

**EAST PALO ALTO SANITARY DISTRICT
BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2014**

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**EAST PALO ALTO SANITARY DISTRICT
BASIC FINANCIAL STATEMENTS
For the Year Ended June 30, 2014**

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INDEPENDENT AUDITOR'S REPORT

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

We have audited the accompanying financial statements of the East Palo Alto Sanitary District (District) as of and for the year ended June 30, 2014, and the related notes to the financial statements, which collectively 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 the 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 audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the 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 District'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 District's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the District as of June 30, 2014, and changes in financial position and cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of a Matter

Management adopted the provisions of the *Governmental Accounting Standards Board Statement 65- Items Previously Reported as Assets and Liabilities*, which became effective during the year ended June 30, 2014. See Note 1K to the financial statements for relevant disclosures.

The emphasis of this matter does not constitute a modification to our opinion.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that Management's Discussion and Analysis, 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 November 26, 2014 on our consideration of the 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 the 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.



Pleasant Hill, California
November 26, 2014

EAST PALO ALTO SANITARY DISTRICT
STATEMENT OF NET POSITION
JUNE 30, 2014

ASSETS

Current Assets:

Cash and investments (Note 2)	\$11,269,883
Prepaid insurance	<u>22,673</u>
Total Current Assets	<u>11,292,556</u>

Noncurrent Assets:

Notes receivable	32,494
OPEB asset (Note 7)	16,188
Capital assets (Note 3):	
Land	184,601
Sewer collection facilities	6,007,857
Cured in place pipe	1,474,518
Buildings	2,460,036
Furniture and equipment	1,938,467
Less accumulated depreciation	<u>(5,639,086)</u>
Total capital assets, net	<u>6,426,393</u>
Total Non-Current Assets	<u>6,475,075</u>

TOTAL ASSETS	<u>17,767,631</u>
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LIABILITIES

Current Liabilities

Accounts payable	82,062
Accrued liabilities	70,132
Long-term debt, current portion (Note 5)	<u>414,347</u>
Total Current Liabilities	<u>566,541</u>

Noncurrent Liabilities

Long-term debt (Note 5)	<u>1,644,170</u>
Total Long-Term Liabilities	<u>1,644,170</u>
Total Liabilities	<u>2,210,711</u>

NET POSITION (Note 8)

Net investment in capital assets	4,367,876
Unrestricted	<u>11,189,044</u>
Total Net Position	<u><u>\$15,556,920</u></u>

See accompanying notes to financial statements

EAST PALO ALTO SANITARY DISTRICT
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION
FOR THE YEAR ENDED JUNE 30, 2014

OPERATING REVENUES:

Sewer service charges	\$4,205,285
Other revenues	97,405
Total Operating Revenues	4,302,690

OPERATING EXPENSES:

Personnel services	1,368,152
Purchased services	1,487,177
Utilities, fuel and supplies	83,742
Depreciation and amortization	340,840
Other expenses	211,477
Total Operating Expenses	3,491,388

NET OPERATING INCOME 811,302

NONOPERATING REVENUE (EXPENSE)

Property taxes	471,200
Pass through receipts	203,873
Interest income	60,359
Interest expense	(167,534)
Other revenue	132,468
Nonoperating revenue, net	700,366

CHANGE IN NET POSITION 1,511,668

NET POSITION AT BEGINNING OF YEAR 14,045,252

NET POSITION AT END OF YEAR \$15,556,920

See accompanying notes to financial statements

EAST PALO ALTO SANITARY DISTRICT
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2014

CASH FLOWS FROM OPERATING ACTIVITIES	
Receipts from customers and users	\$4,328,813
Payments to suppliers	(1,738,354)
Payments to employees	<u>(1,368,152)</u>
Cash Flows provided by Operating Activities	<u>1,222,307</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES	
Property taxes	471,200
Pass through receipts	<u>203,873</u>
Net Cash Flows provided by Noncapital Financing Activities	<u>675,073</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES	
Acquisition and construction of capital assets	(531,396)
Principal paid on debt	(393,976)
Interest paid on debt	(167,534)
Payment of note receivable	4,288
Other	<u>106,588</u>
Cash Flows provided (used) by Capital and Related Financing Activities	<u>(982,030)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:	
Interest received	<u>60,359</u>
Cash Flows from Investing Activities	<u>60,359</u>
NET CASH FLOWS	975,709
Cash and cash equivalents at beginning of year	<u>10,294,174</u>
Cash and cash equivalents at end of year	<u><u>\$11,269,883</u></u>
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES	
Operating income	\$811,302
Adjustment to reconcile operating income to net cash provided by operating activities:	
Depreciation and amortization expense	340,840
Change in assets and liabilities:	
Receivables, net	26,123
Prepaid expenses	(5,610)
Accounts payable and accrued expenses	<u>49,652</u>
Net cash provided by operating activities	<u><u>\$1,222,307</u></u>

See accompanying notes to financial statements

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**EAST PALO ALTO SANITARY DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS
For the Year Ended June 30, 2014**

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. *Description of the Reporting Entity*

The financial statements of East Palo Alto Sanitary District (District) include the financial activities of the District as well as the financial activity of the East Palo Alto Sanitary District Financing Corporation (Corporation), a component unit of the District. The Corporation is a nonprofit public benefit corporation established in fiscal year 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.

B. *Basis of Presentation and Accounting*

Basic Financial Statements are prepared in conformity with accounting principles generally accepted in the United States of America. The Governmental Accounting Standards Board is the acknowledged standard setting body for establishing accounting and financial reporting standards followed by governmental entities in the United States.

These Standards require that the financial statements described below be presented.

The Statement of Net Position and the Statement of Activities display information about the East Palo Alto Sanitary District. Business-type activities are financed in whole or in part by fees charged to external parties.

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. Nonoperating revenues, such as interest income and connection fees, result from nonexchange transactions or ancillary activities.

Enterprise funds are accounted for on the flow of economic resources measurement focus utilizing full accrual accounting. Under this method, assets and revenues are recorded when earned, and liabilities and expenses are recorded when the related obligations are incurred.

C. *Budgets and Budgetary Accounting*

East Palo Alto Sanitary District adopts an operating budget at the beginning of each year for the following fiscal year. The District General Manager is authorized to transfer any unencumbered amounts from one department to another within the same major account and to transfer any unencumbered appropriation from one line item account to another within the same major account. The major accounts are defined as salaries and employee benefits, maintenance and operation, capital outlay and reserves. Any additional appropriations require approval by the Board of Directors.

EAST PALO ALTO SANITARY DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS
For the Year Ended June 30, 2014

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

D. *Cash and Cash Equivalents*

For purposes of the statement of cash flows, cash equivalents include time deposits, certificates of deposit, and all highly liquid debt instruments with original maturities of three months or less.

E. *Compensated Absences*

The District records the expense of employees' vacation and sick leave benefits in the period in which they accumulate and become vested. At June 30, 2014, the balance is \$52,218, and is included in accrued liabilities on the Statement of Net Position.

F. *Capital Assets*

The cost of additions to utility plant and major replacements of property is capitalized. Costs include material, direct labor, transportation and indirect items such as interest, engineering, supervision and employee fringe benefits. Contributed property is recorded at estimated fair market value at time of acquisition. Capital assets are defined by the District as assets with an initial, individual cost of more than \$500 and an estimated useful life in excess of one year.

Depreciation is 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

G. *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 all amounts due, under the Teeter Plan.

H. *Sewer Connection Fees*

Connection fees represent a one-time contribution of resources to the District imposed on contractors and developers for the purpose of financing growth-related construction and improvements. Connection fees are recognized as other non-operating revenues in the statement of revenues, expenses and Changes in Net Position. Any cumulative fees collected in excess of amounts expended are shown as restricted net position.

I. *Bond Issuance Costs*

Bond issuance costs are expensed in the year of the debt issuance.

**EAST PALO ALTO SANITARY DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS
For the Year Ended June 30, 2014**

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

J. Use of Estimates

The preparation of basic financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

K. Implementation of Governmental Accounting Standards Board (GASB) Statements

GASB Statement No. 65 – (Items Previously Reported as Assets and Liabilities). This statement establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities.

The provisions of this Statement are effective for financial statements for periods beginning after December 15, 2012. This Statement required the District to remove its remaining unamortized bond issuance costs of \$20,400, previously reported as a non-current asset on the Statement of Net Position as of June 30, 2013. As the balance did not materially impact the District’s net position, the balance was expensed in the current fiscal year ended June 30, 2014.

NOTE 2 – CASH AND INVESTMENTS

A. Policies and Classification

California Law requires banks and savings and loan institutions to pledge government securities with a market value of 110% of the District’s cash on deposit, or first trust deed mortgage notes with a market value of 150% of the deposit, as collateral for these deposits. Under California Law this collateral is held in a separate investment pool by another institution in the District’s name and places the District ahead of general creditors of the institution.

The District’s investments are carried at fair value, as required by generally accepted accounting principles. The District adjusts the carrying value of its investments to reflect their fair value at each fiscal year end, and it includes the effects of these adjustments in income for that fiscal year.

The District’s cash and investments consist of the following at June 30, 2014:

Deposits with financial institutions	\$105,194
Cash and investments with San Mateo County Treasurer	11,164,689
Total cash and investments	\$11,269,883

The District has authorized staff to invest cash with the San Mateo County Treasurer in a series of pooled accounts with cash from various other governmental entities within the County, for investment purposes. The County’s investment policies are governed by State statutes.

**EAST PALO ALTO SANITARY DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS
For the Year Ended June 30, 2014**

NOTE 2 – CASH AND INVESTMENTS (Continued)

In addition, the County has an investment committee, which prescribes written investment policies regarding the types of investments that may be made. The policies limit amounts that may be invested in any one financial institution or amounts, which may be invested in long-term instruments. Interest earned from such time deposits and investments is allocated quarterly to the District based on its average daily cash balances. The fair value of the account at June 30, 2014 was provided by the County Treasurer.

NOTE 3 – CAPITAL ASSETS

Changes in property, plant and equipment accounts are summarized below:

	Balance at June 30, 2013	Additions	Balance at June 30, 2014
Capital assets not being depreciated:			
Land	\$184,601		\$184,601
Total capital assets not being depreciated	184,601		184,601
Capital assets being depreciated:			
Sewer collection facilities	5,582,702	\$425,155	6,007,857
Cured in place pipe	1,474,518		1,474,518
Buildings	2,388,217	71,819	2,460,036
Furniture and equipment	1,904,045	34,422	1,938,467
Total capital assets being depreciated:	11,349,482	531,396	11,880,878
Less accumulated depreciation for:			
Sewer collection facilities	2,469,798	115,905	2,585,703
Cured in place pipe	48,411	49,151	97,562
Buildings	1,335,530	91,014	1,426,544
Furniture and equipment	1,490,651	38,626	1,529,277
Total accumulated depreciation	5,344,390	\$294,696	5,639,086
Net capital assets being depreciated	6,005,092		6,241,792
Total Capital Assets, net	\$6,189,693		\$6,426,393

NOTE 4 – CAPACITY RIGHTS IN TREATMENT PLANT

The District has a contract with the City of Palo Alto whereby the District has rights to a specified capacity (11.90%) of the capacity of their sewage treatment facilities. 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.

The District is also required to pay a portion of the operating cost on an annual basis for the treatment of the sewage. For the year ending June 30, 2014, such annual operating cost was \$75,098.

**EAST PALO ALTO SANITARY DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS
For the Year Ended June 30, 2014**

NOTE 5 – LONG-TERM DEBT

A. Current Year Transactions and Balances

Long-term debt at June 30, 2014 is summarized as follows:

	Original Issue Amount	Balance June 30, 2013	Retirements	Balance June 30, 2014	Amount due within one year
2000 Installment sale of bonds 5.75%, due 10/01/2014	\$3,070,500	\$529,000	\$257,100	\$271,900	\$271,900
Palo Alto 1990 Utility Revenue Bonds 5.75%, due 6/30/2024	469,595	273,115	19,159	253,956	19,974
Palo Alto 2000 Utility Revenue Bonds 5.75%, due 6/30/2024	573,000	334,043	23,302	310,741	24,630
Vactor Truck Note 4.75%, due 3/31/2016	270,000	144,491	45,941	98,550	48,109
State Revolving Fund Loan 2.60%, due 1/31/32	1,225,420	1,171,844	48,474	1,123,370	49,734
Total Long-Term Debt		2,452,493	<u>\$393,976</u>	2,058,517	<u>\$414,347</u>
Less:					
Amount due within one year		<u>(393,956)</u>		<u>(414,347)</u>	
Total Long-Term Debt, net		<u>\$2,058,537</u>		<u>\$1,644,170</u>	

B. 2000 Installment Sale of Bonds

Represents indebtedness to Municipal Leasing Associates, Inc. in connection with the discharge of a 1990 Installment Sale Agreement used to finance the acquisition and construction of the District's sewer system improvements. The bonds are payable from revenues of the District.

C. Palo Alto 1990 Utility Revenue Bonds

Represents the District's portion of the City of Palo Alto's (City) debt related to the treatment plant (see Note 4). The District is liable to the City for this debt as long as the District utilizes the City's treatment plant. The bonds are payable from revenues of the District.

D. Palo Alto 2000 Utility Revenue Bonds

Represents a portion of the Palo Alto 1990 Utility Revenue Bonds which was refinanced. The bonds are payable from revenues of the District.

E. Vactor Truck Note

Represents a note with Municipal Finance Corporation for the purchase of a sewer vacuum truck. This note is payable from revenues of the District.

F. State Revolving Fund Loan

Represents a loan from the State Water Resources Control Board to finance the construction of the Cured in Place Siphoning Project. This loan is payable from revenues of the District.

**EAST PALO ALTO SANITARY DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS
For the Year Ended June 30, 2014**

NOTE 5 – LONG-TERM DEBT (Continued)

G. Debt Service Requirements

For The Year Ending June 30	Principal	Interest	Total
2015	\$414,347	\$70,503	\$484,850
2016	148,259	56,839	205,098
2017	101,488	51,370	152,858
2018	105,590	47,432	153,022
2019	109,748	43,375	153,123
2020 - 2024	615,470	148,683	764,153
2025 - 2029	338,594	56,116	394,710
2030 - 2032	225,021	11,801	236,822
Total payments due	<u>\$2,058,517</u>	<u>\$486,119</u>	<u>\$2,544,636</u>

NOTE 6 – DEFINED BENEFIT PENSION PLAN

Substantially all District employees are eligible to participate in pension plans offered by California Public Employees Retirement System (CALPERS), an agent multiple employer defined benefit pension plan which acts as a common investment and administrative agent for its participating member employers. CALPERS provides retirement and disability benefits, annual cost of living adjustments and death benefits to plan members, who must be public employees and beneficiaries. The District's employees participate in the Miscellaneous Plan. Benefit provisions under the Plan are established by State statute and District resolution. Benefits are based on years of credited service, equal to one year of full time employment. Funding contributions for the Plan are determined annually on an actuarial basis as of June 30 by CALPERS; the District must contribute these amounts. The District's labor contracts require it to pay employee contributions as well as its own. The Plans' provisions and benefits in effect at June 30, 2014, are summarized as follows:

	Miscellaneous Tier 1	Miscellaneous Tier 2
Hire Date	Prior to 1/1/13	On or after 1/1/13
Benefit vesting schedule	5 years service	5 years service
Benefit payments	monthly for life	monthly for life
Retirement age	50	60
Monthly benefits, as a % of annual salary	2.0 - 2.7%	2.0%
Required employee contribution rates	8%	N/A
Required employer contribution rates	17.523%	N/A
Annual pension cost, all paid	\$172,569	N/A

**EAST PALO ALTO SANITARY DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS
For the Year Ended June 30, 2014**

NOTE 6 – DEFINED BENEFIT PENSION PLAN (Continued)

CALPERS determines contribution requirements using a modification of the Entry Age Normal Method. Under this method, the District’s total normal benefit cost for each employee from date of hire to date of retirement is expressed as a level percentage of the related total payroll cost. Normal benefit cost under this method is the level amount the District must pay annually to fund an employee’s projected retirement benefit. This level percentage of payroll method is used to amortize any unfunded actuarial liabilities. The District does not have a net pension obligation since it pays these actuarially required contributions monthly. Annual Pension Costs, representing the payment of all contributions required by CALPERS, for the last three years were as follows:

Fiscal Year Ending	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation
<i>Miscellaneous Plan</i>			
June 30, 2012	\$144,838	100%	\$0
June 30, 2013	156,582	100%	0
June 30, 2014	172,569	100%	0

CALPERS uses the market related value method of valuing the Plan’s assets. Significant actuarial assumptions used to compute the actuarially determined contribution requirement for fiscal year 2014 include an investment rate of return of 7.50%, net of administrative expenses and assumed inflation at 2.75%. Annual salary increases are assumed to vary by duration of service. Changes in liability due to plan amendments, changes in actuarial assumptions, or changes in actuarial methods are amortized as a level percentage of payroll on a closed basis over twenty years. Investment gains and losses are accumulated as they are realized and amortized over a rolling thirty year period.

As required by State law, effective July 1, 2005, the District’s Plan was terminated, and the employees in the plan were required by CALPERS to join a new State-wide pool. One of the conditions of entry to these pools was that the District true-up any unfunded liability in the former Plan, either by paying cash or by increasing its future contribution rates through a Side Fund offered by CALPERS. The District satisfied this Miscellaneous Plan’s unfunded liability by agreeing to contribute additional amounts to its normal contribution rates over 20 years.

**EAST PALO ALTO SANITARY DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS
For the Year Ended June 30, 2014**

NOTE 6 – DEFINED BENEFIT PENSION PLAN (Continued)

The schedule of funding progress presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits. CALPERS' latest actuarial value (which differs from market value) and funding progress for the State-wide pools are shown below:

Actuarial						
Valuation Date	Entry Age Accrued Liability	Value of Assets	Unfunded (Overfunded) Liability	Funded Ratio	Annual Covered Payroll	Unfunded (Overfunded) Liability as % of Payroll
2010	\$2,297,871,345	\$1,815,671,616	\$482,199,729	79.0%	\$434,023,381	111.1%
2011	2,486,708,579	1,981,073,089	505,635,490	79.7%	427,300,410	118.3%
2012	2,680,181,441	2,178,799,790	501,381,651	81.3%	417,600,034	120.1%

Audited annual financial statements and ten-year trend information are available from CALPERS at P.O. Box 942709, Sacramento, CA 94229-2709.

NOTE 7 – POST RETIREMENT BENEFITS

The District provides post-retirement benefits to eligible employees in the form of reimbursement for post-retirement health insurance premiums. Retired employees have a choice of remaining on the District's group health insurance plan or purchasing a plan of their choice. Reimbursement is made quarterly upon receipt of proof of payment. The District's contribution is capped at the amount of the Kaiser premium which was set at \$1,019 per month per individual for fiscal year 2013-2014, \$1,019 per month per individual for fiscal year 2012-2013, and \$676 for fiscal year 2011-2012.

The obligation of the District to provide these benefits is determined annually by the Board of Directors.

In order to qualify for postemployment medical benefits, an employee must retire from the District with at least 5 years of service and be over 50 years of age.

The District follows the provisions of Governmental Accounting Standards Board Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. This Statement establishes uniform financial reporting standards for employers providing postemployment benefits other than pensions (OPEB). The provisions of this statement are applied prospectively and do not affect prior year's financial statements. Required disclosures are presented below.

The District joined the California Employers' Retiree Benefit Trust (CERBT), an agent multiple-employer plan administered by CALPERS, consisting of an aggregation of single-employer plans.

**EAST PALO ALTO SANITARY DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS
For the Year Ended June 30, 2014**

NOTE 7 – POST RETIREMENT BENEFITS (Continued)

Funding Policy and Actuarial Assumptions

The District's policy is to fund minimally the Annual Required Contribution (ARC) of these benefits by accumulating assets with CERBT discussed above pursuant to the District's annual budget approved by Board. The annual required contribution (ARC) was determined as part of the July 1, 2013 actuarial valuation using the entry age normal actuarial cost method. This is a projected benefit cost method, which takes into account those benefits that are expected to be earned in the future as well as those already accrued. The actuarial assumptions included (a) 7.50% investment rate of return, (b) 3% inflation rate, (c) 3.25% projected annual salary increase, and (d) health care cost trend rates of 4.64% to 8.50% for medical benefits. The actuarial methods and assumptions used include techniques that smooth the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets. Actuarial calculations reflect a long-term perspective and actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of events far into the future. Actuarially determined amounts are subject to revision at least tri-ennially as results are compared to past expectations and new estimates are made about the future. The District's OPEB unfunded actuarial accrued liability is being amortized as a level percentage of projected payroll using a 30 year amortization period on a closed basis.

Funding Progress and Funded Status

Generally accepted accounting principles permit contributions to be treated as OPEB assets and deducted from the Actuarial Accrued Liability when such contributions are placed in an irrevocable trust or equivalent arrangement. As a result, the District has calculated and recorded the Net OPEB Asset, representing the difference between the ARC, amortization and contributions, as presented below:

Annual OPEB expense:	
Annual required contribution (ARC)	\$76,370
Interest on net OPEB obligation (asset)	(1,232)
Adjustment to annual required contribution	1,474
Total annual OPEB expense	76,612
Change in net OPEB payable obligation:	
Contributions paid to trust	(41,819)
Premiums paid	(34,551)
Total payments	(76,370)
Total change in net OPEB payable obligation	242
OPEB obligation (asset) - beginning of year	(16,430)
OPEB obligation (asset) - end of year	(\$16,188)

The actuarial accrued liability (AAL) representing the present value of future benefits, included in the actuarial study dated July 1, 2013, amounted to \$689,923. The AAL is partially funded since assets have been transferred into CERBT.

**EAST PALO ALTO SANITARY DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS
For the Year Ended June 30, 2014**

NOTE 7 – POST RETIREMENT BENEFITS (Continued)

The Plan's annual required contributions and actual contributions for the last three fiscal years are set forth below:

Fiscal Year	Annual OPEB Cost (AOC)	Actual Contribution	Percentage of AOC Contributed	Net OPEB Obligation (Asset)
June 30, 2012	\$77,406	\$153,293	198%	\$0
June 30, 2013	74,372	90,802	122%	(16,430)
June 30, 2014	76,612	76,370	100%	(16,188)

The Schedule of Funding Progress presents trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits. Trend data from the last three actuarial studies are presented below:

Actuarial Valuation Date	Actuarial Value of Assets (A)	Entry Age Actuarial Accrued Liability (B)	Unfunded (Overfunded) Actuarial Accrued Liability (A – B)	Funded Ratio (A/B)	Covered Payroll (C)	Unfunded (Overfunded) Actuarial Liability as Percentage of Covered Payroll [(A – B)/C]	Interest Rate
1/1/2008	\$101,295	\$455,360	\$354,065	22.25%	\$705,947	50.15%	7.75%
7/1/2011	227,878	560,420	332,542	40.66%	758,410	43.85%	7.50%
7/1/2013	494,957	689,923	194,966	71.74%	676,728	28.81%	7.50%

NOTE 8 – NET POSITION

Net Position is the excess of all the District's assets and deferred outflows of resources, over all its liabilities and deferred inflows of resources, regardless of fund. The following captions apply only to Net Position, which is determined only at the Government-wide level, and are described below:

Net investment in capital assets describes the portion of Net Position which is represented by the current net book value of the District's capital assets, less the outstanding balance of any debt issued to finance these assets.

Unrestricted describes the portion of Net Position which is not restricted to use.

**EAST PALO ALTO SANITARY DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS
For the Year Ended June 30, 2014**

NOTE 9 – 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 disaster. The District joined together with other entities to form the California Sanitation Risk Management Authority (CSRMA), a public entity risk pool currently operating a common risk management and insurance program for 60 member entities. The purpose of CSRMA is to spread the adverse effects of losses among the member entities and to purchase excess insurance as a group, thereby reducing its cost. The District pays annual premiums to CSRMA for its general liability, property damage, workers compensation insurance and automobile coverage. Settled claims for CSRMA have not exceeded coverage in any of the past three fiscal years.

CSRMA is governed by a Board composed of one representative from each member agency. The Board controls the operations of CSRMA including selection of management and approval of operating budgets, independent of any influence by member entities.

CSRMA is not a component unit of the District, and the District's share of CSRMA's assets, liabilities, and equity has not been calculated.

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**INDEPENDENT AUDITOR'S 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***

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

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 basic financial statements of the East Palo Alto Sanitary District (District), as of and for the year ended June 30, 2014 and the related notes to the financial statements, and have issued our report thereon dated November 26, 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 District'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.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the District's financial statements are free from 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*.

We have also issued a separate Memorandum on Internal Control dated November 26, 2014 which is an integral part of our audit and should be read in conjunction with this report.

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 District'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 District's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.



Pleasant Hill, California
November 26, 2014