DEPARTMENT OF WATER RESOURCES
ELECTRIC POWER FUND

Financial Statements

For the Years Ended June 30, 2015 and 2014

Certified
Public
Accountants

Department of Water Resources
Electric Power Fund
Financial Statements
For the years ended June 30, 2015 and 2014

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Independent Auditor's Report

To the Director of the Department of Water Resources
Department of Water Resources Electric Power Fund
Sacramento, California

Report of the Financial Statements

We have audited the accompanying financial statements of the Department of Water Resources Electric Power Fund (Fund) of the State of California, as of and for the years ended June 30, 2015 and 2014, and the related notes to financial statements, as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Department of Water Resources Electric Power Fund of the State of California as of June 30, 2015 and 2014, and the changes in financial position and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Macias Gini & O'Connell LLP
3000 S Street, Suite 300
Sacramento, CA 95816

Emphasis of Matters

Basis of Presentation

As discussed in Note 2, the financial statements present only the Department of Water Resources Electric Power Fund and do not purport to, and do not, present fairly the financial position of the State of California as of June 30, 2015 and 2014, the changes in its financial position, or where applicable, its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Change in Accounting Principles

As discussed in Note 2, for the year ended June 30, 2015, the Fund implemented Governmental Accounting Standards Board (GASB) Statement No. 68, *Accounting and Financial Reporting for Pensions – An Amendment of GASB Statement No. 27* and GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date – an amendment of GASB Statement No. 68*. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that management's discussion and analysis, schedule of the Fund's proportionate share of the net pension liability, and schedule of the Fund's contributions, as listed in the table of contents, be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the 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 financial statements, and other knowledge we obtained during our audit of the financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated October 14, 2015 on our consideration of the State of California's internal control over financial reporting as it relates to the Fund and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants agreements and other matters as it relates to the Fund. 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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the State of California's internal control over financial reporting and compliance as it relates to the Fund.

Macias Gini & O'Connell LLP

Sacramento, California
October 14, 2015

USING THIS REPORT

This discussion and analysis is designed to assist the reader in focusing on significant financial issues and activities and to identify any significant changes in financial position of the Department of Water Resources Electric Power Fund (the Fund), which is administered by the California Department of Water Resources (DWR). Readers are encouraged to consider the information presented in the *Management's Discussion and Analysis* in conjunction with the financial statements that follow. This discussion and analysis and the financial statements do not relate to DWR's other governmental and proprietary funds.

The financial statements include three required statements, which provide different views of the Fund. The three required statements are:

- The Statements of Net Position: include all assets, liabilities and deferred outflows and inflows of resources as of the period ending date.
- The Statements of Revenues, Expenses and Changes in Net Position: present all of the current year's revenues, expenses, and changes in net position.
- The Statements of Cash Flows: report cash receipts, disbursements and the net change in cash resulting from four principal types of activities: operating, capital financing, non-capital financing and investing.

These statements provide current and long-term information about the Fund and its activities. These financial statements report information using accounting methods similar (although not identical) to those used by private sector companies. In order for the financial statements to be complete, they must be accompanied by a complete set of notes. The notes to financial statements provide disclosures which are required to conform to generally accepted accounting principles. The Fund is required to follow accounting standards promulgated by the Governmental Accounting Standards Board.

PURPOSE OF FUND

The Fund was established in January 2001 through legislation to assist in mitigation of the effects of a statewide energy supply emergency.

The Fund has the authority to secure and retain title to power for resale to end use customers of the State's investor owned utilities (IOUs) under power supply contracts entered into prior to January 1, 2003. The scheduling, dispatch, and certain other administrative functions for the long-term contracts were performed by the IOUs as agents for the Fund. However, the Fund retained the legal and financial responsibility for each contract for the life of the contract or until such time as there was a complete assignment of the contract to an IOU and release of the Fund. The last remaining contract terminated during 2015 fiscal year, releasing the Fund from any future obligation. The Fund does not have any significant legal or financial responsibility for any power supply contracts entered into pursuant to the legislation establishing its authority.

The Fund is entitled to recover revenue requirements for authorized activities, including but not limited to debt service, the costs of power purchases, administrative expenses and reserves. Revenue requirements are determined at least annually and transmitted to the California Public Utilities Commission (CPUC) for implementation. Under the terms of the rate agreement between the CPUC and the Fund, the CPUC is required to set rates for customers of the IOUs and "direct access" Electric Service Providers (ESPs) such that the Fund will always have monies to meet its revenue requirements.

CONDENSED STATEMENTS OF NET POSITION

The Fund's assets, liabilities and net position as of June 30 are summarized as follows (in millions):

	2015	2014	2013
Long-term restricted cash, equivalents and investments	$ 911	$ 929	$ 937
Recoverable costs	3,770	4,490	5,083
Restricted cash and equivalents:			
Operating and priority contract accounts	221	137	210
Bond charge collection and bond charge payment accounts	531	514	554
Recoverable costs receivable	108	156	111
Interest receivable	4	3	4
Other assets	-	-	14
Total assets	5,545	6,229	6,913
Deferral of loss on defeasance	144	80	104
Deferral of derivative cash outflows	-	-	2
Total deferred outflows of resources	144	80	106
Total assets and deferred outflows of resources	$ 5,689	$ 6,309	$ 7,019
Long-term debt, including current portion	$ 5,631	$ 6,249	$ 6,951
Derivative instruments	-	-	2
Net pension liability	5	-	-
Other postretirement benefits and accrued vacation	7	6	5
Other current liabilities	45	54	61
Total assets	5,688	6,309	7,019
Deferred Inflows of resources related to pensions	1	-	-
Total liabilities and deferred inflows of resources	$ 5,689	$ 6,309	$ 7,019

Long-Term Restricted Cash, Equivalents and Investments

The $18 million decrease in long-term restricted cash, equivalents and investments during fiscal 2015 is a result of the reduction in the Operating Reserve Account to $2 million from $10 million and a reduction of the Debt Service Reserve Account to $909 million from $919 million. The amount is determined in accordance with the Trust Indenture among the State of California, Department of Water Resources, Treasurer of the State of California, as Trustee and U.S. Bank, N.A, as Co-Trustee (Trust Indenture) and is equal to twelve percent of the Department's total projected annual Operating Expenses through the end of the program based on assumptions supporting the Fund's 2015 Revenue Requirement Determination. The $10 million decrease in the Debt Service Reserve Account resulted from a lower requirement after a refunding of power supply revenue bonds decreased the maximum future annual debt service amount to $909 million.

The $8 million decrease in long-term restricted cash, equivalents and investments during fiscal 2014 was a result of the reduction in the Operating Reserve Account to $10 million from $18 million. The amount is determined in accordance with the Trust Indenture among the State of California, Department of Water Resources, Treasurer of the State of California, as Trustee and U.S. Bank, N.A, as Co-Trustee (Trust Indenture) and is equal to twelve percent of the Department's total projected annual Operating Expenses through the end of the program based on assumptions supporting the Fund's 2014 Revenue Requirement

Determination. The Debt Service Reserve Account remained at $919 million as the maximum future annual debt service was unchanged.

Recoverable Costs

Recoverable costs consist of costs that are recoverable through future billings. The $720 million decrease during fiscal 2015 is due to 1) recovery of operating costs of $23 million, 2) bond charges plus interest income exceeding interest and investment expense by $704 million, and 3) adjustment to the beginning balance of net pension liability as a result of the implementation of GASB 68 for $5 million. The surplus of Bond Charge Collections over interest costs is primarily a result of the Fund's rate design which includes funding for annual debt service, including principal payments.

The $593 million decrease during fiscal 2014 is due to 1) negative recovery of operating costs of $47 million, as a result of the reduction in excess reserves returned to IOU customers and 2) bond charges plus interest income exceeding interest and investment expense by $640 million. The surplus of Bond Charge Collections over interest costs is primarily a result of the Fund's rate design which includes funding for annual debt service, including principal payments

Restricted Cash and Equivalents

The Operating and Priority Contract Accounts increased by $84 million in 2015 as a result of energy settlements received during the year offsetting the return of excess amounts as the Fund continues to return reserves to IOU customers.

The Operating and Priority Contract Accounts decreased by $73 million in 2014 due to the return of excess amounts to IOU customers as power purchase contracts expire and lower reserve account balances were required as specified in the Trust Indenture.

The Bond Charge Collection and Bond Charge Payment Accounts increased by $17 million in 2015 and decreased by $40 million in 2014 in accordance with required amounts specified in the Trust Indenture.

Recoverable Costs Receivable

Recoverable costs receivable reflects power and bond charges to IOU customers that have not yet been collected and amounts receivable from litigation settlements. The $108 million of recoverable costs receivable at June 30, 2015 is $48 million lower than at June 30, 2014. The decrease in 2015 is primarily due to the expected receipt of several energy settlements after the end of fiscal year 2014.

The $156 million of recoverable costs receivable at June 30, 2014 is $45 million higher than at June 30, 2013. The increase is primarily due to receipt of several energy settlements after the end of the fiscal year.

Deferral of Loss on Defeasance

Deferral of loss on defeasance increased by $64 million at June 30, 2015. The increase was primarily a result of the $86 million loss on defeasance associated with the Series O refunding transaction, offset by amortization of prior loss on defeasance during the fiscal year.

Long-Term Debt

Long-term debt decreased to $5,631 million as of June 30, 2015 from $6,249 million as of June 30, 2014. On April 1, 2015, the Fund issued $766 million of Series O refunding revenue bonds. Proceeds of $917 million from the refunding bonds, which included a $154 million premium less $3 million for issuance expenses, along with $29 million released from the Debt Service Reserve and Bond Charge Payment accounts totaling $946 million were used to purchase securities that were deposited in an irrevocable trust with an escrow agent that will provide amounts sufficient to pay the future debt service on the advance refunded $813 million of outstanding Series H and Series L revenue bonds. As a result, the refunded bonds are considered defeased and have been removed from the Statement of Net Position.

The refunding resulted in a loss on defeasance of $86 million, which has been deferred over the life of the refunding bonds.

Revenue bond principal payments were $618 million in fiscal 2015. Net amortization of bond premium was $80 million at June 30, 2015.

Long-term debt decreased to $6,249 million as of June 30, 2014 from $6,951 million as of June 30, 2013. Revenue bond principal payments were $611 million in fiscal 2014. Net amortization of bond premium was $91 million at June 30, 2014.

Net Pension Liability

The net pension liability as of June 30, 2015 was $5 million as a result of the implementation of GASB 68 this fiscal year.

Other Postemployment Benefits and Accrued Vacation

In addition to the pension benefits, the State of California provides postemployment health care benefits to all employees who retire on or after attaining certain age and length of service requirements. The State of California is funding postemployment benefits on a pay-as-you-go basis. The Fund’s other postemployment benefits (OPEB) and accrued vacation time liability is $7 million at June 30, 2015, up from $6 million at the end of fiscal year 2014. Staffing levels remained approximately the same at the end of the fiscal year 2015 when compared to 2014.

Other Current Liabilities

Other current liabilities consist of accounts payable and accrued interest payable. Accounts payable reflect one month’s accrual for power and fuel purchases, as payments are normally made in the latter half of the month following purchase.

Accounts payable at June 30, 2015 is $4 million lower than at June 30, 2014 as a result of the expiration of the last power purchase contract

Accounts payable at June 30, 2014 is $3 million lower than at June 30, 2013 as a result of power purchase contract volumes decreasing due to the expiration of two power supply contracts.

Accrued interest payable at June 30, 2015 is $5 million lower than at June 30, 2014 due to the maturity of $618 million in bonds in fiscal 2015 and lower total debt outstanding after the Series O refunding.

Accrued interest payable at June 30, 2014 is $4 million lower than at June 30, 2013 due to fewer bonds outstanding resulting from the maturity of $611 million in bonds in fiscal 2014.

Deferred Inflows of Resources Related to Pensions

Deferred inflows of resources were $1 million as of June 30, 2015 as a result of the implementation of GASB 68 this fiscal year.

CONDENSED STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION

The Fund's activities for the years ended June 30 are summarized as follows (in millions):

	2015	2014	2013
Revenues:			
Power charges, net of refunds	$ (137)	$ (47)	$ (405)
Surplus sales	5	3	3
Bond charges	911	862	875
Interest income	20	19	21
Total revenues	799	837	494
Expenses:			
Power purchases	7	39	43
Energy settlements	(174)	(53)	(21)
Interest expense	227	241	258
Investment loss	-	2	6
Administrative expenses	12	15	18
Recovery of recoverable costs	727	593	190
Total expenses	799	837	494
Net increase in net position	-	-	-
Net position, beginning of year	-	-	-
Net position, end of year	$ -	$ -	$ -

Power Charges

The cost of providing energy is recoverable primarily through Power Charges to IOU customers and certain customers of ESPs. Charges are determined by applying a CPUC adopted rate for each IOU service area to the megawatt hours of power delivered by the Fund to customers of each IOU.

Power Charges decreased by $90 million during fiscal year 2015 reflecting the larger return of excess amounts and previously received remittances to ratepayers. The return of excess amounts and previously received remittances are an allocation of excess reserves and prior year over-collections from ratepayers. The return is implemented through an adjustment to the power charge and is administered through separate monthly payments to ratepayers for amounts the Fund holds in excess of Trust Indenture required levels. The allocation of excess amounts and reserves was authorized by the CPUC in Decision 14-12-002 for calendar year 2015 and in Decision 13-12-004 for calendar year 2014. During fiscal year 2015, the Fund returned $183 million to ratepayers in the monthly payments.

Power Charges revenue increased by $358 million during fiscal year 2014 compared to fiscal year 2013. The difference primarily reflects a much smaller return of excess amounts and previously received remittances to ratepayers. During fiscal year 2014, the Fund returned $93 million in these monthly payments, as compared to a return of $449 million in fiscal 2013.

Surplus Sales

The Fund receives revenue from the sale of surplus power. Surplus sales for the year ended June 30, 2015 were $2 million higher than in the same period in 2014. Surplus Sales for the year ended June, 30 2014 were $3 million, unchanged from the same period in 2013.

Bond Charges

Bond Charges provide revenue for the payment of debt service on the revenue bonds and are determined by applying a CPUC adopted rate to the total megawatt hours of power delivered to all IOU customers and certain ESP customers. Bond Charges for the years ended June 30, 2015, 2014 and 2013 were $911 million, $862 million and $875 million respectively, and were adequate to meet all debt service requirements and maintain Trust Indenture required account balances in the Bond Charge Collection, Bond Charge Payment, and Debt Service Reserve Accounts. The $49 million increase in 2015 is due to a combination of higher Bond Charge rates and higher sales to IOU customers.

Interest Income

Interest income for 2015 is $1 million higher than in 2014, due to slightly higher cash balances and interest rates earned on investments in the State of California Surplus Money Investment Fund (SMIF). The average yield earned on SMIF for the year ended June 30, 2015 was 0.27% compared to 0.25% for the year ended June 30, 2014.

Interest income for 2014 is $2 million lower than in 2013, due to lower balances and lower interest rates earned on investments in the State of California Surplus Money Investment Fund (SMIF). The average yield earned on SMIF for the year ended June 30, 2014 was 0.25% compared to 0.31% for the year ended June 30, 2013.

Power Purchases

Power Purchase costs decreased by $32 million in 2015 compared to 2014 and decreased by $4 million in 2014 compared to 2013. The differences are primarily a result of lower volumes of power purchased as all remaining power purchase contracts expired or were terminated over the past two fiscal years.

Energy Settlements

Energy settlements, including those related to complex regulatory proceedings before the Federal Energy Regulatory Commission (FERC) arising from events in California energy markets in 2001, are recorded as a decrease in operating expenses.

Energy settlements received in 2015 were $174 million. The Fund received $141 million from Powerex Corporation, Dynergy Inc. $26 million, State Water Resources Development System $5 million and $2 million from Williams Energy Marketing and Trading Company.

Energy settlements received in 2014 were $53 million. The Fund received $5 million from Avista Corporation and is entitled to $48 million from TransAlta Energy Marketing (US), of which $25 million was received on July 3, 2014. The remaining balance of $23 million will be received in July 2015. These settlements were a result of FERC approved settlement agreements to resolve certain claims arising from events and transactions in Western Energy Markets during the period January 1, 2000 through June 20, 2001.

Interest Expense

Interest expense was $14 million lower in 2015 when compared to 2014. The decrease was due to lower total interest paid on outstanding debt along with higher amortization of loss on defeasance offset by higher amortization of bond premium.

Interest expense is $17 million lower in 2014 when compared to 2013. The decrease is due to lower total interest paid on outstanding debt and lower amortization of loss on defeasance offset by lower amortization of bond premium.

Administrative Expenses

Administrative expenses decreased by $3 million in 2015 and by $3 million in 2014 primarily as a result of continued reductions in staffing levels and consultants due to lower workload in administering power purchase contracts as those contracts expired.

Recovery of Recoverable Costs

The individual components of the recovery of recoverable costs are as follows (in millions):

	2015	2014	2013
Operations	$ 23	$ (47)	$ (448)
Debt service and related costs	704	640	638
	$ 727	$ 593	$ 190

<u>Operations</u>

The $23 million operations recovery in the year ended June 30, 2015 reflects the return of excess reserves to ratepayers offset by higher energy settlements received during the year.

The negative $47 million operations recovery in the year ended June 30, 2014 resulted from return of excess reserves to ratepayers partially offset by energy settlements received during the year.

<u>Debt Service and Related Costs</u>

The recovery of debt service and related costs in all three years is a result of bond charges and interest income providing funds to pay interest expense and retire debt. The recovery in 2015 was higher due to lower interest expense and higher bond charges collected from IOU customers.

LIQUIDITY

Various provisions of the Trust Indenture provide resources for the Fund to meet its cash requirements. In addition to its determination of revenue requirements, prepared annually or more frequently if necessary, to meet both operating and bond related expenditures. The Fund has an Operating Reserve and a Debt Service Reserve Fund in order to meet expenditures if revenue is impaired. The minimum balance in the Operating Reserve Account is set to be the greater of (i) the maximum seven-month difference between operating revenues and expenses as calculated under a high expense scenario, (ii) 12% of the Department's annual operating expenses and (iii) an amount equal to the maximum projected monthly power purchase contract cost. The minimum balance in the Debt Service Reserve Fund is set to be the maximum annual debt service over the remaining life of the Fund's bonds.

Under the Section 80130 of the California Water Code, the Fund has a total debt issuance limit of $13.4 billion, which does not include refunding debt issued: (i) to obtain a lower interest rate, (ii) to convert variable rate debt to fixed rate debt or (iii) to replace debt for which the credit rating of the insurer or credit facility provider has been or will be downgraded or withdrawn.

On March 24, 2015, the Fund's Power Supply Revenue Bonds were upgraded by Standard & Poor's Ratings Services to "AA" from "AA-" with a stable outlook. Also, on March 24, 2015, Fitch Ratings upgraded the bonds to "AA+" from "AA" with a stable outlook. The bonds are rated Aa2 by Moody's Investor Services.

Department of Water Resources Electric Power Fund
Statements of Net Position
June 30, 2015 and 2014 (in millions)

	2015	2014
Assets		
Long-term assets:		
Restricted cash, equivalents and investments:		
Operating Reserve Account	$ 2	$ 10
Debt Service Reserve Account	909	919
Recoverable costs	3,770	4,490
Total long-term assets	4,681	5,419
Current assets:		
Restricted cash and equivalents:		
Operating and Priority Contract Accounts	221	137
Bond Charge Collection and Bond Charge Payment Accounts	531	514
Recoverable costs receivable	108	156
Interest receivable	4	3
Total current assets	864	810
Total assets	5,545	6,229
Deferred outflows of resources		
Deferral of loss on defeasance	144	80
Total assets and deferred outflows of resources	$ 5,689	$ 6,309
Liabilities		
Non-Current liabilities:		
Long-term debt	$ 4,881	$ 5,555
Net pension liability	5	-
Other postemployment benefits and accrued vacation	7	6
Total non-current liabilities	4,893	5,561
Current liabilities:		
Current portion of long-term debt	750	694
Accounts payable	2	6
Accrued interest payable	43	48
Total current liabilities	795	748
Total liabilities	5,688	6,309
Deferred inflows of resources		
Deferred inflows of resources related to pensions	1	-
Total liabilities and deferred inflows of resources	$ 5,689	$ 6,309

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

Department of Water Resources Electric Power Fund
Statements of Revenue, Expenses and Changes in Net Position
For the years ended June 30, 2015 and 2014 (in millions)

	2015	2014
Operating revenues:		
Power charges, net of refunds	$ (137)	$ (47)
Surplus sales	5	3
Total operating revenues	(132)	(44)
Operating expenses:		
Power purchases	7	39
Energy settlements	(174)	(53)
Administrative expenses	12	15
Recovery of recoverable operating costs	23	(47)
Total operating expenses	(132)	(46)
Income from operations	-	2
Nonoperating revenues and expenses:		
Bond charges	911	862
Interest income	20	19
Interest expense	(227)	(241)
Investment loss from gas related derivatives	-	(2)
Recovery of recoverable debt service and related costs	(704)	(640)
Net increase in net position	-	-
Net position, beginning of year	-	-
Net position, end of year	$ -	$ -

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

Department of Water Resources Electric Power Fund
Statements of Cash Flows
For the years ended June 30, 2015 and 2014 (in millions)

	2015	2014
Cash flows from operating activities:		
Receipts:		
Power charges, net of refunds	$ (137)	$ (42)
Surplus sales	4	4
Energy settlements	227	-
Payments to employees for services	(2)	(4)
Payments for power purchases and other expenses	(19)	(38)
Net cash used in operating activities	73	(80)
Cash flows from non-capital financing activities:		
Receipt of bond charges	905	864
Bond payments	(618)	(611)
Interest payments	(268)	(312)
Proceeds from issuance of revenue bonds	1	-
Payment to advance refund escrow agent	(29)	-
Net cash used in non-capital financing activities	(9)	(59)
Cash flows from investing activities:		
Interest received on investments	19	20
Loss from derivative investments	-	(2)
Net cash provided by investing activities	19	18
Change in cash and equivalents	83	(121)
Restricted cash and equivalents, beginning of period	1,280	1,401
Restricted cash and equivalents, end of period	$ 1,363	$ 1,280
Restricted cash and equivalents included in:		
Operating Reserve Account	$ 2	$ 10
Debt Service Reserve Account (a component of the total of $909 and $919 at June 30, 2015 and 2014, respectively)	609	619
Operating and Priority Contract Accounts	221	137
Bond Charge Collection and Bond Charge Payment Accounts	531	514
Restricted cash and equivalents, end of year	$ 1,363	$ 1,280

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

Department of Water Resources Electric Power Fund
Statements of Cash Flows
For the years ended June 30, 2015 and 2014 (in millions)

	2015	2014
Reconciliation of operating income to net cash used in operating activities:		
Income from operations	$ -	$ 2
Adjustments to reconcile operating income to net cash used in operating activities:		
Recovery of recoverable operating costs	23	(47)
	23	(45)
Changes in net assets and liabilities to reconcile operating income to net cash used in operations:		
Recoverable costs receivable	52	(33)
Net pension liability and related deferred inflows/outflows	1	-
Other postemployment benefits and accrued vacation	1	1
Accounts payable	(4)	(3)
Net change in operating assets & liabilities:	50	(35)
Net cash used in operating activities	$ 73	$ (80)
Noncash financing and investing activities:		
Amortization of revenue bond premiums	$ 80	$ -
Amortization of deferral of loss on defeasance	22	-
Bond proceeds paid directly to advance refund escrow agent	917	-
Accrued interest on refunded revenue bonds	20	-
Underwriters discount paid directly from bond proceeds	2	-

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

1. Reporting Entity

In January 2001, the Governor of California issued an emergency proclamation directing the Department of Water Resources (DWR) to enter into contracts and arrangements for the purchase and sale of electric power to assist in mitigating the effect of a statewide energy supply emergency.

The Department of Water Resources Electric Power Fund (the Fund), administered by DWR, was established in January 2001 through legislation adding Division 27 to the California Water Code (the Code).

The Fund purchases power from wholesale suppliers under contracts entered into prior to January 1, 2003 for resale to customers of the State's investor owned utilities (IOUs): Pacific Gas & Electric Company (PG&E), Southern California Edison Company (SCE), and San Diego Gas and Electric Company (SDG&E). The Code prohibits the Fund from entering into new power purchase agreements, but allows the Fund to enter into gas purchase contracts to provide fuel for power generation.

The Fund's power is delivered to customers through the transmission and distribution systems of the IOUs and payments from customers are collected for the Fund by the IOUs pursuant to servicing arrangements approved and/or ordered by the California Public Utilities Commission (CPUC).

Under the Code, the Fund has the authority to establish a revenue requirement to recover all Fund costs, including debt service. At least annually, Fund management establishes a determination of the revenue requirement, which then is submitted to the CPUC. Under the terms of a rate agreement between the Fund and the CPUC, the CPUC implements the Fund's determination of its revenue requirements by establishing end use customer rates that meet the Fund's revenue needs to assure the payment of debt service, power purchases, administrative expenses and maintenance of operating and debt service reserves.

2. Summary of Significant Accounting Policies

Basis of Presentation

The Fund is accounted for as an enterprise fund and is financed and operated in a manner similar to that of a private business enterprise. The Fund uses the economic resources measurement focus and the accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles, which considers the Fund a Regulated Operation under GASB codification Re10. The Fund is accounted for with a set of self-balancing accounts that comprise of assets, liabilities, net position, revenues and expenses.

The financial statements of the Fund are intended to present the financial position, and the changes in financial position and cash flow, of only that portion of the business-type activities and major funds of the State of California 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 and the changes in its financial position and its cash flows, in conformity with accounting principles generally accepted in the United States of America.

Current Year GASB Implementation

For the year ended June 30, 2015, the Fund implemented GASB Statement No. 68 (GASB 68), *Accounting and Financial Reporting for Pensions – An Amendment of GASB Statement No. 27* (GASB 27) and GASB Statement No. 71 (GASB 71), *Pension Transition for Contributions Made Subsequent to the Measurement Date – an amendment of GASB Statement No. 68* (collectively, the Statements). The primary objective of the Statements is to improve accounting and financial reporting by state and local governments for pensions by establishing standards for measuring and recognizing liabilities, deferred outflows of resources, deferred inflows of resources, and expenses. It requires employers to report a net pension liability for the difference between the present value of projected pension benefits for past service and restricted resources held in trust for the payment of benefits. The Statements identify the methods and assumptions that should be used to project benefit payments, discount projected benefit payments to their actuarial present value, and attribute that present value to periods of employee service.

Since the Statements require retroactive application, the net pension liability offset by the related deferred outflow of resources as of June 30, 2014 reduces the beginning long-term recoverable costs for the year ended June 30, 2015. As a result, for the year ended June 30, 2015, the long-term recoverable costs increased by $5 million as the cumulative effect of the change in accounting principles.

Restricted Cash, Equivalents and Investments

Under the terms of the Trust Indenture among the State of California, Department of Water Resources, Treasurer of the State of California, as Trustee and U.S. Bank, N.A, as Co-Trustee (Trust Indenture) separate restricted cash and investment accounts were established. The accounts and their purpose follow:

Power Charge Accounts:

- <u>Operating Account</u>: Power Charges (see Revenues and Recoverable Costs) and miscellaneous revenue are deposited into the operating account. Monthly, funds are transferred to the priority contract account as needed to make payments on priority contracts. Remaining monies are available for payment of all operating costs of the Fund other than priority contracts, debt service, and debt-related costs.
- <u>Priority Contract Account</u>: Priority contracts are those power purchase contracts that require monthly payment prior to any debt service payments. Monies in the priority contract account are used to make scheduled payments on priority contracts. As of December 31, 2013, the last two priority power purchase contracts expired and the only priority natural gas contract was amended to remove the priority designation.
- <u>Operating Reserve Account</u>: The Operating Reserve Account was initially funded with proceeds of the Series 2002 Bonds. The Operating Reserve Account must maintain a balance equal to the greater of (i) the maximum seven-month difference between operating revenues and expenses as calculated under a high expense scenario, (ii) 12% of the Department's annual operating expenses and (iii) an amount equal to the maximum projected monthly power purchase contract cost. If the Operating Reserve Account needed to be replenished, the funds would be transferred from the Operating Account.

Bond Charge Accounts:

- <u>Bond Charge Collection Account</u>: Bond Charges (see Revenues and Recoverable Costs) are deposited into the Bond Charge Collection account. Monthly, funds needed for debt service payments are transferred to the Bond Charge Payment account.
- <u>Bond Charge Payment Account</u>: Monies in the Bond Charge Payment account are used to pay debt service and related fees for the revenue bonds. After receipt of the monthly transfer from the Bond Charge Collection account, the balance in the Bond Charge Payment account must at least equal debt service and fees estimated to accrue or be payable for the next succeeding three months.
- <u>Debt Service Reserve Account</u>: The Debt Service Reserve Account was initially funded with proceeds of the Series 2002 Bonds. The Debt Service Reserve Account is to be funded at all times with the amount of maximum aggregate annual debt service on all outstanding debt. If the Debt Service Reserve Account needed to be replenished, the funds would be transferred from either the Operating Account and/or the Bond Charge Collection Account.

Restricted cash and equivalents, for purposes of the Statements of Cash Flows, include cash on hand and deposits in the Surplus Money Investment Fund (SMIF). The Operating Reserve Account and Debt Service Reserve Account (net of investments) are classified as long-term restricted cash. Due to requirements under the Trust Indenture to hold amounts in excess of anticipated current payments for operating and bond related expenses. Amounts required to be held in reserve are determined annually by the Fund's revenue requirement.

SMIF has an equity interest in the State of California Pooled Money Investment Account (PMIA). Generally, the investments in the PMIA are available for withdrawal on demand. The PMIA cash and investments are recorded at amortized cost, which approximates fair value. The PMIA funds are on deposit with the State's Centralized Treasury System and are managed in compliance with the California Government Code, described in Note 3.

Long-term investments are held solely in the Debt Service Reserve Account by the bond co-trustee and consist of guaranteed investment contracts (GICs) and a U.S. government backed agency security in accordance with a forward purchase agreement (FPA). The GICs are carried at cost and the U.S. government backed agency security is carried at amortized cost and not at fair value because the investments are non-negotiable and non-transferable.

Net Position

The Fund does not record the difference between assets and liabilities as changes in net position. The difference between assets and deferred outflows of resources and liabilities on the Statements of Net Position is presented as recoverable costs such that there is no net position outstanding. The Fund anticipates that amounts in the recoverable costs will be recovered in subsequent years prior to program expiration.

Revenues and Recoverable Costs

The Fund is required, at least annually, to establish a determination of the revenue requirement to be transmitted to the CPUC, which then sets end use customer remittance rates. The Fund's financial statements are prepared in accordance with Section Re10 of the GASB Codification, "*Regulated Operations,*" which requires that the effects of the revenue requirement process be recorded in the financial statements. Accordingly, all expenses and credits, normally reflected in the change in net position as incurred, are recognized as recoverable costs in the Statements of Net Position and are recovered from IOU customers. Costs that are recoverable through future billings are recorded as long-term assets.

Customer charges are separated into two primary components, power charges and bond charges. Power charge revenues recover the cost of power purchases, other expenses and operating reserves and are recognized when energy provided by the Fund is delivered to IOU customers. Bond charge revenues recover debt service, debt service reserves and other bond related costs and are recognized when energy provided by the Fund, the IOU, or an ESP, is delivered to IOU or ESP customers. Costs are recovered over the life of the bonds as determined by the Fund's revenue requirement process.

Surplus sales represent the Fund's sale of energy dispatched by the California Independent System Operator (CAISO) for grid reliability from the Fund's power purchase agreements and natural gas not needed for the generation of power.

Pensions

For purposes of measuring the net pension liability and deferred outflows/inflows of resources related to pensions, and pension expense, information about the fiduciary net position of the Fund's portion of the California Public Employees' Retirement System (CalPERS) Miscellaneous and Safety Defined Benefit Pension Plans (Plans) and additions to/deductions from the Plans' fiduciary net position have been determined on the same basis as they are reported by CalPERS. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value.

3. Restricted Cash and Investments

As of June 30, 2015 and 2014, the Fund had the following cash, equivalents and investments (in millions):

Investment	Maturity June 30, 2015	Maturity June 30, 2014	2015	2014
State of California Pooled Money Investment Account - Surplus Money Investment Fund	7.9 months avg.	7.6 months avg.	$ 1,360	$ 1,276
Cash			3	4
Total cash and equivalents			1,363	1,280
Guaranteed investment contracts	May 1, 2022		200	200
Forward purchase agreement	November 1, 2015		100	100
			$ 1,663	$ 1,580
Reconciliation to Statements of Net Position:				
Operating Reserve Account			$ 2	$ 10
Debt Service Reserve Account			909	919
Operating and Priority Contract Accounts			221	137
Bond Charge Collection and Bond Charge Payment Accounts			531	514
			$ 1,663	$ 1,580

Custodial Credit Risk: Under GASB Statement No. 40, custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of investment or collateral securities that are in the possession of an outside party. The State of California has a deposit policy for custodial credit risk that requires deposits held by financial institutions to be insured by federal depository insurance or secured by collateral held in the State's name. At June 30, 2015 and 2014, one of the guaranteed investment contracts in the amount of $100 million was uninsured and uncollateralized.

Interest Rate Risk: Under GASB Statement No. 40, interest rate risk is the risk that the value of fixed income securities will decline because of changing interest rates. The prices of fixed income securities with a longer time to maturity, measured by effective maturity, tend to be more sensitive to changes in interest rates and, therefore, more volatile than those with shorter maturities. The State Treasurers Investment Policy, Pooled Money Investment Account, provides for spreading investments over various maturities to minimize the risk of portfolio depreciation due to a rise in interest rates. The State Treasurers Investment Policy limits investments to the following maximum maturities: U.S. Treasury securities, 5 years; federal agency securities, 5 years; bankers acceptances – domestic and foreign, 180 days; certificates of deposits, 5 years; commercial paper, 180 days; corporate bonds and notes, 5 years; repurchase agreements and reverse repurchase agreements, 1 year.

Credit Risk: Under GASB Statement No. 40, credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The PMIA funds are on deposit with the State's Centralized Treasury System and are managed in compliance with the California Government Code, according to a statement of investment policy which sets forth permitted investment vehicles, liquidity parameters and maximum maturity of investments. These investments consist of U.S. government securities, securities of federally-sponsored agencies, U.S. corporate bonds, interest bearing time deposits in California banks, prime-rated commercial paper, bankers' acceptances, negotiable certificates of deposit, repurchase and reverse repurchase agreements. The PMIA policy limits the use of reverse repurchase agreements to limits of no more than 10% of the PMIA and commercial paper to limits not to exceed 30% of the PMIA. The PMIA does not invest in leveraged products or inverse floating rate securities. The PMIA is not rated.

Concentration of Credit Risk: The SMIF concentration of credit risk is limited by spreading the investment mix over different investment types and issuers to minimize the impact any one industry, investment class, or institution can have on the SMIF portfolio. At June 30, 2015, the Fund's investments in the FPA and two GICs individually exceed 5.0% of total investments. The ratings of the investments and their relative percentages of total investments is shown in the following table:

	Amount	S&P Credit Rating	Percent of Total Investments 2015	Percent of Total Investments 2014
FPA Provider				
Merrill Lynch: FHLMC Discounted Notes	$ 100	Not Rated	6.01%	6.33%
GIC Providers				
FSA	$ 100	Not Rated	6.01%	6.33%
Royal Bank of Canada	100	Not Rated	6.01%	6.33%
	$ 200			

Interest on deposits in the SMIF varies with the rate of return of the underlying portfolio and approximated 0.3% and 0.2% at June 30, 2015 and 2014, respectively. For both years ended June 30, 2015 and 2014, interest earned on the deposit in the SMIF was $4 million.

Interest on the GICs is paid semi-annually at interest rates ranging from 5.3% to 5.5%. Interest earned on the GICs was $11 million for the years ended June 30, 2015 and 2014.

The FPA allows the Fund to continuously reinvest funds in U.S. government or U.S. government agency securities through May 2022 to earn a minimum rate of return of 4.7%, as specified in the Reserve Fund Forward Purchase and Sale Agreement, dated May 1, 2004. The reinvested securities are to mature every six months. Interest earned on the FPA was $4 million for the years ended June 30, 2015 and 2014.

4. Long-Term Debt

The following activity occurred in the long-term debt accounts during the years ended June 30, 2015 and 2014 (in millions):

	Revenue Bonds	Unamortized Premium	Total
Balance, June 30, 2013	$ 6,554	$ 397	$ 6,951
Payments	(611)	-	(611)
Amortization	-	(91)	(91)
Balance, June 30, 2014	5,943	306	6,249
Refunding			
Issuance of Debt	766	154	920
Defeasance of Debt	(813)	(27)	(840)
Payments	(618)	-	(618)
Amortization	-	(80)	(80)
Balance, June 30, 2015	5,278	353	5,631
Less current portion	669	81	750
	$ 4,609	$ 272	$ 4,881

Long term debt consists of the following at June 30, 2015 and 2014, respectively (in millions):

Series	Rates	Fiscal Year of Final maturity	Fiscal Year of First Call Date	Amount Outstanding 2015	Amount Outstanding 2014	Current Portion
F	Fixed (4.38-5.00%)	2022	2018	$ 348	$ 348	$ -
G	Fixed (4.35-5.00%)	2018	Non-callable	173	173	98
H	Fixed (3.75-5.00%)	2022	2018	488	1,007	-
K	Fixed (4.00-5.00%)	2018	Non-callable	279	279	-
L	Fixed (2.50-5.00%)	2022	2020	1,841	2,447	177
M	Fixed (2.00-5.00%)	2020	Non-callable	617	884	394
N	Fixed (2.00-5.00%)	2021	Non-callable	766	805	-
O	Fixed (2.00-5.00%)	2022	Non-callable	766	-	-
				5,278	5,943	669
Plus unamortized bond premium				353	306	81
				$ 5,631	$ 6,249	$ 750

Bond Debt Refunding Transaction

On April 1, 2015, the Fund issued $766 million of Series O refunding revenue bonds. Proceeds of $917 million from the refunding bonds, which included a $154 million premium less $3 million for issuance expenses, along with $29 million released from the Debt Service Reserve and Bond Charge Payment accounts totaling $946 million were used to purchase securities that were deposited in an irrevocable trust with an escrow agent that will provide amounts sufficient to pay the future debt service on the advance refunded $813 million of outstanding Series H and Series L revenue bonds. As a result, the refunded bonds are considered defeased and have been removed from the Statement of Net Position.

The reacquisition price (the $946 million placed in escrow) exceeded the net carrying amount of the refunded bonds ($860 million: $813 million par value plus $27 million unamortized premium plus $20 million accrued interest) by $86 million. This loss on the bond refunding is reported as a deferred outflows of resources on the Statement of Net Position and will be amortized over the life of the refunding bonds. This advance refunding was undertaken to reduce total debt service payments over the next 7 years by $52 million and resulted in an economic gain of $46 million.

Key terms

Principal and interest payments are payable from bond charges. The Fund is subject to certain bond covenants, including establishing funding and expenditure requirements for several restricted cash and investment accounts. The bonds are limited special obligations of the Fund. Neither the principal nor any interest thereon constitutes a debt of the State of California.

The Series F, H, and L are callable at a redemption rate of 100 percent. The Series F and Series H are callable in 2018. The Series L bonds are callable in 2020. The Series G, K, M, N, and O are non-callable.

Maturities

Future payment requirements on the revenue bonds are as follows at June 30, 2015 (in millions):

Fiscal Year	Principal	Interest	Total
2016	$ 669	$ 256	$ 925
2017	686	225	911
2018	713	192	905
2019	749	157	906
2020	786	121	907
2021-22	1,675	126	1,801
	$ 5,278	$ 1,077	$ 6,355

5. Commitments and Contingencies

Litigation and Regulatory Proceedings

Certain pending legal and administrative proceedings involving the Fund or affecting the Fund's power supply program are summarized below.

California Refund Proceedings: During 2001 and 2002, the Fund purchased power in bilateral transactions (both short-term and long-term), sold power to the California Independent System Operator (CAISO), paid for power purchased by the CAISO and purchased power from the CAISO for sale to customers of the IOUs. In July 2001, the Federal Energy Regulatory Commission (FERC) initiated an administrative proceeding to calculate refunds for inflated prices in the CAISO and California Power Exchange (PX) markets during 2000 and 2001. FERC ruled that the Fund would not be entitled in that proceeding to approximately $3,500 million in refunds associated with the Fund's approximately $5,000 million of short-term purchases because the Fund made those purchases bilaterally, not in the PX or CAISO markets. The Ninth Circuit Court of Appeals affirmed FERC, but left open the possibility of refunds on the Fund's bilateral purchases in other FERC proceedings. In contrast, FERC ruled that the Fund is entitled to refunds on purchases made by the CAISO where the Fund actually paid the bill.

Of the Fund's $5,000 million in short-term bilateral purchases, $2,900 million was imbalance energy which the Fund sold to the CAISO at the Fund's cost in order to meet the CAISO's emergency needs during 2001. The Fund is treated in the FERC refund proceeding as a seller of that energy to CAISO, and in May 2004, FERC issued an order requiring the Fund to pay refunds on the sales to the CAISO. In September 2005, the Ninth Circuit Court of Appeals held that FERC does not have authority to order refunds from governmental entities such as the Fund. In November 2008, FERC found that although FERC cannot order a governmental entity, such as the Fund, to pay refunds, it can enforce the terms of the CAISO's tariff, which requires that all purchases and sales in a given hourly settlement period are netted. But for the more than 50 refund settlements the Fund has entered into to date, this order would have resulted in a substantial reduction to the refunds payable to the Fund. Settlements executed to date with various sellers, however, have reduced to a de minimus amount, the amount by which refunds payable to the Fund will be reduced on account of the Fund's sales to the CAISO. Refund payable to the Fund will be offset to the extent that the Fund must pay refunds on its sales to the CAISO.

Proceedings before FERC, including related appeals, are ongoing and could, together with the terms of any future settlements entered into by the Fund to resolve its remaining claims in the California Refund Proceedings, increase or decrease of refunds the Fund ultimately receives.

Direct Access Proceeding: On February 28, 2008, the CPUC approved a decision concluding that the suspension of direct access cannot be lifted at the present time because the Fund is still supplying power under the Act. However, the decision continued the proceeding to consider possible approaches to expediting the Fund's exit from its role of supplying power under the Act. On November 21, 2008, the CPUC adopted a plan with the goal of the early exit of the Fund from its role as supplier of power to retail electric customers. Under this plan, the Fund's power purchase contracts would be replaced by agreement between the IOUs and the Fund's power supplier counterparties that are not detrimental to ratepayers, through novation and/or negotiation.

Senate Bill 695: On October 11, 2009, Senate Bill (SB) 695 was signed into law as an urgency statute. SB 695 allows individual retail nonresidential end-use customers to acquire electric service from other providers in each IOU service area, up to a maximum allowable limit. Except for this express authorization for increased direct access transactions under SB 695, the previously enacted suspension of direct access remains in effect. On March 15, 2010, the CPUC issued Decision 10-03-022 which authorizes increases in the maximum direct access load for each IOU service area, as specified in SB 695. The maximum load of allowable direct access volume is established for each IOU as the maximum total kWh supplied by all other providers to distribution customers of the IOU during any sequential 12-month period between April 1, 1998 and the effective date of the section of the Public Utilities code modified by SB 695, October 11, 2009.

Decision 10-03-033 phases in the additional load allowance over a four-year period beginning on April 11, 2010. The annual phase in of the limits combined with the concurrent expiration of several long-term contracts has not resulted in impacts to the Power Charges. Regardless of the level of direct access participation within the IOU service area, direct access customers will still be assessed Bond Charges and the Fund's revenue requirement will be recovered in the same manner as has been successfully implemented over the duration of the Power Supply Program.

Other Contingencies

The Fund is self-insured for most risks, including general liability and workers' compensation. Management believes the Fund's exposure to loss is immaterial and that any costs associated with such potential losses are recoverable from customers as part of the Fund's revenue requirement.

Commitments

The last remaining power purchase contract and natural gas transmission capacity contract were terminated during fiscal year 2015. The Fund is no longer exposed to future obligations related to power or natural gas purchases under any of the contracts which had been scheduled to require payments through 2018.

6. Energy Settlements

The Fund and other parties have entered into settlement agreements with various energy suppliers which resolve potential and alleged causes of action against suppliers for their part in alleged manipulation of natural gas and electricity commodity and transportation markets during the 2000 - 2001 California energy crisis, and also received settlements from other FERC actions.

Energy settlements received in 2015 were $174 million. The Fund received $141 million from Powerex Corporation, Dynergy Inc. $26 million, State Water Resources Development System $5 million and $2 million from Williams Energy Marketing and Trading Company.

Energy settlements in 2014 totaled $53 million. The Fund received $5 million from Avista Corporation and is entitled to $48 million from TransAlta Energy Marketing (US), of which $25 million was received on July 3, 2014. The remaining balance of $23 million was received in July 2015. These settlements are as a result of FERC approved settlement agreements to resolve certain claims arising from events and transactions in Western Energy Markets during the period January 1, 2000 through June 20, 2001.

7. Pension Plan

Plan Description

All of the employees of the Fund participate in either the CalPERS Miscellaneous or Safety Defined Benefit Pension Plans (Plans), which are included in the State of California's (State) Comprehensive Annual Financial Report as a fiduciary component unit. CalPERS administers the Plans within the Public Employees' Retirement Fund (PERF-A). PERF-A is an agent multiple-employer defined benefit pension plan. Departments and agencies within the State, including the Funds, are in a cost-sharing arrangement in which all risks and costs are shared proportionately by participating State agencies. Since all State agencies and certain related organizations, including the Funds, are considered collectively to be a single employer for plan purposes, the actuarial present value of vested and non-vested accumulated plan benefits attributable to the Fund employees cannot be determined. The significant actuarial assumptions used to compute the actuarially determined State contribution requirements are the same as those used to compute the State pension benefit obligation as defined by CalPERS. CalPERS issues a publicly available financial report that includes financial statements and required supplementary information for this plan. This report is available online at www.calpers.ca.gov.

The California Legislature passed and the Governor signed the "Public Employees' Pension Reform Act of 2013" (PEPRA) on September 12, 2012. PEPRA contained a number of provisions intended to reduce future pension obligations. PEPRA primarily affects new pension plan members who are enrolled for the first time after December 2012. Benefit provisions and other requirements are established by State statute.

Benefits Provided (2015 disclosures in accordance with GASB 68)

The benefits for the Plan are based on members' years of service, age, final compensation, and benefit formula. Benefits are provided for disability, death, and survivors of eligible members or beneficiaries. Members become fully vested in their retirement benefits earned to date after five or ten years of credited service.

The Plans' provisions and benefits in effect at June 30, 2015, are summarized as follows:

First Tier:

Hire date	Prior to January 15, 2011	January 15, 2011 to December 31, 2012	On or after January 1, 2013
Benefit formula	2% @ 55	2% @ 60	2% @ 62
Benefit vesting schedule	5 years service	5 years service	5 years service
Benefit payments	monthly for life	monthly for life	monthly for life
Retirement age	50 to 67	50 to 67	52 to 67
Monthly benefits, as a % of eligible compensation	1.1 to 2.5%	1.092 to 2.418%	1.0 to 2.5%

Second Tier:

Hire date	Prior to January 1, 2013	On or after January 1, 2013
Benefit formula	1.25% @ 65	1.25% @ 67
Benefit vesting schedule	10 years service	10 years service
Benefit payments	monthly for life	monthly for life
Retirement age	50 to 67	52 to 67
Monthly benefits, as a % of eligible compensation	0.5 to 1.25%	0.65 to 1.25%

Contributions

Section 20814(c) of the California Public Employees Retirement Law (PERL) requires that the employer contribution rates for all public employers be determined on an annual basis by the actuary and shall be effective on the July 1 following notice of a change in the rate. The total plan contributions are determined through the CalPERS' annual actuarial valuation process. The actuarially determined rate is the estimated amount necessary to finance the costs of benefits earned by employees during the year, with an additional amount to finance any unfunded accrued liability. The Fund is required to contribute the difference between the actuarially determined rate and the contribution rate of employees.

For the measurement period ended June 30, 2014 (the measurement date), the average active employee contribution rate was 6.525% of annual pay and the employer's contribution rate is 21.137% of annual payroll.

These rates reflect Section 20683.2, which mandates that certain employees must contribute more as of July 1, 2013. Furthermore, any reduction in employer contributions due to the increase in the employee contributions must be paid by the employer towards the unfunded liability. It is the responsibility of the employer to make necessary accounting adjustments to reflect the impact due to any Employer Paid Member Contributions or situations where members are paying a portion of the employer contribution.

For the year ended June 30, 2015, the contributions recognized as part of pension expense was $0.3 million.

Pension Liabilities, Pension Expense and Deferred Outflows/Inflows of Resources Related to Pensions

As of June 30, 2015, the Fund reported net pension liabilities for their proportionate share of the net pension liability of $4.8 million.

The Fund's net pension liability for the Plan is measured as the proportionate share of the net pension liability. The net pension liability of the Plan is measured as of June 30, 2014, and the total pension liability for the Plan used to calculate the net pension liability was determined by an actuarial valuation as of June 30, 2013 rolled forward to June 30, 2014 using standard update procedures. The Funds' proportion of the net pension liability was based on the State Controller's Office (SCO) projection for the fund. The SCO identified a total of 29 entities that are reported in the State's CAFR which are proprietary funds (enterprise and internal service) and fiduciary funds, component units (discretely presented and fiduciary), and related organizations, that have State employees with pensionable compensation (covered payroll). The SCO calculated and provided these funds/organizations with their allocated pensionable compensation percentages by plan. The Fund's proportionate share of the net pension liability for the Plan as of June 30, 2014 was 0.01777%, which is 0.77% of DWR's proportionate share of 2.30778%.

For the year ended June 30, 2015, the Fund recognized pension expense of $0.3 million. At June 30, 2015, the Fund reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources (in millions):

	Deferred Outflows of Resources	Deferred Inflows of Resources
Fund contributions subsequent to the measurement date	$ 0.5	$ -
Net difference between projected and actual earnings on pension plan investments	-	0.9
Total	$ 0.5	$ 0.9

The $0.5 million reported as deferred outflows of resources related to contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ending June 30, 2016. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized as pension expense as follows (in millions):

Year Ended June 30	
2016	$ (0.3)
2017	(0.2)
2018	(0.2)
2019	(0.2)
Total	$ (0.9)

Actuarial Assumptions

For the measurement period ended June 30, 2014 (measurement date), the total pension liability was determined by rolling forward the June 30, 2013 total pension liability. The June 30, 2013 and the June 30, 2014 total pension liabilities were based on the following actuarial method and assumptions:

Actuarial Cost Method	Entry-Age Normal
Actuarial Assumptions:	
Discount Rate	7.5%
Inflation	2.75%
Salary Increases	Varies (1)
Investment Rate of Return	7.5% (2)
Mortality(3)	CalPERS' Membership Data
Post Retirement Benefit Increase	Up to 2.75%(4)

(1) Depending on age, service and type of employment
(2) Net of pension plan investment and administrative expenses, including inflation
(3) The mortality table used was developed based on CalPERS specific data. The table includes 20 years of mortality improvements using Society of Actuaries Scale BB. For more details on this table, please refer to the 2014 experience study report.
(4) Contract COLA up to 2.75% until Purchasing Power Protection Allowance Floor on Purchasing Power applies

All other actuarial assumptions used in the June 30, 2013 valuation were based on the results of an actuarial experience study for the period from 1997 to 2011, including updates to salary increase, mortality and retirement rates. The Experience Study report can be obtained at CalPERS website under Forms and Publications.

Discount Rate

The discount rate used to measure the total pension liability was 7.50% for the Plan. To determine whether the municipal bond rate should be used in the calculation of a discount rate for each plan, CalPERS stress tested plans that would most likely result in a discount rate that would be different from the actuarially assumed discount rate. Based on the testing, none of the tested plans run out of assets. Therefore, the current 7.50% discount rate is adequate and the use of the municipal bond rate calculation is not necessary. The stress test results are presented in a detailed report called "GASB Crossover Testing Report" that can be obtained at CalPERS' website under the GASB 68 section.

According to Paragraph 30 of GASB 68, the long-term discount rate should be determined without reduction for pension plan administrative expense. The 7.50% investment return assumption used in this accounting valuation is net of administrative expenses. Administrative expenses are assumed to be 15 basis points. An investment return excluding administrative expenses would have been 7.65%. Using this lower discount rate has resulted in a slightly higher Total Pension Liability and Net Pension Liability. CalPERS checked the materiality threshold for the difference in calculation and did not find it to be a material difference.

CalPERS is scheduled to review all actuarial assumptions as part of its regular Asset Liability Management (ALM) review cycle that is scheduled to be completed in February 2018. Any changes to the discount rate will require CalPERS Board action and proper stakeholder outreach. For these reasons, CalPERS expects to continue using a discount rate net of administrative expenses for GASB 67 and 68 calculations through at least the 2017-18 fiscal year. CalPERS will continue to check the materiality of the difference in calculation until such time when CalPERS may change its methodology.

The long-term expected rate of return on pension plan investments was determined using a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class.

In determining the long-term expected rate of return, CalPERS took into account both short-term and long-term market return expectations as well as the expected pension fund cash flows. Such cash flows were developed assuming that both members and employers will make their required contributions on time and as scheduled in all future years. Using historical returns of all the funds' asset classes, expected compound returns were calculated over the short-term (first 10 years) and the long-term (11-60 years) using a building-block approach. Using the expected nominal returns for both short-term and long-term, the present value of benefits was calculated for each fund. The expected rate of return was set by calculating the single equivalent expected return that arrived at the same present value of benefits for cash flows as the one calculated using both short-term and long-term returns. The expected rate of return was then set equivalent to the single equivalent rate calculated above and rounded down to the nearest one quarter of one percent.

The table below reflects the long-term expected real rate of return by asset class. The rate of return was calculated using the capital market assumptions applied to determine the discount rate and asset allocation. These rates of return are net of administrative expenses.

Asset Class	New Strategic Allocation	Real Return Years 1 – 10 (a)	Real Return Years 11+ (b)
Global Equity	47.0%	5.25%	5.71%
Global Fixed Income	19.0%	0.99%	2.43%
Inflation Sensitive	6.0%	0.45%	3.36%
Private Equity	12.0%	6.83%	6.95%
Real Estate	11.0%	4.50%	5.13%
Infrastructure and Forestland	3.0%	4.50%	5.09%
Liquidity	2.0%	-0.55%	-1.05%
Total	100.0%		

(a) An expected inflation of 2.5% used for this period.
(b) An expected inflation of 3.0% used for this period.

Sensitivity of the Fund's Proportionate Share Net Pension Liability to Changes in the Discount Rate

The following presents the Fund's proportionate share of the net pension liability of the Plan as of the measurement date, calculated using the discount rate of 7.50 percent, as well as what the Fund's proportionate share of the net pension liability would be if it were calculated using a discount rate that is 1 percentage-point lower (6.50 percent) or 1 percentage-point higher (8.50 percent) than the current rate:

	Discount Rate – 1% (6.50%)	Current Discount Rate (7.50%)	Discount Rate + 1% (8.50%)
The Fund's Proportionate Share of Plan's Net Pension Liability	$ 6.9	$ 4.8	$ 3.0

Annual Pension Cost (2014 disclosures in accordance with GASB 27)

The Fund's annual pension cost payable from the Fund and actual contribution allocated to the Fund based on the Fund's payroll costs at June 30, 2014 was $0.5 million.

The following tables shows the Department's annual pension cost and the percentage contributed for the years ended June 30, 2014, 2013, and 2012 (in millions):

Year Ended	Annual Required Contribution (ARC)	Percentage of ARC Contributed
6/30/2012	$ 1.0	100%
6/30/2013	1.0	100%
6/30/2014	0.5	100%

8. Other Postemployment Benefits and Accrued Vacation

In addition to the pension benefits, the State of California provides postemployment health care benefits, in accordance with Section 22754 (g) of the State Government Code, to all employees who retire on or after attaining certain age and length of service requirements. The State of California is funding postemployment benefits on a pay-as-you-go basis.

A portion of the State's postemployment benefit costs have been allocated to the Fund as follows (in millions):

	2015	2014
Annual required contribution	$ 0.8	$ 1.7
Interest on net OPEB obligation	0.1	0.2
Adjustment to annual required contribution	(0.1)	(0.2)
Annual OPEB cost (expense)	0.8	1.7
Contributions made	(0.3)	(0.6)
Increase in net OPEB obligation	0.5	1.1
Net OPEB obligation - beginning of year	5.6	4.5
Net OPEB obligation - end of year	$ 6.1	$ 5.6

The Fund's net OPEB obligation is included in the other postemployment benefits and accrued vacation on the Statements of Net Position.

The Fund's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for the years ended June 30, 2015, 2014, and 2013 were as follows (in millions):

Year Ended	Annual OPEB Cost	Percentage of OPEB Cost Contributed	Net OPEB Obligation
6/30/2013	1.1	35%	4.5
6/30/2014	1.7	35%	5.6
6/30/2015	0.8	38%	6.1

Additional disclosure detail required by Government Accounting Standards Board Statement No.45, regarding other postemployment benefits is presented in the State's Comprehensive Annual Financial Report for the year ended June 30, 2014, which is the latest available.

REQUIRED SUPPLEMENTARY INFORMATION

SCHEDULE OF THE FUND'S PROPORTIONATE SHARE OF THE NET PENSION LIABILITY
As of June 30, 2015
Last 10 Years*
(in millions)

		2015
The Fund's proportion of the net pension liability		0.01777%
The Fund's proportionate share of the net pension liability	$	4.8
The Fund's covered-employee payroll	$	1.9
The Fund's proportionate share of the net pension liability as a percentage of their covered-employee payroll		39.06%
Plan fiduciary net position as a percentage of the total pension liability		73.05%

Notes to Schedule:

Changes of benefit terms. In 2015, there were no changes to the benefit terms.

Changes in assumptions. In 2015, there were no changes in assumptions.

* - Fiscal year 2015 was the 1st year of implementation, therefore only one year is shown.

SCHEDULE OF THE FUND'S CONTRIBUTIONS
As of June 30, 2015
Last 10 Years*
(in millions)

		2015
Contractually required contribution	$	0.5
Contributions in relation to the contractually required contribution		0.5
Contribution deficiency (excess)	$	--
Funds' covered-employee payroll	$	1.9
Contributions as a percentage of covered-employee payroll		25.85%

Notes to Schedule:

The actuarial methods and assumptions used to determine contribution rates for year ended June 30, 2015 was from the June 30, 2013 Valuation Date.

Actuarial Cost Method	Entry-Age Normal
Actuarial Assumptions:	
Inflation	2.75%
Salary Increase	Varies (1)
Payroll Growth	3.0%(2)
Investment Rate of Return	7.5%
Retirement Age	2010 Experience Study(3)
Mortality	2010 Experience Study(4)

(1) Depending on age, service and type of employment
(2) Net of pension plan investment and administrative expenses, including inflation
(3) The probabilities of Retirement are based on the 2010 CalPERS Experience Study for the period from 1997 to 2007.
(4) The probabilities of mortality are based on the 2010 CalPERS Experience Study for the period from 1997 to 2007. Pre-retirement and Post-retirement mortality rates include 5 years of projected mortality improvement using Scale AA published by the Society of Actuaries.

* - Fiscal year 2015 was the 1st year of implementation, therefore only one year is shown

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*

To the Director of the Department of Water Resources
Department of Water Resources Electric Power Fund
Sacramento, California

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contacted in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the Department of Water Resources Electric Power Fund (Fund) of the State of California, as of and for the year ended June 30, 2015, and the related notes to financial statements, and have issued our report thereon dated October 14, 2015.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the State of California's internal control over financial reporting (internal control) as it relates to the Fund to determine the audit procedures that are appropriate in the circumstances 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 State of California's internal control as it relates to the Fund. Accordingly, we do not express an opinion on the effectiveness of the State of California's internal control as it relates to the Fund.

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 a 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. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control 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 material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Fund's financial statements are free from material misstatement, we performed tests of the State'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 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*.

Macias Gini & O'Connell LLP
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Purpose of this Report

The purpose of this report is solely to describe the scope of our testing on internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Macias Gini & O'Connell LLP

Sacramento, California
October 14, 2015