ANNUAL REPORT **08**

MODESTO IRRIGATION DISTRICT

THE BALANCE OF POWER

THE BALANCE OF POWER

At the Modesto Irrigation District (MID) we strive to maintain a balance of power in the services we provide and the customers we serve. We weigh the challenges of the water and electricity industries, generate balanced strategies and seek sound solutions. We do so in conjunction with balancing the diverse interests of our customers as well.

2008 was a busy year as we juggled large infrastructure projects, introduced new programs, continued advocating for fishery vitality and ramped up to meet aggressive timelines of new state and federal energy mandates.

We experienced our second consecutive critically dry year – affecting both the power and water sides of the house. MID countered with sound water management practices and communication and coordination with farmers to ensure an ample supply of water – a precious commodity – for our local farms. However, the dry year forced us to buy more power than planned, run our local power plants longer hours and in turn impacted our bottom line.

MID also continued with our long-standing commitment to research and efforts ensuring water quality and protecting our fisheries. We are determined to restore habitat balance for our native salmon populations.

On the electrical side, we completed the Westley-Rosemore Transmission Line. The 230 kilovolt transmission line brings up to 350 megawatts of power to us from throughout the western United States. It is also a conduit to green energy under development in other regions.

Also enhancing our electric system, MID got on board with smart grid technology and began installation of smart electric meters. These advanced new meters communicate with one another to send energy usage data right to the MID offices. The smart meters will also soon provide our customers the opportunity to closely monitor and make informed choices about their energy consumption.

To complement the new meters, we have empowered our customers to take control of their energy usage with the introduction of several new MID MPower energy efficiency programs and rebates. This year alone our customers saved more than 20 million kilowatthours and were awarded approximately $1.5 million in rebates.

MID is challenged with achieving aggressive state environmental mandates – obtaining more renewable energy and reducing greenhouse gases. While MID supports green energy, we continued to share our concerns with legislators regarding the impacts on reliability and costs to customers.

The fulcrum of MID's balance of power is treating every customer fairly and equally, operating efficiently and economically and delivering reliable water and power service at the best possible rates.

Allen Short

Allen Short, General Manager

TRANSMISSION & DISTRIBUTION

Poised for more power

The Westley-Rosemore Transmission Line – MID's new pathway to power – was completed in July. Years of planning combined with months of crews constructing the 110 steel towers and stringing more than one million feet of electrical conductor to form the 16-mile 230 kilovolt transmission line poised MID to import up to one-third more power.

Beginning at the Westley Switchyard near Westley and ending at MID's Rosemore Substation in west Modesto, the transmission line brings up to 350 megawatts of power to us from throughout California and the western United States. This flexibility not only improves reliability, it allows us to seek out the best power prices as well.

With the foresight for balancing our customers' energy demands and continuing to meet strict industry reliability standards, MID strategically designed the transmission line so that it one day can be augmented to increase its power importing capacity up to 700 megawatts. Also, in light of aggressive state renewable energy mandates, the Westley-Rosemore Transmission Line serves as a valuable conduit to green energy resources currently under development in Northern California and the Pacific Northwest.

A smart decision

July was a big month for MID. In addition to the completion of the Westley-Rosemore Transmission Line, the MID Board of Directors unanimously approved replacing all traditional electric meters with advanced digital smart meters.

Wireless wonder, digital data, read by remote, cellular communications – however you describe the smart meter's features, these new meters represent a giant technological leap. Smart meters transmit customers' electric usage data by radio to data collection points. From there the data is relayed via fiber-optic cable or secure cellular telephone network to MID's downtown Modesto office.

The smart meter technology allows for faster turning on and off of electric service, speedier repairs during power outages, fewer miles driven to read meters – resulting in cleaner air and lower gasoline expenses, and innovative energy-saving programs in the future. Smart meters also lead customers to smart energy decisions as they will soon have the ability to view their consumption from their own home and office computers.

Installation and testing of the first batch of smart meters took place at the end of the year with anticipation of a full deployment of all residential and commercial smart electric meters in the MID service area – about 100,000 total – to be complete by summer 2009. The state of California is expected to eventually mandate that all electric utilities install smart electric meters. MID is proud to be ahead of the curve.

MPowering energy efficiency

The new infrastructure projects of 2008 were complemented by the introduction of a multitude of new residential and commercial energy efficiency programs. Refrigerator recycling, new home and new commercial construction programs rounded out the list of growing programs.

Along with the new programs came a new brand – "Get MPowered with MID." Customers were encouraged to take control of their energy costs. From switching to compact fluorescent light bulbs or weather stripping windows and doors to replacing an air conditioner or installing a solar photovoltaic system, MID designed energy-saving plans to match any budget.

The energy-saving programs were a hit as MID processed approximately 3,300 rebate applications, paid customers over $1.5 million in rebates and helped customers reduce their energy use by more than 20 million kilowatthours over the course of the year.

Westley-Rosemore
sixteen-mile transmission line
two hundred and thirty kilovolts

ELECTRIC RESOURCES

Mother Nature likes to keep things in balance, and so does MID. MID learned the importance of balance when a severe drought in the late 1970s all but dried up the hydropower that was MID's only source of electricity at the time. Today MID diversifies our electric resources to cushion electric customers from price and supply shocks by generating some power at facilities we own and buying some power from other suppliers. MID avoids being dependent on any single fuel source, facility, geographic location, supplier or contract.

2008 was an important planning year as MID ventured down a path of considering new resources and searching for renewable energy to enhance our diverse power mix.

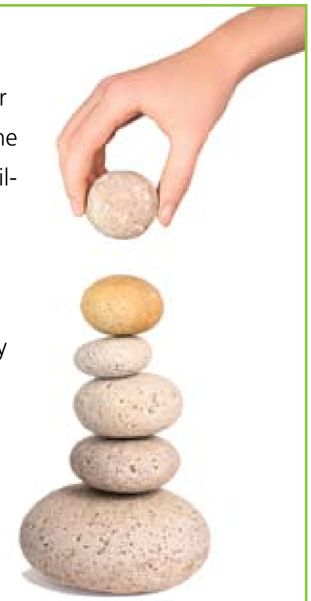
A new equilibrium

To meet part of our customers' increasing demand for peak power, MID shaped ideas for a reciprocating engine generation plant. The quick-starting generation provided by reciprocating engines will supply 49.6 megawatts of the estimated 70 megawatts of peaking power needed by 2011. The project's progression this year included approval of the purchase of six natural gas-fired engines.

Also contributing to the equilibrium of the MID power mix is participation in the Transmission Agency of Northern California's (TANC) transmission project. The proposed 600-mile system of high-voltage transmission lines and substations will increase California's electric system reliability and provide increased access to California-based renewable energy resources.

Ongoing strategic resource planning such as this tipped the scale in favor of continued reliable electric service for MID customers.

Balancing acts



Striking a balanced power mix can be a challenge with the push and pull of today's reliability regulations and legislative mandates.

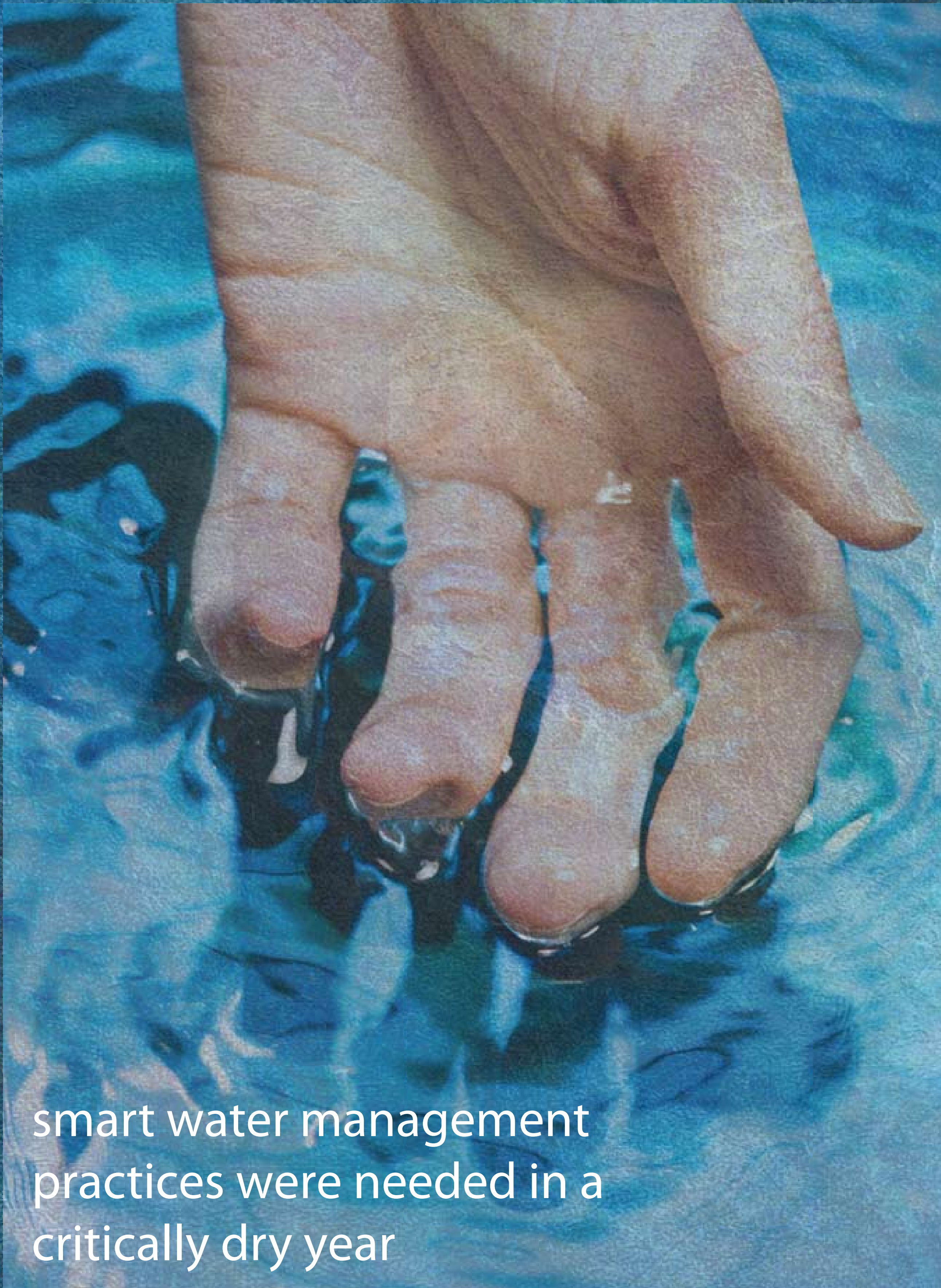
In 2008, California passed sweeping new laws – Assembly Bill 32 and Senate Bill 1368 – to address global warming. The state committed to reducing greenhouse gas emissions by 25 percent by the year 2020. All economic sectors, including every California utility, must comply by reducing their greenhouse gas emissions. For electric utilities like MID, a big part of reducing greenhouse gases is switching to renewable energy.

A few years ago MID set a goal to supply 20 percent of our customers' electricity from renewable sources by 2017. We are tracking well towards this goal as we reached more than 11 percent renewable energy in 2008. To carry this momentum, MID issued a request for offers for renewable power supplies in April. A wide range of proposals for solar, wind, biomass and methane digester projects resulted.

However, the chase for renewable energy intensified in November when Governor Schwarzenegger issued an executive order calling for increasing California's renewable energy sources to 33 percent in the next decade. This aggressive goal further drove up the demand for renewable energy. And as demand for the same limited renewable energy supplies rises, unfortunately, so do the costs.

MID continues to explore renewable energy opportunities while providing steady service at a reasonable cost to our customers.

smart meters put MID ahead of the curve with more accurate and faster data collection


smart water management practices were needed in a critically dry year

WATER

In California, water is a precious commodity. The state was challenged by its second consecutive critical dry year in 2008. MID countered the dry weather conditions with smart water management practices to maintain a robust water supply and continue reliable water service. Through communication, coordination and cooperation with farmers, we yielded a good balance of water for our community's thirsty farms.

Conjunctive use

Hard hats, orange cones and flying dirt were typical sights at the Modesto Regional Water Treatment Plant throughout 2008 as construction of the Phase Two expansion project continued. **The expansion will double the capacity of the plant allowing MID to provide two-thirds of the City of Modesto drinking water supply.** The project is on track for completion in the summer of 2009.

The plant, owned and operated by MID, ensures that City water customers will have a quality, reliable drinking water supply even in dry years. MID supplements the City's well system water supply with treated surface water from the Tuolumne River – a water management practice called conjunctive use. The reliance on groundwater from wells in dry years balanced with groundwater recharge in wetter years is much like a playground teeter-totter. MID and Modesto stay steady in the seat as we move fluidly with the ups and downs of the weather and jointly manage our water resources accordingly.

Restoring balance

Restoring balance to the myriad management initiatives of our native fisheries was a priority for MID this year. Predation by non-native species, commercial fishing, interference by Delta water exports, ocean conditions and river flows have all been blamed for the rapidly declining California native salmon populations. MID continued efforts to examine these factors and dedicated resources to researching the various factors – natural and man-made – affecting migrating salmon and their ecosystems.

For the past 12 years, MID has participated in the Vernalis Adaptive Management Plan (VAMP), sending more water down the Tuolumne River each spring to aid fish migration. Together with members of the San Joaquin River Group Authority and state and federal fishery agencies we have carefully monitored the effects of the increased river flows.

MID feels strongly that no matter how much water we send down the river, predation by non-native species bubbles to the top of the list of reasons why our salmon are nearing extinction. MID began discussion with legislators to entertain reining in predatory non-native species in Central Valley habitats such as the Delta. MID stands firm on a long-term commitment to protecting salmon and will continue to promote actions to restore salmon populations through the coming years.

COMMUNITY & ENVIRONMENT

Steady support

MID is committed to being a stable community partner. Through its community service program, the District donated more than $20,000 to local non-profit organizations in 2008. From festivals to fundraisers, MID was able to support a myriad of events and causes in our communities.

MID also introduced some new programs and partnerships to help those in need in our communities. In conjunction with the Greater Modesto Tree Foundation and the Weed and Seed Project, MID helped plant more than 50 shade trees in low-income areas in Modesto. Conserving energy and saving money can be as simple as planting a shade tree. Once mature, the shade trees will reduce electric cooling needs of the customers' homes by 3,400 kilowatthours annually and will sequester 2,000 pounds of carbon dioxide per year. This program benefits both our low-income customers and the environment.

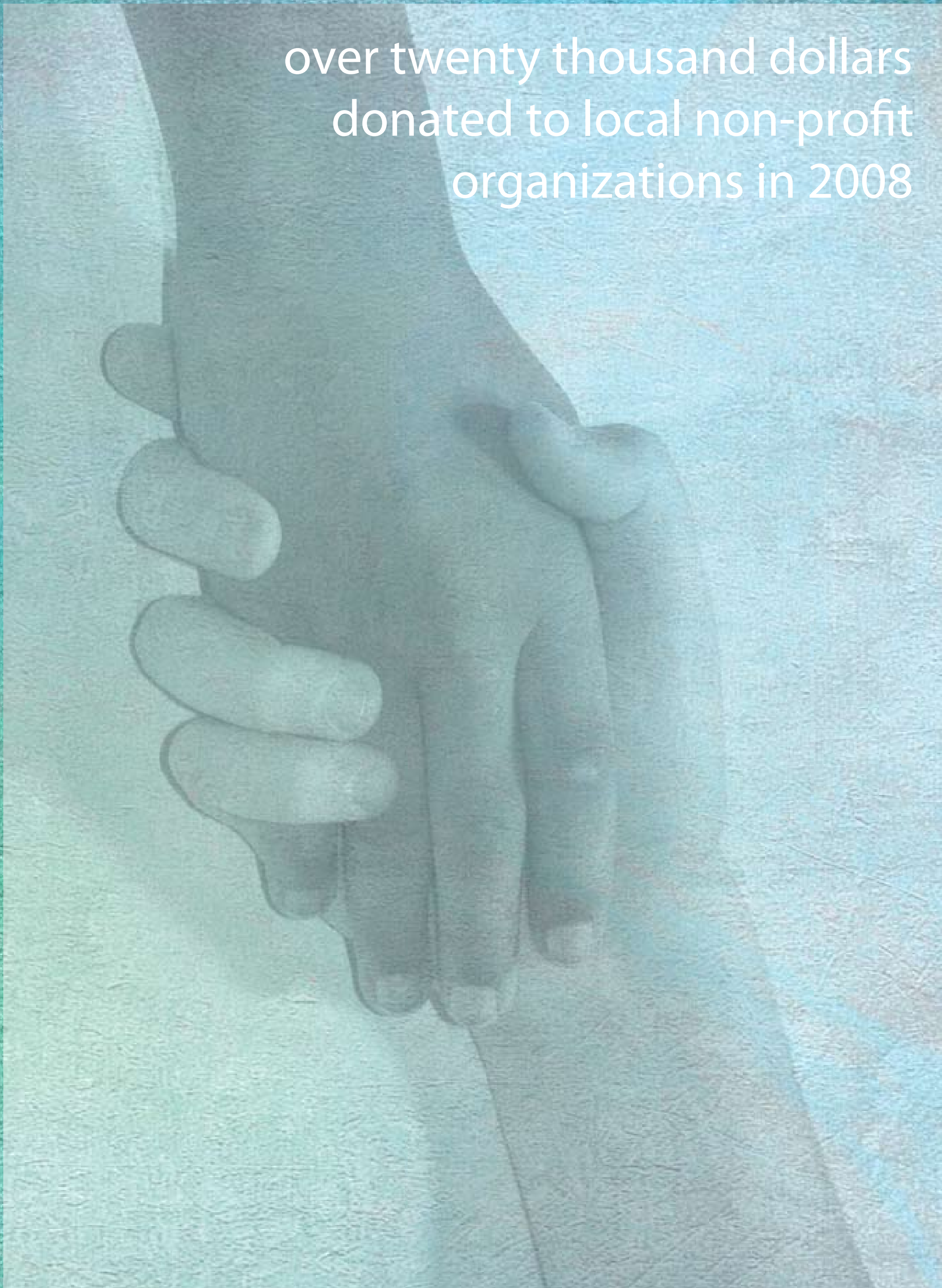
MID also assisted seniors and the disabled in our communities in making their homes more energy efficient. Working in tandem with the Stanislaus County Area Agency on Aging, MID provided 750 compact fluorescent light bulbs (CFLs) to replace incandescent bulbs in these customers' homes. Replacing five 60-watt incandescent light bulbs with five 15-watt CFLs provides an individual an annual savings of almost $50 on his or her electric bill. This small savings made a big difference to these customers who are often on limited fixed incomes.

Sustainable practices

Environmental stewardship is important and MID makes an effort to recycle a number of the materials we use daily. We needed heavy duty scales to weigh all that we recycled in 2008. Some materials recycled included:

- 17,000 pounds of assorted batteries
- 66,000 gallons of waste oil
- 74 tons of oil-filled equipment like oil filters and transformers
- 174,507 pounds of scrap iron
- 17,114 pounds of cardboard
- 15,000 pounds of copier paper and
- Almost 160 tons of aluminum, copper and lead electrical cable.

Also, making some simple changes have led to significant environmental impacts. Switching to reusable steel cable reels saved 168,000 pounds of total environmental wood over the last four years. Utilizing paper shredding services throughout the year saved approximately 34 trees.


over twenty thousand dollars
donated to local non-profit
organizations in 2008

FINANCE

Checks and balances

Balancing budgets and resources is critical to MID providing reliable service at the lowest possible cost. Each year we take a close look at day-to-day operating costs, build only essential projects and as always, operate on a not-for-profit basis.

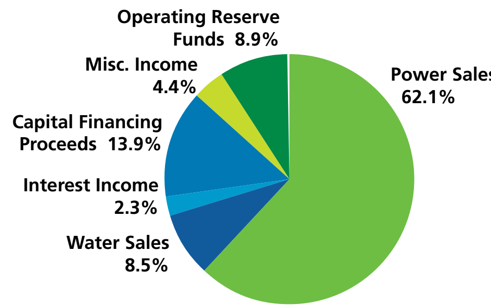
Power supply – buying and generating electricity – is by far the biggest piece of the MID budget pie. In 2008, power supply was approximately 63 percent of MID's total operating expenses. The dry water year forced us to buy more power than planned and run our local power plants longer hours. In turn, this drove up our operating costs and significantly impacted our bottom line.

Facing a $33.6 million budget shortfall in 2008, MID approved drawing down reserves by almost $11 million and increasing electric rates in two steps. Residential customers saw a 9.5 percent increase and commercial and industrial customers saw five to 15 percent increases in their monthly bills.

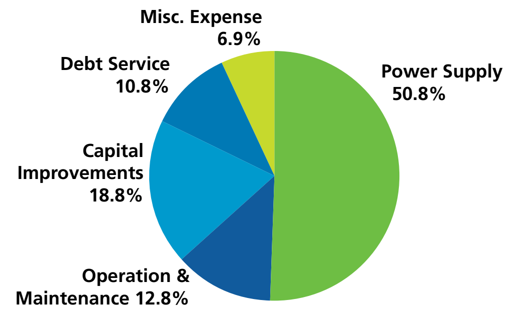
In addition to balancing budgets and costs to our customers, the District weathered the 2008 financial crisis and stock market volatility. MID persevered by maintaining a diverse financial portfolio which had minimal exposure to the fall of various large financial institutions during the year.

In November, MID approved a 14 percent revenue increase by raising electric rates in three steps and drawing down District reserve funds by $4.5 million. This increase was approved to go into effect in 2009 to account for forecasted increased power supply costs and compliance with unfunded state and federal mandates.

SOURCE OF FUNDS



USE OF FUNDS



COMPARATIVE STATISTICS

	2008	2007	2006	2005	2004
Electric Revenues					
Retail Revenues					
Residential	$122,397	$110,603	$111,989	$99,938	$89,767
Commercial	83,887	77,498	76,020	67,857	62,520
Industrial	64,344	56,724	52,706	47,606	41,694
Other	13,085	10,896	9,842	9,126	8,398
Total Retail Revenue	283,713	255,721	250,557	224,527	202,379
Wholesale Revenue	13,994	20,815	28,380	40,867	29,851
Total Electric Revenue	$297,707	$276,536	$278,937	$265,394	$232,230
Electric kWh Sales (000)					
Retail Kwh					
Residential	896,528	881,087	914,665	875,238	861,273
Commercial	758,921	757,247	754,447	735,351	725,387
Industrial	842,303	819,968	801,578	792,027	766,018
Other	121,735	107,704	94,540	105,156	106,910
Total Retail Sales	2,619,487	2,566,006	2,565,230	2,507,772	2,459,588
Wholesale Sales	255,962	452,307	1,050,037	744,538	526,572
Total Electric Sales	2,875,449	3,018,313	3,615,267	3,252,310	2,986,160
Retail Customers At Year End					
Residential	91,598	91,360	93,372	91,061	88,741
Commercial	12,279	12,511	12,671	11,682	11,319
Industrial	144	210	188	173	155
Other	6,886	6,443	6,135	5,608	5,488
Total Retail Customers	110,907	110,524	112,366	108,524	105,703
Retail Revenue Per kWh Sold (cents)					
Residential	13.7	12.6	12.2	11.4	10.4
Commercial	11.1	10.2	10.1	9.2	8.6
Industrial	7.6	6.9	6.6	6.0	5.4
Other	10.7	10.1	10.4	8.7	7.9
System Average	10.8	10.0	9.8	9.0	8.2
Wholesale Revenue Per kWh Sold (cents)	5.5	4.6	2.7	5.5	5.7
Financial Ratios					
Operating Ratio	0.92	0.87	0.80	0.81	0.88
Current Ratio	1.11	1.17	1.62	1.10	1.27
Quick Ratio	0.70	0.72	1.14	0.69	0.91
Debt Service Coverage - Sr. Lien Debt [1]	-	-	7.35	4.91	3.44
Debt Service Coverage - Jr. Lien Debt	1.10	1.49	2.31	1.91	1.55
Power Supply (GWh)					
Power Purchased	2,354.1	2,485.9	3,008.3	2,638.5	2,594.6
Power Generated	584.2	551.8	755.4	674.2	459.2
Total System Requirements	2,938.3	3,037.7	3,763.7	3,312.7	3,053.8
Annual System Peak Load (MWh)	650.0	675.2	697.3	632.5	606.4

[1] MID no longer has any outstanding Senior Lien Debt.

(kWh=Kilowatthours; MWh=Megawatthours; GWh=Gigawhatthours)

LONGTERM DEBT SUMMARY

(In Thousands of Dollars)	2008	2007	2006	2005	2004
Outstanding Debt At Year End					
Modesto Irrigation District Debt					
Electric Debt					
1967 Don Pedro G. O. Bonds	$ -	$ -	$ -	$ -	$985
1996A Geysers Refunding Revenue Bonds	-	-	-	87,060	93,445
1999A Certificates of Participation	42,934	45,028	47,222	49,523	51,936
1999B Certificates of Participation	37,790	39,580	41,285	42,900	44,440
2001A Certificates of Participation	87,175	89,245	91,245	93,180	95,050
2003A Certificates of Participation	82,805	85,095	87,330	89,515	91,650
2004A Certificates of Participation	50,000	50,000	50,000	50,000	50,000
2004B Certificates of Participation	66,025	66,025	66,025	66,025	66,025
2006A Certificates of Participation	131,715	139,490	146,960	-	-
	$498,444	$514,463	$530,067	$478,203	$493,531
Domestic Water Debt					
1998 D Refunding Revenue Bonds - Domestic Water	67,435	70,690	73,780	76,710	79,490
2007 F Revenue Bonds - Domestic Water	93,190	93,190			
	$160,625	$163,880	$73,780	$76,710	$79,490
Total Outstanding MID Debt	$659,069	$678,343	$603,847	$554,913	$573,021
MID Share Of Joint Power Agency Debt					
MSR Public Power Agency - 50%					
1993 Series F Refunding San Juan A Bonds	10,205	10,205	10,205	10,205	10,205
1997 Series G Refunding San Juan C Bonds	-	-	27,560	28,263	28,810
1997 Series H Refunding San Juan D Bonds	-	-	-	-	-
2001 Series I Refunding San Juan E Bonds	24,415	26,620	28,743	30,783	32,115
1995 Series B Refunding San Juan B Bonds	-	8,750	8,750	8,750	8,750
1995 Series C Refunding San Juan B Bonds	-	-	-	-	-
1997 Series D Refunding San Juan C Bonds	32,500	32,500	32,500	32,500	32,500
1997 Series E Refunding San Juan C Bonds	-	32,500	32,500	32,500	32,500
1998 Series F Refunding San Juan A&C Bonds	-	31,250	31,250	31,250	31,250
1998 Series G Refunding San Juan A&C Bonds	-	8,500	8,500	8,500	8,500
2003 Series I Refunding San Juan F Bonds	-	19,447	21,513	23,490	25,380
2004 Series J Refunding San Juan F Bonds	8,818	12,513	16,110	19,633	23,095
2007 Series K Refunding San Juan G Bonds	23,860	24,152	-	-	-
2008 Series L Refunding San Juan 1995b/1997e/2003i Bonds	59,433	-	-	-	-
2008 Series M Refunding San Juan 1998F Bonds	31,250	-	-	-	-
2008 Series N Refunding San Juan 1998G Bonds	8,500	-	-	-	-
	$198,980	$206,437	$217,631	$225,874	$233,105
Transmission Agency Of Northern California - 21.3%					
1990 Series A Revenue Bonds	$6,011	$6,011	$6,011	$6,011	$6,470
1993 Series A Revenue Bonds	3,989	5,817	7,574	9,243	9,564
2002 Series A Revenue Refunding Bonds	18,382	19,060	19,702	20,307	20,879
2003 Series A & B Revenue Refunding Bonds	39,331	39,558	39,758	39,954	40,143
2003 Series C Revenue Refunding Bonds	8,601	8,052	8,400	8,733	9,055
Commercial Paper	18,256	9,841	7,307	7,307	7,307
	$94,569	$88,339	$88,752	$91,555	$93,418
Total MID Share of JPA Debt	$293,549	$294,776	$306,383	$317,429	$326,523
Total Outstanding MID & JPA Debt	$952,618	$973,119	$910,230	$872,342	$899,544

INDEPENDENT AUDITORS' REPORT

To the Board of Directors
Modesto Irrigation District
Modesto, California

We have audited the accompanying consolidated balance sheets of the Modesto Irrigation District and its component unit (the District) as of December 31, 2008 and 2007 and the related consolidated statements of revenues, expenses, and changes in net assets and cash flows for the years then ended. These consolidated financial statements are the responsibility of the District's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated 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 2, the District consists of both enterprise funds, as reported in these consolidated financial statements, and fiduciary funds, which are excluded from these financial statements. Such fiduciary funds comprise pension plans and other postemployment benefit plans disclosed in Note 8 which are managed for the benefit of the District's employees, retirees and related beneficiaries. Because of the exclusion of these fiduciary funds, the accompanying consolidated financial statements do not purport to, and do not, present fairly the financial position of the District, as a whole inclusive of the fiduciary funds, as of December 31, 2008 and 2007, or the changes in its financial position or its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of revenues, expenses, and changes in net assets and cash flows present fairly, in all material respects, the financial position of the enterprise funds of the District as of December 31, 2008 and 2007 and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As described in Note 2, the District adopted the provisions of GASB 45, *Accounting and Financial Reporting for Postemployment Benefits Other than Pensions,* effective January 1, 2007.

As discussed in Note 9, the District adopted the provisions of FASB Statement No. 157 - Fair Value Measurements, effective January 1, 2008 prospectively, for interest rate swap agreements and natural gas and electricity derivative financial instruments that are measured at fair value on a recurring basis.

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

Virchow, Krause & Company, LLP

Madison, Wisconsin
May 5, 2009

MANAGEMENT'S DISCUSSION AND ANALYSIS

Years ended December 31, 2008, 2007 and 2006

Overview

The following management discussion and analysis of Modesto Irrigation District (the District) provides an overview of the financial activities and transactions for fiscal years 2008 and 2007 in the context of the requirements of the Statement of Governmental Accounting Standards (SGAS) Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, as amended. This discussion and analysis should be read in conjunction with the District's audited financial statements and accompanying notes.

Financial Reporting

The District's accounting records are maintained in accordance with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (GASB) and, where not in conflict with GASB pronouncements, accounting principles prescribed by the Financial Accounting Standards Board.

Explanation of Financial Statements

District financial statements include a consolidated balance sheet, statement of revenues, expenses and changes in net assets and a statement of cash flows. The balance sheet provides information about assets and obligations of the District at a specific point in time. The statement of revenues, expenses and changes in net assets provides information regarding the District's operations during the fiscal year. The statement of cash flows reports cash sources and cash uses for operations, capital financing and investing activities.

Financial Summary

($ in millions)	December 31, 2008	December 31, 2007	December 31, 2006	Change from 2008 to 2007
Assets				
Utility plant, net	$617.9	$558.1	$527.9	$59.8
Other noncurrent assets and investments	170.8	281.0	247.5	(110.2)
Current assets	83.9	82.5	71.1	1.4
Total Assets	$872.6	$921.6	$846.5	$(49.0)
Liabilities and Net Assets				
Long-term debt	$647.8	$668.3	$594.0	$(20.5)
Current liabilities	75.8	71.4	58.6	4.4
Noncurrent liabilities	135.0	117.3	128.0	17.7
Net assets				
Invested in capital assets, net	30.2	16.0	18.0	14.2
Restricted	2.7	7.7	0.1	(5.0)
Unrestricted	(18.9)	40.9	47.8	(59.8)
Total Liabilities and Net Assets	$872.6	$921.6	$846.5	$(49.0)
Revenues, Expenses and Changes in Net Assets				
Operating revenues	$341.7	$316.6	$306.6	$25.1
Operating expenses	(344.0)	(303.9)	(270.9)	(40.1)
Operating income (loss)	(2.3)	12.7	35.7	(15.0)
Investment and other income	6.6	14.7	8.1	(8.1)
Interest expense	(34.3)	(32.2)	(25.3)	(2.1)
Other non-operating income, net	(20.5)	4.2	8.0	(24.7)
Change in net assets	(50.5)	(0.6)	26.5	(49.9)
Net assets, beginning of year	64.5	66.0	39.5	(1.5)
Restatement	-	(0.9)	-	0.9
Net assets, beginning of year, as adjusted	64.5	65.1	39.5	(0.6)
Net Assets, End of Year	$14.0	$64.5	$66.0	$(50.5)

Assets

Utility plant

Utility plant increased by a net of $59.8 million in 2008. Utility plant additions of $90.1 million were primarily the result of continued construction work on the Westley Rosemore Transmission Line and associated substations, and the Domestic Water Treatment Plant Phase II expansion. The increase is partially offset by depreciation expense of $29.9 million.

Additionally, in 2008, new distribution system infrastructure continued as the District installed new meters and continued construction on substations. The District also initiated costs for two new power plant projects; a reciprocating power plant and a natural gas fired plant.

Utility plant increased by a net of $30.2 million in 2007 over 2006. In 2007, utility plant additions of $58.3 million were primarily the result of continued construction work on the Westley Rosemore Transmission Line and associated substations, and the Domestic Water Treatment Plant Phase II expansion. The increase was partially offset by depreciation expense of $28.0 million.

Additionally, in 2007, construction of new distribution system infrastructure continued as the District installed new meters and continued construction on new substations. The District also continued to build infrastructure in the Mountain House area of the District's service territory, acquired in 1998.

Other non-current assets and investments

Other non-current assets and investments decreased by $110.2 million in 2008. The decrease is primarily due to use of the general fund investments for projects that were later reimbursed through the 2009A COP issue. Other uses of bond funds were for the Westley Rosemore project and the Domestic Water Treatment Plant Expansion.

Other non-current assets and investments increased by $32.3 million in 2007 over 2006. The increase was primarily due to an increase in investments as a result of issuing the 2007F Domestic Water Revenue Bonds.

Current assets

Current assets increased in 2008 by $1.4 million due primarily to receivables.

Current assets increased from 2006 to in 2007 by $12.6 million. The increase was attributable to a $9.5 million increase in cash and cash equivalents as a result of the issuance of the Series 2007F Domestic Water Revenue Bonds. Receivables and other current assets increased a net $3.1 million.

Liabilities and Net Assets

Long-term debt

Long-term debt decreased by $20.5 million in 2008. This decrease was primarily due to normal debt service payments.

Long-term debt increased by $74.3 million in from 2006 to 2007. This increase was primarily due to the issuance of $93.2 million in Series 2007F Domestic Water Revenue Bonds. This increase was offset by $19.6 million normal debt service payments.

Current liabilities

Current liabilities increased by $4.4 million in 2008. The increase is primarily due to an increase in construction accounts payable resulting from large projects such as the Domestic Water Treatment Plant Phase II expansion.

Current liabilities increased in 2007 by $12.8 million in 2007 over 2006. The increase was primarily due to an increase in construction accounts payable resulting from large projects such as the Westley Rosemore Transmission line and Substations, and the Domestic Water Treatment Plant phase II expansion.

Non-current liabilities

Non-current liabilities increased $17.7 million in 2008. This is due primarily to a $33.3 million increase in derivative financial instruments with maturities greater than one year. This increase is partially offset by a decrease of $21.3 million unearned revenue.

Non-current liabilities decreased $10.7 million in 2007 over 2006. This decrease was due primarily to a $9.5 million net change in the District's investment in other joint power agencies, a $7.2 million decrease in unearned revenue and other liabilities, and a $6.0 million increase in derivative financial instruments with maturities greater than one year and other non-current liabilities.

Net assets

In 2008, the District's net assets invested in capital assets increased by $14.2 million. A $78.7 million increase in capital assets net of related debt is primarily the result of the capital additions and normal debt service payment. This increase is offset by the $64.4 million change in reserve funds resulting from normal debt service payments.

Restricted net assets decreased in 2008 by $5.0 million. This was primarily due to a decrease in debt service funds.

Unrestricted net assets changed primarily as a result of the net loss in 2008 and other previous explanations.

In 2007, the District's net assets invested in capital assets decreased by $2.0 million from the prior year. A $46.1 million decrease in capital assets net of related debt was primarily the result of the issuance of the Series 2007F Domestic Water Revenue Bonds. This decrease was offset by the $44.1 million change in reserve funds resulting from the Series 2007F Domestic Water Revenue Bonds and the continued construction of financed capital electric distribution projects.

Restricted net assets increased in 2007 over 2006 by $6.4 million. The increase was due to a $50.9 million increase in reserve funds, primarily offset by a $43.5 million decrease in debt service funds and unspent bond proceeds.

Unrestricted net assets changed primarily as a result of the changes above and the overall change in net assets resulting from a net loss in 2007.

Changes in Net Assets

Operating revenues

Changes from 2007 to 2008

Retail electric revenue in 2008 increased by $26.10 million or approximately 10.2%. The District implemented two rate increases during 2008. Electric retail consumption remained relatively flat in 2008 as the District's service territory experienced fewer housing starts which contributed to a smaller than anticipated revenue increase.

Wholesale electric revenue decreased by $6.8 million. The decrease was due to a critical dry water year which resulted in less excess power available to sell on the wholesale market.

Water revenues from agricultural water remained relatively constant with revenues from prior years. Domestic wholesale water revenue increased $17.6 million. This was a result of accounting for the year end unrealized change in the valuation of the 2007F Domestic Water Revenue Bonds interest rate swap, which is passed through to the City of Modesto.

Equity in Joint Power Authorities decreased by $12.6 million for 2008. This was a result of a $12 million decrease in MSR equity due to accounting for the year end realized and unrealized losses of interest rate swaps for bonds held by the Agency.

Other operating income remained relatively flat, increasing by $0.8 million.

Changes from 2006 to 2007

Retail electric revenue in 2007 increased by $7.0 million or approximately 2.7%. The District implemented a 2.8% electric revenue increase effective January 1, 2007. Electric retail consumption remained relatively flat in 2007 as the District's service territory experienced fewer housing starts and cooler weather which contributed to a smaller than anticipated revenue increase.

Wholesale electric revenue decreased by $8.5 million. The decrease was due to a critical dry water year which resulted in less excess power available to sell on the wholesale market.

Water revenues from agricultural water remained relatively constant with revenues from prior years. Domestic wholesale water revenue increased by $8.3 million. This was a result of accounting for the year end unrealized change in the valuation of the 2007F Domestic Water Revenue Bonds interest rate swap, which is passed through to the City of Modesto.

Other operating income increased $2.7 million in 2007. The increase is due primarily to an increase in net income from MSR Public Power Agency (the Agency) of $1.2 million and a $0.7 million increase in net income from TANC.

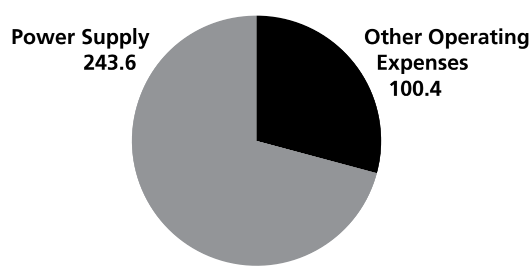
Operating expenses

Changes from 2007 to 2008

Operating Expenses increased by $40.1 million. This was driven by purchased power and power generation cost increases of $38.0 million. Electric usage was up 2% over 2007. Fuel used for generation was higher than in 2007. Additionally Don Pedro was unavailable for production coupled with the San Juan plant off line early in 2008 forced the District to buy short term power at a time when rates were high.

Other operating expenses increased by $2.1 million in 2008. The increase is due to cost on electric transmission and distribution and water operations, partially offset by decrease in administrative and general expenses.

2008 OPERATING EXPENSES
($ in Millions)

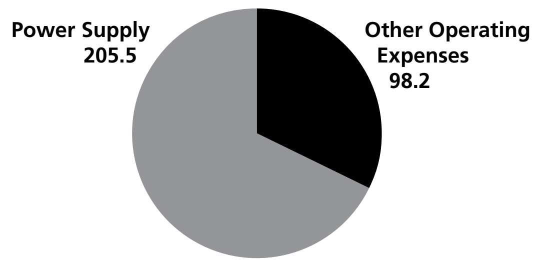


Changes from 2006 to 2007

Purchased power and power generation costs for 2007 increased by $17.7 million. The increase was due to a $14.0 million increase in purchased power costs and a $3.7 million increase in power generation expenses. Purchased power costs were reduced in 2006 primarily due to a $15.6 million purchased power litigation settlement. The District's power generation cost increase was due to increased generation at the Woodland generation station which had reduced generation in 2006 due to planned maintenance.

Other operating expenses increased by $15.3 million in 2007. The increase is primarily the result of an unrealized loss on the interest rate swap for the 2007F Domestic Water Revenue Bonds of $7.5 million, charged back to the City of Modesto, increased post-retirement benefit costs from implementing GASB 45, and increased depreciation expense for the Ripon Generation Station of $2.2 million which had only one half year of commercial operation in 2006.

2007 OPERATING EXPENSES
($ in Millions)



Investment and other income

Investment and other income decreased in 2008 by $9 million. The decrease was primary based on lower reserves and lower interest rates in 2008. Additionally there were unrealized losses on investments primarily due to a downgraded security.

Investment and other income decreased in 2007 over 2006 by $2.1 million. The District received several legal settlements in 2006 resulting in a higher level of other income for the year. The decrease was partially offset by increases in interest income and unrealized gains on investments in 2007 which were the result of higher interest rates in 2007.

Interest expense

Interest expense for 2008 decreased $2.1 million, primarily as a result of lower interest payments on outstanding bonds.

Interest expense for 2007 increased $2.0 million primarily over the prior year as a result of a full year's interest expense for the Series 2006A COPs.

Rate Adjustment

The District increased its rates effective January 1, 2009, and has additional increases approved for June 1, 2009, and September 1, 2009.

The District increased rates effective January 1, 2008 and May 1, 2008.

CONSOLIDATED BALANCE SHEET

December 31, 2008 and 2007

(Dollars in Thousands)

ASSETS	2008	2007
Capital Assets		
Plant in service	$904,951	$842,243
Less accumulated depreciation	(362,589)	(332,912)
Plant in service - net	542,362	509,331
Construction work in progress	75,509	48,778
Total Capital Assets	617,871	558,109
Other Assets and Investments		
Cash and investments - restricted	72,110	130,301
Investments - unrestricted	88,476	138,616
Interest receivable - restricted	692	1,190
Unamortized debt issuance costs	7,850	7,807
Derivative financial instruments	-	2,572
Equity interest in TANC	1,677	512
Equity interest in MSR Energy Authority	25	-
Total Other Assets and Investments	170,830	280,998
Current Assets		
Cash and cash equivalents - unrestricted	16,909	9,628
Cash and cash equivalents - restricted	9,015	16,630
Interest receivable - unrestricted	1,173	1,793
Customer accounts receivable, net	30,891	31,940
Wholesale power receivables, net	3,520	2,626
Materials and supplies	10,617	10,162
Prepayments	2,543	2,280
Derivative financial instruments maturing within one year	-	251
Other current assets	9,247	7,210
Total Current Assets	83,915	82,520
TOTAL ASSETS	$872,616	$921,627
LIABILITIES AND NET ASSETS		
Noncurrent Liabilities		
Long-term debt, net of current portion	$647,832	$668,322
Unamortized premium	8,236	8,135
Unamortized debt discount	(2,811)	(2,938)
Unamortized loss on advance refunding	(12,582)	(14,625)
Unearned revenue and other liabilities	2,718	24,000
Derivative financial instruments	40,874	7,619
Equity interest in M-S-R	98,534	95,131
Total Noncurrent Liabilities	782,801	785,644
Current Liabilities		
Accounts payable and other accruals	34,255	38,903
Current liabilities payable from restricted assets		
Current portion of long-term debt	21,875	20,315
Interest payable	12,002	11,165
Derivative financial instruments maturing within one year	7,635	1,046
Total Current Liabilities	75,767	71,429
Net Assets		
Invested in capital assets, net of related debt	30,270	15,986
Restricted	2,716	7,677
Unrestricted	(18,938)	40,891
Total Net Assets	14,048	64,554
TOTAL LIABILITIES AND NET ASSETS	$872,616	$921,627

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

Years Ended December 31, 2008 and 2007

(Dollars in Thousands)

	2008	2007
OPERATING REVENUES		
Residential, commercial and industrial electric	$282,023	$255,899
Wholesale electric	13,994	20,815
Domestic water	37,165	19,571
Irrigation water	3,603	3,667
Equity in net income of public power agencies	(2,238)	10,339
Other operating income, net	7,190	6,360
Total Operating Revenues	341,737	316,651
OPERATING EXPENSES		
Purchased power	195,732	162,403
Power generation	47,838	43,141
Electric resources	8,085	7,106
Electric transmission and distribution	15,051	12,617
Irrigation operations	8,043	7,561
Domestic water operations	6,543	5,208
Customer account service	5,559	4,855
Administrative and general	26,852	33,029
Depreciation and amortization	30,302	28,008
Total Operating Expenses	344,005	303,928
Operating Income / (Loss)	(2,268)	12,723
NON-OPERATING REVENUES (EXPENSES)		
Investment income	5,358	14,535
Interest expense	(32,388)	(30,292)
Capitalized interest	1,207	167
Amortization of debt discount and issuance costs	(725)	(707)
Amortization of premium	905	963
Amortization of loss on refunding	(2,043)	(2,171)
Mark to market adjustment for derivative contracts	(24,051)	(1,241)
Other non-operating income, net"	2,359	3,987
Total Non-Operating Expenses	(49,378)	(14,759)
Change in Net Assets Before Contributions	(51,646)	(2,036)
CAPITAL CONTRIBUTIONS	1,140	1,433
CHANGE IN NET ASSETS	(50,506)	(603)
NET ASSETS - Beginning of Year	64,554	65,157
NET ASSETS - END OF YEAR	$14,048	$64,554

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years Ended December 31, 2008 and 2007

(Dollars in Thousands)

	2008	2007
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from electric customers	$299,094	$307,441
Payments to suppliers for goods and services	(236,581)	(239,427)
Payments to employees for services	(35,221)	(32,870)
Net Cash Flows Provided by Operating Activities	27,292	35,144
CASH FLOWS FROM CAPITAL FINANCING ACTIVITIES		
Net proceeds from issuance of long-term debt obligations	-	93,190
Repayment of long-term debt	(18,930)	(19,635)
Debt issuance costs	365	(1,218)
Construction expenditures	(92,485)	(47,526)
Interest paid	(31,551)	(24,763)
Contributions received for construction	168	355
Net Cash Flows Provided by Capital Financing Activities	(142,433)	403
CASH FLOWS FROM INVESTING ACTIVITIES		
Investments purchased	(103,225)	(280,362)
Investments sold and matured	210,836	222,392
Interest received	6,476	11,040
Net Cash Flows Provided by (Used in) Investing Activities	114,087	(46,930)
Decrease in Cash and Cash Equivalents	(1,054)	(11,383)
CASH AND CASH EQUIVALENTS, Beginning of Year	32,204	43,587
CASH AND CASH EQUIVALENTS, END OF YEAR	$31,150	$32,204
SUPPLEMENTAL DISCLOSURE OF NONCASH FINANCING AND INVESTING ACTIVITIES		
Accretion of capital appreciation bonds	$(1,385)	$(1,449)
Noncash contributions by developers	$972	$1,078
Capitalized interest	$1,207	$167
Amortization	$(1,863)	$(1,915)
Change in valuation of derivative financial instruments	$(24,051)	$(7,533)
CASH FLOWS FROM OPERATING ACTIVITIES		
Operating income / (loss)	$(2,268)	$12,723
Adjustments to reconcile operating income to net cash flows provided by operating activities		
Other income	2,359	3,987
Depreciation and amortization	30,302	28,008
Undistributed income from public power agencies	2,213	(9,788)
Change in value of derivative financial instruments	18,616	1,705
Change in operating assets and liabilities		
Customer accounts receivable, net	1,049	2,523
Wholesale power receivables, net	(894)	877
Other current assets	(2,037)	2,945
Materials and supplies	(455)	(1,644)
Prepayments	(263)	3,049
Accounts payable and other accruals	(48)	(728)
Unearned revenue and other liabilities	(21,282)	(8,513)
NET CASH FLOWS PROVIDED BY OPERATING ACTIVITIES	$27,292	$35,144
RECONCILIATION OF CASH AND CASH EQUIVALENTS TO BALANCE SHEET ACCOUNTS		
Cash and cash equivalents - unrestricted	$16,909	$9,628
Cash and cash equivalents - restricted	9,015	16,630
Investments - unrestricted	88,476	138,616
Cash and investments - restricted	72,110	130,301
Total Cash and Investments	186,510	295,175
Less: Noncash equivalents	155,360	262,971
CASH AND CASH EQUIVALENTS	$31,150	$32,204

See accompanying notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - ORGANIZATION AND DESCRIPTION OF BUSINESS

The Modesto Irrigation District (the "District") was formed in 1887 and operates as a nonregulated special district of the State of California. The District provides electric power on an exclusive basis within a 160 square mile service area in Stanislaus County and in the Don Pedro Reservoir area in Tuolumne County. The District also provides electric power in portions of southern San Joaquin County. The District provides irrigation water to an area of California's Central Valley that lies between the Tuolumne and Stanislaus rivers. The District also operates a surface water treatment plant that provides water for the City of Modesto's (the "City") domestic water supply.

The District is managed by a Board of Directors. The District's Board of Directors has the authority to fix rates and charges for the District's commodities and services. As a public power utility, the District is not subject to regulation or oversight by the California Public Utilities Commission (CPUC). The District may also incur indebtedness including issuing bonds. The District is exempt from payment of federal and state income taxes.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements of the District have been prepared in conformity with accounting principles generally accepted in the United States of America as applied to enterprise funds of governmental units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

The significant accounting principles and policies utilized by the District are described below.

Measurement Focus, Basis of Accounting and Financial Statement Presentation

The District is presented as an enterprise fund. Enterprise funds are used to account for operations that are financed and operated in a manner similar to private business or where the governing body has decided that the determination of revenues earned, costs incurred and net income is necessary for management accountability.

The financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recorded when the liability is incurred or economic asset used. Revenues, expenses, gains, losses, assets and liabilities resulting from exchange and exchange-like transactions are recognized when the exchange takes place.

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed in the District's financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. The District also has the option of following subsequent private-sector guidance subject to this same limitation. The District has elected to follow subsequent private-sector guidance. The District's accounting records generally follow the Uniform System of Accounts for Public Utilities and Licensees prescribed by the Federal Energy Regulatory Commission (FERC).

The Modesto Irrigation District Financing Authority (the "Authority"), a joint power authority composed of the District and the City of Redding, provides financing for public improvements of the District. The District's Board of Directors serves as the Authority's Board, and District employees provide all of the Authority's administrative and management functions. All of the Authority's financial transactions, except the payment of debt service, are transacted with the District. Accordingly, all operations of the Authority are consolidated into the District's financial statements.

These consolidated financial statements present only the enterprise funds of the District and exclude the fiduciary funds of the District. The District's fiduciary funds comprise the pension plans and other postemployment benefit plans disclosed in Note 8.

In June 2004, the Governmental Accounting Standards Board (GASB) issued Statement No. 45 - *Financial Reporting by Employers for Postemployment Benefit Plans Other Than Pensions.* This statement establishes standards for the measurement, recognition, and display of other postemployment benefits (OPEB) expenses and related liabilities (assets), note disclosures, and, if applicable, required supplementary information (RSI) in the financial reports of state and local governmental employers.

The District made the decision to implement this standard effective January 1, 2007.

In September 2006, FASB issued SFAS No. 157, "Fair Value Measurements". FAS 157 provides guidance for measuring assets and liabilities at fair value based on a hierarchy that determines the level of assurance of fair value. The District implemented this standard effective January 1, 2008. See Note 9.

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

Cash and Cash Equivalents

Cash equivalents include all debt instruments with maturity dates of 90 days or less from the date of purchase and all investments in the Local Agency Investment Fund (LAIF), and money market mutual funds. LAIF has an equity interest in the State of California Pooled Money Investment Account (PMIA). PMIA funds are on deposit with the State's Centralized Treasury System and are managed in compliance with the California Government Code, according to a statement of investment policy which sets forth permitted investment vehicles, liquidity parameters and maximum maturity of investments. The PMIA cash and investments are recorded at amortized cost which approximates market. The District's deposits with LAIF are generally available for withdrawal on demand.

Investments

Generally, all investments are carried at their fair market value, except for guaranteed investment contracts (GICs), which are carried at cost. Market values may have changed significantly after year-end.

Allowance for Doubtful Accounts

The District recognizes an estimate of uncollectible accounts for its customer accounts receivable related to electric service based upon its historical experience with collections. The District has an allowance for doubtful accounts for its electric retail customers of $4,037 and $3,400 as of December 2008 and 2007, respectively. For its wholesale power receivables, the District maintained an allowance for doubtful accounts of $172 at December 31, 2008 and 2007 due to collection issues resulting from the uncertain California wholesale energy markets. The District's net expense relating to doubtful accounts for all accounts receivable is included in the accompanying statements of revenues, expenses, and changes in net assets as an offset to operating revenues.

Materials and Supplies

Materials and supplies are generally used for construction, operation and maintenance work, not for resale. They are valued at the lower of cost or market utilizing the average cost method and charged to construction or expense when used.

Restricted Assets

Mandatory segregations of assets are presented as restricted assets. Such segregations are required by bond agreements and other external parties. Current liabilities payable from these restricted assets are so classified.

Prepayments

The balance represents payments to vendors for costs applicable to future accounting periods.

Other Current Assets

The balance represents miscellaneous receivables and deposits.

Capital Assets

Capital assets are generally defined by the District as assets with an initial, individual cost of more than $2.5 and an estimated useful life in excess of three years.

Capital assets are stated at cost. Costs and related accumulated depreciation of assets sold or otherwise disposed of are eliminated from the accounts and related gains or losses are considered non-operating. The costs of replacement are charged to utility plant. Repair and maintenance costs are charged to expense in the period incurred. Interest costs incurred, plus amortization of deferred debt issue costs and related bond discounts/premiums, less any related interest earned during periods of construction of utility plant assets are capitalized at a rate based on the District's borrowings related to that construction.

Depreciation is computed using the straight-line method over the useful lives of the assets, which generally range from twenty to fifty years for electric and domestic water plant assets and ten to one hundred years for irrigation system assets. The estimated useful lives of furniture, fixtures, equipment and other assets range from five to twenty years.

Unearned Revenue and Other Liabilities

Billings to the City in connection with the Domestic Water Project (the "Project") in advance of the operation of the facility were recorded as deferred revenues. The deferred revenues are being amortized over the life of the facility. Annual differences between billings to the City and the District's annual Project costs are charged or credited to deferred revenues. Accordingly, the District's financial statements reflect Domestic Water operations on a break-even basis, consistent with the operating agreements between the District and the City. The balance in this account was a receivable from the City of $20.2 in 2008 and an account payable of $5.6 in 2007. the amount receivable from the City in 2008 and 2007 included unrealized losses on interest rate swaps for the related debt. These losses were $24.1 and $7.5 respectively. These amounts partially offset total derivative financial instrument liabilities of $40.9 and $7.6 for the District shown as non-current liabilities in 2008 and 2007 respectively.

Other liabilities include the pension and OPEB obligations, customer meter deposits, power cost true-ups, potential rate refunds, and other miscellaneous long-term liabilities.

Asset Retirement Obligations

The District has identified potential retirement obligations related to certain transmission, distribution and irrigation canal facilities located on properties that do not have perpetual lease rights. The District's nonperpetual leased land rights generally are renewed continuously because the District intends to utilize these facilities indefinitely. Since the timing and extent of any potential asset retirements are unknown, the fair value of any obligations associated with these facilities cannot be reasonably estimated. Accordingly, a liability has not been recorded at December 31, 2008 and 2007 for these assets.

The District has identified retirement obligations for transformers that are known to contain PCB oil and has estimated a liability for the disposal of these transformers at retirement at the fair value of the obligation. The District has recorded a liability in 2008 and 2007 for this obligation in the amount of $145 and $138, respectively. This amount is included under Unearned Revenue and Other Liabilities.

The District has no other potential asset retirement obligations that represent a material asset retirement obligation (ARO). The District accrues costs related to capital assets when an obligation to decommission facilities or other liability is legally required. Additionally, the District recognizes the ARO as an increase in the capitalized carrying amount of the related long-lived asset. Annual accretions of ARO liabilities are recorded as operating expenses and the capitalized costs are depreciated over the useful life of the related long-lived assets.

Long-Term Debt

Long-term debt and other obligations are reported as liabilities. Bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds using the effective interest rate method. Gains or losses on prior refundings are amortized over the remaining life of the old debt or the life of the new debt, whichever is shorter.

Derivative Financial Instruments

The District has gas price swap agreements and positions on natural gas commodity futures that meet the definition of derivative financial instruments and are, therefore, recorded on the balance sheet at fair market value with a corresponding charge to purchase power expense and power generation expenses in the statements of revenues, expenses and changes in net assets. Fair market value is estimated by comparing contract prices to forward market prices quoted by third party market participants or provided in relevant industry publications. The total fair value of the District's gas price swap agreements and natural gas commodity futures positions, net at December 31, 2008 and 2007 is a liability of $16,925 and $1,691, respectively.

Additionally, during 2007, the District entered into a variable-to-fixed interest rate swap agreement (the swap) that meets the definition of a derivative financial instrument and is recorded on the balance sheet at fair value at December 31, 2008. The swap agreement has a notional amount of $93,190 that is represented by two transactions in the amounts of $23,370 and $69,820. The District pays a fixed rate of 4.378% on the $23,370 transaction with a term ending on September 1, 2027. The District pays a fixed rate of 4.440% on the $69,820 transaction with a term ending on September 1, 2037. In return the counterparty pays the District the index market interest rate on the variable rate bonds. The total fair value of the District's interest rate swap agreement at December 31, 2008 and 2007 is a liability of $31,584 and $7,533, respectively.

The District is exposed to risk of nonperformance if the counterparties default or if the agreements are terminated. The District monitors the risk, and does not anticipate nonperformance.

Net Assets

GASB No. 34 requires the classification of net assets into three components - invested in capital assets, net of related debt; restricted; and unrestricted. These classifications are defined as follows:

> ***Invested in capital assets, net of related debt*** - This component of net assets consists of capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets. If there are significant unspent related debt proceeds at year-end, the portion of the debt attributable to the unspent proceeds is not included in the calculation of invested in capital assets, net of related debt. Rather, that portion of the debt is included in the same net assets component as the unspent proceeds.
>
> ***Restricted*** - This component of net assets consists of constraints placed on net asset use through external constraints imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments or constraints imposed by law through constitutional provisions or enabling legislation.
>
> ***Unrestricted*** - 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."

When both restricted and unrestricted resources are available for use, it is the District's policy to use restricted resources first, then unrestricted resources as they are needed.

Revenues and Expenses

The District distinguishes operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the District's principal ongoing operations. The principal operating revenues of the District are charges to customers for sales and services. Operating expenses for enterprise funds include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

Electric and Irrigation Revenues

Retail and wholesale electric revenues are billed on the basis of monthly cycle bills and are recorded as revenue when the electricity is delivered. The District records an estimate for unbilled revenues earned from the dates its retail customers were last billed to the end of the month. At December 31, 2008 and 2007, unbilled revenues of $16,140 and $14,617 are included in customer accounts receivable in the balance sheet.

Irrigation revenues are recognized when billed based on annual assessments, payable with installment payments due in June and December.

Purchased Power

The majority of the District's power needs are provided by power purchases. These power purchases are principally made under long-term agreements with the M-S-R Public Power Agency and the Hetch Hetchy System, owned and operated by the City and County of San Francisco. Additionally, the District purchases power from others under various power purchase agreements. Gains or losses on power purchase and sale transactions that are settled without physical delivery are recorded as net additions or reductions to purchased power expense.

Capital Contributions

Cash and capital assets are contributed to the District from customers and external parties. The value of property contributed to the District is reported as capital contributions on the statements of revenues, expenses and changes in net assets.

Comparative Data

Certain amounts presented in the prior year data have been reclassified in order to be consistent with the current year's presentation.

NOTE 3 - CASH AND INVESTMENTS

The District's investment policies are governed by the California Government Codes and its bond Indenture, which restricts the District's investment securities to obligations which are unconditionally guaranteed by the United States (U.S.) Government or its agencies or instrumentalities; direct and general obligations of the State of California (State) or any local agency within the State; bankers' acceptances; commercial paper; certificates of deposit; time certificates of deposit; repurchase agreements; reverse repurchase agreements or securities lending agreements; medium-term corporate notes; shares of beneficial interest; mortgage pass-through securities; financial futures and financial option contracts; and deposits with the LAIF. Investments in LAIF are unregistered, pooled funds. LAIF is a component of the Pooled Money Investment Account Portfolio managed by the State Treasurer, in accordance with Government Code Sections 16430 and 16480. The fair value of the District's investments in LAIF approximates the value of its pool shares.

The District's investment policy includes restrictions for investments relating to maximum amounts invested as a percentage of total portfolio and with a single issuer, maximum maturities, and minimum credit ratings.

Deposits in each local and area bank are insured by the FDIC in the amount of $100 for interest bearing accounts and $100 for non-interest bearing accounts as of December 31, 2007 and in the amount of $250 for interest bearing accounts and unlimited amounts for non-interest bearing accounts as of December 31, 2008.

The District maintains a rate stabilization fund to protect District customers from extreme rate increases that would otherwise be necessitated by dramatic short-term changes in purchased power or other operating costs. Annual transfers into and out of the fund are determined by the District's Board of Directors (Board), which may utilize these unrestricted funds for any lawful purposes. The rate stabilization fund consists of an undivided portion of the District's general operating funds. No transfers occurred during fiscal years 2008 and 2007.

Custodial Credit Risk

Deposits

Custodial credit risk is the risk that in the event of a financial institution failure, the District's deposits may not be returned to the District.

As of December 31, 2008 and 2007, $10,680 and $15,623 of the District's bank balances are known to be individually exposed to custodial credit risk, respectively.

	12/31/2008	12/31/2007
Uninsured and uncollateralized	$10,680	$15,623

The District's investment policy does not address this risk.

Investments

For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the District will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party.

The District does not have any investments exposed to custodial credit risk.

The District's investment policy does not address this risk.

Credit Risk

Credit risk is the risk an issuer or other counterparty to an investment will not fulfill its obligations.

As of December 31, 2008 and 2007, the District's investments were rated as follows:

	Standard & Poors	
Investment Type	2008	2007
Commercial Paper	A1/P1	A1/P1
LAIF	NR	NR
Money Market Mutual Funds	AAA	AAA
Federal Farm Credit Bank Notes	AAA	AAA
Freddie Mac	AAA	AAA
Federal Home Loan Bank Bonds	AAA	AAA
Fannie Mae	AAA	AAA
Corporate Medium Term Notes	A+	A+
Investment Agreement Contracts	NR	NR

The District's investment policy addresses this risk. The District limits investments to those rated, at a minimum, "A" or equivalent for medium-term notes and commercial paper by a nationally recognized rating agency.

Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer.

At December 31, 2008 and 2007, the District's investment portfolio was concentrated as follows:

	Percentage of Portfolio	
Investment Type	2008	2007
Guaranteed Investment Contracts:		
AIG Matched Funding Corporation	25.00%	26.00%
IXIS Funding Corporation	2.00%	10.00%
FSA Capital Management Services	5.00%	4.00%
Federal Home Loan Bank Bonds	8.00%	17.00%
Fannie Mae	14.00%	11.00%
Corporate Medium Term Notes	15.00%	9.00%
Federal Farm Credit Bank Notes	8.00%	3.00%
Freddie Mac	6.00%	7.00%

The District's investment policy does not address this risk and places no limit on the amounts invested in any one issuer for federal agency securities.

Interest Rate Risk

Interest rate risk is the risk changes in interest rates will adversely affect the fair value of an investment.

Though the District has restrictions as to the maturities of some of the investments, it does not have a formal policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increases in interest rates. As of December 31, 2008 and 2007, the District's total portfolio, $172,256 and $275,866, is subject to interest rate risk at December 31, 2008 and 2007, respectively. $16,896 and $44,185 of this amount has maturities of one year or less as of December 31, 2008 and 2007, respectively. $137,886 and $216,077 of this amount has maturities of between one and five years and the remaining investments mature in greater than five years.

NOTE 4 - RESTRICTED ASSETS

Restricted Accounts

Certain proceeds of the District's debt, as well as certain resources set aside for their repayment, are classified as restricted assets on the statement of net assets because their use is limited. The following accounts are reported as restricted assets:

Redemption – Used to segregate resources accumulated for debt service payments over the next twelve months.

Reserve – Used to report resources set aside to make up potential future deficiencies in the redemption account.

Project – Used to report debt proceeds restricted for use in construction.

	Carrying Value as of Year-end	
	2008	2007
Restricted Accounts		
Project fund	$42,875	$105,691
Reserve fund	24,225	23,589
Redemption fund	12,955	16,630
Domestic water and reserve contingency fund	1,070	1,021
Total Restricted Accounts	$81,125	$146,931

Domestic Water Reserve And Contingency

As a condition of the Treatment and Delivery Agreement with the City of Modesto for domestic water, the District has established an account for the payment of emergency maintenance items that arise.

NOTE 5 - CHANGES IN CAPITAL ASSETS

A summary of changes in capital assets for 2008 follows:

	Balance 01/01/08	Increases	Decreases	Balance 12/31/08
Capital assets, not being depreciated				
Land and land rights	$21,414	$6,240	$ -	$27,654
Capital assets being depreciated				
Electric system	613,898	53,106	228	666,776
Domestic water plant	104,772	123	-	104,895
Irrigation system	46,648	115	-	46,763
General and administrative facilities	55,511	3,3352	-	58,863
Total Capital Assets Being Depreciated	820,829	56,696	228	877,297
Total Capital Assets	842,243	62,936	228	904,951
Less: Accumulated depreciation	(332,912)	(30,295)	(618)	(362,589)
Construction in progress	48,778	89,133	62,402	75,509
Net Capital Assets	$558,109	$121,774	$62,012	$617,871

A summary of changes in capital assets for 2007 follows:

	Balance 01/01/07	Increases	Decreases	Balance 12/31/07
Capital assets, not being depreciated				
Land and land rights	$21,394	$20	$ -	$21,414
Capital assets being depreciated				
Electric system	589,061	25,036	199	613,898
Domestic water plant	104,717	55	-	104,772
Irrigation system	46,500	148	-	46,648
General and administrative facilities	55,258	1,899	1,646	55,511
Total Capital Assets Being Depreciated	795,536	27,138	1,845	820,829
Total Capital Assets	816,930	27,158	1,845	842,243
Less: Accumulated depreciation	(306,652)	(28,001)	(1,741)	(332,912)
Construction in progress	17,574	57,284	26,080	48,778
Net Capital Assets	$527,852	$56,441	$26,184	$558,109

NOTE 6 - INVESTMENT IN PUBLIC POWER AGENCIES

The District's investments in public power agencies are accounted for using the equity method of accounting and consist of the following at December 31, 2008 and 2007:

	2008	2007
M-S-R Public Power Agency (M-S-R)	$(98,534)	$(95,131)
Transmission Agency of Northern California (TANC)	$1,677	$512

M-S-R

The District, Silicon Valley Power and the City of Redding formed M-S-R for the principal purpose of acquiring electric power resources for the electric systems of its members. The District owns a 50% interest in generation assets owned by M-S-R. The District's deficit investment derives from its proportionate interest in M-S-R's deficit and the District's commitment to repay its share of M-S-R's debt, among other costs and obligations, through its take-or-pay commitment. The generation activities of M-S-R consist of a 28.8% ownership interest in a 507-megawatt (MW) unit of a coal-fired electricity generating plant located in New Mexico (the San Juan Plant). M-S-R is also a participant in the Southwest Transmission Project, a 500-kilovolt alternating current transmission line between Central Arizona and Southern California that provides a firm transmission path for the transmission of electric power from the San Juan plant. The District is obligated to make interest and other generation and transmission project related payments to M-S-R commensurate with its 50% interest in M-S-R, and receives 50% of the electrical power generated by M-S-R. In 2006, M-S-R entered into agreements with PPM Energy, Inc. to purchase renewable energy from the Big Horn wind project. The District's share of the Big Horn output is 12.5% and is obligated to make payments commensurate with its share of the project. During 2008 and 2007, the District incurred purchased power costs of $42,327 and $47,076, respectively, in connection with these M-S-R resources. At December 31, 2008 and 2007, the District had a payable of $192 and $3,886, respectively, to M-S-R for its proportionate share of project related expenditures.

TANC

TANC is a joint power agency that owns a portion of the California Oregon Transmission Project (COTP), a transmission line between central California and southern Oregon. The District has a 21.3% ownership interest in TANC. TANC is entitled to approximately 87% of the 1,600 MW transmission capacity of the COTP. In addition, the District has a 34% share of TANC's transmission entitlement under the South of Tesla transmission agreements with Pacific Gas & Electric Company (PG&E) that provides the District with 102 MW of transmission between Tesla and Midway. The District is responsible for 34% of the South of Tesla operating costs. In July 2006, TANC changed the method used to invoice members for transmission costs. TANC began invoicing its members at the monthly TANC Open Access Transmission Tariff (OATT) rate. The OATT rate is charged to the member based on their entitlement share of kWs. During 2008 and 2007, the District incurred transmission costs of $16,015 and $10,265, respectively, relating to these projects, which are included in purchased power expense in the accompanying statements of revenues, expenses and changes in net assets. At December 31, 2008 and 2007, the District has a long-term payable of $8,196 and $5,179, respectively, to TANC relating primarily to certain non-cash expenses of TANC. This liability is included in unearned revenue and other liabilities in the accompanying consolidated balance sheets. In 2006, the District began selling excess transmission capabilities from the COTP transmission lines through TANC, as agent of the District. The District recognized $597 and $94 in revenues from transmission sales in the 2008 and 2007, respectively.

Summary

Summarized audited financial information of M-S-R and unaudited information for TANC is as follows at December 31:

	2008	2007
Total Assets	$736,130	$693,092
Total liabilities	$932,440	$880,773
Total net assets	(196,310)	(187,681)
Total Liabilities and Net Assets	$736,130	$693,092
Changes in net assets during the year	$(12,408)	$18,491

The long-term debt of M-S-R and TANC, which totals approximately $754,960 and $784,575 at December 31, 2008 and 2007, respectively, are collateralized by a pledge and assignment of net revenues of each agency, supported by take-or-pay commitments of the District and the other members. Should other members of these agencies default on their obligations to the agencies, the District would be required to make "step up" payments to cover a portion of the defaulted payments.

Modesto Irrigation District Financing Authority

The Authority is a joint power authority that provides financing for public improvements of the District, and is accounted for as a component unit of the District. The revenues and expenses of the Authority are eliminated upon consolidation with the District. The Authority's summary financial information as of December 31, 2008 and 2007 and for the years then ended is as follows:

	2008	2007
Assets		
Current assets	$7,547	$14,852
Other noncurrent assets	53,247	75,477
Debt service installment receivable, less current portion	129,730	79,010
Total Assets	190,524	169,339
Liabilities and Net Assets		
Current liabilities	5,912	5,764
Derivative financial instruments	31,584	7,533
Long-term debt	153,028	156,042
Net assets	-	-
Total Liabilities and Net Assets	190,524	169,339
Revenues and Expenses		
Revenues:		
Debt service contributions	28,548	12,546
Interest income	3,506	2,259
Total Revenues	32,054	14,805
Change in fair value of derivatives	(24,051)	(7,533)
Interest expense	(8,003)	(7,272)
Change in net assets	-	-
NET ASSETS, Beginning of Year	-	-
NET ASSETS, END OF YEAR	$ -	$ -

NOTE 7 - LONG-TERM DEBT

Long-Term Debt

The following bonds have been issued:

Date	Issue	Final Maturity	Interest Rate	Original Amount	Outstanding Amount 12/31/08
2/26/98	1998D Domestic Water Bonds	9/1/22	4.75 - 5.50%	$94,715	$67,435
1/7/99	1999A Certificates of Participation Refunding Bonds	7/1/26	4.25 - 4.75	70,501	42,934
1/11/99	1999B Certificates of Participation Refunding Bonds	7/1/22	5.30	49,775	37,790
12/20/01	2001A Certificates of Participation Bonds	7/1/31	3.50 - 5.00	98,600	87,175
5/9/03	2003A Certificates of Participation Bonds	7/1/33	2.25 - 5.00	93,225	82,805
3/17/04	2004A Certificates of Participation Bonds	7/1/26	3.50 - 5.00	50,000	50,000
3/17/04	2004B Certificates of Participation Bonds	7/1/35	5.00 - 5.50	66,025	66,025
7/25/06	2006A Certificates of Participation Bonds	10/1/36	4.00 - 5.00	146,950	131,715
6/26/07	2007F Domestic Water Revenue Bonds	9/1/37	Index Rate	93,190	93,190
1/7/99	1999A Capital Appreciation Certificates - Accreted Interest	12/31/21	4.10 - 5.30	N/A	10,638

General Debt Terms

The net revenue of the District's electric system is pledged for repayment of COPs and Revenue Bonds. The Domestic Water Revenue Bonds are collateralized by a pledge of payments made by the City of Modesto relating to domestic water services. Interest on certificates and revenue bonds is generally payable semi-annually, except for interest on certain COPs that is payable on the last day of each interest rate reset period and, interest on capital appreciation certificates (a component of COPs), which are paid at the date of maturity.

Required GASB 48 disclosures for pledged revenues are as follows:

Electric System	2008	2007
Principal and interest payments	$39,536	$40,009
Net revenues	$44,208	$38,466
Total remaining principal and interest	$498,444	$514,463
Percent of future gross revenues	6%	6%
Domestic Water System		
Principal and interest payments	$10,810	$8,856
Net revenues	$25,602	$8,270
Total remaining principal and interest	$160,625	$163,880
Percent of future gross revenues	12%	21%

The District is in compliance with required bond covenants.

Long-Term Debt Repayment

Revenue bonds debt service requirements to maturity follows, not including accreted interest from Capital Appreciation Bonds:

Year Ending December 31,	Principal	Interest	Total
2009	$20,726	$30,622	$49,744
2010	22,665	29,745	50,885
2011	22,749	28,771	50,460
2012	23,038	27,832	50,319
2013	23,899	26,848	50,165
2014-2018	118,175	117,816	233,610
2019-2023	125,605	89,318	212,917
2024-2028	117,700	60,175	175,829
2029-2033	120,135	30,648	150,447
2034-2037	64,377	5,762	70,897
Total Requirements	$659,069	$447,537	$1,095,273

The District had outstanding debt obligations totaling $67,815 at December 31, 2008 and 2007, which were defeased and excluded from the District's long-term debt.

Fair Value

The estimated fair values of the District's long-term debt, calculated using the value of each individual series based on quoted market prices for the same or similar issues at December 31, are as follows:

	2008	2007
Carrying amount	$659,069	$678,343
Fair value	713,890	687,228

Long-Term Obligation Summary

Long-term obligation activity for the year ended December 31, 2008 is as follows:

	01/01/08 Balance	Additions	Reductions	12/31/08 Balance	Due Within One Year
Domestic Water Revenue Bonds	$163,880	$ -	$3,255	$160,625	$3,440
Certificate of Participation	514,463	-	16,019	498,444	17,286
Accreted interest on Capital Appreciation Certificates	10,294	1,385	1,041	10,638	1,149
Unamortized debt discount	(2,938)	(17)	(144)	(2,811)	-
Unamortized premium	8,135	1,006	905	8,236	-
Unamortized loss on advance refunding	(14,625)	-	(2,043)	(12,582)	-
Unearned revenue and other liabilities	24,000	-	21,282	2,718	-
Derivative financial instruments	8,665	39,844	-	48,509	7,635
Equity interest in M-S-R	95,131	-	3,403	98,534	-
Totals	$807,005	$42,218	$41,534	$807,689	$29,510

Long-term obligation activity for the year ended December 31, 2007 is as follows:

	01/01/07 Balance	Additions	Reductions	12/31/07 Balance	Due Within One Year
Domestic Water Revenue Bonds	$73,780	$93,190	$3,090	$163,880	$3,255
Certificate of Participation	531,008	-	16,545	514,463	16,019
Accreted interest on Capital Appreciation Certificates	8,846	1,448	-	10,294	10,041
Unamortized debt discount	(3,074)	-	(136)	(2,938)	-
Unamortized premium	9,098	-	963	8,135	-
Unamortized loss on advance refunding	(16,796)	-	(2,171)	(14,625)	-
Unearned revenue and other liabilities	32,513	-	8,513	24,000	-
Derivative financial Instruments	3,740	4,925	-	8,665	1,046
Equity interest in M-S-R	104,605	-	9,474	95,131	-
Totals	$743,720	$99,563	$36,278	$807,005	$21,361

NOTE 8 - EMPLOYEE BENEFIT PLANS

The District maintains two retirement plans and a retiree medical benefits plan for its eligible employees. The Retirement Committee of the District's Board of Directors oversees the plans. The District has a Retirement Department that performs plan administrative functions. Plan investments are managed by the District Treasury Department and third-party investment managers. All funds of the plans are separate assets of the retirement plans, and are not assets of the District.

Basic Retirement Plan

Plan Description. The Basic Retirement Plan (the Plan) is a single-employer noncontributory defined benefit pension plan for eligible employees. The Plan provides retirement, disability and death benefits to plan members and beneficiaries. The District issues publicly available financial statements and required supplementary information of the Plan.

Annual Pension Cost. The District contributes at an actuarially determined rate. The annual required contribution was determined in accordance with the projected unit credit actuarial cost method. The actuarial value of assets is based on fair market valuations prepared by an appraisal service. The unfunded liability is amortized over a 30-year period using the "rolling amortization" approach. The amortization period is still open. Significant assumptions used to determine the actuarial accrued liabilities as of January 1, 2008, the most recently completed actuarial valuation, include the following, all reflecting annual compounding:

- Rate of return on the investment of present and future assets of 7.75% per year;
- Discount rate applied to the pension benefit obligation of 7.75% per year;
- Salary increases of 4% per year; and
- Cost of living increases to retirees of 2.5% per year.

The District's annual pension cost and net pension obligation for 2008 was as follows:

	2008	2007
Annual required contribution	$8,009	$7,490
Interest on net pension (prepaid) obligation	103	137
Adjustment to annual required contribution	(87)	(116)
Annual Pension Cost	8,025	7,511
Contributions made	7,380	7,950
Increase (Decrease) in net pension obligation	645	(439)
Net pension obligation, beginning of period	1,332	1,771
Net Pension Obligation, End of Period	$1,977	$1,332

Funding Policy. The Board of Directors has established, and may amend, the contribution requirements for Plan members and the District set forth in the terms of the Plan. The Terms of the Plan empower the Retirement Committee of the District (the Committee) to make, at reasonable intervals, an analysis of the funding requirements of the Plan for the payment of retirement benefits and expenses, based on reasonable actuarial assumptions and methods which take into account the experience of the Plan and the reasonable expectations, and on the basis of this analysis, to establish a funding policy for the Plan. The terms of the Plan state that, subject to the Board of Directors' right to suspend or reduce contributions to the Plan at any time, the District shall contribute to the Plan at least once a year, the amounts necessary to maintain the Plan on a sound actuarial basis, in a manner consistent with the funding policy established by the Committee.

The funding policy currently established by the Committee requires the District to contribute an amount set forth in the Recommendation Regarding Total Contributions presented in the Plan actuary's 2007 Actuarial report. The Required Annual Contributions set forth in the Recommendation regarding total contributions presented in the Actuarial Report are $8,025 and $7,511 which were contributed January 2, 2008 and 2007 for 2008 and 2007, respectively.

The District is the sole contributing entity. Prior to 1989, participants were allowed to make voluntary contributions and prior to 1977, participating contributions were required.

Certain historical trend information is summarized as follows:

Fiscal Year Ending	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation (Prepaid)	Net Change in Net Pension Obligation
12/31/08	$8,025	92%	$1,977	$645
12/31/07	$7,511	106%	$1,332	(439)
12/31/06	$8,287	100%	$1,771	20

The schedule of funding progress is presented below:

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ([b-a]/c)
12/31/08	$147,037	$178,276	$31,239	82.5%	$32,299	96.7%
12/31/07	$134,628	$163,698	$29,069	82.2%	$28,622	101.6%
12/31/06	$120,922	$151,878	$30,956	79.6%	$29,616	104.5%

Supplemental Retirement Plan

Eligible employees of the District also participate in the District's supplemental retirement plan (the Supplemental Plan). The Supplemental Plan is a defined contribution plan and serves as partial or full replacement of social security for participants, depending upon date of employment. Participants are required to contribute 5% of their compensation on a pre-tax basis. The District wholly matches the contributions. Participants become fully vested in the District's portion of their account after six months of employment. Covered payroll of Participants is the same as under the Basic Retirement Plan. Participants have three investment options, a fund comprised of short-term fixed income money market securities, managed by the District's Treasury Department, a fund comprised primarily of equities, managed by third party investment managers, and a fund comprised of long-term fixed income securities, managed by third party investment managers. The District made contributions to the Supplemental Plan of $1,759 and $1,643 for 2008 and 2007, respectively.

Health Care Benefits

Plan Description. The Retiree Health Program is a single-employer defined benefit healthcare plan. The District provides health care benefits, in accordance with District policy, to qualified retirees and their spouses. The qualification requirements for these benefits are similar to those under the District's retirement plans.

Funding Policy. Currently 263 employees and surviving spouses meet those eligibility requirements. The District contributes the full cost of coverage for employees who retired before 1992; employees who retire in 1992 and thereafter pay a portion of the monthly premium for eligible dependent coverage, and the District pays the remainder of the cost of the plan. Covered retirees are also responsible for personal deductibles and co-payments. The District pays for post-retirement dental and vision care for retirees only to age 65. These other postemployment benefits are charged to expense on a pay-as-you-go basis.

Annual OPEB Cost and Net OPEB Obligation. The District contributes at an actuarially determined rate. The annual required contribution was determined in accordance with the projected unit credit actuarial cost method. The actuarial value of assets is based on fair market valuations prepared by an appraisal service. Significant assumptions used to determine the actuarial accrued liabilities as of January 1, 2007, the most recently completed actuarial valuation, include the following, all reflecting annual compounding:

- Rate of return on the investment of present and future assets of 7.75% per year;
- An assumed inflation rate of 3.0% per year;
- Salary increases of 3.5% per year; and
- Projected health care cost increases of 8.0% for medical plans in 2008 trending to 5.0% in 2011 and thereafter and 3.0% per year for vision and 4.0% per year for dental for all future periods.

The District's annual OPEB cost (expense) is calculated based on the annual required contribution of the employer (ARC), an amount actuarially determined in accordance with the parameters of GASB Statement 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) over thirty years as a percentage of rising covered payroll. The following table illustrates the amount actually contributed to the plan, and changes in the District's net OPEB obligation (dollar amounts in thousands).

	2008	2007
Annual required contribution	$5,395	$4,993
Interest on net OPEB obligation	418	387
Adjustment to annual required contribution	(299)	(253)
Annual OPEB cost (expense)	5,514	5,127
Contributions made	5,422	4,520
Increase in net OPEB obligation	104	607
Net OPEB obligation, beginning of period	607	-
Net OPEB Obligation (asset), End of Period	$711	$607

The District's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for 2008 was as follows (dollars in thousands):

Fiscal Year Ending	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation
12/31/08	$5,514	98.33%	$711
12/31/07	$5,127	88.17%	$607

The schedule of funding progress was as follows for 2008 (dollars in thousands):

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ([b-a]/c)
12/31/07	$4,198	$56,238	$52,040	7.46%	$30,038	173.25%

Actuarial valuations of an ongoing plan involve estimates for the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future.

The required schedule of funding progress immediately following the Notes presents trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing benefit costs between the employer and plan members to that point. Actuarial calculations reflect a long-term perspective. The methods and assumptions used include techniques that are designed to reduce short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

NOTE 9 - FAIR VALUE MEASUREMENTS

Effective January 1, 2008, the District adopted FASB No. 157 as discussed in Note 3, which, among other things, requires enhanced disclosures about assets and liabilities carried at fair value. FASB No. 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (an exit price). The District utilizes market data or assumptions that market participants would use in pricing the asset or liability, including assumptions about risk and the risks inherent in the inputs to the valuation technique. The District primarily applies the market approach for recurring fair value measurements, maximizing the use of observable inputs and minimizing the use of unobservable inputs.

The District values natural gas and electricity derivatives based on an average of monthly quoted prices from an independent external pricing service.

FASB No. 157 establishes a fair value hierarchy that prioritizes the inputs used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1) and the lowest priority to unobservable inputs (level 3). The three levels of the fair value hierarchy defined by FASB No. 157 are as follows:

Level 1 Quoted prices (unadjusted) in active markets for identical assets or liabilities at the reporting date. An active market is a market in which the transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an ongoing basis.

Level 2 Pricing inputs that are other than quoted prices included in Level 1 which are either directly or indirectly observable as of the reporting date.

Level 3 Pricing inputs that are unobservable for the asset or liability for which there is little, if any, market activity as of the reporting date. These inputs may be used with internally developed methodologies that result in the District's best estimate of fair value.

The following table sets forth by level within the fair value hierarchy the District's financial assets and liabilities that were accounted for at fair value on a recurring basis as of December 31, 2008. As required by FASB No. 157, financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. The District's assessment of the significance of a particular input to the fair value measurement requires judgment, and may affect the valuation of the fair value assets and liabilities and their placement within the fair value hierarchy levels.

Recurring Fair Value Measures

	At fair value as of December 31, 2008			
	Level 1	Level 2	Level 3	Total
Description				
Liabilities				
Derivative Financial Instrument Liabilities				
Gas related agreements	$15,270	$-	$-	$15,270
Electric related agreements	1,656	-	-	1,656
Interest rate swap related agreements	-	31,584	-	31,584
Total Liabilities	$16,926	$31,584	$-	$48,510

NOTE 10 - COMMITMENTS

The District purchases most of its purchased power from M-S-R (Note 6) and through the following long-term agreements:

The City And County Of San Francisco Power Purchase Agreement

The City and County of San Francisco (CCSF) Power Purchase Agreement (Agreement) titled the "Amended and Restated Long Term Power Sales Agreement" (ARLTPSA) was amended in 2007 and is now titled the "Long Term Energy Sales Agreement between the City and County of San Francisco and the Modesto Irrigation District" (LTESA). Under the LTESA, CCSF sells as available generated energy to meet the District's Class One requirements through 2015. Class One power is limited to power necessary for municipal and pumping loads pursuant to the Raker Act (the 1913 federal law enabling construction of the Hetch Hetchy project in the national park). The cost for Class One power is at a price that reimburses CCSF for developing, maintaining, and transmitting such energy to the District.

The LTESA provides Class One power for the District at a minimum schedule of 40% of the capacity for the month and the agreement expires on June 30, 2015. The District's purchases under the LTESA in 2008 totaled $1,251. Total commitments under this agreement over the next five years are as follows as of December 31, 2008:

2009	$1,417
2010	1,481
2011	1,551
2012	1,621
2013	1,697

Other Energy Purchase Commitments

The District has a number of other power and natural gas purchase agreements with various entities, which provide for power and fuel deliveries, under various terms and conditions through 2016. Total commitments under these agreements over the next five years are as follows as of December 31, 2008:

2009	$115,051
2010	92,224
2011	60,215
2012	55,326
2013	41,985

NOTE 11 - CONTINGENCIES

California Energy Market Refund Dispute

In 2001, FERC issued an order establishing evidentiary hearings for the purpose of determining the amount of refunds, if any, due to customers of the California ISO and PX spot markets from market participants selling into those markets for the period October 2, 2000 through June 20, 2001 (the refund period). During this time period, the District was both a seller and a buyer in the California spot markets. This matter has been the subject of various proceedings with FERC and court filings with the Ninth District since 2001. The Administrative Law Judge (ALJ) assigned to the proceedings adopted hearing procedures that, among other issues, addressed the calculation of refunds and identification of the amount currently owed to each supplier (with separate quantities due from each entity) by the California ISO, the investor owned utilities, and the State of California. In December 2002, the ALJ issued his Certification of Proposed Findings, and in March 2003, FERC issued an Order (the March Order) accepting most of the Findings and adjusting the formula used to calculate the mitigated market-clearing price (MMCP) to be used in resettling the markets during the refund period. In its March Order, FERC noted that any future FERC findings of energy market manipulation that result from its ongoing review of additional evidence filed would neither result in a resetting of the refund effective date for this proceeding, nor impact the just and reasonable MMCP developed for the refund period. Throughout the process, the District challenged the FERC's jurisdictional authority to order refunds against the District, as a municipal utility.

In September 2005, the Ninth Circuit found that FERC does not have refund authority over wholesale power sales made by governmental entities and other non-public utilities, including the District. On March 7, 2007, the Ninth Circuit denied the California Parties' petition for rehearing and rehearing en banc as to the September 2005 decision. One of the California Parties filed a petition for writ of certiorari to the U.S. Supreme Court, which was denied. The mandate has issued for the September 2005 decision and proceedings have begun at FERC to determine how the Ninth Circuit's decision should be implemented.

In August 2006, the Ninth Circuit issued a decision, as amended, which could have expanded the scope of transactions for which the District would have been required to pay refunds, but for the September 2005 decision addressing jurisdiction. The August 2006 decision requires FERC to review certain evidence in considering whether to open up the time period for refunds back to May 2000. The decision also requires FERC to review multi-day transactions, but denies refunds for bilateral sales, including to the California Energy Resources Scheduling ("CERS") division of the California Department of Water Resources ("CDWR"). The California Parties may also use such ruling to support their cases in the civil proceedings discussed below. The mandate for the Ninth Circuit's August 2006 decision has issued and the case returns to FERC. Even if the Ninth Circuit's decision stands, the District must still defend several civil actions filed by the California Parties and the State of California as described below. Under the latest MMCP formula announced by FERC, the District estimates its potential refund exposure to be in the range of $4,900 to $7,700, though the range may be increasing due to potential, accrued interest, if ordered by a court.

Claims for 2000 and 2001 Power Sales

Following the Ninth Circuit's jurisdictional ruling in September 2005, the California Parties began to seek refunds through other jurisdictions. In December 2005, the California Parties presented a claim for damages pursuant to California Government Code §905 et seq. ("Tort Claims Act"). The California Parties' claim arises from the District's power sales from May 1, 2000 through June 20, 2001 in the wholesale electricity markets operated by the California ISO and the California PX. The California Parties allege that the District is contractually obligated under the California PX Participation Agreement and/or the ISO Scheduling Coordinator Agreement to reimburse the California Parties for any amounts that FERC might find were unjust under the California Refund Proceedings. The District returned the claim without action as untimely filed. In March 2006, the California Parties filed lawsuits in the Federal District Court for the Eastern District of California, Sacramento Division. The District, in conjunction with other municipal entities, filed motions to dismiss for failure to state a claim, raising defenses such as expiration of the statute of limitations and lack of standing. Other entities argued that the U.S. District Court had no jurisdiction to hear the claims. On October 24, 2006, the Federal District Court heard oral argument on the issue concerning subject matter jurisdiction. The judge deferred oral argument on the issue of failure to state a claim. On March 16, 2007, the judge issued an order dismissing both complaints before him for lack of subject matter jurisdiction.

The judge's order has been appealed by the California Parties to the Ninth Circuit. On April 9, 2007, the California Parties filed a Complaint in state Superior Court in Los Angeles against the District and other entities, seeking substantively similar relief as they did in the U.S. District Court, Eastern District. The California Parties have served their Complaint on the District, and the District intends on vigorously defending against this Complaint.

On January 3, 2006 the Attorney General of the State of California and the California Department of Water Resources (collectively, the State) presented a claim for damages pursuant to the Tort Claims Act. The State's claim arises out of the District's power sales into the California IS0/ California PX from October 2, 2000 through June 20, 2001. Similar to the California Parties' claim, discussed above, the State alleges that the District is contractually obligated under the California PX Participation Agreement and the ISO Scheduling Coordinator Agreement to reimburse the State for any amounts that FERC might find were unjust under the California Refund Proceedings. The District returned the claim without action as untimely. On June 14, 2006, the State filed a lawsuit against the District. On February 23, 2007, the Plaintiffs served their Complaint on the District, triggering the time period for the District to answer. On February 28, 2007, the

District and other entities entered into tolling agreements with the State. As an outcome of the tolling agreement, on March 1, 2007, the State moved to dismiss its Complaint against the District without prejudice.

The District intends on defending against these suits. The District has stated that this estimated range accounts for the plaintiffs' positions before the FERC, and on appeal to the U.S. Courts of Appeal and before the civil courts, concerning potential increased refund liability due to claims for an extended period, for a larger universe of transactions and other adjustments to the proxy price desired by the plaintiffs which would increase refund liability. While the plaintiffs may have the opportunity to refresh their arguments before the Eastern District Court and state court, the District will be able to refresh arguments it had raised before the FERC, but which were rejected, e.g., that the District made sales under emergency conditions to the ISO, which we contend is a mitigating factor in deciding whether the District ought to be held liable for paying refunds.

These parties' lawsuits make it possible that netting of the District's accounts receivable and the District's refund liability may not occur through the same administrative mechanism. It may be that these processes will be bifurcated. The District also estimates that a payment for some part of the California Parties' claims is probable in these proceedings, given the aggressiveness of the California Parties' claims.

With regard to the issue of refunds for a longer refund period than that ordered by the FERC, i.e., starting the refund period from May 2000 rather than from October 2, 2000, it is the District's conclusion that it is currently impossible to determine whether it is probable that the above-referenced plaintiffs and potential plaintiffs will be able to obtain refunds for the lengthened period. Those parties rely on the U.S. Court of Appeals for the Ninth Circuit decision, *State of California, ex. rel. Bill Lockyer v. FERC*, 383 F.3d 2006 (2004), and other pending litigation, e.g., an appeal in Ninth Circuit case number 01-71051, et. al., to support their claim for refunds for the extended period and *Public Utils. Comm'n of the State of California v. FERC*, 456 F.3d 1025, *as amended* 426 F.3d 1027 (2006) *as amended* Aug. 31, 2006. Those parties have received substantial opposition to their positions. Moreover, the FERC has not applied its proxy price methodology for the pre-October period. In addition, the California Parties have pursued their CERS claim in the Puget Sound case, and it will be difficult to see the impact of decisions concerning that arena on transactions with CERS, if any, until FERC applies those decisions.

In the meantime, the U.S. Court of Appeals for the Ninth Circuit has been mediating settlement efforts which are ongoing, and in which the District has been participating.

Although the California Parties' lawsuits and the State's claims do not specify the amount of damages that the California Parties seek, the District expects that the amounts would parallel the refund that the District would owe to the market if it were subject to the FERC-based refund liability. Under the latest MMCP formula prescribed in the FERC proceedings, the District estimates its potential refund exposure to be in the range of $4,900 to $7,700, though the range may be increasing due to potential, accrued interest, if ordered by a court.

As such, the District has maintained an accrued liability of $4,900 related to their contingent refund obligations at December 31, 2008.

General Contingencies

In the normal course of operations, the District is party to various claims, legal actions and complaints. However, the District's counsel and management believe that the ultimate resolution of these matters will not have a significant adverse effect on the financial position or results of operations of the District.

Open Contracts

The District has open contracts for approximately $131,490 for the domestic water plant expansion, advanced metering infrastructure, a reciprocating power plant and the Lodi Power plan. As of December 31, 2008, approximately $57,083 has been expended.

Electric Purchase Contracts. The District has entered into numerous electric purchase contracts with amounts totaling 3.9 million megawatt hours (MWh) for the purpose of fixing the rate on the District's electric power purchases. These electric purchase contracts result in the District paying fixed rates ranging from $46 to $107 per MWh. The contracts expire periodically from February 2009 through September 2026.

Gas Purchase Contracts. The District has entered into numerous gas purchase contracts with amounts totaling 4.8 million British Thermal Units (mmbtu) for the purpose of fixing the rate on the District's natural gas purchases for its gas-fueled power plants. These gas purchase contracts result in the District paying fixed rates ranging from $7.96 to $9.40 per mmbtu. The contracts expire periodically from January 2009 through December 2012.

NOTE 12 - RISK MANAGEMENT

The District is exposed to various risks of loss related to torts; theft of, damage to, or destruction of assets; errors and omissions; workers compensation; and health care of its employees. These risks are covered through the purchase of commercial insurance. The District is self insured for general and liability claims up to $1,000. The District also has excess liability insurance for claims over $1,000. There was no significant decrease in coverage over the prior year. Settled claims have not exceeded insurance coverage in each of the past three years. Claims are paid as they are incurred. Total accrual and payment history is shown below.

	2008	2007	2006
Claims liability - beginning of year	$ -	$ -	$ -
Claims accrued	199	556	268
Claims paid/other	(199)	(556)	(268)
Claims Liability - End of Year	$ -	$ -	$ -

NOTE 13 - SUBSEQUENT EVENT

Debt Issuance

On March 31, 2009, the District issued $132,145 of Series 2009A Certificates of Participation debt to finance various routine capital additions. The debt is payable over 30 years and bears a net interest rate from 4.5% to 6.0%.

Rate Adjustment

The District implemented a 14% three-step rate increase effective January 1, 2009, June 1, 2009 and September 1, 2009.

Other Post Employment Benefits (OPEB) Required Supplementary Information

The schedule of funding progress, presented as required supplementary information, present multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

The schedule of funding progress as of December 31, 2008 is as follows:

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ([b-a]/c)
12/31/07	$4,198	$56,238	$52,040	7.46%	$30,038	173.25%

MID MANAGEMENT

Board of Directors

Division 1:
Cecil O. Hensley

Division 2:
Michael L. Serpa

Division 3:
Tom Van Groningen (2008 Board Vice President)

Division 4:
Paul Warda (2008 Board President)

Division 5:
John Kidd

Secretary to the Board:
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General Manager
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Assistant General Managers

Electric Resources:
Roger VanHoy

Finance:
Lou Hampel

Transmission & Distribution:
Tom Kimball

Water Operations:
Walter Ward

Managers

Human Resources:
Irma Perrone

Information Technology:
Pat Wheeler

General Counsel
Tim O'Laughlin

MID Management Team (L-R) Roger Van Hoy, Lou Hampel, Allen Short, Irma Perrone, Tom Kimball, Walter Ward. Not pictured: Pat Wheeler

Advisors

Government Relations Advisors:
The Gualco Group, Inc., Sacramento
The Ferguson Group, LLC, Washington, D.C.

Trustee:
The Bank of New York Trust Company, N.A., San Francisco

Independent Accountants:
Virchow Krause & Company, LLP, Madison, Wisconsin

Bond Counsel:
Orrick, Herrington & Sutcliffe, San Francisco

Financial Advisor:
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