

CITY OF LOS ANGELES
SEWER CONSTRUCTION AND MAINTENANCE FUND
(An Enterprise Fund of the City of Los Angeles)

Financial Statements and
Required Supplementary Information

For the Fiscal Years Ended June 30, 2015 and 2014
(With Independent Auditor's Report Thereon)



Certified
Public
Accountants

CITY OF LOS ANGELES
SEWER CONSTRUCTION AND MAINTENANCE FUND
Financial Statements and Required Supplementary Information
For the Fiscal Years Ended June 30, 2015 and 2014

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Independent Auditor's Report

Honorable Members of the City Council
City of Los Angeles, California

Report on the Financial Statements

We have audited the accompanying financial statements of the City of Los Angeles Sewer Construction and Maintenance Fund (Fund), an enterprise fund of the City of Los Angeles, California, as of and for the fiscal years ended June 30, 2015 and 2014, and the related notes to the 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.

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the City of Los Angeles Sewer Construction and Maintenance Fund as of June 30, 2015 and 2014, and the changes in its financial position and its cash flows for the fiscal years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matters

Basis of Presentation

As discussed in Note 1 to the financial statements, the financial statements present only the Fund and do not purport to, and do not, present fairly the financial position of the City of Los Angeles, California, as of June 30, 2015 and 2014, the changes in its financial position, or, where applicable, its cash flows for the fiscal 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 the management's discussion and analysis on pages 3 through 13 be presented to supplement the financial statements. Such information, although not a part of the financial statements, is required by the GASB 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 February 5, 2016 on our consideration of the Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on 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 Fund's internal control over financial reporting and compliance.



Los Angeles, California
February 5, 2016

CITY OF LOS ANGELES
SEWER CONSTRUCTION AND MAINTENANCE FUND
Management's Discussion and Analysis
June 30, 2015 and 2014
(Unaudited)

The City of Los Angeles' (City) Sewer Construction and Maintenance Fund (Fund) is one of the major funds of the City. It is structured as an enterprise fund by virtue of City Ordinance No. 140190 effective on May 11, 1970, and as amended by City Ordinance No. 162864 effective on November 22, 1987. The Fund accounts for the City's wastewater collection and treatment systems.

This section of the financial report of the Fund presents our discussion and analysis of the Fund's financial performance for the fiscal years ended June 30, 2015 and 2014 and should be read in conjunction with the Fund's financial statements that begin on page 15. Descriptions and other details pertaining to the Fund are included in the notes to the Fund financial statements (Notes). A reference to the Notes is indicated where applicable.

OVERVIEW OF THE FINANCIAL REPORT

The Fund's financial statements are prepared on an accrual basis of accounting in accordance with generally accepted accounting principles (GAAP) practiced in the United States of America.

This financial report consists of management's discussion and analysis (MD&A) and basic financial statements, which includes the accompanying notes to the basic financial statements.

The *statement of net position* presents information on the Fund's assets, deferred outflows of resources, liabilities, and deferred inflows of resources. The fund's total assets and deferred outflows of resources minus total liabilities and deferred inflows of resources result to the fund's *net position*. Deferred outflows of resources and deferred inflows of resources are consumption or acquisition, respectively, of net position that are applicable to future periods, as distinguished from assets and liabilities. Net position indicates the net worth of the fund. Over time, increases and decreases in net position may serve as a useful indicator of whether the financial position of the fund is improving or deteriorating.

The *statement of revenues, expenses and changes in net position*, presents information that shows how the Fund's net position changed between the recent fiscal years. All changes in net position are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the related cash flows.

The *statement of cash flows* present the cash provided and used by operating activities, as well as other cash sources and uses, including but not limited to, investment income, proceeds from issuance of long-term debt, payments for bond principal and interest, and capital assets additions and betterments.

CITY OF LOS ANGELES
SEWER CONSTRUCTION AND MAINTENANCE FUND
Management's Discussion and Analysis (Continued)
June 30, 2015 and 2014
(Unaudited)

FINANCIAL HIGHLIGHTS AND ANALYSIS

The following tables summarize the Fund's financial condition and changes in net position as of the fiscal years ended June 30, 2015 and 2014.

Table 1 – Schedule of Assets, Liabilities and Net Position
(in thousands)

	2015	2014
ASSETS		
Current assets		
Cash and pooled investments held by the City Treasurer - unrestricted	\$ 130,251	\$ 118,576
Cash and pooled investments held by the City Treasurer - restricted	315,548	218,101
Accounts receivable, net of allowance for doubtful accounts of \$4,353 and \$4,090 for 2015 and 2014, respectively	111,409	96,111
Accrued unbilled revenue	43,274	34,135
Intergovernmental receivable	147	2,613
Due from other City funds	2,649	7,949
Investment income receivable	575	459
Materials and supplies inventory	15,012	14,297
Total current assets	618,865	492,241
Noncurrent assets		
Restricted assets		
Cash and pooled investments held by the City Treasurer	107,703	102,082
Cash held in escrow	3,379	3,817
Total restricted assets	111,082	105,899
Capital assets		
Not depreciated	451,709	327,234
Depreciated, net of accumulated depreciation of \$3,424,210 and \$3,280,838 for 2015 and 2014, respectively	3,539,154	3,567,957
Total capital assets	3,990,863	3,895,191

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Management's Discussion and Analysis (Continued)
June 30, 2015 and 2014
(Unaudited)

	2015	2014
Other noncurrent assets		
Advances to other City funds	41,020	39,156
Intergovernmental receivable	33,706	33,786
Total other noncurrent assets	74,726	72,942
Total noncurrent assets	4,176,671	4,074,032
TOTAL ASSETS	4,795,536	4,566,273
 DEFERRED OUTFLOWS OF RESOURCES		
Deferred loss on debt refundings	114,563	104,724
Deferred outflows on derivative instruments	26,759	25,457
TOTAL DEFERRED OUTFLOWS OF RESOURCES	141,322	130,181
 TOTAL ASSETS AND DEFERRED OUTFLOWS OF RESOURCES	\$ 4,936,858	\$ 4,696,454
 LIABILITIES		
Current liabilities		
Accounts, contracts and retainage payable	\$ 51,616	\$ 24,878
Interest payable	10,796	11,190
Current portion of due to other City funds	3,120	3,078
Current portion of long-term debt	88,228	84,675
Current portion of claims payable	681	1,638
Total current liabilities	154,441	125,459
Noncurrent liabilities		
Due to other City funds, net of current portion	22,118	22,041
Long-term debt, net of current portion	2,887,048	2,770,717
Claims payable, net of current portion	6,661	30,216
Derivative instrument liabilities	26,759	25,457
Unearned revenue	4,348	4,348
Total noncurrent liabilities	2,946,934	2,852,779
TOTAL LIABILITIES	3,101,375	2,978,238
 TOTAL DEFERRED INFLOWS OF RESOURCES		
Deferred gain on debt refundings	494	-
NET POSITION		
Net investment in capital assets	1,490,409	1,398,714
Restricted		
Debt service	17,555	20,538
Operations and maintenance and other reserves	45,437	45,454
Unrestricted	281,588	253,510
TOTAL NET POSITION	\$ 1,834,989	\$ 1,718,216

CITY OF LOS ANGELES
SEWER CONSTRUCTION AND MAINTENANCE FUND
Management's Discussion and Analysis (Continued)
June 30, 2015 and 2014
(Unaudited)

	2015	2014
OPERATING REVENUES		
Sewer service charges	\$ 524,807	\$ 513,154
Wastewater service contracts	21,902	22,417
Industrial waste surcharges	18,025	16,782
Sewerage facilities charges	17,224	12,079
Other operating revenues	12,066	7,138
Total operating revenues	594,024	571,570
 OPERATING EXPENSES		
Operations and maintenance	289,498	265,284
Depreciation	143,461	144,250
Total operating expenses	432,959	409,534
 OPERATING INCOME	161,065	162,036
 NON-OPERATING REVENUES (EXPENSES)		
Investment income	2,426	2,202
Interest expense	(96,616)	(99,956)
Other non-operating revenues (expenses)	27,252	(21,718)
Total non-operating expenses	(66,938)	(119,472)
Income before capital contributions	94,127	42,564
Capital contributions	22,646	12,674
 CHANGE IN NET POSITION	116,773	55,238
NET POSITION, BEGINNING OF YEAR	1,718,216	1,662,978
NET POSITION, END OF YEAR	\$ 1,834,989	\$ 1,718,216

CITY OF LOS ANGELES
SEWER CONSTRUCTION AND MAINTENANCE FUND
Management's Discussion and Analysis (Continued)
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Assets

Capital Assets

Of the total assets and deferred outflows of resources, capital assets comprises 80.8%. Net capitalized additions and betterments to the Fund's depreciable assets, including transfers from construction in progress, amounted to \$114.7 million. Of this amount, \$68.9 million was capitalized for project data collection systems and \$31.8 million for treatment plants and equipment. \$13.4 million was acquired for other equipment and vehicles including maintenance yards and \$0.5 million was acquired for pumping plants. Charges to the construction in progress totaled \$124.5 million net of \$64.8 million transferred from construction-in-progress.

In fiscal year 2014, capital assets comprised 82.9% of the total assets and deferred outflows of resources, of which net capitalized additions and betterments to the Fund's depreciable assets, including transfers from construction in progress, amounted to \$117.1 million. Of this amount, \$20.3 million was capitalized for treatment plants and equipment, while \$85.9 million was capitalized for the wastewater collection system. Charges to the construction in progress totaled \$58.7 million net of \$55.6 million transferred from construction in progress.

The ongoing capital improvement program (CIP) of the Fund includes Secondary Sewer Renewal Program for \$25.0 million in fiscal year 2015 and \$45.0 million in 2014. There were no significant improvements for the 4th Avenue Slauson Sewer Rehabilitation and the Hyperion Treatment Plant Auxiliary Boiler No. 2 Replacement in fiscal year 2015 compared to \$14.0 million and \$8.0 million respectively in fiscal year 2014. Additional CIP large projects capitalized during fiscal year 2015 are the Central Outfall Sewer Rehabilitation Market Street to Slauson Avenue, \$23.0 million, the Central Outfall Sewer at 59th Street and Fourth Avenue, \$8.0 million, and the Los Angeles Glendale Water Reclamation Plant Electrical Power System Modification, \$6.0 million.

The objectives of the Fund's CIP are to meet Federal and State requirements and City policy regarding water pollution control; to provide satisfactory levels of service to users of the wastewater system; and to maintain the integrity of the wastewater system. The CIP includes installation of major interceptor sewers, renovation or replacement of other major sewers and pumping stations, and modernization and upgrading of wastewater treatment or reclamation facilities.

Liabilities and Fund Net Position

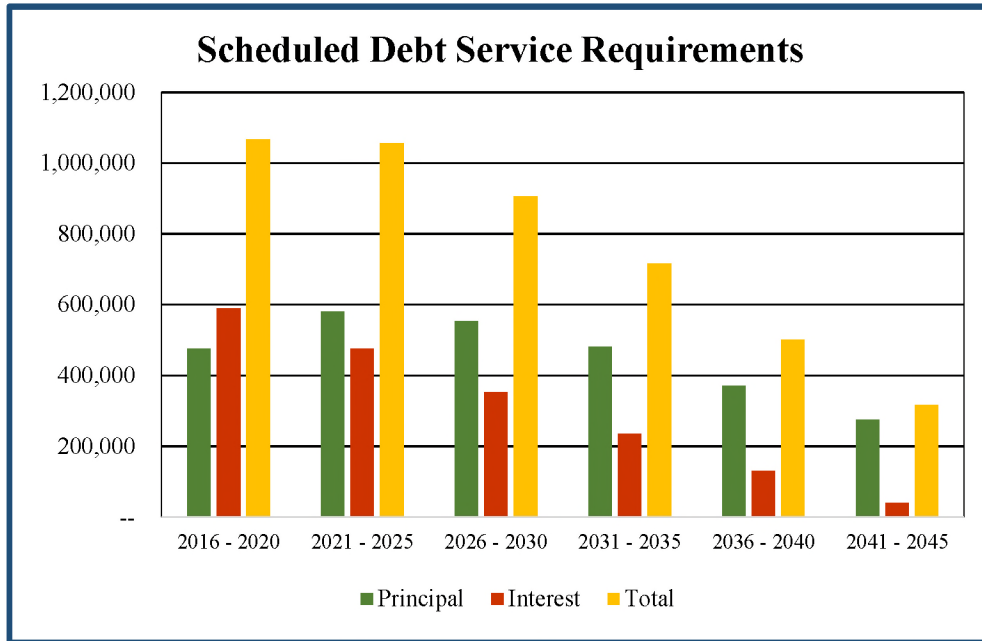
Long-term Debt

As of June 30, 2015, the Fund's total long-term debt balance was \$2,975 million and \$2,855 million in fiscal year 2014. The net increase of \$120 million or 4.2% was mainly due to the issuance of Series 2015A bonds in June 2015, offset by the scheduled principal payments and bond refunding.

As of June 30, 2014, the Fund's total long-term debt balance was \$2,855 million, a slight net increase of \$13.0 million or 0.5% from the prior fiscal year balance of \$2,842 million. The increase was mainly due to the issuance of commercial paper notes of \$110.0 million, bond redemption, and amortization of bond premium of \$72.0 million and \$24.2 million, respectively.

CITY OF LOS ANGELES
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The Fund's long-term debt final maturities range from June 1, 2016 to June 1, 2045. The total debt service for the next fiscal year 2016 is \$213.3 million, of which \$125.1 million and \$88.2 million is for interest and principal, respectively. The scheduled annual debt service (principal maturities and interest payments) requirements from June 30, 2016 to June 30, 2045 are presented in the chart below.



The Fund's bond issuances maintained high bond ratings. The most recent ratings of the senior debt were "AA+" by Standard & Poor's Rating Services, Fitch Ratings and Kroll Ratings.

Derivative Instruments

The Fund has recorded the fair value of interest rate swaps and corresponding deferred outflows on the statement of net position as of June 30, 2015 for \$26.7 million. The interest rate swaps meet the definition of effective hedging derivatives in accordance with the GASB Statement No. 53, "Accounting and Financial Reporting for Derivative Instruments."

Fund Net Position

Of the total fund net position of \$1.84 billion in fiscal year 2015, 81.2% reflects the Fund's significant net investment in capital assets, compared to 81.4% in fiscal year 2014. The increase was mainly due to the unspent Series 2015A bond proceeds that was issued in June 2015. The Fund uses this portion of net position to provide services to the citizens and contract agencies using the City's wastewater collection and treatment facilities, and therefore, these assets are not available for future spending. An additional 3.4% of the fund net position is restricted for debt service and operations and maintenance. The remaining 15.4% of the total fund net position (14.8% in fiscal year 2014) consist of the unrestricted portion which may be used to meet the Fund's ongoing obligations for operations and maintenance, other debt service and other capital projects expenses.

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Of the total fund net position of \$1.7 billion in fiscal year 2014, 81.4% reflects the Fund's significant investments in capital assets, net of related debts, compared to 81.3% in fiscal year 2013. The increase was mainly due to the net increase in long term debts as discussed under the long term debt section above. The Fund uses this portion of net position to provide services to the citizens and contract agencies using the City's wastewater collection and treatment facilities, and therefore, these assets are not available for future spending. Another restricted portion of the Fund's net position is 3.8% (3.8% in fiscal year 2013) which represents the resources that are restricted for debt service, capital construction projects, operations and maintenance and other reserves required by bond covenants. The remaining 14.8% of the total fund net position (14.9% in fiscal year 2013) consist of the unrestricted portion which may be used to meet the Fund's ongoing obligations for operations and maintenance, debt service and capital projects expenses.

The Fund has restated the beginning net position in fiscal year 2014, which decreased the Fund's beginning net position by \$14.1 million. The restatement was to reflect the write off of unamortized bond issuance costs incurred in prior years previously reported as an asset. In addition, the remaining unamortized loss on refunding in the amount of \$113.7 million in fiscal year 2013 was reclassified from a contra liability account to deferred outflows of resources. The changes are a result of GASB Statement No. 65 implementation.

Revenues, Expenses and Changes in Fund Net Position

Operating Revenues

The Fund recovers the cost of operations and maintenance and a portion of major capital expenditures of the City's wastewater system through a user fee consisting of five major components enumerated below, in addition to Federal and State grants, interest earnings and miscellaneous revenues. The five components of the user fees currently imposed by the City are:

Sewer Service Charge: This charge is based on metered water usage and includes reduced rates for low income households and a compensating surcharge for non-low income households and commercial customers.

Sewerage Facilities Charge: This charge is designed to recover the cost of the system capacity required by new sewer connections and increases in capacity required by current users.

Wastewater Service Contract: The City provides wastewater conveyance, treatment and disposal services to certain local entities. Payments from these entities provide for reimbursement of capital and operation and maintenance expenses.

Industrial Wastewater Surcharge and Fees: The Quality Surcharge Fee is designed to recover the costs related to suspended solids and biochemical oxygen demand strengths above normal or domestic strength values as well as cost for administering and maintaining the surcharge program. Industrial Wastewater Permit Application Fee is designed to recover the costs required to process permit applications for applicable users. Inspection and Control Fee is designed to recover the costs of necessary inspections of permitted users. Significant Industrial User Fee recovers a portion of additional costs incurred in monitoring and inspection of certain industrial users subject to EPA categorical pretreatment requirements.

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Management's Discussion and Analysis (Continued)
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Miscellaneous Fee: These include bonded sewer fee, septage fee, sewer tap fee and other miscellaneous revenue sources.

For fiscal year 2015, the Fund generated total operating revenues of \$594 million, an increase of \$22.4 million or 3.9% from fiscal year 2014. Sewer service charges increased by \$11.6 million or 2.3% from fiscal year 2014, generating \$524.8 million or 88.4% of the total operating revenues.

In fiscal year 2014, the Fund's total operating revenues was \$571.6 million, which decreased by \$5.5 million or 0.95% from fiscal year 2013. \$513.2 million or 89.8% of the total operating revenues were from sewer service charges, which decreased by \$16.6 million or 3.1% compared to fiscal year 2013.

Ordinance No. 182076 dated March 1, 2012 authorized an increase of 4.5% in sewer service charge from users of water on July 1, 2013. The Ordinance also authorized a series of increases of 6.5% every July 1st from July 1, 2014 through fiscal year 2021.

Customers Class and Wastewater Volume

The Fund has five major customer classes. These classes include single family, small multi-family, large multi-family, commercial/industrial and other. There was no significant change in the number of customers and billable wastewater volume subject to sewer service charges in fiscal years 2015 compared to fiscal year 2014.

The wastewater volume for single family and small multi-family dwellings of up to four units, representing 86.0% of total wastewater system customers for both fiscal years 2015 and 2014, is based on each residential customer's minimum average daily water consumption during winter, further reduced by a dry winter compensation factor.

The default billable wastewater volume for large multi-family, commercial/industrial and other customers, representing the remaining 14.0% of total wastewater system customers, is 93% of their total annual water consumption. All customers who can demonstrate that their billable wastewater volume is less than 74% of their annual water consumption can be billed at the lower estimate.

During fiscal year 2015, wastewater system customers were 627,000, a 4,000 or 0.6% reduction from fiscal year 2014 of 631,000. This follows a 4.4% reduction from 2013 to 2014. In fiscal year 2015, total billable wastewater volume was 142.0 million cubic feet, a 3.3% or 4.9 million cubic feet reduction compared to fiscal year 2014's 146.9 million cubic feet. The apparent reductions in the number of customers were due to the September 2013 implementation of a new billing system by the Los Angeles Department of Water and Power (LADWP), the billing agent for the sewer service charges. With the new system, a single customer account can include service at multiple addresses and have multiple service agreements per address. These were treated as separate accounts under the old system; therefore, there is no true reduction in the number of customers, just in the way they are reported. The reduction in billable wastewater volume reflects water conservation in California's ongoing drought.

CITY OF LOS ANGELES
SEWER CONSTRUCTION AND MAINTENANCE FUND
Management's Discussion and Analysis (Continued)
June 30, 2015 and 2014
(Unaudited)

Operating Expenses

The Fund's major operating expenses include operations and maintenance expenses and reimbursements to the General Fund for services rendered to the Fund. The Fund's operating expenses for fiscal years 2015 was \$432.9 million which increased by \$23.4 million or 5.7% compared to fiscal year 2014. The increase was mainly due to adjustments and labor and non-labor expenses for \$18.6 million and the net effect of the adjustments in the allowance for uncollectible receivables for sewer service charges provided by the Los Angeles Department of Water and Power (DWP) for \$8.3 million in the previous year. DWP is the billing agent of the fund for sewer service charges.

For fiscal year 2014, operating expenses decreased by \$36.2 million or 8.1%. Operation and maintenance expenses decreased by \$14.3 million or 5.1% compared to fiscal year 2013. The decrease was mainly due to a decrease of \$21.9 million and \$10.2 million in depreciation and capitalized costs, respectively; and a decrease of \$8.3 million in uncollectible expense as a result of a change in the collection protocols of the Los Angeles Department of Water and Power (LADWP), the billing agent for the sewer service charges.

Non-operating Revenues

Major components of non-operating revenues are investment income, grants, non-recurring fees and other non-operating revenues. Interest rate on the Fund's investment pool reflects the current economic trend which averaged 0.50% in fiscal year 2015, a decrease of 0.11% from fiscal year 2014. The Fund's investment income for fiscal year 2015 was \$2.4 million, a 10.2% increase from fiscal year 2014. The Fund's other non-operating revenues for fiscal years 2015 and 2014 were \$10.9 million and \$10.8 million, respectively.

The Fund's investment income for fiscal year 2014 was \$2.2 million as compared to an investment loss of \$0.5 million in fiscal year 2013. The Fund's other non-operating revenues for fiscal years 2014 and 2013 were \$10.8 million and \$12.4 million, respectively.

Non-operating Expenses

Major components of the non-operating expenses are interest expense, litigation settlement, and other non-operating expenses. The Fund's interest expense for fiscal years 2015 and 2014 were \$96.6 million and \$99.9 million, respectively; the decrease of \$3.4 million or 3.4% was mainly due to the refunding of old bonds. Other non-operating expenses for fiscal year 2015 was (\$16.3) million, a 150.3% decrease from fiscal year 2014 of \$32.5 million. The significant decrease in other non-operating expenses was due to the reversal of a \$24.0 million prior year accrual for litigation settlement.

For fiscal year 2014, interest expense decreased by \$8.9 million or 8.2% mainly due to the refunding of portions or all of Subordinate or Senior Series 2003-A, 2003-B, Series 2005-A, and Series 2008 A-H in the prior year. Other non-operating expenses increased by \$17.3 million or 113.7% primarily due to increase in litigation settlement expenses of \$26.4 million offset by a decrease in loss on abandonment of \$8.4 million and \$2.3 million in bond and note fees.

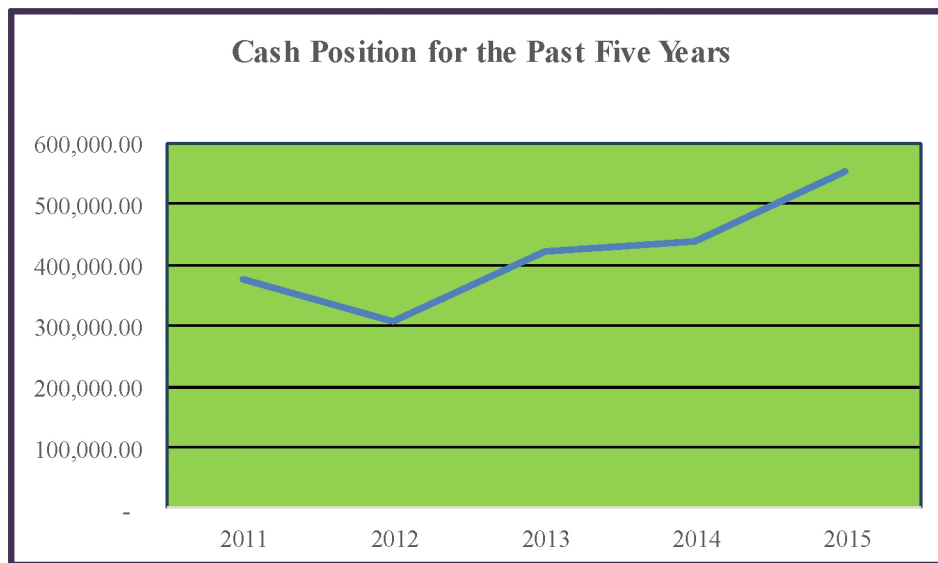
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Capital Contributions

Certain agencies located outside the City receive wastewater disposal service from the City by contract. These agencies share the costs of the City's treatment and reclamation plants and of the City's larger trunk sewers (known as the Amalgamated System). The agencies pay shares of the operation and maintenance and capital costs of the Amalgamated System as the costs are incurred by the City and do not participate in the City's debt financing program. Payment received from these billings is recorded in the Fund's financial statements as capital contribution, stated at gross amount, without any adjustments for abandonment and maintenance costs. Capital contributions for fiscal years 2015 and 2014 amount to \$22.6 million and \$12.7 million, respectively.

Cash Position

Cash and pooled investments held by the City Treasurer in the Statement of Net Position and Statement of Cash Flows include adjustments for the increase or decrease in the fair market value (FMV) of investments (see Note 1 of the Notes to Basic Financial Statements). The cash position of the Fund without the adjustment for the increase or decrease in the FMV of investments is shown in the chart below.



As of June 30, 2015, the cash position of the Fund was \$553.5 million, an increase of \$114.7 million over last fiscal year's cash position of \$438.8 million or 26.2%. The increase was mainly due to the proceeds from the issuance of Series 2015A Senior Bonds in June 2015, net of issuance costs and refunding of old bonds.

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SEWER CONSTRUCTION AND MAINTENANCE FUND
Management's Discussion and Analysis (Continued)
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Requests for Information

This financial report is designed to provide interested parties, public and private sector alike, a general overview of the Fund's financial performance for fiscal year 2015. Questions concerning any of the information presented in this report or requests for additional financial information should be addressed to Victoria A. Santiago, Director, Department of Public Works Office of Accounting, City Hall 9th Floor, 200 North Spring Street, Los Angeles, CA 90012.

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CITY OF LOS ANGELES
SEWER CONSTRUCTION AND MAINTENANCE FUND

Statements of Net Position (Continued)

June 30, 2015, and 2014

(amounts expressed in thousands)

	2015	2014
ASSETS		
Current assets		
Cash and pooled investments held by the City Treasurer - unrestricted	\$ 130,251	\$ 118,576
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TOTAL ASSETS AND DEFERRED OUTFLOWS OF RESOURCES	\$ 4,936,858	\$ 4,696,454

(Continued)

CITY OF LOS ANGELES
SEWER CONSTRUCTION AND MAINTENANCE FUND
 Statements of Net Position (Continued)
 June 30, 2015, and 2014
 (amounts expressed in thousands)

	2015	2014
LIABILITIES		
Current liabilities		
Accounts, contracts and retainage payable	\$ 51,616	\$ 24,878
Interest payable	10,796	11,190
Current portion of due to other City funds	3,120	3,078
Current portion of long-term debt	88,228	84,675
Current portion of claims payable	681	1,638
Total current liabilities	154,441	125,459
Noncurrent liabilities		
Due to other City funds, net of current portion	22,118	22,041
Long-term debt, net of current portion	2,887,048	2,770,717
Claims payable, net of current portion	6,661	30,216
Derivative instrument liabilities	26,759	25,457
Unearned revenue	4,348	4,348
Total noncurrent liabilities	2,946,934	2,852,779
TOTAL LIABILITIES	3,101,375	2,978,238
 TOTAL DEFERRED INFLOWS OF RESOURCES		
Deferred gain on debt refundings	494	-
 NET POSITION		
Net investment in capital assets	1,490,409	1,398,714
Restricted		
Debt service	17,555	20,538
Operations and maintenance and other reserves	45,437	45,454
Unrestricted	281,588	253,510
TOTAL NET POSITION	\$ 1,834,989	\$ 1,718,216

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

CITY OF LOS ANGELES
SEWER CONSTRUCTION AND MAINTENANCE FUND
 Statements of Revenues, Expenses and Changes in Net Position
 For the Fiscal Years Ended June 30, 2015 and 2014
 (amounts expressed in thousands)

	<u>2015</u>	<u>2014</u>
OPERATING REVENUES		
Sewer service charges	\$ 524,807	\$ 513,154
Wastewater service contracts	21,902	22,417
Industrial waste surcharges	18,025	16,782
Sewerage facilities charges	17,224	12,079
Other operating revenues	12,066	7,138
Total operating revenues	<u>594,024</u>	<u>571,570</u>
OPERATING EXPENSES		
Operations and maintenance	289,498	265,284
Depreciation	143,461	144,250
Total operating expenses	<u>432,959</u>	<u>409,534</u>
OPERATING INCOME	<u>161,065</u>	<u>162,036</u>
NON-OPERATING REVENUES (EXPENSES)		
Investment income	2,426	2,202
Interest expense	(96,616)	(99,956)
Other non-operating revenues (expenses)	27,252	(21,718)
Total nonoperating expenses	<u>(66,938)</u>	<u>(119,472)</u>
Income before capital contributions	94,127	42,564
Capital contributions	<u>22,646</u>	<u>12,674</u>
CHANGE IN NET POSITION	116,773	55,238
NET POSITION, BEGINNING OF YEAR	<u>1,718,216</u>	<u>1,662,978</u>
NET POSITION, END OF YEAR	<u>\$ 1,834,989</u>	<u>\$ 1,718,216</u>

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

CITY OF LOS ANGELES
SEWER CONSTRUCTION AND MAINTENANCE FUND
 Statements of Cash Flows
 For the Fiscal Years Ended June 30, 2015 and 2014
 (amounts expressed in thousands)

	2015	2014
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from customers	\$ 580,499	\$ 546,106
Receipts from interfund services	3,555	3,784
Payments to suppliers for goods and services	(24,537)	(81,765)
Payments for interfund services	(238,500)	(202,044)
Net cash provided by operating activities	321,017	266,081
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Amounts received on advances to other funds	--	70
Cash received from noncapital grants	2,466	1,418
Net cash provided by noncapital financing activities	2,466	1,488
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Acquisition and construction of capital assets	(237,378)	(180,716)
Payments on construction litigation settlement	--	(9,055)
Proceed from sale of bonds and notes	524,276	110,000
Payments on bonds and notes - principal	(375,125)	(71,977)
Payments on bonds and notes - interest	(111,850)	(119,011)
Payments of bonds and notes expenses	(5,067)	(1,208)
Deposits to refunds debt escrow account	(24,200)	-
Sewage disposal contracts capital contributions	18,294	12,153
Interest subsidies from U.S. Treasury	--	5,467
Net cash used for capital and related financing activities	(211,050)	(254,347)
CASH FLOWS FROM INVESTING ACTIVITIES		
Investment income	2,310	2,203
Net cash provided by investing activities	2,310	2,203
Net increase in cash and cash equivalents	114,743	15,425
CASH AND CASH EQUIVALENTS, JULY 1	438,759	423,334
CASH AND CASH EQUIVALENTS, JUNE 30	\$ 553,502	\$ 438,759

(Continued)

CITY OF LOS ANGELES
SEWER CONSTRUCTION AND MAINTENANCE FUND

Statements of Cash Flows (Continued)
For the Fiscal Years Ended June 30, 2015 and 2014
(amounts expressed in thousands)

	2015	2014
CASH AND CASH EQUIVALENTS COMPONENTS:		
Cash and pooled investments held by the City Treasurer		
Unrestricted	\$ 130,251	\$ 118,576
Restricted		
Current	315,548	218,101
Noncurrent	107,703	102,082
Cash and cash equivalents, June 30	553,502	\$ 438,759
 RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Operating income	161,065	\$ 162,036
Adjustments to reconcile operating income to net cash provided by operating activities		
Depreciation	143,461	144,250
Provision for uncollectible accounts	263	(4,330)
Cash provided by other nonoperating revenues	5,458	5,330
Changes in assets and liabilities		
Accounts receivable and accrued unbilled revenue	(19,758)	(22,680)
Materials and supplies inventory	(715)	(119)
Accounts, contracts and retainage payable	27,176	3,142
Claims payable/Other liabilities	512	3,391
Due to other City Funds	3,555	(24,939)
Total adjustments	159,952	104,045
 NET CASH PROVIDED BY OPERATING ACTIVITIES	 321,017	 \$ 266,081
 NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES:		
Net proceeds of refunding bonds deposited with an irrevocable trust account	\$ 157,473	-
Amortization of deferred loss on debt refundings	9,345	8,921
Acquisition of capital assets included in liabilities	40,872	16,293
Loss on abandonment of capital assets	2,764	3,898
Wastewater service contracts capital contributions	586	521

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

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CITY OF LOS ANGELES
SEWER CONSTRUCTION AND MAINTENANCE FUND

Notes to the Fund Financial Statements
June 30, 2015 and 2014

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization and Reporting Entity

The City of Los Angeles (City) Sewer Construction and Maintenance Fund (Fund) was established as an enterprise fund of the City by City Ordinance No. 140190 on May 11, 1970, which was later amended by City Ordinance No. 162864 effective on November 22, 1987. The Fund was established to account for the operations of the City's wastewater collection and treatment system. All monies received from sewer fees are deposited to the Fund and are expended only for sewerage related purposes.

The Fund is reported as a major enterprise fund in the City's basic financial statements presented in its Comprehensive Annual Financial Report. The accompanying financial statements present the net position and changes in net position and cash flows of the Fund. These financial statements are not intended to present the financial position and the results of operation and cash flows of the City.

Basis of Accounting and Financial Statement Presentation

The Fund is reported as an enterprise fund and maintains its records on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America (GAAP) as promulgated by the Governmental Accounting Standards Board (GASB). Under this method, revenues are recorded when earned and expenses are recorded when the related liability is incurred.

Cash, Cash Equivalents, and Investments

The Fund's cash, cash equivalents, and investments and a significant portion of its restricted cash and investments are maintained as part of the City's pool of cash and investments. The Fund's portion of the pool is presented on the statements of net position as "Cash and Pooled Investments held by the City Treasurer." The Fund's investments, including its share in the City's investment pool, are stated at fair value based on quoted market prices except for money market investments that have remaining maturities of one year or less at time of purchase, which are reported at amortized cost. Interest earned on such pooled investments is allocated to the participating City funds based on each fund's average daily cash balance during the allocation period.

As permitted by the California Government Code, the City engages in securities lending activities. The Fund's share of assets and liabilities arising from the reinvested cash collateral has been recognized in the statements of net position.

The Fund considers its unrestricted and restricted cash and pooled investments held in the City Treasury as demand deposits and therefore these amounts are reported as cash equivalents. Investments with maturities of three months or less at the time of purchase are considered cash equivalents.

For the purpose of reporting cash flows, the Fund's cash and pooled investments held by the City Treasurer plus any other cash deposits or other short-term investments that are both readily convertible to known amounts of cash and have maturity dates of three months or less at the time of purchase, are considered to be cash and cash equivalents.

CITY OF LOS ANGELES
SEWER CONSTRUCTION AND MAINTENANCE FUND
Notes to the Fund Financial Statements (Continued)
June 30, 2015 and 2014

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Cash Held in Escrow

Agreements with the City allow contractors to place securities or cash in escrow with banks, pending satisfactory completion of a contract, in lieu of retention. Such balances are reported as restricted assets and retainage payable on the statements of net position.

Accounts Receivable and Unbilled Receivables

The Fund recognizes revenue in the period earned. In general, receivables outstanding beyond 70 days from the invoice date are put into the collection process and referred to the City’s collection agency for amounts under \$5,000, and Office of Finance for those \$5,000 or more. Allowance for uncollectible accounts for sewer services charges amount to 3% of outstanding receivables based on the Los Angeles Department of Water and Power (LADWP) report. Allowance for uncollectible accounts for industrial wastewater surcharges amount to 80% of active accounts over 120 days, 100% of all inactive accounts, and 100% of pending accounts over 120 days.

Materials and Supplies Inventory

Materials and supplies inventory is valued at weighted average cost.

Capital Assets

Purchased or constructed capital assets including intangible assets are valued at historical cost or estimated historical cost if actual historical cost is not available. Estimated historical cost is computed by deflating current replacement costs to the year in which the asset was purchased or constructed. The dollar value threshold amounts for capitalization are as follows:

Buildings and structures	\$25,000
Collection system	\$25,000
Site improvements	\$10,000
Equipment and vehicles	\$ 5,000

The Fund capitalizes interest costs of bond borrowings used during construction. Interest costs capitalized during the fiscal years ended June 30, 2015 and 2014 were \$5.2 million and \$2.9 million, respectively.

Depreciation

Depreciation is computed on a straight-line basis over the estimated useful life of the related asset. The estimated useful lives of property, plants and equipment are as follows:

Collection system	80 years
Site improvements	40 years
Treatment plants and equipment	5 – 50 years
Pumping plants and equipment	7 – 40 years
Other equipment and vehicles	3 – 15 years

CITY OF LOS ANGELES
SEWER CONSTRUCTION AND MAINTENANCE FUND
Notes to the Fund Financial Statements (Continued)
June 30, 2015 and 2014

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Self-Insurance Program

The City is self-insured for workers' compensation, general, automobile and public liability claims. The City's self-insurance program is administered by the General Fund. Claims from the Fund are charged to the Fund based on estimated cash payment in the following fiscal year.

The Fund has commercial insurance for risks of physical damage to real and personal properties and for business interruption expenses. Claims settlements have not exceeded commercial insurance coverage during the last three fiscal years.

Employee Compensation

The Fund has no direct employees. All services related to wastewater collection and treatment operations are performed by employees of the City's General Fund. The Fund reimburses the City's General Fund on a monthly basis based on the budgeted costs of providing these services and adjusts such reimbursements to actual costs at year-end. Compensated absences related to the General Fund employees providing services to the Fund are accrued in accordance with the City policy and are included in Due to Other City Funds.

Revenue Recognition

The Fund's user charges, such as sewer service charges, industrial waste surcharges, wastewater service contract revenues, and sewerage facilities charges, are adopted by the City Council based on estimated operations and maintenance costs and a portion of capital replacement costs. Except for sewerage facilities charges which are recognized as income when cash is collected, the rest of the user charges are recognized as income when the service is provided.

Certain capital improvements are financed by the Federal and State of California (State) grants. When eligible costs are incurred, grant revenue with a corresponding grant receivable are recognized. Disaster assistance grants from Federal and State agencies are recognized as revenue when the damage survey report is approved by grantor agencies and eligible expenses have been incurred by the Fund.

The capital component of wastewater service contracts that represents capital contributions from contracting agencies using the City's wastewater collection and treatment system is recognized as capital contributions in the statements of revenues, expenses and changes in net position.

Operating and Non-operating Revenues and Expenses

Operating revenues and expenses generally result and occur, respectively, from providing services and producing and delivering goods in connection with the Fund's normal and regular ongoing operations. The Fund's major operating expenses include operations and maintenance expenditures. All revenues and expenses that do not meet this definition are reported as non-operating revenues and expenses.

CITY OF LOS ANGELES
SEWER CONSTRUCTION AND MAINTENANCE FUND
Notes to the Fund Financial Statements (Continued)
June 30, 2015 and 2014

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Premiums and Discounts

Bond premiums and discounts are deferred and amortized over the life of the bonds. Bonds payable is reported net of the applicable bond premium or discount.

Deferred Outflows/Inflows of Resources

Deferred outflows and inflows of resources is defined as a consumption and acquisition of net position applicable to a future reporting period. Unamortized gains and losses on extinguishment of refunding debt are reported as deferred inflows and deferred outflows of resources, respectively, and amortized over the life of the bonds.

The annual change in the fair value of a hedging derivative is reported as deferred outflows of resources on the statement of net position. Please see note 5 for further details.

Net Position

The financial statements utilize a net position presentation. Net position is categorized as follows:

- *Net Investment in Capital Assets*– This category of net position consists of capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, mortgages, notes or other borrowings and any deferred outflows of resources related to such borrowings that are attributable to the acquisition, construction or improvement of those assets. If there are significant unspent related debt proceeds at year-end, the portion of the debt attributable to the unspent proceeds is not included in the calculation of net investment in capital assets. Rather, that portion of the debt is offset by unspent proceeds.
- *Restricted Net Position* – This category presents restricted assets reduced by liabilities and deferred inflows of resources related to those assets. Those assets are restricted due to external restrictions imposed by creditors (such as through bond covenants), grantors or laws and regulations of other governments and restrictions imposed by law through constitutional provisions or enabling legislation. There were no amounts restricted by enabling legislation as of June 30, 2015 and 2014.
- *Unrestricted* – This category represents net position of the Fund that is not restricted for any project or other purposes.

Use of Restricted/Unrestricted Net Position

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

Use of Estimates

The preparation of the financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions, in some cases when applicable, that

CITY OF LOS ANGELES
SEWER CONSTRUCTION AND MAINTENANCE FUND
Notes to the Fund Financial Statements (Continued)
June 30, 2015 and 2014

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

affect the amounts in the financial statements and accompanying notes. Actual results could differ from the estimates.

Reclassifications

Certain reclassifications have been made in the prior year fiscal financial statements to conform to the current year presentation.

Recent GASB Pronouncements

The following GASB Statements have been implemented beginning fiscal year 2015:

Issued in June 2012, GASB Statement No. 68, “*Accounting and Financial Reporting for Pensions - an Amendment of GASB Statement No. 27*” replaces the requirements of previously issued statements as they relate to governments that provide pensions through pension plans administered by trusts or similar arrangements that meet certain criteria. This statement requires governments providing defined benefit pensions to recognize their long-term obligation for pension benefits as a liability. Governments will report in their financial statements a net pension liability that represents the difference between the total pension liability and the pension plan’s fiduciary net position. This statement also enhances accountability and transparency through revised and new note disclosures and required supplementary information, including descriptive information about the types of benefits available, how to determine the amount of pension plan contributions, and assumptions and methods used in calculating the pension liability. This statement requires the Fund to record a liability and expense equal to their proportionate share of the collective net pension liability and expense of the City’s single-employer defined benefit pension plan. As the Fund has no direct employees, this statement had no material effect on the financial statements.

Issued in November 2013, GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date – an Amendment of GASB Statement No. 68*, amends GASB Statement No. 68 to require that, at transition, a government recognize a beginning deferred outflow of resources for its pension contributions, if any, made subsequent to the measurement date of the beginning net pension liability. GASB Statement No. 68, as amended, continues to require that beginning balances for other deferred outflows of resources and deferred inflows of resources related to pensions be reported at transition only if it is practical to determine such amounts. The provisions of this statement are required to be applied simultaneously with the provisions of GASB Statement No. 68. As the Fund has no direct employees, this statement had no material effect on the financial statements.

Issued in January 2013, GASB Statement No. 69, *Government Combinations and Disposals of Government Operations*, establishes accounting and financial reporting standards related to mergers, acquisitions, transfers of operations, and disposal of operations applicable to state and local entities. This statement had no impact on the City’s financial statements for fiscal year 2015.

The GASB has issued several pronouncements that have effective dates that may impact future presentations. The Fund is evaluating the potential impacts of the following GASB statements on its accounting practices and financial statements.

CITY OF LOS ANGELES
SEWER CONSTRUCTION AND MAINTENANCE FUND
Notes to the Fund Financial Statements (Continued)
June 30, 2015 and 2014

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Issued in February 2015, GASB Statement No. 72, *Fair Value Measurement and Application*, addresses accounting and financial reporting issues related to fair value measurements. The definition of fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This statement provides guidance for determining a fair measurement for financial reporting purposes. This statement also provides guidance for applying fair value to certain investments and disclosures related to all fair value measurements. Implementation of this statement is effective fiscal year 2016.

Issued in June 2015, GASB Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68*, establishes requirements for defined benefit pensions that are not within the scope of GASB Statement No. 68 as well as for the assets accumulated for purposes of providing those pensions. In addition, this statement also clarifies the application of certain provisions of GASB Statement No. 68 with regard to the information that is required to be presented as notes to the 10-year schedules of required supplementary information about investment-related factors that significantly affect trends in the amounts reported. Implementation of this statement is effective fiscal year 2017.

Issued in June 2015, GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, addresses accounting and financial reporting for other postemployment benefit (OPEB) that is provided to the employees of state and local governmental employers. This statement establishes standards for recognizing and measuring liabilities, deferred outflows of resources, deferred inflows of resources, and expense. For defined benefit OPEB, this statement identifies the methods and assumptions that are required to 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. Implementation of this statement is effective fiscal year 2018.

Issued in June 2015, GASB Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles (GAAP) for State and Local Governments*, consists of the sources of accounting principles used to prepare financial statements of state and local governmental entities in conformity with GAAP and the framework for selecting those principles. This statement reduces the GAAP hierarchy to two categories of authoritative GAAP and addresses the use of authoritative and non-authoritative literature in the event that the accounting treatment for a transaction or other event is not specified within a source of authoritative GAAP. Implementation of this statement is effective fiscal year 2016.

Issued in August 2015, GASB Statement No. 77, *Tax Abatement Disclosures*, requires disclosure of tax abatement information about a reporting government's own tax abatement agreements and those that are entered into by other governments and that reduce the reporting government's tax revenues. Implementation of this statement is effective for fiscal year 2017.

In December 2015, the GASB issued Statement No. 78, *Pensions Provided through Certain Multiple-Employer Defined Benefit Pension Plans*. The objective of this statement is to address a practice issue regarding the scope and applicability of Statement No. 68 associated with pensions provided through certain cost-sharing multiple-employer defined benefit pension plans and to state or local governmental employers whose employees are provided with such pensions. Such plans are not considered a state or local government pension plan and are used to provide benefits to both employees of state and local governments and employees of employers that are not state or local governments. The requirements of this statement are effective for financial statements for periods beginning after December 15, 2015.

CITY OF LOS ANGELES
SEWER CONSTRUCTION AND MAINTENANCE FUND
Notes to the Fund Financial Statements (Continued)
June 30, 2015 and 2014

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

In December 2015, the GASB issued Statement No. 79, *Certain External Investment Pools and Pool Participants*. This statement establishes criteria for an external investment pool to qualify for making the election to measure all investments at amortized cost for financial reporting purposes. Pool participants should also measure their investments at amortized cost if the external pool meets these criteria. If an external investment pool does not meet the criteria, then the pool should apply the provisions in paragraph 16 of Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*. Pool participants should measure their investments in that pool at fair value in accordance with paragraph 11 of Statement No. 31. This statement establishes additional note disclosure requirements for qualifying external investment pools that measure all of their investments at amortized cost and for governments that participate in those pools. The requirements of this statement are effective for financial statements for periods beginning after June 15, 2015, except for provisions on portfolio quality, custodial credit risk and shadow pricing, which are effective for periods beginning after December 15, 2015.

NOTE 2 – CASH AND INVESTMENTS

Cash and investments as of June 30, 2015 and 2014, consist of the following:

	2015	2014
Cash deposited with the City	\$ 36,877	\$ 21,541
Investments	516,625	417,218
Total Cash and Investments	\$ 553,502	\$ 438,759

Cash and Pooled Investments Held by the City Treasurer

The cash balances of substantially all funds on deposit in the City Treasury are pooled and invested by the City Treasurer for the purpose of maximizing interest earnings through pooled investment activities but safety and liquidity still take precedence over return. Interest earned on pooled investments is allocated to the participating funds based on each fund's average daily deposit balance during the allocation period with all remaining interest allocated to the General Fund. The Fund receives all interest earned on its deposits in the City Treasury. Investments in the City Treasury are stated at fair value based on quoted market prices except for money market investments that have remaining maturities of one year or less at time of purchase, which are reported at amortized cost.

Pursuant to California Government Code Section 53607 and the Los Angeles City Council (City Council) File No. 94-2160, the City Treasurer shall render to the City Council a statement of investment policy (the Policy) annually. City Council File No. 11-1740 was adopted on February 12, 2014, as the City's investment policy. This Policy shall remain in effect until the City Council and the Mayor approve a subsequent revision. The Policy governs the City's pooled investment practices. The Policy addresses soundness of financial institutions in which the Treasurer will deposit funds and types of investment instruments permitted by California Government Code Sections 53600-53635 and 16429.1.

Each investment transaction and the entire portfolio must comply with the California Government Code and Policy. Examples of investments permitted by the Policy are obligations of the U.S. Treasury and

CITY OF LOS ANGELES
SEWER CONSTRUCTION AND MAINTENANCE FUND
Notes to the Fund Financial Statements (Continued)
June 30, 2015 and 2014

NOTE 2 – CASH AND INVESTMENTS (Continued)

government agencies, local agency bonds, commercial paper notes, certificates of deposit (CD) placement service, bankers' acceptances, medium-term notes, repurchase agreements, mutual funds, money market mutual funds, and the State of California Local Agency Investment Fund.

The City issues a publicly available financial report that includes complete disclosures related to the entire cash and investment pool. The financial report may be obtained by writing to the City of Los Angeles, Office of the Controller, 200 North Main Street, City Hall East Suite 300, Los Angeles, CA 90012 or by calling (213) 978-7200.

The Fund's investment in the City's cash and investment pool is tracked separately. At June 30, 2015, the investments held in the City Treasury's Special Investment Pool Program and their maturities are as follows (in thousands):

Type of Investments	Amount	Investment Maturities June 30, 2015				
		1 to 30 Days	31 to 60 Days	61 to 365 Days	366 Days To 5 Years	Over 5 Years
U.S. Treasury Notes	\$ 63,089	\$ -	\$ -	\$ -	\$ 31,894	\$ 31,195
U.S. Sponsored Agency Issues	297,474	20,338	28,096	206,973	24,638	17,429
Commercial Paper	148,217	10,399	36,303	10,1515	-	-
Short Term Investment Funds	1	1	-	-	-	-
Supranational Coupons	7,844	7,844	-	-	-	-
Total Special Pool	\$ 516,625	\$ 38,582	\$ 64,399	\$ 308,488	\$ 56,532	\$ 48,624

Type of Investments	Amount	Investment Maturities June 30, 2014				
		1 to 30 Days	31 to 60 Days	61 to 365 Days	366 Days To 5 Years	Over 5 Years
U.S. Treasury Notes	\$ 62,590	\$ -	\$ -	\$ 26,888	\$ 35,702	\$ -
U.S. Sponsored Agency Issues	302,181	36,240	63,912	162,666	25,298	14,065
Commercial Paper	52,443	11,801	30,485	10,157	-	-
Short Term Investment Funds	4	4	-	-	-	-
Supranational Coupons	7,844	7,844	-	-	-	7,844
Total Special Pool	\$ 417,218	\$ 48,045	\$ 94,397	\$ 199,711	\$ 61,000	\$ 14,065

Disclosure Relating to Credit Risk

Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. Presented below is the actual rating as of year-end for each of the Fund's investment types.

Investment Type June 30, 2015	Total	AAA	AA+	A-1	Unrated
U.S. Treasury Notes	\$ 63,089	\$ -	\$ 63,089	\$ -	\$ -
U.S. Sponsored Agency Issues	297,474	-	57,194	-	240,280
Commercial Paper	148,217	-	-	148,217	-
Short Term Investment Funds	1	1	-	-	-
Supranational Coupons	7,844	-	-	-	7,844
Total Investments	516,625	1	120,283	148,217	248,124
Investment Type June 30, 2014	Total	AAA	AA	A-1	Unrated
U.S. Treasury Notes	\$ 62,590	\$ -	\$ 62,590	\$ -	\$ -
U.S. Sponsored Agency Issues	302,181	-	48,319	-	253,862
Commercial Paper	52,443	-	-	52,443	-
Short Term Investment Funds	4	4	-	-	-
Total Investments	417,218	4	110,909	52,443	253,862

CITY OF LOS ANGELES
SEWER CONSTRUCTION AND MAINTENANCE FUND
Notes to the Fund Financial Statements (Continued)
June 30, 2015 and 2014

NOTE 2 – CASH AND INVESTMENTS (Continued)

In accordance with the terms of the Fund's revenue bond agreements, cash is deposited in segregated funds for specified purposes as follows:

Unrestricted Funds

For receiving revenue and to pay or provide for the ordinary and reasonable expenses of the operations and maintenance, debt service and capital expenditures of the sewerage system.

Restricted Funds

Capital Construction Projects – to receive bond proceeds and other capital funds and to pay for capital construction and reconstruction projects, other capital acquisitions and certain maintenance costs for the sewerage system.

Debt Service Reserve– to be held as a reserve from which payments of principal and interest on the bonds can be made.

Debt Service– to receive money to be used to pay debt service on the bonds issued by the Fund.

Operations and Maintenance Reserve– an amount to be held that is at least equal to the amount reasonably estimated by the City to provide for the Fund's operations and maintenance expenses for the next 45 days.

Other Reserves– includes the Emergency, Rebate, and Insurance and Liability Claims Funds.

CITY OF LOS ANGELES
SEWER CONSTRUCTION AND MAINTENANCE FUND
Notes to the Fund Financial Statements (Continued)
June 30, 2015 and 2014

NOTE 2 – CASH AND INVESTMENTS (Continued)

The Fund's cash on hand and pooled investments held by the City Treasurer as of June 30, 2015 and 2014 were allocated to the following funds (in thousands):

	<u>2015</u>	<u>2014</u>
Unrestricted funds	\$ 130,251	\$ 118,576
Restricted funds		
Current		
Capital construction projects	252,556	152,109
Debt service	17,555	20,538
Operations and maintenance reserve	40,061	40,081
Other reserves	5,376	5,373
	<u>315,548</u>	<u>218,101</u>
Noncurrent		
Debt service reserve	107,703	102,082
Total restricted funds	<u>423,251</u>	<u>320,183</u>
Total cash and pooled investments held by the City Treasurer	<u>\$ 553,502</u>	<u>\$ 438,759</u>

Cash Held by Escrow Agents

Pursuant to Section 22300 of the Public Contract Code of the State of California, a contractor has the option to deposit securities with the escrow agent as a substitute for retention earnings required to be withheld by the City based on the construction contract entered into between the City and the contractor.

The escrow agent must be a member of the Federal Deposit Insurance Corporation and must be federally insured pursuant to California Government Code Section 53648 and chartered to transact business in California. The contract to implement this type of agreement is called the Escrow Agreement for Security Deposits In Lieu of Retention (Escrow Agreement). The three parties to the Escrow Agreement are the contractor, the escrow company and the City. There are times when cash with escrow is invested in accordance with the direction of the contractor. Interest earned when funds are invested by escrow accrues for the benefit of the contractor. The City has the right to draw upon the securities in the event of default by the contractor. The escrow agent holds the securities for a market value at least equal to the cash amount required to be withheld as retention. As of June 30, 2015 and 2014, cash held by escrow agents amounted to \$3.4 million and \$3.8 million respectively. The decrease in cash was due to decrease in number of escrow accounts during the year.

In accordance with the Escrow Agreement, the escrow agents agree to insure the deposits or collateralize any deposits in excess of \$100,000 pursuant to federal law in compliance with Government Code Section 53652. Thus, assets held by escrow agents are not exposed to custodial credit risk.

CITY OF LOS ANGELES
SEWER CONSTRUCTION AND MAINTENANCE FUND
Notes to the Fund Financial Statements (Continued)
June 30, 2015 and 2014

NOTE 3 – ACCOUNTS RECEIVABLE

Accounts receivable balances as of June 30, 2015, are summarized as follows (in thousands):

	<u>Billed</u>	<u>Unbilled</u>	<u>Total</u>
Sewer service charges	\$ 92,105	\$ 35,412	\$ 127,517
Sewage disposal contracts			
Operations and maintenance	12,132	3,203	15,335
Capital	5,878	4,659	10,537
Industrial waste surcharges	5,506	-	5,506
Bonded sewer fees	141	-	141
Allowance for doubtful accounts	<u>(4,353)</u>	<u>-</u>	<u>(4,353)</u>
Total	<u>\$ 111,409</u>	<u>\$ 43,274</u>	<u>\$ 154,683</u>

Accounts receivable balances as of June 30, 2014, are summarized as follows (in thousands):

	<u>Billed</u>	<u>Unbilled</u>	<u>Total</u>
Sewer service charges	\$ 77,090	\$ 33,829	\$ 110,919
Sewage disposal contracts			
Operations and maintenance	11,955	4	11,959
Capital	5,292	302	5,594
Industrial waste surcharges	5,734	-	5,734
Bonded sewer fees	130	-	130
Allowance for doubtful accounts	<u>(4,090)</u>	<u>-</u>	<u>(4,090)</u>
Total	<u>\$ 96,111</u>	<u>\$ 34,135</u>	<u>\$ 130,246</u>

CITY OF LOS ANGELES
SEWER CONSTRUCTION AND MAINTENANCE FUND
Notes to the Fund Financial Statements (Continued)
June 30, 2015 and 2014

NOTE 4 – CAPITAL ASSETS

Capital assets activity for the fiscal year ended June 30, 2015 was as follows (in thousands):

	Balance July 1, 2014	Additions	Deductions	Balance June 30, 2015
Capital assets, non-depreciable				
Land	\$ 40,093	\$ -	\$ -	\$ 40,093
Construction in progress	287,141	189,353	(64,878)	411,616
Total capital assets, non-depreciable	<u>327,234</u>	<u>189,353</u>	<u>(64,878)</u>	<u>451,709</u>
Capital assets depreciated				
Collection system	2,724,454	68,876	-	2,793,330
Treatment plants and equipment	3,806,693	31,839	-	3,838,532
Pumping plants	196,911	461	-	197,372
Site improvements	26,048	-	-	26,048
Other equipment and vehicles	94,689	13,482	(89)	108,082
Total capital assets depreciated	<u>6,848,795</u>	<u>114,658</u>	<u>(89)</u>	<u>6,963,364</u>
Less: accumulated depreciation				
Collection system	(562,419)	(32,559)	-	(594,978)
Treatment plants and equipment	(2,510,592)	(100,226)	-	(2,610,818)
Pumping plants	(136,651)	(4,767)	-	(141,418)
Site improvements	(4,955)	(1,192)	-	(6,147)
Other equipment and vehicles	(66,221)	(4,717)	89	(70,849)
Total accumulated depreciation	<u>(3,280,838)</u>	<u>(143,461)</u>	<u>89</u>	<u>(3,424,210)</u>
Capital assets depreciated, net	<u>\$ 3,567,957</u>	<u>(28,803)</u>	<u>-</u>	<u>\$ 3,539,154</u>
Total capital assets	<u>\$ 3,895,191</u>	<u>\$ 160,550</u>	<u>\$ (64,878)</u>	<u>\$ 3,990,863</u>

CITY OF LOS ANGELES
SEWER CONSTRUCTION AND MAINTENANCE FUND

Notes to the Fund Financial Statements (Continued)

June 30, 2015 and 2014

NOTE 4 – CAPITAL ASSETS (Continued)

Capital assets activity for the fiscal year ended June 30, 2014 was as follows (in thousands):

	July 1, 2013	Additions	Deductions	June 30, 2014
Capital assets, non-depreciable				
Land	\$ 40,093	\$ -	\$ -	\$ 40,093
Construction in progress	228,428	114,274	(55,561)	287,141
Total capital assets, non-depreciable	<u>268,521</u>	<u>114,274</u>	<u>(55,561)</u>	<u>327,234</u>
Capital assets depreciated				
Collection system	2,638,463	85,991	-	2,724,454
Treatment plants and equipment	3,786,403	20,290	-	3,806,693
Pumping plants	196,241	670	-	196,911
Site improvements	25,457	595	(4)	26,048
Other equipment and vehicles	85,249	9,539	(99)	94,689
Total capital assets depreciated	<u>6,731,813</u>	<u>117,085</u>	<u>(103)</u>	<u>6,848,795</u>
Less: accumulated depreciation				
Collection system	(530,798)	(31,624)	3	(562,419)
Treatment plants and equipment	(2,408,466)	(102,119)	(7)	(2,510,592)
Pumping plants	(131,078)	(5,573)	-	(136,651)
Site improvements	(3,750)	(1,205)	-	(4,955)
Other equipment and vehicles	(62,496)	(3,729)	4	(66,221)
Total accumulated depreciation	<u>(3,136,588)</u>	<u>(144,250)</u>	<u>-</u>	<u>(3,280,838)</u>
Capital assets depreciated, net	<u>\$ 3,595,225</u>	<u>(27,165)</u>	<u>(103)</u>	<u>\$ 3,567,957</u>
Total capital assets	<u>\$ 3,863,746</u>	<u>\$ 87,109</u>	<u>\$ (55,664)</u>	<u>\$ 3,895,191</u>

CITY OF LOS ANGELES
SEWER CONSTRUCTION AND MAINTENANCE FUND
Notes to the Fund Financial Statements (Continued)
June 30, 2015 and 2014

NOTE 5 – LONG-TERM DEBT

Refunding revenue bonds and loans outstanding at June 30, 2015 and 2014 are summarized as follows (in thousands):

	Amount of original issue	Final maturity date	Outstanding At June 30, 2015	Outstanding At June 30, 2014
Refunding Series 2002-A, 4.0% to 6.0%	\$ 102,850	6/1/2022	\$ -	\$ 37,110
Refunding Series 2005-A, 4.0% to 5.0%	300,655	6/1/2035	-	52,455
Refunding Series 2009-A, 1.6% to 5.75%	454,785	6/1/2039	261,965	365,720
Refunding Series 2010-A, 5.713%	177,420	6/1/2039	177,420	177,420
Refunding Series 2010-B, 5.813%	89,600	6/1/2040	89,600	89,600
Refunding Series 2010-A, Subordinate, 2.0% to 5.0%	199,790	6/1/2032	162,500	195,740
Refunding Series 2012-A, 5.0%	49,650	6/1/2024	49,650	49,650
Refunding Series 2012-A, Subordinate, 1.0% to 5.0%	157,055	6/1/2024	153,045	153,850
Refunding Series 2012-B, Subordinate, 2.0% to 5.0%	253,880	6/1/2032	251,090	252,510
Refunding Series 2012-C, Subordinate, 4.0% to 5.0%	133,715	6/1/2027	130,415	131,100
Refunding Series 2012-D, Subordinate, variable	280,860	6/1/2032	280,860	280,860
Refunding Series 2013-A, Subordinate, 2% to 5%	349,505	6/1/2035	323,300	336,720
Refunding Series 2013-A, 5.0%	149,980	6/1/2043	149,980	149,980
Refunding Series 2013-B, 2.0% to 5.0%	143,880	6/1/2035	123,680	134,815
Refunding Series 2015-A, 4.0% to 5.0%	188,755	6/1/2045	188,755	-
Refunding Series 2015-B, 5.0%	41,175	6/1/2035	41,175	-
Refunding Series 2015-C, 5.0%	100,835	6/1/2045	100,835	-
Refunding Series 2015-D, 2.0% to 5.0%	108,860	6/1/2034	108,860	-
Refunding Series 2015-A, Subordinate, 5.0%	21,650	6/1/2024	21,650	-
Total principal amount			<u>2,614,780</u>	<u>2,407,530</u>
Unamortized bond premium			237,429	203,695
Debt due within one year			<u>(76,920)</u>	<u>(73,575)</u>
			<u>2,775,289</u>	<u>2,537,650</u>
Commercial paper notes - current year's issue, variable			<u>-</u>	<u>110,000</u>
State Revolving Fund loan, 1.8%	219,081	8/9/2024	123,067	134,167
Debt due within one year			<u>(11,308)</u>	<u>(11,100)</u>
			<u>111,759</u>	<u>123,067</u>
Long-term debt due in more than one year			<u>\$ 2,887,048</u>	<u>\$ 2,770,717</u>

Wastewater revenue bonds and commercial paper notes are issued under Senior Lien and Subordinate Lien General Resolutions dated November 10, 1987 and March 26, 1991, respectively, with a total authorization of \$3.5 billion. Proceeds of wastewater revenue bonds and notes are restricted for the funding of the costs of construction, replacement and improvement of the sewerage system of the City. Under the terms of the

CITY OF LOS ANGELES
SEWER CONSTRUCTION AND MAINTENANCE FUND

Notes to the Fund Financial Statements (Continued)

June 30, 2015 and 2014

NOTE 5 – LONG-TERM DEBT (Continued)

General Resolution, the City has pledged the Fund's revenues (as defined) to secure the payment of all bonds issued under the General Resolution. Certain bond agreements provide for the early redemption of the revenue bonds at the City's option at various dates with redemption prices ranging from 100% to 102% of the principal amount of the bonds called for redemption.

Long-term Debt Activity

The Fund had the following activity in long-term debt during fiscal year 2015 (in thousands):

	<u>July 1, 2014</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance June 30, 2015</u>	<u>Due within one year</u>
Revenue bonds	\$ 2,407,530	\$ 461,275	\$ (254,025)	\$ 2,614,780	\$ 76,920
Unamortized bond premium	203,695	63,000	(29,266)	237,429	-
Net revenue bonds	<u>2,611,225</u>	<u>524,275</u>	<u>(283,291)</u>	<u>2,852,209</u>	<u>76,920</u>
State Revolving Fund loan	134,167	-	(11,100)	123,067	11,308
Commercial paper notes	110,000	-	(110,000)	-	-
Total	<u>\$ 2,855,392</u>	<u>\$ 524,275</u>	<u>\$ (404,391)</u>	<u>\$ 2,975,276</u>	<u>\$ 88,228</u>

The Fund had the following activity in long-term debt during fiscal year 2014 (in thousands):

	<u>July 1, 2013</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance June 30, 2014</u>	<u>Due within one year</u>
Revenue bonds	\$ 2,468,610	\$ -	\$ (61,080)	\$ 2,407,530	\$ 73,575
Unamortized bond premium	227,928	-	(24,233)	203,695	-
Net revenue bonds	<u>2,696,538</u>	<u>-</u>	<u>(85,313)</u>	<u>2,611,225</u>	<u>73,575</u>
State Revolving Fund loan	145,064	-	(10,897)	134,167	11,100
Commercial paper notes	-	110,000	-	110,000	-
Total	<u>\$ 2,841,602</u>	<u>\$ 110,000</u>	<u>\$ (96,210)</u>	<u>\$ 2,855,392</u>	<u>\$ 84,675</u>

New Issuances

Fiscal Year 2015

On June 4, 2015, the Fund issued Wastewater System Revenue Bonds Series 2015-A and 2015-B in the amount of \$188.8 million with interest rates ranging from 4% to 5% and \$41.2 million with an interest rate of 5%, respectively. The proceeds of the Senior Series 2015-A were used to finance the construction and improvement of the System, fund a deposit to the Reserve Fund, and pay certain costs of issuing the Series

CITY OF LOS ANGELES
SEWER CONSTRUCTION AND MAINTENANCE FUND

Notes to the Fund Financial Statements (Continued)

June 30, 2015 and 2014

NOTE 5 – LONG-TERM DEBT (Continued)

2015-A Senior Lien Bonds. The Senior Series 2015-B proceeds together with certain available monies of the city were used to current refund certain of the Senior Series 2005-A of \$47.0 million, fund a deposit to the Reserve Fund and pay certain cost of issuing the Series 2015-B Senior Lien Bonds. As a result of the refunding, the principal balance of \$52.5 million of Senior Series 2005-A is considered defeased and the liability for this bond has been removed from the statements of net position.

On June 30, 2015, the Fund issued Wastewater System Revenue Bonds Series 2015-C in the amount of \$100.8 million with an interest rate of 5%, Wastewater System Revenue Bonds Refunding Series 2015-D in the amount of \$108.9 million with interest rates ranging from 2% to 5%, and Wastewater System Subordinate Revenue Bonds Refunding Series 2015-A in the amount of \$21.7 million with an interest rate of 5%. The proceeds of the Senior Series 2015-C were used to current refund all of the currently outstanding CP Notes in the aggregate principal amount of \$110.0 million, fund a deposit to the Reserve Fund, and pay certain costs of issuing the Series 2015-C Senior Lien Bonds. The Senior Series 2015-D proceeds were used to advance refund certain of the City's Wastewater System Revenue Bonds, Refunding Series 2009-A of \$70.5 million and certain of the City's Wastewater System Subordinate Bonds, Refunding Series 2010-A of \$16.3, fund a deposit to the Reserve Fund for the Senior Lien bonds and pay certain costs of issuing the Series 2015-D Senior Lien Bonds. The Subordinate Series 2015-A proceeds were used to defease to maturity certain of the City's Series 2002-A Senior Lien Bonds of \$13.1 million, advance refund certain of the Series 2009-A Senior Lien Bonds of \$5.0 million, and advance refund certain of the City's Series 2010-A Subordinate Bonds of \$4.1 million and pay certain costs of issuing the Series 2015-A Subordinate Bonds. As a result of the refunding, the principal balance of \$37.1 million of Senior Series 2002-A is considered defeased and the liability for this bond has been removed from the statements of net position.

The total economic gain for the refunding transactions Senior Series 2015-B, Senior Series 2015-D and Subordinate Series 2015-A were \$6.1 million, \$7.0 million and \$676 thousand respectively. The total cash flow saving for the refunding transactions Senior Series 2015-B, Senior Series 2015-D and Subordinate Series 2015-A were \$10.1 million, \$12.7 million and 2.7 million respectively. The Senior Series 2015-C was used to refund the outstanding Commercial Paper notes, thus there is no resulting cash flow saving and economic gain or loss that are being calculated for the Senior Series 2015-C refunding bonds.

The differences between the net carrying amount of the old debt and the amount required to retire the debt in the amount of \$518 thousand is deferred and amortized over the original remaining life of the old debt or the life of the new debt, whichever is shorter.

Fiscal Year 2014

On May 7, 2013, the City Council authorized the issuance of up to \$400,000,000 maximum aggregate principal amount of commercial paper notes but the City has determined to limit the aggregate principal amount of Wastewater System Commercial Paper Revenue Notes to be issued to the principal amount supported by reimbursement agreements, which is \$200,000,000. On June 20, 2014, the City issued \$110,000,000 in new commercial paper notes.

Debt Defeasance

During the fiscal year 2015, the Fund defeased outstanding bonds by placing the proceeds of the refunding issues into irrevocable trusts to provide for all future debt service payments on the old bonds. During the

CITY OF LOS ANGELES
SEWER CONSTRUCTION AND MAINTENANCE FUND
Notes to the Fund Financial Statements (Continued)
June 30, 2015 and 2014

NOTE 5 – LONG-TERM DEBT (Continued)

fiscal year 2014 there were no outstanding bonds defeased. Accordingly, the trust account assets and liabilities for the defeased bonds are not included in the Fund’s financial Statements. At June 30, 2015 and 2014, \$157.5 million and \$211.4 million of defeased bonds remain outstanding, respectively.

Interest Subsidies

The City has designated the Senior Lien Bonds Series 2010-A and 2010-B as “Build America Bonds” and “Recovery Zone Economic Development Bonds”, respectively, under the provisions of the American Recovery and Reinvestment Act of 2009. The City expects to receive a direct subsidy of 35% and 45% of the interest due to bondholders from the United States Treasury for the Series 2010-A and 2010-B, respectively. As of June 30, 2015 and 2014, the Fund recorded interest subsidies of \$5.53 million and \$5.48 million, respectively, as other non-operating revenues.

State Revolving Fund Loan

In 2003, the City Council adopted a resolution, approved by the Mayor, authorizing a State Revolving Fund Loan (Loan) from the State Water Resources Control Board (SWRCB) in the amount of \$262.9 million to assist in financing the construction of the North Outfall Sewer-East Central Interceptor Project (Project). The Project fulfills certain requirements of the Cease and Desist Order issued by the Regional Water Quality Control Board. The Project is shared by other contract agencies.

As of June 30, 2015 and 2014, the Loan balance amounted to \$123.1 million and \$134.2 million, respectively. The Loan matures in fiscal year 2025 and annual repayment commenced in August 2005 based on a standard fully amortized loan calculation at an effective interest rate of 1.8%. The Loan is paid from the Fund’s revenues subordinate to the Wastewater System revenue bonds and commercial paper notes. The contract agencies were billed beginning August 2005 for their proportionate share of the debt service costs. Payments received from the contract agencies are recorded as capital contribution, which represents their proportionate share of the costs of the Project.

Commercial Paper Notes

The City issues commercial paper notes (Notes) at prevailing interest rates for periods of maturity not to exceed 270 days under the commercial paper program on behalf of the Fund. The Notes are secured by letters of credits (LOCs) from the Bank of New York and the Sumitomo Mitsui Banking Corporation that expire on December 18, 2015 and December 17, 2017, respectively. The aggregate maximum principal amount of the two LOCs is \$218.0 million, which consists of \$100.0 million in principal plus interest for each bank. The Fund is responsible for the payment of a non-refundable letter of credit fee for each of the LOCs. Should the City draw on the LOCs and not repay the advance within six months, the advance is converted to a term loan with semiannual payments due for three years at interest rates not to exceed 12.0% or the maximum rate as permitted by law. Since these Notes are secured by LOCs with expiration dates in excess of one year after June 30, 2014, the Fund reported these Notes as long-term liabilities. There were no outstanding Notes as of June 30, 2015. The outstanding principal balance of the Notes as of June 30, 2014 was \$110.0 million.

CITY OF LOS ANGELES
SEWER CONSTRUCTION AND MAINTENANCE FUND
Notes to the Fund Financial Statements (Continued)
June 30, 2015 and 2014

NOTE 5 – LONG-TERM DEBT (Continued)

Scheduled Principal Maturities and Interest

Scheduled annual principal maturities and interest are as follows (in thousands):

<u>Fiscal year ending June 30</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2016	\$ 88,228	\$ 125,142	\$ 213,370
2017	90,779	122,399	213,178
2018	94,889	118,568	213,457
2019	96,983	114,363	211,346
2020	104,606	109,922	214,528
2021 - 2025	580,667	476,113	1,056,780
2026 - 2030	553,975	352,726	906,701
2031 - 2035	480,990	236,067	717,057
2036 - 2040	370,865	131,062	501,927
2041 - 2045	275,865	40,379	316,244
Subtotal	<u>2,737,847</u>	<u>1,826,741</u>	<u>4,564,588</u>
Unamortized bond premiums,	237,429	-	237,429
Total	<u>\$ 2,975,276</u>	<u>\$ 1,826,741</u>	<u>\$ 4,802,017</u>

The maturity schedule presented above reflects the scheduled debt service requirements for all of the Fund's long-term debt. Additionally, the above schedule includes interest requirements for the variable rate Refunding Series 2012-D Subordinated Revenue Bonds using the weighted average rate in effect as of June 30, 2015 of 0.123%.

Interest Rate Swap Agreements

Objective of the swaps. In March 2006, in order to protect against the potential of rising interest rates, the Fund entered into two separate pay-fixed, receive-variable interest rate swap agreements (Swap Agreements) on the \$316.8 million Wastewater System Subordinate Variable Rate Revenue Refunding Bonds Series 2006 A-D (Series 2006 A-D). The expected costs associated with the swaps are less than what the Fund would have paid if it had issued fixed-rate debt.

On May 1, 2008, the Fund refunded Series 2006 A-D with the issuance of \$314.8 million Wastewater System Subordinate Revenue Bonds Variable Rate Revenue Refunding Series 2008 A-H (Series 2008 A-F1). On April 17, 2012, the Fund refunded a portion of the Series 2008 A-F1 and partially terminated the Swap Agreements by issuing the Series 2012-A Subordinate Bonds. On December 18, 2012, the Fund refunded the remaining outstanding Series 2008 A-H with the issuance of \$280.9 million Wastewater System Subordinate Revenue bonds, Variable Rate Refunding Series 2012-D. Of this amount, the swaps serve as a hedge for \$151.1 million of the Series 2012-D Bonds as of June 30, 2015.

CITY OF LOS ANGELES
SEWER CONSTRUCTION AND MAINTENANCE FUND
Notes to the Fund Financial Statements (Continued)
June 30, 2015 and 2014

NOTE 5 – LONG-TERM DEBT (Continued)

The fair value and notional amounts of the interest rate swaps outstanding at June 30, 2015, and 2014, classified by type, and changes in fair value for the fiscal years then ended as reported in the financial statements are as follows (dollar amounts in thousands):

	Changes in Fair Value		Fair Value at June 30, 2015		Notional
	Classification	Amount	Classification	Amount	
Cash flow hedges:					
Interest rate swaps	Deferred outflows of resources	\$ (1,302)	Liabilities	\$ (26,759)	\$ 151,085

	Changes in Fair Value		Fair Value at June 30, 2014		Notional
	Classification	Amount	Classification	Amount	
Cash flow hedges:					
Interest rate swaps	Deferred outflows of resources	\$ (724)	Liabilities	\$ (25,457)	\$ 151,085

Terms, fair values and credit risk. Under the interest Swap Agreements, the Fund owes interest to the counterparties calculated on a notional amount at a fixed rate and the counterparties owe the Fund interest on the same notional amount at a variable rate.

Specific terms, including the fair values and counterparty credit ratings of the outstanding swaps as of June 30, 2015, are as follows (dollar amounts in thousands):

Notional Amount	Effective Date	Fixed Rate Paid	Variable Rate Received	Fair Value	Swap Termination Date	Counterparty Credit Ratings ⁽¹⁾
\$ 75,543	4/6/2006	3.34%	64.1% of LIBOR ⁽²⁾	\$ (13,380)	6/1/2028	Aa2/AA-/AA
\$ 75,542	4/6/2006	3.34%	64.1% of LIBOR ⁽²⁾	\$ (13,379)	6/1/2028	Baa3/BBB/BBB+

(1) Moody's Investors Service, Standard & Poor's, and Fitch Ratings, respectively as of June 30, 2015.

(2) One-month LIBOR reset monthly. Applicable one-Month LIBOR as of June 30, 2015 was 0.185%.

The notional amounts of the swaps match the principal amount of the associated debt. The Swap Agreements contain scheduled reductions to outstanding notional amounts that follow scheduled reductions in the associated debt.

Method of calculating fair value. Because swap interest rates were lower on June 30, 2015, than at the date the Swap Agreements were entered into, the swaps have a negative fair value as of June 30, 2015 and 2014. The fair values were estimated using the zero-coupon method and include accrued interest. This method calculates the future net settlement payments required by the swap agreements, assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These payments are then discounted using the spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the date of each future net settlement on the swap.

CITY OF LOS ANGELES
SEWER CONSTRUCTION AND MAINTENANCE FUND
Notes to the Fund Financial Statements (Continued)
June 30, 2015 and 2014

NOTE 5 – LONG-TERM DEBT (Continued)

Risks and description of risks that the Swap Agreements are exposed to that could give rise to financial loss are extant as of June 30, 2015.

Credit risk. The fair values of the swaps represented the Fund’s credit exposure to the swap counterparties as of June 30, 2015 and 2014. If a counterparty to a swap transaction failed to perform according to the terms of the swap contract, and the Fund chose to terminate the swap, the Fund would be owed a termination payment by the counterparty. If the swaps had a negative fair value at the time the counterparty failed to perform, the Fund would be required to make a payment to the counterparty. To mitigate credit risk, a counterparty must fully collateralize the fair value of the swap with U.S. government securities if two of its credit ratings fall below Moody’s Investors Service Aa3, or AA- of Fitch Ratings or Standard & Poor’s. Collateral would be posted with a third-party custodian. Dexia Credit Locale, New York Branch was rated below the specified requirements as of June 30, 2015 and 2014; however, no collateralization was necessary because the fair value of the swap indicated that Dexia Credit Locale would not be required to make a payment to the Fund in the event of a termination at that time.

Basis risk. The Fund is exposed to basis risk when the relationship between 64.1% of LIBOR and the actual rates on the associated variable rate bonds diverge. In this situation the expected savings may not be realized. As of June 30, 2015, the weighted average rate on the variable rate bonds were 0.12328% whereas 64.1% of applicable LIBOR was equal to 0.11955%.

Termination risk. The Fund or the counterparties may terminate the Swap Agreements if the other party fails to perform under the terms of the contract or if various other events occur. If at the time of the termination the swap has a negative fair value, the Fund would be liable to the counterparty for a payment equal to the swap’s fair value. If any of the swaps were terminated and not replaced, the Fund would not receive a payment from the counterparty to offset its variable interest expense on the associated variable rate bonds. Annual net interest paid and or received started July 1, 2015 through termination date.

Swap Payments and Associated Debt. Using rates as of June 30, 2015, net swap payments and debt service requirements of the associated variable-rate debt are as follows (in thousands):

<u>Fiscal year ending June 30</u>	<u>Variable-rate bonds</u>		<u>Interest rate swaps, net⁽²⁾</u>	<u>Total</u>
	<u>Principal</u>	<u>Interest⁽¹⁾</u>		
2016	-	186	4,866	5,052
2017	-	186	4,866	5,052
2018	-	186	4,866	5,052
2019	-	186	4,866	5,052
2020	-	186	4,866	5,052
2021-2025	35,935	932	24,327	61,194
2026-2028	115,150	287	7,497	122,934
Total	\$ 151,085	\$ 2,149	\$ 56,154	\$ 209,388

CITY OF LOS ANGELES
SEWER CONSTRUCTION AND MAINTENANCE FUND
Notes to the Fund Financial Statements (Continued)
June 30, 2015 and 2014

NOTE 5 – LONG-TERM DEBT (Continued)

- (1) Assumes rate of 0.12328% (the applicable rate on June 30, 2015), excluding fixed rate component.
- (2) Assumes swap rate of 3.34% less 0.11955% (64.1% of applicable LIBOR on June 30, 2015).

As rates vary, variable-rate bond interest payments and net swap payments will vary.

NOTE 6 – DISASTER ASSISTANCE GRANT

Earthquake Damage

On January 17, 1994, a 6.8 magnitude earthquake centered in Northridge, California, caused widespread damage to commercial and residential structures. Since the Northridge earthquake, the Fund has systemically made repairs to its wastewater facilities that were damaged. Much of this work is eligible for reimbursement from the Federal Emergency Management Agency (FEMA) and the California Emergency Management Agency (CalEMA), now the California Office of Emergency Services (CalOES). As of June 30, 2015, the Fund expended \$225.5 million in earthquake related repair costs, of which \$211.2 million is eligible for reimbursement from FEMA and CalOES. Grants receivable from FEMA and CalOES amounted to \$33.7 million and \$33.8 million at June 30, 2015 and 2014, respectively.

During fiscal year 2009, the Fund was informed of a de-obligation of the City's FEMA Northridge earthquake grant in the amount of \$35.7 million to offset a portion of the \$75.0 million advance from FEMA received by the City immediately after the Northridge earthquake. The advance was used for earthquake related costs incurred by various City Council controlled departments. The de-obligation may result in FEMA and CalOES withholding the Fund's outstanding grant receivables. The Fund continues to pursue this outstanding receivable and was informed by the Office of the City Administrative Officer that the City's Inspector General will focus on the final closeout and payment in fiscal year 2016.

Also, as a result of the de-obligation, \$10.3 million of the Fund's grants receivable was reclassified from grants receivable to advances to other City funds in fiscal year 2010. In October 2011, the City Council adopted Council File 10-1947 that provides for the offsetting of receivables between the Fund and the City's General Fund in the amount of \$4.2 million. Consequently, the Fund's advances to other City funds that arose from the de-obligation of the City's FEMA Northridge earthquake grant decreased from \$10.3 million to \$6.1 million. The same Council File instructed the elimination of the remaining \$6.1 million General Fund obligation through write-offs or other similar means. The feasibility of the Council instruction for write-off is continually being determined by the City.

NOTE 7 – RELATED PARTY TRANSACTIONS

During the normal course of business, the Fund is charged for operations and maintenance services, including salaries and employee benefits, performed on behalf of the Fund by various City General Fund departments. The department performing the most significant services is the Department of Public Works. The Fund makes advances to the City's General Fund at certain intervals throughout the year. At year-end, advances are reconciled with actual amounts incurred by the General Fund on behalf of the Fund and accounts are appropriately adjusted and the General Fund owed the Fund \$34.9 million and \$37.6 million at June 30, 2015 and 2014, respectively. The related charges of approximately \$238.5 million and \$243.1 million were incurred to the City's General Fund during the fiscal years ended June 30, 2015 and 2014, respectively.

CITY OF LOS ANGELES
SEWER CONSTRUCTION AND MAINTENANCE FUND

Notes to the Fund Financial Statements (Continued)

June 30, 2015 and 2014

NOTE 7 – RELATED PARTY TRANSACTIONS (Continued)

The City of Los Angeles Department of Water and Power (DWP) performs the billing and collection function for the Fund's sewer service charges. Accordingly, accounts receivable related to sewer service charges are collected by DWP on behalf of the Fund. DWP's charges for performing the billing and collection functions were \$3 million for each of the fiscal years ended June 30, 2015 and 2014.

The Fund provided \$4.4 million funding for the construction of the Los Angeles Zoo wastewater facilities. Repayment of the construction costs by the City's Zoo Department (Zoo) will be provided primarily through a \$0.25 surcharge on the Zoo's admission fees. As of June 30, 2015 and 2014, the amounts due from the Zoo were \$2.4 million and \$2.5 million, respectively, and were included in advances to other City funds.

Various departments of the General Fund provide services for the operation of the Fund during the fiscal year. The Fund reimburses the departments based on budgeted expenditures during the year and any differences between budget and actual are reimbursed to the Fund periodically. The City intends to repay the Fund in four equal annual installments beginning in fiscal year 2016-17.

Due from/ (to) and advances to other City funds as of June 30, 2015 and 2014 are as follows (in thousands):

	<u>2015</u>	<u>2014</u>
Current portion		
Due from other City funds	\$ 2,649	\$ 7,949
Due to other City funds	<u>(3,120)</u>	<u>(3,078)</u>
Total	<u>\$ (471)</u>	<u>\$ 4,871</u>
Noncurrent portion		
Advances to other City funds	\$ 41,020	\$ 39,156
Due to other City funds	<u>(22,118)</u>	<u>(22,041)</u>
Total	<u>\$ 18,902</u>	<u>\$ 17,115</u>

NOTE 8 – COMMITMENTS AND CONTINGENCIES

Pollution Remediation Obligations

The City was named as a potentially responsible party in a case of contamination which migrated in the soil and ground onto the adjacent property. Cross-claimants assert that their records show that hazardous material was transported to the site from the Hyperion Treatment Plant. There are more than 1,500 potentially responsible parties. The parties are still working on the investigation and extent of contamination. As of June 30, 2014, the City has not been served with a complaint. The case was subsequently dismissed during November 2014.

The County of Los Angeles (County) has notified the City and other entities of potential liabilities for cleanup and maintenance of a public golf course, which was created over an old landfill due to environmental issues including leachate and gas migration. According to the County's review of prior customer records, the Fund used the site for disposal of grit waste from the Hyperion Treatment Plan. Prior

CITY OF LOS ANGELES
SEWER CONSTRUCTION AND MAINTENANCE FUND

Notes to the Fund Financial Statements (Continued)

June 30, 2015 and 2014

NOTE 8 – COMMITMENTS AND CONTINGENCIES (Continued)

to 2014 the City entered into and paid a settlement with the County for \$0.2 million and remained an active participant in the site investigation. The next phase for site cleanup and maintenance is under review by the California Department of Toxic Substance Control (SDTSC) and, hence, additional remediation costs, if any, are not known at this time.

Pending Lawsuits and Claims

Certain claims and lawsuits are pending against the Fund for construction claims and other alleged liabilities arising during the ordinary course of Fund operations. The Fund recognizes liabilities for claims and lawsuits when it is probable that an asset has been impaired or a liability has been incurred and the amount of the loss can be reasonably estimated.

The City Attorney estimates the amount of liabilities that are probable of occurring from these claims and lawsuits. For fiscal years 2015 and 2014, \$7.3 million and \$31.8 million were accrued as claims payable, respectively.

The changes in claims payable of the Fund are as follows (in thousands):

	2015	2014
Balance, July 1	\$ 30,216	\$ 13,637
Provisions for current year and changes in estimates for prior years	(21,856)	45,490
Claims payments	(1,018)	(27,273)
Balance, June 30	\$ 7,342	\$ 31,854
Estimated to be payable in one year	\$ 681	\$ 1,638
Payable in more than one year	\$ 6,661	\$ 30,216

Outstanding Contractual Commitments

As of June 30, 2015 and 2014, the Fund had outstanding commitments to fund planned modification and improvement of the City’s wastewater collection and treatment system of approximately \$140.8 million and \$105.4 million, respectively.

Other Matters

Judicial Interpretation of Articles XIII C and XIII D of Proposition 218

In *Bighorn-Desert View Water Agency v. Beringson (Bighorn)*, the California Supreme Court held that fees and charges for ongoing water service through an existing connection were property related fees and charges imposed on a person as an incident of property ownership for purposes of Article XIII D, whether the fees and charges are calculated based on consumption or are imposed as a fixed monthly fee.

CITY OF LOS ANGELES
SEWER CONSTRUCTION AND MAINTENANCE FUND
Notes to the Fund Financial Statements (Continued)
June 30, 2015 and 2014

NOTE 8 – COMMITMENTS AND CONTINGENCIES (Continued)

The City believes that the Bighorn decision, which applied to water fees and charges, would apply equally to sewer service charges. As a result, if the sewer service charges are a “fee” or “charge” under Article XIID, any increase would require a public hearing, preceded by mailed notices, and would be subject to a majority written protest. The City currently provides written notices to all property owners and rate-payers receiving service in connection with proposed increases in sewer service charges and holds public hearings with respect to such increases.

Article XIIC provides that the initiative power shall not be prohibited or otherwise limited in matters of reducing or repealing any local tax, assessment, fee or charge and that the power of initiative to affect local taxes, assessments, fees and charges shall be applicable to all local governments. Article XIIC does not define the terms “local tax,” “assessment,” “fee” or “charge.”

No assurance can be given that the voters of the City will not, in the future, approve an initiative, which reduces or repeals local taxes, assessments, fees or charges, including a reduction of all or any portion of the sewer service charge. The use of the initiative power is arguably limited in the case of levies directly pledged to bonded indebtedness, such as the sewer service charge. However, there is no assurance that the voters of the City will not approve an initiative that attempts to reduce the sewer service charge. The interpretation and application of Proposition 218 will likely be subject to further judicial determinations, and it is not possible at this time to predict with certainty the outcome of such determinations.

Revenue and Financial Issues

Sewer Service Charge Revenues

The Los Angeles Department of Water and Power (LADWP) acts as the billing agent for the Sewer Service Charges (SSCs) assessed to customers who use the wastewater system. The LADWP transfers revenues to the Fund on a weekly basis, based on anticipated revenues. After the end of the month, a reconciliation between the transfers and the actual SSC revenues is made. The final SSC revenue transferred by LADWP to the Fund for FY 2014-15 was \$88.1 million, or 14.6 percent, below the budgeted revenue. The FY 2014-15 revenue was 1.0 percent less than the actual revenue in FY 2012-13, even though two rate adjustments occurred on July 1, 2013 (4.5%) and July 1, 2014 (6.5%). Approximately \$14 million of the \$88.1 million revenue shortfall was related to overestimated revenue from certain customers who only pay for wastewater conveyance because their wastewater treatment is provided by another agency. The budgeted amount had included an assumption that \$25 million in uncollected revenues from FY 2013-14 would be recovered in FY 2014-15. Only part of the \$25 million may have been collected in late FY 2014-15. The remaining part of the revenue shortfall was due to a combination of water conservation during the City’s ongoing drought and delays in collections of amounts from both FY 2013-14 and FY 2014-15, arising from implementation of LADWP’s new billing system, discussed below. The FY 2014-15 budgeted revenue was not based on the reduced water consumption in FY 2013-14 due to the timing of the budget cycle and the unavailability of reports immediately after the billing conversion. There is insufficient information to know how much of the revenue reduction was due to water conservation or to the delays in collections because revenue reports from LADWP do not indicate the ages of the accounts receivable that are collected in the SSC payments from the customers. However, it is known that the actual billable sewage volume in FY 2014-15 was 8.6 percent less than the volume that was used to calculate the budgeted amount, so at least 75 percent of the revenue shortfall is an actual loss, not a deferral. Los Angeles Sanitation (LASAN) is working with LADWP to obtain the accounting reports needed to resolve this issue.

CITY OF LOS ANGELES
SEWER CONSTRUCTION AND MAINTENANCE FUND
Notes to the Fund Financial Statements (Continued)
June 30, 2015 and 2014

NOTE 8 – COMMITMENTS AND CONTINGENCIES (Continued)

LADWP transitioned to its new billing system in September 2013. As part of that transition, LADWP encountered some problems with billings; for instance, the parameters for the system identifying if a water read was "too high" or "too low" were set too narrowly, resulting in some meter reads that were correct being replaced with an estimated read. While these billing issues were being resolved, LADWP suspended the normal collections protocols. Certain customers who were not experiencing billing issues appear to have taken advantage of this suspension and have fallen in arrears with their payments. During the past few months, LADWP has been returning to their collections protocols, which involve notifying customers of past due amounts, sending a final notice, and turning off power or water service.

Budgeted SSC revenues for FY 2015-16 were \$541 million. However, in issuing bonds in June, 2015, LASAN revised the projected SSC revenue downward to \$504 million, reflecting further water conservation and assuming that the FY 2014-15 collection rate would continue through FY 2015-16. SSC collections in the first two months of FY 2015-16 were 1.0 percent less than expected in the budget, but 6.4 percent higher than the amount projected for the bond issuance. However, the estimate of the impacts in the remainder of FY 2015-16 is highly uncertain because it is unknown how many customers might leave the service area, resulting in the need to write off their past due amounts, and how soon all residential past-due customers will receive service shut-off notices. A positive feature of the new billing system is that past-due amounts will follow customers even if they move within the service area.

The Los Angeles City Council approved a ten-year series of SSC rate adjustments on February 29, 2012 and the Mayor concurred on March 1, 2012. The rates were increased by 4.5 percent on April 6, 2012, July 1, 2012 and July 1, 2013 and by 6.5 percent on July 1, 2014. The last rate adjustment increased billings by \$29 million in FY 2014-15. An additional 6.5 percent rate increase occurred on July 1, 2015. The rates will be further increased by 6.5 percent on July 1 in each of the following five years.

SSC rates will increase by 6.5 percent on July 1, 2016. For its 2015 bond issuance, LASAN projected SSC revenues of \$537 million in FY 2016-17, 6.6 percent more than is estimated for FY 2015-16. This assumed a continuance of the water conservation reflected in the estimated FY 2015-16 revenues. Because of lower projected SSC revenues, LASAN reduced its capital program in Fiscal Years 2015-16 and 2016-17 by thirty percent and reduced its FY 2017-18 capital program by ten percent to preserve its high debt service coverage ratios. Projects are deferred using risk-based criteria to ensure that the most critical projects are still constructed.

Sewerage Facilities Charge Credit

Effective April 6, 2012, the City Council and Mayor authorized credits of past Sewerage Facilities Charges (SFCs) paid by Significant Industrial Users (SIUs) to offset Quality Surcharge Fees (QSFs) paid by the customers. It is anticipated that a small number of SIUs are eligible for this program. Granting of a credit will reduce the amount of wastewater an SIU is allowed to discharge, allowing that capacity to be used by other customers who will be required to pay the SFCs. \$896,474 in credits were given in FY 2014-15. Until all of the SIUs have been evaluated, the extent that QSF revenue after FY 2014-15 will be reduced due to future credits is unknown, but \$61,400 is projected to be credited in FY 2015-16.

Contract Agencies

LASAN has entered into universal terms agreements with twenty contract agencies for which the City provides wastewater treatment services. Billings for a fiscal year are estimated based on the City's budgeted costs and the agencies' projected wastewater flow and strength. After the close of the fiscal year,

CITY OF LOS ANGELES
SEWER CONSTRUCTION AND MAINTENANCE FUND
Notes to the Fund Financial Statements (Continued)
June 30, 2015 and 2014

NOTE 8 – COMMITMENTS AND CONTINGENCIES (Continued)

these bills are then reconciled based on actual costs, flows and strengths. Revenues from the estimated and reconciliation bills were \$6.8 million more than projected in FY 2014-15. The projections had not included receipts from the City of Glendale for its share of costs at the Los Angeles-Glendale Water Reclamation Plant (LAGWRP) or payments made by two agencies in FY 2014-15 for bills that were due in FY 2013-14. Reconciliation bills for service in FY 2014-15 have not been completed at this time, so LASAN does not have sufficient data to determine if there is a likelihood of reconciliation amounts that would have a material impact to the Fund in FY 2015-16. The reconciliation bills will include interest for late payment by agencies.

Disagreements over flow and strength measurements of the City of Burbank's wastewater will soon be addressed with the joint hiring of a consultant to investigate the differences. Los Angeles has sent reconciliation invoices to Burbank for FY 2009-10 to 2014-15 and an estimated invoice for FY 2015-16, totaling approximately \$23 million, though Burbank rejected the invoices until the disagreements can be resolved. Potential reasons for the flow and strength differences include errors in the measuring devices, inaccurate calibration of the devices, and a net flow equation that does not reflect a representative flow calculation. At this time, LASAN does not have sufficient data to determine the longer-term impact to the Fund.

The contract agencies' share in the Fund's capital expenditures, billed to and paid by said contract agencies are recorded as capital contributions in the equity fund. A portion of the amount in the capital contributions may not be capitalized at the end of the year as projects are later determined as either abandoned or maintenance costs. The capital contribution, as of this fiscal year, is stated at gross amount, without any adjustments for abandonment and maintenance costs.

The City's service agreements with twenty of the twenty-nine contract agencies require the City to reimburse an agency the depreciated value of its capital contributions to the City's wastewater system in the event that the agency removes its wastewater from the system. This would require a refund of some of the capital contributions made by the contract agencies to the fund. None of the contract agencies has informed the City of its intent to cease utilizing the City's wastewater system and it is management's opinion that such an event is very unlikely in the future.

Removal of Uncollectible Accounts Receivable Balance Owed by Inactive Industrial Users

In FY 2014-15, the Board of Public Works instructed the Industrial Waste Management Division to pursue collection of delinquent industrial waste fees, including the revocation of industrial waste permits for some of the active permit-holders, before proposing write-offs for non-active permit-holders. In FY 2014-15, the Division submitted six cases to the Board for industrial waste permit revocation. One permit was revoked and five industrial users were granted installment payment plans by the Board. In FY 2014-15, LASAN did not refer uncollectible delinquent accounts receivable to the Board for write-off.

Front-funded Grants

The Fund has provided grant front-funding of \$1,983,771 for the Integrated Regional Water Management Plan (IRWMP) – North Atwater Creek Restoration and Water Quality Enhancement Project. The Fund is reimbursed the funded amounts when the City receives the grants covering the amounts. The grants are

CITY OF LOS ANGELES
SEWER CONSTRUCTION AND MAINTENANCE FUND
Notes to the Fund Financial Statements (Continued)
June 30, 2015 and 2014

NOTE 8 – COMMITMENTS AND CONTINGENCIES (Continued)

reduced by a 2.5 percent administrative fee, in accordance with the memorandum of understanding between City and the Los Angeles County Flood Control District. \$1. 7 million, or 91 percent, of the expected grant receipts have already been received. The remaining amount, which is retention, is expected to be received when the project is closed out in 2016.

On August 11, 2014, the Mayor and City Council authorized a loan from the Fund to the Stormwater Pollution Abatement Fund (CF 14-0914) in the amount of \$6,863,853 for construction of the Ballona Creek Water Quality Improvement and Beneficial Use Project. The project will use the existing North Outfall Wastewater Treatment Facility to treat dry weather flow in the creek. LASAN currently projects making the loan in FY 2016-17. The loan is to be repaid by grant proceeds and the Stormwater Pollution Abatement Fund, with interest, and is contingent upon the City receiving a 2012 Clean Beaches Initiative Grant Program award of at least \$2,500,000 from the State Water Resources Control Board (SWRCB). At this time, it is unknown how long it may take for the Fund to fully recover these costs.

Front-funded Programs

In 2005, City entered into a memorandum of understanding with the Los Angeles Regional Water Quality Control Board (LARWQCB) to regulate Onsite Wastewater Treatment Systems. During the time that the City has been developing this program, it has been front-funded by the Fund. The costs incurred as of June 30, 2015 were \$2.7 million. When the ordinance governing this program is adopted, a schedule of fees will be included. These fees will be required to recover the past program costs as well as the ongoing operational costs of the program in order to remain in compliance with Proposition 218. At this time it is unknown how long it may take for the Fund to fully recover these costs.

Capital Projects

Collection System Settlement Agreement (CSSA)

The CSSA has required the construction of several projects including, but not limited to, the Figueroa Meridian York Relief Sewer project, Mission and Jesse Air Treatment Facility (ATF) project, Central Outfall Sewer - 59th Street and Fourth Avenue project, Supplemental Environmental Projects (SEPs) and numerous projects in the Secondary Sewer Renewal Program. All of these projects were successfully completed on or before the end of the term of the agreement on June 30, 2014. The CSSA was officially terminated by the Court on May 26, 2015 and the City's CSSA obligations are complete, including all ATF requirements.

Pending Construction Issues with Collection System Projects

Certain construction projects have pending construction issues that could exceed the project budgets. Ongoing efforts are taken to resolve these issues as the construction progresses. However, since significant scope of work has yet to be completed, it is estimated that aggregate amounts of \$1 million may be requested by the contractors. The City believes it has sufficient defense to allow the resolution of the issues at a lower price. The City was successful in settling with the ATF – ECIS Mission and Jesse contractor over delays attributable to not receiving LADWP power in a timely manner, so there is no pending issue with the contract.

CITY OF LOS ANGELES
SEWER CONSTRUCTION AND MAINTENANCE FUND
Notes to the Fund Financial Statements (Continued)
June 30, 2015 and 2014

NOTE 8 – COMMITMENTS AND CONTINGENCIES (Continued)

Regulatory and Legal Issues

Total Maximum Daily Loads (TMDLs)

The USEPA and the LARWQCB are required to develop TMDLs for impaired water bodies. Various watersheds in the Los Angeles area have water body segments that are listed as impaired due to a variety of pollutants. Although some TMDLs have already been released, additional TMDLs will be under development and compliance with both existing and new TMDLs will continue into the next decade. At this time, it is difficult to predict the full impact of TMDLs on the National Pollutant Discharge Elimination System (NPDES) effluent limits at the City's four water reclamation and wastewater treatment plants. In addition, the proposed Greater Los Angeles County Municipal Separate Stormwater Sewer Systems (MS4) permit, adopted by the LARWQCB in November 2012, contains provisions that require compliance with all the adopted TMDLs. It is expected that significant capital improvements funded by the Fund may be required to comply with the TMDLs and their resulting impact on the City's NPDES permits.

NPDES Permits

The LARWQCB adopted new NPDES permits for the DC Tillman Water Reclamation Plant (DCTWRP) and LAGWRP on December 8, 2011. Currently, both DCTWRP and LAGWRP are complying with their final permit limits for copper, and neither plant is expected to experience difficulty meeting these final copper effluent limits. The Cities of Burbank and Los Angeles completed a Copper Site-Specific Objective Study for the Los Angeles River. The study was adopted by the LARWQCB on May 6, 2010. The study has been approved by the SWRCB, USEPA and the Office of Administrative Law. The study has been incorporated into the Los Angeles River heavy metal TMDL. Based upon the new copper effluent limit in the permits and the current level of copper removal achieved, it is anticipated that there will be no potential financial impact to the City.

The previous permits also required compliance with the Nitrogen TMDL and construction of Nitrification-Denitrification (NDN) facilities. NDN facilities have been constructed at DCTWRP and LAGWRP. DCTWRP and LAGWRP have been operating in full NDN mode since September 2007 and have met their final ammonia effluent limits. An Ammonia Site Specific Objective (SSO) Study was approved by the LARWQCB and recently was adopted by the SWRCB, Office of Administrative Law and USEPA. The final adoption of the SSO study into the DCTWRP and LAGWRP NPDES's permits will allow adjustment of the final ammonia limits, allowing operators flexibility in the disinfection process. The LARWQCB reopened the Nitrogen TMDL and revised the Waste Load Allocations for Ammonia. Consideration to include the new limits in the permits is ongoing. The inclusion of the ammonia effluent limit in the NPDES permit is expected to take place in the next permit cycle; meanwhile, LASAN has received a Time Schedule Order from the LARWQCB for the ammonia effluent limit for DCTWRP until the adoption of the new NPDES permit, when the new limits are expected to be included in the permit. If the results of the SSO study are not incorporated into the permits, then operator flexibility may be limited and additional modifications to the treatment process may be required. Potential costs for compliance are unknown at this time.

CITY OF LOS ANGELES
SEWER CONSTRUCTION AND MAINTENANCE FUND
Notes to the Fund Financial Statements (Continued)
June 30, 2015 and 2014

NOTE 8 – COMMITMENTS AND CONTINGENCIES (Continued)

On June 11, 2015, the LARWQCB adopted the Terminal Island Water Reclamation Plant's (TIWRP's) new NPDES permit, which will expire on July 31, 2020. The prohibition language in the new permit was modified to allow for the discharge of the brine and the occasional discharge of the tertiary treated wastewater into the Los Angeles Harbor. The new NPDES permit is based upon Resolution 94-009 adopted by LARWQCB in 1994 and, as required by the 1974 Bay and Estuary policy that called for the City to eliminate TIWRP tertiary discharge to the Harbor. Resolution 94-009 sets the goal of eliminating the effluent discharge by 2020 through expansion of the Advance Water Purification Facility (AWPF) and increasing water reuse. LASAN has submitted new Water Recycling Requirements permit renewal applications to the RWQCB for expansion of the AWPF facility, including the future discharge of the AWPF recycled water to Machado Lake. Previous water recycling facilities constructed and operated at TIWRP received direct funding from the LADWP. However, LASAN and LADWP have agreed that LASAN will pay for and own the AWPF expansion and will recover the costs of the facility by selling the recycled water from the facility to LADWP.

Employment Claims

There are two outstanding lawsuits involving City employees. These lawsuits do not state amounts. One of the lawsuits are class actions which could in the aggregate exceed the \$950,000 reporting threshold. The class action lawsuit alleges LASAN's improper control of the sewer maintenance workers at lunch time, which, if successful, could also result in the payment of retroactive overtime pay to workers. All lawsuits are currently in discovery, wherein settlement negotiations are attempted during court mandated meditations.

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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***

Honorable Members of the City Council
City of Los Angeles, 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 contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the City of Los Angeles’ Sewer Construction and Maintenance Fund (Fund), an Enterprise Fund of the City of Los Angeles (City), as of and for the year ended June 30, 2015, and the related notes to the financial statements, and have issued our report thereon dated February 5, 2016.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Fund’s internal control over financial reporting (internal control) 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 Fund’s internal control. Accordingly, we do not express an opinion on the effectiveness of the Fund’s internal control.

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 and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We did identify a deficiency in internal control, described in the accompanying schedule of finding and recommendations as item 2015-001 that we consider to be a significant deficiency.

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 its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with

those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

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

Los Angeles, California
February 5, 2016

CITY OF LOS ANGELES
SEWER CONSTRUCTION AND MAINTENANCE FUND
Schedule of Finding and Recommendations
June 30, 2015

2015-001 – Reconciliation and collectability of interfund receivables

Criteria:

The reconciliation of and the maintenance of documentation detailing the listing of interfund receivables/payables as well as determining the collectability of the interfund balance is critical in preparing financial statements in conformity with Generally Accepted Accounting Principles (GAAP) in the United States.

Condition:

During our audit, we noted that the initial reconciliation process over interfund receivables and its repayment provisions were not performed to the concurrence of all key related parties. While concurrence on the reconciliation was ultimately achieved, we recommended and management recorded an entry to reclassify \$32.6 million to advances to other funds as the amount would be repaid over the next 4 years.

Cause:

Based on our discussion with management, the Department of Public Works had various vacant professional, scientific, and technical positions, such as accounting and management positions that went un-filled due to early retirements, Great Recession of 2008 economic downturn, and managed hiring. These vacancies spanned across the entire department, reducing the available resources needed.

Effect:

Absent an internal control to reconcile interfund receivables/payables to the concurrence of all key related parties and perform an assessment of repayment provisions may result in the financial statements not being in conformity with GAAP.

Recommendation:

We recommend that procedures be established to ensure that interfund receivables are reconciled to the concurrence of all key related parties during the year and that a determination of repayment provisions of these amounts occur at year end. This procedure will assist in ensuring the accuracy of interfund receivables for financial reporting.

Management's Response:

The Board of Public Works (Board) and Bureau of Sanitation (BOS) are implementing additional reconciliation procedures to institute a more robust internal control process, in addition to the regular reconciliation process already in place. The Board and BOS, in coordination with other Bureaus and City departments, will make all the necessary adjustments in order to ensure that accounts are reconciled at fiscal year-end.

In terms of repayment, the Fund offsets over-reimbursements to the General Fund (Due From) against under-reimbursements to General Fund (Due To) to decrease uncollected over-reimbursements from the General Fund at year end. Most important, the City will ensure receipts and/or reduction of the Fund's collectible accounts at least annually with adjustments beginning in the current fiscal year 2015-16.