HESPERIA WATER DISTRICT

COMPONENT UNIT FINANCIAL STATEMENTS

WITH REPORT ON AUDIT BY
INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

June 30, 2014

June 30, 2014

INDEPENDENT AUDITORS' REPORT

The Board of Directors
Hesperia Water District
Hesperia, California

We have audited the accompanying financial statements of the Hesperia Water District (a component unit of the City of Hesperia) 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 component unit 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.

Auditors' Responsibility

Our responsibility is to express an opinion on these component unit financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the State Controller's Minimum Audit Requirements for California Special Districts. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free 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 auditors' 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 auditors consider 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.

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Offices located in Orange and San Diego Counties

Opinion

In our opinion, the component unit financial statements referred to above present fairly, in all material respects, the financial position of the Hesperia Water District as of June 30, 2014, 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, as well as the accounting systems prescribed by the State Controller's Office and State regulations governing Special Districts.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and the schedule of funding progress for DPHP as identified in the accompanying 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.

White Nelson Diehl Evans LLP

December 17, 2014
Carlsbad, California

MANAGEMENT'S DISCUSSION AND ANALYSIS

Our discussion and analysis of the Hesperia Water District's financial performance provides an overview of the District's financial activities for the fiscal year ended June 30, 2014. Please read it in conjunction with the accompanying basic financial statements.

FINANCIAL HIGHLIGHTS

- The District's net position increased approximately $10.5 million from $78.3 million to $88.8 million or 13.5% primarily due to the addition of $11.7 million of previously unrecorded water rights acquired in prior years and which was netted against a $1.4 million increase in operating expenditures including increases such as electricity expenses, salaries and benefits, and water well repairs.

- During the year, the District's outstanding long-term debt decreased by $1.8 million to $13.7 million. This is, in large part, due to the repayment of $1.2 million of a $6.0 million loan held by the Hesperia Housing Authority and a $0.8 million decrease from scheduled 1998 A&B Lease Revenue Refunding Bond and 1992B Certificate of Participation payments, partially offset by a $0.3 million increase in insurance claims payable.

- The District's capital assets, net of depreciation, increased by $10.1 million to $96.1 million. This increase is primarily the net effect of the addition of $11.7 million in previously unrecorded water rights, the $1.2 million increase in water facilities from waterline improvements, the $0.4 million increase in construction in progress pertaining to the pipeline replacement program, the $0.2 million increase in machinery and equipment, the $0.1 million increase in land, against net depreciation expense of $3.5 million.

- The total cost of the District's operations and capital improvements was $22.0 million, which is an increase of 7.3% from the June 2013 total of $20.5 million. This is the result of an increase in operating costs such as electricity, salaries and expenses, and unforeseen water well repairs.

USING THIS ANNUAL REPORT

The basic financial statements of the District consist of the Statement of Net Position, the Statement of Revenues, Expenses, and Changes in Net Position, and the Statement of Cash Flows.

The Statement of Net Position provides information about the activities of the District as a whole and with the water and sewer functions separately. Also, it presents a longer-term view of the District's finances.

The Statement of Revenues, Expenses, and Changes in Net Position describes how the services of the District were financed in the short term as well as what remains for future spending. The Statement also provides information on the District's operations and can be used to determine whether the District has recovered all of its costs through its rates and other charges. This statement can also be used to determine the District credit worthiness and profitability.

The Statement of Cash Flows provides information regarding the District's cash receipts, cash payments, and changes in cash resulting from operations, investments and financing activities. Additionally, the Statement of Cash Flows provides answers to questions such as where did cash come from, what was cash used for, and what was the change in cash balance during the reporting period.

REPORTING THE DISTRICT AS A WHOLE

Financial Statements. One of the most important questions asked about the District's finances is, "Is the District better off or worse off as a result of this year's activities?" The Statement of Net Position and the Statement of Revenues, Expenses and Changes in Net Position report information about the District in a way that helps answer this question. These statements include all assets and liabilities using the accrual basis of accounting, which is similar to the accounting used by most private sector companies. All of the current year's revenues and expenses are taken into account regardless of when the cash is received or paid.

These two statements report the District's net position and changes to it. You can think of the District's net position – the difference between assets plus deferred outflows of resources less liabilities and deferred inflows of resources – as one way to measure the District's financial health, or financial position. Over time, increases or decreases in the District's net position are one indicator of whether its financial health is improving or deteriorating. However, one will need to consider other non-financial factors such as changes in economic conditions, population growth, zoning and new or changed government legislation, such as changes in Federal and State water quality standards.

The basic financial statements can be found on pages 9-13 of this report.

Notes to the Basic Financial Statements. The notes provide additional information that is essential to a full understanding of the data provided in the basic financial statements. The notes to the basic financial statements can be found on pages 14 through 29.

THE DISTRICT AS A WHOLE

Our analysis focuses on the Condensed Statement of Net Position (Table 1) and Changes in Net Position (Table 2) of the District. In the current year, net position increased from $78.3 million to $88.8 million. This increase of approximately $10.5 million comes primarily from $11.7 million of previously unrecorded water rights acquired in prior years through the adjudicated contribution and non-capitalized purchases. The Water District continues to maintain the water and sewer infrastructure, which includes water storage tanks, water pumping equipment, water transmission lines, and sewer lines, etc.

Table 1

Condensed Statement of Net Position

			Changes from 2013 to 2014	
	2013	2014	Amount	Percentage
Current and other assets	$ 19,109,708	$ 18,929,875	$ (179,833)	-0.9%
Capital assets	85,945,342	96,103,431	10,158,089	11.8%
Total Assets	105,055,050	115,033,306	9,978,256	9.5%
Deferred Outflows of Resources	3,430,250	3,064,890	(365,360)	-10.7%
Other liabilities	14,734,550	15,560,393	825,843	5.6%
Long-term debt outstanding	15,463,911	13,686,495	(1,777,416)	-11.5%
Total Liabilities	30,198,461	29,246,888	(951,573)	-3.2%
Deferred Inflows of Resources	-	-	-	N/A
Net Position:				
Net Investment in capital assets	73,201,861	83,007,645	9,805,784	13.4%
Restricted	1,890,305	1,888,888	(1,417)	-0.1%
Unrestricted	3,194,673	3,954,775	760,102	23.8%
Total Net Position	$ 78,286,839	$ 88,851,308	$ 10,564,469	13.5%

The following is a list of factors that explain the $10.5 million increase in net position:

- Current and other assets – experienced a slight decrease of $0.2 million during the fiscal year. The decrease is primarily the result of a $0.6 million decrease in the inter-fund loan between water and sewer operations, a $0.5 million decrease in accounts receivable due to ongoing operations, a $0.3 million decrease in the district's prepaid expenses, and a $0.2 million decrease in inventory. This is almost entirely offset by a $1.4 million increase in cash.
- Capital assets – increased by $10.2 million, net of depreciation, from June 30, 2013. The increase is largely due to $11.7 million in previously unrecorded water rights which were acquired in previous fiscal years, $1.2 million increase in water infrastructure improvements, $0.4 million increase in construction in progress, $0.2 million increase in machinery and equipment, and $0.1 million increase in land. These increases are offset, in part, by the depreciation expense of $3.5 million of the assets currently in use.
- Deferred Outflow of Resources – decreased by $0.4 million due to the net of a $0.1 million decrease in the deferred charges on refunding and $0.3 million decrease in the change of the derivative investment valuation, which shows a decrease in the fair value of the interest rate swap agreement of $10.0 million in connection with the Variable Rate Lease Revenue Refunding Bonds, Taxable Series 1998A.
- Other liabilities – increased $0.8 million from June 30, 2013, which is primarily the net result of an increase of $1.5 million in accounts payable related to ongoing operations, an increase of $0.1 million from the change of the liability related to other post-employment benefits (OPEB), a combined increase of $0.1 million between the accrued personnel costs and deposits, a decrease of $0.6 million from the change from an inter-fund cash transfer, offset by a $0.3 million decrease related to the change in the derivative investment valuation.
- Long-term debt outstanding – debt service activity during the fiscal year resulted in a net decrease of $1.8 million from June 30, 2013. During the fiscal year, the District made a $1.2 million note payment to the Hesperia Housing Authority and a total of $0.9 million of principal payments on other outstanding debts, as shown in Table 4. This decrease is partially offset by a $0.3 million increase in claims payable during the fiscal year.
- Deferred Inflow of Resources – no change occurred from June 30, 2013.
- Net Investment in capital assets – increased by $9.8 million, or 13.4%, from the year ended June 30, 2013, which is primarily due to the addition of $11.7 million of previously unrecorded water rights acquired in prior years.
- Restricted net position – no significant change occurred from June 30, 2013.
- Unrestricted net position – increased by $0.8 million or 23.8% primarily due to the $1.4 million increase in cash position from sewer operations, a decrease in accounts payable of $1.5 million, and a decrease in accounts receivable of $0.5 million, all from ongoing operations.

DISTRICT ACTIVITIES

The District's net position increased $10.5 million or 13.5%. The cost of all Water District activities this year was $22.0 million which is an increase of $1.5 million from the $20.5 million from the prior year. As shown in the Changes in Net Position (Table 2), the amount paid by users of the systems was $19.8 million, which is a decrease of $0.4 million or 2.0% from the June 30, 2013 total of $20.2 million. The decrease is attributed to water conservation by the District's residential customers along with a decrease in water consumption related to new construction projects. Non-operating revenues of $1.0 million made up the remainder of the $20.8 million total revenues**.**

Table 2

Changes in Net Position

	2013	2014	Changes from 2013 to 2014 Amount	Changes from 2013 to 2014 Percentage
Revenues				
Operating revenues:				
Charges for services	$ 20,163,627	$ 19,756,973	$ (406,654)	-2.0%
Non-operating revenues:				
Property taxes	285,575	320,722	35,147	12.3%
Interest income	14,569	14,717	148	1.0%
System improvement and replacement	157,211	306,762	149,551	95.1%
Rent income	408,399	394,474	(13,925)	-3.4%
Gain on disposal of capital assets	523,974	-	(523,974)	-100.0%
Subtotal non-operating revenues	1,389,728	1,036,675	(353,053)	-25.4%
Total revenues	21,553,355	20,793,648	(759,707)	-3.5%
Expenses				
Water	17,675,401	19,014,005	1,338,604	7.6%
Wastewater	2,851,639	2,944,634	92,995	3.3%
Total expenses	20,527,040	21,958,639	1,431,599	7.0%
Change in net position	1,026,315	(1,164,991)	(2,191,306)	-213.5%
Net position at July 1,	77,506,411	78,286,839	780,428	1.0%
Restatement of net position at July 1,	(245,887)	11,729,460	11,975,347	4870.3%
Net position at July 1, as restated	77,260,524	90,016,299	12,755,775	16.5%
Net position at June 30,	$ 78,286,839	$ 88,851,308	$ 10,564,469	13.5%

Non-operating revenues had an overall decrease of $0.4 million, as the District did not receive any gains from the disposal of capital assets as it did in FY 2012-13. The District's total expenses increased $1.4 million in FY 2013-14. This is largely due to an increase in operating costs such as electricity expenses, salaries and benefits, and water well repairs.

CAPITAL ASSETS

The capital assets of the District are those assets that are used in the performance of the District's functions, including infrastructure assets. At June 30, 2014, capital assets, net of depreciation, totaled $96.1 million, which is an increase of $10.2 million. This increase is primarily due to the addition of the $11.7 million in previously unrecorded water rights which were acquired in previous fiscal years, a $1.2 million increase in water facilities from waterline improvements, a $0.4 million increase in construction in progress pertaining to the pipeline replacement program, a $0.2 million increase in machinery and equipment, and a $0.1 million increase in land, which is offset by depreciation expense of $3.5 million.

The addition of $11.7 million in water rights to $13.4 million reflects the District's ownership of 13,688 acre feet of water rights in the Alto Subarea. The latest June 30, 2014 sales transaction of permanent water rights recorded at a value of $5,000 per acre-foot making the current market value of the 13,688 acre-feet $68.4 million.

The District has elected to use the "Basic Approach" as defined by GASB Statement No. 34 for infrastructure reporting for water lines. Using the "Basic Approach," the District will depreciate the value of the infrastructure over a forty (40) year period. As replacing of water line segments is done, the value of that work will be added and any remaining book value of the replaced segment will be reduced from the water facilities infrastructure class. The District's other capital assets are depreciated as outlined in the Notes to the Basic Financial Statements.

Table 3
Capital Assets at Year-End

	Balance at June 30, 2013 Net of Accumulated Depreciation	Increases	Decreases	Current Year Depreciation	Balance at June 30, 2014 Net of Accumulated Depreciation
Land	$ 3,172,128	$ 130,750	$ -	$ -	$ 3,302,878
Water rights	1,699,000	11,729,460	-	-	13,428,460
Land improvements	178,869	-	-	(19,321)	159,548
Vehicles	407,684	-	(18,031)	(151,985)	237,668
Buildings and structures	1,256,227	-	-	(233,281)	1,022,946
Machinery and equipment	505,324	202,749	-	(126,794)	581,279
Infrastructure:					
Water facilities	72,617,366	1,421,367	(247,433)	(2,794,465)	70,996,835
Sewer facilities	3,611,814	-	-	(178,262)	3,433,552
Construction in progress	2,496,930	1,864,702	(1,421,367)	-	2,940,265
	$ 85,945,342	$ 15,349,028	$ (1,686,831)	$ (3,504,108)	$ 96,103,431

DEBT ADMINISTRATION

Debt issued by the Hesperia Water District is not the responsibility of the City of Hesperia. In like manner, the debt issued by the City of Hesperia is not the responsibility of the Hesperia Water District. Debt of the Hesperia Water District decreased by a net amount of $1.8 million in FY 2013-14. The decrease is largely due to an annual scheduled payment of $1.2 million on the 5-year $6.0 million loan held by the Hesperia Housing Authority, a $0.9 million decrease from scheduled 1998 A&B Lease Revenue refunding Bond and 1992B Certificate of Participation payments, partially offset by a $0.3 million increase in claims payable. Table 4 below, presents the outstanding debt.

Table 4
Outstanding Debt at Year-End

	Principal Balance at June 30, 2013	Additions	Deductions	Principal Balance at June 30, 2014	Due Within One Year
Loans	$ 2,400,000	$ -	$ (1,200,000)	$ 1,200,000	$ 1,200,000
Certificates of participation	825,000	-	(65,000)	760,000	70,000
Revenue bonds	12,010,000	-	(790,000)	11,220,000	820,000
Less deferred amounts:					
Bond discounts	(91,519)	-	7,305	(84,214)	-
Compensated Absences	187,657	176,722	(169,554)	194,825	187,032
Claims payable	132,773	369,270	(106,159)	395,884	-
	$ 15,463,911	$ 545,992	$ (2,323,408)	$ 13,686,495	$ 2,277,032

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

As reflected In the FY 2014-15 Budget, the District's revenue in the operating funds, water and sewer, is expected to increase slightly to $21.1 million, or 1.5%, over the FY 2013-14 revised of $20.8 million. The District's operating expenses are expected to increase by 2.6% to $20.9 million for FY 2014-15 over the FY 2013-14 revised of $20.3 million.

However, the District's FY 2014-15 First Quarter report to the Board of Directors, presented at the November 18, 2014 City Council meeting, identified $0.3 million or 4.8% less water sales revenue than expected for the first three months of FY 2014-15 compared to the first three months of FY 2013-14. This can be attributed to the State of California Governor's drought declaration that encouraged the water users in the State to reduce water use as much as possible.

Also In the FY 2014-15 Budget, the District's revenue in the capital funds, water and sewer, is expected to decrease 5.0% to $274,509 from the FY 2013-14 revised of $288,863. The District's budgeted capital expenses are $390,000, which are 53.5% less than the FY 2013-14 Budget revised of $839,126. As reflected in the FY 2014-15 Budget, the capital funds expended about $0.7 million more than the capital revenues in FY 2013-14 revised and are projected to expend about $0.1 million more than the revenue in FY 2014-15.

As detailed in the FY 2014-15 Budget, through the end of FY 2013-14 the District completed the water line relocation and improvements near Interstate 15 and Ranchero Road as part of the Interstate 15 and Ranchero Road Interchange Project. The capital project represents the majority of the $390,000 capital expenses in the FY 2014-15 Budget is the sewer pipeline expansion related to the reconstruction of the Hesperia Fire Protection District Station 301.

CONTACTING THE DISTRICT'S FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, taxpayers, customers, investors, and creditors with a general overview of the District's finances and to show the District's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the District's Finance Division, at the Hesperia Water District, 9700 Seventh Avenue, Hesperia, California 92345.

STATEMENT OF NET POSITION
June 30, 2014

	Water Operations & Capital	Sewer Operations & Capital	Total
ASSETS			
Current Assets:			
Cash and cash equivalents	$ -	$ 4,553,409	$ 4,553,409
Receivables:			
Accounts	2,803,830	518,996	3,322,826
Accrued interest	1,164	1,883	3,047
Due from other governmental agencies	33,878	11,536	45,414
Deposits	22,284	3,315	25,599
Inventories	954,910	-	954,910
Due from other funds	-	7,275,554	7,275,554
Restricted Assets:			
Cash and investments with fiscal agent	1,888,888	-	1,888,888
Cash held for bondholders	412,406	-	412,406
Total Current Assets	6,117,360	12,364,693	18,482,053
Noncurrent Assets:			
Other Noncurrent Assets:			
Prepaid expenses	228,749	-	228,749
Deposits for self-insurance	201,504	17,569	219,073
Total Other Noncurrent Assets	430,253	17,569	447,822
Capital Assets:			
Land	1,369,341	1,933,537	3,302,878
Water rights	13,428,460	-	13,428,460
Construction in progress	2,940,265	-	2,940,265
Land improvements	790,727	-	790,727
Vehicles	2,253,271	75,819	2,329,090
Machinery and equipment	4,153,811	295,790	4,449,601
Buildings and improvements	7,425,207	-	7,425,207
Water and sewer facilities	119,985,822	7,137,408	127,123,230
Less: Accumulated depreciation	(61,756,497)	(3,929,530)	(65,686,027)
Total Capital Assets	90,590,407	5,513,024	96,103,431
Total Noncurrent Assets	91,020,660	5,530,593	96,551,253
Total Assets	$ 97,138,020	$ 17,895,286	$ 115,033,306
DEFERRED OUTFLOWS OF RESOURCES			
Deferred charges on refunding	887,850	-	887,850
Deferred asset derivative instrument	2,177,040	-	2,177,040
Total Deferred Outflows of Resources	3,064,890	-	3,064,890

See accompanying independent auditors' report and notes to financial statements.

STATEMENT OF NET POSITION
June 30, 2014

LIABILITIES	Water Operations & Capital	Sewer Operations & Capital	Total
Current Liabilities:			
Accounts payable	$ 3,996,542	$ 225,347	$ 4,221,889
Accrued personnel costs	227,504	16,082	243,586
Accrued interest payable	54,501	-	54,501
Deposits	562,748	-	562,748
Due to other funds	7,275,554	-	7,275,554
Due to other governments	-	5,625	5,625
Current liabilities payable from restricted assets - due to bondholders	412,406	-	412,406
Liability from derivative instrument	2,177,040	-	2,177,040
Long term debt due within one year	2,245,856	31,176	2,277,032
Total Current Liabilities	16,952,151	278,230	17,230,381
Noncurrent Liabilities:			
Net OPEB obligation	607,044	-	607,044
Compensated absences	6,494	1,299	7,793
Claims payable	363,025	32,859	395,884
Revenue bonds (net of unamortized discounts)	10,315,786	-	10,315,786
Certificates of participation	690,000	-	690,000
Total Noncurrent Liabilities	11,982,349	34,158	12,016,507
Total Liabilities	28,934,500	312,388	29,246,888
DEFERRED INFLOWS OF RESOURCES	-	-	-
NET POSITION			
Net investment in capital assets	77,494,621	5,513,024	83,007,645
Restricted for debt service	1,888,888	-	1,888,888
Unrestricted	(8,115,099)	12,069,874	3,954,775
Total Net Position	$ 71,268,410	$ 17,582,898	$ 88,851,308

See accompanying independent auditors' report and notes to financial statements.

STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION
For the Year Ended June 30, 2014

	Water Operations & Capital	Sewer Operations & Capital	Total
OPERATING REVENUES			
Water sales	$ 15,706,061	$ -	$ 15,706,061
Water services	331,167	-	331,167
Sewer services	-	3,513,751	3,513,751
Other	205,994	-	205,994
Total Operating Revenues	16,243,222	3,513,751	19,756,973
OPERATING EXPENSES			
General and administrative	4,065,371	-	4,065,371
Engineering	745,727	-	745,727
Production	6,135,644	-	6,135,644
Distribution	1,106,763		1,106,763
Wastewater collection	-	2,755,812	2,755,812
Customer service	2,288,940	-	2,288,940
Depreciation and amortization	3,571,598	188,822	3,760,420
Total Operating Expenses	17,914,043	2,944,634	20,858,677
OPERATING INCOME (LOSS)	(1,670,821)	569,117	(1,101,704)
NONOPERATING REVENUES (EXPENSES)			
Unrestricted system improvement and replacement	306,762	-	306,762
Property taxes	319,836	-	319,836
Property taxes - debt service	886	-	886
Rent income	394,474	-	394,474
Interest income	6,671	8,046	14,717
Interest expense	(1,090,810)	-	(1,090,810)
Loss on disposal of capital assets	(9,152)	-	(9,152)
Total Nonoperating Revenues (Expenses), Net	(71,333)	8,046	(63,287)
Change In Net Position	(1,742,154)	577,163	(1,164,991)
Net position at beginning of year, as previously stated	61,281,104	17,005,735	78,286,839
Prior Period Adjustment	11,729,460	-	11,729,460
Net position at beginning of year, as restated	73,010,564	17,005,735	90,016,299
Net position at end of year	$ 71,268,410	$ 17,582,898	$ 88,851,308

See accompanying independent auditors' report and notes to financial statements.

STATEMENT OF CASH FLOWS
For the Year Ended June 30, 2014

	Water Operations & Capital	Sewer Operations & Capital	Total
Cash Flows from Operating Activities:			
Cash received from water and sewer customers	$ 16,481,888	$ 3,586,018	$ 20,067,906
Cash received from other operating receipts	205,994	-	205,994
Cash payments for water purchases	(4,133,096)	-	(4,133,096)
Cash payments for sewer collection and maintenance	-	(2,698,656)	(2,698,656)
Cash payments for services and supplies	(872,079)	-	(872,079)
Cash payments to employees for services	(6,993,967)	-	(6,993,967)
Net Cash Provided (Used) by Operating Activities	4,688,740	887,362	5,576,102
Cash Flows from Noncapital and Related Financing Activities:			
Property taxes received	320,722	-	320,722
Advances from/to other funds	(590,462)	590,462	-
Net Cash Provided (Used) by Noncapital and Related Financing Activities	(269,740)	590,462	320,722
Cash Flows from Capital and Related Financing Activities:			
Acquisition and construction of capital assets	(2,067,451)	(130,750)	(2,198,201)
Unrestricted system improvement and replacement receipts	306,762	-	306,762
Cash received from bondholders	6,335	-	6,335
Cash payment on loan payable to HCRA	(1,200,000)	-	(1,200,000)
Interest payments on long-term debt	(1,005,628)	-	(1,005,628)
Principal payments on long-term debt	(855,000)	-	(855,000)
Net Cash Provided (Used) by Capital and Related Financing Activities	(4,814,982)	(130,750)	(4,945,732)
Cash Flows from Investing Activities:			
Rents received	394,474	-	394,474
Interest received	6,426	7,800	14,226
Net Cash Provided by Investing Activities	400,900	7,800	408,700
Net Increase (Decrease) in Cash and Cash Equivalents	4,918	1,354,874	1,359,792
Cash and cash equivalents at beginning of year	2,296,376	3,198,535	5,494,911
Cash and cash equivalents at end of year	$ 2,301,294	$ 4,553,409	$ 6,854,703

(continued)

See accompanying independent auditors' report and notes to financial statements.

STATEMENT OF CASH FLOWS
For the Year Ended June 30, 2014

	Water Operations & Capital	Sewer Operations & Capital	Total
Reconciliation of Operating Income to Net Cash Flows Provided by Operating Activities:			
Operating income (Loss)	$ (1,670,821)	$ 569,117	$ (1,101,704)
Adjustments to Reconcile Operating Income to Net Cash Provided by Operating Activities:			
Depreciation and amortization	3,571,598	188,822	3,760,420
Changes in operating assets and liabilities:			
(Increase) decrease in accounts receivable	444,660	67,664	512,324
(Increase) decrease in deposits	(33,363)	(3,015)	(36,378)
(Increase) decrease in inventory	234,684	-	234,684
(Increase) decrease in prepaid expenses	268,851	-	268,851
(Increase) decrease in due from other governments	(29,826)	-	(29,826)
Increase (decrease) in accounts and claims payable	1,733,697	53,234	1,786,931
Increase (decrease) in accrued personnel costs	29,370	4,603	33,973
Increase (decrease) in customer deposits	15,235	-	15,235
Increase (decrease) in due to other governments	-	5,625	5,625
Increase (decrease) in net OPEB obligation	118,799	-	118,799
Increase (decrease) in compensated absences	5,856	1,312	7,168
Total Adjustments	6,359,561	318,245	6,677,806
Net Cash Provided (Used) by Operating Activities	$ 4,688,740	$ 887,362	$ 5,576,102
Supplemental Disclosures:			
Noncash Capital and Financing Activities			
Amortization Related to Long-Term Debt	$ 84,243		

See accompanying independent auditors' report and notes to financial statements.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

The accounting policies of the Hesperia Water District (the District) conform to generally accepted accounting principles as applicable to governmental units. The following is a summary of the more significant policies:

a. Description of Reporting Entity:

The District was organized pursuant to Section 30000 et seq. of the California Water Code. The District has two main areas of responsibility that are as follows:

Water Operations & Capital - The Water Division's main objective is to deliver and ensure adequate supplies of water. The water is to meet all drinking water quality regulations and to maintain District Facilities to ensure unobstructed flows during water runoff.

Sewer Operations & Capital - The Sewer Division's main objective is to transmit and ensure continuous unobstructed flows of sewage to the regional plant.

The District is an integral part of the reporting entity of the City of Hesperia (the City). The accounts of the District have been included within the scope of the basic financial statements of the City because the City Council has financial accountability over the operations of the District. Only the accounts of the District are included herein, therefore, these financial statements do not purport to represent the financial position or results of operations of the City of Hesperia.

b. Basic Financial Statements:

The basic financial statements are comprised of the Statement of Net Position, Statement of Revenues, Expenses, and Changes in Net Position, the Statement of Cash Flows and the Notes to Basic Financial Statements.

c. Basis of Presentation:

The District reports its activities as an enterprise fund, which is used to account for operations that are financed and operated in a manner similar to a private business enterprise, where the intent of the District is that the costs (including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges. Revenues and expenses are recognized on the accrual basis. Revenues are recognized in the accounting period in which they are earned and expenses are recognized in the period incurred. For the most part, the effect of inter-fund activity has been removed from these statements.

d. Measurement Focus and Basis of Accounting:

Measurement focus is a term used to describe “which” transactions are recorded within the various financial statements. Basis of accounting refers to “when” transactions are recorded regardless of the measurement focus applied. The accompanying financial statements are reported using the “economic resources measurement focus”, and the “accrual basis of accounting”. The accounting objectives of economic measurement focus are the determination of operating income, changes in net position (or cost recovery), financial position, and cash flows. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued):

d. Measurement Focus and Basis of Accounting (Continued):

When both restricted and unrestricted resources are available for use, it is the District's policy to use restricted resources first, then unrestricted resources as they are needed.

The District distinguishes operating revenues and expenses from those revenues and expenses that are non-operating. Operating revenues are those revenues that are generated by water sales and sewer services while operating expenses pertain directly to the furnishing of those sales and services. Non-operating revenues and expenses are those revenues and expenses generated that are not directly associated with the normal business of supplying water and sewer services.

e. New Accounting Pronouncements:

Implemented

- GASB 66 - "*Technical Corrections, an amendment of GASB Statement No. 10 and Statement No. 62"*, required to be implemented for periods beginning after December 15, 2012, did not impact the District.
- GASB 70 - *"Accounting and Financial Reporting for Non-exchange Financial Guarantees"*, required to be implemented for periods beginning after June15, 2013, did not impact the District.

Pending Accounting Standards

GASB has issued the following statements which may impact the District's financial reporting requirements in the future:

- GASB 68 - "*Accounting and Financial Reporting for Pensions, an amendment of GASB Statement No. 27"*, effective for the fiscal years beginning after June 15, 2014.
- GASB 69 - *"Government Combinations and Disposals of Government Operations"*, effective for periods beginning after December 15, 2013.
- GASB 71 - *"Pension Transition for Contributions Made Subsequent to the Measurement Date"*, effective for the periods beginning after June 15, 2014.

f. Net Position:

In the Statement of Net Position, net position is classified in the following categories:

- Net Investment in capital assets - This amount consists of capital assets net of accumulated depreciation and reduced by outstanding debt that is attributed to the acquisition, construction, or improvement of the assets.
- Restricted net position – This amount is restricted by external creditors, grantors, contributors, or laws or regulations of other governments or constraints imposed by law through constitutional provisions or enabling legislation.
- Unrestricted net position – This amount is the portion of net position that do not meet the definition of "net investment in capital assets" or "restricted net position".

g. Inventories:

Inventories consist of materials and supplies that are valued at cost and are recorded as expenses on a first-in, first-out basis when consumed.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued):

h. Compensated Absences:

A liability is recorded for unused vacation and similar compensatory leave balances since the employees' entitlement to these balances are attributable to services already rendered and it is probable that virtually all of these balances will be liquidated by either paid time off or payments upon termination or retirement.

Vacation pay is payable to employees at the time vacation is taken or upon termination of employment. Normally, an employee cannot accrue more than 160 hours during a one year accrual period.

Sick leave is payable when an employee is unable to work because of illness. Upon termination, any unused sick leave will not be paid.

i. Unbilled Services:

Unbilled water revenue of the enterprise fund is recognized as earned when the water is consumed.

j. Use of Estimates:

The preparation of financial statements in conformity with generally accepted accounting principles in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

k. Property Taxes:

Property tax in California is levied in accordance with Article 13A of the State Constitution at one percent of county-wide assessed valuations. This levy is allocated pursuant to state law to the appropriate units of local government.

The property tax calendar is as follows:

Lien Date:	January 1
Levy Date:	July 1
Due Date:	First Installment - November 10
	Second Installment - February 10
Delinquent Date:	First Installment - December 11
	Second Installment - April 11

l. Cash and Investments:

Investments are stated at fair value (quoted market price or best available estimate thereof, see Note 2).

m. Capital Assets and Depreciation:

Capital Assets are stated at cost or estimated historical cost. Contributed fixed assets are recorded at estimated fair market value at the time received. Net interest costs are capitalized on projects during the construction period. The District’s capitalization policy sets the threshold for reporting capital assets at $5,000.

See accompanying independent auditors' report.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued):

m. Capital Assets and Depreciation (continued):

Depreciation is charged using the straight-line method based on the estimated useful life of the related asset. The estimated useful life of the assets are as follows:

Buildings	30 years
Improvements	20 years
Machinery and equipment	5-30 years
Vehicles	8 Years
Water and sewer facilities	40 years

n. Deferred Outflows/Inflows of Resources:

In addition to assets, the Statement of Net Position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element, *deferred outflows of resources*, represents a consumption of net position that applies to a future period(s) and so will not be recognized as an outflow of resources (expense/expenditure) until then. The District has two items that qualify for reporting in this category. They are the deferred loss on refunding, and the deferred asset from derivative investment. A deferred loss on refunding results from the difference in the carrying value of refunded debt and its reacquisition price. This amount is deferred and amortized over the shorter of the life of the refunded or refunding debt. The deferred asset from derivative investment relates to the swap agreement between the Hesperia Water District and Bank of America, N.A. (see note 8).

In addition to liabilities, the statement of net position will sometimes report a separate section for deferred inflows of resources. This separate financial statement element, deferred inflows of resources, represents an acquisition of net position that applies to a future period(s) and will not be recognized as an inflow of resources (revenue) until that time. The District does not have any type of these items as of June 30, 2014.

o. Statement of Cash Flows:

For purposes of the statement of cash flows, the District considers all highly liquid investments with an original maturity of three months or less when purchased and all amounts invested in a cash and investment pool to be cash equivalents.

p. Claims and Judgments and Self-Insurance Program:

When it is probable that a claim liability has been incurred at year end, and the amount of the loss can be reasonably estimated, the District records the estimated loss, net of any insurance coverage under its self-insurance program. At June 30, 2014, in the opinion of the District's Attorney, the District had no material unrecorded claims which would require loss provision in the financial statements, including losses for claims which are Incurred But Not Reported (IBNR). Small dollar claims and judgments are recorded as expenses when paid.

The District participates in the self-insurance program of the City of Hesperia. Information relating to the self-insurance program is available in the City of Hesperia Comprehensive Annual Financial Report.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued):

   q. Accounts Receivable and Allowances:

   Accounts receivable are recorded at the invoiced amount. The District maintains an allowance for doubtful accounts. The allowance for doubtful accounts is based on the best estimate of the amount of probable future credit losses in existing accounts receivable. The District reviews the allowance for doubtful accounts on an annual basis. There was no allowance for doubtful accounts at June 30, 2014.

   r. Interest Expense:
   The District incurs interest charges on long-term debt. Interest expenses for the year ended June 30, 2014 was $1,090,810. No amounts were capitalized as a cost of construction projects.

2. CASH, CASH EQUIVALENTS, AND INVESTMENTS:

   Cash and investments at June 30, 2014 are classified in the accompanying financial statements as follows:

STATEMENT OF NET POSITION:	
Current Assets:	
Cash and cash equivalents	$ 4,553,409
Restricted assets:	
Cash and investments with fiscal agent	1,888,888
Cash held for bondholders	412,406
Total cash and investments	$ 6,854,703

See accompanying independent auditors' report.

2. CASH, CASH EQUIVALENTS, AND INVESTMENTS (Continued):

Investments Authorized by the California Government Code and the District's Investment Policy:

The table below identifies the investment types that are authorized for the District by the California Government Code (or the District's investment policy, where more restrictive). The table also identifies certain provisions of the California Government Code (or the District's investment policy, where more restrictive) that address interest rate risk, credit risk, and concentration of credit risk. This table does not address investments of debt proceeds held by a bond trustee that are governed by the provisions of debt agreements of the District's, rather than the general provisions of the California Government Code or the District's investment policy.

Authorized Investment Type	Maximum Maturity	Maximum Percentage Of Portfolio	Maximum Investment In One Issuer
U.S. Treasury Obligations	5 years	100%	None
U.S. & State or Local Agency Securities	5 years	100%	None
Banker's Acceptances	180 days	25%	5%
Commercial Paper	270 days	15%	None
Negotiable Certificates of Deposit	5 years	25%	None
Repurchase Agreements	1 years	20%	None
Local Agency Investment Fund (LAIF)	N/A	100%	None
Medium-Term Notes	5 years	30%	None
Mutual & Money Market Funds	90 days	20%	None
Collateralized Bank Deposits	5 years	10%	None
Investment Pools	N/A	30%	None
Municipal Bonds	5 years	10%	None

Investments Authorized by Debt Agreements:

Investment of debt proceeds held by the bond trustee are governed by provisions of the debt agreements, rather than the general provisions of the California Government Code or the City of Hesperia's investment policy. Investments authorized for funds held by bond trustee include, U.S. Treasury Obligations, Export-Import Bank, Federal Housing Administration Debentures, Government National Mortgage Association, U.S. Maritime Administration, U.S. Agency Securities, Money Market Funds, Certificates of Deposits, Commercial Paper, Interest Bearing Demand or Time Deposits, Banker's Acceptances, Repurchase Agreements, Repurchase Agreements Collateralized, Federal Home Loan Bank, Federal National Mortgage Association, Federal Home Loan Mortgage Corporation, Municipal Obligations, and any other investment approved by the credit entity. There were no limitations on the maximum amount that can be invested in one issuer, maximum percentage allowed or the maximum maturity of an investment.

Disclosures Related to Interest Rate Risk, Credit Risk, and Custodial Credit Risk:

The District's cash and investments are pooled with the City of Hesperia's cash and investments. Additional disclosures regarding $6,854,703 in pooled investments related to interest rate risk, credit risk, and custodial credit risk are available in the City of Hesperia's Comprehensive Annual Financial Report.

See accompanying independent auditors' report.

2. CASH, CASH EQUIVALENTS, AND INVESTMENTS (Continued):

Investment in State Investment Pool:

The District is a voluntary participant in the Local Agency Investment Fund (LAIF) that is regulated by the California Government Code under the oversight of the Treasurer of the State of California. The fair value of the District's investment in this pool is reported in the accompanying financial statements at amounts based upon the District's pro-rata share of the fair value provided by LAIF for the entire LAIF portfolio (in relation to the amortized cost of that portfolio). The balance available for withdrawal is based on the accounting records maintained by LAIF, which are recorded on an amortized cost basis.

3. CAPITAL ASSETS AND DEPRECIATION:

Capital asset activity for the year ended June 30, 2014 was as follows:

	Balance at June 30, 2013	Increases	Decreases	Balance at June 30, 2014
Capital assets, not being depreciated				
Land	$ 3,172,128	$ 130,750	$ -	$ 3,302,878
Water Rights	1,699,000	11,729,460	-	13,428,460
Construction in Progress	2,496,930	1,864,702	(1,421,367)	2,940,265
Total capital assets, not being depreciated	7,368,058	13,724,912	(1,421,367)	19,671,603
Capital assets being depreciated:				
Land Improvements	790,727	-	-	790,727
Vehicles	2,347,121	-	(18,031)	2,329,090
Machinery and Equipment	4,246,852	202,749	-	4,449,601
Building and Improvements	7,425,207	-	-	7,425,207
Water facilities	118,811,888	1,421,367	(247,433)	119,985,822
Sewer facilities	7,137,408	-	-	7,137,408
Total capital assets, being depreciated	140,759,203	1,624,116	(265,464)	142,117,855
Less accumulated depreciation for:				
Land Improvements	(611,858)	(19,321)	-	(631,179)
Vehicles	(1,939,437)	(170,016)	18,031	(2,091,422)
Machinery and Equipment	(3,741,528)	(126,794)	-	(3,868,322)
Building and Improvements	(6,168,980)	(233,281)	-	(6,402,261)
Water facilities	(46,194,522)	(3,032,746)	238,281	(48,988,987)
Sewer facilities	(3,525,594)	(178,262)	-	(3,703,856)
Total accumulated depreciation	(62,181,919)	(3,760,420)	256,312	(65,686,027)
Total capital assets, being depreciated,net	78,577,284	(2,136,304)	(9,152)	76,431,828
Total capital assets, net	$ 85,945,342	$ 11,588,608	$ (1,430,519)	$ 96,103,431

Depreciation expense for the year ended June 30, 2014 was $3,571,598 for Water operating and capital and $188,822 for Sewer operating and capital.

4. LONG-TERM DEBT:

Following is a summary of the changes in principal balance of long-term debt for the year ended June 30, 2014:

	Principal Balance at June 30, 2013	Additions	Deductions	Principal Balance at June 30, 2014	Due Within One Year
Loans	$ 2,400,000	$ -	$ (1,200,000)	$ 1,200,000	$ 1,200,000
Certificates of Participation	825,000	-	(65,000)	760,000	70,000
Revenue Bonds	12,010,000	-	(790,000)	11,220,000	820,000
Less deferred amounts:					
Bond discounts	(91,519)	-	7,305	(84,214)	-
Total Revenue Bonds	11,918,481	-	(782,695)	11,135,786	820,000
Compensated absences	187,657	176,722	(169,554)	194,825	187,032
Claims Payable	132,773	369,270	(106,159)	395,884	-
Total Long-term Debt	$ 15,463,911	$ 545,992	$ (2,323,408)	$ 13,686,495	$ 2,277,032

Long-term debt at June 30, 2014 is comprised of the following issues:

	Balance at June 30, 2014
2010 Loan from Hesperia Community Redevelopment Agency:	
The District was issued a 5-year loan by the former Hesperia Community Redevelopment Agency on June 30, 2010, for $6,000,000 for various water capital projects. The issue bears quarterly variable interest based on the Local Agency Investment Fund Quarterly Apportionment Rate which at June 30, 2014 had a rate of 0.22%. The loan matures June 30, 2015 with annual principal payments of $1,200,000. The loan will be financed by revenues generated by the District through set rates and charges for water and sewer services. Due to the dissolution of redevelopment agencies by AB 26x1, the Hesperia Housing Authority assumed this loan.	$ 1,200,000
1992B Certificates of Participation:	
The District issued 30-year Certificates of Participation on June 1, 1992 for $1,405,000 for the Administration Facilities Acquisition Project. The issue bears interest at a rate of 9% over its remaining life and matures in 2022 with principal payments ranging from $20,000 to $125,000. The Certificates will be financed by revenues generated by the District through set rates and charges for water and sewer services.	760,000

See accompanying independent auditors' report.

4. LONG-TERM DEBT (Continued):

1998A Variable Rate Lease Revenue Refunding Bonds:

The District issued 28-year variable rate lease revenue refunding bonds on July 2, 1998 for $18,040,000 to refund a 1991, $17,675,000 Certificate of Participation issue. The 1991 Certificate of participation is considered defeased; therefore, the issue is not included in the District's financial statements. The bonds require the District to collect gross revenues, as defined in the agreement, of at least 125% of the annual debt service of the bonds and any parity debt of the District. The District is legally required to make principal and interest payments from the net revenues of the District. The 1998A issue has an initial interest rate of 5.95%, and weekly variable rates thereafter until the fixed rate conversion date, with maturities through the year 2026, ranging from $435,000 to $1,105,000. The 1998A bonds were issued at a discount of $180,400, which is being amortized over the life of the 1998A Bonds. The difference between the reacquisition price and the net carrying value of the 1991 Certificate of Participation, $1,906,482, has been deferred and is being amortized over the remaining life of the Bonds as a component of interest expense. In June 2004, the District entered into a variable-to-fixed-interest rate swap with Bank of America, N.A. The swap requires Bank of America, N.A. to pay the variable rate while fixing the District rate at 5.96%. The agreement provides up to $10,000,000 which is fixed at 5.96%. The amount fixed with the counterparty decreases over time to $6,910,000 at June 20, 2020. At June 30, 2014 the amount fixed was $10,000,000.	10,310,000
1998B Variable Rate Lease Revenue Refunding Bonds:	
The District issued 24-year variable rate lease revenue refunding bonds on July 2, 1998 for $2,070,000 to refund a 1992, $1,855,000 Certificate of Participation issue. The 1992A Certificate of Participation is considered defeased; therefore, the issue is not included in the District's financial statements. The bonds require the District to collect gross revenues, as defined in the agreement, of at least 125% of the annual debt service of the bonds and any parity debt of the District. The District is legally required to make principal and interest payments from the net revenues of the District. The 1998B issue has a initial interest rate of 3.95%, and weekly variable rates thereafter until the fixed rate conversion date, with maturities through the year 2022, ranging from $55,000 to $130,000. The difference between the reacquisition price and the net carrying value of the 1992A Certificate of Participation, $212,358, has been deferred and is being amortized over the remaining life of the Bonds as a component of interest expense.	910,000
Compensated Absences	194,825
Claims Payable	395,884
Subtotal	13,770,709
Less: Bond Discounts	(84,214)
Total Long-Term Debt Before Current Portion	13,686,495
Less: Current Portion – Due Within One Year	(2,277,032)
Total Long-Term Portion of Long-Term Debt	$11,409,463

See accompanying independent auditors' report.

4. LONG-TERM DEBT (Continued):

The annual debt service requirements by year for Loans Payable are as follows:

Fiscal Year Ending	Principal	Interest	Total
2015	$ 1,200,000	$ -	$ 1,200,000
	$ 1,200,000	$ -	$ 1,200,000

The 2010 Hesperia Community Redevelopment Agency Loan was subsequently paid off on July 1, 2014, thereby avoiding any interest charges in FY 2014-15.

The annual debt service requirements by year for Revenue Bonds are as follows:

Fiscal Year Ending	Principal	Interest	Total
2015	$ 820,000	$ 598,140	$ 1,418,140
2016	855,000	572,779	1,427,779
2017	885,000	527,922	1,412,922
2018	920,000	481,276	1,401,276
2019	955,000	432,835	1,387,835
2020-2024	4,785,000	1,397,568	6,182,568
2025-2027	2,000,000	179,992	2,179,992
	$ 11,220,000	$ 4,190,512	$ 15,410,512

Variable interest rate used for the 1998A Variable Rate Lease Revenue Refunding Bonds above the $10,000,000 fixed amounts was 0.25% at June 30, 2014. Variable interest rate used for the 1998B Variable rate Lease revenue Refunding Bonds was 0.15% at June 30, 2014.

The annual debt service requirements by year for the Certificates of Participation are as follows:

Fiscal Year Ending	Principal	Interest	Total
2015	$ 70,000	$ 68,400	$ 138,400
2016	75,000	62,100	137,100
2017	80,000	55,350	135,350
2018	90,000	48,150	138,150
2019	100,000	40,050	140,050
2020-2022	345,000	63,900	408,900
	$ 760,000	$ 337,950	$ 1,097,950

5. PENSION PLAN OBLIGATIONS:

Plan Description:

The District's employees participate in the Risk Pool of California Public Employees' Retirement System (CalPERS). This plan is a cost-sharing, multiple-employer defined benefit pension plan administered by CalPERS. CalPERS provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. A menu of benefit provisions as well as other requirements is established by State statutes within the Public Employees' Retirement Law. The District selects optional benefit provisions from the benefit menu by contract with CalPERS and adopts those benefits through local ordinance. Copies of CalPERS' annual financial report may be obtained from the CalPERS Executive Office: 400 P Street, Sacramento, CA 95814.

In September 2012 the Governor signed AB 340 and AB 197, two bills which enacted the California Public Employees' Pension Reform Act of 2013 (PEPRA). AB 340 established a new retirement plan that made several changes to the pension benefits that are offered to employees hired on or after January 1, 2013, including setting a new maximum benefit, a lower-cost pension formula for safety and non-safety employees (miscellaneous) with requirements to work longer in order to reach full retirement age, and a cap on the amount used to calculate a pension. Among other things, AB 340 also enacted pension spiking reform for new and existing employees, required three-year averaging of final compensation for new employees, and provided new authority to negotiate cost-sharing agreements with current employees. AB 340 also placed limitations on the use of retired annuitants, requiring that an annuitant have a six-month break in service prior to returning to work. AB 197 contained corrections to two drafting errors discovered in AB 340.

Funding Policy:

The District's has two retirement formulas for miscellaneous members: PEPRA members' formula 2.0% at 62 and "classic" (as defined by PEPRA) members' formula 2.7% at 55. The District has no safety members.

The PEPRA plan, was created in January of 2013 and CALPERS established the normal cost rate for Risk Pools at 12.5 percent. Under the PEPRA plans, the member contributes 50% of the normal cost, 6.25% of their annual covered salary and the employer contributes the remaining 6.25%. The contribution rates will remain in effect until the actuarial valuation is completed in 2014, which will set the contribution requirements for fiscal year 2015/16. As of June 30, 2014 the District has fifteen (15) employees in the PEPRA plan.

Under the "classic" plan, members contributions are established by State statue and based upon the benefit formula. The employer is required to contribute the actuarially determined amounts necessary to the fund the benefits for its members as established by CalPERS. This actuarially amount includes the normal cost rate. The District's member contribution is 8% of annual covered salary, which the employees contribute the entire 8%.

The actuarial methods and assumptions used are those adopted by the CalPERS Board of Administration. The required employer contribution for fiscal year 2013/14, ended June 30, 2014 was 13.624%, of their annual covered payroll. The District's employer contribution for the last three fiscal years, which were equal to the required contribution each year were $398,557, $368,428, and $358,057 for the years ended June 30, 2014, 2013, and 2012 respectively. CalPERS does not provide individual plan trend information for risk pools.

6. OTHER POST EMPLOYMENT BENEFITS (OPEB):

The District pays the minimum health premium contribution, as established by the California Government Code 22892 of the Public Employees' Medical and Hospital Care Act (PEMHCA), for the participating active employees. The minimum health premium contribution for 2014 was $119 a month in post-employment health care benefits for each retiree until age 65. The District's defined benefit post-employment healthcare plan, (DPHP), provides medical benefits to eligible retired District employees and beneficiaries. DPHP is part of the Public Agency portion of the California Employers' Retiree Benefit Trust Fund (CERBT), an agent multiple-employer plan administered by California Public Employees' Retirement System (CalPERS), which acts as a common investment and administrative agent for participating public employers within the State of California. A menu of benefit provisions, as well as other requirements, is established by State statute within the Public Employees' Retirement Law. The DPHP selects optional benefit provisions from the benefit menu by contract with CalPERS and adopts those benefits through City resolution. CalPERS issues a separate Comprehensive Annual Financial Report. Copies of the CalPERS' Annual Financial Report may be obtained from the CalPERS Executive Office, 400 P Street, Sacramento, California 95814.

Funding Policy:

The contribution requirements of plan members and the District are established and may be amended by the Board of Directors. The DPHP members receiving benefits contribute based on their selected plan options. The District makes all contributions of the plan members.

Annual OPEB Cost and Net OPEB Obligation/Asset:

The District's annual 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 the normal annual cost. Any unfunded actuarial liability (or funding excess) is amortized over a period not to exceed thirty years. The current ARC rate is 4.4% of the annual covered payroll.

The following table shows the components of the District's annual OPEB cost for the year ending June 30, 2014, the amount actually contributed to the plan, and changes in the District's net OPEB obligation:

Annual Required Contribution (ARC)	$ 131,955
Interest on net OPEB asset	22,022
Adjustment to Annual Required Contribution (ARC)	(24,024)
Annual OPEB cost (expense)	129,953
Contributions made	(11,154)
Increase in net OPEB asset	118,799
Net OPEB obligation - beginning of year	488,245
Net OPEB obligation - end of year	$ 607,044

6. OTHER POST EMPLOYMENT BENEFITS (OPEB) (Continued):

Annual OPEB Cost and Net OPEB Obligation/Asset (Continued):

The District's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for the fiscal years 2014, 2013 and 2012 were as follows:

THREE-YEAR TREND INFORMATION FOR CERBT

Fiscal Year	Annual OPEB Cost (AOC)	Percentage of OPEB Cost Contributed	Net OPEB Obligation
6/30/2014	$ 129,953	8.6%	$ 607,044
6/30/2013	121,890	4.7%	488,245
6/30/2012	118,728	7.1%	372,074

Funded Status and Funding Progress:

The funded status of the plan as of June 30, 2012, the most recent actuarial valuation date, was as follows:

Actuarial Accrued Liability (AAL)	$ 780,000
Actuarial Value of Plan Assets	-
Unfunded Actuarial Accrued Liability (UAAL)	780,000
Funded Ratio (Actuarial Value of Plan Assets/AAL)	0.0%
Covered Payroll (Active Members)	2,715,000
UAAL as a Percentage of Covered Payroll	28.7%

Actuarial Methods and Assumptions:

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 employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for the benefits.

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 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 actuarial accrued liabilities and the actuarial assets, consistent with the long-term perspective of the calculations.

The following is a summary of the actuarial assumptions and methods:

6. OTHER POST EMPLOYMENT BENEFITS (OPEB) (Continued):

Valuation Date	June 30, 2012
Actuarial Cost Method	Entry Age Normal Cost Method
Amortization Method	Level Percent of Payroll
Remaining Amortization Period	26 Years as of the Valuation Date
Asset Valuation method	15 Year Smoothed Market
Actuarial Assumptions:	
Investment Rate of Return	4.25% (Net of Administrative Expenses)
Projected Salary Increase	3.25%
Inflation	3.00%
PEMHCA Minimum Growth	4.50%
Individual Salary Growth	CalPERS 1997-2007 Experience Study

7. SELF-INSURANCE RISK POOL:

Public Entity Risk Management Authority:

The Water District is a member of the Public Entity Risk Management Authority (PERMA), a joint powers authority of 28 California cities and districts, for the purpose of pooling the District's risk for worker's compensation and general liability insurance with those of other member cities and districts. The Governing Board of PERMA is comprised of directors nominated and selected by each member city and district. Each governing board member has one vote regarding all financial and management issues coming before the Board.

Each member is billed annually for general liability and premiums are paid quarterly for workers' compensation insurance. Estimated premiums for claims to be paid and a reserve are advanced upon joining PERMA. Each year PERMA adjusts its premiums based on District payroll figures, claims paid, and claims incurred but not reported. The District receives audited financial statements of PERMA each year which have been audited by other auditors.

The Water District is self-insured for the first $250,000 of each claim, pertaining to Worker's Compensation Liability Coverage, and PERMA will assume each claim's liability between $250,000 and $500,000. For any Worker's Compensation Liability claim exceeding $500,000, the District is insured by Excess Insurer's Limited Liability for up to $5,000,000 of each employer's liability claim and up to Statutory for each Workers' Compensation Claim. For General Liability, the District is self-insured for up to $50,000. PERMA will assume each claim exceeding $50,000 to $1,000,000. For all General Liability claims exceeding $1,000,000, the District is insured by Excess Insurers Limit of Liability for up to $50,000,000. There were no instances in the past three years where a settlement exceeded the District's general liability coverage and one instance in 2012 of a workers' compensation claim exceeding the District's coverage which was transferred to excess coverage for settlement.

8. DERIVATIVE INSTRUMENT - INTEREST RATE SWAP AGREEMENT:

Objective:

The Hesperia Water District executed an interest rate swap agreement on June 1, 2005 with swap provider Bank of America, N.A (counterparty) in connection with the issuance of the $18,040,000 Variable Rate Lease Revenue Refunding Bonds, Taxable Series 1998A (Federally Taxable). The Swap Agreement is a 15 year swap agreement scheduled to terminate on June 1, 2020. The swap establishes a fixed interest rate of 5.96%.

See accompanying independent auditors' report.

8. DERIVATIVE INSTRUMENT - INTEREST RATE SWAP AGREEMENT (Continued):

Details on the swap agreement are as follows:

Notional Amount	Interest Rate	Issue	Termination Date	Initial Effective Date
$ 10,000,000	5.96%	Bank of America	6/1/2020	6/1/2005

Terms:

Under the swap agreement, the Water District will make a monthly interest payment at the fixed rate of 5.96%. The Water District will receive a variable rate interest payment for those variable interest rates in excess of the 5.96% cap and makes a payment if the variable rate is less than 5.96%. The rate is adjusted weekly every Wednesday at the 1-Month USD-LIBOR-BBA rate. The swap is for a total notional amount of $10,000,000 and will terminate on June 1, 2020.

Summary of Activities in Cash Flow Hedging Derivative Instrument:

Notional Amount	Fair Value At June 30, 2013	Change In Fair Value	Fair Value At June 30, 2014
$ 10,000,000	$ (2,465,464)	$ 288,424	$ (2,177,040)

Due to the implementation of GASB 63, the June 30, 2014 negative fair value of $2,177,040 is reported as a deferred outflow of resources in the Statement of Net Position. In previous years, prior to the implementation of GASB 63, the fair value of the derivative instrument was reported as a deferred asset from derivative instrument in the Statement of Net Position.

Credit Risk:

As of June 30, 2014, the Water District was exposed to credit risk because the swap had a negative fair value. However, should interest rates change and the fair value of the swap becomes positive, the Water District would not be exposed to credit risk in the amount of the derivative's fair value.

The swaps counterparty, Bank of America N.A., have the following credit ratings:

	Standards & Poor	Moody's
Bank of America N.A.	A	A2

Basis Risk:

The swaps do expose the Water District to basis risk, which refers to a mismatch between the interest rate received from the swap contract and the interest paid on the variable rate payments to be made on the debt. The Water District pays the counterparty a fixed interest rate of 5.96% and receives a variable rate in excess of the 5.96% cap, based on the 1-month UDS-LIBOR-BBA. The Water District is at risk that the variable interest rate calculated on the debt is less than the 5.96%.

8. DERIVATIVE INSTRUMENT - INTEREST RATE SWAP AGREEMENT (Continued):

Termination Risk:

The swaps may be terminated by the Water District or the counterparty if the other party fails to perform under the terms of the swap agreements. In addition, the Water District has the option to terminate the swaps upon proper notification to the counterparty. If the swaps are terminated, the Water District would prospectively pay the variable rates on the portion of the outstanding bonds related to the swap agreements. The termination of the swap agreements could therefore increase the Water District's total debt service. Also, if at the time of the termination, the swaps have a negative fair value, the Water District would be liable to the counterparty for a payment equal to such negative fair value. As of June 30, 2014 the swap had a negative fair value of $2,177,040.

Swap Payments and Associated Debt:

	Variable Rate Debt					
Year Ending June 30,	Outstanding Swap Balance	Principal	Interest	Total	Interest Rate Swap, Net	Fixed Debt Service
2015	10,000,000	-	25,000	25,000	571,000	571,000
2016	9,340,000	-	24,864	24,864	567,903	567,903
2017	8,560,000	-	23,190	23,190	529,653	529,653
2018	7,750,000	-	21,234	21,234	484,975	484,975
2019	6,910,000	-	19,202	19,202	438,583	438,583
2020	-	-	15,885	15,885	362,138	362,138

Using a fixed rate of 5.96% related to a swap agreement for $10,000,000 of the $18,040,000 Variable Rate Lease Revenue Refunding Bonds, Taxable Series 1998A, as of June 30, 2014, debt service requirements of the Bonds and the swap payments through the swap termination date of June 1, 2020, assuming a current variable interest rate of 0.25% are as follows. As rates vary, the variable rate interest payments and net swap payments will vary.

9. PRIOR PERIOD ADJUSTMENT:

Water Rights:

The Hesperia Water District did not capitalize 387 acre-feet of water rights purchases in prior years valued at $493,500. Additionally, the District did not record the initial 12,213 acre-feet of water rights contributed to the District as a result of the January 1996 adjudication, which was valued at $11,235,960.

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REQUIRED SUPPLEMENTARY INFORMATION

Schedule of Funding Progress for DPHP

Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability (AAL) Entry Age	Unfunded (Over Funded) AAL (UAAL)	Funded Ratio	Covered Payroll	UAAL as a % of Covered Payroll
	(A)	(B)	(B - A)	(A / B)	(C)	(B - A / C)
6/30/2012:						
Water	$ -	$ 780,000	$ 780,000	0.0%	$ 2,715,000	28.7%
Total	$ -	$ 780,000	$ 780,000	0.0%	$ 2,715,000	28.7%
6/30/2010:						
Water	$ -	$ 631,000	$ 631,000	0.0%	$ 3,079,000	20.5%
Total	$ -	$ 631,000	$ 631,000	0.0%	$ 3,079,000	20.5%
6/30/2008:						
Water	$ -	$ 383,000	$ 383,000	0.0%	$ 2,861,500	13.4%
Total	$ -	$ 383,000	$ 383,000	0.0%	$ 2,861,500	13.4%

The Water District is only required to perform actuarial valuations biennially. An actuarial was not performed for the year ending June 30, 2013. An actuarial valuation will be done for the year ending June 30, 2014, but has not yet been prepared.

See accompanying independent auditors' report.