

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, 2010



JOHN CHIANG
California State Controller

January 2011



JOHN CHIANG
California State Controller

January 21, 2011

Mark B. Horton, 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. Horton:

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, 2010.

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.

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: Kevin Reilly, DVM, MPVM, Chief Deputy Director of Policy and Programs
California Department of Public Health (via e-mail)
Jose Ortiz, Acting Chief Deputy Director of Operations
California Department of Public Health (via e-mail)
Alan Lum, Acting Deputy Director–Administration
California Department of Public Health (via e-mail)
Merrienne McDonald, Chief of Accounting
California Department of Public Health (via e-mail)
Rufus Howell, Deputy Director, Center for Environmental Health
California Department of Public Health (via e-mail)
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)
Julianne Talbot, CPA, Division of Accounting
and Reporting, State Controller’s Office (via e-mail)

Contents

	<u>Page</u>
Independent Auditor’s Report	1
Management’s Discussion and Analysis	3
Statement of Net Assets	5
Statement of Revenues, Expenses, and Changes in Fund Net Assets	6
Statement of Cash Flows	7
Notes to the Financial Statements	8



JOHN CHIANG
California State Controller

Mark B. Horton, 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

We have 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 year ended June 30, 2010. These financial statements are the responsibility of the California Department of Public Health's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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. Those standards require that we 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. We believe that our audit provides a reasonable basis for our opinion.

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, 2010, or the changes in its financial position of 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 3 and 4 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. 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 inquires of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquires, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Fund as of June 30, 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.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the department'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 our opinion on the effectiveness of the department's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the department'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 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 department's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and contracts, 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 department management, those charged with governance, and state control agencies, and is not intended to be used by anyone other than these 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 21, 2011

STATE OF CALIFORNIA
CALIFORNIA DEPARTMENT OF PUBLIC HEALTH
DRINKING WATER PROGRAM
MANAGEMENT DISCUSSION AND ANALYSIS

For the Year Ended June 30, 2010

The following discussion and analysis of the California Department of Public Health's (CDPH) Drinking Water Program's (Program) financial performance provides an overview of the Program's financial activities for the year ended June 30, 2010. Please read it in conjunction with the financial statements.

Most of the Program's funds are Non-governmental Trust and Agency Funds (Federal) with the three 0629 funds being Service Enterprise Funds. Fund 0625 is the Administration Account, fund 0626 is the Water System Reliability Account, fund 0628 is the Small System Technical Assistance Account, and funds 0629 and 7500 are Safe Drinking Water State Revolving Funds (SDWSRF).

The interest rate CDPH uses is calculated in accordance with California Health and Safety Code Section 116761.65 at 50 percent of the average interest rate, computed by the true interest cost method paid by the State on general obligation bonds issued during the previous calendar year.

CDPH uses the resources of the SDWSRF for low interest loans and, in some cases, principal forgiveness ("grants") to enable water systems to fund necessary infrastructure improvements. CDPH manages the SDWSRF resources to fund projects to ensure that public water systems are able to provide an adequate, reliable supply of safe clean drinking water in conformance with federal and state standards. The SDWSRT project ranking process ensures that program resources and funds are applied to the most significant public health and compliance problems.

USING THIS FINANCIAL REPORT

The CDPH Program financial statements consist of the Statement of Net Assets; the Statement of Revenues, Expenses and Changes in Net Assets; and the Statement of Cash Flows. The Statement of Net Assets and the Statement of Revenues, Expenses, and Changes in Net Assets provide an indication of the CDPH Program's financial health. The Statement of Net Assets includes all CDPH Program's assets and liabilities. The Statement of Revenues, Expenses, and Changes in Net Assets reports off of the revenues and expenses during the time period indicated. The Statement of Cash Flows reports the cash provided and used by operating activities, as well as other cash sources such as bond proceeds, transfers, and grants.

FINANCIAL HIGHLIGHTS

	<u>Year ended</u> <u>June 30, 2010</u>	<u>Year ended</u> <u>June 30, 2009</u>
Assets		
Current assets	160,835,892	169,762,764
Noncurrent assets	537,967,132	498,429,980
Total assets	698,793,024	668,192,744
Liabilities		
Current liabilities	9,616,776	1,656,388
Noncurrent liabilities	787,726	565,433
Total liabilities	10,404,502	2,221,821
Net assets		
Total net assets	688,388,522	665,970,923
Changes in net assets		
Operating revenues	22,643,339	22,434,406
Operating expenses	29,119,484	12,010,652
Net operating income/loss	(6,476,145)	10,423,754
Nonoperating revenues	28,893,744	47,671,474
Change in net assets	22,417,599	58,095,228

FINANCIAL ANALYSIS

CDPH Program's net assets were increased by approximately \$58.1 million in 2009 and increased by \$22.4 million in 2010 as more the EPA grant was smaller in 2010. The increase in total assets in 2009 is primarily due to a large number of loans to other governments, a large cash deposit in the State of California's Surplus Money Investment Fund (SMIF), and a large EPA grant. The increase in total liabilities in 2010 is primarily due to the approximate \$17.6 million in grant awards for the year.

The largest component of the CDPH Program's total assets is loans receivable from other governments. These receivables represent approximately 80% of the total assets as of June 30, 2010. The largest component of the CDPH Program's total liabilities is deferred revenue. Deferred revenue constitutes approximately 73% of the Program's total liabilities as of June 30, 2010.

The Program's operating revenues consist primarily of investment earnings (SMIF interest) and interest on the loans to the water entities plus transfers in from EPA Administrative money. The transfers in from EPA Administrative money represent 51% of 2010 total revenues. The Program's operating expenses are primarily comprised of principal debt forgiveness. Principal debt forgiveness represents 55% of the 2010 operating expenses.

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

	<u>June 30, 2010</u>	<u>June 30, 2009</u>
ASSETS		
Current assets:		
Cash and pooled investments (Note 3)	\$ 133,231,354	\$ 146,783,179
Receivables:		
Loan interest	2,795,051	1,991,612
SMIF interest (Note 4)	154,027	348,002
Due from Environmental Protection Agency (Note 5)	2,832,213	1,692,569
Current portion of loans receivable (Note 6)	<u>21,813,247</u>	<u>18,947,402</u>
Total current assets	<u>160,825,892</u>	<u>169,762,764</u>
Noncurrent assets:		
Noncurrent loans receivable	<u>537,967,132</u>	<u>498,429,980</u>
Total noncurrent assets	<u>537,967,132</u>	<u>498,429,980</u>
Total assets	<u><u>\$ 698,793,024</u></u>	<u><u>\$ 668,192,744</u></u>
LIABILITIES		
Current liabilities:		
Accounts payable	\$ 452,650	\$ 894,896
Deferred revenue (Note 8)	6,982,979	195,263
Due to California Department of Public Health (Note 9)	<u>2,181,147</u>	<u>566,229</u>
Total current liabilities	<u>9,616,776</u>	<u>1,656,388</u>
Noncurrent liabilities:		
Compensated absences payable	<u>787,726</u>	<u>565,433</u>
Total noncurrent liabilities	<u>787,726</u>	<u>565,433</u>
Total liabilities	<u><u>\$ 10,404,502</u></u>	<u><u>\$ 2,221,821</u></u>
NET ASSETS		
Restricted	<u>688,388,522</u>	<u>665,970,923</u>
Total net assets	<u><u>\$ 688,388,522</u></u>	<u><u>\$ 665,970,923</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
Year Ended June 30, 2010**

	<u>June 30, 2010</u>	<u>June 30, 2009</u>
Operating revenues:		
Loan interest	\$ 11,174,639	\$ 9,636,551
EPA administrative reimbursements	<u>11,468,700</u>	<u>12,797,855</u>
Total operating revenues	<u>22,643,339</u>	<u>22,434,406</u>
Operating expenses:		
Salaries and benefits	6,254,488	5,106,067
Other expenses	5,214,210	4,372,667
Principal debt forgiveness (Note 7)	<u>17,650,786</u>	<u>2,531,918</u>
Total operating expenses	<u>29,119,484</u>	<u>12,010,652</u>
Income (loss) from operations	<u>(6,476,145)</u>	<u>10,423,754</u>
Nonoperating revenues (expenses):		
SMIF interest	666,835	1,902,950
EPA capitalization grant	28,226,909	40,079,672
State match	<u>—</u>	<u>5,688,852</u>
Total nonoperating revenues (expenses)	<u>28,893,744</u>	<u>47,671,474</u>
Change in net assets	22,417,599	58,095,228
Total net assets—beginning	<u>665,970,923</u>	<u>607,875,695</u>
Total net assets—ending	<u>\$ 688,388,522</u>	<u>\$ 665,970,923</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
Year Ended June 30, 2010

	June 30, 2010	June 30, 2009
CASH FLOW FROM OPERATING ACTIVITIES		
Cash received from interest on loans	\$ 12,550,161	\$ 11,443,994
Cash paid for loans and grants disbursed	(80,489,004)	(42,956,363)
Principal received on loans receivable	18,256,265	15,662,376
Cash received for fines and penalties	—	—
Cash paid to employees and vendors	(10,139,148)	(11,217,850)
Payments for interfund services used	—	—
EPA grants for administrative and set-aside costs	10,394,469	11,105,286
Net cash flows from operating activities	<u>(49,427,257)</u>	<u>(15,962,557)</u>
CASH FLOW FROM INVESTING ACTIVITIES		
Interest received from investments	861,162	2,157,774
Net cash flows from investing activities	<u>861,162</u>	<u>2,157,774</u>
CASH FLOW FROM NONCAPITAL FINANCING ACTIVITIES		
Transfers from the Environmental Protection Agency	35,014,270	58,655,681
Transfers from the State of California	—	6,485,615
Net cash flows from noncapital financing activities	<u>35,014,270</u>	<u>65,141,296</u>
Net increase in cash and cash equivalents	(13,551,825)	51,336,513
Cash and cash equivalents—July 1, 2009, and 2008	146,783,179	95,446,666
Cash and cash equivalents—June 30, 2010	<u>\$ 133,231,354</u>	<u>\$ 146,783,179</u>
Reconciliation of operating income (loss) to net cash flows provided by (used in) operating activities:		
Operating income (loss)	\$ (6,476,142)	\$ 10,423,754
Adjustments to reconcile operating income (loss) to net cash provided (used) by operating activity:		
(Increase) decrease in interest receivable	(803,439)	345,658
(Increase) in loans receivable	(42,402,997)	(18,508,639)
(Increase) due from EPA for administrative expenses	(1,139,644)	(1,692,569)
(Decrease) in accounts payable	(442,246)	(2,297,962)
Increase (decrease) due to the California Department of Public Health	1,614,918	(766,555)
Increase (decrease) principal debt forgiveness payable	—	(3,455,980)
Increase (decrease) in compensated absences payable	222,293	(10,264)
Total adjustments	<u>(42,951,115)</u>	<u>(26,386,311)</u>
Net cash flows from operating activities	<u>\$ (49,427,257)</u>	<u>\$ (15,962,557)</u>

The notes to the financial statements are an integral part of this statement.

Notes to the Financial Statements Year Ended June 30, 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, 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, 2009, the Fund's compensated absences totaled \$787,726.

g. Restricted Net Assets

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

h. Reclassifications

Certain reclassifications have been made to fiscal year 2008-09 balances to conform to the presentation used in fiscal year 2009-10.

i. Restatement of Beginning Net Assets

Beginning fund balance decreased by \$38,264,982 to correct capitalization grant revenue that was over recognized in the prior year.

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 \$111.4 million for administrative expenses, program management, small system technical assistance, loan assistance, and other state program expenses (collectively known as set-asides), and \$891.8 million for loans. Set-asides are accounted for in other funds. There is an additional ARRA grant received this year of which \$9.1 million are designated for set-asides and \$149.8 million for loans.

The grants awarded, amounts drawn on each grant, and the loan balances available for active grants, as of June 30, 2010, 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	11,016,282	70,949,917	70,949,917	—
2005	84,957,600	16,601,008	68,356,592	34,470,672	33,885,920
2006	84,847,500	12,248,614	72,598,886	—	72,598,886
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
ARRA					
2009	159,008,000	9,197,000	149,811,000	—	48,351,411

NOTE 3— CASH AND POOLED INVESTMENTS

Cash and pooled investments comprise of the following items:

	<u>June 30, 2010</u>	<u>June 30, 2009</u>
General cash	\$ 3,430,219	\$ 4,941,581
Cash in State Treasury	16,626,691	17,582,536
Deposits on hand	7,444	334,062
Deposits in Surplus Money Investment Fund	<u>113,167,000</u>	<u>123,925,000</u>
Total	<u>\$ 133,231,354</u>	<u>\$ 146,783,179</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 Boars and is administered by the Office of the State Treasurer. Investments in the SMIF are stated at fair value. As of June 30, 2010, the Fund has invested funds in SMIF in the amount of \$113,167,000.

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 less 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, 2010 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, 2010, and June 30, 2009, is \$154,027 and \$348,002, 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, 2010, and June 30, 2009, is \$2,832,213 and \$1,692,569, 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 semiannual or, in some cases, annual payments, generally starting 12 months after project completion. Loan interest revenue and its related receivable is recorded as it accrues. The Fund has loan interest receivable as of June 30, 2010, and June 30, 2009, in the amount of \$2,795,051 and \$1,991,612, respectively.

The following schedule of loans receivable activity for the year ended June 30, 2010, 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 Loan Amounts Disbursed as of June 30, 2010	Total Principal Payments as of June 30, 2010	Outstanding Loan Balance as of June 30, 2010
<u>Fully Disbursed Loans</u>				
Anaheim, City of	\$ 18,062,849	\$ 18,062,849	\$ 6,476,658	\$ 11,586,191
Angels, City of	1,489,361	1,489,361	521,277	968,084
Asoleado Mutual Water Company	59,200	59,200	42,827	16,373
Bella Vista Water District	10,171,641	10,171,641	609,686	9,561,955
Benicia, City of	11,716,747	11,716,747	1,423,011	10,293,736
Biola Community Services District	177,000	177,000	30,975	146,025
Blythe, City of	9,807,160	9,807,160	1,176,859	8,630,301
Brawley, City of (102)	15,823,475	15,823,475	7,120,564	8,702,911
Brawley, City of (103)	4,127,516	4,127,516	1,754,194	2,373,322
California Water Service Co - (301)	7,078,698	7,078,698	117,978	6,960,720
California Water Service Co - (316)	494,276	494,276	35,304	458,972
Capell Valley Estates, Inc.	648,000	648,000	77,815	570,185
Carpinteria Valley Water District (121)	9,236,658	9,236,658	-	9,236,658
Carpinteria Valley Water District (125)	8,140,452	8,140,452	977,550	7,162,902
Colusa, County of	171,720	171,720	11,448	160,272
Contra Costa Water District (106)	15,137,776	15,137,776	4,813,164	10,324,612
Contra Costa Water District (118)	5,942,427	5,942,427	1,363,707	4,578,720
Contra Costa Water District 101 (SWAP)	2,000,000	2,000,000	591,666	1,408,334
Crescent City (401)	7,000,000	7,000,000	2,100,000	4,900,000
Del Rey Community Services District	172,380	172,380	22,984	149,396
Dinuba, City of	6,956,217	6,956,217	133,694	6,822,523
Dunsmuir, City of	55,800	55,800	11,160	44,640
Dutch Flat Mutual Water Company	201,530	201,530	41,372	160,158
East Bay Municipal Utility District	2,188,000	2,188,000	545,937	1,642,063
East Valley Water District	169,052	169,052	30,429	138,623
Eastern Municipal Water District	42,098,388	42,098,388	4,209,839	37,888,549
El Dorado Irrigation Water District (102)	806,954	806,954	222,677	584,277
El Dorado Irrigation Water District (103)	639,925	639,925	176,586	463,339
El Dorado Irrigation Water District (104)	754,130	754,130	208,100	546,030
El Dorado Irrigation Water District (105)	1,022,963	1,022,963	282,284	740,679
El Dorado Irrigation Water District (130)	959,041	959,041	195,487	763,554
El Dorado Irrigation Water District (131)	1,928,791	1,928,791	393,157	1,535,634
El Dorado Irrigation Water District (140)	5,749,808	5,749,808	457,258	5,292,550
El Dorado Irrigation Water District (141)	3,387,107	3,387,107	409,047	2,978,060
El Dorado Irrigation Water District (142)	1,732,745	1,732,745	209,256	1,523,489
El Dorado Irrigation Water District (143)	5,873,746	5,873,746	348,193	5,525,553
Escondido, City of	2,048,125	2,048,125	511,036	1,537,089

Water Entity	Authorized Loan Amounts	Total Loan Amounts Disbursed as of June 30, 2010	Total Principal Payments as of June 30, 2010	Outstanding Loan Balance as of June 30, 2010
<u>Fully Disbursed Loans</u> (continued)				
Fort Bragg, City of	2,141,532	2,141,532	374,768	1,766,764
Fruitridge Vista	3,272,505	3,247,959	486,639	2,761,320
Garberville Sanitary District	100,000	100,000	8,411	91,589
Georgetown Divide - PUD - Lake Walton	400,511	400,511	-	400,511
Grenada Water Company	590,000	590,000	108,167	481,833
Grizzly Flats Community District	253,336	253,336	61,863	191,473
Hillview Water Company (302-02)	3,808,447	3,808,447	190,422	3,618,025
Humboldt Bay Municipal Water District	10,946,739	10,946,739	3,284,022	7,662,717
Imperial County - West Lake County Campground	83,374	83,374	21,092	62,282
Imperial County - Red Hill Marina Campground	146,789	146,789	25,688	121,101
Indian Valley Community Services District	113,557	113,557	18,169	95,388
Ivanhoe Public Utility District	1,494,247	1,494,247	298,849	1,195,398
Kerman, City of	3,300,000	3,299,999	247,500	3,052,499
Kern County Water Agency	2,825,780	2,825,705	-	2,825,705
Kings, County of	991,251	991,251	99,125	892,126
Konocti - Ford's Acres Mobile Home Park	183,336	183,336	54,058	129,278
Lake Alpine Water Company	2,413,362	2,413,362	151,349	2,262,013
Lake Combie Mobile Home Village	54,951	54,951	13,711	41,240
Los Angeles, City of (101)	17,751,425	17,751,425	4,495,036	13,256,389
Meadow Vista County Water District (102)	73,305	73,305	57,902	15,403
Metropolitan Water District of Southern California	20,000,000	20,000,000	4,589,732	15,410,268
Montecito Water District	9,236,658	9,236,658	-	9,236,658
North Marin Water District	16,528,850	16,528,853	114,419	16,414,434
Placer County Water Agency	20,000,000	20,000,000	798,395	19,201,605
Redlands, City of	6,100,844	6,100,844	873,542	5,227,302
Redwood Mobile Home Park	78,441	78,441	78,441	-
Richardson Beardsley Park, Inc.	57,093	57,093	14,457	42,636
Rio Dell, City of	2,720,000	2,720,000	68,000	2,652,000
River Pines Public Utility District	190,000	190,000	28,500	161,500
Rural North Vacaville Water District	8,838,365	8,838,365	2,631,055	6,207,310
San Buenaventura, City of	20,000,000	20,000,000	2,012,067	17,987,933
San Diego, City of	21,525,249	21,525,249	4,418,904	17,106,345
San Jose Water Water Company (301)	2,006,782	2,006,782	372,260	1,634,522
San Jose Water Water Company (303)	1,069,265	1,069,265	83,819	985,446
San Luis Obispo CFCO (105)	325,430	325,430	81,199	244,231
Santa Barbara, City of (123)	19,997,928	19,997,928	2,340,134	17,657,794
Santa Barbara, City of (111)	17,900,849	17,900,849	3,286,376	14,614,473
Santa Clara Valley Water District	6,350,000	6,349,999	508,012	5,841,987
Santiago County Water District	1,300,000	1,300,000	242,571	1,057,429
Sequoia Crest Water Company	120,949	120,949	4,815	116,134
Sereno Del Mar Water Company	250,000	250,000	85,337	164,663
Serrano Water District	3,460,882	3,460,882	1,828,609	1,632,273
Shady Glen Enterprises	136,878	136,878	16,700	120,178
Sierra Lakes County Water District	1,307,195	1,307,195	268,353	1,038,842
Sierra Mobile Home Park	59,110	59,110	17,733	41,377
Solano Irrigation District - Gibson Ranch (101)	2,124,896	2,124,896	586,360	1,538,536
Solano Irrigation District - Blue Ridge Oaks (107)	865,675	865,675	161,259	704,416
Solano Irrigation District - Peabody Improvement	386,000	386,000	71,904	314,096
Sonoma County CSA#41 - Jenner	120,000	120,000	2,384	117,616
Sonoma County Water Agency (107)	15,857,115	15,857,295	1,219,818	14,637,477
Southern Humboldt - Whitehorn Unified School	28,616	28,616	9,300	19,316
Spanish Flat Water District (419)	176,867	176,867	13,174	163,693
Spanish Flat Water District (112)	95,646	95,646	3,780	91,866
Stinson Beach County Water District	411,500	411,500	85,330	326,170
Strathmore Public Utility District (413)	451,500	451,500	45,150	406,350
Strathmore Public Utility District (420)	151,903	151,903	2,532	149,371

Water Entity	Authorized Loan Amounts	Total Loan Amounts Disbursed as of June 30, 2010	Total Principal Payments as of June 30, 2010	Outstanding Loan Balance as of June 30, 2010
<u>Fully Disbursed Loans</u> (continued)				
Terra Bella Irrigation District (105)	1,218,820	1,218,820	517,999	700,821
Terra Bella Irrigation District (404)	102,000	102,000	35,700	66,300
Tracy, City of	20,000,000	20,000,000	2,021,553	17,978,447
Truckee Donner Public Utility District	12,732,965	12,732,965	2,371,908	10,361,057
Tuolumne Utilities District - Monte Grande	501,452	501,452	16,715	484,737
Tuolumne Utilities District - Railbed Road	49,015	49,015	12,254	36,761
Union Public Utility District	2,296,451	2,296,451	180,018	2,116,433
Vallejo Water System (101)	6,675,000	6,675,000	2,832,174	3,842,826
Vallejo Water System (414)	68,080	68,080	18,722	49,358
Westmorland, City of	670,632	670,632	670,632	-
Willow Creek Community Services District	470,884	470,884	47,088	423,796
Yolo County Airport	249,333	249,333	41,042	208,291
Yuba, City of	732,726	732,726	201,500	531,226
Total fully disbursed loans	<u>500,971,949</u>	<u>500,947,509</u>	<u>83,581,676</u>	<u>417,365,833</u>
<u>Active Loans</u>				
Anderson Valley USD	17,350	48,363	-	48,363
Capell Valley Estates Inc (ARRA)	172,358	69,671	-	69,671
Escondido, City of (ARRA)	2,899,400	56,940	-	56,940
Farm Mutual Water Co	1,193,600	302,045	-	302,045
Fresno, City of (150)	2,210,000	825,115	-	825,115
Fresno, City of (422)	80,000	80,000	-	80,000
Garrapatta Water Company Inc (ARRA)	114,813	47,192	-	47,192
Grass Valley	3,203,750	204,684	-	204,684
Jensen Mobile Home Park (ARRA)	27,671	3,992	-	3,992
Kings Mountain Park W/C	24,880	24,476	-	24,476
London	1,244,000	57,836	-	57,836
Los Angeles, City of (139)	25,335,671	25,335,671	-	25,335,671
Los Angeles, City of (144)	36,432,000	35,405,298	-	35,405,298
Los Angeles, City of (147)	38,684,250	38,684,250	-	38,684,250
Meadow Vista County Water District (149)	21,546,100	6,927,105	-	6,927,105
Plainview Mutal Water District	294,075	294,075	-	294,075
Rainbow Municipal Water District (ARRA)	3,351,340	1,619,260	-	1,619,260
Sacramento, City of (ARRA)	10,000,000	1,323,843	-	1,323,843
San Luis Obispo Cnty. Flood Cntrl.& Water Cons.	26,000,000	25,390,148	-	25,390,148
Santiago Association	788,354	788,354	-	788,354
Shady Lane Mobile Home Park (ARRA)	75,000	57,500	-	57,500
Shasta Community Services District	2,031,111	1,933,996	-	1,933,996
Sierra Grande	52,383	41,328	-	41,328
Spring Valley Heights Homeowners Association	1,907,000	1,775,823	-	1,775,823
Terra Bella Irrigation District (146)	480,000	369,210	-	369,210
Villa Del Monte Mutual Water	1,056,328	741,371	-	741,371
West Side Union SD	7,000	7,000	-	7,000
Total active loans	<u>179,228,434</u>	<u>142,414,546</u>	<u>-</u>	<u>142,414,546</u>
Total	<u>\$ 680,200,383</u>	<u>\$ 643,362,055</u>	<u>\$ 83,581,676</u>	<u>\$ 559,780,379</u>
				Current loans receivable \$ 21,813,247
				Noncurrent loans receivable 537,967,132
				<u>Total loans receivable \$ 559,780,379</u>

Loans mature at various intervals through July 1, 2039. The scheduled principal and interest payments on loans for fully disbursed projects maturing in the next four years and every five years thereafter are as follows:

Year Ending June 30	Principal	Interest	Total Receivable
2011	\$ 24,918,862	\$ 7,859,108	\$ 32,777,970
2012	22,211,834	7,457,307	29,669,141
2013	22,624,720	7,040,960	29,665,679
2014	23,047,892	6,614,327	29,662,219
2015	23,485,119	6,177,055	29,662,174
2016-2020	123,145,030	23,986,119	147,131,149
2021-2025	118,520,679	11,824,094	130,344,773
2026-2030	56,649,921	2,283,173	58,933,095
2031-2035	2,141,912	141	2,142,053
2036-2040	619,863	—	619,863
Total	<u>\$ 417,365,832</u>	<u>\$ 73,242,284</u>	<u>\$ 490,608,116</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, 2010, the Fund has not incurred principal forgiveness expense as a result of a loan recipient's inability to repay a loan. During the year ended June 30, 2010, the Fund recognized Principal Debt Forgiveness Expenses of \$17,650,786.

NOTE 8— DEFERRED REVENUES

The Fund draws from the federal capitalization grant for the purpose of making loan disbursements 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 in the subsequent year.

Deferred revenue is the amount drawn from the federal capitalization grants for which no loan has yet been disbursed.

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, 2010, the Fund owes CDPH \$2,181,147 for reimbursement of these expenditures.

NOTE 10— PENALTIES AND FEES

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. However, for the fiscal year ended June 30, 2010, the department elected not to impose late payment penalties. Changes to workload priorities associated with the department's reorganization delayed the preparation of loan recipient invoices, and late payment penalties were waived as a result. In prior years, late payment penalties were insignificant.

NOTE 11— RETIREMENT PLANPlan 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*.

**State Controller's Office
Division of Audits
Post Office Box 942850
Sacramento, CA 94250-5874**

<http://www.sco.ca.gov>