

EAST PALO ALTO SANITARY DISTRICT
AUDITED FINANCIAL STATEMENTS
FOR THE YEAR ENDED
JUNE 30, 2012

Table of Contents

Page

Independent Auditors' Report	1
Management's Discussion and Analysis	2
Financial Statements:	
Statement of Net Assets	7
Statement of Revenues, Expenses, and Changes in Net Assets	8
Statement of Cash Flows.....	9
Notes to the Financial Statements	
Note 1 – Definition of Reporting Entity	11
Note 2 - Summary of Significant Accounting Policies.....	11
Note 3 – Pooled Cash and Investments.....	14
Note 4 - Capital Assets.....	15
Note 5 – Sewer Treatment Facility Capacity Rights.....	15
Note 6 – Long-Term Debt.....	16
Note 7 - Retirement Benefits	18
Note 8 - Post-Employment Benefits Other Than Pensions	19
Note 9 – Customers and Rates.....	21
 REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING BASED ON AN AUDIT OF BASIC FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH <i>GOVERNMENT AUDITING STANDARDS</i>	 22
SCHEDULE OF FINDINGS AND QUESTIONED COSTS	23
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS.....	24



CHRISTOPHER CHIME OGBODO

CERTIFIED PUBLIC ACCOUNTANT

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors of
East Palo Alto Sanitary District
East Palo Alto, California

I have audited the accompanying statements of financial position of the East Palo Alto Sanitary District (the "District"), for the year ended June 30, 2012 and the related statement of activities, cash flows and change in net assets for the year then ended. The accompanying financial statements are the responsibility of the District's management. My responsibility is to express an opinion on these financial statements based on the audit.

I conducted the audit in accordance with generally accepted auditing standards generally accepted in the United States 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 I plan and perform the audit to obtain reasonable assurance about whether the basic financial statements are free of material misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the basic financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall basic financial statement presentation. I believe that the audit provide a reasonable basis for my opinion.

In my opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the East Palo Alto Sanitary District as of June 30, 2012 and the results of its activities and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America as well as accounting systems prescribed by the State controller's Office and state requirements governing special districts.

The Management's Discussion and Analysis on pages two to six, is presented for purposes of additional analysis and is not a required part of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, I have also issued my report dated November 6, 2012 in consideration of East Palo Alto Sanitary District's internal controls over financial reporting and my test of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards*, and should be read in conjunction with this report in considering the results of the audit.

CHRISTOPHER CHIME OGBODO

Certified Public Accountant

Oakland, California
November 6, 2012

**EAST PALO ALTO SANITARY DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2012**

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 two components: 1) the financial statements and 2) notes to the financial statements that explain in more detail some of the information in the financial statements.

Required Financial Statements

The financial statements of the District report information about the District using accounting methods similar to those used by private-sector companies. These statements provide both long term and short-term information about the District's overall financial status.

The Statement of Net Assets presents information on all of the District's assets and liabilities, with the difference between the two reported as net assets. This statement provides information about the nature and the amounts of investments in resources (assets) and the obligations to District creditors (liabilities). It provides one way to measure the financial health of the District by providing the basis for evaluating the capital structure of the District and assessing the liquidity and financial flexibility of the District. However, there are several outside nonfinancial factors that need to be considered. Factors such as changing economic conditions, population and customer growth, and new or changed rules and regulations should also be considered.

All of the current year's revenue and expenses are accounted for in the Statement of Revenues, Expenses, and Changes in Net Assets. This statement measures the success of the District's operations over the past year and can be used to determine whether the District has successfully recovered all its cost through its user fees.

The final required statement is the Statement of Cash Flows. The statement reports cash receipts, cash payments, and net changes in cash resulting from operations, investing, and financing activities. This statement provides answers to such questions as where did cash come from, what was cash used for, and what was the change in the cash balance during the reporting period.

Financial Analysis of the District

As previously noted, net assets may serve over time as a useful indicator of an entity's financial position. In the case of the District, assets exceeded liabilities by \$12,872,057 at the close of the most recent fiscal year. As can be seen in Table A , on the next page, the largest portion of the District's net assets (48%) reflect its investment in capital assets (e.g., sewers, buildings, machinery and equipment), less any related debt used to acquire those assets that is still outstanding. These capital assets are used primarily in the collection and treatment of wastewater throughout the District's service area. The related debt will be repaid with resources provided by system users through rates and fees.

**EAST PALO ALTO SANITARY DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2012**

**Table A
Summary of Net Assets**

A summary of the statements of net assets as of June 30, 2012 and 2011 is shown in the following table:

	<u>2012</u>	<u>2011</u>	<u>Change</u>
Current assets	\$ 9,289,573	\$ 8,174,409	\$ 1,115,164
Noncurrent assets	112,520	141,868	(29,348)
Net capital assets	<u>6,279,949</u>	<u>5,054,904</u>	<u>1,225,045</u>
Total assets	<u>15,682,042</u>	<u>13,371,181</u>	<u>2,310,861</u>
Current liabilities	488,384	487,492	892
Noncurrent liabilities	<u>2,321,601</u>	<u>1,607,050</u>	<u>714,551</u>
Total liabilities	<u>2,809,985</u>	<u>2,094,542</u>	<u>715,443</u>
Net assets	<u><u>\$ 12,872,057</u></u>	<u><u>\$ 11,276,639</u></u>	<u><u>\$ 1,595,418</u></u>

Net assets increased \$1,595,418 in 2012. The increases are a combination of income in the form of connection fees, assessments, and other income.

Current assets increased by \$1,115,164 compared to the prior year primarily due to:

- An increase in cash of \$1,115,164 as detailed in the statement of cash flows on page 9

Noncurrent assets decreased \$29,348 primarily due to amortization expenses and a decrease in notes receivable.

Current liabilities decreased 892 due to an increase in accounts payable of \$2,172, decreased in accrued liabilities of \$65,362, increase in current portion of long term debt of \$64,082.

**EAST PALO ALTO SANITARY DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2012**

**Table B
Summary of Revenues
Expenses and Changes in Net Assets**

	<u>2012</u>	<u>2011</u>	<u>Change</u>
Total operating revenues	\$ 4,874,888	\$ 4,135,597	\$ 739,291
Total operating expenses	<u>(3,550,562)</u>	<u>(3,055,643)</u>	<u>(494,919)</u>
Operating Income (loss)	1,324,326	1,079,954	244,372
Total nonoperating revenues and expenses	<u>271,092</u>	<u>389,562</u>	<u>(118,470)</u>
Increase in net assets	1,595,418	1,469,516	125,902
Net assets , beginning of year	<u>11,276,639</u>	<u>9,807,123</u>	<u>1,469,516</u>
Net assets, end of year	<u><u>\$ 12,872,057</u></u>	<u><u>\$ 11,276,639</u></u>	<u><u>\$ 1,595,418</u></u>

While the Summary of Net Assets (Table A) shows the change in financial position of net assets, (Table B) shows the Summary of Revenues, Expenses, and Changes in Net Assets and provides details as to the nature and source of these changes.

Table B shows that during 2012 total operating revenues increased \$739,291. Operating expenses increased by \$494,919. Non operating revenue and expenses decreased by \$111,296. The major factors which contributed to these results include:

- The increase in operating revenues of \$739,291 was primarily the result of rate increase in sewerage service charges of \$187,083 and increased in other revenues of \$552,208
- The increase in operating expenses of \$494,919 was due to an increase in personnel services of \$132,234 increase in purchased services of \$255,051, an increase in depreciation of \$7,243 and a decrease in other expenses of \$100,391.
- The decrease of \$118,470 in non-operating revenues and expenses was due to an increase in interest income of \$ 25,443, a decrease in property tax collections of \$152,118 and a decrease in interest expense of \$8,205.

**EAST PALO ALTO SANITARY DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2012**

BUDGETARY HIGHLIGHTS

The District has an annual operating budget that is approved by its Board of Directors. Capital budgets are approved on a project by project basis, annually as a part of an overall five (5) year projected spending plan also approved by the Board of Directors. The 2012 expenses were under the approved budget. The principal areas of savings were the use of televising equipment to more accurately identify sewer line breaks, and the delaying of some City of Palo Alto Redevelopment Projects which required sewer line improvements. The delayed projects are currently being rescheduled as a part of the District's new sewer master plan study.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

As of June 30, the District's investment in capital assets amounted to \$6.28 million and \$5.05 million (net of accumulated depreciation) as shown in Table C for 2012 and 2011, respectively. In 2012, the District spent \$1,341,384 on construction in progress, \$127,392 on building renovations and \$41,539 on furniture.

**Table C
Capital Assets**

	2012	2011	Change
Land	\$ 184,601	\$ 184,601	\$ -
Construction in progress	\$ 1,341,384		\$ 1,341,384
Sewer collection facilities	5,582,702	5,582,702	\$ 0
Buildings	2,344,522	2,217,130	\$ 127,392
Furniture and equipment	1,891,663	1,850,124	\$ 41,539
Accumulated depreciation	(5,064,923)	(4,779,653)	(285,270)
Net fixed assets	<u>\$ 6,279,949</u>	<u>\$ 5,054,904</u>	<u>\$ 1,225,045</u>

**EAST PALO ALTO SANITARY DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2012**

Debt Administration

The District has financed its construction program primarily through the issuance of revenue bonds. Additional information on the District's long-term debt can be found in Note 6 to the financial statements.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

The service area of the District is best described as mature. The District is not in a growth situation but one in which the system is continually televised, upgraded and repaired on an as-needed basis.

Requests for Information

The financial report is designed to provide a general overview of the District's finances and operations for all those with an interest in the District's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to:

Office of the General Manager
East Palo Alto Sanitary District
901 Week Street
Palo Alto, CA 94303

EAST PALO ALTO SANITARY DISTRICT

Statement of Net Assets

June 30, 2012

Assets

Current assets:

Cash and cash equivalents	\$ 9,263,450
Accounts receivable	<u>26,123</u>
Total current assets	<u>9,289,573</u>

Noncurrent assets:

Notes receivable	40,630
Other Assets	71,890
Capital assets:	
Construction in Progress	1,341,384
Land	184,601
Sewer collection facilities	5,582,702
Buildings	2,344,522
Furniture and equipment	1,891,663
Less accumulated depreciation	<u>(5,064,923)</u>
Total noncurrent assets	<u>6,279,949</u>
Total assets	<u>15,682,042</u>

Liabilities

Current liabilities:

Accounts payable	18,500
Accrued liabilities	95,558
Current portion of long term debt	<u>374,326</u>
Total current liabilities	488,384

Noncurrent liabilities:

Bonds and notes payable	<u>2,321,601</u>
Total liabilities	<u>2,809,985</u>

Net assets

Invested in capital assets	3,911,819
Unrestricted	<u>8,960,238</u>
Net assets	\$ <u>12,872,057</u>

See accompanying notes to the financial statements.

EAST PALO ALTO SANITARY DISTRICT
Statement of Revenues, Expenses and Changes in Net Assets
For the Year Ended June 30, 2012

Operating revenues

Sewerage service charges	\$ 4,059,351
All other revenues	<u>815,537</u>
Total operating revenue	<u>4,874,888</u>

Operating expenses

Personnel services	1,400,281
Purchased services	1,531,527
Utilities, fuel and supplies	83,795
Depreciation and amortization	311,015
Other expenses	<u>223,944</u>
Total operating expenses	<u>3,550,562</u>

Operating Income	<u>1,324,326</u>
------------------	------------------

Nonoperating revenues (expenses)

Property taxes	315,418
Interest income	60,901
Interest expense	<u>(105,227)</u>
Total nonoperating revenues (expenses)	<u>271,092</u>

Increase in net assets	1,595,418
------------------------	-----------

Net assets, beginning of year	<u>11,276,639</u>
Net assets, end of year	<u>\$ 12,872,057</u>

See accompanying notes to the financial statements.

EAST PALO ALTO SANITARY DISTRICT

Statement of Cash Flows
For the Year Ended June 30, 2012

Cash flows from operating activities

Cash receipts from customers	\$ 4,729,816
Cash payments to suppliers for goods and services	(1,403,634)
Cash payments to employees for services	<u>(1,837,094)</u>
Net cash used in operating activities	<u>1,489,088</u>

Cash flows from noncapital financing activities

Property taxes	<u>315,418</u>
Net cash provided by noncapital financing activities	<u>315,418</u>

Cash flows from capital and related financing activities

Acquisition of capital assets	(1,510,314)
Principal paid on debt	310,244
Revolving fund loan	1,088,877
Interest paid on debt	(98,053)
Payment of note receivable	<u>3,602</u>
Net cash provided by capital and related financing activities	<u>(826,132)</u>

Cash flows from investing activities

Interest received	<u>60,901</u>
Net cash provided by investing activities	<u>60,901</u>

Net change in cash and cash equivalents 1,115,164

Cash and cash equivalents, beginning of year 8,148,286

Cash and cash equivalents, end of year \$ 9,263,450

See accompanying notes to the financial statements

EAST PALO SANITARY DISTRICT
Statement of Cash Flows (Continued)
For the Year Ended June 30, 2012

Reconciliation of operating loss to net cash used in operating activities:	
Operating income	\$1,324,326
Adjustments to reconcile operating income to	
Net cash used in operating activities:	
Depreciation and amortization	<u>311,015</u>
	1,559,452
 Changes in operating assets and liabilities:	
Increase (decrease) in:	
Accounts payable and other	2,172
Accrued liabilities	<u>(72,536)</u>
 Net cash used in operating activities	<u>\$1,489,088</u>

See accompanying notes to the financial statements.

EAST PALO ALTO SANITARY DISTRICT
NOTES TO FINANCIAL STATEMENTS
June 30, 2012

NOTE 1- DEFINITION OF REPORTING ENTITY

The basic financial statements of the East Palo Alto Sanitary District (the District) include the financial activity of the East Palo Alto Sanitary District Financing Corporation (the Corporation), a component unit of the District. All significant inter-entity transactions have been eliminated.

The Corporation is a nonprofit public benefit corporation established in fiscal 1991 to provide financial assistance to the District by financing improvements to the District's sewer collection system and to refinance the purchase and renovation of the District's administration building. The Corporation has no employees. The District is governed by a five-member Board of Directors elected at large to four-year terms by residents within the District. These Directors also serve as Directors of the Corporation.

NOTE 2- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Basis of Presentation

Government-wide Financial Statements

The statement of net assets and statement of activities display information about the District. These statements include the financial activities of the overall government, except for the fiduciary activities. The District does not have fiduciary activities. Eliminations would have been made to minimize the double counting of internal service fund activities but the District has no internal service fund activities. Business type activities normally rely, to a significant extent, on fees charged to external parties.

The statements of activities present a comparison between direct expenses and program revenues for each function of the business type activities. Direct expenses are those that are specifically associated with a service, program or department and are therefore clearly identifiable to a particular function. Program revenues include charges paid by the recipient of goods or services offered by the programs. Revenues that are not classified as program revenues, including all taxes, are presented as general revenues. The comparison of program revenues and expenses identifies the extent to which each program is self-financing or draws from the general revenues of the District.

When both restricted and unrestricted net assets are available, restricted resources are used only after the unrestricted resources are depleted.

Fund Financial Statements

Fund financial statements are organized into funds, each of which is considered to be separate accounting entities. Each fund is accounted for by providing a separate set of self-balancing accounts that constitute its assets, liabilities, fund equity, revenues and expenditure/expenses. Funds are organized into three major categories; governmental, proprietary and fiduciary. These are separate statements for each fund category. The emphasis of fund financial statements is on major governmental and enterprise funds rather than reporting funds by type. Each major fund is presented in a separate column. Non-major funds are aggregated and presented in a single column. The internal service fund is presented in a single column in the proprietary fund financial statements. The District has no governmental, fiduciary, or internal service funds.

EAST PALO ALTO SANITARY DISTRICT
NOTES TO FINANCIAL STATEMENTS
June 30, 2012

NOTE 2- SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Proprietary fund *operating* revenues, such as charges for services, result from exchange transactions associated with the principal activity of the fund. Exchange transactions are those in which each party receives and gives up essentially equal values. *Non-operating* revenues, such as subsidies and investment earnings, result from non-exchange transactions or ancillary activities.

Proprietary Fund

The District has one proprietary fund:

- *Enterprise Fund* accounts for operations that are financed and operated in a manner similar to private business enterprises, where the intent of the governing body is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered, primarily through user charges. The whole District is an enterprise fund.

B. Basis of Accounting

The accounting policies of the District and the Corporation conform to generally accepted accounting principles for special districts. The accounts are maintained on the accrual basis in accordance with Uniform System of Accounting for Waste Disposal Districts.

C. Cash and Cash Equivalents

The District's cash and cash equivalents are invested pursuant to investment policy guidelines established by the County Treasurer of San Mateo. The objectives of the policy are, in order of priority, preservation of capital, liquidity and yield. The policy addresses soundness of financial institutions in which the County will deposit funds, types of investments as permitted by the California Government Code and the percentage of the portfolio which may be invested in certain instruments with longer terms of maturity. The District considers all highly liquid unrestricted investments with maturity of three months or less when purchased to be cash equivalents.

D. Capital Assets

The cost of additions to utility plant and major replacements of property is capitalized. Costs include material, direct labor, transportation and such indirect items as interest, engineering, supervision and employee fringe benefits. Contributed property is recorded at fair market value at the date of donation. Repairs, maintenance and minor replacements of property are charged to expense.

Depreciation computed on a straight-line basis over the estimated useful lives of the property as follows:

Sewer Collection facilities	50 years
Building	30 years
Furniture and Equipment	10 years
Computers	5 years

EAST PALO ALTO SANITARY DISTRICT
NOTES TO FINANCIAL STATEMENTS
June 30, 2012

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

E. Sewer Service Charges

Sewer service charges are billed and collected, on behalf of the District, by San Mateo County (the County) as a separate component of semi-annual property tax billings. Property taxes are levied on March 1 and are due in equal installments on November 1 and February 1. The County remits to the District all amounts due, under the Teeter Plan.

F. Sewer Connection Fees

Sewer connection fees represent one-time charges, which are due upon connection to the system.

G. Bond Issuance Costs

Bond issuance costs are recorded as an asset and are amortized on a straight-line basis over the life of the related debt issue.

H. Equity Classifications

In the government-wide and proprietary fund financial statements, equity is classified as net assets and divided into three components:

- *Invested in Capital Assets, Net of Related Debt*---This category groups all capital assets into one component of net assets, Accumulated depreciation and the outstanding balances of debt that are attributable to the acquisition, construction or improvements of these assets reduce the balance in this category.
- *Restricted Net Assets*---This category pertains to the amount restricted by law for future capital project expenditures.
- *Unrestricted Net Assets*--- This category represents net assets of the District, not restricted for any project or other purpose.

I. Use of Estimates and Assumptions

The preparation of financial statements in conformity with generally accepted accounting principles in the United States of America require management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period.

EAST PALO ALTO SANITARY DISTRICT
NOTES TO FINANCIAL STATEMENTS
June 30, 2012

NOTE 3 – POOLED CASH AND INVESTMENTS

Pooled Cash

The County maintains a cash investment pool that is available for use by all funds with various financial institutions and a safekeeping agent. Statutes authorize the County to invest in obligations of the U.S. Treasury, Agencies, and instrumentalities, commercial paper rated A-I by Standard & Poor's Corporation or P-1 by Moody's Commercial Paper Record, bankers' acceptances repurchase agreements and the State Treasurer's investment pool. The County is also authorized to enter into reverse repurchase agreements.

The deposit and investment risks of the District are required to be disclosed as follows:

- Deposits that are covered by depository insurance and are (a) uncollateralized, (b) collateralized with securities held by the pledging financial institution, or (c) collateralized with securities held by the pledging financial institution's trust department or agent but not in the depositor-government's name. All of the District's cash and investments fall under this group.
- Investment securities that are insured, are not registered in the name of the government, and are held by either (a) the counterparty or (b) the counterparty's trust department or agent but not in the government's name.

Cash and investments at June 30, 2012 consist of the following:

<u>Description</u>	<u>Carrying Value</u>	<u>Fair Value</u>
Cash and investments with San Mateo County Treasurer	\$ 9,149,317	\$ 9,149,317
Cash in bank	114,133	114,133
Total cash and investments	<u>\$ 9,263,450</u>	<u>\$ 9,263,450</u>

The District maintains checking accounts with California Bank and Trust. As of June 30, 2012, the balance of these checking accounts was \$114,133. This balance is insured by the Federal Deposit Insurance Corporation up to \$ 250,000.

EAST PALO ALTO SANITARY DISTRICT
NOTES TO FINANCIAL STATEMENTS
June 30, 2012

NOTE 4- CAPITAL ASSETS

The following is a summary of the changes in capital assets for the year ended June 30, 2012

	<u>June 30, 2011</u>	<u>Additions</u>	<u>Deletions</u>	<u>June 30, 2012</u>
<i>Non-depreciable capital assets:</i>				
Land	\$ 184,601	\$ -	\$ -	\$ 184,601
Total non-depreciable capital assets, gross	<u>184,601</u>			<u>184,601</u>
<i>Depreciable capital assets:</i>				
Construction in progress		1,341,383		1,341,383
Sewer collection Facilities	5,582,702		-	5,582,702
Buildings	2,217,130	127,392		2,344,522
Furniture and equipment	<u>1,850,124</u>	<u>41,539</u>		<u>1,891,663</u>
Total depreciable capital assets, gross	<u>9,649,956</u>	<u>1,510,314</u>	<u>-</u>	<u>11,160,270</u>
Less accumulated depreciation	<u>(4,779,653)</u>	<u>(285,269)</u>		<u>(5,064,922)</u>
Total depreciable capital assets, net	<u>4,870,303</u>	<u>1,225,045</u>		<u>6,095,348</u>
Capital assets, net	<u>\$ 5,054,904</u>	<u>\$ 1,225,045</u>	<u>\$ -</u>	<u>\$ 6,279,949</u>

The District owns 11.90% of capacity rights of the City of Palo Alto Treatment Plant. Operation and maintenance of these treatment and outfall facilities are the responsibility of the City, with the Sanitary District paying its proportionate share based on actual levels of flow. The District's investment in the City Treatment Plant is included in the District's capital assets.

NOTE 5- SEWER TREATMENT FACILITIES CAPACITY RIGHTS

The District has an agreement with the city of Palo Alto whereby the District has rights to a specified capacity (11.90%) of the City's sewer treatment plant. The carrying value of such rights represents the District's share of construction costs relating to expansion and improvements of the City's treatment plant, net of amortization. The District is amortizing such cost (\$85,421 per year) over twenty-five years, the approximate life of the treatment Plant.

Under the terms of the agreement, the District must also pay a share of the operating cost on an annual basis for the treatment of sewage. For the years ended June 30, 2012, such annual operating cost was \$902,657.

EAST PALO ALTO SANITARY DISTRICT
NOTES TO FINANCIAL STATEMENTS
June 30, 2012

NOTE 6- LONG-TERM DEBT

Long-term debt at June 30, 2012 is summarized as follows:

Description	Final Maturity Date	Interest Rate	Balance June 30, 2012	Current Portion	Long-term Portion
(A) 2000 Installment sale of bonds	2014	5.75%	\$ 772,100	\$ 243,100	\$ 529,000
(B) Palo Alto 1990 Utility Revenue Bonds	2024	5.75%	289,856	18,344	271,512
(B) Palo Alto 2000 Utility Revenue Bonds	2024	5.75%	356,788	22,538	334,250
(C) Vactor Truck Note	2016	4.75%	188,306	43,815	144,491
(D) State Revolving Fund Loan	2032	2.60%	\$ 1,088,877	\$ 46,529	\$ 1,042,348
Total			<u>\$ 2,695,927</u>	<u>\$ 374,326</u>	<u>\$ 2,321,601</u>

- A. The 2000 Installment Sale of Bonds represents indebtedness to Municipal Leasing Associates, Inc. in connection with the discharge of the 1990 Installment Sale Agreement used to finance the acquisition and construction of the District's sewer system improvements.
- B. The 1990 Utility Revenue Bonds (Refinanced in 2000) represents the District's portion of the City of Palo Alto's debt related to the City of Palo Alto's treatment plant (see Note 5). The District is liable to the City for this debt as long as the District utilizes the City's treatment plant.
- C. The Vactor Truck Note is for the purchase of a sewer vacuum truck with Municipal Finance Corporation.
- D. State Revolving Fund Loan is for financing the construction of the Cured in Place Siphoning Project. The loan is with the State Water Resources Control Board.

Deferred costs on refinancing as presented in the balance sheet will be amortized over the shorter of the remaining life of the new debt or the life of the old debt. In this case, it is the life of the old debt and the deferred amount on refunding is being amortized over 14 years. As of June 30, 2012 the remaining balance of this deferred cost is \$71,890.

EAST PALO ALTO SANITARY DISTRICT
NOTES TO FINANCIAL STATEMENTS
June 30, 2012

NOTE 6- LONG-TERM DEBT (continued)

Maturities of long-term debt in each of the next five years and thereafter are as follows

City of Palo Alto 1990 (Refunded in 2000) Utility Revenue Bonds

2013	18,344	15,075	33,419
2014	19,159	14,158	33,317
2015	19,974	13,200	33,174
2016	21,197	12,201	33,398
2017	22,012	11,115	33,127
2018-2024	<u>189,170</u>	<u>42,131</u>	<u>231,301</u>
Subtotal	289,856	107,880	397,736

City of Palo Alto Utility Revenue Bond

2013	22,538	18,453	40,991
2014	23,302	17,326	40,628
2015	24,830	16,161	40,991
2016	25,594	14,919	40,513
2017	27,122	13,608	40,730
2018-2024	<u>233,402</u>	<u>51,406</u>	<u>284,808</u>
Subtotal	356,788	131,873	488,661

Vactor Truck Note

2013	43,814	8,430	52,244
2014	45,924	6,325	52,249
2015	48,129	4,117	52,246
2016	<u>50,439</u>	<u>1,804</u>	<u>52,243</u>
Subtotal	188,306	20,676	208,982

State Revolving Fund

2013	46,529	23,689	70,218
2014	43,117	27,101	52,249
2015	44,238	25,980	52,246
2016	45,388	24,830	52,243
2017-2032	<u>909,605</u>	<u>213,886</u>	<u>52,243</u>
Subtotal	1,088,877	315,486	1,404,363

EAST PALO ALTO SANITARY DISTRICT
NOTES TO FINANCIAL STATEMENTS
June 30, 2012

NOTE 7- PUBLIC EMPLOYEES' RETIREMENT PLAN

a. Plan Description and Provisions

East Palo Alto Sanitary District contributes to the California Public Employees' Retirement System (CalPERS), an agent multiple employer public employee retirement system that acts as a common investment and administrative agent for participating public entities within the State of California. Benefits provisions and all other requirements are established by state statutes. Copies of CalPERS annual financial report may be obtained from its Executive Office at 400 P Street, Sacramento, CA 95814.

b. Funding Policy

Active employees are required to contribute to CalPERS 7% of their annual covered salary. The District makes the contributions required of the District's employees on their behalf to their account. The East Palo Alto Sanitary District is required to contribute at an actuarially determined rate; the contribution rate for fiscal year ended June 30, 2012, is 5.215% for employees of annual covered payroll. The contribution requirements of plan members and the agency are established and may be amended by CalPERS.

c. Annual Pension Cost

For the fiscal year ended June 30, 2012, East Palo Alto Sanitary District's annual pension cost was \$ 119,788 for CalPERS, which was equal to 100% of the District's required actual contributions. The required contribution was determined as part of the June 30, 2009 actuarial valuation using the entry age normal actuarial cost method. The actuarial assumptions included (a) 7.75 % investment rate of return, (b) 3.0 % inflation rate and (c) 3.25 % across the board increase and merit increases that vary by length of service. In order to dampen the effect of short-term market value fluctuations on employer contribution rates, the following asset smoothing techniques are used. First, an Expected Value of Assets is computed by bringing forward the prior year's Actuarial Value of Assets and the contributions received and benefits paid during the year at the assumed actuarial rate of return. The Actuarial Value of Assets is then computed as the Expected Value of Assets plus one-third of the difference between the Actual Market Value of Assets and the Expected Value of Assets as of the valuation date. However, in no case will the Actuarial Value of Assets be less than 90% or greater than 110% of the Actual Market Value of Assets. The employer contribution rate for fiscal year ending June 30, 2012 was 16.710%.

d. Schedule of Funding Progress (Required Supplementary Information)

The District's Actuarial Assets are included in CalPERS total Risk Pool's History of Funded Status and Funding Progress. Because the District has less than 100 employees such Accrued Liabilities and Asset valuation are not required to be detailed in the Actuarial Report.

EAST PALO ALTO SANITARY DISTRICT
NOTES TO FINANCIAL STATEMENTS
June 30, 2012

NOTE 8- POST-EMPLOYMENT BENEFITS OTHER THAN PENSIONS (OPEB)

a. Plan Description

The District provides other post employment benefits (OPEB) through the California Employers' Retiree Benefit Fund (CERBT), an agent multiple-employer defined benefit healthcare plan administered by the California Public Employees' Retirement System (CalPERS). Benefits are provided to employees who retire at age 50 or older with five years of eligible CalPERS service. Coverage is also provided to eligible retirees, spouses and surviving spouses. These benefits are provided per contract between the District and the employee associations. Separate financial statements for the CERBT may be obtained by writing to CalPERS at Lincoln Plaza North 400 Q Street, Sacramento, CA 95814 or by visiting the CalPERS website at www.calpers.ca.gov.

b. Funding Policy

The District has indicated that the only OPEB provided are medical and dental plan coverage. The District has been under contract with CalPERS for medical plan coverage since 1994. The District's contribution will be based on each retiree's age and enrollment status. The contribution requirements of plan members and the District are established and may be amended by the District and the employee associations. Currently, contributions are not required from plan members.

A contribution of \$153,293 was made during the 2011-2012 fiscal year to cover the annual OPEB cost, to pay for the net OPEB obligation from the prior year and to fund a portion of future OPEB costs. As a result, the District calculated and recorded a net OPEB obligation (asset), representing the difference between the annual required contribution (ARC) and actual contributions, as presented below:

	2012	2011
Annual required contribution (ARC)	\$ 77,406	\$ 75,887
Contributions made	(153,293)	-0-
(Decrease)increase in net OPEB obligation	(75,887)	75,887
Net OPEB obligation (asset) - beginning of year	75,887	-0-
Net OPEB obligation (asset) - end of year	\$ -0-	\$ 75,887

The District's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan and the net OPEB (obligation) asset for 2011-2012 and the two preceding years were as follows:

Fiscal Year Ended	Annual OPEB Cost	Actual Contribution	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation (Asset)
6/30/2010	\$ 80,408	\$ 80,408	100%	\$ -0-
6/30/2011	\$ 75,887	\$ -0-	0%	\$ 75,887
6/30/2012	\$ 77,406	\$ 153,293	100%	\$ -0-

EAST PALO ALTO SANITARY DISTRICT
NOTES TO FINANCIAL STATEMENTS
June 30, 2012

NOTE 8– POST-EMPLOYMENT BENEFITS OTHER THAN PENSIONS (OPEB) (continued)

c. Funded Status and Funding Progress

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the District 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 below 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. Only two years are presented as there is not complete multiyear trend information to present.

Valuation Type	Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability	Unfunded Actuarial Accrued Liability	Funded Ratio	Covered Payroll	UAAL as a % of covered Payroll	Interest rate
Actual	1/1/2008	\$ 101,295	\$455,360	\$354,065	22.2%	\$690,872	51.2%	7.75%
Actual	7/1/2011	\$227,878	\$560,420	\$332,542	40.7%	\$758,410	43.8%	7.50%

d. Actuarial Methods and Assumptions

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and the plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short term volatility in the actuarial accrued liabilities and the actuarial value of assets. In the July 1, 2011, actuarial valuation, the entry age normal cost method was used. The actuarial value of assets is set equal to the reported market value of assets. The UAAL is being amortized as a level percentage of payrolls on a closed basis. The remaining amortization period at June 30, 2012, was twenty-seven years. The number of active participants is 9.

**EAST PALO ALTO SANITARY DISTRICT
NOTES TO FINANCIAL STATEMENTS
June 30, 2012**

NOTE 9- CUSTOMERS AND RATES

The following rates were in effect for the year ended June 30, 2012:

Maximum Rates	
RESIDENTIAL	
Annual charge per dwelling unit *	\$520
COMMERCIAL/INDUSTRIAL	
Rate per hundred cubic feet of metered water use from prior year	
Restaurant	\$7.5417
Motel/Hotel	4.3299
Office	3.9193
General commercial	4.3310
Church	3.9193
Industrial	4.6430
Schools	4.1729
Medical	4.8289
Recreational	4.3299
* Applies to each dwelling unit per single family residence, duplex, triplex, apartment, multi-family, hotel/motel, auto court, rooming house, trailer park, mobile home, cottage, flat.	



CHRISTOPHER CHIME OGBODO

CERTIFIED PUBLIC ACCOUNTANT

**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
East Palo Alto Sanitary District
East Palo Alto, California

I have audited the basic financial statements of East Palo Alto Sanitary District as of and for the year ended June 30, 2012, and have issued my report thereon dated November 6, 2012. I conducted the audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing my audit, I considered East Palo Alto Sanitary District's internal control over financial reporting as a basis for designing my auditing procedures for the purpose of expressing my opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of East Palo Alto Sanitary District's internal control over financial reporting. Accordingly, I do not express an opinion on the effectiveness of East Palo Alto Sanitary District's internal control over financial reporting.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or 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.

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

Compliance and Other Matters

As part of obtaining reasonable assurance about whether East Palo Alto Sanitary District's financial statements are free of material misstatement, I 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 my audit, and accordingly, I do not express such an opinion. The results of my tests disclosed no instances of noncompliance or other matters that are required to be reported under Government Auditing Standards. I noted other matters that I reported to management of East Palo Alto Sanitary District in a separate letter.

This report is intended for the information of the audit committee, management, and federal award agencies and pass-through entities and is not intended to be and should not be used by anyone other than those specified parties.

CHRISTOPHER CHIME OGBODO
Certified Public Accountant

Oakland, California
November 6, 2012

Summary of Auditor's Results

EAST PALO ALTO SANITARY DISTRICT
Summary Schedule of Prior Audit Findings
For the Years Ended June 30, 2012

Financial Schedule Findings

The audit of the basic financial statements of the East Palo Alto Sanitary District as of and for the years ended June 30, 2012, disclosed no findings nor questioned costs.

The unqualified report on East Palo Alto Sanitary District's compliance and on internal control over financial reporting based on an audit of the basic financial statements performed in accordance with *Government Auditing Standards* as of and for the years ended June 30, 2012, disclosed no findings nor questioned costs.

Federal Award Findings and Questioned Costs

Not Applicable