Net Assets Restricted by Legislation an amendment of GASB Statement No. 34" among other things clarifies what a legally enforceable enabling legislation restriction is and requires governments to disclose the portion of total net assets that is restricted by enabling legislation (see Note 13).

Certain reclassifications of fiscal year 2006 amounts have been made to conform to the current year's presentation.

(c) Revenue Policies

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

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

Metropolitan's rate structure includes separate rates for supply, treatment, conveyance and distribution, power, and demand management. The rate structure also includes tiered pricing for supply, a capacity charge, and a financial commitment from Metropolitan's member agencies in the form of a purchase order designed to improve regional water resources management and accommodate a water transfer market.

Revenues from the capacity charge totaled $32.3 million and $31.8 million for fiscal years 2007 and 2006, respectively. Wheeling/exchange-type arrangements are transacted through Board-approved agreements. During fiscal years 2007 and 2006, wheeling/exchange revenues totaled $14.4 million and $9.1 million, respectively.

(d) Taxing Authority

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

Property tax revenue is used to pay Metropolitan's general obligation bond debt service and a portion of its obligations under its contract with the State for a water supply (the State Water Contract). Special taxes collected pursuant to pre-1978 annexation proceedings are also used for payments under the State Water Contract. In developing the annual tax levy, Metropolitan takes into account potential delinquencies, tax allocations to redevelopment agencies, and supplemental tax collections. Property tax revenues are accounted for as "imposed nonexchange revenues" as required by GASB Statement No. 33, "Accounting and Financial Reporting for Nonexchange Transactions". Metropolitan recognizes property taxes receivable on July 1 of each fiscal year and recognizes revenue over the following twelve-month period beginning July 1 through June 30 (the period for which the tax is levied). The property tax receivable is included in the basic financial statements, net of an allowance for doubtful accounts.

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

(e) Annexation Charges

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

Prior to fiscal year 1978, annexation charges were primarily collected in installments, including interest on unpaid balances, through the levy of special ad valorem taxes. It is Metropolitan's policy to record an allowance for uncollectible receivables on pre-1978 annexations when the principal and interest thereon cannot be collected within 50 years following the date of annexation. Accordingly, at June 30, 2007 and 2006, annexation receivables of $6,559,000 and $1,719,000, respectively, were reflected in the accompanying basic financial statements, net of allowance of $12,754,000 and $18,471,000, respectively.

(f) Plant and Equipment

Metropolitan's capital assets include plant and equipment, which are recorded at cost. Construction costs are capitalized if the costs exceed $25,000 and the asset has a useful life of at least five years. The cost of constructed assets includes labor, materials, certain general and administrative expenses, and interest incurred during construction periods. Depreciation is calculated using the straight-line method based on the estimated average useful lives of the assets, which are 80 years for storage and distribution facilities and 50 years for treatment plants and hydroelectric power recovery facilities. Improvements or overhauls with aggregated costs exceeding $25,000 and that extend the useful life of an existing asset by at least five years are capitalized.

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

(g) Participation Rights

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

(h) Prepaid State Water Project Costs

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

(i) Compensated Absences

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

(j) Interest Rate Swaps

Metropolitan enters into interest rate swap agreements to manage interest rate risk and reduce debt service costs on debt. During fiscal year 2002, the Board established a policy governing the use of interest rate swaps. The policy defines the parameters under which the program will operate. Other than the net interest receipts and expenditures resulting from these agreements, no amounts are recorded in the basic financial statements. (See Note 5f.)

(k) Operating and Nonoperating Revenues and Expenses

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

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

(l) Disaggregation of Payable Balances

Accounts payable and accrued expenses at June 30, 2007 and 2006 were as follows:

	June 30,	
(Dollars in thousands)	**2007**	2006
Department of Water Resources (State Water Project):		
Capital, operating, maintenance, power and replacement	**$ 180,289**	$ 184,433
Variable power	**79,733**	39,989
Palo Verde Irrigation District	**176**	3,714
Vendors	**58,466**	88,699
Accrued power costs	**90**	85
Accrued salaries	**—**	1,102
Readiness-to-serve overcollection	**1,585**	953
Conservation credits	**6,497**	4,003
Total accounts payable and accrued expenses	**$ 326,836**	$ 322,978

(m) Restricted and Unrestricted Resources

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

(n) Inventories

Metropolitan's inventories are valued based on a moving-average cost. Components of inventories at June 30, 2007 and 2006 were as follows:

	June 30,	
(Dollars in thousands)	**2007**	2006
Water in storage	**$ 64,704**	$ 74,750
Operating supplies	**9,466**	10,220
Total inventories	**$ 74,170**	$ 84,970

(o) Use of Estimates

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

(p) Capital Contributions

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

2. CAPITAL ASSETS

Capital asset activity for the fiscal years ended June 30, 2007 and 2006 was as follows:

(Dollars in thousands)	June 30, 2005	Additions	Reductions
Capital assets not being depreciated:			
Land, easements, and rights-of-way	$ 539,448	$ 5,019	$ (9,929)
Construction in progress	1,782,727	504,768	(251,452)
Total capital assets not being depreciated	2,322,175	509,787	(261,381)
Other capital assets:			
Parker power plant and dam	13,009	—	—
Power recovery plants	176,051	—	(198)
Other dams and reservoirs	1,429,927	562	—
Water transportation facilities	1,516,023	9,961	(6,519)
Pumping plants and facilities	226,735	43	—
Treatment plants and facilities	995,316	255,395	(932)
Power lines and communication facilities	30,432	—	(2)
Computer systems software	59,727	37	—
Miscellaneous	494,260	1,323	—
Major equipment	68,218	7,797	(4,162)
Pre-operating interest and other expenses of original aqueduct	44,595	—	—
Participation rights in other facilities (Note 4)	314,342	11,723	—
Total other capital assets at historical cost	5,368,635	286,841	(11,813)
Accumulated depreciation and amortization:			
Parker power plant and dam	(9,401)	(163)	—
Power recovery plants	(53,604)	(3,507)	—
Other dams and reservoirs	(123,291)	(18,007)	—
Water transportation facilities	(453,622)	(19,101)	1,374
Pumping plants and facilities	(47,990)	(2,894)	—
Treatment plants and facilities	(236,987)	(19,817)	566
Power lines and communication facilities	(6,220)	(336)	—
Computer systems software	(48,907)	(4,011)	—
Miscellaneous	(50,935)	(5,185)	—
Major equipment	(54,562)	(5,095)	4,157
Pre-operating interest and other expenses of original aqueduct	(28,029)	(1,036)	—
Participation rights in other facilities (Note 4)	(53,457)	(6,855)	—
Total accumulated depreciation and amortization	(1,167,005)	(86,007)	6,097
Other capital assets, net	4,201,630	200,834	(5,716)
Total capital assets, net	$ 6,523,805	$ 710,621	$ (267,097)
Depreciation and amortization was charged as follows:			
Depreciation of water-related assets			
Amortization of participation rights			
Depreciation and amortization expense related to capital assets			
Amortization of State Water Project capacity costs			
Plus/minus net retirements adjusted to expense			
Total depreciation and amortization expense			

June 30, 2006	Additions	Reductions	June 30, 2007
$ 534,538	$ 3,087	$ (407)	$ 537,218
2,036,043	528,863	(250,984)	2,313,922
2,570,581	531,950	(251,391)	2,851,140
13,009	—	—	13,009
175,853	—	—	175,853
1,430,489	1,247	(1,800)	1,429,936
1,519,465	16,857	(62)	1,536,260
226,778	455	—	227,233
1,249,779	191,068	(298)	1,440,549
30,430	—	(897)	29,533
59,764	11,519	(2)	71,281
495,583	85,287	(837)	580,033
71,853	5,751	(6,411)	71,193
44,595	—	—	44,595
326,065	2,148	—	328,213
5,643,663	314,332	(10,307)	5,947,688
(9,564)	(163)	—	(9,727)
(57,111)	(3,508)	—	(60,619)
(141,298)	(17,930)	—	(159,228)
(471,349)	(19,085)	39	(490,395)
(50,884)	(2,858)	—	(53,742)
(256,238)	(26,772)	17	(282,993)
(6,556)	(379)	134	(6,801)
(52,918)	(5,758)	—	(58,676)
(56,120)	(7,186)	37	(63,269)
(55,500)	(5,288)	6,387	(54,401)
(29,065)	(1,035)	—	(30,100)
(60,312)	(7,122)	—	(67,434)
(1,246,915)	(97,084)	6,614	(1,337,385)
4,396,748	217,248	(3,693)	4,610,303
$ 6,967,329	$ 749,198	$ (255,084)	$ 7,461,443
$ 79,152			$ 89,962
6,855			7,122
86,007			97,084
113,778			116,425
5,512			886
$ 205,297			$ 214,395

3. CASH AND INVESTMENTS

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

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

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

(a) Deposits

The California Government Code requires California banks and savings and loan associations to secure a local government agency's deposits by pledging government securities as collateral. There was no cash on hand at June 30, 2007. Cash on hand of $963,500 at June 30 2006, was designated for construction of the water education center and collateralized with pledged government securities pursuant to the California Government Code Section 53600 et seq. Such securities are in the name of the Center, a blended component unit.

(b) Investments

Metropolitan is permitted by State law and Board policy to invest in a variety of instruments including U.S. Treasury securities, federal agencies, repurchase agreements, negotiable certificates of deposit, bankers' acceptances, prime commercial paper, asset- and mortgage-backed securities, municipal bonds, and corporate notes. As of June 30, 2007 and 2006, Metropolitan had the following investments at fair value:

	June 30,	
(Dollars in thousands)	**2007**	2006
U.S. Treasury notes	**$ 161,000**	$ 163,939
U.S. Treasury strips	**28,011**	30,624
U.S. Guarantees—GNMAs	**37**	50
Federal agency securities	**126,750**	118,305
Bankers' acceptances	**4,467**	—
Prime commercial paper	**340,166**	164,430
Corporate notes	**304,257**	175,703
Negotiable certificates of deposit	**322,136**	164,891
Shares of beneficial interest	**756**	1,267
Asset- and mortgaged-backed securities	**46,990**	71,900
Municipal bonds	**93,270**	85,126
Total investments	**$ 1,427,840**	$ 976,235

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

Internally Managed Segment

This component of the portfolio was managed against the Merrill Lynch 3-Month Treasury Bill index. For fiscal years 2007 and 2006, the benchmark was .24 and the portfolio was permitted to vary from the duration by plus or minus 0.20. As of June 30, 2007 and 2006, the investments and durations for this segment were as follows:

	June 30,			
	2007		2006	
(Dollars in thousands)	**Fair Value**	**Duration**	Fair Value	Duration
U.S. Treasury notes	**$ —**	**—**	$ 10,003	0.04
Federal agency securities	**$ 95,028**	**0.53**	$ 60,685	0.36
Banker's acceptances	**$ 4,467**	**0.21**	$ —	—
Prime commercial paper	**$ 339,827**	**0.08**	$ 159,822	0.02
Corporate notes	**$ 276,887**	**0.43**	$ 113,435	0.13
Negotiable certificates of deposit	**$ 322,136**	**0.50**	$ 164,891	0.30
Municipal bonds	**$ —**	**—**	$ 1,990	0.38
Weighted average duration		**0.34**		0.18

Externally Managed Segment

This component of the portfolio was managed against the Merrill Lynch U.S. Corporate and Government, 1 to 5 years, A Rated and above index. For fiscal years 2007 and 2006, the benchmarks were 2.36 and 2.39, respectively, and the portfolio was permitted to vary from the duration by plus or minus 1.50. As of June 30, 2007 and 2006, Metropolitan's investments and durations for this segment were as follows:

	June 30,			
	2007		2006	
(Dollars in thousands)	**Fair Value**	**Duration**	Fair Value	Duration
U.S. Treasury notes	**$ 161,000**	**3.20**	$ 153,936	2.54
U.S. Treasury strips	**$ 4,455**	**16.94**	$ 8,121	17.91
U.S. Guarantees—GNMAs	**$ 37**	**4.59**	$ 50	4.61
Federal agency securities	**$ 8,548**	**1.81**	$ 54,396	2.47
Corporate notes	**$ 26,994**	**1.84**	$ 61,214	2.63
Shares of beneficial interest	**$ 756**	**—**	$ 1,267	0.00
Asset- and mortgaged-backed securities	**$ 46,990**	**1.55**	$ 71,900	1.93
Weighted average duration		**2.93**		2.77

Bond Reserves Segment

Investments in the bond reserves were managed based on the requirements of each of the bond issues. Per Board authorization, the Treasurer was authorized to invest these monies in excess of five years. As of June 30, 2007 and 2006, Metropolitan's bond reserves investments and durations for this segment were as follows:

	June 30,			
	2007		2006	
(Dollars in thousands)	**Fair Value**	**Duration**	Fair Value	Duration
U.S. Treasury strips	**$ 23,556**	**14.01**	$ 22,503	14.60
Federal agency securities	**$ 23,174**	**0.75**	$ 3,225	0.61
Prime commercial paper	**$ 339**	**0.01**	$ 4,608	0.01
Corporate notes	**$ 376**	**0.43**	$ 1,054	0.21
Municipal bonds	**$ 93,270**	**8.59**	$ 83,135	8.63
Weighted average duration		**8.16**		9.15

Credit risk. Credit risk was managed by purchasing investments with the nationally recognized credit ratings specified in Metropolitan's investment policy. Additionally, the policy required monitoring the credit ratings of securities held in the portfolio, and if the securities' credit ratings were downgraded, evaluating for potential sale. For certain securities, additional requirements included consideration of net worth, length of time in business, and specified market values. Metropolitan's exposure to credit risk as of June 30, 2007 and 2006, was as follows (excluding obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government):

	June 30,	
(Dollars in thousands)	**2007**	2006
AAA	**$ 267,766**	$ 276,597
A or better	**$ 304,257**	$ 175,703
F1 or better	**$ 326,603**	$ 164,892
A1/P1 or better	**$ 340,166**	$ 164,430

Concentration of credit risk. In accordance with Metropolitan's investment policy, the minimum requirements for limiting concentration of credit risk defined the maximum percent allowable for investment in each security type as well as the percent allowable for investment by issuer per type. Generally, the maximum allowable for investment by security type varied from 20 percent, for asset and mortgage backed securities, to 100 percent for U.S. Treasury and agency securities. The percentages of investments that can be purchased by a single issuer, within each security type, ranged from 5 percent, for asset-backed securities, to 10 percent for banker's acceptances. At June 30, 2007 and 2006, Metropolitan had the following investments (obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government not listed) representing five percent or more of its net investments:

	June 30,			
	2007		2006	
ERSTE Fin	**$ 72,021**	**5.04%**	$ —	—%
Federal Home Loan Bank	**$ —**	**—%**	$ 49,134	5.03%
Federal National Mortgage Association	**$ 86,830**	**6.08%**	$ 51,905	5.32%

Custodial credit risk. At June 30, 2007 and 2006, all of Metropolitan's investments, consisted of investments that were insured or registered, or for which the securities were held, in Metropolitan's name, in safekeeping at Metropolitan's bank, which was not a counterparty to the investment transactions.

(c) Reverse Repurchase Agreements

Metropolitan was permitted, subject to conditions imposed by State law, to sell securities owned under written agreements and to buy back the securities on or before a specified date for a specified amount. No such reverse repurchase agreements were entered into during the fiscal years ended June 30, 2007 and 2006.

(d) Restricted Cash and Investments

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

4. PARTICIPATION RIGHTS

Participation rights activity for the fiscal years ended June 30, 2007 and 2006 was as follows:

(Dollars in thousands)	June 30, 2005	Additions	Reductions	June 30, 2006	**Additions**	**Reductions**	**June 30, 2007**
Participation rights:							
Imperial Irrigation District	$ 112,313	$ —	$ —	$ 112,313	**$ —**	**$ —**	**$ 112,313**
Palo Verde Irrigation District	68,518	11,723	—	80,241	**2,148**	**—**	**82,389**
South County Pipeline	72,371	—	—	72,371	**—**	**—**	**72,371**
Semitropic Water Storage District	31,319	—	—	31,319	**—**	**—**	**31,319**
Arvin-Edison Water Storage District	29,821	—	—	29,821	**—**	**—**	**29,821**
Total	314,342	11,723	—	326,065	**2,148**	**—**	**328,213**
Accumulated amortization:							
Imperial Irrigation District	(29,449)	(2,271)	—	(31,720)	**(2,270)**	**—**	**(33,990)**
Palo Verde Irrigation District	(979)	(2,045)	—	(3,024)	**(2,313)**	**—**	**(5,337)**
South County Pipeline	(11,248)	(912)	—	(12,160)	**(913)**	**—**	**(13,073)**
Semitropic Water Storage District	(6,649)	(813)	—	(7,462)	**(813)**	**—**	**(8,275)**
Arvin-Edison Water Storage District	(5,132)	(814)	—	(5,946)	**(813)**	**—**	**(6,759)**
Total	(53,457)	(6,855)	—	(60,312)	**(7,122)**	**—**	**(67,434)**
Participation rights, net	$ 260,885	$ 4,868	$ —	$ 265,753	**$ (4,974)**	**$ —**	**$ 260,779**

(a) Imperial Irrigation District

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

As capital projects were completed, the costs contributed by Metropolitan were capitalized as participation rights in Metropolitan's accounting records. The construction phase of this program was completed as of September 30, 1998, and the operation and maintenance phase commenced on October 1, 1998. The October 2003 amendment to the agreement extended the term through December 31, 2041 or 270 days beyond the termination of the Quantification Settlement Agreement plus any extension applicable over the agreement (see Note 9d). Participation rights for this project totaled $112,313,000 as of June 30, 2007 and 2006, and are amortized using the straight-line method over the remaining life of the agreement. Amortization expense totaled $2,270,000 and $2,271,000 in fiscal years 2007 and 2006, respectively.

(b) Palo Verde Irrigation District

In August 2004, Metropolitan entered into a land management, crop rotation, and water supply program with the Palo Verde Irrigation District (PVID). This fallowing program will make available up to 130,000 acre-feet of water in certain years for transfer to Metropolitan from PVID. The term of the program is 35 years.

Under the terms of the agreement, Metropolitan is obligated to pay certain program start-up costs that are capitalized as participation rights. These costs include sign-up payments to individual landowners, funding for a community improvement program and program setup costs.

Participation rights for this program totaled $82,389,000 and $80,241,000 as of June 30, 2007 and 2006, respectively, and are being amortized using the straight-line method over 35 years. Amortization expense totaled $2,313,000 and $2,045,000 in fiscal years 2007 and 2006, respectively.

(c) South County Pipeline

In 1989, Metropolitan entered into an agreement with two member agencies and one of their subagencies to participate in the construction of an upsized version of a 26-mile long pipeline serving the south Orange County portion of its service area. Participation in this project provides Metropolitan capacity to transport its water in the central part of its service area. Participation rights for this project totaled $72,371,000 as of June 30, 2007 and 2006. These participation rights are amortized using the straight-line method over 80 years. Amortization expense totaled $913,000 and $912,000 in fiscal years 2007 and 2006, respectively.

(d) Semitropic Water Storage District

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

In 1999, Metropolitan became fully vested for 35 percent of the 1,000,000 acre-foot banking project. Metropolitan has a storage allocation of 350,000 acre-feet and currently has 343,327 acre-feet in the program. Metropolitan is entitled to 31,500 acre-feet per year (minimum) of pump back capacity and 46,550 acre-feet per year (minimum) of entitlement exchange rights. Additionally, Metropolitan has the ability to use other banking partner's rights when they are not being used. As a result, the estimated minimum return capability for Metropolitan is 107,000 acre-feet per year.

Participation rights for this program totaled $31,319,000 as of June 30, 2007 and 2006. These participation rights are amortized using the straight-line method over the remaining life of the agreement. Amortization expense totaled $813,000 in fiscal years 2007 and 2006.

(e) Arvin-Edison Water Storage District

In December 1997, Metropolitan entered into an agreement for a water management program with Arvin-Edison Water Storage District (Arvin-Edison). The agreement includes a Regulation Program and a Transportation Program. Under the terms of the Regulation Program, Arvin-Edison will regulate the storage and delivery for Metropolitan of up to 350,000 acre-feet of water and currently has 209,251 acre-feet in the program. The minimum estimated return capability for the Arvin-Edison program varies from 40,000 acre-feet per year to 75,000 acre-feet per year depending on hydrologic/groundwater conditions. As a result of the operational history, the long-term return capability for the program during dry years has been estimated to be 90,000 acre-feet per year. Return water will be delivered to Metropolitan upon request through a new intertie pipeline to the California Aqueduct and by exchange of existing Arvin-Edison supplies in the California Aqueduct. The agreement terminates on December 31, 2022 with provisions for automatic extension if all stored water has not been returned.

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

Participation rights for the Arvin-Edison program totaled $29,821,000 as of June 30, 2007 and 2006. These participation rights are amortized using the straight-line method over the longer life of the Transportation Program. Amortization expense totaled $813,000 and $814,000 in fiscal years 2007 and 2006, respectively.

5. SHORT-TERM AND LONG-TERM DEBT

Metropolitan's enabling Act specifies that its indebtedness shall be limited to 15 percent of the assessed value of all taxable property within Metropolitan's service area. Existing outstanding debt of $4.616 billion and $3.866 billion at June 30, 2007 and 2006, respectively, represents less than one percent of the fiscal years 2007 and 2006 total taxable assessed valuation of $2,015.4 billion and $1,839.5 billion, respectively.

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

(a) Short-term Debt
Metropolitan may issue up to $400,000,000 in commercial paper to fund a portion of its capital plan. At June 30, 2007 and 2006, there were no commercial paper notes outstanding. Metropolitan may also issue other forms of short-term debt such as variable rate water revenue bonds (see Note 5c).

(b) General Obligation Bonds
In 1966, voters authorized Metropolitan to incur up to $850.0 million of general obligation bond indebtedness to finance a portion of Metropolitan's capital plan. The original amounts, issued as Series A through H under the 1966 authorization, totaled $850.0 million at June 30, 2007 and 2006. Metropolitan has advance refunded some of these general obligation bond issues through the issuance of refunding bonds. A total of $359.1 million and $389.6 million in general obligation bonds and general obligation refunding bonds was outstanding at June 30, 2007 and 2006, respectively.

Each general obligation bond issue consists of both serial and term bonds that mature in varying amounts through March 2037 at interest rates ranging from 3 percent to 8 percent. The term bonds are subject to mandatory redemption prior to maturity. All general obligation bonds maturing on or after the earliest applicable call date are subject to optional redemption prior to maturity, callable on interest payment dates, and subject to early redemption premiums.

No general obligation bonds were issued during the fiscal years ended June 30, 2007 or 2006.

(c) Revenue Bonds
Pursuant to a 1974 voter authorization, additional funds, primarily for funding the capital investment plan, were obtained through the sale of revenue bonds. Revenue bonds may be issued subject to certain conditions, including a requirement that the total of revenue bonds outstanding does not exceed the equity (net assets) of Metropolitan as of the fiscal year end prior to such issuance. Metropolitan has advance refunded some of these revenue bonds through the issuance of refunding bonds. A total of $4.279 billion and $3.531 billion of revenue bonds and revenue refunding bonds was outstanding at June 30, 2007 and 2006, respectively.

Each fixed rate revenue bond issue consists of both serial and term bonds that mature in varying amounts through July 2037 at interest rates ranging from 2 percent to 6 percent. The term bonds are subject to mandatory redemption prior to maturity. All revenue bonds maturing on or after the earliest applicable call date are subject to optional redemption prior to maturity, callable on interest payment dates, and subject to early redemption premiums.

New revenue bonds issued during fiscal 2007 were as follows:

- On August 23, 2006, Metropolitan issued $200,000,000 of Water Revenue Bonds, 2005 Authorization Series C, at a true interest cost of 4.753 percent, to finance a portion of the capital investment plan. The maturities extend to July 1, 2035 and are subject to mandatory and optional redemption provisions.

- On August 23, 2006, Metropolitan issued $100,000,000 of Water Revenue Bonds, 2005 Authorization Series D-1 and D-2, (Auction Rate Securities) at variable rates, to finance a portion of the capital investment plan. The maturities extend to July 1, 2027 and are subject to mandatory and optional redemption provisions.

- On May 23, 2007, Metropolitan issued $400,000,000 of Water Revenue Bonds, 2006 Authorization Series A, at a true interest cost of 4.584 percent, to finance a portion of the capital investment plan. The maturities extend to July 1, 2037 and are subject to mandatory and optional redemption provisions.

- On June 7, 2007, Metropolitan issued $100,000,000 of Water Revenue Bonds, 2006 Authorization Series B, (Auction Rate Securities) at variable rates, to finance a portion of the capital investment plan. The maturities extend to July 1, 2037 and are subject to mandatory and optional redemption provisions.

New revenue bonds issued during fiscal 2006 were as follows:

- On July 28, 2005, Metropolitan issued $100,000,000 of Water Revenue Bonds, 2005 Authorization Series A, at a true interest cost of 4.518 percent, to finance a portion of the capital investment plan. The maturities extend to July 1, 2035 and are subject to mandatory and optional redemption provisions.
- On July 28, 2005, Metropolitan issued $100,000,000 of Water Revenue Bonds, 2005 Authorization Series B-1and B-2, at variable rates, to finance a portion of the capital investment plan. The maturities extend to July 1, 2028 and are subject to mandatory and optional redemption provisions.

(d) Bond Refundings and Defeasances

Metropolitan has issued Waterworks General Obligation Refunding Bonds and Water Revenue Refunding Bonds to advance refund various issues of Waterworks General Obligation Bonds, Waterworks General Obligation Refunding Bonds, Water Revenue Bonds, and Water Revenue Refunding Bonds previously issued. The net proceeds from these sales were used to purchase U.S. Treasury securities that were deposited in irrevocable escrow trust accounts with a bank acting as an independent fiscal agent to provide for all future debt service on the bonds being refunded. As a result, those bonds are considered defeased and the related liabilities have been excluded from Metropolitan's basic financial statements. At June 30, 2007 and 2006, outstanding general obligation bonds and revenue bonds (including prior year's refundings) of $962,280,000 and $1,199,815,000, respectively, are considered to be defeased.

Refunding and defeasance transactions during fiscal 2007 were as follows:

- On October 17, 2006, Metropolitan issued $45,875,000 of Water Revenue Refunding Bonds, 2006 Series B at a true interest cost of 4.482 percent, to refund $21,880,000 of Water Revenue Refunding Bonds, 1996 Series B and $25,110,000 of Water Revenue Bonds, 1996 Series C. Their maturities extend to July 1, 2037.
- On June 7, 2007, Metropolitan issued $218,425,000 of Water Revenue Refunding Bonds, 2007 Series A-1 and A-2, at variable rates, to refund $222,400,000 of Water Revenue Refunding Bonds, 2001 Series B-1 and B-2. Their maturities extend to July 1, 2020.

Refunding and defeasance transaction during fiscal 2006 was as follows:

- On May 18, 2006, Metropolitan issued $74,140,000 of Water Revenue Refunding Bonds, 2006 Series A-1 and Series A-2 at variable rates to refund $73,365,000 of Water Revenue Refunding Bonds, 1996 Series B. Their maturities extend to July 1, 2021. The bonds were issued in conjunction with four pay-fixed, receive-variable interest rate swap transactions entered into April 2005 with an effective date of April 2006. These four swap transactions totaled $74,450,000 and were entered into to hedge the variable rate cost of the 2006 Series A-1 and A-2 Water Revenue Refunding Bonds.

These refundings and defeasances were accomplished to take advantage of lower interest rates. The transactions resulted in cash flow savings of $13.4 million and $7.5 million and economic gains (difference between the present values of the debt service payments on the old debt and new debt) of $9.2 million and $5.4 million for fiscal years 2007 and 2006, respectively. The difference between the book value of the old debt and the amount required to retire the debt is deferred and amortized over the original remaining life of the old debt or the life of the new debt, whichever is less. Bonds payable are reported net of these deferred costs. In fiscal years 2007 and 2006, approximately $1,662,000 and $712,000 of costs were deferred. Amortization of all deferred refunding costs was approximately $11,576,000 and $10,674,000 in fiscal years 2007 and 2006, respectively.

(e) Other Long-term Debt

Other long-term debt includes two loans from the State Revolving Fund. Metropolitan's contractual obligation with a member agency for the purchase of the Allen-McCulloch Pipeline has been paid in full and is no longer outstanding.

The contractual obligation for the Allen-McCulloch Pipeline consisted of annual payments of $4,600,000 through 2006 with an imputed interest rate of 5.61 percent. At June 30, 2007 and 2006, there was no outstanding balance.

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

- In November 2003, Metropolitan received $20,000,000 through the Department of Water Resources for oxidation retrofit facilities at the Mills filtration plant in Riverside County. This twenty-year loan carries interest at 2.39 percent with the final payment due July 1, 2024. At June 30, 2007 and 2006, the outstanding balance was $17,988,000 and $18,807,000, respectively.

- During fiscal years 2002 and 2001, Metropolitan received funds totaling $20,000,000 through the State Water Resources Control Board for development and implementation of nonpoint source pollution control projects and programs. This twenty-year loan carries interest at 2.8 percent with the final payment due February 1, 2020. At June 30, 2007 and 2006, the outstanding balance was $15,012,000 and $15,879,000, respectively.

(f) Interest Rate Swaps

Metropolitan has entered into twenty-four separate interest rate swap agreements of which twenty were outstanding as of June 30, 2007. Of the agreements, sixteen require that Metropolitan pay fixed interest rates and receive interest at variable interest rates; one requires that Metropolitan pay a variable rate based on a tax-exempt index and receive a variable rate payment based on a taxable index; and three require that Metropolitan pay a variable rate based on a five-year index and receive a variable rate payment based on a one-month index. Only the net difference in interest payments is actually exchanged and reflected as interest expense or interest income.

The table on the following page summarizes Metropolitan's interest rate swap portfolio as of June 30, 2007.

Summary: The terms, fair values, and credit ratings of the outstanding swaps as of June 30, 2007 were as follows:

(Dollars in thousands)

Associated Bond Issue	Notional Amount	Effective Date	Variable Rate Paid	Variable Rate Received	Fair Value[1]	Swap Termination Date	Counterparty Credit Rating[2]
WRRB[3] 1996 A	$ 74,830	01/01/94	4.990%	WRRB 1996 A	$ (6,938)	06/01/23	Aa2/AA/NR[4]
2001 Payor[5]	111,200	09/06/01	4.219%	SIFMA[6] less 35 basis points	(5,273)	07/01/20	Aaa/AA+/AA+
2001 Payor[5]	111,200	09/06/01	4.219%	SIFMA less 35 basis points	(5,273)	07/01/20	Aaa/AAA/NR
WRRB 2002 A	94,112	09/12/02	3.300%	57.74% of 1MoLIBOR[7]	(751)	07/01/25	Aa3/A+/AA-
WRRB 2002 B	35,208	09/12/02	3.300%	57.74% of 1MoLIBOR	(265)	07/01/25	Aaa/AAA/NR
WRRB 2003 C-1 — C-3	167,580	12/18/03	3.257%	61.20% of 1MoLIBOR	3,538	07/01/30	Aaa/AA+/AA+
WRRB 2003 C-1 — C-3	167,580	12/18/03	3.257%	61.20% of 1MoLIBOR	3,538	07/01/30	Aaa/AA/AA-
WRRB 2004 A-1 — A-2	160,745	02/19/04	2.917%	61.20% of 1MoLIBOR	6,846	07/01/23	Aa3/A+/AA-
WRRB 2004 C	74,143	11/16/04	2.980%	61.55% of 1MoLIBOR	2,905	10/01/29	Aa3/A+/AA-
WRRB 2004 C	60,662	11/16/04	2.980%	61.55% of 1MoLIBOR	2,373	10/01/29	Aa1/AA/AA+
2005 Payor[5]	58,548	07/06/05	3.360%	70.00% of 3MoLIBOR	3,682	07/01/30	Aaa/AA/AA-
2005 Payor[5]	58,547	07/06/05	3.360%	70.00% of 3MoLIBOR	3,682	07/01/30	Aa1/AA/AA+
2006 Payor[5]	31,198	04/04/06	3.210%	63.00% of 3MoLIBOR	805	07/01/21	Aaa/AA+/AA+
2006 Payor[5]	31,197	04/04/06	3.210%	63.00% of 3MoLIBOR	805	07/01/21	Aaa/AA/AA-
2006 Payor[5]	6,028	04/04/06	2.911%	63.00% of 3MoLIBOR	130	07/01/12	Aaa/AA+/AA+
2006 Payor[5]	6,027	04/04/06	2.911%	63.00% of 3MoLIBOR	130	07/01/12	Aaa/AA/AA-
Sub-total pay-fixed receive-variable	1,248,805				9,934		
2004 Basis	125,000	05/19/04	SIFMA	70% 1MoLIBOR +31.5 basis points	2,340	07/01/14	Aaa/AAA/NR
2004 Amended basis	125,000	05/19/04	SIFMA	64.54% 5YrLIBOR +31.5 basis points	1,880	07/01/14	Aaa/AA/AA-
2006 Constant maturity swap	62,500	07/03/06	70% of 1MoLIBOR	64.6 % of 5YrLIBOR	(209)	07/01/14	Aa3/A+/AA-
2006 Constant maturity swap	62,500	07/03/06	70% of 1MoLIBOR	64.6 % of 5YrLIBOR	(209)	07/01/14	Aaa/AAA/NR
Sub-total basis swap	375,000				3,802		
Total swaps	$ 1,623,805				$ 13,736		

1 Includes accrued interest.
2 Credit Ratings—Moody's Investors Service, Standard & Poor's, and Fitch Ratings, respectively.
3 Water Revenue Refunding Bonds.
4 Not Rated.
5 These swaps lock in a fixed rate for an equivalent amount of variable rate debt.
6 The Securities Industry and Financial Markets Municipal Swap Index, previously known as Bond Marketing Index.
7 London Interbank Offered Rate.

Pay-Fixed, Receive-Variable

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

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

Fair Values: At June 30, 2007, certain pay-fixed, receive-variable swaps had a negative fair value and certain pay-fixed, receive-variable swaps had a positive fair value. Because the coupons on Metropolitan's variable rate bonds adjust to changing interest rates, the bonds do not have corresponding fair value changes. The fair values of the swaps were estimated using the zero-coupon method and include accrued interest. This method calculates the future net settlement payments required by the swap, assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These payments are then discounted using spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the date of each future net settlement on the swaps.

Credit Risks: As of June 30, 2007, Metropolitan was not exposed to credit risk on the outstanding pay-fixed, receive-variable swaps that had negative fair values. However, should interest rates change and the fair values of the swaps become positive, Metropolitan would be exposed to credit risk to each swap counterparty in the amount of the derivatives' fair value. For those pay-fixed, receive-variable swaps with a positive fair value, Metropolitan was exposed to credit risk to the counterparties to those swaps. Should the counterparties to the transactions fail to perform according to the terms of the swap contract, Metropolitan would face a maximum possible loss equal to the fair market value of these swaps.

All swap agreements, with the exception of the swap associated with the Series 1996A bonds, contain specific collateral requirements that are in effect for Metropolitan and the counterparties. The swaps require different collateral levels based on credit ratings and the fair value of the swap. Generally, the fair value threshold levels are also reduced as the credit ratings are reduced. Collateral on all swaps is to be in the form of U.S. government securities that may be held by the party posting the collateral. The swap payments associated with the Series 1996A bonds are guaranteed by an AMBAC Inc. surety agreement. Collateral postings are only required in the event AMBAC's rating is reduced.

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

As of June 30, 2007, Metropolitan has swap transactions with one counterparty in the amount of $391.5 million or 24.1 percent of the notional amount of Metropolitan's outstanding swap transactions. The swap transactions include $329.0 million for pay-fixed, receive-variable swaps, and a $62.5 million pay-variable receive-variable swap. This counterparty is rated Aa3/A+/AA- by Moody's Investors Service (Moody's), Standard & Poor's, and Fitch Ratings, respectively.

Basis Risk: The interest rates on Metropolitan's variable rate bonds are expected to be equivalent, but not necessarily equal to the variable rate payments received from counterparties on pay-fixed, receive-variable interest rate swaps. To the extent these variable payments differ, Metropolitan is exposed to basis risk. Metropolitan has no basis risk for the swap associated with the Series 1996A bonds, as the interest rate received from the counterparty is equal to the interest rate paid on Metropolitan's Series 1996A variable rate bonds. As of June 30, 2007, the interest rates of the variable rate debt (excluding the Series 1996A variable rate bonds) associated with these swap transactions were 3.67 percent, 3.73 percent, 3.66 percent, 3.70 percent, 3.68 percent, 3.67 percent, and 3.58 percent. However, Metropolitan's variable rate payments received from the counterparties of these swaps were 3.38 percent, 3.07 percent, 3.26 percent, 3.26 percent, 3.27 percent, 3.75 percent, and 3.38 percent, respectively.

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

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

Pay-Variable, Receive-Fixed

Objective of the Swaps: Metropolitan's asset/liability strategy is to have a mixture of fixed and variable rate debt to take advantage of market fluctuations. To achieve strategy objectives, Metropolitan synthetically created variable rate debt by entering into two $100.0 million pay-variable, receive-fixed swaps.

Terms: In March 2002, Metropolitan entered into two pay-variable, receive-fixed interest rate swaps with two counterparties. The terms of both swaps were five years and terminated in March 2007.

Pay-Variable, Receive-Variable

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

Terms: On May 17, 2004, Metropolitan entered into two basis swap transactions (2004 Basis Swaps) with two counterparties. The terms of both swaps are ten years and terminate in July 2014. The notional amount of each swap is $125.0 million. Under the original terms of the swaps, Metropolitan pays a variable rate equal to the SIFMA Index and receives a variable rate based on 70.0 percent of the one-month LIBOR plus 31.5 basis points. On May 5, 2006, one of the $125.0 million 2004 Basis Swaps was amended to change the rate that Metropolitan receives to 64.54 percent of the five-year LIBOR index plus 31.5 basis points from 70.0 percent of the one-month LIBOR rate. The amended swap was effective on July 3, 2006. The terms of the other 2004 Basis Swap remained unchanged.

Fair Value: As of June 30, 2007, the amended swap had a positive fair value of $1.88 million and the other 2004 basis swap had a positive fair value of $2.34 million. The fair values were estimated using the zero-coupon method and include accrued interest. This method calculates the future net settlement payments required by the swap, assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These payments are then discounted using spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the date of each future net settlement on the swaps.

Credit Risk: The swap's fair value represents Metropolitan's credit exposure to the two counterparties as of June 30, 2007. Should the counterparties to this transaction fail to perform according to the terms of the swap contract, Metropolitan would face a maximum possible loss equivalent to the swap's fair value. As of June 30, 2007, the two swap counterparties were rated Aaa/AAA/not rated and Aaa/AA/AA- by Moody's, Standard & Poor's, and Fitch Ratings, respectively.

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

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

Terms: On July 1, 2005, Metropolitan entered into two basis swap transactions with two counterparties (2005 Basis Swaps). The terms of both 2005 Basis Swaps were eleven years and were scheduled to terminate in July 2017. The notional amount of each swap was $56.0 million. On January 11, 2007, Metropolitan took advantage of market conditions and terminated the two swap transactions for a total termination payment of $2.73 million.

Terms: On May 5, 2006, Metropolitan entered into two constant maturity swap transactions with two counterparties. The terms of both swaps are eight years and terminate in July 2014. The swaps were effective July 3, 2006. The notional amount of each swap is $62.5 million. Under the terms of the swaps, Metropolitan pays a variable rate equal to 70.0 percent of the one-month LIBOR index and receives a variable rate based on 64.6 percent of the five-year LIBOR index. This swap is called a constant maturity swap as Metropolitan receives a payment based on a longer-term, five-year, LIBOR index.

Fair Value: As of June 30, 2007, the swaps had a negative fair value of $418,000. The fair values were estimated using the zero-coupon method and include accrued interest. This method calculates the future net settlement payments required by the swap, assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These payments are then discounted using spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the date of each future net settlement on the swaps.

Credit Risk: As of June 30, 2007, Metropolitan was not exposed to credit risk on this pay-variable, receive-variable constant maturity swap because the swaps had negative fair values. However, should interest rates change and the fair values of the swaps become positive, Metropolitan would be exposed to credit risk to each swap counterparty in the amount of the derivatives' fair value.

Basis Risk: Since the payments received by Metropolitan for the constant maturity swaps are based on a percentage of a the five-year taxable LIBOR index and the payments made by Metropolitan are based on the one-month LIBOR index, certain changes in interest rates could expose Metropolitan to basis risk as payments received by Metropolitan could be less than payments made by Metropolitan to the counterparties.

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

(g) Swap Payments and Associated Debt

Using rates as of June 30, 2007, debt service requirements on Metropolitan's swap-related variable rate debt and net swap payments are as follows. As rates vary, variable rate bond interest payments and net swap payments will vary.

Swap-Related Variable Rate Debt and Net Swap Payments

(Dollars in thousands)	Variable Rate Bonds Principal	Variable Rate Bonds Interest	Interest Rate Swaps, Net	Total
Year ending June 30:				
2008	$ 7,895	$ 46,018	$ 1,481	$ 55,394
2009	13,290	45,483	1,410	60,183
2010	9,510	45,062	1,335	55,907
2011	9,870	44,714	1,260	55,844
2012	13,070	44,249	1,171	58,490
2013-2017	226,165	200,078	3,899	430,142
2018-2022	484,700	128,344	(1,188)	611,856
2023-2027	356,865	52,252	(812)	408,305
2028-2031	127,440	6,246	(228)	133,458
	$ 1,248,805	$ 612,446	$ 8,328	$ 1,869,579

(h) Long-term Debt Obligation Summary

Interest rates on all outstanding fixed-rate obligations range from 2.0 percent to 8.0 percent. Interest on the variable rate debt is reset either daily or weekly based upon market conditions. Future principal and interest obligations as of June 30, 2007 are as follows:

(Dollars in thousands)	Principal	Interest	Total
Year ending June 30:			
2008	$ 89,634	$ 233,091	$ 322,725
2009	112,020	231,712	343,732
2010	124,726	223,989	348,715
2011	125,978	210,901	336,879
2012	131,667	206,770	338,437
2013-2017	710,068	912,540	1,622,608
2018-2022	753,208	684,750	1,437,958
2023-2027	724,144	489,684	1,213,828
2028-2032	822,985	331,242	1,154,227
2033-2037	943,980	142,240	1,086,220
2038	132,835	877	133,712
	4,671,245	$ 3,667,796	$ 8,339,041
Unamortized bond discount, premium, and deferred amount on refundings, net	(54,877)		
Total debt	4,616,368		
Less current portion	(87,499)		
Long-term portion of debt	$ 4,528,869		

6. LONG-TERM LIABILITIES

Long-term liability activity for the fiscal years ended June 30, 2007 and 2006 is shown on the following table. Payments on the bonds are made from the restricted debt service funds; other long-term debt, the off-aqueduct power facilities obligation, and the compensated absences liability will be liquidated primarily with water revenues.

(Dollars in thousands)	Maturity Dates	Range of Interest Rates	June 30, 2005	Additions
Waterworks general obligation bonds (Note 5):				
1966 Series H	3/1/06—3/1/37	4.60%—5.25%	$ 42,355	$ —
Waterworks general obligation refunding bonds:				
1993 Series A1—A2	3/1/07—3/1/09	7.25%—8.00%	30,970	—
1998 Series A	3/1/06—3/1/14	5.00%—5.25%	19,685	—
2001 Series A—B	3/1/06—3/1/22	3.40%—5.25%	56,805	—
2002 Series A	3/1/06—3/1/17	2.25%—4.25%	46,020	—
2003 Series A	3/1/06—3/1/12	2.00%—5.00%	90,505	—
2004 Series A	3/1/09—3/1/15	3.00%—5.00%	68,345	—
2005 Series A	3/1/12—3/1/21	3.00%—5.00%	64,705	—
Total general obligation and general obligation refunding bonds			419,390	—
Water revenue bonds (Note 5):				
1992	7/1/09	5.75%	17,635	—
1996 Series C	7/1/05—7/1/37	5.50%—6.00%	47,475	—
1997 Series A	7/1/05—7/1/37	4.50%—5.50%	127,515	—
1997 Series B—C	7/1/28	Variable	100,000	—
1999 Series A	7/1/06—7/1/09	4.60%—4.875%	8,225	—
1999 Series B—C	7/1/23—7/1/27	Variable	100,000	—
2000 Series B-1—B-4	7/1/29—7/1/35	Variable	355,200	—
2001 Series C-1—C-2	7/1/29—7/1/36	Variable	200,000	—
2003 Series B-1—B-2	10/1/23—10/1/36	5.00%	200,000	—
2003 Series B-3—B-4	10/1/05—10/1/31	2.50%—5.00%	300,000	—
2005 Series A	7/1/09—7/1/35	3.00%—5.00%	—	100,000
2005 Series B-1—B-2	7/1/14—7/1/28	Variable	—	100,000
2005 Series C	7/1/08—7/1/35	4.00%—5.00%	—	—
2005 Series D-1—D-2	7/1/27	Variable	—	—
2006 Series A	7/1/10—7/1/37	4.00%—5.00%	—	—
2006 Series B	7/1/37	Variable	—	—
Water revenue refunding bonds:				
1993 Series A—B	7/1/07—7/1/21	5.70%—5.80%	110,145	6,540
1996 Series A	6/1/05—6/1/23	Variable	83,495	—
1996 Series B	7/1/05—7/1/11	4.625%—6.00%	122,395	—
1998 Series A	7/1/05—7/1/22	4.00%—5.25%	137,760	—
2001 Series A	7/1/05—7/1/29	3.375%—5.15%	149,955	—
2001 Series B-1—B-2	7/1/05—7/1/20	Variable	224,000	—
2002 Series A—B	7/1/04—7/1/25	Variable	130,265	—
2003 Series A	7/1/08—7/1/14	3.25%—5.00%	36,215	—
2003 Series C-1—C-3	7/1/04—7/1/30	Variable	337,230	—
2004 Series A-1—A-2	7/1/05—7/1/23	Variable	162,455	—
2004 Series B	7/1/05—7/1/16	2.00%—5.00%	274,415	—
2004 Series C	10/1/05—10/1/29	Variable	136,090	—
2006 Series A-1—A-2	7/1/07—7/1/21	Variable	—	74,140
2006 Series B	7/1/10—7/1/37	4.00%—5.00%	—	—
2007 Series A-1—A-2	7/1/20	Variable	—	—
Total water revenue and water revenue refunding bonds			3,360,470	280,680
Other long-term debt (Note 5e):				
Municipal Water District of Orange County	7/1/05—7/1/06	5.61%	4,356	—
State revolving fund loans	7/1/07—7/1/24	2.39%—2.80%	35,931	—
Unamortized bond discount, premiums, and deferred amount on refunding, net			(97,087)	3,232
Total long-term debt			3,723,060	283,912
Other long-term liabilities (See table next page)			225,381	71,004
Total long-term liabilities			$3,948,441	$ 354,916

Reductions	June 30, 2006	Additions	Reductions	June 30, 2007	Amounts Due Within One Year
$ (630)	$ 41,725	$ —	$ (660)	$ 41,065	$ 695
—	30,970	—	(10,765)	20,205	—
(2,440)	17,245	—	(2,575)	14,670	2,690
(5,835)	50,970	—	(6,025)	44,945	6,230
(3,190)	42,830	—	(3,285)	39,545	3,430
(17,360)	73,145	—	(7,140)	66,005	18,855
—	68,345	—	—	68,345	—
(370)	64,335	—	—	64,335	—
(29,825)	389,565	—	(30,450)	359,115	31,900
—	17,635	—	—	17,635	—
(7,050)	40,425	—	(32,545)	7,880	7,880
(11,370)	116,145	—	(11,945)	104,200	12,565
—	100,000	—	—	100,000	—
—	8,225	—	(1,915)	6,310	2,005
—	100,000	—	—	100,000	—
—	355,200	—	—	355,200	—
—	200,000	—	—	200,000	—
—	200,000	—	—	200,000	—
(6,375)	293,625	—	(4,500)	289,125	6,375
—	100,000	—	—	100,000	—
—	100,000	—	—	100,000	—
—	—	200,000	—	200,000	—
—	—	100,000	—	100,000	—
—	—	400,000	—	400,000	—
—	—	100,000	—	100,000	—
—	116,685	—	—	116,685	5,600
(4,215)	79,280	—	(4,450)	74,830	4,690
(74,405)	47,990	—	(29,945)	18,045	3,825
(460)	137,300	—	(480)	136,820	8,070
(1,625)	148,330	—	—	148,330	—
(800)	223,200	—	(223,200)	—	—
(465)	129,800	—	(480)	129,320	490
—	36,215	—	—	36,215	—
(1,025)	336,205	—	(1,045)	335,160	1,090
(845)	161,610	—	(865)	160,745	895
(505)	273,910	—	(4,525)	269,385	2,975
(630)	135,460	—	(655)	134,805	675
—	74,140	—	—	74,140	55
—	—	45,875	—	45,875	—
—	—	218,425	—	218,425	—
(109,770)	3,531,380	1,064,300	(316,550)	4,279,130	57,190
(4,356)	—	—	—	—	—
(1,245)	34,686	—	(1,686)	33,000	1,730
4,559	(89,296)	19,240	15,179	(54,877)	(3,321)
(140,637)	3,866,335	1,083,540	(333,507)	4,616,368	87,499
(75,941)	220,444	54,556	(35,502)	239,498	64,833
$ (216,578)	$ 4,086,779	$ 1,138,096	$ (369,009)	$ 4,855,866	$ 152,332

(Dollars in thousands)	June 30, 2005	Additions	Reductions	June 30, 2006	**Additions**	**Reductions**	**June 30, 2007**	**Amounts Due Within One Year**
Off-aqueduct power facilities (Note 9e)	$ 88,263	$ —	$ (8,526)	$ 79,737	**$ —**	**$ (7,214)**	**$ 72,523**	**$ 6,047**
Compensated absences	37,347	14,215	(11,798)	39,764	**15,561**	**(14,829)**	**40,496**	**14,200**
Customer deposits and trust funds	41,234	10,389	(13,256)	38,367	**10,024**	**(7,000)**	**41,391**	**19,922**
Other postemployment benefits (Note 8)	—	21,718	—	21,718	**21,400**	**—**	**43,118**	**—**
Workers' Compensation and third-party claims (Note 14)	57,368	20,432	(42,262)	35,538	**7,420**	**(6,365)**	**36,593**	**24,614**
Other long-term liabilities	1,169	4,250	(99)	5,320	**151**	**(94)**	**5,377**	**50**
Total other long-term liabilities	$ 225,381	$ 71,004	$ (75,941)	$ 220,444	**$ 54,556**	**$ (35,502)**	**$ 239,498**	**$ 64,833**

Off-Aqueduct Power Facilities. Interest rate for this debt is 5.82 percent and the maturity dates range from July 1, 2007 through July 1, 2024.

Other Long-Term Liabilities. The interest rates range from 2.80 percent to 5.61 percent and the maturity dates range from July 1, 2007 through February 1, 2020.

7. PENSION PLAN

(a) Plan Description

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

(b) Funding Policy

Active plan members are required to contribute 7.0 percent of their annual covered salary. Effective July 1, 2001, Metropolitan contributes the full 7.0 percent for all active plan members. In addition, Metropolitan is required to contribute the actuarially determined remaining amount necessary to fund the benefits for its members. The actuarial methods and assumptions used are those adopted by the CalPERS Board of Administration. The required employer contribution rate for fiscal year 2007 and 2006 was 11.315 percent and 11.667 percent, respectively. The contribution requirements of the plan members are established by State statute and the employer contribution rate is established and may be amended by CalPERS.

(c) Annual Pension Cost and Net Pension Obligation

Metropolitan's annual pension cost and net pension obligation (asset) to CalPERS for fiscal years 2007 and 2006 were as follows:

	June 30,		
(Dollars in thousands)	**2007**	2006	2005
Annual required contribution	**$ 31,708**	$ 30,314	$ 17,390
Interest on net pension obligation (asset)	**—**	(118)	(138)
Adjustment to annual required contribution	**926**	1,542	390
Annual pension cost	**32,634**	31,738	17,642
Contributions made	**(32,634)**	(30,314)	(17,390)
Increase in net pension obligation (asset)	**—**	1,424	252
Net pension obligation (asset), beginning of year	**—**	(1,424)	(1,676)
Net pension obligation (asset), end of year	**$ —**	$ —	$ (1,424)

For fiscal year 2007, Metropolitan's annual pension cost and contribution made was $32,634,000. The annual pension cost includes $12,473,000 for Metropolitan's pickup of the employee's 7.0 percent share. The required contribution was based on CalPERS June 30, 2004 actuarial valuation using the entry-age-normal actuarial cost method with the contributions determined as a percent of pay. This is the latest information available from CalPERS relating to the current fiscal year. The actuarial assumptions included (a) a 7.75 percent investment rate of return (net of administrative expenses), (b) projected annual salary increases that vary by duration of service, and (c) an inflation component of 3.0 percent. Metropolitan's net pension obligation (asset) was being amortized as a level percentage of payroll on a closed basis. However, as of June 30, 2006, the remaining $1.4 million balance was written-off. The actuarial value of CalPERS assets was determined using techniques that smooth the effect of short-term volatility in the market value of investments over a fifteen-year period (smoothed market value). Metropolitan's net pension asset, as of June 30, 2005, was recorded as a prepaid expense and classified as a deferred charge on the balance sheets.

Three-Year Trend Information for CalPERS

(Dollars in thousands)	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation (Asset)
Year ended June 30:			
2005	$ 17,642	99%	$ (1,424)
2006	$ 31,738	96%	$ —
2007	$ 32,634	100%	$ —

8. POSTEMPLOYMENT BENEFITS OTHER THAN PENSIONS

(a) Plan Description

Through CalPERS, Metropolitan offers medical insurance to active and retired employees, as well as their qualified dependents. The CalPERS plan is an agent multiple-employer plan governed by the Public Employees' Medical & Hospital Care Act (PEMHCA). Under PEMHCA, health coverage for the employee continues into retirement. Current plans offered are PERS Care PPO, PERS Choice PPO, Blue Shield HMO, and Kaiser HMO. Benefit provisions are established through negotiations between Metropolitan and its various bargaining units, which also apply to retirees. This benefit was provided to 1,259 and 1,206 retired Metropolitan employees at June 30, 2007 and 2006 respectively. CalPERS issues a separate comprehensive annual report that includes financial statements for its Health Care Fund. Copies of CalPERS' annual financial report may be obtained from its Executive Office, 400 Q Street, Sacramento, CA 95811.

(b) Funding Policy

Contribution requirements are negotiated between Metropolitan and its various bargaining units. During fiscal year 2007, Metropolitan contributed 90% of the PERS Care PPO Los Angeles regional basic plan rate towards all plans. Funding was on a pay-as-you-go basis for fiscal year 2007 and 2006. During fiscal year 2007 and 2006, Metropolitan contributed, net of participant contributions as determined by CalPERS, $9,207,000 and $8,038,000, respectively.

(c) Annual OPEB Cost and Net OPEB Obligation

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

The annual OPEB cost and net OPEB obligation at June 30, 2007 and 2006 were as follows:

	June 30,	
(Dollars in thousands)	**2007**	2006
Annual required contribution	**$ 30,648**	$ 29,756
Interest on net OPEB obligation	977	—
Adjustment to annual required contribution	**(1,018)**	—
Annual OPEB cost	**30,607**	29,756
Contributions made	**(9,207)**	(8,038)
Increase in net OPEB obligation	**21,400**	21,718
Net OPEB obligation, beginning of year	**21,718**	—
Net OPEB obligation, end of year	**$ 43,118**	$ 21,718

For fiscal year 2007, Metropolitan's annual OPEB cost was $30,607,000. Contributions made of $9,207,000 were equal to the pay-as-you-go amount and represented 30 percent of the annual OPEB cost. The required contribution was based on a January 1, 2005 actuarial valuation using the entry age normal actuarial cost method with contributions determined as a level percent of pay. The actuarial assumptions included (a) a 4.5 percent investment rate of return, (b) a 3.0 percent inflation component, and (c) healthcare cost trend rates as follows: (i) HMO – starting at 11.0 percent, grading down to 4.0 percent over ten years, (ii) PPO – starting at 12.0 percent, grading down to 5.0 percent over ten years. The assumptions used in the actuarial valuation are subject to future revisions as actual results are compared to past expectations and new assumptions are made about the future.

(d) Funded Status

The funded status of the plan at June 30, 2007 and 2006, based on the January 1, 2005 actuarial valuation, were as follows:

	June 30,	
(Dollars in thousands)	**2007**	2006
Actuarial accrued liability (AAL)	**$ 310,461**	$ 310,461
Actuarial value of plan assets	**—**	—
Unfunded actuarial accrued liability (UAAL)	**$ 310,461**	$ 310,461
Funded ratio (actuarial value of plan assets / AAL)	**0.00%**	0.00%
Covered payroll (active plan members)	**$ 161,990**	$ 161,990
UAAL as a percentage of covered payroll	**191.6%**	191.6%

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

9. COMMITMENTS AND CONTINGENCIES

(a) State Water Contract (see Note 10)

Estimates of Metropolitan's share of the projected fixed costs of the State Water Project (SWP) are provided annually by the State. The estimates are subject to future increases or decreases resulting from changes in planned facilities, refinements in cost estimates, and inflation.

During the next five years, payments under the State Water Contract, exclusive of variable power costs, are currently estimated by the State to be as follows:

(Dollars in thousands)	State Water Contract Payments
Year ending June 30:	
2008	$ 375,804
2009	$ 369,865
2010	$ 344,670
2011	$ 350,165
2012	$ 356,129

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

(Dollars in thousands)	State Water Contract Long-Term Commitments
Transportation facilities	$ 3,983,369
Conservation facilities	1,492,826
Off-aqueduct power facilities (see Note 9e)	584,617
East Branch enlargement	709,890
Revenue bond surcharge	701,730
Total long-term SWP contract commitments	$ 7,472,432

Metropolitan intends to exercise its option to extend its agreement with the State through 2052, which will result in annual minimum operations and maintenance costs through 2052. In addition, the amounts shown above do not contain any escalation for inflation, are subject to significant variation over time because the amounts are based on a number of assumptions, and are contingent on future events. None of the estimated long-term commitments, other than $180.3 million of State Water Contract payments for July through December 2007 (see Note 1l) and the $72.5 million obligation related to loss accruals on certain off-aqueduct power facilities (see Note 9e), are recorded as liabilities in the accompanying basic financial statements.

Bay/Delta Regulatory and Planning Activities. The State Water Resources Control Board (State Board) is the agency responsible for setting water quality standards and administering water rights throughout California. Decisions of the State Board can affect the availability of water to Metropolitan and other water users throughout California. The State Board exercises its regulatory authority over Bay/Delta watershed supplies by means of public proceedings leading to regulations and decisions. In 1995, the State Board adopted a Water Quality Control Plan establishing water quality standards and flow improvements in the Bay/Delta watershed.

In August 2000, the California Federal (CALFED) Bay/Delta Program Record of Decision (Decision) was approved with mandates to improve water quality, enhance water supply reliability, augment ecosystem restoration, and assure long-term protection for Delta levees. During its first seven years, CALFED has invested more than $2.0 billion in hundreds of local and regional projects to meet these program goals.

To guide future development of the CALFED Program and identify a strategy for managing the Delta as a sustainable resource, in September 2006, Governor Schwarzenegger established by Executive Order a Delta Vision Process. The process is tied to legislation that created a cabinet-level committee tasked with developing a strategic vision for the Delta. Although it builds on work done through the CALFED Program, the Delta Vision is anticipated to broaden the focus of past efforts and recommend actions that will address the full array of natural resource, infrastructure, land use, and governance issues necessary to achieve a sustainable Delta. Recommendations of a 41-member Delta Vision stakeholder group are due January 1, 2008, with a final Delta strategic plan to be submitted to the Governor and the Legislature by December 31, 2008.

Other issues such as the recent decline of some fisheries in the Delta and surrounding regions and certain operational actions in the Delta may significantly impact Metropolitan's water supply from the Delta. The impact on future revenues of such potential actions is not known at this time.

DWR Pumping Plants. The listing of several fish species as threatened or endangered under the federal and/or California Endangered Species Acts (respectively, the "Federal ESA" and the "California ESA" and, collectively, the "ESAs") have impacted State Water Project operations and limited the flexibility of the State Water Project. Currently, five species, the winter-run and spring-run Chinook salmon, Delta smelt, North American green sturgeon, and Central Valley steelhead, are listed under the ESAs. In addition, The San Francisco Bay Institute, Center for Biological Diversity and Natural Resources Defense Council on August 9, 2007, petitioned to list the long fin smelt for protection under both ESAs.

The Federal ESA requires that before any federal agency authorizes, funds or carries out an action it must consult with the appropriate federal fishery agency to determine whether the action would jeopardize the continued existence of any threatened or endangered species, or adversely modify habitat critical to the species' needs. The result of the consultation is known as a "biological opinion." In the biological opinion the federal fishery agency determines whether the action would cause jeopardy to a threatened or endangered species or adverse modification to critical habitat and recommends reasonable and prudent alternatives or measures that would allow the action to proceed without causing jeopardy or adverse modification. The biological opinion also includes an "incidental take statement." The incidental take statement allows the action to go forward even though it will result in some level of "take," including harming or killing some members of the species, incidental to the agency action, provided that the agency action does not jeopardize the continued existence of any threatened or endangered species and complies with reasonable mitigation and minimization measures recommended by the federal fishery agency. The United States Fish and Wildlife Service and National Marine Fisheries Service have issued biological opinions and incidental take statements that govern operations of the State Water Project and Central Valley Project with respect to the Delta smelt, the winter-run and spring-run Chinook salmon and the Central Valley steelhead. An additional biological opinion will be required for the North American green sturgeon, which was listed in April 2006. The Bureau of Reclamation initiated consultations with the United States Fish and Wildlife Service and National Marine Fisheries Service for new biological opinions with respect to the coordinated operations of the State Water Project and Central Valley Project in July 2006, following the filing of the challenges to the biological opinions and incidental take statements described below.

Litigation filed by several environmental interest groups in the United States District Court for the Eastern District of California alleges that these biological opinions and incidental take statements inadequately analyzed impacts on listed species under the Federal ESA. On May 25, 2007, a Federal district court judge issued a decision on summary judgment in *NRDC v. Kempthorne*, finding the United States Fish and Wildlife Service's biological opinion for Delta smelt to be invalid. On August 31, 2007, the judge ruled from the bench that the State Water Project and Central Valley Project operate according to certain specified criteria until a new Biological Opinion for the Delta smelt is issued sometime in 2008. The operational criteria generally specify a range of reverse flows for Old and Middle River near the location of the project pumps during the winter and spring. Based on initial estimates supplied by the Department of Water Resources, Metropolitan staff estimate that Metropolitan may lose as much as 30 percent of its State Water Project supplies next year and possibly longer, under the preliminary ruling. The judge has directed the parties to submit proposed findings of fact and conclusions of law and a proposed preliminary injunction by October 22, 2007. The judge's formal, written ruling will be issued after that date. Under the preliminary ruling, the U.S. Fish and Wildlife Service may vary Project operations in the winter and spring depending on prevailing conditions and the status of the Delta smelt. A hearing on the plaintiffs' motion for summary judgment in *Pacific Coast Federation of Fishermen's Associations v. Gutierrez*, which challenges the National Marine Fisheries Service's Biological Opinion for the salmon and other anadromous species, is scheduled for October 3, 2007.

Metropolitan's State Water Project allocation for 2007 is unchanged. Actual water supply curtailments of State Water Project water to Metropolitan in 2008 will depend on fish, weather and flow conditions in the Bay-Delta and how curtailments are divided between the State Water Project and Central Valley Project and on the terms of the final, written ruling.

In addition to this litigation under the Federal ESA, other environmental groups sued the Department of Water Resources on October 4, 2006 in the Superior Court of the State of California for Alameda County alleging that the Department of Water Resources was taking listed species without authorization under the California ESA. This litigation requests that the Department of Water Resources be mandated to either cease operation of the State Water Project pumps, which deliver water to the California Aqueduct, in a manner that results in such "taking" of listed species or obtain authorization for such "taking" under the California ESA. On April 18, 2007, the Alameda County Superior Court issued its Statement of Decision in *Watershed Enforcers v. California Department of Water Resources*. The Statement of Decision finds that the Department of Water Resources is illegally "taking" listed fish through operation of the State Water Project export facilities. The Court ordered the Department of Water Resources to "cease and desist from further operation" of those facilities within 60 days unless it obtains take authorization from the California Department of Fish and Game.

The Department of Water Resources appealed the Superior Court's order on May 7, 2007. This appeal automatically stays the order pending the outcome of the appeal, unless the plaintiff obtains an order from the trial or appellate court that the appeal not act as a stay based on a showing of irreparable injury. Also on May 7, 2007, the Department of Water Resources executed a memorandum of understanding ("MOU") with the California Department of Fish and Game to assist in reinitiated consultations with the United States Fish and Wildlife Service and National Marine Fisheries Service for new biological opinions on the coordinated operations of the State Water Project and Central Valley Project as they relate to the listed species of fish. In the MOU, the Department of Water Resources and the California Department of Fish and Game agree that the biological assessment and resulting biological opinions under the Federal ESA should be developed to include State Water Project operations that are consistent with the California ESA and set goals for completion of the biological assessment by October 2007 to facilitate completion of the biological opinions by April 2008. After the new biological opinions and incidental take statements for the listed species of fish are completed, Metropolitan anticipates that the Department of Water Resources will apply to the Department of Fish and Game for a consistency determination under the California ESA based on the new biological opinions and incidental take statements.

The Department of Water Resources has altered the operations of the State Water Project to accommodate species of fish listed under the Federal and California ESAs. These changes in project operations have influenced the manner in which water is diverted from the Bay-Delta and State Water Project deliveries. After juvenile Delta smelt were drawn into fish screens at the State Water Project's Harvey O. Banks pumping plant facility between May 25 and May 31, 2007, the Department of Water Resources announced on May 31 that it stopped pumping at SWP facilities in the Bay-Delta to provide maximum protection to Delta smelt. The Department of Water Resources recommenced pumping after changing water conditions resulted in the Delta smelt moving away from the pumps.

State Water Project operational requirements may be further modified through the consultation process for new biological opinions for listed species under the Federal ESA or from the California Department of Fish and Game's actions regarding a consistency determination under the California ESA. No assurances can be given whether or when new biological opinions or a consistency determination will be issued under the Federal ESA and California ESA or how long the Alameda County Superior Court's order will be stayed.

Decisions in these cases or future litigation, listings of additional species (such as the long fin smelt) or new regulatory requirements could adversely affect State Water Project operations in the future by requiring additional export reductions, releases of additional water from storage or other operational changes impacting water supply operations. Metropolitan cannot predict the ultimate outcome of any of the litigation or regulatory processes described above at this time or whether such outcome will result in any materially adverse impact on the operation of the State Water Project pumps, Metropolitan's State Water Project supplies or Metropolitan's water reserves. However, management believes that this case will not have a material adverse effect on the financial position or the results of operations of Metropolitan.

(b) Imperial Irrigation District

As of June 30, 2007, Metropolitan had advanced to IID a total of $217.7 million for construction costs, operations and maintenance costs, and conservation projects. Metropolitan remains obligated to pay IID approximately $9.2 million per year (2007 dollars) for actual operation and maintenance costs for the remainder of this agreement through at least 2041. In return, Metropolitan will receive between 85,000–105,000 acre-feet of water annually depending upon the amount used by Coachella Valley Water District. A total of 85,000 and 81,160 acre-feet was available for diversion by Metropolitan in calendar years 2007 and 2006, respectively (see Note 4a).

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

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

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

(d) Quantification Settlement Agreement

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

(e) Abandoned Off-Aqueduct Power Facilities

The State Department of Water Resources (DWR) has financed the construction of certain off-aqueduct power facilities in order to provide power for water transportation purposes for the State Water Project system. Two geothermal facilities have been abandoned by DWR due to insufficient steam supply to operate the plants at their planned capacities. As a result of these actions by DWR, Metropolitan recorded losses of $204.1 million in prior fiscal years. Metropolitan's estimated remaining long-term contractual obligations for these facilities as of June 30, 2007, which are based on the State's latest estimates, including average interest of 5.60 percent through the year 2024, are shown in the following table:

(Dollars in thousands)	Principal	Interest	Total
Year ending June 30:			
2008	$ 6,047	$ 4,130	$ 10,177
2009	6,393	3,787	10,180
2010	7,042	3,427	10,469
2011	5,964	3,033	8,997
2012	6,399	2,618	9,017
2013-2017	30,567	6,544	37,111
2018-2022	7,451	1,944	9,395
2023-2024	2,660	218	2,878
Total obligations	72,523	$ 25,701	$ 98,224
Less current portion	(6,047)		
Long-term portion of obligations	$ 66,476		

(f) Construction Programs and Contracts

At June 30, 2007, the estimated cost, excluding contingencies, of Metropolitan's capital program through fiscal year 2015 totals approximately $2.038 billion, including escalation of 2.77 percent per year for the unfunded components of the capital investment plan.

Included in Metropolitan's capital program is $196.2 million to complete the Inland Feeder Project, a pipeline conveyance system that will nearly double the capability to receive water from the East Branch of the State Water Project. This pipeline system is scheduled for completion in fiscal year 2011 with an estimated total cost of $1.186 billion.

The capital program also includes $592.1 million of estimated costs for facilities that may be required to meet current water quality standards (see Note 9h) and $156.9 million for San Diego Pipeline No. 6.

Metropolitan had commitments under construction contracts in force as follows:

	June 30,	
(Dollars in thousands)	**2007**	2006
Inland Feeder Project	**$ 167,005**	$ 104,086
Filtration plants oxidation retrofit project	**142,355**	230,279
Treatment plant chemical systems modifications/upgrades	**19,088**	112,541
Skinner treatment plant expansion 4	**—**	14,286
San Diego Pipeline No. 6	**—**	5,973
Diemer treatment plant—entrance, vehicle maintenance	**1,017**	12,647
Diamond Valley Lake recreation area	**—**	5,489
Diemer plant maintenance facilities	**—**	4,555
Weymouth solids handling	**—**	20
Diemer treatment plant Yorba Linda feeder bypass	**—**	27
Weymouth treatment plant replace surface wash headers	**—**	128
Orange County 88 modifications	**—**	357
Weymouth operations and maintenance building	**9,030**	—
Perris Valley pipeline	**7,801**	—
Distribution system air release vacuum	**4,357**	—
Other	**4,741**	7,994
	$ 355,394	$ 498,382

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

(g) Claims and Litigation

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

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

The legal issue heard by the California Supreme Court was limited to the standard of eligibility for PERS benefits and did not address plaintiffs' claims for rights and benefits under Metropolitan's Administrative Code. The parties have reached a court-approved settlement of the Administrative Code claim. Pursuant to the settlement, Metropolitan paid $35.0 million to a settlement fund. The remaining portion of the case concerns implementing the Supreme Court's ruling establishing common law eligibility for PERS benefits. That effort involves enrolling eligible temporary workers, resolving eligibility disputes and addressing the potential penalties associated with late PERS enrollment. Metropolitan has thus far identified 344 individuals as eligible for enrollment, which may increase once PERS further clarifies the eligibility standard. The parties agreed to address eligibility disputes by submitting test cases before administrative judges covering different categories of temporary worker services.

Metropolitan received an adverse determination from PERS on the penalty issue that has been affirmed by an administrative law judge. While Metropolitan continues to maintain that PERS should not apply any penalty provision, the parties have settled this controversy by approving a settlement agreement that fully resolves plaintiffs' CalPERS claim (other than plaintiffs' demand for attorney fees). The settlement is subject to final approval by the court, following notice to class members and hearing of any objections. The settlement provides for a claims process which Metropolitan estimates will result in approximately 2,000 claims for PERS benefits. The estimated potential liability on the PERS claim and plaintiff's demand for attorney fees is in the range of $15.0 to $40.0 million. As of June 30, 2006, $15.0 million was expensed and a corresponding liability established, which as of June 30, 2007 was classified as a current liability.

Metropolitan also is the defendant in a lawsuit by Cadiz, Inc. alleging breach of contract, breach of fiduciary duty, breach of implied contract, promissory estoppel and specific performance against Metropolitan based on a series of preliminary agreements for the development of a program to store water from the Colorado River Aqueduct in an aquifer underlying Cadiz's land and to supply water from that aquifer. The water was to be conveyed to and from the aquifer via an aqueduct to be constructed for this purpose. The agreements also provided for cost sharing for the environmental documentation and review necessary under National Environmental Policy Act (NEPA) and California Environmental Quality Act (CEQA). Cadiz alleges that Metropolitan breached its duty to complete environmental review of the project. Metropolitan contends that it had no obligation, under the agreements or otherwise, to proceed with the project, absent the approval of Metropolitan's Board, and that the Board had full discretion in determining not to proceed. Cadiz's Second Amended Complaint seeks compensatory damages, including general damages in excess of $2.0 million, unspecified special damages (i.e., lost profits), and specific performance. Metropolitan is vigorously defending this action. However, if plaintiff is successful in all its contentions, an award for special damages and costs of specific performance could reach tens of millions of dollars.

On April 25, 2005, a group of fourteen State Water Project contractors filed suit against the Department of Water Resources challenging the manner in which it allocates certain energy costs and revenues related to operation of the State Water Project. Among other things, these contractors allege that the Department of Water Resources has been and is administering certain provisions of State Water Contract incorrectly, depriving them of "all benefits" derived from the sale or other disposal of electrical energy generated at the Hyatt-Thermalito power facility. The plaintiffs have not alleged specific amounts for damages. Metropolitan and twelve other State Water Project contractors have intervened in the litigation. Metropolitan believes that Hyatt-Thermalito energy costs and revenues have been and are being allocated by the Department of Water Resources in a manner that is both legal and equitable. However, if plaintiffs are successful, tens of millions of dollars in annual costs could be shifted from State Water Project contractors located north of the Tehachapi Mountains to State Water Project contractors located south of the Tehachapi Mountains and on the Central Coast, including Metropolitan.

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

(h) Drinking Water Quality Standards

Under the Safe Drinking Water Act Amendments of 1996, Congress required the United States Environmental Protection Agency to set new drinking water quality standards. New standards to control microbial pathogens and disinfection by-products (DBPs) became effective in 2002. These rules are known as the Interim Enhanced Surface Water Treatment Rule and the Stage 1 Disinfectants/Disinfection By-Product Rule. These standards became more stringent in a second set of regulations effective 2006. The second set of regulations (the Stage 2 Disinfectants/Disinfection By-Products Rule and the Long-Term 2 Enhanced Surface Water Treatment Rule) will be phased in over the next five years but will not require additional capital investment by Metropolitan.

Metropolitan identified ozone disinfection as the most cost-effective option to minimize the production of DBPs and achieve other water quality objectives. Ozone is being installed as the primary disinfectant at all five of Metropolitan's treatment plants. Ozone is in various stages of implementation. It is operational at the Mills and Jensen plants and in design or construction at the Skinner, Weymouth, and Diemer plants. It will be operational at the three remaining plants between 2009 and 2011. The estimated cost of implementing ozone treatment at all five plants is approximately $910.0 million.

(i) Arbitrage Rebate Obligation

At June 30, 2007 and 2006, Metropolitan had general obligation and revenue bonds outstanding which are subject to arbitrage limitations. The term arbitrage rebate refers to the required payment to the U.S. Treasury of excess earnings received on applicable tax-exempt bond proceeds that are invested at a higher yield than the yield of the tax-exempt bond issue. Metropolitan's ultimate rebate of arbitrage earnings on these issues is contingent on various factors, including future yields on invested proceeds.

As of June 30, 2007 and 2006, Metropolitan's recorded arbitrage rebate liability was $110,000 and $10,000, respectively. The rebate obligations are generally computed and adjusted, as applicable, on an annual basis in accordance with regulations promulgated by the U.S. Treasury Department. Required rebates are generally due and payable in five-year intervals during the life of debt issues, with final rebates due upon the retirement of the debt issues.

(j) Landfill Obligation

Federal and State laws and regulations require that Metropolitan perform certain maintenance and monitoring functions at its sole landfill site for 30 years after closure. They further require that a separate funding mechanism be established to ensure that sufficient funds are available for closure and postclosure costs. In October 1995, the landfill was closed and management's estimate of closure and postclosure costs for this site totaled approximately $2.0 million. The required thirty-year postclosure maintenance and monitoring of the landfill officially started in January 1998, after the installation of the landfill's final cover was completed. During fiscal year 2007, $94,000 was expended for postclosure maintenance and monitoring activities.

The actual cost of postclosure care may be higher due to inflation, changes in technology, or changes in landfill laws or regulations. Funding of these costs has been derived from a separate trust account that has been established for closure and postclosure costs. At June 30, 2007 and 2006, approximately $1,017,000 and $1,060,000 net of interest receipts and disbursements were available, respectively, in this account.

10. PREPAID STATE WATER PROJECT COSTS

State Water Project activity for the fiscal year ended June 30, 2007 and 2006 was as follows:

(Dollars in thousands)	June 30, 2005	Additions	Reductions	June 30, 2006	**Additions**	**Reductions**	**June 30, 2007**
State Water Project costs	$ 3,750,549	$ 154,271	$ (171,081)	$ 3,733,739	**$ 171,880**	**$ (65,760)**	**$ 3,839,859**
Accumulated amortization	(2,213,045)	(113,778)	81,200	(2,245,623)	**(116,426)**	**—**	**(2,362,049)**
State Water Project costs, net	$ 1,537,504	$ 40,493	$ (89,881)	1,488,116	**$ 55,454**	**$ (65,760)**	**$ 1,477,810**
Less current portion				(113,778)			**(116,425)**
Noncurrent portion				$ 1,374,338			**$ 1,361,385**

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

Approximately 23 percent and 26 percent of Metropolitan's total expenditures during fiscal years 2007 and 2006, respectively, pertained to its net payment obligations for the State Water Project. These payments were primarily based on contractual water delivery entitlements, the requested and actual deliveries received, and the cost of power required for such deliveries, offset by credits received from the project.

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

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

Metropolitan defers its share of system construction costs as prepaid State Water Project costs when such costs are billed by the State (see Note 9a). Unamortized prepaid State Water Project costs essentially represent a prepayment for future water deliveries through the State system. Metropolitan's share of system operations and maintenance costs is charged to expense. In fiscal year 2006, net operations and maintenance costs of $56.4 million, previously deferred, were expensed to power and water costs.

Metropolitan amortizes a portion of prepaid State Water Project costs each month using a formula that considers the total estimated cost of the project, the estimated useful life, and estimated production capacity of the assets based upon information provided by the State of California. In fiscal year 2006, the formula was modified to use entitlements in place of deliveries as the production capacity estimate. Amortization expense totaled $116,426,000 and $113,778,000 in fiscal years 2007 and 2006, respectively.

11. DEPOSITS, DEFERRED CHARGES, AND OTHER

Balances at June 30, 2007 and 2006 were as follows:

	June 30,	
(Dollars in thousands)	**2007**	2006
Deferred charges—SWP Minimum OMP&R	**$ 73,773**	$ 80,645
Deferred water rights	**103,810**	111,315
Deferred charges—Kern Delta	**20,840**	13,435
Deferred charges—Bay/Delta	**7,537**	7,400
Prepaid expenses	**26,779**	20,139
Feasibility studies	**18,731**	11,782
Other	**2,035**	2,804
Total deposits, deferred charges and other	**253,505**	247,520
Less current portion	**(77,897)**	(84,109)
Noncurrent portion	**$ 175,608**	$ 163,411

(a) Deferred Charges—SWP Minimum OMP&R
Metropolitan receives calendar year billings from the Department of Water Resources each July for the subsequent calendar year. The invoice is accrued and payable over the twelve-month period. The amount deferred at June 30 of each fiscal year represents the operating, maintenance, power and replacement (OMP&R) costs applicable to the first six months of the next fiscal year. Accordingly, these deferred charges are classified as current assets at June 30, 2007 and 2006.

(b) Deferred Water Rights
Metropolitan has entered into several water exchange and storage agreements with other agencies. These agreements provide Metropolitan with additional reliable water supplies to supplement deliveries of Colorado River and State Water Project water. Metropolitan is also actively pursuing other agreements, both within and outside its service area, to provide additional water supplies. The exchange and storage agreements generally provide for advance delivery of water during periods when water is available. Expenditures associated with these agreements have been recorded as deferred charges and are charged to the cost of water as the rights are exercised. At June 30, 2007 and 2006, deferred water rights totaled approximately $103.810 million and $111.315 million, respectively, based on volumes of 1,413,000 acre-feet and 1,521,000 acre-feet, as of such dates.

(c) Deferred Charges—Kern Delta
Metropolitan entered into an agreement with the Kern Delta Water District for the development of a water management program. The agreement includes a Regulation Program and a Transportation Program. Under the terms of the Regulation Program, Kern Delta will regulate the storage and delivery for Metropolitan of up to 250,000 acre-feet of water and currently has 36,299 acre-feet in the program.The program is intended to provide a minimum recharge and return capability of 50,000 acre-feet annually. Construction of infrastructure is required in order to meet the program's dry year minimum return. Total capital costs are expected to be $33.0 million in 1999 dollars with an escalation clause. These costs will be recorded as deferred charges until construction is completed.

The agreement also provides a Transportation program whereby Metropolitan is provided priority rights to convey water acquired by Metropolitan from third parties through the Kern-Delta facilities to the California Aqueduct for ultimate delivery to Metropolitan. This program terminates on December 31, 2029.

(d) Deferred Charges—Bay/Delta
In December 1994, representatives from state and federal resource agencies, and urban, agricultural, and environmental agencies agreed to a set of principles to implement a protection plan for the San Francisco Bay/Delta Estuary. Among the principles was a commitment by agricultural and urban water agencies to fund $60.0 million to help initiate a comprehensive program to address nonoutflow-related impacts to the Bay/Delta environment. The Secretary of the Interior requested Metropolitan to guarantee $10.0 million annually for three years, for a total of $30.0 million, to be made available for the restoration fund created by the principles. Metropolitan's final payment of its $30.0 million commitment was made in June 1998. Metropolitan's contributions are accounted for as deferred charges that are charged to expense based on expenses by the restoration fund. The amount charged to expense totaled $(137,000) and $18,000 for fiscal years ended June 30, 2007 and 2006, respectively. During fiscal year 2001, Metropolitan became trustee for the unspent funds, which totaled $7.5 million and $7.4 million at June 30, 2007 and 2006, respectively.

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

12. DEFERRED COMPENSATION AND SAVINGS PLANS

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

Prior to November 2003, Metropolitan managed the investment of the funds. The plan assets, together with the corresponding liability, were included in the basic financial statements. In November 2003, the plan assets were transferred to a third-party administrator. Accordingly, at June 30, 2007 and 2006, neither the plan assets nor the related liability were included in the accompanying basic financial statements.

Prior to March 2006, Metropolitan had two compensation deferral arrangements in accordance with Section 401(k) of the Internal Revenue Code. Savings Plan I was available to management, confidential, and supervisory employees. Savings Plan II was available to employees represented by Metropolitan's Employees Association (AFSCME Local 1902). Effective March 2006, the two plans were combined into a single plan available to substantially all employees. At June 30, 2007 and 2006, 1,668 and 1,646 employees participated in the combined 401(k) plan. Amounts deferred by participants, Metropolitan matching contributions, and accumulated earnings thereon are fully vested. Deferred amounts and matching contributions are transferred by Metropolitan each pay period to a third-party administrator who coordinates the investment of such proceeds in a variety of investment vehicles in accordance with the instructions of each participant. The Treasurer serves as Trustee for each plan. Metropolitan is not liable to its employees for any losses that may be incurred in connection with their participation in such plans.

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

Contributions to the savings plans were as follows:

	June 30,	
(Dollars in thousands)	**2007**	2006
Employees	**$ 14,434**	$ 12,995
Metropolitan	**6,948**	6,393
	$ 21,382	$ 19,388
Eligible payroll	**$ 180,900**	$ 166,379
Employee contributions as percent of eligible payroll	**8.0%**	7.8%

13. NET ASSETS

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

Net assets that are *invested in capital assets and State Water Project costs, net of related debt* consist of capital assets and State Water Project costs, net of accumulated depreciation and amortization, and reduced by the outstanding balances of any bonds, notes, or other borrowings attributable to the acquisition or construction of those assets. Metropolitan's capital assets and State Water Project costs include plant and equipment, participation rights (see Note 2) and prepaid State Water Project costs (see Notes 1h and 10). Approximately $4.7 billion and $4.6 billion were invested in capital assets and State Water Project costs, net of related debt at June 30, 2007 and 2006, respectively.

Restricted net assets are those net assets that have external constraints placed on them by creditors, grantors, contributors, or laws or regulations of other governments, or imposed by law through constitutional provisions of enabling legislation. Restricted net assets totaled $471.5 million and $411.6 million at June 30, 2007 and 2006, respectively, of which $70.5 million and $70.7 million were restricted by enabling legislation at June 30, 2007 and 2006, respectively.

Unrestricted net assets consist of net assets that do not meet the definition of "restricted" or "invested in capital assets and State Water Project costs, net of related debt." Unlike the restricted net assets, the Board has discretion in determining the use and establishing minimum/maximum balance requirements for the unrestricted cash and investment portion of net assets. The Board may at any time change or eliminate amounts established for these purposes. Unrestricted net assets totaled $541.7 million and $515.1 million at June 30, 2007 and 2006, respectively.

Certain of the unrestricted amounts have been designated. The designated balances at June 30, 2007 and 2006 were as follows:

	June 30,	
(Dollars in thousands)	**2007**	2006
Water rate stabilization	**$ 124,373**	$ 97,841
Working capital	**166,904**	157,595
Water transfer	**28,067**	40,450
Water stewardship	**30,865**	26,284
Self-insurance retention	**26,609**	25,090
Replacement and refurbishment	**62,819**	94,220
Desalination	**17,930**	16,895
Total designated balances	**$ 457,567**	$ 458,375

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

14. RISK MANAGEMENT

Metropolitan is exposed to various risks of loss related to design, construction, treatment, and delivery of water resources. Metropolitan self-insures most Metropolitan property losses, the first $25 million for general liability and $5 million for workers' compensation. Metropolitan supplements its self-insurance program with $75 million excess general liability coverage and $25 million excess workers' compensation insurance. Excess liability policies also purchased include $60 million for fiduciary liability and $65 million for directors' and officers' liability. Specialty insurance policies purchased include aircraft hull and liability, crime insurance, and travel accident coverage. Coverage types and limits for fiscal year 2007 were unchanged from fiscal year 2006. Settlement amounts did not exceed the self-insurance or insurance coverage limits in any of the past three years.

Metropolitan has had, and recently concluded owner-controlled insurance programs (OCIP) to cover all work on the Diamond Valley Lake Project and the Inland Feeder Project. These owner-controlled insurance programs (OCIP's) provided coverage for all contractors, subcontractors, and construction managers on the project. Funds totaling $40.8 million have been approved for the Diamond Valley Lake OCIP. As of June 30, 2007, $38.7 million had been expended. Funds totaling $35.6 million have been approved for the Inland Feeder OCIP. As of June 30, 2007, $18.5 million had been expended. Though the OCIP's have been concluded, workers' compensation and liability coverages remain in place for open claims and those incurred but not reported.

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

	June 30,		
(Dollars in thousands)	**2007**	2006	2005
Unpaid claims, beginning of fiscal year	**$ 35,538**	$ 57,368	$ 31,576
Incurred claims (including IBNR)	**7,420**	20,432	42,303
Claim payments and adjustments	**(6,365)**	(42,262)	(16,511)
Unpaid claims, end of fiscal year	**36,593**	35,538	57,368
Less current portion	**(24,614)**	(6,316)	(40,236)
Noncurrent portion	**$ 11,979**	$ 29,222	$ 17,132

Funding Progress of Pension Plan

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

(Dollars in thousands)

Actuarial Valuation Date	Entry Age Normal Accrued Liability	Actuarial Asset Value	Unfunded Liability/ (Excess Assets)	Funded Ratio	Covered Payroll	Unfunded Actuarial Liability/ (Excess Assets) as Percentage of Covered Payroll
June 30:						
2003	$ 910,841	$ 889,941	$ 20,900	97.7%	$ 145,700	14.3%
2004	$ 975,350	$ 918,873	$ 56,477	94.2%	$ 154,441	36.6%
2005	$1,063,784	$ 987,759	$ 76,025	92.9%	$ 159,584	47.6%

Funding Progress of Other Postemployment Benefits

The table below provides the schedule of funding progress of Metropolitan's OPEB obligation. The information reflects the most recent actuarial valuation.

(Dollars in thousands)

Actuarial Valuation Date	Accrued Liability	Actuarial Asset Value	Unfunded Liability	Funded Ratio	Covered Payroll	Unfunded Actuarial Liability as Percentage of Covered Payroll
1/01/05	$ 310,461	$ —	$ 310,461	0.00%	$ 161,990	191.6%

See accompanying independent auditors' report.

KPMG

KPMG LLP
Suite 2000
355 South Grand Avenue
Los Angeles, CA 90071-1568

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

We have audited the accompanying statement of cash and investments of The Metropolitan Water District of Southern California (Metropolitan) as of June 30, 2007, and the related statement of cash receipts and disbursements, by fund category and in total, for the year then ended. These financial statements are the responsibility of Metropolitan's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of Metropolitan's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the statements of cash and investments and cash receipts and disbursements, by fund category and in total, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the statements of cash and investments and cash receipts and disbursements, by fund category and in total. We believe that our audit provides a reasonable basis for our opinion.

As described in note 1, these financial statements present a summary of the cash and investment activity of Metropolitan, prepared on the basis of cash receipts and disbursements, which is a comprehensive basis of ccounting other than generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the cash and investments of The Metropolitan Water District of Southern California as of June 30, 2007, and its cash receipts and disbursements, by fund category and in total, for the year then ended on the basis of accounting described in note 1.

KPMG LLP

November 1, 2007

This page intentionally left blank.

STATEMENT OF CASH AND INVESTMENTS
(CASH BASIS)

June 30, 2007

(Dollars in thousands)	Book Value	Fair Value
Cash (Notes 1 and 2):		
Cash	$ —	$ —
Investments (Notes 1, 2, and 3):		
U.S. Treasury notes	162,182	161,000
U.S. Treasury strips	29,096	28,011
U.S. guarantees—GNMAs	35	37
Federal agency securities	127,149	126,750
Bankers' acceptances	4,467	4,467
Prime commercial paper	340,166	340,166
Corporate notes	304,767	304,257
Negotiable certificates of deposit	322,136	322,136
Municipals zero coupon	15,880	15,789
Shares of beneficial interest	756	756
Asset-backed securities	3,254	3,208
Mortgage-backed securities	43,874	43,782
Municipal bonds	74,903	77,481
Total investments	1,428,665	1,427,840
Total cash and investments	1,428,665	1,427,840
Less: overdraft	(4,772)	(4,772)
Total cash and investments, net of overdraft	$ 1,423,893	$ 1,423,068
Summary of cash and investments:		
Unrestricted cash and investments	$ 465,229	$ 464,963
Restricted cash and investments	963,436	962,877
Overdraft	(4,772)	(4,772)
Total cash and investments, net of overdraft	$ 1,423,893	$ 1,423,068

See accompanying notes to cash basis financial statements.

STATEMENT OF CASH RECEIPTS AND DISBURSEMENTS, BY FUND CATEGORY AND IN TOTAL (CASH BASIS)

Fiscal year ended June 30, 2007

(Dollars in thousands)	Operating Funds	Debt Service Funds	Construction Funds
Cash and investments at July 1, 2006, at book value	$ 436,479	$ 209,289	$ 171,943
Receipts:			
Tax collections, net	—	46,908	—
Water sales	878,401	—	—
Wheeling / exchange	13,069	—	—
Readiness-to-serve charge	80,869	—	—
Capacity charge	32,251	—	—
Power recoveries	44,940	—	—
Investment income	19,897	9,482	10,358
Proceeds from debt issuances, net (Note 3)	1,305	36,347	795,346
Proceeds from refunding bonds, transferred to escrow (Note 3)	—	—	—
Reimbursements	20,741	—	499
Other collections	4,743	616	403
Total receipts	1,096,216	93,353	806,606
Interfund transfers	(352,503)	186,991	74,124
Disbursements:			
Operations and maintenance	344,056	—	—
Operating equipment, net	6,239	—	—
Construction	40,619	—	526,022
State Water Contract:			
Capital payments	—	—	—
Minimum operations and maintenance	119,712	—	—
Off-aqueduct power facilities	56,081	—	—
Variable power costs	88,817	—	—
Credit (Note 4)	(8,831)	—	—
Colorado River Aqueduct—power	21,468	—	—
Water transfer programs	38,322	—	—
Debt service—other	7,039	—	—
Debt service on Metropolitan Water District bonds	—	247,214	—
Total disbursements, net	713,522	247,214	526,022
Other trust and escrow bank account transactions, net (Note 3)	2,466	(108)	—
Cash and investments at June 30, 2007, at book value	$ 469,136	$ 242,311	$ 526,651

See accompanying notes to cash basis financial statements.

Rate Stabilization Funds	State Contract Funds	Trust and Other Funds	Total
$ 98,106	$ 60,204	$ 2,087	$ 978,108
—	54,176	—	101,084
—	—	—	878,401
—	—	—	13,069
—	—	—	80,869
—	—	—	32,251
—	—	—	44,940
4,692	1,448	61	45,938
—	—	500	833,498
—	—	259,448	259,448
—	—	1,365	22,605
—	680	2,090	8,532
4,692	56,304	263,464	2,320,635
21,422	58,314	11,652	—
—	—	638	344,694
—	—	—	6,239
—	—	4,239	570,880
—	145,341	—	145,341
—	—	—	119,712
—	34,386	—	90,467
—	—	—	88,817
—	(65,368)	—	(74,199)
—	—	—	21,468
—	—	—	38,322
—	—	—	7,039
—	—	193	247,407
—	114,359	5,070	1,606,187
—	—	(271,021)	(268,663)
$ 124,220	$ 60,463	$ 1,112	$ 1,423,893

This page intentionally left blank.

(1) SIGNIFICANT ACCOUNTING POLICIES

The accompanying statements of cash and investments and cash receipts and disbursements, by fund category and in total, have been prepared by management for the purpose of presenting the cash and investments of The Metropolitan Water District of Southern California (Metropolitan) as of June 30, 2007, and disclosing the changes in total cash and investments, by fund category and in total, for the fiscal year ended June 30, 2007, on the cash basis of accounting in accordance with established Metropolitan policy.

The statements include the activity of The Center for Water Education (Center), which was incorporated on November 20, 2001 as a nonprofit public benefit corporation and was created by vote of the board of directors (Board) of Metropolitan. For accounting purposes, the Center is treated as a blended component unit of Metropolitan. That is, each fund or account of the Center is presented as though it is a fund or account of Metropolitan.

Financial statements prepared on the basis of cash receipts and disbursements, which is a comprehensive basis of accounting other than U.S. generally accepted accounting principles, may differ from presentations under U.S. generally accepted accounting principles since certain revenues and related assets are recognized when received rather than when earned, and certain expenses are recognized when paid rather than when the obligations are incurred. Accordingly, the accompanying financial statements are not intended to present Metropolitan's financial position and results of operations in conformity with U.S. generally accepted accounting principles.

In accordance with Governmental Accounting Standards Board Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, Metropolitan's investments are reported at fair value in its accrual basis basic financial statements. To facilitate reconciliation between the cash basis financial statements and Metropolitan's accrual basis basic financial statements, cash and investments have been presented in the accompanying statement of cash and investments as of June 30, 2007 at both book value value (cost plus amortized discount and/or premium) and fair value.

Cash receipts and disbursements are allocated to the various funds and may not necessarily reflect actual cash transfers. Certain funds are also legally restricted to use for a specific purpose. See Note 5 for a description of the currently active funds of Metropolitan.

(2) CASH AND INVESTMENTS

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

Cash and investments may or may not be restricted as to use, depending on the specific purposes for which such assets are held.

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

(a) Deposits

The California Government Code requires California banks and savings and loan associations to secure a local government agency's deposits by pledging government securities as collateral.

(b) Investments

Metropolitan is permitted by state law and the Board's policy to invest in a variety of instruments including U.S. Treasuries, federal agency securities, repurchase agreements, negotiable certificates of deposit, bankers' acceptances, prime commercial paper, asset- and mortgaged-backed securities, municipal bonds, corporate notes, and shares of beneficial interest.

Interest Rate Risk. In accordance with Metropolitan's investment policy, interest rate risk was managed by limiting the duration of the various portfolio segments that have limitations on the amount of duration exposure for each segment. See below for specific duration by segment.

Internally Managed Segment

This component of the portfolio was managed against the Merrill Lynch 3-Month Treasury Bill index. For fiscal year 2007, the benchmark was .24 and the portfolio was permitted to vary from the duration by plus or minus 0.2. As of June 30, 2007, Metropolitan's investments and durations for this segment were as follows:

(Dollars in thousands)	Fair Value	Duration
Federal agency securities	$ 95,028	0.53
Bankers' acceptances	$ 4,467	0.21
Prime commercial paper	$ 339,827	0.08
Corporate notes	$ 276,887	0.43
Negotiable certificates of deposit	$ 322,136	0.50
Weighted average duration		0.34

Externally Managed Segment

This component of the portfolio was managed against the Merrill Lynch U.S. Corporate and Government, 1 to 5 years, A Rated and above index. For fiscal year 2007, the benchmark was 2.36 and the portfolio was permitted to vary from the duration by plus or minus 1.5. As of June 30, 2007, Metropolitan's investments and durations for this segment were as follows:

(Dollars in thousands)	Fair Value	Duration
U.S. Treasury notes	$ 161,000	3.20
U.S. Treasury strips	$ 4,455	16.94
U.S. guarantees—GNMAs	$ 37	4.59
Federal agency securities	$ 8,548	1.81
Corporate notes	$ 26,994	1.84
Shares of beneficial interest	$ 756	0.00
Asset- and mortgaged-backed securities	$ 46,990	1.55
Weighted average duration		2.93

Bond Reserves Segment

Investments in the bond reserves segment were managed based on the requirements of each of the bond issues. Per the Board's authorization, the treasurer was authorized to invest these monies in excess of five years. As of June 30, 2007, Metropolitan's bond reserves' investments and durations were as follows:

(Dollars in thousands)	Fair Value	Duration
U.S. Treasury strips	$ 23,556	14.01
Federal agency securities	$ 23,174	0.75
Prime commercial paper	$ 339	0.01
Corporate notes	$ 376	0.43
Municipal bonds	$ 93,270	8.59
Weighted average duration		8.16

Credit Risk: Credit risk was managed by purchasing investments with the nationally recognized credit ratings specified in Metropolitan's investment policy. Additionally, the policy required monitoring the credit ratings of securities held in the portfolio and, if the securities' credit ratings were downgraded, evaluating for potential sale. For certain securities, additional requirements included consideration of net worth, length of time in business, and specified market values. Metropolitan's exposure to credit risk as of June 30, 2007 was as follows (excluding obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government):

(Dollars in thousands)	Exposure
AAA	$ 267,766
A or better	$ 304,257
F1 or better	$ 326,603
A1/P1 or better	$ 340,166

Concentration of Credit Risk: In accordance with Metropolitan's investment policy, the minimum requirements for limiting concentration of credit risk defined the maximum percentage allowable for investment in each security type as well as the percentage allowable for investment by issuer per type. Generally, the maximum allowable for investment by security type varied from 20 percent, for asset- and mortgage-backed securities, to 100 percent for U.S. Treasury and federal agency securities. The percentages of investments that can be purchased by a single issuer, within each security type, ranged from 5 percent, for asset-backed securities, to 10 percent for bankers' acceptances. At June 30, 2007, Metropolitan had the following investments (obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government not listed) representing 5 percent or more of the net investments.

(Dollars in thousands)	Fair Value	Concentration
ERSTE Fin	$ 72,021	5.04%
Federal National Mortgage Association	$ 86,830	6.08%

Custodial Credit Risk: At June 30, 2007, all of Metropolitan's investments consisted of investments that were insured or registered, or for which the securities were held, in Metropolitan's name, in safekeeping at Metropolitan's bank, which was not counterparty to the investment transactions.

(c) Reverse Repurchase Agreements

Metropolitan was permitted, subject to conditions imposed by state law, to sell securities owned under written agreements and to buy back the securities on or before a specified date for a specified amount. No such reverse repurchase agreements were entered into during the fiscal year ended June 30, 2007.

(d) Restricted Cash and Investments

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

(3) INVESTMENTS HELD IN ESCROW

When long term debt is defeased with the issuance of refunding debt, the net proceeds of the new debt are wire transferred directly to the escrow agent by the purchasers and recorded as a transfer to escrow account. During the fiscal year ended June 30, 2007, refunding debt with a total par value of $264,300,000 was issued and net proceeds totaling $259,447,682 (including discounts and premiums) and $16,114,363 were wire transferred to the escrow agent by purchasers and Metropolitan, respectively. When long term debt is cash defeased, required funds are transferred to an escrow agent. During the fiscal year ended June 30, 2007, no debt was cash defeased.

At June 30, 2007 and July 1, 2006, U.S. Treasury securities with an aggregated fair value of $991,109,025 and $1,250,262,198, respectively, were held in escrow trust accounts and represent amounts sufficient to provide debt service for the advance refunding of portions of the Water Revenue Bonds, 1992, 1995A, 1996 B and C, 1997A, 1998A, 1999A Series, and 2001 Series A; the Water Revenue Refunding Bonds, 1993 Series A and B, 1996 Series B, 1998 Series A, and 2001 Series A and B; the Waterworks General Obligation Bonds, Authorization 1969 Series E; the Waterworks General Obligation Bonds, Election 1966 Series A and H; the Waterworks General Obligation Bonds 1998 Series A, and the Waterworks General Obligation Refunding Bonds, 1966 Series A and B. Such refundings resulted in the defeasance of the respective bonds. Note that refunding amounts transferred to escrow agent were not included in the accompanying statements.

(4) STATE WATER CONTRACT CREDIT

The Department of Water and Resources invoices Metropolitan annually for capital and minimum operating, maintenance, and power costs and monthly for variable power costs. The invoices include some estimates based on information known at the time. The estimates are adjusted based on actual expenditures. The adjustments are refunded to Metropolitan as billing credits.

(5) DESCRIPTION OF CURRENTLY ACTIVE FUNDS OF METROPOLITAN BY FUND CATEGORY

(a) Operating Funds

• General Fund (Fund No. 1001)

This fund was established in 1929. This fund contains operating revenues and other monies not specifically allocable to other funds and may be used for general purposes of Metropolitan. In practice, this fund is used to finance reimbursable works and, since 1990, to pay for capital costs incurred under contracts with the Imperial Irrigation District (IID) and others for specified water conservation projects.

• Water Revenue Fund (Fund No. 1002)

This fund was established in 1975. Receipts from water sales and standby charges are deposited in this fund and are transferred to various other funds in accordance with revenue bond covenants and other board resolutions to pay in order of priority:

– Operation and maintenance expenditures

– Debt service on outstanding revenue bonds and commercial paper

– Water Standby Charge Fund

– Any other obligations, which are charges, liens, or encumbrances upon operating revenues.

Monies remaining at the end of each month, after the foregoing transfers, are transferred to the Revenue Remainder Fund.

• Operations and Maintenance Fund (Fund No. 1003)

This fund was established in 1975. This fund is used to pay all operation and maintenance expenditures, including State Water Contract operation, maintenance, power, and replacement charges. The revenue bond resolutions require that, at the beginning of each month, monies equal to estimated operation and maintenance expenditures for that month and the succeeding month be set aside in these funds, and such amounts represent the minimum fund balance requirements specified in Section 5201(f) of Metropolitan's Administrative Code.

• Revenue Remainder Fund (Funds No. 1004)

This fund was established in 1975. Monies remaining in the Water Revenue Fund at month-end, after meeting the priority expenditures set forth in the bond resolutions, are transferred to this fund and may be used for any lawful purpose by Metropolitan. As specified by Section 5202(a) of the Administrative Code, the minimum balance to be held in the Revenue Remainder Fund as of June 30 of each year shall be equal to the portion of fixed costs of Metropolitan estimated to be recovered by water sales revenues for the 18 months beginning with the immediately succeeding July. Such funds are to be used in the event that revenues are insufficient to pay the costs of Metropolitan. Amounts remaining in the Revenue Remainder Fund and Replacement and Refurbishment Fund, collectively, on June 30 of each year, after meeting the requirements set forth in Sections 5202(a) and (b) of the Administrative Code, shall be transferred to the Water Rate Stabilization Fund and, to the extent required under Section 5202(d) of the Administrative Code, to the Water Treatment Surcharge Stabilization Fund.

• Water Standby Charge Fund (Fund No. 1005)

This fund was established in 1992. Revenues attributable to water standby charges are transferred to this fund, which is treated as an operating fund for financial reporting purposes. Monies in this fund are used exclusively for the purpose for which the water standby charge was imposed.

• Water Transfer Fund (Fund No. 1007)

This fund was established in 1995. This fund is used for the purpose of purchasing water through transfers or similar arrangements and for the costs of filling Diamond Valley Lake.

• Self-Insured Retention Fund (Fund No. 1008)

This fund was established in 1999. This fund is used for emergency repairs and claims against Metropolitan. The minimum balance of the fund as of June 30 of each year is $25 million.

• Water Stewardship Fund (Fund No. 1009)

This fund was established in 2005. This fund is used to collect revenue from the Water Stewardship Rate and to pay costs associated with water recycling, seawater desalination, conservation, brackish water desalination, or other demand management programs. These funds can also be used to fund administrative costs associated with these programs. Funds may be used as directed by the Board, for other lawful purposes, in accordance with Sections 5201(p) and 5202 (d) of the Administrative Code.

• Center for Water Education Fund (Fund No. 1010)

This fund was established in 2007. This fund is used to complete construction of and temporarily maintain the water education facility at Diamond Valley Lake, and assist the Center in paying the reasonable and appropriate value of its debts.

(b) Debt Service Funds

Interest and Principal Funds and Reserve Funds are established for each bond issue. The cash and securities in each fund are equal to the minimum required by the resolutions of issuance for such bonds.

(c) Construction Funds

• Water Revenue Bonds, 2003 Series B-3 Construction Fund (Fund No. 4016)

This fund was established in 2004. Net proceeds from the sale of the revenue bonds were deposited in this fund and are used to pay costs of construction of Metropolitan's capital improvement program and certain costs of issuance of these bonds.

• Water Revenue Bonds, 2003 Series B-4 Construction Fund (Fund No. 4017)

This fund was established in 2004. Net proceeds from the sale of the revenue bonds were deposited in this fund and are used to pay costs of construction of Metropolitan's capital improvement program and certain costs of issuance of these bonds.

• Water Revenue Bonds, 2005 Series A Construction Fund (Fund No. 4018)

This fund was established in 2005. Net proceeds from the sale of the revenue bonds were deposited in this fund and are used to pay costs of construction of Metropolitan's capital improvement program and certain costs of issuance of these bonds.

• Water Revenue Bonds, 2005 Series B-1 Construction Fund (Fund No. 4019)

This fund was established in 2005. Net proceeds from the sale of the revenue bonds were deposited in this fund and are used to pay costs of construction of Metropolitan's capital improvement program and certain costs of issuance of these bonds.

• Water Revenue Bonds, 2005 Series B-2 Construction Fund (Fund No. 4020)

This fund was established in 2005. Net proceeds from the sale of the revenue bonds were deposited in this fund and are used to pay costs of construction of Metropolitan's capital improvement program and certain costs of issuance of these bonds.

• Water Revenue Bonds, 2005 Series C Construction Fund (Fund No. 4021)

This fund was established in 2006. Net proceeds from the sale of the revenue bonds were deposited in this fund and are used to pay costs of construction of Metropolitan's capital improvement program and certain costs of issuance of these bonds.

• Water Revenue Bonds, 2005 Series D-1 Construction Fund (Fund No. 4022)

This fund was established in 2006. Net proceeds from the sale of the revenue bonds were deposited in this fund and are used to pay costs of construction of Metropolitan's capital improvement program and certain costs of issuance of these bonds.

• Water Revenue Bonds, 2005 Series D-2 Construction Fund (Fund No. 4023)

This fund was established in 2006. Net proceeds from the sale of the revenue bonds were deposited in this fund and are used to pay costs of construction of Metropolitan's capital improvement program and certain costs of issuance of these bonds.

• Water Revenue Bonds, 2006 Series A Construction Fund (Fund No. 4024)

This fund was established in 2007. Net proceeds from the sale of the revenue bonds were deposited in this fund and are used to pay costs of construction of Metropolitan's capital improvement program and certain costs of issuance of these bonds.

• Water Revenue Bonds, 2006 Series B Construction Fund (Fund No. 4025)

This fund was established in 2007. Net proceeds from the sale of the revenue bonds were deposited in this fund and are used to pay costs of construction of Metropolitan's capital improvement program and certain costs of issuance of these bonds.

• Replacement and Refurbishment (formerly Pay-As-You-Go) Fund (Fund No. 5001)

Used to finance certain capital program expenditures from current revenues in accordance with Section 5109 of the Administrative Code. As specified by Section 5202(b) of the Administrative Code, the end-of-year balance may not exceed $95 million. Available monies in excess of $95 million at June 30 shall be transferred to the Water Rate Stabilization Fund, unless otherwise determined by the Board.

• Revolving Construction Fund (Fund No. 5003)

This fund was established in 1988. Capital expenditures made from this fund are to be reimbursed with proceeds from security sales to the extent such expenditures are authorized uses of debt proceeds under the Metropolitan Water District Act. As specified in Section 5201(g) of the Administrative Code, there is no minimum balance requirement for this fund.

(d) Rate Stabilization Funds

• Water Rate Stabilization Fund (Fund No. 5501)

This fund was established in 1987. This fund is for the principal purpose of reducing water revenue requirements in order to smooth water rate adjustments over time. As specified in Sections 5202(b) and (c) of the Administrative Code, amounts that exceed the Board's Revenue Remainder and Replacement and Refurbishment Funds' requirements on June 30 of each year are transferred to this fund, except as required under Section 5202(d) of the Administrative Code. Notwithstanding the principal purpose of this fund, amounts assigned may be used by the Board for any lawful purpose.

• Water Treatment Surcharge Stabilization Fund (Fund No. 5502)

This fund was established in 1988. This fund is used for the principal purpose of mitigating required increases in the surcharge for water treatment. Notwithstanding the principal purpose of this fund, the Board may use amounts assigned to this fund for any lawful purpose of Metropolitan. After making the required year-end transfer to the Water Rate Stabilization Fund required by Section 5202(c) of the Administrative Code, a determination is made to identify the portion, if any, of such transferred monies attributable to collections of treatment surcharge revenue in excess of water treatment cost. Such monies are then transferred to the Water Treatment Surcharge Stabilization Fund. If the calculation determines a deficiency in treatment surcharge revenue, a transfer of monies will be made to this fund as needed to reimburse amounts used for the deficiency.

(e) State Contract Funds

• State Contract Fund (Fund No. 5701)

This fund was established in 1960. Items billed to Metropolitan as capital charges under the State Water Contract, including the capital costs of off-aqueduct power facilities, are paid from this fund. Revenues from sales of water are transferred to this fund to meet most costs, with the residual met from ad valorem property tax revenues and annexation fees, as determined by the formula in Chapter 3 of Division IV of the Administrative Code or the Board's action. As specified by Section 5201(d) of the Administrative Code, the required minimum balance to be held as of June 30 and December 31 of each year shall equal the capital payments due on July 1 of the same calendar year and January 1 of the following calendar year, respectively.

• Special Tax Fund (Fund No. 5702)

This fund was established in 1951. Annexation fees (cash payments and special tax collections) are deposited in this fund and are transferred to the State Contract Fund to pay a portion of Metropolitan's State Water Contract capital charges. As specified by Section 5201(e) of the Administrative Code, there is no minimum balance requirement for this fund.

(f) Trust and Other Funds

• Iron Mountain Landfill Closure/Postclosure Maintenance Trust Fund (Fund No. 6005)

This fund was established in 1990. This fund is used as a trust fund to maintain monies to be used for the costs of closure and postclosure maintenance of Metropolitan's solid waste landfill facility at Iron Mountain, in accordance with regulations of the California Integrated Waste Management Board.

• Lake Mathews Multi Species Reserve Trust Fund (Fund No. 6101)

This fund was established in 1997. This fund is used solely for the purposes described in the terms and conditions set forth in the agreement between Metropolitan and the Riverside County Habitat Conservation Agency (RCHCA). Metropolitan has conveyed conservation easements to RCHCA for consideration, which Metropolitan holds in trust. The funds are used to protect and enhance the habitat value.

• Bond Excess Earnings Funds

Bond Excess Earnings Funds are established for each bond issue. The minimum requirement is equal to the amounts deposited into these funds in accordance with the provisions of the Tax and Nonarbitrage Certificates and Resolutions for the respective bonds.

• The Center for Water Education Funds

The Center for Water Education pays its operating and construction costs out of monies obtained from various grants and donations. Various funds are established to record the monies received based on grantor, donor, and the like.