State of California

California Natural Resources Agency

CONFIDENTIAL – ATTORNEY CLIENT PRIVILEGE

Memorandum

Date: July 8, 2014

To: 1. Carl A. Torgersen
2. Laura King Moon
3. Mark W. Cowin

Cathy Crothers, Chief Counsel CC 7-8-14
Perla Netto-Brown, Chief, Division of Fiscal Services PNB 7/11/14
Robert Cooke, Chief, State Water Project Analysis Office RC 7/8/14

From: **Department of Water Resources**

Subject: Agreement in Principle for Water Supply Contract Extension

Attached for the signature of the Director is the "Agreement in Principle Concerning Extension of the State Water Project Water Supply Contracts." This memo contains a summary of the Agreement in Principle (AIP) and makes a recommendation to the Director to sign the AIP.

Status of AIP:

On June 18, 2014, the negotiators for DWR and the Contractors reached an Agreement in Principle (AIP) on an extension of the long term Water Supply Contracts through the year 2085. The AIP was reached after 23 negotiating sessions, the first of which was held in May 2013. In attendance or on the conference line at various times during the public negotiating sessions were representatives of environmental organizations, the Legislature, other water agencies and the news media. It is anticipated that all but three of the Contractors (discussed later in the memo), through their representatives, will sign the AIP to indicate their concurrence with the AIP and interest in moving forward with the next steps.

Next Steps:

The next steps will entail the preparation of an Environmental Impact Report under the California Environmental Quality Act (CEQA) and the concurrent drafting of contract amendment language. The AIP will be used during the environmental review process to define the project. The AIP will also be used as the basis for drafting the contract amendment language. However, DWR and each Contractor will retain their full discretion under CEQA to consider and adopt mitigation measures and alternatives to the contract extension project, including seeking changes to the contract extension principles and language or not going forward with the contract extension at all.

Legislative Hearing:

DWR is required to make a presentation to the Legislature at an informational hearing concerning the proposed Water Supply Contract extension at least 60 days prior to final approval of such extension. (Water Code Section 147.5, added in June 2012)

Term:

The current Contracts each have a term of 75 years, but since they were signed at various times, they also have various termination dates that range between 2035 and 2042. This amendment would set the termination date for each extended contract to December 31, 2085.

Major Billing Change:

In the early years of the Contracts (in the 1960's), the Contractors were billed for costs while the initial facilities were being built and before water was able to be delivered. To address this situation, the current contract billing provisions have provided for amortizing capital costs (other than certain costs financed by revenue bonds) and conservation facility operations costs over a relatively long repayment period ending in the year 2035, and all such amortized costs are repaid with interest at the project interest rate.

The AIP establishes a date (referred to as the freeze-go date) and provides for the current contract billing methodology (which includes amortization of costs and the Water System Revenue Bond Surcharge) to continue to apply to all costs incurred prior to the freeze-go date and for a new pay-as-you-go billing methodology to apply to all costs incurred on and after the freeze-go date. The actual freeze-go date will depend on when the contract amendment is able to take effect. This effective date will in turn depend on a yet to be specified number of Contractors signing the amendment and all litigation challenging the amendment being resolved.

Moving to a pay-as-you-go billing system will result in a better real time match of revenues and expenditures and will ultimately make administration of the billing process less complicated. The AIP contains a number of items addressing the manner in which the new pay-as-you-go methodology will be implemented and administered.

Reserves-General Operating Account (GOA)

The Monterey Amendment established the current General Operating Account and set a cap that is currently approximately $32 million. This amendment would increase the cap to at least $150 million with a provision to provide for cap adjustments in the future based on a business case analysis presented to the Director.

The purpose of the GOA is to provide a fund to be used for (1) cash flow deficiencies relating to water supply activities for which DWR can charge the Contractors and (2) a State Water Resources Development System (SWRDS) emergency for any SWRDS purpose (whether or not the activity is chargeable to the Contractors). The AIP specifies the funding sources to be used to fund and replenish the GOA. These include available 51(e) revenues, which are revenues available in any year after providing full rate management reductions to the Contractors, and transfers from the SWRDS Reinvestment Account (see following paragraph).

SWRDS Reinvestment Account (SRA):

The AIP provides for the establishment of the SRA, the primary purpose of which is to provide a post-2035 SWRDS revenue stream. The revenue stream will be generated by investing funds from the SRA in facilities and programs for which DWR can charge the Contractors and recovering these costs with interest consistent with the prevailing bond interest rate. It is expected that these investments will be made in lieu of the issuance of revenue bonds. The proceeds of these investments will be available to provide a source of funds to the SWRDS Support Account (discussed below), to be held in the SRA for additional investment purposes, and to provide a funding source for cap adjustments to the GOA.

The SWRDS Finance Committee (discussed below) is to be consulted about the investments and activities to be funded from the SRA. DWR will prepare regular reports for the Director, which reports will be provided to the Finance Committee.

SWRDS Support Account (SSA):

The AIP provides for the establishment of the SSA, the primary purpose of which is to provide a source of funds to pay for non-chargeable expenditures where there are no funds or revenue sources available to pay for such costs. (Examples might include funding of the San Joaquin Valley Drainage Program or funding of recreation and fish and wildlife enhancement expenditures which exceed available Davis-Dolwig appropriations). Funding of the SSA may come from 51(e) revenues, transfers from the SRA, and several other sources.

The SWRDS Finance Committee (discussed below) is to be consulted about the projects and activities to be funded from the SSA. DWR will prepare regular reports on the SSA for the Director, which will be provided to the Finance Committee.

State Water Facilities Capital Account (FCA):

There currently exists an FCA that was established by the Monterey Amendment and receives $4.5 million annually before rate management reductions are made. The account is used for capital expenditures for which bonds cannot be sold, such as repayment of the loan from the Pooled Money Investment Account or Davis-Dolwig

capital expenditures. The AIP provides for a SWRDS Finance Committee evaluation five years from the date of the amendment to recommend to the Director whether the Director, in his or her discretion, should close the FCA and transfer the balance of the account to the SSA.

Flow of Funds:

The annual rate reductions provided in the Monterey Amendment of $40.5 million will be increased to $48 million, but only if available revenues permit such reductions. The annual rate reductions shall no longer apply after December 31, 2035 and many of the other Monterey Amendment financial provisions will also be deleted as of that date.

The AIP specifies that any funds in excess of the $48 million rate reductions shall be deposited in certain accounts as the Director, in his or her discretion, determines. The Contractors agree to forego additional rate management reductions including additional rate management reductions to make up for deficiencies in past projected rate management reductions or to provide any additional rate management reductions above $48 million annually.

The Contractors have also agreed to waive and release issues related to DWR's recent adjustment of the Contractor's responsibility for facilities south of Dos Amigos Pumping Plant, which was made as part of the effort to obtain the recent Davis-Dolwig annual appropriation.

Financial Management:

DWR will establish a joint DWR and Contractor SWRDS Finance Committee (Committee). The Committee's primary purpose will be to make recommendations to the Director concerning the financial policies of SWRDS. During the AIP negotiations, DWR and the Contractors also developed and agreed to a Committee Charter that will govern the Committee once the contract amendment takes effect. The Charter provides that the Committee will include five representatives each from DWR and the Contractors. The Charter also provides, among other things, that DWR will, consistent with State personnel rules, establish a new position of Chief Financial Manager. The Charter is a separate agreement referenced in the AIP and will be signed concurrently with the contract amendment. A copy of the Draft Final Charter is attached.

Supplemental Billing:

The current contract supplemental billing provisions shall remain in effect through December 31, 2035, unless the Director determines to eliminate the provisions sooner. However, the provisions are being amended to provide additional cash flow and consultation conditions before DWR may issue a supplemental bill.

Cost Recovery:

The AIP provides that if DWR proposes to charge any Contractor less than the full amount that DWR is entitled to charge that Contractor, DWR shall first present a proposal to the Finance Committee to give the Committee an opportunity to submit a recommendation to the Director before DWR implements such a proposal.

Reporting:

The AIP requires DWR to prepare certain annual and quarterly revenue and activity reports. The AIP also specifies in detail the funds and activities that will be the subject of the reports.

A list of principles to be applied when DWR prepares reports required by the contract amendment or by the Finance Committee Charter is contained in the AIP and will be attached as an exhibit to the contract amendment.

Replacement Accounting System (RAS):

The AIP provides for the elimination of the RAS with the intent to have all replacement costs treated as minimum or capital costs under the contract. All unencumbered funds in the RAS Account, currently totaling about $30 million, will be returned to the Contractors.

Facilities to be Financed by Water System Revenue Bonds:

The AIP expands the list of water system facilities that may be financed by water system revenue bonds and provides a flexible mechanism (requiring the agreement of only 80 percent of the affected Contractors) to add additional facilities to the list.

Davis-Dolwig Language:

The Contractors requested during the AIP negotiations and DWR ultimately agreed to include verbatim language from the Davis-Dolwig Act regarding the prohibition on including recreation and fish and wildlife enhancement costs in bills to the Contractors. Language (not from the Davis-Dolwig Act) is also included that states that in administering the contract, the term "development of public recreation" shall include recreation capital and operation and maintenance.

BDCP and DHCCP Participation:

Butte County and Plumas County Flood Control and Water Conservation District had requested that language be included in this contract extension amendment providing for an opt-in/ opt-out option for Contractor participation in the BDCP and DHCCP. DWR expressed the view that this subject would be better addressed in a separate

negotiation for a BDCP/ DHCCP amendment. As a result, language is included in the AIP stating that this item will not be part of the contract extension amendment, but instead will be addressed in the BDCP/DHCCP contract amendment public negotiations which are scheduled to begin in December 2014. However, Butte and Plumas have indicated that this is not sufficient and have indicated that they will not be signing the AIP until they are satisfied that this item has been adequately addressed in the separate process.

Santa Barbara County Flood Control and Water Conservation District (Santa Barbara):

Santa Barbara authorized the Central Coast Water Authority (CCWA) to participate on Santa Barbara's behalf in the negotiations for the contract extension, but Santa Barbara retained its authority to sign the AIP and the contract amendment. CCWA has informed DWR and the other Contractors that the AIP will not be presented to the Santa Barbara County Supervisors (who serve as the Board of Directors for the County Flood Control and Water Conservation District) at this time and therefore will not be signed at this time.

Recommended Action:

It is recommended that the Director sign the attached AIP for the extension of the Water Supply Contracts to December 31, 2085.

APPROVAL RECOMMENDED:

Carl A. Torgersen
Deputy Director

Date 7/15/14

APPROVED:

for Mark W. Cowin
Director

Date 7.29.14

APPROVAL RECOMMENDED:

Laura King Moon
Chief Deputy Director

Date 7.21.14

As of March 13, 2015, the Department of Water Resources and the following State Water Project Contractors have signed the Agreement in Principle for the Contract Extension Project.

Alameda County Flood Control and Water Conservation District, Zone 7
Alameda County Water District
Antelope Valley-East Kern Water Agency
Castaic Lake Water Agency
City of Yuba City
Coachella Valley Water District
County of Kings
Crestline-Lake Arrowhead Water Agency
Desert Water Agency
Dudley Ridge Water District
Empire West Side Irrigation District
Kern County Water Agency
Littlerock Creek Irrigation District
The Metropolitan Water District of Southern California
Mojave Water Agency
Napa County Flood Control and Water Conservation District
Oak Flat Water District
Palmdale Water District
San Bernardino Valley Municipal Water District
San Gabriel Valley Municipal Water Agency
San Gorgonio Pass Water Agency
Santa Clara Valley Water District
Solano County Water Agency
Tulare Lake Basin Water Storage District
Ventura County Watershed Protection District

DATE: June 18, 2014

SUBJECT: Agreement in Principle Concerning Extension of the State Water Project[1] Water Supply Contracts

This document contains a statement of principles that could provide the foundation for an agreement between each State Water Project Contractor[2] (Contractor) and the Department of Water Resources (DWR or Department) that will extend and otherwise amend the Water Supply Contract between such Contractor and DWR.

Outline of Agreement in Principle

I.	Objective 1	Term of Contract
II.	Objective 2A	Reserves
III.	Objective 2B	Accounts (SRA, SSA, FCA)
IV.	Objective 2C	Flow of Funds
V.	Objective 2D	Financial Management
VI.	Objective 2E	Supplemental Billing
VII.	Objective 2F	Cost Recovery
VIII.	Objective 2G	SWRDS Reporting Principles
IX.	Objective 2H	51(e) Revenue Reporting Requirements
X.	Objective 3A	Simplification of Billing
XI.	Objective 3B	Replacement Accounting System
XII.	Objective 3C	Article 1(hh)
XIII.	Objective 3D	Billing Authorization
XIV.	Objective 4	BDCP and DHCCP Participation
XV.	Provision 1	Other Contract Provisions
XVI.	Provision 2	Environmental Review Process
XVII.	Provision 3	Authorized Representative Signatures

[1] The State Water Project is the name commonly used to refer to the State Water Resources Development System (Water Code Section 12931)

[2] The State Water Project Contractors includes Alameda County Flood Control and Water Conservation District (Zone 7), Alameda County Water District, Antelope Valley-East Kern Water Agency, Castaic Lake Water Agency, City of Yuba City, Coachella Valley Water District, County of Butte, County of Kings, Crestline-Lake Arrowhead Water Agency, Desert Water Agency, Dudley Ridge Water District, Empire West Side Irrigation District, Kern County Water Agency, Littlerock Creek Irrigation District, The Metropolitan Water District of Southern California, Mojave Water Agency, Napa County Flood Control and Water Conservation District, Oak Flat Water District, Palmdale Water District, Plumas County Flood Control and Water Conservation District, San Bernardino Valley Municipal Water District, San Gabriel Valley Municipal Water District, San Gorgonio Pass Water Agency, San Luis Obispo County Flood Control and Water Conservation District, Santa Barbara County Flood Control and Water Conservation District, Santa Clara Valley Water District, Solano County Water Agency, Tulare Lake Basin Water Storage District, and Ventura County Flood Control District.

STATEMENT OF PRINCIPLES

I. OBJECTIVE 1: TERM OF CONTRACT

A. Water Supply Contract Term Extension

1. Extend term of the SWP water supply contracts to December 31, 2085.

II. OBJECTIVE 2A: RESERVES

A. General Operating Account (GOA)

1. **Uses of GOA** - Cash flow deficiencies resulting from chargeable water supply purposes and/or during a SWRDS emergency for any SWRDS purpose.

2. **SWRDS Emergency** - An immediate, urgent, critical, unexpected, or impending situation that, in the judgment of the Director, Department of Water Resources (Director), may cause or pose a risk of causing injury, loss of life, damage to the property, impairment of the financial condition, and/or interference with the normal activities of the State Water Resources Development System which requires immediate attention and remedial action.

3. **Initial Cap** - Increase the authorized General Operating Account (GOA) initial cap to $150 million in Article 51(a)(3).

4. **Cap Adjustment Determination** - Every five years subsequent to the year of the initial cap increase, there shall be a business case analysis on the GOA authorized cap including an evaluation of the cap and business risks associated with SWRDS cash flow provided to the SWRDS Finance Committee for recommendation to the Director regarding a GOA cap adjustment. If there is a decrease in the cap (but the cap shall not be lower than $150 million), the excess funds would be transferred to the SWRDS Reinvestment Account (SRA).

5. **Cap Adjustment Funding Source (Pre-2035)** - Shall be the Director's discretion to use 51(e) revenues[3], investment earnings retained in the GOA, and transfers of funds from the SRA and SWRDS Support Account (SSA).

6. **Cap Adjustment Funding Source (Post-2035)** - Shall be the Director's discretion to use the investment earnings retained in GOA and the funds within the SRA and SSA.

7. **Rate of Funding for Cap** - Limitation on the amount ($2 million per year) and timing of additional contributions to the GOA contained in Article 51(e)(3)(v) will be deleted. DWR will be able to use any amount of available 51(e) revenues to increase funds in the GOA up to the authorized maximum GOA funding level and such funding shall be subordinate to the annual rate management reductions to the Contractors.

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[3] The definition and calculation of 51(e) revenues will be included in the contract amendment language.

8. **GOA Replenishment** - Replenishment of the use of GOA funds will come from charges to the Contractors to the extent the expended funds were spent on chargeable water supply purposes and from the SSA or other available revenues for costs not chargeable to the Contractors.

9. **GOA Reporting** - DWR will prepare monthly reports on the balance and use of the GOA for the Director, which will be provided to the SWRDS Finance Committee. The SWRDS Finance Committee will periodically review reporting frequency and make recommendations to the Director regarding reporting frequency.

10. **GOA Investment Earnings** - shall be used as follows:

    a) Funding GOA to authorized GOA funding level;

    b) Transferred, at the discretion of the Director, to the SSA and/or to the SRA.

III. OBJECTIVE 2B: ACCOUNTS (SRA, SSA, FCA)

A. SWRDS Reinvestment Account (SRA)

1. **Effective Date of SRA** - The SRA shall be established and take effect upon the effective date of the contract extension amendment.

2. **SRA Uses** - The primary purpose is to provide a post-2035 SWRDS revenue stream by investing SRA funds in chargeable SWRDS facilities and programs.

3. **Funding Source** - At the discretion of the Director, available Article 51(e)(1)(ii) revenues collected by the State pre-2035. The Director also has discretion to transfer funds from the SSA or the GOA.

4. **Cap on SRA** - There will be no Cap or Cap Adjustments to the SRA.

5. **SRA Investments** - At the discretion of the Director, authorized SRA investments shall be as follows:

    a) Investment in SWRDS capital facilities, recovered at the prevailing municipal bond market rates corresponding to the SWRDS bond rating at the time of financing, in maturity ranges that may extend 10 to 50 years, provided that if the capital asset being financed has a useful life of less than 10 years, the investment may be recovered over a comparable period of less than 10 years;

    b) Bridge financing of capital costs in lieu of the SWRDS commercial paper program; and

c) Allowable investments for SWRDS that generate a monetary return on investment.

6. **Use of SRA Funds** - At the discretion of the Director, the SRA funds, including but not limited to investment earnings, shall be used to:

   a) Provide a source of replenishment funds to the SSA;

   b) Provide a source of funds to be held in the SRA for investment purposes; and

   c) Provide a funding source for funding level adjustments to the GOA.

7. **SRA Review** - The SWRDS Finance Committee is to be consulted about the investments and activities to be funded from the SRA.

8. **SRA Reporting** - DWR will prepare regular reports on the SRA for the Director, which reports will be provided to the SWRDS Finance Committee.

B. SWRDS Support Account (SSA)

1. **Effective Date of SSA** - The SSA shall be established and take effect upon the effective date of the contract extension amendment.

2. **SSA Uses** - The purpose of the SSA shall be to provide a source of funds to pay for non-chargeable expenditures where there are no funds or revenue sources available to pay for such costs. If reimbursement or a source of revenue is received after the expenditure is incurred this revenue shall be deposited in the SSA.

3. **SSA Review** - The SWRDS Finance Committee shall be consulted about the projects and activities to be funded from the SSA.

4. **SSA Reporting** - DWR will prepare regular reports on the SSA for the Director, which will be provided to the SWRDS Finance Committee.

5. **Initial Cap** - There would be no cap on the SSA.

6. **Funding Source for Initial Funding** - 51(e) revenues and/or the remaining balance of the State Water Facilities Capital Account (FCA) once the FCA is closed.

7. **SSA Replenishment** - Shall be accomplished through 1) reimbursements received for expenditures made from the SSA; 2) at the discretion of the Director, transfers from the SRA and/or from the GOA's available investment earnings, 3) deposits, in the discretion of the Director, from other available revenues, and 4) interest and other investment income retained in the SSA. DWR will not charge the Contractors to replenish the SSA for costs not chargeable to the Contractors under the Water Supply Contracts.

8. **SSA Interest Earnings** – At the Director's discretion, retained in the SSA to reduce the annual SRA replenishment requirement.

C. State Water Facilities Capital Account (FCA)

1. The State Water Facilities Capital Account (FCA) pursuant to Article 51(c)(2)(v) shall be reviewed by the SWRDS Finance Committee after five years from the date of the contract amendment to recommend to the Director whether or not it should be closed and the balance of the account transferred to the SSA.

IV. OBJECTIVE 2C: FLOW OF FUNDS

A. Maintain the Monterey Amendment Article 51 Flow of Funds with the following edits/additions:

1. Increase Annual Rate Reductions to $48 million. The Annual Rate Reductions shall no longer apply after December 31, 2035 and the applicable provisions in Article 51 shall be deleted as of that date.

2. After the $48 million in annual rate reductions, the Director shall have the discretion to allocate and transfer up to 80% of available 51(e) revenues, as determined on a projected basis, and up to 100% on an actual basis into one or more of the following accounts:

   a) General Operating Account (GOA)

   b) SWRDS Support Account (SSA)

   c) SWRDS Reinvestment Account (SRA)

   After funds are deposited into a, b, and c above, any remaining available 51(e) revenues will remain in the Systems Revenue Account and will be tracked separately in DWR's Enterprise Resource Planning (ERP) system. The Director will have full discretion over the use of these funds. DWR will prepare financial reports annually with supporting documentation of the determination and provide these reports to the Finance Committee.

3. Contractors shall agree to forego additional rate management reductions including additional rate management reductions to make up for deficiencies in past projected rate management reductions or to provide any additional rate management reductions above $48 million annually pursuant to Article 51(e)(3). Effective with the contract amendment, Article 51(e)(3) shall be deleted.

4. The contract amendment shall specify those provisions in Article 51 that shall remain in effect after December 31, 2035 (such as the General Operating Account provision as it may be amended) and those provisions that will no longer apply after December 31, 2035 and shall be deleted as of that date.

5. Contractors shall agree to waive and release issues related to DWR's recent adjustment of the Contractors' responsibility for facilities south of Dos Amigos.

V. OBJECTIVE 2D: FINANCIAL MANAGEMENT

A. State Water Resources Development System Finance Committee

1. Immediately, the Department of Water Resources shall establish a joint Department of Water Resources and Contractor finance committee (Committee).

2. The membership of the Committee shall include both representatives from the Department of Water Resources and representatives from the Contractors.

3. The primary purpose of the Committee shall be to make recommendations to the Director of the Department of Water Resources concerning the financial policies of the State Water Resources Development System.

4. The Department of Water Resources and the Contractors shall describe the scope of the committee in a charter mutually agreeable to the Department of Water Resources and the Contractors.

VI. OBJECTIVE 2E: SUPPLEMENTAL BILLING

A. Supplemental Billing

1. The supplemental billing provisions authorized under Article 51(c)(4) shall remain in effect through December 31, 2035, unless the Director determines in his or her discretion to eliminate the use of supplemental billing prior to that date or upon Director's acceptance of a recommendation from the SWRDS Finance Committee. In full consultation with the SWRDS Finance Committee, DWR will review the System cash balances when the System's forecasted 120 days cash balance becomes critical. The Committee will make a recommendation for action to the Director. The supplemental billing provision may only be used when available System cash balances are projected to be less than an amount equal to 90 days operating expenditures[4]. The term "available System cash balances" shall mean the funds in the following California Water Resources Development Bond Fund accounts: System Revenue Account (to the extent the funds in the System Revenue Account are not projected to be needed for payment of Burns-Porter General Obligation Bond debt service for the next two years), GOA, SRA and SSA (to the extent the funds in the SSA are not projected to be needed for non-chargeable expenditures for the next two years).

[4] A description of "operating expenditures" will be included in the contract amendment language.

VII. OBJECTIVE 2F: COST RECOVERY

A. Cost Recovery

1. In general, DWR should seek reimbursement for all SWRDS costs from the appropriate customers and users of SWRDS facilities, including the State. With respect to those SWRDS costs that are reimbursable by the Contractors, DWR should allocate financial responsibility for such costs in a manner that is both lawful and equitable, and which endeavors to recover such costs from the appropriate Contractors. If the Department proposes to not charge any Contractor the full amount that the Department is entitled to charge the Contractor under the contract, DWR shall bring a written proposal to the Finance Committee for purposes of developing a recommendation to the Director regarding the proposal. DWR shall submit such proposal in writing to the Finance Committee 90 days in advance of the Director issuing any decision and within such 90 day period the Finance Committee shall provide the Director with a recommendation regarding such proposal. Such proposals will comply with the structure set out in II.D.2 of the SWRDS Finance Committee Charter.

VIII. OBJECTIVE 2G: SWRDS REPORTING PRINCIPLES [EXHIBIT TO THE CONTRACT]

A. During the term of the water supply contracts, it is likely that financial reports and financial management reports will change in scope, nature, and frequency. Regardless of the exact reports used, such reports shall follow the below principles and guidelines to the extent applicable.

1. Principle 1: Financial reporting will be generated from the general ledger or data warehouse of the financial information system (system of record), such as SAP.

   - The financial system of record is the authoritative source for financial reporting data values in a system. To ensure data integrity, there must be one, and only one, system of record for financial reporting values.

2. Principle 2: Financial reporting is not limited to annual financial statements but will be developed for regular reporting periods.

3. Principle 3: Financial management reporting generated from other financial systems, such as Utility Cost Accounting Billing System (UCABS), will identify and analyze significant variances from prior years or budgets.

4. Principle 4: Financial reporting and financial management reporting will identify unusual items and exceptions, and these items will be documented, reviewed, and resolved by management.

5. Principle 5: DWR will use standardized System-wide business rules and utilize a centralized financial system, such as SAP, UCABS, or other system, to provide controls/validations to ensure data integrity and reliable reporting.

6. Principle 6: DWR will use standardized data integrity rules in the development and publication of reports, including but not limited to the following:

   (1) Data integrity refers to the accuracy and consistency of data stored in a database, data warehouse, data mart or other construct.
   (2) Data integrity processes verify that data has remained unaltered in transit from creation to reception or remains unaltered in transit from one system to the next.
      a. Data used outside of the Enterprise Resource Planning (ERP) systems to meet the reporting needs of Program will undergo any number of operations in support of decision-making, such as capture, storage, retrieval, update and transfer. It is important to have confidence that during these operations, the data will be kept free from corruption, modification and remain unaltered.
   (3) Data with "integrity" has a complete or whole structure. Data values are standardized according to a data model and/or data type. All characteristics of the data must be correct – including business rules, relations, dates, definitions and lineage – for data to be complete.
   (4) Data integrity is imposed within an ERP database when it is created and is authenticated through the ongoing use of error checking and validation routines.
   (5) Data integrity state or condition is to be measured by the validity and reliability of the data values.
   (6) Data integrity service and security maintains information exactly as it was input, and is auditable to affirm its reliability.

The SWRDS Finance Committee is charged with providing financial policy recommendations to the Director, and the Director has final discretion on whether or not to accept the recommendations. While the SWRDS Finance Committee is not charged with reviewing the content of financial reports, timely and accurate financial reporting and financial management reporting provides technical committees access to useful information that can be used to formulate proposals on financial policy matters that may be brought to the SWRDS Finance Committee.

IX. OBJECTIVE 2H: 51(e) REVENUE REPORTING REQUIREMENTS

A. 51(e) Revenue Report

1. Create and distribute the Annual Rate Reduction Determination Report. In addition, display the distribution of Gross Annual Revenues before Recreation, Fish and Wildlife

Expenditures, Facilities Capital Account and Rate Management Credits and Net Annual Revenues after Rate Management Credits to the accounts listed in item 2 below.

2. Create and distribute quarterly an Activity Report by fund-account for all uses, including but not limited to the following accounts:
   a) General Operating Account (GOA)
   b) SWRDS Support Account (SSA)
   c) SWRDS Reinvestment Account (SRA)
   d) Systems Revenue Account, 51(e) Sub-Account
   e) Davis-Dolwig Fund
   f) Facilities Capital Account
   g) Suspended Costs

3. The Activity Report shall display the annual and accumulated 51(e) revenue and expenditure activity, including the beginning balance, the annual activity and the ending balance for the year.

4. Reporting data shall be auditable which includes an audit trail from the costing ledgers to the general ledger or the Bulletin 132 estimates to the Activity Report.

5. Report should have sufficient detail to provide comprehensive accounting of annual 51(e) revenues and the uses the of annual 51(e) revenues to enable the SWRDS Finance Committee to assess the utilization of these revenues.

X. OBJECTIVE 3A: SIMPLIFICATION OF BILLING

A. Implement the Freeze-Go Billing Methodology

1. The freeze-go date shall be January 1 of the first calendar year starting six (6) months after the contract extension takes effect, but not earlier than January 1, 2017, provided that if the Department determines it to be necessary, the Department may rely on estimates and later true-up for billing and reporting purposes in the initial implementation years after the freeze go date.

2. Methodology will recover all costs incurred on and after the freeze-go date, by converting and authorizing repayment on a Pay-As-You-Go methodology.

3. Amend the definition of the Project Repayment Period to apply only to those costs incurred prior to the freeze-go date.

4. The term of the Project Repayment Period, January 1, 1961 through December 31, 2035, will remain the same.

5. The Water Systems Revenue Bond Surcharge will apply only to those costs incurred prior to the freeze-go date and will terminate at the completion of the Project Repayment Period.

6. Amend the definition of the Project Interest Rate to apply only to those costs incurred prior to the freeze-go date. No interest rate, including the Project Interest Rate, shall be applied to the over/under charges for costs incurred after the freeze-go date. The Project Interest Rate will remain 4.610%.

7. In identifying "costs incurred" for purposes of determining whether the cost is incurred before the freeze-go date or on or after the freeze-go date, the following shall apply:

   a) Variable costs shall be deemed to occur when the goods or service is provided, regardless of when the expenditure for such goods or service is recorded in the financial information system;

   b) Capital and minimum costs shall be deemed to occur when the expenditure for the goods or service is recorded in the financial information system, regardless of the date the goods or service is provided.

B. Defining the Pay-As-You-Go Repayment of Costs Incurred On and After the Freeze-Go Date

1. The annual cost recovery within a bill year for estimated annual operation, maintenance, power, and replacement costs for project conservation facilities.

2. The annual recovery of actual debt service, including repayment of the SRA, created by SWRDS financing activities, within a bill year for financed capital transportation and conservation facilities.

3. A capital asset which has a short useful life and/or will not have a substantial cost, may be charged to the Contractors in the year the cost is incurred. The SWRDS Finance Committee may review and make recommendations to the Director regarding the policy of charging the costs of such assets.

C. Defining the Pay-As-You-Go Repayment of Actual Debt Service from SWRDS Financing Capital Costs On and After the Freeze-Go Date

1. Authorize DWR to finance 100% of all capital costs.

2. Authorize DWR to use various methods of financing including Water System Revenue Bonds and SRA, with each method providing an annual repayment schedule which includes a principal and interest (debt service) component over the life of the financing.

3. Authorize DWR to bill an amount that is equal to the accumulated annual debt service payments due per the debt service schedules for SRA investments or matching dollar for dollar the SWRDS annual debt service payments including the bond cover requirements, providing 100% capital cost recovery at the financed interest rate over the term of the financing while meeting the additional bond debt cover requirements.

XI. OBJECTIVE 3B: REPLACEMENT ACCOUNTING SYSTEM (RAS)

A. Elimination of the Replacement Accounting System (RAS)

1. Eliminate the Replacement Accounting System (RAS) for Transportation and Conservation Facilities with the intent to have replacement costs treated as a minimum or capital cost.

2. The unencumbered cash balance of the RAS funds are to be returned to the SWP Contractors using the RAS allocation methodology.

XII. OBJECTIVE 3C: ARTICLE 1 (hh)

A. Expanding Water System Facilities Authorized to be Financed by Water System Revenue Bonds Under Article 1(hh)

1. Eliminate the January 1, 1987 date for existing facilities within Article 1(hh)(8); provision to now read as follows, " Finance all repairs, additions, and betterments to conservation or transportation facilities and to all other facilities described in this sub-article (hh) except for item (5) the land acquisition prior to December 31, 1995 for the Kern Fan Element of the Kern Water Bank."

2. Add provision to expand Article 1(hh) to include "Finance all other capital projects (i.e. projects and programs for which revenue bonds can be sold) mutually agreed upon in writing by DWR and 80% of the affected Contractors, provided that the approving Contractors' Table A amounts exceed 80% of the Table A amounts representing all affected Contractors". "Affected Contractors" means those Contractors which would be obligated to pay a share of the debt service for such project.

XIII. OBJECTIVE 3D: BILLING AUTHORIZATION

A. Billing Authorization

The Department, in fixing and establishing prices, rates, and charges for water and power, shall include as a reimbursable cost of any state water project an amount sufficient to repay all costs incurred by the department, directly or by contract with other agencies, for the preservation of fish and wildlife and determined to be allocable to the costs of the project works constructed for the development of that water and power, or either. Costs incurred for the enhancement of fish and wildlife or for the development of public recreation shall not be included in the prices, rates, and charges for water and power, and shall be nonreimbursable costs.

Such recreational purposes include, but are not limited to, those recreational pursuits generally associated with the out-of-doors, such as camping, picnicking, fishing, hunting, water contact sports, boating, and sightseeing, and the associated facilities of campgrounds, picnic areas,

water and sanitary facilities, parking areas, viewpoints, boat launching ramps, and any others necessary to make project land and water areas available for use by the public.

In administering this Contract "development of public recreation" shall include recreation capital and operation and maintenance.

XIV. OBJECTIVE 4: BDCP AND DHCCP PARTICIPATION

This Objective will not be part of the SWP contract amendment based on this AIP. Instead, Contractor participation in the BDCP and DHCCP will be addressed through a separate public negotiation and environmental review process to develop appropriate SWP water supply contract amendments. DWR has begun the administrative process that will be used to facilitate the public negotiations of such amendments. The first public negotiation session is scheduled for December 2014.

XV. PROVISION 1 – OTHER CONTRACT PROVISIONS

Except as amended, all provisions of the Water Supply Contract shall be and remain in full force and effect.

XVI. PROVISION 2 – ENVIRONMENTAL REVIEW PROCESS

DWR and the Contractors agree that this AIP is intended to be used during the environmental review process for the California Environmental Quality Act (CEQA), to define the proposed project description for the purposes of CEQA, and to permit the next steps of the water supply contract extension process, including scoping and the preparation of the EIR.

The AIP principles are not final contract language and do not represent a contractual commitment by either DWR or the Contractors to approve any proposed project, to sign contract amendments, or to extend the contract. By concurring with the AIP, DWR and the Contractors express their intent to move forward with the CEQA process with DWR as lead agency and the Contractors as responsible agencies, and ultimately develop a proposed project consisting of contractual amendments consistent with the AIP principles and prepare the EIR for consideration by DWR and the Contractors.

At the end of the CEQA process and in compliance with CEQA, DWR and the Contractors will each individually evaluate the EIR and contract amendments, exercise their independent judgment, and determine whether or not to certify the EIR, approve the proposed project and sign the contract amendments or to approve an alternative project. Consequently, even though DWR and the Contractors have agreed to the AIP for the purposes described in the preceding paragraphs, DWR and each Contractor retain their full discretion under CEQA to consider and adopt mitigation measures and alternatives, including the alternative of not going forward with the proposed project.

XVII. PROVISION 3 – AUTHORIZED REPRESENTATIVE SIGNATURES

DWR and each Contractor may express concurrence with this AIP by having their authorized representatives sign below. DWR and each Contractor will use their best efforts to make a decision whether to sign the AIP by September 1, 2014. The AIP may be signed in counterparts.

STATE OF CALIFORNIA
DEPARTMENT OF WATER RESOURCES

By: _____
Name: _____
Title: _____
Date: _____

ALAMEDA COUNTY FLOOD CONTROL AND WATER CONSERVATION DISTRICT, ZONE 7

By: _____
Name: _____
Title: _____
Date: _____

ALAMEDA COUNTY WATER DISTRICT

By: _____
Name: _____
Title: _____
Date: _____

ANTELOPE VALLEY – EASTERN KERN WATER AGENCY

By: _____
Name: _____
Title: _____
Date: _____

CASTAIC LAKE WATER AGENCY

By: _____
Name: _____
Title: _____
Date: _____

CITY OF YUBA CITY

By: _____
Name: _____
Title: _____
Date: _____

COACHELLA VALLEY WATER DISTRICT

By: _____
Name: _____
Title: _____
Date: _____

COUNTY OF BUTTE

By: _____
Name: _____
Title: _____
Date: _____

COUNTY OF KINGS

By: _____
Name: _____
Title: _____
Date: _____

CRESTLINE LAKE ARROWHEAD WATER AGENCY

By: _____
Name: _____
Title: _____
Date: _____

DESERT WATER AGENCY

By: _____
Name: _____
Title: _____
Date: _____

DUDLEY RIDGE WATER DISTRICT

By: _____
Name: _____
Title: _____
Date: _____

EMPIRE WESTSIDE IRRIGATION DISTRICT

By: _____
Name: _____
Title: _____
Date: _____

KERN COUNTY WATER AGENCY

By: _____
Name: _____
Title: _____
Date: _____

LITTLEROCK CREEK IRRIGATION DISTRICT

By: _____
Name: _____
Title: _____
Date: _____

MOJAVE WATER AGENCY

By: _____
Name: _____
Title: _____
Date: _____

THE METROPOLITAN WATER DISTRICT OF SOUTHERN CALIFORNIA

By: _____
Name: _____
Title: _____
Date: _____

NAPA COUNTY FLOOD CONTROL AND WATER CONSERVATION DISTRICT

By: _____
Name: _____
Title: _____
Date: _____

OAK FLAT WATER DISTRICT

By: _____
Name: _____
Title: _____
Date: _____

PALMDALE WATER DISTRICT

By: _____
Name: _____
Title: _____
Date: _____

PLUMAS COUNTY FLOOD CONTROL AND WATER CONSERVATION DISTRICT

By: _____
Name: _____
Title: _____
Date: _____

SAN BERNARDINO VALLEY MUNICIPAL WATER DISTRICT

By: _____
Name: _____
Title: _____
Date: _____

SAN GABRIEL VALLEY MUNICIPAL WATER DISTRICT

By: _____
Name: _____
Title: _____
Date: _____

SAN GORGONIO PASS WATER AGENCY

By: _____
Name: _____
Title: _____
Date: _____

SAN LUIS OBISPO COUNTY FLOOD CONTROL AND WATER CONSERVATION DISTRICT

By: _____
Name: _____
Title: _____
Date: _____

SANTA BARBARA COUNTY FLOOD CONTROL AND WATER CONSERVATION DISTRICT

By: _____
Name: _____
Title: _____
Date: _____

SANTA CLARA VALLEY WATER DISTRICT

By: _____
Name: _____
Title: _____
Date: _____

SOLANO COUNTY WATER AGENCY

By: _____
Name: _____
Title: _____
Date: _____

TULARE LAKE BASIN WATER STORAGE DISTRICT

By: _____
Name: _____
Title: _____
Date: _____

VENTURA COUNTY FLOOD CONTROL DISTRICT

By: _____
Name: _____
Title: _____
Date: _____