

**EAST PALO ALTO SANITARY DISTRICT
ANNUAL FINANCIAL REPORT
FOR THE YEAR ENDED JUNE 30, 2017**

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EAST PALO ALTO SANITARY DISTRICT

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VAVRINEK, TRINE, DAY & CO., LLP
Certified Public Accountants

VALUE THE *difference*

INDEPENDENT AUDITOR'S REPORT

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

Report on the Financial Statements

We have audited the accompanying financial statements of the East Palo Alto Sanitary District (District), as of and for the year ended June 30, 2017, 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 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. 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 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.


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, 2017, and the changes in financial position and cash flows thereof for the year 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, the schedule of funding progress for retiree health benefit plan, the schedule of proportionate share of the net pension liability, and the schedule of contributions, as listed in the table of contents, 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.

Vaurinek, Trine, Day 

Palo Alto, California
February 5, 2018

EAST PALO ALTO SANITARY DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS JUNE 30, 2017

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 position presents information on all of the District's assets deferred outflows and liabilities deferred inflows, with the difference between the four reported as net position. 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; such as changing economic conditions, population and customer growth, and new or changed rules and regulations.

All of the current year's revenue and expenses are accounted for in the statement of revenues, expenses, and changes in net position. 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 operating, 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 position may serve over time as a useful indicator of an entity's financial position. In the case of the District, assets exceeded liabilities by \$19.5 million 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 position (25%) 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, 2017

Table A
Summary of Net Position

A summary of the statements of net position as of June 30, 2017 and 2016 is shown in the following table:

	Fiscal Year 2017	Fiscal Year 2016	Variance
Current assets	\$ 15,920,266	\$ 14,378,509	\$ 1,541,757
Noncurrent assets	66,324	72,181	(5,857)
Net capital assets	6,253,459	6,118,211	135,248
Total assets	<u>22,240,049</u>	<u>20,568,901</u>	<u>1,671,148</u>
Deferred outflows	<u>308,949</u>	<u>151,874</u>	<u>157,075</u>
Current liabilities	153,326	265,956	(112,630)
Noncurrent liabilities	<u>2,758,981</u>	<u>2,574,928</u>	<u>184,053</u>
Total liabilities	<u>2,912,307</u>	<u>2,840,884</u>	<u>71,423</u>
Deferred inflows	<u>140,087</u>	<u>260,412</u>	<u>(120,325)</u>
Net position	<u>\$ 19,496,604</u>	<u>\$ 17,619,479</u>	<u>\$ 1,877,125</u>

Net position increased by \$1,877,125 in 2017. The increases are a combination of income in the form of sewer service charges, connection fee charges and property taxes.

Current assets increased by \$1,541,757 compared to the prior year primarily due to:

An increase in cash of \$1,541,757 as detailed in the statement of cash flows on page 10, an increase in accounts receivable of \$2,142 and a decrease in prepaid insurance of \$39,542.

Noncurrent assets decreased by \$5,857 primarily due a decrease in notes receivable of \$4,816 and a decrease in OPEB asset of \$1,041.

Current liabilities decreased by \$112,630 due to a decrease in accounts payable of \$60,331, a decrease in accrued liabilities of \$56,411 and an increase in current portion of long term debt of \$4,112.

EAST PALO ALTO SANITARY DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS JUNE 30, 2017

Table B
Summary of Revenues
Expenses and Changes in Net Position

	<u>Fiscal Year 2017</u>	<u>Fiscal Year 2016</u>	<u>Variance</u>
Total operating revenues	\$ 4,570,234	\$ 4,867,493	\$ (297,259)
Total operating expenses	<u>(3,662,726)</u>	<u>(4,142,986)</u>	<u>480,260</u>
Operating income (loss)	907,508	724,507	183,001
Total nonoperating revenues and expenses	<u>969,617</u>	<u>824,187</u>	<u>145,430</u>
Increase in net position	1,877,125	1,548,694	328,431
Net position, beginning of year	<u>17,619,479</u>	<u>16,070,785</u>	<u>1,548,694</u>
Net position, end of year	<u>\$ 19,496,604</u>	<u>\$ 17,619,479</u>	<u>\$ 1,877,125</u>

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

Table B shows that during 2017 total operating revenues decreased by \$297,259. Total operating expenses decreased by \$480,260. Non-operating revenue and expenses increased by \$145,430. The major factors which contributed to these results include:

- The decrease in operating revenues of \$297,259 was due to a decrease in sewer service charges of \$302,863 and a decrease in other operating revenue of \$5,604.
- The decrease in operating expenses of \$480,260 was due to a decrease in personnel services expense of \$815,599, an increase in depreciation and amortization of \$17,333, a decrease in fuel and supplies of \$14,689, a decrease in other expenses of \$32,127, and an increase in purchased services of \$364,822.
- The increase of \$145,430 in non-operating revenues and expenses was due to an increase in interest income of \$62,216, an increase in property tax collections of \$31,086, a decrease in interest expense of \$5,527, and an increase in pass through receipts of \$ 46,601.

EAST PALO ALTO SANITARY DISTRICT

**MANAGEMENT’S DISCUSSION AND ANALYSIS
JUNE 30, 2017**

BUDGETARY HIGHLIGHTS

The District has an annual operating budget that is approved by its Board of Directors. Capital projects are approved on a project by project basis within the annually approved capital budget. The 2017 expenses were under the approved budget.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

As of June 30, 2017, the District's investment in capital assets amounted to \$6.25 million and \$6.12 million (net of accumulated depreciation) as shown in Table C for 2017 and 2016, respectively. In 2017, the District spent \$445,252 on sewer replacement and \$11,354 on furniture and equipment. Additional information on the District's capital assets can be found in Note 3 to the Financial Statements.

**Table C
Capital Assets**

	<u>Fiscal Year 2017</u>	<u>Fiscal Year 2016</u>	<u>Variance</u>
Land	\$ 184,601	\$ 184,601	\$ -
Cured in place pipe	1,474,518	1,474,518	-
Sewer collection facilities	6,525,476	6,080,224	445,252
Buildings	2,587,577	2,587,579	(2)
Furniture and equipment	2,050,550	2,039,196	11,354
Accumulated depreciation	(6,569,263)	(6,247,907)	(321,356)
Net capital assets	<u>\$ 6,253,459</u>	<u>\$ 6,118,211</u>	<u>\$ 135,248</u>

EAST PALO ALTO SANITARY DISTRICT

**MANAGEMENT’S DISCUSSION AND ANALYSIS
JUNE 30, 2017**

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 5 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 given budgetary constraints.

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 Weeks Street
East Palo Alto, CA 94303

EAST PALO ALTO SANITARY DISTRICT

STATEMENT OF NET POSITION JUNE 30, 2017

ASSETS

Current assets	
Deposits and investments	\$ 15,859,815
Prepaid insurance	60,451
Total current assets	<u>15,920,266</u>
Noncurrent assets	
Notes receivable	17,578
Net OPEB asset	48,746
Capital assets	
Non depreciable capital assets	184,601
Capital assets, net of depreciation	6,068,858
Total non-current assets	<u>6,319,783</u>
Total Assets	<u>22,240,049</u>

DEFERRED OUTFLOWS OF RESOURCES

Deferred outflows of resources related to pensions	<u>308,949</u>
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LIABILITIES

Current liabilities	
Accounts payable	26,711
Accrued liabilities	21,015
Current portion of long-term liabilities	105,600
Total current liabilities	<u>153,326</u>
Noncurrent liabilities	
Due beyond one year	1,288,823
Net pension liability	1,470,158
Total long-term liabilities	<u>2,758,981</u>
Total Liabilities	<u>2,912,307</u>

DEFERRED INFLOWS OF RESOURCES

Deferred inflows of resources related to pensions	<u>140,087</u>
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NET POSITION

Net investment in capital assets	4,859,036
Unrestricted	<u>14,637,568</u>
Total Net Position	<u>\$ 19,496,604</u>

The accompanying notes are an integral part of these financial statements.

EAST PALO ALTO SANITARY DISTRICT

STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION FOR THE YEAR ENDED JUNE 30, 2017

OPERATING REVENUES

Sewer service charges	\$ 4,519,886
Rental income	23,562
Other revenue	26,786
Total Operating Revenues	<u>4,570,234</u>

OPERATING EXPENSES

Personnel services	937,637
Purchased services	2,203,071
Utilities, fuel and supplies	61,302
Depreciation (Note 3)	321,358
Other expenses	139,358
Total Operating Expenses	<u>3,662,726</u>
Operating Income	<u>907,508</u>

NONOPERATING REVENUES (EXPENSES)

Property taxes	571,862
Pass through receipts	293,985
Interest income	156,236
Interest expense	(52,466)
Total Nonoperating Revenues (Expenses)	<u>969,617</u>
Change in Net Position	1,877,125
Total Net Position - Beginning	<u>17,619,479</u>
Total Net Position - Ending	<u>\$ 19,496,604</u>

The accompanying notes are an integral part of these financial statements.

EAST PALO ALTO SANITARY DISTRICT

STATEMENT OF CASH FLOWS FOR THE YEAR ENDED JUNE 30, 2017

CASH FLOWS FROM OPERATING ACTIVITIES	
Receipts from customers and users	\$ 4,545,590
Payments to suppliers	(2,560,015)
Payments to employees	(924,343)
Cash receipts from other operating activities	26,786
Net cash provided by operating activities	<u>1,088,018</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES	
Property taxes	571,862
Pass through receipts	293,985
Net cash provided by noncapital financing activities	<u>865,847</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES	
Acquisition and construction of capital assets	(456,606)
Principal paid on debt	(101,488)
Interest paid on debt	(52,466)
Collections on note receivable	4,816
Net cash used for capital and related financing activities	<u>(605,744)</u>
CASH FLOWS FROM INVESTING ACTIVITIES:	
Interest received	156,236
Net increase in cash and cash equivalents	1,504,357
Cash and cash equivalents at beginning of year	14,355,458
Cash and cash equivalents at end of year	<u>\$ 15,859,815</u>
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES	
Operating income	\$ 907,508
Adjustment to reconcile operating income to net cash provided by operating activities:	
Depreciation and amortization expense	321,358
(Increase) decrease in assets and deferred outflows of resources:	
Accounts receivable	2,142
OPEB asset	1,041
Prepaid expenses	(39,542)
Pension related deferred outflows of resources	(157,075)
Increase (decrease) in liabilities and deferred inflows of resources:	
Accounts payable and accrued expenses	(116,742)
Net pension liability	289,653
Pension related deferred inflows of resources	(120,325)
Net cash provided by operating activities	<u>\$ 1,088,018</u>

The accompanying notes are an integral part of these financial statements.

EAST PALO ALTO SANITARY DISTRICT

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2017

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Description of the Reporting Entity

The primary purpose of the East Palo Alto Sanitary District (District) is to provide safe, efficient and cost-effective sanitary services to portions of East Palo Alto and Menlo Park, in San Mateo County. The collection system carries wastewater from the District's service area to the Palo Alto treatment plant where it is treated and disposed of in a manner which meets federal and state standards.

The District is governed by a five-member Board of Directors elected at large to four year terms by residents within the District.

The financial statements of East Palo Alto Sanitary 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 legally separate organization for which the District is financially accountable. 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 governing board of the District serves as the Governing board of the Corporation. The Corporation is so intertwined with the District that it is, in substance, the same as the District and, therefore, is reported as blended component unit of the District. The Corporation does not issue separately financial statements

B. Basis of Presentation and Accounting

Enterprise fund activities are financed in whole or in part by fees charged to external parties, and are accounted for in an enterprise fund. Enterprise funds maintain their records using the economic resources measurement focus and the accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded when the related liability is incurred, regardless of the timing of the cash flows.

The statement of net position and the statement of revenues, expenses, and changes in net position displays information about the primary government (the District) and its component unit (the Corporation). Eliminations have been made to minimize the double-counting of activities between the entities.

Operating revenues, such as charges for services, result from exchange transactions associated with the principal activity of the District. Exchange transactions are those in which each party receives and gives up essentially equal values.

C. Budgets and Budgetary Accounting

The 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 FINANCIAL STATEMENTS JUNE 30, 2017

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, 2017, the balance is \$9,651 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. Donated capital assets are recorded at estimated acquisition value at the date of donation.

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. Deferred Outflows and Inflows of Resources

In addition to assets, the statement of net position reports separate sections for deferred outflows of resources and deferred inflows of resources. Deferred outflows of resources, represents a consumption of net position that applies to future period(s) and so will not be recognized as an outflow of resources (expense) until then. Deferred inflows of resources, represents an addition of net position that applies to future period(s) and so will not be recognized as an inflows of resources (revenues) until then.

EAST PALO ALTO SANITARY DISTRICT

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2017**

H. 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. The County assesses properties, bills for and collects property taxes on the following schedule:

	<u>Secured</u>	<u>Unsecured</u>
Valuation dates	March 1	March 1
Lien/levy dates	January 1	January 1
Due dates	50% on November 1 50% on February 1	July 1
Delinquent as of	December 10 April 10	August 31

The term "Unsecured" refers to taxes on property not secured by liens on real property. Property taxes levied are recorded as revenue and receivables, net of estimated uncollectible amounts, in the fiscal year of levy.

I. 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 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.

J. Bond Issuance Costs

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

K. 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.

L. Fair Value Measurements

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.

EAST PALO ALTO SANITARY DISTRICT

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2017

M. Net Position

The District's net position is required to be classified for accounting and reporting purposes into the following categories:

Net Investment in Capital Assets – This component of net position, includes capital assets, net of accumulated depreciation, reduced by the outstanding balances of any bonds, notes or other borrowings that are attributable to the acquisition, construction or improvement of those assets.

Unrestricted – This component of net position consists of assets that do not meet the definition of restricted or invested in capital assets, net of related debt.

N. Spending Order Policy

When an expense is incurred for which there are both restricted and unrestricted net position is available, it is the District's policy to apply these expenses to restricted net position to the extent that such are available and then to unrestricted net position.

O. New Accounting Pronouncements

The GASB has issued the following accounting pronouncements that will become effective in future fiscal years:

- GASB Statement No. 75 – Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions
- GASB Statement No. 81 – Irrevocable Split-Interest Agreements
- GASB Statement No. 83 – Certain Asset Retirement Obligations
- GASB Statement No. 84 – Fiduciary Activities
- GASB Statement No. 85 – Omnibus 2017
- GASB Statement No. 86 – Certain Debt Extinguishment Issues
- GASB Statement No. 87 – Leases

The District has not determined the effect of these statements as of June 30, 2017.

EAST PALO ALTO SANITARY DISTRICT

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2017

NOTE 2 – CASH AND INVESTMENTS

Policies and Classification

The District's cash and investments consist of the following at June 30, 2017:

Deposits with financial institutions	\$ 197,278
Cash and investments with San Mateo County Treasurer	<u>15,662,537</u>
Total cash and investments	<u><u>\$ 15,859,815</u></u>

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. State statutes govern the County's investment policies.

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, 2017 was provided by the County Treasurer.

The District is a voluntary participant in the San Mateo County Investment Fund (SMCIF) that is regulated by California Government Code Section 53600 under the oversight of the treasurer of the County of San Mateo. The District reports its investment in SMCIF at the fair value amount provided by SMCIF. The balance available for withdrawal is based on the accounting records maintained by SMCIF, which are recorded on an amortized cost basis.

Interest Rate Risk – Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment the greater the sensitivity of its fair value to changes in market interest rates. The District manages its exposure to interest rate risk by investing in the SMCIF. The sensitivity of the fair values of the District's investments to market interest rate fluctuation is measured as the weighted average maturity of the investment portfolio, which was 1.01 years on June 30, 2017.

Fair Value Measurements – The District categorizes the fair value measurements of its investments based on the hierarchy established by generally accepted accounting principles. The fair value hierarchy has three levels, and is based on the valuation inputs used to measure an asset's fair value. Deposits and withdrawals in the SMCIF are made in the basis of \$1 and not fair value. Accordingly, the District's proportionate share of investments in those funds at June 30, 2017, is an uncategorized input not defined as Level 1, Level 2 or Level 3 input.

EAST PALO ALTO SANITARY DISTRICT

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2017**

NOTE 3 – CAPITAL ASSETS

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

	Balance at June 30, 2016	Additions	Retirements	Balance at June 30, 2017
Capital assets not being depreciated:				
Land	\$ 184,601	\$ -	\$ -	\$ 184,601
Total capital assets not being depreciated:	<u>184,601</u>	<u>-</u>	<u>-</u>	<u>184,601</u>
Capital assets being depreciated:				
Sewer collection facilities	6,080,224	445,252	-	6,525,476
Cured in place pipe	1,474,518	-	-	1,474,518
Buildings	2,587,577	-	-	2,587,577
Furniture and equipment	2,039,196	11,354	-	2,050,550
Total capital assets being depreciated:	<u>12,181,515</u>	<u>456,606</u>	<u>-</u>	<u>12,638,121</u>
Less accumulated depreciation for:				
Sewer collection facilities	2,828,187	98,008	-	2,926,195
Cured in place pipe	195,864	49,149	-	245,013
Buildings	1,639,562	98,913	-	1,738,475
Furniture and equipment	1,584,294	75,286	-	1,659,580
Total accumulated depreciation	<u>6,247,907</u>	<u>\$ 321,356</u>	<u>\$ -</u>	<u>6,569,263</u>
Total capital assets, net	<u>\$ 6,118,209</u>			<u>\$ 6,253,459</u>

EAST PALO ALTO SANITARY DISTRICT

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2017**

NOTE 4 – LONG TERM DEBT

A. Current Year Transactions and Balances

Long-term debt at June 30, 2017 is summarized as follows:

Business-Type Liabilities	Original Issue Amount	Balance June 30, 2016	Retirements	Balance June 30, 2017	Amount due within one year
Palo Alto 1990 Utility Revenue Bonds 5.75%, due 6/30/2024	\$ 469,595	\$ (212,785)	\$ 22,012	\$ (190,773)	\$ 23,235
Palo Alto 2000 Utility Revenue Bonds 5.75%, due 6/30/2024	573,000	(260,517)	27,122	(233,395)	28,650
State Revolving Fund Loan 2.60%, due 1/31/2032	1,225,420	(1,022,609)	52,354	(970,255)	53,715
Total Long-Term Debt		<u>\$ (1,495,911)</u>	<u>\$ 101,488</u>	<u>\$ (1,394,423)</u>	<u>\$ 105,600</u>

The bonds are payable from general operating revenues of the District. The approximate amount of the pledge revenues is equal to the remaining principal and interest requirements of the secured debt, which was \$1.7 million on June 30, 2017. The revenue bonds mature through fiscal year 2032. Total debt service requirements for the year ended June 30, 2017 were \$153 thousand, which is 3.3% of current year pledged revenues.

B. Palo Alto 1990 Utility Revenue Bonds

The District has a contract with the City of Palo Alto (City) whereby the District has rights to a specified ability (11.90%) of the total ability of the City’s sewage treatment facilities. The 1990 utility revenue bonds are the District's part of the City of Palo Alto's (City) debt related to capital improvements of the treatment plant.

C. Palo Alto 2000 Utility Revenue Bonds

The 2000 Utility Revenue Bonds represent a portion of the Palo Alto 1990 Utility Revenue Bonds which was refinanced. The bonds are payable from revenues of the District.

D. State Revolving Fund Loan

The District has 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 FINANCIAL STATEMENTS
JUNE 30, 2017**

E. Debt Service Requirements

For The Year Ending June 30	Principal	Interest	Total
2018	\$ 105,590	\$ 47,432	\$ 153,022
2019	109,748	43,375	153,123
2020	113,550	39,074	152,624
2021	118,153	34,611	152,764
2022	122,819	29,946	152,765
2023-2027	458,866	83,958	542,824
2028-2032	365,697	29,012	394,709
Total payments due	<u>\$ 1,394,423</u>	<u>\$ 307,408</u>	<u>\$ 1,701,831</u>

NOTE 5 – DEFINED BENEFIT PENSION PLAN

A. Plan Descriptions

The District contributes to the California Public Employees Retirement System (CalPERS), a cost sharing multiple-employer public employee retirement system. CalPERS provides retirement and disability benefits, annual cost-of living adjustments, and death benefits to plan members and beneficiaries. CalPERS acts as a common investment and administrative agent for participating public entities within the State of California. Benefit provisions and all other requirements are established by state statute and District resolution. CalPERS issues a publicly available financial report that includes financial statements and required supplementary information. The report may be obtained from CalPERS, 400 Q Street, Sacramento, CA 95811.

Benefits Provided

CalPERS provides service retirement and disability benefits, annual cost of living adjustments and death benefits to plan members, who must be public employees and beneficiaries. Benefits are based on years of credited service, equal to one year of full time employment. Members with five years of total service are eligible to retire at age 50 with statutorily reduced benefits. All members are eligible for non-duty disability benefits after 10 years of service. The death benefit is one of the following: the Basic Death Benefit, the 1957 Survivor Benefit, or the Optional Settlement 2W Death Benefit. The cost of living adjustments for each plan are applied as specified by the Public Employees' Retirement Law.

The Plan's provisions and benefits in effect at June 30, 2016, are summarized as follows:

Hire Date	Prior to 1/1/13	On or after 1/1/13
Formula	2.0% @ 55	2% @ 62
Benefit vesting schedule	5 years of service	5 years of service
Benefit payments	monthly for life	monthly for life
Retirement age	50 - 55	52-67
Monthly benefits, as a % of annual salary	2.00 - 2.50%	1.00-2.50%
Required employee contribution rates	7.00%	6.25%
Required employer contribution rates	11.68%	6.56%

EAST PALO ALTO SANITARY DISTRICT

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2017**

Contributions — Section 20814(c) of the California Public Employees' Retirement Law requires that the employer contribution rates for all public employers are determined on an annual basis by the actuary and shall be effective on the July 1 following notice of a change in the rate. Funding contributions for the Plan is determined annually on an actuarial basis as of June 30 by CalPERS. The actuarially determined rate is the estimated amount necessary to finance the costs of benefits earned by employees during the year, with an additional amount to finance *any* unfunded accrued liability. The District is required to contribute the difference between the actuarially determined rate and the contribution rate of employees.

For the year ended June 30, 2017, the contributions to the Plan were \$42,955.

B. Pension Liabilities, Pension Expenses and Deferred Outflows/Inflows of Resources Related to Pensions

As of June 30, 2017 the District reported net pension liability for its proportionate share of collective net pension liability in the amount of \$1,470,158.

The District's net pension liability for the Plan is measured as the proportionate share of the collective plans net pension liability. The net pension liability of the Plan is measured as of June 30, 2016, and the total pension liability for the Plan used to calculate the net pension liability was determined by an actuarial valuation as of June 30, 2015 rolled forward to June 30, 2016 using standard update procedures. The District's proportion of the net pension liability was based on a projection of the District's long-term share of contributions to the pension plan relative to the projected contributions of all participating employers, actuarially determined. The District's proportionate share of the net pension liability for the Plan as of the June 30, 2015 and 2016 measurement dates was as follows:

Proportion - June 30, 2015	0.04306%
Proportion - June 30, 2016	<u>0.03637%</u>
Change	<u><u>-0.00669%</u></u>

For the year ended June 30, 2017, the District recognized pension expense of \$55,208. At June 30, 2017, the District reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Pension contributions subsequent to measurement date	\$ 42,955	\$ -
Differences between actual and expected experience	5,007	(1,147)
Changes in assumptions	-	(47,351)
Difference between proportional and actual contributions	2,414	(2,628)
Net differences between projected and actual earnings on plan investment	246,442	-
Adjustments due to differences in proportion	<u>12,131</u>	<u>(88,961)</u>
Total	<u><u>\$ 308,949</u></u>	<u><u>\$ (140,087)</u></u>

EAST PALO ALTO SANITARY DISTRICT

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2017**

The \$42,955 reported as deferred outflows of resources related to contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended June 30, 2018. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized as pension expense as follows:

Year Ended June 30	Deferred Outflows/(Inflows) of Resources
2018	\$ (33,656)
2019	(18,774)
2020	114,504
2021	63,833
Total	<u>\$ 125,907</u>

Actuarial Assumptions — The total pension liabilities in the June 30, 2015 actuarial valuation was determined using the following actuarial assumptions for both plans:

Valuation Date	June 30, 2015
Measurement Date	June 30, 2016
Actuarial Cost Method	Entry-Age Normal Cost Method
Actuarial Assumptions:	
Discount Rate	7.65%
Inflation	2.75%
Payroll Growth	3.00%
Projected Salary Increase	Varies by Entry-Age and Service
Investment Rate of Return	7.65% (1)
Mortality	(2)

(1) Net of pension plan investment and administrative expenses, includes inflation.

(2) The probabilities of mortality are based on the 2014 CalPERS experience study for the period From 1997 to 2011.

The underlying mortality assumptions and all other actuarial assumptions used in the June 30, 2015 valuation were based on the results of a January 2014 actuarial experience study for the period 1997 to 2011. Further details of the Experience Study can found on the CalPERS website.

EAST PALO ALTO SANITARY DISTRICT

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2017**

Discount Rate — The discount rate used to measure the total pension liability was 7.65% for the Plan. To determine whether the municipal bond rate should be used in the calculation of a discount rate for the plans, CalPERS stress tested plans that would most likely result in a discount rate that would be different from the actuarially assumed discount rate. Based on the testing, none of the tested plans run out of assets. Therefore, the current 7.65% discount rate is adequate and the use of the municipal bond rate calculation is not necessary. The long term expected discount rate of 7.65 percent will be applied to all plans in the Public Employees Retirement Fund (PERF). The stress test results are presented in a detailed report that can be obtained from the CalPERS website.

The long-term expected rate of return on pension plan investments was determined using a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class.

In determining the long-term expected rate of return, CalPERS took into account both short-term and long-term market return expectations as well as the expected pension fund cash flows. Using historical returns of all the funds' asset classes, expected compound returns were calculated over the short-term (first 10 years) and the long-term (11-60 years) using a building-block approach. Using the expected nominal returns for both short-term and long-term, the present value of benefits was calculated for each fund. The expected rate of return was set by calculating the single equivalent expected return that arrived at the same present value of benefits for cash flows as the one calculated using both short-term and long-term returns. The expected rate of return was then set equivalent to the single equivalent rate calculated above and rounded down to the nearest one quarter of one percent.

The table below reflects the long-term expected real rate of return by asset class. The rate of return was calculated using the capital market assumptions applied to determine the discount rate and asset allocation. These rates of return are net of administrative expenses.

Asset Class	New Strategic Allocation	Real Return Years 1 - 10(a)	Real Return Years 11+(b)
Global Equity	51.00%	5.25%	5.71%
Global Fixed Income	20.00%	0.99%	2.43%
Inflation Sensitive	6.00%	0.45%	3.36%
Private Equity	10.00%	6.83%	6.95%
Real Estate	10.00%	4.50%	5.13%
Infrastructure and Forestland	2.00%	4.50%	5.09%
Liquidity	1.00%	-0.55%	-1.05%
Total	100.00%		

(a) An expected inflation of 2.5% used for this period.

(b) An expected inflation of 3.0% used for this period.

EAST PALO ALTO SANITARY DISTRICT

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2017**

Sensitivity of the Proportionate Share of the Net Pension Liability to Changes in the Discount Rate — The following presents the District's proportionate share of the net pension liability for the Plans, calculated using the discount rate for the Plans, as well as what the District's proportionate share of the net pension liability would be if it were calculated using a discount rate that is 1-percentage point lower or 1-percentage point higher than the current rate:

1% Decrease		6.65%
Net Pension Liability	\$	2,290,468
Current Discount Rate		7.65%
Net Pension Liability	\$	1,470,158
1% Increase		8.65%
Net Pension Liability	\$	792,213

Pension Plan Fiduciary Net Position — Detailed information about each pension plan's fiduciary net position is available in the separately issued CalPERS financial reports.

NOTE 6 – OTHER POST RETIREMENT BENEFITS

Plan description

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.

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 is a contracting agency under the Public Employees' Medical and Hospital Care Act (PEMHCA), which is administered by CalPERS for the provision of healthcare insurance programs for both active and retired employees. The District participates in the California Employers' Retiree Benefit Trust Fund Program (CERBT), an agent-multiple employer postemployment health plan, to prefund other postemployment benefits through CalPERS. The financial statements for CERBT may be obtained by writing the California Public Employees' Retirement System, Constituent Relations Office, CERBT (OPEB), P.O. Box 242709, Sacramento, California 94229-2709 or by calling 888-225-7377.

EAST PALO ALTO SANITARY DISTRICT

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2017

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, 2015 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) 7.28% investment rate of return, (b) 3% inflation rate, (c) 3.25% projected annual salary increase, and (d) health care cost trend rates of 4.50% to 6.00% 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-annually 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. The remaining amortization period on June 30, 2017 is 22 years.

The contribution requirements of plan members and the District are established and may be amended by the Board. As of June 30, 2017, the District contributed \$81,996, or 100%, of the annual required contribution (ARC) to the CERBT.

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), an amount actuarially determined in accordance with the parameters of GASB Statement 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years. The following table shows the components of the District's annual OPEB cost for the year, the amount actually contributed to the plan, and changes in the District's net OPEB asset with the CERBT:

Annual required contribution (ARC)	\$ 81,996
Interest on net OPEB (asset)	(3,845)
Adjustment to annual required contribution	<u>4,886</u>
Total annual OPEB expense	83,037
Contributions made	<u>(81,996)</u>
Decrease in net OPEB asset	1,041
OPEB (asset), beginning of year	(49,787)
OPEB (asset), end of year	<u><u>\$ (48,746)</u></u>

EAST PALO ALTO SANITARY DISTRICT

**NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2017**

The District’s annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for fiscal year 2017 and the two preceding years were as follows:

Year Ended June 30	Annual OPEB Costs (AOC)	Actual Contribution	Percentage of AOC Contributed	Net OPEB (Asset)
2015	\$ 74,923	\$ 74,663	100%	\$ (15,928)
2016	\$ 76,797	\$ 110,656	144%	\$ (49,787)
2017	\$ 83,037	\$ 81,996	99%	\$ (48,746)

Funded Status and Funding Progress

The funded status of the most recent actuarial valuation date, was as follows:

Actuarial valuation date	Actuarial Value of Assets (a)	AAL Entry Age Normal (b)	Unfunded AAL (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ([b-a]/c)
7/1/2015	\$ 735,544	\$ 921,240	\$ 185,696	79.84%	\$ 972,500	19.09%

NOTE 7 – 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 Special District Risk Management Authority (SDRMA), a public entity risk pool currently operating a common risk management and insurance program for 60 member entities. The purpose of SDRMA 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 SDRMA for its general liability, property damage, workers compensation insurance and automobile coverage. Settled claims for SDRMA have not exceeded coverage in any of the past three fiscal years, nor has there been a significant reduction in coverage from the previous year.

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

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

NOTE 8 – COMMITMENTS AND CONTINGENCIES

Litigation

The District is involved in litigation arising from the normal course of business. In the opinion of management and legal counsel, the disposition of all litigation pending is not expected to have a material adverse effect on the overall financial position of the District at June 30, 2017.

REQUIRED SUPPLEMENTAL INFORMATION

EAST PALO ALTO SANITARY DISTRICT

**SCHEDULE OF OTHER POSTEMPLOYMENT BENEFITS (OPEB) FUNDING PROGRESS
FOR THE YEAR ENDED JUNE 30, 2017**

Actuarial valuation date	Actuarial Value of Assets (a)	AAL Entry Age Normal (b)	Unfunded AAL (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ([b-a]/c)
7/1/2011	\$ 227,878	\$ 560,420	\$ 332,542	40.66%	\$ 758,410	43.85%
7/1/2013	494,957	689,923	194,966	71.74%	676,728	28.81%
7/1/2015	735,544	921,240	185,696	79.84%	972,500	19.09%

EAST PALO ALTO SANITARY DISTRICT

**SCHEDULE OF THE DISTRICT'S PROPORTINATE SHARE OF THE NET PENSION LIABILITY
FOR THE YEAR ENDED JUNE 30, 2017**

Measurement Date	<u>6/30/2014</u>	<u>6/30/2015</u>	<u>6/30/2016</u>
Proportion of the net pension liability	0.03807%	0.04306%	0.03637%
Proportion share of the net pension liability	\$ 940,823	\$ 1,180,505	\$ 1,470,158
Covered payroll	577,858	678,974	701,673
Proportionate share of the net pension liability as a percentage of covered payroll	162.81%	173.87%	209.52%
Plan's proportionate share of the fiduciary net position as a percentage of the plan's total pension liability	79.82%	78.40%	74.06%

* Fiscal year 2015 was the 1st year of implementation.

EAST PALO ALTO SANITARY DISTRICT

**SCHEDULE OF DISTRICT'S PENSION CONTRIBUTIONS
FOR THE YEAR ENDED JUNE 30, 2017**

Fiscal Year End	<u>6/30/2015</u>	<u>6/30/2016</u>	<u>6/30/2017</u>
Actuarially determined contributions	126,764	76,889	42,955
Contributions in relation to the actuarially determined contributions	<u>(126,764)</u>	<u>(76,889)</u>	<u>(42,955)</u>
Contribution deficiency (excess)	<u>-</u>	<u>-</u>	<u>-</u>
Covered payroll	<u>678,974</u>	<u>701,673</u>	<u>367,923</u>
Contributions as a percentage of covered payroll	<u>18.67%</u>	<u>10.96%</u>	<u>11.68%</u>

EAST PALO ALTO SANITARY DISTRICT

NOTE TO REQUIRED SUPPLEMENTARY INFORMATION FOR THE YEAR ENDED JUNE 30, 2017

Schedule of Other Postemployment Benefit (OPEB) Funding Progress

This schedule shows trends about the funding progress of the District's actuarially determined liability for postemployment benefits other than pensions.

Schedules of District's Proportionate Share of the Net Pension Liability (NPL)

This schedule presents information on the District's proportionate share of the net pension liability (NPL), the plans' fiduciary net position and, when applicable, the State's proportionate share of the NPL associated with the District. In the future, as data becomes available, ten years of information will be presented.

Changes in Benefit Terms – There were no changes in benefit terms since the previous valuations for CalPERS.

Changes in Assumptions – CalPERS discount rate was changed from 7.50% to 7.65% in 2016.

Schedules of District's Pension Contributions

This schedule presents information on the District's required contribution, the amounts actually contributed, and any excess or deficiency related to the required contribution. In the future, as data becomes available, ten years of information will be presented.