SMUD

SACRAMENTO MUNICIPAL UTILITY DISTRICT
The Power To Do More.®

P.O. Box 15830, Sacramento, CA 95852-1830; 1-888-742-SMUD (7683)

NQA 06-019

May 25, 2006

U.S. Nuclear Regulatory Commission
Document Control Desk
Washington, DC 20555

Docket No. 50-312
Rancho Seco Nuclear Generating Station
License No. DPR-54

ANNUAL FINANCIAL REPORT

Attention: John Hickman

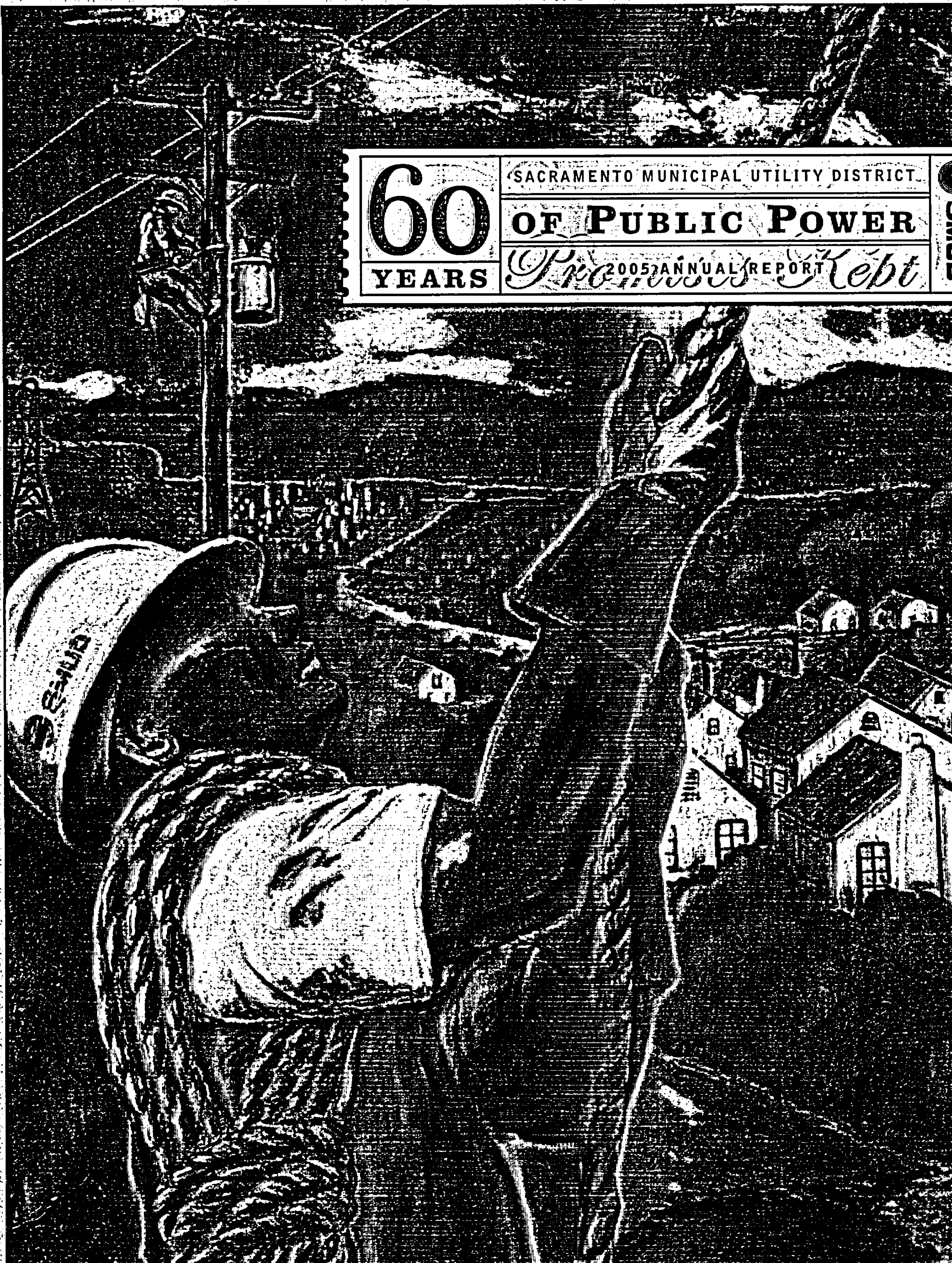
In accordance with 10 CFR 50.71(b), we are submitting the 2005 annual financial report for the Sacramento Municipal Utility District. If you, or members of your staff, have questions requiring additional information or clarification, please contact Bob Jones at (916) 732-4843.

Sincerely,

Bob Jones
Supervising Quality Engineer

Cc: NRC, Region VI

MSS01



SACRAMENTO MUNICIPAL UTILITY DISTRICT

60 YEARS OF PUBLIC POWER

Promises Kept

2005 ANNUAL REPORT

SMUD

2005 Statistics

Service area population:
1.38 million

Record peak demand:
2,957 megawatts
on July 15, 2005

Total operating revenue:
$1.23 billion

Number of customers (year-end):
577,946

Employees:
2,165

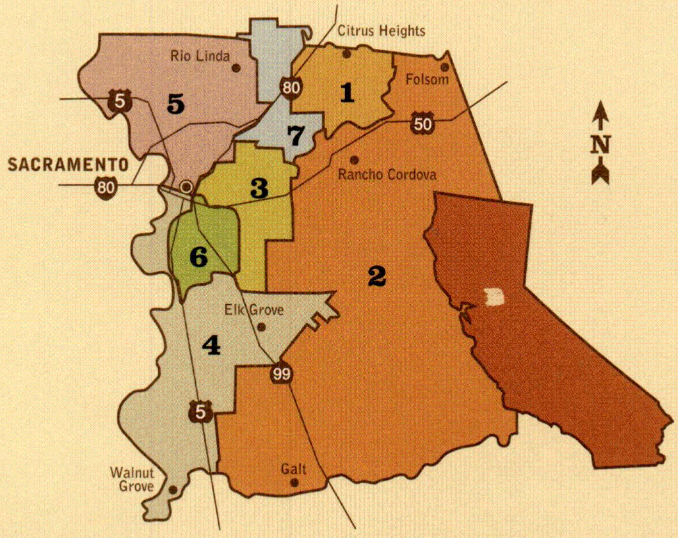
Credit rating:
A Standard & Poor's
A1 Moody's
A Fitch

SMUD Board of Directors:

- **Linda Davis**
  Ward 1
- **Susan Patterson**
  Ward 2
  Vice President 2006
- **Howard Posner**
  Ward 3
- **Genevieve Shiroma**
  Ward 4
  Vice President 2005,
  President 2006
- **Peter R. Keat**
  Ward 5
- **Larry Carr**
  Ward 6
- **Bill Slaton,**
  Ward 7
  President 2005

SMUD Service Area and Board Member Wards

SMUD generates, transmits and distributes electric power to a 900-square-mile territory that includes California's capital city, Sacramento County and a small portion of Placer County. As a municipal utility, SMUD is governed by a seven-member board of directors elected by the voters for staggered four-year terms. The Board of Directors determines policy for the District and appoints the General Manager, who is responsible for the District's operations.



Produced by: Communication & Advertising Services | Monica Siewert, Manager | ©2006 SMUD

Executive Management:

Jan E. Schori
General Manager and
Chief Executive Officer

James R. Shetler
Assistant General Manager,
Energy Supply

John DiStasio
Assistant General Manager,
Energy Delivery & Customer Services

Betty Masuoka
Assistant General Manager,
Administrative Services

Arlen Orchard
General Counsel and Secretary

James A. Tracy
Chief Financial Officer

Noreen Roche-Carter
Treasurer

Cary M. Nethaway
Controller

Linda Carey Johnson
Director of Business Technology &
Change Management

C-01

General Manager's message

As SMUD enters its 60th year of operations, we remain dedicated to what the people of Sacramento created this utility to do: Provide reliable electricity at reasonable rates, accountable to our customer owners and the community we serve.

2005 saw burgeoning prices for natural gas due to Hurricane Katrina and other industry factors. Our board of directors acted early to confront the issue, enacting a 6 percent average rate increase. It was only our second rate increase in 15 years.

As SMUD enters its 60th year of operations, we remain dedicated to what the people of Sacramento created this utility to do: Provide **reliable electricity at reasonable rates,** accountable to our customer owners and the community we serve.

Promises Kept

Rain and snow meant a good water year for hydroelectric facilities. We stuck to our budget in meeting customer service objectives and ended the year with $83 million in net income to reinvest in the utility.

Our competitive advantage over neighboring Pacific Gas & Electric Co. increased, with SMUD rates averaging nearly 30 percent below PG&E rates as of Jan. 1, 2006. Thanks to our strategy of hedging natural gas risks with longer term advance purchases, we expect to weather 2006 and 2007 with no rate increase.

We completed a 500-megawatt, combined cycled power plant, a new, local source of affordable, reliable energy to replace power purchase contracts while adding voltage support to further improve electrical service reliability for our customers.

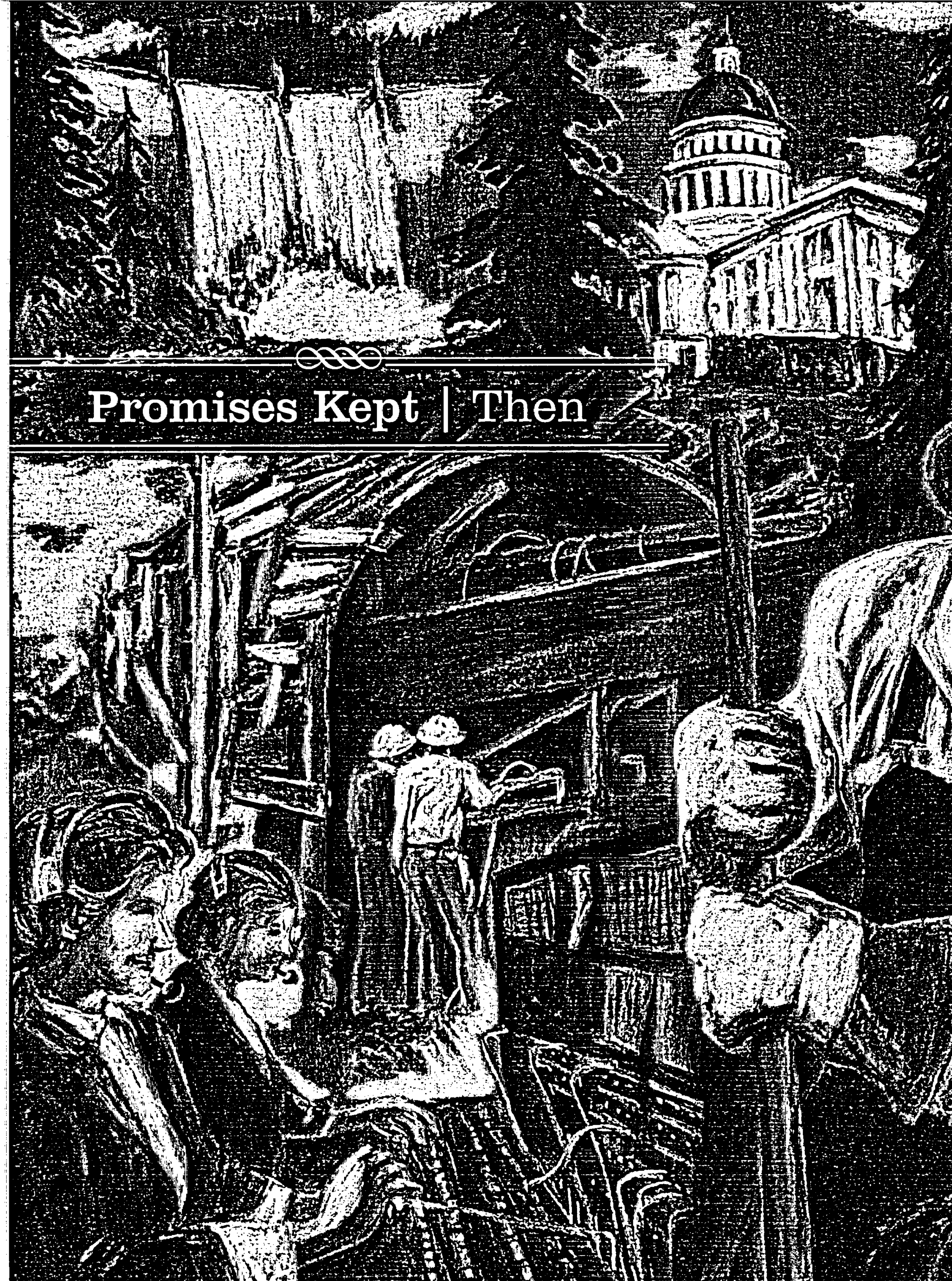
We intend to remain an industry leader in renewable energy and energy efficiency with programs and services that give customers the "power to do more." Since air conditioning accounts for at least 50 percent of our customers' peak energy use, we have tested a super efficient, water-cooled residential air conditioning system designed to keep customers comfortable while lowering their electric bills. For commercial customers, we're testing a new refrigeration management system that can reduce electrical usage by nearly 25 percent.

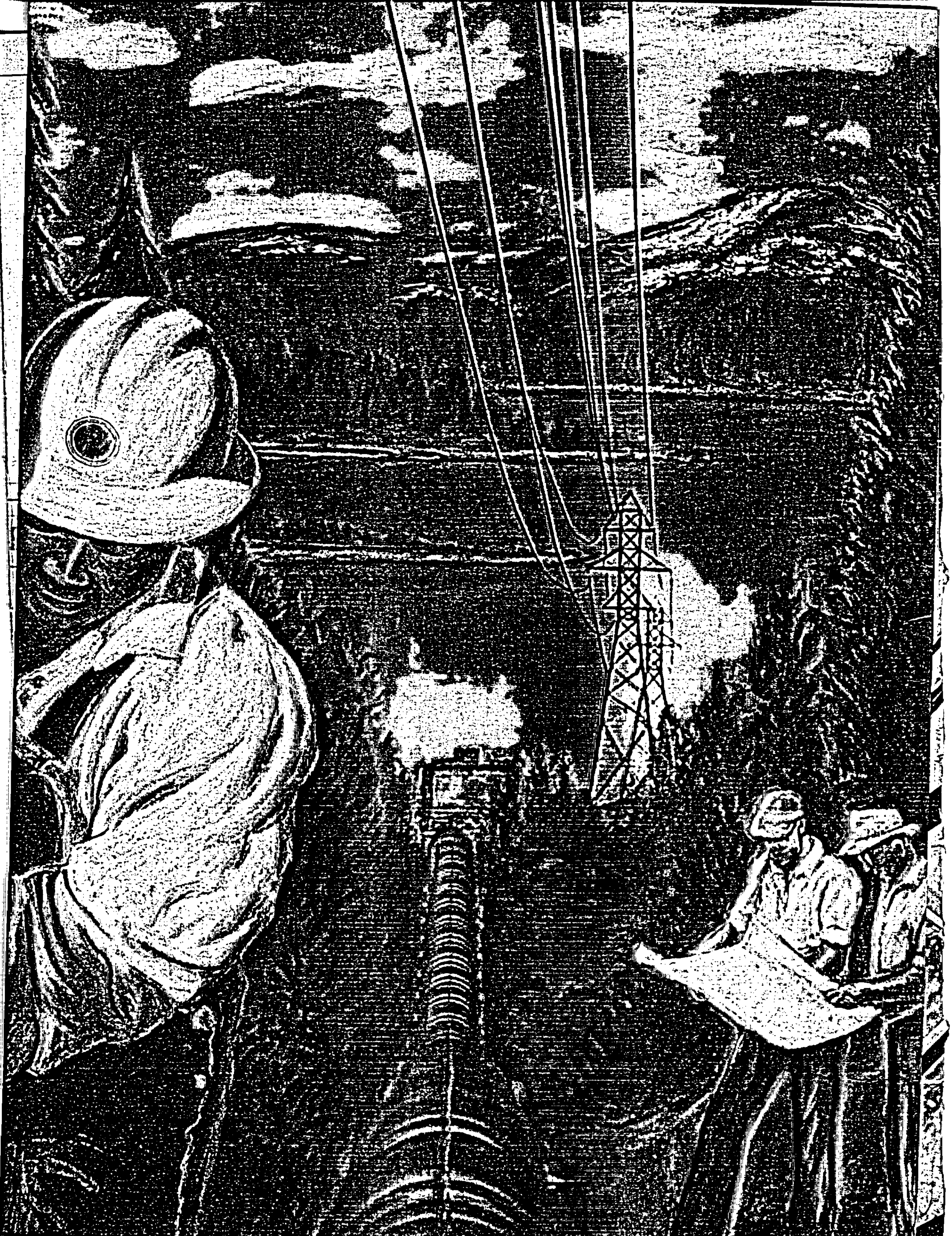
We are committed to finding the best energy solutions for our customers now and in the decades to come. I hope you will take a few minutes to read on and see how.

Jan Schori

Jan Schori

Promises Kept | Then





60 YEARS

SACRAMENTO MUNICIPAL UTILITY DISTRICT

OF PUBLIC POWER

Promises Kept

2005 ANNUAL REPORT

SMUD

1884 The first poles and lines for distributing electricity in Sacramento are built.

1895 Electricity is first transmitted 22 miles to Sacramento from Folsom Powerhouse, a transmission distance thought to be the longest in the world.

1910 One in 10 U.S. homes has electricity.


BEE

Electric Power District Created; Citizens' Club Director Ticket Wins

City Of Sacramento And Adjacent Territory Take First Step To Get Municipally Owned Electricity; Leonard, Jones, Elkus, McLaughlin, Herndon Make Clean Sweep

COMPLETE RETURNS

1923 Sacramento voters create the Sacramento Municipal Utility District.

Sacramento Bee article


Utility District Takes Over Power System

1934 The fluorescent lamp is developed.

1946 After years of court battles, SMUD replaces PG&E as Sacramento's electric service provider. The changeover takes place on New Year's Eve.

1900 1910 1920 1930 1940

Tired of the unreliable, overpriced electricity they received from two private utilities, **Sacramento residents turned to the power of the ballot box.**

Back in 1923, the public overwhelmingly approved the formation of the Sacramento Municipal Utility District. The vote was a first step in what a *Sacramento Bee* editorial described as a campaign to free the city, "to remove from her throat the throttling clutch of syndicated power companies."

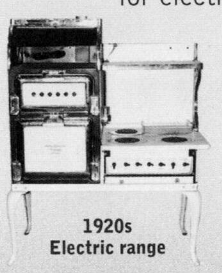
But the Depression and World War II would come and go before SMUD was up and running on Dec. 31, 1946. Pacific Gas & Electric Co. fought SMUD in the courts for 12 years until the California Supreme Court refused PG&E's final petition in March 1946.


Early 20th-century streetcar


1946 Ownership of electrical system transferred from PG&E to SMUD

Through the decades, SMUD has supplied its customers with electricity at rates consistently lower than investor-owned utilities around the state.

Today, in SMUD's 60th year of service, the nation's sixth-largest public utility offers rates nearly 30 percent lower than PG&E's.


1920s Electric range

SMUD's 578,000 customers take their reliable, affordably priced electricity for granted.

But there were no guarantees in 1946. The electrical system that had taken so long to acquire was old, some of it dating back to 1895. Postwar shortages made supplies difficult to obtain. The stack of unfilled requests for new service was two feet high. Sacramento's population was on the brink of explosive growth that would greatly increase the demand for electricity.

Automobiles replaced streetcars as suburbs sprang up across the landscape. The Cold War fueled expansion of Sacramento's military bases.


1940s Customer service center


1950s Line operations

Sacramento County's population more than doubled in the 1950s to 310,000.

SMUD began serving Sacramento as a wave of household innovations flooded the marketplace – electric washers and dryers, dishwashers, kitchen appliances and air conditioners.

In 1948, SMUD took a major step toward generating its own power by introducing plans to build the Upper American River Project in the Sierra Nevada. Construction on the dams and reservoirs began in 1957, and the Jaybird Powerhouse began operating in 1961.


1950s Modern electrical appliances debut

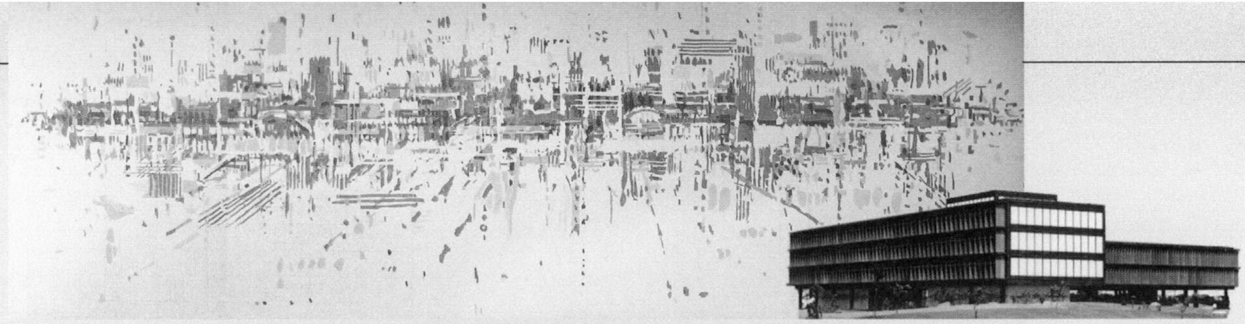
SMUD has built numerous power plants since, but the Upper American River Project's hydroelectricity remains the utility's largest and most economical power source.

With its numerous reservoirs, campgrounds and hiking trails, the hydroelectric system also provides year-round recreational opportunities for thousands of visitors each year.

Sacramento and SMUD grew apace in the 1950s and '60s, but the next two decades put utilities to the test nationwide. In response to drought and energy shortages, SMUD staff developed an energy efficiency plan that became an industry model.

SMUD weathered the 2000–2001 energy crisis better than most California utilities. SMUD quickly followed up with strategies to reduce its vulnerability to market uncertainties and provide customers with greater price stability in the future.


1953 Line crew



In 1957, Sacramento artist Wayne Thiebaud completed his "Water City" mural on new SMUD Headquarters building.

1953 | The first television station in Sacramento opens to great fanfare.

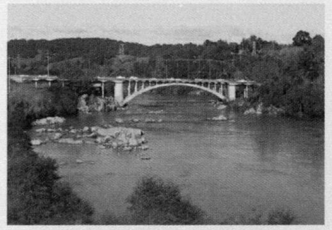
1957 | Construction begins on the dams and reservoirs in SMUD's Upper American River Project.

1959 | For the first time in Sacramento, demand for electricity in the summer months exceeds winter demand. The sale of air conditioners nearly doubles in one year.

1969 | Interstate freeways change the face of Sacramento life.

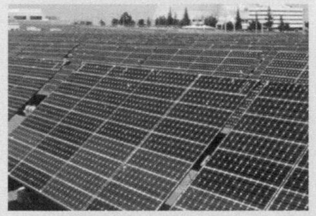
1974 | SMUD's Rancho Seco nuclear power plant begins operations.

1976 | Drought conditions leave the floor of Union Valley Reservoir dry and cracked.



1984 | Folsom and surrounding unincorporated areas are annexed into SMUD's service area.

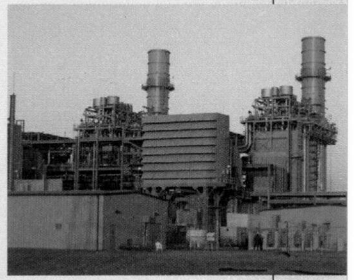
1989 | Sacramento residents vote to shut down the Rancho Seco nuclear plant.



1994 | SMUD's photovoltaic installation is the largest utility-owned solar plant in the country.

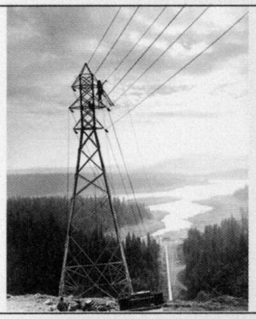
1995 | Customer Service Center opens on S Street.

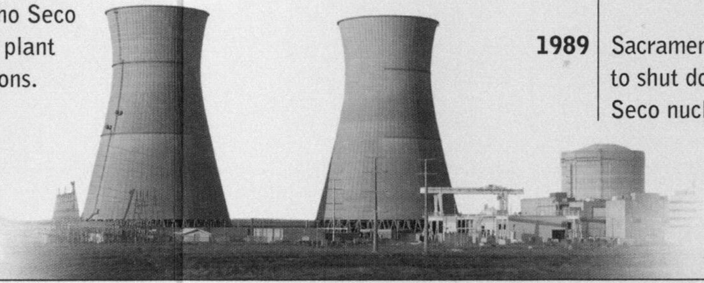
2005 | SMUD selected to test hydrogen fuel cell vehicles.



2006 | SMUD's highly efficient Cosumnes Power Plant begins commercial service.

1950 1960 1970 1980 1990 2000





SMUD is recognized worldwide for its research and development of renewable resources such as wind and solar. And after much experience operating electric vehicles, SMUD was chosen by the U.S. Department of Energy to operate one of the largest fleets of hydrogen fuel cell vehicles in the country.

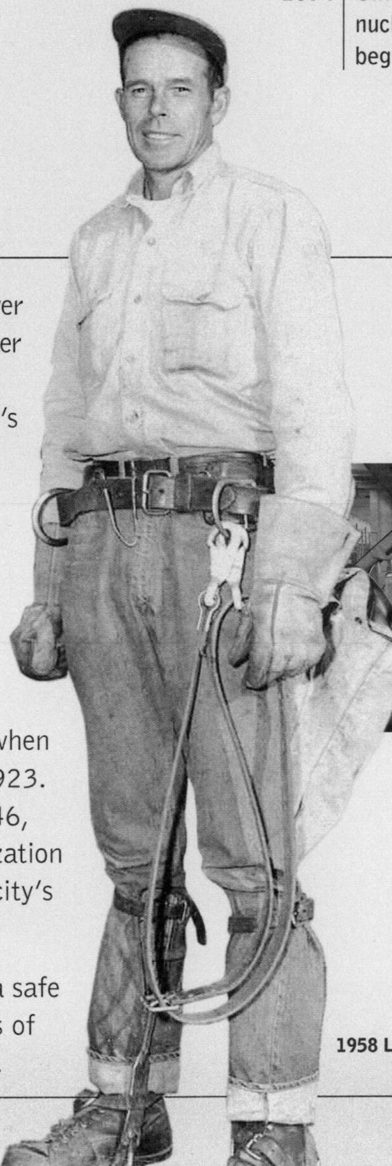
Historic Station A

The benefits of public power are clear – lower rates, better service and local control. SMUD's customers experience these benefits each day.

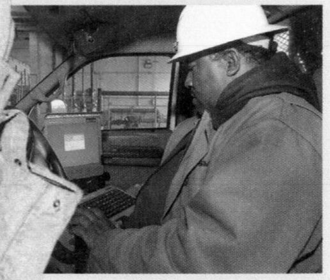
Intrigued by the promise of public power, Sacramento residents took a gamble when they created SMUD in 1923. The risk remained in 1946, when an untested organization took the controls of the city's electric system.

Today, SMUD looks like a safe bet. That's what 60 years of keeping promises will do.

Hydroelectric construction

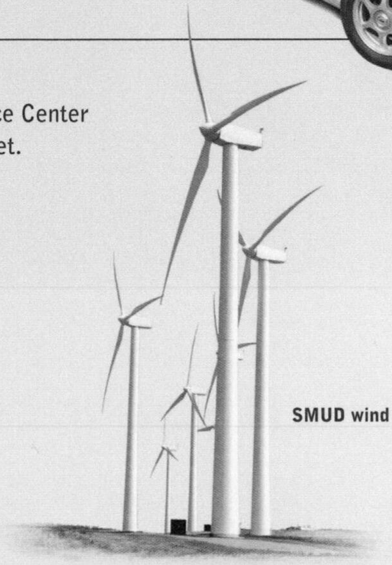


1958 Lineman



Line foreman operating mobile data unit

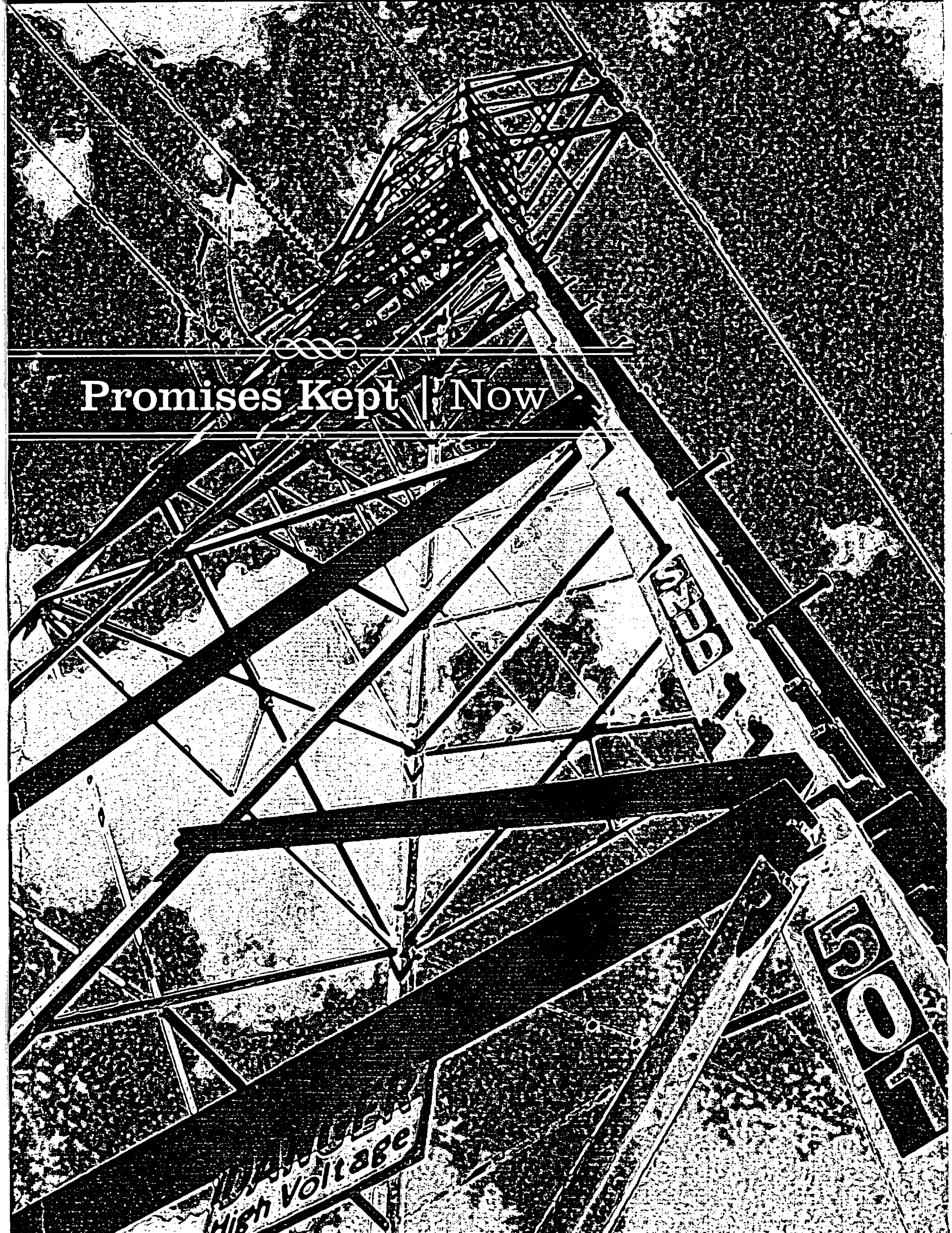
SMUD Customer Service Center



SMUD wind turbines

60 years of keeping promises.

Promises Kept | Now



Promises Kept

Founded on the public's desire for more reliable and less expensive electricity, SMUD has a solid track record for both as it enters its 60th year of operation.

At the start of 2006, SMUD electric rates averaged nearly 30 percent lower than those of neighboring PG&E and were among the lowest in the state. SMUD's rate advantage over PG&E has grown despite the fact that SMUD enacted a 6 percent rate increase in March 2005 to maintain its sound financial position.

J.D. Power and Associates 2005 Electric Utility Residential Customer Satisfaction Study[SM]

In a J.D. Power study released July 21, 2005, SMUD was rated tops in residential customer satisfaction among large electric utilities in California.

SMUD	**108**
Southern California Edison	101
L.A. Dept. of Water & Power	94
San Diego Gas & Electric	93
Pacific Gas & Electric	91

SMUD's constant efforts to improve service and keep rates as low as possible are reflected in strong ratings for customer satisfaction.

In a national survey of 105 utility Web sites, E Source rated smud.org the best site in California.

SMUD acted to cover rising expenditures related to natural gas costs and to ensure continued progress toward its financial goal of raising equity levels to 20 percent by the end of 2007. While raising rates is always painful, SMUD's increase was considerably less than the rate hikes announced by other California utilities. In addition, the adjustment is expected to be sufficient to meet costs and financial objectives with no additional rate increase in 2006 or 2007.

In terms of service reliability, SMUD also compares favorably with other utilities. According to the most recent state statistics, the average length of power outages for SMUD was less than half the average length of PG&E outages in 2004.

In a move designed to support electric system reliability, reduce costs and better control its future, SMUD formed its own high-voltage transmission control area in 2002. The Western Area Power Administration's Sierra region opted to join the SMUD control area in 2004. With the addition in November 2005 of the California-Oregon Transmission Project and facilities owned by the Modesto Irrigation District, SMUD now manages transmission systems from the Oregon border to the San Joaquin Valley.

The control area is not something customers notice. But SMUD's constant efforts to improve service reliability and keep rates as low as possible are reflected in its strong customer satisfaction scores.

In 2005, J.D. Power and Associates ranked SMUD the No. 1 electric utility in California for residential customer satisfaction. It marked the fifth time in six years that SMUD has earned that distinction.

Comparing Monthly Electric Bills*

Roseville Electric	$69.93
SMUD	**$73.01**
L.A. Dept. of Water & Power	$78.11
PG&E	$105.96
Southern California Edison	$108.94
San Diego Gas & Electric	$110.36

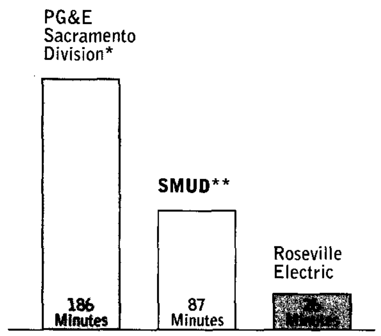
*Reflects 12-month average for residential rates in effect Jan. 10, 2006 for 750 kilowatt hours of electricity

"We have found SMUD to be a very professional and well-managed utility, responding quickly to our requests....We have direct input in the rates they charge, the policies under which they operate, and the services they provide."

— **Scott Neish**
President, Aerojet

Good for Business

Electric Service Reliability
Annual Average Duration of Outages, Per Customer 2000–2004



*PG&E Sacramento division includes all of Sacramento, and Yolo counties, most of Solano, Colusa and parts of Sutter and Glenn counties

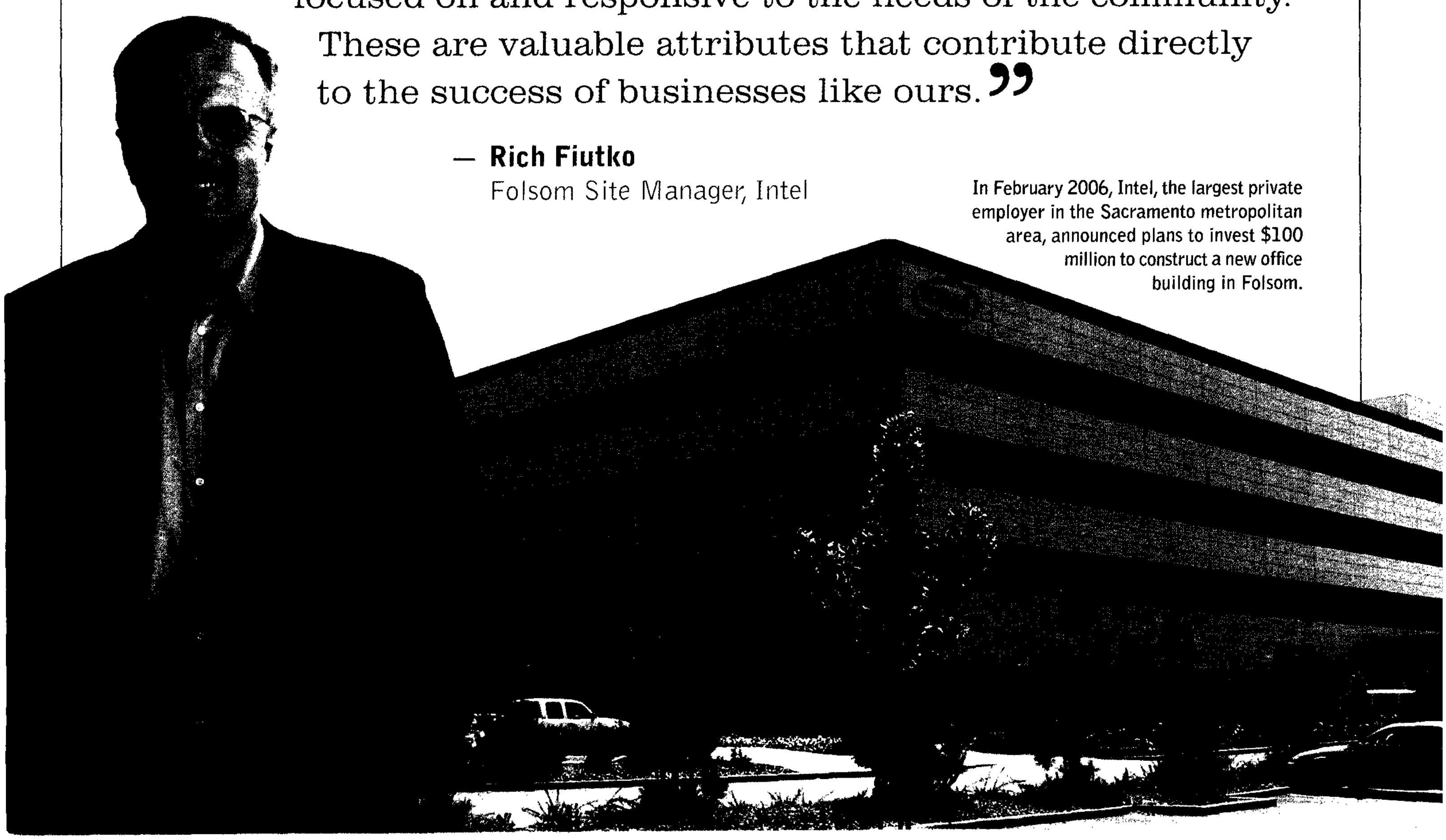
**SMUD uses more stringent reporting criteria than PG&E

Source: Roseville Electric, SMUD and California Public Utilities Commission

"SMUD's leadership and capability was an important factor in our decision to expand Intel's Folsom campus in 1997. SMUD is focused on and responsive to the needs of the community. These are valuable attributes that contribute directly to the success of businesses like ours."

— **Rich Fiutko**
Folsom Site Manager, Intel

In February 2006, Intel, the largest private employer in the Sacramento metropolitan area, announced plans to invest $100 million to construct a new office building in Folsom.



"Procter & Gamble's plant in Sacramento has enjoyed a very positive relationship with our electricity provider, the Sacramento Municipal Utility District, for more than 50 years. ...As ratepayer-owners, our voice is clearly heard."

— **Raymond G. Parks**
Public Affairs Manager,
Procter & Gamble

Good for Business

Public power utilities are not-for-profit electric systems owned and operated by the people they serve. Today, public power serves nearly 15 percent of all retail electricity customers nationwide. While sometimes perceived as representing only very small communities or only consumers, public power serves all kinds of customers, including many big businesses.

In the Sacramento region, the rates differential is huge: SMUD rates average nearly **30 percent less** than those of neighboring PG&E. For businesses trying to control costs in a competitive environment, that difference can be critical.

Controlled locally through elected representatives who are accountable only to their customer-owners, public power utilities have no allegiance to distant shareholders and are single-minded in their focus on serving their customers and their communities. SMUD and other public power utilities have a long history of striving to attract and retain businesses that create jobs and expand the local economy and tax base.

Public power utilities are actively involved in their communities' economic development efforts, providing reliable electricity, outstanding customer service, and rates that are significantly lower than those of investor-owned utilities.

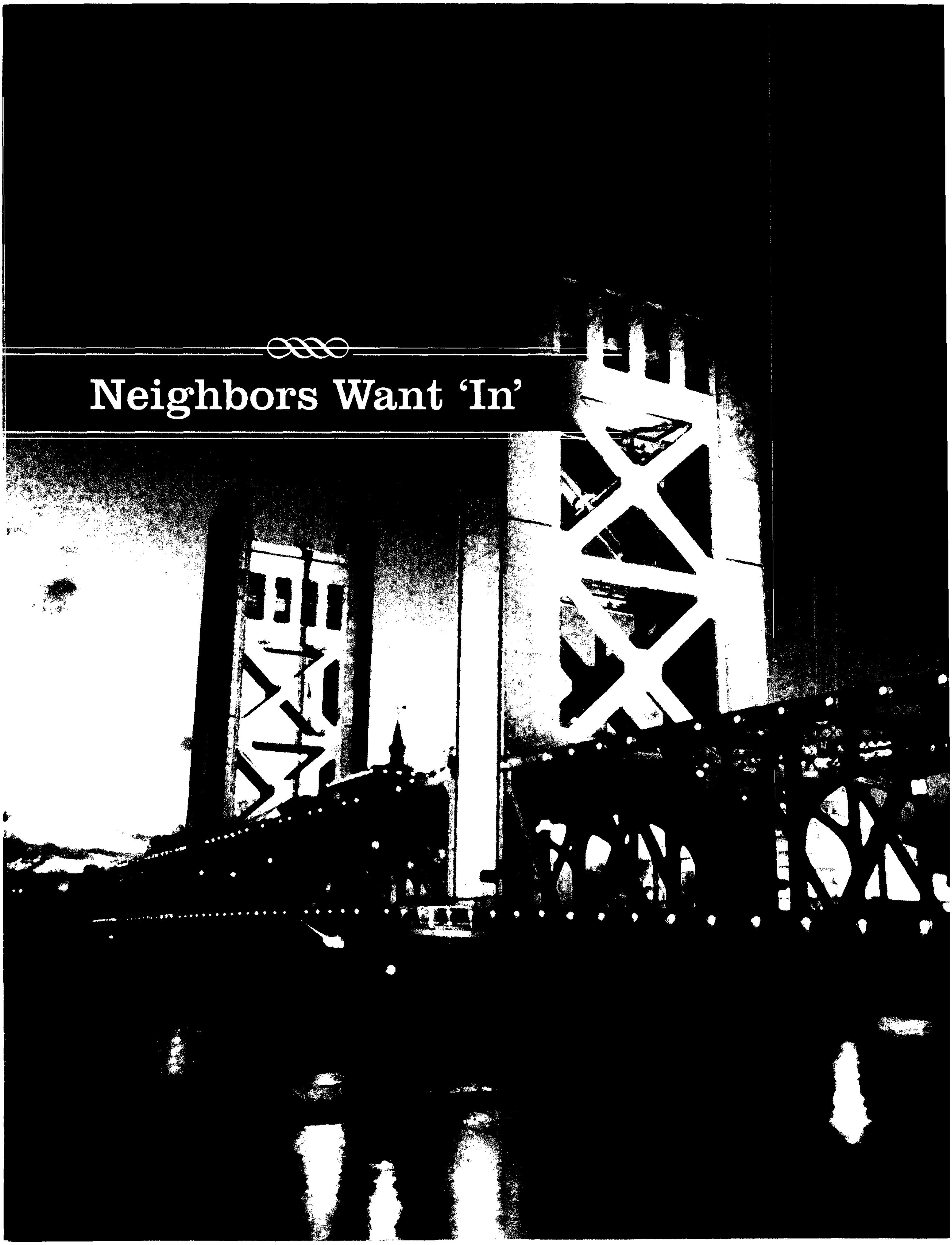
In the Sacramento region, the rates differential is huge: SMUD rates average nearly 30 percent less than those of neighboring PG&E. For businesses trying to control costs in a competitive environment, that difference can be critical.

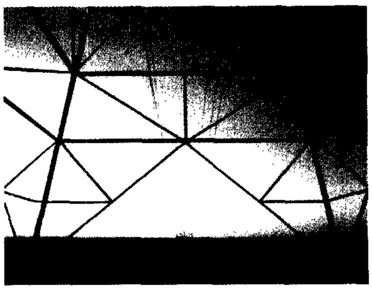
As president of the American Public Power Association for 12 months through mid-2005, SMUD General Manager Jan Schori worked to spread the word: Public power is good for business.

"With the deregulation activities in California, our Sacramento facility has been relatively immune to the volatility of energy prices experienced by other large commercial businesses served by investor-owned utilities....A stable rate structure over the years has offered us a major benefit in budgeting anticipated facility costs from year to year."

— **Frank Beisel**
Chief Engineer,
Shriners Hospitals for Children

Neighbors Want 'In'





Neighbors Want 'In'

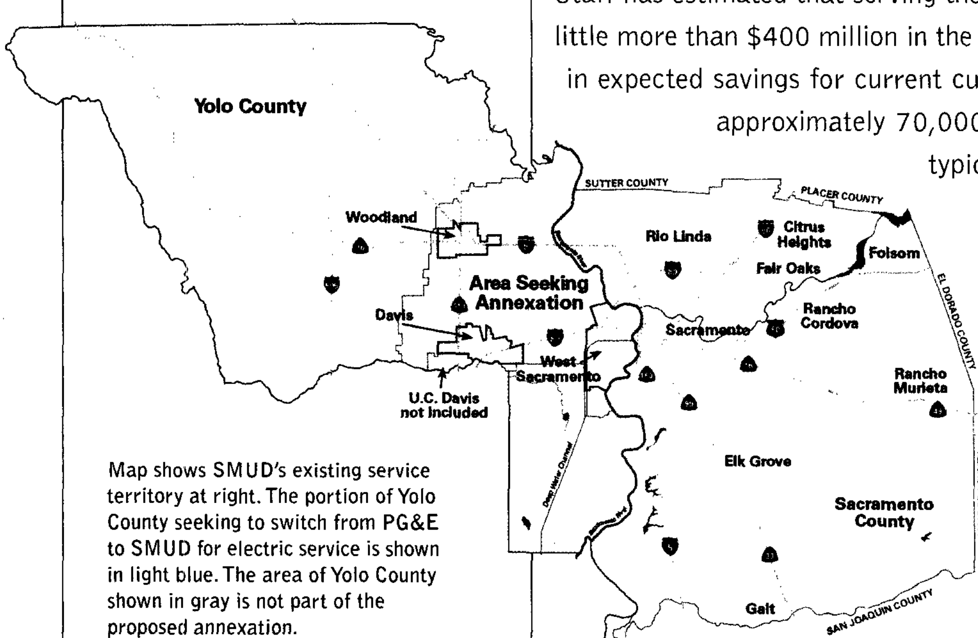
Portions of Yolo County on the west side of the Sacramento River spoke as one with an unusual request in the early months of 2005. Elected officials representing West Sacramento, Davis, Woodland and adjacent unincorporated areas of Yolo County voted unanimously to seek electric service from SMUD.

These areas currently receive their electricity from PG&E. **They want to switch to SMUD** for lower rates, better customer service and reliability, and local control.

After extensive study and public input, the SMUD Board of Directors concluded that adding the neighboring Yolo communities would be a good business move that would strengthen SMUD.

Staff has estimated that serving the Yolo areas could create total benefits of a little more than $400 million in the first 20 years alone, including $155 million in expected savings for current customers. Serving the Yolo area would add approximately 70,000 customers, the equivalent of six years of typical growth for SMUD.

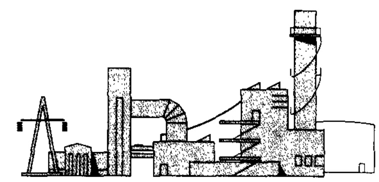
On Aug. 1, SMUD filed with the Sacramento Agency Local Formation Commission a proposal structured so that existing SMUD customers would not pay the cost of serving the Yolo areas. The commission is conducting an independent review of the proposal and is expected to accept or reject it by May 2006. Approval would trigger an election on the issue in November 2006.



Map shows SMUD's existing service territory at right. The portion of Yolo County seeking to switch from PG&E to SMUD for electric service is shown in light blue. The area of Yolo County shown in gray is not part of the proposed annexation.

Power for the Future

Five years ago, SMUD came away from the California energy crisis determined to protect customers from profiteering and an uncertain market structure. Out of this determination grew a commitment to own or control a larger portion of its electricity supply.



Output from the new power plant replaces power purchase contracts and **will save a projected $25 million to $30 million annually**, based on recent market prices.

That commitment is coming to fruition with completion of the Cosumnes Power Plant project, a $435 million investment that will provide enough power to serve approximately 450,000 households. After several months of testing, the 500-megawatt plant was declared to be in commercial operation on Feb. 24, 2006.

The plant has substantially higher fuel efficiency than the average fossil-fired plant, giving it a significant competitive edge. The higher the cost of natural gas, the greater the plant's advantage compared with buying power at wholesale rates.

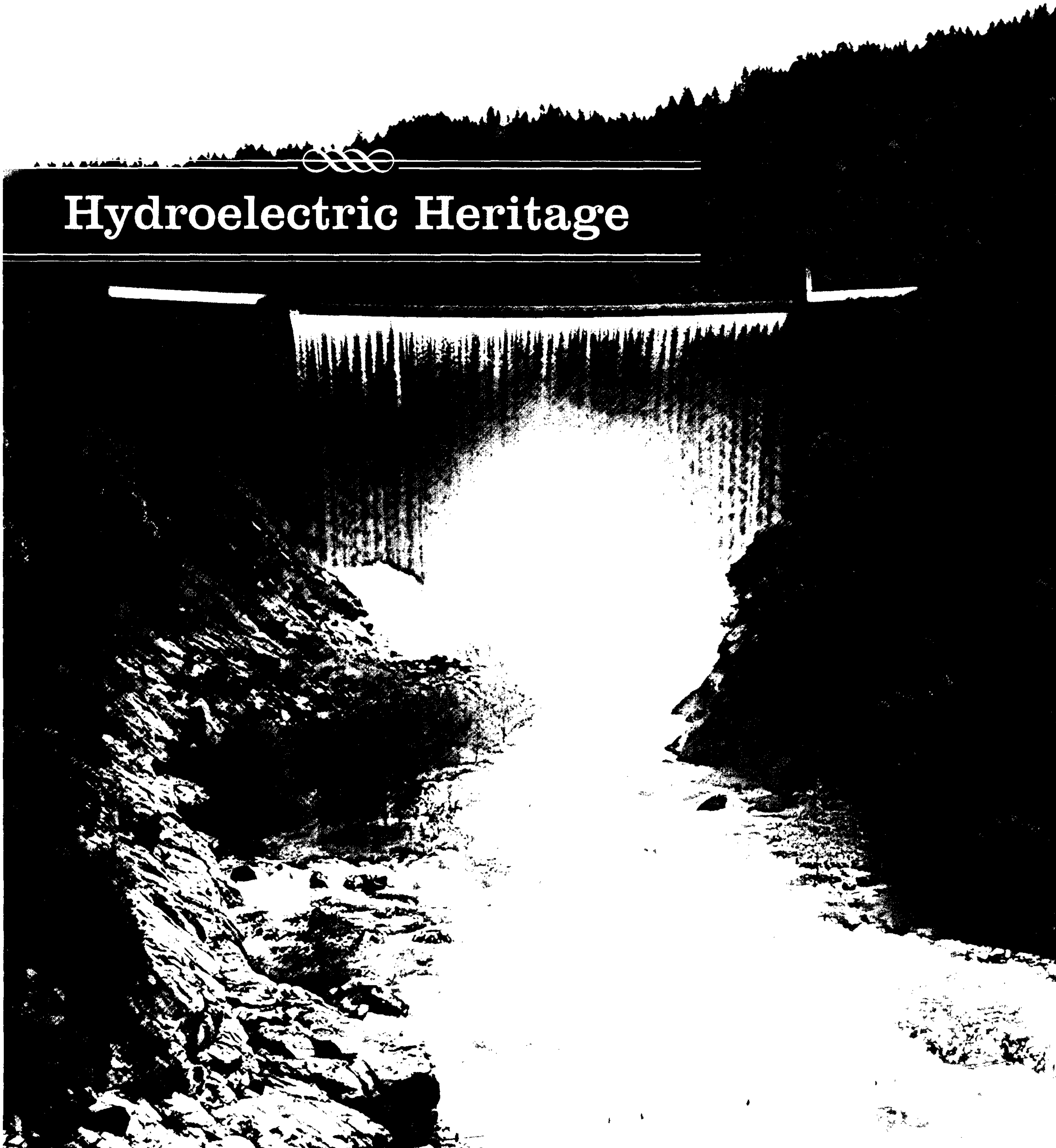
Located in southeast Sacramento County, the plant provides voltage support for better service reliability and avoids the energy losses that occur with long-distance transmission of imported electricity. It also will reduce power purchases to satisfy peak demand in the summer months.

The new plant will go a long way in helping SMUD meet increased power needs as the Sacramento area continues to grow. And, at least in the early years, it will at times generate surplus power for SMUD to sell in a market that has been commanding high prices.

Cosumnes is a state-of-the-art plant that uses combined-cycle technology to capture heat normally lost in the production of electricity, making it highly fuel efficient and clean. Two gas turbine generators burn natural gas to produce electricity, while heat from those turbines is used to create steam that powers a third generator.

Power for the Future

Hydroelectric Heritage



Hydroelectric Heritage

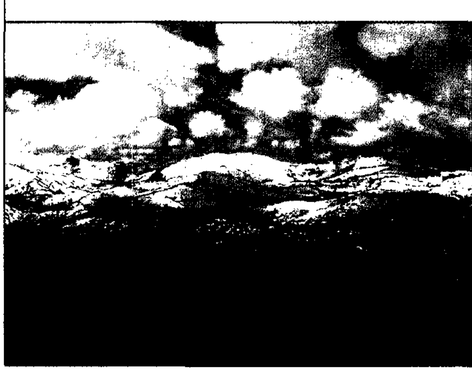
In the first two decades of utility operations, much of the focus at SMUD was on starting construction of the Upper American River Project, an ambitious hydroelectric system in the Sierra Nevada range east of Sacramento.

Today, with 688 megawatts of power generating capacity, the system of 11 reservoirs and eight powerhouses remains the **crown jewel** of SMUD's energy supply.

On July 15, 2005, SMUD filed an application for a new federal operating license to replace the original 50-year license, which will expire in mid-2007. This 25,000-page application culminated nearly five years of continuous preparation, including 73 technical studies.

SMUD is using the federal review process to plan for future decades with a request for permission to add a pumped storage development in the hydro system. This would entail construction of an off-stream reservoir and a new powerhouse at Iowa Hill. Estimated to cost $450 million, this option would expand SMUD's hydroelectric generating capacity by 400 megawatts, or more than 50 percent.

In November, relicensing took a major step forward as SMUD directors approved an historic agreement with entities in El Dorado County, where the hydroelectric system is located. Hailed as a prime example of regional cooperation, the agreement resolved longstanding legal issues, providing monetary compensation and water supply and drought storage capacity for the El Dorado interests in exchange for their support of SMUD's relicensing application.



Endless Energy

Back in the 1980s, SMUD was a pioneer in the solar energy field, working to develop and demonstrate photovoltaics for use by electric utilities and their customers. Today, the state of California is implementing solar programs, technologies and policies that are a direct result of the work SMUD has done over the last 20 years.

SMUD will significantly expand its renewable energy resources in 2006

with an investment in wind turbine generators capable of producing 24 megawatts of power.

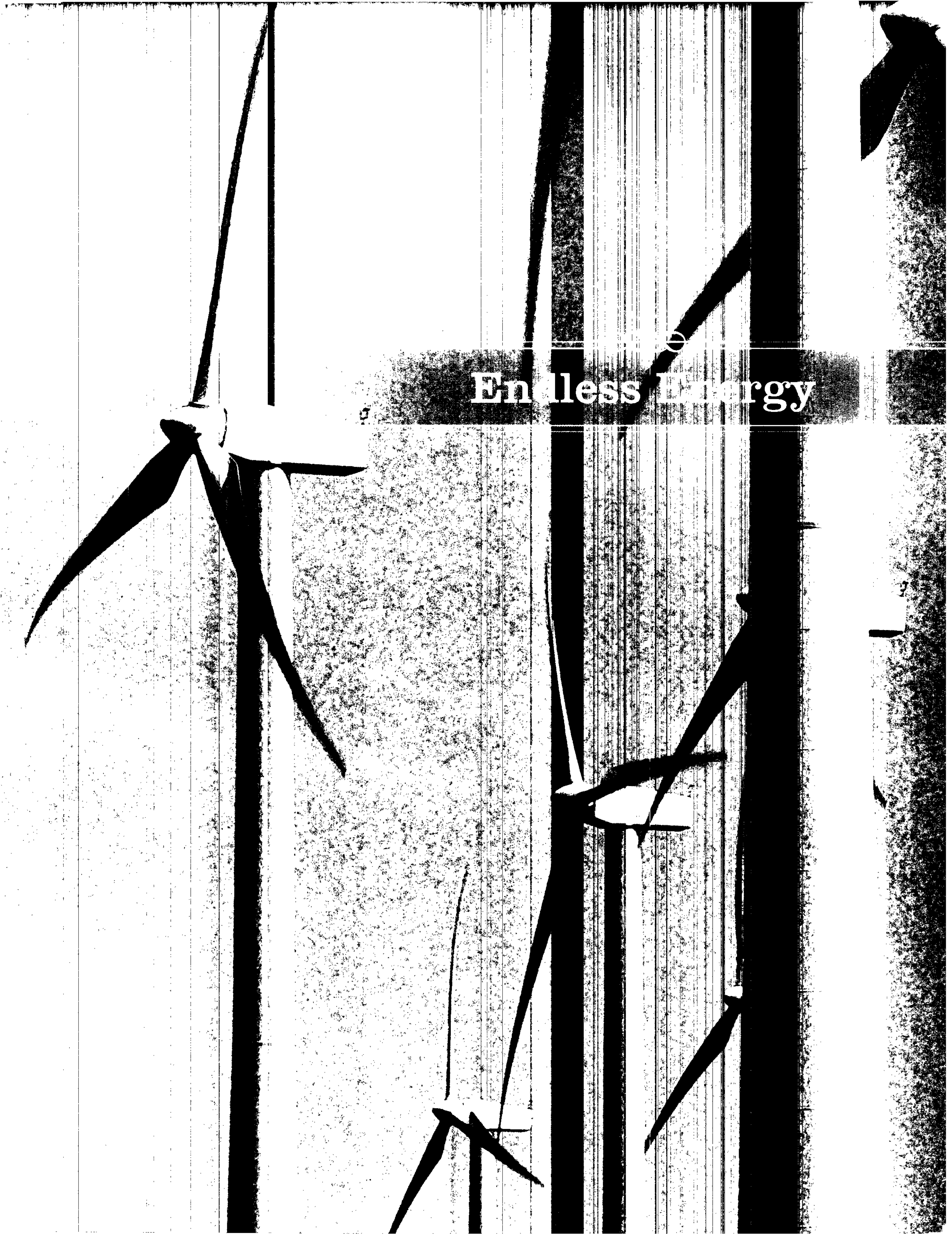
SMUD is planning an 87-megawatt expansion of its Solano Wind Project, with the first 24 megawatts of capacity to be installed in 2006. The SMUD-owned property will have a total of 39 megawatts of generating capacity by May.

In 2005, the utility contracted to increase purchases of energy generated from methane gas at landfills and small hydroelectric plants. All told, SMUD has procured enough renewable energy for 2006 to be more than halfway to its goal of a renewable portfolio standard of 20 percent of power supplies by 2011.

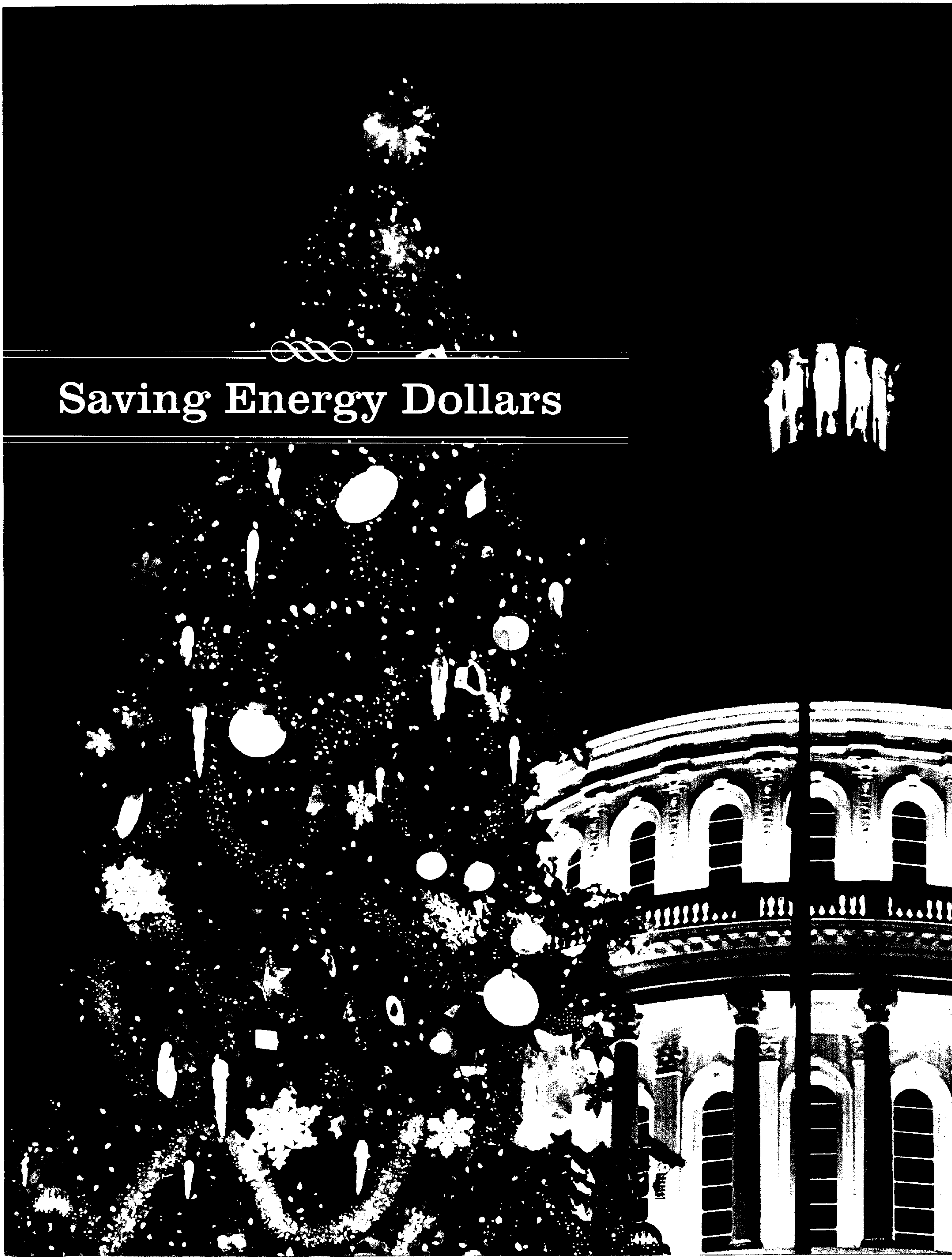
Since 1997, SMUD has offered customers the option of supporting environmentally friendly renewable power through its Greenergy® subscription program. Today, some 30,000 residential customers and more than 1,300 commercial customers participate in Greenergy,® making it one of the largest and most successful programs of its kind nationwide. Including Greenergy,® SMUD's renewable energy supply target is 23 percent by 2011.

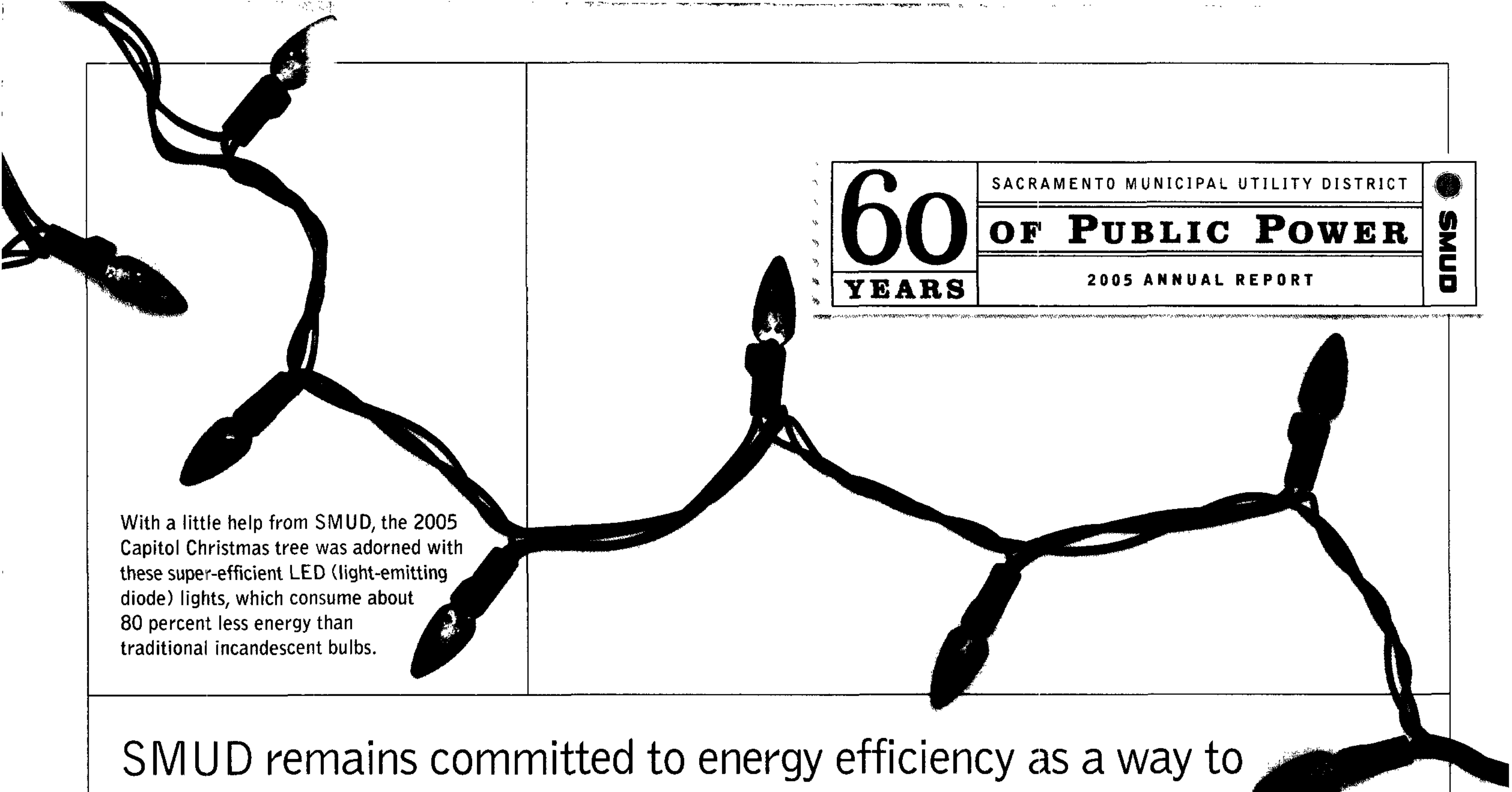
In addition to helping the environment, expanding renewable energy resources reduces the financial risk of over-reliance on any single generating source.

Endless Energy



Saving Energy Dollars





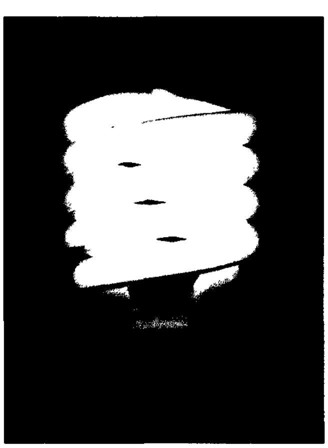
With a little help from SMUD, the 2005 Capitol Christmas tree was adorned with these super-efficient LED (light-emitting diode) lights, which consume about 80 percent less energy than traditional incandescent bulbs.

SMUD remains committed to energy efficiency as a way to

help customers reduce their electric bills

and to minimize the need for new power plants.

For more than a decade, SMUD has spurred a conversion to energy-efficient compact fluorescent lights by offering incentives that reduce the cost for SMUD customers.



Saving Energy Dollars

The SMUD Board of Directors has made a high priority of reducing peak demand for power with an emphasis on energy efficiency.

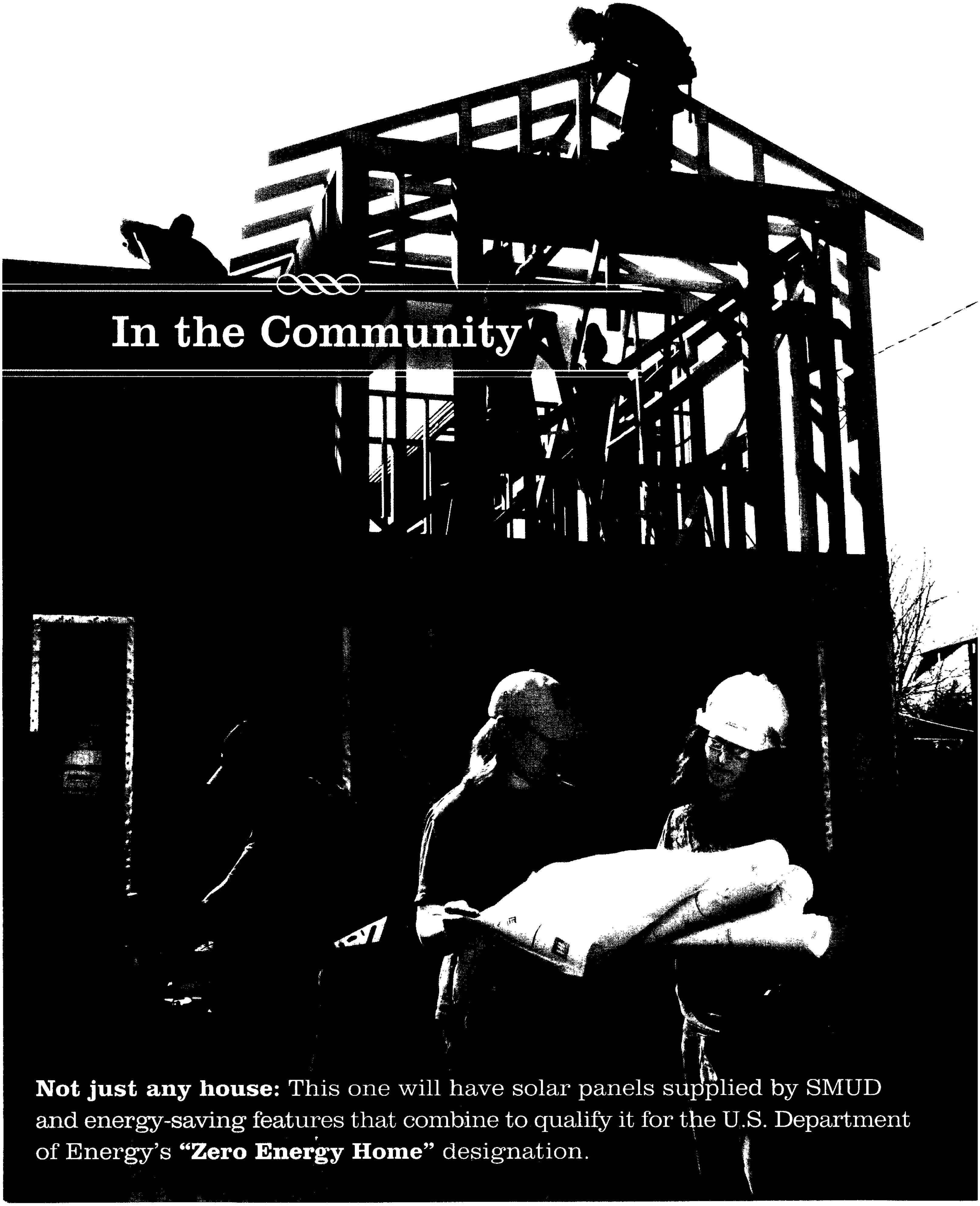
SMUD has been a national leader in this area since the first energy crisis hit the United States in the mid-1970s. One sign of success: Many of the energy efficiency technologies SMUD has encouraged with rebates have become part of California's building standards.

In 2005, SMUD's energy efficiency programs removed the need for 81 gigawatt hours of power generation. That's enough to satisfy the annual energy needs of 9,000 homes while avoiding 56,000 pounds of nitrous oxide emissions from power generation.

The utility's budget for 2006 includes $24.4 million for energy efficiency programs, a $2.1 million increase over 2005.

Ongoing projects at SMUD include the study of more efficient air-conditioning systems for residential use and testing of a new refrigeration management system that helps commercial customers reduce energy use. Reducing energy consumed by air conditioners could go a long way to rein in peak demand, conserve energy when it is most expensive, and help protect our environment by minimizing the need to build more power plants.

In the Community



Not just any house: This one will have solar panels supplied by SMUD and energy-saving features that combine to qualify it for the U.S. Department of Energy's **"Zero Energy Home"** designation.

In the Community

SMUD's 2,000-plus employees live in the Sacramento area, work in the Sacramento area and volunteer in the Sacramento area. Throughout the year, they raise money for good causes and contribute thousands of hours to projects and programs that give back to the community.

In cooperation with Sacramento Habitat for Humanity, SMUD employees contributed $40,000 and **the people power to build a house for a needy family** in the Oak Park neighborhood of Sacramento.

After hurricanes Katrina and Rita devastated the Gulf region, employees collected and packed supplies, volunteered time and donated thousands of dollars. A month later, they contributed nearly $350,000 in the utility's annual charity drive to support local, national and global non-profit groups.

The Face of Change

Over the course of six decades, the population of Sacramento has evolved into a racial and ethnic kaleidoscope. As a result of this demographic shift, a commitment to diversity has become an integral part of SMUD's business.

SMUD aims to attract and maintain a high-quality and diverse work force that reflects the community it serves: a community TIME magazine has labeled the most ethnically diverse in the country. A workplace that cultivates respect for ethnic and cultural differences helps SMUD connect better with its customers. Putting employees' talents to good use is part of the commitment.

Employees fluent in Spanish, Hmong, Laotian, Swahili, Hindi, Punjabi or Tagalog sat in on job interviews in 2005 to help evaluate candidates' language and translation skills as SMUD strove to recruit and hire more bilingual employees.

5 YEAR SUMMARY (UNAUDITED)

Operating Statistics (i)	2005	2004	2003	2002	2001
Customers at year-end	577,946	567,176	553,337	541,296	528,969
KWH Sales (thousands):					
Sales to customers —					
Residential	4,534,276	4,446,117	4,372,111	4,093,714	3,929,563
Commercial, industrial & other	5,951,447	5,790,984	5,547,617	5,413,730	5,379,658
Subtotal	10,485,723	10,237,101	9,919,728	9,507,444	9,309,221
Sales of surplus power	1,496,569	858,234	1,547,595	2,502,646	3,610,564
Total	11,982,292	11,095,335	11,467,323	12,010,090	12,919,785
Revenues (thousands of dollars)					
Sales to customers —					
Residential	$ 480,100	$ 442,704	$ 444,713	$ 411,993	$ 380,378
Commercial, industrial & other	557,305	527,828	516,562	506,613	490,580
Subtotal	1,037,405	970,532	961,275	918,606	870,958
Sales of surplus power	73,475	23,856	62,382	66,521	606,931
Sales of surplus gas	114,313	62,022	65,279	29,413	-0-
Total (ii)	$ 1,225,193	$ 1,056,410	$ 1,088,936	$ 1,014,540	$ 1,477,889
Average kWh sales per residential customer	8,909	8,927	8,998	8,629	8,476
Average revenue per residential kWh sold (cents)	10.41	9.91	10.11	10.03	9.63
Power supply (thousands of kWh)					
Hydroelectric	2,236,818	1,259,570	1,575,534	1,409,537	415,530
Cogeneration	2,196,055	2,417,533	2,292,179	2,482,552	2,767,246
Windpower	36,828	41,644	27,376	4,521	7,243
Photovoltaic	2,341	2,201	2,380	2,834	2,953
Gas turbine/Fuel cell	2,225	13,445	2,568	19,710	79,623
Purchases	7,968,762	7,853,322	8,067,294	8,566,718	10,013,909
Net system peak demand — 1 hour (kW)	2,959,000	2,672,000	2,809,000	2,779,000	2,484,000
Equivalent Full Time Employees at year-end	2,279	2,209	2,219	2,191	2,140
Financial Statistics (thousands of dollars)					
Operating revenues	$ 1,225,193	$ 1,068,727	$ 1,032,867	$ 1,012,073	$ 1,520,751
Operating expenses —					
Purchased and interchanged power	463,710	373,362	387,985	363,338	863,472
Operation and maintenance	461,229	398,696	386,423	400,026	405,797
Depreciation and amortization	107,751	99,754	138,881	134,958	144,222
Decommissioning	29,408	29,166	29,708	31,552	30,346
Total operating expenses	1,062,098	900,978	942,997	929,874	1,443,837
Operating income	163,095	167,749	89,870	82,199	76,914
Other income	26,591	24,972	29,828	39,555	53,839
Income before interest charges	189,686	192,721	119,698	121,754	130,753
Interest charges	106,414	108,860	119,698	121,754	130,753
Net increase in net assets	$ 83,272	$ 83,861	$ -0-	$ -0-	$ -0-
Funds available for revenue bond debt service	$ 310,257	$ 310,739	$ 254,036	$ 256,413	$ 252,260
Revenue bond debt service	$ 159,611	$ 136,929	$ 119,238	$ 127,487	$ 159,063
Revenue bond debt service coverage ratio	1.94	2.27	2.13	2.01	1.59
Electric utility plant — net	$ 2,662,311	$ 2,493,785	$ 2,239,073	$ 1,918,966	$ 1,819,751
Capitalization					
Long-term debt, net of current portion	$ 2,303,188	$ 2,406,325	$ 2,358,710	$ 2,058,280	$ 2,073,721
Customers' equity	$ 385,588	$ 302,316	$ 218,455	$ 219,652	$ 219,652

i Financial information is consolidated (except the debt service information).

ii Prior to the net deferral/transfer of revenues to/from the Rate Stabilization Fund and deferral of Public Good revenue.

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REPORT OF INDEPENDENT ACCOUNTANTS

PricewaterhouseCoopers LLP
400 Capitol Mall, Suite 600
Sacramento CA 95814-4602

To the Board of Directors of Sacramento Municipal Utility District:

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of revenues, expenses and changes in net assets and of cash flows present fairly, in all material respects, the financial position of Sacramento Municipal Utility District (the "District") and its blended component units at December 31, 2005 and December 31, 2004, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the District's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

The management's discussion and analysis included on pages 26 through 33 is not a required part of the basic consolidated financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

PricewaterhouseCoopers LLP

April 3, 2006

The following discussion and analysis of the Sacramento Municipal Utility District and its component units (District) financial performance provides an overview of the District's financial activities for the years ended December 31, 2005 and 2004. This discussion and analysis should be read in conjunction with the District's financial statements and accompanying notes, which follow this section.

BACKGROUND

The District was formed by a vote of the electors in 1923, under provisions of the State of California Municipal Utility District Act, and began electric operations in 1947. The District is governed by an elected Board of Directors and has the rights and powers to fix rates and charges for commodities or services furnished, to incur indebtedness and issue bonds or other obligations, and, under certain circumstances, to levy and collect ad valorem property taxes. The District is responsible for the acquisition, generation, transmission, and distribution of electric power to its service area, which includes most of Sacramento County and a small adjoining portion of Placer County.

Setting of Rates

The District's Board of Directors (Board) has autonomous authority to establish the rates charged for all District services. Changes in such rates require formal action, after public hearing, by the Board.

In May 2001, the Board approved a temporary rate surcharge to replenish the Rate Stabilization Fund. The surcharge expired May 2004. In March 2005, the Board approved an average system rate increase of approximately six percent that was effective in rates beginning April 1, 2005.

Financial Reporting

The District's accounting records are maintained in accordance with generally accepted accounting principles for proprietary funds as prescribed by the Governmental Accounting Standards Board (GASB) and, where not in conflict with GASB pronouncements, accounting principles prescribed by the Financial Accounting Standards Board (FASB). The District's accounting records generally follow the Uniform System of Accounts for Public Licensees prescribed by the Federal Energy Regulatory Commission (FERC), except as it relates to the accounting for contributions of utility property in aid of construction.

In accordance with Statement of Financial Accounting Standards No. 71, "Accounting for the Effects of Certain Types of Regulation", the Board has taken various regulatory actions for ratemaking purposes that result in the deferral of expense or revenue recognition. As of December 31, 2005, the District had total regulatory costs for future recovery of $280 million, which is a net decrease of $82 million from 2004. The decrease is due primarily to the change in value of derivative financial instruments, a decrease in the deferred decommissioning liability due to continued decommissioning progress and an updated estimate for the liability to the U.S. Bureau of Reclamation (Bureau), partially offset by an increase in the deferred liability related to the year-end valuation of precipitation hedges. The District also had regulatory credits of $476 million as of December 31, 2005, which is a net increase of $231 million over 2004. The increase is primarily due to the change in value of derivative financial instruments, the deferral of gains from contribution in aid of construction, partially offset by the revenue recognition of a settlement with El Paso Natural Gas that was previously deferred. The regulatory costs and regulatory credits will be recognized in the consolidated statement of revenues, expenses and changes in net assets in future periods as determined by the Board for ratemaking purposes.

For the last several years, the Board had a strategic directive to build up the Rate Stabilization Fund as a reserve against the need for future rate increases. As a result, the District would defer any net income or recoup any net loss through the use of the Rate Stabilization Fund as part of its rate policy. In 2004, the Board ceased this practice in connection with adoption of a strategic directive to increase customer equity to a targeted level of 20 percent by 2007.

Using This Financial Report

This financial annual report consists of management's discussion and analysis and the consolidated financial statements, including notes to the consolidated financial statements. The financial annual report reflects the activities of the District primarily funded through the sale of energy, transmission, and distribution services to its customer-owners.

Consolidated Balance Sheets, Statements of Revenues, Expenses and Changes in Net Assets, and Statements of Cash Flows

The consolidated financial statements provide both short-term and long-term information about the District's financial status. The consolidated Balance Sheets include all of the District's assets and liabilities, using the accrual method of accounting, as well as an indication about which assets can be utilized for general purposes, and which assets are restricted as a result of bond covenants, Board action and other commitments. The consolidated Balance Sheets provide information about the nature and amount of resources and obligations at a specific point in time. The consolidated Statements of Revenues, Expenses and Changes in Net Assets report all of the District's revenues and expenses during the periods indicated. The consolidated Statements of Cash Flows report the cash provided and used by operating activities, as well as other cash sources such as investment income and debt financing, and other cash uses such as payments for bond principal and capital additions and betterments.

FINANCIAL HIGHLIGHTS

Condensed Consolidated Balance Sheets
(millions)

	December 31,		
Assets	2005	2004	2003 As Restated[1]
Electric Utility Plant — net	$ 2,662	$ 2,494	$ 2,239
Restricted and Designated Assets	243	251	271
Current Assets	950	629	750
Noncurrent Assets and Deferred Charges	577	527	501
	$ 4,432	$ 3,901	$ 3,761
Liabilities and Net Assets			
Long-Term Debt — net	$ 2,303	$ 2,407	$ 2,359
Current Liabilities and Deferred Credits	877	473	488
Noncurrent Liabilities and Deferred Credits	866	719	696
Net Assets	386	302	218
	$ 4,432	$ 3,901	$ 3,761

ASSETS

Utility Plant — net

2005 Compared to 2004 The District has invested approximately $2.7 billion in utility plant assets and construction work in progress net of accumulated depreciation at December 31, 2005. Net utility plant makes up about 60 percent of the District's assets, approximately 4 percent less than the previous year. During 2005, the District capitalized approximately $278 million of additions to utility plant, including additions to construction work in progress in the District's consolidated financial statements. The primary increase was due to the 2005 costs of approximately $101 million for the 500 MW, gas-fired Cosumnes Power Plant project (Project). The Project is currently planned to cost approximately $435 million and became operational on February 24, 2006.

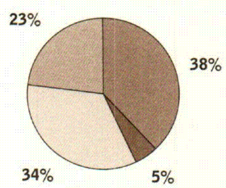
The District entered into a contract with Fru-Con Construction Corporation (Fru-Con) to construct the Project. Unable to resolve the disputes over costs and delays to the satisfaction of the District, the contract was terminated in February 2005. The District is currently in litigation with Fru-Con to resolve these disputes. The District has assumed the construction management responsibilities for the completion of the Project. See Note 18 for additional details.

2004 Compared to 2003 The District has invested approximately $2.5 billion in utility plant assets and construction work in progress net of accumulated depreciation at December 31, 2004. Net utility plant makes up about 64 percent of the District's assets, approximately 4 percent greater than the previous year. During 2004, the District capitalized approximately $356 million of additions to utility plant, including additions to construction work in progress in the District's consolidated financial statements. The primary increase was due to the 2004 costs of approximately $161 million for the Project.

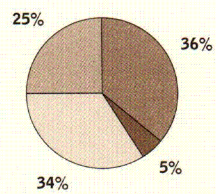
[1] The 2003 Balance Sheet was restated to correct the presentation of derivative financial instruments, the effect of which was deferred for ratemaking purposes, therefore, there was no impact on the Change in Net Assets for the year ended December 31, 2003.

The following charts show the breakdown of net utility plant by major plant category — Generation (Gen), Transmission (Trans), Distribution (Distr), and Other:

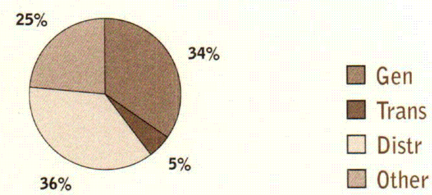
December 31, 2005



December 31, 2004



December 31, 2003



Restricted Assets

2005 Compared to 2004 The District's level of restricted assets (noncurrent) decreased by $8 million during 2005 primarily due to a reduction in the decommissioning trust fund balance as the District continues with decommissioning of the Rancho Seco nuclear power plant.

2004 Compared to 2003 The District's level of restricted assets (noncurrent) decreased by $20 million during 2004 reflecting a reduction of Revenue bond, debt service, and construction reserves, a reduction in the Rate Stabilization Fund, and a lower decommissioning trust fund balance as the District continues to decommission the Rancho Seco nuclear power plant.

Current Assets

2005 Compared to 2004 Current assets increased by $321 million in 2005 partially due to an increase in credit support collateral of $149 million for energy purchase contracts. The District has begun to employ credit support agreements with which to mitigate large credit exposures with certain energy trading partners. The agreements outline certain specific criteria and requirements for the timely posting of collateral to limit the unsecured portions of the contracts. The increase is also due to the value of derivative financial instruments maturing within one year, an increase in the current portion of restricted and designated assets, a higher level of unrestricted cash, and higher receivables for wholesale energy and gas sales. These increases were partially offset by lower materials and supplies and lower prepayments.

2004 Compared to 2003 (As Restated) Current assets decreased by $121 million in 2004 as a result of a lower level of unrestricted cash and investments reflecting significant expenditures for construction, a lower level of regulatory costs to be recovered in one year, reflecting the completion of recovering certain regulatory charges through rates, and a lower level of prepayments. These decreases were partially offset by higher receivables for wholesale energy sales.

Noncurrent Assets and Deferred Charges

2005 Compared to 2004 Total noncurrent assets and deferred charges increased by $50 million. This reflects an increase in the value of derivative financial instruments and higher conservation loans, partially offset by a decrease in regulatory costs for future recovery reflecting changes in the valuation of derivative financial instruments, which are deferred for ratemaking purposes, the continued decommissioning of the Rancho Seco nuclear power plant and a revised estimate for the liability to the Bureau.

2004 Compared to 2003 (As Restated) Total noncurrent assets and deferred charges increased by $26 million. This increase reflects an increase in the amount of regulatory assets to be recovered in future periods as a result of a proposed settlement with the Bureau, changes in the valuation of derivative financial instruments, which are deferred for ratemaking purposes, and an increase in other noncurrent assets due to a credit from a settlement with El Paso Natural Gas.

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LIABILITIES

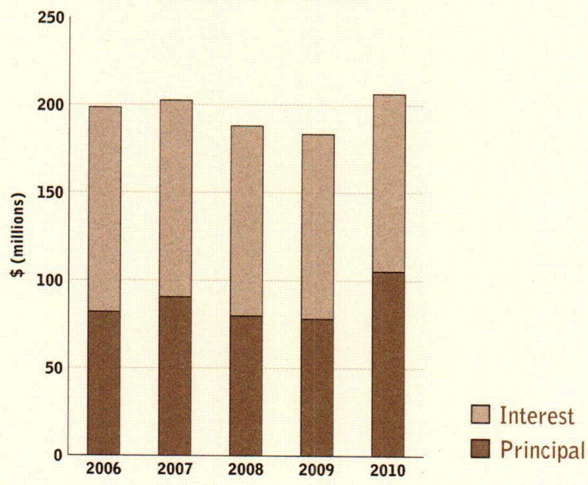
Long-Term Debt

2005 Compared to 2004 During 2005, the District issued $123 million of 2005 Series Sacramento Power Authority (SPA) Revenue Refunding Bonds, a component unit of the District, the proceeds of which plus cash were used to refund $124 million of previously issued SPA bonds. During 2005, the District also called approximately $9 million of Central Valley Financing Authority (CVFA) Bonds, and approximately $14 million of Sacramento Cogeneration Authority (SCA) Bonds, both component units of the District, reducing future debt service. In January 2006, the District issued $300 million of 2006 Series Sacramento Municipal Utility District Financing Authority (SFA) Revenue Bonds, also a component unit of the District.

2004 Compared to 2003 The District completed one debt issuance for a total of $131 million, which was used to refund $101 million of Commercial Paper Notes and $17 million of previously issued revenue bonds through legal defeasance. During 2004, the District called approximately $4 million of CVFA Bonds reducing future debt service.

The following table shows the District's future debt service requirements through 2010 as of December 31, 2005:

Debt Service Requirements



As of December 31, 2005, the District had an underlying rating of "A" from both Standard & Poor's and Fitch, and a higher rating of "A1" from Moody's. Most of the District's bonds are insured and are therefore rated "AAA" by the rating agencies.

Current Liabilities and Deferred Credits

2005 Compared to 2004 Current liabilities and deferred credits increased by approximately $404 million during 2005. The District issued $200 million of Commercial Paper Notes primarily to provide short-term financing for the construction of the Cosumnes Power Plant.

Regulatory credits to be recovered in one year increased by approximately $99 million reflecting changes in the valuation of derivative financial instruments. The current portion of credit support collateral for energy purchases, which was implemented in 2005, grew to $58 million. Additionally, purchased power payable increased by approximately $34 million reflecting higher power costs for 2005.

2004 Compared to 2003 (As Restated) Current liabilities and deferred credits decreased by approximately $15 million during 2004. As described in Long-Term Debt above, the District refunded $101 million of Commercial Paper Notes

C-03

through long-term senior debt after issuing $50 million during 2004. Additionally, accounts payable and accrued interest both decreased in 2004. The decreases were partially offset by an increase in the current portion of long-term debt, purchased power payable, and customer deposits and other.

Noncurrent Liabilities and Deferred Credits

2005 Compared to 2004 Noncurrent liabilities and deferred credits have increased by $147 million as a result of the increase in valuation of derivative financial instruments, which are deferred for ratemaking purposes and the non-current portion of credit support collateral for energy purchases, partially offset by a decrease in the decommissioning liability as the District continues with decommissioning of the Rancho Seco nuclear power plant.

2004 Compared to 2003 (As Restated) Noncurrent liabilities and deferred credits have increased by $23 million as a result of the increase in valuation of derivative financial instruments, which are deferred for rate-making purposes, an increase in regulatory credits and the recognition of a liability to the Bureau related to the tentative settlement of a billing dispute.

Condensed Statement of Consolidated Revenues, Expenses and Changes in Net Assets
(millions)

	December 31, 2005	2004	2003
Operating revenues	$ 1,225	$ 1,069	$ 1,033
Operating expenses	(1,062)	(901)	(943)
Operating income	163	168	90
Interest and other income	26	25	30
Interest charges	(106)	(109)	(120)
Increase in net assets	$ 83	$ 84	$ -0-

CHANGES IN NET ASSETS

Operating Revenues

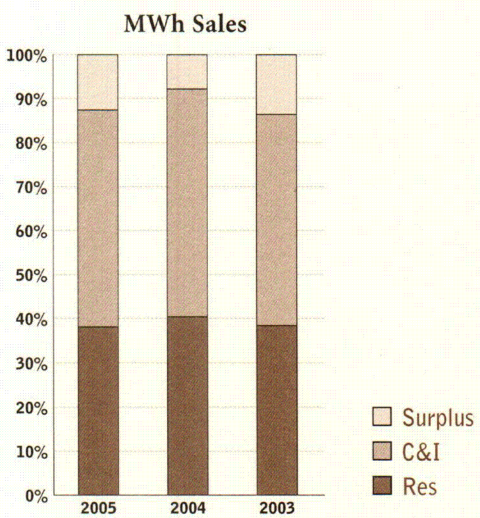
2005 Compared to 2004 Operating revenues were $1,225 million in 2005, an increase from 2004 of $156 million even though no funds were transferred to or from the Rate Stabilization Fund in 2005 versus a $12 million transfer from the Rate Stabilization Fund in 2004. Sales to customers were $1,028 million in 2005, an increase of $65 million over 2004 sales. The District sold 2.4 percent more energy to its retail customers, which grew from 567,176 customers in 2004 to 577,946 customers in 2005, at average revenue per kilowatt hour that increased by 4.3 percent, reflecting the rate increase in 2005.

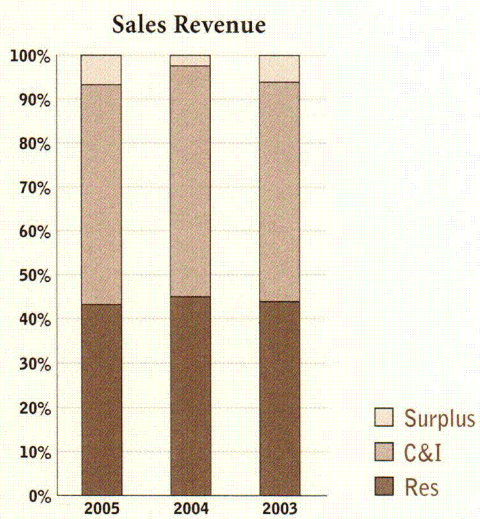
Wholesale revenues are comprised of both surplus energy and gas sales. In 2005, surplus gas sales were $114 million as compared to $62 million in 2004. The increase was primarily due to a higher amount sold (36 percent) as a result of the delayed start-up of the Cosumnes Power Plant. Additionally, the surplus gas sales were at higher average prices (35 percent) as compared to 2004. Surplus energy sales in 2005 were $50 million higher than in 2004. The increase is due to higher volume (74 percent) and higher average prices (77 percent) than in 2004. Higher surplus energy sales are a result of a number of factors, including higher hydro generation, the timing of hydro generation for reservoir management, and test energy from the Project.

2004 Compared to 2003 Operating revenues were $1,069 million in 2004, an increase from 2003 of $36 million after transferring approximately $12 million from the Rate Stabilization Fund in 2004 versus a $56 million transfer to the Rate Stabilization Fund in 2003. Sales to customers were $962 million in 2004, an increase of $9 million over 2003 sales. The District sold 3.2 percent more energy to its retail customers, which grew from 553,337 customers in 2003 to 567,176 customers in 2004, at average revenue per kilowatt hour that decreased by 2.1 percent, reflecting the end of a temporary rate surcharge in May 2004.

Wholesale revenues are comprised of both surplus energy and gas sales. In 2004, surplus gas sales were $62 million as compared to $65 million in 2003. The decrease was due to a lower amount sold (9 percent) although at higher average prices reflecting market conditions (4 percent) as compared to 2003. Surplus energy sales in 2004 were $39 million lower than in 2003. The decrease is due to lower volume (45 percent) and lower average prices (31 percent) than in 2003.

The following charts show the percentage of megawatt hour (MWh) sales and sales revenue in 2005, 2004 and 2003 by surplus energy sales (Surplus), commercial and industrial (C&I), and residential (Res) customers:





Operating Expenses

2005 Compared to 2004 Operating expenses were $1,062 million in 2005 as compared to $901 million in 2004. The District's purchased power expense was $90 million higher in 2005 than in 2004. The District spent $105 million more for power purchases in 2005 mainly due to higher market prices and some additional energy as compared to 2004. This was partially offset by revenue recognition for the advance payment of the settlement with El Paso Natural Gas in 2005. Approximately 1.5 percent more energy was purchased in 2005 at average prices that were 18 percent higher than in 2004. In 2005, fuel costs for generation, a component of production costs, were approximately $77 million, or $11 million lower than 2004. Less fuel was used in 2005 due to lower JPA generation (1.8 million decatherms) at average prices that were 3.6 percent lower than in 2004.

Transmission and distribution operations expense was $9 million higher in 2005 as compared to 2004 due to higher transmission expenses for the Western Area Power Administration, both for a new transmission contract and higher rates on an existing contract, and the California Independent System Operator.

The District had higher expenses for administrative and general due to litigation expenses related to the contract disputes with Fru-Con, and higher expenditures for public good activities primarily for energy efficiency lighting programs.

Depreciation expense increased due to additions to plant in service, primarily for general and distribution plant.

In 2005, power supply costs made up approximately 66 percent of total operating expenses as compared to 63 percent for 2004.

2004 Compared to 2003 Operating expenses were $901 million in 2004 as compared to $943 million in 2003. The District spent $15 million less for purchased power in 2004 than in 2003. Approximately 2.4 percent less energy was purchased in

C-04

2004 at average prices that were 1.4 percent lower than in 2003. In 2004, fuel costs for generation, a component of production costs, were approximately $88 million, or $12 million higher than 2003. More fuel was used in 2004 (974 thousand decatherms) at average prices that were 10 percent higher than in 2003.

The District also had lower expenses for administrative and general due to lower property insurance premiums, lower A&G salaries, and lower expenditures for public good activities for research and development of photovoltaic generation and distributed technology.

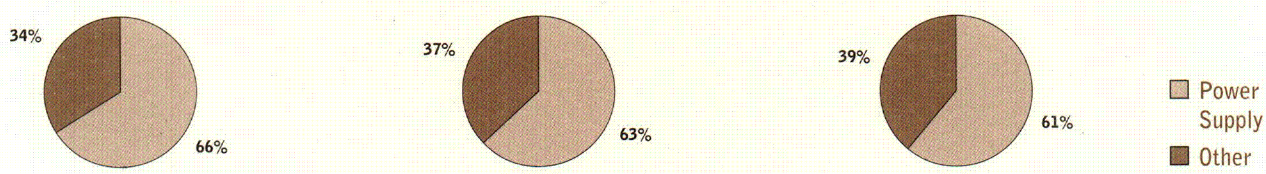
Maintenance increased due to repairs at hydro facilities and preventative maintenance projects. Depreciation expense increased due to additions to plant in service, primarily for distribution plant.

Regulatory deferrals collected in rates significantly decreased due to the complete recovery through rates for deferred nuclear plant costs and other regulatory assets during 2003.

In 2004, power supply costs made up approximately 63 percent of total operating expenses as compared to 61 percent for 2003.

The following charts compare the relative cost of purchased power, production expenses, and depletion of the Rosa gas field (power supply costs) to all other operating expenses in 2005, 2004 and 2003:

2005 Operating Expenses **2004 Operating Expenses** **2003 Operating Expenses**



Interest and Other Income

2005 Compared to 2004 Interest and other income was higher by $2 million in 2005 as compared to 2004. Interest income was higher due to higher cash balances and higher interest rates in 2005 as compared to 2004. Other income was lower in 2005 primarily as a result of lower JPA earnings and grant revenues, partially offset by lower unrealized holding losses on investments. JPA earnings were lower due to funds being used for debt reduction as opposed to being distributed to the member.

2004 Compared to 2003 Interest and other income was lower by $5 million in 2004 as compared to 2003. Interest income was lower due to lower cash balances and lower interest rates in 2004 as compared to 2003. Other income was lower in 2004 primarily as a result of lower unrealized holding gains on investments.

Interest Charges

2005 Compared to 2004 Interest charges in 2005 were $2 million lower than in 2004, which is due primarily to higher allowance for funds used during construction as a result of the progress on the Cosumnes Power Plant project, partially offset by higher interest on long-term debt and commercial paper.

2004 Compared to 2003 Interest charges in 2004 were $11 million lower than in 2003, which is due primarily to higher allowance for funds used during construction as a result of the progress on the Cosumnes Power Plant project and due to lower amortization of debt issuance costs and discounts.

C-05

CONSOLIDATED BALANCE SHEETS

Assets	December 31, 2005	2004
	(thousands of dollars)	
Electric Utility Plant		
Plant in service	$ 3,125,347	$ 2,945,909
Less accumulated depreciation and depletion	(1,150,513)	(1,065,631)
Plant in service — net	1,974,834	1,880,278
Construction work in progress	687,477	613,507
Total electric utility plant — net	2,662,311	2,493,785
Restricted and Designated Assets		
Revenue bond reserve, debt service and construction reserves	178,016	179,793
Nuclear decommissioning trust fund	83,177	87,968
Rate stabilization fund	75,000	75,000
Securities lending collateral	66,136	66,427
Other funds	6,310	6,072
Less current portion	(165,124)	(177,168)
Total restricted and designated assets	243,515	238,092
Current Assets		
Unrestricted cash, cash equivalents and investments	329,457	123,322
Restricted and designated cash, cash equivalents and investments	165,124	177,168
Receivables — net:		
Retail customers	128,703	123,722
Wholesale	58,280	50,475
Conservation loans due within one year, accrued interest and other	18,353	16,508
Regulatory costs to be recovered within one year	77,818	72,836
Derivative financial instruments maturing within one year	136,412	32,309
Materials and supplies	28,531	33,631
Prepayments	6,874	11,837
Total current assets	949,552	641,808
Noncurrent Assets and Deferred Charges		
Regulatory costs for future recovery	202,501	289,373
Derivative financial instruments	287,512	150,971
Unamortized debt issuance costs	29,645	30,323
Conservation loans	37,573	33,730
Preliminary project studies and other	19,782	22,857
Total noncurrent assets and deferred charges	577,013	527,254
Total assets	$ 4,432,391	$ 3,900,939

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

CONSOLIDATED BALANCE SHEETS

Liabilities	December 31, 2005	2004
	(thousands of dollars)	
Long-Term Debt — net	$ 2,303,188	$ 2,406,325
Current Liabilities and Deferred Credits		
Commercial paper notes	200,000	-0-
Accounts payable	88,584	74,285
Purchased power payable	110,158	76,610
Credit support collateral obligation	57,628	-0-
Long-term debt due within one year	82,340	67,165
Accrued decommissioning	41,514	41,500
Accrued interest	37,097	39,141
Accrued salaries and compensated absences	27,499	25,178
Derivative financial instruments maturing within one year	33,829	48,317
Regulatory credits to be recognized within one year	105,351	7,495
Securities lending collateral obligation	66,136	66,427
Customer deposits and other	27,357	27,355
Total current liabilities and deferred credits	877,493	473,473
Noncurrent Liabilities and Deferred Credits		
Accrued decommissioning	248,479	283,758
Derivative financial instruments	128,860	155,523
Regulatory credits	362,067	238,497
Credit support collateral obligation	90,972	-0-
Due to affiliated entity	15,425	14,863
Due to U.S. Bureau of Reclamation	9,732	12,485
Self insurance, deferred credits and other	10,587	13,699
Total noncurrent liabilities and deferred credits	866,122	718,825
Total liabilities	4,046,803	3,598,623
Net Assets		
Invested in capital assets, net of related debt	200,218	152,809
Restricted	52,827	44,068
Unrestricted	132,543	105,439
Total net assets	385,588	302,316
Commitments and Contingencies (Notes 17 and 18)		
Total liabilities and net assets	$ 4,432,391	$ 3,900,939

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

Consolidated Statements of Revenues, Expenses and Changes in Net Assets

	Year Ended December 31, 2005	2004
	(thousands of dollars)	
Operating Revenues		
Residential	$ 480,100	$ 442,704
Commercial and industrial	548,113	514,670
Street lighting and other	9,192	13,158
Wholesale	187,788	85,878
Rate stabilization fund transfers	-0-	12,317
Total operating revenues	1,225,193	1,068,727
Operating Expenses		
Operations:		
Purchased power	463,710	373,362
Production	234,626	189,502
Transmission and distribution	41,952	32,553
Administrative, general and customer	97,574	93,609
Public good	26,690	22,933
Maintenance	54,146	54,834
Depreciation	106,588	98,614
Depletion	6,241	5,265
Decommissioning	29,408	29,166
Regulatory deferrals collected in rates	1,163	1,140
Total operating expenses	1,062,098	900,978
Operating Income	163,095	167,749
Nonoperating Revenues and Expenses		
Other revenues		
Interest income	22,146	17,550
Other income — net	4,445	7,422
Total other revenues	26,591	24,972
Interest charges		
Interest on debt	126,923	124,230
Allowance for funds used during construction	(20,509)	(15,370)
Total interest charges	106,414	108,860
Increase in Net Assets	83,272	83,861
Net Assets — Beginning of Year	302,316	218,455
Net Assets — End of Year	$ 385,588	$ 302,316

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

Consolidated Statements of Cash Flows

	Year Ended December 31, 2005	2004
	(thousands of dollars)	
Cash Flows from Operating Activities		
Receipts from retail customers	$ 1,025,925	$ 965,211
Receipts from surplus power sales	71,193	32,942
Receipts from surplus gas sales	110,605	61,874
Receipts from federal and state grants	1,355	3,727
Receipts from steam sales	8,555	7,931
Receipts for credit support collateral	148,600	-0-
Other receipts	4,208	5,076
Issuance/repayment of conservation loans, net	(2,829)	2,102
Payments to employees — payroll and other	(174,906)	(176,518)
Payments for wholesale power	(437,517)	(354,050)
Payments for gas purchases	(185,055)	(149,712)
Payments to vendors/others	(72,982)	(72,578)
Payments for weather hedge/insurance	(14,955)	(1,550)
Payments for decommissioning	(37,252)	(32,249)
Net cash provided by operating activities	444,945	292,206
Cash Flows from Investing Activities		
Sales and maturities of securities	331,378	309,633
Purchases of securities	(286,969)	(377,799)
Interest and dividends received	15,429	13,937
Securities lending collateral — net	(260)	954
Net cash provided by (used in) investing activities	59,578	(53,275)
Cash Flows from Capital and Related Financing Activities		
Construction expenditures	(258,469)	(348,414)
Contributions in aid of construction	13,742	13,252
Net proceeds from bond issues	125,722	131,188
Repayment and defeasance of debt	(219,645)	(65,627)
Issuance of commercial paper	200,000	50,000
Repayment of commercial paper	-0-	(101,000)
Interest on debt	(121,936)	(124,038)
Net cash used in capital and related financing activities	(260,586)	(444,639)
Net increase (decrease) in cash and cash equivalents	243,937	(205,708)
Cash and cash equivalents at the beginning of the year	226,151	431,859
Cash and cash equivalents at the end of the year	$ 470,088	$ 226,151
Cash and cash equivalents included in:		
Unrestricted cash, cash equivalents and investments (a component of the total of $329,457 and $123,322 at December 31, 2005 and 2004, respectively)	$ 329,457	$ 119,113
Restricted and designated cash, cash equivalents and investments (a component of the total of $165,124 and $177,168 at December 31, 2005 and 2004, respectively)	84,735	91,554
Revenue bond, debt service and construction reserves (a component of the total of $178,016 and $179,793 at December 31, 2005 and 2004, respectively)	55,896	15,484
Cash and cash equivalents at the end of the year	$ 470,088	$ 226,151

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

NOTE 1. ORGANIZATION

The Sacramento Municipal Utility District (District) was formed and operates under the State of California Municipal Utility District Act (Act). The Act confers upon the District the rights and powers to fix rates and charges for commodities or services furnished, to incur indebtedness and issue bonds or other obligations and, under certain circumstances, to levy and collect ad valorem property taxes. As a public utility, the District is not subject to regulation or oversight by the California Public Utilities Commission. The District is responsible for the acquisition, generation, transmission, and distribution of electric power to its service area, which includes most of Sacramento County and a small adjoining portion of Placer County. The Board of Directors (Board) determines the District's rates. The District is exempt from payment of federal and state income taxes and real and personal property taxes.

NOTE 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Method of Accounting. The District's accounting records are maintained in accordance with generally accepted accounting principles for proprietary funds as prescribed by the Governmental Accounting Standards Board (GASB) and, where not in conflict with GASB pronouncements, accounting principles prescribed by the Financial Accounting Standards Board (FASB). The District's accounting records generally follow the Uniform System of Accounts for Public Utilities and Licensees prescribed by the Federal Energy Regulatory Commission (FERC), except as it relates to the accounting for contributions of utility property in aid of construction (CIAC). The District's consolidated financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of the related cash flows. Electric revenues and costs that are directly related to generation, purchase, transmission, and distribution of electricity are reported as operating revenues and expenses. All other revenues and expenses are reported as non-operating revenues and expenses.

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

The Financial Reporting Entity. These consolidated financial statements include the District and its component units. Although the component units are legally separate from the District, they are blended into and reported as part of the District because of the extent of their operational and financial relationships with the District. All significant inter-component transactions have been eliminated in consolidation.

Component Units. The component units include the Central Valley Financing Authority (CVFA), the Sacramento Cogeneration Authority (SCA), and the Sacramento Power Authority (SPA). The primary purpose of the component units is to own and operate electric utility plants that supply power to the District. The District's Board comprises the Commissions that govern these entities.

Plant in Service. The cost of additions to Plant in Service and replacement property units is capitalized. Repair and maintenance costs are charged to expense when incurred. When the District retires portions of its Electric Utility Plant, retirements are recorded against Accumulated Depreciation and the retired portion of Electric Utility Plant is removed from Plant in Service. The costs of removal and the related salvage value, if any, are charged or credited as appropriate to

Accumulated Depreciation. The District generally computes depreciation on Plant in Service on a straight-line, service-life basis. The consolidated average annual composite depreciation rates for 2005 and 2004 were 3.67 percent and 3.59 percent. Depreciation is calculated using the following estimated lives:

Generation	5 to 74 years
Transmission and Distribution	5 to 50 years
General	2 to 45 years

Investments in Joint Power Agency (JPA). The District's investment in the Transmission Agency of Northern California (TANC) is accounted for under the equity method of accounting and is reported as a component of Plant in Service. The District's share of the TANC debt service costs and operations and maintenance expense, inclusive of depreciation, are included in Transmission and Distribution expense in the consolidated statements of revenues, expenses and changes in net assets.

Investments in Gas Properties. The District has an approximate 23 percent non-operating ownership interest in the Rosa Unit gas properties in New Mexico of which, the District's portion of the extracted gas is transported for use in its natural gas fired cogeneration power plants (see Note 6). The District uses the successful efforts method of accounting for its investment in gas producing properties. Costs to acquire mineral interests in gas properties, to drill and equip exploratory wells that find proved reserves, and to drill and equip development wells are capitalized as a component of Plant in Service on the consolidated balance sheets. Costs to drill exploratory wells that do not find proved reserves, geological and geophysical costs, and costs of carrying and retaining unproved properties are expensed. Capitalized costs of producing gas properties, after considering estimated residual salvage values, are depleted by the unit-of-production method based on the estimated future production of the proved developed producing wells. The District's investment in gas properties is reported as a component of Plant in Service.

Restricted and Designated Assets. Cash, cash equivalents and investments, which are restricted under terms of certain agreements for payments to third parties or Board actions limiting the use of such funds are included as restricted assets.

Restricted Bond Funds. The District's Indenture Agreements and Bond Resolutions require the maintenance of minimum levels of reserves for debt service and certain construction costs intended by the related debt offerings.

Nuclear Decommissioning Trust Fund. The District makes annual contributions to its Nuclear Decommissioning Trust Fund (Trust Fund) to cover the cost of its primary decommissioning activities associated with the Rancho Seco facility. Primary decommissioning excludes activities associated with the spent fuel storage facility after 2008 and most non-radiological decommissioning tasks. The District annually evaluates its contribution rate to ensure the Trust Fund will fully fund primary decommissioning by the end of 2008, the same year in which active decommissioning is planned to be complete (see Note 13). The annual contribution rate is determined in advance of each year, during the budget process, based on calculation of the planned expenditure rate over the remaining number of years estimated to complete the primary decommissioning activities. Changes in the estimate of the decommissioning liability serve to increase the contribution rate in future years (not in the year the estimate is updated, if changed).

Interest earnings on the Trust Fund assets are recorded as Interest Income and are accumulated in the Trust Fund. Annual Decommissioning expense comprises the district's annual contribution to the Trust Fund and the interest earnings on Trust Fund assets during the year.

Accrued Decommissioning. The District accrues decommissioning costs related to Utility Plant when an obligation to decommission facilities is legally required. Adjustments are made to such liabilities based on estimates by District staff in accordance with Statement of Financial Accounting Standards (SFAS) No. 143, "Accounting for Asset Retirement Obligations (ARO)". For active plants, such costs are included in the Utility Plant's cost and included as a component of Depreciation expense over the Utility Plant's life. Expenditures for decommissioning activities are recorded as reductions to Accrued Decommissioning liability. Changes in Rancho Seco decommissioning liability estimates, arising from inflation, annual accretion and other changes to the cost assumptions are recorded directly to Accrued Decommissioning with a corresponding adjustment to the related regulatory deferral. The current portion of the accrued decommissioning liability represents the District's estimate of actual expenditures in the next year, generally as set forth in the annual budget.

The District has identified potential retirement obligations related to certain generation, distribution and transmission facilities. The District's non-perpetual leased land rights generally are renewed continuously because the District intends to utilize these facilities indefinitely. Since the timing and extent of any potential asset retirements are unknown, the fair value of any obligations associated with these facilities cannot be reasonably estimated. Accordingly, a liability has not been recorded.

At December 31, 2005 and 2004, the District's Accrued Decommissioning balance in the consolidated balance sheets relating to Rancho Seco was $285.0 million and $320.5 million, respectively (See Note 13). Other electricity generation and gas production facilities Accrued Decommissioning balance in the consolidated balance sheets totaled $5.0 million and $4.8 million as of December 31, 2005 and 2004, respectively.

Securities Lending Transactions. The District lends its securities to broker-dealers and other entities for collateral with a simultaneous agreement to return the collateral for the same securities in the future. District policy requires cash collateral of 102 percent of the market value of the loaned securities. Both the investments purchased, with the collateral received, and the related liability to repay the collateral are included in the consolidated balance sheets.

Cash and Cash Equivalents. Cash and cash equivalents include all debt instruments purchased with an original maturity of 90 days or less and all investments in the Local Agency Investment Fund (LAIF), and money market mutual funds. LAIF has an equity interest in the State of California Pooled Money Investment Account (PMIA). PMIA funds are on deposit with the State's Centralized Treasury System and are managed in compliance with the California Government Code, according to a statement of investment policy which sets forth permitted investment vehicles, liquidity parameters and maximum maturity of investments. The District's deposits with LAIF comprise cash representing demand deposits up to $40.0 million maximum and cash equivalents representing amounts above $40.0 million which are able to be withdrawn after a thirty day period. The debt instruments and money market mutual funds are reported at amortized cost which approximates fair value and the LAIF is reported at the value of its pool shares.

Investments. The District's investments are reported at fair value. Realized and unrealized gains and losses are included in Interest and Other Income in the consolidated statements of revenues, expenses and changes in net assets. Premiums and discounts on zero coupon bonds are amortized using the effective interest method. Premium and discounts on other securities are amortized using the straight-line method, which approximates the effective interest method.

Electric Operating Revenues. Electric revenues are billed on the basis of monthly cycle bills and are recorded as revenue when the electricity is delivered. The District records an estimate for unbilled revenues earned from the dates its retail customers were last billed to the end of the month. At December 31, 2005 and 2004, unbilled revenues were $56.3 million and $59.9 million, respectively.

Purchased Power Expenses. A portion of the District's power needs are provided through power purchase agreements. Expenses from such agreements, along with associated transmission costs paid to other utilities, are charged to Purchased Power expense, on the consolidated statements of revenues, expenses and changes in net assets, in the period the power is received. The costs, or credits, associated with energy swap agreements (gas and electricity) or other arrangements that affect the net cost of Purchased Power, are recognized in the period in which the underlying power delivery occurs. Contract termination payments and adjustments to prior billings are included in Purchased Power expense once the payments or adjustments can be reasonably estimated.

Advanced Capacity Payments. Some long-term agreements to purchase energy from other providers call for up-front payment. Such costs are generally recorded as an asset and amortized over the length of the contract. One advance capacity contract, with a fair value of $103.4 and $103.7 million at December 31, 2005 and 2004, is accounted for as a derivative financial instrument (see Note 9).

Credit and Market Risk. The District enters into forward purchase and sales commitments for physical delivery of gas and electricity with utilities and power marketers. The District 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 District has a wholesale counterparty evaluation policy, which includes the assignment of internal credit ratings to the District's counterparties based on counterparty and/or debt ratings, the requirement for credit enhancements for counterparties that do not meet an acceptable risk level, and the use of standardized agreements that allow for the netting of positive and negative exposures associated with a single counterparty. The District is also subject to similar requirements for many of its gas and electricity purchase agreements. As of December 31, 2005 and 2004, the District held $148.6 million and $0, respectively, on deposit by counterparties. The amount is recorded as unrestricted cash with an associated short-term and long-term liability.

Accounts Receivable and Allowance for Doubtful Accounts. Accounts Receivable are recorded at the invoiced amount and do not bear interest except for accounts related to energy loans. The District recognizes an estimate of uncollectible accounts for its receivables related to electric service, wholesale activities and conservation loans based upon its historical experience with collections, and current energy market conditions. For large wholesale receivable balances, the District determines its bad debt reserves based on the specific credit issues for each account. The District records bad debts for its estimated uncollectible accounts related to electric service and wholesale activities as a reduction to the related operating revenues in the consolidated statements of revenues, expenses and changes in net assets. The District records bad debts for its estimated uncollectible accounts related to energy loans in Administrative, General and Customer expense in the consolidated statements of revenues, expenses and changes in net assets.

The summarized activity of the changes in the allowance for doubtful accounts during 2005 and 2004 is presented below (thousand of dollars):

	Balance at beginning of Year	Additions	Write-offs and Recoveries	Balance at end of Year
California ISO/PX:				
December 31, 2005	$ 23,928	$ 346	$ -0-	$ 24,274
December 31, 2004	40,193	457	16,722	23,928
Wholesale power and other:				
December 31, 2005	$ 3,895	$ 1,006	$ 3,988	$ 913
December 31, 2004	3,674	564	343	3,895
Retail Customers:				
December 31, 2005	$ 2,883	$ 4,089	$ 4,416	$ 2,556
December 31, 2004	2,533	6,410	6,060	2,883
Conservation Loans:				
December 31, 2005	$ 1,254	$ -0-	$ 141	$ 1,113
December 31, 2004	1,248	1,164	1,158	1,254

Through December 31, 2003 the District's allowance for doubtful accounts for its receivables related to wholesale power sales for transactions executed through the California Independent System Operator (California ISO) and Power Exchange (California PX) were reserved at 100 percent of the outstanding balances due to collectibility issues and disputes over amounts billed from October 2000 through June 2001. In 2004, the District negotiated a reduced settlement of $5.5 million with the California ISO relating to $16.7 million of disputed amounts. District management believes collection of this amount is reasonably assured and, as a result, there is no allowance for this amount at December 31, 2005 and 2004. Write-offs and recoveries of $16.7 million in 2004 in the above table reflect the $5.5 million settlement (recovery) and the associated $11.2 million write-off.

Regulatory Deferrals. The Board has the authority to establish the level of rates charged for all District services. As a regulated entity, the District's financial statements are prepared in accordance with SFAS No. 71, "Accounting for the Effects of Certain Types of Regulation", which requires that the effects of the rate-making process be recorded in the financial statements. Accordingly, certain expenses and credits, normally reflected in Net Increase (Decrease) in Net Assets as incurred, are recognized when included in rates and recovered from, or refunded to customers. The District records various regulatory assets and credits to reflect rate-making actions of the Board.

Materials and Supplies. Materials and supplies are stated at average cost, which approximates the first-in, first-out method.

Unamortized Debt Issuance Costs. The costs incurred in connection with the issuance of debt obligations, principally underwriter's fees and legal costs, are recorded as Unamortized Debt Issuance Costs in the consolidated balance sheets and are amortized over the terms of the related obligations using the bonds outstanding method, which approximates the effective interest method.

Compensated Absences. The District accrues vacation leave and compensatory time when the employees earn the rights to the benefits. The District does not record sick leave or other leave as a liability until it is taken by the employee, since there are no cash payments for sick leave or other leave made when employees terminate or retire. At December 31, 2005 and 2004, the total estimated liability for vacation and other compensated absences was $20.5 million and $20.1 million, respectively.

Public Good. Public Good expenses consist of non-capital expenditures for energy efficiency programs, renewable energy resources and technologies research.

Gains/Losses on Bond Refundings. Gains and losses resulting from bond refundings are included as a component of Long-Term Debt on the consolidated balance sheets and amortized as a component of Interest on Debt in the consolidated statements of revenues, expenses and changes in net assets, over the shorter of the life of the refunded debt or the new debt using the bonds outstanding method, which approximates the effective interest method.

Gains/Losses on Bond Defeasances. Gains and losses resulting from bond defeasances that were not financed with the issuance of new debt are included as a component of Interest on Debt in the consolidated statements of revenues, expenses and changes in net assets.

Allowance for Funds Used During Construction. The District capitalizes, as an additional cost of Construction Work In Progress (CWIP), an Allowance for Funds Used During Construction (AFUDC), which represents the cost of borrowed funds used for such purposes. The amount capitalized is determined by a formula prescribed by FERC. The AFUDC rates for 2005 and 2004 were 4.4 percent and 4.1 percent of eligible CWIP, respectively.

Derivative Financial Instruments. The District records derivative financial instruments (interest rate swap and gas price swap agreements, certain wholesale sales agreements, certain electricity purchase agreements and option agreements) at fair value on its consolidated balance sheets. The District generally does not enter into agreements for trading purposes. However, the District does not elect hedge accounting. Fair market value is estimated by comparing contract prices to forward market prices quoted by third party market participants and/or provided in relevant industry publications. The Board defers recognition of the unrealized gains or losses from such instruments for rate-making purposes. The District is exposed to risk of nonperformance if the counterparties default or if the swap agreements are terminated. The District reports derivative financial instruments with remaining maturities of one year or less and the next twelve months portion of long-term contracts as current on the consolidated balance sheets.

Interest Rate Swap Agreements. The District enters into interest rate swap agreements to modify the effective interest rates on outstanding debt. Interest expense is reported net of the swap payments received or paid as a component of Interest on Debt in the consolidated statements of revenues, expenses and changes in net assets.

Gas and Electricity Price Swap and Option Agreements. The District uses forward contracts to hedge the impact of market volatility on gas commodity prices for its gas fueled power plants and for energy prices on purchased power for the District's retail load. Net cash payments or receipts incurred under the price swap and option agreements are reported as a component of Production for fuel related contracts and Purchased Power for electricity contracts in the consolidated statements of revenues, expenses and changes in net assets over the periods of the agreements.

Precipitation Hedge Agreements. The District enters into non-exchange traded precipation hedge agreements to hedge the increased cost of power caused by low precipitation years (Precipitation Agreements). The District records the intrinsic value of the Precipitation Agreements on the consolidated balance sheets. Settlement of the Precipitation Agreements is not performed until the end of the period covered (water year ended September 30). The intrinsic value of a Precipitation Agreement is the difference between the expected results from a monthly allocation of the cumulative rainfall amounts, in a normal rainfall year, and the actual rainfall during the same period.

Insurance Programs. The District records liabilities for unpaid claims at their present value when they are probable of occurrence and the amount can be reasonably estimated. The District records a liability for unpaid claims associated with general, auto, workers' compensation, and short-term and long-term disability, based upon estimates derived by the District's claims administrator or District staff. The liability comprises the present value of the claims outstanding, and includes an amount for claim-events incurred but not reported based upon the District's experience.

Net Assets. The District classifies its net assets into three components as follows:

- **Invested in capital assets, net of related debt** — This component of net assets consists of capital assets, net of accumulated depreciation reduced by the outstanding debt balances, net of unamortized debt expenses.
- **Restricted** — This component consists of net assets with constraints placed on their use, either externally or internally. Constraints include those imposed by Debt Indentures (excluding amounts considered in net capital, above), grants or laws and regulations of other governments, or by law through constitutional provisions or enabling legislation or by the Board.
- **Unrestricted** — This component of net assets consists of net assets that do not meet the definition of "invested in capital, net of related debt" or "restricted."

Contributions in Aid of Construction. The District records CIAC from customer contributions, primarily relating to expansions to the District's distribution facilitates, as Nonoperating Revenues in the consolidated statements of revenues, expenses and changes in net assets. Contributions of capital are valued at estimated market cost. For rate-making purposes, the Board does not recognize such revenues when received; rather CIAC is included in revenues as such costs are amortized over the estimated useful lives of the related distribution facilities.

Grants. The District receives grant proceeds from federal and state assisted programs for its advanced and renewable technologies, electric vehicle, and energy efficiency programs. The District also periodically receives grant proceeds from federally assisted programs as partial reimbursements for costs it has incurred as a result of storm damages. When applicable, these programs may be subject to financial and compliance audits pursuant to regulatory requirements. The District considers the possibility of any material disallowances to be remote. During 2005 and 2004, the District recognized grant proceeds of $1.0 million and $2.5 million, respectively, as a component of Interest and Other Income, in the consolidated statements of revenues, expenses and changes in net assets.

Implementation of GASB Statement No. 40. In 2005, the District implemented Government Accounting Standards Board Statement (SGAS) No. 40, *Deposit and Investment Risk Disclosures — an amendment of GASB Statement No. 3.* SGAS No. 40 requires disclosure of credit risk, concentration of credit risk, interest rate risk, and foreign currency risk and modifies previous custodial credit risk disclosure requirements. Deposit and investment risk disclosures relating to 2004 balances presented in Note 7 have been modified to conform with the new standard.

Recent Accounting Pronouncements. In June 2004, GASB issued SGAS No. 45, "Accounting and Financial Reporting by Employers for Postemployment Benefits other than Pensions (OPEB)", which establishes standards of accounting and financial reporting for OPEB expense and related OPEB liabilities or assets. OPEB arises from an exchange of salaries and benefits for employee services rendered. It refers to postemployment benefits other than pension benefits such as postemployment healthcare benefits. This Statement is effective for the District beginning in 2007. The District's estimate of its OPEB obligation is approximately $327.0 million as of December 31, 2005.

In June 2005, GASB issued SGAS No. 47, "Accounting for Termination Benefits", which establishes standards of accounting and financial reporting for termination benefits. Termination benefits are benefits provided to employees as an incentive to hasten the termination of services, as a result of a voluntary early termination, or as a consequence of involuntary early termination. This Statement is effective for the District beginning in 2006. The District is currently assessing the financial statement impact of adopting the new Statement, but does not believe that its impact will be material.

Reclassifications. Certain amounts in the 2004 consolidated financial statements have been reclassified in order to conform with the 2005 presentation.

NOTE 3. REVISION IN CLASSIFICATION

In connection with the preparation of the December 31, 2005 consolidated financial statements the District determined it had included certain short-term investments with original maturities in excess of 90 days in cash and cash equivalents. The District has revised its consolidated statement of cash flows for the year ended December 31, 2004 to include such short-term investments in investments rather than cash and cash equivalents. Cash and cash equivalents as of January 1, 2004 and December 31, 2004 have been revised on the consolidated statement of cash flows. Cash and cash equivalents have been decreased by $120.1 million as of January 1, 2004 and $95.2 million as of December 31, 2004 and sales and maturities of securities were increased by $145.0 million and purchases of securities were increased by $120.2 million. The revision does not affect the previously reported cash flows from operating or from financing activities in the previously reported consolidated statements of cash flows or the previously reported consolidated balance sheets, or the consolidated statement of revenues, expenses and changes in net assets.

Balances presented in the 2004 consolidated statement of cash flows are revised as follows:

	As Previously Reported	As Revised
	(thousands of dollars)	
Cash Flow from Investing Activities:		
Sales and maturities of securities	$ 164,596	$ 309,633
Purchase of securities	(257,582)	(377,799)
Net cash provided by (used in) investing activities	(78,095)	(53,275)
Net decrease in cash and cash equivalents	$ (230,528)	$ (205,708)
Cash and cash equivalents at the beginning of the year	551,926	431,859
Cash and cash equivalents at the end of the year	$ 321,398	$ 226,151
Cash and cash equivalents included in:		
Unrestricted cash, cash equivalents and investments	$ 123,322	$ 119,113
Restricted and designated cash, cash equivalents and investments	177,168	91,554
Revenue bond, debt service and construction reserves	20,908	15,484

NOTE 4. UTILITY PLANT

The summarized activity of the District's utility plant during 2005 is presented below (thousands of dollars):

	Balance December 31, 2004	Additions	Transfers and Deletions	Balance December 31, 2005
Nondepreciable Utility Plant:				
Land	$ 65,845	$ 7,632	$ -0-	$ 73,477
CWIP	613,507	271,688	(197,718)	687,477
Total nondepreciable utility plant	679,352	279,320	(197,718)	760,954
Depreciable Utility Plant:				
Generation	803,762	10,957	(3,647)	811,072
Transmission	186,638	3,542	(262)	189,918
Distribution	1,169,238	80,912	(8,446)	1,241,704
Investment in gas properties	136,975	7,802	-0-	144,777
General	583,451	93,236	(12,288)	664,399
	2,880,064	196,449	(24,643)	3,051,870
Less: accumulated depreciation and depletion	(1,065,631)	(112,643)	27,761	(1,150,513)
Total depreciable plant	1,814,433	83,806	3,118	1,901,357
Total Utility Plant — net	$ 2,493,785	$ 363,126	$ (194,600)	$ 2,662,311

The summarized activity of the District's utility plant during 2004 is presented below (thousands of dollars):

	Balance December 31, 2003	Additions	Transfers and Deletions	Balance December 31, 2004
Nondepreciable Utility Plant:				
Land	$ 64,692	$ 1,153	$ -0-	$ 65,845
CWIP	425,490	357,929	(169,912)	613,507
Total nondepreciable utility plant	490,182	359,082	(169,912)	679,352
Depreciable Utility Plant:				
Generation	786,889	17,745	(872)	803,762
Transmission	173,906	13,805	(1,073)	186,638
Distribution	1,087,646	86,075	(4,483)	1,169,238
Investment in gas properties	136,975	-0-	-0-	136,975
General	556,277	49,410	(22,236)	583,451
	2,741,693	167,035	(28,664)	2,880,064
Less: accumulated depreciation and depletion	(992,802)	(103,789)	30,960	(1,065,631)
Total depreciable plant	1,748,891	63,246	2,296	1,814,433
Total Utility Plant — net	$ 2,239,073	$ 422,328	$ (167,616)	$ 2,493,785

In 2002, the District began active development of the Cosumnes Power Plant (CPP Project), a 500 megawatts (MW) natural gas fueled generation facility located on the Rancho Seco site. The CPP Project became operational on February 24, 2006 (see note 18 relating to construction contract issues). Included in Utility Plant and CWIP at December 31, 2005 and 2004, are cumulative capitalized costs of $459.6 million and $356.4 million, respectively, relating to the CPP Project's construction and development, including the related natural gas pipeline.

NOTE 5. INVESTMENT IN JOINT POWERS AGENCY

TANC. The District and fourteen other California municipal utilities are members of TANC, a JPA. TANC, along with the other California municipal utilities, own and operate the California-Oregon Transmission Project (COTP), a 500-kilovolt transmission line between central California and southern Oregon. The District is obligated to pay 27.1 percent of TANC's COTP debt service and operations costs in exchange for ownership of 339 MW of TANC's 1,269 MW transfer capability. Additionally, the District has a 46 MW share of TANC's 300 MW firm, bi-directional transmission over Pacific Gas and Electric's (PG&E) system between PG&E's Tesla and Midway substations. The District recorded transmission expenses related to TANC of $11.0 million and $10.7 million in 2005 and 2004, respectively.

Summary financial information for TANC is presented below:

	December 31, 2005 (Unaudited)	December 31, 2004 (Unaudited)
	(thousands of dollars)	
Total assets	$ 466,741	$ 473,754
Total liabilities	$ 466,360	$ 473,391
Total net assets	381	363
Total liabilities and net assets	$ 466,741	$ 473,754
Changes in net assets for the year ended December 31	$ 18	$ 8

The long-term debt of TANC, which totals $398.9 million (unaudited) at December 31, 2005, is collateralized by a pledge and assignment of net revenues of TANC, supported by take-or-pay commitments of the District and other members. Should other members default on their obligations to TANC, the District would be required to make additional payments to cover a portion of such defaulted payments, up to 25 percent of its current obligation of 27.1 percent.

Copies of the TANC annual financial reports may be obtained from the District at 6201 S Street, P.O. Box 15930, Sacramento, California 95852.

NOTE 6. COMPONENT UNITS

CVFA Carson Cogeneration Project. CVFA is a JPA formed by the District and the Sacramento Regional County Sanitation District. CVFA operates the Carson Project, a 57 MW (net) natural gas-fired cogeneration facility and a 43 MW (net) natural gas-fired simple cycle peaking plant, which is financed primarily by CVFA non-recourse revenue bonds.

SCA Procter & Gamble Cogeneration Project. SCA is a JPA formed by the District and the Sacramento Municipal Utility District Financing Authority (SFA). SFA is a JPA formed by the District and the Modesto Irrigation District. SCA operates the Procter & Gamble Project, a 120 MW (net) natural gas-fired cogeneration facility and a 44 MW (net) natural gas-fired simple cycle peaking plant, which is financed primarily by SCA non-recourse revenue bonds.

SPA Campbell Soup Cogeneration Project. SPA is a JPA formed by the District and SFA. SPA operates the Campbell Soup Project, a 160 MW (net) natural gas-fired cogeneration facility, which is financed primarily by SPA non-recourse revenue bonds.

As described in Note 2, all of the activities and balances of the component units are blended into and reported as part of the District because of the extent of their operational and financial relationships with the District. Copies of CVFA's, SCA's, and SPA's annual financial reports may be obtained from their Executive Office at 6201 S Street, P.O. Box 15930, Sacramento, California 95852.

NOTE 7. CASH, CASH EQUIVALENTS, AND INVESTMENTS

Cash Equivalents and Investments. The District's investment policies are governed by the California State and Municipal Codes and its Indenture, which restricts District investment securities to obligations which are unconditionally guaranteed by the United States (U.S.) Government or its agencies or instrumentalities; direct and general obligations of the State of California (State) or any local agency within the State; bankers' acceptances; certificates of deposit; repurchase agreements; and taxable government and tax-exempt money market portfolios. The District's investment policy includes restrictions for investments relating to maximum amounts invested as a percentage of total portfolio and with a single issuer, maximum maturities, and minimum credit ratings.

Credit Risk. To mitigate the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment, the District limits investments to those rated by a nationally recognized rating agency of "A-1" (or equivalent) or better for commercial paper and "A" (or equivalent) or better for medium-term notes.

Custodial Credit Risk. This is the risk that in the event of the failure of a depository financial institution or counterparty to a transaction, the District's deposits may not be returned or the District will not be able to recover the value of its deposits, investments or collateral securities that are in the possession of another party. The District does not have a deposit policy for custodial credit risk. As of December 31, 2005, $5.5 million in deposits was uninsured and uncollateralized. Additionally, at December 31, 2005 and 2004, $66.1 million and $66.4 million, respectively, in commercial paper and repurchase agreements were held by a counterparty that was acting as the District's agent in securities lending transactions.

Concentration of Credit Risk. This is the risk of loss attributed to the magnitude of an entity's investment in a single issuer. At December 31, 2005, more than 5 percent of the District's portfolio is invested in Wells Fargo Repurchase Agreements (17 percent); Federal Home Loan Banks (11 percent); Federal Home Loan Mortgage Corporation (Freddie Mac) (10 percent); Morgan Stanley Repurchase Agreements (8 percent); and Federal National Mortgage Association (Fannie Mae) (8 percent). At December 31, 2004, more than 5 percent of the District's portfolio is invested in Freddie Mac (20 percent); Federal Home Loan Banks (13 percent); First Boston Repurchase Agreements (12 percent) and Fannie Mae (9 percent). The District places no limit on the amounts invested in any one issuer for repurchase agreements and federal agency securities.

Interest Rate Risk. This is the risk of loss due to the fair value of an investment falling due to interest rates rising. The table below details investments by security type and maturity. Though the District has restrictions as to the maturities of some of the investments, it does not have a formal policy that limits investment maturities as means of managing its exposure to fair value losses arising from increasing interest rates.

Securities Lending Transactions. The District enters into securities lending agreements for up to 20 percent of its investment portfolio only with counterparties that are primary dealers of the Federal Reserve Bank of New York. At December 31, 2005 and 2004, the District had no credit risk exposure to borrowers because the amount the District owes the borrowers exceeds the amounts the borrowers owe the District. The contract with the District's custodial bank requires it to indemnify the District if the borrowers fail to return the securities (and the collateral is inadequate to replace the securities lent) or fail to pay the District for income distributions by the securities' issuers while the securities were on loan.

The following schedules indicate the credit and interest rate risk at December 31, 2005 and 2004. The credit ratings listed are from Standard and Poor's (S&P).

At December 31, 2005, the District's cash, cash equivalents and investments consist of the following:

		Remaining Maturities (in years)			
Description	Credit Rating	Less Than 1	1–5	More than 5	Total Fair Value
Cash and Cash Equivalents:					
LAIF	Not Rated (NR)	$ 5,645	$ -0-	$ -0-	$ 5,645
Money market mutual funds	AA-/AA/AAAm	85,443	-0-	-0-	85,443
Certificates of Deposits	A-1/A-1+	115,000	-0-	-0-	115,000
Fannie Mae	A-1+	3,004	-0-	-0-	3,004
Federal Home Loan Banks	A-1+	19,897	-0-	-0-	19,897
Freddie Mac	A-1+	9,966	-0-	-0-	9,966
Commercial paper	A-1	39,952	-0-	-0-	39,952
Repurchase agreements	NR	191,181	-0-	-0-	191,181
Total cash and cash equivalents		470,088	-0-	-0-	470,088
Investments:					
Fannie Mae	A-1+/AAA	45,841	7,167	4,820	57,828
Federal Farm Credit Bonds	AAA	-0-	14,920	-0-	14,920
Federal Home Loan Banks	A-1+/AAA	26,782	36,628	-0-	63,410
Freddie Mac	A-1+/AAA	26,884	38,500	-0-	65,384
Farmer Mac	NR	2,400	-0-	-0-	2,400
United States Treasuries	NR	-0-	20,819	-0-	20,819
Corporate Note	A+/AA	13,858	7,748	-0-	21,606
Commercial paper	A-1+	21,641	-0-	-0-	21,641
Total investments		137,406	125,782	4,820	268,008
Total cash, cash equivalents and investments		$ 607,494	$ 125,782	$ 4,820	$ 738,096

At December 31, 2004, the District's cash, cash equivalents and investments consist of the following:

Description	Credit Rating	Remaining Maturities (in years) Less Than 1	1–5 (As Revised — See Note 3)	More than 5	Total Fair Value
Cash and Cash Equivalents:					
LAIF	NR	$ 104,047	$ -0-	$ -0-	$ 104,047
Money market mutual funds	AA-/AAAm/AAA	58,677	-0-	-0-	58,677
Repurchase agreements	NR	63,427	-0-	-0-	63,427
Total cash and cash equivalents		226,151	-0-	-0-	226,151
Investments:					
Fannie Mae	NR/A-1+/AAA	16,276	23,558	9,696	49,530
Federal Farm Credit Bonds	AAA	9,966	-0-	-0-	9,966
Federal Home Loan Banks	NR/A-1+/AAA	45,919	25,338	-0-	71,257
Freddie Mac	A-1+/AAA	56,411	50,918	-0-	107,329
United States Treasuries	NR	57,119	983	-0-	58,102
Commercial paper	A-1/A-1+	16,247	-0-	-0-	16,247
Total investments		201,938	100,797	9,696	312,431
Total cash, cash equivalents and investments		$ 428,089	$ 100,797	$ 9,696	$ 538,582

At December 31, 2005 and 2004, the District reported its book overdraft of $3.7 million and $2.7 million, respectively, as a component of Accounts Payable on the consolidated balance sheets.

The District's cash, cash equivalents, investments and securities lending collateral are classified in the consolidated balance sheets as follows:

	December 31, 2005	2004
	(thousands of dollars)	
Total Cash, Cash Equivalents and Investments:		
Revenue bond reserve, debt service and construction funds:		
Revenue bond reserve fund	$ 79,477	$ 82,671
Debt service fund	40,281	37,558
Component unit bond reserve and construction funds	58,258	59,564
Total revenue bond reserve, debt service and construction funds	178,016	179,793
Nuclear decommissioning trust fund	83,177	87,968
Rate stabilization fund	75,000	75,000
Securities lending collateral	66,136	66,427
Other restricted funds	6,310	6,072
Unrestricted funds	329,457	123,322
Total cash, cash equivalents and investments	$ 738,096	$ 538,582

NOTE 8. REGULATORY DEFERRALS

The District's Board has taken various regulatory actions that result in differences between the recognition of revenues and expenses for rate-making purposes and their treatment under generally accepted accounting principles for non-regulated entities. These actions result in regulatory assets and liabilities, which are summarized in the tables below. Changes to these balances, and their inclusion in rates, occur only at the direction of the Board.

Regulatory Assets

Decommissioning. The District's regulatory asset relating to the unfunded portion of its decommissioning liability is being collected in rates and through interest earnings on the Trust Fund, through 2008 when radiological decommissioning is expected to be complete. Subsequently, nuclear fuel storage costs and non-radiological decommissioning costs are to be collected in rates commencing in 2009.

Wholesale Power Receivables. The District's regulatory asset relates to its wholesale receivables that were fully reserved as uncollectible in 2001. These wholesale receivable reserves relate to amounts due from the California PX totaling $24.3 million and $23.9 million at December 31, 2005 and 2004, respectively. The ultimate recovery of these amounts is dependent on numerous factors and cannot be determined at this time. This regulatory asset will be reversed concurrent with the reasonable certainty of collections or by inclusion in rates in future periods. In connection with the tentative settlement of one of its receivable balances due from the California ISO in 2004 (See Note 2), the District reduced the related regulatory asset by $16.7 million. Of this amount, $5.5 million was recorded as an increase to net receivables (now determined to be collectable), and $11.2 million was recorded as a reduction to 2004 wholesale revenues.

TANC Operations Costs. The District's regulatory asset relating to deferred TANC costs comprises the difference between its cash payments made to TANC and its share of TANC's accrual-based costs of operations. This regulatory asset is being collected in rates over the life of TANC's assets during the period that cash payments to TANC exceed TANC's accrual-based costs.

U.S. Bureau of Reclamation. In December 2004, the District established a regulatory asset to defer recognizing the expense related to the settlement with the U.S. Bureau of Reclamation (Bureau) on a billing dispute. The District will make increased payments in future rates to settle the dispute (See Note 18). This regulatory asset will be collected in rates for future water service over the twenty-five year period the District is committed to making the increased rate payments to the Bureau.

Enrichment Facility Decommissioning Assessment. The District's regulatory asset relating to obligations associated with the federal nuclear fuel enrichment program is being collected in rates, based on cash payments made, through 2008.

Derivative Financial Instruments. The District's regulatory asset relating to derivative financial instruments is intended to defer the net difference between the fair value of derivative instruments and their cost basis, if any. Derivatives are reflected in rates at contract cost and as such, the balance is charged or credited into rates as the related asset or liability is utilized.

Precipitation Hedges. Settlements of Precipitation Agreements are included in rates in the year settled, and accordingly the intrinsic value of open precipitation hedges is deferred as regulatory assets or liabilities.

The District's total regulatory costs for future recovery are presented below:

	December 31, 2005	December 31, 2004
	(thousands of dollars)	
Regulatory Costs for Future Recovery:		
Decommissioning	$ 205,196	$ 233,345
Wholesale power receivables	24,274	23,928
TANC operations costs	15,425	14,864
U.S. Bureau of Reclamation	9,732	12,485
Enrichment facility decommissioning assessment	3,576	4,651
Derivative financial instruments	-0-	71,234
Precipitation hedges	22,116	1,702
Total regulatory costs	280,319	362,209
Less: regulatory costs to be recovered within one year	(77,818)	(72,836)
Total regulatory costs for future recovery — net	$ 202,501	$ 289,373

Regulatory Liabilities

CIAC. In 2005 and 2004, the District capitalized CIAC totaling $18.3 million and $18.2 million, respectively, in Plant in Service in the consolidated balance sheets and recorded $6.3 million and $5.8 million, respectively, of depreciation expense in the consolidated statements of revenues, expenses and changes in net assets. The District's regulatory credit relating to CIAC is intended to offset the revenue and expense associated with this accounting treatment. Thus, this regulatory credit is being amortized into rates over the depreciable lives of the related contributed distribution plant assets in order to offset the earnings effect of these nonexchange transactions.

Rate Stabilization. The District's regulatory credit relating to Rate Stabilization is intended to defer the need for future rate increases when costs exceed existing rates. At the direction of the Board, amounts may be either transferred into this fund (which reduces revenues) or amounts are transferred out of this fund (which increases revenues). For several years through 2003, the Board deferred all residual income or loss into this account, as part of its strategy to maintain break-even operations while building up the Rate Stabilization Fund. In 2004, the Board ceased this practice and adopted a practice of authorizing Rate Stabilization Fund transfers on an event driven basis. In 2004, the Board determined that $12.3 million should be withdrawn in connection with payments made to PG&E associated with the Scheduling Coordinator Services (SCS) Tariff issue as described in Note 18.

El Paso Settlement. In December 2004, the District established a regulatory credit relating to the settlement of a class action lawsuit with El Paso Natural Gas (El Paso), which is comprised of the present value of the amount the District will collect from El Paso over the twenty year repayment term. This regulatory deferral was credited to purchase power expense when the payment from El Paso was received in May 2005.

Public Good. The District's regulatory credit relating to Public Good comprises the amounts collected in rates for specifically identified Public Good programs that have not been fully expended. These regulatory deferrals are credited to revenue in the period when the expenditures on identified projects occur.

The District's total regulatory credits for future revenue recognition are presented below:

	December 31, 2005	December 31, 2004
	(thousands of dollars)	
Regulatory Credits for Future Revenue Recognition:		
CIAC	$ 175,204	$ 163,197
Derivative financial instruments	215,453	-0-
Rate stabilization	75,000	75,000
El Paso settlement	-0-	6,900
Public good	1,761	895
Total regulatory credits for future revenue recognition	467,418	245,992
Less — regulatory credits to be recognized within one year	(105,351)	(7,495)
Total regulatory credits — net	$ 362,067	$ 238,497

NOTE 9. DERIVATIVE FINANCIAL INSTRUMENTS

The District enters into contracts for electricity and natural gas to meet the expected needs of its retail customers. The District sells excess capacity during periods when it is not needed to meet its retail requirements. The District's energy risk management program uses various physical and financial contracts to hedge exposure to fluctuating commodity prices. The District also enters into interest rate swap agreements to reduce interest rate risk or to enhance the relationship between the risk and return regarding the District's assets or debt obligations. During 2005 and 2004, the District executed numerous new gas related and power related purchase agreements, which are recorded as derivative financial instruments and are included in the table below.

The fair value of the District's derivative financial instruments are as follows:

	December 31, 2005	December 31, 2004
	(thousands of dollars)	
Derivative Financial Instrument Assets:		
Gas related agreements	$ 228,736	$ 41,371
Electric related agreements	172,398	119,987
Treasury related agreements	22,790	21,922
Total derivative financial instruments	423,924	183,280
Less — derivative financial instruments maturing within one year	(136,412)	(32,309)
Total derivative financial instrument assets — net	$ 287,512	$ 150,971
Derivative Financial Instrument Liabilities:		
Gas related agreements	$ 7,575	$ 3,515
Electric related agreements	136,963	173,010
Treasury related agreements	18,151	27,315
Total derivative financial instruments	162,689	203,840
Less — derivative financial instruments maturing within one year	(33,829)	(48,317)
Total derivative financial instrument liabilities — net	$ 128,860	$ 155,523

The Board has deferred recognition of the effects of reporting the fair value of derivative financial instruments for rate-making purposes, and maintains regulatory accounts to defer the accounting impact of these accounting adjustments (see Note 8).

NOTE 10. LONG-TERM DEBT

The District's total long-term debt is presented below:

	December 31, 2005	December 31, 2004
	(thousands of dollars)	
Electric Revenue Bonds:		
Electric revenue bonds, 2.5%–6.5%, 2006–2033	$ 1,669,250	$ 1,727,090
Subordinated electric revenue bonds, 2.9%–8.0%, 2006–2028	478,425	478,850
Total electric revenue bonds	2,147,675	2,205,940
Component unit cogeneration project revenue bonds, 5.0%–7.0%, 2006–2022	263,485	295,625
Total long-term debt outstanding	2,411,160	2,501,565
Bond premiums — net	75,813	78,614
Deferred losses on bond refundings — net	(101,445)	(106,689)
Total long-term debt	2,385,528	2,473,490
Less: amounts due within one year	(82,340)	(67,165)
Total long-term debt — net	$ 2,303,188	$ 2,406,325

The summarized activity of the District's long-term debt during 2005 is presented below (thousands of dollars):

	December 31, 2004	Additions	Payments or Amortization	December 31, 2005	Amounts Due Within One Year
Electric revenue bonds	$ 1,727,090	$ -0-	$ (57,840)	$ 1,669,250	$ 65,660
Subordinate electric revenue bonds	478,850	-0-	(425)	478,425	9,000
Component unit cogeneration project revenue bonds	295,625	122,960	(155,100)	263,485	7,680
Total	2,501,565	122,960	(213,365)	2,411,160	$ 82,340
Unamortized premiums — net	78,614	6,224	(9,025)	75,813	
Deferred losses on bond refundings — net	(106,689)	(7,282)	12,526	(101,445)	
Total long-term debt	$ 2,473,490	$ 121,902	$ (209,864)	$ 2,385,528	

The summarized activity of the District's long-term debt during 2004 is presented below (thousands of dollars):

	December 31, 2003	Additions	Payments or Amortization	December 31, 2004	Amounts Due Within One Year
Electric revenue bonds	$ 1,638,760	$ 130,950	$ (42,620)	$ 1,727,090	$ 57,840
Subordinate electric revenue bonds	487,650	-0-	(8,800)	478,850	425
Component unit cogeneration project revenue bonds	310,525	-0-	(14,900)	295,625	8,900
Total	2,436,935	130,950	(66,320)	2,501,565	$ 67,165
Unamortized premiums — net	84,881	2,412	(8,679)	78,614	
Deferred losses on bond refundings — net	(118,861)	(1,518)	13,690	(106,689)	
Total long-term debt	$ 2,402,955	$ 131,844	$ (61,309)	$ 2,473,490	

At December 31, 2005, scheduled annual principal maturities and interest are as follows (thousands of dollars):

	Principal	Interest	Total
2006	$ 82,340	$ 116,393	$ 198,733
2007	90,810	112,003	202,813
2008	80,070	108,239	188,309
2009	78,485	105,109	183,594
2010	105,490	101,069	206,559
2011 – 2015	618,270	415,964	1,034,234
2016 – 2020	622,985	259,579	882,564
2021 – 2025	420,850	126,053	546,903
2026 – 2030	267,680	41,449	309,129
2031 – 2033	44,180	4,490	48,670
Total Requirements	$ 2,411,160	$ 1,390,348	$ 3,801,508

Interest in the preceding table includes interest requirements for variable rate debt ranging from 3.5 percent to 4.5 percent using the debt interest rate in effect at December 31, 2005 for each issue.

2005 Revenue Bonds Refunding and Calls. In April 2005, the District issued $123.0 million of 2005 Series SPA Revenue Refunding Bonds at a premium of $6.2 million. Proceeds from the 2005 Series bonds and $5.6 million of available funds were used to refund $123.5 million of previously issued SPA Revenue Bonds and accordingly the liability for the defeased bonds has been removed from Long-term Debt in the consolidated balance sheets. The refunding resulted in the recognition of a deferred accounting loss of $7.3 million, which is being amortized over the life of the refunding issue; and a current accounting loss of $0.3 million, which is included in Interest on Debt in the consolidated statements of revenues, expenses and changes in net assets. The 2005 refunding reduced future aggregate debt service payments by $19.1 million and resulted in a total economic gain of $13.6 million, the difference between the present value of the old and new debt service payments.

In January and July 2005 the District called $9.0 million of CVFA Bonds 1993 Series due in 2009 at a cost of $9.0 million. In July 2005 the District called $13.7 million of SCA Revenue Bonds 1995 Series due in 2006 and 2010 at a cost of $14.0 million. These bond calls resulted in a current accounting loss of $0.4 million, which is included in Interest on Debt in the consolidated statements of revenues, expenses and changes in net assets. Calling the bonds will reduce the aggregate future debt service payments by $26.2 million.

2004 Electric Revenue Bonds. In May 2004, the District issued $130.9 million of 2004 Series T Electric Revenue Bonds at a premium of $2.4 million. Proceeds from the 2004 Series T Bonds and $1.4 million of available District funds were used to refund $101.0 million of Commercial Paper Notes (Notes) and $16.9 million of previously issued revenue bonds through a legal defeasance, and accordingly, the liability for the defeased bonds has been removed from Long-term Debt in the consolidated balance sheets. The refunding resulted in the recognition of a deferred accounting loss of $1.5 million, which is being amortized over the life of the refunding issue; and a current accounting loss of $0.5 million, which is included in Interest on Debt in the consolidated statements of revenues, expenses and changes in net assets. The 2004 refunding reduced future aggregate debt service payments by $3.3 million and resulted in a total economic gain of $1.3 million, the difference between the present value of the old and new debt service payments. Proceeds from the 2004 Series T Bonds were also used to fund $14.0 million of capital expenditures.

Subsequent Event. On January 19, 2006 the Sacramento Municipal Utility District Financing Authority (SFA), a new component unit of the District, issued 2006 Series SFA Revenue Bonds. The proceeds of the offering were used to purchase the CPP project from the District.

Interest Rate Swap Agreements. A summary of the District's five swap agreements are as follows:

Notional Amount (000's)	District Pays	Fixed Rate	Floating Rate	Termination Date	Counterparty Credit Rating (S&P)
$ 269,095	Fixed	4.345%	70% of LIBOR	8/15/18	AA+
131,030	Variable	5.154%	BMA	7/1/24	A+
111,075	Fixed	2.894%	63% of LIBOR	8/15/28	A+
14,210	Fixed	4.500%	65% of LIBOR	7/1/10	A+
257,020	Fixed	3.743%	BMA	1/19/06	AA-/A+

The District has a fixed-to-variable interest rate swap agreement with a notional amount of $131.0 million, which is equivalent to the principal amount of the District's 1997 Series K Electric Revenue Bonds. Under this swap agreement, the District pays a variable rate equivalent to the Bond Market Association (BMA Index) (3.51 percent at December 31, 2005) and receives fixed rate payments of 5.15 percent. In connection with the swap agreement, the District has a put option agreement, also with a notional amount of $131.0 million which gives the counterparty the right to sell to the District, at par, either the 1997 Series K bonds, or a portfolio of securities sufficient to defease the 1997 Series K bonds. The exercise of the option terminates the swap at no cost to the District. The term of both the swap and the put is equal to the maturity of the 1997 Series K bonds.

Additionally, the District has three variable-to-fixed interest rate swap agreements with a combined notional amount of $394.4 million for the purpose of fixing the effective interest rate associated with certain of its Subordinated Bonds. The notional values of all three swaps are amortized over the life of the respective swap agreements concurrently with scheduled principal payments. The District can terminate all swap agreements at any time, with payment or receipt of the fair market value of the swaps as of the date of termination.

In September 2005 the District entered into a variable-to-fixed swap agreement with a counterparty to hedge interest rate risk on the CPP Project financing, which subsequently funded on January 19, 2006. The swap had a notional amount of $257.0 million and was scheduled to amortize through 2030. Although the agreement was scheduled to become effective March 1, 2006, the intent was to terminate and cash settle the swap upon funding of the CPP Project. Consequently, on January 19, 2006 the swap cash settled with a $2.0 million payment from the counterparty.

Subordinated Electric Revenue Bonds. Payment of and interest on the Subordinated Electric Revenue Bonds is subordinate to the payment of the principal and interest on the District's Electric Revenue Bonds.

Variable Rate Bonds. The District's variable rate bonds bear interest at daily, weekly and monthly rates, ranging from 2.75 percent to 3.25 percent at December 31, 2005. The District can elect to change the interest rate period or fix the interest rate, with certain limitations. Certain variable rate bondholders have the right to tender the bonds to the tender agent. The District's variable rate bonds cannot be put to the District by the bondholders. Accordingly, the District has recorded such bonds as long-term debt, less amounts scheduled for redemption within one year.

Component Unit Cogeneration Bonds. The component units of the District have each issued bonds to finance their respective cogeneration projects. These bonds have limited-recourse to the District. Principal and interest associated with these bonds are paid solely from the component units' revenues and receipts collected in connection with the operation of the cogeneration projects. Most operating revenues earned by the component units are collected from the District in connection with the sale of electricity to the District. The ability of the component units to service the debt is dependent upon the successful operation of the respective cogeneration projects (see Note 6).

Callable Bonds. The District has $24.6 million of fixed rate electric system revenue bonds that are currently callable and $921.3 million of bonds that become callable from 2006 through 2014. These bonds can be called until maturity. In addition, all $453.9 million of the District's variable rate subordinated bonds are currently callable.

Collateral. The principal and interest on the District's bonds are payable exclusively from, and are collateralized by a pledge of, the net revenues of the electric system of the District. Neither the credit nor the taxing power of the District is pledged to the payment of the bonds and the general fund of the District is not liable for the payment thereof.

Covenants. The District's bond resolutions contain various covenants that include requirements to maintain minimum debt service coverage ratios, certain other financial ratios, stipulated minimum funding of revenue bond reserves, and various other requirements.

NOTE 11. COMMERCIAL PAPER NOTES

The District issues Notes to finance or reimburse capital expenditures. At December 31, 2004, there were no Notes outstanding and as of December 31, 2005, Notes outstanding totaled $200.0 million. The effective interest rate for the Notes outstanding at December 31, 2005 was 3.18 percent and the average term was 39 days. The District maintains a $204.9 million letter of credit to support the sale of these outstanding Notes and incurs an annual fee of 0.2 percent on undrawn balances and 0.4 percent on drawn balances. There has not been a term advance under the letter of credit agreement.

The summarized activity of the District's Notes during 2005 and 2004 is presented below (thousands of dollars):

	Balance at beginning of Year	Additions	Reductions	Balance at end of Year
December 31, 2005	$ -0-	$ 200,000	$ -0-	$ 200,000
December 31, 2004	51,000	50,000	101,000	-0-

NOTE 12. FAIR VALUE OF FINANCIAL INSTRUMENTS

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate the value:

Investments. The fair values of investments, including cash equivalents, are based upon quoted market prices.

Long-term Debt. The fair value of Long-term Debt, which includes the short-term portion, was calculated by determining the value of each individual series using a standard bond pricing formula and market yields from representative yield curves. The District's electric revenue bonds, including subordinated bonds, were priced using the fair market curve for insured municipal revenue bonds, except the taxable Series F Bonds, which were priced using the taxable general obligation bond curve. A similar fair value calculation was performed for the component units' bonds, except that all uninsured component unit debt was priced using the yield curve for "BBB" rated municipal power bonds and insured component debt was calculated using the yield curve for "A" rated municipal power bonds. All yield curves were obtained from Bloomberg L.P.

Interest Rate Swap and Put Agreements. The fair values of interest rate swap and put agreements are based on quoted market prices.

Gas and Electricity Related Derivatives. The fair values of gas and electricity price swap agreements and electricity option agreements are based on forward prices from established indexes for the applicable regions. The fair values of electricity purchase agreements are based on forward prices from established indexes from applicable regions and discounted using established interest rate indexes. Additionally, for electricity purchase contracts that include options and/or exchanges, the fair values of such contracts are based on models prepared by District staff that include forecasted future usage and/or exchanges and electricity pricing based on price curves as described above for the periods covered by the agreements.

The estimated fair values of the District's financial instruments are presented below:

	December 31, 2005	
	Recorded Value	Fair Value
	(thousands of dollars)	
Investments, including cash and cash equivalents	$ 738,096	$ 738,096
Long-term debt	(2,385,528)	(2,559,789)
Interest rate swap and put agreements	4,639	4,639
Gas and electricity related derivatives, net	256,596	256,596

	December 31, 2004	
	Recorded Value	Fair Value
	(thousands of dollars)	
Investments, including cash and cash equivalents	$ 538,582	$ 538,582
Long-term debt	(2,473,490)	(2,683,913)
Interest rate swap and put agreements	(5,393)	(5,393)
Gas and electricity related derivatives, net	(15,167)	(15,167)

NOTE 13. RANCHO SECO DECOMMISSIONING LIABILITY

Background. The Rancho Seco decommissioning liability relates to the nuclear decommissioning of the former 913 MW nuclear power plant, which terminated commercial operations in 1989. Nuclear decommissioning is the process of safely removing nuclear facilities from service and reducing residual radioactivity to a level that permits termination of the Nuclear Regulatory Commission (NRC) license and release of the property for unrestricted use. The NRC has approved the District's decommissioning plan, which provides for removing low-level radioactive material beginning in 1997 and completing active decommissioning in 2008. The plant license is planned to be terminated in phases. The license for the main areas of the Rancho Seco power plant site will be terminated in 2008 after removal of waste, most of which will be sent to licensed disposal sites or licensed radioactive waste processors. The remaining waste will be stored on site for an unspecified period after 2008 pending availability of appropriate disposal sites. The license for the storage facilities will be terminated after the waste is removed.

The Department of Energy (DOE), under the Nuclear Waste Policy Act of 1982, is responsible for permanent disposal of spent nuclear fuel and high-level radioactive waste. The District has a contract with the DOE for the removal and disposal of spent nuclear fuel and high-level (greater than class "C": GTCC) radioactive waste. However, the date when fuel and GTCC waste removal will be complete is uncertain. The DOE has announced that it would not meet the projected 2010 opening date for the Yucca Mountain waste site. The rate at which DOE will remove fuel is also uncertain. The District maintains a separately licensed on-site independent spent fuel storage facility (Storage Facility) which stores all of the District's spent fuel in sealed canisters. The District has received a license amendment to store the GTCC waste at the Storage Facility. The Storage Facility will remain under the regulation of NRC until such time as it is decommissioned after the DOE removes the nuclear fuel and GTCC radioactive waste.

Asset Retirement Obligations. Rancho Seco is one of the first large commercial nuclear power plants to be removed from service. Due to the substantial technical, regulatory and legal issues in connection with its nuclear decommissioning, the District cannot predict with certainty how long various decommissioning processes will take nor the eventual cost of decommissioning. These financial statements reflect the District's current estimate of its obligation for the cost of decommissioning under the requirements of SFAS No. 143 based on studies completed each year. There was no increase in cost in the 2005 study. The 2004 study included an increase of $26.1 million, which related primarily to additional internal and outsourced staffing costs and other support costs related to spent fuel management from 2009 through the date of removal of spent nuclear fuel.

Rancho Seco's decommissioning liability is presented below (thousands of dollars):

	December 31, 2005	December 31, 2004
Active decommissioning	$ 176,523	$ 217,341
Spent fuel management	108,419	103,208
Total ARO	$ 284,942	$ 320,549
Less: Current portion	41,500	41,500
Total Non-current portion of ARO	$ 243,442	$ 279,049

The summarized activity of the Rancho Seco decommissioning liability during 2005 and 2004 are presented below (thousands of dollars). The annual adjustments include a savings computed as the difference between the fair value of the obligation as if the decommissioning activities were perform by a third party and the amount actually incurred by the District performing the decommissioning activities.

	December 31, 2005	December 31, 2004
ARO at beginning of year	$ 320,549	$ 316,540
Accretion	16,185	16,158
Expenditures and annual adjustments	(36,872)	(38,221)
Annual adjustments	(14,920)	-0-
Additional decommissioning liability from 2004 study	-0-	26,072
Total ARO	$ 284,942	$ 320,549

The District contributed $27.0 million to the Trust Fund in 2005 and 2004, and plans the same contribution rate in 2006.

NOTE 14. PENSION PLANS

Defined Benefit Pension Plan. The District participates in the California Public Employee's Retirement System (PERS), an agent multiple-employer public employee defined benefit pension plan. PERS provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. PERS acts as a common investment and administrative agent for participating public entities within the State. Benefit provisions and all other requirements are established by State statute and District policies. The pension plan provides retirement benefits, survivor benefits, and death and disability benefits based upon employee's years of credited service, age and final compensation. Copies of PERS' annual financial report may be obtained from their Executive Office at 400 P Street, Sacramento, California 95814.

Funding Policy. Participants are required to contribute approximately 7.0 percent of their annual covered salary. The District makes either the full or partial contributions required of District employees on their behalf and for their account. The District is currently required to contribute 4.9 percent of payroll to the plan. The contribution requirements of plan members and the District are established and may be amended by PERS.

Annual Pension Cost. For 2005, the District's pension cost for PERS was $9.0 million. For 2004 and 2003, the District's annual pension cost for PERS was $0 since it was not required to make, and did not make, pension contributions. Contributions are determined by actuarial valuations which are performed based on the entry age normal actuarial cost method. The contribution for the first half of 2005 was determined by PERS as part of the annual actuarial valuation as of June 30, 2003; the contribution for the second half of 2005 was determined by PERS as part of the annual actuarial valuation as of June 30, 2004. The actuarial assumptions included (a) a 7.75 percent investment rate of return (net of administrative expenses), (b) projected annual salary increases that vary by duration of service, and (c) 3.0 percent per year cost-of-living adjustments. Both (a) and (b) also included an inflatiǒn component of 3.0 percent. The actuarial value of PERS' assets was determined using techniques that smooth the effects of short-term volatility in the market value of investments over a three-year period (smoothed market value).

Three-year trend information for PERS is presented below (dollars in thousands):

Fiscal Year	Annual Pension Cost (APC)	Percentage of APC Contribution
6/30/03	$ -0-	100%
6/30/04	-0-	100
6/30/05	9,047	100

Required supplementary information for PERS is presented below for the three most recent years for which the District has available data (dollars in thousands):

Actuarial Valuation Date	Entry Age Normal Liability	Actuarial Value of Assets	Funding Excess	Funded Status Percent	Annual Covered Payroll	Funding Excess as a Percent of Payroll
6/30/02	$ 858,245	$ 1,043,256	$ 185,011	121.6	$ 137,257	134.8
6/30/03	980,081	1,045,473	65,392	106.7	146,404	44.7
6/30/04	1,054,410	1,087,532	33,122	103.1	155,289	21.3

Other Plans. The District provides its employees with two cash deferred compensation plans, one pursuant to Internal Revenue Code (IRC) Section 401(k) [401(k) Plan] and one pursuant to IRC Section 457 (457 Plan) (collectively, the Plans). The Plans are contributory plans in which the District's employees contribute the funds. Each of the District's eligible full-time or permanent part-time employees may participate in either or both Plans and amounts contributed are vested immediately. Such funds are held by a Trustee in trust for the employees upon retirement from District service and, accordingly, are not subject to the general claims of the District's creditors. The District is responsible for ensuring compliance with IRC requirements concerning the Plans and has the duty of reasonable care in the selection of investment alternatives, but neither the District nor its Board or officers have any liability for market variations in the Plans' asset values. District employees are responsible for determining how their funds are to be invested and pay all ongoing fees related to the Plans. The Plans are currently not subject to discrimination testing or the requirements of the Employee Retirement Income Security Act of 1974. The District employees participating in the Plans are allowed to contribute a portion of their gross income not to exceed the annual dollar limits prescribed by the IRC.

The District makes annual contributions to the 401(k) Plan on behalf of certain employees pursuant to a memorandum of understanding with both of its collective bargaining units. The District does not match employee contributions nor make contributions on behalf of its employees to the 457 Plan. Participating employees and the District made contributions into the Plans totaling $14.7 million and $0.3 million in 2005, respectively, and $13.9 million and $0.3 million in 2004, respectively.

NOTE 15. OTHER POST-EMPLOYMENT BENEFITS

The District provides post-employment health care benefits, in accordance with District policy and negotiated agreements with employee representation groups, to all employees who retire from the District, and their dependents, on or after attaining age 50 with at least 5 years of service. The District also provides post-employment health care benefits to covered employees who are eligible for disability retirement. The District contributes the full cost of coverage for employees hired before January 1, 1991, and a portion of the cost based on credited years of service for employees hired after January 1, 1991. The District also contributes a portion of the costs of coverage for these employees' dependents. At December 31, 2005, 2,269 post-employment participants, including retirees, spouses of retirees, surviving spouses, and eligible dependents, participate in the District's health care benefits program.

The post-employment health care benefits are unfunded. The District records post-employment health care benefit expenses on a pay-as-you-go basis. During 2005 and 2004, post-employment health care benefit expenditures were $10.8 million and $9.5 million, respectively. At December 31, 2005 and 2004, the District estimates that the actuarially determined accumulated post-employment benefit obligation was approximately $327.0 million and $321.1 million, respectively. The increase in this estimate in 2005 was caused primarily by an increase due to changes in mortality tables and demographic changes; partially offset by decreased starting claims cost assumptions. The health care inflation rate assumption used to estimate the net present value of the post-employment benefit obligation for 2005 ranged between 5.0 percent and 11.5 percent compared to a range of 5.0 percent to 13.0 percent used in the 2004 study for various elements of the health care obligations. The decrease reflects most recent experience and expectations. The effect of a one percent change in these assumed health care cost trends would increase or decrease the District's total benefit obligation at December 31, 2005 by approximately $48.4 million or $39.6 million, respectively.

NOTE 16. INSURANCE PROGRAMS AND CLAIMS

The District is exposed to various risks of loss related to torts, theft of and destruction to assets, errors and omissions, and natural disasters. In addition, the District is exposed to risks of loss due to injuries to, and illnesses of, its employees. The District carries commercial insurance coverage to cover most claims in excess of specific dollar thresholds, which range from $0.2 million to $1.0 million per claim with total excess liability insurance coverage for most claims of $100.0 million. District property insurance coverage is based on the replacement value of the asset. There have been no significant reductions in insurance coverage in 2005. In 2005 and 2004, the insurance policies in effect have adequately covered all settlements of the claims against the District. The claims liability is included as a component of Self Insurance, Deferred Credits and Other in the consolidated balance sheets.

The District's total claims liability, comprising claims received and claims incurred but not reported, at December 31, 2005 and 2004 is presented below:

	2005	2004
	(thousands of dollars)	
Workers' compensation claims	$ 4,741	$ 6,429
General and auto claims	2,940	3,069
Short- and long-term disability claims	1,691	2,501
Claims liability	$ 9,372	$ 11,999

Changes in the District's total claims liability during 2005 and 2004 is presented below:

	2005	2004
	(thousands of dollars)	
Claims liability, beginning of year	$ 11,999	$ 10,573
Add: Provisions for claims	2,808	5,851
Less: payments on claims	(5,435)	(4,425)
Claims liability, end of year	$ 9,372	$ 11,999

NOTE 17. COMMITMENTS

Electric Power Purchase Agreements. The District has numerous power purchase agreements with other power producers to purchase capacity and associated energy to supply a portion of its load requirements. The District has minimum take-or-pay commitments for energy on most contracts. Certain contracts allow for the District to exchange energy, received primarily in the summer months, when the District most needs the energy and to return energy during the winter months, or other subsequent periods.

At December 31, 2005, the approximate minimum obligations for these contracts over the next five years are as follows:

Year ending:	Amount (thousands of dollars)
2006	$ 321,033
2007	229,987
2008	198,185
2009	195,122
2010	150,576

Contractual Commitments beyond 2010. Several of the District's purchase power contracts extend beyond the five-year summary presented above. These contracts expire between 2011 and 2026 and provide for power under various terms and conditions. The District estimates its annual minimum commitments under these contracts range between $115.7 million in 2011 and $12.8 million in 2026. The District's largest purchase power source is the Western Area Power Administration Base Resource contract (Western), whereby the District receives 31.25 percent of the amount of energy made available by Western in any given year at a 31.25 percent share of their revenue requirement. The Western contract expires in 2024.

Gas Supply Agreements. The District has numerous long-term natural gas supply agreements with Canadian and U.S. companies to supply a portion of the consumption needs of the District's natural gas fired cogeneration power plants, which expire through 2015.

Gas Transport Capacity Agreements. The District has numerous long-term natural gas transport capacity agreements with Canadian and U.S. companies to transport natural gas to the District's natural gas fired cogeneration power plants from the supply basins in Alberta to the California-Oregon border and from supply basins in the southwest and Rocky Mountains to the Southern California border. These gas transport capacity agreements provide for the delivery of gas into District owned pipeline capacity within California. The gas transport capacity agreements provide the District with 32,000 decatherms per day (Dth/d) of natural gas pipeline capacity to the Canadian Basins through 2023 and 40,000 Dth/d to the Southwest or Rocky Mountain Basins through at least 2018.

Gas Storage Agreements. The District also has an agreement for the storage of up to 2.25 million Dth of natural gas at a regional facility. The gas storage agreement expires in 2009.

At December 31, 2005, the approximate minimum obligations for these natural gas related contracts over the next five years are as follows:

Year ending:	Amount (thousands of dollars)
2006	$ 160,983
2007	163,184
2008	61,879
2009	26,742
2010	25,993

Contractual Commitments beyond 2010. Several of the District's gas transport and gas storage contracts extend beyond the five-year summary presented above. These contracts expire between 2011 and 2023 and provide for transportation and storage under various terms and conditions. The District estimates its annual minimum commitments under these contracts to be between $25.9 million in 2011 and $5.4 million in 2023.

Gas Price Swap Agreements. The District has entered into numerous variable to fixed rate swaps with notional amounts totaling 117,925,000 million British Thermal Units (mmbtu) for the purpose of fixing the rate on the District's natural gas purchases for its gas fueled power plants and gas indexed electric contracts. These gas price swap agreements result in the District paying fixed rates ranging from $4.60 to $10.75 per mmbtu. The swap agreements expire periodically from March 2006 through October 2010.

NOTE 18. CLAIMS AND CONTINGENCIES

U.S. Bureau of Reclamation Water Service Contract Billing Dispute. The District entered into a 40-year water service contract with the Bureau, which expires in 2012, for the delivery of up to 75,000 acre-feet of water per year to originally meet the District's needs at Rancho Seco. This amount includes 60,000 acre-feet of municipal and industrial (M&I) water from the Central Valley Project (CVP). Over time, Bureau revenues have been insufficient to cover actual CVP operations and maintenance (O&M) costs; CVP contractor payments have been insufficient to cover amortization of their respective shares of CVP capital costs and, in the case of M&I contractors, have been insufficient to cover interest on unpaid capital. Although the District's contract contains a specific rate methodology, the Bureau maintained that the District and other M&I contractors are running substantial O&M deficits which, by the Bureau's definition, includes as O&M costs both unpaid interest on capital and interest on the O&M deficit. The District, in concert with the M&I contractors, filed their complaint against the Bureau in March 2003 in the U.S. District Court. Under the guidance of a federal magistrate, negotiations were held and a settlement was reached with the Department of the Interior in March 2005.

In general, the settlement reduces each contractor's obligation based on a combination of lower interest rates and simple interest; and the contractors commit to repayment of under-recovered capital and O&M costs. The contractors can either pay off the obligation or retire it in rates. The District estimates that its obligation under this settlement is $9.7 million as of December 2005. In December 2004 the Board approved the settlement and deferred the obligation as a Regulatory item (See Note 8) to be recovered in future rates as the obligation is repaid to the Bureau. This amount is included in Due to U.S. Bureau of Reclamation in the balance sheet.

California Energy Market Refund Dispute. In 2001, FERC issued an order establishing evidentiary hearings for the purpose of determining the amount of refunds, if any, due to customers of the California ISO and California PX spot markets from market participants selling into those markets for the period October 2, 2000 through June 20, 2001. During this time period, the District was both a seller and a buyer in the California spot markets. This matter has been the subject of various proceedings with FERC and court filings with the Ninth District since 2001. In March 2003, FERC issued an Order adjusting the formula used to calculate the mitigated market-clearing price (MMCP) to be used in retroactively resettling the markets during the refund period. In October 2003, FERC issued an Order on Rehearing, where in relevant part (1) rejected the District's request for rehearing regarding the District's $4.1 million sleeve transaction, (2) rejected the District's request for rehearing regarding adjustments made by the California PX, (3) declined to address the issue of FERC's jurisdiction over municipal sellers and (4) determined that individual sellers, and not the California PX, should be subject to refund liability and refunds should be paid on a pro rata basis. The District has filed a Petition for Review of the Order on Rehearing with the Court of Appeals for the Ninth Circuit, for the purposes of appealing the decision regarding the District's $4.1 million sleeve transaction. In November 2004, the Ninth Circuit Court issued an order severing the Petitions for Review of the jurisdictional issues and other transaction issues (which includes the District's sleeve transaction). The Ninth Circuit Court heard oral arguments in April 2005 to consider the transaction issues (including the District's sleeve transaction).

In August 2005, FERC issued an opinion that involves how entities may demonstrate that their overall costs of selling power to the California ISO/California PX exceeded their overall revenue received under the MMCP. In the Order, the Commission approved the District's proposed methodology for determining its actual costs, but denied the District's request to use its replacement costs for hydro sales, noting only that the District did not justify the use of replacement costs. The District filed for rehearing of the August Order on September 7, 2005. In the meantime, FERC has required parties to submit cost showings on an expedited basis.

On September 6, 2005, the Ninth Circuit found that FERC does not have refund authority over wholesale power sales made by governmental entities and other non-public utilities, including the District. On October 3, 2005, PG&E, Southern California Edison Company (Edison), San Diego Gas & Electric Company (SDG&E) and the Electricity Oversight Board (EOB)(collectively "the California Parties") filed a motion with the Ninth Circuit requesting that the timeline for filing for rehearing of the September 6 decision be extended for forty-five days after the Ninth Circuit Court issues a decision in the pending appeal related to the scope/transactions issues. The motion also seeks a delay in the issuance of the mandate in the jurisdictional case until after the extended deadline to seek rehearing and/or rehearing *en banc* has passed. The Ninth Court granted the California Parties motion on October 17, 2005. Accordingly, the time for filing for rehearing is tolled pending the outcome of the pending appeal related to the scope/transactions issues discussed above.

If the Ninth District's decision stands, the District will have no liability. Under the latest MMCP formula announced by FERC, the District estimated that its potential refund liability could be as high as $12.0 million, if the District is found to be subject to FERC's authority in this matter. The District's liability would likely be partially offset by refunds it would eventually realize as a buyer in the California ISO and California PX spot markets. However, since District management believes it is unlikely that the Ninth Circuit Court's decision will be overturned, it has not accrued any liability in this matter.

Scheduling Coordinator Services Tariff Dispute. In January 2000, PG&E filed its proposed SCS Tariff with FERC, designed to charge the District and other existing wholesale contract customers for the cost shortfall or surpluses resulting from the amount that PG&E could collect for transmission service under its existing transmission contracts and the charges imposed on PG&E under the California ISO Tariff. PG&E claims that such services were new services that were due to the advent of industry restructuring; while the District and others believe that their existing contracts require PG&E to provide such services under the terms of their existing contracts. Accordingly, the District and other utilities affected by the proposed SCS Tariff filing rigorously opposed the proposed tariff action and participated in numerous FERC proceedings in this regard. Although PG&E's tariff filing was made in 2000, PG&E sought to have the proposed SCS Tariff charges apply retroactively from April 1998 when the operations of the California ISO commenced and PG&E began incurring the ISO-related costs it is attempting to recover. In June 2002, the District commenced operations as a separate control area and, therefore, is not subject to the proposed SCS Tariff as of that date.

In January 2000, FERC accepted for filing PG&E's proposed SCS Tariff and set the matter for hearing. In August 2003, the Administrative Law Judge issued an Order Phasing Proceeding bifurcating the proceeding into two phases. The first phase addressed whether PG&E could collect the cost differences under the SCS Tariff. The second phase addressed cost allocation issues. In October 2004, FERC issued its Phase 1 Opinion in which it found PG&E's SCS Tariff to be a new service and that PG&E could recover the charges under the SCS Tariff, but refused to allow PG&E to recover SCS Tariff charges retroactively from April 1998 through December 1999. The hearings in Phase 2 of the proceeding were held in June 2005.

On July 12, 2005, the District of Columbia (D.C.) Circuit Court of Appeals issued a decision finding that the ISO Tariff required PG&E to recover the above-referenced cost differentials under either PG&E's Transmission Owner Tariff (TO Tariff) or through bilateral negotiations to reform the existing contracts. On December 20, 2005, in light of the D.C. Court of Appeals decision, the FERC issued a remand order terminating the SCS Tariff proceeding, which would effectively require

PG&E to refund amounts collected under the SCS Tariff, including amounts previously paid by the District of approximately $19.2 million plus interest. The District and PG&E filed motions for clarification and/or rehearing of the December 20 order on January 19, 2006. In its motion, PG&E requested that, consistent with FERC's remand order, FERC clarify that it can recover all of the costs that it incurred as a Scheduling Coordinator for existing transmission contracts under the TO Tariff. To the extent that FERC does not provide such clarification, PG&E requests that FERC not terminate the SCS Tariff so that PG&E may recover these additional costs. The District believes that the possibility that FERC will reverse its decision to terminate the SCS Tariff is unlikely.

In June 2004, PG&E issued the District an invoice in the amount of $19.2 million, which the District paid in full. Since the FERC's October 2004 Order (issued after the payment was made) clarified that the District was owed a refund on $2.8 million of the amounts paid to PG&E, a receivable of $2.8 million was recorded at December 31, 2004 and the $16.4 million of net costs were charged to purchased power expense in 2004.

Replacement Reserves Dispute. In August 2003, PG&E issued invoices totaling $2.2 million for replacement reserve charges purportedly incurred by PG&E for energy scheduled through its Rancho Seco intertie point from July 2000 through June 2002. In September 2003, the District provided PG&E notice of dispute of the invoices due to the fact that the billing was inconsistent with the Restated Interim Agreement, the primary agreement between the parties governing such transactions and, therefore, there should never have been any Replacement Reserve charges incurred in connection with the power deliveries at issue. PG&E functioned as the Scheduling Coordinator on the District's behalf for transactions with the California ISO at this intertie point until June 2002, when the District became its own control area. These Replacement Reserve charges purportedly relate to power purchased by the California ISO to cover deviations between actual load and forecasted load. The District believes that, even if the charges were appropriate, PG&E's delay in billing within a reasonable timeframe compromised the District's ability to modify its operations or scheduling procedures to eliminate or mitigate the charges. Further, PG&E has already collected these charges from the District under the SCS Tariff described above. Given the FERC's termination of the SCS Tariff proceeding, PG&E will likely be required to refund these charges to the District but may be able to recover these charges under its TO Tariff. To the extent that PG&E recovers these charges under its TO Tariff, it will not be able to collect these charges under the Restated Interim Agreement.

Since October 2003 the parties have entered into a series of tolling agreements that hold this dispute in abeyance until the SCS Tariff Dispute described above is resolved.

District management believes that it is likely that it will not be found liable for any charges in this matter, and therefore no liability has been recorded.

COTP II Arbitration. The California ISO filed to pass through charges on transactions involving the COTP, the District and Western control area. The California ISO is seeking to pass through $14.0 million in new charges to PG&E as the COTP's and Western's control areas proxy scheduling coordinator. These charges include emissions costs, start-up costs, and minimum load costs. PG&E disputes the California ISO's authority to impose any charges on it as the Scheduling Coordinator for COTP and filed for arbitration in July 2004. The District filed its intervention in the arbitration in July 2004. The California ISO and Edison filed motions for summary disposition in November 2004. The District, PG&E, and other aligned parties filed a joint reply to the California ISO's and Edison's motion for summary disposition in January 2005. In March 2005 the arbitrator issued an order denying the summary disposition motions of the California ISO and Edison.

Arbitration hearings were conducted in July 2005. In September 2005, the arbitrator issued an award finding that the California ISO improperly assessed PG&E the Must Offer Charges related to the COTP and related transactions involving municipal utilities within California. Accordingly, the arbitrator ordered the California ISO to adjust the billings to reflect a full refund of all Must Offer Charges for transactions on the COTP and Western transactions through the close of the record. However, the arbitrator's order did not award PG&E interest on the refunded amount based on his belief that PG&E did not request interest. In October 2005, the California ISO filed a petition for review of the arbitrator's award with FERC. PG&E filed a petition for review on that same day raising as its sole issue the arbitrator's failure to provide PG&E with interest on the refunded amount. In November 2005 the District and the other Joint Interveners filed a motion to intervene, motion to reject the California ISO's petition for review, and, in the alternative, motion to consolidate PG&E's petition for review with that of the California ISO's. On January 12, 2006, the FERC issued an order denying the motion to reject, consolidating the proceedings, and establishing a procedural schedule.

The District believes that the California ISO will not prevail in its attempts to pass charges through to the COTP and the District and the Western control area. The District believes that previous COTP arbitration and subsequent FERC orders confirmed that such a pass through was in violation of the California ISO Tariff. Should the California ISO ultimately prevail, the District estimates that its share of the $13.0 million that the California ISO seeks to charge may be as much as $3.0 million. The District believes that it will prevail in this matter and, therefore, no liability has been recorded at December 31, 2005.

Claims for 2000 and 2001 Power Sales. On December 6, 2005, the California Parties filed a claim for damages pursuant to California Government Code § 910.4 ("Tort Claims Act") and in March 2006 filed complaints against the District and other governmental entities for damages and/or restitution and declaratory relief in Federal District Court in the eastern District of California. The California Parties' claim arises from the District's power sales from May 1, 2000 through June 20, 2001 in the wholesale electricity markets operated by the California ISO and the California PX under tariffs filed with FERC. The California Parties allege that the District is contractually obligated under the California PX Participation Agreement to reimburse the California Parties for any amounts that FERC might find were unjust under the California Refund Proceedings. While the District has not fully analyzed the complaint, the District believes that as to the non-governmental California Parties, the claim is untimely filed under the one-year statute of limitations under the Tort Claims Act and as to the Electricity Oversight Board is untimely filed under the four-year statute of limitations for contract claims. In addition, the District is analyzing the impact of the Ninth Circuit Court of Appeals recent decision that FERC lacks refund authority over wholesale power sales made by governmental entities, like the District, may have on the claim (see related discussion in *California Energy Market Refund Dispute* above).

Although the California Parties' claim and complaint does not specify the amount of damages that the California Parties seek, the District expects that this amount would parallel the refund that the District would owe to the market if it were subject to refund liability. Accordingly, the District estimates that its potential refund liability ranges between no liability and approximately $12.0 million plus interest. Ultimately, the District does not believe that the California Parties will be successful in pursuing the claim.

On January 3, 2006 the Attorney General of the State of California and the California Department of Water Resources (collectively, the State) filed a claim for damages pursuant to the Tort Claims Act. The State's claim arises out of the District's power sales into the California ISO/ California PX markets from May 1, 2000 through June 20, 2001, as well as the District's bilateral power sales to the Department of Water Resources (DWR) through the California Energy Resource Scheduler (CERS). Similar to the California Parties' claim, discussed above, the State alleges that the District is contractually obligated under the California PX Participation Agreement to reimburse the State for any amounts that FERC might find were unjust under the California Refund Proceedings. With respect to the District's bilateral sales to CERS, the State claims that the District is contractually obligated to reimburse the State for the difference between the rates received for any sales made under the Western Systems Power Pool Agreement and a lawful rate as determined by FERC. While the District has not fully analyzed the claim, the District believes that the claim is untimely filed under the one-year statute of limitations under the Tort Claims Act, if applicable, and the four-year statute of limitations for contract claims. With respect to the District's bilateral sales to the DWR, FERC has already refused to mitigate bilateral power sales to CERS. This issue is still pending at the Ninth Circuit Court of Appeals. In addition, the District is analyzing the impact of the Ninth Circuit Court of Appeals recent decision that FERC lacks refund authority over wholesale power sales made by governmental entities, like the District, may have on the claim.

Similar to the California Parties' claim, the State seeks the difference between the market price paid to the District and the FERC-mitigated price. Accordingly, the District estimates that its liability for these market sales ranges between no liability and $12.0 million. Further, while the State does not specify the amount of damages that it seeks for the bilateral CERS sales, the District estimates that this amount is approximately $72.0 million based on the FERC-mitigated price as of July 2004. Ultimately, the District does not believe that either party will be successful in pursuing the claims. Consequently, District management believes that the outcome of these matters will not have a material adverse impact on the District's financial position or results of operations.

Fru-Con Construction Corporation Construction Matters. In August 2003, the District entered into a contract with Fru-Con Construction Corporation (Fru-Con) to construct the District's 500 MW CPP Project. St. Paul Travelers Casualty Company (Travelers) is obligated, under a Performance Bond, to guarantee Fru-Con's performance under the contract. The original construction schedule for the CPP Project called for commercial operation in September 2005. The CPP Project became operational on February 24, 2006.

Though Fru-Con has previously made claims for comparably smaller amounts that have been resolved through negotiation; in October 2004, Fru-Con asserted additional claims totaling $26.0 million. Beginning in October 2004 and continuing until early February 2005, the District and Fru-Con participated in negotiations to resolve disputes over both cost and delays in the CPP Project schedule. The parties were unable to resolve the disputes to the satisfaction of the District and in February 2005, the District terminated its contract with Fru-Con on the basis of breach of contract by Fru-Con. Also, in February the District received notice from Fru-Con that Fru-Con claims the contract was wrongfully terminated. On February 28, 2005, the District filed suit in the Sacramento County Superior Court against Fru-Con and one of its sub-contractors alleging breach of contract.

On March 24, 2005, Fru-Con filed its complaint against the District in federal court, alleging breach of contract. Then, on March 29, 2005, Fru-Con attempted to remove the State Court Action to federal court. On May 23, 2005, the federal court granted the District's motion to remand, and transferred the State Court Action back to the Sacramento County Superior Court. On August 10, 2005, the federal court denied without prejudice the District's motion to stay the Federal Court Action. Upon remand to state court, Fru-Con moved to stay the State Court Action in favor of its later-filed federal court action. On August 19, 2005, the Superior Court denied Fru-Con's motion to stay the State Court Action. In addition, six separate but related actions were filed in Sacramento County Superior Court by Fru-Con subcontractors and suppliers, claiming non-payment for work on the Project. Fru-Con settled all but one of the subcontractor lawsuits. Both parties have filed estimates of damages, with the District estimating its claims at $40.0 million or more. Fru-Con estimates that its claims will be roughly $22.0 million, plus fees.

Since January 2005, the District has also been pursuing a claim against Travelers under the performance bond. On September 28, 2005, Travelers denied the District's claim and filed a declaratory relief action in the same federal court as the Fru-Con Federal Court Action. The District filed a counterclaim in response to Travelers' lawsuit. In general, the District is seeking to recover from Travelers all of the damages it claims against Fru-Con plus attorneys' fees related to the Travelers suit.

Fru-Con's federal case has been consolidated with the Travelers lawsuit for purposes of discovery, and the federal court has issued a comprehensive discovery order setting a discovery cut-off of January 18, 2007. The discovery cut-off in the state court action should mirror the federal court discovery cut-off. Document production and interrogatories are underway, with depositions to commence in 2006. In the State Court Action, the court issued an order indicating the case should be resolved by February 28, 2007, and setting a case management conference for July 2006.

District management believes it is reasonably likely to be successful in refuting, at a minimum, a majority of Fru-Con's claims and it is reasonably likely to prevail in a majority of its claims against Fru-Con and Travelers. District management also believes that the outcome of this matter will not have a material adverse impact on the District's financial position or results of operations. No liabilities or receivable has been recorded by the District in connection with these disputes.

Other Construction Matters. The District contracts with various other firms to design and construct facilities for the District. Currently, the District is party to various claims, legal actions and complaints on some of these construction projects. District management believes that it will be successful in refuting these allegations, and estimates that the ultimate resolution of these matters will not have a material adverse effect on the District's financial position. In 2005 one construction related case was decided against the District for $1.6 million; the matter is currently under appeal. Accordingly, a liability of $1.6 million has been recorded at December 31, 2005.

Environmental Matters. The District is one of many potentially responsible parties that have been named in a number of actions relating to environmental claims and/or complaints. Due to the nature of these claims, legal actions or complaints, the District is unable to predict the range of costs for resolution of these actions and intends to take all actions necessary to defend its position. Some of these matters name the District along with other electric utilities as potentially responsible parties. The District has estimated its exposure to such costs based on its proportionate share of the potential claim and recorded its share as a liability; in most instances this is a relatively small percentage. However, should other named responsible parties become insolvent and unable to pay their share of the claims, the District's share of these contingent liabilities would increase and could be material. District management does not believe this will occur, and accordingly, management believes that the outcome of these environmental claims will not have a material adverse impact on the District's financial position or results of operations.

Other Matters. In the normal operation of business, the District is party to various claims, legal actions and complaints. Management and the District's legal counsel believe that there are no other material loss contingencies that would have a material adverse impact on the District's financial position or results of operations.

NOTE 19. SUPPLEMENTAL CASH FLOW INFORMATION

A reconciliation of the consolidated statements of cash flows operating activities to operating income is as follows:

	Year Ended December 31, 2005	Year Ended December 31, 2004
	(thousands of dollars)	
Operating income	$ 163,095	$ 167,749
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	106,588	98,614
Depletion	6,241	5,265
Regulatory deferrals collected in rates, including decommissioning	30,571	30,306
Amortization of advance capacity	4,711	4,711
Revenue (recognized from) deferred to regulatory credits	866	(12,317)
Federal and State grants revenue	1,355	3,727
Interest income from energy efficiency loans	(2,829)	2,102
Other	(3,282)	945
Changes in operating assets and liabilities:		
Customer and wholesale receivables	(1,327)	7,003
Other assets	6,502	6,764
Payables and accruals	169,706	10,167
Decommissioning	(37,252)	(32,830)
Net cash provided by operating activities	$ 444,945	$ 292,206

The supplemental disclosure of noncash financing and investing activities is as follows:

	Year Ended December 31, 2005	Year Ended December 31, 2004
	(thousands of dollars)	
Loss on defeasance of debt	$ (706)	$ (548)
Amortization of debt related costs	6,115	5,351
Unrealized holding loss	(14)	(1,868)
Change in valuation of derivative financial instruments	281,795	11,737
Assets contributed in aid of construction	4,591	4,975
Allowances for funds used during construction	20,509	15,370
Construction costs included in accounts payable	39,837	40,868

Call of Duty

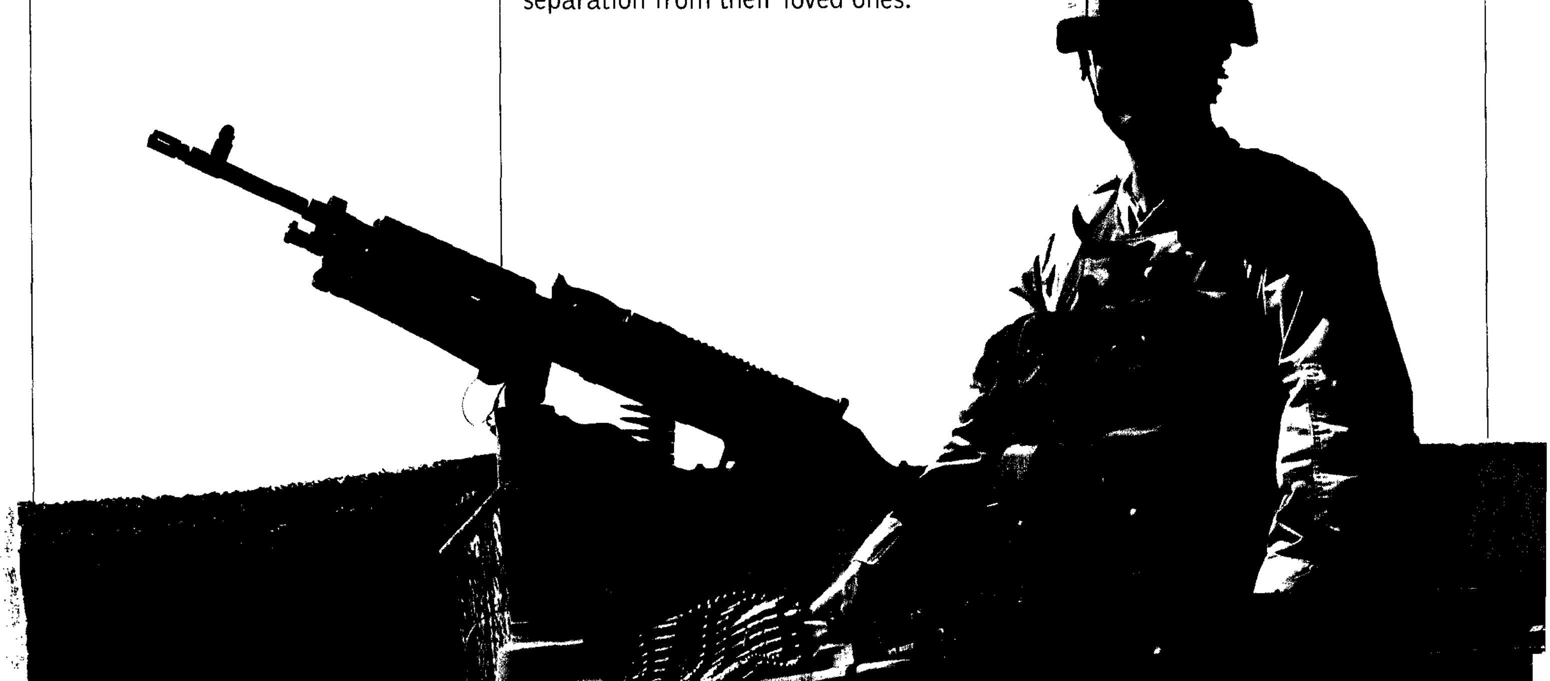
More than 10 percent of SMUD's employees are military veterans. A number of those 250 veterans continue to serve in the reserves, taking them far from home and job during the current hostilities in Iraq.

Since the 9/11 terrorist attacks, a number of SMUD **employees have served their country as military reservists** in Iraq and Afghanistan.

SMUD apprentice lineman Jeremy Carlin (above right, in black cap) recently served in Afghanistan with the U.S. Army Reserves. Meter reader Michael Biermann (below) returned to work in 2005 after serving a full year in Iraq.

To lessen that burden, SMUD supports active-duty personnel by making up the difference in their military pay and providing full medical benefits to their families.

At a board of directors' meeting in March 2005, five employees thanked SMUD for its assistance. Knowing their families were covered with full benefits while they were gone allowed these citizen-soldiers the peace of mind they needed to do their jobs. Providing that financial security was the least SMUD could do to honor its employees' sacrifice and ease the pain of separation from their loved ones.



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SMUD

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