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**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.

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Board of Directors  
California State Water Resources Control Board

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.

Board of Directors  
California State Water Resources Control Board

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.

Clifton Larson Allen 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.

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**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.

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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 |

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**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.

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**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 |

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**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 |

IX

**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  
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