

Audited Financial Statements June 30, 2010

Business and Finance Committee
November 8, 2010

Agenda

- Background
- New accounting rules
- Financial statements
- Interest rate swaps
- Footnotes

Background

- The financial statements reflect the operating results and financial condition of an entity
- Annual audit required by bond covenants and single audit

Background (continued)

- Metropolitan is an Enterprise Fund (footnote 1b)
 - Accounting and reporting similar to business entities
 - Generally accepted accounting principles (GAAP)
 - Governmental Accounting Standards Board
 - 59 statements
 - Financial Accounting Standards Board
 - 102 statements -- through 11/30/89

Background (continued)

- Classified financial statements
 - Current and noncurrent assets and liabilities
 - Current assets – will be used within 12 months
 - Current liabilities – may be paid within 12 months (pages 54 and 55)
 - Operating and nonoperating revenues and expenses
- Investments and derivatives stated at fair market value; all other accounts stated at cost

Two New Pronouncements (rules)

- GASB 51 – Accounting and Financial Reporting for Intangible Assets
 - No change to State Water Project – capital costs recorded as prepaid asset and amortized through 2052 (footnote 10)
- GASB 53 – Accounting and Financial Reporting for Derivative Instruments
 - Change in accounting and reporting for interest rate swap agreements
 - Fair value now included in financial statements as well as footnotes (footnotes 1q and 5f)

Change in Balance Sheets

- Assets and Deferred Outflows (page 14)
 - Deferred Outflows new line item for effective interest rate swaps – moves information from footnotes to financial statements
- Liabilities (page 15)
 - Fair value of interest rate swaps new line item – moves information from footnotes to financial statements
- 2009 restated for comparability reflecting new accounting rules for interest rate swaps

Statements of Revenues and Expenses Restated

- 2009 restated for comparability reflecting new accounting rules for interest rate swaps
- 2009 net income reduced \$4.7 million reflecting write-off of 'deemed terminated' and ineffective hedges
- 2010 net income includes \$3.1 million for write-off of 'deemed terminated' and ineffective hedges

Statements of Cash Flows

(pages 18 and 19)

- No restatements – no cash impact from new accounting rules relating to interest rate swaps
- No budget or rate impact from new accounting rules relating to interest rate swaps
 - If swaps held to maturity or terminated at a gain, a one time increase in net revenue will be recognized

Balance Sheet – Assets

(\$ Billions)

	<u>FY10</u>	<u>FY09 (Restated)</u>	<u>Change</u>
Cash & Investments - FMV	\$ 1.095	\$ 1.064	\$ 0.031
Prepaid SWP costs	1.412	1.400	0.012
Plant, net	8.464	8.210	0.254
Other	0.553	0.593	(0.040)
	\$ 11.524	\$ 11.267	\$ 0.257

Balance Sheet – Assets

(\$ Billions)


	<u>FY10</u>	<u>FY09 (Restated)</u>	<u>Change</u>
Cash & Investments - FMV	\$ 1.095	\$ 1.064	\$ 0.031
Prepaid SWP costs	1.412	1.400	0.012
Plant, net	8.464	8.210	0.254
	0.553	0.593	(0.040)
	\$ 11.524	\$ 11.267	\$ 0.257

95% of total assets

Balance Sheet – Assets

(\$ Billions)

	<u>FY10</u>	<u>FY09 (Restated)</u>	<u>Change</u>
Cash & Investments - FMV	\$ 1.095	\$ 1.064	\$ 0.031
Prepaid SWP costs	1.412	1.400	0.012
Plant, net	8.464	8.210	0.254
Other	0.553	0.593	(0.040)
	\$ 11.524	\$ 11.267	\$ 0.257



Balance Sheet – Assets

(\$ Billions)

	FY10	FY09 (Restated)	Change
Cash & Investments - FMV	\$ 1.095	\$ 1.064	\$ 0.031
Restricted	1.412	1.400	0.012
Unrestricted	8.464	8.210	0.254
Other	0.553	0.593	(0.040)
	\$ 11.524	\$ 11.267	\$ 0.257

Restricted \$ 645M

Unrestricted 450M

\$ 1,095M

Cash & Investments – FMV

June 30, 2010

(\$ Millions)

	Contractual Restricted	Board Restricted	Unrestricted
O&M Fund	\$ 169.3		
Bonds – Principal & Interest	165.8		
Bond reserves	132.4		
Construction	137.8		
Trust funds	40.4		
Stabilization funds			\$ 298.9
State Contract		\$ 68.9	
Self Insurance		25.4	
R&R			34.0
General fund - Desalination		18.9	
Other		1.9	1.8
	\$ 645.7	\$ 115.1	\$ 334.7

\$449.8

Balance Sheet – Assets

(\$ Billions)

Accounts receivable:

Water sales	\$ 186.2M
Taxes & annexations	22.6
Other (power, interest)	20.6

Water inventories:

In-basin	65.9
Outside basin	85.9
Deferred outflow swaps	61.5
Bay-Delta prepayments	29.9
Prepaid natural gas hedging	14.2
Feasibility/reimb proj	19.4
Supplies – inventory	12.4
Other	34.4
	<u>\$ 553.0M</u>

	FY10	FY09 (Restated)	Change
	\$ 1.095	\$ 1.064	\$ 0.031
	1.412	1.400	0.012
	8.464	8.210	0.254
	0.553	0.593	(0.040)
	\$ 11.524	\$ 11.267	\$ 0.257

Balance Sheet – Liabilities and Net Assets (Equity)

(\$ Billions)

	<u>FY10</u>	<u>FY09 (Restated)</u>	<u>Change</u>
Long-term debt	\$ 4.770	\$ 4.672	\$ 0.098
Net assets (equity)	6.146	6.043	0.103
Other	0.608	0.552	0.056
	\$ 11.524	\$ 11.267	\$ 0.257

Balance Sheet – Liabilities and Net Assets (Equity)

(\$ Billions)

	FY10	FY09 (Restated)	Change
Long-term debt	\$ 4.770	\$ 4.672	\$ 0.098
Net assets (equity)	6.146	6.043	0.103
	0.608	0.552	0.056
	\$ 11.524	\$ 11.267	\$ 0.257

95% of total

Balance Sheet – Liabilities and Assets (Equity)

FMV swaps	\$148.2 M
OPEB	106.3
Payable to DWR (incl OAPF)	81.9
Interest payable	75.5
Accrued compensation	47.0
Customer deposits/trusts	42.8
Power costs payable	43.1
Vendors	25.1
W/C & 3 rd Party	16.7
Other	<u>21.4</u>
	\$608.0M

(\$ Billions)

	FY10	FY09 (Restated)	Change
	\$ 4.770	\$ 4.672	\$ 0.098
	6.146	6.043	0.103
	0.608	0.552	0.056
	\$ 11.524	\$ 11.267	\$ 0.257

Income Statement

(\$ Billions)

	<u>FY10</u>	<u>FY09 Restated</u>	<u>Change</u>
Operating revenues	\$ 1.165	\$ 1.136	\$ 0.029
Operating expenses	(0.829)	(0.842)	0.013
Depreciation/amortization	(0.246)	(0.226)	(0.020)
Non-op rev/exp, net	<u>0.008</u>	<u>0.032</u>	<u>(0.024)</u>
Net income	0.098	0.100	(0.002)
Capital contributions	<u>0.005</u>	<u>0.066</u>	<u>(0.061)</u>
Increase in equity	\$ 0.103	\$ 0.166	\$ (0.063)

Income Statement

(\$ Billions)

	FY10	FY09 Restated	Change
Operating revenues	\$ 1.165	\$ 1.136	\$ 0.029
Operating expenses		(0.42)	0.013
Depreciation/amortization		(0.02)	(0.020)
Non-op rev/exp, net		0.32	(0.024)
Net income		16.0	(0.002)
Capital contributions		1.7	(0.061)
Increase in equity	\$ 0.103	\$ 0.166	\$ (0.063)

Water sales:

Price \$ 180.5 M

Volume (169.2)

RTS 11.3

Other 16.0

29.0 M

Income Statement

(\$ Billions)

	FY10	FY09 Restated	Change
Operating revenues	\$ 1.165	\$ 1.136	\$ 0.029
Operating expenses	(0.829)	(0.842)	0.013
Depreciation/amortization		(0.020)	(0.020)
Non-op rev/exp		(0.024)	(0.024)
Net income		0.000	(0.002)
Capital contributions		0.066	(0.061)
Increase in equity		0.066	\$ (0.063)

Cost of water:		
Price	\$ (99.7) M	
Volume	<u>68.1</u>	
	(31.6)	
Water mgt programs	24.8	
Insurance claims	14.9	
Other	<u>4.9</u>	
	13.0 M	

Income Statement

(\$ Billions)

	<u>FY10</u>	<u>FY09 Restated</u>	<u>Change</u>
Operating revenues	\$ 1.165	\$ 1.136	\$ 0.029
Operating expenses	(0.829)	(0.842)	0.013
Depreciation/amortization	(0.246)	(0.226)	(0.020)
Non-op rev/exp, net	<u>0.008</u>	<u>0.032</u>	<u>(0.024)</u>
Net income			(0.002)
Capital contribution			(0.061)
Increase in equity			\$ (0.063)

Interest expense \$ (29.9) M
 Property taxes (7.3)
 Investment income 13.2
 \$ (24.0)

Income Statement

(\$ Billions)

	<u>FY10</u>	<u>FY09 Restated</u>	<u>Change</u>
Operating revenues	\$ 1.165	\$ 1.136	\$ 0.029
Operating expenses	(0.829)	(0.842)	0.013
Depreciation/amortization	(0.246)	(0.226)	(0.020)
Non-op rev/exp, net	<u>0.008</u>	<u>0.032</u>	<u>(0.024)</u>
Net income	0.098	0.100	(0.002)
Capital contributions	<u>0.005</u>	<u>0.066</u>	<u>(0.061)</u>
Increase in equity			(0.063)

Prop 13 and 50 grants

Cash Flow (\$ Millions)

	<u>FY10</u>	<u>FY09</u>	<u>Change</u>
Cash provided by operations	\$ 331.1	\$ 358.2	\$ (27.1)
Cash used for financing activities	(339.2)	(404.3)	65.1
Cash provided by investments	<u>7.0</u>	<u>47.9</u>	<u>(40.9)</u>
Change in cash	\$ (1.1)	\$ 1.8	\$ (2.9)
Beginning cash	1.8	--	1.8
Ending cash	\$ 0.7	\$ 1.8	\$ (1.1)

Cash Flow (\$ Millions)

	<u>FY10</u>	<u>FY09</u>	<u>Change</u>
Cash provided by operations	\$ 331.1	\$ 358.2	\$ (27.1)
Cash used for final			
Water transfers		\$(39.6)M	65.1
SWP variable/O&M costs		(23.1)	
Cash provided by i			
Water sales (incl wheeling)	23.0	<u>1.9</u>	<u>(40.9)</u>
Conservation	18.5		
Local projects		<u>(5.9)</u>	\$ (2.9)
Change in			
Beginning		\$(27.1)M	--
Ending casn	\$ 0.7	\$ 1.8	\$ (1.1)

Cash Flow (\$ Millions)

	FY10	FY09	Change
Cash provided by operations	\$ 331.1	\$ 358.2	\$ (27.1)
Cash used for financing activities	(339.2)	(404.3)	65.1
Cash provided		\$99.0 M	<u>(40.9)</u>
Change		56.9	\$ (2.9)
Begin		(20.4)	1.8
End		(52.5)	\$ (1.1)
		(13.2)	
		<u>(4.7)</u>	
		\$65.1 M	

Cash Flow (\$ Millions)

	<u>FY10</u>	<u>FY09</u>	<u>Change</u>
Cash provided by operations	\$ 331.1	\$ 358.2	\$ (27.1)
Cash used for financing activities	(339.2)	(404.3)	65.1
Cash provided by investments	7.0	47.9	<u>(40.9)</u>
Change in cash			\$ (2.9)
Beginning cash			1.8
Ending cash			\$ (1.1)

Higher net purchases of investment securities and lower interest earnings

Interest Rate Swaps

June 30, 2010

(\$ millions)

	Fair Market Value	Accounting
Effective (15)	(\$61.5)	Deferred outflow
Ineffective (2)	0.5	Recognize income or (loss)
Refunded	(87.2)	Defer and amortize loss on refunding
	(\$148.2)	

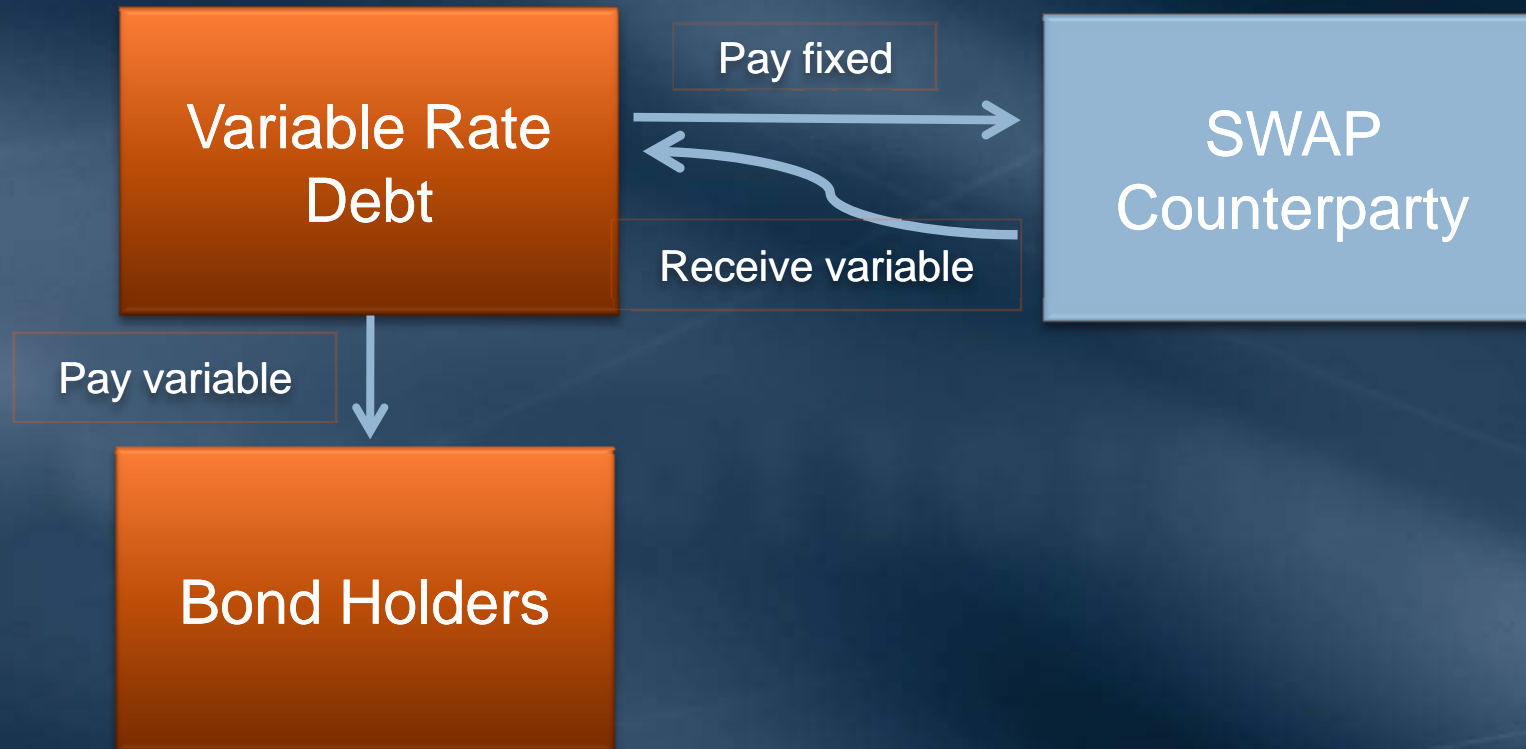
Interest Rate Swaps

June 30, 2010

- Objective – manage interest rate risk and reduce debt service payments
- 17 swap agreements
- 15 effective; 2 ineffective
- 8 ‘deemed terminations’ due to refunding variable rate debt associated with swap agreements
 - Swap agreements re-associated with other outstanding variable rate debt

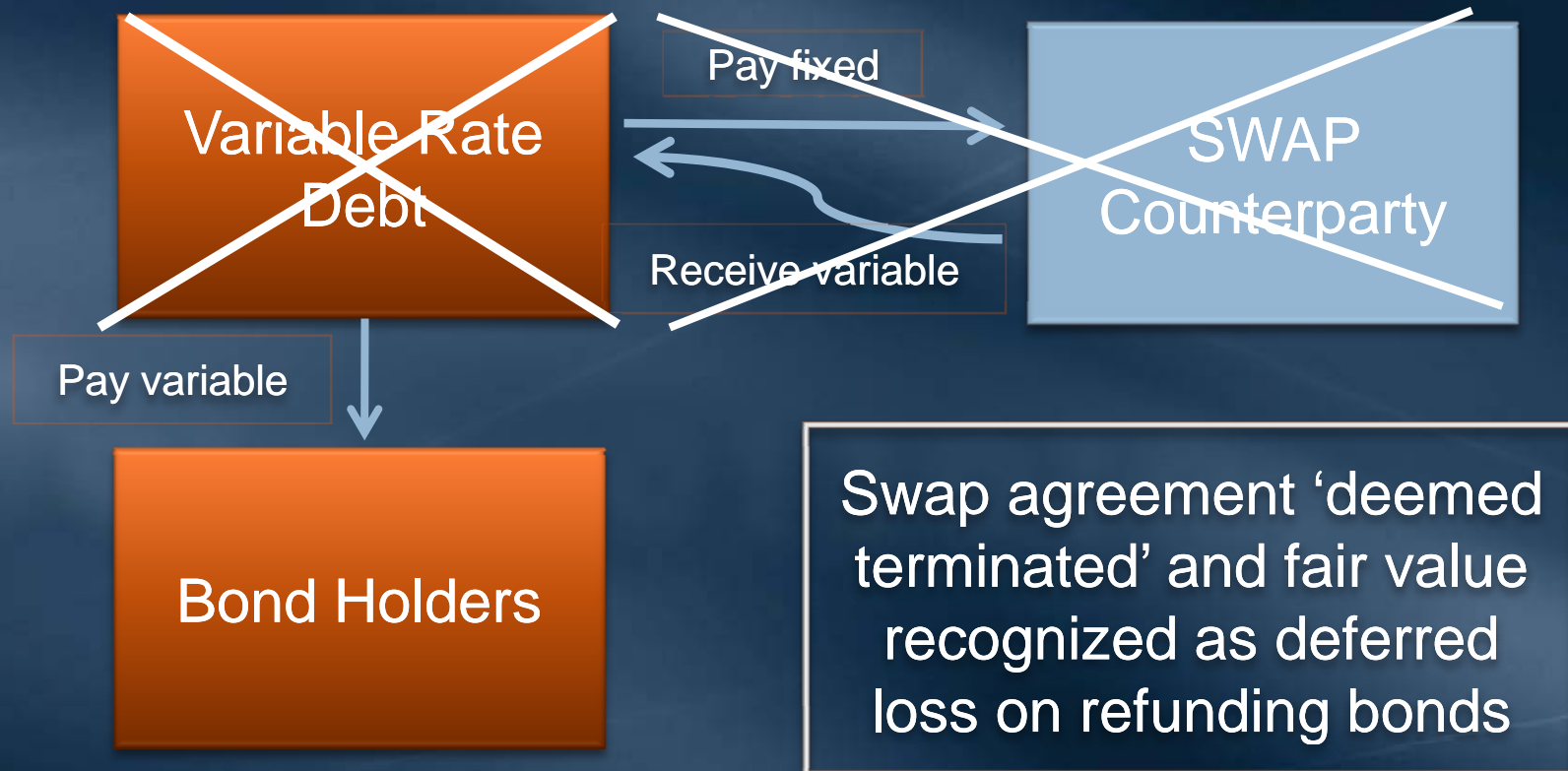
Deemed Termination and Re-Association

1. Typical swap agreement structure



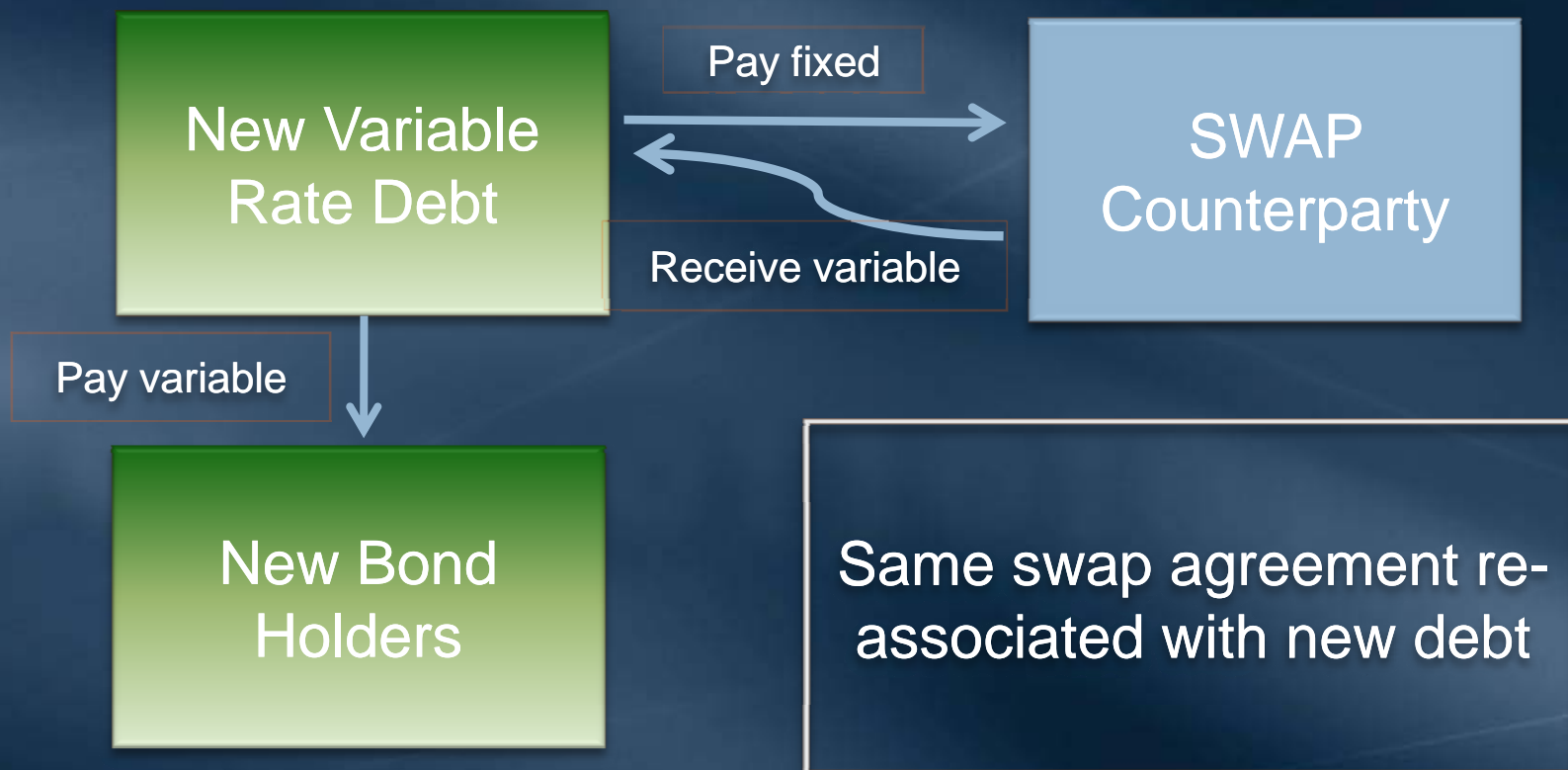
Deemed Termination and Re-Association

2. Variable debt refunded



Deemed Termination and Re-Association

3. Swap agreement re-associated with new variable rate debt



Interest Rate Swaps

June 30, 2010

(\$ millions)

	Fair Market Value	Accounting
Effective (15)	(\$61.5)	Deferred outflow
Ineffective (2)	0.5	Recognize income or (loss)
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Interest Rate Swaps

June 30, 2010

(\$ millions)

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Effective (15)	(\$61.5)	Deferred outflow
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Refunded	(87.2)	Defer and amortize loss on refunding
	(\$148.2)	

Balance Sheet

Assets & Deferred Outflows		Liabilities and Net Assets	
Deferred outflow	\$61.5	FMV of SWAPS	(\$61.5)

Interest Rate Swaps

June 30, 2010

(\$ millions)

	Fair Market Value	Accounting
Effective (15)	(\$61.5)	Deferred outflow
Ineffective (2)	0.5	Recognize income or (loss)
Refunded	(87.2)	Defer and amortize loss on refunding
	(\$148.2)	

Balance Sheet

Assets & Deferred Outflows		Liabilities and Net Assets	
Deferred outflow	\$61.5	FMV of SWAPS	(\$61.0)
		Net assets	(0.5)

Interest Rate Swaps

June 30, 2010

(\$ millions)

	Fair Market Value	Accounting
Effective (15)	(\$61.5)	Deferred outflow
Ineffective (2)	0.5	Recognize income or (loss)
Refunded	(87.2)	Defer and amortize loss on refunding
	(\$148.2)	

Balance Sheet

Assets & Deferred Outflows		Liabilities and Net Assets	
Deferred outflow	\$61.5	FMV of SWAPS	(\$148.2)
		Net assets	(0.5)
		Long-term debt	87.2

Interest Rate Swaps

June 30, 2010

(\$ millions)

	Fair Market Value	Accounting
Effective (15)	(\$61.5)	Deferred outflow
Ineffective (2)	0.5	Recognize income or (loss)
Refunded	(87.2)	Defer and amortize loss on refunding
	(\$148.2)	

Balance Sheet

Assets & Deferred Outflows		Liabilities and Net Assets	
Deferred outflow	\$61.5	FMV of SWAPS	(\$148.2)
		Net assets	(0.5)
		Long-term debt	87.2

Interest Rate Swaps

June 30, 2010

(\$ millions)

	Fair Market Value	Accounting
Effective (15)	(\$61.5)	Deferred outflow
Ineffective (2)	0.5	Recognize income or (loss)
Refunded	(87.2)	Defer and amortize loss on refunding
	(\$148.2)	

Income Statement

Revenues		Expenses	
Investment Income	\$1.5		
Change in FMV -- 6/30/09 = \$(1.0M); 6/30/10 = \$0.5M; change = \$1.5M			

Interest Rate Swaps

June 30, 2010

(\$ millions)

	Fair Market Value	Accounting
Effective (15)	(\$61.5)	Deferred outflow
Ineffective (2)	0.5	Recognize income or (loss)
Refunded	(87.2)	Defer and amortize loss on refunding
	(\$148.2)	

Income Statement

Revenues		Expenses	
		Bond interest expense	\$4.6
		Deferred loss on refunding is amortized over the life of the old or new debt, whichever is shorter	

FY 2010 Net Income Impact Accounting for Interest Rate Swaps

(\$ millions)

Investment Income	\$1.5
Bond interest expense	(4.6)
Impact on net income	\$(3.1)

Footnotes

- 50 pages
- In addition to describing what is on the face of the financial statements, footnotes also disclose what is not recorded on the statements
 - SWP – footnote 9(a), page 60
 - \$8.1 billion obligation to the state (excludes variable)
 - Only \$54 million of obligation recorded

Footnotes (continued)

- OPEB Obligation (retirement medical benefit) – RSI, page 72 and footnote 8, page 58
 - \$404.2 million obligation
 - \$106.3 million of obligation recorded representing the unpaid portion of the annual required contribution for the past 5 years
- Pension Obligation – RSI, page 72 and footnote 7, page 56
 - \$102.5 million obligation
 - Not recorded because annual required contribution paid in full each year

Footnotes (continued)

- Subsequent Events – page 71
 - Events that occurred after June 30, 2010, but before financial statements were issued
 - 2 debt refundings
 - 4 interest rate swap agreements were assigned by UBS to Deutsche Bank
 - Agreements considered terminated
 - Loss of \$18.7 million FMV may be recognized in fiscal year 2010/11
 - GASB preparing Technical Bulletin to address accounting treatment

