

HUMBOLDT BAY MUNICIPAL WATER DISTRICT

BASIC FINANCIAL STATEMENTS

and

REQUIRED SUPPLEMENTARY INFORMATION

Years Ended June 30, 2014 and 2013

TABLE OF CONTENTS

INDEPENDENT AUDITORS' REPORT	1 - 2
MANAGEMENT'S DISCUSSION AND ANALYSIS	3 - 10
BASIC FINANCIAL STATEMENTS:	
Statements of Net Position - Proprietary Fund	11
Statements of Revenues, Expenses, and Changes In Net Position - Proprietary Fund	12
Statements of Cash Flows - Proprietary Fund	13
Notes to Financial Statements	14 - 32
REPORT ON INTERNAL CONTROL AND COMPLIANCE AND OTHER MATTERS:	
Independent Auditors' Report on Internal Control over Financial Reporting and on Compliance and other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>	33 - 34
Schedule of Findings	35 - 36

1315 Fourth Street
Eureka, California 95501

Hunter, Hunter & Hunt, LLP

CERTIFIED PUBLIC ACCOUNTANTS

Members of the AICPA

Phone 707-476-0674

Fax 707-476-0675

www.hhh-cpa.com

INDEPENDENT AUDITORS' REPORT

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

Report on the Financial Statements

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, 2014 and 2013, and the related notes to the financial statements, which comprise the District's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America as well as accounting systems prescribed by the State Controller's Office and state regulations governing special districts; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. 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 and the State Controller's Minimum Audit Requirements and Reporting Guidelines for California Special Districts. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. According, 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 opinions.

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, 2014 and 2013, and the changes in financial position and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

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

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated December 31, 2014, 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, 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 District's internal control over financial reporting and compliance.

Hunter, Hunter & Hunt

December 31, 2014

MANAGEMENT'S DISCUSSION AND ANALYSIS

**HUMBOLDT BAY MUNICIPAL WATER DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
For FY 2013-14**

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, 2014 (FY 2013-14). 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 including the John R. Winzler Operations and Control Center.

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 Community Services Districts of: Fieldbrook/Glendale, Humboldt, Manila and McKinleyville. Via the wholesale relationship, the District serves water to an estimated residential 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. There were \$145,000 in charges for additions to reserves to the wholesale customers for FY 2013-14, and no charges of additions to reserves to the wholesale customers for FY2012-13.

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 Position (page 11), b) the Statements of Revenues, Expenses, and Changes in Net Position (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 Position 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 Position. 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 position was \$17,171,011 as of June 30, 2014, an increase of \$1,534,072 compared to June 30, 2013.
- Revenues were \$8,996,868, an increase of \$3,046,456 from FY 2012-13.
- Expenses were \$7,462,796, an increase of \$1,959,857 from FY 2012-13.
- Notes payable net of current portion is \$5,615,619, a decrease of \$681,525 from FY 2012-13.

DISCUSSION AND ANALYSIS

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

TABLE 1				
CONDENSED STATEMENTS OF NET POSITION				
ASSETS	FY 2013-14	FY 2012-13	Change	
			\$	%
Current Assets	\$4,954,592	\$2,115,550	\$2,839,042	134.2%
Restricted Cash & Investments	\$3,800,109	\$3,292,138	\$507,971	15.4%
Land, Property & Equipment (net Accumulated Depreciation)	\$18,945,068	\$18,166,238	\$778,830	4.3%
Total Assets	\$27,699,769	\$23,573,926	\$4,125,843	17.5%
LIABILITIES				
Current Liabilities	\$4,317,414	\$1,202,195	\$3,115,219	259.1%
Unearned grant revenue	\$33,321	\$27,357	\$5,964	21.8%
Post-Retirement Health Benefits Obligation	\$562,404	\$410,291	\$152,113	37.1%
Long-term Debt	\$5,615,619	\$6,297,144	-\$681,525	-10.8%
Total Liabilities	\$10,528,758	\$7,936,987	\$2,591,771	32.7%
NET POSITION				
Net Investment in Capital Assets	\$12,647,910	\$11,191,016	\$1,456,894	13.0%
Restricted (for debt service)	\$706,962	\$703,468	\$3,494	0.5%
Restricted (for capital projects)	\$1,685,098	\$1,422,386	\$262,712	18.5%
Restricted (for credits to municipalities)	\$346,872	\$76,759	\$270,113	351.9%
Unrestricted	\$1,784,169	\$2,243,310	-\$459,141	-20.5%
TOTAL NET POSITION	\$17,171,011	\$15,636,939	\$1,534,072	9.8%

As can be seen from the table above, the net position as of June 30, 2014 was \$17,171,011, an increase of \$1,534,072 (9.8%) as compared to June 30, 2013. The majority of this increase is related to the grant funded construction projects.

The largest portion of the District's net position is 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 satisfy these liabilities.

The Statements of Revenues, Expenses, and Changes in Net Position (page 12) present information showing how the District's net position changed during the most recent fiscal year. All changes in net position 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 Condensed Statements of Revenues, Expenses, and Changes in Net Position is presented in Table 2.

**TABLE 2
CONDENSED STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET
POSITION**

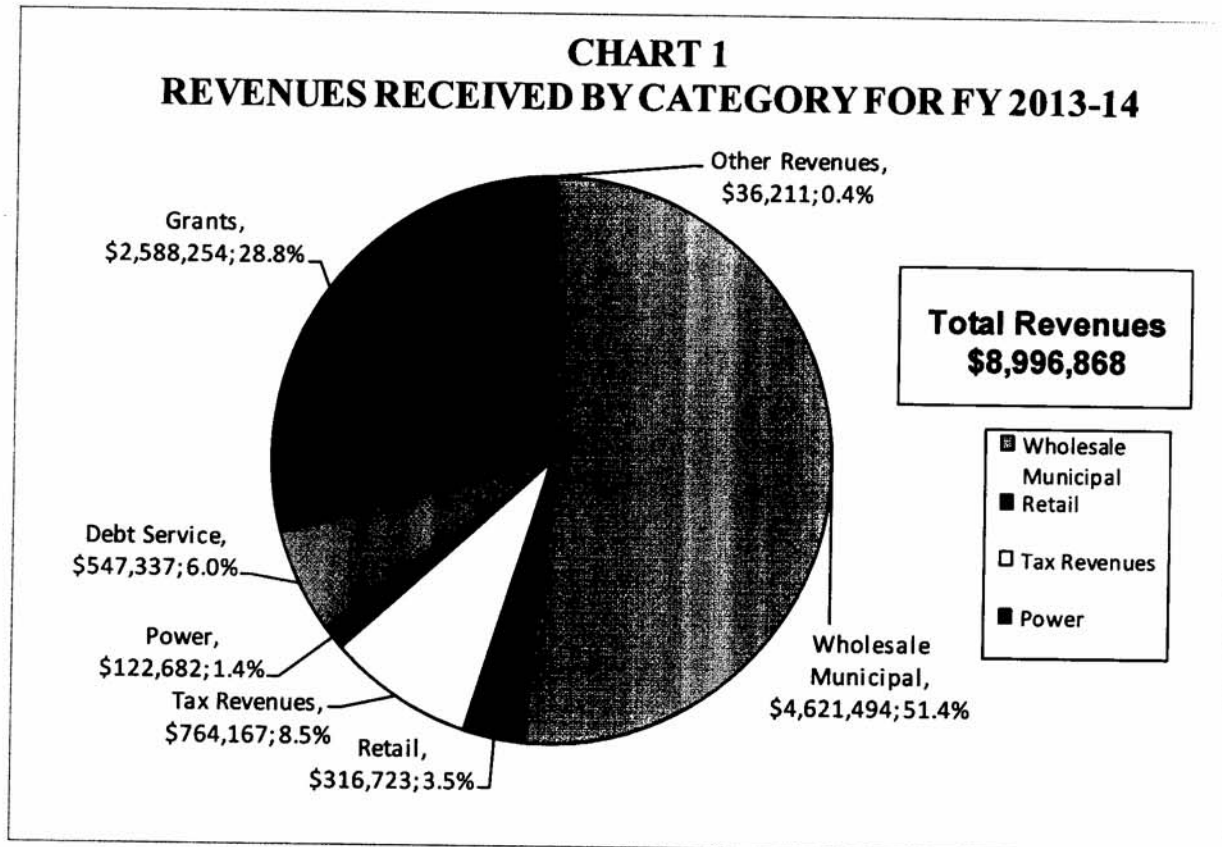
	FY 2013-14	FY 2012-13	Change	
			\$	%
REVENUES				
*Operating:				
Water Sales	\$4,938,217	\$4,022,129	\$916,088	22.8%
Power Sales	\$122,682	\$212,696	-\$90,014	-42.3%
SRF Debt Service Receipt	\$547,337	\$547,337	\$0	0.0%
Other Operating	\$11,102	\$5,642	\$5,460	96.8%
*Non-Operating:				
Taxes	\$764,167	\$830,442	-\$66,275	-8.0%
Interest Income	\$25,109	\$26,059	-\$950	-3.6%
Grant Revenues	\$2,588,254	\$306,107	\$2,282,147	745.5%
Other Income	\$0	\$0	\$0	
Total Revenues	\$8,996,868	\$5,950,412	\$3,046,456	51.2%
EXPENSES				
Operating expense	\$4,491,739	\$4,690,653	-\$198,914	-4.2%
Non-operating expense	\$33,007	\$34,031	-\$1,024	-3.0%
Loss on asset disposal	\$4,548	\$0	\$4,548	100.0%
Depreciation	\$975,723	\$964,125	\$11,598	1.2%
Grant expenses	\$2,164,154	\$0	\$2,164,154	100.0%
Less Reimbursements	-\$206,375	-\$185,870	-\$20,505	11.0%
Total Expenses	\$7,462,796	\$5,502,939	\$1,959,857	35.6%
Change in Net Position	\$1,534,072	\$447,473	\$1,086,599	242.8%
Beginning Net Position	\$15,636,939	\$15,189,466	\$447,473	2.9%
Ending Net Position	\$17,171,011	\$15,636,939	\$1,534,072	9.8%

While the Statements of Net Position show the changes in financial position, the Statements of Revenues, Expenses, and Changes in Net Position explain the nature and source of these changes. As shown in Table 2, the change in net position increased by \$1,086,599 compared to the prior year. The changes in revenues and expenses which contributed to this change in net position are reflected in the above line-item detail.

Although the change in current year net position is shown as an increase of \$1,534,072, it is important to understand that depreciation (a non-cash expense) is included in the expenses. Absent depreciation, the change in current year net position would be a gain of \$2,509,795 (\$1,534,072 + 975,723). The majority of this increase is related to the grant funded construction projects.

As a supplement to the Statements of Revenues, Expenses, and Changes in Net Position, Chart 1 presents operating and non-operating revenues earned in FY 2013-14 by category along with the proportionate share of the total revenue each category represents. The total revenues reflected in Chart 1 are \$8,996,868. 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 and the grant funding receipts of

\$2,588,254, are associated with repayment of long-term debt and special funding respectively and not current operations. The major fluctuations in revenues and expenses relate to the increased grant funding and related expenditures. The Power revenue was lower due to management's decision to reduce outflows to maximize water retention in the reservoir in response to the drought conditions.



PROPERTY AND EQUIPMENT

The District has invested approximately \$52,000,000 in a broad range of infrastructure for the regional water system. Table 3 presents a summary of the District's property and equipment.

	FY 2013-14	FY 2012-13	Change	
			\$	%
Buildings	\$1,221,352	\$1,144,328	\$77,024	6.7%
Equip - Auto/Mobile/Office/Radio/Tools	\$2,280,645	\$1,958,003	\$322,642	16.5%
Water System Infrastructure (excludes land)	\$49,291,013	\$48,916,791	\$374,222	0.8%
Total Property and Equipment	\$52,793,010	\$52,019,122	\$773,888	1.5%
Less Accumulated Depreciation	-\$36,817,763	-\$35,863,955	\$953,808	2.7%
Add Projects in Progress	\$1,597,849	\$639,098	\$958,751	150.0%
Total Property & Equipment (net of Depr)	\$17,573,096	\$16,794,265	\$778,831	4.6%

LONG-TERM DEBT

At FY 2013-14 year-end, the District has two long-term notes payable outstanding for a total amount of \$6,297,158. The first has an outstanding balance of \$5,199,701 (long-term note payable of \$4,652,364 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 \$1,097,457 (long-term note payable of \$963,255 plus current liabilities-current portion of note payable of \$134,202). 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. This industrial property was recently acquired by the Humboldt Bay Harbor Recreation and Conservation District for development.

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 completed large infrastructure project undertaken was the Ranney Collector #3 Rehabilitation project. For financing purposes this was bundled with 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	630,000
US Bank Loan (10 year loan at 2.63%)	1,418,000
FEMA Grant for Techite project	<u>2,795,000*</u>
Total Projected Project Costs and Financing	<u>\$ 5,165,000</u>

*For the Techite Replacement project, the District received the grant agreement for a Federal Emergency Management Agency (FEMA) grant in the amount of \$2,795,000. The project was put out to bid and a contractor was selected prior to the June 30, 2014 fiscal year end. The contractor commenced the construction project in August 2014 and expects completion by March 31, 2015.

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 \$3,500,000 in current dollars. For this project, the District has been awarded 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. Similar to the Techite Replacement project, the District has received a commitment for a Federal Emergency Management Agency (FEMA) Hazard Mitigation grant in the amount of \$2,668,750. FEMA has initiated its National Environmental Policy Act (NEPA) process for this project. Once this is completed, the District anticipates receiving the FEMA grant agreement. Any shortfall will be funded by the District through financing and/or water rates.

The Emergency Intertie project is a multijurisdictional project that the District is leading. The project partners are: HBMWD, the City of Arcata, the City of Eureka and the McKinleyville Community Services District. This project installs new water transmission interconnections between the agencies to allow for water supply redundancy in the event of a supply line disruption. A State of California Department of Public Health Proposition 50 grant in the amount of \$3,648,550 has been received for this project. The Grant Agreement was executed at the beginning of the 2013/14 fiscal year. The project was put out to bid and a contractor was selected. The construction began prior to the end of the 2013/14 fiscal year and is expected to be completed by December 31, 2014. Subsequent to Grant Close Out, the assets created via this construction project will be transferred to the respective agencies via the terms and conditions of the Special Facilities Agreement dated May 3, 2013.

BASIC FINANCIAL STATEMENTS

HUMBOLDT BAY MUNICIPAL WATER DISTRICT
STATEMENTS OF NET POSITION
PROPRIETARY FUND
June 30, 2014 and 2013

	2014	2013
ASSETS:		
CURRENT ASSETS:		
Cash & cash equivalents	\$ 1,212,920	\$ 1,370,604
Accounts receivable	534,560	443,530
Grants receivable	871,706	139,729
Property to be transferred	2,164,154	-
Interest receivable	5,742	3,908
Prepaid expenses	160,510	152,779
Deposits	5,000	5,000
TOTAL CURRENT ASSETS	4,954,592	2,115,550
NON-CURRENT ASSETS:		
Restricted cash equivalents	3,800,109	2,744,800
Restricted investment	-	547,338
Land	1,371,972	1,371,972
Projects in progress	1,597,849	639,098
Property & equipment, net	15,975,247	16,155,168
TOTAL ASSETS	27,699,769	23,573,926
LIABILITIES:		
CURRENT LIABILITIES:		
Accounts payable	569,040	79,556
Accrued wages, payroll taxes & benefits	132,144	117,723
Contract retentions payable	95,531	-
Interest payable	9,621	8,076
Accrued absences	268,144	244,422
Project advances from municipal partners	335,427	-
Property transfer payable	2,164,154	-
Current other postemployment benefits obligation	61,814	74,340
Current portion of notes payable	681,539	678,078
TOTAL CURRENT LIABILITIES	4,317,414	1,202,195
LONG-TERM LIABILITIES:		
Unearned grant revenue	33,321	27,357
Other postemployment benefits obligation, net	562,404	410,291
Note payables, net	5,615,619	6,297,144
TOTAL LIABILITIES	10,528,758	7,936,987
NET POSITION:		
Net investment in capital assets	12,647,910	11,191,016
Restricted for debt service	706,962	703,468
Restricted for capital projects	1,685,098	1,422,386
Restricted for credits to municipalities	346,872	76,759
Unrestricted	1,784,169	2,243,310
TOTAL NET POSITION	\$ 17,171,011	\$ 15,636,939

See accompanying notes.

HUMBOLDT BAY MUNICIPAL WATER DISTRICT
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION
PROPRIETARY FUND
For the Years Ended June 30, 2014 and 2013

	2014	2013
OPERATING REVENUES:		
Water sales:		
Municipal customers	\$ 4,621,494	\$ 3,724,625
Retail customers	316,723	297,504
Debt service receipts	547,337	547,337
Total water sales	5,485,554	4,569,466
Power sales	122,682	212,696
Other operating revenues	11,102	5,642
TOTAL OPERATING REVENUES	5,619,338	4,787,804
OPERATING EXPENSES:		
Payroll & related costs	2,600,195	2,643,249
Employee retirement contributions	358,966	319,478
Power & pumping	625,202	616,500
Engineering	160,133	338,674
Materials & supplies	114,531	120,047
Repairs & maintenance	131,286	186,226
Auto & travel expenses	74,951	67,469
Insurance	88,747	84,174
Depreciation	975,723	964,125
Legal & accounting fees	42,143	46,540
Professional assistance	102,556	79,286
Tax and license	88,495	92,323
Training	27,266	19,542
Bad debt	508	-
Other operating expenses	76,760	77,145
Total operating expenses before reimbursements	5,467,462	5,654,778
Reimbursements for services & costs	(206,375)	(185,870)
TOTAL OPERATING EXPENSES	5,261,087	5,468,908
OPERATING INCOME (LOSS)	358,251	(681,104)
NONOPERATING REVENUES (EXPENSES):		
Tax revenues	764,167	830,442
Grant revenues	2,588,254	306,107
Grant expenses	(2,164,154)	-
Interest revenues	25,109	26,059
Interest expense	(33,007)	(34,031)
Gain (loss) on disposal of capital assets	(4,548)	-
TOTAL NONOPERATING REVENUES (EXPENSES)	1,175,821	1,128,577
CHANGE IN NET POSITION	1,534,072	447,473
BEGINNING NET POSITION	15,636,939	15,189,466
ENDING NET POSITION	\$ 17,171,011	\$ 15,636,939

See accompanying notes.

**HUMBOLDT BAY MUNICIPAL WATER DISTRICT
STATEMENTS OF CASH FLOWS
PROPRIETARY FUND
For the Years Ended June 30, 2014 and 2013**

	2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES:		
Receipts from customers	\$ 5,734,175	\$ 4,931,810
Payments to suppliers	(1,530,392)	(1,720,960)
Payments to employees	(2,781,431)	(2,781,892)
NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES	1,422,352	428,958
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:		
Taxes for general operations	764,167	830,442
NET CASH PROVIDED (USED) BY NONCAPITAL FINANCING ACTIVITIES	764,167	830,442
CASH FLOWS FROM CAPITAL & RELATED FINANCING ACTIVITIES:		
Payments to acquire, construct & improve capital assets	(3,347,649)	(918,324)
Receipts of grants for capital financing	1,862,241	234,373
Advances received from municipal partnership	335,427	-
Principal paid on capital debt	(678,064)	(674,706)
Interest paid on capital debt	(31,462)	(34,819)
NET CASH PROVIDED (USED) BY CAPITAL & RELATED FINANCING ACTIVITIES	(1,859,507)	(1,393,476)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds on redemption of certificate of deposit	547,338	-
Interest received	23,275	28,547
NET CASH PROVIDED (USED) BY INVESTING ACTIVITIES	570,613	28,547
INCREASE (DECREASE) IN CASH & CASH EQUIVALENTS	897,625	(105,529)
CASH & CASH EQUIVALENTS AT BEGINNING OF YEAR	4,115,404	4,220,933
CASH & CASH EQUIVALENTS AT END OF YEAR	\$ 5,013,029	\$ 4,115,404
FINANCIAL STATEMENT PRESENTATION RECONCILIATION:		
Cash & cash equivalents	\$ 1,212,920	\$ 1,370,604
Restricted cash equivalents	3,800,109	2,744,800
CASH & CASH EQUIVALENTS AT END OF YEAR	\$ 5,013,029	\$ 4,115,404
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES:		
Operating Income (loss)	\$ 358,251	\$ (681,104)
Adjustments to reconcile operating income (loss) to net cash provided by operating activities:		
Depreciation	975,723	964,125
Changes in assets and liabilities:		
Receivables	(91,030)	(41,864)
Prepaid expenses	(7,731)	(1,497)
Accounts payable related to operating activities	9,409	8,463
Accrued liabilities	177,730	180,835
NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES	\$ 1,422,352	\$ 428,958

NONCASH CAPITAL FINANCING ACTIVITIES

Earned grant revenue of \$2,169 recognized in the current year was received in the prior year.

Grant expenses of \$2,164,154 recognized in the current year for grant-funded property under construction that will be transferred to participating municipal partners in the subsequent year.

See accompanying notes.

HUMBOLDT BAY MUNICIPAL WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the years ended June 30, 2014 and 2013

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) as applied to government units. The Governmental Accounting Standards Board (GASB) is the accepted standard setting body for establishing governmental accounting and financial reporting principles.

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 financial statements required by GASB Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*, as amended by GASB Statement No. 63, include a statement of net position, a statement of revenues, expenses, and changes in net position, and a statement of cash flows.

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 funds account for goods or services that are provided to outside parties. The District has elected to use the reporting model for special-purpose governments engaged only in business-type activities. In accordance with the business-type activities reporting model, the District prepares its statement of cash flows using the direct method.

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.

HUMBOLDT BAY MUNICIPAL WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the years ended June 30, 2014 and 2013

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.

Allowance for Doubtful Accounts

The District evaluates the collectability of water sales and grants receivable in order to determine the allowance for doubtful accounts. As of June 30, 2014, the District determined that the various receivables are fully collectible and recorded \$0 for the allowance for doubtful accounts. Based on historical experience, the District does not expect amounts to become uncollectible, however if they are, they will be charged to operations as a bad debt expense. The impact of any bad debt expense recorded in the future is expected to be immaterial to the financial statements.

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 Humboldt 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 Humboldt 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. Normal cash flow withdrawals for operations are paid on a "one dollar net asset value". Withdrawals of funds for another purpose, such as total withdrawal from the County Pool or for an alternative investment of funds, may be paid out based on fair market value at the County's discretion.

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 Humboldt County Treasurer's Investment Pool.

**HUMBOLDT BAY MUNICIPAL WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the years ended June 30, 2014 and 2013**

The District accounts for cash equivalents in the Humboldt County Treasurer's Investment Pool and the LAIF Pool at cost. Management considers the difference between book value and fair value immaterial. 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 above the threshold amount.

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 position. 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 and piping	40 Years
Pump station and related facilities	10 - 40 Years
Hydro plant turbine and generators	20 Years
Tools and shop equipment, office equipment, pipeline connections, and hydro switchgear and controls	10 Years
Radio communication system and 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

**HUMBOLDT BAY MUNICIPAL WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the years ended June 30, 2014 and 2013**

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 Position

Net position represents the difference between assets and deferred outflows of resources less liabilities and deferred inflows of resources. The District reports three categories of net position, as follows:

Net investment in capital assets - consists of net capital assets reduced by outstanding balances of any related debt obligations and deferred inflows of resources attributable to the acquisition, construction, or improvement of those assets and increased by balances of deferred outflows of resources related to those assets.

Restricted net position - net position is considered restricted if its use is constrained to a particular purpose. Restrictions are imposed by creditors, grantors, laws, or regulations. The District has restricted net position for debt service, advance charges related to capital projects per contracts, and for revenue credits to the seven municipal customers per Ordinance 16 (see Notes 6, 9, 10 and 11).

Unrestricted net position - consists of all other net position that does not meet the definition of "net investment in capital assets" or "restricted net position" and is available for general use by the District.

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.

**HUMBOLDT BAY MUNICIPAL WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the years ended June 30, 2014 and 2013**

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 Position 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, 2014 and 2013 (see Note 14).

Reclassifications

Certain items in the 2013 financial statement disclosures have been reclassified for comparative purposes to conform to presentation in the current year financial statements. Such reclassifications had no effect on previously reported changes in net position.

NOTE 2 - CASH, CASH EQUIVALENTS AND INVESTMENT

Cash, cash equivalents, and investment at June 30, 2014 and 2013, consist of the following:

	<u>2014</u>	<u>2013</u>
Cash and cash equivalents:		
Unrestricted:		
U.S. Bank commercial checking	\$ 192,886	\$ 157,251
Petty cash	650	650
LAIF	1,591	1,587
Humboldt County Treasurer's Investment Pool	<u>1,017,793</u>	<u>1,211,116</u>
Total unrestricted cash and cash equivalents	<u>1,212,920</u>	<u>1,370,604</u>
Restricted:		
U.S. Bank Money Market Account	159,624	156,130
U.S. Bank Money Market Account restricted for loan repayment	547,406	-
U.S. Bank "Ranney" Capital Project Fund Account	467,835	534,819
U.S. Bank "Prop 50" Capital Project Fund Account	459,101	-
Humboldt County Treasurer's Investment Pool	<u>2,166,143</u>	<u>2,053,851</u>
Total restricted cash and cash equivalents	<u>3,800,109</u>	<u>2,744,800</u>
Total cash and cash equivalents	<u>\$ 5,013,029</u>	<u>\$ 4,115,404</u>
Investment:		
Restricted:		
U.S. Bank Certificate of Deposit	<u>\$ -</u>	<u>\$ 547,338</u>

The U.S. Bank commercial checking account balance is carried at cost. One of the U.S. Bank money market accounts is restricted for servicing the Safe Drinking Water State Revolving Fund (SRF) loan (see Note 9). The District transfers \$136,834 quarterly from a fund in the

**HUMBOLDT BAY MUNICIPAL WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the years ended June 30, 2014 and 2013**

Humboldt County Treasurer's Investment Pool to the restricted U.S. Bank money market account. U.S. Bank, acting as a fiscal agent, administers the semiannual loan payments for a total annual payment of \$547,337.

The District had \$547,338 in a three-year certificate of deposit with U.S. Bank restricted for semiannual SRF loan payments and pledged to U.S. Bank as required by the SRF loan agreement. The certificate of deposit carried a 1.26% percent interest rate, paid interest quarterly and matured on December 22, 2013. The Board of Directors intended to reinvest in a certificate collateralized at zero percent but the certificate would have had an effective negative interest rate. The funds were placed in a U.S. Bank money market account carrying a .3% interest rate for the interim.

For the years ended June 30, 2014 and 2013, the District earned interest income from the certificate of deposit of \$3,458 and \$6,887, respectively. The interim investment in the money market earned interest income of \$72 for the year ended June 30, 2014.

Restricted cash and cash equivalents include restrictions imposed by creditors, grantors, laws, regulations, and designations imposed by the Board of Directors (see Note 10). Restricted cash and cash equivalents in the Humboldt County Treasurer's Investment Pool are as follows:

	2014	2013
Restricted for debt service	\$ 47,421	\$ 47,173
Restricted for municipalities	439,570	486,641
Restricted for capital projects	1,679,152	1,520,037
Total restricted cash in County Investment Pool	\$ 2,166,143	\$ 2,053,851

At June 30, 2014, the balances in the U.S. Bank accounts exceeded federally insured limits by \$2,244,639. The amounts in government accounts held by U.S. Bank are collateralized at 110 percent by the Bank. 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 District participates in two external investment pools: the Humboldt 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, 2014 and 2013, consist of the following:

	2014	2013
Resale customers:		
City of Eureka	\$ 183,097	\$ 154,679
City of Arcata	87,695	68,024
Humboldt CSD	62,040	49,409
McKinleyville CSD	65,344	53,844
Others	38,947	28,643
Subtotal resale customers	437,123	354,599

**HUMBOLDT BAY MUNICIPAL WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the years ended June 30, 2014 and 2013**

Maintenance and operations charges to others	48,659	49,157
Domestic customers and others	29,571	24,388
Hydroelectric sales, Pacific Gas & Electric	19,207	15,386
Total accounts receivable	<u>\$ 534,560</u>	<u>\$ 443,530</u>

NOTE 4 - GRANTS RECEIVABLE, UNEARNED GRANT REVENUE, GRANT REVENUES AND GRANT EXPENSES

Federal Emergency Management Agency (FEMA)

The District was awarded a capital grant from FEMA to be used for the Techite pipeline seismic retrofit project. FEMA originally obligated \$2,185,178 in funds and has since granted the District's request for supplemental funding in the amount of \$610,000. The grant is administered by the California Office of Emergency Services (CalOES), formerly the California Emergency Management Agency (CalEMA). Federal funds are available for 75 percent of the total eligible costs of approximately \$3,700,000. Payments are made on a reimbursement basis with 10 percent retention withheld from each payment to be released at the project's closeout.

FEMA and California Department of Water Resources (CDWR)

The District plans to use funding from FEMA and CDWR to replace 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 \$3,500,000.

The District was awarded a Proposition 84 (Round 1) capital grant from CDWR via the North Coast Integrated Regional Water Management Plan (NCIRWMP) in the amount of \$700,000. Expenses in the amount of \$31,113 incurred thus far under this grant only qualify for the District's match.

FEMA has approved a Phase One funding request for \$220,000, of which FEMA has obligated a 75% Federal share of \$165,000. These funds are available for eligible reimbursements which include a cultural resource survey and design plans. The District has a twelve-month timeframe to complete Phase One. The grant is administered by CalOES.

Upon FEMA's determination of eligibility for construction funding, FEMA will consider the District's request to increase the project cost from \$2,800,000 (with a \$2,100,000 Federal share) to \$3,558,334 (\$2,668,750 Federal share).

California Department of Fish and Wildlife (CDFW)

The District was awarded a grant from CDFW to be used for the Mad River instream flow enhancement project. The grant was effective from June 1, 2012 through March 31, 2014, and was not to exceed \$51,989. The District was responsible for providing up to \$36,863 in funds or in-kind services as cost sharing to complete the tasks. Payments were made on a reimbursement basis with no retention withheld from the payments.

CDWR

The District was awarded a Proposition 84 (Round 2) capital grant from CDWR via NCIRWMP in the amount of \$667,000 to be used to replace pipe laterals in Collectors 1 and 1A. The Proposition 84 Sub-Grantee Agreement for this grant was entered into on October 29, 2014. Expenses in the amount of \$234,680 incurred thus far only qualify for the District's match.

**HUMBOLDT BAY MUNICIPAL WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the years ended June 30, 2014 and 2013**

California Department of Public Health (CDPH)

The District was awarded a Proposition 50 capital grant from CDPH not to exceed \$3,648,550 to be used for new water transmission interconnections (interties) between the participating jurisdictions to allow for water supply redundancy in the event of a supply line disruption. The grant is administered by the State Water Resources Control Board (SWRCB). Payments are made on a reimbursement basis with 5% retention withheld only on the claims that the District has withheld 5% from the contractor. There is no requirement that the District provide matching funds.

Grants Receivable

Grants receivable for the years ended June 30, 2014 and 2013, consist of the following:

	<u>2014</u>	<u>2013</u>
CalOES Techite project	\$ 58,307	\$ 136,908
CalOES Blue Lake project	44,520	-
SWRCB Interties project	768,879	-
CDFW	-	2,821
Total grants receivable	<u>\$ 871,706</u>	<u>\$ 139,729</u>

The CalOES Techite project grant receivable at June 30, 2014, includes \$50,833 of retentions on claims submitted from April 2012 through June 2014. The SWRCB grant receivable at June 30, 2014, includes \$95,531 of retentions on claims submitted from January 2014 through June 2014. As of June 30, 2014, the District has recorded contract retentions payable of \$95,531 for amounts withheld from payments to one of the contractors providing services on the Proposition 50 grant funded interties project.

Unearned Grant Revenue

In May 2012, the District received an administrative share allowance of \$40,136 from CalOES for the Techite pipeline project. During the year ended June 30, 2014, the District received an additional administrative allowance of \$8,133.

For the years ended June 30, 2014, 2013 and 2012, grant administrative expenses incurred and thus earned were \$2,169, \$9,867, and \$2,912, respectively.

For the years ended June 30, 2014 and 2013, unearned grant revenue was \$33,321 and \$27,357, respectively.

Grant Revenues

Grant revenues for the years ended June 30, 2014 and 2013, consist of the following:

	<u>2014</u>	<u>2013</u>
CalOES Techite project	\$ 92,700	\$ 282,238
CalOES Blue Lake project	44,520	-
SWRCB Interties project	2,432,338	-
CDFW	18,696	23,869
Total grant revenues	<u>\$ 2,588,254</u>	<u>\$ 306,107</u>

**HUMBOLDT BAY MUNICIPAL WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the years ended June 30, 2014 and 2013**

Grant Expenses

As outlined in a special facilities agreement between the participating jurisdictions, the District has the right and obligation to complete the interties project funded by the Proposition 50 capital grant. Upon completion, the District will transfer the constructed property to the City of Arcata, the City of Eureka and the McKinleyville Community Services District.

The transfer is considered to be a voluntary nonexchange transaction and as such, grant expenses and the related liability are recognized in the period when the grantor approves the costs as eligible. The District incurred \$2,164,154 in eligible intertie construction costs during the year ended June 30, 2014. The District has recognized \$2,164,154 as grant expenses, a related liability labeled property transfer payable, and as a current asset labeled property to be transferred (see Notes 6 and 8).

NOTE 5 - LAND

Land at June 30, 2014 and 2013, 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, 2014 and 2013.

NOTE 6 - PROPERTY AND EQUIPMENT

Changes in property and equipment during the year ended June 30, 2014, are as follows:

	<u>Balance</u> <u>06/30/13</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance</u> <u>06/30/14</u>
Buildings	\$ 1,144,327	\$ 84,913	\$ (7,888)	\$ 1,221,352
Equipment:				
Automotive	588,396	285,885	(9,313)	864,968
Mobile	462,661	-	-	462,661
Office	434,467	17,003	(6,075)	445,395
Radio communications	84,775	-	-	84,775
Tools & shop	387,706	38,129	(2,989)	422,846
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	104,070	-	6,575,392
Pumping plant	4,148,349	3,980	(198)	4,152,131
Storage tank	1,352,300	-	-	1,352,300
Water treatment facility	11,219,506	83,067	-	11,302,573
Ruth Lake Infrastructure:				
Ruth dam & works	6,980,914	115,609	-	7,096,523

**HUMBOLDT BAY MUNICIPAL WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the years ended June 30, 2014 and 2013**

Ruth hydroelectric plant	3,278,653	67,694	-	3,346,347
Ruth Lake fishing access	118,041	-	-	118,041
District No. U-1:				
Supplemental development	<u>5,354,898</u>	<u>-</u>	<u>-</u>	<u>5,354,898</u>
Total property & equipment	52,019,123	800,350	(26,463)	52,793,010
Accumulated depreciation	<u>(35,863,955)</u>	<u>(975,723)</u>	<u>21,915</u>	<u>(36,817,763)</u>
Net property & equipment	16,155,168	(175,373)	(4,548)	15,975,247
Projects in progress	<u>639,098</u>	<u>994,698</u>	<u>(35,947)</u>	<u>1,597,849</u>
Total property & equipment, net	<u>\$ 16,794,266</u>	<u>\$ 819,325</u>	<u>\$ (40,495)</u>	<u>\$ 17,573,096</u>

Total depreciation expense charged to operations for the years ended June 30, 2014 and 2013, was \$975,723 and \$964,125, 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 \$130,539 as of June 30, 2014. The remainder of the industrial system is fully depreciated. The idled industrial pump station may potentially be put back into service.

Property under construction in the amount of \$2,164,154 that will be subsequently transferred to other jurisdictions has been recognized as a current asset as of June 30, 2014 (see Note 4).

Gain (loss) on disposal of equipment for the years ended June 30, 2014 and 2013, was \$(4,548) and \$0, respectively.

Net investment in capital assets as of June 30, 2014 and 2013, consist of the following:

	<u>2014</u>	<u>2013</u>
Land	\$ 1,371,972	\$ 1,371,972
Projects in progress	1,597,851	639,098
Property & equipment, net	15,975,245	16,155,168
Current portion of notes payable	(681,539)	(678,078)
Notes payable, net	<u>(5,615,619)</u>	<u>(6,297,144)</u>
Total net investment in capital assets	<u>\$ 12,647,910</u>	<u>\$ 11,191,016</u>

Net position restricted for capital projects as of June 30, 2014 and 2013 consist of the following:

	<u>2014</u>	<u>2013</u>
Municipal customer advance charges for boom truck	\$ -	\$ 244,866
Municipal customer advance charges for Ranney projects	333,461	218,000
Municipal customer advance charges for Techite project	<u>424,701</u>	<u>424,701</u>
Subtotal customer advance charges	758,162	887,567
Restricted for Ranney and Techite projects	<u>926,936</u>	<u>534,819</u>
Total net position restricted for capital projects	<u>\$ 1,685,098</u>	<u>\$ 1,422,386</u>

**HUMBOLDT BAY MUNICIPAL WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the years ended June 30, 2014 and 2013**

NOTE 7 - 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 California Public Employees' Retirement System (CalPERS) contract to convert 100% of the unused sick leave accrual to CalPERS service credit, or to receive a 35% cash payment and convert the remainder to CalPERS 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 CalPERS service credit conversion. Accrued absences as of June 30, 2014 and 2013, consist of the following:

	2014	2013
Accrued vacation	\$ 140,715	\$ 127,082
Accrued sick leave	127,429	117,340
Total accrued absences	\$ 268,144	\$ 244,422

NOTE 8 - PROJECT ADVANCES FROM MUNICIPAL PARTNERS

The District has had to pay significant construction costs on the multijurisdictional interties project before being reimbursed by the grantor. To help the District cover the cash shortfalls, the City of Arcata and the McKinleyville Community Services District have advanced funds to the District which will be repaid when the project is completed.

	2014	2013
City of Arcata advance	\$ 255,852	\$ -
McKinleyville Community Services District advance	79,575	-
Total project advances	\$ 335,427	\$ -

NOTE 9 - 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 U.S. Bank money market account is restricted for servicing the loan. 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
2015	\$ 547,337	\$ -	\$ 547,337
2016	547,337	-	547,337

**HUMBOLDT BAY MUNICIPAL WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the years ended June 30, 2014 and 2013**

2017	547,337	-	547,337
2018	547,337	-	547,337
2019	547,337	-	547,337
2020 to 2024	<u>2,463,016</u>	-	<u>2,463,016</u>
Total	5,199,701	-	5,199,701
Due within one year	<u>(547,337)</u>	-	<u>(547,337)</u>
Due after one year	<u>\$ 4,652,364</u>	<u>\$ -</u>	<u>\$ 4,652,364</u>

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:

<u>Year Ending June 30</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2015	\$ 134,202	\$ 27,986	\$ 162,188
2016	137,755	24,433	162,188
2017	141,401	20,787	162,188
2018	145,145	17,043	162,188
2019	148,987	13,201	162,188
2020 to 2022	<u>389,967</u>	<u>15,518</u>	<u>405,485</u>
Total	1,097,457	118,968	1,216,425
Due within one year	<u>(134,202)</u>	<u>(27,986)</u>	<u>(162,188)</u>
Due after one year	<u>\$ 963,255</u>	<u>\$ 90,982</u>	<u>\$ 1,054,237</u>

Notes payable as of June 30, 2014 and 2013, consists of the following:

	<u>2014</u>	<u>2013</u>
SRF Note	\$ 5,199,701	\$ 5,747,038
MFC Note	<u>1,097,457</u>	<u>1,228,184</u>
Total notes payable	6,297,158	6,975,222
Less current portion	<u>(681,539)</u>	<u>(678,078)</u>
Total notes payable, net	<u>\$ 5,615,619</u>	<u>\$ 6,297,144</u>

Net position restricted for debt service for the years ended June 30, 2014 and 2013 was \$706,962 and \$703,468, respectively.

NOTE 10 - NET POSITION

Restrictions on net position are imposed by creditors, grantors, laws, and regulations. Restrictions on net position as designated by the Board of Directors are reported as unrestricted net position. Unrestricted net position as of June 30, 2014 and 2013, consists of the following:

**HUMBOLDT BAY MUNICIPAL WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the years ended June 30, 2014 and 2013**

	2014	2013
Designated as restricted by Board of Directors:		
Drinking Water Filtration Plant reserve account	\$ 574,555	\$ 632,470
Municipal Supplemental Reserve Account	362,192	409,762
Revolving loan fund	47,421	47,173
Other	4,226	4,158
Net position designated by Board as restricted	988,394	1,093,563
Other unrestricted net position	795,775	1,149,747
Total unrestricted net position	\$ 1,784,169	\$ 2,243,310

NOTE 11 - WHOLESALE WATER CONTRACTS

The District is primarily a wholesale water provider. The District's Ordinance 16 as amended in 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.

**HUMBOLDT BAY MUNICIPAL WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the years ended June 30, 2014 and 2013**

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, 2014 and 2013, the reserve account had a balance of \$362,192 and \$409,762, respectively.

As of June 30, 2014 and 2013, the municipal customers overpaid \$346,435 and \$76,759, respectively, for operating, maintenance, and capital costs. Overpayments in the amount of \$76,759 were credited to the municipalities' 2013/2014 billings. Overpayments in the amount of \$346,435 will be credited to the municipalities' 2014/2015 billings. As of June 30, 2014, there were additional credits to the municipalities in the amount of \$437. At June 30, 2014 and 2013, total net position restricted for credits to the municipalities were \$346,872 and \$76,759, respectively.

The municipal water customers may be charged in advance in order to fund future capital projects. For the year ended June 30, 2013, the municipal customers paid advance charges of \$887,567 for improvement projects and the purchase of a capital asset. For the year ended June 30, 2014, the municipal customers paid advance charges of \$758,162 for improvement projects (see Note 6).

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, 2014 and 2013, the District charged the wholesale customers \$145,000 and \$0, respectively.

NOTE 12 - 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.

Effective January 1, 2013, the District contributes \$25 for each employee who is not currently participating in the deferred compensation program. The District will provide a contribution match of up to \$50 per month for employees who are participating in the deferred compensation program.

**HUMBOLDT BAY MUNICIPAL WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the years ended June 30, 2014 and 2013**

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 13 - RETIREMENT PLAN

The District contributes to 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, 2014 and 2013, was 13.741% and 13.108%, respectively. The contribution requirements of the plan members are established by state statute. The District's contributions to CalPERS for the fiscal years ending June 30, 2014, 2013, and 2012 were \$358,966, \$319,478, and \$297,010, respectively.

NOTE 14 - OTHER POSTEMPLOYMENT BENEFITS

Plan Description

The District provides a defined benefit healthcare plan (the "Retiree Health Plan"). The District pays a certain percentage of eligible retirees' actual costs subject to a maximum of \$640.

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 the medical costs premium during the life of a retired subject to a maximum of \$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 \$640 per month, 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.

**HUMBOLDT BAY MUNICIPAL WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the years ended June 30, 2014 and 2013**

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:

	2014	2013
Annual required contribution	\$ 227,019	\$ 227,019
Interest on net OPEB obligation	26,655	18,960
Adjustment to annual required contribution	(25,258)	(17,966)
Annual OPEB cost (expense)	228,416	228,013
Estimated contributions made:		
Premiums paid	(57,551)	(57,743)
Implicit subsidy contributions	(31,278)	(30,367)
Increase in net OPEB obligation	139,587	139,903
Net OPEB obligation - beginning of year	484,631	344,728
Net OPEB obligation - end of year	\$ 624,218	\$ 484,631
Current OPEB obligation	\$ 61,814	\$ 74,340
Noncurrent OPEB obligation	562,404	410,291
Total OPEB obligation	\$ 624,218	\$ 484,631

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	Amount Contributed	% of Annual OPEB Cost Contributed	Net OPEB Obligation (Asset)
June 30, 2014	\$ 228,416	\$ 57,551	26%	\$ 624,218
June 30, 2013	\$ 228,013	\$ 57,743	25%	\$ 484,631
June 30, 2012	\$ 198,692	\$ 81,436	41%	\$ 344,728

Funding Status and Funding Progress

As of July 1, 2012, the actuarial accrued liability (AAL) for benefits was \$2,413,787, 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

**HUMBOLDT BAY MUNICIPAL WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the years ended June 30, 2014 and 2013**

progress presents multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

Methods and Assumptions

Projections of 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 perspective 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 59, 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 3%.

Health insurance premiums - 2012 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 - Payroll for current employees is 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, 2012, was twenty-seven years.

**HUMBOLDT BAY MUNICIPAL WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the years ended June 30, 2014 and 2013**

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)
July 1, 2012	\$2,413,787	\$ -	\$2,413,787	0%	\$1,567,071	154.0%
July 1, 2009	\$1,994,945	\$ -	\$1,994,945	0%	\$1,520,676	131.2%

NOTE 15 - 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.

**HUMBOLDT BAY MUNICIPAL WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the years ended June 30, 2014 and 2013**

- 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.

REPORT ON INTERNAL CONTROL AND COMPLIANCE AND OTHER MATTERS



INDEPENDENT AUDITORS' 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, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States as well as accounting systems prescribed by the State Controller's Office and state regulations governing special districts, 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, 2014, and the related notes to the financial statements, which comprise the District's basic financial statements, and have issued our report thereon dated December 31, 2014.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the District's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control. Accordingly, we do not express an opinion on the effectiveness of the District's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying schedule of findings, we identified certain deficiencies in internal control that we consider to be material weaknesses and significant deficiencies.

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. We consider deficiency 2014-1 described in the accompanying schedule of findings to be a material weakness.

A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider deficiencies 2014-2 and 2014-3 described in the accompanying schedule of findings to be significant deficiencies.

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*.

District's Response to Findings

The District's response to the findings identified in our audit is described in the accompanying schedule of findings. The District's response was not subjected to the auditing procedures applied in the audit of the financial statements, and , accordingly, we express no opinion on it.

Purpose of this Report

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

Hunter, Hunter & Hunt

December 31, 2014

SCHEDULE OF FINDINGS

Material Weakness:

2014-1

Criteria - Expenditures incurred during the current fiscal year but paid in the following fiscal year should be recorded as current fiscal year accounts payable. All contract payments held in retention by the District at the fiscal year-end should be recorded as current fiscal year contract retentions payable. Capital additions should be recognized in the same period in which the expenditures (including amounts retained from payment) are incurred.

Condition - For the year ended June 30, 2014, the District did not recognize \$407,970 of contract expenditures as accounts payable and property to be transferred, and did not record \$95,531 in amounts retained from contract payments as contract retentions payable and property to be transferred.

Cause - The District maintains the accounting records on a cash basis during the fiscal year. The accounting records are converted to accrual basis at year-end. The District's internal controls over financial reporting did not identify the misstatements in a timely manner.

Effect or Potential Effect - Although the potential effect of the material weakness would be to understate accounts payable by \$407,970, understate contract retentions payable by \$95,531, understate property to be transferred by \$503,501, understate property transfer payable by \$503,501, and understate grant expenses by \$503,501, the items noted above were corrected, so there is no effect upon the financial statements issued.

Recommendation - We recommend that the year-end closing procedures include a thorough examination and review of all expenditures and contract retentions to ensure that they are accounted for in the proper period.

Actions Taken - District management reviewed the auditor's findings and respectfully provided the following in response:

Management and the accounting staff have reviewed the internal accounting control procedures relating to grant revenue accrual including retention for proper recording in the financial records to ensure that they are accounted for in the proper period. As mentioned above, the items noted by the auditor were corrected and there was no effect upon the financial statements issued

Significant Deficiencies:

2014-2

Criteria - Bank reconciliations at the end of the fiscal year should be prepared for all cash accounts.

Condition - Bank reconciliations at year-end were requested but not provided to the auditors for the cash accounts held with the Humboldt County Treasurer's Pooled Investment Fund. It appeared that the reconciliations were not performed.

Cause - Management did not provide a bank reconciliation for the Humboldt County Treasurer's Pooled Investment Fund. Audit procedures identified a significant error in the ending cash balance of the fund that could have been identified if a bank reconciliation had been prepared.

Effect or Potential Effect - Although the potential effect of the significant deficiency would be to understate cash equivalents by \$58,395 and understate tax revenues by the same amount, the items noted above were corrected, so there is no effect upon the financial statements issued.

Recommendation - We recommend that management provide all bank reconciliations for all cash accounts.

Actions Taken - District management and accounting staff reviewed the auditor's findings and respectfully provided the following in response:

Although the bank reconciliations were performed on the Humboldt County Treasurer's Pooled Investment Fund, due to an erroneous computation, the resulting reconciliation was not accurate. Accounting staff has consulted with Humboldt County Treasurer's staff to obtain a clear understanding and interpretation of the account statements provided by the County so that the reconciliations will be performed accurately. As mentioned above, the items noted by the auditor were corrected and there was no effect upon the financial statements issued.

2014-3

Criteria - The depreciation schedule should be reconciled to the capital asset account balances.

Condition - The depreciation schedule prepared by management had mathematical inaccuracies and did not include all capital additions. As a result, the cost basis of the assets according to the depreciation schedule did not match the capital asset account balances according to the general ledger, and depreciation expense was understated in the general ledger.

Cause - Management did not reconcile the depreciation schedule to the capital asset account balances. The asset additions report that management used to prepare the depreciation schedule was not complete. Audit procedures identified significant differences that could have been identified if a reconciliation had been prepared.

Effect or Potential Effect - Although the potential effect of the significant deficiency would be a difference of \$146,800 in the asset cost basis according to the depreciation schedule compared to the asset cost basis according to the general ledger, as well as an understatement of \$1,500 in depreciation expense, the items noted above were corrected, so there is no effect upon the financial statements issued.

Recommendation - We recommend that management reconcile the depreciation schedule to the capital asset account balances.

Actions Taken - District management and accounting staff reviewed the auditor's findings and respectfully provided the following in response:

Management and the accounting staff have reviewed the internal accounting control procedures relating to the preparation and reconciliation of the depreciation schedule and capital account balances to ensure that proper reconciliations are performed. As mentioned above, the items noted by the auditor were corrected and there was no effect upon the financial statements issued.