

INDEPENDENT AUDITORS' REPORT

Board of Directors
California State Water Resources Control Board
Sacramento, California

Report on the Financial Statements

We have audited the accompanying financial statements of the California State Water Resources Control Board, Water Pollution Control Revolving Fund (Water Pollution Control Revolving Fund), an enterprise fund of the State of California, as of and for the years ended June 30, 2017 and 2016, and the related notes to the financial statements, which collectively comprise the entity's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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 and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

As discussed in Note 1 - Definition of Reporting Entity, the basic financial statements of the California State Water Resources Control Board, Water Pollution Control Revolving Fund are intended to present the financial position, changes in financial position and cash flows of only that portion of the financial reporting entity of the California State Water Resources Control Board that is attributable to the transactions of the California State Water Resources Control Board, Water Pollution Control Revolving Fund. They do not purport to, and do not, present fairly the financial position of the California State Water Resources Control Board or the State of California as of June 30, 2017 and 2016, and the changes in their financial position and their cash flows, where applicable, for the years then ended, in conformity with the accounting principles generally accepted in the United States of America.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the California State Water Resources Control Board, Water Pollution Control Revolving Fund as of June 30, 2017 and 2016, and the respective changes in financial position and cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages IV through X be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audits were conducted for the purpose of forming an opinion on the financial statements that collectively comprise the California State Water Resources Control Board, Water Pollution Control Revolving Fund's basic financial statements. The schedule of federal awards, as required by Title 2 U.S. Code of Federal Regulations Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards*, is also presented for purposes of additional analysis and is not a required part of the basic financial statements.

The schedule of expenditures of federal awards is the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated October 2, 2017, on our consideration of the Water Pollution Control Revolving Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the result of that testing, and not to provide an opinion on the effectiveness of the Water Pollution Control Revolving Fund's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Water Pollution Control Revolving Fund's internal control over financial reporting and compliance.

A handwritten signature in cursive script that reads "CliftonLarsonAllen LLP".

CliftonLarsonAllen LLP

Greenwood Village, Colorado
October 2, 2017

**California State Water Resources Control Board
Water Pollution Control Revolving Fund
State Revolving Fund Program**

Management's Discussion & Analysis

The following Management's Discussion and Analysis is a required supplement to the California State Water Resources Control Board's (State Water Board), Water Pollution Control Revolving Fund (Clean Water State Revolving Fund program) (CWSRF) financial statements. It describes and analyzes the financial position of the CWSRF providing an overview of the CWSRF's activities for the years ended June 30, 2017 and 2016. We encourage readers to consider the information presented here in conjunction with information that is in the financial statements and notes, which follow this section.

Financial Highlights

- Net position increased by \$113.1 million to a total of \$4 billion in 2017, which was \$8.4 million less than the increase of \$121.5 million in 2016. The smaller increase in net position is a direct result of lower capital contributions during the year from the U.S. Environmental Protection Agency (EPA).
- Capital contributions decreased by \$8.9 million to \$65.8 million as compared to \$74.7 million in 2016. The decrease in capital contributions was mostly a result of less capital available from EPA capitalization grants for loan disbursements. Capital contributions from EPA capitalization grant funds that were forgiven decreased by \$3 million to \$5 million as compared to \$8 million in 2016.
- Cash and cash equivalents increased by \$308 million in 2017 as compared to an increase of \$452 million in 2016. The increase in 2017 was mostly the result of an increase in cash from the issuance of the Series 2017 Revenue Bond and several payoffs of loan receivables.
- Loans receivable increased by \$309 million to \$4 billion in 2017 and increased by \$155 million in 2016. The larger increase in 2017 mostly reflects an increase in loan disbursements.
- On March 23, 2017, the CWSRF issued California Infrastructure and Economic Development Bank, Clean Water State Revolving Fund Revenue Bonds, Series 2017 for \$450 million at a premium of \$79.5 million. The Series 2017 Revenue Bonds were issued for the purpose of making financial assistance available to recipients for eligible projects.
- Restricted portion of net position decreased by \$100 million to \$1.5 billion in 2017 as compared to an increase of \$1.3 billion in 2016. The decrease in 2017 reflects the decrease in notes receivables for loans pledged to the Series 2012, 2016 and 2017 Revenue Bonds as a result of repayments received and the related debt service payments. The increase in 2016 reflects the greater pledged loan requirements of the Series 2016 Revenue Bonds.

Using this Annual Financial Report

The financial statements included in this annual financial report are those of the CWSRF. As discussed in Note 1, Definition of Reporting Entity, the basic financial statements of the CWSRF are intended to present the financial position, changes in financial position, and cash flows of only that portion of the financial reporting entity of the State Water Board that is attributable to the transactions of the CWSRF. They do not purport to present the financial position of the State Water Board or the State of California (State) as of June 30, 2017 and 2016 and the change in their financial positions and their cash flows for the years then ended.

Overview of Financial Statements

This discussion and analysis is an introduction to the CWSRF financial statements and accompanying notes to financial statements. This report also contains required supplementary information and other supplementary information.

The financial statements of the CWSRF are presented as a special purpose government engaged only in business type activities - providing loans to other governmental entities. The statements provide both short-term and long-term information about the CWSRF's financial position, which assists the reader in assessing the CWSRF's economic condition at the end of the fiscal year. These statements are prepared using the accrual basis of accounting. The financial statements include the following three statements:

- The *Statements of Net Position* present information on all of the CWSRF's assets, deferred outflows of resources, liabilities and deferred inflows of resources with the difference reported as net position. Over time, increases or decreases in net position are expected to serve as a useful indicator of whether the financial position of the CWSRF is improving or deteriorating.
- The *Statements of Revenues, Expenses, and Changes in Net Position* present information which reflects how the CWSRF's net position changed during the past year. All changes in the net position are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the cash flows. Thus, revenues and expenses are reported in the statement for some items that will only result in cash flows in future fiscal periods.
- The *Statements of Cash Flows* report the CWSRF's cash flows from operating activities, noncapital financing activities, and investing activities.

The *Notes to Financial Statements* provide additional information that is essential to a full understanding of the data provided in the financial statements. These notes can be found immediately following the financial statements.

Net Position

In 2017, the growth of the CWSRF's net position continued to strengthen increasing by \$113.1 million, or 2.9%, to \$4 billion at June 30, 2017 as compared to an increase of \$121.5 million, or 3.2%, the previous year. The increase in net position was \$8.4 million lower than in the previous year, mostly reflecting the lower level of capital contributions from EPA capitalization grants.

The current portion of the CWSRF's liabilities was \$57 million in 2017 and \$29 million in 2016. Current liabilities primarily correspond to continuing principal payments for the Series 2012, 2016 and 2017 Revenue Bonds. Noncurrent liabilities increased by \$481 million in 2017 as compared to an increase of \$476 million in 2016. The increase in 2017 is a result of the issuance of the Series 2017 Revenue Bonds while the increase in 2016 is the result of the issuance of the Series 2016 Revenue Bond.

A segment of the CWSRF's net position is subject to external restriction due to the debt service requirements of the Series 2012, 2016 and 2017 Revenue Bonds. The net position that is restricted decreased in 2017 by \$100 million to \$1.5 billion, or 6.1%, as compared to an increase in 2016 of \$1.3 billion to \$1.6 billion, or 377.7%. The decrease in 2017 was primarily due to several early payoffs of loan receivables and ongoing debt service payments. The increase in 2016 was primarily due to an increase in pledged loan receivables to secure the issuance of the Series 2016 Revenue Bonds.

Of the total restricted net position, \$1.377 billion in 2017 and \$1.567 billion in 2016 represent the balance of outstanding loans that were pledged as security to the Series 2012, 2016 and 2017 Revenue Bond debt service. The principal and interest received during the fiscal year from these loans is used to make the semi-annual debt service payments on the revenue bonds.

The CWSRF received total payments on pledged loans of \$234.3 million (\$207.3 million of principal and \$27 million of interest) in 2017 of which the debt service payment was \$31.5 million (\$13 million of principal and \$18.5 million of interest). In 2016, the CWSRF received total payments on pledged loans of \$40.9 million (\$32.7 million of principal and \$8.2 million of interest) of which the debt service payments were \$14.3 million (\$13 million of principal and \$1.3 million of interest).

The remaining \$157.6 million of restricted net position in 2017 and \$66.9 million in 2017 represent pledged loan repayments, which are restricted for future loan disbursements and/or debt service payments. Any excess of principal and interest received over the required debt service may be used for future loan disbursements and/or released from restriction in the event that certain criteria are met.

Table 1

Net Position

(in thousands)

	June 30,		
	2017	2016	2015
ASSETS			
Cash and cash equivalents	\$ 1,039,972	\$ 731,798	\$ 279,374
Loans receivable	4,010,218	3,700,721	3,545,617
All other assets	28,525	24,341	20,075
Total assets	5,078,715	4,456,860	3,845,066
LIABILITIES			
Current liabilities	56,921	29,157	15,830
Noncurrent liabilities	988,785	507,846	30,905
Total liabilities	1,045,706	537,003	46,735
NET POSITION			
Restricted			
Debt service	157,601	66,876	37,320
Security for revenue bonds	1,376,682	1,567,358	304,797
Subtotal restricted assets	1,534,283	1,634,234	342,117
Unrestricted	2,498,726	2,285,623	3,456,214
Total net position	\$ 4,033,009	\$ 3,919,857	\$ 3,798,331

Changes in Net Position

Program revenue for the CWSRF in 2017 was \$59.6 million of which \$25.3 million is restricted for debt service. Program revenue in 2016 was \$57.6 million of which \$22.2 million was restricted for debt service. In 2017, program revenue increased by \$2 million or 3.43% and in 2016 increased by \$2.1 million or 3.75%. In 2017 and 2016, program revenue reflects an increase in outstanding receivables and the interest earned year over year on those receivables.

In 2017, general revenue was \$6.0 million, which was an increase of \$4.6 million or 331%, when compared to \$1.4 million in 2016. In 2016, general revenue increased \$0.6 million or 75% compared to \$0.8 million in 2015. The increase in investment income during 2017 and 2016 mostly reflects increased earnings that resulted from more cash on deposit

Total expenses increased by \$6 million in 2017 as compared to a decrease of \$12.8 million in 2016. The increase in 2017 was primarily due to an increase in revenue bond expenses. The decrease in 2016 was primarily due to a decrease in principal forgiveness expenses.

Administrative expenses decreased \$1.2 million to -\$0.8 million in 2017 compared to 2016. Administrative expenses decreased \$0.8 million to \$0.3 million in 2016 compared to 2015. The reduction of administrative expenses charged to the CWSRF during 2017 and 2016 primarily reflects the use of the CWSRF Administration Fund instead of the CWSRF as the primary source of administrative funding. In 2017 and 2016, administrative expenses of \$9.2 million and \$8.7 million, respectively, were charged to the CWSRF Administration Fund.

Capital contributions to the CWSRF decreased by \$6 million, or 9%, in 2017 when compared to 2016. The decrease in 2017 was primarily due to a decrease in available contributions from EPA capitalization grants. In 2016, capital contributions decreased by \$41 million, or 38% when compared to 2015. The decrease in 2016 was due to a decrease in available contributions from EPA capitalization grants.

The CWSRF program received principal forgiveness funds from EPA capitalization grants of \$4.8 million and \$7.8 million, in 2017 and 2016, respectively. The loans made with these funds were forgiven as disbursed and must be repaid if certain loan conditions are not met.

Table 2

Changes in Net Position
 (in thousands)

	Year Ended June 30,		
	2017	2016	2015
Revenues			
Program revenues:			
Loan interest income	\$ 59,615	\$ 57,638	\$ 55,554
General revenues:			
Investment income	6,020	1,396	796
Total revenues	65,635	59,034	56,350
Expenses			
Program expenses:			
Administrative expenses	(844)	329	1,096
Capitalization Principal Forgiveness expense	4,790	7,792	23,629
Revenue bond interest expense	12,458	2,199	293
Revenue bond issuance costs	1,896	1,894	-
Total expenses	18,300	12,214	25,018
Increase in net position before contributions	47,335	46,820	31,332
Capital contributions:			
EPA capitalization grant	60,966	66,846	100,584
EPA capitalization grant Principal Forgiveness	4,790	7,792	23,629
State and other contributions	61	68	7,162
Subtotal capital contributions	65,817	74,706	131,375
Change in net position	113,152	121,526	162,707
Net position - beginning of year	3,919,857	3,798,331	3,636,875
Net position - Restatement	-	-	(1,251)
Net position - beginning of year (restated)	3,919,857	3,798,331	3,635,624
Net position - end of year	\$ 4,033,009	\$ 3,919,857	\$ 3,798,331

Budgetary Information

Under the California constitution, money may only be drawn from the treasury by a legal appropriation. The State Legislature authorized the CWSRF to operate under a continuous appropriation. Continuous appropriation authority means that no further appropriations are necessary to expend all funds deposited into the CWSRF. This has the effect of allowing funds to be expended as soon as they are deposited into the CWSRF rather than waiting for appropriation authority. Since the funds in the CWSRF can only be used for limited purposes, the continuous appropriation authority allows for expeditious expenditure of funds and maximizes the benefits to local entities.

Debt Administration

The State Water Board administers a leveraged CWSRF program. The State Water Board maintains high bond ratings from Fitch (AAA), Moody's Investors Service (Aaa), and Standard and Poor's Ratings Services (AAA) on the CWSRF Series 2017, 2016 and 2012 Revenue Bonds. In 2017, the CWSRF issued Series 2017 Revenue Bonds for \$450 million at a premium of \$79.5 million. In 2016, the CWSRF issued Series 2016 Revenue Bonds for \$410.7 million at a premium of \$91.2 million. The Series 2017 and 2016 Revenue Bonds were issued for the purpose of making financial assistance available to recipients for eligible projects. In 2012, the CWSRF issued Series 2012 Refunding Revenue Bonds for \$68.9 million at a premium of \$6.0 million. The Series 2012 Revenue Bonds were issued to refund the Series 2002 Revenue Bonds.

As of June 30, 2017, outstanding bonds totaled \$1.035 billion, an increase of \$504.2 million, compared to \$530.8 million last year as shown in Table 3. The increase in 2017 was due to the issuance of the Series 2017 Revenue Bonds. The increase in 2016 was due to the issuance of the Series 2016 Revenue Bonds. The revenue bonds are backed by a pledge of specific revenue for which the annual collections are generally predictable.

Additional information on the CWSRF long-term debt can be found in Note 5, Long-Term Debt.

Table 3

Outstanding Long-term Debt
(in thousands)

	June 30,		
	2017	2016	2015
Revenue bonds			
Bond principal	\$ 877,735	\$ 440,675	\$ 42,940
Bond premium	157,251	90,118	1,957
Total revenue bonds	\$ 1,034,986	\$ 530,793	\$ 44,897

Economic Conditions and Outlook

In 2017, new binding loan commitments (encumbrances) were \$1.378 billion, a significant increase of 34% above the new commitments made in 2016. The higher level of financing activity reflects continued improvement in the general economic conditions in California along with recent CWSRF program improvements to make the program a more attractive choice compared to other financing options for publicly owned treatment works projects. A steady demand in CWSRF financing activity is anticipated in the near term.

Capitalization grant funds from EPA continue to be an important component of cash flows for financing activities. For the grant year 2017, the EPA allocated \$94.6 million to the CWSRF. The 2017 grant allocation is a reduction of 1% compared to the 2016 grant allocation of \$95 million. Presently available information indicates that the 2018 grant will be approximately equal to the 2017 grant but could be lower as a result of ongoing congressional budget negotiations.

Additionally, the CWSRF continues to maintain a large loan portfolio that generates significant program revenues for financing activity and administrative expenses. CWSRF program staff and its financial advisors continuously monitor the demand for new loans in order to be prepared to quickly sell a revenue bond if needed to meet required cash flows.

Although improving economic conditions has reduced the number of local entities experiencing strained revenue flows, the CWSRF diligently works with loan recipients to ensure full repayment of all loans.

Requests for Information

This financial report is designed to provide interested parties with a general overview of the CWSRF finances. Questions concerning the information provided in this report or requests for additional information should be addressed to Ms. Heather Bell, Manager, Accounting Branch, Division of Administrative Services, P.O. Box 100, Sacramento, California 95812 or Heather.Bell@waterboards.ca.gov.