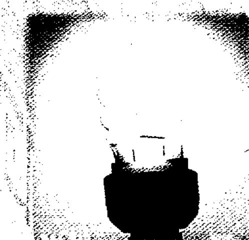
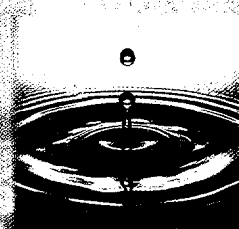
Los Angeles Department of Water and Power

"...a model for



other utilities



preparing for deregulation."

The Wall Street Journal,
Thursday, June 10, 1999

1998 - 1999 Annual Report

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President's Message

The Los Angeles Department of Water and Power enters the millennium poised to be a powerful force in a newly competitive California electric utility industry. Now two years into our aggressive business plan, the Department is fiscally strong and increasing the level of service to our customers – the residents and business owners in the City of Los Angeles.

"My confidence in the DWP's ability to meet the challenges of the future is directly attributable to the Department's people..."

We have taken several important steps over the past year to make our utility leaner and more nimble. The reorganization of the management team is complete, with the appointment of five assistant general managers, a new financial officer, a budget director and controller. Debt reduction continued at a robust pace, putting the utility on pace to be free of generation debt by 2003.

The Department also tapped new revenue sources, generating net revenue of $98 million from wholesale energy marketing and transmission services. Combined with other wholesale revenue sources, this represents a 118 percent increase from the prior fiscal year. The Department signed long-term electricity contracts with two dozen of our top industrial customers, securing more than $883 million in revenue over the lifetime of the contracts.

A vote of confidence from Moody's Investors Service reaffirmed the Aa3 credit rating. Equally important was the Standard and Poors rating of A+ of the DWP's electric bonds.

The DWP also demonstrated tremendous innovation during the past fiscal year. We launched the *Green Power for a Green LA* program that allows customers to purchase a portion of their electricity from renewable sources such as sun, wind, water and biomass. This effort has been enormously successful, resulting in over 20,000 new "green" customers to date. The DWP is proving that green power is not only good for the environment; it is good business, too.

As we move into the next millennium, I am extremely proud of what has been accomplished in a remarkably short period of time. My confidence in the DWP's ability to meet the challenges of the future is directly attributable to the Department's people and their ability and willingness to make the tough changes that are necessary. This determined spirit will be the key to the Department's success in the future.

Rick Caruso, Board President

1999 Board of Water and Power Commissioners

Kenneth T. Lombard
Vice President

Judy M. Miller
Commissioner

Dominick W. Rubalcava
Commissioner

Marcia F. Volpert
Commissioner

City of Los Angeles

Richard J. Riordan
Mayor of Los Angeles

John Ferraro
President, City Council
Councilmember, Fourth District

Mike Hernandez
Councilmember, First District

Joel Wachs
Councilmember, Second District

Laura Chick
Councilmember, Third District

Michael Feuer
Councilmember, Fifth District

Ruth Galanter
Councilmember, Sixth District

Alex Padilla
Councilmember, Seventh District

Mark Ridley-Thomas
Councilmember, Eighth District

Rita Walters
Councilmember, Ninth District

Nate Holden
Councilmember, Tenth District

Cindy Miscikowski
Councilmember, Eleventh District

Hal Bernson
Councilmember, Twelfth District

Jackie Goldberg
Councilmember, Thirteenth District

Nick Pacheco
Councilmember, Fourteenth District

Rudy Svorinich, Jr.
Councilmember, Fifteenth District

James K. Hahn
City Attorney

Rick Tuttle
Controller

General Manager's Letter

"We are leaner and more nimble now than we have ever been. Much of the work is behind us as we near competition,..."

Over the last year, the Los Angeles Department of Water & Power (DWP) continued taking giant leaps forward to prepare for a competitive energy marketplace. All eyes continue to be focused on DWP – the nation's largest municipal utility – and the steps we are taking to define public power's role in a deregulated arena.

Just two years ago many questioned DWP's ability to compete. Our utility faced more than $4.1 billion in generation debt and held the unenviable claim of having the largest workforce per kilowatt-hour in the industry. Through a disciplined approach and the extraordinary efforts of the entire DWP family, this utility has slashed its generation debt by $1.5 billion in two years time, and is on schedule to be generation debt-free by 2003. On an operational basis, we have moved out of the red and into the black with the goal of generating and delivering electricity at or below market prices before competition.

The Department achieved other fiscal milestones many thought improbable, including:

- Expanded the revenue garnered from the wholesale trading area resulting in net revenue of $98 million this fiscal year.
- Transferred a $129 million "dividend" to the City of Los Angeles to support vital city services.
- Signed long-term contracts with two dozen top commercial and industrial customers that will secure over $883 million in revenue over the lifetime of the agreements as of November 1999.
- Maintained an Aa3 credit rating and had removed the "under pressure" caveat from Moody's Investors Service.
- Negotiated new coal contracts for the Intermountain Generating Station facility, with significant present value savings. These new contracts will bring the fuel cost down to market by 2002.

This year marked another important first for the Los Angeles Department of Water & Power as we launched our Green Power for a Green LA program in May. I am extremely proud of this effort to reduce reliance on coal and nuclear power plants and replace them with renewable energy programs powered by the sun, wind and water. DWP's Green Power program is fast becoming the largest and most substantive program of its kind in the country and, in just five short months, we have signed more than 20,000 customers, including many of this City's flagship businesses.

The *Green Power for a Green LA* program has environmental <u>and</u> economic development advantages and works as a catalyst to bring renewable energy manufacturers and new jobs to Los Angeles.

This is just one of DWP's numerous public benefits programs which are a $43.5 million effort to serve our community, and underscores our principal mission to provide safe and reliable energy and water services to our customers at the lowest possible price.

DWP also made significant strides on the water side of our business this year including the launch of a citywide water fluoridation program which is expected to help prevent tooth decay. And, in an effort to meet stricter water quality state regulations, we put forth a proposal to bypass two of our open reservoirs which is expected to save an estimated $80-$100 million.

We also kicked-off dust mitigation efforts on the dry Owens Lake that are part of the historic agreement with the Great Basin Unified Air Pollution Control District to permanently meet air quality standards in the southern Owens Valley. These efforts are the first steps in solving what was identified as the single largest source of particulate pollution in the United States. Under the agreement, control measures will be in place over 10 square miles of the 110-square mile lake bed by the end of 2001, an additional 3-1/2 square miles in 2002, and over three more square miles in 2003. In addition, measures must be installed over at least two additional square miles every year until clean-air standards are met. The deadline required by the Clean Air Act is 2006.

We are leaner and more nimble now than we have ever been. Much of the work is behind us as we near competition, but we must not be complacent. Although complete fiscal stability is now within our grasp, we must continue to innovate and to operate smarter than our competitors. We must also continue our absolute commitment to serving our customers and preserving the environment in the process.

The Department looks forward to continuing the hard work of turning this utility into a national model for public power.

S. David Freeman, General Manager

Comparative Highlights

Year ended June 30	WATER 1999	WATER 1998	WATER % Increase (Decrease)	ENERGY 1999	ENERGY 1998	ENERGY % Increase (Decrease)
SERVICE	GALLONS IN BILLIONS			KILOWATT HOURS IN BILLIONS		
Sales	192.0	185.8	3.3%	26.2	22.9	14.4%
Customers — average number (thousands)	645.0	645.5	-0.1%	1,386.0	1,370.1	1.2%
FINANCIAL	IN MILLIONS			IN MILLIONS		
Revenue (A)	$ 439.4	$ 435.6	0.9%	$2,261.0	$2,232.5	1.3%
Operating Costs (B)	240.1	254.6	-5.7%	1,531.9	1,493.7	2.6%
Net Income	94.1	71.9	30.9%	312.1	328.1	-4.9%
Transfers to City of Los Angeles (C)	16.3	25.9	-37.1%	108.1	80.4	34.5%
Capital additions, net	155.6	151.1	3.0%	151.9	144.6	5.0%
Net utility plant	2,177.5	2,087.6	4.3%	4,355.6	4,464.5	-2.4%
Capitalization — equity and long-term debt (D)	2,178.5	2,093.1	4.1%	5,393.2	5,044.1	6.9%

(A) Includes other income and expenses - net

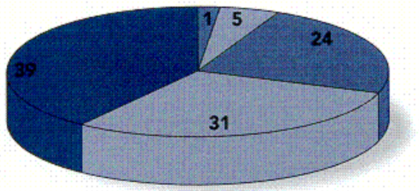
(B) Excludes depreciation expense

(C) Includes Water Services payable of $5.0 in fiscal year 1998

(D) Excludes advance refunding bonds

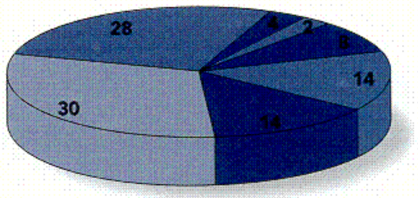
Revenue and Expenditure Dollar

Water Revenue and Expenditures



Water Revenue
dollar in cents

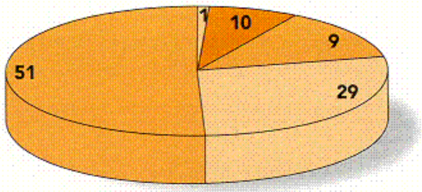
39 Single dwelling residential
31 Multi-dwelling residential
24 Commercial and industrial
5 Governmental
1 Other



Water Expenditure
dollar in cents

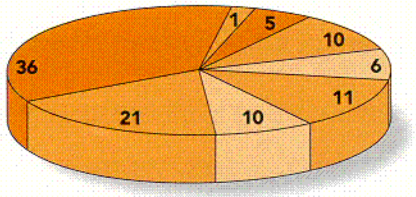
28 Capital improvements
30 Other operating expenses
14 Operating salaries and wages
14 Debt service costs
8 Purchased water
2 Retirement Plan costs related to operations
4 Transfers to the City

Energy Revenue and Expenditures



Energy Revenue
dollar in cents

51 Commercial
29 Residential
9 Industrial
10 Other
1 Street lighting



Energy Expenditure
dollar in cents

36 Purchased energy
21 Other operating expenses
10 Debt service costs
11 Operating salaries and wages
6 Capital improvements
10 Fuel
5 Transfers to the City
1 Retirement Plan costs related to operations

C01

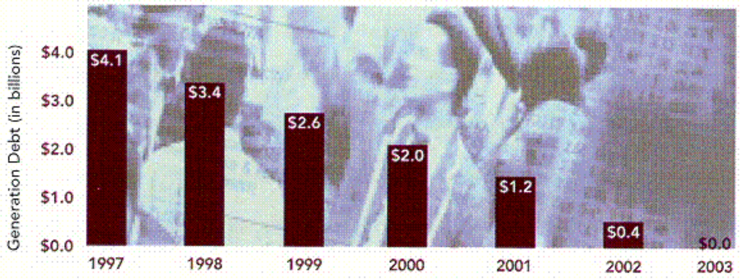
A Stable Financial Future

The Los Angeles Department of Water and Power, the nation's largest municipal utility, hovered on the brink of fiscal collapse only two years ago. But today it stands on firm financial footing, ready to compete in the newly deregulated electric utility industry. Thanks to innovative management decisions, the DWP has achieved what many thought to be improbable and perhaps impossible. Here are the fiscal highlights for 1999:

Debt Reduction

The Department is continuing its aggressive debt reduction and revenue generation program to eliminate the $4.1 billion in stranded generation debt that existed two years ago. Since that time, the Department has offset that debt by $1.5 billion, from $4.1 billion to $2.6 billion. In fiscal year 1998-99, DWP reduced this debt by $793 million and remained on track to meet its goal of retiring (including defeasing) generation debt entirely by June 30, 2003.

Remaining Generation Debt by Fiscal Year*

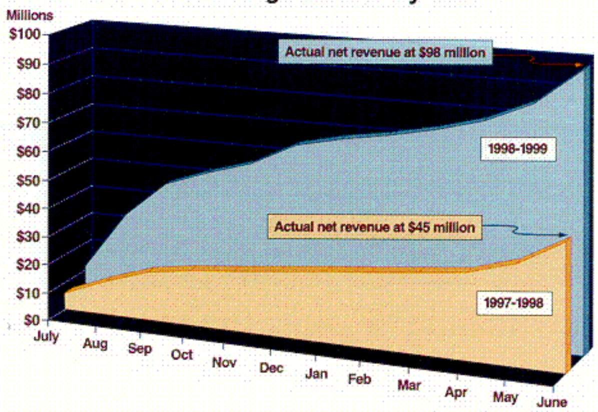


*This chart includes off-balance sheet debt and is presented net of debt reduction investments.

Revenue Gains

The DWP generated net revenue of $98 million from wholesale marketing of excess energy and transmission services which, combined with other wholesale revenues, represents a 118 percent increase from the prior fiscal year.

Cumulative Net Trading Revenue by Year*



*Net trading revenue includes net revenue resulting from energy, transmission and ancillary services sales.

C02

"The DWP generated $98 million in revenue from wholesale marketing of excess energy"...

Customer Retention

For the first time, the utility signed long-term electricity retention contracts with two dozen of its major customers. These agreements represent more than $883 million in revenue over the lifetime of the contracts. They are an important step toward securing a dependable revenue stream in the competitive era of deregulation.

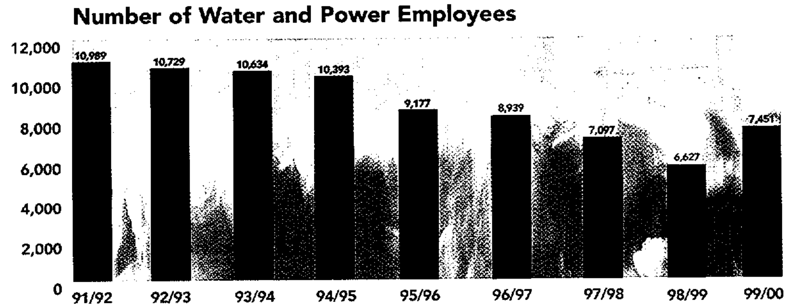
New Coal Contracts Negotiated

Under a renegotiated agreement with Arch Coal Inc., DWP and the other Southern California purchasers are expected to achieve significant present value savings in coal purchased to supply the Intermountain Generating Station, a Utah power plant that provides a third of the City of Los Angeles' electricity. The agreement calls for Arch Coal to lower prices beginning in 2002 which will help the Department in reducing its generation debt and will lower consumer electricity rates.

Streamlining the Workforce

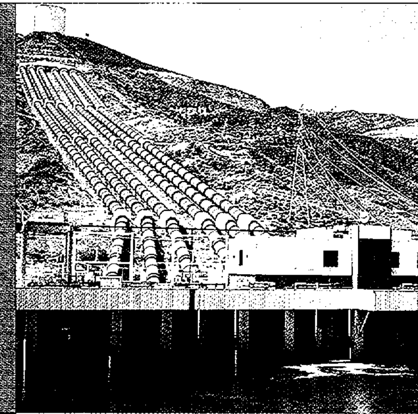
The Department completed a Staff Reduction Plan, which resulted in a net reduction of more than 2,000 employees. The Department foresees no further staff reductions, but rather is deploying its staff in the most effective manner to meet the Department's goals in preparation for competition. Backfilling of some positions is expected in order to replace essential jobs formerly held by employees who opted to leave the Department. Meanwhile, the reorganization of the management team was completed with the appointment of five assistant general managers, a new chief financial officer, a budget director and a controller.

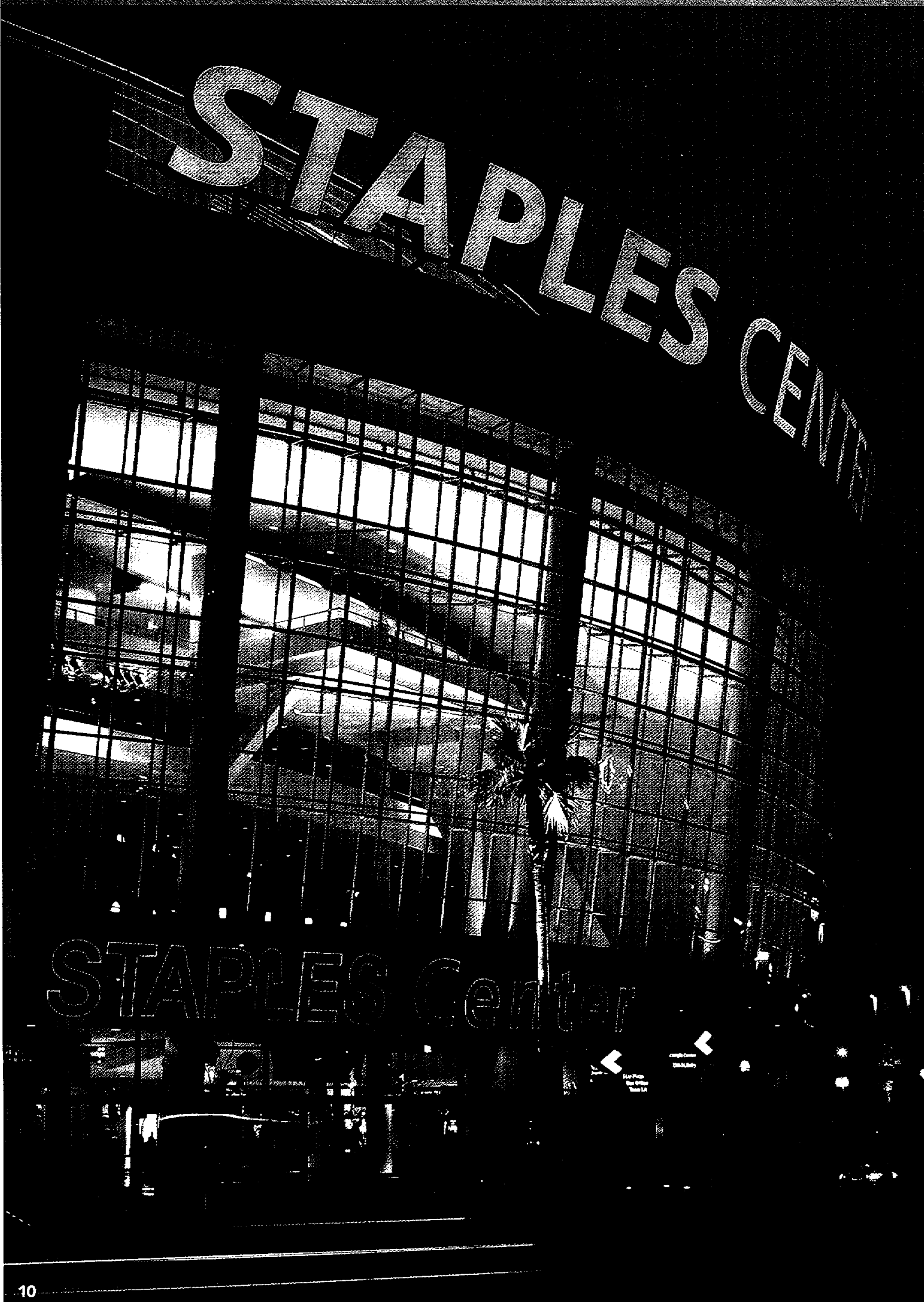
Number of Water and Power Employees



Credit Ratings

Moody's Investors Service reaffirmed the Aa3 credit rating and removed the "under pressure" caveat from $2.4 billion of electric plant revenue bonds. And the Wall Street Journal noted recently that the DWP "could become a model for other utilities preparing for deregulation." Standard and Poor's, meanwhile, assigned a rating of A+ to the DWP's electric plant revenue bonds, noting that the intermediate-to-long-term outlook was stable. DWP's water revenue bonds also maintained their outstanding AA rating, the highest in California.



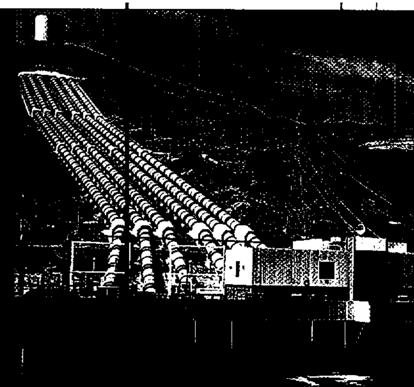


At its Castaic hydroelectric power plant, the DWP makes money by pumping water uphill. Sounds illogical, but here is how it works:

DWP's Castaic Power Plant produces electricity from falling water (hydroelectric power) that flows from Pyramid Reservoir, through a 7.2 mile tunnel and then into seven penstocks, supplying water for the six main pump-turbine generator units in the plant and a smaller pump-starting turbine generator. Water discharges from the plant into the Elderberry Reservoir, a forebay created by Elderberry Dam, for storage.

The unique operating feature of Castaic Power Plant is the pumped-storage operation that allows water to be pumped uphill with inexpensive off-peak energy and stored in Pyramid Lake. The stored water enables DWP to generate electrical power during peak periods when the cost of energy is substantially higher and make a profit on the margin. Its quick start capability also allows DWP to sell standby capability to other utilities.

The spectacular new STAPLES Center brings professional sports and other major events to the heart of Los Angeles.



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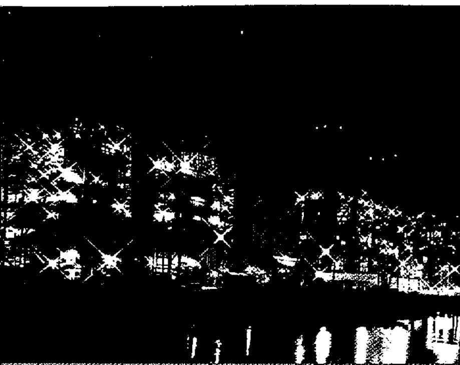
Environmental Leadership

As a municipal utility, the DWP's first duty has always been to provide safe and reliable water and power service to its customers. But the utility has also assumed an increasingly important role in helping to create a healthier planet. Many of the Department's programs and practices demonstrate our belief that long-term success as a water and power provider goes hand-in-hand with being a responsible environmental steward. Here are some examples:

Green Power for a Green LA

In May 1999, DWP launched a renewable energy initiative, Green Power for a Green LA. Under this innovative program, customers can now opt to purchase a portion of their electricity from renewable sources such as sun, wind, water and biomass. Residential customers are assessed a monthly fee of about $3, or roughly 6 percent of the average $50 household electric bill. This fee is offset through efficiencies provided by DWP. Our Green Power program is distinctive because it combines the use of clean energy with incentives to reduce consumption, is open to all classes of customers, and it funnels extra dollars into the development of new sources of renewable energy. Some 20,000 customers already have signed up, including many of Los Angeles' major businesses.

U.S. Secretary of Energy Bill Richardson joins Los Angeles Mayor Richard J. Riordan, Los Angeles City Councilmembers Ruth Galanter, Mike Hernandez and Jackie Goldberg in introducing Green Power for a Green LA. Consumer advocate Ralph Nader later announced his support of the new initiative, the only one he has supported.

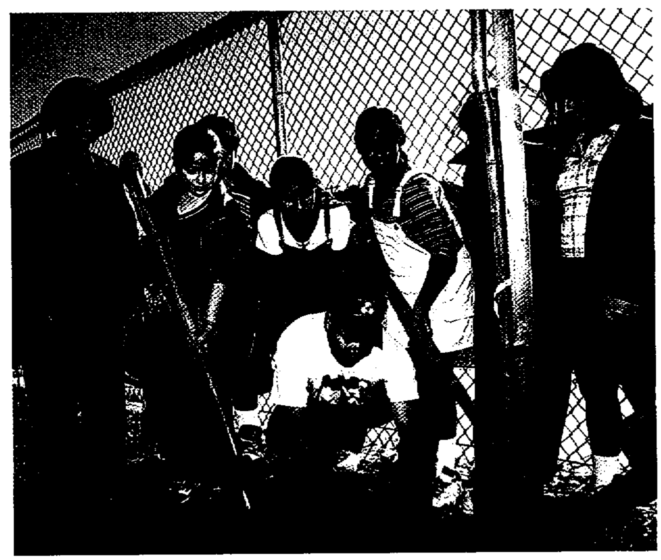


As summer approached and electricity demand surged, several DWP employees recognized a terrific opportunity for the Department to earn additional revenue from the sale of excess electricity on the wholesale market. These employees made a compelling case for DWP to reactivate three dormant generating units that were shut down more than five years ago at a time when they were thought to be no longer useful. These natural gas-fired units, two at Valley Generating Station and one at Haynes Generating Station, were brought back on-line this year. And, not only did the Department earn money from the sale of excess energy, but the electricity system's overall reliability increased during summer's hottest months.

Los Angeles exuberates with economic growth, evident in the rise of new buildings such as the Metropolitan Transit Authority building.

Cool Schools

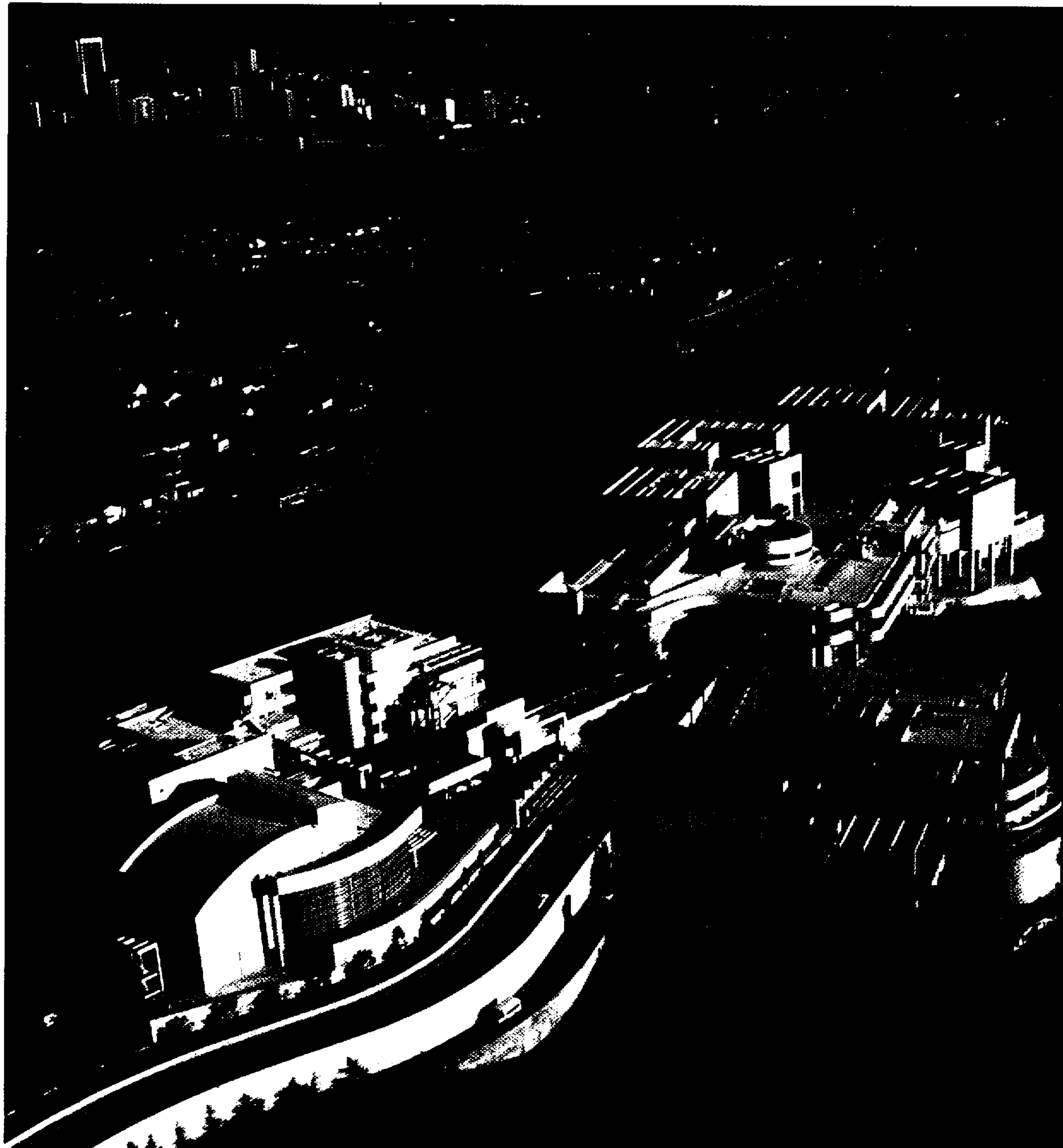
In only one year of operation, DWP's Cool Schools tree planting program has added more than 3,000 trees to Los Angeles Unified School District campuses, with more than 1,000 still to be planted. In this, the city's largest school-based community tree-planting program, forty-two schools will be newly shaded by June 30, 2000. The trees are strategically placed to shade buildings, lessening the need for air conditioning and thus reducing energy consumption and costs. Besides improving the landscape, the program teaches school children important lessons in science and caring for the environment. DWP's partners in the program are the Los Angeles Unified School District, TreePeople, Hollywood Beautification Team, Los Angeles Conservation Corps and North East Trees.



Electric Transportation

DWP's electric transportation program is designed to prepare Los Angeles for 2003, when the State of California will require that 10 percent of all new vehicles offered for sale must produce zero emissions. Recent accomplishments include: the installation of more than 200 electric vehicle charging stations; the purchase of 25 electric buses (which will supplement shuttle operations at the National League of Cities Convention and the Democratic National Convention); more than 100 electric-powered bicycles to law enforcement officers and security patrol officers; a partnership with the U.S. Post Office in Harbor City to convert its fleet to all electric, the first in the nation; and support of the launch of EV Rental Cars at Los Angeles International Airport.

DWP enlisted the creativity of its local students by sponsoring the Green Power for a Green L.A. student art and multi-media contest for youngsters kindergarten through 12th grades. A total of 325 entries from 425 students in 60 schools were received. Winning entries were incorporated into paid ads promoting the green power initiative. One song served as background music for a radio ad. Student works were displayed at DWP facilities and also made part of Green Power community exhibits.

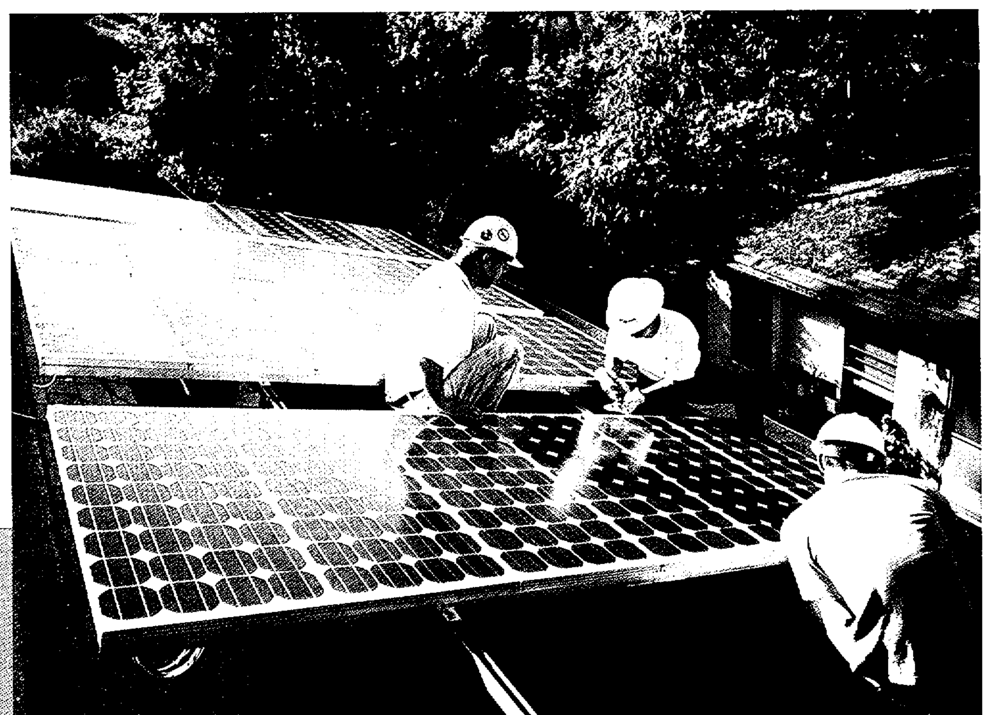


The Getty Center was constructed with the latest in energy efficient lighting, air conditioning and control systems with assistance from DWP. The J. Paul Getty Trust is a long-term customer of DWP, as well as a Green Power purchaser and a partner in environmental programs

The DWP EV Service Center has partnered with the U.S. Post Office in Harbor City to convert its entire fleet to electric vehicles, the first in the nation. The model EV Service Center will provide support services, repairs and training on the electric vehicles.

Solar Electric

The City of Los Angeles possesses a wealth of sunlight which makes for a terrific opportunity to create solar energy. DWP's solar electric program provides a clean source of electricity that helps reduce air pollution and the harmful effects of global warming. It also benefits the city by providing a new source of jobs and economic development.



Fact A: Building rooftops are an excellent place to install solar energy collectors. Fact B: The City of Los Angeles owns hundreds of buildings suited to hosting solar panels. That logic is helping to propel one of the DWP's most ambitious solar energy programs, the installation of 100,000 commercial photovoltaic (PV) roof systems in Los Angeles by the year 2010. A typical system can capture enough energy from the sun to power an average house for eight months of the year. The first PV installation on a city-owned building was completed in February. It covers a portion of the roof at the Westchester Municipal Building at 7166 W. Manchester Avenue, and produces enough electricity to power not only the building, but other DWP customers as well. In one year, this system will displace burning four tons of coal and will prevent 11,500 pounds of greenhouse gases from entering the atmosphere.

DWP crews are now working to install PV systems on other city buildings. At the same time, the utility is making PV installations available to its residential and commercial customers.

DWP At Work

Serving more than 3.7 million people over a 470 square mile area, DWP continues to provide safe and reliable water and electric service to Los Angeles businesses and residents, a service we have been providing for almost 100 years. We are able to fulfill this mission to our customers with an innovative and dedicated workforce whose professionalism reflects the utility's sound business practices and philosophies. DWP workers have the ideas, the energy and the creativity to ensure that the Department will continue to be the finest public utility in the country. Here are some examples of DWP at work:

Energy Efficiency

DWP's energy efficiency program has embarked on a seven-year project to retrofit more than 600 city facilities with new energy efficient equipment. In this aggressive and innovative program, DWP provides management and technical expertise for this ambitious project, which promises to deliver millions of dollars to the city in energy savings. This program extends beyond city government and reaches residential and commercial customers too, who through a broad portfolio of assistance, now make wiser use of water and power services. DWP, on request, sends experts to analyze the energy needs of homes and businesses and provides discounts for efficient lighting, cash incentives for small businesses to install efficient lighting and space conditioning systems, and provides refrigeration unit maintenance.

Low Income Assistance

Through a variety of programs and subsidies, DWP provides $43 million per year in assistance to low income residents to help them pay the costs of water and electricity. This year, the utility went one step further and launched the Neighborhood Bill Reduction Service, an innovative community-based partnership that aims to lower utility bills through good conservation practices. Under the new program, DWP representatives visit the homes of low income residents and advise them on ways to use less energy and water – and thus shrink their utility bills. The home visits include such practical assistance as cleaning refrigerator coils and providing energy efficient fluorescent light bulbs and low-flow showerheads. The program reaches up to 1,200 low-income customers per week, and thus far has reached more than 20,000 residents.

"DWP workers have the ideas, the energy and the creativity to ensure that the Department will continue to be the finest public utility in the country."

New Technologies

The DWP continues to explore new technologies to improve its services and benefit the communities it serves. This year, it is funding an exciting new combination of medical and electro-technology research conducted by the Harvard School of Public Health and St. Vincent's Hospital of Los Angeles. The research is exploring the use of ultra-violet germicidal irradiation to control infectious diseases. Scientists believe it is potentially a better way to disinfect room air, especially in schools and hospitals – and it promises to be far more energy-efficient than methods in use today.

BRIGHT IDEAS

Working with Maytag, DWP has developed a new, super-efficient, 18.6 cubic foot refrigerator. The energy saving appliance will first be made available to Los Angeles housing authorities and targeted customers. It consumes a mere 436 kilowatt-hours per year, less than half the 1,100-kilowatt hours per year required by traditional designs. Utilities across the country are expected to follow DWP's lead and begin providing the same units to their customers.

Electric Leaf Blower

During 1998-1999, DWP and AeroVironment, Inc. continued to make rapid progress in the market research and development of a commercially viable, quiet and zero emission electric battery-powered leaf blower. The initial investment was funded from the Public Benefit program. An application was filed with the U.S. Patent Office. A Request for Proposals was developed for the manufacturing and marketing of a leaf blower that will be sold at retail stores. Plans were finalized calling for a demonstration launch of 1,500 leaf blowers in spring 2000 with commercial models ready for sale in fall 2000. The plan also included a licensing arrangement providing DWP the opportunity to recover its costs and receive a return on its investment through royalties. Cost recovery will be based largely on the success of the new product in the marketplace. Revenues received will be invested in the development of other new technologies.

Putting Ideas Into Action

A new incentive-based employee suggestion program is paying off for DWP and its work force. All employees are encouraged to submit ideas that have the potential to reduce costs or improve Department operations. When an employee's idea is put into action, he or she receives a cash award equal to 10 percent of the cost savings, up to $25,000. Some recent winners included:

- Edgar C. Wingerd, a steam plant operating supervisor, who collected the maximum $25,000 for his suggestion to install a larger steam conditioning valve that would shorten the start-up time for the combined cycle turbines at Harbor Generating Station.

An icon of downtown L.A.'s past is back. The renovation and return of Angel's Flight is yet another sign of the city's bustling new economy.

Remote Electro Optical Sensor (REOS) Technology: DWP scientists, working with Biospherical Instruments, Inc. have created a state-of-the-art monitoring system that checks water quality and algae presence. In use at five DWP reservoirs, the REOS system catches algae growth in its early stages and minimizes the amount of chlorine necessary to treat it. Chlorine can react with organic material to form trihalomethanes, or THMs, which are a suspected carcinogen. Prior to the use of REOS, biologists collected water samples from each reservoir once a week. Now they can review the data collected from the REOS instrument on a daily basis and treat any algae problem right away. A recent one-year study of the Los Angeles Reservoir found that using REOS resulted in 42 percent fewer chlorine treatment days and a 40 percent decline in tons of chlorine used, compared to the previous three years.

Customer Service Guarantees

How a utility responds to service calls can shape its relationship with customers for years to come. That is why the DWP took the bold step to guarantee that its service will satisfy. The six key points of the policy are:

- **We guarantee to arrive on time for scheduled appointments!**
- **We guarantee to notify you at least 2 business days in advance of any planned service outage longer than 2 hours!**
- **We guarantee to complete routine service turn-on on the agreed upon date!**
- **We guarantee to respond to service outage reports ASAP!**
- **We guarantee to respond to temporary shutoff requests ASAP!**
- **We guarantee to fix it if we're at fault for breaking it!**

• Eight employees from Integrated Support Services (John Catalano, Roland Chivers, Raymundo Coronado, Craig Hauck, Kenneth M. Houlette, Roy Ransom, David Weinstein and Raymond Wilson) shared a $20,111.20 award for their proposal to replace fleet vehicle batteries with zero maintenance, longer life "gel-cell" batteries.

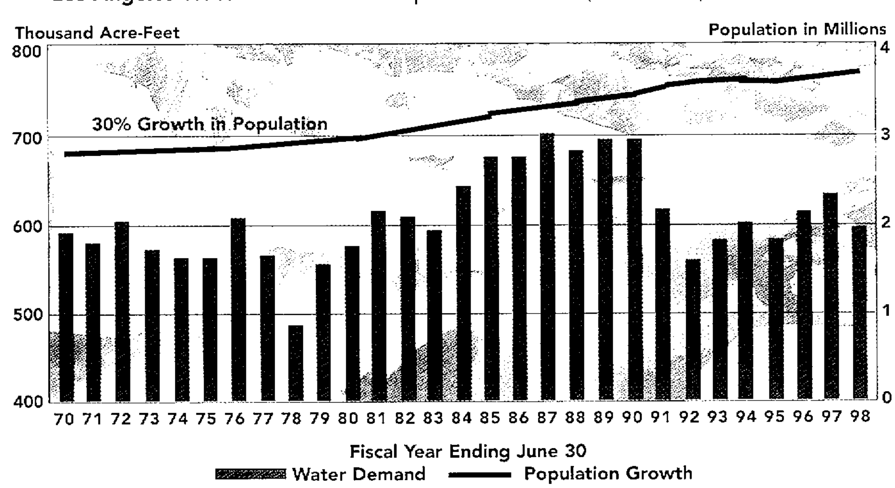
Water Services

The DWP is proud to provide a clean, safe and reliable water supply to its customers every day. Here are some important Water Services highlights:

• **Water Conservation:** DWP continues to lead the way in water conservation by providing incentives to residential customers for installing water efficient toilets, washing machines, and to commercial customers for replacing inefficient water-using equipment. DWP also continued to provide conservation information to our customers and support conservation-focused educational programs at both elementary and secondary school levels. Despite a population increase in Los Angeles of nearly one million since 1970, customers last year essentially used the same amount of water as they did 29 years ago.

• **Water Fluoridation:** The Department began providing fluoride to a portion of the city's water supply in August 1999. This was the first step in a construction program to install the facilities required to provide optimal levels of fluoride to all of the city's water supply within three years. Fluoridation helps prevent tooth decay. Worldwide more than 360 million people use fluoridated water.

Los Angeles Water Demand and Population Growth (in acre-feet)



The DWP has provided to customers 880,000 ultra low flush toilets to date, 1.75 million low flow shower heads and 6,300 High Efficiency Clothes Washer rebates. DWP's rebate program encouraged Whirlpool to bring efficient clothes washing machines to market.

The new Department program is in compliance with a 1995 state law requiring fluoridation of public water supplies to protect and maintain dental health.

Water Quality Improvement Projects

• **Hollywood Reservoir:** In November, construction began on the Hollywood Water Quality Improvement Project located at the Hollywood Reservoir Complex. This is the first project to put one of the Department's four open reservoirs in compliance with the state mandated Surface Water Treatment Rule. The project consists of two of the largest pre-stressed concrete water tanks of their type in the world, two tunnels, the Department's first membrane filtration plant and a new trunk line. It is the Department's largest water project since the Los Angeles Aqueduct Filtration Plant was built in 1986.

• **Stone Canyon-Encino Reservoirs:** A proposal to bypass Encino and Stone Canyon Reservoirs and remove them from active service has been developed and conceptually approved by the California Department of Health Services. The proposal was presented to the Board of Water and Power Commissioners in June and approved September 7, 1999. This proposal is expected to save $80 - $100 million. The two reservoirs will be maintained for emergency use, such as after a major earthquake or as a reserve supply in case of drought.

Owens Valley Restoration and Land Management

The DWP continues to implement smart land use and water management practices in the Owens Valley, the source of more than 55 percent of Los Angeles' water supply. In the past, the utility's role in Owens Valley was clouded by controversy. But today, DWP's success stories abound in the Owens Valley and its overall ecosystem, which although under pressure for many years, is gradually being restored. DWP is emerging as a national leader in ecosystem restoration and watershed management. Success stories include:

As part of complying with the Surface Water Treatment Rule, the DWP will be implementing a state-of-the-art water treatment technology called membrane filtration for use at some of its open reservoirs. Membrane filtration provides an absolute barrier against water pathogens such as Giardia and Crytosporidium and offers a number of advantages over the conventional filtration process.

• **Gorge Re-watering Project**: In the 1950's DWP diverted water from the Owens River Gorge for hydropower operation, and, as a result, the lower 10 miles of the river flowing through the gorge dried up. When a penstock ruptured in 1991, the Department began a re-watering process that today has resulted in the restoration of an entire ecosystem. The restoration has resulted in multiple

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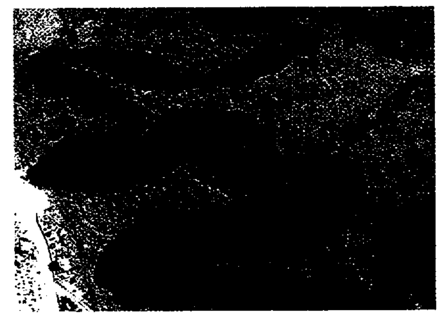
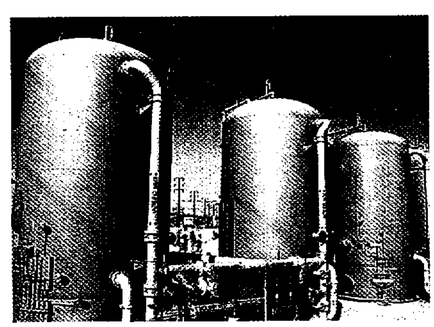


• **Lower Owens River Restoration:** Entailing 56 miles of river channel, the Lower Owens River Project is the largest restoration effort ever undertaken by the Department. This section of river was dewatered in 1913 when the Los Angeles Aqueduct diversions began diverting the flow from the river. The major goal of the project is to produce a healthy river ecosystem that will support a recreational fishery as well as diverse wildlife habitat. The restoration planning has been completed, and implementation will begin after completion of environmental approvals in late summer.

• **Owens Dry Lake:** After two decades of dispute, DWP forged an historic agreement with the Great Basin Unified Air Pollution Control District which establishes a schedule of compliance with air quality regulations. Under the agreement, 10 square miles of the 110-square-mile lake bed will be treated by the end of 2001, an additional 3-1/2 square miles in 2002 and three more in 2003. In addition, at least two square miles must be treated every year until clean-air standards are met. These mitigation efforts will permanently stop the dust storms in Owens Lake that made the area the single largest source of particle pollution in the United States.

Pollock Wells



DWP's Pollock Wells Treatment Plant reopened in March and moves 3,000 gallons per minute of groundwater through four vessels packed with granular activated carbon to remove contaminants. With Pollock Wells on-line again, DWP is able to recapture a valuable water supply that was placed off limits in the early 1980s because of quality concerns. And, the plant was recently honored as one of the best-designed industrial buildings in Los Angeles by the *L.A. Weekly* newspaper.

"We Get Letters"

"...We discovered a massive water leak in our street. My wife called the DWP and a crew seemed to materialize on the scene virtually instantaneously. The crew members worked constantly into the late evening hours, in good humor and cheer...we not only appreciate the prompt response to restore our water supply, but also the good graces in which it was done..."

J.D.,

"...I had an electrical upgrade installed in my home. The contractor tried to pull a fast one by installing a subpanel and calling it an upgrade. Mr. Compton [a DWP electric service rep] had been by and saw the old electrical panel before it was removed. After the supposed upgrade, he saw it again and was very surprised. He showed me a sketch of what an upgrade looks like...it had no resemblance to what had been installed. By clarifying the obvious difference...he helped me avoid being taken by a bad contractor..."

A.K.,

"I am writing a short note to let you know that a Van Nuys office employee... went beyond the call of duty. I was very angry about the loss of my payment in the drop box. Although she couldn't locate my lost check, she made an entry on her computer and extended my due date..."

B.L.,

"I am very interested in the Green Power program and would love to enroll. This is a good project. I am excited to see alternative energy coming into mainstream consciousness...Thank you."

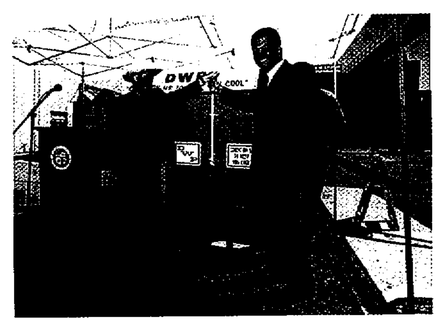
C.M.

Keeping customers satisfied and being responsive to their needs is a priority at DWP. Our trained staff prides itself on providing excellent customer service.

Energy Services

With 1.39 million electric customers, the DWP is the largest municipal utility in the nation, providing reliable energy at affordable rates. As outlined in this report, the DWP has reinvented itself in preparation for deregulation by paying off generation debt, renegotiating coal contracts, generating new revenue and entering long-term contracts with our largest customers. Other Energy Services highlights include:

• **Castaic Power Plant Dedication Event:** After 27 years of operation, DWP's Castaic Hydroelectric power plant was officially dedicated in September. More than 75 Department employees were joined by Board President Rick Caruso and General Manager David Freeman at the event which culminated with the unveiling of two plaques which will adorn the facility permanently. The Castaic plant has long been lauded as a state-of-the-art facility, unique among other generating facilities in the country, for its operating feature that pumps water uphill during off-peak periods to store water for use during peak periods.



• **Valley Generating Station Event:** Under a DWP banner promising to "Keep the Valley Cool," newly elected Los Angeles City Councilman Alex Padilla joined General Manager David Freeman in July for a ceremonial "flipping of the switch" at Valley Generating Station in Sun Valley. As noted earlier, this year DWP reactivated three dormant generating facilities in order to ensure reliability during peak months of energy usage, and to enable the Department to earn extra income from the sale of excess energy on the wholesale market. Reactivating the Valley plant is a welcome shot in the arm to neighboring retailers in Sun Valley who can expect patronage from the 30 DWP employees based there.

• **Outdoor Lighting Program:** The Department's Outdoor Lighting Program continues to provide safety and security through low-cost, energy-efficient area lighting. DWP's program provides outdoor lighting fixtures, installation and maintenance for residential and business customers. Customers pay only a low monthly cost.

BRIGHT IDEAS

Customers of DWP enjoy electric service with a high reliability rate as compared to other utilities. One of the ways the DWP keeps its system strong is through the use of infrared technology. The infrared scanning device checks the Department's electric system and pin-points weak spots so repairs can be made before problems occur. DWP is using this technology not only on its own mainline system, but also to help large customers check their electrical equipment.

Used at schools, homes and businesses, DWP's outdoor lighting program is endorsed by the Los Angeles Police Department as a deterrent to crime, vandalism and accidents. This year, DWP partnered with the Department of Recreation and Parks to provide lighting at 84 parks within the city. DWP's lights are making communities safer and residents feel more secure.

• **Energy Solution Program:** The new Energy Solution Program is another example of how the Department is finding new ways to enhance customer service. The program helps commerical and industrial customers prevent potential electrical problems by offering to clean and maintain the electric service on the customer's side of the meter. In the past, customers had to hire contractors for this type of costly work. DWP provides this service at a fraction of the cost, saving the customer money and providing the priceless assurance of quality work performed by a known, trusted and experienced utility.

• **Powering L.A.'s Economic Expansion:** DWP is providing support, technical assistance and new electric services to several new projects and expansions in the City of Los Angeles. Among them are the Alameda Corridor Transit Authority rail line, Port of Los Angeles' Pier 400 project and Playa Vista. Energy Services also is working with the STAPLES Center in preparation for the Democratic convention, and has installed new lights for the Vincent Thomas Bridge in San Pedro.

• **State-of-the-Art Generation:** As the 21st century begins, DWP is poised to deliver energy from state-of-the-art generation. DWP is working to develop and implement new technologies such as fuel cells, distributed generation and micro turbines. The Department's energy mix will continue to provide reliability and low cost, while employing the latest and cleanest technologies.

The Community Dividend

No public utility takes its community service role more seriously than DWP. Here are some examples, large and small, of how the Department gives back to its most valuable stakeholders the citizens of Los Angeles:

Revenue Transfer

DWP continues to meet its commitment to transfer at least 5 percent of gross revenues to the City of Los Angeles General Fund. This year's revenue transfer amounted to $129 million, a 17 percent increase over the previous year, continuing DWP's role as the city's largest "taxpayer." The city uses the DWP funds to help pay for vital municipal services, including police and fire protection, and recreational facilities.

Involvement in Education

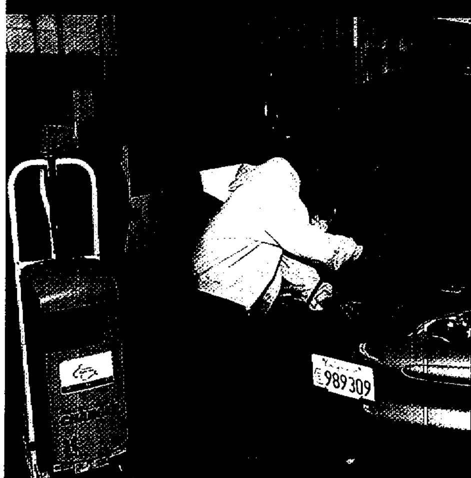
The DWP has a tradition of involvement in city schools. Its activities include the following:

- DWP partners with the Los Angeles Unified School District to sponsor the nationally-recognized Youth Service Academy which places students into part-time positions at the Department. This 10-year-old program was initiated to assist "at-risk" youth in developing basic office skills and computer literacy. This program has been created as a national model by the U.S. Department of Labor.

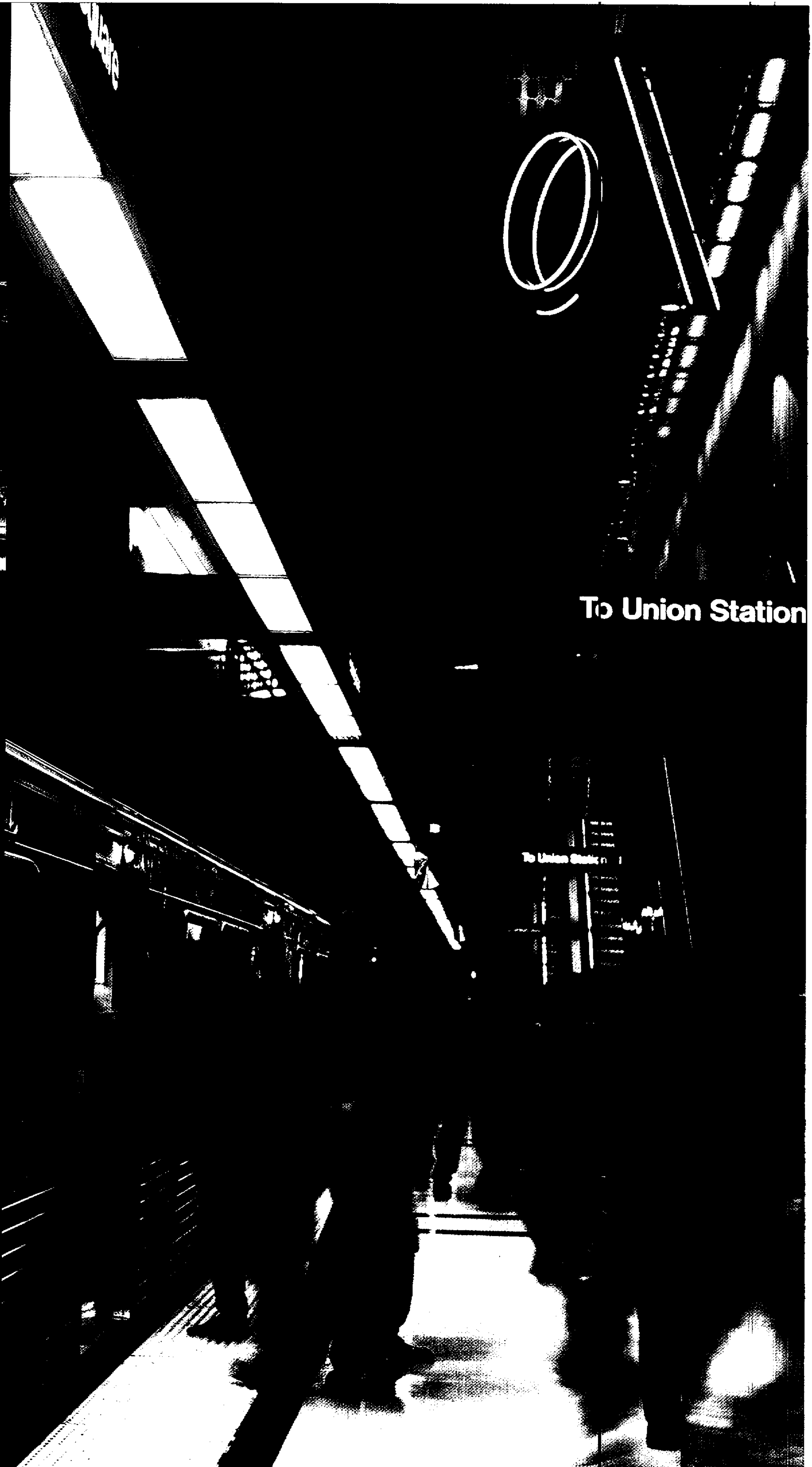
- DWP sponsors the regional DWP Science Bowl, in which local high school students use their science knowledge to compete for a berth in the National Science Bowl. In 1999, for the second year in a row, the North Hollywood High team finished second in the national contest. Team members won an expenses-paid, one-week trip to a Department of Energy laboratory in Savannah, Georgia where they studied issues such as waste management and protection of wetland ecosystems. Teams from the DWP Science Bowl also captured the title in 1995, 1996 and 1997, an unsurpassed record. Science Bowl is sponsored nationally by the U.S. Department of Energy.

- Employees take part in Adopt-a-School programs. DWP adopted 10 elementary schools and one high school. Under the program, DWP employees volunteer their time to work with students in the classrooms.

- DWP sponsors a series of workshops for teachers and provides curriculum materials on electric vehicle technology, air quality, water conservation and environmental issues for use in Los Angeles Unified School District and private/parochial school classrooms.



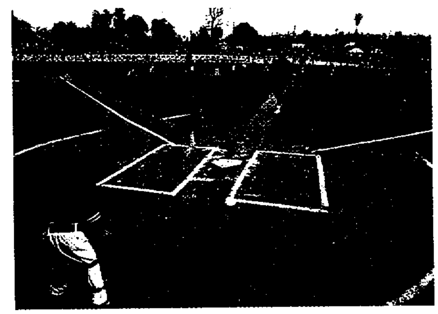
In May 1999, 10 students from the Downtown Business Magnet High School visited the DWP EV Service Center for a personal tour of the facility and for a hands-on look at electric vehicles and how they work.



DWP provides electric service to the Metrolink Rail system, L.A.'s response to the city's growing mass transportation needs.

Weingart Foundation Little League Field

A brand new Little League baseball field now shares space on the DWP Meridian Tank site in Highland Park. In addition to granting permission to the Weingart Foundation to use the property, the utility provided technical assistance and made various improvements to help prepare the ball field for games.



Sponsorships – "We're L.A.'s Home Team Too"

"Power Hitters," "Football Frenzy" & "Spot Shot": More than 2,000 kids from throughout Los Angeles participated in DWP-sponsored community events that paired boys and girls with professional athletes who provided one-on-one instruction in the fundamentals of baseball, football and basketball.

"DWP continues to meet its commitment to transfer at least 5 percent of gross revenues to the City of Los Angeles General Fund."

1998 – 1999 Financial Statements

Water Services

Energy Services

Report of Independent Accountants

To the Board of Water and Power Commissioners

Department of Water and Power

City of Los Angeles

In our opinion, the accompanying balance sheets and the related statements of income, of retained income reinvested in the business and of cash flows present fairly, in all material respects, the financial position of the Water System (Water Services) of the Department of Water and Power of the City of Los Angeles at June 30, 1999 and 1998, and the results of its operations and its cash flows for each of the three years in the period ended June 30, 1999 in conformity with generally accepted accounting principles. These financial statements are the responsibility of the Department's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with generally accepted auditing standards, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

PricewaterhouseCoopers LLP Simpson & Simpson

September 15, 1999, except as to Note 9, which is as of October 15, 1999

Water Services Balance Sheet

(Amounts in thousands)	June 30, 1999	1998
ASSETS		
Utility Plant		
Source of water supply	$ 304,394	$ 282,995
Pumping	165,592	163,774
Purification	209,583	195,237
Distribution	2,102,406	1,991,160
General	301,926	304,221
	3,083,901	2,937,387
Accumulated depreciation	1,078,740	1,011,476
	2,005,161	1,925,911
Construction work in progress	172,381	161,740
	2,177,542	2,087,651
Restricted Investments	307,706	142,554
Current Assets		
Cash and cash equivalents	62,566	83,185
Cash collateral received from securities lending transactions	20,219	27,964
Customer and other accounts receivable, net of $4,500 and $5,400 allowance for losses	79,608	62,272
Due from Energy Services	2,208	10,278
Accrued unbilled revenue	37,252	35,928
Materials and supplies, at average cost	15,284	17,978
Prepayments and other current assets	6,486	5,975
	223,623	243,580
Net Pension Asset	47,845	35,766
	$2,756,716	$2,509,551
CAPITALIZATION AND LIABILITIES		
Equity		
Retained income reinvested in the business	$ 968,091	$ 890,222
Contributions in aid of construction	576,597	550,214
	1,544,688	1,440,436
Long-term Debt	633,840	652,641
Advance Refunding Bonds	314,212	138,676
	2,492,740	2,231,753
Current Liabilities		
Debt due within one year	18,720	18,400
Accrued interest	13,714	13,120
Accounts payable and accrued expenses	59,960	69,275
Accrued employee expenses	17,189	20,188
Obligations under securities lending transactions	20,219	27,964
Overrecovered costs	36,940	43,488
Customer deposits	40,174	39,627
	206,916	232,062
Accrued Postretirement Liability	57,060	45,736
Commitments and Contingencies (Note 8)	–	–
	$2,756,716	$2,509,551

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

Water Services Statement of Income

(Amounts in thousands)	1999	Year Ended June 30, 1998	1997
Operating Revenues			
Residential	$ 173,812	$ 159,407	$ 168,643
Commercial and industrial	244,144	240,168	224,930
Other	25,456	25,475	24,698
	443,412	425,050	418,271
Operating Expenses			
Purchased water	37,192	40,719	35,530
Other operating expenses	143,887	148,771	137,181
Maintenance	59,000	65,098	63,156
Depreciation	68,299	65,362	61,881
	308,378	319,950	297,748
Operating Income	135,034	105,100	120,523
Other Income and Expense, net	(4,060)	10,594	8,554
Gain on Sale of Land	5,524	–	–
	136,498	115,694	129,077
Debt Expenses			
Interest on debt	44,987	45,738	48,532
Allowance for funds used during construction	(2,610)	(1,910)	(1,907)
	42,377	43,828	46,625
Net Income	$ 94,121	$ 71,866	$ 82,452

Statement of Retained Income Reinvested in the Business

(Amounts in thousands)	1999	Year Ended June 30, 1998	1997
Balance at beginning of year	$ 890,222	$ 844,270	$ 782,962
Net income for the year	94,121	71,866	82,452
Less – Transfers to the reserve fund of the City of Los Angeles	16,252	25,914	21,144
Balance at end of year	$ 968,091	$ 890,222	$ 844,270

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

Water Services Statement of Cash Flows

(Amounts in thousands)	1999	Year Ended June 30, 1998	1997
Cash Flows from Operating Activities:			
Operating income	$ 135,034	$ 105,100	$ 120,523
Adjustments to reconcile operating income to net cash provided by operating activities			
Depreciation	68,299	65,362	61,881
Provision for losses on customer and other accounts receivable	2,172	3,595	1,522
Gain on sale of land	5,524	–	–
Other	903	(957)	(1,855)
Changes in assets and liabilities:			
Customer and other accounts receivable	(18,967)	(6,553)	14,114
Net pension asset	(12,079)	(29,030)	(3,095)
Accounts payable and accrued expenses	(4,315)	18,211	7,249
Overrecovered costs	(6,548)	8,639	15,820
Accrued postretirement liability	11,324	20,989	(2,766)
Other	6,477	180	12,451
	187,824	185,536	225,844
Cash Flows from Noncapital Financing Activities:			
Payments to the reserve fund of the City of Los Angeles	(21,252)	(20,914)	(21,144)
Cash Flows from Capital and Related Financing Activities:			
Additions to plant and equipment, net	(155,580)	(151,131)	(163,802)
Contributions in aid of construction	26,383	17,205	26,275
Proceeds from escrow investment maturities	65,933	14,742	16,341
Purchases of escrow investments	(235,069)	–	–
Principal payments and maturities on long-term debt, net	(78,675)	(27,222)	(29,912)
Sale of advance refunding bonds	235,730	–	–
Debt interest payments	(57,457)	(54,581)	(48,661)
	(198,735)	(200,987)	(199,759)
Cash Flows from Investing Activities:			
Cash collateral received under securities lending transactions	7,745	7,263	(35,227)
Obligations under securities lending transactions	(7,745)	(7,263)	35,227
Investment income	11,544	17,184	8,183
	11,544	17,184	8,183
Cash and Cash Equivalents			
Net (decrease) increase	(20,619)	(19,181)	13,124
Beginning of year	83,185	102,366	89,242
	$ 62,566	$ 83,185	$ 102,366

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

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Department of Water and Power of the City of Los Angeles (the Department) exists as a separate proprietary agency of the City of Los Angeles (the City) under and by virtue of the City Charter enacted in 1925. The Department's Water Services is responsible for the procurement, quality and distribution of water for sale in the City.

Method of accounting – The accounting records of the Water Services are maintained in accordance with generally accepted accounting principles applicable to governmental utilities. The Department applies all statements issued by the Governmental Accounting Standards Board (GASB) and all statements and interpretations issued by the Financial Accounting Standards Board which are not in conflict with statements issued by the GASB. The accounting records generally follow the Uniform System of Accounts for Public Utilities and Licensees prescribed by the California Public Utilities Commission (CPUC), except for the method of accounting for contributions in aid of construction described below.

The Department's rates are subject to review and approval by the City Council. As a regulated enterprise, the Department's financial statements are prepared in accordance with Statement of Financial Accounting Standards (SFAS) No. 71, *Accounting for the Effects of Certain Types of Regulation,* which requires that the effects of the ratemaking process be recorded in the financial statements. Such effects primarily concern the time at which various items enter into the determination of net income in order to follow the principle of matching costs and revenues. Accordingly, the Water Services records various regulatory assets and liabilities to reflect the regulator's actions. Management believes that the Water Services meets the criteria for continued application of SFAS No. 71, but will continue to evaluate its applicability based on changes in the regulatory and competitive environment.

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

Utility plant – The costs of additions to utility plant and replacements of retired units of property are capitalized. Costs include labor, materials, an allowance for funds used during construction (AFUDC), and allocated indirect charges such as engineering, supervision, transportation and construction equipment, retirement plan contributions, health care costs, and certain administrative and general expenses. The costs of maintenance, repairs and minor replacements are charged to the appropriate operations and maintenance expense accounts. The original cost of property retired, plus removal cost, less salvage, is charged to accumulated depreciation.

Depreciation – Depreciation expense is computed using the straight-line method based on service lives. Estimated service lives range from 5 to 70 years. Depreciation expense as a percentage of average depreciable utility plant in service was 2.6%, 2.6% and 2.7% for fiscal years 1999, 1998 and 1997, respectively.

Cash and cash equivalents – The Department's cash is deposited with the City Treasurer in the City's general investment pool. The City Treasurer invests available funds of the City and its independent operating departments on a combined basis. At June 30, 1999 and 1998, cash and cash equivalents includes $12 million of internally-designated balances relating to bond redemption and interest funds and a self-insurance fund. The Department considers all unrestricted investments with an original maturity of three months or less to be cash equivalents.

Contributions in aid of construction – Under the provisions of the City Charter, amounts received from customers and others for constructing utility plant are combined with retained income reinvested in the business and represent equity for purposes of computing the Water Services borrowing limits. Accordingly, contributions in aid of construction are shown in the accompanying balance sheet as a component of equity.

Revenues – The Water Services rates are established by a rate ordinance which is approved by the City Council. The Water Services sells water to other City departments at rates provided in the ordinance. The Water Services recognizes water costs in the period incurred and accrues for estimated water sold but not yet billed.

Revenues consist of billings to customers for water consumption and include amounts resulting from a cost adjustment formula designed to permit the full recovery of purchased water and other expenditures specifically approved for inclusion by rate ordinance. The Department is also authorized to collect certain demand-side management and water reclamation expenditures, and expenditures to upgrade water quality and to improve facilities to meet State and Federal water quality standards, including related debt service; a substantial part of these revenues relate to billings for water reclamation and water quality expenditures and are dedicated to those capital projects. The Department estimates these costs to establish the cost recovery component of customer billings and any difference between billed and actual costs, resulting in over or underrecovery of such costs, is adjusted in subsequent billings.

Debt expenses – Debt premium, discount and issue expenses are deferred and amortized to expense over the lives of the related debt issues. Losses on refundings related to bonds redeemed by advance refunding bonds are amortized over the shorter of the life of the advance refunding bonds or the remaining term of the bonds refunded.

Allowance for funds used during construction – Allowance for funds used during construction represents the cost of borrowed funds used for the construction of utility plant. Capitalized AFUDC is included as part of the cost of utility plant and as a reduction of debt expenses. The average AFUDC rate was 6.4% in each of the fiscal years 1999, 1998 and 1997.

Restricted investments – The Department accounts for cash and cash equivalents and restricted investments in accordance with GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools,* which requires that investments be reported at fair value. All investment income, including changes in fair value, is included in Other Income and Expense, net.

Reclassification – Certain financial statement items for prior years have been reclassified to conform to the current year presentation.

NOTE 2: SECURITIES LENDING TRANSACTIONS

The City Treasurer's investment policy for its general investment pool (the Pool) includes a securities lending program (the Program) which was approved by the City Council on October 28, 1991. The City's custodial bank serves as the securities lending agent and indemnifies the City from losses incurred as a result of its operational failure, its failure to carry out adequate credit analysis and/or insufficient collateralization of the loaned securities. The City does not have the ability to pledge or sell collateral assets unless the borrower is in default of its obligation.

Under the Program, up to 60% of the par value of pooled investments are available for loan on a short-term basis. Collateral, which is limited to cash, U.S. Treasury certificates and non-callable U.S. Government Agency securities, must be at least equal to 102% of the market value of the loaned securities as of the loan initiation date; in addition, matched maturities, which include investments associated with term loans and overnight investments associated with open loans, must represent at least 75% of securities loaned under the Program.

The Department recognizes its proportionate share of the cash collateral received for securities loaned and the related obligation. At June 30, 1999, management believes that there is no credit risk exposure for the Department because the amounts owed to the borrowers by the Pool exceed the amounts the borrowers owe to the Pool.

NOTE 3: LONG-TERM DEBT AND ADVANCE REFUNDING BONDS

Long-term debt and advance refunding bonds consist of the following at June 30, 1999 (amounts in thousands):

Bond Issues	Date of Issue	Effective Interest Rate	Fiscal Year of Last Scheduled Maturity	Principal Outstanding
Second Issue of 1969	09/01/69	6.008%	2000	$ 600
Issue of 1971	02/01/71	5.479%	2011	7,200
Issue of 1972	02/01/72	5.127%	2012	6,500
Second Issue of 1972	08/15/72	5.180%	2013	7,000
Refunding Issue of 1973	01/01/73	4.933%	2000	820
Issue of 1973	09/15/73	5.249%	2014	7,500
Refunding Issue of 1977	02/01/77	5.804%	2015	20,960
Issue of 1987	08/01/87	7.516%	2000	850
Refunding Issue of 1989	11/01/89	7.060%	2022	16,600
Issue of 1991	04/01/91	7.053%	2031	72,450
Second Issue of 1991	11/01/91	6.623%	2032	98,400
Refunding Issue of 1992	02/01/92	6.435%	2028	63,110
Issue of 1992	04/15/92	6.559%	2032	49,200
Second Issue of 1992	07/15/92	6.114%	2033	69,600
Refunding Issue of 1993	04/15/93	5.880%	2024	80,230
Second Refunding Issue of 1993	12/01/93	5.297%	2030	142,375
Issue of 1994	07/01/94	6.338%	2035	50,000
Issue of 1995	05/15/95	6.111%	2025	49,500
Refunding Issue of 1998	10/15/98	4.689%	2035	235,730
			Total principal amount	978,625
			Unamortized debt-related costs	(11,853)
			Long-term debt due within one year	(18,720)
				$ 948,052

Long-term debt outstanding at June 30, 1999 consists of revenue bonds due serially in varying annual amounts through 2035. The revenue bonds generally are callable ten years after issuance. Scheduled annual principal maturities during the five fiscal years following June 30, 1999 are $19, $19, $21, $22 and $23 million, respectively. Revenue bonds are secured by the future revenues of the Water Services.

The Department has agreed to certain covenants with respect to bonded indebtedness. Significant covenants include the requirement that the Water Services net income, as defined, will be sufficient to pay certain amounts of future annual bond interest and of future annual aggregate bond interest and principal maturities.

Advance refunding bonds – During fiscal year 1999, the Water Services sold advance refunding bonds totaling approximately $236 million. This advance refunding will decrease its aggregate future debt service payments by approximately $59 million over the next 36 years and will result in an economic gain (the difference between the present values of the old and new debt service payments) of approximately $29 million.

During fiscal year 1999, bonds with a par value of $58 million were refunded using proceeds from the balance in the restricted escrow investments. The remaining escrow investments of $308 million (stated at fair value) will be used to refund bonds presently included in long-term debt at scheduled redemption dates as follows (amounts in thousands):

Bond Issues	Redemption Date	Principal Amount to be Redeemed
Issue of 1991	04/01/01	$ 69,600
Second Issue of 1991	11/01/01	81,400
Issue of 1992	04/15/02	40,700
Second Issue of 1992	07/15/02	53,100
Issue of 1994	07/01/04	38,400
Issue of 1995	05/15/05	29,120
		$ 312,320

The related advance refunding bonds will be reclassified to long-term debt at the time that the bonds to be refunded are called. Interest expense from refunding bonds and interest income earned on related escrow investments are included in Other Income and Expense.

Fair value – The fair value of long-term debt and advance refunding bonds is $994 and $897 million at June 30, 1999 and 1998, respectively. Management has estimated fair value based on the present value of interest and principal payments on the long-term debt and advance refunding bonds, discounted using current interest rates obtainable by the Department for debt of similar quality and maturities.

NOTE 4: STAFF REDUCTION PROGRAM

During fiscal year 1998, the Board of Water and Power Commissioners (the Board of Commissioners) approved the Staff Reduction Program (the SRP). The SRP was a voluntary program which offered monetary compensation or enhanced retirement benefits to employees during an acceptance period from June 1, 1998 to July 15, 1998. Employee acceptances during the enrollment period were as follows:

	Year Ended June 30, 1999	1998
Monetary benefits	284	438
Enhanced retirement	502	839
	786	1,277

The cost of monetary benefits offered under the SRP were recognized in the fiscal year employees elected to accept the package. The Department's total cost of monetary benefits offered under the SRP was $32 million, which included $12 million and $20 million related to employee acceptances in fiscal years 1999 and 1998, respectively. The Water Services included its $5 million share of these costs for each of the fiscal years 1999 and 1998 in Other operating expenses. The cost of enhanced retirement benefits related to the SRP is considered in the determination of future actuarially required contributions to the retirement plan (see Note 5).

NOTE 5: RETIREMENT, DISABILITY AND DEATH BENEFIT INSURANCE PLAN

The Department has a funded contributory retirement, disability and death benefit insurance plan covering substantially all of its employees. The Water and Power Employees' Retirement, Disability and Death Benefit Insurance Plan (the Plan) operates as a single-employer benefit plan to provide pension benefits to eligible Department employees and also to provide disability and death benefits from the respective insurance funds. Plan benefits are generally based on years of service, age at retirement and the employee's highest 12 consecutive months of salary before retirement. Active participants who joined the plan on or after June 1, 1984 are required to contribute 6% of their annual covered payroll. Participants who joined the plan prior to June 1, 1984 contribute an amount based upon an entry-age percentage rate. The Department contributes $1.10 for each $1.00 contributed by participants plus an actuarially determined percentage of covered payroll as determined by the Plan's independent actuary. The contributions are allocated between the Water Services and the Energy Services based on the current year labor costs.

The Retirement Board of Administration (the Retirement Board) is the administrator of the Plan. The Plan is subject to provisions of the Charter of the City of Los Angeles and the regulations and instructions of the Board of Commissioners. The Plan is an independent pension trust fund of the Department.

Plan amendments must be approved by both the Retirement Board and the Board of Commissioners. During March 1998, two amendments were made to the Plan. The amendments change the retirement age required to receive unreduced benefits with thirty years of service from 55 to 50 years of age, and provide participants with the option of purchasing other governmental service for purposes of enhancing benefits and eligibility for retirement. These amendments are considered in the determination of actuarially determined annual required contributions.

The Department's measurement, recognition and disclosure of pension information is in accordance with GASB Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers.*

The Water Services allocated share of annual pension cost (APC) and net pension obligation (NPO) consists of the following (amounts in millions):

	Year Ended June 30, 1999	1998
Annual required contribution	$ –	$ 8
Interest on net pension asset	(2)	(1)
Adjustment to annual required contribution	7	2
APC (including $2 and $3 million of amounts capitalized in fiscal 1999 and 1998, respectively)	5	9
Department contributions	(13)	(32)
Services performed by the Water Services benefitting the Energy Services (see Note 7)	(4)	(5)
Change in NPO (asset)	(12)	(28)
NPO (asset) at beginning of year	(36)	(8)
NPO (asset) at end of year	$ (48)	$ (36)

Annual required contributions are determined through actuarial valuations using the entry age normal actuarial cost method. The actuarial value of assets in excess of the Department's actuarial accrued liability (AAL) is being amortized by level contribution offsets over the period ending June 30, 2003. In accordance with actuarial valuations, the Department's required contribution rates are as follows:

Actuarial Valuation Date June 30	Normal Cost	Surplus Amortization	Contribution Rate
1998	9.64%	-13.39%	0.00%
1997	9.14%	-1.82%	7.32%

The significant actuarial assumptions for both valuations include an investment rate of return of 8%, projected inflation-adjusted salary increases of 5.5%, and postretirement benefit increases of 3%. The actuarial value of assets is determined using techniques that smooth the effects of short-term volatility in the market value of investments over a four-year period. Plan assets consist primarily of corporate and government bonds, common stocks, mortgage-backed securities and short-term investments.

Trend information for the current and two preceding fiscal years for the Water Services is as follows (amounts in millions):

Year Ended June 30	APC	Percentage of APC Contributed	NPO
1999	$ 5	285%	$ (48)
1998	$ 9	350%	$ (36)
1997	$ 26	108%	$ (8)

The following schedule represents required supplemental information and provides information about the Department's overall progress made in accumulating sufficient assets to pay benefits when due, prior to allocations to the Water Services and Energy Services (amounts in millions):

Actuarial Valuation Date June 30,	Actuarial Value of Assets	AAL	Actuarial Assets Over/(Under) AAL	Funded Ratio	Covered Payroll	Over/(Under) Funding as a % of Covered Payroll
1998	$ 4,514	$ 4,340	$ 174	104%	$ 355	49%
1997	$ 3,851	$ 3,812	$ 39	101%	$ 430	9%
1996	$ 3,400	$ 3,699	$ (299)	92%	$ 431	-69%

Disability and death benefits – The Water Services allocated share of disability and death benefit plan costs and administrative expenses totaled $4 million for each of the fiscal years 1999, 1998, and 1997.

NOTE 6: HEALTH CARE COSTS

The Department provides certain health care benefits to active and retired employees and their dependents. The total number of active and retired Department participants entitled to receive benefits was approximately 15,000 at June 30, 1999. The allocated cost to the Water Services of providing such benefits amounted to $22, $37, and $29 million for fiscal years 1999, 1998 and 1997, respectively. Of these costs, $7, $12, and $10 million were capitalized and the remainder was charged to expense for fiscal years 1999, 1998 and 1997, respectively.

Postretirement benefits – The Department accounts for postretirement benefits in accordance with Statement SFAS No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions,* which requires that the cost of postretirement benefits be recognized as expense over employees' service periods. In fiscal year 1999, the Department adopted SFAS No. 132, *Employers' Disclosures about Pensions and Other Postretirement Benefits – an amendment of FASB Statements No. 87, 88, and 106,* which revises the disclosure requirements of SFAS No. 106.

The Water Services allocated share of postretirement benefit costs is summarized as follows (amounts in millions):

	Year Ended June 30, 1999	1998	1997
Service cost	$ 2	$ 3	$ 2
Interest cost	7	7	7
Expected return on plan assets	(1)	(1)	–
Amortization of transition obligation	4	4	4
Curtailment loss	–	9	–
Special termination benefits	2	4	–
	$ 14	$ 26	$ 13

The funded status and the accrued benefit cost related to postretirement benefits for the Department, prior to allocations to the Water Services and the Energy Services, are summarized as follows (amounts in millions):

	June 30, 1999	1998
Change in benefit obligation:		
Benefit obligation at beginning of year	$ 454	$ 399
Service cost	8	11
Interest cost	30	30
Actuarial losses (gains)	37	(41)
Plan amendment	–	25
Curtailment loss	–	38
Special termination benefits	9	11
Benefits paid	(25)	(19)
	513	454
Change in fair value of plan assets:		
Fair value of plan assets at beginning of year	65	62
Actual return on plan assets	4	3
	69	65
Funded status	(444)	(389)
Unrecognized net loss (gain)	4	(33)
Unrecognized transition obligation	212	228
Unrecognized prior service cost	23	25
Accrued benefit cost	$(205)	$(169)
Water Services allocated share of accrued benefit cost	$ (57)	$ (46)

Weighted average actuarial assumptions used in determining postretirement benefit costs are as follows:

	1999	June 30, 1998	1997
Discount rate	7.25%	6.75%	7.50%
Expected return on plan assets	7.00%	7.00%	N/A

Plan assets consist primarily of short-term treasury obligations. No funding policy has been established for the future benefits to be provided under this plan.

For measurement purposes, a 7.5% annual rate of increase in the per capita cost of covered health care benefits was assumed for 1999; the rate was assumed to decrease gradually to 5.5% in 2004 and remain at that level thereafter. The effect of a 1% change in these assumed health care cost trend rates would increase or decrease the Department's total benefit obligation by approximately $64 million or $58 million, respectively. In addition, such a 1% change would increase or decrease the aggregate service and interest cost components of net periodic benefit cost by approximately $7 million or $6 million, respectively.

During fiscal year 1998, the Department implemented two changes in postretirement benefits to employees. The changes increase the subsidy rate applicable to retirees under age 65 with a spouse under age 65 and grant service credit years to employees and retirees with qualified service to other governmental organizations. These permanent changes resulted in a $25 million increase in the Department's accumulated postretirement benefit obligation at June 30, 1998. The Water Services allocated $6 million share of this increase will be amortized over the remaining average service period of approximately 12 years.

The Department recognized curtailment and termination charges of $49 million during fiscal year 1998 related to employees who accepted benefits under the SRP. During fiscal year 1999, the Department recognized termination charges of $9 million related to employees who resigned subsequent to June 30, 1998. The Water Services included its allocated share of these charges related to fiscal years 1999 and 1998 of $2 and $13 million, respectively, in postretirement benefit costs.

NOTE 7: SHARED OPERATING EXPENSES

The Water Services shares certain administrative functions with the Department's Energy Services. Generally, the costs of these functions are allocated on the basis of the benefits provided. Operating expenses shared with the Energy Services were $430, $440, and $522 million for fiscal years 1999, 1998 and 1997, respectively, of which $146, $143, and $184 million were allocated to the Water Services.

NOTE 8: COMMITMENTS AND CONTINGENCIES

Transfers to the reserve fund of the City of Los Angeles – Under the provisions of the City Charter, the Water Services transfers funds at its discretion to the reserve fund of the City. Pursuant to covenants contained in the bond indentures, the transfers may not be in excess of net income of the prior fiscal year. Such payments are not in lieu of taxes and are recorded as distributions of retained income.

The Department made payments of approximately $21 million in fiscal year 1999 from the Water Services to the reserve fund of the City, which included a transfer of $5 million authorized by the Board of Commissioners in June 1998. The Department expects to make a transfer declaration from the Water Services of approximately $22 million during fiscal year 2000.

Environmental matters

Surface Water Treatment Rule – The Department is subject to the State of California Surface Water Treatment Rule (SWTR) which increases filtration requirements at open distribution reservoirs. The Department has four major reservoirs subject to SWTR: Hollywood, Rowena, Lower Stone Canyon and Encino. The Department entered into an agreement with the State Department of Health Services establishing a timeline for SWTR compliance. Under the terms of this agreement, all four reservoirs are scheduled to be in compliance with the filtration requirements by the end of 2004.

As of June 30, 1999, the Department has incurred capital costs of approximately $135 million associated with SWTR compliance. These costs relate to engineering studies associated with all four reservoirs and construction costs for the Hollywood and Rowena reservoirs. As of June 30, 1999, management estimates that the total cost of compliance with SWTR will be approximately $300 million. The total estimated cost of compliance has decreased from the prior year as a result of revised plans for compliance at the Lower Stone Canyon and Encino reservoirs.

Owens Valley – During July 1997, the Great Basin Unified Air Pollution Control District (the District) adopted an initial State Implementation Plan and an implementing order requiring the Department to initiate pollution control measures to control particulate matters emitting from the Owens Lake bed. The Department disputed the remediation measures imposed by the original order; however, in July 1998, the Board of the District and the City Council approved a Memorandum of Agreement (MOA) resolving the level of control measures required.

Under the MOA, the City committed to providing control measures on the lake bed in a phased manner until the lake bed emissions are reduced to a level that complies with the requirements of the Federal Clean Air Act. In addition, the District agreed to adopt a revised State Implementation Plan (SIP) that would extend the period for the City to complete the installation of control measures until 2006, which is the deadline currently required by the Clean Air Act. In November 1998, the District approved the revised SIP, which incorporated the provisions of the MOA. The SIP was subsequently approved by the California Air Resources Board and ultimately by the United States Environmental Protection Agency in August 1999. The SIP anticipates that the City will have control measures in place over a minimum of 22.5 miles of the lake bed by 2006. It is estimated that about 40,000 acre feet of water will be required on an annual basis to operate the pollution control facilities. The current plan assumes that a portion of this water will be obtained from the local sub-potable groundwater basin, however, the actual quantity available will not be known until additional studies are completed.

Based on the current plan, management estimates that the cost of implementing the pollution control measures through 2006 will be approximately $120 million; however, the cost estimate may change as additional information becomes available. The SIP also provides that the District shall develop a new SIP in 2003 to incorporate actual experience and to revise the schedule and plan as necessary to meet the air quality standards.

Litigation

A number of claims and suits are pending against the Department for alleged damages to persons and property and for other alleged liabilities arising out of its operations. In the opinion of management, any ultimate liability which may arise from these actions will not materially affect the Water Services financial position as of June 30, 1999.

Risk management

The Water Services is subject to certain business risks common to the utility industry. The majority of these risks are mitigated by external insurance coverage obtained by the Water Services. For other significant business risks, however, the Water Services has elected to self-insure. It is management's belief that exposure to loss arising out of self-insured business risks will not materially affect the Water Services financial position as of June 30, 1999.

Credit risk

Financial instruments which potentially expose the Department to concentrations of credit risk consist primarily of trade accounts receivable. The Department's customer base is concentrated among commercial, industrial, residential and governmental customers located within the City. Although the Department is directly affected by the City's economy, management does not believe significant credit risk exists at June 30, 1999 except as provided in the allowance for losses. The Department manages its credit exposure by requiring deposits from certain customers and through procedures designed to identify and monitor credit risk.

NOTE 9: SUBSEQUENT EVENT

On October 15, 1999, the Department issued revenue bonds with principal amount of approximately $100 million. The bonds were issued for the purpose of Water Services additions to, betterments of and replacements of physical plant.

Report of Independent Accountants on Required Supplementary Information

To the Board of Water and Power Commissioners
Department of Water and Power
City of Los Angeles

Our report on the audits of the financial statements of the Water System (Water Services) of the Department of Water and Power of the City of Los Angeles as of June 30, 1999 and 1998, and for each of the three years in the period ended June 30, 1999, is presented in the first section of this document. Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The year 2000 supplementary information is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board, and we did not audit and do not express an opinion on such information. Further, we were unable to apply to the information certain procedures prescribed by professional standards because the disclosure criteria specified by Technical Bulletin 98-1, as amended, are not sufficiently specific and, therefore, preclude the prescribed procedures from providing meaningful results. In addition, we do not provide assurance that the Department is or will become year 2000 compliant, that the Department's year 2000 remediation efforts will be successful in whole or in part, or that parties with which the Department does business are or will become year 2000 compliant.

PricewaterhouseCoopers LLP　　Simpson & Simpson

September 15, 1999

YEAR 2000 COMPLIANCE (UNAUDITED)

The year 2000 issue refers to the fact that many computer programs use only the last two digits to refer to a year; therefore, both 1900 and 2000 would be referred to as "00." Computer programs must be adjusted to differentiate between the two years or the programs will fail or create errors. Also, some programs may not be able to recognize that 2000 is a leap year. Further, the year 2000 issue could affect equipment, such as environmental systems, elevators, and vehicles, containing computer chips that have date recognition features.

During fiscal year 1996, the Department initiated a year 2000 compliance project (the Year 2000 Project). An executive-level manager was assigned to oversee the Year 2000 Project and the services of year 2000 consultants were obtained. The scope of the Year 2000 Project includes the Department's traditional mainframe-based application software, mid-range and personal computer platforms, and systems with embedded microprocessors. In addition to the systems that directly affect the delivery of water and power to customers, the project scope also includes non-utility systems such as building elevators, lighting, telephones, and ventilation. The Year 2000 Project includes the following stages of work: inventory, assessment, remediation, testing and implementation.

The Department has completed all stages of this process with respect to its mission-critical systems and as of June 30, 1999, management believes that all systems necessary to deliver water and power services to customers are year 2000 ready. The Department has incurred approximately $45 million on the Year 2000 Project through June 30, 1999.

The Year 2000 Project also includes a contingency component that will provide for alternative methods of conducting business, if necessary. The contingency plan covers the mission-critical functions necessary to deliver water and power services to customers. The contingency plans were approved by Department management during fiscal year 1999.

The Department is in the process of evaluating the year 2000 progress of its major vendors and suppliers. Based on the results of these evaluations, the Department may prepare supplemental contingency plans to address any additional year 2000 concerns.

Although management believes that it is taking necessary steps to prepare for the year 2000, it cannot guarantee that the Department or others will not experience year 2000 problems. Also, since the operations of the Department are dependent upon the systems of other organizations with whom the Department conducts business, the failure by these other organizations to become year 2000 compliant on a timely basis could have an adverse effect on the Department's operations.

Report of Independent Accountants

To the Board of Water and Power Commissioners
Department of Water and Power
City of Los Angeles

In our opinion, the accompanying balance sheets and the related statements of income, of retained income reinvested in the business and of cash flows present fairly, in all material respects, the financial position of the Power System (Energy Services) of the Department of Water and Power of the City of Los Angeles at June 30, 1999 and 1998, and the results of its operations and its cash flows for each of the three years in the period ended June 30, 1999 in conformity with generally accepted accounting principles. These financial statements are the responsibility of the Department's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with generally accepted auditing standards, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

PricewaterhouseCoopers LLP   Simpson & Simpson

September 15, 1999, except as to Note 13, which is as of December 21, 1999

Energy Services Balance Sheet

(Amounts in thousands)	June 30, 1999	1998
ASSETS		
Utility Plant		
Generation	$ 2,425,760	$ 2,327,186
Transmission	773,413	769,077
Distribution	3,351,081	3,219,453
General	796,680	806,013
	7,346,934	7,121,729
Accumulated depreciation	3,106,132	2,869,554
	4,240,802	4,252,175
Construction work in progress	103,280	200,210
Nuclear fuel, at amortized cost	11,562	12,088
	4,355,644	4,464,473
Restricted and Trust Fund Investments	1,755,163	1,440,031
Current Assets		
Cash and cash equivalents	288,189	256,257
Cash collateral received from securities lending transactions	92,434	85,175
Customer and other accounts receivable, net of $14,500 and $11,900 allowance for losses	241,553	208,526
Accrued unbilled revenue	96,907	102,676
Materials and fuel, at average cost	94,135	95,157
Prepayments and other current assets	25,765	6,958
	838,983	754,749
Net Pension Asset	107,670	82,912
	$ 7,057,460	$ 6,742,165
CAPITALIZATION AND LIABILITIES		
Equity		
Retained income reinvested in the business	$ 2,473,488	$ 2,269,546
Contributions in aid of construction	280,792	262,654
	2,754,280	2,532,200
Long-term Debt	2,638,936	2,511,897
Advance Refunding Bonds	858,255	952,674
	6,251,471	5,996,771
Current Liabilities		
Debt due within one year	136,685	139,760
Accrued interest	54,236	55,699
Accrued employee expenses	39,248	39,744
Accounts payable and accrued expenses	121,828	166,619
Due to Water Services	2,208	10,278
Obligations under securities lending transactions	92,434	85,175
	446,639	497,275
Accrued Postretirement Liability	148,520	123,261
Deferred Credits	210,830	124,858
Commitments and Contingencies (Note 12)	–	–
	$ 7,057,460	$ 6,742,165

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

Energy Services Statement of Income

(Amounts in thousands)	1999	Year Ended June 30, 1998	1997
Operating Revenues			
Residential	$ 633,633	$ 625,696	$ 599,914
Commercial and industrial	1,333,868	1,327,864	1,303,665
Other	235,863	119,094	113,487
Regulatory gain from rate restructuring	–	90,262	–
	2,203,364	2,162,916	2,017,066
Operating Expenses			
Fuel for generation	213,030	158,705	156,427
Purchased power	797,743	770,507	751,380
Other operating expenses	378,398	396,092	375,481
Maintenance	142,748	168,352	188,633
Depreciation	257,072	245,117	239,693
	1,788,991	1,738,773	1,711,614
Operating Income	414,373	424,143	305,452
Other Income and Expenses, net	57,598	69,597	33,189
	471,971	493,740	338,641
Debt Expenses			
Interest on debt	162,644	168,532	179,527
Allowance for funds used during construction	(2,761)	(2,899)	(4,414)
	159,883	165,633	175,113
Net Income	$ 312,088	$ 328,107	$ 163,528

Statement of Retained Income Reinvested in the Business

(Amounts in thousands)	1999	Year Ended June 30, 1998	1997
Balance at beginning of year	$2,269,546	$2,021,878	$1,955,693
Net income for the year	312,088	328,107	163,528
Less – Transfers to the reserve fund of the City of Los Angeles	108,146	80,439	97,343
Balance at end of year	$2,473,488	$2,269,546	$2,021,878

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

Energy Services Statement of Cash Flows

(Amounts in thousands)	1999	Year Ended June 30, 1998	1997
Cash Flows from Operating Activities:			
Operating income	$ 414,373	$ 424,143	$ 305,452
Adjustments to reconcile operating income to net cash provided by operating activities:			
Depreciation	257,072	245,117	239,693
Amortization of nuclear fuel	6,458	6,835	7,500
Provision for losses on customer and other accounts receivable	16,763	14,581	16,873
Other	15,831	9,839	7,098
Changes in assets and liabilities:			
Customer and other accounts receivable	(50,259)	(30,216)	(19,726)
Net pension asset	(24,758)	(60,361)	(4,448)
Accounts payable and accrued expenses	(44,791)	44,256	7,552
Overrecovered energy costs	–	(130,192)	30,341
Deferred credits	85,972	93,410	(1,822)
Accrued postretirement liability	25,259	62,153	(21,518)
Other	(20,582)	4,617	17,642
	681,338	684,182	584,637
Cash Flows from Noncapital Financing Activities:			
Payments to the reserve fund of the City of Los Angeles	(108,146)	(89,300)	(97,343)
Cash Flows from Capital and Related Financing Activities:			
Additions to plant and equipment, net	(151,940)	(144,560)	(201,706)
Contributions in aid of construction	18,138	18,580	18,813
Purchases of escrow investments	–	(227,447)	(161,755)
Proceeds from escrow investment maturities	117,019	509,573	38,467
Principal payments and maturities on long-term debt, net	(150,455)	(485,763)	(99,908)
Issuance of revenue bonds and revenue certificates	180,000	136,400	162,100
Debt interest payments	(213,595)	(231,188)	(181,470)
	(200,833)	(424,405)	(425,459)
Cash Flows from Investing Activities:			
Purchases of investment securities	(1,852,273)	(1,246,506)	(185,651)
Proceeds from maturities of investment securities	1,436,041	952,207	35,753
Cash collateral received under securities lending transactions	(7,259)	10,542	95,717
Obligations under securities lending transactions	7,259	(10,542)	(95,717)
Investment income	75,805	98,024	27,115
	(340,427)	(196,275)	(122,783)
Cash and Cash Equivalents:			
Net increase (decrease)	31,932	(25,798)	(60,948)
Beginning of year	256,257	282,055	343,003
	$ 288,189	$ 256,257	$ 282,055

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

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Department of Water and Power of the City of Los Angeles (the Department) exists as a separate proprietary agency of the City of Los Angeles (the City) under and by virtue of the City Charter enacted in 1925. The Department's Energy Services is responsible for the generation, transmission and distribution of electric power for sale in the City.

Method of accounting – The accounting records of the Energy Services are maintained in accordance with generally accepted accounting principles applicable to governmental utilities. The Department applies all statements issued by the Governmental Accounting Standards Board (GASB) and all statements and interpretations issued by the Financial Accounting Standards Board (FASB) which are not in conflict with statements issued by the GASB. The accounting records generally follow the Uniform System of Accounts for Public Utilities and Licensees prescribed by the Federal Energy Regulatory Commission (FERC) and the California Public Utilities Commission (CPUC), except for the method of accounting for contributions in aid of construction described below.

The Department's rates are subject to review and approval by the City Council. As a regulated enterprise, the Department's financial statements are prepared in accordance with Statement of Financial Accounting Standards (SFAS) No. 71, *Accounting for the Effects of Certain Types of Regulation,* which requires that the effects of the ratemaking process be recorded in the financial statements. Such effects primarily concern the time at which various items enter into the determination of net income in order to follow the principle of matching costs and revenues. Accordingly, the Energy Services records various regulatory assets and liabilities to reflect the regulator's actions. Management believes that the Energy Services meets the criteria for continued application of SFAS No. 71, but will continue to evaluate its applicability based on changes in the regulatory and competitive environment (see Note 2).

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

Utility plant – The costs of additions to utility plant and replacements of retired units of property are capitalized. Costs include labor, materials, an allowance for funds used during construction (AFUDC), and allocated indirect charges such as engineering, supervision, transportation and construction equipment, retirement plan contributions, health care costs, and certain administrative and general expenses. The costs of maintenance, repairs and minor replacements are charged to the appropriate operations and maintenance expense accounts. The original cost of property retired, plus removal cost, less salvage, is charged to accumulated depreciation.

Depreciation – Depreciation expense is computed using the straight-line method based on service lives for all projects completed after July 1, 1973, and for all office and shop structures, related furniture and equipment, and transportation and construction equipment. Depreciation for facilities completed prior to July 1, 1973 is computed using the 5% sinking fund method based on estimated service lives. Estimated service lives range from 5 to 75 years. Depreciation expense as a percentage of average depreciable utility plant in service was 3.8%, 3.7% and 3.7% for fiscal years 1999, 1998 and 1997, respectively.

Nuclear decommissioning – The Department owns a 5.7% direct ownership interest in the Palo Verde Nuclear Generating Station (PVNGS). In addition, through its participation in the Southern California Public Power Authority (SCPPA), the Department owns an additional indirect interest of 3.95%. Costs associated with the Department's indirect interest are included in purchased power expense (see Note 4).

Decommissioning of PVNGS is expected to commence subsequent to the year 2024. The total cost to decommission the Department's direct ownership interest in PVNGS is estimated to be $101 million in 1998 dollars. This estimate is based on an updated site specific study prepared by an independent consultant in 1998. The Department is providing for its direct share of the estimated future decommissioning costs over the remaining life of the nuclear power plant through annual charges included in depreciation expense which amounted to $11 million for each of the fiscal years 1999, 1998 and 1997.

The Department contributes to external trusts established in accordance with the Arizona Nuclear Power Plant participation agreement and the Nuclear Regulatory Commission requirements. As of June 30, 1999, decommissioning funds totaled approximately $69 million (see Note 5).

Nuclear fuel – Nuclear fuel is amortized and charged to fuel for generation on the basis of actual thermal energy produced relative to total thermal energy expected to be produced over the life of the fuel. Under the provisions of the Nuclear Waste Policy Act of 1982, the federal government assumed responsibility for the future disposal of spent nuclear fuel and assesses each utility with nuclear operations, including the Department, $1 per megawatt hour of nuclear generation to fund this future disposal. The Department includes this charge as a current year expense (see Note 12).

Cash and cash equivalents – The Department's cash is deposited with the City Treasurer in the City's general investment pool. The City Treasurer invests available funds of the City and its independent operating departments on a combined basis. At June 30, 1999 and 1998, cash and cash equivalents includes $35 and $60 million, respectively, of internally-designated balances relating to bond redemption and interest funds and a self-insurance fund. In addition, at June 30, 1999, the cash and cash equivalents balance includes $108 million of funds restricted by bond indenture for use in construction. The Department considers all unrestricted investments with an original maturity of three months or less to be cash equivalents.

Contributions in aid of construction – Under the provisions of the City Charter, amounts received from customers and others for constructing utility plant are combined with retained income reinvested in the business and represent equity for purposes of computing the Energy Services borrowing limits. Accordingly, contributions in aid of construction are shown in the accompanying balance sheet as a component of equity.

Revenues – The Energy Services rates are established by a rate ordinance which is approved by the City Council. The Energy Services sells energy to other City departments at rates provided in the ordinance. The Energy Services recognizes energy costs in the period incurred and accrues for estimated energy sold but not yet billed.

Debt expenses – Debt premium, discount and issue expenses are deferred and amortized to expense over the lives of the related debt issues. Losses on refundings related to bonds redeemed by advance refunding bonds are amortized over the shorter of the life of the advance refunding bonds or the remaining term of the bonds refunded.

Allowance for funds used during construction – Allowance for funds used during construction represents the cost of borrowed funds used for the construction of utility plant. Capitalized AFUDC is included as part of the cost of utility plant and as a reduction of debt expenses. The average AFUDC rate was 6.0% in each of the fiscal years 1999, 1998 and 1997.

Restricted investments – The Department accounts for cash and cash equivalents and restricted investments in accordance with GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools,* which requires that investments be reported at fair value. All investment income, including changes in fair value, is included in other income and expense, net (see Note 5).

New accounting standards – In November 1998, the Emerging Issues Task Force (EITF) of the FASB reached a consensus related to the accounting for energy trading activities. In accordance with EITF 98-10, energy trading contracts must be marked to market with the gains and losses included in earnings and separately disclosed in the financial statements. The Department adopted this guidance as required on July 1, 1999. The Department purchases and sells electricity but does not currently engage in the types of activities defined in EITF 98-10 as energy trading; therefore, adoption of this statement is not expected to have an impact on the Energy Services financial statements.

In June 1998, the FASB issued SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities.* This statement, as amended, is effective for fiscal years beginning after June 15, 2000. SFAS No. 133 requires companies to record derivatives on the balance sheet as assets and liabilities, measured at fair value. Gains and losses resulting from changes in the value of these derivatives would be reported in income or other comprehensive income, depending on the use of the derivative and whether it qualifies for hedge accounting. The Department has not determined the impact that adoption of this statement will have on the Energy Services financial statements.

Reclassification – Certain financial statement items for prior years have been reclassified to conform to the current year presentation.

NOTE 2: REGULATORY MATTERS

Effective May 1, 1998, the City Council approved a new rate ordinance for the Energy Services. The previous rate ordinance included an energy cost adjustment factor (ECAF) designed to permit the full recovery of current and future energy costs, funding requirements of nuclear plant decommissioning costs and the costs of funding certain conservation programs intended to reduce current and future energy consumption. The new rate ordinance froze the ECAF at the rate in effect as of October 1, 1997. Management believes the frozen rates are adequate to cover future associated costs.

Regulatory Gain from Rate Restructuring – Under the previous rate ordinance, the Department estimated recoverable costs to establish the energy cost component of customer billings and any difference between billed and actual costs was deferred and recorded as a regulatory liability. The Department is no longer required to defer and offset these amounts in future billings; therefore, overrecovered costs of $90 million were recognized as a regulatory gain on May 1, 1998. In accordance with the new ordinance, the Department transferred a related amount of cash to the debt reduction trust funds.

Deferred Credits – On January 2, 1991, pursuant to a City Rate Ordinance, the Department established an energy cost stabilization account with surplus construction funds received from the Intermountain Power Agency. These funds were used at the discretion of management to reduce purchased power costs. In accordance with the new rate ordinance, on May 1, 1998 the remaining balance of $31 million was transferred from the energy cost stabilization account to the debt reduction trust funds. The related regulatory liability was recognized as an offset to purchased power expense.

The Department's current rates include amounts designated for the precollection of out-of-market future purchased power costs. These amounts are included in deferred credits and will be recognized as revenue when the related purchased power expense is incurred. At June 30, 1999 and 1998, deferred credits includes $185 and $114 million, respectively, related to precollected purchased power costs.

Deregulation

Effective April 1, 1998, competition was introduced to California's electric utility market and customers of the state's investor-owned utilities (IOUs) became eligible for direct access. The implementation of competition in accordance with Assembly Bill 1890 (AB 1890) resulted in significant structural changes to the electric power industry, including mandated direct access for IOU customers, energy sales through a Power Exchange, management of transmission assets through an Independent System Operator (ISO), and recovery of stranded investment through the assessment of a non-bypassable competition transition charge (CTC).

AB 1890 applies to the state's IOUs and generally does not compel participation by publicly-owned utilities such as the Department; however, publicly-owned utilities that do not begin the phase in of direct access and participation in the ISO by March 31, 2000 will not be entitled to recovery of stranded costs through the state legislated CTC.

If the Department adopts direct access, it is likely that its generation business will no longer qualify for accounting under SFAS No. 71. Management has evaluated its generation assets and the potential stranded investment that would arise in the event of offering direct access to customers and consequently ceasing to apply SFAS No. 71 to this portion of the business. Management estimates that the Department's total stranded costs and obligations, including obligations related to its purchased power contracts, is between approximately $3.0 and $3.5 billion, depending on the assumed market price of energy. Differences between the assumed market price of energy and actual prices in the future competitive market could result in material changes to the above estimate of stranded costs and obligations. The Department has approximately $815 million in debt reduction trust funds at June 30, 1999, which are expected to be used to reduce stranded costs.

Management is considering the issues involved with the decision to participate in direct access and the ISO; however, no definitive plan for deregulation has been adopted as of June 30, 1999. Management has implemented debt and cost reduction programs in order to reduce stranded costs absent a state-mandated CTC; however, management cannot ensure that these programs will mitigate stranded costs if the Department chooses to offer a direct access program to its customers.

Public benefits – AB 1890 also requires publicly-owned utilities to levy a non-bypassable public benefits charge to all customers effective January 1, 1998. These funds must be used for qualifying public benefits programs, including: cost-effective demand-side management services to promote energy-efficiency and energy conservation; new investment in renewable energy resources and technologies consistent with existing statutes and regulations which promote those resources and technologies; research, development and demonstration programs for the public interest to advance science or technology which is not adequately provided by competitive and regulated markets; or, services provided for low-income electricity customers, including but not limited to, targeted energy efficiency service and rate discounts.

In accordance with this requirement, 2.85% of the Department's retail revenue is designated for use for qualifying public benefits programs. Any difference between amounts collected from customers and costs incurred under qualifying programs is deferred as part of deferred credits and will be recognized as revenue when the related costs are incurred. At June 30, 1999, deferred credits includes $12 million of deferred public benefits collections.

NOTE 3: JOINTLY-OWNED UTILITY PLANT

The Energy Services has undivided interests in several electric generating stations and transmission systems which are jointly-owned with other utilities. Each project participant is responsible for financing its share of construction and operating costs. The Energy Services ownership interest in each jointly-owned utility plant as of June 30, 1999 is as follows (amounts in millions, except as indicated):

			Plant in Service		
	Ownership Interest	Share of Capacity (MW)	Cost	Accummulated Depreciation	Construction Work in Progress
Palo Verde Nuclear Generating Station	5.7%	217	$ 512	$ 172	$ –
Navajo Generating Station	21.2%	477	204	135	2
Mohave Generating Station	20.0%	316	121	65	–
Pacific Intertie DC Transmission Line	40.0%	1240	188	48	12
Other transmission systems	Various		76	31	–
			$ 1,101	$ 451	$ 14

The Energy Services will incur certain minimum operating costs related to the jointly-owned facilities, regardless of the amount or its ability to take delivery of its share of energy generated. The Energy Services proportionate share of the operating costs of the joint plants is included in the corresponding categories of operating expenses.

NOTE 4: PURCHASED POWER COMMITMENTS
The Department has entered into a number of energy and transmission service contracts which involve substantial commitments, scheduled to expire from 2027 to 2030, as follows (amounts in millions, except as indicated):

			Department Share of Interest held by Agency			
	Agency	Agency Share	Interest	Capacity (MW)	Debt Outstanding	Commitment Expiration Date
Intermountain Power Project	IPA	100.0%	66.8%	1,068	$ 2,168	2027
Palo Verde Nuclear Generating Station	SCPPA	5.9%	67.0%	151	$ 506	2030
Mead-Adelanto Project	SCPPA	67.9%	35.7%	291	$ 89	2030
Mead-Phoenix Project	SCPPA	17.8%-22.4%	24.8%	148	$ 20	2030
Southern Transmission System	SCPPA	100.0%	59.5%	1,142	$ 527	2027

IPA: The Intermountain Power Agency is an Agency of the State of Utah established to own, acquire, construct, operate, maintain, and repair the Intermountain Power Project (IPP). The Energy Services serves as the Project Manager and Operating Agent of IPP.

SCPPA: The Southern California Public Power Authority, a California Joint Powers Agency.

Note: SCPPA's interest in the Mead-Phoenix Project includes three components.

The above agreements require the Energy Services to make certain minimum payments, which are based mainly upon debt service requirements. In addition to fixed charges of approximately $360 million in each of the next five years, the Department is required to pay for operating and maintenance costs related to actual deliveries of energy under these agreements (approximately $205 million in each of the next five years). The Department made total payments under these agreements of approximately $610, $620, and $570 million in fiscal years 1999, 1998 and 1997, respectively.

Energy Entitlement – The Department also has a contract through 2017 with the U.S. Department of Energy for the purchase of available energy generated at the Hoover Power Plant. The Department's share of capacity at Hoover is approximately 500 megawatts. The cost of power purchased under this contract was $12, $10, and $11 million in fiscal years 1999, 1998 and 1997, respectively.

NOTE 5: RESTRICTED AND TRUST FUND INVESTMENTS
A summary of the Energy Services restricted and trust fund investments is as follows (amounts in millions):

	June 30, 1999	June 30, 1998
Escrow investments	$ 871	$ 963
Debt reduction trust funds	815	420
Nuclear decommissioning trust funds	69	57
	$ 1,755	$ 1,440

All restricted and trust funds are held in accounts to be used for a designated purpose as follows:

Escrow investments – Escrow investments are held to call specified revenue bonds at scheduled maturity dates.

Debt reduction trust funds – The debt reduction trust funds were established during fiscal year 1997 to provide for the payment of principal and interest on long-term debt obligations and purchased power obligations arising from the Department's participation in the Intermountain Power Project and the Southern California Public Power Authority (see Note 4). Purchased power precollections are transferred to these accounts as amounts are collected from customers; funds from operations also may be transferred by management as funds become available.

Nuclear decommissioning trust funds – Nuclear decommissioning trust funds will be used to pay the Department's share of decommissioning the Palo Verde Nuclear Generating Station at the end of its useful life.

NOTE 6: SECURITIES LENDING TRANSACTIONS

The City Treasurer's investment policy for its general investment pool (the Pool) includes a securities lending program (the Program) which was approved by the City Council on October 28, 1991. The City's custodial bank serves as the securities lending agent and indemnifies the City from losses incurred as a result of its operational failure, its failure to carry out adequate credit analysis and/or insufficient collateralization of the loaned securities. The City does not have the ability to pledge or sell collateral assets unless the borrower is in default of its obligation.

Under the Program, up to 60% of the par value of pooled investments are available for loan on a short-term basis. Collateral, which is limited to cash, U.S. Treasury certificates and non-callable U.S. Government Agency securities, must be at least equal to 102% of the market value of the loaned securities as of the loan initiation date; in addition, matched maturities, which include investments associated with term loans and overnight investments associated with open loans, must represent at least 75% of securities loaned under the Program.

The Department recognizes its proportionate share of the cash collateral received for securities loaned and the related obligation. At June 30, 1999, management believes that there is no credit risk exposure for the Department because the amounts owed to the borrowers by the Pool exceed the amounts the borrowers owe to the Pool.

NOTE 7: LONG-TERM DEBT AND ADVANCE REFUNDING BONDS

Long-term debt and advance refunding bonds consist of the following at June 30, 1999 (amounts in thousands):

Bond Issues	Date of Issue	Effective Interest Rate	Fiscal Year of Last Scheduled Maturity	Principal Outstanding
Third Issue of 1971	11/01/71	4.859%	2012	$ 21,450
Issue of 1972	03/15/72	5.293%	2012	16,900
Third Issue of 1972	10/15/72	5.232%	2013	23,100
Issue of 1973	02/15/73	5.252%	2013	23,100
Second Issue of 1973	06/01/73	5.298%	2013	21,980
Second Issue of 1977	12/15/77	5.792%	2018	27,200
Refunding Issue of 1989	10/15/89	7.358%	2026	73,770
Second Issue of 1989	12/15/89	6.970%	2030	142,200
Issue of 1990	05/15/90	7.172%	2030	94,400
Second Issue of 1990	09/15/90	7.318%	2031	95,200
Issue of 1991	01/15/91	7.179%	2031	144,900
Second Issue of 1991	06/01/91	6.821%	2031	96,600
Third Issue of 1991	10/01/91	6.684%	2032	147,600
Refunding Issue of 1992	02/01/92	6.398%	2028	160,255
Issue of 1992	04/01/92	6.687%	2032	147,600
Second Issue of 1992	08/15/92	6.083%	2033	124,300
Issue of 1993	01/15/93	6.222%	2033	198,800
Refunding Issue of 1993	04/15/93	5.824%	2031	579,465
Second Issue of 1993	10/15/93	5.210%	2034	125,000
Second Refunding Issue of 1993	11/15/93	5.424%	2032	596,920
Refunding Issue of 1994	02/01/94	4.779%	2019	157,405
Issue of 1994	02/01/94	5.284%	2034	85,000
Issue of 1999	06/15/99	5.445%	2029	180,000
			Total principal amount	3,283,145
			Revenue certificates	388,500
			Unamortized debt-related costs	(37,769)
			Debt due within one year (including current portion of revenue certificates)	(136,685)
				$ 3,497,191

Long-term debt outstanding at June 30, 1999 consists of revenue bonds due serially in varying annual amounts through 2034. The revenue bonds generally are callable ten years after issuance. Scheduled annual principal maturities during the five years following June 30, 1999 are $57, $69, $77, $79 and $84 million, respectively. Revenue bonds are secured by the future revenues of the Energy Services.

The Department has agreed to certain covenants with respect to bonded indebtedness. Significant covenants include the requirement that the Energy Services net income, as defined, will be sufficient to pay certain amounts of future annual bond interest and of future annual aggregate bond interest and principal maturities.

Advance refunding bonds – During fiscal year 1999, bonds with a par value of $93 million were refunded using proceeds from the balance in the restricted escrow investments. The remaining escrow investments of $871 million (stated at fair value) will be used to refund bonds presently included in long-term debt at scheduled redemption dates as follows (amounts in thousands):

Bond Issues	**Redemption Date**	**Principal Amount to be Redeemed**
Refunding Issue of 1989	09/01/99	$ 71,300
Second Issue of 1989	12/15/99	139,200
Issue of 1990	05/15/00	92,400
Second Issue of 1990	09/15/00	91,400
Issue of 1991	01/15/01	139,200
Second Issue of 1991	06/01/01	77,000
Third Issue of 1991	10/01/01	122,100
Issue of 1992	04/01/02	118,200
		$ 850,800

The related advance refunding bonds will be reclassified to long-term debt at the time that the bonds to be refunded are called. Interest expense from refunding bonds and interest income earned on related escrow investments are included in other income and expense.

Revenue certificates – As of June 30, 1999, the Department has outstanding commercial paper of $389 million bearing interest at an average rate of 3.0%. The commercial paper matures not more than 108 days from the date of issuance. The Department intends and has the ability to refinance $309 million of the outstanding revenue certificates upon their maturity and, therefore, has included this portion of the balance outstanding in long-term debt at June 30, 1999. The commercial paper is an unsecured obligation of the Department.

Letters of credit – During fiscal year 1997, the Department arranged a $432 million multi-year letter of credit, including a component for accrued interest, with two financial institutions. The letter of credit is available for refinancing amounts outstanding under the commercial paper program and may be utilized on a revolving basis. In June 1999, the Department notified the financial institutions of its intent to phase out the existing letter of credit through November 1999.

Effective September 1, 1999, the Department entered into a new letter of credit and reimbursement agreement (the Agreement) with a commercial banking syndicate in the amount of $400 million to provide liquidity and credit support for the Department's commercial paper program. The Agreement secures the payment when due of the principal and interest on commercial paper issued on or subsequent to September 1, 1999. Drawings on the Agreement will represent advances to the Department and will bear interest that is payable monthly at the Federal Funds Rate plus 0.50% or an adjusted LIBOR rate, as defined. The unpaid principal of each advance is payable in ten equal semi-annual installments, commencing on the date six months after the advance. The Agreement terminates on August 31, 2002, unless extended.

Fair value – The fair value of long-term debt and advance refunding bonds is $3.37 and $3.43 billion at June 30, 1999 and 1998, respectively. Management has estimated fair value based on the present value of interest and principal payments on the long-term debt and advance refunding bonds, discounted using current interest rates obtainable by the Department for debt of similar quality and maturities.

The carrying amount of revenue certificates of $389 million at June 30, 1999 and 1998 approximates fair value due to the short maturities of these instruments.

NOTE 8: STAFF REDUCTION PROGRAM

During fiscal year 1998, the Board of Water and Power Commissioners (the Board of Commissioners) approved the Staff Reduction Program (the SRP). The SRP was a voluntary program which offered monetary compensation or enhanced retirement benefits to employees during an acceptance period from June 1, 1998 to July 15, 1998.

Employee acceptances during the enrollment period were as follows:

	Year Ended June 30,	
	1999	**1998**
Monetary benefits	284	438
Enhanced retirement	502	839
	786	1,277

The cost of monetary benefits offered under the SRP were recognized in the fiscal year employees elected to accept the package. The Department's total cost of monetary benefits offered under the SRP was $32 million, which included $12 million and $20 million related to employee acceptances in fiscal years 1999 and 1998, respectively. The Energy Services included its $7 million and $15 million share of these costs for fiscal years 1999 and 1998, respectively, in other operating expenses. The cost of enhanced retirement benefits related to the SRP is considered in the determination of future actuarially required contributions to the retirement plan (see Note 9).

NOTE 9: RETIREMENT, DISABILITY AND DEATH BENEFIT INSURANCE PLAN

The Department has a funded contributory retirement, disability and death benefit insurance plan covering substantially all of its employees. The Water and Power Employees' Retirement, Disability and Death Benefit Insurance Plan (the Plan) operates as a single-employer benefit plan to provide pension benefits to eligible Department employees and also to provide disability and death benefits from the respective insurance funds. Plan benefits are generally based on years of service, age at retirement and the employee's highest 12 consecutive months of salary before retirement. Active participants who joined the plan on or after June 1, 1984 are required to contribute 6% of their annual covered payroll. Participants who joined the plan prior to June 1, 1984 contribute an amount based upon an entry-age percentage rate. The Department contributes $1.10 for each $1.00 contributed by participants plus an actuarially determined percentage of covered payroll as determined by the Plan's independent actuary. The contributions are allocated between the Energy Services and the Water Services based on the current year labor costs.

The Retirement Board of Administration (the Retirement Board) is the administrator of the Plan. The Plan is subject to provisions of the Charter of the City of Los Angeles and the regulations and instructions of the Board of Commissioners. The Plan is an independent pension trust fund of the Department.

Plan amendments must be approved by both the Retirement Board and the Board of Commissioners. During March 1998, two amendments were made to the Plan. The amendments change the retirement age required to receive unreduced benefits with thirty years of service from 55 to 50 years of age, and provide participants with the option of purchasing other governmental service for purposes of enhancing benefits and eligibility for retirement. These amendments are considered in the determination of actuarially determined annual required contributions.

The Department's measurement, recognition and disclosure of pension information is in accordance with GASB Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers.*

The Energy Services allocated share of annual pension cost (APC) and net pension obligation (NPO) consists of the following (amounts in millions):

	Year Ended June 30, 1999	1998
Annual required contribution	$ –	$ 23
Interest on net pension asset	(6)	(2)
Adjustment to annual required contribution	21	5
APC (including $3 and $5 million of amounts capitalized in fiscal years 1999 and 1998, respectively)	15	26
Department contributions	(44)	(92)
Services performed by the Water Services benefitting the Energy Services (see Note 11)	4	5
Change in NPO (asset)	(25)	(61)
NPO (asset) at beginning of year	(83)	(22)
NPO (asset) at end of year	$(108)	$ (83)

Annual required contributions are determined through actuarial valuations using the entry age normal actuarial cost method. The actuarial value of assets in excess of the Department's actuarial accrued liability (AAL) is being amortized by level contribution offsets over the period ending June 30, 2003.

In accordance with actuarial valuations, the Department's required contribution rates are as follows:

Actuarial Valuation Date June 30	Normal Cost	Surplus Amortization	Contribution Rate
1998	9.64%	-13.39%	0.00%
1997	9.14%	-1.82%	7.32%

The significant actuarial assumptions for both valuations include an investment rate of return of 8%, projected inflation-adjusted salary increases of 5.5%, and postretirement benefit increases of 3%. The actuarial value of assets is determined using techniques that smooth the effects of short-term volatility in the market value of investments over a four-year period. Plan assets consist primarily of corporate and government bonds, common stocks, mortgage-backed securities and short-term investments.

Trend information for the current and two preceding fiscal years for the Energy Services is as follows (amounts in millions):

Year Ended June 30	APC	Percentage of APC Contributed	NPO
1999	$ 15	285%	$ (108)
1998	$ 26	350%	$ (83)
1997	$ 70	108%	$ (22)

The following schedule represents required supplemental information and provides information about the Department's overall progress made in accumulating sufficient assets to pay benefits when due, prior to allocations to the Water Services and Energy Services (amounts in millions):

Actuarial Valuation Date June 30,	Actuarial Value of Assets	AAL	Actuarial Assets Over/(Under) AAL	Funded Ratio	Covered Payroll	Over/(Under) Funding as a % of Covered Payroll
1998	$ 4,514	$ 4,340	$ 174	104%	$ 355	49%
1997	$ 3,851	$ 3,812	$ 39	101%	$ 430	9%
1996	$ 3,400	$ 3,699	$ (299)	92%	$ 431	-69%

Disability and death benefits – The Energy Services allocated share of disability and death benefit plan costs and administrative expenses totaled $9, $9 and $8 million for fiscal years 1999, 1998, and 1997, respectively.

NOTE 10: HEALTH CARE COSTS

The Department provides certain health care benefits to active and retired employees and their dependents. The total number of active and retired Department participants entitled to receive benefits was approximately 15,000 at June 30, 1999. The allocated cost to the Energy Services of providing such benefits amounted to $73, $104, and $66 million for fiscal years 1999, 1998 and 1997, respectively. Of these costs, $15, $20, and $14 million were capitalized and the remainder was charged to expense for fiscal years 1999, 1998 and 1997, respectively.

Postretirement benefits – The Department accounts for postretirement benefits in accordance with SFAS No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions,* which requires that the cost of postretirement benefits be recognized as expense over employees' service periods. In fiscal year 1999, the Department adopted SFAS No. 132, *Employers' Disclosures about Pensions and Other Postretirement Benefits – an amendment of FASB Statements No. 87, 88, and 106,* which revises the disclosure requirements of SFAS No. 106.

The Energy Services allocated share of postretirement benefit costs is summarized as follows (amounts in millions):

	Year Ended June 30, 1999	1998	1997
Service cost	$ 6	$ 8	$ 7
Interest cost	23	23	20
Expected return on plan assets	(3)	(3)	–
Amortization of transition obligation	12	14	14
Amortization of prior service costs	2	1	–
Curtailment loss	–	28	–
Special termination benefits	7	8	–
	$ 47	$ 79	$ 41

The funded status and the accrued benefit cost related to postretirement benefits for the Department, prior to allocations to the Water Services and the Energy Services, are summarized as follows (amounts in millions):

	June 30, 1999	1998
Change in benefit obligation:		
Benefit obligation at beginning of year	$ 454	$ 399
Service cost	8	11
Interest cost	30	30
Actuarial losses (gains)	37	(41)
Plan amendment	–	25
Curtailment loss	–	38
Special termination benefits	9	11
Benefits paid	(25)	(19)
	513	454
Change in fair value of plan assets:		
Fair value of plan assets at beginning of year	65	62
Actual return on plan assets	4	3
	69	65
Funded status	(444)	(389)
Unrecognized net loss (gain)	4	(33)
Unrecognized transition obligation	212	228
Unrecognized prior service cost	23	25
Accrued benefit cost	$(205)	$(169)
Energy Services allocated share of accrued benefit cost	$(148)	$(123)

Weighted average actuarial assumptions used in determining postretirement benefit costs are as follows:

	June 30, 1999	1998	1997
Discount rate	7.25%	6.75%	7.50%
Expected return on plan assets	7.00%	7.00%	N/A

Plan assets consist primarily of short-term treasury obligations. No funding policy has been established for the future benefits to be provided under this plan.

For measurement purposes, a 7.5% annual rate of increase in the per capita cost of covered health care benefits was assumed for 1999; the rate was assumed to decrease gradually to 5.5% in 2004 and remain at that level thereafter. The effect of a 1% change in these assumed health care cost trend rates would increase or decrease the Department's total benefit obligation by approximately $64 million or $58 million, respectively. In addition, such a 1% change would increase or decrease the aggregate service and interest cost components of net periodic benefit cost by approximately $7 million or $6 million, respectively.

During fiscal year 1998, the Department implemented two changes in postretirement benefits to employees. The changes increase the subsidy rate applicable to retirees under age 65 with a spouse under age 65 and grant service credit years to employees and retirees with qualified service to other governmental organizations. These permanent changes resulted in a $25 million increase in the Department's accumulated postretirement benefit obligation at June 30, 1998. The Energy Services allocated $19 million share of this increase will be amortized over the remaining average service period of approximately 12 years.

The Department recognized curtailment and termination charges of $49 million during fiscal year 1998 related to employees who accepted benefits under the SRP. During fiscal year 1999, the Department recognized termination charges of $9 million related to employees who resigned subsequent to June 30, 1998. The Energy Services included its allocated share of these charges of $7 and $36 million related to fiscal years 1999 and 1998, respectively, in postretirement benefit costs.

NOTE 11: SHARED OPERATING EXPENSES

The Energy Services shares certain administrative functions with the Department's Water Services. Generally, the costs of these functions are allocated on the basis of the benefits provided. Operating expenses shared with the Water Services were $430, $440, and $522 million for fiscal years 1999, 1998 and 1997, respectively, of which $284, $297 and $338 million were allocated to the Energy Services.

NOTE 12: COMMITMENTS AND CONTINGENCIES

Transfers to the reserve fund of the City of Los Angeles – Under the provisions of the City Charter, the Energy Services transfers funds at its discretion to the reserve fund of the City. Pursuant to covenants contained in the bond indentures, the transfers may not be in excess of net income of the prior fiscal year. Such payments are not in lieu of taxes and are recorded as distributions of retained income.

The Department made payments of approximately $108 million in fiscal year 1999 from the Energy Services to the reserve fund of the City. The Department expects to make a transfer declaration from the Energy Services of approximately $110 million during fiscal year 2000.

Palo Verde Nuclear Generating Station – As a joint project participant in PVNGS, the Department has certain commitments with respect to nuclear spent fuel and waste disposal. Under the Nuclear Policy Act, the Department of Energy (DOE) was to develop the facilities necessary for the storage and disposal of spent fuel and to have the first such facility in operation by 1998. That facility was to be a permanent repository, but the DOE has announced that such a repository now cannot be completed before 2010. There is ongoing litigation with respect to the DOE's ability to accept spent nuclear fuel; however, no permanent resolution has been reached.

Arizona Public Service (APS), PVNGS' operating agent, has capacity in existing fuel storage pools at PVNGS which, with certain modifications could accommodate all fuel expected to be discharged from normal operation of PVNGS through 2002. In addition, APS believes it could augment that wet storage with new facilities for on-site storage of spent fuel for an indeterminate period of operation beyond 2002, subject to obtaining required government approvals. The Department currently estimates that it will incur $23 million (in 1998 dollars) over the life of PVNGS for its direct share of the costs related to the on-site interim storage of spent nuclear fuel. During fiscal year 1999, the Department expensed approximately $7 million for its direct share of on-site interim nuclear fuel storage costs related to nuclear fuel burned prior to fiscal year 1999. In addition, the Department began accruing for current nuclear fuel storage costs as a component of fuel expense as the fuel is burned. The Department's share of spent nuclear fuel costs related to its indirect interest in PVNGS is included in purchased power expense. APS currently believes that spent fuel storage or disposal methods will be available for use by PVNGS to allow its continued operation beyond 2002.

The Price-Anderson Act (the Act) requires that all utilities with nuclear generating facilities share in payment for claims resulting from a nuclear incident. The Act limits liability from third-party claims to $8.9 billion per incident. Participants in PVNGS currently insure potential claims and liability through commercial insurance with a $200 million limit; the remainder of the potential liability is covered by the industry-wide retrospective assessment program provided under the Act. This program limits assessments to $79 million for each licensee for each nuclear incident occurring at any nuclear reactor in the United States; payments under the program are limited to $10 million per incident, per year. Based on the Department's 5.7% direct interest and its 3.95% indirect investment interest through SCPPA, the Department would be responsible for a maximum assessment of $8 million per incident, limited to payments of $1 million per incident annually.

Environmental matters – Numerous environmental laws and regulations affect the Energy Services facilities and operations. The Department monitors its compliance with laws and regulations and reviews its remediation obligations on an ongoing basis.

The Department is subject to the Regional Clean Air Incentives Market (RECLAIM) emission reduction program adopted by the South Coast Air Quality Management District. In accordance with this program, an emissions cap is established for each company that controls emissions. Companies that exceed the required limit may buy emissions credits from other companies that have emissions below the maximum threshold. The Department has established a program of installing emission controls and purchasing RECLAIM trading credits to meet the emissions requirements.

The Department is involved in environmental matters related to its 20% ownership interest in the Mohave Generating Station, including the possible adoption of increased opacity standards by regulators and litigation that alleges violations of Federal and State air regulations. The Department is currently unable to determine the financial statement impact, if any, related to these matters.

Litigation – A number of claims and suits are pending against the Department for alleged damages to persons and property and for other alleged liabilities arising out of its operations. In the opinion of management, any ultimate liability which may arise from these actions will not materially affect the Energy Services financial position as of June 30, 1999.

Risk management – The Energy Services is subject to certain business risks common to the utility industry. The majority of these risks are mitigated by external insurance coverage obtained by the Energy Services. For other significant business risks, however, the Energy Services has elected to self-insure. It is management's belief that exposure to loss arising out of self-insured business risks will not materially affect the Energy Services financial position as of June 30, 1999.

Credit risk – Financial instruments which potentially expose the Department to concentrations of credit risk consist primarily of retail and wholesale receivables. The Department's retail customer base is concentrated among commercial, industrial, residential and governmental customers located within the City. Although the Department is directly affected by the City's economy, management does not believe significant credit risk exists at June 30, 1999, except as provided in the allowance for losses. The Department manages its credit exposure by requiring deposits from certain customers and through procedures designed to identify and monitor credit risk.

The Energy Services also enters into forward purchase and sale commitments for the physical delivery of energy with utility companies and energy marketers. The Energy Services is exposed to credit risk related to nonperformance by its wholesale counterparties under the terms of these contractual agreements. In order to limit the risk of counterparty default, the Department has implemented a Wholesale Marketing Counterparty Evaluation Policy (the Policy). The Policy includes provisions to limit risk including: the assignment of internal credit ratings to all Department counterparties based on counterparty and/or debt ratings; the requirement for credit enhancements (including irrevocable letters of credit, escrow trust accounts and parent company guarantees) for counterparties that do not meet an acceptable level of risk; and the use of standardized agreements which allow for the netting of positive and negative exposures associated with a single counterparty. The Energy Services does not anticipate nonperformance by any of its counterparties and has no reserves related to nonperformance at June 30, 1999 and 1998, respectively. The Energy Services did not experience any material counterparty default during fiscal years 1999 or 1998.

NOTE 13: SUBSEQUENT EVENT

On November 22, 1999, the Department entered into an agreement to terminate a power contract with the Montana Power Company (Montana) under which the Department was required to take approximately 750,000 megawatt hours annually through 2010, at rates that are above current spot prices. The Department entered into a simultaneous agreement to purchase power from Montana which it subsequently assigned to a power marketer. The Department recorded a net loss of approximately $77 million when the transaction closed on December 21, 1999.

Management currently estimates the net present value savings of the combined transaction to be approximately $25 million, based on estimated market prices.

Report of Independent Accountants on Required Supplementary Information

To the Board of Water and Power Commissioners
Department of Water and Power
City of Los Angeles

Our report on the audits of the financial statements of the Power System (Energy Services) of the Department of Water and Power of the City of Los Angeles as of June 30, 1999 and 1998, and for each of the three years in the period ended June 30, 1999, is presented in the first section of this document. Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The year 2000 supplementary information is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board, and we did not audit and do not express an opinion on such information. Further, we were unable to apply to the information certain procedures prescribed by professional standards because the disclosure criteria specified by Technical Bulletin 98-1, as amended, are not sufficiently specific and, therefore, preclude the prescribed procedures from providing meaningful results. In addition, we do not provide assurance that the Department is or will become year 2000 compliant, that the Department's year 2000 remediation efforts will be successful in whole or in part, or that parties with which the Department does business are or will become year 2000 compliant.

PricewaterhouseCoopers LLP Simpson & Simpson

September 15, 1999

YEAR 2000 COMPLIANCE (UNAUDITED)

The year 2000 issue refers to the fact that many computer programs use only the last two digits to refer to a year; therefore, both 1900 and 2000 would be referred to as "00." Computer programs must be adjusted to differentiate between the two years or the programs will fail or create errors. Also, some programs may not be able to recognize that 2000 is a leap year. Further, the year 2000 issue could affect equipment, such as environmental systems, elevators, and vehicles, containing computer chips that have date recognition features.

During fiscal year 1996, the Department initiated a year 2000 compliance project (the Year 2000 Project). An executive-level manager was assigned to oversee the Year 2000 Project and the services of year 2000 consultants were obtained. The scope of the Year 2000 Project includes the Department's traditional mainframe-based application software, mid-range and personal computer platforms, and systems with embedded microprocessors. In addition to the systems that directly affect the delivery of water and power to customers, the project scope also includes non-utility systems such as building elevators, lighting, telephones, and ventilation. The Year 2000 Project includes the following stages of work: inventory, assessment, remediation, testing and implementation.

The Department has completed all stages of this process with respect to its mission-critical systems, and as of July 1, 1999, management believes that all systems necessary to deliver water and power services to customers are year 2000 ready. The Department has incurred approximately $45 million on the Year 2000 Project through June 30, 1999.

The Year 2000 Project also includes a contingency component that will provide for alternative methods of conducting business, if necessary. The contingency plan covers the mission-critical functions necessary to deliver water and power services to customers. The contingency plans were approved by Department management during fiscal year 1999. The Department's year 2000 contingency plans were designed in accordance with recommendations of the Western System Coordinating Council and North American Reliability Council. The Department has worked with these industry groups, as well as the Electric Power Research Institute, in the development of its contingency plans.

The Department is in the process of evaluating the year 2000 progress of its major vendors and suppliers and is also monitoring the year 2000 compliance progress of the other major utilities in the Western United States. Based on the results of these evaluations, the Department may prepare supplemental contingency plans to address any additional year 2000 concerns.

Although management believes that it is taking necessary steps to prepare for the year 2000, it cannot guarantee that the Department or others will not experience year 2000 problems. Also, since the operations of the Department are dependent upon the systems of other organizations with whom the Department conducts business, the failure by these other organizations to become year 2000 compliant on a timely basis could have an adverse effect on the Department's operations.

Water Services Selected Financial Data And Statistics

($ Millions)	1999	1998	Restated 1997	Restated 1996	Restated 1995
Statement of Income					
Operating revenues					
Residential	$ 173.8	$ 159.4	$ 168.6	$ 166.6	$ 150.8
Commercial and industrial	244.1	240.2	224.9	230.5	228.6
Other	25.5	25.5	24.7	25.8	25.5
Total revenues	$ 443.4	$ 425.1	$ 418.2	$ 422.9	$ 404.9
Operating income	135.0	105.1	120.5	142.8	89.0
As % of revenues	30.4%	24.7%	28.8%	33.8%	22.0%
Net Income	$ 94.1	$ 71.9	$ 82.5	$ 110.2	$ 49.8
Balance Sheet					
Net utility plant	$ 2,177.5	$ 2,087.7	$ 2,000.0	$ 1,896.1	$ 1,796.0
Capital additions, net	155.6	151.1	163.8	157.8	141.4
Capitalization					
Equity	1,544.7	1,440.4	1,377.3	1,289.7	1,179.5
Long-term debt	633.8	652.6	668.4	682.4	693.9
Advance refunding bonds	314.2	138.7	153.1	170.2	215.5
Total capitalization	2,492.7	2,231.7	2,198.8	2,142.3	2,088.9
Debt as % of net utility plant (A)	29.1%	31.3%	33.4%	36.0%	38.6%
Interest on debt	45.0	45.7	48.5	48.4	46.8
Transfers to City of L.A.	16.3	25.9	21.1	20.2	40.0
Operations					
Gallons sold (billions)	192.0	185.8	193.6	190.5	179.1
Customers — average number (thousands)	645.0	645.5	639.8	642.1	638.2
Average revenue per hundred cu. ft. sold (in cents)					
Residential	175.7	175.1	169.3	175.0	173.0
Commercial and industrial	166.7	168.4	160.0	162.8	170.1
Water supply (billions of gallons)					
Local supply	41.9	33.1	37.0	25.2	32.9
DWP Aqueduct	137.8	128.9	145.2	151.0	83.3
Metropolitan Water District	23.7	33.0	24.8	21.5	75.0
Gross supply	203.4	195.0	207.0	197.7	191.2
Diversion from (to) local storage	(0.9)	(0.8)	(0.4)	0.9	(2.0)
Net supply to distribution systems	202.5	194.2	206.6	198.6	189.2

(A) Excludes revenue notes and advance refunding bonds

Energy Services Selected Financial Data and Statistics

($ Millions)	1999	1998	Restated 1997	Restated 1996	Restated 1995
Statement of Income					
Operating revenues					
Residential	$ 633.6	$ 625.7	$ 599.9	$ 580.0	$ 591.2
Commercial and industrial	1,333.9	1,327.9	1,303.7	1,275.9	1,276.0
Other	235.9	119.1	113.5	91.0	105.6
Regulatory gain from rate restructuring	–	90.3	–	–	–
Total revenues	$ 2,203.4	$ 2,163.0	$ 2,017.1	$ 1,946.9	$ 1,972.8
Operating income	414.4	424.1	305.5	288.1	203.1
As % of revenues	18.8%	19.6%	15.1%	14.8%	10.3%
Net Income	$ 312.1	$ 328.1	$ 163.5	$ 97.7	$ 101.4
Balance Sheet					
Net utility plant	$ 4,355.6	$ 4,464.5	$ 4,569.0	$ 4622.8	$ 4,665.6
Capital additions, net	151.9	144.6	201.7	190.7	235.4
Capitalization					
Equity	2,754.3	2,532.2	2,265.9	2,180.9	2,133.3
Long-term debt	2,638.9	2,511.9	2,716.6	2,622.3	2,691.5
Advance refunding bonds	858.3	952.7	1,075.5	1,112.5	1,117.2
Total capitalization	6,251.5	5,996.8	6,058.0	5,915.7	5,941.9
Debt as % of net utility plant (A)	53.5%	49.4%	59.5%	56.7%	57.7%
Interest on debt	162.6	168.5	179.5	181.2	186.2
Transfers to City of L.A.	108.1	80.4	97.3	59.9	69.3
Operations					
Kilowatt hours sold (billions)	26.2	22.9	23.0	22.2	21.7
Customers — average number (thousands)	1,386.0	1,370.1	1,358.0	1,350.8	1,338.5
Average revenue per kWh sold (in cents)					
Residential	10.3	10.3	9.7	9.6	9.9
Commercial and industrial	9.3	9.3	8.8	8.6	9.0
Energy production (billion kWh)					
Hydro	2.8	2.6	1.9	1.6	0.9
Thermal	13.1	9.9	8.7	9.1	13.2
Total generation	15.9	12.5	10.6	10.7	14.1
Purchases	13.3	14.1	15.4	14.5	10.8
Total production	29.2	26.6	26.0	25.2	24.9
Net system capability (thousand megawatts)					
Hydro	1.5	1.5	1.5	1.5	1.4
Thermal	3.2	3.2	3.2	3.2	3.0
	4.7	4.7	4.7	4.7	4.4
Jointly-owned and firm purchases	2.9	2.9	2.9	2.9	2.9
	7.6	7.6	7.6	7.6	7.3

(A) Excludes revenue notes and advance refunding bonds

Water Services Facts in Brief

	Year ended June 30 1999	1998
Use of Water		
Average Los Angeles population served	3,807,500	3,748,500
Average daily use per capita (gallons)	138.2	135.9
Water sales for fiscal year (billion gallons)	192.0	185.8
Maximum daily demand (million gallons)	780.7	790.4
Water Supply (in billions of gallons)		
Local supply (groundwater)	41.9	33.1
Los Angeles Aqueduct (Owens Valley)	137.8	128.9
Metropolitan Water District (California and Colorado River Aqueducts)	23.7	33.0
Gross supply	203.4	195.0
Diversion from (to) local storage	(0.9)	(0.8)
Net supply to distribution systems	202.5	194.2

Energy Services Facts in Brief

	Year ended June 30 1999	1998
Number of Customers		
Residential	1,190,171	1,177,328
Commercial	174,489	173,608
Industrial	18,475	15,965
All others	3,097	3,194
Total customers of all classes	1,386,232	1,370,095
Power Use		
Sales to ultimate customers – kilowatt (kW) hours	21,862,286,105	21,583,627,000
Sales to other utilities – kW hours	4,967,241,741	1,360,162,000
Average annual kW hours per residential customer	5,423	5,341
Net dependable capacity, kilowatts	7,061,300	6,555,000

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