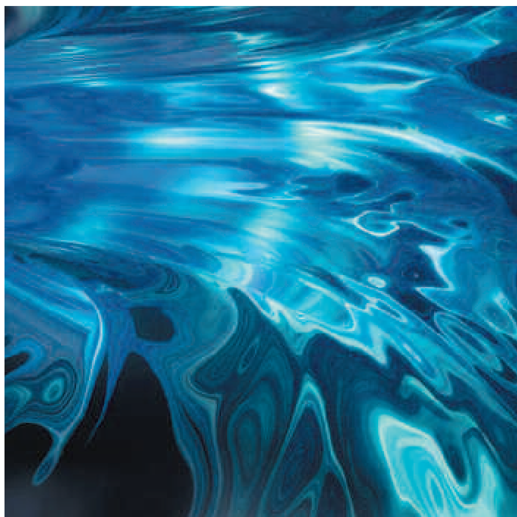
Financial Statements
2005-2006



RIVERSIDE
PUBLIC UTILITIES

Mission Statement

Mission

Riverside Public Utilities is committed to the highest quality water and electric services at the lowest possible rates to benefit the community.

Vision

Riverside Public Utilities will be recognized as a community treasure with a national reputation for excellence.

Core Values

(not in priority order)

Safety
Honesty and Integrity
Teamwork
Professionalism
Quality Service
Creativity and Innovation
Inclusiveness and Mutual Respect
Community Involvement

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Board of Public Utilities

The Board of Public Utilities is composed of nine citizen-volunteers appointed by the City Council to four-year terms without compensation. Board members oversee the utility's policies, operations, revenues, expenditures, planning, and regulatory compliance. In addition to bi-weekly Board meetings, members also serve on subcommittees to provide input on the development of new facilities and equipment; performance measures; and programs to conserve energy and water resources; and appropriate technology to protect our water supply and secure our energy resources. The citizen-volunteers who serve on the Board of Public Utilities provide an ongoing, year-round citizen review of all actions by Riverside Public Utilities before any measure is sent to the elected City Council representatives for a final determination.

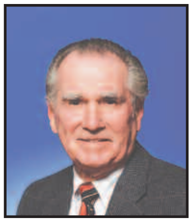
The Board of Public Utilities meets at 8:15 a.m. on the first and third Fridays of each month in the Public Utilities Board Room at 3901 Orange Street, Riverside. Board meetings are open to the public.

James W. Anderson
2005-06 Board Chairman
Occupation: Retired Attorney, Environmental and Administrative Law
Riverside Resident: 33 years
Years of Service: 7

Joe Tavaglione
2004-05 Board Vice Chairman
Occupation: President of Construction & Development Co.
Riverside Resident: lifetime
Years of Service: 6

David E. Barnhart
Occupation: Director of Transportation
Riverside Resident: 11 years
Years of Service: 3

Mary Curtin
Occupation: Teacher of English, RCC and Executive Director Riverside & San Bernardino Central Labor
Riverside Resident: 42 years
Years of Service: New Member 2006



Robert Elliot
Occupation: Retired Kern County Employee Association General Manager
Riverside Resident: 54 years
Years of Service: New Member 2006

Bernie Titus
Occupation: President/CEO of Service Plus Credit Union
Riverside Resident:20 years
Years of Service: New Member 2006

Peter G. Hubbard
Occupation: Director Medical Services
Riverside Resident: lifetime
Years of Service: 8

Robert A. Stockton
Occupation: Vice President, Civil Engineering Consulting
Riverside Resident: 5 years
Years of Service: 3

Ken L. Sutter
Occupation: Retired California-Licensed Architect
Riverside Resident: 19 years
Years of Service: 2

Public Utilities Administration

David H. Wright
Public Utilities General Manager

Stephen H. Badgett
Public Utilities Deputy Director - Energy Delivery

Gary L. Nolff
Public Utilities Assistant Director - Resources

Jerry D. Rogers
Public Utilities Assistant Director - Finance and Customer Relations

Kevin S. Milligan
Public Utilities Assistant Director - Water

Fiscal Message

At Riverside Public Utilities (RPU), our mission to provide the highest quality water and electric services at the lowest possible rates to benefit the community has never been in better focus.

Day in and day out, over 500 employees work together to maintain our facilities, deliver safe, quality services, and prepare for RPU's bright future. All of this is done without losing sight of the ultimate goal that is produced by the flip of a light switch or the turn of a water faucet - reliability without fail.

Throughout the years, our financial plans have been a cornerstone of all RPU activity. In 2005-2006, we enhanced our commitments to our customer-owners by improving our financial condition by almost every measure.

Additionally, we continued to make improvements to our water and electric facilities. The adoption of the SAFE Water Plan begins a 20 year water system infrastructure replacement program that will enable high quality service delivery for decades to come. While two major electric projects, to build an additional peak demand power plant and new substation, will improve system capacity and ensure more reliable service delivery well into the future.

It is easy to say we are doing a great job. However, external validation by industry experts tells the same story. The information below highlights recent evaluations conducted by the internationally recognized firms of Fitch Ratings and Standard & Poor's.

Electric Utility

- Rating upgrade from A+ to AA-
- Fiscally conservative management team
- Strong financial performance
- Strong liquidity to meet future capital needs
- Strong cash reserves
- Strong financial margins
- Successful debt reduction program
- Strong debt service coverage ratios
- Successful implementation of business strategy
- Favorable power resource mix
- Growing customer base
- Rate stability during electric market volatility
- Management's attention to system reliability
- Retail rates among the lowest in the State
- Favorable customer mix
- Cost advantage within California energy markets

Water Utility

- Stable AA rating
- Strong financial performance
- Very good debt service coverage
- Low comparative water rates
- Indigenous water supply
- Secure long-term supply
- Continued financial flexibility
- Growing service territory
- Strong rate support
- Excellent water quality
- Limited need for imported water

AA ratings represent one of the highest financial ratings available in the industry and are shared by only a handful of other utilities, water or electric.

As we look toward the future, we see many challenges in both the electric and water industries. We also see tremendous opportunity to improve and deliver the products and services to which you are entitled. But through it all, rest assured, we will keep our eye on the ultimate goal – fiscal and operational reliability without fail.

Jerry D. Rogers
Assistant Director, Finance & Customer Relations

The information contained in this report would not be possible without the dedication of my co-workers in Financial Services. Outstanding leadership by Reiko Kerr, as well as substantial contributions by Aileen Wong, Cindy Reeley, Shelly Almgren, and Kimberly Wyman made this report possible. Thank you for all your efforts throughout the year.

Independent Auditors' Report

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www.mhm-pc.com

To the Honorable City Council and Board of Public Utilities
City of Riverside
Riverside, California

INDEPENDENT AUDITORS' REPORT

We have audited the accompanying financial statements of the City of Riverside, California, Electric Utility, an enterprise fund of the City, as of and for the year ended June 30, 2006 as listed in the table of contents. These financial statements are the responsibility of the City of Riverside Electric Utility's management. Our responsibility is to express an opinion on these financial statements based on our audits. The prior year summarized comparative financial information has been derived from the City of Riverside, California, Electric Utility's 2005 financial statements which were audited by McGladrey and Pullen, LLP, and whose report dated September 30, 2005 expressed unqualified opinions on the financial statements.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1 to the financial statements, the financial statements of the City of Riverside, California, Electric Utility are intended to present the financial position and the changes in financial position and cash flows for the City of Riverside, California, Electric Utility, a fund of the City, and do not purport to, and do not, present fairly the financial position of the City of Riverside, California, and the changes in its financial position and its cash flows, where applicable, in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the City of Riverside, California, Electric Utility, as of June 30, 2006, and the changes in its financial position and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis, as listed in the table of contents, is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Independent Auditors' Report

MHM

To the Honorable City Council and Board of Public Utilities
City of Riverside

Our audits were conducted for the purpose of forming an opinion on the financial statements that comprise the City of Riverside, California, Electric Utility's basic financial statements. The supplementary information entitled Electric Key Historical Data, as listed in the table of contents, is presented for the purpose of additional analysis and is not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in the audits of the basic financial statements and, accordingly, we express no opinion on it.

In accordance with Government Auditing Standards, we have also issued our report dated September 30, 2006 on our consideration of the City of Riverside's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.

Mayer Hoffman McCann P.C.

Irvine, California
September 30, 2006

Management's Discussion and Analysis

As management of Riverside Public Utilities (a department of the City of Riverside), we offer the readers of Riverside's Electric Utility financial statements, an enterprise fund of the City, this narrative overview and analysis of the financial activities of the Electric Utility (Utility) for the fiscal years ended June 30, 2006 and 2005. We encourage readers to consider the information presented here in conjunction with additional information furnished in our financial statements, which begin on page 14 of this report. All amounts, unless otherwise indicated, are expressed in thousands of dollars.

FINANCIAL HIGHLIGHTS

Fiscal years 2006 and 2005 reflected strong operating results for the Electric Utility, with each year's retail revenues exceeding the previous all-time record – primarily the result of an expanded customer base and the effects of rate increases. Retail sales, net of reserve/recovery were $216,868 and $204,526 for years ended June 30, 2006 and 2005, respectively. As a result of the positive operating results, the Electric Utility was able to increase unrestricted cash reserves by $11,076 and $17,685, respectively, which supports the Utility's long-term financial plan goal of strengthening its financial position and building liquidity.

In August 2005, Fitch upgraded the City of Riverside's Electric Utility's Revenue bonds to AA- from its previous rating of A+.

The assets of the Electric Utility exceeded its liabilities (equity) at the close of fiscal years 2006 and 2005 by $283,603 and $255,202, respectively. Of this amount, $123,854 and $118,880, respectively, may be used to meet the Utility's ongoing obligations to creditors and customers.

The Utility's total equity increased by $28,401 and $57,454 from fiscal years ended June 30, 2006 and 2005, respectively, primarily due to an increase in net retail sales of $12,342 and $4,397, respectively, and contributions from developers totaling $8,231 and $16,716, respectively.

As of June 30, 2006 and 2005, unrestricted equity represented over 58% and 63% of annual operating expenses, respectively.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to the City of Riverside Electric Utility financial statements. The Electric Utility is a department of the City of Riverside, and its activities are recorded in a separate enterprise fund. These financial statements include only the activities for the City of Riverside Electric Utility and provide comparative information for the last two fiscal years. Information on city-wide financial results is available in the City of Riverside's "Comprehensive Annual Financial Report."

The City of Riverside Electric Utility's financial statements comprise two components: 1) financial statements, and 2) notes to the financial statements. In addition, this report also contains other supplementary information to provide the reader additional information about the Electric Utility, including historical sales, operating, and other relevant data.

Included as part of the financial statements are three separate statements, which collectively provide an indication of the Electric Utility's financial health.

The ***Balance Sheets*** present information on assets and liabilities, with the difference between the two reported as equity. Over time, increases or decreases in equity may serve as a useful indicator of whether the financial condition of the utility is improving or deteriorating.

The ***Statements of Revenues, Expenses and Changes in Equity*** present information showing how the Utility's equity changed during the most recent two fiscal years. Results of operations are reported as underlying events occur, regardless of the timing of cash flows. Thus, revenues and expenses are reported in these statements for some items that will result in cash flows in future fiscal periods, i.e. accounts payable and accounts receivable. This is called the accrual basis of accounting and is more fully described in the accompanying Notes to the Financial Statements.

The ***Statements of Cash Flows*** present the cash flow changes occurring during the last two fiscal years in highly liquid cash and cash equivalents, including certain restricted assets.

The ***Notes to the Financial Statements*** provide additional information that is essential to a full understanding of the data provided in the financial statements. The notes to the financial statements can be found on pages 18 to 31 of this report.

UTILITY FINANCIAL ANALYSIS

As noted earlier, equity (also called net assets) may serve over time as a useful indicator of the fund's financial position. In the case of Riverside's Electric Utility, assets exceeded liabilities (equity) by $283,603 and $255,202 at the close of the fiscal years 2006 and 2005, respectively.

The Electric Utility's overall equity increased by $28,401 and $57,454 during fiscal years 2006 and 2005, respectively. The increase is primarily a result of retail revenues, for each respective year, reaching an historic high and contributions from developers.

A portion of the Utility's equity ($107,969, or 38% and $97,207 or 38% of total equity as of June 30, 2006 and 2005, respectively) reflects its investment in capital assets, such as production, transmission, and distribution facilities, less any related outstanding debt used to acquire those assets. The Electric Utility uses these capital assets to provide services to customers; consequently, these assets are not available for future spending. Resources needed to repay the outstanding debt shown on the balance sheet must come from other sources such as operations, since the capital assets themselves cannot be used to liquidate these long-term liabilities.

The Utility's net assets invested in capital assets, net of related debt as of June 30, 2006 and 2005, increased by $10,762 (11.1%) and $37,402 (62.5%), respectively from the prior fiscal year. Significant projects during these respective fiscal years include $3,100 and $2,800 for the City's portion of capital additions at the San Onofre Nuclear Generating Station ("SONGS"), $26,100 and $47,900 for engineering, construction, and purchases of equipment for the Riverside Energy Resource Center, $1,400 and $10,000 to relocate electrical facilities for the State of California funded Caltrans I-215/60/91 freeway interchange project, $400 and $4,600 for the 4kV to 12kV Downtown Power Upgrade Project, and $27,300 and $29,200 in facility additions to serve existing customers and connect new customers to the electric system.

The largest portion of the Electric Utility's equity is the Unrestricted portion – $123,854 or 44% and $118,880 or 47% for fiscal years ended June 30, 2006 and 2005, respectively – which may be used to meet the Utility's ongoing obligations to creditors and customers.

An additional portion of the Electric Utility's equity ($51,780 or 18% and $39,115 or 15% of total equity as of June 30, 2006 and 2005, respectively) represents resources that are subject to internal and external restrictions on how they may be used. These are reserved for items such as debt repayment, Public Benefit Programs, and other legally restricted assets.

RIVERSIDE'S ELECTRIC UTILITY'S CONDENSED STATEMENTS OF EQUITY (NET ASSETS)

	2006	2005	2004
Current and other assets	$ 326,420	$ 286,227	$ 311,063
Capital assets	426,853	375,523	291,289
Total assets	753,273	661,750	602,352
Long-term debt outstanding	361,389	306,144	322,110
Other liabilities	108,281	100,404	82,494
Total liabilities	469,670	406,548	404,604
Equity (net assets)			
Invested in capital assets, net of related debt	107,969	97,207	59,805
Restricted	51,780	39,115	33,917
Unrestricted	123,854	118,880	104,026
Total equity (net assets)	$ 283,603	$ 255,202	$ 197,748

As of June 30, 2006

ASSETS

Total assets for the two most recent fiscal years were $753,273 and $661,750, respectively. The $91,523 (13.8%) increase in total assets is due to a $51,330 increase in net capital assets (Utility plant), relating to the completion of a 99.6 megawatt ("MW") peaking generation plant, and other improvements to the Electric Utility's distribution system, and a $40,193 increase in current and other assets. This $40,193 increase is primarily due to an increase of $32,055 in restricted cash and investments, mostly relating to $71,389 in new bond proceeds on September 20, 2005 and $9,640 increase in current assets primarily from positive operating results, offset by $65,494 of bond proceeds and operating cash used for construction projects.

LIABILITIES

Total liabilities as of June 30, 2006 and 2005 were $469,670 and $406,548, respectively, an increase of $63,122 (15.5%). Long-term debt outstanding increased by $55,245, primarily due to a $115,725, refunding/revenue bond issue, offset by a $43,515 deposit into a refunding escrow account and $15,015 of principal payments. Other liabilities increased by $7,877, primarily due to increases of $3,049 in decommissioning liabilities, and $3,800 in the current portion of long-term obligations.

EQUITY (NET ASSETS)

Total Electric fund equity for fiscal years ended June 30, 2006 and 2005 was $283,603 and $255,202, respectively, an increase of $28,401 (11.1%) during the fiscal year. The restricted portion increased by $12,665 primarily due to an increase in the required debt service reserve as a result of the $115,725 bond issue. The Unrestricted portion increased by $4,974 primarily attributable to results of operations in the current fiscal year. The portion of equity invested in capital assets, net of related debt, increased by $10,762 due to the amount of capital assets constructed or purchased that are not bond financed.

As of June 30, 2005

ASSETS

Total assets as of June 30, 2005 and 2004 were $661,750 and $602,352, respectively. The $59,398 (9.9%) increase in total assets is due to a $84,234 increase in net capital assets (Utility plant), relating to the continuing construction of a 99.6 megawatt ("MW") peaking generation plant, and other improvements to the Electric Utility's distribution system, offset by a $24,836 decrease in current and other assets. This $24,836 decrease is comprised primarily of increases of $9,261 in deferred costs, $17,685 in cash from operations, and $3,066 in accounts receivable, offset by a $57,223 decrease in restricted cash and investments (primarily use of bond proceeds for construction projects).

LIABILITIES

Total liabilities as of June 30, 2005 and 2004 were $406,548 and $404,604, respectively, an increase of $1,944 (0.5%). Although long-term obligations decreased by $15,966 (primarily due to current year principal payments of $14,555), this was offset by an increase of $17,910 in other liabilities. This increase in other liabilities primarily represents increases of $2,873 in decommissioning liabilities and $13,690 for the Electric Utility's portion of the City's issuance of pension obligation bonds. Overall, current liabilities are consistent with prior year.

EQUITY (NET ASSETS)

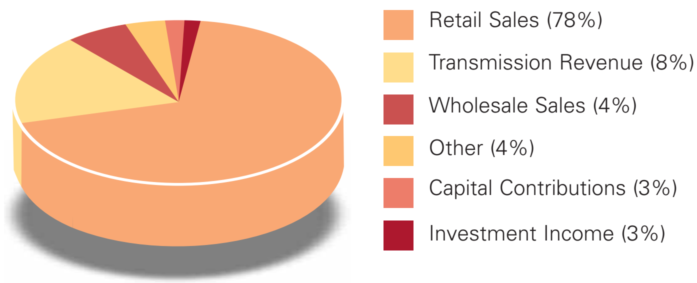
Total Electric fund equity for fiscal years ended June 30, 2005 and 2004 was $255,202 and $197,748, respectively, an increase of $57,454 (29.1%) during the fiscal year. The restricted portion increased by $5,198 primarily due to the effects of Public Benefit Programs. The Unrestricted portion increased by $14,854 primarily attributable to results of operations in the 2005 fiscal year. The portion of equity invested in capital assets, net of related debt, increased by $37,402 due to the amount of capital assets constructed or purchased that are not bond financed.

RIVERSIDE'S ELECTRIC UTILITY'S CONDENSED STATEMENTS OF CHANGES IN EQUITY (NET ASSETS)

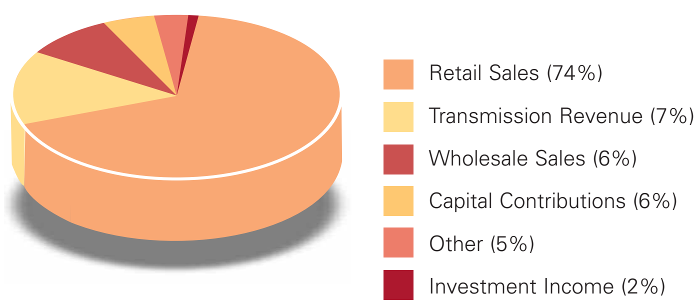
	2006	2005	2004
Revenues:			
Retail Sales, net	$ 216,868	$ 204,526	$ 200,129
Wholesale sales	11,952	15,249	9,581
Transmission	21,185	20,213	20,917
Investment income	7,269	5,183	2,747
Other operating	10,735	14,169	3,315
Capital contributions	8,231	16,716	8,227
Total revenues	$ 276,240	$ 276,056	$ 244,916
Expenses:			
Production and purchased power	129,298	113,747	111,422
Transmission	30,661	28,348	33,651
Distribution	35,727	31,301	25,484
Depreciation	16,501	15,116	14,994
Interest and fiscal charges	13,615	11,518	10,194
Total expenses	$ 225,802	$ 200,030	$ 195,745
Transfers to the City's general fund	(22,037)	(18,572)	(16,177)
Changes in Equity	28,401	57,454	32,994
Equity, July 1	255,202	197,748	164,754
Equity, June 30	$ 283,603	$ 255,202	$ 197,748

REVENUES BY SOURCES – ELECTRIC UTILITY

June 30, 2006



June 30, 2005



Year ended June 30, 2006

Total revenues for the two most recent fiscal years were $276,240 as compared to $276,056.

Retail sales (residential, commercial, industrial, and other sales), net of reserve/recovery, of $216,868 and $204,526 for the years ended June 30, 2006 and 2005, respectively, continue to be the primary revenue source for the Electric Utility, making up 78.5% and 74.1% of total revenues for the respective years. Retail sales showed an increase of $12,342 (6.0%) from the prior year due to a 2.2% overall rate increase that became effective November 1, 2004, and an increase in consumption. The number of electric meters increased by 831 (0.8%), and the average annual consumption per residential meter increased by 91 kilowatt hours (1.2%).

Wholesale sales were $11,952 at June 30, 2006, a decrease of $3,297 (21.6%) below the $15,249 reflected in the prior year. The decrease is due to less "excess" power available for resale as a result of unplanned unit outages.

Investment income for the most recent fiscal year was $7,269, an increase of $2,086, or 40.2%, from the $5,183 in the prior year, due to an overall increase in the size of the investment portfolio from $71,389 in new bond funds in September 2005, positive operating results and a stabilization of market conditions.

Other revenues were $10,735 and $14,169 for fiscal years 2006 and 2005, respectively, a decrease of $3,434 (24.2%). The decrease primarily reflects the effects of Public Benefit Programs.

Capital contributions for fiscal years 2006 and 2005 were $8,231 and $16,716, respectively – a decrease of $8,485 (50.8%), reflecting a decreased level of construction projects funded by others primarily related to relocations of electrical facilities for the State of California funded Caltrans I-215/60/91 freeway interchange project.

Year ended June 30, 2005

Total revenues for the year ended June 30, 2005 were $276,056 compared to $244,916 in the 2004 fiscal year, an increase of $31,140 (12.7%).

Retail sales (residential, commercial, industrial, and other sales), net of reserve/recovery, of $204,526 and $200,129 for the years ended June 30, 2005 and 2004, respectively, continue to be the primary revenue source for the Electric Utility, making up 74.1% and 81.7% of total revenues for the respective years. Retail sales showed an increase of $4,397 (2.2%) from the prior year due to a 2.2% overall rate increase that became effective November 1, 2004. Although the number of electric meters increased by 2,697 (2.7%), the average annual consumption per residential meter decreased by 460 kilowatt hours (5.8%) due to milder and wetter weather patterns.

Wholesale sales were $15,249 at June 30, 2005, an increase of $5,668 (59.2%) above the $9,581 reflected in the prior year. The increase is due to lower than expected retail consumption resulting in "excess" power available for resale, and an increase in the market price of power.

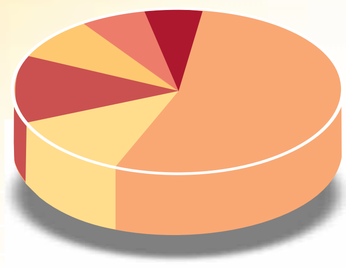
Investment income for fiscal year 2005 was $5,183, an increase of $2,436, or 88.7%, from the $2,747 for the 2004 fiscal year, due to an overall increase in the size of the investment portfolio from a $110,000 bond issue in June 2004, positive operating results and a stabilization of market conditions.

Other revenues were $14,169 and $3,315 for fiscal years 2005 and 2004, respectively, an increase of $10,854 (327.4%). The increase reflects the effects of Public Benefit Programs, settlement reimbursements relating to the power crisis of 2000-2001, as well as an increase in operating grants.

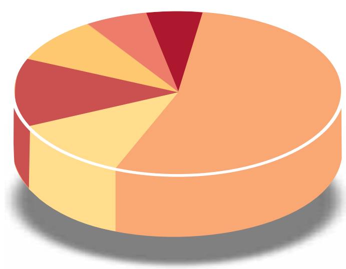
Capital contributions for fiscal years 2005 and 2004 were $16,716 and $8,227, respectively--an increase of $8,489 (103.2%), reflecting an increased level of construction projects funded by others, including $9,904 for relocations of electrical facilities for the State of California funded Caltrans I-215/60/91 freeway interchange project.

EXPENSES BY SOURCES – ELECTRIC UTILITY

June 30, 2006



June 30, 2005



Year ended June 30, 2006

Total expenses for the year ended June 30, 2006 were $225,802 as compared to $200,030 in the prior year. The increase in total expenses of $25,772 (12.9%) is due to increased staffing levels, personnel cost increases, cost of living type increases in other operating categories, as well as an increase in borrowing costs due to a $115,725 refunding/revenue bond issue in September 2005.

Production and purchased power costs were $129,298 and $113,747 for fiscal years 2006 and 2005, respectively, an increase of $15,551 (13.7%) primarily due to a payment of a cashout provision for relief of energy delivery obligation, increase in capacity costs for Intermountain Power Project, overall increase in spot market energy prices, and additional power purchased during unplanned unit outages.

Transmission costs for the two most recent fiscal years were $30,661 as compared to $28,348, an increase of $2,313 (8.2%), primarily due to increased costs to procure transmission capacity, as well as a large credit received last fiscal year for over charges in fiscal year 2003/04.

Distribution costs for the year ended June 30, 2006 and 2005, respectively, were $35,727 and $31,301, an increase of $4,426 (14.1%). The largest portion of this increase relates to personnel costs, which increased by $1,802 due to increased staffing levels and an increase in overall benefit costs of $830.

Interest expense and fiscal charges in the current fiscal year of $13,615 increased by $2,097 (18.2%) over the prior year level of $11,518, as a result of the $115,725 refunding/revenue bond issue in September 2005, discussed previously.

Year ended June 30, 2005

Total expenses for the year ended June 30, 2005 were $200,030 as compared to $195,745 in the prior year. The increase in total expenses of $4,285 (2.2%) is due to personnel cost increases, cost of living type increases in other operating categories, as well as an increase in borrowing costs due to an $110,000 bond issue in June 2004.

Production and purchased power costs were $113,747 and $111,422 for fiscal years 2005 and 2004, respectively, an increase of $2,325 (2.1%) primarily due to $2,751 in cost increases at the Intermountain Power Project relating to increases in coal, transportation charges, and storm damage repairs.

Transmission costs for the year ended June 30, 2005 were $28,348 compared to $33,651 in the 2004 fiscal year, a decrease of $5,303 (15.8%), primarily due to a large credit received in the 2005 fiscal year for over charges in 2004 fiscal year, as well as reflecting additional costs due to increased retail consumption and increased costs from the ISO relating to settlement of disputes for previous years' transmission costs.

Distribution costs for the year ended June 30, 2005 and 2004, respectively, were $31,301 and $25,484, an increase of $5,817 (22.8%). The largest portion of this increase relates to personnel costs, which increased by $3,628 due to 10 new positions added and an increase in overtime charges in order to operate the Springs generation plant and maintain or increase customer service levels in various functional areas within the Utility (combined $1,987 impact), as well an increase in overall benefit costs ($1,641).

Interest expense and fiscal charges in the 2005 fiscal year of $11,518 increased by $1,324 (13.0%) over the 2004 year level of $10,194, as a result of an $110,000 bond issue in June 2004, discussed previously.

TRANSFERS

Year ended June 30, 2006

Transfers to the City's general fund are limited by Section 1204(f) of the City Charter to a maximum of 11.5% of prior year gross operating revenue. The Electric Utility transferred $22,037, or approximately 9% of prior year's operating revenues, in the current year, a $3,465 increase from the $18,572 in the prior year, primarily as a result of an additional transfer of $3,000 to the City's general fund in order to address the impacts of certain provisions of the state budget.

Year ended June 30, 2005

Transfers to the City's general fund of $18,572 increased by $2,395 from the $16,177 in fiscal year 2004, primarily due to the $25,725 increase in retail sales for fiscal year 2004 from 2003.

CAPITAL ASSET AND DEBT ADMINISTRATION

The Electric Utility's investment in Capital Assets includes investments in production, transmission, and distribution related facilities, construction in progress, nuclear fuel, as well as general items such as office equipment, furniture, etc.

For descriptions of major capital assets constructed during the fiscal years 2006 and 2005, see discussion under "Utility Financial Analysis" on page 6 of this report.

RIVERSIDE'S ELECTRIC UTILITY'S CAPITAL ASSETS (NET OF ACCUMULATED DEPRECIATION)

	2006	2005	2004
Production	$ 147,460	$ 77,694	$ 81,568
Transmission	16,383	11,222	5,576
Distribution	212,374	171,802	156,525
General	13,677	9,572	9,436
Land	7,040	6,848	5,839
Construction in progress	26,790	95,988	29,941
Nuclear fuel, at amortized costs	3,129	2,397	2,404
Total	$ 426,853	$ 375,523	$ 291,289

Additional information regarding capital assets can be found in Note 3 on Page 22 of this report.

As of June 30, 2006

Capital assets, net of accumulated depreciation for the Electric Utility were $426,853 and $375,523 as of June 30, 2006 and 2005, respectively, an increase of $51,330 (13.7%) over the prior year. This increase is primarily due to the completion of a 99.6 MW generating project, as well as relocation of facilities, replacement of overhead electrical lines with underground facilities, expansion and improvement of existing substations, and system additions and improvements to connect new customers to the Electric system.

As of June 30, 2005

Capital assets, net of accumulated depreciation for the Electric Utility were $375,523 and $291,289 as of June 30, 2005 and 2004, respectively. The current period was a record year for construction activity for the Electric Utility, showing an $84,234 (28.9%) increase in net capital assets over the prior year. This increase is primarily due to continued construction of a 99.6 MW generating project, as well as relocation of facilities, replacement of overhead electrical lines with underground facilities, expansion and improvement of existing substations, and system additions and improvements to connect new customers to the Electric system.

ELECTRIC UTILITY'S OUTSTANDING DEBT (REVENUE BONDS)

As of fiscal years ended June 30, 2006 and 2005, the City of Riverside's Electric Utility had long-term debt outstanding of $361,389 and $306,144, respectively. This debt is backed by the revenues of the Utility (revenue bonds).

	2006	2005	2004
Revenue bonds	$ 371,645	$ 311,110	$ 325,665
Less: Current portion	(18,815)	(15,015)	(14,555)
Unamortized premium	8,559	10,049	11,000
Total	$ 361,389	$ 306,144	$ 322,110

The Electric Utility's bond indentures require the Utility to maintain a minimum debt service coverage ratio, as defined by the bond covenants, of 1.10. The Electric Utility's debt service coverage ratio was 2.64 at June 30, 2006 and 3.68 at June 30, 2005.

As of June 30, 2006

Long-term debt of $371,645 increased by $60,535 (19.5%) from June 30, 2005, due to principal payments of $15,015 and the issuance of $115,725 Electric Refunding/Revenue bonds on September 20, 2005 of which a portion was used to advance refund $30,915 of the outstanding 1998 and $9,260 of the outstanding 2001 Electric Revenue bond issues.

As of June 30, 2005

Long-term debt of $311,110 decreased by $14,555 (4.5%) from June 30, 2004, due to the repayment of principal on the Electric Utility's outstanding revenue bonds.

In August 2005, Fitch upgraded Riverside Public Utilities' ("RPU's") electric bonds to 'AA-' from 'A+' and cited "several improvements to RPU's credit fundamentals resulting from management's successful execution of its business strategy coupled with the increased stability in the California power market over the last several years," as rationale.

Also in August 2005, Standard and Poors affirmed the Electric Utility's A+ rating, and issued a Debt Derivative Profile score of '2' on a 5-point scale (with 1 representing the lowest risk and 5 representing the highest risk) for the swap portfolio (see note 4 regarding Interest Rate Swaps on Revenue Bonds), indicating their view that the swap portfolio is a neutral credit risk.

Additional information on the Electric Utility's long-term debt can be found in Note 4 on pages 23 to 26 of this report.

ECONOMIC FACTORS AND RATES

Although inflationary trends in the Riverside region continue to compare favorably to the national indices, history has shown that certain costs such as purchased power during the California energy crisis can exponentially exceed inflation. The June 2001 FERC imposed price cap on purchased power is still in effect, which continues to help stabilize power prices. Forward price curves have stabilized. However, regulatory actions and other factors including volatility in the natural gas and coal prices, the California Independent System Operator's Market Redesign and Technology Upgrade (scheduled for November 2007), and expiring long-term contracts could impact future power rates.

The California Governor recently signed into law legislation that will impact RPU and other electricity service providers. The new laws will subject municipal utilities such as RPU to certain requirements of the California Energy Commission and California Public Utilities Commission. While it doesn't appear that the new laws will create significant rate impacts in the near future, the long-term rate impacts from legislation relating to future power procurement or mandated programs are still being analyzed. RPU's prudent financial planning, including building liquidity, provides additional flexibility to implement appropriate courses of action and minimize customer rate impacts.

In addition to inflation, management continually plans for and identifies issues or potential contingencies that could impact future rates, such as system expansion, infrastructure needs, accelerated debt payments, market restructuring, future power supply costs, regulatory changes, legislative mandates, and others.

As a result of this process, RPU is currently undertaking efforts to adopt a Reliability Rate Plan that will finance significant system capacity improvements to address system reliability, additional generation and transmission resources, preventing rolling blackouts, emergency preparedness, and financial planning.

Requests for Information

This financial report is designed to provide a general overview of the City of Riverside Electric Utility's finances. Questions concerning any information provided in this report or requests for additional financial information should be addressed to the Assistant Director Finance/Customer Relations or the Utilities Assistant Chief Financial Officer, Riverside Public Utilities, 3900 Main Street, Riverside, CA 92522.

Balance Sheets

ASSETS	June 30, 2006	June 30, 2005
	(in thousands)	
UTILITY PLANT:		
Production	$ 255,431	$ 178,505
Transmission	26,082	20,418
Distribution	327,685	279,106
General	27,210	22,588
	636,408	500,617
Less accumulated depreciation	(246,514)	(230,327)
	389,894	270,290
Land	7,040	6,848
Construction in progress	26,790	95,988
Nuclear fuel, at amortized cost	3,129	2,397
Total utility plant (Note 3)	426,853	375,523
RESTRICTED ASSETS:		
Cash and cash equivalents (Note 2)	16,742	13,939
Cash and investments at fiscal agent (Note 2)	76,731	64,742
Total restricted assets	93,473	78,681
OTHER NON-CURRENT ASSETS:		
Deferred pension costs	13,657	13,690
Deferred purchased power (Note 8)	11,692	15,034
Deferred bond issuance/refunding costs	13,043	11,291
Total other non-current assets	38,392	40,015
Total non-current assets	558,718	494,219
CURRENT ASSETS:		
Unrestricted Assets:		
Cash and cash equivalents (Note 2)	99,368	88,292
Accounts receivable, less allowance for doubtful accounts 2006 $252; 2005 $361	24,794	22,176
Accounts receivable other utilities and governments, less allowance for doubtful accounts 2006 $1,059; 2005 $2,461	7,375	11,792
Accrued interest receivable	1,317	941
Prepaid expenses	6,551	6,628
Nuclear materials inventory	1,375	1,311
Total unrestricted assets	140,780	131,140
Restricted assets:		
Cash and investments at fiscal agent (Note 2)	48,275	31,551
Cash and cash equivalents (Note 2)	4,784	4,245
Public Benefit Programs receivable	716	595
Total restricted assets	53,775	36,391
Total current assets	194,555	167,531
Total assets	$ 753,273	$ 661,750

See accompanying notes to the financial statements

Balance Sheets

EQUITY AND LIABILITIES

	June 30, 2006	June 30, 2005
	(in thousands)	
EQUITY:		
Invested in capital assets, net of related debt	$ 107,969	$ 97,207
Restricted for:		
Debt service (Note 5)	46,521	34,383
Public Benefit Programs	5,259	4,732
Unrestricted	123,854	118,880
Total equity	283,603	255,202
LONG-TERM OBLIGATIONS, LESS CURRENT PORTION (NOTE 4)	361,389	306,144
OTHER NON-CURRENT LIABILITIES:		
Pension obligation (Note 4)	13,534	13,690
Nuclear decommissioning liability (Note 4)	47,079	44,030
Total other non-current liabilities	60,613	57,720
CURRENT LIABILITIES PAYABLE FROM RESTRICTED ASSETS:		
Accrued interest payable	2,024	2,678
Public Benefit Programs payable	240	108
Current portion of long-term obligations (Note 4)	18,815	15,015
Total current liabilities payable from restricted assets	21,079	17,801
CURRENT LIABILITIES:		
Accounts payable	18,512	17,576
Accrued liabilities	5,346	4,708
Customer deposits	2,731	2,599
Total current liabilities	26,589	24,883
Total liabilities	469,670	406,548
COMMITMENTS AND CONTINGENCIES (NOTES 8 AND 9):		
Total equity and liabilities	$ 753,273	$ 661,750

See accompanying notes to the financial statements

Statements of Revenues, Expenses and Changes in Equity

	For the Fiscal Years Ended June 30, 2006 (in thousands)	2005
OPERATING REVENUES:		
Residential sales	$ 85,243	$ 79,786
Commercial sales	53,773	59,998
Industrial sales	71,084	59,157
Other sales	7,139	6,337
Wholesale sales	11,952	15,249
Transmission revenue	21,185	20,213
Other operating revenue	9,183	12,697
Total operating revenues before (reserve)/recovery	259,559	253,437
Reserve for uncollectible	(384)	(761)
Bad debt recovery	13	9
Total operating revenues, net of (reserve)/recovery	259,188	252,685
OPERATING EXPENSES:		
Production and purchased power	129,298	113,747
Transmission	30,661	28,348
Distribution	35,727	31,301
Depreciation	16,501	15,116
Total operating expenses	212,187	188,512
Operating income	47,001	64,173
NON-OPERATING REVENUES (EXPENSES):		
Investment income	7,269	5,183
Interest expense and fiscal charges	(13,615)	(11,518)
Gain on retirement of utility plant	308	217
Other	1,244	1,255
Total non-operating expenses	(4,794)	(4,863)
Income before capital contributions and transfers	42,207	59,310
Capital contributions	8,231	16,716
Transfers out - contributions to the City's general fund	(22,037)	(18,572)
Total capital contributions and transfers out	(13,806)	(1,856)
Increase in equity	28,401	57,454
EQUITY, BEGINNING OF YEAR:	255,202	197,748
EQUITY, END OF YEAR:	$ 283,603	$ 255,202

See accompanying notes to the financial statements

Statements of Cash Flows

	For the Fiscal Years Ended June 30, 2006	2005
	(in thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Cash received from customers and users	$ 260,998	$ 245,677
Cash paid to suppliers and employees	(186,572)	(163,615)
Other receipts	1,244	1,255
Net cash provided by operating activities	75,670	83,317
CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES:		
Transfers out - contributions to the City's general fund	(22,037)	(18,572)
Principal paid on pension obligation bonds	(156)	0
Net cash used by non-capital financing activities	(22,193)	(18,572)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Purchase of utility plant	(63,791)	(95,562)
Purchase of nuclear fuel	(1,703)	(984)
Proceeds from the sale of utility plant	364	274
Deposit to escrow account for advanced bond refunding	(40,175)	0
Proceeds from sale of revenue bonds, net of premium	116,820	0
Principal paid on long-term obligations	(15,015)	(14,555)
Interest paid on long-term obligations	(14,046)	(11,284)
Contributed capital	4,866	12,864
Bond issuance costs	(4,559)	25
Net cash used by capital and related financing activities	(17,239)	(109,222)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of investment securities	(11,989)	(2,686)
Income from investments	6,893	4,939
Net cash provided (used) by investing activities	(5,096)	2,253
Net increase (decrease) in cash and cash equivalents	31,142	(42,224)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR:	138,027	180,251
CASH AND CASH EQUIVALENTS, END OF YEAR:	$ 169,169	$ 138,027
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Operating income	$ 47,001	$ 64,173
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	16,501	15,116
Amortization of deferred charges-pension costs	32	0
Amortization of nuclear fuel/purchased power	4,313	4,331
Increase (decrease) in allowance for uncollectible accounts	(1,511)	324
Decrease (increase) in accounts receivable	3,189	(3,395)
Decrease (increase) in prepaid expenses	77	(2,044)
Increase in nuclear materials inventory	(64)	(82)
Increase in accounts payable	936	4,971
Increase (decrease) in accrued liabilities	638	(142)
Increase (decrease) in Public Benefit Programs	133	(3,851)
Increase (decrease) in customer deposits	132	(212)
Increase in nuclear decommissioning liability	3,049	2,873
Other receipts	1,244	1,255
Net cash provided by operating activities	$ 75,670	$ 83,317
SCHEDULE OF NON-CASH INVESTING, CAPITAL AND FINANCING ACTIVITIES:		
Pension obligation	0	13,690
Capital contributions – capital assets	3,365	3,852

See accompanying notes to the financial statements

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Electric Utility exists under, and by virtue of, the City Charter enacted in 1883. The Electric Utility is responsible for the generation, transmission and distribution of electric power for sale in the City.

Basis of Accounting The Electric Utility uses the accrual basis of accounting as required for enterprise funds with accounting principals generally accepted in the United States of America as applicable to governments. The accounting records of the Electric Utility are also substantially in conformity with the Uniform System of Accounts prescribed by the Federal Energy Regulatory Commission (FERC). The Electric Utility is not subject to the regulations of the FERC. The Electric Utility is not required to and does not elect to implement the pronouncements of the Financial Accounting Standards Board issued after November 1989.

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

Revenue Recognition Electric Utility customers are billed monthly. Unbilled electric service charges are recorded at year-end and are included in accounts receivable. Unbilled accounts receivable totaled $12,551 at June 30, 2006, and $10,813 at June 30, 2005.

An allowance for doubtful accounts is maintained for utility and miscellaneous accounts receivable. The balance in this account is adjusted at fiscal year-end to approximate the amount anticipated to be uncollectible.

Utility Plant and Depreciation Utility plant assets are valued at historical cost or estimated historical cost, if actual historical cost is not available. Costs include labor; materials; interest during construction; allocated indirect charges such as engineering, supervision, construction and transportation equipment; retirement plan contributions and other fringe benefits. Contributed plant assets are valued at estimated fair value on the date contributed. The cost of relatively minor replacements is included in maintenance expense.

Depreciation is provided over the estimated useful lives of the related assets using the straight-line method. The estimated useful lives are as follows:

Production plant	17-30 years
Transmission and distribution plant	20-50 years
General plant and equipment	3-15 years

Nuclear Fuel The Electric Utility amortizes and charges to expense, the cost of nuclear fuel, on the basis of actual thermal energy produced relative to total thermal energy expected to be produced over the life of the fuel. In accordance with the Nuclear Waste Disposal Act of 1982, the Electric Utility is charged one dollar per megawatt-hour of energy generated by the City's share of San Onofre Nuclear Generating Station's Units 2 and 3 to provide for estimated future storage and disposal of spent nuclear fuel. The Electric Utility pays this fee to its operating agent, Southern California Edison Co (SCE), on a quarterly basis (see Note 7).

Restricted Assets Proceeds of revenue bonds yet to be used for capital projects, as well as certain resources set aside for debt service, are classified as restricted assets on the Balance Sheets because their use is limited by applicable bond covenants. Funds set aside for the nuclear decommissioning reserve are also classified as restricted assets because their use is legally restricted to a specific purpose.

In January 1998, the Electric Utility began collecting a surcharge for Public Benefit Programs on customer utility bills. This surcharge is mandated by state legislation included in Assembly Bill 1890 and is restricted to various socially beneficial programs and services. The programs and services include cost effective demand-side management services to promote energy efficiency and conservation and related education and information; ongoing support and new investments in renewable resource technologies; energy research and development; and programs and services for low-income electric customers. The activity associated with the surcharge for Public Benefit Programs is reflected in the accompanying financial statements on the Balance Sheets, Statements of Revenues, Expenses and Changes in Equity, and Statements of Cash Flows.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Cash and Investments In accordance with Utility policy, the Utility's cash and investments, except for cash and investments with fiscal agents, are invested in a pool managed by the Treasurer of the City. The Utility does not own specific, identifiable investments of the pool. The pooled interest earned is allocated monthly based on the month end cash balances.

The City values its cash and investments in accordance with the provisions of the Government Accounting Standards Board (GASB) Statement no. 31, "Accounting and Financial Reporting for Certain Investments and External Investment Pools (GASB 31)," which requires governmental entities, including governmental external investment pools, to report certain investments at fair value in the Statement of Net Assets/Balance Sheets and recognize the corresponding change in the fair value of investments in the year in which the change occurred. Fair value is determined using quoted market prices.

Cash accounts of all funds are pooled for investment purposes to enhance safety and liquidity, while maximizing interest earnings.

City-wide information concerning cash and investments for the year ended June 30, 2006, including authorized investments, custodial credit risk, credit and interest rate risk for debt securities and concentration of investments, carrying amount and market value of deposits and investments may be found in the notes to the City's "Comprehensive Annual Financial Report."

Cash and Investments at Fiscal Agents Cash and investments maintained by fiscal agents are considered restricted by the Utility and are pledged as collateral for payment of principal and interest on bonds, or for use on construction of capital assets.

Bond Discounts and Issuance Costs Bond premiums, discounts, and issuance costs are deferred and amortized over the life of the bonds using the effective interest method. Bonds payable are reported net of the applicable bond premium or discount, whereas issuance costs are recorded as other assets.

Nuclear Decommissioning Liability Federal regulations require the Electric Utility to provide for the future decommissioning of its ownership share of the nuclear units at San Onofre. The Electric Utility has established a trust account to accumulate resources for the decommissioning of the nuclear power plant and restoration of the beachfront at San Onofre. Based on the most recent site specific cost estimate as of June 30, 2006 prepared by ABZ Incorporated, the Electric Utility plans to set aside approximately $1,600 per year to fund this obligation. The funding will occur over the useful life of the generating plant or until the account is fully funded.

Increases to the trusts are from amounts set aside and investment earnings. The investment earnings are included in investment income in the Utility's financial statements. These amounts, as well as amounts set aside, are contributed to the trusts and reflected as decommissioning expense, which are considered part of power supply costs. The total amounts held in the trust accounts are classified as restricted assets and other non-current liability in the accompanying Balance Sheets. To date, the Electric Utility has set aside $47,079 in cash investments with the trustee as Riverside's estimated share of the decommissioning cost of San Onofre. The plant site easement at San Onofre terminates May 2050. The plant must be decommissioned and the site restored by the time the easement terminates.

Internally Restricted Cash Reserves Effective July 1, 2003, the City Council approved a Regulatory Risk Reserve Account of $4,000, an Energy Risk Management Reserve Account of $11,000 and an Operating Reserve Account of $14,000, all of which are considered internally restricted assets. The balance as of June 30, 2006 and 2005 respectively are as follows: Regulatory Risk Reserve $45,500 and $31,900, Energy Risk Management Reserve $11,000 and $11,000 and Operating Reserve $27,500 and $21,400, for a combined total of $84,000 and $64,300 and are reflected in cash and cash equivalents in the accompanying Balance Sheets.

Customer Deposits The City holds customer deposits as security for the payment of utility bills. The Electric Utility's portion of these deposits as of June 30, 2006 and 2005, was $2,731 and $2,599, respectively.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

■ **Compensated Absences** The accompanying financial statements include accruals for salaries, fringe benefits and compensated absences due employees at June 30, 2006 and 2005. The Electric Utility treats compensated absences due employees as a current liability. The amount accrued for compensated absences was $5,346 at June 30, 2006, and $4,708 at June 30, 2005, and is included in accrued liabilities in the accompanying Balance Sheets.

Employees receive 10 to 25 vacation days per year based upon length of service. A maximum of two years vacation may be accumulated, and unused vacation is paid in cash upon separation.

Employees primarily receive one day of sick leave for each month of employment with unlimited accumulation. Upon retirement or death only, a percentage of unused sick leave is paid to certain employees or their estates in a lump sum based on longevity.

■ **Insurance Programs** The Electric Utility participates in a self-insurance program for worker's compensation and general liability coverage that is administered by the City. The Electric Utility pays an amount to the City representing an estimate of amounts to be paid for reported claims incurred, and incurred but unreported claims based upon past experience, modified for current trends and information. The City maintains property insurance on most City property holdings, including Utility Plant with a limit of $100 million.

Citywide information concerning risks, insurance policy limits and deductibles and designation of general fund balance for risks for the year ended June 30, 2006, may be found in the notes to the City's "Comprehensive Annual Financial Report."

Although the ultimate amount of losses incurred through June 30, 2006 is dependent upon future developments, management believes that amounts paid to the City are sufficient to cover such losses. Premiums paid to the City by the Electric Utility were $680 and $773 for the years ended June 30, 2006 and 2005, respectively. Any losses above the City's reserves would be covered through increased rates charged to the Electric Utility in future years.

■ **Employee Retirement Plan** The City contributes to the California Public Employees Retirement System (PERS), an agent multiple-employer public employee retirement system that acts as a common investment and administrative agency for participating public entities within the State of California.

All permanent full-time and selected part-time employees are eligible for participation in PERS. Benefits vest after five years of service and are determined by a formula that considers the employee's age, years of service and salary. Employees may retire at age 55 and receive 2.7 percent of their highest average annual salary for each year of service completed. PERS also provides death and disability benefits. These benefit provisions and all other requirements are established by state statute and City ordinance.

Employee contributions are 8.0 percent of their annual covered salary. The Electric Utility is required to contribute the remaining amounts necessary to fund the benefits for its employees using the actuarial basis recommended by the PERS actuaries and actuarial consultants and adopted by the PERS Board of Administration. The employer portion of the PERS funding as of June 30, 2006 and 2005 was 19.74 percent and 12.34 percent, respectively, of annual covered payroll. The Electric Utility pays both the employee and employer contributions. The total Electric Utility's contribution to PERS as of June 30, 2006 and 2005 was $3,923 and $3,609, respectively.

Citywide information concerning elements of the unfunded actuarial accrued liabilities, contributions to PERS for the year ended June 30, 2006 and recent trend information may be found in the notes to the City's "Comprehensive Annual Financial Report" for the fiscal year ended June 30, 2006.

■ **Pension Obligation Bonds** In 2005, the City issued Pension Obligation Bonds in the amount of $60,000, of which the Electric Utility's share is $13,690 as reflected in the accompanying Balance Sheets as deferred pension costs and a corresponding long-term obligation. The deferred charge relating to the net

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

pension asset will be amortized over 19 years in accordance with the method used by CalPERS for calculating actuarial gains and losses. The Bonds will be used to fund the unfunded actuarial accrued liability for non-safety employees and the proceeds were deposited with CalPERS. The balance in deferred pension costs as of June 30, 2006 and 2005, was $13,657 and $13,690, respectively. For more discussion relating to the City's issue see the notes to the City's "Comprehensive Annual Financial Report" for the fiscal year ended June 30, 2006.

■ **Equity** The Electric Utility's equity consists of its net assets (assets less liabilities) which are classified into the following three components:

Invested in capital assets, net of related debt – this component consists of capital assets (net of accumulated depreciation) and unamortized debt expenses reduced by the outstanding balances of any bonds or other borrowings that are attributable to the acquisition, construction, or improvement of those assets.

Restricted – this component consists of net assets on which constraints are placed as to their use. Constraints include those imposed by creditors (such as through debt covenants) contributors, or laws or regulation of other governments or constraints imposed by law through constitutional provisions or through enabling legislation.

Unrestricted net assets – this component of net assets consists of net assets that do not meet the definition of "restricted" or "invested in capital assets, net of related debt."

■ **Contributions to the City's General Fund** Pursuant to the City Charter, the Electric Utility may transfer up to 11.5 percent of its prior year's gross operating revenues to the City's general fund. In fiscal years 2005-06 and 2004-05, the Electric Utility transferred approximately 9 percent of gross operating revenues, or $22,037 and $18,572, respectively.

■ **Cash and Cash Equivalents** For the Statements of Cash Flows, cash and cash equivalents include all unrestricted and restricted highly liquid investments with original purchase maturities of three months or less, and all bond construction proceeds available for capital projects. Pooled cash and investments in the City's Treasury represent monies in a cash management pool. Such accounts are similar in nature to demand deposits, and are classified as cash equivalents for the purpose of presentation in the Statements of Cash Flows.

■ **Budgets and Budgetary Accounting** The Electric Utility presents, and the City Council adopts, an annual budget. The proposed budget includes estimated expenses and forecasted revenues. The City Council adopts the Electric Utility's budget in June each year via resolution.

NOTE 2. CASH AND INVESTMENTS

Cash and investments at June 30, 2006 and 2005, consist of the following (in thousands):

	June 30, 2006	June 30, 2005
	Fair Value	
Equity interest in City Treasurer's investment pool	$ 120,894	$ 106,476
Investments at fiscal agent	125,006	96,293
Total cash and investments	$ 245,900	$ 202,769

The amounts above are reflected in the accompanying financial statements as:

	June 30, 2006	June 30, 2005
Unrestricted cash and cash equivalents	$ 99,368	$ 88,292
Restricted assets:		
Cash and cash equivalents	21,526	18,184
Cash and investments at fiscal agent	48,275	31,551
Total cash and cash equivalents	169,169	138,027
Cash and investments at fiscal agent	76,731	64,742
Total cash and investments	$ 245,900	$ 202,769

NOTE 2. CASH AND INVESTMENTS (CONTINUED)

Cash and investments at fiscal agent are as follows:

Investment Type	Total	Remaining Maturity (in Months) 12 Months or Less	13 to 24 Months	25 to 60 Months	More than 60 Months
Held by Fiscal Agent					
Money Market Funds	$ 4,175	$ 4,175	$ 0	$ 0	$ 0
Federal Agency Securities	37,760	15,121	16,344	6,295	0
Investment Contracts[1]	83,071	9,416	48,268	0	25,387
City Treasurer's investment pool[2]					
Money Market Funds	14,328	14,328	0	0	0
Federal Agency Securities	87,199	27,923	13,023	46,253	0
Corp Medium Term Notes	13,812	8,391	5,421	0	0
State Investment Pool	5,555	5,555	0	0	0
Total	$ 245,900	$ 84,909	$ 83,056	$ 52,548	$ 25,387

All cash and investments held by fiscal agent are held in AAA investments.

[1] Amounts related to bond construction proceeds are invested in specific maturities but are available for construction of capital assets as funding is needed.

[2] Additional information on investment types and credit risk may be found in the City's "Comprehensive Annual Financial Report."

NOTE 3. UTILITY PLANT

The following is a summary of changes in utility plant during the fiscal years ended June 30, 2006 and 2005 (in thousands):

	Balance, As of 6/30/2004	Additions	Retirements/ Transfers	Balance, As of 6/30/2005	Additions	Retirements/ Transfers	Balance, As of 6/30/2006
Production	$ 175,595	$ 2,910	$ 0	$ 178,505	$ 76,926	$ 0	$ 255,431
Transmission	14,402	6,016	0	20,418	5,664	0	26,082
Distribution	256,626	22,528	(48)	279,106	48,654	(75)	327,685
General	22,250	904	(566)	22,588	4,916	(294)	27,210
Depreciable utility plant	468,873	32,358	(614)	500,617	136,160	(369)	636,408
Less accumulated depreciation:							
Production	(94,027)	(6,784)	0	(100,811)	(7,160)	0	(107,971)
Transmission	(8,826)	(370)	0	(9,196)	(503)	0	(9,699)
Distribution	(100,101)	(7,216)	13	(107,304)	(8,029)	22	(115,311)
General	(12,814)	(746)	544	(13,016)	(809)	292	(13,533)
Accumulated depreciation	(215,768)	(15,116)	557	(230,327)	(16,501)	314	(246,514)
Net depreciable utility plant	253,105	17,242	(57)	270,290	119,659	(55)	389,894
Land	5,839	1,009	0	6,848	192	0	7,040
Construction in progress	29,941	99,414	(33,367)	95,988	63,551	(132,749)	26,790
Nuclear fuel	2,404	984	(991)	2,397	1,703	(971)	3,129
Nondepreciable utility plant	38,184	101,407	(34,358)	105,233	65,446	(133,720)	36,959
Total utility plant	$ 291,289	$ 118,649	($ 34,415)	$ 375,523	$ 185,105	($ 133,775)	$ 426,853

NOTE 4. LONG-TERM OBLIGATIONS

The following is a summary of changes in long-term obligations during the fiscal years ended June 30, 2006 and 2005 (in thousands):

	Balance, As of 6/30/2004	Additions	Reductions	Balance, As of 6/30/2005	Additions	Reductions	Balance, As of 6/30/2006	Due Within One Year
Revenue bonds	$ 336,665	$ 0	($ 15,506)	$ 321,159	$ 115,725	($ 56,680)	$ 380,204	$ 18,815
Pension obligation	0	13,690	0	13,690	0	(156)	13,534	144
Nuclear decommissioning liability	41,157	2,873	0	44,030	3,049	0	47,079	0
Total long-term obligations	$ 377,822	$ 16,563	($ 15,506)	$ 378,879	$ 118,774	($ 56,836)	$ 440,817	$ 18,959

Long-term debt consists of the following (in thousands):

Revenue Bonds Payable

	June 30, 2006	June 30, 2005
$98,730 1998 Electric Refunding/Revenue Bonds: $63,165 serial bonds due in annual installments from $3,200 to $7,085 through October 1, 2013, interest from 5.0 percent to 5.38 percent; $21,595 term bonds due October 1, 2018, interest at 5.0 percent; $13,970 term bonds due October 1, 2022 were advance refunded on September 20, 2005 with the 2005 Electric Refunding/Revenue bonds	$ 52,900	$ 89,085
$47,215 2001 Electric Revenue Bonds: $47,215 serial bonds due in annual installments from $3,035 to $4,280 through October 1, 2014, interest from 3.25 percent to 5.25 percent, were partially advance refunded on September 20, 2005 with the 2005 Electric Refunding/Revenue bonds	32,160	44,360
$75,405 2003 Electric Refunding/Revenue Bonds: $75,405 serial bonds due in annual installments from $6,980 to $8,535 through October 1, 2013, interest from 3.0 percent to 5.0 percent	60,860	67,665
$110,000 2004 Electric Revenue Bonds:		
A - $27,500 2004 Series A Bonds - Serial bonds due in annual installments from $2,615 to $3,695 through October 1, 2014, interest from 4.0 percent to 5.5 percent	27,500	27,500
B - $82,500 2004 Series B Bonds - Auction Rate Securities due in annual installments from $1,250 to $7,000 from October 1, 2014 through October 1, 2029. Interest is variable and rate is subject to weekly repricing (rate at June 27, 2006 was 3.7 percent)	82,500	82,500
$115,725 2005 Electric Refunding/Revenue Series A & B Bonds: $57,850 Series A and $57,875 Series B Auction Rate Securities due in annual installments from $600 to $10,375 from October 1, 2006 through October 1, 2035. Interest is variable and rate is subject to weekly repricing (rate at June 28, 2006 was 3.75 percent for series A and 3.8 percent at June 30, 2006 for Series B)	115,725	0
Total electric revenue bonds payable	371,645	311,110
Unamortized bond premium	8,559	10,049
Total long-term electric revenue bonds payable, net of bond premium	380,204	321,159
Less current portion	(18,815)	(15,015)
Total long-term electric revenue bonds payable	$ 361,389	$ 306,144

NOTE 4. LONG-TERM OBLIGATIONS (CONTINUED)

Annual debt service requirements to maturity, excluding amounts for nuclear decommissioning liability, as of June 30, 2006, are as follows (in thousands):

	2007	2008	2009	2010	2011	2012-2016	2017-2021	2022-2026	2027-2031	2032-2036	Total
Principal	$ 18,815	$ 19,460	$ 20,345	$ 21,300	$ 22,295	$ 94,795	$ 45,485	$ 39,850	$ 40,925	$ 48,375	$ 371,645
Interest	14,364	13,602	12,735	11,781	10,810	39,197	25,050	17,718	11,002	3,723	159,982
Total	$ 33,179	$ 33,062	$ 33,080	$ 33,081	$ 33,105	$ 133,992	$ 70,535	$ 57,568	$ 51,927	$ 52,098	$ 531,627

2005 Electric Refunding/Revenue Bonds On September 20, 2005, the Electric Utility issued $115,725 of Electric Refunding/Revenue bonds, Series A and B, to finance capital improvement programs and refund certain existing Electric revenue bonds. $60,000 of Electric revenue bonds will be used to finance the costs of certain improvements to the City's Electric System as part of the Capital Improvement Program. The remaining portion was used to refund $30,915 of the outstanding 1998 and $9,260 of the outstanding 2001 Electric revenue bond issues. The advance refunding resulted in a difference between the reacquisition price and the net carrying amount of the old debt of $3,431. This difference is being charged to operations using a proportional method. The City completed the current refunding to reduce net aggregate debt service payments over the next 17 years by $3,111 and to obtain an economic gain (difference between present value of the old and new debt service payments) of $2,612. Series A bonds of $57,850 and Series B bonds of $57,875 are variable Auction Rate Securities term bonds, maturing on October 1, 2006 through October 1, 2035 with principal payments ranging from $600 to $10,375. Assuming a variable rate of 3.2%, the all-intrue interest cost for this issue is 3.56%.

Interest Rate Swaps on Revenue Bonds

Objective: As a means to lower borrowing costs, when compared against fixed-rate bonds at the time of issuance in September 2005, the City entered into interest rate swap agreements in connection with its $115,725 2005 Electric Refunding/Revenue Bonds (Series A and B). Also in September 2005, the City entered into the interest rate swap agreement for the $82,500 2004 Electric Revenue Bonds (Series B). The intention of the swap was to effectively change the City's variable interest rate on the bonds to a synthetic fixed rate of 3.11% for the 2004 Electric Revenue Bonds (Series B) and 3.20% for the other respective Revenue Bonds.

Terms: Under the swaps, the City pays the counterparty a fixed payment as noted above and receives a variable payment computed as 62.68% of the London Interbank Offering Rate ("LIBOR") one month index plus 12 basis points. The swaps have notional amounts equal to the principal amounts stated above. Starting in fiscal year 2007, the notional value of the swaps and the principal amounts of the associated debt decline by $300 to $7,000 until the debt is completely retired in fiscal year 2036. The bonds' variable rate coupons are established on a weekly basis through the results of an auction process administered through an auction agent, termed Auction Rate Securities ("ARS").

NOTE 4. LONG-TERM OBLIGATIONS (CONTINUED)

The bonds and the related swap agreements for the 2004 Electric Revenue Bonds mature on October 1, 2029 and the 2005 Electric Refunding/Revenue Bonds mature on October 1, 2035. As of June 30, 2006 rates were as follows:

	Terms	2005 Electric Refunding/ Revenue Bonds Series A Rates	2005 Electric Refunding/ Revenue Bonds Series B Rates	2004 Electric Revenue Bonds Series B Rates
Interest rate swap:				
Fixed payment to counterparty	Fixed	3.2010%	3.2040%	3.1110%
Variable payment from counterparty	62.68 LIBOR +12bps	(3.13914%)	(3.18514%)	(2.95092%)
Net interest rate swap payments		0.06186%	0.01886%	0.16008%
Variable-rate bond coupon payments	ARS	3.02844%	3.08817%	2.83964%
Synthetic interest on bonds		3.09030%	3.10703%	2.99972%

Fair Value: As of June 30, 2006, in connection with all swap arrangements; the transactions had a total positive fair value of $11,795. Because the coupons on the City's variable-rate bonds adjust to changing interest rates, the bonds do not have a corresponding fair value decrease. The fair value was developed by a pricing service using the zero-coupon method. This method calculates the future net settlement payments required by the swap, assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These payments are then discounted using the spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the date of each future net settlement of the swap.

Credit risk: As of June 30, 2006, the City was exposed to credit risk in the amount of $11,795 because the swap had a positive fair value. The swap counterparty's, Bear Sterns and Merrill Lynch were rated A and A+, respectively by Standard & Poors. To mitigate the potential for credit risk, if either counterparties's credit quality falls below A-, the fair value of the swap will be collateralized by the counterparty with U.S. Government securities. Collateral would be posted with a third-party custodian.

Basis risk: As noted above, the swaps expose the City to basis risk should the relationship between LIBOR and the auction-rate converge, changing the synthetic rate on the bonds. If a change occurs that results in the rates' moving to convergence, the expected cost savings may not be realized.

Termination risk: The derivative contract uses the International Swap Dealers Association Master Agreement, which includes standard termination events, such as failure to pay and bankruptcy. The Schedule to the Master Agreement includes an "additional termination event." That is, a swap may be terminated by the City if either counterparty's credit quality falls below "BBB-" as issued by Standard and Poor's. The City or the counterparty may terminate a swap if the other party fails to perform under the terms of the contract. If a swap is terminated, the variable-rate bond would no longer carry a synthetic interest rate. Also, if at the time of termination a swap has a negative fair value, the City would be liable to the counterparty for a payment equal to the swap's fair value.

NOTE 4. LONG-TERM OBLIGATIONS (CONTINUED)

Swap payments and associated debt: As of June 30, 2006, the debt service requirements of the variable-rate debt and net swap payments assuming current interest rates remain the same, for their term are summarized as follows. As rates vary, variable-rate bond interest payments and net swap payments will vary.

Fiscal Year Ending June 30,	Variable-Rate Bonds Principal	Variable-Rate Bonds Interest	Interest Rate Swaps, Net	Total
2007	$ 600	$ 5,667	$ 394	$ 6,661
2008	525	5,652	393	6,570
2009	550	5,637	392	6,579
2010	575	5,620	391	6,586
2011	575	5,603	389	6,567
2012-2016	25,325	26,450	1,839	53,614
2017-2021	40,925	20,761	1,443	63,129
2022-2026	39,850	14,947	1,039	55,836
2027-2031	40,925	9,358	650	50,933
2032-2036	48,375	2,871	200	51,446
Total	$ 198,225	$ 102,566	$ 7,130	$ 307,921

NOTE 5. RESTRICTED EQUITY

Pursuant to applicable bond indentures, a reserve for debt service has been established by restricting assets and reserving a portion of equity. Bond indentures for Riverside's electric revenue and refunding bonds require reserves that equate to the maximum annual debt service required in future years plus three months interest and nine months principal due in the next fiscal year. The 2004 Revenue bonds and 2005 Refunding/ Revenue bonds require 110% of the monthly accrued interest be included in the reserve. Additional reserves for the 1998 revenue bonds are not required due to the purchase of surety bonds to cover the reserve requirements.

NOTE 6. JOINTLY-GOVERNED ORGANIZATIONS

■ **Southern California Public Power Authority** On November 1, 1980, the City of Riverside joined with the Imperial Irrigation District and the cities of Los Angeles, Anaheim, Vernon, Azusa, Banning, Colton, Burbank, Glendale and Pasadena to create the Southern California Public Power Authority (SCPPA) by a Joint Powers Agreement under the laws of the state of California. As of July 2001, the cities of Cerritos and San Marcos were admitted as members of SCPPA. In August 2003, the Authority rescinded the membership of the City of San Marcos, as the City no longer met the criteria for membership. The primary purpose of SCPPA is to plan, finance, develop, acquire, construct, operate and maintain projects for the generation and transmission of electric energy for sale to its participants. SCPPA is governed by a Board of Directors, which consists of one representative from each of the members. During the 2005-06 and 2004-05 fiscal years, the Electric Utility paid approximately $15,211 and $13,032, respectively, to SCPPA under various take-or-pay contracts that are described in greater detail in Note 8. These payments are reflected as a component of production and purchased power or transmission expense in the financial statements.

■ **Power Agency of California** On July 1, 1990, the City of Riverside joined with the cities of Azusa, Banning and Colton to create the Power Agency of California (PAC) by a Joint Powers Agreement under the laws of the State of California. The City of Anaheim joined PAC on July 1, 1996. The primary purpose of PAC is to take advantage of synergies and economies of scale as a result of the five cities acting in concert. PAC has the ability to plan, finance, develop, acquire, construct, operate and maintain projects for the generation and transmission of electric energy for sale to its participants. PAC is governed by a Board of

NOTE 6. JOINTLY-GOVERNED ORGANIZATIONS (CONTINUED)

Directors, which consists of one representative for each of the members. The term of the Joint Powers Agreement is 50 years. Effective June 30, 2001, PAC was placed in an inactive status by the Board of Directors. The Agency can only be reactivated by authorization of the Agency Board.

NOTE 7. JOINTLY-OWNED UTILITY PROJECT

Pursuant to a settlement agreement with SCE, dated August 4, 1972, the City was granted the right to acquire a 1.79 percent ownership interest in San Onofre Nuclear Generating Station (SONGS), Units 2 and 3, equating to 19.2 MW and 19.3 MW respectively, of the available capacity. In the settlement agreement, SCE agreed to provide the necessary transmission service to deliver the output of SONGS to Riverside. SCE and the City entered into the SONGS Participation Agreement that sets forth the terms and conditions under which the City, through the Electric Utility, participates in the ownership and output of SONGS. Other participants in this project include SCE, 75.05 percent; San Diego Gas & Electric Company, 20.00 percent; and the City of Anaheim, 3.16 percent. Maintenance and operation of SONGS remain the responsibility of SCE, as operating agent for the City.

SCE, as operating agent, has declared an "operating impairment" due to deterioration of the steam generators ("SGs"), which would likely result in permanent shutdown of the plant in the 2009-2010 timeframe. The estimated costs to replace the SGs is $680,000, of which approximately $12,200 would represent the City's share. Replacement of the SGs is expected to enable plant operations through at least 2022, and perhaps beyond if Nuclear Regulatory Commission approval is obtained. Although the City Council has approved participation in the replacement of the SGs, Anaheim has opted not to participate. As a result, upon approval from the California Public Utility Commission (CPUC), Riverside and San Diego will retain their 1.79 percent, and 20.00 percent ownership shares, respectively, and SCE will assume Anaheim's interest, for a combined 78.21 percent interest in both units 2 and 3 at SONGS.

The original operating license for SONGS units 2 and 3 was set to expire in 2013; however, this was subsequently extended due to a construction recapture provision, and now expires February 16, 2022 and November 15, 2022 for Units 2 and 3 respectively.

There are no separate financial statements for the jointly-owned utility plant since each participant's interests in the utility plant and operating expenses are included in their respective financial statements. The Electric Utility's 1.79 percent share of the capitalized construction costs for SONGS totaled $136,039 and $132,912 for fiscal years ended June 30, 2006 and 2005, respectively. During the current fiscal year the City Council approved participation in SONGS through the extended operations date. As a result, all acquisitions are now depreciated through 2022, to include the construction recapture extension period. The accumulated depreciation amounted to $103,082 and $97,647 for the fiscal years ended June 30, 2006 and 2005, respectively. The Electric Utility made provisions for future decommissioning costs of $1,581 for both fiscal years plus earnings on the Decommissioning Trust Fund of $1,468 and $1,293 for fiscal years June 30, 2006 and June 30, 2005, respectively (see Note 1). The Electric Utility's portion of current and long-term debt associated with SONGS is included in the accompanying financial statements.

NOTE 8. COMMITMENTS

Take-or-Pay Contracts The Electric Utility has entered into a power purchase contract with Intermountain Power Agency (IPA) for the delivery of electric power. The Electric Utility's share of IPA power is equal to 7.6 percent, or approximately 137.1 MW, of the net generation output of IPA's 1,800 MW coal-fueled generating station located in central Utah. The contract expires in 2027 and the debt fully matures in 2024.

The contract constitutes an obligation of the Electric Utility to make payments solely from operating revenues. The power purchase contract requires the Electric Utility to pay certain minimum charges that are based on debt service requirements. Such payments are considered a cost of production.

The Electric Utility is a member of the Southern California Public Power Authority (SCPPA), a joint powers agency (see Note 6). SCPPA provides for the financing and construction of electric generating and transmission projects for participation by some or all of its members. To the extent the Electric Utility participates in projects developed by SCPPA, it has entered into Power Purchase or Transmission Service Agreements, entitling the Electric Utility to the power output or transmission service, as applicable, and the Electric Utility will be obligated for its proportionate share of the project costs.

The projects and the Electric Utility's proportionate share of SCPPA's obligations, including final maturities and contract expirations are as follows:

PROJECT	PERCENT SHARE	ENTITLEMENT	FINAL MATURITY	CONTRACT EXPIRATION
Palo Verde Nuclear Generating Station	5.4 percent	11.7 MW	2017	2030
Southern Transmission System	10.2 percent	195.0 MW	2023	2027
Hoover Dam Uprating	31.9 percent	30.0 MW	2017	2017
Mead-Phoenix Transmission	4.0 percent	12.0 MW	2020	2030
Mead-Adelanto Transmission	13.5 percent	118.0 MW	2020	2030

As part of the take-or-pay commitments with IPA and SCPPA, the Electric Utility has agreed to pay its share of current and long-term obligations. Management intends to pay these obligations from operating revenues received during the year that payment is due. A long-term obligation has not been recorded on the accompanying financial statements for these commitments. Take-or-pay commitments terminate upon the later of contract expiration or final maturity of outstanding bonds for each project.

Interest rates on the outstanding debt associated with the take-or-pay obligations range from 3.0 percent to 6.125 percent. The schedule below details the amount of principal and interest that is due and payable by the Electric Utility as part of the take-or-pay contract for each project in the fiscal year indicated.

DEBT SERVICE PAYMENTS (in thousands) Year Ending June 30,	IPA	SCPPA					TOTAL
	Intermountain Power Project	Palo Verde Nuclear Generating Station	Southern Transmission System	Hoover Dam Uprating	Mead-Phoenix Transmission	Mead-Adelanto Transmission	**All Projects**
2007	$ 30,693	$ 863	$ 7,565	$ 704	$ 259	$ 2,817	$ 42,901
2008	32,360	859	7,066	704	260	2,819	44,068
2009	31,120	855	6,947	704	259	2,814	42,699
2010	31,789	717	6,702	703	259	2,818	42,988
2011	35,336	714	6,736	702	289	2,814	46,591
2012-2016	145,557	3,517	38,097	3,486	1,341	13,918	205,916
2017-2021	105,998	693	37,591	1,382	1,241	14,012	160,917
2022-2026	25,218	0	22,473	0	0	0	47,691
Total	$ 438,071	$ 8,218	$ 133,177	$ 8,385	$ 3,908	$ 42,012	$ 633,771

NOTE 8. COMMITMENTS (CONTINUED)

In addition to debt service, Riverside's entitlements require the payment of fuel costs, operating and maintenance, administrative and general and other miscellaneous costs associated with the generation and transmission facilities discussed above. These costs do not have a similar structured payment schedule as debt service and vary each year. The costs incurred for the years ended June 30, 2006 and 2005, are as follows (in thousands):

FISCAL YEAR	Intermountain Power Project	Palo Verde Nuclear Generating Station	Southern Transmission System	Mead-Adelanto Transmission	Mead-Phoenix Transmission	Hoover Dam Uprating	TOTAL
2006	$ 24,121	$ 2,122	$ 1,845	$ 220	$ 43	$ 96	$ 28,447
2005	$ 21,362	$ 1,906	$ 1,714	$ 212	$ 43	$ 90	$ 25,327

These costs are included in production and purchased power or transmission expense on the Statements of Revenues, Expenses and Changes in Equity.

Power Purchase Agreements The Electric Utility has executed five firm power purchase agreements. The agreements are with Deseret Generation and Transmission Cooperative (Deseret) of Murray, Utah; California Department of Water Resources (CDWR); and Bonneville Power Administration (BPA). The minimum annual obligations under each of these contracts are shown in the table below.

Minimum Obligations 2006-2007 (in thousands):

Supplier	Capacity	Energy	Total
Deseret	$ 3,463	$ 1,827	$ 5,290
CDWR III	437	0	437
CDWR IV	571	0	571
BPA (two agreements)	1,811	0	1,811
Total:	$ 6,282	$ 1,827	$ 8,109

The agreement with Deseret is for five megawatts of capacity and associated energy from January 1, 1992, through December 31, 1994, then increasing to 52 megawatts of capacity and associated energy through December 31, 2009. A notice of termination of the power purchase agreement was provided to Deseret effective March 31, 1998, resulting in litigation which was settled on July 31, 1999. Under the terms of the settlement agreement, the notice of termination was rescinded and the power purchase agreement was amended to reflect substantial price reductions after fiscal year 2002 through the term of the agreement in 2009. In exchange, Riverside Public Utilities paid Deseret $25,000 from Electric fund reserves, which is reflected on the Balance Sheets as Deferred purchased power. On July 1, 2002, the Electric Utility began to amortize the $25,000, and will continue to amortize the remaining balance over the term of the agreement using the straight-line method.

As of June 30, 2006 and 2005, Deferred purchased power was $11,692 and $15,034, respectively, and the Utility had recorded amortization of $3,341 in both fiscal years.

There are two separate agreements with CDWR. CDWR III is for the purchase of 23 megawatts of capacity from May through October of each year beginning June 1, 1996, for 15 years. CDWR IV is for the purchase of 30 megawatts of capacity from May through October beginning June 1, 1996, for 15 years, subject to early termination.

In early 2005, CDWR and the City disagreed if the Power Sale Agreements III and IV were still in effect as of December 31, 2004. While CDWR believed the agreements were terminated, the City contended that CDWR did not provide proper notification under the terms of the Power Sale Agreements. During May and June, CDWR continued to provide power under the terms of the original contracts, pending staff's resolution of the dispute. On September 13, 2005, in order to maintain the City's long-term relationship with CDWR and to avoid costly litigation, the City Council approved the contract amendments, effectively terminating the contract in September 2007 and reducing the final two years of the contracts to a period of May through September.

NOTE 8. COMMITMENTS (CONTINUED)

The first agreement with BPA is for the purchase of firm capacity (23 megawatts in the summer months and 16 megawatts in the winter months) beginning February 1, 1991, for a period of 20 years. The second BPA agreement is for the purchase of capacity (50 megawatts during the summer months and 13 megawatts during the winter months) beginning April 30, 1996, for 20 years. Effective May 1, 1998, these summer and winter capacity amounts increased to 60 megawatts and 15 megawatts, respectively, for the remainder of the second agreement.

■ **Nuclear Insurance** The Price-Anderson Act ("the Act") requires that all utilities with nuclear generating facilities share in the payment for claims resulting from a nuclear incident. The Act limits liability from third-party claims to approximately $10.8 billion per incident. Under the industry wide retrospective assessment program provided for under the Act, assessments are limited to $101 million per reactor for each licensee for each nuclear incident occurring at any nuclear reactor in the United States, with payments under the program limited to $15 million per reactor, per year to be indexed for inflation every five years. Based on the Electric Utility's interest in Palo Verde and ownership in SONGS, the Utility would be responsible for a maximum assessment of $4,583, limited to payments of $681 per incident, per year.

■ **Renewable Portfolio Standard** On June 6, 2003 and July 8, 2003, the Public Utilities Board and the City Council respectively, adopted a Renewable Portfolio Standard to increase procurement of renewable resources to reach a target of 20 percent of the Utility's energy by 2015. The contracts in the following table were executed as part of compliance with this standard. The Utility also has an agreement with Bonneville Power Administration for the purchase of energy credits that add to the total renewable portfolio. In the current year, renewable resources provided 13 percent of retail energy requirements of total power produced or purchased.

Long-term renewable power purchase agreements (in thousands):

SUPPLIER	Type	Maximum Contract	Contract Expiration	Estimated Annual Cost For 2007
Milliken Genco	Landfill Gas	2.3 MW	12/31/2007	$ 825
Mid Valley Genco	Landfill Gas	2.3 MW	12/31/2007	943
Riverside County (Badlands Landfill)	Landfill Gas	1.2 MW	12/31/2008	255
Wintec	Wind	1.3 MW	4/30/2018	171
Salton Sea Power LLC	Geothermal	20.0 MW	5/31/2020	9,618
Total:		27.1 MW		$ 11,812

All contracts are contingent on energy production from specific related generating facilities. Riverside has no commitment to pay any amounts except for energy produced on a monthly basis from these facilities.

■ **Power Purchase Agreement** On August 23, 2005, the City Council approved an amendment to the Power Purchase Agreement between Salton Sea and the City. The agreement increases the amount of renewable energy available to the City from the current 20 MW to 46 MW effective June 1, 2009 through May 31, 2020, at the same price under the current contract until 2013, with escalation thereafter based on an inflationary type index. Similar to other renewable power purchase agreements, the City is only obligated for purchases of energy delivered to the City.

■ **Construction Commitments** As of June 30, 2006, the Electric Utility had major commitments of approximately $8,300, with respect to unfinished capital projects, of which $3,600 is expected to be funded by bonds and $4,700 funded by rates.

NOTE 8. COMMITMENTS (CONTINUED)

Forward Purchase Agreements In order to meet summer peaking requirements, the Utility may contract on a monthly or quarterly basis, for energy and or capacity products on a short term basis. As of June 30, 2006, the electric utility had summer peaking commitments for fiscal years 05/06 through 07/08, of approximately $5,713, with a market value of $5,826.

NOTE 9. LITIGATION

The City continues to participate in key FERC dockets impacting the City's Electric Utility, such as the Market Design and Western Markets refunding dockets.

On January 1, 2003, the City became a PTO with the ISO, entitling the City to receive compensation for use of its transmission facilities committed to the ISO's operational control. The compensation is based on the City's TRR as approved by the FERC. The California Investor Owned Utilities (IOUs), the CDWR, and the CPUC, among others, objected to various aspects of the City's TRR at the FERC. The City and the objecting parties submitted, and the FERC accepted for filing, a settlement agreement that disposes of all City TRR issues except for CDWR's and CPUC's contention that the City is not entitled to its TRR for the majority of its transmission facilities committed to the ISO's control. After trial on this TRR issue, the FERC Administrative Law Judge rendered a decision in favor of the City in March 2005. FERC upheld that decision in a October 2005 order and denied all rehearing requests on march 27, 2006. CDWR has appealed this final FERC ruling to the U.S. Court of Appeals for the D.C. Circuit. If the objecting parties prevail upon appeal, up to $38,900 of transmission revenue collected through June 30, 2006 may have to be refunded to the ISO.

The City is owed approximately $300 by the California Independent System Operator (ISO) and $1,000 by the California Power Exchange (PX), primarily due to Pacific Gas & Electric's (PG&E) defaulting on its payments to the ISO and PX in early 2001. These amounts were fully reserved with an allowance for potentially uncollectible receivables in fiscal year 2001, and any amounts subsequently collected will be included in earnings in the period collected. After PG&E's default on its payments in 2001, PG&E and the PX filed voluntary Chapter 11 petitions in the U.S. Bankruptcy Courts in San Francisco, California, and Los Angeles, California, respectively. PG&E was the largest purchaser of electricity from the ISO and the PX, and therefore was the largest creditor of the ISO and PX. PG&E's various creditors' classes and the Bankruptcy Court approved a Settlement Plan under which PG&E paid the PX and ISO 100% of its debts to creditors in the same class as the City. Payments to the City of the City's share of these PG&E funds by the PX and ISO are contingent upon the FERC's issuance of orders in various dockets that will determine the methodology for the ISO's and PX's calculations of refunds and charge backs to its participants, including the City.

The Electric Utility is a defendant in various lawsuits arising in the normal course of business. Present lawsuits and other claims against the Electric Utility are incidental to the ordinary course of operations of the Electric Utility and are largely covered by the City’s self-insurance program. In the opinion of management and the city attorney, such claims and litigation will not have a materially adverse effect upon the financial position or results of operation of the Electric Utility.

Key Historical Operating Data

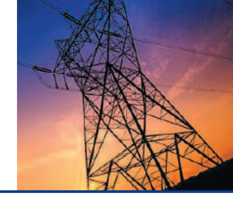
POWER SUPPLY (MWH)	2005/06	2004/05	2003/04	2002/03	2001/02
Nuclear					
San Onofre	275,100	282,700	316,600	321,800	312,100
Palo Verde	72,600	87,500	86,400	97,200	94,700
Coal					
Intermountain Power	1,091,000	1,081,600	1,091,700	1,029,400	1,027,000
Deseret	396,000	432,200	404,300	404,600	394,700
Hoover (Hydro)	35,100	28,100	35,600	36,200	40,200
Gas					
Springs	1,600	1,700	1,900	9,800	1,300
RERC	9,300	0	0	0	0
Renewable Resources	264,000	270,200	237,600	224,700	109,500
Other purchases	517,300	440,000	437,200	270,900	538,000
Exchanges In	89,900	83,300	95,100	89,300	115,000
Exchanges Out	(174,600)	(79,100)	(171,700)	(137,700)	(172,700)
Total:	2,577,300	2,628,200	2,534,700	2,346,200	2,459,800
System peak (MW)	550.6	519.1	517.2	474.2	446.6

ELECTRIC USE

Number of meters as of year end	2005/06	2004/05	2003/04	2002/03	2001/02
Residential	93,607	92,914	90,583	89,149	88,044
Commercial	10,038	10,060	9,683	9,356	9,203
Industrial	496	344	351	374	403
Other	153	145	149	139	143
Total:	104,294	103,463	100,766	99,018	97,793
Millions of kilowatt-hours sales					
Residential	697	675	707	618	600
Commercial	474	530	522	451	434
Industrial	810	707	687	658	629
Wholesale sales	321	470	354	378	541
Other	57	50	52	49	53
Total:	2,359	2,432	2,322	2,154	2,257

ELECTRIC FACTS	2005/06	2004/05	2003/04	2002/03	2001/02
Average annual kWh per residential customer	7,515	7,424	7,884	6,970	6,905
Average price (cents/kWh) per residential customer	12.22	11.81	11.44	10.99	10.77
Debt service coverage ratio	2.64	3.68	3.38	2.91	2.27
Operating income as a percent of operating revenues	18.1%	25.4%	20.3%	14.4%	6.7%
Employees[1]	338	307	306	292	283

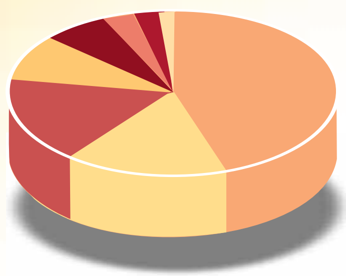
[1]Approved positions



Key Historical Operating Data

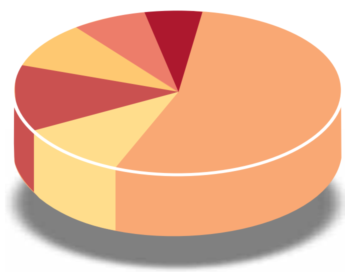
2005/06 ELECTRIC REVENUE AND RESOURCES

Source of Revenue



- Residential Sales (31¢)
- Industrial Sales (26¢)
- Commercial Sales (19¢)
- Transmission Revenue (8¢)
- Other Revenues (7¢)
- Wholesale Sales (4¢)
- Investment Income (3¢)
- Other Sales (2¢)

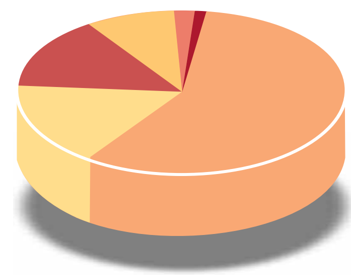
Distribution of Revenue



- Production (47¢)
- Distribution (13¢)
- Debt Service (11¢)
- Transmission (11¢)
- Additions & Replacements to the System (9¢)
- Transfers to the City's general fund* (8¢)
- Additional Reserves (1¢)

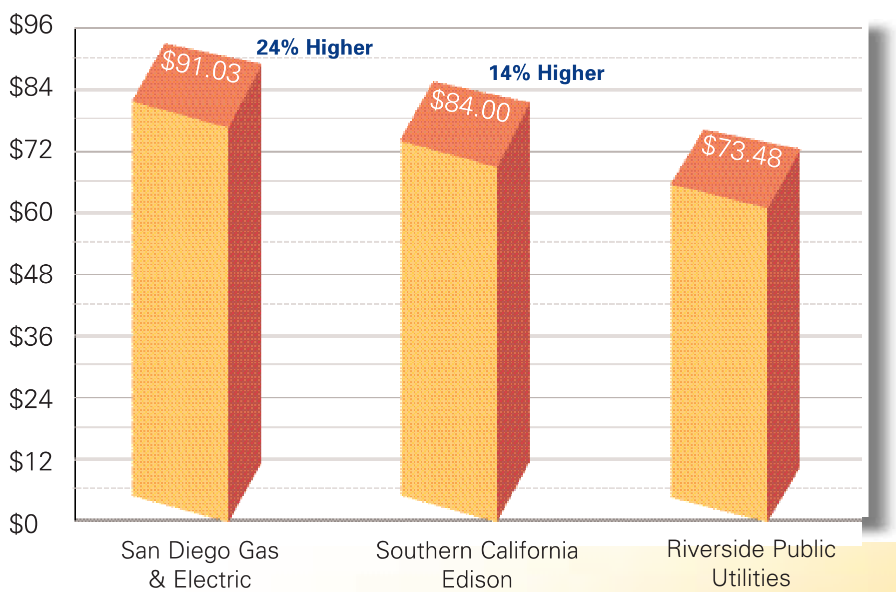
**Based on transfer of 9.0 percent of fiscal year 2004/05 revenues (excludes wholesale sales, interest and other non-operating income).*

Energy Resources



- Coal (58%)
- Other Purchases (17%)
- Nuclear (14%)
- Renewables (10%)
- Hydropower (1%)
- Gas (<1 %)

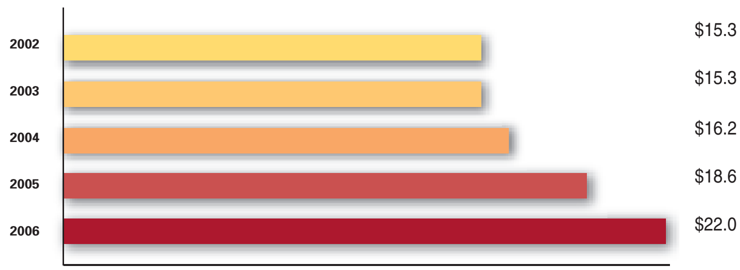
Residential Electrical Rate Comparison
600 kWh per month



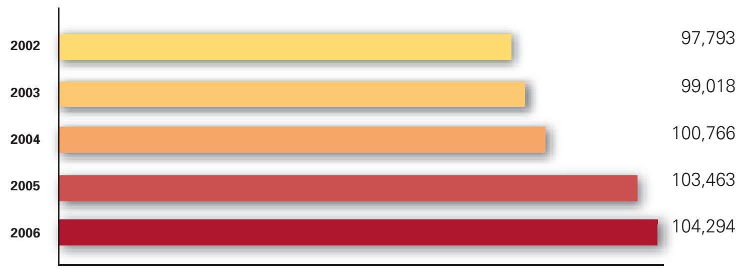
RATE COMPARISONS AS OF JUNE 1, 2006

Key Historical Operating Data

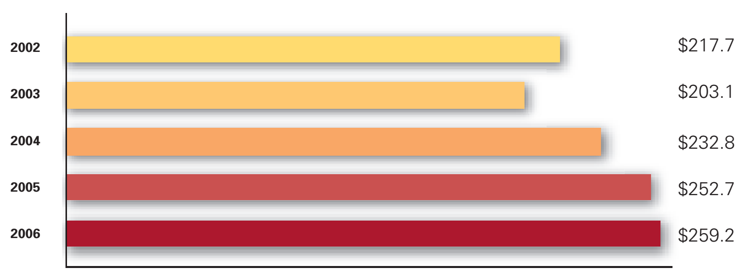
General Fund Transfer (in millions)



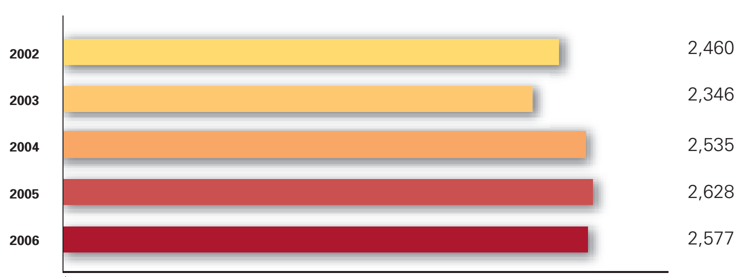
Number of Meters at Year End



Total Operating Revenue (in millions)

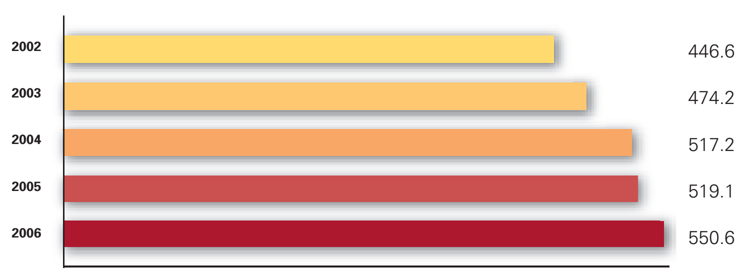


Production (in million kilowatt-hours)[1]



[1] Energy shown before losses, net of exchanges

Peak Day Demand (in megawatts)



Electric Facts and System Data

Established:	1895
Service Area Population:	287,800
Service Area Size (square miles):	80.1
System Data:	
Transmission lines (circuit miles):	88.7
Distribution lines (circuit miles):	1,190
Number of substations:	14
2005-06 Peak Day (megawatts):	551
Highest single hourly use:	
7/21/05, 4pm, 103 degrees	
Historical peak (megawatts):	551
Highest single hourly use:	
7/21/05, 4pm, 103 degrees	

Bond Ratings

FITCH, INC. (August '05)	AA-
STANDARD & POOR'S	A+
Debt Derivative Profile Score	2

ELECTRIC

Independent Auditors' Report

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Conrad Government Services Division
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To the Honorable City Council and Board of Public Utilities
City of Riverside
Riverside, California

INDEPENDENT AUDITORS' REPORT

We have audited the accompanying financial statements of the City of Riverside, California, Water Utility, an enterprise fund of the City, as of and for the year ended June 30, 2006 as listed in the table of contents. These financial statements are the responsibility of the City of Riverside Water Utility's management. Our responsibility is to express an opinion on these financial statements based on our audits. The prior year summarized comparative financial information has been derived from the City of Riverside, California, Water Utility's 2005 financial statements which were audited by McGladrey and Pullen, LLP, and whose report dated September 30, 2005 expressed unqualified opinions on the financial statements.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1 to the financial statements, the financial statements of the City of Riverside, California, Water Utility are intended to present the financial position and the changes in financial position and cash flows for the City of Riverside, California, Water Utility, a fund of the City, and do not purport to, and do not, present fairly the financial position of the City of Riverside, California, and the changes in its financial position and its cash flows, where applicable, in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the City of Riverside, California, Water Utility, as of June 30, 2006 and the changes in its financial position and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis, as listed in the table of contents, is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Independent Auditors' Report

MHM

To the Honorable City Council and Board of Public Utilities
City of Riverside

Our audits were conducted for the purpose of forming an opinion on the financial statements that comprise the City of Riverside, California, Water Utility's basic financial statements. The supplementary information entitled Water Key Historical Data, as listed in the table of contents, is presented for the purpose of additional analysis and is not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in the audits of the basic financial statements and, accordingly, we express no opinion on it.

In accordance with Government Auditing Standards, we have also issued our report dated September 30, 2006 on our consideration of the City of Riverside's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.

Mayer Hoffman McCann P.C.

Irvine, California
September 30, 2006

Management's Discussion and Analysis

As management of Riverside Public Utilities (a department of the City of Riverside), we offer the readers of Riverside's Water Utility financial statements, an enterprise fund of the City, this narrative overview and analysis of the financial activities of the Water Utility (Utility) for the fiscal years ended June 30, 2006 and 2005. We encourage readers to consider the information presented here in conjunction with additional information furnished in our financial statements, which begin on page 45 of this report. All amounts, unless otherwise indicated, are expressed in thousands of dollars.

FINANCIAL HIGHLIGHTS

The assets of the Water Utility exceeded its liabilities (equity) at the close of fiscal years 2006 and 2005 by $228,880 and $199,483, respectively. Of this amount, $35,344 and $15,870, respectively, may be used to meet the Utility's ongoing obligations to creditors and customers.

The Utility's total equity as of June 30, 2006 and 2005, respectively, increased by $29,397 and $5,141 from fiscal years ended June 30, 2005 and 2004, respectively.

As of June 30, 2006 and 2005, unrestricted equity represented over 103% and 48% of annual operating expenses, respectively.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis are intended to serve as an introduction to the City of Riverside Water Utility financial statements. The Water Utility is a department of the City of Riverside, and its activities are recorded in a separate enterprise fund. These financial statements include only the activities for the City of Riverside Water Utility and provide comparative information for the last two fiscal years. Information on city-wide financial results is available in the City of Riverside's "Comprehensive Annual Financial Report."

The City of Riverside Water Utility's financial statements comprise two components: 1) financial statements, and 2) notes to the financial statements. In addition, this report also contains other supplementary information to provide the reader additional information about the Water Utility, including historical sales and other relevant data.

Included as part of the financial statements are three separate statements.

The ***Balance Sheets*** present information on assets and liabilities, with the difference between the two reported as equity. Over time, increases or decreases in equity may serve as a useful indicator of whether the financial condition of the utility is improving or deteriorating.

The ***Statements of Revenues, Expenses and Changes in Equity*** present information showing how the Utility's equity changed during the most recent two fiscal years. Results of operations are reported as underlying events occur, regardless of the timing of cash flows. Thus, revenues and expenses are reported in these statements for some items that will result in cash flows in future fiscal periods, i.e. accounts payable and accounts receivable. This is called the accrual basis of accounting and is more fully described in the accompanying Notes to the Financial Statements.

The ***Statements of Cash Flows*** present the cash flow changes occurring during the last two fiscal years in highly liquid cash and cash equivalents, including certain restricted assets.

The ***Notes to the Financial Statements*** provide additional information that is essential to a full understanding of the data provided in the Water Utility's financial statements. The notes to the financial statements can be found on pages 49 to 57 of this report.

UTILITY FINANCIAL ANALYSIS

As noted earlier, equity (also called net assets) may serve over time as a useful indicator of the fund's financial position. In the case of Riverside's Water Utility, assets exceeded liabilities by $228,880 and $199,483 at the close of the fiscal years 2006 and 2005, respectively.

The Water Utility's overall equity increased by $29,397 and $5,141 during fiscal years 2006 and 2005, respectively, primarily due to capital contributions from developers and other parties totaling $16,511 and $11,826, respectively, and sale of excess water property totaling $15,400 and $600, respectively, offset by contributions to the general fund of $3,539 and $3,487, respectively. The prior fiscal year is further reduced by a special item write off of $3,014, discussed more fully in Note 7 on Page 57 of this report.

The largest portion of the Water Utility's equity (79% and 88% as of June 30, 2006 and 2005, respectively) reflects its investment in capital assets, such as treatment, pumping, source of supply, transmission and distribution facilities, less any related outstanding debt used to acquire those assets. The Water Utility uses these capital assets to provide services to customers; consequently, these assets are not available for future spending. Resources needed to repay the outstanding debt shown on the balance sheet must come from other sources such as operations, since the capital assets themselves cannot be used to liquidate these long-term liabilities.

The Utility's net assets invested in capital assets, net of related debt as of June 30, 2006, and 2005 was $180,708 and $175,041, respectively, an increase of $5,667 (3.2%) and $7,716 (4.6%),from the respective prior fiscal year. Significant projects during the corresponding fiscal years included $10,700 and $4,500 for the pipeline replacement program, $700 and $1,700 to relocate water facilities for the State of California funded Caltrans I-215/60/91 freeway interchange project, and $5,300 and $5,200 in system expansion and improvements. In addition, during fiscal year 2005, $4,600 was spent to complete rehabilitation of the Riverside Canal to facilitate future water deliveries.

The Unrestricted portion of the Utility's net assets (15% and 8% for fiscal years ended June 30, 2006 and 2005, respectively) may be used to meet the Utility's ongoing obligations to creditors and customers.

An additional portion of the Water Utility's equity (6% and 4%, respectively as of June 30, 2006 and 2005) represents resources that are subject to internal and external restrictions on how they may be used. These are reserved for items such as debt repayment, and funds collected for the Water Conservation and Reclamation programs.

RIVERSIDE'S WATER UTILITY'S CONDENSED STATEMENTS OF EQUITY (NET ASSETS)

	2006	2005	2004
Current and other assets	$ 89,399	$ 37,701	$ 40,754
Capital assets	254,425	241,699	230,912
Total assets	343,824	279,400	271,666
Long-term debt outstanding	97,548	63,684	66,593
Other liabilities	17,396	16,233	10,731
Total liabilities	114,944	79,917	77,324
Equity (net assets)			
Invested in capital assets, net of related debt	180,708	175,041	167,325
Restricted	12,828	8,572	8,431
Unrestricted	35,344	15,870	18,586
Total equity (net assets)	$ 228,880	$ 199,483	$ 194,342

As of June 30, 2006

ASSETS

Total assets for the two most recent fiscal years were $343,824 and $279,400, respectively. The $64,424 (23.1%) increase in total assets is due to a $12,726 increase in net capital assets (Utility plant), primarily relating to improvements to the Water Utility's distribution system, and a $51,698 increase in current and other assets. The $51,698 increase is comprised of $28,900 in restricted cash and investments (primarily due to 34,400 in new bond proceeds offset by use of bond proceeds for construction projects), $2,094 increase in accounts receivable, and $17,854 in cash from operations, primarily relating to sales of excess of water property.

LIABILITIES

Total liabilities as of June 30, 2006 and 2005 were $114,944 and $79,917, respectively, an increase of $35,027 (43.8%). Long-term obligations increased by $33,864 primarily due to $61,125 Water Refunding/ Revenue bond issue, offset by a $26,598 deposit into a refunding escrow account and $3,912 of principal payments. Overall, other current liabilities are consistent with prior year.

EQUITY (NET ASSETS)

Total Water fund equity for the fiscal year ended June 30, 2006 and 2005 was $228,880 and $199,483, respectively, an increase of $29,397 (14.7%) during the fiscal year. The restricted portion increased by $4,256, due to an increase in the required debt service reserve as a result of the $61,125 bond issue. The Unrestricted portion increased by $19,474 primarily attributable to results of operations in the current fiscal year. The portion of equity invested in capital assets, net of related debt, increased by $5,667 due to the amount of capital assets constructed or purchased that are not bond financed.

As of June 30, 2005

ASSETS

Total assets as of June 30, 2005 and 2004, were $279,400 and $271,666, respectively. The $7,734 (2.8%) increase in total assets is due to a $10,787 increase in net capital assets (Utility plant), primarily relating to improvements to the Water Utility's distribution system, offset by a $3,053 decrease in current and other assets. The $3,053 decrease is comprised of a $5,890 increase in deferred pension costs, offset by decreases of $5,749 in restricted cash and investments (primarily use of bond proceeds for construction projects), $1,701 in accounts receivable, and $1,391 in cash from operations.

LIABILITIES

Total liabilities as of June 30, 2005 and 2004 were $79,917 and $77,324, respectively, an increase of $2,593 (3.4%). Although long-term obligations decreased by $2,909 primarily due to current year principal payments, this was offset by an increase of $5,502 in other liabilities, primarily representing the Water Utility's portion of the City's issuance of pension obligation bonds. Overall, current liabilities are consistent with prior year.

EQUITY (NET ASSETS)

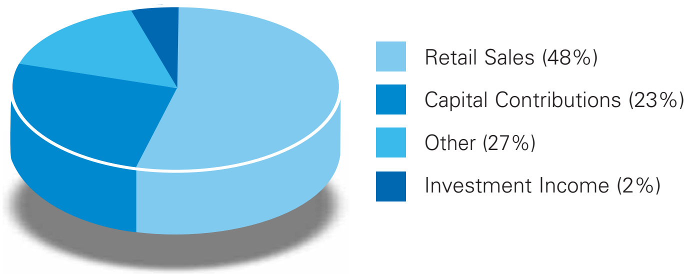
Total Water fund equity for the fiscal year ended June 30, 2005 and 2004 was $199,483 and $194,342, respectively, an increase of $5,141 (2.6%) during the fiscal year. The restricted portion increased by $141, primarily due to the unspent Water Conservation and Reclamation funds. The Unrestricted portion decreased by $2,716 primarily attributable to results of operations in the current fiscal year. The portion of equity invested in capital assets, net of related debt, increased by $7,716 due to the amount of capital assets constructed or purchased that are not bond financed.

RIVERSIDE'S WATER UTILITY'S CONDENSED STATEMENTS OF CHANGES IN EQUITY (NET ASSETS)

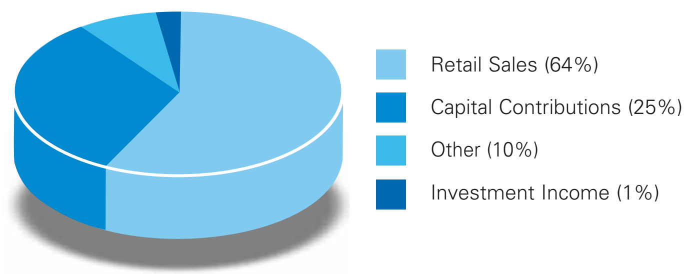
	2006	2005	2004
Revenues:			
Retail sales, net	$ 34,301	$ 30,754	$ 30,363
Other revenues	19,123	4,769	2,881
Investment income	1,773	582	664
Wholesale sales	151	142	149
Conservation and reclamation	434	155	0
Capital contributions	16,511	11,826	15,494
Total revenues	72,293	48,228	49,551
Expenses:			
Operations and maintenance	21,286	20,105	17,432
Purchased energy	3,910	3,822	3,724
Purchased water	1,832	2,509	2,481
Depreciation	7,142	6,314	6,273
Conservation and reclamation	228	24	0
Interest and fiscal charges	4,959	3,812	3,881
Total expenses	39,357	36,586	33,791
Transfers to the City's general fund	(3,539)	(3,487)	(3,163)
Special Item	0	(3,014)	0
Changes in Equity	29,397	5,141	12,597
Equity, July 1	199,483	194,342	181,745
Equity, June 30	$ 228,880	$ 199,483	$ 194,342

REVENUES BY SOURCES – WATER UTILITY

June 30, 2006



June 30, 2005



Year ended June 30, 2006

Total revenues for the two most recent fiscal years were $72,293 as compared to $48,228, a increase of $24,065 (49.9%).

Retail sales (residential, commercial, industrial, and other sales), net of reserve/recovery were $34,301 and $30,754 for years ended June 30, 2006 and 2005, respectively, and continue to be the primary revenue source for the Water Utility, making up 47.4% and 63.8% of total revenues in the respective fiscal years. Retail sales, net of reserve/recovery increased $3,547 (11.5%) from the prior year due to a 8.5% rate increase that became effective June 1, 2005 and a 3.6% increase in consumption over prior year.

Other revenues of $19,123 and $4,769 at June 30, 2006 and 2005, respectively, increased by $14,354 (301%) primarily due to $15,384 received in the current year for sales of surplus property.

Capital contributions during fiscal years 2006 and 2005 were $16,511 and $11,826, respectively, an increase of $4,685 (39.6%). The increase reflects an increased level of construction projects funded by others and back up facility charges.

Total revenues collected for the Conservation and Reclamation Program were $434 and $155, respectively, an increase of $279 (180%), implemented as part of the current three year rate plan in 2005 (see discussion under "Economic Factors and Rates" on page 43 and 44 of this report).

Year ended June 30, 2005

Total revenues for the year ended June 30, 2005 were $48,228 as compared to $49,551 in the prior fiscal year, a decrease of $1,323 (2.7%).

Retail sales (residential, commercial, industrial, and other sales), net of reserve/recovery were $30,754 and $30,363 for years ended June 30, 2005 and 2004, respectively, and continue to be the primary revenue source for the Water Utility, making up 63.8% and 61.3% of total revenues in the respective fiscal years. Retail sales, net of reserve/recovery increased $391 (1.3%) from the prior year due to a 8.5% rate increase that became effective June 1, 2004, offset by 8.9% lower water consumption due to cooler and wetter weather conditions.

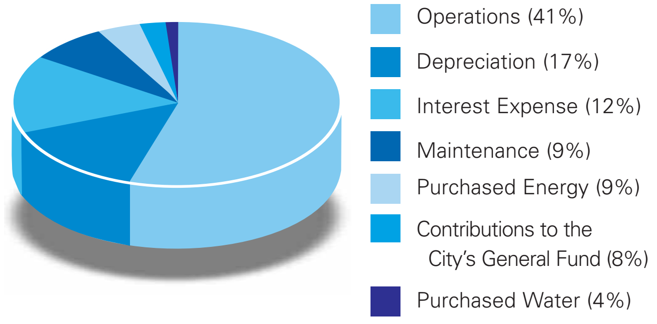
Other revenues of $4,769 and $2,881 at June 30, 2005 and 2004, respectively, increased by $1,888 (65.5%) due to an additional $1,025 of operating treatment costs reimbursed by other responsible parties for contaminating the City's water supply and $903 received in the current year for sales of surplus property.

Capital contributions during fiscal years 2005 and 2004 were $11,826 and $15,494, respectively, a decrease of $3,668 (23.7%). The decrease reflects a reduction in relocations of water facilities for the State of California funded Caltrans I-215/60/91 freeway interchange project.

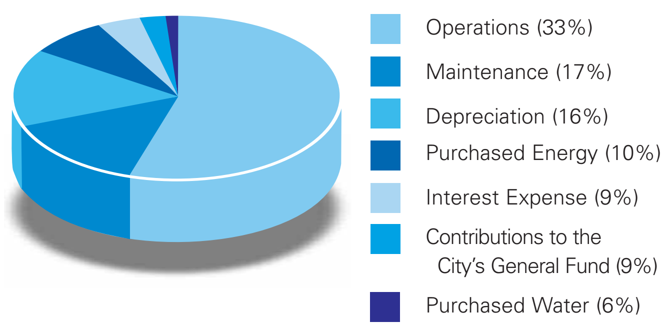
New for fiscal year ended June 30, 2005 were monies collected for Conservation and Reclamation efforts of $155, implemented as part of the current three year rate plan (see discussion under "Economic Factors and Rates" on page 43 and 44 of this report).

EXPENSES BY SOURCES – WATER UTILITY

June 30, 2006



June 30, 2005



Year ended June 30, 2006

Total expenses for the year ended June 30, 2006 were $39,357 as compared to $36,586 in the prior year. The increase in total expenses of $2,771 (7.6%) is due to higher interest expense as a result of a new revenue bond issue, higher labor costs and taxes and assessments, offset by lower purchased water costs and charges for professional services.

Operations and maintenance costs were $21,286 and $20,105 for fiscal years 2006 and 2005, respectively, an increase of $1,181 (5.9%). The majority of the increase is primarily due to an increase in labor costs and taxes and assessments, offset by a decrease in professional service costs.

Year ended June 30, 2005

Total expenses for the year ended June 30, 2005 were $36,586 as compared to $33,791 in the prior year. The increase in total expenses of $2,795 (8.3%) is due to personnel cost increases in the current year and cost of living type increases in other operating categories,

Operations and maintenance costs were $20,105 and $17,432 for fiscal years 2005 and 2004, respectively, an increase of $2,673 (15.3%). The majority of the increase is primarily due to a $1,287 increase in salary costs – including overtime expenses to maintain or increase customer service levels ($545) and related benefits ($742), and an increase in professional services ($736) to prepare the water master and water supply plans.

TRANSFERS

Year ended June 30, 2006

Transfers to the City's general fund are limited by Section 1204(f) of the City Charter to a maximum of 11.5% of prior year gross operating revenue. The Water Utility transferred approximately 11.5% of prior year operating revenues, or $3,539 in the current year, compared to $3,487 in the prior year primarily as a result of an increase in retail sales of $391 for fiscal year 2005 over prior year levels.

Year ended June 30, 2005

Transfers to the City's general fund of $3,487 increased by $324, primarily as a result of the $3,026 increase in retail sales for fiscal year 2004 over the prior year levels.

CAPITAL ASSET AND DEBT ADMINISTRATION

The Water Utility's investment in Capital Assets includes investments in source of supply, pumping, treatment, transmission and distribution facilities, and construction in progress, as well as general items such as office equipment, furniture, etc.

For descriptions of major capital assets constructed during the fiscal years 2006 and 2005, see discussion under "Utility Financial Analysis" on page 38 of this report.

CITY OF RIVERSIDE WATER UTILITY'S CAPITAL ASSETS (NET OF ACCUMULATED DEPRECIATION)

	2006	2005	2004
Source of supply	$ 22,727	$ 21,935	$ 11,293
Pumping	7,918	4,714	3,238
Treatment	13,483	12,758	13,143
Transmission and distribution	190,708	173,732	160,716
General	3,066	3,352	1,489
Land	3,891	6,283	8,405
Intangible	5,969	6,269	6,269
Construction in progress	6,663	12,656	26,359
Total	$ 254,425	$ 241,699	$ 230,912

Additional information regarding capital assets can be found in Note 3 on Page 53 of this report.

As of June 30, 2006

Capital assets, net of depreciation, for the Water Utility were $254,425 compared to $241,699 as of June 30, 2006 and 2005, respectively, a $12,726 (5.3%) increase. The majority of assets capitalized in the current year were for transmission and distribution and pumping facilities. For more detailed description of assets constructed in the current fiscal year, see discussion above under "Utility Financial Analysis."

As of June 30, 2005

Capital assets, net of depreciation, for the Water Utility were $241,699 compared to $230,912 as of June 30, 2005 and 2004, respectively, a $10,787 (4.7%) increase. The majority of assets capitalized for this period were for transmission and distribution and source of supply facilities. For more detailed description of assets constructed during the fiscal year, see discussion above under "Utility Financial Analysis."

CITY OF RIVERSIDE WATER UTILITY'S OUTSTANDING DEBT (REVENUE BONDS AND CONTRACTS PAYABLE)

At the end of fiscal years ended June 30, 2006 and 2005 the City of Riverside's Water Utility had long-term debt outstanding of $97,548 and $63,684, respectively. This debt is backed by the revenues of the Utility (revenue bonds).

	2006	2005	2004
Revenue bonds	$ 103,815	$ 71,015	$ 75,060
Contracts payable	979	1,015	1,039
Less:			
Unamortized bond discount/capital appreciation	(2,796)	(4,121)	(5,311)
Less: Current portion	(4,450)	(4,225)	(4,195)
Total	$ 97,548	$ 63,684	$ 66,593

The Water Utility's bond indentures require the Utility to maintain a minimum debt service coverage ratio, as defined by the bond covenants, of 1.25. The Water Utility's debt service coverage ratio was 5.11 at June 30, 2006 and 2.85 at June 30, 2005.

As of June 30, 2006

Long-term debt of $103,815 increased by $32,800 (46.2%) from June 30, 2005, due to the issuance of a $61,125 variable rate Water Refunding Revenue bond issue offset by the repayment of principal on the Water Utility's outstanding revenue bonds.

As of June 30, 2005

Long-term debt of $71,015 decreased by $4,045 (5.4%) from June 30, 2004, due to the repayment of principal on the Water Utility's outstanding revenue bonds.

The Water Utility maintains an "AA" credit rating from Standard & Poor's and Fitch, Inc. for its revenue bonds.

Additional information on the Water Utility's long-term debt can be found in Note 4 on pages 53 to 56 of this report.

ECONOMIC FACTORS AND RATES

Although inflationary trends in the Riverside region continue to compare favorably to the national indices, the Water Utility's escalation in costs are not strictly attributable to inflation. One of the primary drivers of the increase in costs relates to the Water Utility's aging infrastructure.

To address this concern, the Board of Public Utilities, after the requisite public hearing, adopted and the City Council unanimously approved, the SAFE W.A.T.E.R. (Water Available to Everyone in Riverside) Plan. This plan implements system improvements contained in the Water Master, Water Supply and Asset Management Plans. The SAFE W.A.T.E.R. Plan is initially funded by a fifty-two percent, five-year water rate increase, consisting of a twelve percent and four–ten percent increases effective November 1, 2006, 2007, 2008, 2009, and 2010, respectively.

In addition to inflation, management continually plans for and identifies issues or potential contingencies that could impact future rates such as reclaimed water, infrastructure needs, system growth, source of supply, ground water contamination, stricter contaminant guidelines, legislative mandates, and others. In an effort to control costs to its customers, the Utility is aggressive in pursuing outside parties and holding them financially responsible for any negative effects they may cause to Riverside's water quality.

Requests for Information

This financial report is designed to provide a general overview of the City of Riverside Water Utility's finances. Questions concerning any information provided in this report or requests for additional financial information should be addressed to the Assistant Director Finance/Customer Relations or the Utilities Assistant Chief Financial Officer, Riverside Public Utilities, 3900 Main Street, Riverside, CA 92522.

Balance Sheets

ASSETS	June 30, 2006	June 30, 2005
	(in thousands)	
UTILITY PLANT:		
Source of supply	$ 32,684	$ 31,315
Pumping	13,986	10,515
Treatment	15,449	14,313
Transmission and distribution	273,785	251,583
General	8,969	8,977
	344,873	316,703
Less accumulated depreciation	(106,971)	(100,212)
	237,902	216,491
Land	3,891	6,283
Intangible	5,969	6,269
Construction in progress	6,663	12,656
Total utility plant (Note 3)	254,425	241,699
RESTRICTED ASSETS:		
Cash and cash equivalents (Note 2)	4,424	3,943
Cash and investments at fiscal agent (Note 2)	8,046	4,457
Total restricted assets	12,470	8,400
OTHER NON-CURRENT ASSETS:		
Deferred pension costs	5,876	5,890
Deferred bond issuance/refunding costs	3,654	1,245
Advances to the City's general fund	28	48
Total other non-current assets	9,558	7,183
Total non-current assets	276,453	257,282
CURRENT ASSETS:		
Unrestricted:		
Cash and cash equivalents (Note 2)	33,765	15,911
Accounts receivable, less allowance for doubtful accounts 2006 $36; 2005 $51	4,283	3,776
Accounts receivable, other utilities and governments, less allowance for doubtful accounts 2006 $215; 2005 $172	3,664	2,077
Accrued interest receivable	327	217
Prepaid expenses	368	0
Total unrestricted assets	42,407	21,981
Restricted assets:		
Cash and investments at fiscal agent (Note 2)	24,627	5
Cash and cash equivalents (Note 2)	276	121
Conservation and Reclamation Programs receivable	61	11
Total restricted assets	24,964	137
Total current assets	67,371	22,118
Total assets	$ 343,824	$ 279,400

See accompanying notes to the financial statements

Balance Sheets

EQUITY AND LIABILITIES

	June 30, 2006	June 30, 2005
	(in thousands)	
EQUITY:		
Invested in capital assets, net of related debt	$ 180,708	$ 175,041
Restricted for:		
Debt service (Note 5)	12,491	8,440
Conservation & Reclamation Programs	337	132
Unrestricted	35,344	15,870
Total equity	228,880	199,483
LONG-TERM OBLIGATIONS, LESS CURRENT PORTION (NOTE 4)	97,548	63,684
OTHER NON-CURRENT LIABILITIES:		
Pension obligation (Note 4)	5,823	5,890
CURRENT LIABILITIES PAYABLE FROM RESTRICTED ASSETS:		
Accrued interest payable	325	610
Conservation & Reclamation Programs	0	1
Current portion of long-term debt (Note 4)	4,300	4,075
Total current liabilities payable from restricted assets	4,625	4,686
CURRENT LIABILITIES:		
Accounts payable	3,248	2,115
Accrued liabilities	2,150	2,027
Current portion of long-term debt (Note 4)	150	150
Customer deposits	1,400	1,365
Total current liabilities	6,948	5,657
Total liabilities	114,944	79,917
COMMITMENTS AND CONTINGENCIES (NOTES 6 AND 8)		
Total equity and liabilities	$ 343,824	$ 279,400

See accompanying notes to the financial statements

Statements of Revenues, Expenses and Changes in Equity

	For the Fiscal Years Ended June 30, 2006 (in thousands)	2005
OPERATING REVENUES:		
Residential sales	$ 22,336	$ 20,043
Commercial sales	10,470	9,252
Other sales	1,617	1,582
Wholesale sales	151	142
Conservation & Reclamation	434	155
Other operating revenue	2,598	2,978
Total operating revenues before (reserve)/recovery	37,606	34,152
Reserve for uncollectible, net of bad debt recovery	(122)	(123)
Total operating revenues, net of (reserve)/recovery	37,484	34,029
OPERATING EXPENSES:		
Operations	17,593	13,293
Maintenance	3,693	6,812
Purchased energy	3,910	3,822
Purchased water	1,832	2,509
Conservation & Reclamation Programs	228	24
Depreciation	7,142	6,314
Total operating expenses	34,398	32,774
Operating income	3,086	1,255
NON-OPERATING REVENUES (EXPENSES):		
Investment income	1,773	582
Interest expense and fiscal charges	(4,959)	(3,812)
Gain on sale of capital assets	12	42
Gain on sale of land	15,384	578
Other	1,129	1,171
Total non-operating revenues (expenses)	13,339	(1,439)
Income (loss) before contributions and transfers	16,425	(184)
Capital contributions	16,511	11,826
Transfers out - contributions to the City's general fund	(3,539)	(3,487)
Total capital contributions and transfers out	12,972	8,339
Income before special item	29,397	8,155
SPECIAL ITEM:		
Canal abandonment	0	(3,014)
Increase in equity	29,397	5,141
EQUITY, BEGINNING OF YEAR:	199,483	194,342
EQUITY, END OF YEAR:	$ 228,880	$ 199,483

See accompanying notes to the financial statements

Statements of Cash Flows

	For the Fiscal Years Ended June 30, 2006 (in thousands)	2005
CASH FLOWS FROM OPERATING ACTIVITIES:		
Cash received from customers and users	$ 35,497	$ 36,852
Cash paid to suppliers and employees	(26,476)	(27,966)
Other receipts	1,129	1,171
Canal abandonment	0	(1,147)
Net cash provided by operating activities	10,150	8,910
CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES:		
Transfers out - contributions to the City's general fund	(3,539)	(3,487)
Principal paid on pension obligation bonds	(67)	0
Net cash used by non-capital financing activities	(3,606)	(3,487)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:		
Purchase of utility plant	(17,167)	(17,242)
Proceeds from the sale of utility plant	18,327	999
Principal paid on long-term debt	(3,912)	(4,069)
Interest paid on long-term debt	(4,086)	(2,548)
Proceeds from sale of revenue bonds, net of premium	61,824	0
Deposit to escrow account for advance bond refunding	(24,450)	0
Bond issuance costs	(2,940)	0
Capital contributions	10,878	9,721
Net cash provided (used) by capital and related financing activities	38,474	(13,139)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Reduction in advances to the City's general fund	20	24
Purchases of investment securities	(3,589)	(296)
Income from investments	1,663	543
Net cash provided (used) by investing activities	(1,906)	271
Net increase (decrease) in cash and cash equivalents	43,112	(7,445)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	19,980	27,425
CASH AND CASH EQUIVALENTS, END OF YEAR	$ 63,092	$ 19,980
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Operating income	$ 3,086	$ 1,255
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	7,142	6,314
Amortization of deferred charges-pension costs	14	0
Increase in uncollectible accounts receivable	28	16
Decrease (increase) in accounts receivable	(2,172)	1,713
Increase in prepaid expenses	(368)	0
Increase (decrease) in accounts payable	1,133	(1,248)
Increase (decrease) in accrued liabilities	123	(136)
Increase in Conservation & Reclamation Programs	0	1
Increase in customer deposits	35	971
Other receipts	1,129	1,171
Canal abandonment	0	(1,147)
Net cash provided by operating activities	$ 10,150	$ 8,910
SCHEDULE OF NON-CASH INVESTING, CAPITAL AND FINANCING ACTIVITIES:		
Capital contributions – capital assets	5,632	2,105
Canal abandonment	0	1,867
Pension obligation	0	5,890

See accompanying notes to the financial statements

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The Water Utility exists under, and by virtue of, the City Charter enacted in 1883. The Water Utility is responsible for the production, transmission and distribution of water for sale in the City, except for certain areas served by another water utility.

Basis of Accounting The Water Utility uses the accrual basis of accounting as required for enterprise funds with accounting principles generally accepted in the United States of America as applicable to governments. The accounting records of the Water Utility are also in conformity with the Uniform System of Accounts prescribed by the California Public Utilities Commission. The Water Utility is not subject to the regulations of the California Public Utilities Commission. The Water Utility is not required to and does not elect to implement the pronouncements of the Financial Accounting Standards Board issued after November 1989.

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

Revenue Recognition Water Utility customers are billed monthly. Unbilled water service charges are recorded at year-end and are included in accounts receivable. Unbilled accounts receivable totaled $2,553 at June 30, 2006, and $2,152 at June 30, 2005.

An allowance for doubtful accounts is maintained for utility and miscellaneous accounts receivable. The balance in this account is adjusted at fiscal year-end to approximate the amount anticipated to be uncollectible.

Utility Plant and Depreciation Utility plant assets are valued at historical cost or estimated historical cost, if actual historical cost is not available. Costs include labor; materials; interest during construction; allocated indirect charges such as engineering, supervision, construction and transportation equipment, retirement plan contributions and other fringe benefits. Contributed plant assets are valued at estimated fair value on the date contributed. The cost of relatively minor replacements is included in maintenance expense.

Depreciation is recorded over the estimated useful lives of the related assets using the straight-line method. The estimated useful lives are as follows:

Supply, pumping and treatment plant	15-50 years
Transmission and distribution plant	25-50 years
General plant and equipment	3-50 years

Restricted Assets Proceeds of revenue bonds yet to be used for capital projects, as well as certain resources set aside for debt service, are classified as restricted assets on the Balance Sheets because their use is limited by applicable bond covenants.

In June 2004, the City began collecting a surcharge for water conservation and reclamation programs. This surcharge was approved by the City Council and is being phased in over a three-year period with a 0.5%, 1.0% and 1.5% surcharge effective June 1, 2004, 2005 and 2006, respectively. The programs and services offered include conservation, education, and water use efficiency programs; programs to encourage the use of reclaimed water; research, development and demonstration programs to advance science and technology with respect to water conservation and reclamation; and water service provided to low-income customers. This surcharge is scheduled to be in effect for services rendered on or after June 1, 2004 through May 31, 2014. The activity associated with the surcharge for water conservation and reclamation programs is reflected in the accompanying financial statements on the Balance Sheets, Statements of Revenues, Expenses and Changes in Equity, and Statements of Cash Flows.

Cash and Investments In accordance with Utility policy, the Utility's cash and investments, except for cash and investments with fiscal agents, are invested in a pool managed by the Treasurer of the City. The Utility does not own specific, identifiable investments of the pool. The pooled interest earned is allocated monthly based on the month end cash balances.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The City values its cash and investments in accordance with provisions of Governmental Accounting Standards Board (GASB) Statement No. 31, Accounting and Financial Reporting for Certain Investments and External Investment Pools (GASB 31), which requires governmental entities, including governmental external investment pools, to report certain investments at fair value in the Statements of Net Assets/Balance Sheets and recognize the corresponding change in the fair value of investments in the year in which the change occurred. Fair value is determined using quoted market prices.

Cash accounts of all funds are pooled for investment purposes to enhance safety and liquidity while maximizing interest earnings.

City-wide information concerning cash and investments for the year ended June 30, 2006, including authorized investments, custodial credit risk, credit and interest rate risk for debt securities and concentration of investments, carrying amount and market value of deposits and investments may be found in the notes to the City's "Comprehensive Annual Financial Report."

■ **Cash and Investments at Fiscal Agents** Cash and investments maintained by fiscal agents are considered restricted by the Utility and are pledged as collateral for payment of principal and interest on outstanding bonds.

■ **Bond Discounts, Capital Appreciation and Issuance Costs** Bond discounts, capital appreciation and issuance costs are deferred and amortized over the term of the bonds using the effective interest method. Bond discounts and capital appreciation are presented as a reduction of the face amount of bonds payable, whereas issuance costs are recorded as other assets. Capital appreciation is the annual increase in the value of bonds originally issued at a discounted amount. These bonds do not pay annual interest and mature at a pre-determined par value.

■ **Customer Deposits** The City holds customer deposits as security for the payment of utility bills. The Water Utility's portion of these deposits as of June 30, 2006 and 2005, was $1,400 (includes $1,032 held on behalf of La Sierra Water Company pending dissolution and distribution of remaining cash asset to shareholders, of which the City is the largest owner) and $1,365, respectively.

■ **Compensated Absences** The accompanying financial statements include accruals for salaries, fringe benefits and compensated absences due employees at June 30, 2006 and 2005. The Water Utility treats compensated absences due employees as a current liability. The amount accrued for compensated absences was $2,150 at June 30, 2006, and $2,027 at June 30, 2005, and is included in accrued liabilities in the accompanying Balance Sheets.

Employees receive 10 to 25 vacation days per year based upon length of service. A maximum of two years vacation may be accumulated, and unused vacation is paid in cash upon separation.

Employees primarily receive one day of sick leave for each month of employment with unlimited accumulation. Upon retirement or death only, a percentage of unused sick leave is paid to certain employees or their estates in a lump sum based on longevity.

■ **Insurance Programs** The Water Utility participates in a self-insurance program for worker's compensation and general liability coverage that is administered by the City. The Water Utility pays an amount to the City representing an estimate of amounts to be paid for reported claims incurred and incurred but unreported claims based upon past experience, modified for current trends and information. The city maintains property insurance on most city property holdings, including Utility plant with a limit of $100 million.

City-wide information concerning risks, insurance policy limits and deductibles and designation of general fund balance for risks for the year ended June 30, 2006, may be found in the notes to the City's "Comprehensive Annual Financial Report."

Although the ultimate amount of losses incurred through June 30, 2006, is dependent upon future developments, management believes that amounts paid to the City are

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

sufficient to cover such losses. Premiums paid to the City by the Water Utility were $376 and $614 for the years ended June 30, 2006 and 2005, respectively. Any losses above the City's reserves would be covered through increased rates charged to the Water Utility in future years.

■ **Employee Retirement Plan** The City contributes to the California Public Employees Retirement System (PERS), an agent multiple-employer public employee retirement system that acts as a common investment and administrative agency for participating public entities within the State of California.

All permanent full-time and selected part-time employees are eligible for participation in PERS. Benefits vest after five years of service and are determined by a formula that considers the employee's age, years of service and salary. Employees may retire at age 55 and receive 2.7 percent of their highest average annual salary for each year of service completed. PERS also provides death and disability benefits. These benefit provisions and all other requirements are established by state statute and City ordinance.

Employee contributions are 8.0 percent of their annual covered salary. The Water Utility is required to contribute the remaining amounts necessary to fund the benefits for its employees using the actuarial basis recommended by the PERS actuaries and actuarial consultants and adopted by the PERS Board of Administration. The employer portion of PERS funding as of June, 30 2006 and 2005, was 19.74 percent and 12.34 percent, respectively, of annual covered payroll. The Water Utility pays both the employee and employer contributions. The total Water Utility's contribution to PERS as of June 30, 2006 and 2005, was $1,539 and $1,537, respectively.

City-wide information concerning elements of the unfunded actuarial accrued liabilities, contributions to PERS for the fiscal year ended June 30, 2006, and recent trend information may be found in the notes to the City's "Comprehensive Annual Financial Report" for the fiscal year ended June 30, 2006.

■ **Pension Obligation Bonds** In 2005, the City issued Pension Obligation Bonds in the amount of $60,000, of which the Water Utility's share was $5,890 as reflected in the accompanying Balance Sheet as deferred pension costs and a corresponding long-term obligation. The deferred charge relating to the net pension asset will be amortized over 19 years in accordance with the method used by CalPERS for calculating actuarial gains and losses. The Bonds will be used to fund the unfunded actuarial accrued liability for non-safety employees and the proceeds were deposited with CalPERS. The balance in deferred pension costs as of June 30, 2006 and 2005 was $5,876 and $5,890, respectively. For more discussion relating to the City's issue, see the notes to the City's "Comprehensive Annual Financial Report" for the fiscal year ended June 30, 2006.

■ **Equity** The Water Utility's equity consists of its net assets (assets less liabilities) which are classified into the following three components:

- Invested in capital assets, net of related debt – this component consists of capital assets (net of accumulated depreciation) and unamortized debt expenses reduced by the outstanding balances of any bonds or other borrowings that are attributable to the acquisition, construction, or improvement of those assets.
- Restricted – this component consists of net assets on which constraints are placed as to their use. Constraints include those imposed by creditors (such as through debt covenants) contributors, or laws or regulation of other governments or constraints imposed by law through constitutional provisions or through enabling legislation.
- Unrestricted net assets – this component of net assets consists of net assets that do not meet the definition of "restricted" or "invested in capital assets, net of related debt."

■ **Contributions to the City's General Fund** Pursuant to the City Charter, the Water Utility may transfer up to 11.5 percent of its prior year's gross operating revenues to the City's general fund. In fiscal years 2005-06 and 2004-05, the Water Utility transferred 11.5 percent of gross operating revenues, or $3,539 and $3,487, respectively.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Cash and Cash Equivalents For the Statements of Cash Flows, cash and cash equivalents include all unrestricted and restricted highly liquid investments with original purchase maturities of three months or less, and all bond construction proceeds available for capital projects. Pooled cash and investments in the City's Treasury represent monies in a cash management pool. Such accounts are similar in nature to demand deposits, and are classified as cash equivalents for the purpose of presentation in the Statements of Cash Flows.

Budgets and Budgetary Accounting The Water Utility presents, and the City Council adopts, an annual budget. The proposed budget includes estimated expenses and forecasted revenues. The City Council adopts the Water Utility's budget in June each year via resolution.

NOTE 2. CASH AND INVESTMENTS

Cash and investments at June 30, 2006 and 2005, consist of the following (in thousands):

	June 30, 2006 Fair Value	June 30, 2005 Fair Value
Equity interest in City Treasurer's investment pool	$ 38,465	$ 19,975
Investments at fiscal agent	32,673	4,462
Total cash and investments	$ 71,138	$ 24,437

The amounts above are reflected in the accompanying financial statements as:

	June 30, 2006	June 30, 2005
Unrestricted cash and cash equivalents	$ 33,765	$ 15,911
Restricted assets:		
Cash and cash equivalents	4,700	4,064
Cash and investments at fiscal agent	24,627	5
Total cash and cash equivalents	63,092	19,980
Cash and investments at fiscal agent	8,046	4,457
Total cash and investments	$ 71,138	$ 24,437

Cash and investments as follows:

Investment Type	Total	Remaining Maturity (in Months): 12 Months or Less	13 to 24 Months	25 to 60 Months	More than 60 Months
Held by Fiscal Agent					
Money Market Funds	$ 132	$ 132	$ 0	$ 0	$ 0
Federal Agency Securities	2,409	2,409	0	0	0
Investment Contracts[1]	30,132	0	0	24,609	5,523
City Treasurer investment pool[2]					
Money Market Funds	4,559	4,559	0	0	0
Federal Agency Securities	27,744	8,884	4,144	14,716	0
Corp Medium Term Notes	4,394	2,670	1,724	0	0
State Investment Pool	1,768	1,768	0	0	0
Total	$ 71,138	$ 20,422	$ 5,868	$ 39,325	$ 5,523

All cash and investments held by fiscal agent are held in AAA investments

[1] Amounts related to bond construction proceeds are invested in specific maturities but are available for construction of capital assets as funding is needed.

[2] Additional information on investment types and credit risk may be found in the City's "Comprehensive Annual Financial Report."

NOTE 3. UTILITY PLANT

The following is a summary of changes in utility plant during the fiscal years ended June 30, 2006 and 2005 (in thousands):

	Balance, As of 6/30/2004	Additions	Retirements/ Transfers	Balance, As of 6/30/2005	Additions	Retirements/ Transfers	Balance, As of 6/30/2006
Source of supply	$ 20,276	$ 11,040	($ 1)	$ 31,315	$ 1,377	($ 8)	$ 32,684
Pumping	8,859	1,656	0	10,515	3,471	0	13,986
Treatment	14,306	7	0	14,313	1,136	0	15,449
Transmission and distribution	233,703	18,074	(194)	251,583	22,374	(172)	273,785
General	7,040	2,202	(265)	8,977	234	(242)	8,969
Depreciable utility plant	284,184	32,979	(460)	316,703	28,592	(422)	344,873
Less accumulated depreciation							
Source of supply	(8,983)	(398)	1	(9,380)	(587)	10	(9,957)
Pumping	(5,621)	(180)	0	(5,801)	(267)	0	(6,068)
Treatment	(1,163)	(392)	0	(1,555)	(411)	0	(1,966)
Transmission and distribution	(72,987)	(5,029)	165	(77,851)	(5,359)	133	(83,077)
General	(5,551)	(314)	240	(5,625)	(518)	240	(5,903)
Accumulated depreciation	(94,305)	(6,313)	406	(100,212)	(7,142)	383	(106,971)
Net depreciable utility plant	189,879	26,666	(54)	216,491	21,450	(39)	237,902
Land	8,405	42	(2,164)	6,283	221	(2,613)	3,891
Intangible	6,269	0	0	6,269	0	(300)	5,969
Construction in progress	26,359	19,375	(33,078)	12,656	22,831	(28,824)	6,663
Nondepreciable utility plant	41,033	19,417	(35,242)	25,208	23,052	(31,737)	16,523
Total utility plant	$ 230,912	$ 46,083	($ 35,296)	$ 241,699	$ 44,502	($ 31,776)	$ 254,425

NOTE 4. LONG-TERM OBLIGATIONS

The following is a summary of changes in long-term obligations during the fiscal years ended June 30, 2006 and 2005 (in thousands):

	Balance, As of 6/30/2004	Additions	Reductions	Balance, As of 6/30/2005	Additions	Reductions	Balance, As of 6/30/2006	Due within one year
Revenue bonds	$ 69,749	$ 0	($ 2,855)	$ 66,894	$ 61,125	($ 27,000)	$ 101,019	$ 4,300
Pension obligation	0	5,890	0	5,890	0	(67)	5,823	62
Water stock acquisition rights	1,039	0	(24)	1,015	0	(36)	979	150
Total long-term obligations	$ 70,788	$ 5,890	($ 2,879)	$ 73,799	$ 61,125	($ 27,103)	$ 107,821	$ 4,512

NOTE 4. LONG-TERM OBLIGATIONS (CONTINUED)

Long-term debt consists of the following (in thousands):

	June 30, 2006	June 30, 2005
Contracts Payable		
Water Stock Acquisitions: Payable on demand to various water companies	$ 979	$ 1,015
Total contracts payable	979	1,015
Revenue Bonds Payable		
$69,840 1991 Water Revenue Bonds: $25,900 serial capital appreciation bonds due in annual installments from $3,235 to $3,240 from October 1, 2006, to October 1, 2010; (partially advance refunded in 1998)	16,185	19,425
$4,710 1994 FARECal Revenue Bonds: All outstanding bonds were advance refunded on September 20, 2005 with the 2005 Water Refunding/Revenue bonds	0	3,425
$30,965 1998 Water Refunding/Revenue Bonds: $15,055 serial bonds due in annual installments from $275 to $3,690 through October 1, 2013, interest from 4.5 percent to 5.38 percent; $10,155 term bonds due October 1, 2018, interest at 5.0 percent; $5,755 term bonds due October 1, 2027 were advance refunded on September 20, 2005 with 2005 Water Refunding/Revenue bonds	21,265	29,230
$20,000 2001 Water Revenue Bonds: $10,070 serial bonds due in annual installments from $390 to $585 through October 1, 2016, interest from 3.25 percent to 4.75 percent; $4,345 term bonds due October 1, 2026 and $5,585 term bonds due October 1, 2031 were advance refunded on September 20, 2005 with 2005 Water Refunding/Revenue bonds	5,240	18,935
$61,125 2005 Water Refunding/Revenue Bonds: $61,125 Auction Rate Securities due in annual installments from $400 to $3,950 from October 1, 2006 through October 1, 2035. Interest is variable and rate is subject to weekly repricing (rate at June 27, 2006 was 3.75 percent)	61,125	0
Total water revenue bonds payable	103,815	71,015
Total water revenue bonds and contracts payable	104,794	72,030
Unamortized capital appreciation	(2,487)	(3,499)
Unamortized bond discount	(309)	(622)
Total water revenue bonds and contracts payable, net of bond discount and capital appreciation	101,998	67,909
Less current portion	(4,450)	(4,225)
Total long-term water revenue bonds and contracts payable	$ 97,548	$ 63,684

Annual debt service requirements to maturity, as of June 30, 2006, are as follows (in thousands):

	2007	2008	2009	2010	2011	2012-2016	2017-2021	2022-2026	2027-2031	2032-2036	Total
Principal	$ 4,450	$ 4,505	$ 4,525	$ 4,565	$ 4,615	$ 25,534	$ 10,500	$ 13,550	$ 15,175	$ 17,375	$ 104,794
Interest	3,234	3,194	3,153	3,109	3,063	12,642	8,274	6,250	3,944	1,371	48,234
Total	$ 7,684	$ 7,699	$ 7,678	$ 7,674	$ 7,678	$ 38,176	$ 18,774	$ 19,800	$ 19,119	$ 18,746	$153,028

NOTE 4. LONG-TERM OBLIGATIONS
(CONTINUED)

2005 Water Refunding/Revenue Bonds On September 20, 2005, the Water Utility issued $61,125 of Water Refunding/Revenue bonds, in the form of Auction Rate Securities, to finance capital improvement programs and refund certain existing Water revenue bonds. $30,000 of Water revenue bonds will be used to finance the costs of certain improvements to the City's Water System as part of the Capital Improvement Program. The remaining portion was used to refund all the outstanding 1994 FARECal bonds ($3,425), $7,705 of the outstanding 1998, and $13,320 of the outstanding 2001 Water revenue bond issues. The advance refunding resulted in a difference between the reacquisition price and the net carrying amount of the old debt of $2,271. This difference is being charged to operations using a proportional method. The City completed the current refunding to reduce net aggregate debt service payments over the next 26 years by $3,663 and to obtain an economic gain (difference between present value of the old and new debt service payments) of $2,303. Annual principal payments ranging from $400 to $3,950 are due from October 1, 2006 through October 1, 2035. Assuming a variable rate of 3.2%, the all-intrue interest cost for this issue is 3.54%.

Interest Rate Swaps on Revenue Bonds
Objective: As a means to lower borrowing costs, when compared against fixed-rate bonds at the time of issuance in September 2005, the City entered into interest rate swap agreements in connection with its $61,125 2005 Water Refunding/Revenue Bonds. The intention of the swap was to effectively change the City's variable interest rate on the bonds to a synthetic fixed rate of 3.20% for the respective Water Refunding/Revenue Bonds.

Terms: Under the swaps, the City pays the counterparty a fixed payment as noted above and receives a variable payment computed as 62.68% of the London Interbank Offering Rate ("LIBOR") one month index plus 12 basis points. The swaps have notional amounts equal to the principal amounts stated above. Starting in fiscal year 2007, the notional value of the swaps and the principal amounts of the associated debt decline by $400 to $3,950 until the debt is completely retired in fiscal year 2036. The bonds' variable rate coupons are established on a weekly basis through the results of an auction process administered through an auction agent, termed Auction Rate Securities ("ARS").

The bonds and the related swap agreements for the 2005 Water Refunding Revenue Bonds mature on October 1, 2035. As of June 30, 2006 rates were as follows:

	Terms	Rates
Interest rate swap:		
Fixed payment to counterparty	Fixed	3.20000%
Variable payment from counterparty	62.68 LIBOR +12bps	(3.00065%)
Net interest rate swap payments		0.19935%
Variable-rate bond coupon payments	ARS	2.86774%
Synthetic interest rate on bonds		3.06709%

Fair Value: As of June 30, 2006, in connection with all swap arrangements, the transactions had a total positive fair value of $3,591. Because the coupons on the City's variable-rate bonds adjust to changing interest rates, the bonds do not have a corresponding fair value decrease. The fair value was developed by a pricing service using the zero-coupon method. This method calculates the future net settlement payments required by the swap, assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These payments are then discounted using the spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the date of each future net settlement of the swap.

NOTE 4. LONG-TERM OBLIGATIONS
(CONTINUED)

Credit risk: As of June 30, 2006, the City was exposed to credit risk in the amount of $3,591 because the swap had a positive fair value. The swap counterparty, Bear Sterns was rated A by Standard & Poors. To mitigate the potential for credit risk, if the counterparty's credit quality falls below A-, the fair value of the swap will be collateralized by the counterparty with U.S. Government securities. Collateral would be posted with a third-party custodian.

Basis risk: As noted above, the swaps expose the City to basis risk should the relationship between LIBOR and the auction-rate converge, changing the synthetic rate on the bonds. If a change occurs that results in the rates' moving to convergence, the expected cost savings may not be realized.

Termination risk: The derivative contract uses the International Swap Dealers Association Master Agreement, which includes standard termination events, such as failure to pay and bankruptcy. The Schedule to the Master Agreement includes an "additional termination event." That is, a swap may be terminated by the City if the counterparty's credit quality falls below "BBB-" as issued by Standard and Poor's. The City or the counterparty may terminate a swap if the other party fails to perform under the terms of the contract. If a swap is terminated, the variable-rate bond would no longer carry a synthetic interest rate. Also, if at the time of termination a swap has a negative fair value, the City would be liable to the counterparty for a payment equal to the swap's fair value.

Swap payments and associated debt: As of June 30, 2006, the debt service requirements of the variable-rate debt and net swap payments assuming current interest rates remain the same, for their term are summarized as follows. As rates vary, variable-rate bond interest payments and net swap payments will vary.

	Variable-Rate Bonds			
Fiscal Year Ending June 30,	**Principal**	**Interest**	**Interest Rate Swaps, Net**	**Total**
2007	$ 400	$ 1,741	$ 121	$ 2,262
2008	425	1,729	120	2,274
2009	425	1,717	119	2,261
2010	425	1,705	119	2,249
2011	450	1,692	118	2,260
2012-2016	4,275	8,101	563	12,939
2017-2021	8,625	7,232	503	16,360
2022-2026	13,550	5,472	380	19,402
2027-2031	15,175	3,390	235	18,800
2032-2036	17,375	1,062	74	18,511
Total	$ 61,125	$ 33,841	$ 2,352	$ 97,318

NOTE 5. RESTRICTED EQUITY

Pursuant to applicable bond indentures, a reserve for debt service has been established by restricting assets and reserving a portion of equity. Bond indentures for Riverside's water revenue bonds require reserves that equate to the maximum annual debt service required in future years plus three months interest and nine months principal due in the next fiscal year. The 2005 Refunding/Revenue bonds require 110% of the monthly accrued interest be included in the reserve. Additional reserves for the 1998 revenue bonds are not required due to the purchase of surety bonds to cover the reserve requirements.

NOTE 6. LITIGATION

The Water Utility is a defendant in various lawsuits arising in the normal course of business. Present lawsuits and other claims against the water utility are incidental to the ordinary course of operations of the Water Utility and are largely covered by the city's self-insurance program. In the opinion of management and the city attorney, such claims and litigation will not have a materially adverse effect upon the financial position or results of operation of the Water Utility.

The Water Utility is also a plaintiff in a lawsuit against the manufacturers and distributors of MTBE and its by-products, and of fuel containing these chemicals, arising out of the threat to the Water Utility wells of contamination with those chemicals from leaking underground storage tanks.

The defendants removed this lawsuit to federal court and then transferred the case to the Judicial Panel on Multidistrict Litigation, New York, where it was consolidated with all other pending MTBE water contamination litigation cases in the country. The consolidated cases are in the discovery phase, with no trial date set.

The City also detected perchlorate in a number of its drinking water wells. While Lockheed Martin has not admitted liability for the presence of perchlorate in the City's wells, Lockheed Martin has agreed to pay for the design, construction, installation, rental and permitting, and to reimburse the City for its operational and maintenance costs associated with perchlorate treatment facilities on certain of the City's drinking water wells, under an agreement between the City and Lockheed Martin dated October 29, 2002 (the "Interim Perchlorate Agreement"). The Interim Perchlorate Agreement has been twice amended, on November 25, 2003 and on February 22, 2005, with each amendment increasing the number of wells from an original four wells to eleven wells now being treated for perchlorate at Lockheed Martin's expense.

NOTE 7. SPECIAL ITEM

In 1984 the City adopted a report by the Riverside Canal Abandonment Task Force, which outlined recommendations for abandoning those portions of the Riverside Canal that do not serve any agricultural water conveyance purposes. One critical component of the abandonment required significant construction of new storm drain facilities to transport water that would otherwise be carried in the Riverside Canal. During the fiscal year 2005, the required construction by the Water Utility was completed. The remaining portions of the storm drain will be constructed in conjunction with a development project planned adjacent to the Riverside canal, and upon completion, the Water Utility will then abandon its portions of the canal. These new facilities will be owned and operated by Riverside County Flood Control District. As a result, the Water Utility has recorded a charge against operations in the prior period of $3,014, comprising $1,147 in fiscal year 2005 and $1,867 in fiscal year 2004 construction costs.

NOTE 8. CONSTRUCTION COMMITMENTS

As of June 30, 2006, the Water Utility had major commitments of approximately $4,159 with respect to unfinished capital projects, of which $3,211 is expected to be funded by bonds and $948 funded by rates.

Key Historical Operating Data

WATER SUPPLY (ACRE FEET)

	2005/06	2004/05	2003/04	2002/03	2001/02
Pumping	76,605	73,732	81,797	70,977	79,937
Purchases	2,670	4,137	1,693	695	900
Total:	79,275	77,869	83,490	71,672	80,837
Percentage pumped	96.6%	94.7%	98.0%	99.0%	98.9%
System peak day (gallons)	118,782,000	112,094,000	105,029,000	101,484,000	102,241,000

WATER USE

Number of meters as of year end	2005/06	2004/05	2003/04	2002/03	2001/02
Residential	57,308	56,916	56,254	55,376	54,910
Commercial	5,204	5,114	4,932	4,782	4,776
Other	473	462	482	467	373
Total:	62,985	62,492	61,668	60,625	60,059
*CCF sales					
Residential	17,702,717	17,245,315	19,056,556	17,824,440	18,653,037
Commercial	9,822,196	9,252,639	9,988,578	9,411,391	9,820,471
Other	1,157,130	1,199,448	1,361,809	995,815	945,519
Wholesale	182,987	177,851	189,377	1,052,205	1,263,144
Total:	28,865,030	27,875,253	30,596,320	29,283,851	30,682,171

*(CCF equals 100 cubic feet)

WATER FACTS

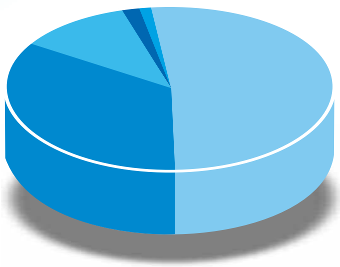
	2005/06	2004/05	2003/04	2002/03	2001/02
Average annual CCF per residential customer	312	308	342	324	343
Average price ($/CCF) per residential customer	$ 1.26	$ 1.16	$ 1.05	$ 1.01	$ .97
Debt service coverage ratio	5.11	2.85	3.52	2.60	3.89
Employees[1]	137	130	130	125	123

[1]Approved positions

Key Historical Operating Data

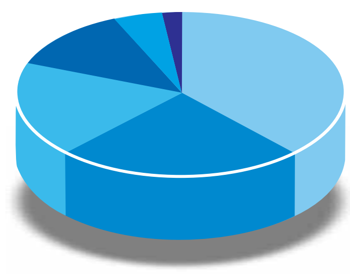
2005/06 WATER REVENUE AND RESOURCES

Source of Revenue



- Other Revenues (50¢)
- Residential Sales (31¢)
- Commercial (15¢)
- Other Sales (2¢)
- Investment Income (2¢)

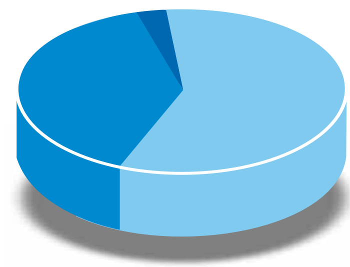
Distribution of Revenue



- Operation & Maintenance (35¢)
- Additional Reserves (30¢)
- Additions & Replacements to the System (17¢)
- Debt Service (11¢)
- Transfers to the City's general fund* (5¢)
- Water Supply (2¢)

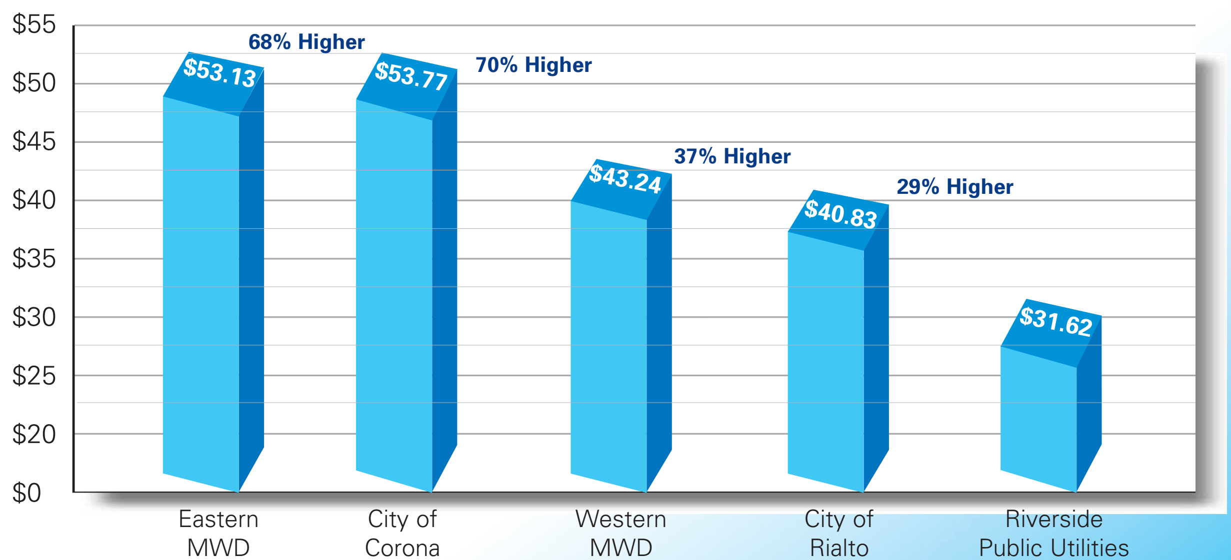
*Based on transfer of 11.5 percent of fiscal year 2004/05 revenues (excludes special item).

Water Resources



- San Bernardino Basin Wells (62%)
- Riverside Basin Wells (34.6%)
- Purchased Water (3.4%)

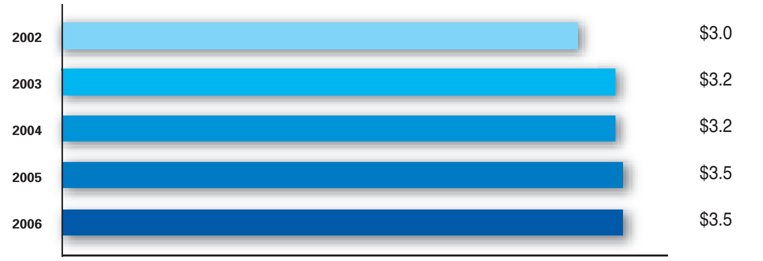
Residential Water Rate Comparison
Monthly Usage of 27 CCF



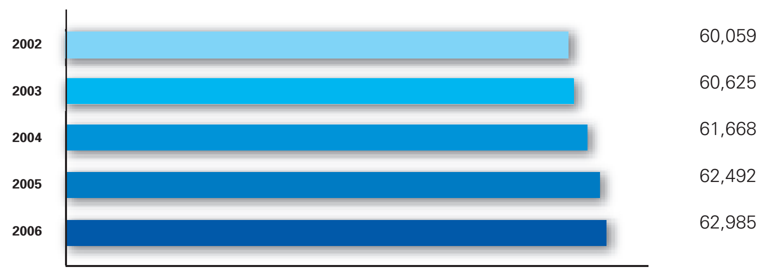
RATE COMPARISONS AS OF JUNE 1, 2006

Key Historical Operating Data

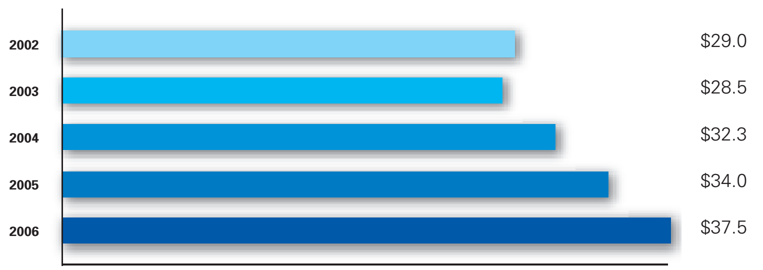
General Fund Transfer (in millions)



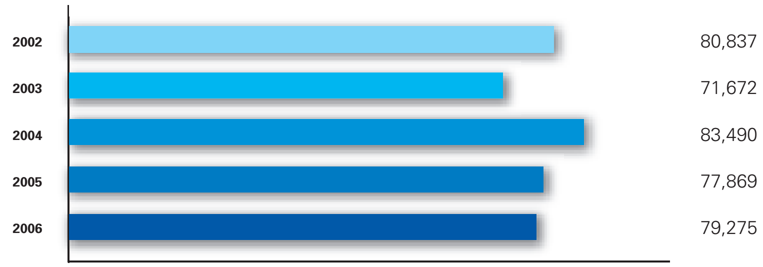
Number of Meters at Year End



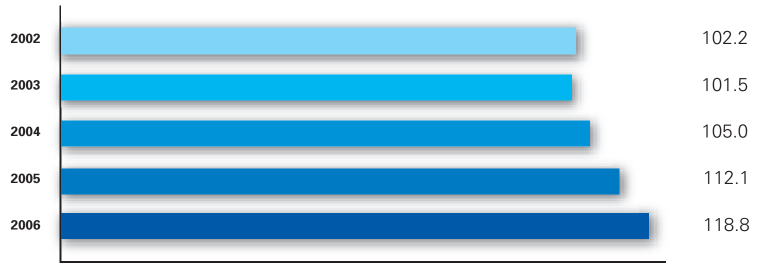
Total Operating Revenue (in millions)



Production (in acre feet)



Peak Day Demand (in million gallons)



Water Facts and System Data

Established:	1913
Service Area Population:	287,800
Service Area Size (square miles):	76.4
System Data:	
Smallest pipeline:	2.0"
Largest pipeline:	72.0"
Miles of pipeline:	967
Number of domestic wells:	51
Number of active reservoirs:	16
Total reservoir capacity (gallons):	100,400,000
Number of treatment plants:	10
Number of treatment vessels:	80
Miles of canal:	14
Number of fire hydrants:	7,127
Daily average production (gallons):	67,840,167
2005-06 Peak day (gallons):	118,782,000
8/9/05, 99 degrees	
Historical peak (gallons):	118,782,000
8/9/05, 99 degrees	

Bond Ratings

FITCH, INC.	AA
STANDARD & POOR'S	AA

WATER