

**CALIFORNIA STATE WATER RESOURCES
CONTROL BOARD WATER POLLUTION
CONTROL REVOLVING FUND
Sacramento, California**

**FINANCIAL STATEMENTS and REPORTS REQUIRED
BY THE SINGLE AUDIT ACT AMENDMENTS OF 1996**

June 30, 2012 and 2011

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Independent Auditor's Report

California State Water Resources Control Board
Water Pollution Control Revolving Fund
Sacramento, California

We have audited the accompanying basic financial statements of California State Water Resources Control Board, Water Pollution Control Revolving Fund, an enterprise fund of the State of California, as of and for the year ended June 30, 2012 and 2011, as listed in the table of contents. These financial statements are the responsibility of California State Water Resources Control Board, Water Pollution Control Revolving Fund'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 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 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 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, 2012 and 2011, 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.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of California State Water Resources Control Board, Water Pollution Control Revolving Fund as of June 30, 2012 and 2011, and the changes in financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 28, 2012 on our consideration of California State Water Resources Control Board, 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 to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages III through IX 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. However, we did not audit the information and express no opinion on it.

Our audits were conducted for the purpose of forming an opinion on the financial statements that collectively comprise the California Water Resources Control Board, Water Pollution Control Revolving Fund's basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the basic financial statements. The schedule of expenditures of federal awards is the responsibility of management and was derived from and relate directly to the underlying accounting and other records used to prepare the financial statements. The 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 financial statements or to the 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 taken as a whole.

CliftonLarsonAllen LLP

Greenwood Village, Colorado
September 28, 2012

**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, 2012 and 2011. 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

- In 2012, net assets increased by \$148 million to a total of \$3.3 billion, which was \$23 million more than the increase of \$125 million in 2011. The increase in net assets was primarily due to an increase in loan receivables, which was a direct result of higher capital contributions during the year from the U.S. Environmental Protection Agency (EPA).
- Capital contributions increased by \$20 million to \$106 million as compared to \$86 million in 2011. Capital contributions increased as a result of the capital available from EPA capitalization grants for loan disbursements.
- Capital contributions from (ARRA) of \$12 million and capitalization funds of \$22 million were forgiven.
- Cash and cash equivalents increased by \$6.5 million in 2012 as compared to an increase of \$15 million in 2011. The smaller increase in 2012 is attributable to the ongoing influence of the disbursement of EPA principal forgiveness and capitalization grant funds relative to the use of loan repayment funds.
- Loans receivable increased by \$118 million to \$3.1 billion in 2012 as compared to an increase of \$91 million in 2011. The larger increase in 2012 reflects the higher disbursement of loans from EPA capitalization grants, which will generate additional future earnings for the CWSRF.
- Restricted portion of net assets decreased by \$81 million to \$271 million in 2012 as compared to a decrease of \$68 million in 2011. This was due to decreases in notes receivable for loans pledged to the Series 2002 Revenue Bonds as a result of repayments received during 2012 and 2011 and the related debt service payments made on the Series 2002 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, 2012 and 2011 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 Assets* present information on all of the CWSRF's assets and liabilities with the difference between the two reported as net assets. Over time, increases or decreases in net assets 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 Assets* present information which reflects how the CWSRF's net assets changed during the past year. All changes in the net assets 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, non-capital 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 Assets

The growth in CWSRF's net assets indicate a continued strong financial position increasing by \$148 million, or 4.7%, to \$3.31 billion at June 30, 2012 as compared to an increase of \$125 million, or 4.1%, the previous year. The increase in net assets was \$23 million higher than in the previous year. This was primarily a reflection of higher capital contributions for loans from EPA capitalization grants.

The current portion of the CWSRF's liabilities was \$25 million in 2012 and \$27 million in 2011. Current liabilities primarily reflect continuing principal payments for the Series 2002 Revenue Bonds. Noncurrent liabilities reflect decreases of \$23 million in 2012 and \$25 million in 2011, which corresponds to those same bond principal payments.

A segment of the CWSRF's net assets are subject to external restriction as to usage. The net assets that are restricted decreased in 2012 by \$81 million to \$271 million, or 23.1%, as compared to a decrease in 2011 of \$68 million to \$352 million, or 16.2%.

Of the total restricted net assets, \$238 million in 2012 and \$304 million in 2011 represent the balance of outstanding loans that were pledged as security to Series 2002 Revenue Bonds 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 restricted portion of net assets will continue to decline as the pledged loans are repaid, and the corresponding debt service payments are made on the Series 2002 Revenue Bonds.

In 2012, the CWSRF received a total of \$74.1 million (\$66 million of principal and \$8.1 million of interest) on pledged loans; the debt service payment was \$30.2 million (\$24.3 million of principal and \$5.9 million of interest). In 2011, the CWSRF received a total of \$101.4 million (\$90.3 million of principal and \$11.1 million of interest); the debt service payment was \$31.5 million (\$24.4 million of principal and \$7.1 million of interest).

The remaining \$33 million of restricted net assets in 2012 and \$48 million in 2011 represent pledged loan repayments, which are restricted for future debt service payments. Any excess of principal and interest received over the required debt service will be released from restriction as debt service payments are issued.

Table 1

Net Assets

(in thousands)

	June 30,		
	2012	2011	2010
ASSETS			
Cash and cash equivalents	\$ 268,664	\$ 262,142	\$ 247,272
Loans receivable	3,135,310	3,017,362	2,926,611
All other assets	26,691	28,052	34,652
Total assets	3,430,665	3,307,556	3,208,535
LIABILITIES			
Current liabilities	25,330	27,070	27,930
Noncurrent liabilities	93,194	116,686	141,709
Total liabilities	118,524	143,756	169,639
NET ASSETS			
Restricted			
Debt service	32,567	47,850	25,509
Security for revenue bonds	238,166	304,195	394,500
Subtotal restricted assets	270,733	352,045	420,009
Unrestricted	3,041,408	2,811,755	2,618,887
Total net assets	\$ 3,312,141	\$ 3,163,800	\$ 3,038,896

Changes in Net Assets

CWSRF's 2012 program revenue was \$49.1 million of which \$7 million is restricted for debt service as compared to \$48.2 million in 2011 of which \$9 million was restricted for debt service. In 2012, program revenue increased by \$0.9 million or 1.76% as compared to a decrease in 2011 of \$3.3 million or 6.4%. In 2012, the small increase in program revenue directly reflects the relatively small increase in CWSRF Service Charges on additional financing agreements for the Small Community Grant Fund. In 2011, the decrease in program revenue was primarily due to the increase in the CWSRF Service Charges applied to financing agreements during the year. The Service Charge is an annual rate on financing agreements, which is deposited to the Small Community Grant Fund for grants to small disadvantaged communities.

General revenue was \$1.1 million in 2012, which was a decrease of \$0.3 million or 19%, when compared to 2011. General revenue decreased \$0.5 million or 26% to \$1.4 million in 2011, when compared to 2010. The decrease in investment income during 2012 and 2011 was the result of lower interest earnings from the Surplus Money Investment Fund (SMIF). The lower earnings from SMIF were the result of lower interest rate yields.

Total expenses decreased \$3 million in 2012 as compared to a decrease of \$5.9 million in 2011. The decrease in 2012 was primarily due to a decrease in administrative expenses associated with the winding down of projects financed with the one-time ARRA funding approved by EPA in 2009 along with the continued reduction in revenue bond interest expenses. In 2012, administrative expenses of \$4 million were charged to the CWSRF Administration Fund. In 2011, the decrease in administrative expenses was related to lower costs associated with administering ARRA and in addition there was no increase in the allowance for bad debt during the year. In 2011, administrative expenses of \$3.2 million were charged to the CWSRF Administration Fund.

Capital contributions to the CWSRF increased by \$20 million, or 23%, in 2012 when compared to 2011. The 2012 increase was due to an increase in contributions from EPA capitalization grants. In 2011, capital contributions decreased by \$6 million, or 6% when compared to 2010. The 2011 decrease was due to a decrease in contributions from EPA capitalization grants.

During 2012, administrative expenses decreased \$2.0 million to \$2.9 million compared to a decrease of \$2.1 million in 2011. The decrease in 2012 and in 2011 was due to administrative expenses being charged to the CWSRF Administration Fund and less administrative cost associated with the ARRA capitalization grant.

In 2012 and 2011, the CWSRF program received principal forgiveness funds of \$33.8 million and \$96.3 million, respectively, from EPA capitalization grants. 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 Assets
(in thousands)**

	Year Ended June 30,		
	2012	2011	2010
Revenues			
Program revenues:			
Loan interest income	\$ 49,080	\$ 48,231	\$ 51,534
General revenues:			
Investment income	1,103	1,354	1,831
Total revenues	50,183	49,585	53,365
Expenses			
Program expenses:			
Administrative expenses	2,860	4,891	7,019
Bad debt allowance expense	-	-	2,870
EPA capitalization Principal Forgiveness	(21,571)	(11,425)	-
Capitalization Principal Forgiveness Expenses	21,571	11,425	-
EPA ARRA Principal Forgiveness grant	(12,223)	(84,830)	(56,318)
ARRA Principal forgiveness expenses	12,223	84,830	56,318
Revenue bond interest expense	4,984	5,996	6,928
Amortization of revenue bond issuance costs	55	66	76
Total expenses	7,899	10,953	16,893
Increase in net assets before contributions	42,284	38,632	36,472
Capital contributions:			
EPA capitalization grant	84,513	31,104	56,996
EPA ARRA capitalization grant	21,337	55,007	34,598
State and other contributions	207	161	214
Subtotal capital contributions	106,057	86,272	91,808
Change in net assets	148,341	124,904	128,280
Net assets - beginning of year	3,163,800	3,038,896	2,910,616
Net assets - end of year	\$ 3,312,141	\$ 3,163,800	\$ 3,038,896

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 a high bond rating from Fitch (AAA), Moody's Investors Service (Aaa), and Standard and Poor's Ratings Services (AAA) on its Revenue Bonds, Series 2002. Outstanding bonds at June 30, 2012 total \$116.5 million, a decrease of \$24.9 million, compared to \$141.4 million last year as shown in Table 3. The decreases are due to amortization of the bond premium and the payment of the scheduled bond principal repayments. The bonds were issued in August 2002 for the purpose of financing a portion of the CWSRF loans administered by the State Water Board by providing financial assistance to local governments for water pollution control projects. Proceeds from the bonds provided funding for the issuance of additional revolving fund loans by the CWSRF. 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)

	<u>2012</u>	<u>June 30, 2011</u>	<u>2010</u>
Revenue bonds			
Bond principal	\$ 114,695	\$ 138,980	\$ 163,370
Bond premium	1,779	2,445	3,247
Total revenue bonds	<u><u>\$ 116,474</u></u>	<u><u>\$ 141,425</u></u>	<u><u>\$ 166,617</u></u>

Economic Conditions and Outlook

The CWSRF program activity remained stable, with revenues continuing to sufficiently support expenses. The program expects continued growth in the number of funding commitments made to loan recipients during 2013. State Water Board staff continued to monitor implementation of ARRA projects during 2012, although that effort decreased from the levels in 2011. Implementation and oversight efforts related to ARRA will continue during 2013, but at a reduced level from 2012.

Some local entities continue to experience strained revenues due to the current general economic conditions. Each CWSRF loan recipient must pledge one or more dedicated sources of revenue toward repayment of its CWSRF loan. These dedicated sources of revenue can include but are not limited to, sewer rate revenue pledges, general tax pledges, or other contractual income. To ensure that loans are repaid on time and in full, the State Water Board uses a variety of analysis and monitoring measures to reduce the possibility of non-payment.

The CWSRF has worked closely with loan recipients with strained revenues to ensure dedicated sources of revenue are sufficient and when necessary to restructure loans in consideration of available short term cash flows. Although the CWSRF maintains a small prudent reserve for doubtful accounts, the program by diligently working with loan recipients anticipates full repayment of all loans.

For the grant year 2012, the EPA allocated \$101 million to the CWSRF. The 2012 grant allocation is a decrease of 4% compared to the 2011 grant allocation of \$105 million. EPA awarded the 2012 capitalization grant in July 2012. Presently available information indicates that the 2013 grant will be less than 50% of the 2012 grant. Although reduced capitalization funds from EPA affect the CWSRF's cash flow, currently loan receivables provide 67% of the cash flow for new loans.

In addition, the CWSRF has significant equity that can be used to provide funds if needed. State Water Board staff continues to monitor the demand for new loans and will work with its financial advisors on a revenue bond sale to meet required cash flows when needed.

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 Mr. Jerrel Bolds, Manager, Accounting Branch, Division of Administrative Services, P.O. Box 100, Sacramento, California 95812 or jbolds@waterboards.ca.gov.

BASIC FINANCIAL STATEMENTS

CALIFORNIA STATE WATER RESOURCES CONTROL BOARD
WATER POLLUTION CONTROL REVOLVING FUND
STATEMENTS OF NET ASSETS
June 30, 2012 and 2011
(in thousands)

	<u>2012</u>	<u>2011</u>
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 221,663	\$ 198,577
Cash and cash equivalents - Restricted	47,001	63,565
Receivables:		
Loan interest	24,686	23,347
Investment interest	257	319
Due from other funds and other governments	1,602	4,185
Loans receivable:		
Current portion	151,765	135,494
Current portion - Restricted	45,618	65,598
Unamortized revenue bond issuance costs	44	55
Total current assets	<u>492,636</u>	<u>491,140</u>
OTHER ASSETS		
Noncurrent unamortized revenue bond issuance costs	102	146
Loans receivable:		
Noncurrent (net of allowance for bad debt)	2,745,378	2,577,673
Noncurrent - Restricted	192,549	238,597
Total other assets	<u>2,938,029</u>	<u>2,816,416</u>
TOTAL ASSETS	<u>3,430,665</u>	<u>3,307,556</u>
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES		
Revenue bond interest payable	1,339	1,632
Deferred revenue	73	74
Due to other funds	486	413
Revenue bonds payable	23,432	24,951
Total current liabilities	<u>25,330</u>	<u>27,070</u>
NONCURRENT LIABILITIES		
Deferred revenue	151	212
Revenue bonds payable	93,043	116,474
Total noncurrent liabilities	<u>93,194</u>	<u>116,686</u>
Total liabilities	<u>118,524</u>	<u>143,756</u>
NET ASSETS		
Restricted for:		
Debt service	32,567	47,850
Security for revenue bonds	238,166	304,195
Unrestricted	3,041,408	2,811,755
Total net assets	<u>\$ 3,312,141</u>	<u>\$ 3,163,800</u>

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

CALIFORNIA STATE WATER RESOURCES CONTROL BOARD
WATER POLLUTION CONTROL REVOLVING FUND
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
Years Ended June 30, 2012 and 2011
(in thousands)

	<u>2012</u>	<u>2011</u>
OPERATING REVENUE		
Loan interest income	\$ 49,080	\$ 48,231
Total operating revenue	<u>49,080</u>	<u>48,231</u>
OPERATING EXPENSES		
Personnel services	1,546	2,476
Other expenses	1,303	2,400
Total operating expenses	<u>2,849</u>	<u>4,876</u>
INCOME FROM OPERATIONS	<u>46,231</u>	<u>43,355</u>
NONOPERATING REVENUE (EXPENSE)		
Net investment income	1,103	1,354
EPA-capitalization grant - Principal Forgiveness	21,571	11,425
Principal forgiveness	(21,571)	(11,425)
EPA-ARRA capitalization grant - Principal Forgiveness	12,223	84,830
ARRA Principal Forgiveness	(12,223)	(84,830)
Revenue bond interest expense	(4,984)	(5,996)
Bond fees	(11)	(15)
Amortization of revenue bond issuance costs	(55)	(66)
Total nonoperating revenue (expense)	<u>(3,947)</u>	<u>(4,723)</u>
INCOME BEFORE CONTRIBUTIONS	<u>42,284</u>	<u>38,632</u>
CONTRIBUTIONS		
EPA capitalization grant	84,513	31,104
EPA - ARRA capitalization grant	21,337	55,007
State match revenue	207	161
Total contributions	<u>106,057</u>	<u>86,272</u>
CHANGE IN NET ASSETS	148,341	124,904
NET ASSETS - BEGINNING OF YEAR	<u>3,163,800</u>	<u>3,038,896</u>
NET ASSETS - END OF YEAR	<u>\$ 3,312,141</u>	<u>\$ 3,163,800</u>

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

CALIFORNIA STATE WATER RESOURCES CONTROL BOARD
WATER POLLUTION CONTROL REVOLVING FUND
STATEMENTS OF CASH FLOWS
Years Ended June 30, 2012 and 2011
(in thousands)

	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash received from interest on loans	\$ 42,608	\$ 44,218
Loans disbursed	(325,435)	(301,164)
Principal received on loans receivable	212,559	215,979
Cash paid to employees and vendors	(2,777)	(5,217)
Cash flows required from operating activities	(73,045)	(46,184)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Funds received from EPA capitalization grant	142,273	187,197
Funds received from the State of California	162	178
ARRA Principal Forgiveness	(12,223)	(84,830)
Principal Forgiveness	(21,571)	(11,425)
Bond fees paid	(11)	(15)
Principal paid on revenue bonds	(24,285)	(24,390)
Interest paid on revenue bonds	(5,943)	(7,066)
Cash flows provided by noncapital financing activities	78,402	59,649
CASH FLOWS FROM INVESTING ACTIVITIES		
Net investment income received	1,165	1,405
Net cash provided by investing activities	1,165	1,405
NET INCREASE IN CASH AND CASH EQUIVALENTS	6,522	14,870
CASH AND CASH EQUIVALENTS - BEGINNING OF YEAR	262,142	247,272
CASH AND CASH EQUIVALENTS - END OF YEAR	\$ 268,664	\$ 262,142
Reconciliation of operating income to net cash required by operating activities		
Income from operations	\$ 46,231	\$ 43,355
Adjustments to reconcile income from operations to net cash required by operating activities		
Construction period interest	(5,072)	(5,567)
Amortization of deferred revenue	(72)	(83)
Effect of changes in operating assets and liabilities:		
Loans receivable	(112,865)	(85,184)
Loan interest receivable	(1,339)	1,636
Due to other funds	72	(341)
Net cash required by operating activities	\$ (73,045)	\$ (46,184)

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

CALIFORNIA STATE WATER RESOURCES CONTROL BOARD
WATER POLLUTION CONTROL REVOLVING FUND
NOTES TO FINANCIAL STATEMENTS
June 30, 2012 and 2011
(Dollar Amounts Expressed in Thousands)

NOTE 1 - DEFINITION OF REPORTING ENTITY

The California State Water Resources Control Board, Water Pollution Control Revolving Fund (Fund) was established pursuant to Title VI of the Federal Clean Water Act of 1987 (Act). The Act established the State Revolving Fund (SRF) program to replace the construction grants program (Title II of the Act) to provide loans at reduced interest rates to finance the construction of publicly owned water pollution control facilities, non-point source pollution control projects, and estuary management plans. Instead of making grants to communities that pay for a portion of building wastewater treatment facilities, the SRF provides for low interest loans to finance the entire cost of qualifying projects. The SRF provides a flexible financing source that can be used for a variety of pollution control projects, including non-point source pollution control projects, and developing estuary conservation and management plans. Loans made must be repaid within 20 years, or 30 years for qualifying disadvantaged communities and communities regionalizing their facilities. All repayments, including interest and principal, must remain in the Fund.

Since 1989, the Fund has been capitalized by a series of grants from the U.S Environmental Protection Agency (EPA). States are required to provide matching funds equal to 20 percent of the Federal capitalization grant amount in order to receive the grants from the EPA. As of June 30, 2012 and 2011, the EPA has awarded cumulative capitalization grant funding of \$2,279,735 and \$2,174,164, respectively to the State of California (State), for which the State is required to provide \$455,947 and \$434,833, respectively, of cumulative matching funding to the Fund. In addition, in February 2009, the EPA awarded \$280,285 in ARRA grant funding for which there is no State Match requirement.

The Fund is administered by the California State Water Resources Control Board (Board), a part of the California Environmental Protection Agency, through the Division of Financial Assistance (Program). The Board's primary responsibilities with the SRF include obtaining capitalization grants from the EPA, soliciting potential interested parties, negotiating loan agreements with local communities, reviewing and approving payment requests from loan recipients, managing the loan repayments, and conducting inspection and engineering reviews to ensure compliance with all applicable laws, regulations, and program requirements. The Board consists of five member positions, which are appointed by the Governor and confirmed by the Senate.

The Board administers the SRF program by charging the Fund for time spent on SRF activities by employees of the Board, and the Fund reimburses the State for such costs in the following month. The charges include the salaries and benefits of the employees, as well as indirect costs allocated to the Fund based on direct salary costs. Employees charging time to the Fund are covered by the benefits available to State employees. The Fund is also charged indirect costs through the cost allocation plan for general State expenses.

Reporting Entity

The Fund follows the Governmental Accounting Standards Board (GASB) accounting pronouncements which provide guidance for determining which governmental activities, organizations and functions should be included within the financial reporting entity. GASB

CALIFORNIA STATE WATER RESOURCES CONTROL BOARD
WATER POLLUTION CONTROL REVOLVING FUND
NOTES TO FINANCIAL STATEMENTS
June 30, 2012 and 2011
(Dollar Amounts Expressed in Thousands)

NOTE 1 - DEFINITION OF REPORTING ENTITY (CONTINUED)

pronouncements set forth the financial accountability of a governmental organization's elected governing body as the basic criterion for including a possible component governmental organization in a primary government's legal entity. Financial accountability includes, but is not limited to, appointment of a voting majority of the organization's governing body, ability to impose its will on the organization, a potential for the organization to provide specific financial benefits or burdens and fiscal dependency.

The activities of the Fund are included in the State's Comprehensive Annual Financial Report as an enterprise fund using the accrual basis of accounting.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies of the Fund conform to generally accepted accounting principles as applicable to a governmental unit accounted for as a proprietary enterprise fund. The enterprise fund is used since the Fund's powers are related to those operated in a manner similar to a for profit business where an increase in net assets is an appropriate determination of accountability.

Basis of Accounting

The Fund's records are maintained on the accrual basis of accounting. Under the accrual basis of accounting revenue is recognized when earned and expenses are recognized when the liability is incurred. Assets and liabilities associated with the operations of the Fund are included in the Statements of Net Assets.

The Fund has elected to follow Governmental Accounting Standards Board pronouncements as well as statements issued by the Financial Accounting Standards Board on or before November 30, 1989, unless the pronouncements conflict with or contradict Governmental Accounting Standards Board pronouncements.

Operating Revenues and Expenses

The Fund distinguishes between operating revenues and expenses and non-operating items in the Statements of Revenues, Expenses and Changes in Net Assets. Operating revenues and expenses generally result from carrying out the purpose of the Fund of providing low interest loans to communities and providing assistance for prevention programs and administration. Operating revenues consist of loan interest repayments from borrowers. Operating expenses include direct salary costs and benefits expenses, allocated indirect costs and bad debt allowance. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses or capital contributions.

In accordance with generally accepted accounting principles, monies received from the EPA and the State are recorded as capital contributions, except for principal forgiveness reported as non-operating revenue. In certain circumstances, local communities have contributed the State's matching share in exchange for reduced interest rate loans, as discussed in Note 4.

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NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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

Budgets

Under the California constitution, money may only be drawn from the Treasury by legal appropriation. The State Legislature authorized the SRF to operate under a continuous appropriation. Continuous appropriation authority means that no further appropriations are necessary to expend all funds deposited into the SRF. Therefore, the Fund operations are not included in California's annual budget.

Use of Estimates in Preparing Financial Statements

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues, expenses, gains, losses and other changes during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

Nearly all monies of the Fund are deposited with the California State Treasurer's office, which is responsible for maintaining these deposits in accordance with California State law. The Fund considers all such deposits to be cash equivalents. According to State law, the Treasurer is responsible for maintaining the cash balances and investing excess cash of the Fund, as discussed in Note 3. Consequently, management of the Fund does not have any control over the investment of the excess cash. Investment earnings on these deposits are received quarterly. The statement of cash flows considers all funds deposited with the Treasurer to be cash or cash equivalents, regardless of actual maturities of the underlying investments.

Loans Receivable

Loans are funded by capitalization grants from the EPA, State matching funds, local contributions, revenue bond proceeds, loan repayments and fund earnings. Loans are advanced to local agencies on a cost reimbursement basis. Interest is calculated from the date that funds are advanced. After the final disbursement has been made, the loan agreement is adjusted for the actual amounts disbursed and interest accrued during the project period (Construction Period Interest). Loans are amortized over periods up to 30 years. Loan repayments must begin within one year of construction completion or one year from the initial loan disbursement, depending upon the type of loan agreement, and are made on an annual and semi-annual basis.

Loans funded by principal forgiveness grants are advanced to local agencies on a cost reimbursement basis and forgiven as each disbursement occurs. Loan agreements require repayment of the forgiven loan if all program requirements are not met.

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NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Allowance for Bad Debts

The allowance for bad debts is established as losses are estimated to have occurred through a provision for bad debts charged to earnings. Loans receivable are charged against the allowance for bad debts when management believes that the uncollectibility of the principal is probable. The allowance for bad debts was \$9,356 at June 30, 2012 and June 30, 2011.

Revenue Bond Issue Costs and Original Issue Premium

Revenue bond issue costs and original issue premium are being amortized over the term of the bonds using the effective interest method.

NOTE 3 - CASH AND INVESTMENTS

The California State Treasurer's Office administers a pooled investment program for the State. This program enables the State Treasurer's Office to combine available cash from all funds and to invest cash that exceeds current needs. The necessary disclosures for the State's pooled investment program are included in the Comprehensive Annual Financial Report of the State of California.

Nearly all monies of the Fund are deposited with the State Treasurer's Office and are considered to be cash equivalents. The Treasurer is responsible for maintaining the cash balances in accordance with California laws, and excess cash is invested in California's Surplus Money Investment Fund, which is part of the Pooled Money Investment Account. The Treasurer is required to maintain a mix of investment portfolios in order to allow funds to be withdrawn at any time to meet normal operating needs, without prior notice or penalty.

The investments allowed by State statute, bond resolutions and investment policy resolutions restrict investments of the pooled investment program to investments in U.S. Government securities, negotiable certificates of deposit, bankers' acceptances, commercial paper, corporate bonds, bank notes, mortgage loans and notes, other debt securities, repurchase agreements, reverse repurchase agreements, equity securities, real estate, mutual funds, and other investments. The Fund's proportionate share of the investment income, based on the average daily balance for the period, is credited to the Fund quarterly. The Treasurer charges all funds of the State an administrative fee, which reduces the interest earned by each fund. All cash and investments are stated at fair value. Details of the investments can be obtained from the State Treasurer's Office.

At June 30, 2012 and 2011, the Fund's cash deposits had a carrying balance of \$5 and \$5, respectively.

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NOTE 3 - CASH AND INVESTMENTS (CONTINUED)

Investments held by the State Treasurer are stated at fair value.

<u>Investments</u>	<u>2012</u>	<u>2011</u>
Treasury/Trust Portfolio	\$ 268,659	\$ 262,137
Total cash deposits and investments	<u>\$ 268,664</u>	<u>\$ 262,142</u>

The State Treasurer is responsible for investing funds of the Treasury/Trust Portfolio and managing the credit risk, custodial credit risk, concentration of credit risk, interest rate risk and foreign currency credit risk of the Portfolio. Refer to the State's Pooled Investments disclosure in the June 30, 2012 and 2011, Comprehensive Annual Financial Reports for disclosure related to the risks applicable to the Portfolio.

Cash deposits and investments are reflected on the June 30, 2012 and 2011 statement of net assets as follows:

	<u>2012</u>	<u>2011</u>
Cash and cash equivalents	\$ 221,663	\$ 198,577
Cash and cash equivalents - Restricted	47,001	63,565
Total cash deposits and investments	<u>\$ 268,664</u>	<u>\$ 262,142</u>

As of June 30, 2012, all revenue bond proceeds have been disbursed. Cash and investments in the amount of \$235 and \$234 representing investment earnings on unspent revenue bonds proceeds at June 30, 2012 and 2011, respectively, were restricted for future loan disbursements. Additionally, cash and investments in the amount of \$46,766 and \$63,331, representing various reserve accounts required by the revenue bonds, at June 30, 2012 and 2011, respectively, were restricted for debt service.

NOTE 4 - LOANS RECEIVABLE

Loans are made to qualified agencies for projects that meet the eligibility requirements of the Federal Clean Water Act of 1987. Loans are financed with capitalization grants, State match, local contributions, revenue bond proceeds and revolving loan funds. Interest rates vary between 0.0 percent and 4.0 percent and loans are repaid over 20 or 30 years starting one year after the project is completed. Interest rates are established in the original loan agreements and are generally 50 percent of the State's General Obligation Bond Rate at the time the loan commitment is made. Local match loans have an effective interest rate of 1.8 percent. Certain communities are offered special interest rates as low as 0.0 percent. Interest earned during the

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NOTE 4 - LOANS RECEIVABLE (CONTINUED)

construction period is calculated from the date funds are disbursed until the project is completed.

As of June 30, 2012 and 2011, the Fund had total binding commitments of \$6,402,218 and \$5,716,857, respectively, since program inception. As of June 30, 2012, the remaining commitment on these loans amounted to \$1,041,070, of which \$169,655 is federal funds. The federal loan commitments included ARRA federal funds of \$11,887, of which \$8,920 will be forgiven and capitalization funds of \$54,346 which will be forgiven. As of June 30, 2011, the remaining commitment on these loans amounted to \$714,903, of which \$111,699 is federal funds. The federal loan commitments included ARRA federal funds of \$43,859, of which \$22,266 will be forgiven and capitalization funds of \$19,524 which will be forgiven. Principal forgiveness loans are forgiven as disbursed, but must be repaid if the recipient fails to meet the program requirements.

At June 30, 2012 and 2011 the unpaid balance on all loans receivable outstanding amounted to \$3,135,310 and \$3,017,362, respectively.

Estimated maturities of the loans receivable and interest payments thereon, at June 30, 2012 are as follows:

<u>Year Ending June 30,</u>	<u>Interest</u>	<u>Principal</u>	<u>Total</u>
2013	\$ 44,316	\$ 197,383	\$ 241,699
2014	42,770	195,235	238,005
2015	40,203	195,112	235,315
2016	39,978	193,683	233,661
2017	36,295	189,584	225,879
2018-2022	129,716	906,461	1,036,177
2023-2027	57,263	614,815	672,078
2028-2032	15,632	267,205	282,837
2033-2037	2,979	31,678	34,657
2038-2042	1,015	23,318	24,333
Total	<u>\$ 410,167</u>	<u>2,814,474</u>	<u>\$ 3,224,641</u>
Loans not yet in repayment		330,192	
Allowance for bad debt		(9,356)	
Total loans receivable		<u>\$ 3,135,310</u>	

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NOTE 4 - LOANS RECEIVABLE (CONTINUED)

Restricted Loans Receivable

At June 30, 2012 and 2011, \$238,166 and \$304,195, respectively, of loans receivable were pledged as security for the revenue bonds outstanding (see Note 5). The principal and interest received during the fiscal year from these loans is to be used to make the annual debt service payments on the revenue bonds. During the year ended June 30, 2012 the Fund received \$66,028 and \$8,074 of principal and interest, respectively, on these loans, and during the year ended June 30, 2011 the Fund received \$90,305 and \$11,063 of principal and interest, respectively, on these loans. Any excess of the principal and interest received over the debt service payments required and the required debt service reserve accounts may be released from restriction upon request of the Fund in the event certain requirements are met.

Local Match Loans

The Fund has offered reduced interest rates on loans to recipients that have agreed to contribute funds that can be used to match federal contributions. In order to obtain one of these loans, the local agency contributes one-sixth or 16.7 percent of the total loan principal. The borrower then repays 100 percent of the loan principal including the contributed amount (see Note 6).

Borrowers have the option of remitting the contributed amount to the Fund when the loan is awarded or paying the contributed amount as the project progresses. For loans where the borrower elects to remit the contributed amount to the Fund at the time the loan is awarded, the amounts remitted are recorded as deferred revenue and are amortized over the life of the loan. For the loans in which the borrowers repay the Fund over 20 or 30 years, the Fund considers a portion of such loans to be a loan origination fee. Such fees are amortized over the life of the loan as an adjustment to the stated interest rate. The imputed interest rate on these loans is approximately 1.8 percent.

As of June 30, 2012 and 2011, the Fund had authorized a total of \$1,729,315 and \$1,729,522, respectively, of local match loans. From these authorizations, certain borrowers elected to remit the State match at the time the loan was awarded in the amount of \$2,296 as of June 30, 2012 and 2011. The remaining borrowers elected to repay the State match over a period of 20 or 30 years, in the amount of \$277,291 and \$275,081 as of June 30, 2012 and 2011, respectively. As of June 30, 2012 and 2011, total local match loans outstanding, including the local match to be paid, amounted to \$ 974,023 and \$1,024,248, respectively, and the remaining State match to be repaid amounted to \$138,343 and \$153,742, respectively.

Loans to Major Local Agencies

The Fund has made loans to the following major local agencies. The aggregate outstanding loan balances for each of these agencies exceeds 5 percent of total loans receivable. The combined outstanding loan balances at June 30, 2012 and 2011 of these major local agencies represent approximately 18.4 and 20 percent, respectively, of the total loans receivable and are as follows:

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NOTE 4 - LOANS RECEIVABLE (CONTINUED)

<u>Borrower</u>	2012		2011
	Authorized Loan Amount	Outstanding Loan Balance	Outstanding Loan Balance
Los Angeles County Sanitation District	\$ 666,307	\$ 422,151	\$ 434,787
City of Los Angeles	262,898	155,761	166,262
	<u>\$ 929,205</u>	<u>\$ 577,912</u>	<u>\$ 601,049</u>

NOTE 5 - LONG-TERM DEBT

The detail of the Fund's long-term debt is as follows:

	Balance June 30, 2011	Issuances	Retirements	Balance June 30, 2012	Due Within One Year
Series 2002 Revenue Bonds:					
Bond principal	\$ 138,980	\$ -	\$ 24,285	\$ 114,695	\$ 22,895
Bond premium	2,445	-	666	1,779	536
	<u>141,425</u>	<u>\$ -</u>	<u>\$ 24,951</u>	<u>116,474</u>	<u>\$ 23,431</u>
Less current portion:					
Bond principal	(24,285)			(22,895)	
Bond premium amortization	(666)			(536)	
Long-term portion	<u>\$ 116,474</u>			<u>\$ 93,043</u>	

	Balance June 30, 2010	Issuances	Retirements	Balance June 30, 2011	Due Within One Year
Series 2002 Revenue Bonds:					
Bond principal	\$ 163,370	\$ -	\$ 24,390	\$ 138,980	\$ 24,285
Bond premium	3,247	-	802	2,445	666
	<u>166,617</u>	<u>\$ -</u>	<u>\$ 25,192</u>	<u>141,425</u>	<u>\$ 24,951</u>
Less current portion:					
Bond principal	(24,390)			(24,285)	
Bond premium amortization	(802)			(666)	
Long-term portion	<u>\$ 141,425</u>			<u>\$ 116,474</u>	

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NOTE 5 - LONG-TERM DEBT (CONTINUED)

On August 7, 2002, the Fund issued \$300,000 of California Infrastructure and Economic Development Bank, Clean Water State Revolving Fund Revenue Bonds, Series 2002, dated August 1, 2002, with interest of 3 to 5 percent. These serial bonds are due annually in varying amounts through 2018. The interest on the bonds is due semi-annually on April 1 and October 1. The bonds maturing on or after October 1, 2013 are subject to redemption prior to their respective stated maturities at the option of the Fund on any date on or after October 1, 2012 without call premium. The bonds were issued to provide funding for the issuance of additional revolving fund loans by the Fund.

At the time of issuance of the revenue bonds by the Fund, the Fund pledged in excess of \$850,000 of outstanding loans receivable of the Fund as security for the bonds (see Note 4). The principal and interest received during the fiscal year from these loans is to be used to make the annual debt service payments on the revenue bonds. Any excess of the principal and interest received over the debt service payments required and the required debt service reserve accounts may be released from restriction upon request of the Fund in the event certain requirements are met.

The Fund's long-term debt will mature as follows:

<u>Year Ending June 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2013	\$ 22,895	\$ 4,819	\$ 27,714
2014	19,940	3,882	23,822
2015	17,900	3,066	20,966
2016	17,130	2,227	19,357
2017	14,980	1,432	16,412
2018-2019	21,850	1,000	22,850
	<u>\$ 114,695</u>	<u>\$ 16,426</u>	<u>\$ 131,121</u>

NOTE 6 - CAPITAL CONTRIBUTIONS

The Fund is capitalized by annual grants from the EPA. The State must also contribute an amount equal to 20 percent of the federal capitalization amount. The State's matching contribution has been provided through the appropriation of State resources as well as through the use of loans from the Water Reclamation program. As of June 30, 2012 and 2011, the EPA has awarded cumulative capitalization grants of \$2,279,735 and \$2,174,164, respectively, to the State, of which \$2,159,393 and \$2,053,309, respectively, has been drawn, cumulatively, for loans and administrative expenses. The State has provided matching funds of \$346,541 and \$346,334, respectively.

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NOTE 6 - CAPITAL CONTRIBUTIONS (CONTINUED)

In addition, as of June 30, 2012, the EPA has awarded the ARRA grant of \$280,285 to the fund for which there is no State matching requirements. As of June 30, 2012 and June 30, 2011, \$268,398, of which \$153,790 was for principal forgiveness and \$234,839, of which \$141,567 was for principal forgiveness, respectively, has been drawn cumulatively (See Note 4).

As discussed in Note 4, certain borrowers have contributed funds that can be used to match federal contributions in exchange for reduced interest rate loans. The EPA allows the State to include amounts provided by borrowers under certain local matching loans in meeting the State's statutory matching obligation. As of June 30, 2012 and 2011, the borrowers had contributed \$279,587 and \$277,377, respectively, which qualify as meeting the State's matching requirement.

Table 1 summarizes the EPA capitalization grants awarded, amounts drawn on each grant as of June 30, 2012 and 2011, and balances available for future loans as of June 30, 2012. Table 2 summarizes the state match amounts paid by the state and local entities as of June 30, 2012 and 2011. As of June 30, 2012 and 2011, the state match required is \$431,879 and \$410,662, respectively. As of June 30, 2012 and 2011, the state match available for potential future state match is \$194,249 and \$213,049, respectively.

TABLE 1

Year	Grant Award	Funds Drawn As of June 30, 2010	Funds Drawn During Year Ended June 30, 2011	Funds Drawn As of June 30, 2011	Funds Drawn During Year Ended June 30, 2012	Funds Drawn As of June 30, 2012	Available for Loans as of June 30, 2012
1989-2007	\$ 1,930,949	\$ 1,930,949	\$ -	\$ 1,930,949	\$ -	\$ 1,930,949	\$ -
2008	48,826	48,730	96	48,826	-	48,826	-
2009	48,668	31,101	16,846	47,947	721	48,668	-
2010	145,721	-	25,587	25,587	75,868	101,455	44,266
2011	105,571	-	-	-	29,495	29,495	76,076
	<u>\$ 2,279,735</u>	<u>\$ 2,010,780</u>	<u>\$ 42,529</u>	<u>\$ 2,053,309</u>	<u>\$ 106,084</u>	<u>\$ 2,159,393</u>	<u>\$ 120,342</u>
2008-ARRA	280,285	95,003	139,836	234,839	33,559	268,398	11,887
	<u>\$ 2,560,020</u>	<u>\$ 2,105,783</u>	<u>\$ 182,365</u>	<u>\$ 2,288,148</u>	<u>\$ 139,643</u>	<u>\$ 2,427,791</u>	<u>\$ 132,229</u>

**CALIFORNIA STATE WATER RESOURCES CONTROL BOARD
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NOTE 6 - CAPITAL CONTRIBUTIONS (CONTINUED)

TABLE 2

	State Match Paid During Year Ended June 30, 2011	State Match Paid As of June 30, 2011	State Match Paid During Year Ended June 30, 2012	State Match Paid As of June 30, 2012
State Disbursed	\$ 161	\$ 346,334	\$ 207	\$ 346,541
Local Disbursed	4,965	277,377	2,210	279,587
	<u>\$ 5,126</u>	<u>\$ 623,711</u>	<u>\$ 2,417</u>	<u>\$ 626,128</u>

Restricted Funds

State matching funds for the 1993 capitalization grant and portions of the 1994 and 1995 capitalization grants were provided by the transfer of \$34,316 of outstanding loans and loan interest earned from California Water Reclamation Loan Fund. In 2006, an additional \$3,545 of outstanding loans and loan interest was transferred to the Fund for future match requirements. Repayments of these loans are restricted for future water reclamation loans that are eligible under the SRF program.

Administrative Fund

In January 2008, legislation in the State of California became effective which allows CWSRF to collect a service charge on loans which will be used for administrative costs. The fees collected and the expenses incurred are not included in the accompanying financial statements. Revenue collected and expenses incurred for the administrative fund are as follows:

	June 30, 2012	June 30, 2011
Administrative fee collected	<u>\$ 8,320</u>	<u>\$ 8,559</u>
Operating expenses incurred	<u>\$ 4,003</u>	<u>\$ 3,190</u>

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WATER POLLUTION CONTROL REVOLVING FUND
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NOTE 6 - CAPITAL CONTRIBUTIONS (CONTINUED)

Small Community Grant Fund

In September 2008, legislation in the State of California became effective which allows CWSRF to collect an annual charge on loans which will be used to assist Small Disadvantage Communities. The fees collected and the expenses incurred are not included in the accompanying financial statements. Revenue collected and expenses incurred for the grant fund are as follows:

	June 30, 2012	June 30, 2011
Grant fee collected	\$ 7,337	\$ 6,358
Grants disbursed	\$ 881	\$ -

NOTE 7 - RISK MANAGEMENT

The Fund participates in the State of California's Risk Management Program. The State has elected, with a few exceptions, to be self-insured against loss or liability. There have been no significant reductions in insurance coverage from the prior year. In addition, settled claims have not exceeded insurance coverage in the last three fiscal years. Refer to the State's Risk Management disclosure in the June 30, 2012 and 2011, Comprehensive Annual Financial Reports.

NOTE 8 - RETIREMENT PLAN

Plan Description

All of the employees of the Fund participate in the California Public Employees' Retirement System (CalPERS), which is included in the State of California's Comprehensive Annual Financial Report as a pension trust fund. CalPERS administers the Public Employees' Retirement Fund (PERF). PERF is an agent multiple-employer defined benefit retirement plan. CalPERS provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. Departments and agencies within the State of California, including the Fund, are in a cost-sharing arrangement in which all risks and costs are shared proportionately by participating State agencies. CalPERS issues a publicly available financial report that includes financial statements and required supplementary information for this plan. This report may be obtained by writing California Public Employees' Retirement System, Central Supply, P.O. Box 942715, Sacramento, California 94229-2715.

CALIFORNIA STATE WATER RESOURCES CONTROL BOARD
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NOTE 8 - RETIREMENT PLAN (CONTINUED)

The pension plan provides retirement benefits, survivor benefits, and death and disability benefits based upon the employee's years of credited service, age and final compensation.

Vesting occurs after five or ten years of credited services depending on the benefit tier. Employees who retire at or after age 50 with five or more years of service are entitled to a retirement benefit, payable monthly for the remainder of their lives. Benefit provisions and all other requirements are established by State statute.

Funding Policy

The Fund is required to contribute the actuarially determined remaining amounts necessary to fund the benefits for its members. The actuarial methods and assumptions used are those adopted by the PERF Board of Administration. The required contribution rates for the years ended June 30, 2012, 2011 and 2010, were 18.175%, 17.528% and 16.917%, respectively, for State Miscellaneous First Tier and 17.025%, 16.442% and 16.737%, respectively, for State Miscellaneous Second Tier. The contribution requirements of the plan members are established by State statute and the employer contribution rate is established and may be amended by CalPERS.

Contributions, annual pension costs and trend information attributable to employees of the Fund for the fiscal year ended June 30, 2012, 2011 and 2010, are not determinable at the Fund level. However, this information is reported at a statewide level in the State of California's Comprehensive Annual Financial Report.

Post-Employment Benefits Other than Pension

In addition to the pension benefits provided by the State, the State also provides post-retirement health care benefits, in accordance with Section 22754(g) of the State Government Code, to all employees who retire from the State on or after attaining certain age and length of service requirements. The post-retirement health care benefits are funded by the State's General Fund on a pay-as-you-go basis. Refer to the State's Post-Employment Benefits Other than Pension disclosure in the June 30, 2012 and June 30, 2011 Comprehensive Annual Financial Reports for disclosure.

NOTE 9 - NET ASSETS

Governmental Accounting Standards Board Statement No. 34 provides for three components of net assets: invested in capital assets, net of related debt, restricted and unrestricted. As of June 30, 2012 and 2011, the Fund had no net assets invested in capital assets, net of related debt.

Restricted net assets include net assets that are restricted for use, either externally imposed by creditors, grantors, contributors, or laws and regulations of other governments, or imposed by law through constitutional provisions or enabling legislation. At June 30, 2012 and 2011, the Fund had restricted net assets of \$32,567 and \$47,850, respectively, representing amounts received from borrower loan repayments on pledged loans. As of June 30, 2012 and 2011

CALIFORNIA STATE WATER RESOURCES CONTROL BOARD
WATER POLLUTION CONTROL REVOLVING FUND
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June 30, 2012 and 2011
(Dollar Amounts Expressed in Thousands)

NOTE 9 - NET ASSETS (CONTINUED)

pledged loans restricted for future bond debt service payments were \$238,166 and \$304,195, respectively, representing loans receivable pledged as security for the revenue bonds (see Note 5).

Unrestricted net assets consists of net assets that do not meet the definition of invested in capital assets, net of related debt or restricted. Although the Fund reports unrestricted net assets on the face of the statements of net assets, unrestricted net assets are to be used by the Fund for the payment of obligations incurred by the Fund in carrying out its statutory powers and duties and are to remain in the Fund.

NOTE 10 - LITIGATION

There are three lawsuits pending in regard to the Fund in which the Board is involved. Board management and its legal counsel estimate that the potential claims against the Board not covered by the State of California's Risk Management Program resulting from such litigation would be insignificant.

This information is an integral part of the accompanying financial statements.

**REPORTS REQUIRED BY THE
SINGLE AUDIT ACT AMENDMENTS OF 1996**

**CALIFORNIA STATE WATER RESOURCES CONTROL BOARD
WATER POLLUTION CONTROL REVOLVING FUND
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
Year Ended June 30, 2012**

<u>Grantor and Program Title</u>	<u>Federal CFDA Number</u>	<u>Federal Expenditures</u>
<u>U.S. Environmental Protection Agency</u>		
Direct Programs:		
Capitalization Grants for State Revolving Funds	66.458	\$ 106,084,445
ARRA Capitalization Grant for State Revolving Funds	66.458	<u>33,559,392</u>
		<u><u>\$ 139,643,837</u></u>

(*) Tested as a Major Program

See notes to schedule of expenditures of federal awards

**CALIFORNIA STATE WATER RESOURCES CONTROL BOARD
WATER POLLUTION CONTROL REVOLVING FUND
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
Year Ended June 30, 2012**

NOTE 1 - BASIS OF PRESENTATION

The accompanying schedule of expenditures of federal awards includes the federal grant activity of the California State Water Resources Control Board, Water Pollution Control Revolving Fund. The information in this schedule is presented in accordance with the requirements of the U.S. Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations*, and is prepared on the accrual basis of accounting.

NOTE 2 - LOANS TO SUBRECIPIENTS

Capitalization Grants for Clean Water State Revolving Fund CFDA# 66.458 include \$105,020,260 of expenditures that were disbursed as loan awards to qualifying subrecipients, which includes \$21,571,252 of principal forgiveness loans.

ARRA Capitalization Grant for Clean Water State Revolving Fund CFDA# 66.458 includes \$31,971,001 of expenditures that were disbursed as loan awards to qualifying subrecipients, which includes \$12,222,885 of principal forgiveness loans.

**Independent Auditor's Report on Internal Control Over Financial Reporting
and on Compliance and Other Matters Based on an Audit of Financial Statements
Performed in Accordance with Government Auditing Standards**

California State Water Resources Control Board
Water Pollution Control Revolving Fund
Sacramento, California

We have audited the financial statements of 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 year ended June 30, 2012, and have issued our report thereon dated September 28, 2012. We conducted our audit 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.

Internal Control Over Financial Reporting

Management of the Water Pollution Control Revolving Fund is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Water Pollution Control Revolving Fund's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the entity's internal control over financial reporting.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. *A material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Water Pollution Control Revolving Fund's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Water Pollution Control Revolving Fund's management and the U.S. Environmental Protection Agency, and is not intended to be and should not be used by anyone other than these specified parties.

CliftonLarsonAllen LLP

Greenwood Village, Colorado
September 28, 2012

Independent Auditor's Report on Compliance with Requirements That Could Have a Direct and Material Effect on Each Major Program and on Internal Control Over Compliance in Accordance with OMB Circular A-133

California State Water Resources Control Board
Water Pollution Control Revolving Fund
Sacramento, California

Compliance

We have audited the compliance of California State Water Resources Control Board, Water Pollution Control Revolving Fund (Water Pollution Control Revolving Fund) with the types of compliance requirements described in the OMB *Circular A-133 Compliance Supplement* that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2012. Water Pollution Control Revolving Fund's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of Water Pollution Control Revolving Fund's management. Our responsibility is to express an opinion on Water Pollution Control Revolving Fund's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Water Pollution Control Revolving Fund's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of Water Pollution Control Revolving Fund's compliance with those requirements.

In our opinion, Water Pollution Control Revolving Fund complied, in all material respects, with the requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2012.

Internal Control Over Compliance

The management of Water Pollution Control Revolving Fund is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered Water Pollution Control Revolving Fund's internal control over compliance with the requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the entity's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

This report is intended solely for the information and use of the Water Pollution Control Revolving Fund's management and the U.S. Environmental Protection Agency and is not intended to be and should not be used by anyone other than these specified parties.

CliftonLarsonAllen LLP

Greenwood Village, Colorado
September 28, 2012

**CALIFORNIA STATE WATER RESOURCES CONTROL BOARD
WATER POLLUTION CONTROL REVOLVING FUND
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
Year Ended June 30, 2012**

PART I - SUMMARY OF AUDITOR'S RESULTS

Financial Statements

Type of auditor's report issued: Unqualified
Internal control over financial reporting:
Material weakness(es) identified? _____ yes no
Significant deficiency(ies) identified
not considered to be material weaknesses? _____ yes none reported
Noncompliance material to financial statements
noted? _____ yes no

Federal Awards

Internal control over major program:
Material weakness(es) identified? _____ yes no
Significant deficiency(ies) identified
not considered to be material weaknesses? _____ yes none reported
Type of auditor's report issued on compliance
for major program: Unqualified
Any audit findings disclosed that are required
to be reported in accordance with section 510 (a)
of OMB Circular A-133? _____ yes no

Identification of major programs:

CFDA Number(s)	Name of Federal Program or Cluster
66.458	Capitalization Grants for State Revolving Funds
66.458	ARRA Capitalization Grants for State Revolving Funds

Dollar threshold used to distinguish between
Type A and Type B programs: \$3,000,000
Auditee qualified as low-risk auditee? yes no

PART II - FINDINGS RELATED TO FINANCIAL STATEMENTS

There were no findings required to be reported under generally accepted *Government Auditing Standards*.

PART III - FINDINGS RELATED TO FEDERAL AWARDS

There were no findings required to be reported under OMB *Circular A-133*.

**CALIFORNIA STATE WATER RESOURCES CONTROL BOARD
WATER POLLUTION CONTROL REVOLVING FUND
SUMMARY SCHEDULE OF PRIOR YEAR AUDIT FINDINGS
Year Ended June 30, 2012**

There were no prior audit findings required to be reported under generally accepted government auditing standards or OMB *Circular A-133*.