Department of Water Resources
Electric Power Fund
Financial Statements

For the years ended June 30, 2016 and 2015

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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 (Department) Electric Power Fund (Fund) of the State of California, as of and for the years ended June 30, 2016 and 2015, 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, 2016 and 2015, 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.

Emphasis of Matter

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, 2016 and 2015, the changes in its financial position, or where applicable, its cash flows thereof 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.

Other Matter

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 19, 2016 on our consideration of the Department'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 Department's internal control over financial reporting and compliance as it relates to the Fund.

Macias Gini & O'Connell LLP

Sacramento, California
October 19, 2016

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):

	2016	2015	2014
Long-term restricted cash, equivalents and investments	$ 911	$ 911	$ 929
Recoverable costs	3,245	3,770	4,490
Restricted cash and equivalents:			
Operating and priority contract accounts	46	221	137
Bond charge collection and bond charge payment accounts	535	531	514
Recoverable costs receivable	72	108	156
Interest receivable	4	4	3
Total assets	4,813	5,545	6,229
Deferred outflows of resources related to pensions	$ 2	$ -	$ -
Deferral of loss on defeasance	116	144	80
Total deferred outflows of resources	118	144	80
Total assets and deferred outflows of resources	$ 4,931	$ 5,689	$ 6,309
Long-term debt, including current portion	$ 4,880	$ 5,631	$ 6,249
Net pension liability	5	5	-
Other postretirement benefits and accrued vacation	7	7	6
Other current liabilities	39	45	54
Total liabilities	4,931	5,688	6,309
Deferred inflows of resources related to pensions	-	1	-
Total liabilities and deferred inflows of resources	$ 4,931	$ 5,689	$ 6,309

Long-Term Restricted Cash, Equivalents and Investments

The Debt Service Reserve Account remained at $911 million at June 30, 2016. With the termination of the last remaining power contract, reserves for operating the Fund's power purchase program are no longer necessary and therefore, $2 million in related reserves were released and transferred to the Operating Account. Additionally, the reserve accounts reported a $2 million unrealized gain on investments.

The $18 million decrease in long-term restricted cash, equivalents and investments during fiscal 2015 was 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 was 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.

Recoverable Costs

Recoverable costs consist of costs that are recoverable through future billings. The $525 million decrease during fiscal 2016 is due to: recovery of operating costs of $191 million and bond charges plus interest income exceeding interest and investment expense by $717 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 $720 million decrease during fiscal 2015 was due to 1) recovery of operating costs of $23 million, as a result of the reduction in excess reserves returned to IOU customers 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.

Restricted Cash and Equivalents

The Operating and Priority Contract Accounts decreased by $175 million in 2016 as no material power charge revenues and energy settlements were received during this fiscal year.

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 Bond Charge Collection and Bond Charge Payment Accounts increased by $4 million in 2016 and increased by $17 million in 2015 in accordance with required amounts specified in the Trust Indenture.

Recoverable Costs Receivable

Recoverable costs receivable reflects power and bond charges to customer in the IOU service areas that have not yet been collected and amounts receivable. The $72 million of recoverable costs receivable at June 30, 2016 is $36 million lower than at June 30, 2015. The decrease is the result of realization of receivables during that period.

The $108 million of recoverable costs receivable at June 30, 2015 was $48 million lower than at June 30, 2014. The decrease in 2015 was primarily due to the expected receipt of several energy settlements after the end of fiscal year 2014.

Deferred Outflows of Resources Related to Pensions

Deferred outflows of resources related to pensions was $2 million at June 30, 2016.

Deferred outflows of resources consists of deferred outflows of resources for fiscal 2015-2016 employer contribution of $1 million and deferred outflows of resources for the change in proportion of $1 million at June 30, 2016.

Deferral of Loss on Defeasance

Deferral of loss on defeasance decreased by $28 million during the period ending June 30, 2016, due to the amortization of deferred loss on defeasance.

Deferral of loss on defeasance increased by $64 million at June 30, 2015. The increase was primarily a result of $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 $4,880 million as of June 30, 2016 from $5,631 million as of June 30, 2015.

Revenue bond principal payments were $669 million in fiscal year 2016. Net amortization of bond premium was $82 million in fiscal year 2016.

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 were considered defeased and have been removed from this 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.

Net Pension Liability

The net pension liability as of June 30, 2016 remained unchanged at $5 million.

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 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 unchanged for period ending June 30, 2016.

The Fund's other postemployment benefits (OPEB) and accrued vacation time liability was $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 employee and consultants, as payments are normally made in the latter half of the month following purchase.

Accounts payable at June 30, 2016 remained unchanged at $2 million at June 30, 2016.

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

Accrued interest payable at June 30, 2016 is $6 million lower than at June 30, 2015 due to fewer bonds outstanding resulting from the maturity of $669 million in bonds in fiscal 2016.

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

Deferred Inflows of Resources Related to Pensions

Deferred inflows of resources decreased $1 million as of June 30, 2016 compared to June 30, 2015.

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

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):

	2016	2015	2014
Revenues:			
Power charges, net of refunds	$ (182)	$ (137)	$ (47)
Surplus sales	-	5	3
Bond charges	886	911	862
Interest income	24	20	19
Total revenues	728	799	837
Expenses:			
Power purchases	-	7	39
Energy settlements	-	(174)	(53)
Interest expense	193	227	241
Investment loss	-	-	2
Administrative expenses	9	12	15
Recovery of recoverable costs	526	727	593
Total expenses	728	799	837
Changes 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 in each IOU service area.

Power Charges decreased by $45 million during fiscal year 2016. The decrease reflects a combination of a larger return of excess amounts and previously received remittances to ratepayers and the diminishing receipt of power charges from the sale of power to end use customers from the Fund's contracts after the termination of the last remaining contract in 2015. The return of excess amounts and previously received remittances is an allocation of excess reserves, litigation settlements and prior year over-collection from ratepayers. The return is implemented through separate monthly payments to the ratepayers through the IOUs.

The amounts the Fund returns are in excess of Trust Indenture required levels, as determined by the annual Revenue Requirement. The allocation of excess amounts and reserves was authorized by the CPUC in Decision 14-12-002 for calendar year 2015 and in Decision 15-12-003 for calendar year 2016. During fiscal year 2016, the Fund returned $178 million to ratepayers in monthly payments.

Power Charges revenue decreased by $90 million during fiscal year 2015 reflecting the larger return of excess amounts and previously received remittances to ratepayers. During fiscal year 2015, the Fund returned $183 million to ratepayers in the monthly payments.

Surplus Sales

The Fund receives revenue from the sale of surplus power. Since the last power contract expired in April 2015, no surplus sales revenues were received during this fiscal year.

Surplus sales for the year ended June 30, 2015 were $2 million higher than in the same period in 2014.

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, 2016, 2015 and 2014 were $886 million, $911 million and $862 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 $25 million decrease in 2016 is due to a combination of lower Bond Charge rates and lower sales to IOU customers. The $49 million increase in 2015 was due to a combination of higher Bond Charge rates and higher sales to IOU customers.

Interest Income

Interest income for 2016 is $4 million higher than in 2015, due to slightly higher cash balances and interest rates earned on investments in the State of California Surplus Money Investment Fund (SMIF) and Forward Purchase Agreement (FPA) and the unrealized gain from Forward Purchase Agreement (FPA). The average yield earned on SMIF for the year ended June 30, 2016 was 0.43% compared to 0.27% for the year ended June 30, 2015.

Interest income for 2015 was $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.

Power Purchases

Power Purchase costs decreased by $7 million in 2016 compared to 2015 and decreased by $32 million in 2015 compared to 2014 due to termination of the last power contract in April 2015.

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.

There was no material revenue received from energy settlements during the period ending June 30, 2016.

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

Interest Expense

Interest expense was $34 million lower in 2016 when compared to 2015. 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 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.

Administrative Expenses

Administrative expenses decreased by $3 million in 2016 and by $3 million in 2015 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):

	2016	2015	2014
Operations	$ (191)	$ 23	$ (47)
Debt service and related costs	717	704	640
	$ 526	$ 727	$ 593

<u>Operations</u>

The negative $191 million operations recovery, in the year ended June 30, 2016, primarily reflects the return of excess amounts to ratepayers in the IOU service areas and no material power charge revenues received.

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.

<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 2016 and 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 a Debt Service Reserve Fund in order to meet expenditures if bond charge revenue is impaired. 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.

With the termination of the last remaining power contract, reserves for operating the Fund's power purchase program are no longer necessary. As of January 2016, the remaining Operating Reserve Account funds were transferred to the Operating Account for return to customers in the IOU service areas.

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.

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

Department of Water Resources Electric Power Fund
Statements of Net Position
June 30, 2016 and 2015 (in millions)

	2016	2015
Assets		
Long-term assets:		
Restricted cash, equivalents and investments:		
Operating Reserve Account	$ -	$ 2
Debt Service Reserve Account	911	909
Recoverable costs	3,245	3,770
Total long-term assets	4,156	4,681
Current assets:		
Restricted cash and equivalents:		
Operating and Priority Contract Accounts	46	221
Bond Charge Collection and Bond Charge Payment Accounts	535	531
Recoverable costs receivable	72	108
Interest receivable	4	4
Total current assets	657	864
Total assets	4,813	5,545
Deferred outflows of resources		
Deferred outflows of resources related to pensions	2	-
Deferral of loss on defeasance	116	144
Total assets and deferred outflows of resources	$ 4,931	$ 5,689
Liabilities		
Non-Current liabilities:		
Long-term debt	$ 4,124	$ 4,881
Net pension liability	5	5
Other postemployment benefits and accrued vacation	7	7
Total non-current liabilities	4,136	4,893
Current liabilities:		
Current portion of long-term debt	756	750
Accounts payable	2	2
Accrued interest payable	37	43
Total current liabilities	795	795
Total liabilities	4,931	5,688
Deferred inflows of resources		
Deferred inflows of resources related to pensions	-	1
Total liabilities and deferred inflows of resources	$ 4,931	$ 5,689

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

Department of Water Resources Electric Power Fund

Statements of Revenues, Expenses and Changes in Net Position

For the years ended June 30, 2016 and 2015 (in millions)

	2016	2015
Operating revenues:		
Power charges, net of refunds	$ (182)	$ (137)
Surplus sales	-	5
Total operating revenues	(182)	(132)
Operating expenses:		
Power purchases	-	7
Energy settlements	-	(174)
Administrative expenses	9	12
Recovery of recoverable operating costs	(191)	23
Total operating expenses	(182)	(132)
Income from operations	-	-
Nonoperating revenues and expenses:		
Bond charges	886	911
Interest income	24	20
Interest expense	(193)	(227)
Recovery of recoverable debt service and related costs	(717)	(704)
Changes 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, 2016 and 2015 (in millions)

	2016	2015
Cash flows from operating activities:		
Receipts:		
Power charges, net of refunds	$ (174)	$ (137)
Surplus sales	-	4
Energy settlements	-	227
Payments to employees for services	(6)	(2)
Payments for power purchases and other expenses	(7)	(19)
Net cash provided by (used in) operating activities	(187)	73
Cash flows from non-capital financing activities:		
Receipt of bond charges	914	905
Bond payments	(669)	(618)
Interest payments	(253)	(268)
Proceeds from issuance of revenue bonds	-	1
Payment to advance refund escrow agent	-	(29)
Net cash used in non-capital financing activities	(8)	(9)
Cash flows from investing activities:		
Interest received on investments	22	19
Changes in restricted cash and equivalents	(173)	83
Restricted cash and equivalents, beginning of period	1,363	1,280
Restricted cash and equivalents, end of period	$ 1,190	$ 1,363
Restricted cash and equivalents included in:		
Operating Reserve Account	$ -	$ 2
Debt Service Reserve Account (a component of the total of $911 and $909 at June 30, 2016 and 2015, respectively)	609	609
Operating and Priority Contract Accounts	46	221
Bond Charge Collection and Bond Charge Payment Accounts	535	531
Restricted cash and equivalents, end of year	$ 1,190	$ 1,363

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

Department of Water Resources Electric Power Fund
Statements of Cash Flows (Continued)
For the years ended June 30, 2016 and 2015 (in millions)

	2016	2015
Reconciliation of income from operations to net cash provided by (used in) operating activities:		
Income from operations	$ -	$ -
Adjustments to reconcile income from operations to net cash provided by (used in) operating activities:		
Recovery of recoverable operating costs	(191)	23
	(191)	23
Changes in net assets and liabilities to reconcile income from operations to net cash provided by (used in) operations:		
Recoverable costs receivable	7	52
Net pension liability and related deferred inflows/outflows	(3)	1
Other postemployment benefits and accrued vacation	-	1
Accounts payable	-	(4)
Net change in operating assets & liabilities:	4	50
Net cash provided by (used in) operating activities	$ (187)	$ 73
Noncash financing and investing activities:		
Amortization of revenue bond premiums	$ 82	$ 80
Amortization of deferral of loss on defeasance	28	22
Bond proceeds paid directly to advance refund escrow agent	-	917
Accrued interest on refunded revenue bonds		20
Unrealized gain on investment	2	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 Statement No. 62. The Fund is accounted for with a set of self-balancing accounts that comprise of assets, deferred outflows of resources, liabilities, deferred inflows of resources, 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

In fiscal year 2016, the Fund adopted Statement No. 72 of the Government Accounting Standards Board, entitled*, Fair Value Measurement and Application*. Statement No. 72 requires the Fund to use valuation techniques which are appropriate under the circumstances and are either a market approach, a cost approach or an income approach. Statement No. 72 establishes a hierarchy of inputs used to measure fair value consisting of three levels. Level 1 inputs are quoted prices in active markets for identical assets or liabilities. Level 2 inputs are inputs other than quoted prices included within level 1, which are observable for the asset or liability, either directly or indirectly. Level 3 inputs are unobservable inputs.

Statement No. 72 also contains note disclosure requirements regarding the hierarchy of valuation inputs and valuation techniques that was used for the fair value measurements. There was no material impact on the Fund's financial statements as a result of the implementation of Statement No. 72. All required disclosures were added to Note 3.

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. Monies are available for payment of residual contract obligations and return of excess amounts to ratepayers.
- <u>Priority Contract Account</u>: Priority contracts were those power purchase contracts that required monthly payment prior to any debt service payments. As of December 2013, there were no more contracts with the priority designation. In August 2015, the Fund transferred the remaining balance amount of the priority contract account to the operating account.
- <u>Operating Reserve Account</u>: With the termination of the last remaining power contract in April 2015, reserves for operating the Fund's power purchase program were no longer necessary. As of January 2016, the remaining balance in the Operating Reserve Account was transferred to the Operating Account for return to ratepayers in the IOU service areas.

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 and administrative costs 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 and administrative costs. 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 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 and deferred inflows of resources on the Statements of Net Position is presented as recoverable costs such that there is no net position. 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 GASB Statement No. 62, 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 Plan (Plan) and additions to/deductions from the Plan’s 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, 2016 and 2015, the Fund had the following cash, equivalents and investments (in millions):

Investment	Maturity June 30, 2016	Maturity June 30, 2015	2016	2015
State of California Pooled Money Investment Account - Surplus Money Investment Fund	5.5 months avg.	7.9 months avg.	$ 1,188	$ 1,360
Cash			2	3
Total cash and equivalents			1,190	1,363
Guaranteed investment contracts	May 1, 2022		200	200
Forward purchase agreement	November 1, 2016		102	100
			$ 1,492	$ 1,663
Reconciliation to Statements of Net Position:				
Operating Reserve Account			$ -	$ 2
Debt Service Reserve Account			911	909
Operating and Priority Contract Accounts			46	221
Bond Charge Collection and Bond Charge Payment Accounts			535	531
			$ 1,492	$ 1,663

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, 2016 and 2015, 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, 2016 and 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 2016	Percent of Total Investments 2015
FPA Provider				
Merrill Lynch: Federal Home Loan Mortgage Corporation Discounted Notes	$ 102	Not Rated	6.84%	6.01%
GIC Providers				
FSA	$ 100	Not Rated	6.70%	6.01%
Royal Bank of Canada	100	Not Rated	6.70%	6.01%
	$ 200			

Interest on deposits in the SMIF varies with the rate of return of the underlying portfolio and approximated 0.4% and 0.3% at June 30, 2016 and 2015, respectively. For the years ended June 30, 2016 and 2015, interest earned on the deposit in the SMIF was $6 million and $4 million, respectively.

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, 2016 and 2015.

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, 2016 and 2015.

Fair Market Value measurement: The Fund categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. The hierarchy is based on the valuation inputs used to measure the fair value of the asset. Level 1 inputs are quoted prices in active markets for identical assets; level 2 inputs are significant other observable inputs; level 3 are significant unobservable inputs.

The Fund has the following recurring fair value measurements as of June 30, 2016:

- The Forward Purchase Agreement of $102 million is valued using market approach (Level 2).

4. Long-Term Debt

The following activity occurred in the long-term debt accounts during the years ended June 30, 2016 and 2015 (in millions):

	Revenue Bonds	Unamortized Premium	Total
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
Payments	(669)	-	(669)
Amortization	-	(82)	(82)
Balance, June 30, 2016	4,609	271	4,880
Less current portion	686	70	756
	$ 3,923	$ 201	$ 4,124

Long term debt consists of the following at June 30, 2016 and 2015, respectively (in millions):

Series	Rates	Fiscal Year of Final maturity	Fiscal Year of First Call Date	Amount Outstanding 2016	Amount Outstanding 2015	Current Portion
F	Fixed (4.375-5.00%)	2022	2018	$ 348	$ 348	$ -
G	Fixed (4.70-5.00%)	2018	Non-callable	75	173	-
H	Fixed (3.75-5.00%)	2022	2018	488	488	255
K	Fixed (4.00-5.00%)	2018	Non-callable	279	279	-
L	Fixed (3.00-5.00%)	2022	2020	1,664	1,841	406
M	Fixed (2.50-5.00%)	2020	Non-callable	223	617	25
N	Fixed (3.00-5.00%)	2021	Non-callable	766	766	-
O	Fixed (2.00-5.00%)	2022	Non-callable	766	766	-
				4,609	5,278	686
Plus unamortized bond premium				271	353	70
				$ 4,880	$ 5,631	$ 756

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 resources 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. As of June 30, 2016, the outstanding balance of the refunded bonds is $813 million.

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, 2016 (in millions):

Fiscal Year	Principal	Interest	Total
2017	$ 686	$ 225	$ 911
2018	713	192	905
2019	749	157	906
2020	786	121	907
2021	803	83	886
2022	872	43	915
	$ 4,609	$ 821	$ 5,430

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 kilowatt hour (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.

There were no material revenues received from energy settlements during the period ended June 30, 2016.

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.

7. Subsequent Event

On September 28, 2016, the Fund refunded with a par of $567 million, the remaining $348 million on the Series 2005 F bonds and $207 million of the 2008 H bonds with the 2016 P refunding bonds. The refunding resulted in a net present value savings of $43 million.

8. Retirement Plan

Plan Description

All of the employees of the Fund participate in the CalPERS Miscellaneous Defined Benefit Pension Plan (Plan), which is included in the State of California's (State) Comprehensive Annual Financial Report as a fiduciary component unit. CalPERS administers the Plan 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 Fund, 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 Fund, 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

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 Plan's provisions and benefits in effect at June 30, 2016 and 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 employer is required to contribute the difference between the actuarially determined rate and the contribution rate of employees. For the measurement periods ended June 30, 2015 and 2014 (the measurement dates) the employer's contribution rates are approximately 24.3% and 21.1%, respectively, of annual payroll. Employer contribution rates may change if plan contracts are amended. 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 years ended June 30, 2016 and 2015, the contributions recognized as part of pension expense were $0.5 million and $0.3 million, respectively.

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

As of June 30, 2016 and 2015, the Fund reported net pension liabilities for their proportionate share of the net pension liability of $5.4 million and $4.8 million, respectively.

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, 2015, 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, 2014 rolled forward to June 30, 2015 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 (pension and other employee benefit trust 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, 2015 was 0.01921%, which is 0.77% of DWR's proportionate share of 2.49432% and as of June 30, 2014 was 0.01777%, which was 0.77% of DWR's proportionate share of 2.30778%.

For the years ended June 30, 2016 and 2015, the Fund recognized pension expense of negative $1.5 million and $0.3 million, respectively. At June 30, 2016 and 2015, the Fund reported deferred outflows of resources and inflows of resources related to pensions from the following sources (in millions):

	Deferred Outflows of Resources		Deferred Inflows of Resources	
	2016	2015	2016	2015
Contributions subsequent to the measurement date	$ 0.5	$ 0.5	$ -	$ -
Change in proportion	1.2	-	-	-
Differences between expected and actual experience	0.1	-	-	-
Net differences between projected and actual earnings on pension plan investments	-	-	0.1	0.9
Total	$ 1.8	$ 0.5	$ 0.1	$ 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, 2017. 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	
2017	$ 0.4
2018	0.4
2019	0.3
2020	0.1
Total	$ 1.2

Actuarial Assumptions

The June 30, 2014 valuation was rolled forward to determine the June 30, 2015 (measurement date) total pension liability, based on the following actuarial method and assumptions:

Actuarial Cost Method	Entry-Age Normal
Actuarial Assumptions:	
Discount Rate	7.65%
Inflation	2.75%
Salary Increases	Varies (1)
Investment Rate of Return	7.65% (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 expenses, includes 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, 2014 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.

Change of Assumptions

GASB 68, paragraph 68 states that the long-term expected rate of return should be determined net of pension plan investment expense but without reduction for pension plan administrative expense. The discount rate of 7.5 percent used for the June 30, 2014 measurement dates was net of administrative expenses. The discount rate of 7.65 percent used for the June 30, 2015 measurement date is without reduction of pension plan administrative expense.

Discount Rate

The discount rate used to measure the total pension liability was 7.65% 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 of the plans, the test revealed the assets would not run out. Therefore, the current 7.65% discount rate is appropriate and the use of the municipal bond rate calculation is not deemed necessary. The long-term expected discount rate of 7.65% is applied to all plans in the Public Employees Retirement Fund. 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.

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 rate 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 (geometric) returns were calculated for each fund. The expected rate of return was set by calculating the single equivalent 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 following table reflects 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. The target allocation shown was adopted by the CALPERS' Board of Administration effective of July 1, 2014.

Asset Class	New Strategic Allocation	Real Return Years 1 – 10 (a)	Real Return Years 11+ (b)
Global Equity	51.0%	5.25%	5.71%
Global Fixed Income	19.0%	0.99%	2.43%
Inflation Sensitive	6.0%	0.45%	3.36%
Private Equity	10.0%	6.83%	6.95%
Real Estate	10.0%	4.50%	5.13%
Infrastructure and Forestland	2.0%	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 table presents the net pension liability as of the measurement date, calculated using the discount rate of 7.65%, as well as what the net pension liability would be if it were calculated using a discount rate that is 1 percentage-point lower (6.65%) or 1 percentage-point higher (8.65%) than the current rate (amounts in thousands):

	Discount Rate -1% (6.65%)	Discount Rate(7.65%)	Discount Rate +1% (8.65%)
The Fund's Proportionate Share of Plan's Net Pension Liability	$ 7.7	$ 5.4	$ 3.5

9. 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):

	2016	2015
Annual required contribution	$ 0.7	$ 0.8
Interest on net OPEB obligation	0.1	0.1
Adjustment to annual required contribution	(0.1)	(0.1)
Annual OPEB cost (expense)	0.7	0.8
Contributions made	(0.2)	(0.3)
Increase in net OPEB obligation	0.5	0.5
Net OPEB obligation - beginning of year	6.1	5.6
Net OPEB obligation - end of year	$ 6.6	$ 6.1

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, 2016, 2015, and 2014 were as follows (in millions):

Year Ended	Annual OPEB Cost	Percentage of OPEB Cost Contributed	Net OPEB Obligation
6/30/2014	$ 1.7	35%	$ 5.6
6/30/2015	0.8	38%	6.1
6/30/2016	0.7	29%	6.6

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, 2015, which is the latest available.

REQUIRED SUPPLEMENTARY INFORMATION

SCHEDULE OF THE FUND'S PROPORTIONATE SHARE OF THE NET PENSION LIABILITY
As of June 30, 2016
Last 10 Years*
(in millions)

	2016	2015
Measurement Period	2015	2014
The Fund's proportion of the net pension liability	0.01921%	0.01777%
The Fund's proportionate share of the net pension liability	$ 5.4	$ 4.8
The Fund's covered-employer payroll	$ 2.0	$ 1.9
The Fund's proportionate share of the net pension liability as a percentage of their covered-employee payroll	37.68%	39.06%
Plan fiduciary net position as a percentage of the total pension liability	70.68%	73.05%

Notes to Schedule:

Change of benefit terms. In 2016 and 2015, there were no changes to the benefit terms.

Change in assumptions. GASB 68 states that the long-term expected rate of return should be determined net of pension plan investment expenses, but without reduction for pension plan administrative expenses. The discount rate changed from 7.5% (net of adminitrative expenses in 2014) to 7.65% as of the June 30, 2015 measurement date to correct the adjustment, which previously reduced the discount rate for administrative expenses. There were no changes in assumptions for the year ended June 30, 2015.

* Fiscal year 2015 was the 1st year of implementation, therefore only two years are shown.

SCHEDULE OF THE FUND'S CONTRIBUTIONS
As of June 30, 2016
Last 10 Years*
(in millions)

	2016	2015
Contractually required contribution	$ 0.5	$ 0.5
Contribution in relation to the contractually required contribution	0.5	0.5
Contribution deficiency (excess)	$ -	$ -
Fund's covered-employee payroll	$ 2.1	$ 2.0
Contributions as a percentage of covered-employee payroll	25.46%	24.28%

Notes to Schedule:

The actuarial method and assumptions used to determine contribution rates for year ended June 30, 2016 were from the June 30, 2014 Valuation Date.

Actuarial Cost Method	Entry-Age Normal
Actuarial Assumptions:	
Inflation	2.75%
Salary Increase	Varies (1)
Payroll Growth	3.0%
Investment Rate of Return	7.5%(2)
Retirement Age	2014 Experience Study(3)
Mortality	2014 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 2014 CalPERS Experience Study for the period from 1997 to 2011.
(4) The probabilities of mortality are based on the 2014 CalPERS Experience Study for the period from 1997 to 2011. Pre-retirement and Post-retirement mortality rates include 20 years of projected mortality improvement using Scale BB published by the Society of Actuaries.

*Fiscal year 2015 was the 1st year of implementation, therefore only two years are shown.

Certified Public Accountants

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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 (Department) Electric Power Fund (Fund) of the State of California, as of and for the year ended June 30, 2016, and the related notes to financial statements, and have issued our report thereon dated October 19, 2016.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Department'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 Department's internal control as it relates to the Fund. Accordingly, we do not express an opinion on the effectiveness of the Department'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 Department'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 of 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 19, 2016