

CALIFORNIA DEPARTMENT OF PUBLIC HEALTH

Independent Auditor's Report

FINANCIAL AUDIT OF THE SAFE DRINKING WATER STATE REVOLVING FUND

For the Fiscal Year Ended June 30, 2011 and 2010



JOHN CHIANG
California State Controller

January 2012



JOHN CHIANG
California State Controller

January 10, 2012

Ron Chapman, M.D., M.S.P.H., Director
California Department of Public Health
1615 Capitol Avenue, MS 0500
P.O. Box 997377
Sacramento, CA 95899-7377

Dear Dr. Chapman:

The following is the report on the financial audit for the California Department of Public Health's Safe Drinking Water State Revolving Fund for the fiscal year ended June 30, 2011.

Our audit disclosed that the fund's financial statements conform to accounting principles generally accepted in the United States of America, and we found no instances of material noncompliance with applicable laws, regulations, contracts, or grant agreements.

We also will issue, at a later date, an audit report on compliance with requirements in accordance with OMB Circular A-133.

If you have any questions, please call Andrew Finlayson, Chief, State Agency Audits Bureau, at (916) 324-6310.

Sincerely,

Original signed by

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

JVB/wm

cc: Kathleen Billingsley, RN, Chief Deputy Director of Policy and Programs
California Department of Public Health (via e-mail)
Daniel Kim, Chief Deputy Director of Operations
California Department of Public Health (via e-mail)
Alan Lum, Deputy Director–Administration
California Department of Public Health (via e-mail)
Annemarie Reno, Chief of Accounting
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Gary Yamamoto, Division Chief, Drinking Water & Environmental Management
California Department of Public Health (via e-mail)
Leah Walker, Chief, Technical Programs Branch
California Department of Public Health (via e-mail)
Addie Aguirre, Chief, Infrastructure Funding Administration Section
California Department of Public Health (via e-mail)
David Whitsell, Chief, Internal Audits
California Department of Public Health (via e-mail)
Karen Petruzzi, CDPH Audit Coordinator
California Department of Public Health (via e-mail)
Beverly Englund, Division of Accounting
and Reporting, State Controller’s Office (via e-mail)

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FINANCIAL SECTION



JOHN CHIANG
California State Controller

Ron Chapman, M.D., M.S.P.H., Director
California Department of Public Health
1615 Capitol Avenue, MS 0500
P.O. Box 997377
Sacramento, CA 95899-7377

INDEPENDENT AUDITOR'S REPORT

The State Controller's Office (SCO) has audited the accompanying Statement of Net Assets, Statement of Revenue, Expenses, and Changes in Net Assets, and Statement of Cash Flows of the Safe Drinking Water State Revolving Fund (Fund) as of and for the years ended June 30, 2011 and 2010. These financial statements are the responsibility of the California Department of Public Health's management. The SCO's responsibility is to express an opinion on these financial statements based on its audit.

The SCO 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. Those standards require that the SCO plan and perform the audit to provide reasonable assurance as to 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. The SCO believes that its audit provides a reasonable basis for its opinion.

In the SCO's opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Fund as of June 30, 2011 and 2010, and the changes in financial position and cash flows thereof for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, the SCO also issued its report dated January 10, 2012, on the SCO's consideration of the department's internal control over financial reporting and on 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 the audits.

As discussed in Note 1, Definition of Reporting Entity, the financial statements of the Fund are intended to present the financial position, and the changes in financial position and cash flows, where applicable, of only that portion of the financial reporting entity of the department that is attributable to the transactions of the Fund. They do not purport to, and do not present the financial position of the State of California as of June 30, 2011 and 2010, or the changes in its financial position or its cash flows.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and budgetary comparison information on pages 4 through 6 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Government 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. The SCO has 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 the SCO's inquiries, the basic financial statements, and other knowledge the SCO obtained during the audit of the basic financial statements. The SCO does not express an opinion or provide any assurance on the information because the limited procedures do not provide the SCO with sufficient evidence to express an opinion or provide any assurance.

Original signed by

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

January 10, 2012

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following discussion and analysis is a narrative overview of the financial activities of the California Department of Public Health's Safe Drinking Water State Revolving Fund for the fiscal year ended June 30, 2011.

FINANCIAL HIGHLIGHTS

- Net assets as of June 30, 2011 were \$772,608,801.
- Total net assets increased by \$84,220,279 during the fiscal year ended June 30, 2011. This is a result of increases in interest income from loans, fines and penalties, and operating transfers in.

USING THIS FINANCIAL REPORT

This annual report consists of two parts – the management's discussion and analysis (this section) and the basic financial statements. The basic financial statements consist of the Statement of Net Assets; the Statement of Revenues, Expenses, and Changes in Fund Net Assets; and the Statement of Cash Flows. The basic financial statements include Notes to the Financial Statements section.

- The Statement of Net Assets includes all of the program's assets and liabilities, using the accrual basis of accounting, as well as an indication about which assets are restricted as a result of bond covenants. Net assets may serve over time as a useful indicator of whether the financial position of the program is improving or deteriorating.
- The Statement of Revenue, Expenses, and Changes in Fund Net Assets reports all of the revenues and expenses during the fiscal years indicated. The Statement also incorporates a reconciliation of beginning and ending net assets.
- The Statement of Cash Flows reports the cash provided and used by operating activities, as well as other cash sources, such as interest from investments and revenues from the Environmental Protection Agency.
- Notes to the Financial Statements provide additional information that is useful for a full understanding of the data provided in the Statement of Net Assets. The notes to the financial statements are located immediately following the Statement of Cash Flows.

FINANCIAL ANALYSIS OF THE PROGRAM

Table 1 presents condensed financial information from the Statement of Net Assets and provides an overview of the program's financial position for the fiscal years ended June 2011 and 2010.

Table 1
Net Assets

	<u>Year Ended June 30</u>		<u>Increase/(Decrease)</u>	
	<u>2011</u>	<u>2010</u>	<u>Amount</u>	<u>Percentage</u>
Cash and pooled investments	\$170,851,120	\$133,231,354	\$37,619,766	28.2%
Receivables	5,623,024	5,781,291	(158,267)	(-2.7)%
Current loans receivable	28,070,851	21,813,247	6,257,604	28.7%
Non-current loans receivable	574,789,923	537,967,132	36,822,791	6.8%
Total Assets	\$779,334,918	\$698,793,024	80,793,024	11.5%
Current liabilities	\$6,039,212	\$9,616,776	\$(3,577,564)	(37.2)%
Non-current liabilities	686,905	787,726	(100,821)	(12.8)%
Total Liabilities	\$6,726,117	\$10,404,502	(3,678,385)	(35.4)%
Net assets:				
Restricted	\$772,608,801	\$688,388,522	\$84,220,279	12.2%
Total Net Assets	\$772,608,801	\$688,388,522	\$84,220,279	12.2%

The following is an explanation of the changes between fiscal years, as shown in Table 1:

- The program received more bond funds and pooled money interest in 2011 by 28.2%.
- There were more loans given out by the program in 2011, a 28.7% difference from 2010, partly due to funding from the American Recovery and Reinvestment Act.
- Current liabilities were reduced from \$9.6 million in 2010 to \$6.0 million in 2011, a 37.2% decrease.
- Non-current liabilities were reduced by 12.8% in 2011.

Table 2 presents condensed financial information from the Statement of Revenues, Expenses, and Changes in Fund Net Assets and summarizes the sources of net assets for the years ended June 30, 2011 and 2010.

Table 2
Change in Net Assets

	Year Ended June 30		Increase/(Decrease)	
	2011	2010	Amount	Percentage
Operating revenue				
Loan interest	\$12,064,658	\$11,174,639	890,019	8.0%
EPA administrative reimbursement	<u>12,315,989</u>	<u>11,468,700</u>	<u>847,289</u>	7.4%
Total operating revenue	<u>\$24,380,647</u>	<u>\$22,643,339</u>	<u>\$1,737,308</u>	7.7%
Operating expenses				
Salaries and benefits	\$6,475,329	\$6,254,488	\$220,841	3.5%
Other Expenses	5,843,355	5,214,210	629,145	12.1%
Principal debt forgiveness	<u>61,940,232</u>	<u>17,650,786</u>	<u>44,289,446</u>	250.9%
Total operating expenditure	<u>74,258,916</u>	<u>29,119,484</u>	<u>45,139,432</u>	155.0%
Total income (loss) from operations	<u>\$(49,878,269)</u>	<u>\$(6,476,145)</u>	<u>\$(43,402,124)</u>	(670.2)%
Non-operating revenue	<u>\$134,098,548</u>	<u>\$28,893,744</u>	<u>\$105,204,804</u>	<u>364.1%</u>
Increase (decrease) in net assets	<u>\$84,220,279</u>	<u>\$22,417,599</u>	<u>61,802,680</u>	275.7%
Total net assets at beginning of year	<u>688,388,522</u>	<u>655,970,923</u>	<u>22,417,599</u>	3.4%
Total net assets at end of year	<u>\$772,608,801</u>	<u>\$688,388,522</u>	<u>\$84,220,279</u>	12.2%

The following is an explanation of the changes between fiscal years, as shown in Table 2

- The change in operating revenue from 2010 to 2011 was small—just a 7.7% increase.
- Salaries and benefits had a small increase of 3.5% between 2010 and 2011 while other expenses increased 12.1%.
- Principal debt forgiveness increased dramatically from 2010 to 2011 by 250.9% which resulted from the additional funding from the American Recovery and Reinvestment Act.

CURRENT AND SUBSEQUENT CONDITIONS

There are no current or subsequent conditions needing to be reported.

FINANCIAL CONTACT

The program’s financial report is intended to present the user with a general overview of the Program’s finances and to demonstrate the Drinking Water Program’s accountability of funds received. Questions about this report or requests for additional financial information should be directed to Jean Billington, State and Federal Reporting, California Department of Public Health, P O Box 997376, MS 1601, Sacramento, CA 95899-7376.

California Department of Public Health
Safe Drinking Water State Revolving Fund
Statement of Net Assets
June 30, 2011 and 2010

	<u>June 30, 2011</u>	<u>June 30, 2010</u>
ASSETS		
Current assets:		
Cash and pooled investments (Note 3)	\$ 170,851,120	\$ 133,231,354
Receivables:		
Loan interest	4,061,263	2,795,051
SMIF interest (Note 4)	172,455	154,027
Due from Environmental Protection Agency (Note 5)	1,389,306	2,832,213
Current portion of loans receivable (Note 6)	<u>28,070,851</u>	<u>21,813,247</u>
Total current assets	<u>204,544,995</u>	<u>160,825,892</u>
Non-current assets:		
Non-current loans receivable	<u>574,789,923</u>	<u>537,967,132</u>
Total non-current assets	<u>574,789,923</u>	<u>537,967,132</u>
Total assets	<u><u>\$ 779,334,918</u></u>	<u><u>\$ 698,793,024</u></u>
LIABILITIES		
Current liabilities:		
Accounts payable	\$ 1,276,159	\$ 452,650
Deferred revenue (Note 8)	3,616,711	6,982,979
Due to California Department of Public Health (Note 9)	<u>1,146,342</u>	<u>2,181,147</u>
Total current liabilities	<u>6,039,212</u>	<u>9,616,776</u>
Non-current liabilities:		
Compensated absences payable	<u>686,905</u>	<u>787,726</u>
Total non-current liabilities	<u>686,905</u>	<u>787,726</u>
Total liabilities	<u><u>\$ 6,726,117</u></u>	<u><u>\$ 10,404,502</u></u>
NET ASSETS		
Restricted	<u>\$ 772,608,801</u>	<u>\$ 688,388,522</u>
Total net assets	<u><u>\$ 772,608,801</u></u>	<u><u>\$ 688,388,522</u></u>

The Notes to the Financial Statements are an integral part of this statement.

**California Department of Public Health
Safe Drinking Water State Revolving Fund
Statement of Revenues, Expenses, and
Changes in Fund Net Assets
Years Ended June 30, 2011 and 2010**

	<u>June 30, 2011</u>	<u>June 30, 2010</u>
Operating revenues:		
Loan interest	\$ 12,064,658	\$ 11,174,639
EPA administrative reimbursements	<u>12,315,989</u>	<u>11,468,700</u>
Total operating revenues	<u>24,380,647</u>	<u>22,643,339</u>
Operating expenses:		
Salaries and benefits	6,475,329	6,254,488
Other expenses	5,843,355	5,214,210
Principal debt forgiveness (Note 7)	<u>61,940,232</u>	<u>17,650,786</u>
Total operating expenses	<u>74,258,916</u>	<u>29,119,484</u>
Income (loss) from operations	<u>(49,878,269)</u>	<u>(6,476,145)</u>
Nonoperating revenues (expenses):		
SMIF interest	633,529	666,835
EPA capitalization grant	114,133,365	28,226,909
State match	<u>19,331,654</u>	<u>—</u>
Total non-operating revenues (expenses)	<u>134,098,548</u>	<u>28,893,744</u>
Change in net assets	84,220,279	22,417,599
Total net assets—beginning	<u>688,388,522</u>	<u>665,970,923</u>
Total net assets—ending	<u>\$ 772,608,801</u>	<u>\$ 688,388,522</u>

The Notes to the Financial Statements are an integral part of this statement.

California Department of Public Health
Safe Drinking Water State Revolving Fund
Statement of Cash Flows
Years Ended June 30, 2011 and 2010

	June 30, 2011	June 30, 2010
CASH FLOW FROM OPERATING ACTIVITIES		
Cash received from interest on loans	\$ 11,689,789	\$ 12,550,161
Cash paid for loans and grants disbursed	(129,844,787)	(80,489,004)
Principal received on loans receivable	23,928,740	18,256,265
Cash paid to employees and vendors	(12,640,799)	(10,139,148)
EPA grants for administrative and set-aside costs	13,770,654	10,394,469
Net cash flows from operating activities	(93,096,403)	(49,427,257)
CASH FLOW FROM INVESTING ACTIVITIES		
Interest received from investments	613,342	861,162
Net cash flows from investing activities	613,342	861,162
CASH FLOW FROM NONCAPITAL FINANCING ACTIVITIES		
Transfers from the Environmental Protection Agency	110,759,574	35,014,270
Transfers from the State of California	19,343,253	—
Net cash flows from noncapital financing activities	130,102,827	35,014,270
Net increase in cash and cash equivalents	37,619,766	(13,551,825)
Cash and cash equivalents—July 1, 2010	133,231,354	146,783,179
Cash and cash equivalents—June 30, 2011	\$ 170,851,120	\$ 133,231,354
Reconciliation of operating income (loss) to net cash flows provided by (used in) operating activities:		
Operating income (loss)	\$ (49,878,269)	\$ (6,476,142)
Adjustments to reconcile operating income (loss) to net cash provided (used) by operating activity:		
(Increase) in interest receivable	(1,266,212)	(803,439)
(Increase) in loans receivable	(43,080,395)	(42,402,997)
(Increase) due from EPA for administrative expenses	1,442,907	(1,139,644)
(Decrease) in accounts payable	823,509	(442,246)
Increase due to the California Department of Public Health	(1,037,122)	1,614,918
Increase in compensated absences payable	(100,821)	222,293
Total adjustments	(43,218,134)	(42,951,115)
Net cash flows from operating activities	\$ (93,096,403)	\$ (49,427,257)

The Notes to the Financial Statements are an integral part of this statement.

Notes to the Financial Statements Years Ended June 30, 2011 and 2010

NOTE 1— SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a. General Information

Effective July 1, 2007, the California Department of Health Services was divided into two separate departments: the California Department of Health Care Services and the California Department of Public Health. Pursuant to Chapter 241, Statutes of 2006 (SB 162), specific programs and public health responsibilities were transferred from the former California Department of Health Services to the newly established California Department of Public Health. The Safe Drinking Water State Revolving Fund (Fund) is now administered by the California Department of Public Health.

The Fund was created pursuant to Health and Safety Code (HSC) section 116760.30, and is continuously appropriated without regard to fiscal year. The Fund is capitalized by the U.S. Environmental Protection Agency (EPA) by a series of federal grants. As a condition for receiving the federal grant, the department is required to provide an additional 20% of matching funds. The department uses the Fund primarily to make loans to public water systems for financing the cost of infrastructure needed to achieve or to maintain compliance with the Safe Drinking Water Act requirements and to protect public health.

The activities of the Fund are included in the State of California's *Comprehensive Annual Financial Report*. The Fund includes the federal loan fund, two state match loan funds, and five set-aside funds. The set-aside funds are the: (1) Administration Account, (2) Water System Reliability Account, (3) Source Protection Account, (4) Small System Technical Assistance Account, and (5) Public Water System, Safe Drinking Water Revolving Fund.

The Public Water System Supervision, Safe Drinking Water State Revolving Fund is a set-aside fund that was created during fiscal year (FY) 2006-07 to pay for expenses to provide public water system oversight activities to support the Fund's loan and grant program. The establishment of the separate set-aside funds to account for the costs related to the administration of the Fund is consistent with federal guidelines. The loan and set-aside funds are combined to form the Fund's financial statements.

b. Basis of Presentation

The Fund is classified as an enterprise fund. The Fund is accounted for on the flow of economic resources measurement focus and the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recorded at the time the liabilities are incurred. Enterprise funds account for goods or services provided to the general public on a continuing basis when: (1) the department intends that all or most of the cost involved is to be financed by user charges, or (2) periodic measurement of the results of operations is appropriate for management control, accountability, capital maintenance, public policy, or other purposes. The Fund applies all applicable Governmental Accounting Standards Board (GASB) pronouncements, pursuant to GASB Statement No. 20, as well as all applicable Financial Accounting Standards Board (FASB) Statements and

Interpretations issued on or before November 30, 1989, unless the pronouncements conflict with or contradict GASB pronouncements. For purposes of the Statement of Cash Flows, all cash and pooled investments, as discussed in Note 4, are considered to be cash equivalents.

c. Revenue Recognition

The operating revenues and expenses are generated through the issuance of loans and the operation of the Fund's set-aside activities. All other revenues and expenses are reported as non-operating revenues and expenses.

Funding from federal capitalization grants and state matching grants for reimbursement of the Fund's set-aside activities is recognized as operating revenue as set-aside activity expenditures are incurred. Funding from federal capitalization grants and state matching grants for loan activities is recognized as a non-operating revenue when loans are disbursed. Amounts received from the federal capitalization grants and state matching grants for the purpose of making loans before the loans are disbursed are recorded as deferred revenues.

d. Cash Flow Presentation

The statement of cash flows is provided in accordance with the provisions of GASB 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting*; and GASB 34, *Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments*. In accordance with GASB 9 and GASB 34, the direct method was used to report net cash flows from operating activities by adjusting operating income to reconcile it to net cash from operating activities.

e. Management Estimates

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

f. Compensated Absences

State employees are eligible to accrue annual leave, vacation, and sick leave. Annual leave accrues at a rate of 11 to 20 hours per month. Vacation accrues at a rate of 7 to 16 hours per month. Accrued annual leave and vacation are paid out upon termination while sick leave is not. As of June 30, 2011, the Fund's compensated absences totaled \$686,905.

g. Restricted Net Assets

Net assets are restricted due to specific provisions of the Federal Safe Drinking Water Revolving Fund Program.

NOTE 2— CAPITALIZATION GRANTS

The Fund is financed by annual grants from the U.S. Environmental Protection Agency (EPA) and a state match equal to 20% of the federal award. In June 2009, the Fund was awarded an additional federal capitalization grant under the American Recovery and Reinvestment Act of 2009 (ARRA). The ARRA grant required that no less than 50% of the funds be provided as additional subsidization in the form of principal forgiveness, grants, or negative interest loans. The Fund is providing the additional subsidization in the form of principal forgiveness and negative interest loans which have been recorded as principal forgiveness expense.

Of the amount awarded by EPA, the department has designated \$131.5 million for administrative expenses, program management, small system technical assistance, loan assistance, and other state program expenses (collectively known as set-asides), and \$1.158 billion for loans. Set-asides are accounted for in other funds.

The grants awarded, amounts drawn on each grant, and the loan balances available for active grants, as of June 30, 2011, are presented below:

Grant Year	Capitalization Grant Amount	Award Available for Set-Aside	Award Available for Loans	Award Drawn for Loans	Available for Loans as of June 30, 2009
1998	\$ 75,682,600	\$ 10,048,176	\$ 65,634,424	\$ 65,634,424	\$ —
1999	77,108,200	4,934,925	72,173,275	72,173,275	—
2000	80,816,700	5,172,269	75,644,431	75,644,431	—
2001	83,993,100	2,000,000	81,993,100	81,993,100	—
2002	84,340,000	7,060,400	77,279,600	77,279,600	—
2003	82,392,347	6,879,101	75,513,246	75,513,246	—
2004	81,966,200	6,917,972	75,048,228	75,048,228	—
2005	84,957,600	12,349,628	72,607,972	59,245,185	13,362,787
2006	84,847,500	8,248,614	76,598,886	—	76,598,886
2007	67,123,678	8,700,249	58,423,429	—	58,423,429
2008	67,105,000	8,960,700	58,144,300	—	58,144,300
2009	66,424,000	8,867,604	57,556,396	—	57,556,396
2010	66,424,000	8,867,604	57,556,396	—	57,556,396
2011	126,958,000	23,284,097	103,673,903	—	103,673,903
ARRA					
2009	159,008,000	9,197,000	149,811,000	93,698,434	56,112,566

NOTE 3— CASH AND POOLED INVESTMENTS

Cash and pooled investments comprise the following items:

	June 30, 2011	June 30, 2010
General cash	\$ 4,411,502	\$ 3,430,219
Cash in State Treasury	19,387,618	16,626,691
Deposits on hand	—	7,444
Deposits in Surplus Money Investment Fund	147,052,000	113,167,000
Total	<u>\$ 170,851,120</u>	<u>\$ 133,231,354</u>

Cash in State Treasury is cash deposits managed by the Centralized Treasury System. Excess cash is invested in the Surplus Money Investment Fund (SMIF). All of the resources of the SMIF are invested through the Pooled Money Investment Account (PMIA). The PMIA investment program is designated by the Pooled Money Investment Board and is administered by the Office of the State Treasurer. Investments in the SMIF

are stated at fair value. As of June 30, 2011, the Fund has invested funds in SMIF in the amount of \$147,052,000.

All cash and investments in SMIF are highly liquid and considered cash equivalents. Cash equivalents are readily convertible to known amounts of cash and are so near their maturity they present insignificant risk of changes in value because of changes in interest rates. Generally, only investments with original maturities of three months or fewer meet this definition.

Additional disclosure details required by GASB 3, GASB Technical Bulletin 94-1, and GASB 40 regarding cash deposits, investments, and derivatives, can be found in the June 30, 2011 Comprehensive Annual Financial Report of the State of California.

NOTE 4— SMIF INTEREST RECEIVABLE

Investment Interest Receivable represents the amount of interest earned but not yet deposited in the Surplus Money Investment Fund. The amount of SMIF interest receivable as of June 30, 2011, and June 30, 2010, is \$172,455 and \$154,027, respectively.

NOTE 5— DUE FROM EPA

For the Fund's set-aside and loan administration activities, amounts due from the Environmental Protection Agency are recognized when expenditures are incurred. The amount Due from EPA is the amount by which expenditures exceed EPA grant reimbursements. The amount Due from EPA as of June 30, 2011, and June 30, 2010, are \$1,389,306 and \$2,832,213, respectively.

NOTE 6— LOAN PRINCIPAL AND INTEREST RECEIVABLE

The department disburses the loan proceeds on a cost reimbursement basis. As entities spend money on projects financed by the Fund and request reimbursement, the department releases the loan proceeds. Interest accrues on all loan disbursements as of the date each disbursement is made.

There is no allowance for uncollectible accounts, as all repayments are current, and management believes all loans will be repaid according to the loan terms. There have been no loan defaults in the program since its inception.

The Fund makes loans to qualified local and private entities at interest rates ranging between 0% and 50% of the average rate paid by the State on general obligation bonds. Loans must be repaid within 20 years after completion of the project (30 years for financially disadvantaged communities). Recipients make semi-annual payments, generally starting 12 months after project completion. The Fund assesses a penalty of one-tenth of 1% per day from the repayment due date on the amount due on loan repayments past due. Loan interest revenue and its related receivable is recorded as it accrues. The Fund has loan interest receivable as of June 30, 2011, and June 30, 2010, in the amounts of \$4,061,263 and \$2,795,051, respectively.

The following schedule of loans receivable activity for the year ended June 30, 2011, lists each water system's outstanding loan balance. Included in the "Active Loans" category are water systems that have both fully disbursed and active loans outstanding.

Water Entity	Authorized Loan Amounts	Total Loans Disbursed as of June 30, 2011	Total Principal Paid as of June 30, 2011	Outstanding Balance as of June 30, 2011
<u>Fully Disbursed Loans</u>				
Anaheim, City of	\$ 18,062,849	\$ 18,062,849	\$ 7,343,952	\$ 10,718,897
Anderson Valley USD	48,363	48,363	-	48,363
Angels, City of	1,489,361	1,489,361	595,745	893,616
Asoleado Mutual Water Company	59,200	59,200	49,240	9,960
Bella Vista Water District	10,399,538	10,171,641	1,028,126	9,143,515
Benicia, City of	11,716,747	11,716,747	1,920,338	9,796,409
Biola Community Services District	177,000	177,000	35,400	141,600
Blythe, City of	9,807,160	9,807,160	1,569,146	8,238,014
Brawley, City of (102)	15,823,475	15,823,475	7,516,151	8,307,324
Brawley, City of (103)	4,127,516	4,127,516	1,857,382	2,270,134
California Water Service Co. - Lucerne (301)	7,078,698	7,078,698	353,935	6,724,763
California Water Service Co. - (316)	494,276	494,276	55,441	438,835
Capell Valley Estates, Inc. (C14)	648,000	648,000	105,077	542,923
Carpinteria Valley Water District (121)	9,950,000	9,236,658	360,535	8,876,123
Carpinteria Valley Water District (125)	8,140,452	8,140,452	977,550	7,162,902
Colusa, County of	171,720	171,720	17,172	154,548
Contra Costa Water District (106)	15,137,776	15,137,776	5,525,761	9,612,015
Contra Costa Water District (118)	5,942,427	5,942,427	1,631,373	4,311,054
Contra Costa Water District 101 (SWAP)	2,000,000	2,000,000	682,938	1,317,062
Crescent City, City of (401)	7,000,000	7,000,000	2,625,000	4,375,000
Del Rey Community Services District	172,380	172,380	28,730	143,650
Dinuba, City of	7,462,450	6,956,217	269,126	6,687,091
Dunsmuir, City of	55,800	55,800	12,555	43,245
Dutch Flat Mutual Water Company	201,530	201,530	50,284	151,246
East Bay Municipal Utility District (109)	2,188,000	2,188,000	695,690	1,492,310
East Valley Water District (412)	169,052	169,052	33,810	135,242
Eastern Municipal Water District	42,098,388	42,098,388	6,314,758	35,783,630
El Dorado Irrigation Water District (102)	806,954	806,954	259,996	546,958
El Dorado Irrigation Water District (103)	639,925	639,925	206,180	433,745
El Dorado Irrigation Water District (104)	754,130	754,130	242,977	511,153
El Dorado Irrigation Water District (105)	1,022,963	1,022,963	329,593	693,370
El Dorado Irrigation Water District (130)	959,041	959,041	237,707	721,334
El Dorado Irrigation Water District (131)	1,928,791	1,928,791	478,068	1,450,723
El Dorado Irrigation Water District (140)	8,699,000	5,749,808	694,380	5,055,428
El Dorado Irrigation Water District (141)	4,670,720	3,387,107	552,177	2,834,930
El Dorado Irrigation Water District (142)	1,732,745	1,732,745	282,478	1,450,267
El Dorado Irrigation Water District (143)	5,873,746	5,873,746	587,493	5,286,253
Escondido, City of	2,048,125	2,048,125	557,180	1,490,945
Fort Bragg, City of	2,141,532	2,141,532	481,845	1,659,687
Garberville Sanitary District	100,000	100,000	48,096	51,904
Georgetown Divide - PUD - Lake Walton	400,511	400,511	16,002	384,509
Grenada Water Company	590,000	590,000	118,000	472,000
Grizzly Flats Community District	253,336	253,336	73,212	180,124
Hillview Water Company (302-02)	3,808,447	3,808,447	317,371	3,491,076
Humboldt Bay Municipal Water District	10,946,739	10,946,739	3,831,359	7,115,380
Imperial County - West Lake County Campground	83,374	83,374	26,842	56,532
Imperial County - Red Hill Marina Campground	146,789	146,789	33,028	113,761
Indian Valley Community Services District	113,557	113,557	18,169	95,388
Ivanhoe Public Utility District	1,494,247	1,494,247	336,206	1,158,041

Water Entity	Authorized Loan Amounts	Total Loans Disbursed as of June 30, 2011	Total Principal Paid as of June 30, 2011	Outstanding Balance as of June 30, 2011
<u>Fully Disbursed Loans</u> (continued)				
Kerman, City of	3,300,000	3,299,999	412,500	2,887,499
Kern County Water Agency	2,825,780	2,825,705	46,777	2,778,928
Kings, County of	991,251	991,251	132,167	859,084
Konocti - Ford's Acres Mobile Home Park	183,336	183,336	62,581	120,755
Lake Alpine Water Company	2,413,362	2,413,362	242,792	2,170,570
Lake Combie Mobile Home Village	54,951	54,951	16,203	38,748
Los Angeles, City of (101)	17,751,425	17,751,425	5,306,570	12,444,855
Los Angeles, City of (139)	25,335,671	25,335,671	980,671	24,355,000
Los Angeles, City of (144)	36,432,000	36,432,000	1,352,333	35,079,667
Los Angeles, City of (147)	38,684,250	38,684,250	1,544,267	37,139,983
Meadow Vista County Water District (102)	73,305	73,305	73,305	-
Metropolitan Water District of Southern California	20,000,000	20,000,000	5,490,597	14,509,403
Montecito Water District	9,950,000	9,236,658	360,535	8,876,123
North Marin Water District	16,528,850	16,528,853	985,840	15,543,013
Placer County Water Agency	20,000,000	20,000,000	1,615,197	18,384,803
Redlands, City of	7,355,000	6,100,844	1,136,470	4,964,374
Richardson Beardsley Park, Inc.	57,093	57,093	17,067	40,026
Rio Dell, City of	2,720,000	2,720,000	204,000	2,516,000
River Pines Public Utility District	190,000	190,000	38,000	152,000
Rural North Vacaville Water District	8,838,365	8,838,365	3,034,698	5,803,667
San Buenaventura, City of	20,000,000	20,000,000	2,850,957	17,149,043
San Diego, City of (120)	21,525,249	21,525,249	4,891,907	16,633,342
San Jose Water Company (301)	2,006,782	2,006,782	460,530	1,546,252
San Jose Water Company (303)	1,069,265	1,069,265	127,381	941,884
San Luis Obispo CFCO (105)	325,430	325,430	95,955	229,475
San Luis Obispo County Flood Control & Water Conservation District (138)	25,945,298	25,945,298	1,003,788	24,941,510
Santa Barbara, City of (123)	19,997,928	19,997,928	3,164,468	16,833,460
Santa Barbara, City of (111)	17,900,849	17,900,849	4,068,212	13,832,637
Santa Clara Valley Water District	6,350,000	6,349,999	773,959	5,576,040
Santiago Association (Paradise Ranch/Residential) 312	788,354	788,354	-	788,354
Santiago County Water District 102	1,300,000	1,300,000	299,982	1,000,018
Sequoia Crest Water Company	120,949	120,949	9,742	111,207
Sereno Del Mar Water Company	250,000	250,000	97,253	152,747
Serrano Water District	3,460,882	3,460,882	2,083,955	1,376,927
Shady Glen Enterprises	136,878	136,878	22,531	114,347
Sierra Lakes County Water District	1,307,195	1,307,195	326,163	981,032
Sierra Mobile Home Park	59,110	59,110	17,733	41,377
Solano Irrigation District - Gibson Ranch (101)	2,124,896	2,124,896	635,211	1,489,685
Solano Irrigation District - Blue Ridge Oaks (107)	865,675	865,675	180,241	685,434
Solano Irrigation District - Peabody Improvement District (108)	386,000	386,000	80,368	305,632
Sonoma County CSA#41 - Jenner	120,000	120,000	4,795	115,205
Sonoma County Water Agency (107)	15,857,295	15,857,295	1,535,495	14,321,800
Southern Humboldt - Whitehorn Unified School District	28,616	28,616	10,016	18,600
Spanish Flat Water District (419)	176,867	176,867	22,018	154,849
Spanish Flat Water District (112)	95,646	95,646	7,652	87,994
Spring Valley Heights Homeowners Association	1,775,823	1,775,823	35,243	1,740,580

Water Entity	Authorized Loan Amounts	Total Loans Disbursed as of June 30, 2011	Total Principal Paid as of June 30, 2011	Outstanding Balance as of June 30, 2011
<u>Fully Disbursed Loans</u> (continued)				
Stinson Beach County Water District	411,500	411,500	103,646	307,854
Strathmore Public Utility District (413)	451,500	451,500	60,200	391,300
Strathmore Public Utility District (420)	151,903	151,903	7,595	144,308
Taylor Investment dba Redwood MHP	78,441	78,441	78,441	-
Terra Bella Irrigation District (105)	1,218,820	1,218,820	578,940	639,880
Terra Bella Irrigation District (404)	102,000	102,000	40,800	61,200
Tracy, City of	20,000,000	20,000,000	2,863,675	17,136,325
Truckee Donner Public Utility District	12,732,965	12,732,965	2,651,110	10,081,855
Tuolumne Utilities District - Monte Grande	501,452	501,452	25,073	476,379
Tuolumne Utilities District - Railbed Road	49,015	49,015	15,930	33,085
Union Public Utility District	2,296,451	2,296,451	273,576	2,022,875
Vallejo Water System (101)	6,675,000	6,675,000	3,163,979	3,511,021
Vallejo Water System (414)	68,080	68,080	22,126	45,954
Westmorland, City of	670,632	670,632	670,632	-
West Side Union School District	7,000	7,000	175	6,825
Willow Creek Community Services District	470,884	470,884	70,633	400,251
Yolo County Airport	249,333	249,333	51,913	197,420
Yuba City, City of (106)	732,726	732,726	238,136	494,590
Total Fully Disbursed Loans	634,364,158	626,716,309	108,158,279	518,558,030
<u>Active Loans</u>				
Del Oro Water Company, Inc.	4,460,879	2,917,061	212	2,916,849
Delano, City of (105)	20,709,156	1,823,488	-	1,823,488
East Valley Water District (119)	7,001,964	-	-	-
Fallbrook (112)	6,160,437	6,159,773	-	6,159,773
Farm Mutual Water Co.	1,193,600	479,369	-	479,369
Fresno, City of (101)	1,968,136	366,082	-	366,082
Fresno, City of (150)	2,210,000	1,411,232	-	1,411,232
Fresno, City of (422)	80,000	80,000	-	80,000
Fruitridge Vista/Cook Endeavors	4,694,096	4,182,805	726,823	3,455,982
Grass Valley, City of	3,203,750	204,684	-	204,684
Keys Community	500,000	369,413	-	369,413
Kings Mountain Park W/C	24,880	24,476	-	24,476
Los Angeles, City of (104)	9,573,792	-	-	-
Lathrop, City of (113)	10,929,000	2,574,893	-	2,574,893
London	1,244,000	57,836	-	57,836
Meadow Vista County Water District (149)	21,546,100	10,531,051	-	10,531,051
Nevada Irrigation	10,844,348	6,900,530	-	6,900,530
North Gualala Water Company	500,000	76,880	-	76,880
Plainview Mutual Water District (CX201)	294,075	294,075	-	294,075
Redway CSD	1,530,000	496,873	-	496,873
Rubidoux CSD (114)	5,667,200	398,183	-	398,183
Santa Barbara, City of	29,283,000	-	-	-
San Diego, City of (111)	12,000,000	12,000,000	-	12,000,000
Shasta (107)	100,000	100,000	-	100,000
Shasta Community Services District	2,031,111	1,933,996	-	1,933,996
Sierra Grande	52,383	52,383	-	52,383
Terra Bella Irrigation District (146)	480,000	480,000	-	480,000
Trabuco Canyon WD (CX102)	3,995,000	3,373,636	-	3,373,636
Tuolumne (110)	1,277,046	128,708	-	128,708

Water Entity	Authorized Loan Amounts	Total Loans Disbursed as of June 30, 2011	Total Principal Paid as of June 30, 2011	Outstanding Balance as of June 30, 2011
<u>Active Loans</u> (continued)				
Villa Del Monte Mutual Water	1,156,328	1,056,328	-	1,056,328
Yuba City, City of (101)	6,817,375	2,690,611	-	2,690,611
Yuba City, City of (102)	19,133,209	6,647,714	-	6,647,714
Capell Valley Estates, Inc.-Joe Family (AR09N105)	1,723,545	179,545	-	179,545
Escondido, City of (AR09FP27-01)	2,899,400	2,535,547	-	2,535,547
Garrapata Water Company Inc. (AR09NI01-01)	114,813	82,844	-	82,844
Golden State Water Company (AR09N102-01)	4,500,000	851,265	-	851,265
Jensen Mobile Home Park (AR09N107-01)	27,857	27,857	-	27,857
Modesto, City of (AR09FP25-01)	573,415	56,129	-	56,129
Rainbow Municipal Water District (AR09FP26-01)	3,351,340	2,652,535	-	2,652,535
Sacramento, City of-Dept. of Utilities (AR09FP22)	10,000,000	6,220,447	-	6,220,447
Shady Lane Mobile Home Park (AR09NI06)	75,000	73,853	-	73,853
Windsor, Town of (AR09FP45)	1,208,501	604,251	-	604,251
Woodland, City of (AR09FP04)	7,419,500	3,933,419	-	3,933,419
Total Active Loans	<u>222,554,236</u>	<u>85,029,772</u>	<u>727,035</u>	<u>84,302,737</u>
Total	<u>\$ 856,918,394</u>	<u>\$ 711,746,081</u>	<u>\$108,885,314</u>	<u>\$ 602,860,767</u>
				Current loans receivable \$ 28,070,851
				Noncurrent loans receivable <u>574,789,923</u>
				Total loans receivable <u>\$ 602,860,774</u>

Loans mature at various intervals through July 1, 2041. The scheduled principal and interest payments on loans for fully disbursed projects maturing in the next five years and every five years thereafter are as follows:

Year Ending June 30	Principal	Interest	Total Receivable
2012	\$ 23,339,167	\$ 8,806,680	\$ 32,145,847
2013	28,181,528	9,921,010	38,102,5383
2014	28,725,634	9,362,859	38,088,493
2015	29,286,692	8,791,171	38,077,863
2016	29,872,560	8,205,315	38,077,875
2017-2021	157,062,552	31,799,210	188,861,762
2022-2026	146,489,552	15,696,944	162,186,496
2027-2031	71,295,681	3,037,327	74,333,008
2032-2036	2,888,321	—	2,888,321
2037-2041	1,416,343	—	1,416,343
Total	<u>\$ 518,558,030</u>	<u>\$ 95,620,516</u>	<u>\$ 614,178,546</u>

The amortization schedules for the active projects may change upon completion of the project when the final loan balance will be determined.

NOTE 7— PRINCIPAL DEBT FORGIVENESS EXPENSE

The Fund has loan agreements with disadvantaged communities for which the Fund intends to forgive loan principal under the Fund’s disadvantaged community assistance program. Principal forgiveness expense is recognized when the Fund makes payment to the disadvantaged community. As of June 30, 2011, the Fund has not incurred principal

forgiveness expense as a result of a loan recipient's inability to repay a loan. During the fiscal year ended June 30, 2011, the Fund recognized Principal Debt Forgiveness Expenses of \$61,940,232.

NOTE 8— DEFERRED REVENUES

The Fund draws from the federal capitalization grant for the purpose of making loan disbursements a few days before the loans are actually disbursed to loan recipients. Deferred revenue is the amount drawn prior to year end for which loan disbursements are expected to be made shortly after the current fiscal year. As of June 30, 2011, the Fund has deferred revenues of \$3,616,711.

NOTE 9— DUE TO CALIFORNIA DEPARTMENT OF PUBLIC HEALTH (CDPH)

CDPH incurs various expenditures related to the Fund's set-aside and loan administration activities including payroll, indirect costs, and other related expenditures. As of June 30, 2011, the Fund owes CDPH \$1,146,342 for reimbursement of these expenditures.

NOTE 10— RETIREMENT PLAN

Plan Description

The State is a member of the California Public Employees' Retirement System (CalPERS), which provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries.

CalPERS is a defined benefit contributory retirement plan. Retirement contributions by employees are set by statute as a percentage of payroll (Tier I employees), or are zero (Tier II employees). Retirement contributions are actuarially determined under a program where total contributions plus CalPERS' investment earnings will provide the necessary funds to pay retirement benefits when incurred. The employer contributions are included in the cost of personal services.

The Fund is included in the State Miscellaneous Category within CalPERS. CalPERS functions as an investment and administrative agent for participating public agencies with the State of California, including the Fund. All risks and costs are shared proportionately by participating State agencies. For further information, refer to the *State of California Comprehensive Annual Financial Report*, and to the *CalPERS Comprehensive Annual Financial Report*.

**OTHER INDEPENDENT AUDITOR'S REPORT
SECTION**



JOHN CHIANG
California State Controller

Ron Chapman, M.D., M.S.P.H., Director
California Department of Public Health
1615 Capitol Avenue, MS 0500
P.O. Box 997377
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**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***

The State Controller's Office (SCO) has audited the accompanying Statements of Net Assets of the Safe Drinking Water State Resolving Fund (Fund), as of and for the years ended June 30, 2011 and 2010, and the related Statements of Revenues, Expenses, and Changes in Fund Net Assets and Cash Flows for the year then ended, and has issued its report thereon dated January 10, 2012. The SCO conducted the 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.

Internal Control Over Financial Reporting

Management of the California Department of Public Health is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing the audits, the SCO considered the 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 Fund's internal control over financial reporting. Accordingly, the SCO does not express an opinion on the effectiveness of the Fund'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 Authority's financial statements will not be prevented, or detected and corrected on a timely basis.

The SCO's 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. The SCO did not identify any deficiencies in internal control over financial reporting that the SCO considers to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Fund's financial statements are free of material misstatement, the SCO performed tests of the Fund's 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 the audits and, accordingly, the SCO does not express such an opinion. The results of the SCO's 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 Fund and the State of California and is not intended to be and should not be used by anyone other than the specified parties. However, this report is a matter of public record and its distribution is not limited.

Original signed by

JEFFREY V. BROWNFIELD, CPA
Chief, Division of Audits

January 10, 2012

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Division of Audits
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