

HUMBOLDT BAY MUNICIPAL WATER DISTRICT

**BASIC FINANCIAL STATEMENTS,
REQUIRED SUPPLEMENTARY INFORMATION,**

AND

ADDITIONAL INFORMATION

Years Ended June 30, 2013 and 2012

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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, 2013 and 2012, 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; 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. 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. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit 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, 2013 and 2012, 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 11 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 January 6, 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

January 6, 2014

MANAGEMENT'S DISCUSSION AND ANALYSIS

**HUMBOLDT BAY MUNICIPAL WATER DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
For FY 2012-13**

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, 2013 (FY2012-13). We recommend that readers review this in conjunction with the remainder of the financial statements.

INTRODUCTION AND BACKGROUND

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

The Regional Water System:

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

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

Customers Served and Associated Wholesale Water Contracts:

The District supplies treated domestic water to seven municipal agencies on a wholesale basis. The municipalities served by the District are the Cities of: Arcata, Blue Lake and Eureka, and the 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 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 12), b) the Statements of Revenues, Expenses, and Changes in Net Position (page 13), and c) the Statements of Cash Flows (page 14). 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 \$15,636,939 as of June 30, 2013, an increase of \$447,473 compared to June 30, 2012.
- Revenues were \$5,950,412, an increase of \$699,705 from FY 2011-12.
- Expenses were \$5,502,939, an increase of \$254,705 from FY 2011-12.
- Notes payable net of current portion is \$6,297,144, a decrease of \$678,078 from FY 2011-12.

DISCUSSION AND ANALYSIS

Our analysis of the District begins on page 12 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 Statements of Net Position is presented in Table 1.

TABLE 1				
CONDENSED STATEMENTS OF NET POSITION				
	FY 2012-13	FY 2011-12	Change	
			\$	%
ASSETS				
Current Assets	\$2,115,550	\$2,281,913	-\$166,363	-7.3%
Restricted Cash & Investment	\$3,292,138	\$3,128,564	\$163,574	5.2%
Land, Property & Equipment (net Accum. Depr.)	\$18,166,238	\$18,318,679	-\$152,441	-0.8%
Total Assets	\$23,573,926	\$23,729,156	-\$155,230	-0.7%
LIABILITIES				
Current Liabilities	\$1,202,195	\$1,262,261	-\$60,066	-4.8%
Unearned Grant Revenue	\$27,357	\$37,224	-\$9,867	-26.5%
Post-Retirement Health Benefits Obligation	\$410,291	\$264,983	\$145,308	54.8%
Long-term Debt	\$6,297,144	\$6,975,222	-\$678,078	-9.7%
Total Liabilities	\$7,936,987	\$8,539,690	-\$602,703	-7.%
NET POSITION				
Net Investment in Capital Assets	\$11,191,016	\$10,668,751	\$522,265	4.9%
Restricted (for debt service)	\$703,468	\$696,581	\$6,887	1.0%
Restricted (for capital projects)	\$1,422,386	\$886,478	\$535,908	60.5%
Restricted (for credits to municipalities)	\$76,759	\$377,947	-\$301,188	-79.7%
Unrestricted	\$2,243,310	\$2,559,709	-\$316,399	-12.4%
TOTAL NET POSITION	\$15,636,939	\$15,189,466	\$447,473	2.9%

As can be seen from the table above, the net position as of June 30, 2013, was \$15,636,939, an increase of \$447,473 (2.9%) as compared to June 30, 2012.

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 13) 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 Statements of Revenues, Expenses, and Changes in Net Position is presented in Table 2.

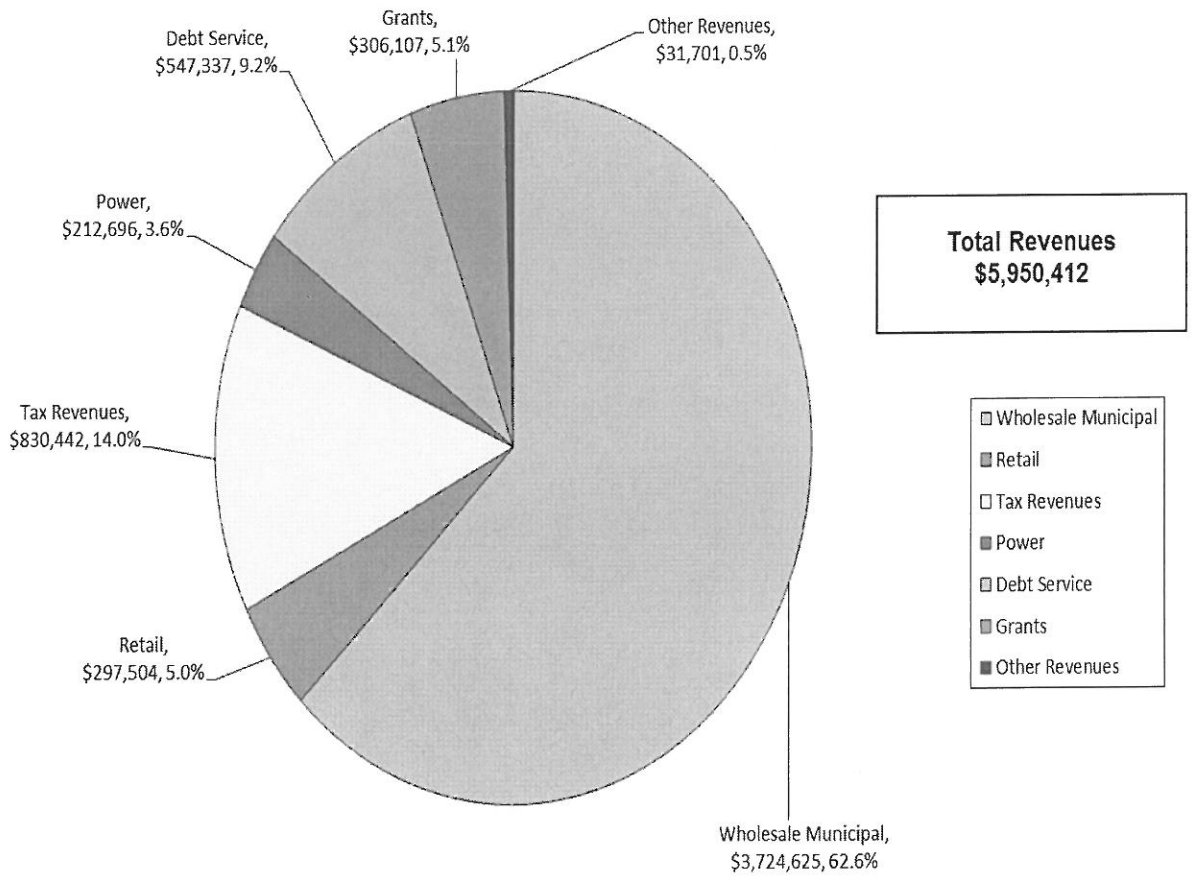
TABLE 2				
CONDENSED STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION				
	FY 2012-13	FY 2011-12	Change	
			\$	%
REVENUES				
*Operating:				
Water Sales	\$4,022,129	\$3,612,925	\$409,204	11.3%
Power Sales	\$212,696	\$144,555	\$68,141	47.1%
SRF Debt Service Receipt	\$547,337	\$547,337	\$0	0.0%
Other Operating	\$5,642	\$46,532	-\$40,890	-87.9%
*Non-Operating:				
Taxes	\$830,442	\$707,061	\$123,381	17.4%
Interest Income	\$26,059	\$37,136	-\$11,077	-29.8%
Grant Revenues	\$306,107	\$146,161	\$159,946	109.4%
Other Income	\$0	\$9,000	-\$9,000	-100.0%
Total Revenues	\$5,950,412	\$5,250,707	\$699,705	13.3%
EXPENSES				
Operating expense	\$4,690,653	\$4,453,827	\$236,826	5.3%
Non-operating expense	\$34,031	\$28,132	\$5,899	21.0%
Depreciation	\$964,125	\$948,696	\$15,429	1.6%
Less Reimbursements	-\$185,870	-\$182,421	-\$3,449	1.9%
Total Expenses	\$5,502,939	\$5,248,234	\$254,705	4.9%
Change in Net Position	\$447,473	\$2,473	\$445,000	17,994.3%
Beginning Net Position	\$15,189,466	\$15,186,993	\$2,473	0.0%
Ending Net Position	\$15,636,939	\$15,189,466	\$447,473	2.9%

While the Statements of Net Position show the changes in financial position of net assets, 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 \$445,000 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 \$447,473, 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 \$1,411,598 (\$447,473 + 964,125).

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 2012-13 by category along with the proportionate share of the total revenue each category represents. The total revenues reflected in Chart 1 are \$5,950,412. 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 \$306,107 are associated with repayment of long-term debt and special funding respectively and not current operations.

**CHART 1
REVENUES RECEIVED BY CATEGORY FOR FY 2012-13**



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.

TABLE 3 PROPERTY AND EQUIPMENT				
	FY 2012-13	FY 2011-12	Change	
			\$	%
Buildings	\$1,144,328	\$1,050,908	\$93,420	8.9%
Equip - Auto/Mobile/Office/Radio/Tools	\$1,958,003	\$1,902,552	\$55,451	2.9%
Water System Infrastructure (excludes land)	\$48,916,791	\$48,756,772	\$160,019	0.3%
Total Property and Equipment	\$52,019,122	\$51,710,232	\$308,890	0.6%
Less Accumulated Depreciation	-\$35,863,955	-\$34,931,077	-\$932,878	2.7%
Add Projects in Progress	\$639,098	\$167,552	\$471,546	281.4%
Total Property & Equipment (net of Depr)	\$16,794,265	\$16,946,707	-\$152,442	-0.9%

LONG-TERM DEBT

At FY 2012-13 year-end, the District has two long-term notes payable outstanding for a total amount of \$6,975,222. The first has an outstanding balance of \$5,747,038 (long-term note payable of \$5,199,701 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 \$1,228,184 (long-term note payable of \$1,097,443 plus current liabilities-current portion of note payable of \$130,741). This is the Water System Improvement Loan or US Bank loan, used to finance various improvements to the water system consisting generally of well and pump improvements, and pipeline replacement. The US Bank loan carries interest at 2.63%, and has a repayment term of 10 years. The District makes semi-annual payments of \$81,094 including principal and interest to US Bank, for a resulting annual payment of \$162,188. The Water System Improvement loan balance at its inception in 2011 was \$1,418,000. The debt service for the Water System Improvement Loan is paid in its entirety by the District's wholesale municipal customers in accordance with the wholesale water contracts (via Price Factor 2).

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

Pulp Mill Closure

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

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

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

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

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

Capital Improvement Program

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

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

Collected from District's wholesale customers for the Ranney project	\$ 322,000
Utilization of the District's Drinking Water Facilities Plant Reserve	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 or has a commitment for a Federal Emergency Management Agency (FEMA) grant in the amount of \$2,795,000. FEMA has initiated its NEPA process for this project. Once this is completed, the District anticipates receiving the FEMA grant agreement.

Another large project is replacement of the District's pipeline that crosses over the Mad River to serve the City of Blue Lake and the Fieldbrook-Glendale Community Services District. The project cost is estimated to be \$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 also initiated its 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 after the end of the current fiscal year.

BASIC FINANCIAL STATEMENTS

**HUMBOLDT BAY MUNICIPAL WATER DISTRICT
STATEMENTS OF NET POSITION
PROPRIETARY FUND
June 30, 2013 and 2012**

	2013	2012
ASSETS:		
CURRENT ASSETS:		
Cash & cash equivalents	\$ 1,370,604	\$ 1,639,707
Accounts receivable	443,530	401,666
Grants receivable	139,729	77,862
Interest receivable	3,908	6,396
Prepaid expenses	152,779	151,282
Deposits	5,000	5,000
TOTAL CURRENT ASSETS	2,115,550	2,281,913
NON-CURRENT ASSETS:		
Restricted cash equivalents	2,744,800	2,581,226
Restricted investment	547,338	547,338
Land	1,371,972	1,371,972
Projects in progress	639,098	167,552
Property & equipment, net	16,155,168	16,779,155
TOTAL ASSETS	23,573,926	23,729,156
LIABILITIES:		
CURRENT LIABILITIES:		
Accounts payable	79,556	71,093
Accrued wages, payroll taxes & benefits	117,723	110,218
Contract retentions payable	-	106,640
Interest payable	8,076	8,864
Accrued absences	244,422	210,995
Current other postemployment benefits obligation	74,340	79,745
Current portion of notes payable	678,078	674,706
TOTAL CURRENT LIABILITIES	1,202,195	1,262,261
LONG-TERM LIABILITIES:		
Unearned grant revenue	27,357	37,224
Other postemployment benefits obligation, net	410,291	264,983
Note payables, net	6,297,144	6,975,222
TOTAL LIABILITIES	7,936,987	8,539,690
NET POSITION:		
Net investment in capital assets	11,191,016	10,668,751
Restricted for debt service	703,468	696,581
Restricted for capital projects	1,422,386	886,478
Restricted for credits to municipalities	76,759	377,947
Unrestricted	2,243,310	2,559,709
TOTAL NET POSITION	\$ 15,636,939	\$ 15,189,466

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, 2013 and 2012

	2013	2012
OPERATING REVENUES:		
Water sales:		
Municipal customers	\$ 3,724,625	\$ 3,310,694
Retail customers	297,504	302,231
Debt service receipts	547,337	547,337
Total water sales	4,569,466	4,160,262
Power sales	212,696	144,555
Other operating revenues	5,642	46,532
TOTAL OPERATING REVENUES	4,787,804	4,351,349
OPERATING EXPENSES:		
Payroll & related costs	2,643,249	2,476,625
Employee retirement contributions	319,478	297,010
Power & pumping	616,500	627,509
Engineering	338,674	182,197
Materials & supplies	120,047	127,887
Repairs & maintenance	186,226	253,850
Auto & travel expenses	67,469	60,276
Insurance	84,174	81,443
Depreciation	964,125	948,696
Legal & accounting fees	46,540	65,161
Professional assistance	79,286	84,947
Tax and license	92,323	87,299
Training	19,542	26,341
Bad debt	-	1,530
Other operating expenses	77,145	81,752
Total operating expenses before reimbursements	5,654,778	5,402,523
Reimbursements for services & costs	(185,870)	(182,421)
TOTAL OPERATING EXPENSES	5,468,908	5,220,102
OPERATING INCOME (LOSS)	(681,104)	(868,753)
NONOPERATING REVENUES (EXPENSES):		
Tax revenues	830,442	707,061
Grant revenues	306,107	146,161
Interest revenues	26,059	37,136
Interest expense	(34,031)	(28,132)
Gain (loss) on disposal of capital assets	-	9,000
TOTAL NONOPERATING REVENUES (EXPENSES)	1,128,577	871,226
CHANGE IN NET POSITION	447,473	2,473
BEGINNING NET POSITION	15,189,466	15,186,993
ENDING NET POSITION	\$ 15,636,939	\$ 15,189,466

See accompanying notes.

**HUMBOLDT BAY MUNICIPAL WATER DISTRICT
STATEMENTS OF CASH FLOWS
PROPRIETARY FUND
For the Years Ended June 30, 2013 and 2012**

	2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES:		
Receipts from customers	\$ 4,931,810	\$ 4,612,701
Payments to suppliers	(1,720,960)	(1,699,991)
Payments to employees	(2,781,892)	(2,681,904)
Other receipts (payments)	-	100
NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES	428,958	230,906
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:		
Taxes for general operations	830,442	707,061
NET CASH PROVIDED (USED) BY NONCAPITAL FINANCING ACTIVITIES	830,442	707,061
CASH FLOWS FROM CAPITAL & RELATED FINANCING ACTIVITIES:		
Payments to acquire, construct & improve capital assets	(918,324)	(1,391,604)
Proceeds on sale of capital assets	-	9,000
Receipts of grants for capital financing	234,373	105,523
Proceeds on capital debt	-	1,418,000
Principal paid on capital debt	(674,706)	(609,784)
Interest paid on capital debt	(34,819)	(19,268)
NET CASH PROVIDED (USED) BY CAPITAL & RELATED FINANCING ACTIVITIES	(1,393,476)	(488,133)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Interest received	28,547	40,413
INCREASE (DECREASE) IN CASH & CASH EQUIVALENTS	(105,529)	490,247
CASH & CASH EQUIVALENTS AT BEGINNING OF YEAR	4,220,933	3,730,686
CASH & CASH EQUIVALENTS AT END OF YEAR	\$ 4,115,404	\$ 4,220,933
FINANCIAL STATEMENT PRESENTATION RECONCILIATION:		
Cash & cash equivalents	\$ 1,370,604	\$ 1,639,707
Restricted cash equivalents	2,744,800	2,581,226
CASH & CASH EQUIVALENTS AT END OF YEAR	\$ 4,115,404	\$ 4,220,933
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES:		
Operating Income (loss)	\$ (681,104)	\$ (868,753)
Adjustments to reconcile operating income (loss) to net cash provided by operating activities:		
Depreciation	964,125	948,696
Changes in assets and liabilities:		
Receivables	(41,864)	80,461
Other receivable	-	100
Prepaid expenses	(1,497)	(2,611)
Accounts payable	8,463	(18,718)
Accrued liabilities	180,835	91,731
NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES	\$ 428,958	\$ 230,906
NONCASH CAPITAL FINANCING ACTIVITIES		

Unearned grant revenue of \$27,357 and earned grant revenue of \$9,867 recognized in the current year were received in the prior year.

See accompanying notes.

HUMBOLDT BAY MUNICIPAL WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the years ended June 30, 2013 and 2012

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 District has adopted Governmental Accounting Standards Board (GASB) Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements* (GASB No. 62). GASB No. 62 incorporates into the GASB's authoritative literature certain accounting and financial reporting guidance that is included in the following pronouncements issued on or before November 30, 1989, which does not conflict with or contradict GASB pronouncements:

- Financial Accounting Standards Board (FASB) Statements and Interpretations,
- Accounting Principles Board Opinions, and
- Accounting Research Bulletins of the American Institute of Certified Public Accountants' (AICPA) Committee on Accounting Procedure.

GASB No. 62 also supersedes GASB No. 20, thereby eliminating the election provided in GASB No. 20 for enterprise funds and governments engaged in business-type activities to apply post-November 30, 1989, FASB Statements and Interpretations that do not conflict with or contradict GASB pronouncements. However, those entities can continue to apply, as other accounting literature, post-November 30, 1989, FASB pronouncements that do not conflict with or contradict GASB pronouncements. Adoption of GASB No. 62 does not have any impact on the District's financial statements.

HUMBOLDT BAY MUNICIPAL WATER DISTRICT
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The District has adopted GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position* which provides guidance for reporting deferred outflows of resources, deferred inflows of resources, and net position in a statement of financial position and related disclosures. The statement of net assets is renamed the statement of net position.

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.

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, 2013, 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.

HUMBOLDT BAY MUNICIPAL WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the years ended June 30, 2013 and 2012

Cash and Cash Equivalents

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

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

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

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

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

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

Capital Assets

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

**HUMBOLDT BAY MUNICIPAL WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the years ended June 30, 2013 and 2012**

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 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 their 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

HUMBOLDT BAY MUNICIPAL WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the years ended June 30, 2013 and 2012

projects per contracts, and for revenue credits to the seven municipal customers per Ordinance 16 (see Notes 6, 8, 9 and 10).

Unrestricted net position - consist 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.

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, 2013 and 2012 (see Note 13).

Reclassifications

Certain items in the 2012 financial statements 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.

HUMBOLDT BAY MUNICIPAL WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the years ended June 30, 2013 and 2012

NOTE 2 - CASH, CASH EQUIVALENTS AND INVESTMENT

Cash, cash equivalents, and investment at June 30, 2013 and 2012, consist of the following:

	2013	2012
Cash and cash equivalents:		
Unrestricted:		
U.S. Bank commercial checking	\$ 157,251	\$ 134,647
Petty cash	650	650
LAIF	1,587	1,582
County Treasurer's Investment Pool	1,211,116	1,502,828
Total unrestricted cash and cash equivalents	1,370,604	1,639,707
Restricted:		
U.S. Bank Money Market Account	156,130	149,243
U.S. Bank Capital Project Fund Account	534,819	641,978
County Treasurer's Investment Pool	2,053,851	1,790,005
Total restricted cash and cash equivalents	2,744,800	2,581,226
Total cash and cash equivalents	<u>\$ 4,115,404</u>	<u>\$ 4,220,933</u>
Investment:		
Restricted:		
U.S. Bank Certificate of Deposit	\$ 547,338	\$ 547,338

The U.S. Bank commercial checking account balance is carried at cost. The U.S. Bank money market account is restricted for servicing the Safe Drinking Water State Revolving Fund (SRF) loan (see Note 8). The District transfers \$136,834 quarterly from a fund in the County Treasurer's Investment Pool to the 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 has \$547,338 in a three-year certificate of deposit with U.S. Bank which is restricted for semiannual SRF loan payments and is pledged to U.S. Bank as required by the SRF loan agreement.

Restricted cash and cash equivalents include restrictions imposed by creditors, grantors, laws, regulations, and designations imposed by the Board of Directors (see Note 9). Restricted cash and cash equivalents in the County Treasurer's Investment Pool are as follows:

	2013	2012
Restricted for debt service	\$ 47,173	\$ 46,882
Restricted for municipalities	486,641	785,074
Restricted for capital projects	1,520,037	958,049
Total restricted cash in County Investment Pool	<u>\$ 2,053,851</u>	<u>\$ 1,790,005</u>

At June 30, 2013, the balances in the U.S. Bank accounts exceeded federally insured limits by \$1,686,573. 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.

**HUMBOLDT BAY MUNICIPAL WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the years ended June 30, 2013 and 2012**

The certificate of deposit carries a 1.26% percent interest rate, pays interest quarterly and will mature on December 22, 2013. For the years ended June 30, 2013 and 2012, the District earned interest income from the certificate of deposit of \$6,887 and \$6,906, respectively.

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

NOTE 3 - ACCOUNTS RECEIVABLE

Accounts receivable from customers at June 30, 2013 and 2012, consist of the following:

	2013	2012
Resale customers:		
City of Eureka	\$ 154,679	\$ 131,736
City of Arcata	68,024	59,816
Humboldt CSD	49,409	42,008
McKinleyville CSD	53,844	45,280
Others	28,643	27,027
Subtotal resale customers	354,599	305,867
Maintenance and operations charges to others	49,157	48,078
Domestic customers and others	24,388	25,165
Hydroelectric sales, Pacific Gas & Electric	15,386	22,556
Total accounts receivable	\$ 443,530	\$ 401,666

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

Federal Emergency Management Agency (FEMA)

The District was awarded a capital grant from FEMA to be used for the Techite pipeline 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. The expected completion date is fall of 2014. The District may apply for an extension to the "project completion date" established by FEMA for any work completed after this time. Payments are made on a reimbursement basis with 10 percent retention withheld from each payment to be released at the project's closeout.

California Department of Fish and Wildlife (DFW)

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

**HUMBOLDT BAY MUNICIPAL WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the years ended June 30, 2013 and 2012**

State of California Department of Water Resources Proposition 84

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. This grant will partially fund the 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. The qualifying expenses in the amount of \$31,113 incurred thus far under this grant only qualify for the District's match under this grant and therefore are not reimbursable. Consequently, no accrued revenue was recorded at June 30, 2013.

Grants receivable for the years ended June 30, 2013 and 2012, consist of the following:

	2013	2012
CalOES	\$ 136,908	\$ 77,862
DFW	2,821	-
Total grants receivable	\$ 139,729	\$ 77,862

The CalOES grant receivable at June 30, 2012, as previously reported, was \$56,922. This amount has been restated to include \$20,940 in grant revenues that were earned as of June 30, 2012, but not previously recorded. The CalOES grant receivable at June 30, 2013, includes \$41,562 of retentions on claims submitted from April 2012 through June 2013.

In May 2012, the District received an administrative share allowance of \$40,136 from CalOES. The total allowance was recognized as grant revenue for the year ended June 30, 2012, but during that period only \$2,912 of CalOES grant administrative expenses were incurred and thus earned. As a result, grant revenues as previously reported for the year ended June 30, 2012, were overstated by \$37,224 and unearned grant revenue at June 30, 2012, was understated by \$37,224. CalOES grant administrative expenses of \$9,867 were incurred and thus earned during the year ended June 30, 2013.

For the years ended June 30, 2013 and 2012, unearned grant revenue (as restated) was \$27,357 and \$37,224, respectively.

The following is a schedule of CalOES and DFW grant revenues from inception:

	CalOES	DFW	Total
FY 11/12 grant revenues earned, previously reported	\$ 162,445	\$ -	\$ 162,445
Prior year grant revenues as restated: (see Note 9)			
Grant revenues earned but not reported adjustment	20,940	-	20,940
Unearned administrative allowance adjustment	(37,224)	-	(37,224)
Subtotal prior year grant revenues restatement	(16,284)	-	(16,284)
FY 11/12 grant revenues earned, as restated	146,161	-	146,161
FY 12/13 administrative allowance earned	9,867	-	9,867
FY 12/13 grant revenues earned	272,371	23,869	296,240
Subtotal FY 12/13 grant revenues earned	282,238	23,869	306,107
Cumulative grant revenues	\$ 428,399	\$ 23,869	\$ 452,268

HUMBOLDT BAY MUNICIPAL WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the years ended June 30, 2013 and 2012

NOTE 5 - LAND

Land at June 30, 2013 and 2012, 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, 2013 and 2012.

NOTE 6 - PROPERTY & EQUIPMENT

Changes in property and equipment during the year ended June 30, 2013, are as follows:

	<u>Balance</u> <u>06/30/12</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance</u> <u>06/30/13</u>
Buildings	\$ 1,050,908	\$ 93,419	\$ -	\$ 1,144,327
Equipment:				
Automotive	553,444	34,952	-	588,396
Mobile	460,268	5,149	-	465,417
Office	415,066	30,044	(10,643)	434,467
Radio communications	80,727	4,048	-	84,775
Tools & shop	393,048	12,506	(17,848)	387,706
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	-	(2,756)	140,851
Pipeline	6,471,322	-	-	6,471,322
Pumping plant	4,042,173	106,176	-	4,148,349
Storage tank	1,352,300	-	-	1,352,300
Water treatment facility	11,165,662	53,844	-	11,219,506
Ruth Lake Infrastructure:				
Ruth dam & works	6,980,914	-	-	6,980,914
Ruth hydroelectric plant	3,278,653	-	-	3,278,653
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	51,710,232	340,138	(31,247)	52,019,123
Accumulated depreciation	<u>(34,931,077)</u>	<u>(964,125)</u>	<u>31,247</u>	<u>(35,863,955)</u>
Net property & equipment	16,779,155	(623,987)	-	16,155,168
Projects in progress	<u>167,552</u>	<u>476,690</u>	<u>(5,144)</u>	<u>639,098</u>
Total property & equipment, net	<u>\$ 16,946,707</u>	<u>\$ (147,297)</u>	<u>\$ (5,144)</u>	<u>\$ 16,794,266</u>

Total depreciation expense charged to operations for the years ended June 30, 2013 and 2012, was \$964,125 and \$948,696, respectively. All capital assets are depreciable except land and projects in progress.

HUMBOLDT BAY MUNICIPAL WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the years ended June 30, 2013 and 2012

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 \$136,523 as of June 30, 2013. The remainder of the industrial system is fully depreciated. The idled industrial pump station may potentially be put back into service.

Gain (loss) on disposal of equipment for the years ended June 30, 2013 and 2012, was \$0 and \$9,000, respectively.

Net investment in capital assets as of June 30, 2013 and 2012, consist of the following:

	<u>2013</u>	<u>2012</u>
Land	\$ 1,371,972	\$ 1,371,972
Projects in progress	639,098	167,552
Property & equipment, net	16,155,168	16,779,155
Current portion of notes payable	(678,078)	(674,706)
Notes payable, net	<u>(6,297,144)</u>	<u>(6,975,222)</u>
Total net investment in capital assets	<u>\$ 11,191,016</u>	<u>\$ 10,668,751</u>

Net position restricted for capital projects as of June 30, 2013 and 2012 (as reclassified, see Note 9), consist of the following:

	<u>2013</u>	<u>2012</u>
Municipal customer advance charges for boom truck	\$ 244,866	\$ 244,500
Municipal customer advance charges for Ranney projects	218,000	-
Municipal customer advance charges for Techite project	<u>424,701</u>	<u>-</u>
Subtotal customer advance charges	887,567	244,500
Restricted for Ranney and Techite projects	<u>534,819</u>	<u>641,978</u>
Total net position restricted for capital projects	<u>\$ 1,422,386</u>	<u>\$ 886,478</u>

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 PERS contract to convert 100% of the unused sick leave accrual to PERS service credit, or to receive a 35% cash payment and convert the remainder to PERS service credit. However, if an employee with less than ten years of employment terminates or retires, the unused accumulated sick leave is not eligible for compensation or PERS service credit conversion. Accrued absences as of June 30, 2013 and 2012, consist of the following:

	<u>2013</u>	<u>2012</u>
Accrued vacation	\$ 127,082	\$ 117,152
Accrued sick leave	117,340	93,843
Total accrued absences	<u>\$ 244,422</u>	<u>\$ 210,995</u>

**HUMBOLDT BAY MUNICIPAL WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the years ended June 30, 2013 and 2012**

NOTE 8 - LONG-TERM NOTES PAYABLE

California Safe Drinking Water State Revolving Fund (SRF) Note

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

Year Ending June 30	Principal	Interest	Total
2014	\$ 547,337	\$ -	\$ 547,337
2015	547,337	-	547,337
2016	547,337	-	547,337
2017	547,337	-	547,337
2018	547,337	-	547,337
2019 to 2023	2,736,685	-	2,736,685
2024	<u>273,668</u>	-	<u>273,668</u>
Total	5,747,038	-	5,747,038
Due within one year	<u>(547,337)</u>	-	<u>(547,337)</u>
Due after one year	<u>\$ 5,199,701</u>	<u>\$ -</u>	<u>\$ 5,199,701</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:

Year Ending June 30	Principal	Interest	Total
2014	\$ 130,741	\$ 31,447	\$ 162,188
2015	134,202	27,986	162,188
2016	137,755	24,433	162,188
2017	141,401	20,787	162,188
2018	145,145	17,043	162,188
2019 to 2022	<u>538,940</u>	<u>28,719</u>	<u>567,659</u>
Total	1,228,184	150,415	1,378,599
Due within one year	<u>(130,741)</u>	<u>(31,447)</u>	<u>(162,188)</u>
Due after one year	<u>\$ 1,097,443</u>	<u>\$ 118,968</u>	<u>\$ 1,216,411</u>

**HUMBOLDT BAY MUNICIPAL WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the years ended June 30, 2013 and 2012**

Notes payable as of June 30, 2013 and 2012, consists of the following:

	2013	2012
SRF Note	\$ 5,747,038	\$ 6,294,375
MFC Note	1,228,184	1,355,553
Total notes payable	6,975,222	7,649,928
Less current portion	(678,078)	(674,706)
Total notes payable, net	\$ 6,297,144	\$ 6,975,222

Net position restricted for debt service for the years ended June 30, 2013 and 2012 (as reclassified), was \$703,468 and \$696,581, respectively (see Note 9).

NOTE 9 - NET POSITION

Net Position at June 30, 2012

Unrestricted net position at June 30, 2012, has been restated for adjustments to grant revenues (see Note 4).

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. As previously reported at June 30, 2012, net position restricted for debt service and capital projects included restricted cash as designated by the Board of Directors. These amounts have been reclassified as unrestricted net position at June 30, 2012.

	Previously Reported 6/30/12	Restated	Reclassified	As Adjusted 6/30/12
Net investment in capital assets	\$ 10,668,751	\$ -	\$ -	\$ 10,668,751
Restricted for debt service	743,463	-	(46,882)	696,581
Restricted for capital projects	1,600,027	-	(713,549)	886,478
Restricted for municipality credits	377,947	-	-	377,947
Unrestricted	1,815,562	(16,284)	760,431	2,559,709
Total adjusted net position	\$15,205,750	\$ (16,284)	\$ -	\$ 15,189,466

Unrestricted Net Position

Unrestricted net position as of June 30, 2013 and 2012, consists of the following:

	2013	2012
Designated as restricted by Board of Directors:		
Drinking Water Filtration Plant reserve account	\$ 632,470	\$ 713,549
Municipal Supplemental Reserve Account	409,762	407,127
Revolving loan fund	47,173	46,882
Other	4,158	4,158
Net position designated by Board as restricted	1,093,563	1,171,716
Other unrestricted net position	1,149,747	1,387,993
Total unrestricted net position	\$ 2,243,310	\$ 2,559,709

**HUMBOLDT BAY MUNICIPAL WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the years ended June 30, 2013 and 2012**

NOTE 10 - 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.

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

HUMBOLDT BAY MUNICIPAL WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the years ended June 30, 2013 and 2012

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, 2013 and 2012, the reserve account had a balance of \$409,762 and \$407,127, respectively.

As of June 30, 2013 and 2012, the municipal customers overpaid \$76,759 and \$377,947, respectively, for operating, maintenance, and capital costs. Overpayments in the amount of \$377,947 were credited to the municipalities' 2012/2013 billings. Overpayments in the amount of \$76,759 will be credited to the municipalities' 2013/2014 billings. At June 30, 2013 and 2012, total net position restricted for credits to the municipalities were \$76,759 and \$377,947, respectively.

The municipal water customers may be charged in advance in order to fund future capital projects. For the year ended June 30, 2012, the municipal customers paid advance charges of \$244,500 for the purchase of a capital asset. 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 (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, 2013 and 2012, the District charged the wholesale customers \$0 and \$200,000, respectively.

NOTE 11 - DEFERRED COMPENSATION PLAN

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

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

NOTE 12 - RETIREMENT PLAN

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

**HUMBOLDT BAY MUNICIPAL WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the years ended June 30, 2013 and 2012**

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, 2013 and 2012, was 13.108% and 12.827%, 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, 2013, 2012, and 2011 were \$319,478, \$297,010, and \$292,195, respectively.

NOTE 13 - 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.

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.

HUMBOLDT BAY MUNICIPAL WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the years ended June 30, 2013 and 2012

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:

	<u>2013</u>	<u>2012</u>
Annual required contribution	\$ 227,019	\$ 194,951
Interest on net OPEB obligation	18,960	12,511
Adjustment to annual required contribution	<u>(17,966)</u>	<u>(8,770)</u>
Annual OPEB cost (expense)	228,013	198,692
Estimated contributions made:		
Premiums paid	(57,743)	(41,981)
Implicit subsidy contributions	<u>(30,367)</u>	<u>(39,455)</u>
Increase in net OPEB obligation	139,903	117,256
Net OPEB obligation - beginning of year	<u>344,728</u>	<u>227,472</u>
Net OPEB obligation - end of year	<u>\$ 484,631</u>	<u>\$ 344,728</u>
Current OPEB obligation	\$ 74,340	\$ 79,745
Noncurrent OPEB obligation	410,291	264,983
Total OPEB obligation	<u>\$ 484,631</u>	<u>\$ 344,728</u>

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:

<u>Fiscal Year Ended</u>	<u>Annual OPEB Cost</u>	<u>Amount Contributed</u>	<u>% of Annual OPEB Cost Contributed</u>	<u>Net OPEB Obligation (Asset)</u>
June 30, 2013	\$ 228,013	\$ 57,743	25%	\$ 484,631
June 30, 2012	\$ 198,692	\$ 81,436	41%	\$ 344,728
June 30, 2011	\$ 192,692	\$ 81,449	42%	\$ 227,472

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 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

**HUMBOLDT BAY MUNICIPAL WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the years ended June 30, 2013 and 2012**

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.

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.

**HUMBOLDT BAY MUNICIPAL WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
For the years ended June 30, 2013 and 2012**

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 14 - RISK MANAGEMENT

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

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

Responsibilities of the ACWA-JPIA:

- a. Provide insurance coverage as necessary.
- b. Assist members in obtaining insurance coverage for risks not included within the coverage of the ACWA-JPIA.
- c. Assist each member's designated risk manager with the implementation risk management function.
- d. Provide loss prevention and safety consulting services to members as required.
- e. Provide claims adjusting and subrogation services for claims covered by the ACWA-JPIA's joint protection programs.
- f. Provide loss analysis and control in order to identify high exposure operations and to evaluate proper levels of self-retention and deductibles.
- g. Review members' contracts to determine sufficiency of indemnity and insurance provisions when requested.
- h. Conduct risk management audits to review the participation of each member in the programs.

**HUMBOLDT BAY MUNICIPAL WATER DISTRICT
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For the years ended June 30, 2013 and 2012**

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

Responsibilities of the District:

- a. The governing board of each member district shall appoint a representative and at least one alternate representative to the Board of Directors.
- b. Each member shall appoint an employee of the member to be responsible for the risk management function within that member and serve as a liaison between the member and the ACWA-JPIA as to risk management.
- c. Each member shall maintain an active safety officer and/or committee, and shall consider all recommendations of the ACWA-JPIA concerning unsafe practices.
- d. Each member shall maintain its own set of records, including a loss log, in all categories of risk covered by the joint protection program to insure accuracy of the ACWA-JPIA's loss reporting system.
- e. Each member shall pay its deposit premium and premium adjustments within thirty days of the invoice date.
- f. Each member shall provide the ACWA-JPIA with such other information or assistance as may be necessary for the ACWA-JPIA to carry out the joint protection programs.
- g. Each member shall cooperate with and assist the ACWA-JPIA, and any insurer of the ACWA-JPIA, in all matters and covered claims and will comply with all bylaws, rules and regulations adopted by the Board of Directors and Executive Committee of the ACWA-JPIA.

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

NOTE 15 - SUBSEQUENT EVENT

A grant agreement was executed in July 2013 in the amount of \$3,648,550 from the California Department of Public Health under the Proposition 50 funds to be used for the construction of emergency interagency water transmission line connections. 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. As of June 30, 2013, the District has incurred \$347,000 in qualifying reimbursable expenses. Based on the execution date of the grant agreement, the corresponding grant revenue was not accrued as of June 30, 2013.

ADDITIONAL INFORMATION



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, 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, 2013, and the related notes to the financial statements, which comprise the District's basic financial statements, and have issued our report thereon dated January 6, 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.

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

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified. We did identify certain deficiencies in internal control, described in the accompanying schedule of findings, that we consider 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*.

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

January 6, 2014

SCHEDULE OF FINDINGS

Significant Deficiencies:

2013-1

Criteria - Reimbursement-type grant revenues should be recognized in the same period in which expenditures are recorded on grant-related activities. Unearned grant revenue should be recorded for grant revenues received but not yet earned. Grants receivable should include all payments held in retention by the grantor. Significant grant revenues should be separately identified in the financial statements.

Condition - This is the second year in which the District has received reimbursement-type grant revenues. For the year ended June 30, 2012, the District did not recognize grant revenues that had been earned and did not record unearned grant revenues that were received but not yet earned. For the year ended June 30, 2013, the District did not record all payments held in retention by the grantor in grants receivable and significant grant revenues were included in miscellaneous revenues. Based on auditor recommendations and further review by District management, the previously issued financial statements have been restated and the current year financial statements were corrected prior to issuance.

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 did not expand its year-end closing procedures to ensure that the reimbursement-type grant revenues were recorded properly on an accrual basis. The District's internal controls over financial reporting did not identify the misstatements in a timely manner.

Effect or Potential Effect - As the items noted above were corrected, there is no effect upon the financial statements issued.

Recommendation - We recommend that the District consider maintaining the accounting records on an accrual basis during the fiscal year. We recommend that the year-end closing procedures include a thorough examination and review of grant revenues to ensure that they are accounted for in the proper period.

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

Under the Humboldt Bay Municipal Water District Ordinance 16 which is entitled "Establishing Rates, Charges and Conditions of Service For Water Sales to Municipal Water Customers", the District is required to utilize the cash basis of accounting to account for its receipts and disbursements with an annual reconciliation of expenditures versus budget to determine the corresponding credit or supplement that must be refunded or charged to the respective Municipal Water Customers. The District management and accounting staff will analyze whether maintaining the accounting records on an accrual basis during the fiscal year will have a negative impact on its compliance with the terms and conditions of Ordinance 16.

At the end of the fiscal year District staff converts its cash basis accounting to the accrual basis for audited financial statement presentation and reporting. During the last several years, the District has been successful in being awarded multiple grants for some of its Capital Improvement Plan projects. Prior to the end of each fiscal year, District management and accounting staff will conduct a thorough review of its year-end closing procedures including the proper accrual accounting for grant revenues.

2013-2

Criteria - Net position should be reported as restricted when constraints placed on net position use are either a) externally imposed by creditors, grantors, contributors, or laws, and regulations of other governments; or b) imposed by law through constitutional provisions or enabling legislation. Net position may also be designated internally to indicate that it is not considered to be available for general operations, in which case it is to be reported as unrestricted net position.

Condition - As previously reported at June 30, 2012, net position restricted for debt service and capital projects included restricted cash as designated by the Board of Directors. Based on auditor recommendations and further review by District management, these amounts have been reclassified as unrestricted net position at June 30, 2012, and the current year financial statements were corrected prior to issuance.

Cause - District management did not fully understand the accounting guidance related to the reporting of externally imposed restrictions and internal designations of net position.

Effect or Potential Effect - As the items noted above were corrected, there is no effect upon the financial statements issued.

Recommendation - We recommend that management work closely with the Board of Directors to properly identify funds that are restricted by external parties compared to funds designated by the Board.

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

District management has reviewed the relevant Governmental Accounting Standards Board (GASB) Statement No.34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments* accounting standards and related interpretations. Although certain Board designated net position amounts were, according to the GASB presentation standards, erroneously designated as "restricted" on the internal financial statements of the District, it was the opinion of staff that this conservative presentation more accurately reflected the reality of policy actions taken by the Board of Directors in implementing compliance with Ordinance 16. That said, management will work closely with the Board of Directors to identify funds that are restricted or unrestricted in accordance with GASB Statement No. 34.