Kern River Funding Corporation
Issuer

Kern River Gas Transmission Company
Guarantor

Kern River
GAS TRANSMISSION COMPANY
A MIDAMERICAN ENERGY HOLDINGS COMPANY

Annual Report

For the years ended December 31, 2003 and 2002

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For the Years Ended December 31, 2003 and 2002

Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion and analysis should be read in combination with the Kern River Gas Transmission Company ("Kern River") historical financial statements and the notes to those statements. Kern River's actual results in the future could differ significantly from the historical results.

Results of Operations for the years ended December 31, 2003 and 2002

Gas transportation revenue increased \$99.4 million, or 61.8%, to \$260.2 million for the year ended December 31, 2003 from \$160.8 million for the same period in 2002. The increase was due to increased capacity reservation charges on additional capacity from the 2003 Expansion Project that was placed into service on May 1, 2003.

Operation and maintenance expense increased \$0.3 million, or 3.0%, to \$10.2 million for the year ended December 31, 2003 from \$9.9 million for the same period in 2002. The increase was due to the higher labor and other costs associated with operating the expanded pipeline that was placed into service on May 1, 2003 partially offset by lower employee moving costs.

Depreciation and amortization expense increased \$10.1 million, or 37.8%, to \$36.8 million for the year ended December 31, 2003 from \$26.7 million for the same period in 2002. The increase was due to higher depreciable asset balances as a result of the completion of the 2003 Expansion Project and higher levelized depreciation on the vintage system.

Taxes other than income expense increased \$3.5 million, or 48.6%, to \$10.7 million for the year ended December 31, 2003 from \$7.2 million for the same period in 2002. The increase was due to higher property taxes and increased use tax on compressor fuel.

Other income, net decreased \$5.3 million, or 26.5%, to \$14.7 million for the year ended December 31, 2003 from \$20.0 million for the same period in 2002. The decrease was primarily due to reduced equity allowance for funds used during construction ("AFUDC") and lower Equity AFUDC regulatory asset tax gross up income included in Other income as a result of the completion of the 2003 Expansion Project on May 1, 2003.

Interest charges, net increased \$20.2 million, or 48.3%, to \$62.0 million for the year ended December 31, 2003 from \$41.8 million for the same period in 2002. The increase was primarily due to higher interest applicable to the new senior notes discussed below, partially offset by higher debt AFUDC applicable to the 2003 Expansion Project and lower amortization of deferred financing costs.

Income tax expense increased \$23.5 million to \$51.6 million for the year ended December 31, 2003 from \$28.1 million for the same period in 2002. The increase was due to higher income before income taxes. The effective tax rate increased to 38.4% for the year ended December 31, 2003 from 37.8% for the same period in 2002.

Liquidity and Capital Resources

Kern River's cash and cash equivalents were \$6.4 million and \$12.4 million at December 31, 2003 and December 31, 2002, respectively.

Kern River generated cash flows from operations of \$151.3 million for the year ended December 31, 2003, compared to \$51.8 million for the same period in 2002. The increase in 2003 was primarily due to higher earnings during 2003 as compared to 2002 and the reduction in current income taxes resulting from the benefit of bonus depreciation on the 2003 Expansion Project.

Kern River used \$427.4 million for investing activities for the year ended December 31, 2003, compared to \$740.8 million for the same period in 2002. In both years, investing activities consisted primarily of investments in the 2003 Expansion Project. Kern River has no material commitments for capital expenditures other than those in the ordinary course of business, for maintenance of its properties and final completion of the 2003 Expansion Project described below. Kern

River anticipates 2004 capital expenditures, excluding equity AFUDC and including amounts charged to trade payables in the prior period, will total approximately $26.6 million.

Kern River generated cash flows from financing activities of $270.1 million for the year ended December 31, 2003, compared to $694.6 million for the same period in 2002. The $270.1 million came primarily from contributions from partners to finance the 2003 Expansion Project.

On July 17, 2002, Kern River received approval from the Federal Energy Regulatory Commission ("FERC") to construct, own and operate the 2003 Expansion Project. The 2003 Expansion Project looped most of Kern River's existing mainline, added three new compressor stations and upgraded or modified six of Kern River's existing compressor stations. On April 16, 2003, Kern River received approval from the FERC to place its 2003 Expansion Project into service on May 1, 2003. The 2003 Expansion Project became operational May 1, 2003, and increased Kern River's capacity by approximately 885,626 decatherms ("Dth") per day. Service is being provided under long-term contracts subject to incremental rates. The estimated cost of the expansion including reclamation and restoration is approximately $1.2 billion, which has been financed with approximately 70% debt and 30% equity, consistent with Kern River's original capital structure, the application for the FERC approval described above and the limitations contained in the indenture for Kern River's existing Senior Notes.

Construction was funded with the proceeds of an $875 million construction financing facility entered into by Kern River on June 21, 2002. The construction financing facility was structured as a two-year construction facility followed by a term loan with a final maturity 15 years after completion of the 2003 Expansion Project and had a variable interest rate which increased over the term of the facility from 1.375% to 4.5% over LIBOR. The credit facility was canceled and Kern River's completion guarantee in favor of the lenders as part of the credit facility terminated upon completion of the 2003 Expansion Project. Kern River had drawn $814.9 million on this facility at May 1, 2003, when it was terminated.

Kern River refinanced the construction financing facility and financed the 70% debt portion of another approximately $29 million construction project through an $836 million debt offering on May 1, 2003. The offering was in the form of a 15-year amortizing senior note bearing a fixed rate of interest of 4.893%.

Mirant Americas Energy Marketing ("Mirant") was one of the shippers that entered into a 15-year, 2003 Expansion Project, firm gas transportation contract (90,000 Dth per day) with Kern River (the "Mirant Agreement") and provided a letter of credit equivalent to 12 months of reservation charges as security for the Mirant Agreement. In July 2003, Mirant filed for Chapter 11 bankruptcy protection and continued to use the Mirant Agreement post-bankruptcy. In October 2003, Mirant informed Kern River that it would not renew its letter of credit and Kern River drew on the letter of credit and held the $14.8 million as cash collateral. Effective December 18, 2003, Mirant rejected the Mirant Agreement pursuant to procedures under the Bankruptcy Code and paid all post-petition amounts owing under the Mirant Agreement through December 18, 2003. On January 13, 2004, Kern River filed a proof of claim with the bankruptcy court for an aggregate total claim of $210.2 million, of which amount Kern River believes it has a secured claim of $14.8 million. The $14.8 million is held by Kern River in an escrow account. These claims arise from Mirant's rejection of the Mirant Agreement. Kern River is not presently able to provide a reasonable estimate as to how much it will ultimately recover on account of such claims.

Under the terms of a 1999 rate case settlement, Kern River is required to file a rate case as early as May 1, 2004 but no later than February 9, 2005. If a case is filed on May 1, 2004, rate changes resulting from Kern River's next rate case may not become effective until November 1, 2004.

Kern River has two customers who account for greater than 10% of its revenue. The loss of either of these, if not replaced, could have a material adverse effect on Kern River's business.

Environmental Matters

Kern River is subject to federal, state, and local environmental laws and regulations. Environmental expenditures are expensed or capitalized depending on their future economic benefit and potential for rate recovery. Kern River believes that, with respect to any expenditures required to meet applicable standards and regulations, FERC would grant the requisite rate relief so thatsuch expenditures would be permitted to be recovered. Kern River believes that compliance with applicable environmental requirements is not likely to have a material effect on Kern River's financial statements. Kern River had no significant environmental remediation obligations at December 31, 2003 or 2002.

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
Kern River Gas Transmission Company:

We have audited the accompanying balance sheets—regulatory basis of Kern River Gas Transmission Company (the "Company") as of December 31, 2003 and 2002, and the related statements of income—regulatory basis, changes in partners' capital—regulatory basis, and cash flows—regulatory basis for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these 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 financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As more fully described in Note 3 to the financial statements, the Company has prepared these financial statements using accounting practices prescribed or permitted by the Federal Energy Regulatory Commission, which practices differ from accounting principles generally accepted in the United States of America. The effects on the financial statements of the variances between the regulatory basis of accounting and accounting principles generally accepted in the United States of America, although not reasonably determinable, are presumed to be material.

In our opinion, because of the effects of the matters discussed in the preceding paragraph, the financial statements referred to above do not present fairly, in conformity with accounting principles generally accepted in the United States of America, the financial position of Kern River Gas Transmission Company as of December 31, 2003 and 2002, or the results of its operations or its cash flow for the years then ended.

In our opinion, the regulatory basis financial statements referred to above present fairly, in all material respects, the financial position of Kern River Gas Transmission Company as of December 31, 2003 and 2002, and the results of its operations and its cash flows for the years then ended, on the basis of accounting described in Note 3.

Deloitte & Touche LLP

February 26, 2004

Kern River Gas Transmission Company
Statements of Income – Regulatory Basis
(In thousands)

	Years Ended December 31, 2003	2002
Revenue – Gas Transportation	$ 260,182	$ 160,787
Operating expenses:		
Operation and maintenance	10,234	9,918
Administrative and general	20,606	20,616
Depreciation and amortization	36,771	26,693
Taxes other than income	10,736	7,232
Other	144	166
Total operating expenses	78,491	64,625
Operating income	181,691	96,162
Other income:		
Interest income	304	195
Allowance for equity funds used during construction	9,336	11,230
Other	5,081	8,585
Total other income	14,721	20,010
Income before interest charges and income taxes	196,412	116,172
Interest charges, net:		
Interest on long-term notes payable to subsidiary	58,823	33,374
Interest on construction financing facility	7,341	7,268
Allowance for debt funds used during construction	(17,293)	(14,770)
Amortization of deferred financing costs	11,450	14,867
Miscellaneous interest expense	1,658	1,062
Total interest charges, net	61,979	41,801
Income before income taxes	134,433	74,371
Income taxes	51,619	28,146
Net income	$ 82,814	$ 46,225

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

Kern River Gas Transmission Company
Balance Sheets – Regulatory Basis
(In thousands)

	December 31, 2003	December 31, 2002
ASSETS		
Current assets:		
Cash and cash equivalents	$ 6,387	$ 12,374
Trade receivables, net	28,711	21,927
Transportation and exchange gas receivable	6,906	3,412
Materials and supplies	4,642	2,766
Prepaid expenses	1,559	1,066
Total current assets	48,205	41,545
Property, plant and equipment, net:		
Cost	2,341,313	1,185,825
Accumulated depreciation	(471,272)	(455,369)
	1,870,041	730,456
Construction work in progress	2,089	820,548
Property, plant and equipment, net	1,872,130	1,551,004
Escrowed security funds	64,257	-
Deferred income taxes	127,569	7,173
Deferred financing costs	13,994	13,493
Deferred financing costs – swap breakage fees	32,342	36,448
Regulatory asset – depreciation	104,083	96,885
Regulatory asset – equity AFUDC tax gross-up	29,728	24,279
Other deferred charges	1,562	1,632
Total assets	$2,293,870	$1,772,459
LIABILITIES AND PARTNERS' CAPITAL		
Current liabilities:		
Current portion of long-term notes payable to subsidiary	$ 61,366	$ 24,000
Trade payables	7,874	83,014
Due to affiliates	1,122	1,611
Transportation and exchange gas payables	6,906	1,356
Customers' shared revenues payable	2,491	6,436
Income taxes payable	67	4,702
Accrued taxes other than income	2,906	2,999
Other accrued liabilities	2,287	3,488
Total current liabilities	85,019	127,606
Long-term portion of 4.893% notes payable to subsidiary	775,808	-
Long-term portion of 6.676% notes payable to subsidiary	439,000	464,000
Construction financing facility	-	789,916
Deferred income taxes	194,425	16,930
Other long-term liabilities	67,050	17,628
Total liabilities	1,561,302	1,416,080
Commitments and contingencies (Note 8)		
Partners' capital:		
Contributed capital	677,871	365,596
Retained earnings (deficit)	54,697	(9,217)
Total partners' capital	732,568	356,379
Total liabilities and partners' capital	$2,293,870	$1,772,459

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

Kern River Gas Transmission Company
Statements of Partners' Capital – Regulatory Basis
(In thousands)

	Contributed Capital	Retained Earnings (Deficit)	Total Partners' Capital
Balance at January 1, 2002	$254,308	$ (9,442)	$244,866
Capital contributions	102,346	-	102,346
Net income	-	46,225	46,225
Deferred tax adjustments (See note 3)	135,358	-	135,358
Current tax adjustments	3,584	-	3,584
Distributions	(130,000)	(46,000)	(176,000)
Balance at December 31, 2002	365,596	(9,217)	356,379
Capital contributions	312,275	-	312,275
Net income	-	82,814	82,814
Distributions	-	(18,900)	(18,900)
Balance at December 31, 2003	$677,871	$54,697	$732,568

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

Kern River Gas Transmission Company
Statements of Cash Flows – Regulatory Basis
(In thousands)

	Year Ended December 31, 2003	2002
Cash flows from operating activities:		
Net income	$ 82,814	$ 46,225
Adjustments to reconcile net income to net cash flows from operating activities:		
Depreciation and amortization	36,771	26,693
Provision for deferred income taxes	57,099	11,036
Amortization of deferred financing costs	11,450	14,867
Allowance for equity funds used during construction	(9,336)	(11,230)
Changes in other items:		
Trade receivables, net and transportation and exchange gas receivable	(10,278)	(8,302)
Materials and supplies	(1,876)	(11)
Prepaid expenses	(493)	(1,050)
Other assets and deferred charges	(5,379)	(6,672)
Trade payables, due to affiliates, transportation and exchange gas payable and customers' shared revenues payable	(2,376)	(31,830)
Other current liabilities	(5,929)	5,084
Other long-term and deferred liabilities	(1,185)	7,033
Cash flows from operating activities	151,282	51,843
Cash flows from investing activities:		
Capital expenditures for property, plant and equipment (including interest capitalized)	(433,125)	(740,760)
Proceeds from (costs for) disposition of property	5,718	(24)
Cash flows used in investing activities	(427,407)	(740,784)
Cash flows from financing activities:		
Contributions from partners	312,275	102,346
Distributions to partners	(18,900)	(176,000)
Proceeds from construction financing facility	25,000	789,916
Payments on construction financing facility	(814,916)	-
Proceeds from long-term notes payable to subsidiary	836,000	-
Deferred financing costs	(7,845)	(14,740)
Payments on long-term notes payable to subsidiary	(47,826)	(22,000)
Proceeds from notes to affiliates	-	1,344
(Payments) Proceeds on customer deposit transactions	(13,650)	13,712
Cash flows from financing activities	270,138	694,578
Net (decrease) increase in cash and cash equivalents	(5,987)	5,637
Cash and cash equivalents at beginning of period	12,374	6,737
Cash and cash equivalents at end of period	$ 6,387	$ 12,374
Supplemental disclosure of cash flow information:		
Interest paid, net of interest capitalized	$ 50,287	$ 24,075
Income taxes (refunded) paid	$ (845)	$ 11,836

Supplemental disclosure of noncash investing and financing activities:
Amounts applicable to capital expenditures for property, plant and equipment (including interest capitalized) that are included above related to trade payables were $5.2 million and $76.9 million for the years ended December 31, 2003 and 2002 respectively.

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

1. History and organization

Kern River Gas Transmission Company ("Kern River") is a Texas general partnership formed pursuant to the Kern River Gas Transmission Company General Partnership Agreement dated as of May 29, 1985, for the purpose of constructing and operating a 926-mile natural gas pipeline from southwestern Wyoming to Kern County, California. With the completion of a major expansion in 2003 and various minor expansions prior to that, the Kern River pipeline currently has 1,678 miles of pipeline, eleven compressor stations and a design capacity of 1,755,626 decatherm ("Dth"), or million British thermal units, per day. Gas transported on the Kern River pipeline is used in enhanced oil recovery operations in the heavy oil fields, food processing, electricity generation and other applications. Kern River is an indirect wholly-owned subsidiary of MidAmerican Energy Holdings Company ("MidAmerican").

On March 27,2002, Kern River was purchased by MidAmerican for $419.7 million, net of cash acquired of $7.7 million and a working capital adjustment, from two subsidiaries of The Williams Companies, Inc. ("Williams").

Kern River's system and the system of Mojave Pipeline Company ("Mojave"), which originates in Arizona, converge and interconnect at a point near Daggett, California. Pursuant to an agreement between Kern River, Mojave and Mojave Pipeline Operating Company ("MPOC"), Mojave and Kern River jointly own as tenants in common the pipeline beginning at Daggett, California. MPOC operates the jointly owned segment of pipeline in California, and Kern River reimburses Mojave for its share of the pipeline expenses in proportion to its ownership interest. As of December 31, 2003, Mojave's ownership interest is approximately 23.2% and Kern River's ownership interest is approximately 76.8%. The common facilities and associated operating costs are consolidated on a prorated basis.

2. Summary of significant accounting policies

Basis of Presentation

The financial statements have been prepared based upon the accounting regulations of the Federal Energy Regulatory Commission ("FERC") pursuant to the Code of Federal Regulations, Title 18, Part 201, Uniform System of Accounts. Therefore, these financial statements contain certain differences from general purpose financial statements prepared in accordance with accounting principles generally accepted in the United States, including account classification and the deferral of FERC prescribed depreciation expense pending future recovery. Also, these financial statements do not reflect the pushdown of goodwill of $22.1 million related to the acquisition of the additional 50% of Kern River acquired by Williams in 1996 and 1997 nor the pushdown of goodwill of $33.9 million related to the acquisition of Kern River by MidAmerican on March 27, 2002.

The financial statements present Kern River parent company information only. In accordance with FERC accounting regulations, Kern River's 100% ownership of Kern River Funding Corporation ("Funding") is accounted for by the equity method. Kern River's investment in Funding is included in Other deferred charges on the accompanying balance sheet.

Use of Estimates

The preparation of financial statements in conformity with the FERC's regulatory basis of accounting requires management to make estimates and assumptions that affect the amounts reported in the financial statements and the accompanying notes. Actual results could differ from those estimates.

Cash and Cash Equivalents

Cash and temporary cash investments include demand and time deposits, certificates of deposit and other marketable securities with a term to maturity of three months or less when acquired.

Allowance for Doubtful Accounts

Kern River normally has negligible uncollectable receivables. However, due to the effects of the bankruptcy of a major customer, Kern River has a reserve for this account of approximately \$1.6 million and \$3.2 million at December 31, 2003 and 2002, respectively.

Exchange Gas Imbalances

In the course of providing transportation services to customers, Kern River may receive different quantities of gas from shippers than the quantities delivered on behalf of those shippers. These transactions result in imbalances, which are settled through the receipt or delivery of gas in the future. Customer imbalances to be repaid or recovered in-kind are recorded as transportation and exchange gas receivables and payables in the accompanying balance sheets. These imbalances are valued at the average of the spot market rates at the Canadian border and the Rocky Mountain market as published in "Inside FERC's Gas Market Report." Settlement of imbalances requires agreement between the pipelines and shippers as to allocations of volumes to specific transportation contracts and timing of delivery of gas based on operational conditions.

Property, Plant and Equipment

Property, plant and equipment ("plant"), consisting principally of natural gas transmission facilities, is recorded at original cost. Certain equipment that is not in service but has a useful life over one year, such as replacement compressors, are included in Materials and Supplies. Kern River accounts for repair and maintenance costs under the guidance of FERC regulations. The FERC identifies installation, construction and replacement costs that are to be capitalized. Routine maintenance, repairs and renewal costs are charged to income as incurred. Gains or losses from the ordinary sale or retirement of plant are charged or credited to accumulated depreciation.

Depreciation and Amortization

A provision for depreciation and amortization of the transmission line and related facilities is included in Kern River's levelized cost of service used to design its rates as approved in its current rate settlements. In Kern River's levelized revenues, recovery of the cost of facilities varies each year throughout the levelization period. The FERC originally prescribed an annual book depreciation rate of 4 percent which was changed, beginning October 2001, to 2.0 percent. As part of a rate settlement approved in 2001, the depreciable life of Kern River's assets was extended through 2032 from the original 25-year life that would have ended in 2017. The difference between depreciation expense as prescribed by the FERC and the plant cost recovered through rates is deferred or charged to regulatory asset - depreciation pending recovery in future years.

Impairment of Long-Lived Assets

Kern River evaluates its long-lived assets for impairment when events or changes in circumstances indicate, in management's judgment, that the carrying value of such assets may not be recoverable. When such a determination has been made, management's estimate of undiscounted future cash flows attributable to the assets is compared to the carrying value of the assets to determine whether an impairment has occurred. If an impairment of the carrying value has occurred, the amount of the impairment recognized in the financial statements is determined by estimating the fair value of the assets and recording a loss for the amount that the carrying value exceeds the estimated fair value.

Judgments and assumptions are inherent in management's estimate of undiscounted future cash flows used to determine recoverability of an asset and the estimate of an asset's fair value used to calculate the amount of impairment to recognize. The use of alternate judgments and assumptions could result in the recognition of different levels of impairment charges in the financial statements.

Allowance for Borrowed and Equity Funds Used During Construction

Allowance for funds used during construction ("AFUDC") represents the estimated cost of borrowed and equity funds applicable to regulated natural gas transmission plant in process of construction. AFUDC is recognized as a cost of regulated natural gas transmission plant because it constitutes an actual cost of construction under established regulatory practices. The FERC has prescribed a formula to be used in computing separate allowances for borrowed and equity AFUDC.

Deferred Financing Costs

Debt financing costs of $8.7 million relating to the issuance of long-term debt issued in 1992 and repaid in 1996 were capitalized and are being amortized over the original 15-year term of the debt, as prescribed by the FERC. The remaining unamortized balances were $2.3 million and $3.0 million at December 31, 2003 and 2002, respectively.

During 2001, additional debt financing costs of $5.7 million relating to the issuance of long-term debt to refinance the long-term debt issued in 1996 and to fund 2001 expansion capital expenditures were recorded in deferred debt costs on the balance sheet. At the same time, $42.4 million related to costs of breaking an interest rate swap agreement was deferred. These costs have been included as a component of approved rates and will be amortized over the 15-year term of the 6.676% debt based on the percentage of debt principal retired each year, as prescribed by the FERC. The remaining unamortized balance of the issuance costs was $4.4 million and $5.0 million at December 31, 2003 and 2002, respectively. The remaining unamortized balance of the costs of breaking the interest rate swap agreement was $32.3 million and $36.4 million at December 31, 2003 and 2002, respectively.

During 2002, additional debt financing costs of $14.7 million relating to the issuance of the construction financing facility that is discussed in Note 4 below were capitalized and were amortized on a straight line basis over the period from June 2002 through April 2003. The unamortized balance was $5.5 million at December 31, 2002.

During 2003, additional debt financing costs of $7.8 million relating to the issuance of long-term debt to refinance the construction financing facility were recorded in deferred debt costs on the balance sheet. These costs have been included as a component of approved rates and will be amortized over the 15-year term of the 4.893% debt based on the percentage of debt principal retired each year, as prescribed by the FERC. The remaining unamortized balance of the issuance costs was $7.3 million at December 31, 2003.

Regulatory Asset - Equity AFUDC Tax Gross-up

A regulatory asset is recorded as prescribed by the FERC related to the tax effects of future revenues generated through rates from equity AFUDC. The regulatory asset is being amortized over the lives of the related depreciable assets.

Fair Value of Financial Instruments

Kern River used the following methods and assumptions, including the use of an outside banking firm, in estimating the fair value of its financial instruments:

Long-term note payable to subsidiary - The fair value of Kern River's private debt is based on similar issuances taking into account current market yields and similar credit spreads.

Construction financing facility - The carrying value of Kern River's construction financing facility approximated fair value.

Other financial instruments – All other financial instruments of a material nature are short-term and the carrying amounts approximated fair value.

The carrying amounts and fair values of Kern River's financial instruments at December 31, 2003 and 2002 are as follows:

	2003		2002	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
	(In thousands)			
Liabilities:				
Long-term 4.893% notes, due 2018	$812,174	$797,213	-	-
Long-term 6.676% notes, due 2016	$464,000	$507,240	$488,000	$530,846
Construction financing facility	-	-	$789,916	$789,916

Revenue Recognition

Revenues from the transportation of gas are recognized based on contractual terms and the related transported volumes. Kern River is subject to FERC regulations and, accordingly, certain revenues collected may be subject to possible refunds upon final orders in pending rate cases. Kern River records rate refund liabilities considering Kern River and other third party regulatory proceedings, advice of counsel and estimated total exposure, as discounted and risk weighted, as well as collection and other risks. Kern River currently has no previously filed, unresolved rate cases.

Income Taxes

Income taxes are a cost component used in determining Kern River's transportation rates allowed by the FERC. Accordingly, Kern River records an income tax provision in its accounts for income tax payable (calculated as if it were a corporation) to represent the partners' liability. Kern River's partners were included in Williams consolidated income tax returns for the period from January 1, 2002 through March 26, 2002. Beginning on March 27, 2002 and for 2003 Kern River's partners were included in the consolidated income tax returns filed by MidAmerican. MidAmerican receives from Kern River an amount equal to the federal income tax computed on Kern River's taxable income less the tax benefits associated with net operating losses and/or tax credits generated by Kern River.

Kern River accounts for income taxes under the provisions of SFAS No. 109, *Accounting for Income Taxes*, which provides for an asset and liability approach for accounting for income taxes. Under this approach, deferred tax assets and liabilities are recognized based on anticipated future tax consequences attributable to differences between financial statement carrying amounts of assets and liabilities and their respective tax bases.

Environmental Matters

Kern River is subject to federal, state, and local environmental laws and regulations. Environmental expenditures are expensed or capitalized depending on their future economic benefit and potential for rate recovery. Kern River believes that, with respect to any expenditures required to meet applicable standards and regulations, FERC would grant the requisite rate relief so thatsuch expenditures would be permitted to be recovered. Kern River believes that compliance with applicable environmental requirements is not likely to have a material effect on Kern River's financial statements. Kern River had no significant environmental remediation obligations at December 31, 2003 or 2002.

Recent Accounting Standards

Effective January 1, 2003, Kern River adopted Statement of Financial Accounting Standards ("SFAS") No. 143, "Accounting for Asset Retirement Obligations." SFAS No. 143 requires the recognition in the financial statements of the fair value of obligations associated with the final retirement of long-lived assets and amends SFAS No. 19, "Financial Accounting and Reporting by Oil and Gas Producing Companies." In adopting SFAS No. 143, Kern River concluded that it is legally obligated to remove or abandon in place its pipeline and related equipment upon the final retirement of the pipeline. While interim removal or abandonment in place and replacement of such equipment is probable, the final retirement date of these assets is not determinable, and therefore, the liability for their removal cannot be reasonably estimated.

Reclassifications

Certain reclassifications have been made in the 2002 financial statements to conform with the 2003 presentation.

3. Income Taxes

Significant components of the deferred tax liabilities and assets are as follows:

	December 31,	
	2003	2002
	(In thousands)	
Property, plant and equipment	$178,608	$ 9,077
Regulatory assets	15,075	7,476
Other – net	742	377
Deferred tax liabilities	194,425	16,930
Customers' shared revenues payables	949	2,432
Unamortized deferred debt costs	1,631	3,943
Net operating loss and credit carryforwards	122,142	-
Accrued liabilities and other liabilities	2,847	798
Deferred tax assets	127,569	7,173
Net deferred tax liabilities	$ 66,856	$ 9,757
Reflected as:		
Deferred income taxes – noncurrent asset	$127,569	$ 7,173
Deferred income taxes – noncurrent liability	194,425	16,930
	$ 66,856	$ 9,757

The acquisition of Kern River by MidAmerican was treated as an asset purchase for tax purposes. Therefore, the tax basis of Kern River's net assets was increased to fair market value at March 26, 2002. This resulted in the elimination of the then existing net deferred tax liability of $135.4 million, in accordance with normalization positions sustained by FERC and in compliance with normalization requirements of Internal Revenue Code Section 168.

Kern River estimates it will report a $320 million net operating loss ("NOL") for federal income tax purposes for the calendar year 2003. This NOL will expire at the end of 2023, if not used sooner by Kern River or used in MidAmerican's consolidated federal income tax return.

The provision for income taxes includes:

	December 31,	
	2003	2002
	(In thousands)	
Current:		
Federal	$ (5,843)	$ 14,952
State	363	2,158
	(5,480)	17,110
Deferred:		
Federal	50,708	9,956
State	6,391	1,080
	57,099	11,036
Total income taxes	$ 51,619	$ 28,146

A reconciliation of the federal statutory tax rate to the effective tax rate applicable to income before provision for income taxes is as follows:

	December 31,	
	2003	2002
Federal statutory rate	35.0%	35.0%
State taxes, net of federal benefit	3.3	2.8
Other	0.1	-
Effective tax rate	38.4%	37.8%

4. Long-term debt

Long-term Debt

On August 13, 2001, Funding issued $510 million in debt securities. The offering was in the form of $510 million of 15-year amortizing senior notes ("6.676% Senior Notes") bearing a fixed rate of interest of 6.676%. For the 6.676% Senior Notes, $405 million will be amortized through June 2016, with a final payment of $105 million to be made on July 31, 2016. Proceeds from the issuance of the 6.676% Senior Notes were loaned to Kern River and used to repay the existing bank debt held by Kern River and to pay financing costs associated with this offering, including breakage costs associated with previously held interest rate swaps. Including all financing costs associated with the offering, the overall effective cost of money to Kern River from this transaction was 8.34%. Kern River entered into a Trust Indenture agreement dated as of August 13, 2001, whereby Kern River guaranteed all $510 million of Funding's debt. At December 31, 2003, the maturities of Funding's securities and the maturities of amounts to be repaid by Kern River to Funding were $25 million, $26 million, $26 million, $26 million and $26 million for the years ended December 31, 2004, 2005, 2006, 2007 and 2008, respectively and $335 million thereafter.

On May 1, 2003, Funding issued $836 million in debt securities. The offering was in the form of $836 million of 15-year amortizing senior notes ("4.893% Senior Notes") bearing a fixed rate of interest of 4.893%. For the 4.893% Senior Notes, $727.7 million will be amortized through March 2018, with a final payment of $108.3 million to be made on April 30, 2018. Proceeds from the issuance of the 4.893% Senior Notes were loaned to Kern River which used the proceeds to repay the outstanding balance and accrued interest under its $875 million construction financing facility, pay financing costs associated with the offering and finance the 70% debt portion of another approximately $29 million construction project. At December 31, 2003, the maturities of amounts to be repaid by Kern River to Funding were $36.4 million, $36.8 million, $40.1 million, $43.5 million and $46.8 million for the years ended December 31, 2004, 2005, 2006, 2007 and 2008, respectively and $608.6 million thereafter.

Construction Financing

On July 17, 2002, Kern River received approval from the FERC to construct, own and operate the 2003 Expansion Project. The 2003 Expansion Project looped most of Kern River's existing mainline, added three new compressor stations and upgraded or modified six of Kern River's existing compressor stations. On April 16, 2003, Kern River received approval from the FERC to place its 2003 Expansion Project into service on May 1, 2003. The 2003 Expansion Project became operational May 1, 2003, and increased Kern River's capacity by approximately 885,626 Dth per day. Service is being provided under long-term contracts subject to incremental rates. The estimated cost of the expansion including reclamation and restoration is approximately $1.2 billion, which has been financed with approximately 70% debt and 30% equity, consistent with Kern River's original capital structure, the application for the FERC approval described above and the limitations contained in the indenture for Kern River's existing Senior Notes.

Construction was funded with the proceeds of an $875 million construction financing facility entered into by Kern River on June 21, 2002. The construction financing facility was structured as a two-year construction facility followed by a term loan with a final maturity 15 years after completion of the 2003 Expansion Project and had a variable interest rate which increased over the term of the facility from 1.375% to 4.5% over LIBOR. The construction financing facility was canceled and Kern River's completion guarantee in favor of the lenders as part of the construction financing facility terminated upon completion of the 2003 Expansion Project. Kern River had drawn $814.9 million on this facility at May 1, 2003, when it was terminated.

Debt Covenants

The terms of Funding's debt indentures to which Kern River is guarantor preclude the issuance of mortgage bonds by Funding and Kern River. The indentures contain provisions for the acceleration of repayment under certain conditions. The indentures also contain restrictions that, under certain circumstances, limit Funding and Kern River's ability to issue additional debt, pay cash distributions, and dispose of a major portion of Kern River's natural gas pipeline system. As of December 31, 2003, management believes Kern River is in compliance with all its debt covenants.

5. Related party transactions

Since the purchase by MidAmerican, Kern River has been directly charged or allocated from MidAmerican administrative and operating costs for the cost of service provided. Total operation and maintenance expenses and administrative and general expenses charged to Kern River by MidAmerican totaled $6.9 million and $4.0 million for the periods ended December 31, 2003 and December 31, 2002, respectively.

Prior to March 27, 2002, Kern River had no employees and was charged by a Williams affiliate for the cost of the employees that rendered services to it in 2002. Kern River was directly charged or allocated from Williams or its affiliates administrative and operating costs including rent for office space. Total operation and maintenance expenses and administrative and general expenses charged to Kern River by Williams or its affiliates were $4.1 million for the three months ended March 31, 2002. Subsequent to the purchase of Kern River by MidAmerican certain employees of Williams became employees of Kern River.

During the periods presented, Kern River's revenues reflect transportation and exchange transactions with subsidiaries of Williams. Combined revenues for these activities totaled $2.9 million through March 31, 2002.

Kern River has entered into various other transactions with certain related parties, the amounts of which were not significant. These transactions and the above-described transactions are charged on the basis of commercial relationships and prevailing market prices or general industry practices.

6. Major customers and other credit risks

In 2003, Kern River had two major customers (Reliant Energy Services, Inc. and Duke Energy Trading & Marketing, L.L.C.) each of which accounted for greater than 10% of gas transportation revenues. Total transportation revenues applicable to these customers for 2003 were $65.9 million. The total balance in accounts receivable at December 31, 2003 for these customers was $7.1 million. In 2002, Kern River had four major customers (Duke Energy Trading & Marketing, L.L.C., Chevron U.S.A. Inc., Coral Energy Resources, L.P., and Reliant Energy Services, Inc.) each of which accounted for greater than 10% of gas transportation revenues. Total transportation revenues applicable to these customers for 2002 were $91.6 million. The total balance in accounts receivable at December 31, 2002 for these customers was $8.1 million.

As a general policy, collateral is not required for receivables from creditworthy customers. Customers' financial condition and creditworthiness are regularly evaluated, and historical losses have been minimal. However, during 2002 and 2003 the creditworthiness of certain customers declined to below investment grade. In order to protect Kern River interests, and as permitted by the terms of Kern River's tariff, Kern River has required these customers to provide cash deposits, included in Other long-term liabilities or letters of credit, not reflected on the balance sheet which will be held until these customers' creditworthiness improves. The customer cash deposits and letters of credit were $64.3 million and $42.0 million, respectively, at December 31, 2003 and $13.7 million and $70.9 million, respectively, at December 31, 2002. In addition, during 2003, the $13.7 million cash deposits received during 2002, which reduced borrowings under the construction financing facility at December 31, 2002, were placed into the Escrowed security funds account by Kern River through the use of additional borrowed funds. Additional deposits from customers included in Other long-term liabilities and placed into the Escrowed security funds account during 2003 were $50.6 million.

7. Post retirement obligations

Prior to the purchase of Kern River by MidAmerican, Kern River had no employees and was charged by Williams affiliates for the cost of employees that rendered services to it. During that period, the Kern River employees who were formerly employed by Williams participated in Williams' pension plans and none of the assets or obligations for these employees transferred to Kern River from Williams at the date of acquisition. Pension-related benefit costs for Williams' employees providing services to Kern River were charged through payroll loading and recovered through Kern River's cost of service in rates.

Since the purchase, all Kern River employees are now participants in MidAmerican's retirement plans. MidAmerican has primarily noncontributory cash balance defined benefit pension plans covering substantially all Kern River employees. Benefit obligations under the plans are based on participants' compensation, years of service and age at retirement. Funding by Kern River to MidAmerican and from MidAmerican to an external trust is based upon the actuarially determined costs of the plans and the requirements of the Internal Revenue Code and the Employee Retirement Income Security Act. Kern River has been allowed to recover pension costs related to its employees in rates.

MidAmerican currently provides certain postretirement health care and life insurance benefits for retired employees. Under the plans, substantially all of Kern River's employees may become eligible for these benefits if they reach retirement age while working for Kern River. However, MidAmerican retains the right to change these benefits anytime at its discretion. Kern River expenses its portion of these postretirement benefit costs on an accrual basis.

Amounts paid for these obligations by Kern River in 2003 and 2002 were not material to the financial statements.

8. Commitments and contingencies

Operating Lease Commitments

Kern River has various non-cancelable operating leases primarily for office space. The minimum payments under these leases are $1.0 million for each of the next five years and $10 million thereafter.

Litigation

In 1998, the United States Department of Justice informed the then current owners of Kern River that Jack Grynberg, an individual, had filed claims in the United States District Court for the District of Colorado under the False Claims Act against such entities and certain of their subsidiaries including Kern River. Mr. Grynberg has also filed claims against numerous other energy companies alleging that the defendants violated the False Claims Act in connection with the measurement and purchase of hydrocarbons. The relief sought is an unspecified amount of royalties allegedly not paid to the federal government, treble damages, civil penalties, attorneys' fees and costs. On April 9, 1999, the United States Department of Justice announced that it declined to intervene in any of the Grynberg qui tam cases, including the actions filed against Kern River in the United States District Court for the District of Colorado. On October 21, 1999, the Panel on Multi-District Litigation transferred the Grynberg qui tam cases, including the ones filed against Kern River, to the United States District Court for the District of Wyoming for pre-trial purposes. Motions to dismiss the complaint, filed by various defendants including Williams, which was the former owner of Kern River, were denied on May 18, 2001. On October 9, 2002, the United States District Court for the District of Wyoming dismissed Grynberg's royalty valuation claims. On November 19, 2002, the United States District Court for the District of Wyoming denied Grynberg's motion for clarification and dismissed his royalty valuation claims. Grynberg appealed this dismissal to the United States Court of Appeals for the Tenth Circuit and on May 13, 2003, the Tenth Circuit Court dismissed his appeal. In connection with the purchase of Kern River from Williams in March 2002, Williams agreed to indemnify MEHC against any liability for this claim; however, no assurance can be given as to the ability of Williams to perform on this indemnity should it become necessary. Kern River believes that the Grynberg case filed against Kern River is without merit and Williams, on behalf of Kern River pursuant to its indemnification, intends to defend these actions vigorously.

On June 8, 2001, a number of interstate pipeline companies, including Kern River, were named as defendants in a nationwide class action lawsuit which had been pending in the 26th Judicial District, District Court, Stevens County Kansas, Civil Department against other defendants, generally pipeline and gathering companies, since May 20, 1999. The plaintiffs allege that the defendants have engaged in mismeasurement techniques that distort the heating content of natural gas, resulting in an alleged underpayment of royalties to the class of producer plaintiffs. In November 2001, Kern River, along with the coordinating defendants, filed a motion to dismiss under Rules 9B and 12B of the Kansas Rules of Civil Procedure. The court denied this motion. In January 2002, Kern River and most of the coordinating defendants filed a motion to dismiss for lack of personal jurisdiction. The plaintiffs filed for certification of the plaintiff class on September 16, 2002. On January 13, 2003, oral arguments were heard on coordinating defendants' opposition to class certification. On April 10, 2003, the court entered an order denying the plaintiffs' motion for class certification. On May 12, 2003, the plaintiffs filed a motion for leave to file a fourth amended petition alleging a class of gas royalty owners in Kansas, Colorado and Wyoming. The court granted the motion for leave to amend on July 28, 2003. Kern River was not a named defendant in the amended complaint and has been dismissed from the action. Williams has agreed to indemnify MEHC against any liability associated with Kern River for this claim; however, no assurance can be given as to the ability of Williams to perform on this indemnity should it become necessary. Kern River believes that this claim is without merit and that Kern River's gas measurement techniques have been in accordance with industry standards and its tariff.

Mirant Americas Energy Marketing ("Mirant") was one of the shippers that entered into a 15-year, 2003 Expansion Project, firm gas transportation contract (90,000 Dth per day) with Kern River (the "Mirant Agreement") and provided a letter of credit equivalent to 12 months of reservation charges as security for the Mirant Agreement. In July 2003, Mirant filed for Chapter 11 bankruptcy protection and continued to use the Mirant Agreement post-bankruptcy. In October 2003, Mirant informed Kern River that it would not renew its letter of credit and Kern River drew on the letter of credit and held the $14.8 million as cash collateral. Effective December 18, 2003, Mirant rejected the Mirant Agreement pursuant to procedures under the Bankruptcy Code and paid all post-petition amounts owing under the Mirant Agreement through

December 18, 2003. On January 13, 2004, Kern River filed a proof of claim with the bankruptcy court for an aggregate total claim of $210.2 million, of which amount Kern River believes it has a secured claim of $14.8 million. The $14.8 million is held by Kern River in an escrow account. These claims arise from Mirant's rejection of the Mirant Agreement. Kern River is not presently able to provide a reasonable estimate as to how much it will ultimately recover on account of such claims.

2002 Expansion

On July 26, 2001, FERC issued Kern River's requested certificate authorization to construct and operate the additional facilities required to accommodate additional long-term contract commitments above those made possible in the California Emergency project for 10,500 Dth per day of firm transportation commencing May 1, 2002. As part of the order FERC granted Kern River's request for a predetermination favoring rolled-in rate treatment with the condition that existing shippers not incur increased incremental fuel cost as a result of the expansion. Rates to implement the 2002 Expansion were implemented and approved by FERC effective May 1, 2002.

On October 24, 2001, FERC denied certain shippers' request for rehearing of FERC's July 26, 2001 order issuing Kern River's certificate. These shippers had argued that providing additional firm capacity rights at Wheeler Ridge would degrade their service. They also argued Kern River should be prohibited from selling additional firm capacity at Wheeler Ridge until there is sufficient take away capacity or that lower scheduling priorities should be established for new capacity at Wheeler Ridge.

On May 1, 2002, Kern River completed and placed the 2002 Expansion facilities into service.

2003 Expansion

On August 1, 2001, Kern River filed a Section 7(c) application with the Commission requesting authorization to construct, own and operate a major expansion to its pipeline system. On July 17, 2002, Kern River received approval from the FERC to construct, own and operate the 2003 Expansion Project. The 2003 Expansion Project looped most of Kern River's existing mainline, added three new compressor stations and upgraded or modified six of Kern River's existing compressor stations. The 2003 Expansion Project became operational May 1, 2003, and increased Kern River's capacity by approximately 885,626 Dth per day. Service is being provided under long-term contracts subject to incremental rates. The estimated final construction cost of the expansion including reclamation and restoration is approximately $1.2 billion.

Summary of Other Legal and Contingent Liabilities

Kern River is party to legal proceedings incidental to its operations. Kern River believes, based on advice of counsel, that the outcome of these proceedings, individually and in the aggregate, will not have a materially adverse effect on the financial position, results of operations or cash flows of Kern River.

Commitments for construction and acquisition of property, plant, and equipment are approximately $26.6 million, net of equity AFUDC, at December 31, 2003. The majority of these commitments relate to capital expenditures incurred by Kern River for the ordinary course of business and for maintenance of its properties.

Kern River Funding Corporation

Financial Statements

For the Years Ended December 2003 and 2002

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
Kern River Funding Corporation:

We have audited the accompanying balance sheets of Kern River Funding Corporation as of December 31, 2003 and 2002, and the related statements of income and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these 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 financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the Company at December 31, 2003 and 2002, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Deloitte & Touche LLP

February 26, 2004

Kern River Funding Corporation
Statements of Income
(In thousands)

	Year Ended December 31, 2003	Year Ended December 31, 2002
Income - Revenues from long-term note activity with parent	$58,823	$33,374
Expenses:		
Interest expense on long-term debt	58,823	33,374
Net Income	$ -	$ -

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

Kern River Funding Corporation
Balance Sheets
(In thousands, except per share data)

	December 31, 2003	December 31, 2002
ASSETS		
Current assets:		
Current portion of long-term notes receivable from parent	$ 61,366	$ 24,000
Receivable due from affiliate	1	1
Total current assets	61,367	24,001
Long-term notes receivable from Parent	1,214,808	464,000
Total assets	$1,276,175	$488,001
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current maturities of long-term debt	$ 61,366	$ 24,000
Long-term portion of 4.893% notes, due 2018	775,808	-
Long-term portion of 6.676% notes, due 2016	439,000	464,000
Stockholders' equity –		
Common stock, par value $1 per share; authorized and outstanding 1,000 shares	1	1
Total liabilities and stockholders' equity	$1,276,175	$488,001

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

Kern River Funding Corporation
Statements of Cash Flows
(In thousands)

	Year Ended December 31, 2003	2002
Cash flows from financing activities:		
Proceeds from issuance of long-term debt, net of issuance costs	828,155	-
Advances on long-term note receivable to parent, net of issuance costs	(828,155)	-
Proceeds received on long-term note receivable from parent	47,826	22,000
Payments on long-term debt	(47,826)	(22,000)
Net cash flows from investing activities	-	-
Net change in cash	-	-
Cash at beginning of period	-	-
Cash at end of period	$ -	$ -
Supplemental disclosure of cash flow information:		
Interest paid	$ 58,823	$ 33,374

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

Kern River Funding Corporation
Notes to Financial Statements

1. General

Kern River Funding Corporation ("Funding") is a wholly-owned subsidiary of Kern River Gas Transmission Company ("Kern River"). Funding was organized to issue and make payments on debt securities for Kern River. There are no other revenues or costs incurred by Funding except for those that are passed from or to Kern River.

2. Long-term debt

On August 13, 2001, Funding issued $510 million in debt securities. The offering was in the form of $510 million of 15-year amortizing senior notes ("6.676% Senior Notes") bearing a fixed rate of interest of 6.676%. For the 6.676% Senior Notes, $405 million will be amortized through June 2016, with a final payment of $105 million to be made on July 31, 2016. Proceeds from the issuance of the 6.676% Senior Notes were loaned to Kern River which used the proceeds to repay other existing debt held by Funding and to pay financing costs associated with the offering, including breakage costs associated with previously held interest rate swaps. Kern River entered into a Trust Indenture agreement dated as of August 13, 2001, whereby Kern River guaranteed all $510 million of Funding's debt. At December 31, 2003, the maturities of Funding's securities and the maturities of amounts to be repaid by Kern River to Funding were $25 million, $26 million, $26 million, $26 million and $26 million for the years ended December 31, 2004, 2005, 2006, 2007 and 2008, respectively and $335 million thereafter.

On May 1, 2003, Funding issued $836 million in debt securities. The offering was in the form of $836 million of 15-year amortizing senior notes ("4.893% Senior Notes") bearing a fixed rate of interest of 4.893%. For the 4.893% Senior Notes, $727.7 million will be amortized through March 2018, with a final payment of $108.3 million to be made on April 30, 2018. Proceeds from the issuance of the 4.893% Senior Notes were loaned to Kern River which used the proceeds to repay the outstanding balance and accrued interest under its $875 million construction financing facility, pay financing costs associated with the offering and finance the 70% debt portion of another approximately $29 million construction project. At December 31, 2003, the maturities of amounts to be repaid by Kern River to Funding were $36.4 million, $36.8 million, $40.1 million, $43.5 million and $46.8 million for the years ended December 31, 2004, 2005, 2006, 2007 and 2008, respectively and $608.6 million thereafter.

The terms of Funding's debt indentures to which Kern River is guarantor preclude the issuance of mortgage bonds by Funding and Kern River. The indentures contain provisions for the acceleration of repayment under certain conditions. The indentures also contain restrictions which, under certain circumstances, limit Funding and Kern River's ability to issue additional debt, pay cash distributions, and dispose of a major portion of Kern River's natural gas pipeline system.

3. Revenue recognition

Funding recognizes revenues based on the interest costs that are passed through to Kern River. For 2003, Funding's reported revenues include $58.8 million of interest income on notes receivable from Kern River. For 2002, Funding's reported revenues included $33.4 million of interest income on notes receivable from Kern River.

4. Income taxes

Funding computes an income tax provision for income taxes payable to represent Fundings' liability as if it filed a separate return. Funding is included in MidAmerican's consolidated federal income tax return for the periods from March 27, 2002 (date of acquisition) through December 31, 2003 and in the consolidated federal tax return of Williams for the period from January 1, 2002 through March 26, 2002. For the years ended December 31, 2003 and 2002 there was no current income tax expense and there were no temporary differences.

5. Financial instruments – Fair Value

Funding used the following methods and assumptions, including the use of an outside investment banking firm, in estimating the fair value of its financial instruments:

Long-term note receivable from parent: The fair value of Funding's note receivable is based on similar issuances taking into account current market yields and similar credit spreads.

Long-term debt: The fair value of Funding's private debt is based on quoted market prices.

The carrying amounts and fair values of Funding's financial instruments at December 31, 2003 and 2002 are as follows:

	2003		2002	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
	(In thousands)			
Assets:				
Affiliates long-term note receivable from parent	$1,276,174	$1,304,453	$488,000	$530,846
Liabilities:				
Long-term 4.893% notes, due 2018	$812,174	$797,213	-	-
Long-term 6.676% notes, due 2016	$464,000	$507,240	$488,000	$530,846