CITY OF LOS ANGELES
DEPARTMENT OF WATER AND POWER
WATER SYSTEM

Financial Statements and
Required Supplementary Information

June 30, 2016 and 2015

(With Independent Auditors' Report Thereon)

CITY OF LOS ANGELES
DEPARTMENT OF WATER AND POWER
WATER SYSTEM

June 30, 2016 and 2015

Table of Contents

KPMG LLP
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Independent Auditors' Report

The Board of Water and Power Commissioners
City of Los Angeles
Department of Water and Power:

Report on the Financial Statements

We have audited the accompanying financial statements of the City of Los Angeles Department of Water and Power Water Revenue Fund (Water System), an enterprise fund of the City of Los Angeles, California, as of and for the years ended June 30, 2016 and 2015, and the related notes to the financial statements, which collectively comprise the Water System's basic financial statements for the years ended 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 U.S. generally accepted accounting principles; 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.

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the City of Los Angeles Department of Water and Power Water Revenue Fund as of June 30, 2016 and 2015, and the changes in its financial position and its cash flows for the years, then ended in accordance with U.S. generally accepted accounting principles.

Emphasis of Matters

As discussed in note 1, the financial statements present only the Water System and do not purport to, and do not, present fairly the financial position of the City of Los Angeles, California, as of June 30, 2016 and 2015, the changes in its financial position, or, where applicable, its cash flows for the year then ended in accordance with U.S. generally accepted accounting principles. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

U.S. generally accepted accounting principles require that the management's discussion and analysis and the required supplementary information on pages 3–13 and 69–71 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated December 21, 2016, on our consideration of the Water System'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 Water System's internal control over financial reporting and compliance.

KPMG LLP

Los Angeles, California
December 21, 2016

The following discussion and analysis of the financial performance of the City of Los Angeles Department of Water and Power Water Revenue Fund (Water System) provides an overview of the financial activities for the fiscal years ended June 30, 2016 and 2015. Descriptions and other details pertaining to the Water System are included in the notes to the financial statements. This discussion and analysis should be read in conjunction with the Water System's financial statements, which begins on page 14.

Using This Financial Report

This annual financial report consists of the Water System's financial statements and required supplementary information and reflects the self-supporting activities of the Water System that are funded primarily through the sale of water to the public it serves.

Statements of Net Position, Statements of Revenue, Expenses, and Changes in Net Position, and Statements of Cash Flows

The financial statements provide an indication of the Water System's financial health. The statements of net position include all of the Water System's assets and liabilities using the accrual basis of accounting, as well as an indication about which assets can be utilized for general purposes, and which assets are restricted as a result of bond covenants and other commitments as of June 30, 2016 and 2015. The statements of revenue, expenses, and changes in net position report all of the revenue and expenses during the time periods indicated. The statements of cash flows report the cash provided and used by operating activities, noncapital financing activities, capital and related financing activities, and investing activities during the years June 30, 2016 and 2015.

(Continued)

The following tables summarize the financial condition and changes in net position of the Water System as of and for the fiscal years ended June 30, 2016, 2015, and 2014:

Table 1 – Condensed Schedule of Assets, Deferred Outflows, Liabilities, and Net Position

(Amounts in millions)

		June 30		
Assets and Deferred Outflows		**2016**	**2015**	**2014**
Utility plant, net	$	7,013	6,513	5,950
Investments		34	34	33
Other noncurrent assets		1,248	1,008	1,154
Current assets		912	752	756
Deferred outflows		259	295	167
Total assets and deferred outflows	$	9,466	8,602	8,060
Net Position				
Net position:				
Net investment in capital assets	$	2,204	2,086	2,020
Restricted		400	377	363
Unrestricted		392	378	351
Total net position		2,996	2,841	2,734
Liabilities and Deferred Inflows				
Long-term debt, net of current portion	$	5,162	4,497	4,115
Other long-term liabilities		402	437	610
Current liabilities		692	501	485
Deferred inflows – debt refunding		13	—	—
Deferred inflows – pension		201	326	116
Total liabilities and deferred inflows		6,470	5,761	5,326
Total net position, liabilities, and deferred outflows	$	9,466	8,602	8,060

(Continued)

Table 2 – Condensed Schedule of Revenues, Expenses, and Changes in Net Position

(Amounts in millions)

		Year ended June 30	
	2016	**2015**	**2014**
Operating revenue:			
Residential	$ 458	432	476
Multiple-dwelling units	340	331	342
Commercial and industrial	278	269	269
Other	56	50	55
Total operating revenue	1,132	1,082	1,142
Operating expenses:			
Purchased water	(262)	(273)	(339)
Maintenance and other operating expenses	(474)	(460)	(431)
Depreciation and amortization	(144)	(137)	(123)
Total operating expenses	(880)	(870)	(893)
Operating income	252	212	249
Nonoperating revenue (expense):			
Investment income	9	6	7
Federal bond subsidies	17	17	17
Other nonoperating revenue and expenses, net	3	2	8
Debt expense, net	(173)	(164)	(156)
Total nonoperating revenue (expense), net	(144)	(139)	(124)
Income before capital contributions	108	73	125
Capital contributions	47	34	28
Increase in net position	155	107	153
Beginning balance of net position	2,841	2,734	2,581
Ending balance of net position	$ 2,996	2,841	2,734

Assets

Utility Plant

The Water System utility plant assets fall into five major categories: source of water supply, pumping, purification, distribution, and general (water infrastructure). Each category of assets is important for providing water services and has a specific purpose. During fiscal years 2016 and 2015, the Water System's net utility plant increased $500 million and $563 million, respectively. Net utility plant consists of significant investments in water infrastructure less accumulated depreciation.

For fiscal year 2016, utility plant additions were $641 million. Of this increase, $577 million was transferred from construction work in progress (CWIP) and the remaining increases were direct additions. Direct additions are mostly related to improvements in distribution infrastructure as part of the Department's reliability program. Many of the Department's assets were installed between 1920 and 1970, thus the reliability program evaluates water main infrastructure to determine which assets should be replaced first to reduce leaks and the frequency of water service disruptions due to water main breaks.

Additions from CWIP are mostly for additional source of water supply and distribution system assets. During fiscal year 2016, the Water System invested $353 million in the Owens Lake Dust Control Program, which includes installing dust control measures, the installation of a fence in seven dust control areas; and the provision of dust control on 3.61 square miles of lakebed using shallow flood, gravel, and managed vegetation. Also contributing to the source of water supply additions and betterments, is the pressurization of the lower reach of the River Supply Conduit.

In 2016, the value of assets in distribution infrastructure was increased by $339 million, which was mainly due to the planning, design, and construction of the Headworks Underground Reservoir; the replacement of deteriorated and obsolete mains; the installation of water service connections and the enlargement of existing services; and the continued replacement of meters with lead-free meters and fittings. With the completion of these large projects, the balance in the CWIP account decreased $577 million.

In 2016, accumulated depreciation increased $142 million. The Water System uses the straight-line depreciation method for all assets based on estimated service lives. The increase in accumulated depreciation was mostly due to depreciation recognized on source of supply and distribution plant assets.

Of the $563 million of additions during fiscal year 2015, $204 million is related to distribution plant assets and is mostly attributable to the installation/replacement of trunk lines, mains, meters, and services. Additions included the construction of the Trunkline Headquarters and Meters Shop, improvements to the Santa Ynez Reservoir, the construction of the Sycamore Trunk Line, the purchase of additional Los Angeles Reservoir shade balls, and the replacement of existing meters with lead-free meters and fittings.

In 2015, the value of assets in source of water supply was increased by $132 million, which is mainly due to the River Supply Conduit Lower Reach 4, improvements made to the Van Norman Reservoir, improvements made to the Los Angeles Aqueduct, and the purchase of groundwater rights. Purification stations and pumping stations increased by $47 million, or 11%, due mostly to improvements made to the Los Angeles Aqueduct Filtration Plant, the conversion of the Manhattan Wells Ammonization Station to chloramine disinfection, and other upgrades and expansions of treatment facilities. General plant was increased by $46 million and was mainly attributable to additions to fleet and office equipment.

(Continued)

Source of water supply assets are the assets that the Department has constructed and/or purchased to help ensure an adequate supply of water. The Department has four major sources of water. These include the following:

- Los Angeles Aqueduct and Second Los Angeles Aqueduct supply imported water from the Owens Valley and the Mono Basin
- Local groundwater supply (with pumping rights in the San Fernando, Sylmar, and Central and West Coast Basins)
- Purchased supply from Metropolitan Water District

  Recycled water

All sources of water, except for recycled water, are supplied for potable use, that is, the water from these sources is of drinkable quality. Table 3 below shows the percentage of potable water delivered from the major sources:

Table 3 – Sources of Potable Water

Supplied during Fiscal years 2016, 2015, and 2014

	Fiscal year 2016		Fiscal year 2015		Fiscal year 2014	
	Millions of gallons	Percentage	Millions of gallons	Percentage	Millions of gallons	Percentage
Source:						
Aqueduct	16,640	11%	17,448	10%	19,922	10%
Wells	25,759	16	31,443	18	21,950	12
Purchases	112,667	71	125,615	70	145,693	76
Recycled w ater	3,229	2	3,394	2	3,275	2
	158,295	100%	177,900	100%	190,840	100%

Water storage during low demand, cold, or wet periods is essential to provide the capacity needed to supply the extra water needed during warm weather or emergency situations. The Water System's 130 tanks and reservoirs, ranging in size from 10 thousand to 60 billion gallons, have a current capacity of approximately, 313,049 acre-feet, or 102.15 billion gallons. Nine aqueduct reservoirs provide 96% of the Water System's storage capacity; major and minor distribution reservoirs provide the remaining 4%.

Further information regarding the Water System's utility plant can be found in note 3 to the accompanying financial statements.

Net Position, Liabilities, and Deferred Inflows

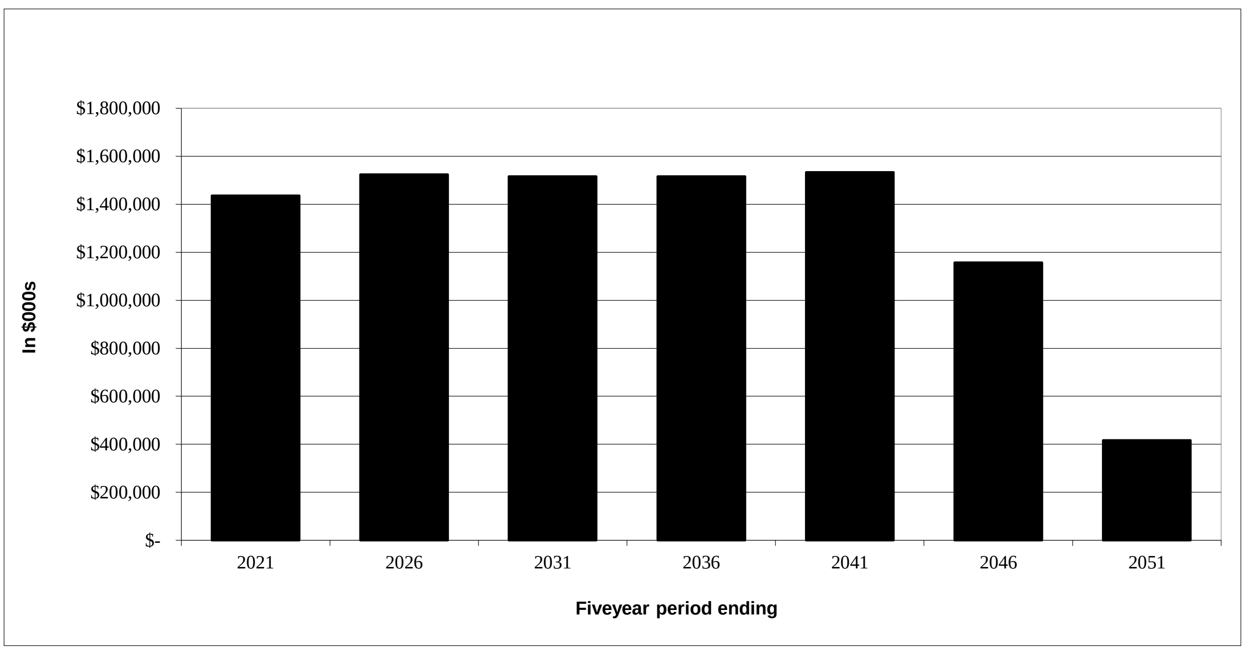
Long-Term Debt

As of June 30, 2016, the Water System's total outstanding long-term debt balance, including the current portion was approximately $5.25 billion. This is an increase of $681 million over the prior year, resulting from the sale of $894 million in Water System revenue bonds plus $172 million in issue premiums and $73 million in loans from the State of California's State Water Resources Control Board (SWRCB), offset by scheduled maturities of $46 million, defeasance of $382 million, and $31 million of amortized premiums and discounts.

As of June 30, 2015, Water System's total outstanding long-term debt balance was approximately $4.6 billion. This is an increase of $394 million over the prior year, resulting from the sale of $271 million in Water System revenue bonds plus $40 million in issue premiums and $128 million in loans from the State of California's State Water Resources Control Board, offset by scheduled maturities of $30 million, and $15 million of amortized premiums and discounts.

Scheduled payments of principal, plus scheduled interest as of June 30, 2016, is shown in the chart below:

Chart: Debt Service Requirements



In March 2016, Standard & Poor's Rating Services upgraded the Water System's bond rating to AA+ from AA, while Moody's Investors Service and Fitch Ratings affirmed the bond rating of Aa2 and AA, respectively. Additional information regarding the Water System's long-term debt can be found in note 6 to the financial statements.

The Master Bond Resolution allows for parity debt to be issued as long as the Department maintains debt service coverage of 1.25. The Water System debt service coverage for fiscal year 2015–16 was 1.99.

The Water System's pension liability decreased $38 million from fiscal year 2015 to 2016 and $172 million from 2014 to 2015 due to the pension activity below:

Description		Fiscal year ending 2016	2015
Beginning net pension liability	$	411,485	583,344
Pension expense		(8,782)	31,187
Employer contributions		(125,944)	(129,061)
New net deferred inflows/outflows		37,376	(99,780)
Recognition of prior deferred inflows/outflows		58,889	25,795
Ending net pension liability	$	373,024	411,485

Assuming actuarial projections are in the line with actual results, the pension liability increases with pension expense and decreases with employer contributions. Differences between expected and actual experience are recorded as deferred outflows and deferred inflows and are amortized over a maximum of six years.

Other Noncurrent Assets

During fiscal year 2016, other noncurrent assets increased $240 million due to a increase of $310.2 million of restricted cash and cash equivalents for construction purposes and a $129.5 million decrease in the regulatory asset for pension offset by a $52.1 million increase in other regulatory assets due to irrigation and reclaimed water upgrades and high efficiency toilet rebates and a $6.9 million increase in the postemployment asset due to Department contributions exceeding actuarially required contributions.

During fiscal year 2015, other noncurrent assets increased $173 million primarily due to a increase of $169.3 million of restricted cash and cash equivalents for construction purposes, a $13.8 million increase in regulatory assets due to irrigation and reclaimed water upgrades and high efficiency toilet rebates, and an increase of $7.5 million in the postemployment asset due to Department contributions exceeding actuarially required contributions.

(Continued)

Changes in Net Position

Revenue

The operating revenue of the Water System are generated from selling water to its customers. The current water rate ordinance effective April 15, 2016 has two types of components, a base rate and adjustable rates, which are referred to as pass-through rates. The pass-through rates are in place to recover the cost of specific expenses. These specific expenses include purchased water, water quality, reclaimed water, demand side management (or conservation expense), water security, Owens Valley regulatory, and low-income subsidy credits. As a result of the inclusion of pass-through rates in the water rates, revenue can increase or decrease from one year to the next based on the Water System incurring greater or smaller expenses in these categories.

The Water System has five major customer categories. These categories include residential, multiple-dwelling units, commercial, industrial, and other. Table 4 below summarizes the percentage contribution of revenue from each customer category during fiscal years 2016 and 2015:

Table 4 – Revenue and Percentage of Revenue by Customer Class
(Amounts in thousands)

	Fiscal year 2016		Fiscal year 2015		Fiscal year 2014	
	Revenue	Percentage	Revenue	Percentage	Revenue	Percentage
Type of customer:						
Residential	$ 457,961	40 %	$ 431,944	40%	$ 475,867	42%
Multiple-dwelling units	339,787	30	331,238	30	342,437	30
Commercial	234,728	21	223,504	21	226,631	20
Industrial	43,057	4	45,467	4	42,784	4
Other, net of uncollectible accounts	56,244	5	50,428	5	54,104	4
	$ 1,131,777	100 %	$ 1,082,581	100%	$ 1,141,823	100%

Residential customers, including those in multiple-dwelling units, provided approximately 70% of the Water System's 2016 and 2015 revenue, respectively, representing the largest class of customers. As of June 30, 2016, the Water System had approximately 678,000 customers. As shown in Table 5 below, 484,000, or 71%, of total customers were in the residential customer class as of June 30, 2016 and 2015:

Table 5 – Number of Customers and Percentage of Customers by Customer Class
(Numbers in thousands)

	Fiscal year 2016		Fiscal year 2015		Fiscal year 2014	
	Number	Percentage	Number	Percentage	Number	Percentage
Type of customer:						
Residential	484	71 %	483	71%	483	71%
Multiple-dwelling units	121	18	121	18	122	18
Commercial	59	9	59	9	60	9
Industrial	6	1	6	1	6	1
Other, including uncollectible accounts	8	1	7	1	8	1
	678	100 %	676	100%	679	100%

During fiscal year 2016, operating revenue increased by $49.2 million, or 4.5%, from fiscal year 2015, due to an increase in project costs funded through pass through revenue of $162.4. The increase was offset by lower billed revenue of $113.2 compared to 2015 due to lower sales of water of 21.3 million hundred cubic feet or 9.8% compared to 2015.

During fiscal year 2015, operating revenue decreased by $59.5 million, or -5.21%, from fiscal year 2014. Primarily due to successful customer conservation, sales of water decreased by 20.1 million hundred cubic feet. Residential and multiple-dwelling units customer classes reported $44 million and $11 million revenue decreases, respectively.

Operating Expenses

Purchased water expense is the single largest expense the Water System incurs each fiscal year and represents the cost of buying water. As California continues to experience one of the most severe droughts on record, successful conservation efforts reduced water usage, which contributed to the $11.2 million decrease, or -4.1%, in purchased water from the Metropolitan Water District.

Table 6 below summarizes the Water System's operating expenses for fiscal years 2016, 2015, and 2014:

Table 6 – Operating Expenses and Percentage of Expense by Type Expense
(Amounts in thousands)

	Fiscal year 2016		Fiscal year 2015		Fiscal year 2014	
	Expenses	**Percentage**	**Expenses**	**Percentage**	**Expenses**	**Percentage**
Type of expense:						
Purchased water	$ 261,971	30 %	$ 273,132	31 %	$ 339,380	38 %
Other operating expenses	334,545	38	323,655	37	303,070	35
Maintenance	139,253	16	136,496	16	127,918	14
Depreciation and amortization	144,186	16	136,559	16	123,337	13
	$ 879,955	100 %	$ 869,842	100 %	$ 893,705	100 %

Fiscal Year 2016

Fiscal year 2016, maintenance and other operating expenses were $14 million higher as compared to the prior year. The increase was due to a $12.3 million increase in customer accounting and collection expenses, a $3.3 million increase administrative and general expenses due to higher legal, special services, and environmental costs, offset by a $1.2 million decrease in maintenance expenses.

Purchased Water decreased by $11.1 million compared to the prior year. Consumption of water was 21.3 million in hundred cubic feet lower year over year.

Fiscal Year 2015

Fiscal year 2015 operating expenses were $23.9 million lower as compared to the prior year. This was principally due to a $66.2 million decrease in purchased water costs. Water supplied by the aqueduct was 12.4% lower year over year due to a reduced snowpack and Owens Valley environmental uses.

The $20.6 million increase in other operating expense was primarily due to higher year-over-year operating costs associated with administrative and general expenses of $18.1 million, pumping expenses of $5.6 million, distribution expenses of $2.2 million, and customer accounting and collecting expenses of $1.7 million offset by lower source of water supply costs of $7.6 million.

The $8.6 million increase in maintenance expense was mainly due to higher year-over-year maintenance costs associated with distribution plant of $5.8 million and source of water supply of $3.9 million offset by lower pumping plant maintenance expenses of $1.6 million.

The $13.2 million increase in depreciation expense was attributed to additions to distribution plant of $3.4 million, purification plant of $2.8 million, intangible plant of $2.4 million, general plant of $2.0 million, and source of supply plant of $1.9 million.

Nonoperating Revenue and Expenses

Fiscal Year 2016

Compared to the prior fiscal year, fiscal year 2016 nonoperating revenue and nonoperating expenses were $3.8 million higher and $0.4 million lower, respectively. The $3.0 million increase in investment income can be attributed to changes in the market values of investments.

Debt costs, excluding the allowance for funds used during construction, increased $7.8 million year over year. The $7.8 million net increase resulted from a $9.3 million increase in interest expense, due to the issuances of new debt, reduced by debt amortization expenses of $1.5 million.

Capital contributions increased by $12.0 million primarily due to receiving State of California Proposition 84 funding in storm water matching grants.

Fiscal Year 2015

Compared to the prior fiscal year, fiscal year 2015 nonoperating revenue and nonoperating expenses were $6.9 million and $0.4 million lower, respectively. The $1.1 million decrease in investment income can be attributed to changes in the market values of investments.

Debt costs, excluding the allowance for funds used during construction, increased by $13.1 million. The interest expense increase was impacted by the issuance of the 2014 A bond issuance of $270 million in fiscal year 2015.

Capital contributions increased by $6.1 million primarily due to a $10.4 million increase in billings to Los Angeles County for costs associated with the Metro Rail system.

Other Matters

Beginning July 1, 2016, the assumed rate of return on retirement and postemployment assets dropped from 7.50% to 7.25%. The change in the investment rate will be smoothed in over a two-year period based on the direction of the Board of Administration over the Retirement Plan.

On December 5, 2016, the first meeting of the Southern California Public Water Authority (SCPWA), a California joint powers authority to allow securitization and financing of certain specified water projects of public water utilities, under AB 850 (2013), was held. The current member agencies are the Los Angeles Department of Water and Power and the City of Burbank Department of Water and Power.

CITY OF LOS ANGELES
DEPARTMENT OF WATER AND POWER
WATER SYSTEM

Statements of Net Position

June 30, 2016 and 2015
(Amounts in thousands)

Assets and Deferred Outflows		2016	2015
Noncurrent assets:			
Utility plant:			
Source of water supply	$	1,939,935	1,576,514
Pumping		284,509	268,816
Purification		804,492	786,730
Distribution		4,815,614	4,476,970
General		721,050	704,764
Total		8,565,600	7,813,794
Accumulated depreciation		(2,613,961)	(2,482,031)
Total		5,951,639	5,331,763
Construction work in progress		1,061,382	1,182,001
Total		7,013,021	6,513,764
Investments		33,706	33,511
Cash and cash equivalents – restricted		447,658	137,422
Regulatory assets – other		158,984	106,911
Regulatory asset – pension		320,481	450,003
Net other postemployment benefit asset		320,463	313,532
Total noncurrent assets		8,294,313	7,555,143
Current assets:			
Cash and cash equivalents – unrestricted		312,009	342,742
Cash and cash equivalents – restricted		146,453	131,650
Cash collateral received from securities lending transactions		7,486	4,180
Customer and other accounts receivable, net of $50,283 and $41,000 allowance for losses for 2016 and 2015, respectively		80,458	85,676
Underrecovered costs		233,730	79,255
Accrued unbilled revenue		92,248	69,042
Materials and supplies		19,784	19,343
Prepayments and other current assets		20,447	19,680
Total current assets		912,615	751,568
Total assets		9,206,928	8,306,711
Deferred outflows – debt refunding		28,420	30,505
Deferred outflows – changes in pension assumptions		112,511	141,130
Deferred outflows – pension contributions made after measurement date		118,425	123,629
Total deferred outflows		259,356	295,264
Total assets and deferred outflows	$	9,466,284	8,601,975

CITY OF LOS ANGELES
DEPARTMENT OF WATER AND POWER
WATER SYSTEM

Statements of Net Position

June 30, 2016 and 2015
(Amounts in thousands)

Net Position, Liabilities, and Deferred Inflows		**2016**	**2015**
Net position:			
Net investment in capital assets	$	2,203,533	2,086,028
Restricted:			
Debt service		51,200	36,919
Other postemployment benefits		320,463	313,532
Other purposes		28,171	27,167
Unrestricted		392,316	377,866
Total net position		2,995,683	2,841,512
Long-term debt, net of current portion		5,162,410	4,496,962
Other noncurrent liabilities:			
Accrued workers’ compensation claims		29,329	25,468
Net pension liability		373,024	411,485
Total other noncurrent liabilities		402,353	436,953
Current liabilities:			
Current portion of long-term debt		87,190	71,535
Accounts payable and accrued expenses		131,390	133,973
Line of credit		150,000	—
Due to Power System		7,918	3,899
Accrued employee expenses		55,781	54,585
Accrued interest		89,767	94,666
Obligations under securities lending transactions		7,486	4,180
Customer deposits		162,127	137,862
Total current liabilities		691,659	500,700
Total liabilities		6,256,422	5,434,615
Deferred inflows – debt refunding		13,215	—
Deferred inflows – pension		200,964	325,848
Total deferred inflows		214,179	325,848
Total net position, liabilities, and deferred inflows	$	9,466,284	8,601,975

See accompanying notes to financial statements.

CITY OF LOS ANGELES
DEPARTMENT OF WATER AND POWER
WATER SYSTEM

Statements of Revenues, Expenses, and Changes in Net Position

Years ended June 30, 2016 and 2015
(Amounts in thousands)

		2016	2015
Operating revenue:			
Residential	$	457,961	431,944
Multiple-dwelling units		339,787	331,238
Commercial and industrial		277,786	268,971
Other		69,096	60,864
Uncollectible accounts		(12,853)	(10,436)
Total operating revenue		1,131,777	1,082,581
Operating expense:			
Purchased water		261,971	273,132
Maintenance and other operating expenses		473,798	460,151
Depreciation and amortization		144,186	136,559
Total operating expenses		879,955	869,842
Operating income		251,822	212,739
Nonoperating revenue (expense):			
Investment income		8,564	5,530
Federal bond subsidies		17,270	17,178
Other nonoperating income		6,653	5,936
Total nonoperating revenue		32,487	28,644
Other nonoperating expenses		(4,208)	(3,825)
Nonoperating revenue (expense), net		28,279	24,819
Debt expenses:			
Interest on debt		181,343	173,550
Allowance for funds used during construction		(8,661)	(9,565)
Total debt expenses		172,682	163,985
Income before capital contributions		107,419	73,573
Capital contributions		46,752	34,390
Increase in net position		154,171	107,963
Net position:			
Beginning of year		2,841,512	2,733,549
End of year	$	2,995,683	2,841,512

See accompanying notes to financial statements.

CITY OF LOS ANGELES
DEPARTMENT OF WATER AND POWER
WATER SYSTEM

Statements of Cash Flows

Years ended June 30, 2016 and 2015
(Amounts in thousands)

	2016	2015
Cash flows from operating activities:		
Cash receipts:		
Cash receipts from customers	$ 1,016,864	1,171,266
Cash receipts from customers for other agency services	559,405	500,423
Cash receipts from interfund services provided	509,994	492,144
Other cash receipts	—	2,537
Cash disbursements:		
Cash payments to employees	(271,899)	(243,931)
Cash payments to suppliers	(407,096)	(423,518)
Cash payments for interfund services used	(669,916)	(663,180)
Cash payments to other agencies for fees collected	(547,023)	(510,950)
Other cash payments	(5,867)	—
Net cash provided by operating activities	184,462	324,791
Cash flows from capital and related financing activities:		
Additions to plant and equipment, net	(614,382)	(687,360)
Capital contributions	40,072	33,685
Principal payments and maturities on long-term debt	(29,032)	(19,650)
Proceeds from issuance of bonds and line of credit	831,631	310,171
Proceeds from California Department of Water Resources Board loan	73,365	128,187
Payments of California Department of Water Resources Board loan	(16,572)	(10,472)
Debt interest payments	(200,876)	(179,770)
Federal bond subsidies	17,270	17,178
Net cash provided by (used in) capital and related financing activities	101,476	(408,031)
Cash flows from investing activities:		
Purchases of investment securities	(86,676)	(62,313)
Sales of investment securities	86,751	62,140
Investment income	8,293	5,580
Net cash provided by investing activities	8,368	5,407
Net increase (decrease) in cash and cash equivalents	294,306	(77,833)
Cash and cash equivalents:		
Cash and cash equivalents at beginning of year (including $269,072 and $353,228 reported in restricted accounts at June 30, 2016 and 2015, respectively)	611,814	689,647
Cash and cash equivalents at end of year (including $594,111 and $269,072 reported in restricted accounts at June 30, 2016 and 2015, respectively)	$ 906,120	611,814

(Continued)

CITY OF LOS ANGELES
DEPARTMENT OF WATER AND POWER
WATER SYSTEM

Statements of Cash Flows

Years ended June 30, 2016 and 2015
(Amounts in thousands)

		2016	2015
Reconciliation of operating income to net cash provided by operating activities:			
Operating income	$	251,822	212,739
Adjustments to reconcile operating income to net cash provided by operating activities:			
Depreciation and amortization		144,186	136,559
Provision for losses on customer and other receivables		12,853	10,436
Changes in assets and liabilities:			
Customer and other accounts receivable		(7,452)	9,822
Accrued unbilled revenue		(23,206)	18,956
Underrecovered costs		(154,475)	(34,224)
Due to Power System		4,019	(36,415)
Materials and supplies		(440)	221
Regulatory assets – other		(52,073)	(39,781)
Accounts payable and accrued expenses for operating		(16,487)	973
Prepayment and other current assets		(767)	(1,612)
Net postemployment benefit asset		(6,931)	(3,752)
Customer deposits		24,265	24,508
Accrued employee expenses		1,196	2,733
Deferred outflow – pensions		33,823	(130,056)
Regulatory assets – pensions		129,522	115,013
Net pension liability		(38,461)	(171,859)
Deferred inflows – pensions		(124,884)	209,473
Accrued workers' compensation claims and other		7,952	1,057
Net cash provided by operating activities	$	184,462	324,791

Supplemental disclosure of noncash capital and relating financing activities:

During the year ended June 30, 2016, the Water System issued revenue bonds to finance capital improvements and refund previously issued debt. The $ 381.1 million of proceeds were deposited immediately into an irrevocable trust for the defeasance of $382.2 million of debt. The net gain on refunding, after the write-off of previously recorded unamortized premiums, resulted in $ 13.3 million, which will be amortized over the debt repayment period.

Accounts payable related to capital expenditures	$	13,722	3,462

See accompanying notes to financial statements.

(1) Summary of Significant Accounting Policies

The City of Los Angeles Department of Water and Power (the Department) exists as a separate proprietary department of the City of Los Angeles (the City) under and by virtue of the City Charter enacted in 1925 and as revised effective July 2000. The Department's Water Revenue Fund (Water System) is responsible for the procurement, quality, and distribution of water for sale in the City. The Water System is operated as an enterprise fund of the City.

(a) Method of Accounting

The accounting records of the Water System are maintained in accordance with U.S. generally accepted accounting principles (GAAP) for governmental entities. The financial statements have been prepared using the economic resources measurement focus and the accrual basis of accounting. The Water System is accounted for as an enterprise fund and applies all applicable Governmental Accounting Standards Board (GASB) pronouncements in its accounting and reporting.

The financial statements of the Water System are intended to present the net position, and the changes in net position and cash flows of only that portion of the business-type activities and each major fund of the City of Los Angeles, California that is attributable to the transactions of the Water System. They do not purport to, and do not, present fairly the financial position of the City of Los Angeles, California as of June 30, 2016 and 2015, the changes in its financial position or, where applicable, its cash flows for the years then ended, in conformity with GAAP.

The Department's rates are determined by the Board of Water and Power Commissioners (the Board) and are subject to review and approval by the Los Angeles City Council. As a regulated enterprise, the Department follows the regulatory accounting criteria set forth in the GASB Codification (GASB 62), which requires that the effects of the rate-making process be recorded in the financial statements. Such effects primarily concern the time at which various items enter into the determination of changes in net position. Accordingly, the Water System records various regulatory assets and liabilities to reflect the Board's actions by deferring expenses and revenue that are recoverable or payable from rates provided in the water rate ordinance. Regulatory liabilities comprise over-recovered costs and deferred inflows and regulatory assets comprise regulatory assets and under recovered costs in the statement of net position. Management believes that the Water System meets the criteria for continued application, and will continue to evaluate its applicability based on changes in the regulatory environment. See note 4.

(b) Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

(Continued)

(c) Utility Plant

The costs of additions to utility plant and replacements of retired units of property are capitalized. Costs include labor, materials, an allowance for funds used during construction (AFUDC), and allocated indirect charges such as engineering, supervision, transportation and construction equipment, retirement plan contributions, healthcare costs, and certain administrative and general expenses. The costs of maintenance, repairs, and minor replacements are charged to the appropriate operations and maintenance expense accounts.

(d) Intangibles

The Department follows GASB 51, *Accounting and Financial Reporting for Intangible Assets* (GASB 51), which requires that an intangible asset be recognized in the statement of net position only if it is considered identifiable. Additionally, it establishes a specified-conditions approach to recognize intangible assets that are internally generated. Effectively, outlays associated with the development of such assets are not capitalized until certain criteria are met. Outlays incurred prior to meeting these criteria are expensed as incurred. The capitalized amounts are included in general utility plant in the accompanying statements of net position. Intangible assets include land easements, water rights, and computer software and are included in general utility plant on the statement of net position.

(e) Impairment of Long-Lived Assets

The Department follows GASB 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries* (GASB 42). Governments are required to evaluate prominent events or changes in circumstances affecting capital assets to determine whether impairment of a capital asset has occurred. A capital asset is considered impaired when its service utility has declined significantly and unexpectedly. Under GASB 42, impaired capital assets that will no longer be used by the government should be reported at the lower of carrying value or fair value. Impairment losses on capital assets that will continue to be used by the government should be measured using the method that best reflects the cause of the diminished service utility of the capital asset.

(f) Depreciation and Amortization

Depreciation expense is computed using the straight-line method based on service lives. The Department uses the composite method of depreciation and, therefore, groups assets into composite groups for purposes of calculating depreciation expense. Estimated service lives range from 5 to 70 years. Amortization expense for computer software is computed using the straight-line method over 5 to 15 years. Depreciation and amortization expense as a percentage of average depreciable utility plant in service was 1.8% for fiscal years ended June 30, 2016 and 2015.

(Continued)

(g) Cash and Cash Equivalents

As provided for by the State of California Government Code (the Code), the Water System's cash is deposited with the City Treasurer in the City's general investment pool for the purpose of maximizing interest earnings through pooled investment activities. Cash and cash equivalents in the City's general investment pool are reported at fair value on a recurring basis, and changes in unrealized gains and losses are recorded in the statements of revenue, expenses, and changes in net position. Interest earned on such pooled investments is allocated to the participating funds based on each fund's average daily cash balance during the allocation period. The City Treasurer invests available funds of the City and its independent operating departments on a combined basis. The Water System classifies all cash and cash equivalents that are restricted either by creditors, the Board, or by law as restricted cash and cash equivalents on the statement of net position. The Water System considers its portion of pooled investments in the City's pool to be cash and cash equivalents and the unspent construction funds as long-term restricted cash and cash equivalents.

At June 30, 2016 and 2015, restricted cash and cash equivalents include the following (amounts in thousands):

		June 30	
		2016	**2015**
Bond and redemption and interest funds	$	146,453	131,650
Cash and cash equivalents – current portion		146,453	131,650
Self-insurance fund		22,750	27,167
Construction funds		424,908	110,255
Cash and cash equivalents – noncurrent portion		447,658	137,422
Total restricted cash and cash equivalents	$	594,111	269,072

(h) Materials and Supplies

Materials and supplies are recorded at average cost.

(i) Accrued Unbilled Revenue

Accrued unbilled revenue is the receivable for estimated water sales during the period at the appropriate rates for which service has been provided but the customer has not been billed.

(j) Investments

The Department adopted GASB Statement No. 72, *Fair Value Measurement and Application*, effective July 1, 2014. This Statement addresses accounting and fair value reporting issues related to fair value measurements by clarifying the definition of fair value, establishing general principles for measuring fair value, providing additional fair value application guidance, and enhancing disclosures about fair value measurements. This statement established a three-level hierarchy of inputs to valuation techniques used to measure fair value. The Water System's investments consist of investments held in the Water Expense Stabilization Fund to stabilize water rates. Such investments include U.S. government and governmental agency securities. Investments are reported at fair value on a recurring basis, and changes in unrealized gains and losses are recorded in the statements of revenue, expenses, and changes in net position. The stated fair value of investments is generally based on published market prices or quotations from major investment dealers. See note 4.

(k) Accrued Employee Expenses

Accrued employee expenses include accrued payroll and an estimated liability for vacation leave, sick leave, and compensatory time, which is accrued when employees earn the rights to the benefits. Below is a schedule of accrued employee expenses as of June 30, 2016 and 2015 (amounts in thousands):

	June 30	
	2016	**2015**
Type of expense:		
Accrued payroll	$ 13,017	12,907
Accrued vacation	29,268	28,378
Accrued sick time	6,070	6,203
Compensatory time	7,426	7,097
Total	$ 55,781	54,585

(l) Debt Expenses

Debt premiums and discounts are capitalized and amortized to debt expense using the effective-interest method over the lives of the related debt issues. Gains and losses on refundings related to bonds redeemed by proceeds from the issuance of new bonds are reported as deferred inflows or outflows of resources and amortized to interest expense using the effective-interest method over the shorter of the life of the new bonds or the remaining term of the bonds refunded.

(m) Accrued Workers' Compensation Claims

Liabilities for unpaid workers' compensation claims are recorded at their net present value. See note 10.

(n) Customer Deposits

Customer deposits represent deposits collected from customers upon opening new accounts. These deposits are obtained when the customer does not have a previously established credit history with the Department. Original deposits plus interest are paid to the customer once a satisfactory payment history is maintained, generally after one to three years.

The Water System is responsible for collection, maintenance, and refunding of these deposits for all Department customers, including those of the Department's Power Revenue Fund (Power System). As such, the Water System's statements of net position include a deposit liability of $162 million and $138 million as of June 30, 2016 and 2015, respectively, for all customer deposits collected.

(o) Revenue

The Water System's rates are established by a rate ordinance set by the Board of Water and Power Commissioners based on the Board's powers and duties established in Section 676 of the City Charter. The Water System sells water to other City departments at rates provided in the ordinance. The Water System recognizes water costs in the period incurred and accrues for estimated water sold but not yet billed.

Revenue consists of billings to customers for water consumption at rates specified in the water rate ordinance. These rates include cost adjustment factors that provide the Water System with full recovery of water supply costs; water quality improvement expenditures and water security costs; base rate revenue based upon established revenue targets published for each major customer class; Owens Valley regulatory costs; lifeline and low-income customer adjustments; water infrastructure costs; and maintain funds to cover costs in the event of unforeseen events impacting water service delivery. Management estimates these costs biannually for a twelve-month prospective period to establish the cost recovery component of customer billings and any difference between billed and actual costs is adjusted in subsequent billings. This difference is reflected as $234 million and $79 million of under recovered costs in the accompanying statements of net position as of June 30, 2016 and 2015, respectively.

During fiscal years 2016 and 2015, the Water System also incurred costs of $89.7 million and $148.5 million, respectively, related to water quality improvement projects in excess of billing limits. Since the rates charged to customers are insufficient to recover all of these specific costs, the capital portion of these costs has not been recorded as under recovered costs, regulatory asset, and is funded through the issuance of debt.

(p) Current Rate Ordinance

The current water rate ordinance has been in effect since April 15, 2016 and covers a five-year period. The water rates are set for each customer class based upon a completed formal marginal cost of service study, which is common industry practice.

For single-family residential customers, water budgets are utilized to design an expanded four tier rate structure. The rate structure provides water conservation signals with tier thresholds set based on indoor and outdoor water budgets, which encourages conservation. Tier one provides eight hundred cubic feet for basic indoor water needs. Tier 2 provides water levels for efficient outdoor native landscaping, Tier 3 provide water levels, which represent much less efficient outdoor irrigation and nondrought tolerant landscaping, and Tier 4 represents excessive water usage. Tiers 2 and 3 allotments also vary based on temperature zone and lot size.

Single-family residential rates are developed to recover the revenue requirement associated with providing service to this class while recognizing the increasing cost of providing water at higher levels of usage. The major differentiating amounts between tier rates are water supply costs, peak pumping, and storage costs. The Tier 1 rate represents indoor basic needs met by the least expensive sources of water supply, the Tier 2 rate covers efficient outdoor water use and reflects water supplies, which include some expensive sources of water, the Tier 3 rate is for above average outdoor use, which may require more expensive sources of water supply, and the tier 4 rate is for excessive use and may include the most costly sources of water supply.

The two-tier structure of the multifamily customer class has been maintained from prior rate ordinances. Multifamily tier thresholds are set based on prior winter usage characteristics for each customer. Water allotments still provide incentives for additional conservation with Tier 1 allotment reductions applied in the second (93%), third (88%), fourth (88%) and fifth (88%) year of the five-year rate action.

The major differentiating amounts between the two tier structure of multifamily rates are water supply costs, peak pumping, and storage costs. Tier 1 rates reflect water supplies, which include the less expensive sources of water and the Tier 2 rate includes the higher costs of water supply sources.

The two-tier structure of the Commercial and Industrial customer class has been maintained from prior rate ordinances. High and Low Season Tier thresholds are also set based on prior winter usage characteristics for each customer. Water budgets still provide incentives for additional conservation with Low Season Tier 1 allotments set at 100% of prior winter usage and the High Season Tier 1 allotment set at 105% of prior winter usage.

Like the multifamily customer class, the major differentiating amounts between the two tier structure of the commercial and Industrial rates are water supply costs, peak pumping, and storage costs. Tier 1 rate reflects water supplies, which include the less expensive sources of water and the Tier 2 rate includes the higher costs of water supply sources.

The rates still reflect equity consideration for water intensive businesses, and other customers having high seasonal variation in their water usage. Fixed monthly service availability charges apply only to private fire service.

The Water System's rate ordinance contains a Water Supply Cost Adjustment Factor, a Water Quality Improvement Adjustment Factor, a Base Rate Revenue Target Adjustment Factor, an Owens Valley Regulatory Adjustment Factor, a Low-income Subsidy Adjustment Factor, a Water Infrastructure Adjustment Factor, and a Water Expense Stabilization Factor. These factors are recovered by direct adjustments to customers' bills. The Water Supply Cost Adjustment Factor recovers the cost of Los Angeles Aqueduct water, purchased water, including water purchased from the Metropolitan Water District, groundwater, water conservation, recycled water, and any additional water supply source expenses. The Water Quality Improvement Factor recovers expenditures to equalize water quality throughout the City, to meet State and Federal water quality standards, and to provide security for water supply, storage, and conveyance infrastructure and related facilities. The Base Rate Revenue Target Adjustment recovers any shortage in revenue from base rates or credits back any excess collection of revenue from base rates due to variation in water sales from established revenue targets published for each major customer class. The Owens Valley regulatory adjustment factor recovers expenditures for the Owens Lake Dust Mitigation Program, the Lower Owens River Project, and the Owens Lake Master Project. The low-income subsidy adjustment factor recovers the cost of credits provided to lifeline and low-income customers. The Water Infrastructure Adjustment Factor recovers capital costs associated specifically with infrastructure investments to maintain and improve the reliability of the water distribution system, and the Water Expense Stabilization Factor recovers funds in order to stabilize rates in the event of unforeseen events impacting water service delivery and also the expense for legal and courts costs or any judgment or settlement.

Operating revenue is revenue generally derived from activities that are billable in accordance with the water rate ordinance established by the City Council. Other types of revenue is generally considered nonoperating.

(q) Capital Contributions

Capital contributions and other grants received by the Department for constructing utility plant and other activities are recognized when all applicable eligibility requirements, including time requirements, are met.

(r) Allowance for Funds Used during Construction (AFUDC)

An AFUDC charge represents the cost of borrowed funds used for the construction of utility plant. Capitalized AFUDC is included as part of the cost of utility plant and as a reduction of interest expenses. As of June 30, 2016 and 2015, the average AFUDC rates used by the Water System were 3.1% and 3.9%, respectively.

(s) Use of Restricted and Unrestricted Resources

The Water System's policy is to use unrestricted resources prior to restricted resources to meet expenses to the extent that it is prudent from an operational perspective. Once it is not prudent, restricted resources will be utilized to meet intended obligations.

(Continued)

(t) Pensions

Eligible employees of the Water System are members of the Water and Power Employees' Retirement Plan (the Plan), which is a single employer defined-benefit pension plan. The Water System's policy is to fund all the required actuarially determined contributions; such costs to be funded are determined annually as of July 1 by an actuary utilized by the Plan. The assets of the Plan are accumulated and reported at fair value in a special trust fund of the City of Los Angeles and, therefore, are not reported in the accompanying financial statements.

The Water System recognizes a net pension liability, which represents the Water System's proportionate share of the excess of the total pension liability over the fiduciary net position of the pension plan as reflected in the financial statements of the Plan. The net pension liability is measured as of the Water System's prior fiscal year-end. Changes in the net pension liability are recorded, in the period incurred, as pension expense or as deferred inflows of resources or deferred outflows of resources depending on the nature of the change. The changes in net pension liability that are recorded as deferred inflows of resources or deferred outflows of resources (that arise from changes in actuarial assumptions or other inputs and differences between expected or actual experience) are amortized over the weighted average remaining service life of all participants in the respective pension plan and are recorded as a component of pension expense beginning with the period in which they are incurred. Projected earnings on pension investments are recognized as a component of pension expense. Differences between projected and actual investment earnings are reported as deferred inflows of resources or deferred outflows of resources and amortized as a component of pension expense on a closed basis over a five-year period beginning with the period in which the difference occurred. Each subsequent year will incorporate an additional closed basis five-year period of recognition. Contributions made after the measurement date are recorded as deferred outflows and a reduction to the pension regulatory asset.

For purposes of measuring the net pension liability and deferred outflows/inflows or resources relating to pensions and pension expense, information about the fiduciary net position of the Water System's pension plan and additions to/deductions from the plan's fiduciary net position have been determined on the same basis as they are reported by the Plan. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefits terms.

(u) Other Retirement Plan Benefits

Eligible employees of the Water System are members of the Water and Power Employees' Retirement Plan (the Plan), which comprise is a single employer defined benefit plan and a system of benefits. In addition to pension benefits, retirees can also receive healthcare and death benefits. The level of benefits is determined based on their years of civil service, age, and to which pension tier they belong. Active employees who qualify for disability can receive permanent disability in accordance with the plan provisions up until retirement, and temporary disability for up to 24 months.

(v) Reclassifications

Certain reclassifications have been made to 2015 amounts to conform to the 2016 financial statement presentation. There was no impact on the previously reported change in net position of the Water System.

(2) Recent Accounting Pronouncements

(a) GASB Statement No. 75

In June 2015, the GASB issued Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions* (GASB Statement No. 75). This statement replaces the requirements of Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, as amended, and establishes standards for recognizing and measuring liabilities, deferred outflows of resources, deferred inflows of resources, and expenses/expenditures. This statement is effective for financial statements for years beginning after June 15, 2017. The Water System is currently evaluating the effects the adoption of this statement will have on the financial statements.

(b) GASB Statement No. 82

In March 2016, the GASB issued Statement No. 82, *Pension Issues – an amendment of GASB Statements No. 67, No. 68, and No. 73* (GASB Statement No. 82). The objective of this Statement is to address certain issues that have been raised with respect to Statements No. 67, *Financial Reporting for Pension Plans, 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*. Specifically, this Statement addresses issues regarding (1) the presentation of payroll-related measures in required supplementary information, (2) the selection of assumptions and the treatment of deviations from the guidance in an Actuarial Standard of Practice for financial reporting purposes, and (3) the classification of payments by employers to satisfy employee (plan member) contribution requirements. This statement is effective for financial statements for years beginning after June 30, 2017. The Water System is currently evaluating the effects the adoption of this statement will have on the financial statements.

(c) GASB Statement No. 83

In November 2016, the GASB issued Statement No. 83, *Accounting and Financial Reporting for Certain Asset Retirement Obligations* (GASB Statement No. 83). This statement addresses accounting and financial reporting for certain asset retirement obligations (AROs). An ARO is a legally enforceable liability associated with the retirement of a tangible asset. A government that has legal obligations to perform future asset retirement activities related to its tangible capital assets should recognize a liability base on the guidance of this statement. This statement is effective for financial statements for years beginning after June 15, 2017. The Water System is currently evaluating the effects the adoption of this statement will have on the financial statements.

(3) Utility Plant

The Water System had the following activity in utility plant during fiscal year 2016 (amounts in thousands):

		Balance, July 1,2015	Additions	Retirements and disposals	Transfers	Balance, June 30,2016
Nondepreciable utility plant:						
Land and land rights	$	154,371	17,405	—	—	171,776
Construction work in progress		1,182,001	456,187	—	(576,806)	1,061,382
Total nondepreciable utility plant		1,336,372	473,592	—	(576,806)	1,233,158
Depreciable utility plant:						
Source of water supply		1,469,752	12,974	—	342,842	1,825,568
Pumping		266,718	5,942	—	9,751	282,411
Purification		777,853	17,729	—	34	795,616
Distribution		4,447,107	122,666	(5,858)	221,834	4,785,749
General		697,993	8,109	(3,967)	2,345	704,480
Total depreciable utility plant		7,659,423	167,420	(9,825)	576,806	8,393,824
Accumulated depreciation:						
Source of water supply		(333,361)	(29,962)	—	—	(363,323)
Pumping		(123,838)	(5,064)	—	—	(128,902)
Purification		(200,458)	(13,571)	—	—	(214,029)
Distribution		(1,485,052)	(67,978)	5,858	—	(1,547,172)
General		(339,322)	(25,180)	3,967	—	(360,535)
Total accumulated depreciation		(2,482,031)	(141,755)	9,825	—	(2,613,961)
Total utility plant, net	$	6,513,764	499,257	—	—	7,013,021

Depreciation and amortization expense during fiscal year 2016 was $144.2 million. Depreciation and amortization expense on the statements of cash flows includes amortization expense on software and regulatory assets, which is not included in additions to accumulated depreciation above.

Land and land rights are included in the balance sheet as utility plant assets in their functional category.

The Water System had the following activity in utility plant during fiscal year 2015 (amounts in thousands):

	Balance, July 1, 2014	Additions	Retirements and disposals	Transfers	Balance, June 30, 2015
Nondepreciable utility plant:					
Land and land rights	$ 139,028	15,343	—	—	154,371
Construction work in progress	923,813	449,029	—	(190,841)	1,182,001
Total nondepreciable utility plant	1,062,841	464,372	—	(190,841)	1,336,372
Depreciable utility plant:					
Source of water supply	1,337,726	44,292	—	87,734	1,469,752
Pumping	261,181	5,032	—	505	266,718
Purification	736,500	18,074	—	23,279	777,853
Distribution	4,247,341	130,655	(4,119)	73,230	4,447,107
General	655,580	39,531	(3,211)	6,093	697,993
Total depreciable utility plant	7,238,328	237,584	(7,330)	190,841	7,659,423
Accumulated depreciation:					
Source of water supply	(305,036)	(28,325)	—	—	(333,361)
Pumping	(119,009)	(4,829)	—	—	(123,838)
Purification	(186,012)	(14,446)	—	—	(200,458)
Distribution	(1,424,681)	(64,490)	4,119	—	(1,485,052)
General	(316,227)	(26,306)	3,211	—	(339,322)
Total accumulated depreciation	(2,350,965)	(138,396)	7,330	—	(2,482,031)
Total utility plant, net	$ 5,950,204	563,560	—	—	6,513,764

Depreciation and amortization expense during fiscal year 2015 was $136.6 million.

Land and land rights are included in the balance sheet as utility plant assets in their functional category. Depreciation and amortization expense on the statement of cash flows includes amortization expense on software and regulatory assets, which is not included in additions to accumulated depreciation above.

(4) Regulatory Assets

Regulatory assets are created by the actions of the Board of Water and Power Commissions by deferring certain expenses that are recoverable by future rate charges in accordance with the current rate ordinances, so as to more evenly match the recognition of revenue and expenses with the water rates charged to retail customers.

Below is a summary of the Water System's regulatory assets:

Description	July 1, 2015	Additions	Reductions	June 30, 2016
Assets:				
(a) Regulatory assets – water conservation rebates	$ 67,809	44,161	(6,445)	$ 105,525
(b) Regulatory assets – stormwater capture program	39,102	—	(1,959)	37,143
(c) Regulatory assets – customer care and billing system	—	19,250	(2,934)	16,316
Regulatory assets – other	106,911	63,411	(11,338)	158,984
(d) Regulatory assets – Pension	450,003	—	(129,522)	320,481
(e) Underrecovered costs	79,255	154,475	—	233,730
Total	$ 636,169	217,886	(140,860)	$ 713,195

Description	July 1, 2014	Additions	Reductions	June 30, 2015
Assets:				
(a) Regulatory assets – water conservation rebates	$ 37,148	34,024	(3,363)	$ 67,809
(b) Regulatory assets – stormwater capture program	29,982	9,840	(720)	39,102
Regulatory assets – other	67,130	43,864	(4,083)	106,911
(d) Regulatory assets – Pension	565,016	—	(115,013)	450,003
(e) Underrecovered costs	45,031	34,224	—	79,255
Total	$ 677,177	78,088	(119,096)	$ 636,169

(a) Regulatory Assets – Water Conservation Rebates

Water conservation is an integral part of the water resources management efforts and is a key element of maintaining a sustainable supply of water for the City. The Water System provides customers with 26 water conservation programs that are designed to reduce indoor and outdoor water usage. Initially the programs included low-flow showerheads and incentives to customers who purchase the high efficiency toilets and high efficiency clothes washing machines in an effort to reduce water use. In 2015, the program was expanded to include outdoor water savings through a turf reduction program to encourage replacing water-guzzling grass with low-water use shrubs and permeable walkways.

As provided in the Water System's rate structure, beginning June 2011, customers' bills include a charge, related to water conservation program payments to be collected over the useful life of the program, which ranges from 5 to 20 years. As rates are established at a level sufficient to recover all such costs, the Water System recorded as a regulatory asset. The balance of the Water Conservation costs at June 30, 2016 and 2015 is $105,525 and $67,809 net of annual amortization of $6,445 and $3,363, respectively.

(b) Regulatory Assets – Watershed Management Stormwater Capture Program

The goal of the Stormwater Capture Program is to capture stormwater for recharging the basin with water that would otherwise runoff to the ocean, and thus be lost as a usable source to customers. Regulatory assets related to the Watershed Management Programs include investing in dams, reservoirs, and spreading grounds owned by other agencies, but the water collected benefits Water System customers.

As provided in the Water System's rate structure, beginning August 2013, customers' bills include a charge, related to payments made related to the Stormwater Capture Program to be collected over a period of at least 30 years. As rates are established at a level sufficient to recover all such costs, the Water System recorded these costs as a regulatory asset. The balance of the Stormwater Capture Program costs at June 30, 2016 and 2015 is $37,143 and $39,102, net of annual amortization of $1,959 and $720, respectively.

(c) Regulatory Assets – Customer Care and Billing System

In 2013, the Water System implemented the Customer Care and Billing system (CC&B). The implementation of the system required significant investment in the training of the Water System's employees.

As provided in the Water System's rate structure, beginning January 2014, customers' bills include a charge to be collected over a 10-year period. As rates are established at a level sufficient to recover all such costs identified above, the Water System recorded a regulatory asset. The balance of CC&B costs at June 30, 2016 is $16,316, net of annual amortization of $2,934. As of June 30, 2015, these amounts were included in general plant as part of software costs.

(d) Regulatory Assets – Pension

In connection with the recognition of the net pension liability under GASB Statement No. 68, the Water System established a regulatory asset in the amount of $745,447 equal to the net pension liability reported at July 1, 2013. The pension regulatory asset is expected be amortized over a period not to exceed 15 years. Amortization of the regulatory asset totaled $129,522 and $115,013 for the years ended June 30, 2016 and 2015, respectively.

(e) *Regulatory Assets – Under recovered Costs*

As provided in the Water System Rate Ordinance, the Department is required to maintain balancing accounts to record differences between specific costs incurred and amounts billed through rates to recover those costs. Under recovered costs is shown as a current asset on the Statement of Net Position and represents the balance in the balancing accounts when the amount billed through rates is less than the costs the Department has incurred. The balance of under recovered costs at June 30, 2016 and 2015 is $233,730 and $79,255.

(5) Cash, Cash Equivalents, and Investments

(a) *Investments*

A summary of the Water System's investments is as follows (amounts in thousands):

Description		June 30 2016	June 30 2015
Water Expense Stabilization Fund	$	33,706	33,511

All investments are to be used for a designated purpose as follows:

(i) Water Expense Stabilization Fund

The Water Expense Stabilization Fund was established under the Master Bond Resolution and can be withdrawn upon and applied to any lawful purpose in connection with the Water System.

As of June 30, 2016, the Water System's investments and their maturities are as follows (amounts in thousands):

Type of investments		Fair value	Investment maturities: 1 to 30 days	31 to 60 days	61 to 365 days	366 days to 5 years
U.S. government agencies	$	19,784	4,200	2,999	1,004	11,581
Medium-term corporate notes		5,007	1,000	—	4,007	—
Commercial paper		1,499	—	999	500	—
Negotiable CDs		4,001	2,000	—	2,001	—
California state bonds		1,002			1,002	
California local agency bonds		1,517	—	515	1,002	—
Other state bonds		502	—	502	—	—
Money market fund		394	394	—	—	—
	$	33,706	7,594	5,015	9,516	11,581

As of June 30, 2015, the Water System's investments and their maturities are as follows (amounts in thousands):

		Investment maturities			
Type of investments	**Fair value**	**1 to 30 days**	**31 to 60 days**	**61 to 365 days**	**366 days to 5 years**
U.S. government agencies	$ 16,599	—	—	13,596	3,003
Medium-term corporate notes	3,786	1,000	—	1,005	1,781
Commercial paper	2,498	1,500	—	998	—
Negotiable CDs	1,000	1,000	—	—	—
California local agency bonds	6,176	1,000	2,676	2,500	—
California state bonds	435	435	—	—	—
Other state bonds	2,654			2,654	
Money market fund	363	363	—	—	—
	$ 33,511	5,298	2,676	20,753	4,784

(ii) *Interest Rate Risk*

The Department's investment policy limits the maturity of its investments to a maximum of 30 years for U.S. government agency securities; 5 years for medium-term corporate notes, municipal bonds, and state bonds; 270 days for commercial paper; and 397 days for negotiable certificates of deposit.

(iii) *Credit Risk*

Under its investment policy and the Code, the Department is subject to the prudent investor standard of care in managing all aspects of its portfolios. The prudent investor standard requires that the Department "shall act with care, skill, prudence, and diligence under the circumstances then prevailing, including, but not limited to, the general economic conditions and the anticipated needs of the agency, that a prudent person acting in a like capacity and familiarity with those matters would use in the conduct of funds of a like character and with like aims, to safeguard the principal and maintain the liquidity needs of the agency."

The U.S. government agency securities in the portfolio consist of securities issued by government-sponsored enterprises, which are not explicitly guaranteed by the U.S. government. As of June 30, 2016 and 2015, the U.S. government agency securities in the portfolio were rated with either the highest or second highest possible credit ratings by each of the Nationally Recognized Statistical Rating Organizations (NRSROs) that rated them.

The Department's investment policy specifies that medium-term corporate notes must be rated in a rating category of "A" or its equivalent or better by a NRSRO upon purchase. Of the Water System's investments in corporate notes as of June 30, 2016, $2,003,036 (40%) was rated in the category of AA and $3,004,394 (60%) was rated in the category of A by at least one NRSRO. Of the Water System's investments in corporate notes as of June 30, 2015, $2,786,201 (74%) was rated in the category of AA and $1,000,000 (26%) was rated in the category of A by at least one NRSRO.

The Department's investment policy specifies that commercial paper must be of the highest ranking or of the highest letter and number rating as provided for by at least two NRSROs. As of June 30, 2016 and 2015, all of the Water System's investments in commercial paper were rated with at least the highest letter and number rating as provided by at least two NRSROs.

The Department's investment policy specifies that municipal obligations, issued by California local agencies must be rated in a rating category of "A" or its equivalent or better by a NRSRO. Of the Water System's investments in municipal bonds as of June 30, 2016, $1,516,905 (100%) was rated in the category of AA by at least one NRSRO. Of the Water System's investments in municipal bonds as of June 30, 2015, $6,175,666 (100%) was rated in the category of AA by at least one NRSRO.

The Department's investment policy specifies that negotiable certificates of deposit must be of the highest ranking or letter and number rating as provided for by at least two NRSROs. As of June 30, 2016 and 2015, all of the Water System's investments in negotiable certificates of deposit were rated with at least the highest letter and number rating as provided by at least two NRSROs.

The Department's investment policy specifies that State of California obligations must be rated in a rating category of "A" or its equivalent or better by a NRSRO. As of June 30, 2016 and June 30, 2015, all of the Water System's investments in State of California Obligations were rated in the rating category of AA by at least one NRSRO.

The Department's Investment Policy specifies that obligations of other states in addition to California must be rated in a rating category of "A" or its equivalent or better by a NRSRO. As of June 30, 2016, 100% of the Water System's investments in obligations of states other than California was rated in the rating category of AA by at least one NRSRO. As of June 30, 2015, $2,613,473 (98%) of the Water System's investments in obligations of states other than California were rated in the rating category of AA and $40,204 (2%) was rated in the rating category of A by at least one NRSRO.

The Department's investment policy specifies that money market funds may be purchased as allowed under the Code, which requires that the fund must have either (1) attained the highest ranking or highest letter and numerical rating provided by not less than two NRSROs or (2) retained an investment adviser registered or exempt from registration with the Securities and Exchange Commission with not less than five years' experience managing money market mutual funds with assets under management in excess of $500 million. As of June 30, 2016 and 2015, the money market funds in the portfolio had attained the highest possible ratings by at least two NRSROs.

(iv) Concentration of Credit Risk

The Department's investment policy specifies that there is no percentage limitation on the amount that can be invested in U.S. government agency securities, except that a maximum of 30% of the cost value of the portfolio may be invested in the securities of any single U.S. government agency issuer.

Of the Water System's total investments as of June 30, 2016, $7,309,669 (22%) was invested in securities issued by the Federal Home Loan Bank; $6,461,749 (19%) was invested in securities issued by the Federal National Mortgage Association; and $5,011,993 (15%) was invested in securities issued by the Federal Home Loan Mortgage Corporation.

Of the Water System's total investments as of June 30, 2015, $7,509,061 (22%) was invested in securities issued by the Federal Home Loan Bank; $4,064,825 (12%) was invested in securities issued by the Federal National Mortgage Association; and $4,004,082 (12%) was invested in securities issued by the Federal Home Loan Mortgage Corporation.

(v) Custodial Risk

All investments are held in the Department's name and therefore they do not have custodial risk.

Facts and Assumptions

The Department holds investments that are measured at fair value on a recurring basis. Because investing is not a core part of the Department's mission, the Department determines that the disclosures related to these investments only need to be disaggregated by major type. The Department chooses a tabular format for disclosing the levels with the fair value hierarchy. The Department categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. The hierarchy is based on the valuation inputs used to measure the fair value of the asset, as follows:

Level 1 inputs are quoted prices for identical assets or liabilities in an active market.

Level 2 inputs are quoted prices of similar assets or liabilities in active or not active markets.

Level 3 are unobservable inputs using the best information available to management.

		Fair value using			
	June 30, 2016	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Not classified
Investments by fair value level:					
Debt securities:					
U.S. government agencies	19,784	—	19,784	—	—
Medium-term corporate notes	5,007	—	5,007	—	—
California state bonds	1,002	—	1,002	—	—
California local agency	1,517	—	1,517	—	—
Other state bonds	502	—	502	—	—
Total debt securities	27,812	—	27,812	—	—
Other:					
Commercial paper	1,499	—	1,499	—	—
Certificate of deposit	4,001	—	4,001	—	—
Money market funds	394	—	—	—	394
Total other	5,894	—	5,500	—	394
Total investments by fair value level	$ 33,706	—	33,312	—	394

	June 30, 2015	Fair value using: Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Not classified
Investments by fair value level:					
Debt securities:					
U.S government agencies	16,599	—	16,599	—	—
Medium-term corporate notes	3,786	—	3,786	—	—
California state bonds	435	—	435	—	—
California local agency bonds	6,176	—	6,176	—	—
Other state bonds	2,654	—	2,654	—	—
Total debt securities	29,650	—	29,650	—	—
Other:					
Commercial paper	$ 2,498	—	2,498	—	—
Certificate of deposit	1,000	—	1,000	—	—
Money market funds	363	—	—	—	363
Total other	3,861	—	3,498	—	363
Total investments by fair value level	$ 33,511	—	33,148	—	363

Debt and other securities classified in Level 1 of the fair value hierarchy are valued using prices quoted in active markets for those securities. Debt securities classified in Level 2 of the fair value hierarchy are valued using a multidimensional relationship model or matrix pricing model utilizing market data including, but not limited to, benchmark yields, reported trades, and broker/dealer quotes.

(b) Pooled Cash

The Water System's cash, cash equivalents, and its collateral value of the City's securities lending program (SLP) are included within the City Treasury's general and special investment pool (the Pool). As of June 30, 2016 and 2015, the Water System's share of the City's general and special investment pool was $913,606 and $615,994, which represents approximately 9.2% and 6.7% of the Pool, respectively. Amounts pooled in the City Treasury's general and special investment pool are not required to be classified in the fair value hierarchy per GASB 72 since they are part of an internal investment pool.

Pooled cash is recorded as follows on the statement of position (in thousands):

Cash and cash equivalents – unrestricted	$	312,009	342,742
Cash and cash equivalents – restricted		146,453	131,650
Cash and cash equivalents – restricted noncurrent		447,658	137,422
Cash – securities lending transactions		7,486	4,180
	$	913,606	615,994

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. Special pool participants include the City, Airports, DWP, Harbor, Sewer, and MICLA. Interest earned on pooled investments is allocated to and recorded in certain participating funds, as authorized by the Council and permitted by the City Charter and the California Government Code, based on each fund's average daily deposit balance. Unless allocation provisions are specifically stipulated in City ordinance, Council action, or funding source, interest earned on certain funds are allocated to and recorded in the General Fund. 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 (State Code) and the Council File No. 94-2160, the City Treasury shall render to the Council a statement of investment policy (the Policy) annually. 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 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 City Treasurer will deposit funds and types of investment instruments permitted by California Government Code Sections 53600-53638, 16340, and 16429.1. The City Treasury further reports that the current policy allows for the purchase of investments with maturities up to thirty (30) years.

At June 30, 2016, the investments held in the City Treasury's General and Special Investment Pool Programs and their maturities are as follows (in thousands):

		Investment maturities				
Type of investments	**Amount**	**1 to 30 Days**	**31 to 60 Days**	**61 to 365 Days**	**366 Days to 5 years**	**Over 5 years**
U.S. Treasury bills	$ 206,762	144,991	34,991	26,780	—	—
U.S. Treasury notes	4,695,497	—	—	36,463	4,631,290	27,744
U.S. Agencies securities	1,362,106	335,597	130,941	430,867	445,957	18,744
Medium-term notes	1,321,557	20,008	—	115,563	1,185,986	—
Mutual fund	126,632	126,632	—	—	—	—
Negotiable certificates of deposit	10,000	10,000	—	—	—	—
Commercial paper	1,617,998	1,166,671	391,383	59,944	—	—
Municipal bonds	60,885	—	—	—	60,885	—
Supranational obligations	242,182	13,971	16,190	70,068	141,953	—
Short-Term Investment Funds	170,261	170,261	—	—	—	—
Securities lending short-term repurchase agreement	166,278	166,278	—	—	—	—
Total general and special pools	$ 9,980,158	2,154,409	573,505	739,685	6,466,071	46,488

Interest Rate Risk. The Policy limits the maturity of its investments to five years for the U.S. Treasury and government agency securities, medium-term notes, CD placement service, negotiable certificates of deposit, collateralized bank deposits, mortgage pass-through securities, supranational obligations, and bank/time deposits; one year for repurchase agreements; 270 days for commercial paper; 180 days for bankers' acceptances; 92 days for reverse repurchase agreements; and no maturity for mutual funds. The Policy also allows City funds with longer-term investments horizons, to be invested in securities that at the time of the investment have a term remaining to maturity in excess of five years, but with a maximum final maturity of thirty years.

Credit Risk. The Policy establishes minimum credit rating requirements for investments. There are no credit quality requirements for local agency bonds, U.S. Treasury Obligations, State of California Obligations, California Local Agency Obligations, and U.S. Agencies (U.S. government sponsored enterprises) securities. The City's $1 billion investments in U.S. government sponsored enterprises consist of securities issued by the Federal Home Loan Bank – $633 million, Federal National Mortgage Association (Fannie Mae) – $428 million, Federal Home Loan Mortgage Corporation (Freddie Mac) – $225 million, Federal Farm Credit Bank – $25 million, Federal Agriculture Mortgage Corporation (Farmer Mac) – $30 million, and Tennessee Valley Authority – $20 million. Of the City's $1 billion investments in U.S. Agencies securities, $545 million were rated AA+ by S&P and Aaa by Moody's; $817 million were not rated individually by S&P nor Moody's (issuers of these securities are rated AA+/A-1+ by S&P and Aaa/P-1 by Moody's).

Medium-term notes must be issued by corporations organized and operating within the United States or by depository institutions licensed by the United States or any state and operating within the United States. Medium-term notes must have at least an A rating at the time of purchase. The City's $1 billion investments in medium-term notes consist of securities issued by banks and corporations that comply with these requirements and were rated A or better by S&P and A3 or better by Moody's. Subsequent to purchase, one issuer of $5 million medium-term notes was downgraded to A- by S&P and Baa2 by Moody's, one issuer of $5 million medium-term notes was downgraded to BBB+ by S&P and Baa1 by Moody's, two issuers of $63 million medium-term notes was downgraded to BBB+ by S&P and A3 by Moody's, and one issuer of $20 million medium-term notes was downgraded to A by S&P and Baa1 by Moody's.

Commercial paper issues must have a minimum of A-1 or equivalent rating. If the issuer has issued long-term debt, it must be rated A without regards to modifiers. The issuing corporation must be organized and operating within the United States and have assets in excess of $500 million. The City's $1.6 billion investments in commercial paper were rated A-1+/A-1 by S&P and P-1 by Moody's.

Mutual fund must receive the highest ranking by at least two nationally recognized rating agencies. The City's $126.6 million investment in mutual fund were rated AAA by S&P and not rated by Moody's.

Negotiable certificates of deposits have no minimum rating requirement. The City's $10 million investments in negotiable certificates of deposits were rated A-1+/A- by S&P and P-1 by Moody's.

Municipal bonds have no minimum rating requirement. The City's $61 million investments in municipal bonds were rated AA/AA- by S&P and Aa2/Aa3 by Moody's.

Investments in supranational coupons must have a minimum of AA rating. The City's investments in supranational coupons of $142 million were rated AAA by S&P and Aaa by Moody's; $100.2 million were not rated individually by S&P nor Moody's. These short-term securities are backed by the full faith of the issuing entities, which are rated AAA/Aaa.

Concentration of Credit Risk. The Policy does not allow more than 40% of its investment portfolio be invested in commercial paper or bankers' acceptances, 30% in certificates of deposit or medium-term notes, 20% in mutual funds, money market mutual funds, or mortgage pass-through securities. The Policy further provides for a maximum concentration limit of 10% in any one issuer including its related entities. There is no percentage limitation on the amounts that can be invested in U.S. Treasury and government agencies. The City's pooled investments comply with these requirements. GAAP requires disclosure of certain investments in any one issuer that represent 5% or more of total investments. Of the City's total pooled investments as of June 30, 2016, $633 million (6%) was invested in securities issued by Federal Home Loan Bank.

The following table identifies the investment types that are authorized by the Policy as of June 30, 2016:

Authorized investment type	Maximum maturity A	Maximum specified percentage of Portfolio B	Minimum credit quality requirements
Local Agency Bonds	5 years	None	None
U.S. Treasury Obligations	5 years *	None	None
State Obligations – CA and Others	5 years	None	None
CA Local Agency Obligations	5 years	None	None
U.S. Agency Obligations	5 years *	None	None
Bankers' Acceptances	180 days	40% * C	None
Commercial Paper – Nonpooled Funds * D	270 days	25% of the agency's money E	"A-1" if long-term debt, must be rated "A" without regard to modifiers F
Commercial Paper – Pooled Funds * G	270 days	40% of the agency's money E	"A-1" if long-term debt, must be rated "A" without regard to modifiers F
Negotiable Certificates of Deposits	5 years	30% H (combined with placement service CD)	None
Non-Negotiable Certificates of Deposits	5 years	None	None
Placement Service Deposits	5 years	30% H (inclusive of placement service CD)	None
Placement Service Certificate of Deposits	5 years	30% H (combined with negotiable CD)	None
Repurchase Agreements	1 year	None	None
Reverse Repurchase Agreements and Securities Lending	92 days I	20%	None J
Medium-Term Notes * K	5 years	30%	"A" Rating
Mutual Funds and Money Market Mutual Funds	N/A	20% L	Multiple M N
Collateralized Bank Deposits	5 years	None	None
Mortgage Pass-Through Securities	5 years	20%	"A" Rating O
County Pooled Investments Funds	N/A	None	None
Joint Powers Authority Pool	N/A	None	Multiple P
Local Agency Investment Fund (LAIF)	N/A	None	None
Voluntary Investment Program Fund Q	N/A	None	None
Supranational Obligations R	5 years	30%	"AA" Rating

* Represents where the City's investment policy is more restrictive than the California Government Code. The sources used are Sections 16340, 16429.1, 53601, 53601.8, 53635, 53635.2, and 53638. Municipal Utilities

Districts have the authority under the Public Utilities Code Section 12871 to invest in certain securities not addressed here.

Other restrictions on investments are summarized as follows:

A Section 53601 provides that the maximum term or any investment authorized under this section, unless otherwise stated, is five years. However, the legislative body may grant express authority to make investments either specifically or as a part of an investment program approved by the legislative body that exceeds this five year maturity limit. Such approval must be issued no less than three months prior to the purchase of any security exceeding the five-year maturity limit.

B Percentages apply to all portfolio investments regardless of source of funds. For instance, cash from a reverse repurchase agreement would be subject to the restrictions.

C No more than 30% of the agency's money may be in bankers' acceptances of any one commercial bank.

D "Select Agencies" are defined as a "city, a district or other local agency that does not pool money in deposits or investment with other local agencies, other than local agencies that have the same governing body."

E Local Agencies, other than counties or a city and county, may purchase no more than 10% of outstanding commercial paper of any single issuer.

F Issuing Corporation must be organized and operating within the United States and have assets in excess of $500.0 million.

G "Other Agencies" are counties, a city and county, or other local agency "that pools money in deposits or investments with other local agencies, including local agencies that have the same governing body." Local agencies that pool exclusively with other local agencies that have the same governing body must adhere to the limits set for "Select Agencies" above.

H No more than 30% of the agency's money may be invested in deposits, including CDs, through a placement service. No more than 30% of the agency's money may be invested in CDs through a placement service and negotiable CDs. Sections 53601.8, 53635.8, and 53601(i). Excluding purchases of certificates of deposit pursuant to section(s) 53601.8 and 53635.8, no more than 10% of the agency's money may be invested with any one private sector entity that assists in the placement of deposits.

I Reverse repurchase agreements or securities lending agreements may exceed the 92-day term if the agreement includes a written codicil guaranteeing a minimum earning or spread for the entire period between the sale of a security using a reverse repurchase agreement or securities lending agreement and the final maturity dates of the same security.

At June 30, 2015, the investments held in the City Treasury's General and Special Investment Pool Programs and their maturities are as follows (in thousands):

		Investment maturities				
Investment type	**Amount**	**1 to 30 Days**	**31 to 60 Days**	**61 to 365 Days**	**366 Days To 5 years**	**Over 5 years**
U.S. Treasury notes	$ 4,713,956	—	—	—	4,682,761	31,195
U.S. agencies securities	1,334,694	171,585	75,705	345,657	724,212	17,535
Medium term notes	1,645,006	40,001	—	202,001	1,403,004	—
Commercial paper	1,302,850	939,479	261,856	101,515	—	—
Municipal bonds	42,496	—	—	—	42,496	—
Supranational coupons	73,074	7,844	—	—	65,230	—
Short-term investment funds	1,678	1,678	—	—	—	—
Securities lending short-term						
Repurchase agreement	59,190	59,190	—	—	—	—
Total general and special pools	$ 9,172,944	1,219,777	337,561	649,173	6,917,703	48,730

Interest Rate Risk: The Policy limits the maturity of its investments to five years for the U.S. Treasury and government agency securities, medium-term notes, CD placement service, negotiable certificate of deposits, collateralized bank deposits, mortgage pass-through securities, and bank/time deposits; one year for repurchase agreements; 270 days for commercial paper; 180 days for bankers' acceptances; and 92 days for reverse repurchase agreements. The Policy also allows City funds with longer-term investments horizons, to be invested in securities that at the time of the investment have a term remaining to maturity in excess of five years, but with a maximum final maturity of thirty years.

Credit Risk: The Policy establishes minimum credit ratings requirement for investments. There is no credit quality requirement for local agency bonds, U.S. Treasury Obligations, State of California Obligations, California Local Agency Obligations, and U.S. Sponsored Agencies (U.S. government-sponsored enterprises) securities. The City's $2 billion investments in U.S. government-sponsored enterprises consist of securities issued by the Federal Home Loan Bank – $897 million, Federal National Mortgage Association – $676 million, Federal Home Loan Mortgage Corporation – $280 million, Federal Farm Credit Bank – $17 million, and Tennessee Valley Authority – $46 million. Of the City's $2 billion investments in U.S. Sponsored Agencies securities, $798 million were rated "AA+" by S&P and "Aaa" by Moody's; $1,117 million were not rated individually by S&P nor Moody's (issuers of these securities are rated "AA+/A-1+" by S&P and "Aaa/P-1" by Moody's).

Medium-term notes must be issued by corporations organized and operating within the United States or by depository institutions licensed by the United States or any state and operating within the United States. Medium-term notes must have at least an “A” rating. The City’s $1.4 billion investments in medium-term notes consist of securities issued by banks and corporations that comply with these requirements and were rated “A” or better by S&P and “A3” or better by Moody’s. Subsequent to purchase, two issuers of $39 million medium-term notes were downgraded to “A-1” by S&P and “Baa1” by Moody’s and one issuer of $7 million medium-term notes was downgraded to “BBB+” by S&P and “A3” by Moody’s.

Commercial paper issues must have a minimum of “A-1” or equivalent rating. If the issuer has issued long-term debt, it must be rated “A” without regard to modifiers. Issuing corporation must be organized and operating within the United States and have assets in excess of $500.0 million. The City’s $904.4 million investments in commercial paper were rated “A-1+/A-1” by S&P and “P-1” by Moody’s.

Municipal bonds have no minimum rating requirement. The City’s $30 million investments in municipal bonds were rated “AA/A” by S&P and “Aa2/Aa3” by Moody’s.

The issuers of the certificates of deposit were not rated.

Concentration of Credit Risk: The Policy does not allow more than 40% of its investment portfolio be invested in commercial paper and bankers’ acceptances, 30% in certificates of deposit and medium-term notes, 20% in mutual funds, money market mutual funds, and mortgage pass-through securities. The Policy further provides for a maximum concentration limit of 10% in any one issuer including its related entities. There is no percentage limitation on the amount that can be invested in the U.S. government agencies. The City’s pooled investments comply with these requirements. GAAP requires disclosure of certain investments in any one issuer that represent 5% or more of total investments. Of the City’s total pooled investments as of June 30, 2014, $897 million (10%) was invested in securities issued by Federal Home Loan Bank and $676 million (8%) was invested in securities issued by Federal National Mortgage Association.

(6) Securities Lending Transactions

The Water System participates in a Securities Lending Program (SLP). As of June 30, 2016 and 2015, amounts held in the City of Los Angeles Program are as follows (collateral amounts in thousands):

		June 30	
Program		**2016**	**2015**
City of Los Angeles Program	$	7,486	4,180

General Investment Pool Securities Lending Program

Securities lending is permitted and limited under provisions of California Government Code Section 53601. The Council approved the SLP on October 22, 1991 under Council File No. 91-1860, which complies with the California Government Code. The objectives of the SLP in priority order are safety of loaned securities and prudent investment of cash collateral to enhance revenue from the investment program. The SLP is governed by a separate policy and guidelines.

The City's custodial bank acts as the securities lending agent. In the event a counterparty defaults by reason of an act of insolvency, the bank shall take all actions, which it deems necessary or appropriate to liquidate permitted investment and collateral in connection with such transaction and shall make a reasonable effort for two business days (Replacement Period) to apply the proceeds thereof to the purchase of securities identical to the loaned securities not returned. If during the Replacement Period the collateral liquidation proceeds are insufficient to replace any of the loaned securities not returned, the bank shall, subject to payment by the City of the amount of any losses on any permitted investments, pay such additional amounts as necessary to make such replacement.

Under the provisions of the SLP, and in accordance with the California Government Code, no more than 20% of the market value of the General Investment Pool (the Pool) is available for lending. The City loans out U.S. Treasury and U.S. agencies securities, i.e., Fannie Mae, Freddie Mac, Federal Home Loan Bank, Federal Agricultural Mortgage Corporation (Farmer Mac), Federal Farm Credit Bank, and Tennessee Valley Authority. The City receives cash as collateral on the loaned securities, which is reinvested in securities permitted under the Policy. In addition, the City receives securities as collateral on loaned securities, which the City has no ability to pledge or sell without borrower default. In accordance with the California Government Code, the securities lending agent marks to market the value of both the collateral and the reinvestments daily. Except for open loans where either party can terminate a lending contract on demand, term loans have a maximum life of 60 days. Earnings from securities lending accrue to the Pool and are allocated on a pro rata basis to all Pool participants.

During the fiscal year 2016 and 2015, collateralizations on all loaned securities were compliant with the required 102% of the market value. The City can sell collateral securities only in the event of borrower default. The lending agent provides indemnification for borrower default. There were no violations of legal or contractual provisions and no borrower or lending agent default losses during the fiscal year. There was no credit risk exposure to the City because the amounts owed to the borrowers exceeded the amounts borrowed. Loaned securities are held by the City's agents in the City's name and are not subject to custodial credit risk.

The following table provides information on securities lent and collateral received as of June 30 (in thousands):

		2016	2015
Type of investment lent:			
For cash collateral:			
U.S. agencies securities	$	10,258	51,695
U.S. Treasury notes		142,280	—
Supranational coupons		8,054	—
Medium-term notes		2,339	6,242
Total lent for cash collateral		162,931	57,937
For noncash collateral:			
U.S. Treasury notes		415,604	693,859
U.S. agencies securities		161,334	1,027
Medium-term notes		1,364	32,064
Total securities lent	$	741,233	784,887
Type of collateral received:			
Cash collateral *	$	166,278	59,190
Noncash collateral **			
For lent U.S. Treasury notes, U.S. agencies securities, and medium-term notes		589,880	746,080
Total collateral received	$	756,158	805,270

* Amount represents cash collateral received and reinvested in repurchase agreements that have mark-to-market value of the cash collateral pool at 102% for the liquidity of the portfolio and 100% for the duration portfolio for the fiscal year 2016.

** The City has no ability to pledge or sell collateral securities without borrower default.

(7) Long-Term Debt

Long-term debt outstanding as of June 30, 2016 and 2015, consists of revenue bonds and refunding revenue bonds due serially in varying annual amounts, and other long-term debt, as follows (amounts in thousands):

Bond issues	Date of issue	Effective-interest rate %	Fiscal year of last scheduled maturity	Principal outstanding 2016	Principal outstanding 2015
Revenue bonds:					
Issue of 2001, Series B	02/28/01	Variable	2036	$ 325,000	325,000
Issue of 2001, Series C	11/15/01	4.788%	2017	1,620	1,622
Issue of 2003, Series B	03/06/03	4.014%	2031	8,780	8,780
Issue of 2006, Series A1	02/07/06	4.600%	2041	—	159,055
Issue of 2006, Series A2	02/07/06	4.650%	2036	—	241,085
Issue of 2007, Series A1	06/26/07	4.764%	2038	82,215	84,715
Issue of 2007, Series A2	06/26/07	4.909%	2044	197,450	197,450
Issue of 2009, Series A	02/04/09	5.118%	2039	150,000	150,000
Issue of 2009, Series B	12/03/09	3.252%	2021	133,165	141,200
Issue of 2009, Series C	12/03/09	3.844%	2040	346,090	346,090
Issue of 2010, Series A	12/14/10	4.374%	2051	492,710	492,710
Issue of 2011, Series A	08/24/11	4.542%	2042	307,140	307,140
Issue of 2012, Series A	06/06/12	4.319%	2044	276,765	276,765
Issue of 2012, Series B	08/09/12	4.023%	2044	322,000	322,000
Issue of 2012, Series C	08/09/12	2.483%	2027	92,715	92,715
Issue of 2013, Series A	05/30/13	2.797%	2035	112,695	113,215
Issue of 2013, Series B	12/05/13	3.836%	2036	380,000	380,000
Issue of 2014, Series A	11/20/14	3.987%	2045	271,000	271,000
Issue of 2016, Series A	04/21/16	3.184%	2047	628,615	—
Issue of 2016, Series B	06/09/16	3.111%	2047	265,730	—
Total principal amount				4,393,690	3,910,542
Unamortized premiums and discounts				377,441	236,279
Revenue bonds, net				4,771,131	4,146,821
Debt due within one year (including current portion of variable rate debt)				(75,795)	(61,530)
				4,695,336	4,085,291

Bond issues	Date of issue	Effective-interest rate %	Fiscal year of last scheduled maturity	Principal outstanding 2016	Principal outstanding 2015
Other long-term debt:					
Loans payable to California State Water Resources Control Board (SWRCB)					
SRF1997CX101	12/27/01	2.320%	2024	$ 7,631	8,552
SRF02CX139	06/28/07	2.600%	2030	19,056	20,171
SRF06CX144	09/11/07	2.452%	2030	27,381	28,996
SRF06CX147	06/28/07	2.292%	2030	28,868	30,599
SRF10CX103	06/24/10	—	2035	42,158	44,500
SRF10CX104	06/24/10	—	2033	7,898	8,377
SRF11CX105	06/30/11	—	2035	22,082	23,275
SRF10CX116	06/30/11	—	2034	16,500	17,500
SRF10CX117	06/30/11	—	2033	8,250	8,750
SRF12CX105	06/30/12	—	2045	122,980	112,705
SRF12CX106	06/30/12	—	2045	31,643	31,572
SRF13P110	06/26/13	—	2019	250	350
SRF13P111	06/26/13	—	2019	250	350
SRF13P112	06/26/13	—	2019	250	350
SRF13CX104	06/26/13	—	2047	3,173	2,777
SRF13CX105	06/26/13	—	2047	38,947	7,373
SRF14CX102	06/26/14	2.085%	2047	8,114	8,038
SRF14CX103	06/26/14	2.085%	2047	48,973	44,375
SRF14CX104	06/26/14	2.085%	2047	17,298	16,736
SRF14CX105	06/26/14	2.085%	2047	13,632	6,330
SRF14-586-550	03/10/15	0.000%	2022	100	—
SRF14-310-550	06/19/15	1.663%	2040	9,786	—
SRF D15-02014	09/29/15	1.663%	2036	3,249	—
Total principal amount				478,469	421,676
Amount due within one year				(11,395)	(10,005)
Loans payable, noncurrent				467,074	411,671
Total long term debt, bonds and loans				$ 5,249,600	4,568,496

Revenue bonds generally are callable 10 years after issuance. The Department has agreed to certain covenants with respect to bonded indebtedness. Significant covenants include the requirement that Water System's net income, as defined, will be sufficient to pay certain amounts of future annual bond interest and of future annual aggregate bond interest and principal maturities. Revenue bonds and refunding bonds are collateralized by the future revenue of the Water System.

The Safe Drinking Water State Revolving Fund (SDWSRF), administered by the State of California's State Water Resources Control Board, provides low interest loans and other assistance to public water systems for infrastructure needs and other drinking water related activities. The SDWSRF utilizes a prioritized project ranking system to ensure that program resources are applied to projects addressing public health risk problems; projects needed to comply with the Safe Drinking Water Act; and projects assisting public water systems most in need on a per household affordability basis. The Department has applied for and received funding from the SDWSRF for critical Water System capital projects required for compliance with federal drinking water regulations, specifically the Long Term 2 Enhanced Surface Water Treatment Rule and the Stage 2 Disinfection By Products Rule. This funding has been made available to the Department in the form of low or zero percent interest loans with a repayment period of up to 30 years.

(a) Long-Term Debt Activity

Water System had the following activity in long-term debt during fiscal year 2016 (amounts in thousands):

	Balance, July 1, 2015	Additions	Reductions	Balance, June 30, 2016	Current portion
Revenue bonds	$ 4,146,820	1,066,331	(442,020)	4,771,131	75,795
Loan from SWRCB	421,677	73,364	(16,572)	478,469	11,395
Total	$ 4,568,497	1,139,695	(458,592)	5,249,600	87,190

	Balance, July 1, 2014	Additions	Reductions	Balance, June 30, 2015	Current portion
Revenue bonds	$ 3,870,709	310,960	(34,849)	4,146,820	61,530
Loan from SWRCB	303,961	128,187	(10,472)	421,676	10,005
Total	$ 4,174,670	439,147	(45,321)	4,568,496	71,535

(b) New Issuances

(i) Fiscal Year 2016

Water System Revenue Bonds

In April 2016, the Water System issued $628.61 million of Water System Revenue Bonds, 2016 Series A. The net proceeds of $735.62 million, including a $107.01 million issue premium net of underwriter's discount, were used to pay for budgeted capital improvements, and refund a portion of the Water System Revenue Bonds, 2006 Series A, Subseries A-1, amounting to $122.67 million and Subseries A-2, amounting to $61.23 million. The transaction resulted in a net present value savings of $74.06 million and a net gain for accounting purposes of $7.07 million, which was capitalized and is being amortized over the life of the refunded bonds.

In June 2016, the Water System issued $265.73 million of Water System Revenue Bonds, 2016 Series B. The net proceeds of $329.06 million, including a $63.33 million issue premium net of underwriter's discount, were used to pay for budgeted capital improvements, and refund all of the outstanding Water System Revenue Bonds, 2006 Series A, Subseries A-1, amounting to $18.42 million and Subseries A-2, amounting to $179.86 million. The transaction resulted in a net present value savings of $53 million and a net gain for accounting purposes of $6.2 million, which was capitalized and is being amortized over the life of the refunded bonds.

State Revolving Fund (SRF) Loans

The Department entered into three (3) loan agreements with the State of California's State Water Resources Control Board (SWRCB). The loan agreements, 14-586-550, 14-310-550, and D15-02014 allow for a total maximum loan of $0.1 million, $102.8 million, and $5.1 million, respectively, at 0% to 1.663% interest rate. As of June 30, 2016, the Department received $0.10 million, $9.8 million, and $3.3 million, respectively, under the agreements. The proceeds are being used to fund water quality capital improvements.

(ii) Fiscal Year 2015

Water System Revenue Bonds

In November 2014, the Water System issued $271 million of Water System Revenue Bonds, 2014 Series A. The net proceeds of $311 million, including a $40 million issue premium net of underwriter's discount, were deposited into the construction fund to be used for capital improvements.

State Revolving Fund (SRF) Loans

In June 2014, the Department entered into four (4) loan agreements with the State of California's State Water Resources Control Board (SWRCB). The loan agreements, SRF14CX102, SRF14CX103, SRF14CX104, and SRF14CX105 allow for a total maximum loan of $11.4 million, $73.8 million, $25.6 million, and $44 million, respectively, at 2.085% interest rate. As of June 30, 2015, the Department received $8.04 million, $44.4 million, $16.8 million, and $6.33 million, respectively, under the agreements. The proceeds are being used to fund water quality capital improvements.

(Continued)

(c) Outstanding Debt Defeased

The Water System defeased certain revenue bonds in the prior years by placing cash or the proceeds of new revenue bonds in irrevocable trusts to provide for all future debt service payments on the old bonds. Accordingly, the trust account assets and the liability for the defeased bonds are not included in the Water System's financial statements. At June 30, 2016, the following revenue bonds outstanding are considered defeased (amounts in thousands):

Bond issues		Principal outstanding
Issue of 1998 R	$	72,690
Issue of 2006 Series A, Subseries A-1		48,795
Issue of 2006 Series A, Subseries A-2		179,855
	$	301,340

(d) Variable Rate Bonds

The variable rate bonds currently bear interest at daily and weekly rates ranging from 0.18% to 0.42% as of June 30, 2016 and 0.01% to 0.06% as of June 30, 2015. The Department can elect to change the interest rate period of the bonds, with certain limitations. The bondholders have the right to tender the bonds to the tender agent on any business day with seven days' prior notice. The Department has entered into standby agreements with a syndicate of commercial banks in an initial amounts of $225 million (2001B, Subseries B 1 to B 3) and $100 million (2001B, Subseries B 4) to provide liquidity for these bonds. The extended standby agreements expire in January 2018 and July 2016, respectively.

Under the agreements, the $225 million variable rate bonds will bear interest that is payable quarterly at the greatest of (i) Prime Rate plus 1.00%; (ii) the Federal Funds Rate plus 2.00%; and (iii) 7.50%, while the $100 million variable rate bonds will bear interest that is payable quarterly at the greater of (i) the Prime Rate or (ii) the Federal Funds Rate plus 1.00%. The unpaid principal of each liquidity advance made by the liquidity provider is payable in ten equal semiannual installments ninety days immediately following the related liquidity advance. At its discretion, the Department has the ability to convert the outstanding bonds to fixed rate obligations, which cannot be tendered by the bondholders.

The variable rate bonds have been classified as long term on the statements of net position as the liquidity facilities give the Department the ability to refinance on a long-term basis and the Department intends to either renew the facilities or exercise its right to tender the debt as a long-term financing. That portion, which would be due in the next fiscal year in the event that the outstanding variable rate bonds were tendered and purchased by the commercial banks under the standby agreements, has been included in the current portion of long-term debt and remains unchanged at $32.5 million as of June 30, 2016 and 2015.

(e) Scheduled Principal Maturities and Interest

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

		Principal	Interest and amortization
Fiscal year(s) ending June 30:			
2017	$	54,690	192,893
2018		75,702	191,580
2019		78,656	190,200
2020		84,509	188,115
2021		88,422	185,257
2022–2026		568,403	864,959
2027–2031		688,625	754,678
2032–2036		836,995	626,713
2037–2041		1,067,015	435,160
2042–2046		958,400	189,134
2047–2051		370,742	46,093
Total requirements	$	4,872,159	3,864,782

The interest and amortization is net of $362.24 million of unamortized discount/premium and gain/loss due to issuances of new and refunding bonds, respectively.

The maturity schedule presented above reflects the scheduled debt service requirements for all of the Water System's long-term debt. The schedule is presented assuming that the tender options on the variable rate bonds, as discussed on the previous page, will not be exercised. Should the bondholders exercise the tender options, the Water System could be required to redeem the $325 million in variable rate bonds outstanding over the next six fiscal years as follows: $32.5 million in fiscal year 2017, $65 million in each of the fiscal years 2018 through 2021, and $32.5 million in fiscal year 2022. Accordingly, the statements of net position recognize the possibility of the exercise of the tender options and reflect the $32.5 million that could be due in fiscal year 2017, as a current portion of long-term debt payable.

Interest and amortization presented in the above schedule include interest requirements for the variable rate debt over the regularly scheduled maturity period. Variable debt interest rate in effect at June 30, 2016, averages 0.36%. Should the tender options be exercised, the interest would be payable at the rate in effect at the time the standby agreements are activated.

(f) Line of Credit

On December 1, 2015, the Water System entered into a revolving credit agreement (the agreement), with Wells Fargo Bank, National Association of up to $300 million dollars. The borrowings bear interest based on the Securities Industry and Financial Markets Association Index Rate or London Interbank Offered Rate plus a 0.29% spread for tax-exempt loans and 0.40% spread for taxable loans. Interest is payable monthly. This agreement is collateralized by the Water Revenue Fund and expires on December 14, 2018. On June 29, 2016, the Water System drew down $150 million on this agreement and at June 30, 2016, $150 million is outstanding. On September 30, 2016, the Water System repaid the line of credit out of the Water Revenue Fund.

(8) Retirement Plan

(a) Plan Description

The Department has funded a contributory retirement plan covering substantially all of its employees. The Water and Power Employees' Retirement Fund (the Fund or Plan) operates as a single-employer defined-benefit plan to provide pension benefits to eligible department employers. The Retirement Fund's assets are held in a special trust fund of the City. Plan benefits are generally based on years of service, age at retirement, and the employee's highest 12 consecutive months of salary before retirement. Active participants who joined the Plan on or after June 1, 1984 are required to contribute 6% of their annual covered payroll. Participants who joined the Plan prior to June 1, 1984 contribute an amount based upon an entry-age percentage rate. A new Tier 2 was added to the Plan and applies to members hired on or after January 1, 2014. Tier 2 plan participants are required to contribute 10% of their salary and plan benefits are based on a three-year final average salary period.

Under the provisions of the City Charter, the Retirement Board of Administration (the Retirement Board) has the responsibility and authority to administer the Plan and to invest its assets. The Retirement Board members serve as trustees and must act in the exclusive interest of the Plan's members and beneficiaries. The Retirement Board has seven members: one member of the Board of Water and Power Commissioners, the General Manager, the Chief Accounting Employee, three employee members who are elected for three-year terms by active members of the Plan, and one retiree who is appointed by the Board of Water and Power Commissioners for a three-year term.

Plan amendments must be approved by both the Retirement Board and the Board. The Plan issues separately available financial statements on an annual basis. Such financial statements can be obtained from the Department of Water and Power Retirement Office, 111 N. Hope, Room 357, Los Angeles, California 90012.

(b) Benefits provided

The Plan provides retirement benefits to eligible employees. Most employees of the Water System become members of the Plan effective on the first day of biweekly payroll following employment or immediately following transfer from another City department. Members employed prior to January 1, 2014 are designated as Tier 1 and those hired on or after January 1, 2014 are designated as Tier 2 (unless a specific exemption applies to employee providing a right to Tier 1 status).

Tier 1 members are eligible to retire once they attain the age of 60 with 5 or more years of service or at age 55 with 10 or more years of service credit acquired in the last 12 years prior to retirement. A Tier 1 member with 30 years of service is eligible to retire regardless of age. Tier 2 members are eligible to retire once they attain the age of 60 with 10 or more years of service or at any age with 30 years of service. For both tiers, combined years of service between the Plan and LACERS is used to determine retirement eligibility and at least 5 years must be actual employment at Department or

City (not purchased). For both tiers, members receiving Permanent Total Disability benefits may retire regardless of age. For Tier 1, to be eligible for a Formula Pension, the employee must have worked or been paid disability four of the last five years immediately preceding eligibility to retire, or while eligible to retire.

The Formula Pension benefit the member will receive is based upon age at retirement, monthly average salary base, and years of retirement service credit. The Tier 1 Formula Pension is equal to 2.1% times years of service credit times monthly average salary base. In addition, members retiring after attaining age 55 with 30 years of service credit, receive an increase in the benefit factor from 2.1% to 2.3%. A reduced early retirement benefit is paid for those members attaining age 55 with 10 years of service or any age (under 55) with 30 years of service. The reduction is 1.5% for each year of retirement age between 60 and 55 and 3.0% for each year of retirement before age 55.

Under Tier 2, there are various benefit factors that apply as shown below:

- 2.0% at age 55 with 30 years of service credit
- 1.5% at age 60 with 10 years of service credit
- 2.0% at age 63 with 10 years of service credit
- 2.1% at age 63 with 30 years of service credit

Reduced early retirement benefits are still available at any age (under 55) with 30 years of service and the reduction factors are the same as Tier 1. Note that these reduction factors continue to include the reduction from age 60 to 55 and from 55 to age at retirement.

For Tier 1 members, the maximum monthly retirement allowance is 100% of monthly average salary base. For Tier 2 members, the maximum monthly retirement allowance is 80% of monthly average salary base. Under Tier 1, pension benefits are calculated based on the highest average salary earned during a 12-month period. Under Tier 2, pension benefits are calculated based on the average salary earned during a 36-month period.

The member may elect the Full Allowance, or choose an optional retirement allowance. The Full Allowance provides the highest monthly benefit and up to a 50% continuance to an eligible surviving spouse or domestic partner. There are five optional retirement allowances the member may choose. Each of the optional retirement allowances requires a reduction in the Full Allowance in order to allow the member the ability to provide various benefits to a surviving spouse, domestic partner, or named beneficiary.

(c) Plan membership

At June 30, 2015, pension plan membership, which consists of Water System and Power System members, consisted of the following:

Retired members or beneficiaries currently receiving benefits	$	8,843
Vested terminated members entitled to, but not yet receiving benefits		1,528
Active members		9,205
Total	$	19,576

(d) Contributions

The Department contributes $1.10 for each $1.00 contributed by participants plus an actuarially determined annual required contribution (ARC) as determined by the Plan's independent actuary. The required contributions are allocated between the Power System and the Water System based on the current year labor costs.

Employer contribution rates are adopted annually based upon recommendations received from the Plan's actuary after the completion of the annual actuarial valuation. The average employer contribution rate as of June 30, 2015 (based on the July 1, 2014 valuation) was 50.62% of compensation. The average member contribution rate as of June 30, 2015 (based on the July 1, 2014 valuation) was 6.53% of compensation. Most Tier 1 members contribute at 6% of compensation and all Tier 2 members contribute at 10% of compensation. Employer contributions in fiscal years 2016, 2015, and 2014 amounted to $118 million, $124 million, and $129 million. These contributions represented 97%, 98%, and 99% of the actuarially determined annual required contributions in fiscal years 2016, 2015, and 2014, respectively.

(e) Net Pension Liability

At June 30, 2016 and 2015, the Water System reported a liability of $373 million and $411 million, respectively, for its proportionate share of the net pension liability. The net pension liability was measured as of June 30, 2015 and 2014, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of the same dates. The Water System's proportion of the net pension liability was based on the Water System's actuarially determined employer contributions to the pension plan for the years ended June 30, 2015 and 2014, respectively, relative to the total of the actuarially determined employer contributions for both the Water System and the Power System. At June 30, 2016 and 2015, the Water System's proportion was 32.6% and 32.3% as compared to 32.3% and 32.6% as of June 30, 2015 and 2014, respectively.

(f) Actuarial Assumptions

The Department's net pension liability as of June 30, 2016 and 2015 was determined by actuarial valuations as of July 1, 2015 and 2014, respectively. The actuarial assumptions used in the July 1, 2015 valuation were based on the results of an experience study for the period from July 1, 2009 through June 30, 2012. They are the same assumptions used in the July 1, 2014 funding actuarial valuation for the Plan. The following assumptions were applied to all periods included in the measurement for the July 1, 2015 and 2014 actuarial valuation:

Actuarial assumptions	2015	2014
Inflation	3.25%	3.25%
Salary increases	4.75% to 10.00%	4.75% to 10.00%
Investment rate of return	7.50%	7.50%
Cost of living adjustments	3.00% (actual increases are contingent upon CPI increases with a 3.00% maximum for Tier 1, 2.00% maximum for Tier 2)	3.00% (actual increases are contingent upon CPI increases with a 3.00% maximum for Tier 1, 2.00% maximum for Tier 2)
Mortality	Healthy: RP-2000 Combined Mortality Table set back one year projected to 2030 with Scale AA	Healthy: RP-2000 Combined Mortality Table set back one year projected to 2030 with Scale AA

(g) Discount Rate:

The discount rate used to measure the pension liability was 7.50% as of June 30, 2016 and 2015, respectively. The projection of cash flows used to determine the discount rate assumed plan member contributions will be made at the current contribution rate and that employer contributions will be made at rates equal to the actuarially determined contribution rates. For this purpose, only employee and employer contributions that are intended to fund benefits for current plan members and their beneficiaries are included. Projected employer contributions that are intended to fund the service costs for future plan members and their beneficiaries, as well as projected contributions from future plan members, are not included. Based on those assumptions, the pension Plan's fiduciary net position was projected to be available to make all projected future benefit payments for current plan members. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments, which is estimated to be 104 years, to determine the total pension liability as of both June 30, 2016 and 2015.

The long-term expected rate of return on pension plan investments was determined using a building-block method in which expected future real rates of return (expected returns, net of inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset proportionate share, adding expected inflation and subtracting expected investment expenses. The target allocation and projected arithmetic real rates of return for each major asset class, after deducting inflation, but before deducting investment expenses, used in the derivation of the long-term expected investment rate of return assumption are summarized in the following table:

Asset class	Target allocation	Long-term expected real rate of return
Domestic equity	33%	0.06%
Developed international equity	21	7.00
Fixed income	24	0.77
Real estate	5	4.90
Real return	6	2.85
Private equity	5	9.00
Covered calls	5	4.88
Cash and cash equivalents	1	—
Total	100%	

(h) Sensitivity of the Net Pension Liability to Changes in the Discount Rate

The following presents the net pension liability of the Department as of June 30, 2016 and 2015, calculated using the discount rate of 7.50%, as well as what the Department's pension liability would be if it were calculated using a discount rate that is one/percentage pointlower (6.50%) or one/percentage point higher (8.50%) than the current rate (amounts in thousands):

Net pension liability		1% Decrease (6.50%)	Current discount rate (7.50%)	1% Increase (8.50%)
June 30, 2016	$	838,737	373,024	(18,205)
June 30, 2015		867,848	411,485	28,252

(i) Pension Plan Fiduciary Net Position

Detailed information about the pension plan's fiduciary net position is available in the separately issued Plan's financial report.

(j) Deferred Outflow of Resources, and Deferred Inflow of Resources

At June 30, 2016 and 2015, the Water System reported $112,511 and $141,130, respectively, for deferred outflow of resources and deferred inflow of resources of $200,964 and $325,848, respectively.

The below table summarizes the deferred inflow of resource and deferred outflow of resources related to pensions at June 30, 2016 and 2015 (amounts in thousands).

		June 30	
Deferred outflow of resources		**2016**	**2015**
Changes in proportion and differences between entity contributions and proportionate share of contributions	$	7,989	4,311
Changes of assumptions and other inputs		104,522	136,819
Total deferred outflow of resources	$	112,511	141,130

		June 30	
Deferred Inflow of Resources		**2016**	**2015**
Changes in proportion and differences between entity entity contributions and proportionate share of contributions	$	1,061	1,400
Net difference between projected and actual earnings on pension plan investments		112,154	264,679
Difference between expected and actual experience in the total pension liability		87,749	59,769
Total deferred inflow of resources	$	200,964	325,848

In addition to the deferred outflows noted above, there are also $118,425 and $123,629 of deferred outflows related to pension contributions made after the measurement date as of June 30, 2016 and 2015, respectively. These deferred outflows of resources are recognized as a reduction of the net pension liability in the subsequent fiscal year.

The net amount of deferred outflows of resources and deferred inflows of resources related to pensions that will be recognized in pension expense during the next five years and thereafter is as follows:

		June 30	
		2016	**2015**
2016	$	—	(53,445)
2017		(41,900)	(53,445)
2018		(41,900)	(53,445)
2019		(15,621)	(27,383)
2020		15,004	3,000
2021		(4,036)	—
Total	$	(88,453)	(184,718)

(9) Other Postemployment Benefit (Healthcare Plan)

(a) Plan Description

The Department provides certain other postemployment benefits (OPEB), such as medical and dental plans, to active and retired employees and their dependents. The healthcare plan is administered by the Department. The Retirement Board and the Board have the authority to approve provisions and obligations. Eligibility for benefits for retired employees is dependent on a combination of age and service of the participants pursuant to a predetermined formula. Any changes to these provisions must be approved by the Retirement Board and the Board. The total number of active and retired Department participants entitled to receive benefits was approximately 17,244 and 16,792 for the fiscal years ended June 30, 2016 and 2015, respectively.

The health plan is a single-employer defined-benefit plan. During fiscal year 2007, the Retiree Health Benefits Fund (the Fund) was created to fund the postemployment benefits of the Department. The Fund is administered as a trust and has its own financial statements. Such financial statements can be obtained from the Department of Water and Power Retirement Office, 111 N. Hope, Room 357, Los Angeles, California 90012.

(b) Funding Policy

The Department pays a monthly maximum subsidy of $1,832 for medical and dental premiums depending on the employee’s work location and benefits earned. Participants choosing plans with a cost in excess of the subsidy are required to pay the difference.

Although no formal funding policy has been established for the future benefits to be provided under this plan, the Department has made significant contributions into the Fund during previous years. In fiscal year 2016, the Department paid $73 million in retiree medical premiums. In fiscal year 2015, the Department paid $73.3 million in retiree medical premiums. The Water System's portion of retiree medical premium payments was $26.6 million and $25.5 million for 2016 and 2015, respectively. The remaining portion was paid by the Power System.

(c) Annual OPEB Cost and Net OPEB Obligation

The annual OPEB cost (expense) is calculated based on the ARC of the employer, an amount actuarially determined in accordance with the parameters of GASB Statement No. 45, Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost under each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed 30 years.

The following table shows the components of the Department's Power and Water fund's annual OPEB cost for the year, the amount actually contributed to the Plan, and changes in the net other postretirement benefit asset (amounts in thousands):

		Year ended June 30	
		2016	**2015**
Annual required contribution	$	64,253	73,354
Interest on net OPEB obligation		(77,024)	(75,980)
Adjustment to annual required contribution		74,238	70,776
Annual OPEB costs		61,467	68,150
Department contributions made		72,994	73,343
Change in net OPEB asset		11,527	5,193
Net OPEB asset – beginning of year		983,424	978,231
Net OPEB asset – end of year	$	994,951	983,424

The following table shows the components of the Water System's share in annual OPEB cost for the year, the amount actually paid in premiums, and changes in the net OPEB asset (amounts in thousands):

	Year ended June 30	
	2016	**2015**
Annual required contribution	$ 20,561	23,473
Interest on net OPEB obligation	(24,647)	(24,313)
Adjustment to annual required contribution	23,756	22,648
Annual OPEB costs	19,670	21,808
Water System contributions made	26,601	25,560
Change in net OPEB asset	6,931	3,752
Net OPEB asset – beginning of year	313,532	309,780
Net OPEB asset – end of year	$ 320,463	313,532

The Department's Power and Water fund's annual OPEB costs, the percentage of ARC contributed to the Plan, and the net postemployment obligation for fiscal years 2016, 2015, and 2014 were as follows (amounts in thousands):

	2016	**2015**	**2014**
Annual OPEB costs	$ 61,467	68,150	51,084
Percentage of OPEB costs contributed	119%	108%	146%
Net postemployment asset at end of year	$ 994,951	983,424	978,231

The Water System's share in the annual OPEB costs, the percentage of ARC contributed to the Plan, and the net postretirement obligation for fiscal years 2016, 2015, and 2014 were as follows (amounts in thousands):

	2016	**2015**	**2014**
Annual OPEB costs	$ 19,670	21,808	16,347
Percentage of OPEB costs contributed	135%	117%	146%
Net postemployment asset at end of year	$ 320,463	313,532	309,780

(Continued)

(d) *Funded Status and Funding Progress Based on Latest Actuarial Study*

On December 8, 2016, the latest actuarial study as of July 1, 2016 was completed for fiscal year 2017. As of July 1, 2016, the Department's actuarial value of assets was $2 billion and actuarial accrued liability (AAL) for benefits was $2.33 billion, resulting in a unfunded actuarial accrued liability (UAAL) of $0.58 billion, which represents 75% funding status. The covered payroll (annual payroll of active employees covered by the Plan) was $929 million, and the ratio of the UAAL to the covered payroll was 63%.

On October 30, 2015, the latest actuarial study as of July 1, 2015 was completed for fiscal year 2016. As of July 1, 2015, the Department's actuarial value of assets was $1.64 billion and AAL for benefits was $1.96 billion, resulting in a UAAL of $0.32 billion, which represents 84% funding status. The covered payroll (annual payroll of active employees covered by the Plan) was $920 million, and the ratio of the UAAL to the covered payroll was 35%.

As of July 1, 2014, the Department's actuarial value of assets was $1.49 billion and AAL for benefits was $1.95 billion, resulting in a UAAL of $0.46 billion, which represents 76% funding status. The covered payroll (annual payroll of active employees covered by the Plan) was $900 million, and the ratio of the UAAL to the covered payroll was 51%.

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the Plan and the ARCs of the Department are subject to continual revision as actual results are compared with past expectations and new estimates are made for the future. The schedule of funding progress, presented as required supplementary information, presents information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the AAL for benefits.

(e) *Actuarial Methods and Assumptions*

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan understood by the Department and the plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the Department and the plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in AAL and the actuarial value of assets, consistent with the long-term perspective of the calculations.

In the July 1, 2016 actuarial valuation, the entry age normal cost method was used. The actuarial assumptions include 7.25% discount rate, which represents the expected long-term return on plan assets, and an annual healthcare cost trend rate of 6.50% initially, reduced by decrements to an ultimate rate of 5.00% over six years. Both rates include a 3.00% inflation assumption. The actuarial value of assets was determined using techniques that spread UAAL being amortized as a level percentage of projected payroll over a closed 30-year period with 19 years remaining.

(Continued)

In the July 1, 2015 actuarial valuation, the entry age normal cost method was used. The actuarial assumptions include 7.50% discount rate, which represents the expected long-term return on plan assets, and an annual healthcare cost trend rate of 6.75% initially, reduced by decrements to an ultimate rate of 5.00% over seven years. Both rates include a 3.25% inflation assumption. The actuarial value of assets was determined using techniques that spread UAAL being amortized as a level percentage of projected payroll over a closed 30-year period with 20 years remaining.

In the July 1, 2014 actuarial valuation, the entry age normal cost method was used. The actuarial assumptions include 7.50% discount rate, which represents the expected long term return on plan assets, and an annual healthcare cost trend rate of 7.00% initially, reduced by decrements to an ultimate rate of 5.00% over 7 years. Both rates include a 3.25% inflation assumption. The actuarial value of assets was determined using techniques that spread UAAL being amortized as a level percentage of projected payroll over a closed 30-year period with 21 years remaining.

(f) Healthcare Reform Legislation

The Patient Protection and Affordable Care Act (PPACA) was signed into law on March 23, 2010. One key provision of the PPACA is the assessment of an excise tax on high cost plans (Cadillac Plans) beginning in 2018. Under this act, a 40% excise tax applies to plans with costs exceeding certain annual thresholds for non-Medicare retirees aged 55–64 ($11,850 for single coverage; $30,950 for family coverage). For all other retirees the thresholds in 2018 are $10,200 for single coverage and $27,500 for family coverage. Significant uncertainties exist regarding the impact of the excise tax on high cost plans without further regulatory guidance. Management estimated the potential impact of this tax on the liability based on unadjusted thresholds and assuming the tax is shared between the Department and its participants in the same way that the current costs are shared. The estimated impact of the 40% excise tax provision on high cost plans beginning in 2018, under the healthcare reform, is reflected in all actuarial valuation reports after July 1, 2010.

(g) Death and Disability Benefits

The Water System’s allocated share of death and disability benefit plan costs and administrative expenses totaled $9.3 million and $9.9 million for fiscal years 2016, and 2015, respectively. Death and disability benefits are administered as part of the Retirement Plan and maintain separate restricted funds to pay for each benefit. Disability benefits are paid to active employees only who qualify under the plan provisions and terminate with the employee’s retirement.

(10) Other Long-Term Liabilities

The Water System has the following other long-term liabilities:

(a) Accrued Workers' Compensation Claims

Liabilities for unpaid workers' compensation claims are recorded at their net present value when they are probable of occurrence and the amount can be reasonably estimated. The liability is actuarially determined, based on an estimate of the present value of the claims outstanding and an amount for claim events incurred but not reported based upon the Department's loss experience, less the amount of claims and settlements paid to date. The discount rate used to calculate this liability at its present value was 2.1% at June 30, 2016 and 4% as of June 30, 2015. The Department has third-party insurance coverage for workers' compensation claims over $1 million.

Overall indicated reserves for workers' compensation claims, for both the Water System and the Power System, undiscounted, have increased from $95 million as of June 30, 2015 to $104 million as of June 30, 2016. This increase is mainly attributable to the number of open cases filed at the Department. Workers' compensation claims typically take longer than one year to settle and close out. The entire discounted liability is shown as long term on the statements of net position as of June 30, 2016 and 2015.

Changes in the Department's undiscounted liability since June 30, 2014 are summarized as follows (amounts in thousands):

		June 30		
		2016	2015	2014
Balance at beginning of year	$	95,379	99,519	90,894
Current year claims and changes in estimates		35,268	26,727	33,945
Payments applied		(26,948)	(30,867)	(25,320)
Balance at end of year	$	103,699	95,379	99,519

The Water System's portion of the discounted reserves as of June 30, 2016 and 2015 is $29.3 million and $25.5 million, respectively.

(11) Commitments and Contingencies

(a) Purchase Water Commitments

As a member of the Metropolitan Water District (Metropolitan), the Department purchases water from Metropolitan pursuant to water supply purchase orders entered into with Metropolitan for specific periods. In January 2015, the Department and Metropolitan executed a new Purchase Order for Imported Water Supply Agreement (the Purchase Order Agreement), which requires the Department to purchase at least 2,033,134 acre-feet of water over a 10-year period commencing on January 1, 2015 and expiring on December 31, 2024. Some of the key terms of the Purchase Order Agreement include the following: (a) the Department's annual maximum Tier 1 allocation of water from Metropolitan is 335,663 acre-feet per year, or 3,356,630 acre-feet for the 10-year term of the Purchase Order Agreement; (b) any obligation to pay Metropolitan's Tier 2 supply rate will only be assessed if a member agency exceeds their total 10-year Tier 1 allocation. Under the previous purchase order agreement, Tier 2 costs were assessed on an annual basis, with no ability for member agencies to carry over unused Tier 1 allocation from one year to the next; (c) opportunity to reset the base period demand using a five-year rolling average; and (d) an appeals process for agencies with unmet purchase commitments has been established. This will allow each acre-foot of unmet Purchase Order commitment to be reduced by the amount of production from a local resource project that commences operation on or after January 1, 2014, which will allow member agencies who successfully develop local supplies, not to be charged if production of these supplies negatively impacts their minimum Purchase Order commitment. The Water System is commitment to purchase 1,513,103 acre feet of water from Metropolitan related to this agreement over the next 8.5 years which is estimated to total $236 million. Based on current annual water purchases, the Water System estimates that they will fulfill this commitment in the next 6.5 years.

(b) Transfers to the Reserve Fund of the City of Los Angeles

In prior fiscal years, under the provisions of the City Charter, the Board authorized transfers of funds from the Water System to the reserve fund of the City. Such transfers were made at the Board's discretion. Pursuant to covenants contained in the bond indentures, the transfers could not be in excess of the increase in net position before transfers to the reserve fund of the City of the prior fiscal year. Such payments were not in lieu of taxes and were recorded as a transfer in the statements of revenue, expenses, and changes in net position.

In July 2009, the court declared that the 2007 and 2008 Water System City transfers were illegal based on Proposition 218. Since that court ruling, no transfers have been made to the reserve fund of the City.

(c) Pollution and Remediation Obligations

The Department follows GASB Statement No. 49, Accounting and Financial Reporting for Pollution and Remediation Obligations (GASB 49). This statement addresses accounting and financial reporting standards for pollution (including contamination) remediation obligations, which are obligations to address the current or potential detrimental effects of existing pollution by participating in pollution remediation activities such as site assessments and cleanups. The scope of the statement excludes pollution prevention or control obligations with respect to current operations, and future pollution remediation activities that are required upon retirement of an asset, such as landfill closure and postclosure care and nuclear power plant decommissioning. The Water System has identified underground storage tanks that require remediation work and is working with the Los Angeles Regional Water Quality Control Board, and the Lahontan Regional Quality Control Board, which have jurisdiction over these sites. The Water System's estimated liability for these sites is approximately $9.8 million and includes remediation and ongoing operation and maintenance costs where estimable. There are no estimated recoveries. This liability is recorded as part of the Water System's accrued expenses.

(d) Surface Water Treatment Rule

The State of California Surface Water Treatment Rule (SWTR) imposed increased filtration requirements at any open distribution reservoir exposed to surface water runoff. The Department had four major reservoirs in its system subject to SWTR: Upper and Lower Hollywood, Lower Stone Canyon, and Encino. To comply with SWTR, the Department designed projects to remove these reservoirs from regular service through construction of larger pipelines and alternate covered storage facilities.

The Hollywood Water Quality Improvement Project was completed in July 2002. Upper and Lower Hollywood Reservoirs were removed from service and functionally replaced by two 30 million gallon tanks and additional pipelines. Construction of the Encino project was completed in December 2007. Construction of the Lower Stone Canyon Water Quality Improvement Project was completed in November 2008. The Department believes it is now in compliance with the SWTR.

(e) Stage 2 Disinfectants and Disinfection Byproduct Rule

In January 2006, the Environmental Protection Agency (EPA) published the Stage 2 Disinfectants and Disinfection Byproduct Rule (Stage 2 DBP Rule) in the federal register. The Stage 2 DBP Rule strengthens public health protection for customers by tightening compliance monitoring requirements for two groups of disinfection byproducts (DBPs): trihalomethanes (TTHM), and haloacetic acids (HAA5). DBPs form when naturally occurring materials in water (e.g., decomposing plant material) combine with chemicals added to disinfect the water. DBPs are associated with cancer.

In order to comply with the requirements of the Stage 2 DBP Rule, the Department must change its primary disinfectant from chlorine to chloramines, a less reactive disinfectant, by April 1, 2014. In order to convert to chloramines, the Department constructed an ultraviolet filtration plant, three chloramination stations, four ammonization stations, two chlorination stations and has and will continue to install mixers in tanks and reservoirs. Additional treatment facilities will be constructed, as ground water sources are improved and/or expanded. The cost of Stage 2 DBP compliance related engineering studies and construction activities is expected to be approximately $380 million at completion. The actual expenditures to date are $303 million.

(f) Long-Term 2 Enhanced Surface Water Treatment Rule

In January 2006, the EPA published the Long Term 2 Enhanced Surface Water Treatment Rule (LT2) in the federal register. The LT2 builds upon the Safe Drinking Water Act and other earlier water quality rules to strengthen protection against microbial contaminants, especially Cryptosporidium. Cryptosporidium is a significant concern in drinking water because it contaminates most watersheds used for the collection of drinking water and can cause gastrointestinal illness. The Department has six reservoirs in its system subject to LT2: Ivanhoe, Silver Lake, Elysian, Upper Stone Canyon, Santa Ynez, and Los Angeles. In order to comply with the requirements of the LT2, the Department is proposing to cover, bypass, or build alternate covered storage for the aforementioned reservoirs and to install additional pipelines and related facilities. Santa Ynez Reservoir has now been covered, Silver Lake Reservoir has been removed from service, and Elysian is out of service while the cover is under construction. The remainder of these projects is in different stages of planning, design, and construction. The cost of LT2 compliance related engineering studies and construction activities is expected to reach $1.30 billion at completion in 2020. The actual cost spent to date has been $752 million.

(g) Owens Lake

Historically, the Owens River was the main source of water for Owens Lake. Diversion of water from the river, first by farmers in the Owens Valley and then by the City, resulted in the lake drying up. The exposed lakebed became a significant source of particulate matters of 10 micrometers or less in diameter (PM10), causing the United States Environmental Protection Agency (EPA) to classify the southern Owens Valley as a serious nonattainment area for PM10 in 1991. The EPA required the Great Basin Unified Air Pollution Control District (District) to prepare a State Implementation Plan (SIP) to bring the region into compliance with the federal Clean Air Act ambient air quality standards by 2006. In 1998, the Department and District entered into a Memorandum of Agreement (MOA) to mitigate PM10 emission from Owens Lake to bring the region into compliance.

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In the intervening years, the Department has constructed facilities at the Lake in Phases responding to a series of supplemental control requirements. The facilities cover nearly 50 square mile area. In November 2014, the Department reached an agreement with the District. The agreement was memorialized in a Stipulated Judgment that provides several benefits to the Department, including provisions: (1) permitting the use of less water intensive and completely waterless measures to control dust at the lakebed, resulting in more water available for customer use; (2) limiting the City's liability for dust mitigation to no more than 53.4 square miles; (3) forming an Owens Lake Scientific Advisory Panel; (4) addressing the discovery of Native American artifacts on or around the lakebed; and (5) allowing dust control measures to be delayed without a penalty if more are discovered. In accordance with the agreement, the previous SIP was revised and calls for the region to be in compliance with the federal Clean Air Act by December 31, 2017.

(h) Litigation

A number of claims and suits are pending against the Department for alleged damages to persons and property and for other alleged liabilities arising out of its operations. In the opinion of management, any ultimate liability, which may arise from these actions, is not expected to materially impact the Water System's net position, changes in net position, or cash flows.

(i) Risk Management

The Water System is subject to certain business risks common to the utility industry. The majority of these risks are mitigated by external insurance coverage obtained by the Water System. For other significant business risks, however, the Water System has elected to self-insure. Management believes that exposure to loss arising out of self-insured business risks will not materially impact the Water System's net position, changes in net position, or cash flows.

(j) Credit Risk

Financial instruments, which potentially expose the Water System to concentrations of credit risk, consist primarily of retail receivables. The Water System's retail customer base is concentrated among commercial, industrial, residential, and governmental customers located within the City. Although the Water System is directly affected by the City's economy, management does not believe significant credit risk exists at June 30, 2016, except as provided in the allowance for losses. The Water System manages its credit exposure by requiring credit enhancements from certain customers and through procedures designed to identify and monitor credit risk.

(k) Subsequent Events

On December 5, 2016, the first meeting of the Southern California Public Water Authority (SCPWA), a California joint powers authority to allow securitization and financing of certain specified water projects of public water utilities, under AB 850 (2013), was held. The current member agencies are the Los Angeles Department of Water and Power and the City of Burbank Department of Water and Power.

On December 19, 2016, the Los Angeles Department of Water and Power requested a $142.4 million draw down from the Revolving Credit Agreement with Wells Fargo Bank, National Association for the Water System.

CITY OF LOS ANGELES
DEPARTMENT OF WATER AND POWER
WATER SYSTEM

Required Supplementary Information

June 30, 2016 and 2015

(Unaudited)

Schedule of the Water System's Proportionate Share of the Net Pension Liability

Last Ten Years*

(Amounts in thousands other than percentages)

		2016	2015	2014
Water System's proportion of the collective net pension liability		32.603%	32.344%	32.573%
Water System's proportionate share of the collective net pension liability	$	373,024	411,485	583,344
Water System's covered-employee payroll	$	273,607	265,192	266,262
Water System's proportionate share of the collective net pension liability as a % of covered payroll		136.34%	155.16%	219.09%
Pension plan's fiduciary net position as a percentage of total pension liability		89.80%	88.41%	82.26%

* The Water System implemented GASB Statement No. 68 effective July 1, 2013, therefore, no information is available for the measurement periods prior to June 30, 2013.

See accompanying independent auditors report.

(Continued)

CITY OF LOS ANGELES
DEPARTMENT OF WATER AND POWER
WATER SYSTEM

Required Supplementary Information

June 30, 2016 and 2015

(Unaudited)

Schedule of the Water System's Contributions

Last 10 Fiscal Years

(Amounts in thousands other than percentages)

Reporting Date for Water System June 30[1]	Actuarially determined contributions[2]	Contributions in relation to the actuarially required contributions	Contributions deficiency (excess)	Water System's covered-employee payroll	Contributions as a percentage of covered employee payroll
2016	$ 123,994	125,944	(1,950)	273,607	46.03%
2015	125,339	129,061	(3,722)	265,192	48.67
2014	120,150	121,914	(1,764)	266,262	45.79
2013	108,045	103,174	4,871	260,146	39.66
2012	97,640	91,952	5,688	253,939	36.21
2011	64,331	64,477	(146)	246,290	26.18
2010	45,316	46,807	(1,491)	223,452	20.95
2009	43,186	45,499	(2,313)	200,029	22.75
2008	43,139	41,423	1,716	193,884	21.36
2007	35,336	32,572	2,764	184,199	17.68

(1) The measurement date under GASB 68 is on a one year lag.

(2) All actuarially determined contributions through June 30, 2014 were determined as the annual requirement under GASB 25 and 27.

See accompanying independent auditors' report.

CITY OF LOS ANGELES
DEPARTMENT OF WATER AND POWER
WATER SYSTEM

Required Supplementary Information

June 30, 2016 and 2015

(Unaudited)

Postemployment Healthcare Plan – Schedule of Funding Progress

The following schedule provides information about the Department's overall progress made in accumulating sufficient assets to pay benefits when due, prior to allocations to the Water System and the Power System (amounts in thousands):

Actuarial valuation date July 1	Actuarial value of assets	Actuarial accrued liability (AAL)	Unfunded AAL (UAAL)	Funded ratio	Covered payroll	UAAL as a percentage of covered payroll
2016	$ 1,752,195	2,334,043	581,848	75%	$ 928,889	63%
2015	$ 1,637,578	1,956,230	318,652	84%	$ 920,781	35%
2014	$ 1,485,140	1,947,912	462,772	76%	$ 900,126	51%

See accompanying independent auditors' report.