HUMBOLDT BAY MUNICIPAL WATER DISTRICT

BASIC FINANCIAL STATEMENTS,

REQUIRED SUPPLEMENTARY INFORMATION,

AND

ADDITIONAL INFORMATION

Years Ended June 30, 2012 and 2011

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INDEPENDENT AUDITORS' REPORT

The Board of Directors
Humboldt Bay Municipal Water District
Eureka, California

We have audited the accompanying financial statements of the business-type activities of Humboldt Bay Municipal Water District as of and for the years ended June 30, 2012 and 2011, as listed in the table of contents. These financial statements are the responsibility of the District's management. Our responsibility is to express opinions 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, the State Controller's Minimum Audit Requirements and Reporting Guidelines for California Special Districts, 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 audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the business-type activities of Humboldt Bay Municipal Water District as of June 30, 2012 and 2011, and the changes in financial position and cash flows thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America, accounting systems prescribed by the State Controller's Office and state regulations governing special districts.

In accordance with *Government Auditing Standards,* we have also issued our report dated November 30, 2012, on our consideration of Humboldt Bay Municipal Water District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, 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* and should be considered in assessing the results of our audit.

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Accounting principles generally accepted in the United State of America require that the management's discussion and analysis on pages 3 through 10 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.

Hunter, Hunter & Hunt

November 30, 2012

MANAGEMENT'S DISCUSSION AND ANALYSIS

HUMBOLDT BAY MUNICIPAL WATER DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
For FY 2011-12

The purpose of this section of the financial statements is to present management's discussion and analysis of the Humboldt Bay Municipal Water District's (District) financial performance during the fiscal year that ended on June 30, 2012 (FY2011-12). We recommend that readers review this in conjunction with the remainder of the financial statements.

INTRODUCTION AND BACKGROUND

We would first like to provide a brief overview of the District and the customers served which will provide a context for the financial statements and the discussion which follows.

The Regional Water System:

The District was formed in 1956 pursuant to the Municipal Water District Act of the California Water Code. The District completed construction of the regional water system in 1961, and service commenced to the Cities of Eureka and Arcata and two pulp mills on the Samoa Peninsula. Since the initial construction, a number of additions and improvements to the regional system have been made, and additional wholesale customers have joined the regional system. Since inception, this regional water system has efficiently and reliably served the municipal and industrial water needs of customers in the Humboldt Bay region.

The regional water system includes the following components: R.W. Matthews Dam (which forms Ruth Lake) and the Gosselin Power House, in Trinity County; and the following facilities in Humboldt County: 1) diversion works on the Mad River northeast of Arcata capable of supplying 75 million gallons per day, 2) treatment facilities, including the Lloyd L. Hecathorn Turbidity Reduction Facility, 3) over 35 miles of pipeline infrastructure around the Humboldt Bay area to deliver water to the wholesale customers, and 4) extensive communication and control systems to operate and control the regional system.

Customers Served and Associated Wholesale Water Contracts:

The District supplies treated domestic water to seven municipal agencies on a wholesale basis. The municipalities served by the District are the Cities of Arcata, Blue Lake and Eureka, and the Fieldbrook/Glendale, Humboldt, Manila and McKinleyville Community Services Districts. Via the wholesale relationship, the District serves water to an estimated population of 88,000 (approximately 65% of the entire County), and to numerous businesses, industries and educational institutions.

The District provides retail water service to about 200 customers who reside outside the service territory of other water purveyors, but are located in close proximity to District facilities.

The District also has facilities to supply untreated water to customers on the Samoa Peninsula. The District was serving one wholesale industrial customer (pulp mill) until it ceased operations on October 15, 2008.

The District has long-term contracts in place with each of its seven wholesale municipal customers. These contracts have a 20-year term and will be in place through 2019 (or technically until the Safe Drinking Water State Revolving Fund (SRF) Loan Debt service to the State is paid in full shortly thereafter). The wholesale municipal customers have an opportunity to extend these contracts by up to ten years.

These contracts define the terms and conditions by which the District provides water service to its customers. The contracts specify that all operating, maintenance and capital costs associated with the regional water system are paid for by the wholesale customers. The contracts also specify the manner in which these costs are allocated *among* the wholesale customers. Furthermore, they specify that revenues received by the District, other than those associated with wholesale water sales, are credited back to the wholesale customers, and thus offset the costs that the wholesale customers otherwise pay. Examples of such revenues which are credited back to the wholesale customers include the District's share of 1% property taxes, power sales from the hydro-electric facility, interest income, revenues associated with retail water service, and other miscellaneous revenues.

A summary of the current cost allocation provisions of the wholesale contract is as follows:

Type of Cost	Municipal Customers' Cost Share	Industrial Customer(s) Cost Share
Debt Service for Turbidity Reduction Facility	100%	0%
Operation, Maintenance and Capital Expenditures associated with drinking water treatment facilities (i.e. facilities associated with providing safe drinking water in accordance with federal and state requirements)	100%	0%
Operation, Maintenance and Capital Expenditures associated with all other aspects of the regional water supply, pumping and distribution system (other than power for pumping water) *Change in % due to pulp mill closure.	55% increased to 100% effective April 1, 2009*	45% decreased to 0% effective April 1, 2009*
Power Costs for Pumping Water	In proportion to actual power use.	n/a

Additionally, the wholesale contracts provide that "Additions to Reserves" may be charged to the wholesale customers should the District need to replenish its General Reserve level. The wholesale customers were charged $200,000 for FY2011-12.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to the District's basic financial statements. The District's basic financial statements are comprised of several components: a) the Statements of Net Assets (page 11), b) the Statements of Revenues, Expenses, and Changes in Net Assets (page 12), and c) the Statements of Cash Flows (page 13). These financial statements present the District's financial position on an enterprise fund basis. An enterprise fund accounts for goods or services which are provided to outside parties – in the District's case, this is wholesale and retail water service.

BASIC FINANCIAL STATEMENTS

The financial statements are designed to provide readers with a broad overview of the District's finances, in a manner similar to a private-sector business. These statements offer short- and long-term financial information about District activities.

The Statement of Net Assets includes all of the District's assets and liabilities and provides information about the nature and amounts of investments in resources (assets) and the obligations to District creditors (liabilities). It also provides the basis for evaluating the capital structure of the District and assessing the liquidity and financial flexibility of the District.

All of the current year's revenues and expenses are accounted for in the Statement of Revenues, Expenses, and Changes in Net Assets. This statement measures the results of the District's operations over the past year and can be used to determine the District's general financial well-being and whether the District has recovered its costs through its water charges.

The final financial statement is the Statement of Cash Flows. The primary purpose of this statement is to provide information about the District's cash receipts and cash payments during the reporting period. The statement reports cash receipts, cash payments, and the changes in cash resulting from operations and investments. It also provides answers to such questions as where did cash come from, what was cash used for, and what was the change in cash balance during the reporting period.

There may be minor rounding differences between the following tables and the financial statements.

FINANCIAL HIGHLIGHTS

- The District's net assets were $15,205,750 as of June 30, 2012, an increase of $18,757 compared to June 30, 2011.
- Revenues were $5,266,991, a decrease of $279,265 from FY 2010-11.
- Expenses were $5,248,234, an increase of $260,576 from FY 2010-11.
- Notes payable net of current portion is $6,975,222 an increase of $680,847 from FY 2010-11.

DISCUSSION AND ANALYSIS

Our analysis of the District begins on page 11 of the financial statements. The Statements of Net Assets present information on all of the District's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the District is improving or deteriorating. A summary of the District's Statements of Net Assets is presented in Table 1.

TABLE 1 CONDENSED STATEMENTS OF NET ASSETS				
			Change	
ASSETS	**FY 2011-12**	**FY 2010-11**	**$**	**%**
Current Assets	$2,668,100	$2,627,522	$40,578	1.5%
Restricted Cash & Investment	$2,721,437	$2,309,364	$412,073	17.8%
Land, Property & Equipment (net Accum. Depr.)	$18,318,679	$17,755,840	$562,839	3.2%
Total Assets	$23,708,216	$22,692,726	$1,015,490	4.5%
LIABILITIES				
Current Liabilities	$1,182,516	$983,886	$198,630	20.2%
Post-Retirement Health Benefits Obligation	$344,728	$227,472	$117,256	51.5%
Long-term Debt	$6,975,222	$6,294,375	$680,847	10.8%
Total Liabilities	$8,502,466	$7,505,733	$996,733	13.3%
NET ASSETS				
Investment in Capital Assets (net of related debt)	$10,668,752	$10,914,128	-$245,376	-2.2%
Restricted (for debt service)	$743,463	$1,396,386	-$652,923	-46.8%
Restricted (for capital projects)	$1,600,027	$322,000	$1,278,027	396.9%
Restricted (for credits to municipalities)	$377,947	$590,978	-$213,031	-36.0%
Unrestricted	$1,815,561	$1,963,501	-$147,940	-7.5%
TOTAL NET ASSETS	**$15,205,750**	**$15,186,993**	**$18,757**	**0.1%**

As can be seen from the table above, the net assets as of June 30, 2012, were $15,205,750, an increase of $18,757 (0.1%) as compared to June 30, 2011.

The largest portion of the District's net assets are its investment in capital assets called property and equipment (e.g., land, buildings, equipment, and water system infrastructure), less any related debt used to acquire those assets that is still outstanding. The District uses these capital assets to provide water services to its wholesale and retail customers, and consequently, these assets are not available for future spending. Although the District's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

The Statements of Revenues, Expenses, and Changes in Net Assets (page 12) present information showing how the District's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported in this statement for some items that will result in cash flows in future fiscal periods (e.g., uncollected taxes, or earned but unused vacation leave). A summary of the District's Statements of Revenues, Expenses, and Changes in Net Assets is presented in Table 2.

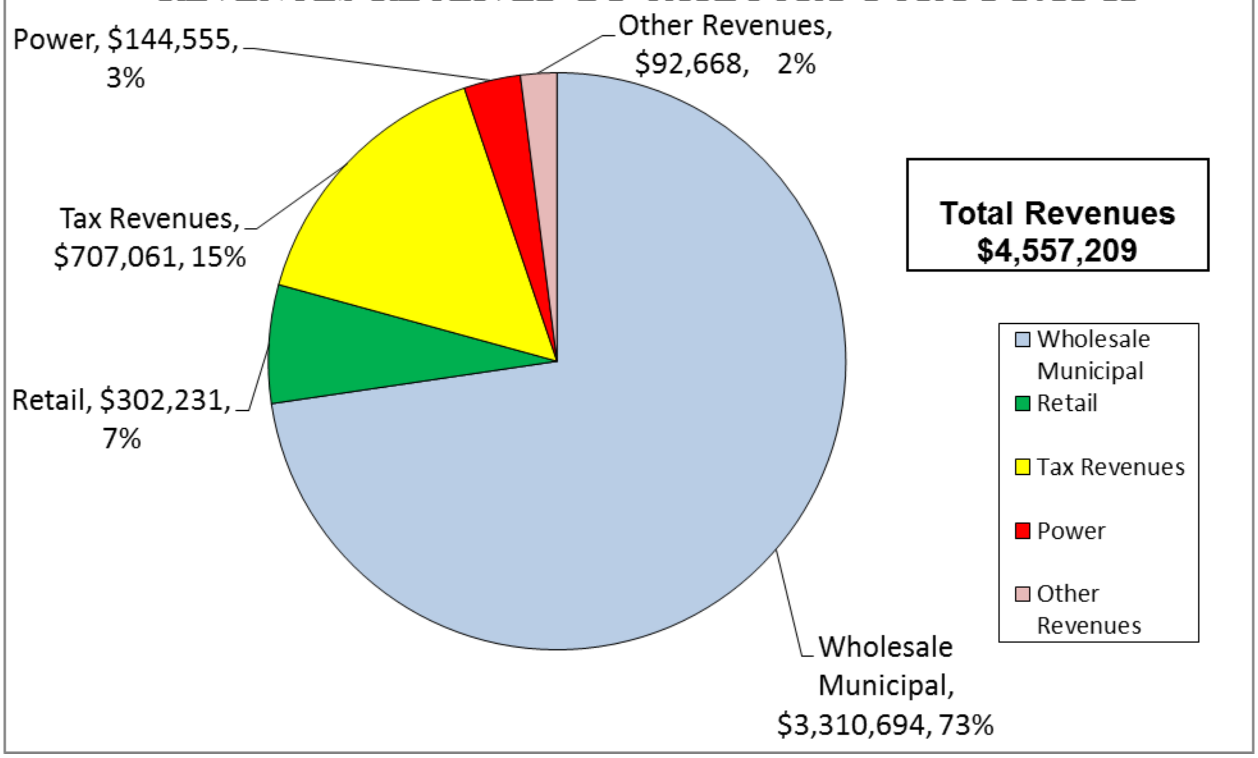
TABLE 2 CONDENSED STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS				
			Change	
	FY 2011-12	**FY 2010-11**	**$**	**%**
REVENUES				
***Operating:**				
Water Sales	$3,612,925	$3,718,103	-$105,178	-2.8%
Power Sales	$144,555	$494,245	-$349,690	-70.8%
Grant Revenues	$162,445	$0	$162,445	0.0%
Other Operating	$46,532	$62,170	-$15,638	-25.2%
SRF Debt Service Receipt	$547,337	$547,337	$0	0.0%
***Non-Operating:**				
Taxes	$707,061	$685,665	$21,396	3.1%
Interest Income	$37,136	$38,736	-$1,600	-4.1%
Other Income	$9,000	$0	$9,000	0.0%
Total Revenues	$5,266,991	$5,546,256	-$279,265	-5.0%
EXPENSES				
Operating expense	$4,453,827	$4,225,062	$228,765	5.4%
Non-operating expense	$28,132	$0	$28,132	0.0%
Depreciation	$948,696	$938,568	$10,128	1.1%
Less Reimbursements	-$182,421	-$175,972	-$6,449	3.7%
Total Expenses	$5,248,234	$4,987,658	$260,576	5.2%
Change in Net Assets	$18,757	$558,598	-$539,841	-96.6%
Beginning Net Assets	$15,186,993	$14,628,395	$558,598	3.8%
Ending Net Assets	**$15,205,750**	**$15,186,993**	**$18,757**	**0.1%**

While the Statements of Net Assets show the changes in financial position of net assets, the Statements of Revenues, Expenses, and Changes in Net Assets explain the nature and source of these changes. As shown in Table 2, the change in net assets decreased by $539,841 compared to the prior year. The changes in revenues and expenses which contributed to this change in net assets are reflected in the above line-item detail.

Although the change in current year net assets is shown as an increase of $18,757, it is important to understand that depreciation (a non-cash expense) is included in the expenses. Absent depreciation, the change in current year net assets would be a gain of $967,453 ($18,757 + $948,696).

As a supplement to the Statements of Revenues, Expenses, and Changes in Net Assets, Chart 1 presents operating and non-operating revenues earned in FY 2011-12 by category along with the proportionate share of the total revenue each category represents. The total revenues reflected in Chart 1 ($4,557,209) are $709,782 less than the total revenues shown in Table 2 ($5,266,991). This difference is associated with the municipal customer receipts of $547,337 for repayment of the District's SRF Loan for the Turbidity Reduction Facility, which is further described in the subsequent Long-Term Debt section plus grant funding receipts of $162,445. These amounts were not included in the revenue chart below since they are associated with repayment of long-term debt and special funding respectively and not current operations.

CHART 1
REVENUES RECEIVED BY CATEGORY FOR FY 2011-12



PROPERTY AND EQUIPMENT

The District has invested approximately $50,000,000 in a broad range of infrastructure for the regional water system. Table 3 presents a summary of the District's property and equipment.

TABLE 3
PROPERTY AND EQUIPMENT

			Change	
	FY 2011-12	**FY 2010-11**	**$**	**%**
Buildings	$1,050,908	$977,399	$73,509	7.5%
Equip - Auto/Mobile/Office/Radio/Tools	$1,902,552	$1,862,923	$39,629	2.1%
Water System Infrastructure (excludes land)	$48,756,772	$47,488,555	$1,268,217	2.7%
Total Property and Equipment	$51,710,232	$50,328,877	$1,381,355	2.7%
Less Accumulated Depreciation	-$34,931,077	-$34,005,566	-$925,511	2.7%
Add Projects in Progress	$167,552	$60,557	$106,995	176.7%
Total Property & Equipment (net of Depr)	**$16,946,707**	**$16,383,868**	**$562,839**	**3.4%**

LONG-TERM DEBT

At FY 2011-12 year-end, the District has two long-term notes payable outstanding for a total amount of $7,649,928. The first has an outstanding balance of $6,294,375 (long-term note payable of $5,747,038 plus current liabilities-current portion of note payable of $547,337). This is the SRF Loan used to finance the Turbidity Reduction Facility. The SRF loan carries no interest (i.e. zero percent), and has a repayment term of 20 years. The initial SRF loan balance at its inception in 2004 was $10,946,736. The debt service for the SRF Loan is paid in its entirety by the District's wholesale municipal customers in accordance with the wholesale water contracts (via Price Factor 1).

The second note payable has an outstanding balance of $1,355,553 (long-term note payable of $1,228,184 plus current liabilities-current portion of note payable of $127,369). This is the Water System Improvement Loan or US Bank loan, used to finance various improvements to the water system consisting generally of well and pump improvements, and pipeline replacement. The US Bank loan carries interest at 2.63%, and has a repayment term of 10 years. The District makes semi-annual payments of $81,094 including principal and interest to US Bank, for a resulting annual payment of $162,188. The Water System Improvement loan balance at its inception in 2011 was $1,418,000. The debt service for the Water System Improvement Loan is paid in its entirety by the District's wholesale municipal customers in accordance with the wholesale water contracts (via Price Factor 2).

DESCRIPTION OF CURRENTLY KNOWN FACTS OR CONDITIONS THAT MAY HAVE A SIGNIFICANT EFFECT ON THE FINANCIAL POSITION OR RESULTS OF OPERATIONS

Pulp Mill Closure

On October 15, 2008 (FY2008-09), the District's only industrial customer, Evergreen Pulp, shut down its pulp mill for "three to six months". The mill did not reopen and was sold on February 6, 2009 to Samoa Acquisition Corporation (SAC). The District had an interim agreement with the new owner until April 30, 2009. The District shut off the water supply to the mill on May 1, 2009.

The mill had been paying 45% of the District's operation, maintenance, and capital expenditure costs associated with all aspects of the regional water supply except for the drinking water treatment facilities. For 2008-09, the mill's contribution to the cost of the regional water system would have been approximately $1.1 million.

Under the terms of the District's Ordinance 16 contracts, costs were shifted to the remaining wholesale customers (seven municipal agencies) beginning April 1, 2009. Whereas the municipalities had previously been paying 55% of costs, they now pay 100%.

SAC did try, under the name Freshwater Tissue, to raise financing to restart the mill but announced on September 28, 2010, that it was unsuccessful and was trying to sell off assets. The mill is not expected to reopen in the foreseeable future.

In order to replace the revenue that was being generated by its former industrial customers, the District has been conducting a comprehensive water resources planning effort to identify possible new customers or uses for the water that is now available. Any water use options that are deemed feasible will likely take several years to implement.

Capital Improvement Program

Going forward, the District needs to implement a substantial capital improvement program (CIP) given the age of its infrastructure (50 years). Mechanisms to finance CIP projects include pursuing grant funding, issuing new long-term debt, and working with wholesale municipal customers to increase revenues through water rates.

The first two large infrastructure projects to be undertaken are the Ranney Collector #3 Rehabilitation project and the Techite Pipeline Replacement project. The funding plan for these combined projects consists of the following components:

Collected from District's wholesale customers for the Ranney project	$ 322,000
Utilization of the District's Drinking Water Facilities Plant Reserve	706,000
US Bank Loan (10 year loan at 2.63%)	1,418,000
FEMA Grant for Techite project	2,185,000*
Total Projected Project Costs and Financing	$ 4,631,000

*For the Techite Replacement project, the District received a Federal Emergency Management Agency (FEMA) grant in the amount of $2,185,000. FEMA has approved the project and committed funds and the District has received the grant agreement.

Another large project is replacement of the District's pipeline that crosses over the Mad River to serve the City of Blue Lake and the Fieldbrook-Glendale Community Services District. The project cost is estimated to be $1,600,000 in current dollars.

For this project, the District is in position to receive a State of California Department of Water Resources Proposition 84 grant via the North Coast Integrated Regional Water Management Plan in the amount of $700,000. It has also applied for a FEMA Hazard Mitigation Grant. Any shortfall will be funded by the District though financing and/or water rates.

BASIC FINANCIAL STATEMENTS

HUMBOLDT BAY MUNICIPAL WATER DISTRICT
STATEMENTS OF NET ASSETS
PROPRIETARY FUND
June 30, 2012 and 2011

	2012	2011
ASSETS:		
CURRENT ASSETS:		
Cash & cash equivalents	$ 2,046,834	$ 1,968,660
Accounts receivable	401,666	482,127
Grants receivable	56,922	-
Interest receivable	6,396	9,673
Other receivable	-	100
Prepaid expenses	151,282	161,962
Deposits	5,000	5,000
TOTAL CURRENT ASSETS	2,668,100	2,627,522
NON-CURRENT ASSETS:		
Restricted cash equivalents	2,174,099	1,762,026
Restricted investment	547,338	547,338
Land	1,371,972	1,371,972
Projects in progress	167,552	60,557
Property & equipment, net	16,779,155	16,323,311
TOTAL ASSETS	$ 23,708,216	$ 22,692,726
LIABILITIES:		
CURRENT LIABILITIES:		
Accounts payable	$ 71,093	$ 89,811
Accrued wages, payroll taxes & benefits	110,218	109,752
Contract retentions payable	106,640	-
Interest payable	8,864	-
Accrued absences	210,995	236,986
Current portion of notes payable	674,706	547,337
TOTAL CURRENT LIABILITIES	1,182,516	983,886
LONG-TERM LIABILITIES:		
Other postemployment benefits obligation	344,728	227,472
Note payables, net	6,975,222	6,294,375
TOTAL LIABILITIES	8,502,466	7,505,733
NET ASSETS:		
Invested in capital assets, net of related debt	10,668,751	10,914,128
Restricted for debt service	743,463	1,396,386
Restricted for capital projects	1,600,027	322,000
Restricted for credits to municipalities	377,947	590,978
Unrestricted	1,815,562	1,963,501
TOTAL NET ASSETS	15,205,750	15,186,993
TOTAL LIABILITIES AND NET ASSETS	$ 23,708,216	$ 22,692,726

See accompanying notes.

HUMBOLDT BAY MUNICIPAL WATER DISTRICT
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
PROPRIETARY FUND
For the Years Ended June 30, 2012 and 2011

	2012	2011
OPERATING REVENUES:		
Water sales:		
Municipal customers	$ 3,310,694	$ 3,429,796
Retail customers	302,231	288,307
Debt service receipts	547,337	547,337
Total water sales	4,160,262	4,265,440
Power sales	144,555	494,245
Other operating revenues	46,532	62,170
TOTAL OPERATING REVENUES	4,351,349	4,821,855
OPERATING EXPENSES:		
Payroll & related costs	2,476,625	2,374,093
Employee retirement contributions	297,010	292,195
Power & pumping	627,509	625,914
Engineering	182,197	160,222
Materials & supplies	127,887	117,906
Repairs & maintenance	253,850	189,460
Auto & travel expenses	60,276	59,302
Insurance	81,443	78,414
Depreciation	948,696	938,568
Legal & accounting fees	65,161	70,261
Professional assistance	84,947	88,707
Tax and license	87,299	83,058
Training	26,341	18,754
Bad debt	1,530	180
Other operating expenses	81,752	66,596
Total operating expenses before reimbursements	5,402,523	5,163,630
Reimbursements for services & costs	(182,421)	(175,972)
TOTAL OPERATING EXPENSES	5,220,102	4,987,658
OPERATING INCOME (LOSS)	(868,753)	(165,803)
NONOPERATING REVENUES (EXPENSES):		
Tax revenues	707,061	685,665
Grant revenues	162,445	-
Interest revenues	37,136	38,736
Interest expense	(28,132)	-
Gain (loss) on disposal of capital assets	9,000	-
TOTAL NONOPERATING REVENUES (EXPENSES)	887,510	724,401
CHANGE IN NET ASSETS	18,757	558,598
BEGINNING NET ASSETS	15,186,993	14,628,395
ENDING NET ASSETS	$ 15,205,750	$ 15,186,993

See accompanying notes.

HUMBOLDT BAY MUNICIPAL WATER DISTRICT
STATEMENTS OF CASH FLOWS
PROPRIETARY FUND
For the Years Ended June 30, 2012 and 2011

	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES:		
Receipts from customers	$ 4,612,701	$ 4,956,220
Payments to suppliers	(1,699,991)	(1,551,355)
Payments to employees	(2,681,904)	(2,572,522)
Other receipts (payments)	100	(100)
NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES	230,906	832,243
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:		
Taxes for general operations	707,061	685,665
NET CASH PROVIDED (USED) BY NONCAPITAL FINANCING ACTIVITIES	707,061	685,665
CASH FLOWS FROM CAPITAL & RELATED FINANCING ACTIVITIES:		
Payments to acquire, construct & improve capital assets	(1,391,604)	(443,757)
Proceeds on sale of capital assets	9,000	-
Receipts of grants for capital financing	105,523	-
Proceeds on capital debt	1,418,000	-
Principal paid on capital debt	(609,784)	(547,337)
Interest paid on capital debt	(19,268)	-
Payments for loan costs	-	-
NET CASH PROVIDED (USED) BY CAPITAL & RELATED FINANCING ACTIVITIES	(488,133)	(991,094)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Interest received	40,413	42,777
INCREASE (DECREASE) IN CASH & CASH EQUIVALENTS	490,247	569,591
CASH & CASH EQUIVALENTS AT BEGINNING OF YEAR	3,730,686	3,161,095
CASH & CASH EQUIVALENTS AT END OF YEAR	$ 4,220,933	$ 3,730,686
FINANCIAL STATEMENT PRESENTATION RECONCILIATION:		
Cash & cash equivalents	$ 2,046,834	$ 1,968,660
Restricted cash equivalents	2,174,099	1,762,026
CASH & CASH EQUIVALENTS AT END OF YEAR	$ 4,220,933	$ 3,730,686
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES:		
Operating Income (loss)	$ (868,753)	$ (165,803)
Adjustments to reconcile operating income (loss) to net cash provided by operating activities:		
Depreciation	948,696	938,568
Changes in assets and liabilities:		
Receivables	80,461	(41,427)
Other receivable	100	(100)
Prepaid expenses	(2,611)	(9,585)
Accounts payable	(18,718)	16,824
Accrued liabilities	91,731	93,766
NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES	$ 230,906	$ 832,243

NONCASH CAPITAL FINANCING ACTIVITIES

Capital assets of $106,640 were acquired through contract retentions.

Prepaid supplies inventory of $13,291 purchased in a prior year were transferred to capital assets in the current year.

See accompanying notes.

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements of Humboldt Bay Municipal Water District (the District) have been prepared in conformity with generally accepted accounting principles (GAAP). The Governmental Accounting Standards Board (GASB) is responsible for establishing GAAP for state and local governments through its pronouncements (Statements and Interpretations). Governments are also required to follow the pronouncements of the Financial Accounting Standards Board (FASB) issued through November 30, 1989 (when applicable) that do not conflict with or contradict GASB pronouncements. The District has the option to apply the private-sector guidance in the FASB pronouncements issued after that date to its business activities. The District has chosen not to follow the subsequent private-sector guidance.

This summary of significant accounting policies of the District is presented to assist in understanding the financial statements. The financial statements and notes are representations of management, who is responsible for their integrity and objectivity. These accounting policies have been consistently applied in the preparation of the financial statements.

Reporting Entity

The District has no oversight responsibility over any other governmental unit and is not included in any other governmental “reporting entity” as defined in GASB pronouncements. The Board of Directors are elected by the public and have the decision-making authority to levy taxes, the power to designate management, the ability to significantly influence operations, and the primary accountability for fiscal matters.

Nature of Activities

The District is a state-authorized special purpose government established to provide water services to the Humboldt Bay region. It was formed in 1956 under provisions of the Municipal Water District Act of 1911. The District provides retail water service to residential customers and it contracts with seven municipal agencies for the purchase of treated domestic water for resale.

Basis of Presentation

The District utilizes an enterprise fund, which is a proprietary fund type. Proprietary funds are used to account for activities similar to those found in the private sector, where the determination of net income is necessary or useful to sound financial administration. Enterprise fund types account for goods or services that are provided to outside parties.

Measurement Focus/Basis of Accounting

Measurement focus refers to what is being measured. Basis of accounting refers to the timing of the recognition of revenues and expenditures in the accounts and their reporting in the financial statements.

Proprietary fund types are accounted for on an economic resources measurement focus using the accrual basis of accounting in which revenues are recognized when earned and expenses are recognized when the related liabilities are incurred.

The proprietary fund distinguishes operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund's principal ongoing operations.

The principal operating revenues of the District are charges to customers for sales and services. Operating expenses for proprietary funds include the cost of sales and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses. When both restricted and unrestricted resources are available for use, it is the District's practice to first use specifically designated restricted resources before using unrestricted resources.

Accounts Receivable

Management considers accounts receivable to be fully collectible; accordingly, no allowance for doubtful accounts is required. If amounts become uncollectible, they will be charged to operations as a bad debt expense.

Cash and Cash Equivalents

Cash and cash equivalents are considered to be cash on hand, demand deposits, cash with a fiscal agent, and short-term highly liquid investments that are readily convertible to cash and mature within 90 days of the date acquired. Cash deposited in external investment pools are considered to be cash equivalents when deposits and withdrawals may be made at any time without prior notice or penalty. The District participates in two external investment pools: the County Treasurer's Investment Pool and the Local Agency Investment Fund (LAIF).

LAIF is a fund for pooling surplus cash of local government agencies and is chartered and administered by the California State Treasurer's Office. LAIF has invested a portion of the pool funds in Structured Notes and Asset-Backed Securities. LAIF's investments are subject to credit risk with the full faith and credit of the State of California collateralizing these investments. In addition, these Structured Notes and Asset-Backed Securities are subject to market risk as to changes in interest rates.

The County Treasurer's Investment Pool is administered by the County of Humboldt Treasurer's Office and conforms to the California Government Code. The County's portfolio normally consists of U.S. Treasury issues, U.S. Agency agreements, banker's acceptances, and the LAIF. All cash invested by the County in demand deposit accounts is collateralized to 110 percent with approved U.S. Government securities, such as Treasury Bills and other U.S. Treasury issues.

The District's investment policy does not restrict the amount the District may deposit with any one issuer and the policy states that all excess funds not required for immediate use be deposited with LAIF or the County Treasurer's Investment Pool.

The District accounts for cash equivalents in the LAIF pool at cost. Management considers the difference between book value and fair value immaterial.

The District accounts for cash equivalents in the County Treasurer's Investment Pool at the lower of cost or fair value. Fair value is calculated annually based on statistics provided by the County Treasurer. Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties.

Capital Assets

Capital assets are defined as assets with an initial cost of $1,000 and projects costing $5,000 or more. All capital assets are valued at historical cost or estimated historical cost if actual historical cost is not available. Assets that individually may be below threshold amounts are capitalized if collectively they are material.

Additions to and replacements of capital assets are recorded at original cost, which includes material, labor, overhead, and an allowance for the cost of funds used during construction when significant. The costs of betterments or repairs that extend the life of a capital asset are added to capital accounts.

Depreciation of all exhaustible capital assets is charged as an expense against operations, with accumulated depreciation reflected in the statement of net assets. Depreciation has been provided over the estimated useful lives using the straight-line method. The estimated useful lives are as follows:

Dam, pipeline, buildings, water collection system, South Bay extension, Fieldbrook extension, Blue Lake extension, Lindley extension, Essex diversion, hydro plant penstock & piping	40 Years
Pump station and related facilities	10 - 40 Years
Hydro plant turbine and generators	20 Years
Tools & shop equipment, office equipment, pipeline connections, & hydro switchgear & controls	10 Years
Radio communication system & computers	5 Years
Vehicles	5 - 10 Years
Supplemental construction – except valves	40 Years
Supplemental construction – valves	20 Years

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 revenues and expenditures/expenses during the reporting period. Actual results could differ from those estimates.

Investments

The District's adopted investment policy seeks to promote the safety of principal, provide adequate liquidity for operational needs, earn market rates of return on investments consistent with liquidity needs and investment quality, and conform to legal requirements.

The District follows the authority governing investments for municipal governments set forth in the California Government Code, Sections 53601 through 53659. The Code authorizes the District to invest in obligations of the U.S. Treasury in the form of notes, bonds, bills or instruments for which the faith and credit of the United States are pledged for payment. The District may also invest in registered treasury notes, or bonds of the State of California and commercial paper of "prime" quality as defined by California Government Code Section 53635 and as rated by Standard and Poors Corporation or Moody's Commercial Paper Record.

The District's investment policy states that the District will structure its portfolio to meet cash requirements for ongoing operations thereby avoiding the need to sell securities prior to their maturity. The policy does not place formal limits on investment maturities.

Net Assets

Net assets represent the difference between assets and liabilities and are classified in the following categories:

Invested in capital assets, net of related debt - consist of the historical cost of capital assets less accumulated depreciation and less any debt that remains outstanding that was used to finance the acquisition, construction, or improvement of the assets.

Restricted net assets - consist of net assets that are restricted by the District's creditors, grantors, contributors, legislation, or the District's own enabling legislation. The District has net assets that are restricted for debt service, for advance charges related to capital projects, and for revenue credits to the seven municipal customers per Ordinance 16 (see Notes 7 and 8).

Unrestricted Net Assets - consist of all net assets that do not meet the definition of "invested in capital assets, net of related debt" or "restricted net assets."

Property Taxes

The lien date for secured property taxes is March 1 of each year. Taxes are levied as of July 1 on all secured real property and are due and payable November 1 and February 1 of the following fiscal year. Humboldt County is responsible for assessing, collecting, and distributing property taxes in accordance with enabling legislation.

Since the passage of California Proposition 13, beginning with fiscal year 1978-79, taxes are based either on a 1% rate applied to the 1975-76 assessed value of the property, or on 1% of the sales price of the property on sales transactions and construction which occur after the 1975-76 assessment. Assessed values on properties (exclusive of increases related to sales transactions and improvements) can rise at a maximum of 2% per year. The amount collected by the County is distributed in accordance with State law to the various public agencies. Therefore, the District does not levy a specific tax rate but receives a share of the property tax revenue based on State formula. The District's tax rate is $1.00/$100 of assessed value, the maximum allowable under Proposition 13.

During fiscal year 1993-94, an alternate method of property tax allocation (the "Teeter Plan") was adopted by the County. Under this plan, the county auditor/controller distributes 100 percent of current secured taxes billed to taxing entities during the current year, whether collected or not. The District recognizes property tax revenues (including tax increment revenues) to the extent of each year's tax allocation received or to be received within 60 days after the end of each fiscal year.

Restricted Assets

Assets that are restricted as to withdrawal or use for other than current operations, for the liquidation of long-term debts or for expenditure in the acquisition or construction of capital assets are separately reported as restricted assets and not as current assets.

Postemployment Benefits other than Pensions

The District implemented GASB Statement No. 45 prospectively during the transition year ending June 30, 2010. The District records a liability on the Statement of Net Assets for the difference between the amount the District contributes for retirees and the actuarially required contribution for funding postemployment benefits other than pension benefits. An actuarial computation of the required contribution was made for the years ended June 30, 2012 and 2011 (see Note 11).

NOTE 2 - CASH, CASH EQUIVALENTS AND INVESTMENT

Cash, cash equivalents, and investment at June 30, 2012 and 2011, consist of the following:

	2012	2011
Cash and cash equivalents:		
Unrestricted:		
Checking	$ 134,647	$ 126,205
Petty cash	650	650
LAIF	1,582	1,577
County Treasurer's Investment Pool	1,909,955	1,840,228
Total unrestricted cash and cash equivalents	2,046,834	1,968,660
Restricted:		
U.S. Bank Money Market Account	149,243	142,336
U.S. Bank Capital Project Fund Account	641,978	-
County Treasurer's Investment Pool	1,382,878	1,619,690
Total restricted cash and cash equivalents	2,174,099	1,762,026
Total cash and cash equivalents	$ 4,220,933	$ 3,730,686
Investment:		
Restricted:		
U.S. Bank Certificate of Deposit	$ 547,338	$ 547,338

The U.S. Bank commercial checking account balance is carried at cost. The U.S. Bank money market account is restricted for servicing the Safe Drinking Water State Revolving Fund (SRF) loan (see Note 7). The District transfers $136,834 quarterly from a fund in the County Treasurer's Investment Pool to the U.S. Bank money market account and U.S. Bank, acting as a fiscal agent, administers the semiannual loan payments for a total annual payment of $547,337. The District has $547,338 in a three-year certificate of deposit with U.S. Bank which is restricted for semiannual SRF loan payments and is pledged to U.S. Bank as required by the SRF loan agreement.

Restricted cash and cash equivalents in the County Treasurer's Investment Pool are as follows:

	2012	2011
Restricted for debt service	$ 46,882	$ 706,712
Restricted for credits to municipalities	377,947	590,978
Restricted for capital projects	958,049	322,000
Total restricted cash in County Investment Pool	$ 1,382,878	$ 1,619,690

At June 30, 2012, the balances in the U.S. Bank accounts exceeded federally insured limits by $1,459,484. This amount was partially uninsured and collaterized at 110 percent. The District has not experienced any losses in these accounts and management believes that the District is not exposed to any significant credit risk related to these accounts.

The certificate of deposit carries a 1.26% percent interest rate, pays interest quarterly and will mature on December 22, 2013. For the years ended June 30, 2012 and 2011, the District earned interest income from the certificate of deposit of $6,906 and $5,021, respectively.

The District participates in two external investment pools: the County Treasurer's Investment Pool and the LAIF. These investments are exempted from the credit risk categorization requirement because they are not securities.

NOTE 3 - ACCOUNTS RECEIVABLE

Accounts receivable from customers at June 30, 2012 and 2011, consist of the following:

	2012	2011
Resale customers:		
City of Eureka	$ 131,736	$ 141,810
City of Arcata	59,816	65,314
Humboldt CSD	42,008	48,021
McKinleyville CSD	45,280	50,417
Others	27,027	19,848
Subtotal resale customers	305,867	325,410
Maintenance and operations charges to others	48,078	40,692
Domestic customers and others	25,165	29,560
Hydroelectric sales, Pacific Gas & Electric	22,556	86,465
Total accounts receivable	$ 401,666	$ 482,127

NOTE 4 - LAND

Land at June 30, 2012 and 2011, consists of land and land rights of the General District, South Bay Water extension, and District No. U-1. There were no changes in land during the years ended June 30, 2012 and 2011.

NOTE 5 - PROPERTY & EQUIPMENT

Changes in property and equipment during the year ended June 30, 2012, are as follows:

	Balance 06/30/11	Additions	Deletions	Balance 06/30/12
Buildings	$ 977,399	$ 73,509	$ -	$ 1,050,908
Equipment:				
Automotive	521,765	31,679	-	553,444
Mobile	460,268	-	-	460,268
Office	417,160	14,393	(16,487)	415,066
Radio communications	80,727	-	-	80,727
Tools & shop	383,003	16,743	(6,698)	393,048
Water System Infrastructure:				
Blue Lake extension	13,808	-	-	13,808
Fieldbrook extension	300,559	-	-	300,559
Lindley extension	11,995	-	-	11,995
South Bay water extension	1,490,263	-	-	1,490,263
Essex diversion	7,549,757	-	-	7,549,757
Idled industrial pump station	482,819	-	-	482,819
Meters	143,607	-	-	143,607
Pipeline	6,471,322	-	-	6,471,322
Pumping plant	2,809,670	1,232,503	-	4,042,173
Storage tank (2 mg)	1,352,300	-	-	1,352,300
Water treatment facility	11,146,534	19,128	-	11,165,662
Ruth Lake Infrastructure:				
Ruth dam & works	6,980,914	-	-	6,980,914
Ruth hydroelectric plant	3,262,068	16,585	-	3,278,653
Ruth Lake fishing access	118,041	-	-	118,041
District No. U-1:				
Supplemental	5,354,898	-	-	5,354,898
Total property & equipment	50,328,877	1,404,540	(23,185)	51,710,232
Accumulated depreciation	(34,005,566)	(948,696)	23,185	(34,931,077)
Net property & equipment	16,323,311	455,844	-	16,779,155
Projects in progress	60,557	149,267	(42,272)	167,552
Total property & equipment, net	$ 16,383,868	$ 605,111	$ (42,272)	$ 16,946,707

Total depreciation expense charged to operations for the years ended June 30, 2012 and 2011, was $948,696 and $938,568, respectively. All capital assets are depreciable except land and projects in progress.

The Hilfiker Pump Station No. 6 is a direct diversion facility at Essex that supplies industrial water. The pump station was idled on May 1, 2009. The carrying value of the idled industrial pump station is $142,508 as of June 30, 2012. The remainder of the industrial system is fully depreciated. The idled industrial pump station may potentially be put back into service.

Gain (loss) on disposal of equipment for the years ended June 30, 2012 and 2011, was $9,000 and $0, respectively.

Net assets invested in capital assets, net of related debt as of June 30, 2012 and 2011, consist of the following:

	2012	2011
Land	$ 1,371,972	$ 1,371,972
Projects in progress	167,552	60,557
Property & equipment, net	16,779,155	16,323,311
Current portion of notes payable	(674,706)	(547,337)
Notes payable, net	(6,975,222)	(6,294,375)
Total net assets invested in capital assets, net of debt	$ 10,668,751	$ 10,914,128

Net assets restricted for capital projects as of June 30, 2012 and 2011, consist of the following:

	2012	2011
Municipal customer advance charges for boom truck	$ 244,500	$ -
Municipal customer advance charges for Ranney project	-	322,000
Restricted for Ranney and Techite projects	641,978	-
Restricted for capital grant matching funds	713,549	-
Total net assets restricted for capital projects	$ 1,600,027	$ 322,000

NOTE 6 - ACCRUED ABSENCES

Accrued absences consist of estimates of future obligations relating to accumulated unpaid vacation and sick leave compensation. There are predetermined limits to the amount of vacation and sick leave hours that can be accumulated by an employee. The District will pay the employee at the end of each calendar year for any excess vacation time accumulated that year.

Upon retirement, an employee will receive compensation for unused accumulated vacation. The employee also has the option under the District's PERS contract to convert 100% of the unused sick leave accrual to PERS service credit, or to receive a 35% cash payment and convert the remainder to PERS service credit. However, if an employee with less than ten years of employment terminates or retires, the unused accumulated sick leave is not eligible for compensation or PERS service credit conversion. Accrued absences as of June 30, 2012 and 2011, consist of the following:

	2012	2011
Accrued vacation	$ 117,152	$ 140,904
Accrued sick leave	93,843	96,082
Total accrued absences	$ 210,995	$ 236,986

NOTE 7 - LONG-TERM NOTES PAYABLE

California Safe Drinking Water State Revolving Fund (SRF) Note

The District has a loan with the California Department of Water Resources (acting on behalf of the California Department of Health Services) under the provisions of the California SRF Law of 1997. The proceeds of the SRF loan were used to finance the construction of the Turbidity Reduction Facility. The loan carries no interest and has a repayment term of 20 years. The District pays $547,337 annually in two semiannual payments. A certificate of deposit is pledged for two semiannual loan payments (see Note 2). The debt service for the loan is paid in its entirety by the District's municipal customers. Future debt service on the loan is:

Year Ending June 30	Principal	Interest	Total
2013	$ 547,337	$ -	$ 547,337
2014	547,337	-	547,337
2015	547,337	-	547,337
2016	547,337	-	547,337
2017	547,337	-	547,337
2018 to 2022	2,736,685	-	2,736,685
2023 to 2024	821,005	-	821,005
Total	6,294,375	-	6,294,375
Due within one year	(547,337)	-	(547,337)
Due after one year	$ 5,747,038	$ -	$ 5,747,038

Water System Improvement Loan

The District has a loan with Municipal Finance Corporation (MFC) to finance various capital improvements to the water supply system. Under the ten-year installment sales agreement, the District is obligated to pay semiannual installment payments of principal and interest at the rate of 2.63% per annum on the unpaid principal balance. MFC assigned its rights to receive and enforce the payments under the agreement to US Bank. The debt service for the loan is paid in its entirety by the District's municipal water customers. Future debt service on the loan is:

Year Ending June 30	Principal	Interest	Total
2013	$ 127,369	$ 34,819	$ 162,188
2014	130,741	31,447	162,188
2015	134,202	27,986	162,188
2016	137,755	24,433	162,188
2017	141,401	20,787	162,188
2018 to 2022	684,084	45,762	729,846
Total	1,355,552	185,234	1,540,786
Due within one year	(127,369)	(34,819)	(162,188)
Due after one year	$ 1,228,183	$ 150,415	$ 1,378,598

Notes payable as of June 30, 2012 and 2011, consists of the following:

	2012	2011
SRF Note	$ 6,294,375	$ 6,841,712
MFC Note	1,355,553	-
Total notes payable	7,649,928	6,841,712
Less current portion	(674,706)	(547,337)
Total notes payable, net	$ 6,975,222	$ 6,294,375

The following net assets have been restricted for debt service:

	2012	2011
Net assets restricted for notes payable	$ 743,463	$ 689,674
Net assets restricted for drinking water filtration plant	-	706,712
Total net assets restricted for debt service	$ 743,463	$ 1,396,386

NOTE 8 - WHOLESALE WATER CONTRACTS

The District is primarily a wholesale water provider. The District's Ordinance 16 as amended June 2006 establishes rates, charges, and conditions of service for water sales to the municipal water customers. The costs of constructing, operating, maintaining, repairing and replacing the water treatment facilities and maintaining reasonable reserves are allocated among the municipal customers.

The District has long-term contracts with its wholesale customers that govern wholesale rates, charges and conditions of service. The District has twenty-year contracts, effective July 1, 1999, in place with the following wholesale municipal customers:

- City of Arcata
- City of Blue Lake
- City of Eureka
- Fieldbrook-Glendale Community Services District
- Humboldt Community Services District
- McKinleyville Community Services District
- Manila Community Services District

All operating, maintenance, and capital costs associated with the regional water system are paid for by the wholesale customers. The rate structure is based on "Price Factor" formulas which allocate, in proportionate shares, the operating, maintenance and capital costs of the District to each of the wholesale customers. Municipal customers are billed monthly for water usage based on their share of such operating, maintenance and capital costs.

Revenues received by the District, other than those associated with wholesale water sales, are credited back to the wholesale municipal customers. These revenues include property tax revenues, power sales, interest income, retail water service revenues and other miscellaneous revenues. The revenue credit is applied ratably on a monthly basis during the course of the year.

The seven wholesale municipal customers are initially billed based on the District's approved budget, with the costs spread out evenly across the fiscal year. At year-end, the budgeted costs are reconciled with actual costs. Any underpayments or overpayments are divided into even monthly installments and applied to the municipalities' billing during the course of the following year.

The District had a contract with Evergreen Pulp, Inc., to supply wholesale industrial and retail water which was cancelled when the mill was sold in February 2009. The mill had been charged based on actual costs as incurred. The mill had been paying 45% of the District's operation, maintenance, and capital expenditure costs associated with all aspects of the regional water supply except for the drinking water treatment. Beginning April 1, 2009, costs were shifted to the seven municipal customers. Whereas the municipalities had previously been paying 55% of costs, they currently pay 100%.

During the fiscal year ended June 30, 2009, the contracts with the municipal customers were amended to provide greater specificity regarding remedies in the event of inaccuracies due to metering equipment. The contracts were also amended to allow the District to retain $393,358 in overpayments due to the municipal customers as of June 30, 2009. The overpayments were placed into the Municipal Supplemental Reserve Account dedicated for municipal customer purposes and benefit. The account is designated as a partially restricted reserve per Board of Director's policy. As of June 30, 2012, the reserve account had a balance of $407,127.

As of June 30, 2012 and 2011, the municipal customers overpaid $377,947 and $590,978, respectively, for operating, maintenance, and capital costs. Overpayments in the amount of $590,978 were credited to the municipalities' 2011/2012 billings. Overpayments in the amount of $377,947 will be credited to the municipalities' 2012/2013 billings. At June 30, 2012 and 2011, total net assets restricted for municipal customer credits were $377,947 and $590,978, respectively.

The municipal water customers may be charged in advance in order to fund future capital projects. For the year ended June 30, 2011, the municipal customers paid advance charges of $322,000 which the District subsequently spent on capital projects during the year ended June 30, 2012. For the year ended June 30, 2012, the municipal customers paid advance charges of $244,500 for purchase of a capital asset. See Note 5 for net assets restricted for capital projects.

Additions to the District's general reserves may be charged to the wholesale customers should the District need to replenish its general reserve level. For the years ended June 30, 2012 and 2011, the District charged the wholesale customers $200,000 and $100,000, respectively.

NOTE 9 - DEFERRED COMPENSATION PLAN

The District offers its employees a deferred compensation plan created in accordance with the Internal Revenue Code Section 457. The plan, available to all District employees, permits them to defer a portion of their salary until future years. All amounts of compensation deferred under the plan, all property and rights purchased with those amounts, and all income attributable to those amounts, property or rights, are (until paid or made available to the employee or other beneficiary) placed in trust for the benefit of the participants or their beneficiaries, and are not the assets of the District.

The District has a fiduciary responsibility to the participating employees in administration of the plan, but is not liable for losses arising from depreciation or other declines in the value of the plan assets.

NOTE 10 - RETIREMENT PLAN

The Humboldt Bay Municipal Water District contributes to the California Public Employees' Retirement System (CalPERS), a cost-sharing multiple-employer public employee retirement system defined benefit pension plan administered by CalPERS. The plan provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. Benefit provisions are established by state statutes, as legislatively amended, within the Public Employees' Retirement Law. CalPERS issues a separate comprehensive annual financial report that includes financial statements and required supplementary information. Copies of the CalPERS annual financial report may be obtained from the CalPERS Executive Office, 400 P Street, Sacramento, California 95814.

Funding Policy

Active plan members are required to contribute 7.0% of their salary (7% of monthly salary over $133.33 if the member participates in social security) and the District has chosen to pay this contribution as an employee benefit. The District is required to contribute an actuarially determined rate. The actuarial methods and assumptions used for determining the rate are those adopted by the CalPERS Board of Administration. The employer contribution rate for the years ended June 30, 2012 and 2011, was 12.827% and 12.162%, respectively. The contribution requirements of the plan members are established by state statue. The Humboldt Bay Municipal Water District's contributions to CalPERS for the fiscal years ending June 30, 2012, 2011, and 2010 were $297,010, $292,195, and $266,496, respectively.

NOTE 11 - OTHER POSTEMPLOYMENT BENEFITS

Plan Description

The District provides a defined benefit healthcare plan (the "Retiree Health Plan"). The District shoulders a certain percentage of eligible retirees' actual costs subject to a maximum of $600 prior to January 1, 2012, and a maximum of $640 after December 31, 2011. The duration of retiree benefits provided by the District depends on the date an employee was hired by the District. For all full-time regular employees hired by the District prior to July 8, 2004, the District will pay a percentage (90% for the first 6 months of the fiscal year 2011, 95% for the last six months of the fiscal year 2011 and first six months of the fiscal year 2012) of the medical costs premium during the life of a retiree subject to a maximum of $600 per month. Effective January 1, 2012, the District's cost share of the retiree's medical premium is limited to paying 100% of the premium, up to $640 per month.

For all full-time regular employees hired by the District after July 8, 2004, the District will pay 100% of the medical cost premium during retirement, subject to a maximum of $600 per month prior to January 1, 2012 and $640 per month after December 31, 2011, for a maximum of 10 years or until the retiree reaches age 65, whichever comes first.

Funding Policy

The District's Board of Directors will not be funding the plan in the current year but will follow a pay-as-you- go approach. The Board will review the funding requirements and policy annually.

Annual OPEB Cost and Net OPEB Obligation

The District's annual other postemployment benefit (OPEB) cost (expense) is calculated based on the annual required contribution of the employer (ARC). The District has elected to calculate the ARC and related information using the alternative measurement method permitted by GASB Statement No. 45 for employers in plans with fewer than one hundred total plan members. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and to amortize any unfunded actuarial liabilities (or funding excess) over the remaining period of 30 years. The following table shows the components of the District's annual OPEB cost of the year, the amount actually contributed to the plan, and changes in its net OPEB obligation to the Retiree Health Plan:

	2012	2011
Annual required contribution	$ 194,951	$ 194,951
Interest on net OPEB obligation	12,511	6,399
Adjustment to annual required contribution	(8,770)	(8,770)
Annual OPEB cost (expense)	198,692	192,580

Estimated contributions made:		
Premiums paid	(41,981)	(41,994)
Implicit subsidy contributions	(39,455)	(39,455)
Increase in net OPEB obligation	117,256	111,131
Net OPEB obligation - beginning of year	227,472	116,341
Net OPEB obligation - end of year	$ 344,728	$ 227,472

The District's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for the current fiscal year is as follows:

Fiscal Year Ended	Annual OPEB Cost	% of Annual OPEB Cost Contributed	Cumulative Net OPEB Obligation
June 30, 2010	$ 194,951	60%	$ 116,341
June 30, 2011	$ 192,580	60%	$ 227,472
June 30, 2012	$ 198,692	60%	$ 344,728

Funding Status and Funding Progress

As of July 1, 2009, the actuarial accrued liability (AAL) for benefits was $1,994,945, all of which was unfunded.

The projection of future benefit payments for an ongoing plan involves estimates of the value of reported amounts and assumptions about the probability of occurrences of events far into the future. Examples include assumptions about future employment, mortality and healthcare cost trends. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress presents multiyear trend information about whether the actuarial value of plan assets are increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

Methods and Assumptions

Projections for benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and 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 employer and plan members to that point. The methods and assumptions used include techniques that are designed to reduce the effects of short term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term prospective of the calculations.

The following simplifying assumptions were made:

Retirement age for active employees - Based on the historical average retirement age for the covered group, active plan members were assumed to retire at age 58, or at the first subsequent year in which the member would qualify for benefits.

Marital Status - Marital status of members at the calculation date was assumed to continue throughout retirement.

Mortality - Life expectancies at the calculation date are based on the most recent mortality tables published by the National Center for Health Statistics website (www.cdc.gov). The calculation of OPEB liability for each year is based on the assumption that all participants will live until their expected age as displayed in the mortality tables.

Turnover - The probability that an employee will remain employed until the assumed retirement age was determined using non-group-specific age-based turnover data provided in Table 1 in paragraph 35 of GASB Statement No. 45. In addition the expected future working lifetimes of employees were determined using Table 2 in paragraph 35c of GASB Statement No. 45.

Healthcare cost trend rate - Healthcare cost trend rates were selected based on a combination of national and state trend surveys as well as professional judgment. The ultimate trend rate was 4.5%.

Heath insurance premiums - 2010 health insurance premiums for retirees were used as a basis for calculation of the present value of total benefits to be paid.

Medicare Coordination - Medicare was assumed as the primary payer for current and future retirees at age 65.

Payroll increase - Changes in the payroll for current employees are expected to increase at the rate of approximately 2.8% annually.

Discount rate - The calculation uses an annual discount rate of 5.5%. This is based on the assumed long-term return on plan assets or employer assets.

Actuarial cost method - The entry age actuarial cost method was used. The unfunded actuarial accrued liability is being amortized as a level percentage of projected payroll on an open basis. The remaining amortization period at July 1, 2009, was thirty years.

Plan for Funding

On an ongoing basis, the District will be reviewing its assumptions, comparing them against actual experience and recalculating the needed funding with the goal of paying for postemployment benefits out of interest earned on designated funds.

Required Supplementary Information: Schedule of Funding Progress

Actuarial Valuation Date	Actuarial Accrued Liability (AAL)—Entry Age (a)	Actuarial Value of Assets (b)	Unfunded Liability (UAAL) (a-b)	Funded Status (b/a)	Annual Covered Payroll (c)	UAAL as a % of Payroll ([a-b]/c)
07/01/09	$1,994,945	$ 0	$1,994,945	0%	$1,520,676	131%

NOTE 12 - RISK MANAGEMENT

The District is exposed to various risks of loss related to torts; theft of, damage to and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The risk of loss is variable as to the deductible amount per occurrence. Liability losses up to $1 million and property losses up to $50,000, are covered through a pooled self-insurance program, administered by the Association of California Water Agencies – Joint Powers Insurance Authority (ACWA-JPIA). Through participation in ACWA-JPIA, the District is covered by commercial liability insurance for losses in excess of $1 million, up to an insured maximum of $60 million. Separately, the District insures for property damages in excess of the pooled limit of $1 million, with commercial insurance for losses up to $100 million.

The ACWA-JPIA began operations on October 1, 1979, and has continued without interruption since that time. The District is one of approximately two hundred and eighty-eight districts participating in the pool. The responsibilities of the ACWA-JPIA and the District are as follows:

Responsibilities of the ACWA-JPIA:

a. Provide insurance coverage as necessary.

b. Assist members in obtaining insurance coverage for risks not included within the coverage of the ACWA-JPIA.

c. Assist each member's designated risk manager with the implementation risk management function.

d. Provide loss prevention and safety consulting services to members as required.

e. Provide claims adjusting and subrogation services for claims covered by the ACWA-JPIA's joint protection programs.

f. Provide loss analysis and control in order to identify high exposure operations and to evaluate proper levels of self-retention and deductibles.

g. Review members' contracts to determine sufficiency of indemnity and insurance provisions when requested.

h. Conduct risk management audits to review the participation of each member in the programs.

i. The ACWA-JPIA shall have such other responsibilities as deemed necessary by the Board of Directors and Executive Committee (of the ACWA-JPIA).

Responsibilities of the District:

a. The governing board of each member district shall appoint a representative and at least one alternate representative to the Board of Directors.

b. Each member shall appoint an employee of the member to be responsible for the risk management function within that member and serve as a liaison between the member and the ACWA-JPIA as to risk management.

c. Each member shall maintain an active safety officer and/or committee, and shall consider all recommendations of the ACWA-JPIA concerning unsafe practices.

d. Each member shall maintain its own set of records, including a loss log, in all categories of risk covered by the joint protection program to insure accuracy of the ACWA-JPIA's loss reporting system.

e. Each member shall pay its deposit premium and premium adjustments within thirty days of the invoice date.

f. Each member shall provide the ACWA-JPIA with such other information or assistance as may be necessary for the ACWA-JPIA to carry out the joint protection programs.

g. Each member shall cooperate with and assist the ACWA-JPIA, and any insurer of the ACWA-JPIA, in all matters and covered claims and will comply with all bylaws, rules and regulations adopted by the Board of Directors and Executive Committee of the ACWA-JPIA.

There have been no significant reductions in insurance coverage from the prior year. The amounts of settlements have not exceeded the insurance coverage in each of the past three fiscal years.

NOTE 13 - GRANT REVENUES & RECEIVABLES

In March, 2012 the Federal Emergency Management Agency (FEMA) awarded the District a capital grant to be used for the Techite pipeline retrofit project. FEMA obligated $2,185,178 in funds to be administered by the California Emergency Management Agency (CalEMA). Federal funds are available for 75% of the total eligible costs of $2,913,570. The expected completion date is October 13, 2014. Any work completed after that date will not be eligible for federal funding.

Payments are made on a reimbursement basis with 10% retention withheld from each payment to be released at the project's closeout. The District began filing claims for reimbursement in April 2012.

For the year ended June 30, 2012, the District recognized $162,445 in CalEMA grant revenue of which $105,523 has been received and $56,922 is a grant receivable at June 30, 2012.

NOTE 14 - CHANGE IN PRIOR YEAR CLASSIFICATIONS

To improve the understandability of the current year financial statements, projects in progress have been reclassified from net property and equipment in the prior year financial statements.

ADDITIONAL INFORMATION

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James A. Hunter, CPA
Scott E. Hunt, CPA/ABV
Donna L. Taylor, CPA, CFE

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CERTIFIED PUBLIC ACCOUNTANTS
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REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

To the Board of Directors
Humboldt Bay Municipal Water District

We have audited the financial statements of the business-type activities of Humboldt Bay Municipal Water District (the District), as of and for the year ended June 30, 2012, and have issued our report thereon dated November 30, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

Management of the District is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the District's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the District's internal control over financial reporting.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the District's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

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This report is intended solely for the information and use of management, the Board of Directors, the audit committee, the State of California, federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record and its distribution is not limited.

Hunter, Hunter + Hunt

November 30, 2012