HESPERIA WATER DISTRICT

COMPONENT UNIT FINANCIAL STATEMENTS

WITH REPORT ON AUDIT BY
INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

June 30, 2013

June 30, 2013

WHITE NELSON DIEHL EVANS LLP
Certified Public Accountants & Consultants

INDEPENDENT AUDITORS' REPORT

The Board of Directors
Hesperia Water District
Hesperia, California

We have audited the accompanying basic financial statements of the Hesperia Water District (a component unit of the City of Hesperia) as of and for the year ended June 30, 2013, 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 of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the 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 auditor considers internal control relevant to the District's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

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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 respective financial position of the Hesperia Water District as of June 30, 2013, and the changes in financial position and cash flows for the year then ended in conformity 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.

Emphasis of Matters

As discussed in Note 1e to the basic financial statements, the District incorporated deferred outflows of resources and deferred inflows of resources into the definitions of the required components of the residual measure of net position due to the adoption of Governmental Accounting Standards Board's Statement No. 63, *"Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position"*. The adoption of this standard also provides a new statement of net position format to report all assets, deferred outflows of resources, liabilities, deferred inflows of resources, and net position. Our opinion is not modified with respect to this matter.

As discussed in Note 1e to the basic financial statements, the District has changed its method for accounting and reporting certain items previously reported as assets or liabilities during fiscal years 2012 and 2013 due to the adoption of Governmental Accounting Standards Board's Statement No. 65, *"Items Previously Reported as Assets and Liabilities"*. The adoption of this standard required retrospective application resulting in a $245,887 reduction of previously reported net position as of July 1, 2012. Our opinion is not modified with respect to this matter.

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 required 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 the 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 19, 2013
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, 2013. Please read it in conjunction with the accompanying basic financial statements.

FINANCIAL HIGHLIGHTS

- The District's net position increased approximately $0.8 million from $77.5 million to $78.3 million or 1.0% as a result of this year's operations. For FY 2012-13, operating revenue exceeded operating expenses by $0.7 million and non-operating revenues exceeded non-operating expenses by $0.4 million.

- During the year, the District's outstanding debt decreased by $2.0 million to $15.5 million. This is, in large part, due to the repayment of $1.2 million of a $6.0 million loan from the former Hesperia Community Redevelopment Agency, which is now held by the Hesperia Housing Authority, and $0.8 million decrease from scheduled 1998 A&B Revenue Bond and 1992B Certificate of Participation payments.

- The District's capital assets, net of depreciation, decreased by $1.8 million to $85.9 million as a result of the year's operations. This decrease is primarily the net effect of the FY 2012-13 depreciation expenses of $3.7 million, and a combined $0.1 million decrease, net of accumulated depreciation, from the sale of assets, along with the disposal of old steel pipe, and an increase of $2.0 million from pipeline replacement.

- The total cost of the District's operations and capital improvements was $20.5 million, which is an increase of 1.0% from the June 2012's total of $20.7 million. This is the net result of increase in expenses of $0.3 million from wastewater treatment rates charged to the District over the fiscal year and a $0.5 million decrease in water operations expenses due to production efficiencies.

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 these services were financed in the short term as well as what remains for future spending.

The Statement of Revenues, Expenses, and Changes in Net Position 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 and cash payments and changes in cash resulting from operations, investments and financing activities. Additionally, the Statement of Cash Flows provides answers to such questions as where did cash come from, what was cash used for, and what was the change in cash balance during the reporting period.

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 10-14 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 15 through 29.

THE DISTRICT AS A WHOLE

Our analysis focuses on the net position (Table 1) and changes in net position (Table 2) of the District. In the current year, net position increased from $77.5 million to $78.3 million. This increase of approximately $0.8 million comes from the change in net position as recorded in the Condensed Statement of Net Position and flows to the Changes in Net Position. 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 2012 to 2013	
	2012 As Restated	2013	Amount	Percentage
Current and other assets	$ 18,281,303	$ 19,109,708	$ 828,405	4.5%
Capital assets	87,696,124	85,945,342	(1,750,782)	-2.0%
Total Assets	105,977,427	105,055,050	(922,377)	-0.9%
Deferred Outflows of Resources	4,304,776	3,430,250	(874,526)	-20.3%
Other liabilities	15,312,733	14,734,550	(578,183)	-3.8%
Long-term debt outstanding	17,463,059	15,463,911	(1,999,148)	-11.4%
Total Liabilities	32,775,792	30,198,461	(2,577,331)	-7.9%
Deferred Inflows of Resources	-	-	-	N/A
Net Position:				
Net Investment in capital assets	75,034,007	73,201,861	(1,832,146)	-2.4%
Restricted	1,890,305	1,890,305	-	0%
Unrestricted	582,099	3,194,673	2,612,574	448.8%
Total Net Position	$ 77,506,411	$ 78,286,839	$ 780,428	1.0%

The following is a list of explanations for the $0.8 million increase in net position:

- Current and other assets – increased by $0.8 million due to the fiscal year's operations. The increase is primarily as a result of a $1.0 million increase in cash and a $0.3 million increase in accounts payable due to ongoing operations. This is offset, in part, by a $0.2 million decrease in the inter-fund loan between water and sewer operations, a $0.2 million decrease in deferred assets, and a $0.1 million decrease in the district's insurance deposit

- Capital assets – decreased by $1.8 million, net of depreciation, from June 30, 2012. The change is mostly due to depreciation expense of $3.7 million of the assets currently in use, sales and disposal of assets of $0.1 million, and the addition of construction in progress of $2.0 million.

- Deferred Outflow of Resources – decreased by $0.9 million due to the net of a $0.1 million decrease in the deferred charges on refunding and $0.8 million decrease in the change of the Derivative Investment valuation, which shows a decrease for the fair value of the interest rate swap agreement of $10.0 million in connection with the issuance of the $18.0 million Variable Rate Lease Revenue Refunding Bonds, Taxable Series 1998A.

- Other liabilities – decreased $0.6 million from June 30, 2012 which is primarily the result of the net between, a decrease of $0.8 million due to the change of the Derivative Investment valuation and a decrease of $0.2 million from the change from an inter-fund cash transfer and an increase of $0.3 million in accounts payable related to ongoing operations, and an increase of $0.1 million from the change of the liability related to other post-employment benefits (OPEB).

- Long-term debt outstanding – debt service activity during the fiscal year resulted in a net decrease of $2.0 million from June 30, 2012. During the fiscal year, the District made a $1.2 million note payment to the Hesperia Housing Authority, and a total of $0.8 million of principal payments on other outstanding debts, as shown in Table 4.

- Deferred Inflow of Resources – no change occurred from June 30, 2012.

- Net Investment in capital assets – decreased by $1.8 million, or 2.4%, from the year ended June 30, 2012, which is due to changes in long-term debt and depreciation expense.

- Restricted net position – no change occurred from June 30, 2012.

- Unrestricted net position – increased by $2.8 million or 448.8% primarily due to the $0.9 million increase in cash position from sewer operations, which is derived from collections from ratepayers exceeding operating costs for the fiscal year.

DISTRICT ACTIVITIES

The District's net position increased $1.0 million or 1.0%. The cost of all Water District activities this year was $20.5 million which is a decrease of 1.0% from the $20.7 million from the prior year. As shown in the Changes in Net Position (Table 2), the amount paid by users of the systems was $20.2 million, which is an increase of $0.6 million or 3.1% from the June 30, 2012 total of $19.6 million. The increase is attributed to the 4% water rate and a 7% sewer rate increase, which became effective on November 1, 2011, being applicable to an entire fiscal year's activities, including the peak usage period of July through October. Non-operating revenues of $1.4 million make up the remainder of the $21.6 million total revenues.

Table 2

Changes in Net Position

	2012	2013	Changes from 2012 to 2013 Amount	Percentage
Revenues				
Operating revenues:				
Charges for services	$ 19,560,078	$ 20,163,627	$ 603,549	3.1%
Non-operating revenues:				
Property taxes	283,473	285,575	2,102	0.7%
Interest income	11,591	14,569	2,978	25.7%
System improvement and replacement	307,599	157,211	(150,388)	-48.9%
Rent income	402,831	408,399	5,568	1.4%
Gain on disposal of capital assets	-	523,974	523,974	100.0%
Subtotal non-operating revenues	1,005,494	1,389,728	384,234	38.2%
Total revenues	20,565,572	21,553,355	987,783	4.8%
Expenses				
Water	18,193,068	17,675,401	(517,667)	-2.8%
Wastewater	2,531,776	2,851,639	319,863	12.6%
Total expenses	20,724,844	20,527,040	(197,804)	-1.0%
Change in net position	(159,272)	1,026,315	1,185,587	744.4%
Net position at July 1,	77,665,683	77,506,411	(159,272)	-0.2%
Restatement of net position at July 1,	-	(245,887)	(245,887)	100.0%
Net position at July 1, as restated	77,665,683	77,260,524	(405,159)	-0.5%
Net position at June 30,	$ 77,506,411	$ 78,286,839	$ 780,428	1.0%

Non-operating revenues had an overall increase of $0.4 million as System Improvement and Replacement decreased $0.1 million due to continued lack of new construction. This was offset by the increase of $0.5 million of a Gain on Disposal of Assets due to the sale of a building rented by the City for the former police station. The District's total expenses decreased $0.2 million in FY 2012-13. This is largely a result of a net between a $0.5 million decrease of overall water operation expenses related to production efficiencies and a $0.3 million increase in wastewater expenses due to increased rates in wastewater treatment costs.

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, 2013, capital assets, net of depreciation, totaled $85.9 million, which is decrease of $1.8 million. This decrease is primarily due to the depreciation expense of $3.7 million, the sale of capital assets totaling $0.1 million net of accumulated depreciation, which is offset by the addition of $2.0 million of construction in progress pertaining to the pipeline replacement.

Table 3
Capital Assets at Year-End

	Balance at June 30, 2012 Net of Accumulated Depreciation	Increases	Decreases	Current Year Depreciation	Balance at June 30, 2013 Net of Accumulated Depreciation
Land	$ 3,174,528	$ -	$ (2,400)	$ -	$ 3,172,128
Water rights	1,699,000	-	-	-	1,699,000
Land improvements	199,726	-	-	(20,857)	178,869
Vehicles	596,431	-	-	(188,747)	407,684
Buildings and structures	1,504,457	-	(10,251)	(237,979)	1,256,227
Machinery and equipment	586,109	131,276	(110,146)	(101,915)	505,324
Infrastructure:					
Water facilities	72,757,998	2,887,981	(15,337)	(3,013,276)	72,617,366
Sewer facilities	3,790,723	-	-	(178,909)	3,611,814
Construction in progress	3,387,152	1,997,759	(2,887,981)	-	2,496,930
	$ 87,696,124	$ 5,017,016	$ (3,026,115)	$ (3,741,683)	$ 85,945,342

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.

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 $2.0 million in FY 2012-13. The decrease is largely due to an annual scheduled payment of $1.2 million on the 5-year $6.0 million loan from the former Hesperia Community Redevelopment Agency, which is being repaid to the Hesperia Housing Authority, and $0.8 million decrease from scheduled 1998 A&B Revenue Bond and 1992B Certificate of Participation payments. Table 4 below, presents the outstanding debt.

Table 4
Outstanding Debt at Year-End

	Principal Balance at June 30, 2012	Additions	Deductions	Principal Balance at June 30, 2013	Due Within One Year
Loans	$ 3,600,000	$ -	$ (1,200,000)	$ 2,400,000	$ 1,200,000
Certificates of participation	885,000	-	(60,000)	825,000	65,000
Revenue bonds	12,770,000	-	(760,000)	12,010,000	790,000
Less deferred amounts:					
Bond discounts	(98,825)	-	7,306	(91,519)	-
Compensated Absences	174,111	191,414	(177,868)	187,657	180,150
Claims payable	132,773	-	-	132,773	-
	$ 17,463,059	$ 191,414	$ (2,190,562)	$ 15,463,911	$ 2,235,150

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

In FY 2013-14, the District's operating revenue is expected to remain relatively unchanged from the $20.2 million operating revenue in FY 2012-13.

Next fiscal year's expense budget for the Water District totals $21.0 million. This 1.1% increase from the FY 2012-13 amount of $20.8 million is a net result of an increase of expenses related to capital projects and a decrease of water operation expenses due to a minor overall production slowdown. As detailed in the FY 2013-14 Budget, the District has budgeted $0.8 million towards capital improvement to complete water line relocation and improvements near Interstate 15 and Ranchero Road as part of the Interstate 15 and Ranchero Road Interchange Project.

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, 2013

	Water Operations & Capital	Sewer Operations & Capital	Total
ASSETS			
Current Assets:			
Cash and cash equivalents	$ -	$ 3,198,535	$ 3,198,535
Receivables:			
Accounts	3,248,490	586,660	3,835,150
Accrued interest	918	1,637	2,555
Due from other governmental agencies	4,052	11,536	15,588
Deposits	22,284	3,315	25,599
Inventories	1,189,594	-	1,189,594
Due from other funds	-	7,866,016	7,866,016
Restricted Assets:			
Cash and investments with fiscal agent	1,890,305	-	1,890,305
Cash held for bondholders	406,071	-	406,071
Total Current Assets	6,761,714	11,667,699	18,429,413
Noncurrent Assets:			
Other Noncurrent Assets:			
Prepaid expenses	497,600	-	497,600
Deposits for self-insurance	168,141	14,554	182,695
Total Other Noncurrent Assets	665,741	14,554	680,295
Capital Assets:			
Land	1,369,341	1,802,787	3,172,128
Water rights	1,699,000	-	1,699,000
Construction in progress	2,496,930	-	2,496,930
Land improvements	790,727	-	790,727
Vehicles	2,271,302	75,819	2,347,121
Machinery and equipment	3,951,062	295,790	4,246,852
Buildings and improvements	7,425,207	-	7,425,207
Water and sewer facilities	118,811,888	7,137,408	125,949,296
Less: Accumulated depreciation	(58,441,211)	(3,740,708)	(62,181,919)
Total Capital Assets	80,374,246	5,571,096	85,945,342
Total Noncurrent Assets	81,039,987	5,585,650	86,625,637
Total Assets	$ 87,801,701	$ 17,253,349	$ 105,055,050
DEFERRED OUTFLOWS OF RESOURCES			
Deferred charges on refunding	964,786	-	964,786
Defferred asset derivative instrument	2,465,464	-	2,465,464
Total Deferred Outflows of Resources	3,430,250	-	3,430,250

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

STATEMENT OF NET POSITION
June 30, 2013

LIABILITIES	Water Operations & Capital	Sewer Operations & Capital	Total
Current Liabilities:			
Accounts payable	$ 2,506,158	$ 191,911	$ 2,698,069
Accrued personnel costs	198,134	11,479	209,613
Accrued interest payable	53,559	-	53,559
Deposits	547,513	-	547,513
Due to other funds	7,866,016	-	7,866,016
Current liabilities payable from restricted assets - due to bondholders	406,071	-	406,071
Liability from derivative instrument	2,465,464	-	2,465,464
Long term debt due within one year	2,205,234	29,916	2,235,150
Total Current Liabilities	16,248,149	233,306	16,481,455
Noncurrent Liabilities:			
Net OPEB obligation	488,245	-	488,245
Compensated absences	6,260	1,247	7,507
Claims payable	119,712	13,061	132,773
Loan payable	1,200,000	-	1,200,000
Revenue bonds (net of unamortized discounts)	11,128,481	-	11,128,481
Certificates of participation	760,000	-	760,000
Total Noncurrent Liabilities	13,702,698	14,308	13,717,006
Total Liabilities	29,950,847	247,614	30,198,461
DEFERRED INFLOWS OF RESOURCES	-	-	-
NET POSITION			
Net investment in capital assets	67,630,765	5,571,096	73,201,861
Restricted for debt service	1,890,305	-	1,890,305
Unrestricted	(8,239,966)	11,434,639	3,194,673
Total Net Position	$ 61,281,104	$ 17,005,735	$ 78,286,839

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

STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION
For the Year Ended June 30, 2013

	Water Operations & Capital	Sewer Operations & Capital	Total
OPERATING REVENUES			
Water sales	$ 16,245,565	$ -	$ 16,245,565
Water services	210,193	-	210,193
Sewer services	-	3,499,280	3,499,280
Other	208,589	-	208,589
Total Operating Revenues	16,664,347	3,499,280	20,163,627
OPERATING EXPENSES			
General and administrative	3,642,699	-	3,642,699
Engineering	810,812	-	810,812
Production	5,586,232	-	5,586,232
Distribution	1,052,379	2,658,089	3,710,468
Customer service	2,015,329	-	2,015,329
Depreciation and amortization	3,548,133	193,550	3,741,683
Total Operating Expenses	16,655,584	2,851,639	19,507,223
OPERATING INCOME (LOSS)	8,763	647,641	656,404
NONOPERATING REVENUES (EXPENSES)			
Unrestricted system improvement and replacement	157,211	-	157,211
Property taxes	283,902	-	283,902
Property taxes - debt service	1,673	-	1,673
Rent income	408,399	-	408,399
Interest income	6,970	7,599	14,569
Interest expense	(1,019,817)	-	(1,019,817)
Gain on disposal of capital assets	523,974	-	523,974
Total Nonoperating Revenues (Expenses), Net	362,312	7,599	369,911
Change In Net Position	371,075	655,240	1,026,315
Net position at beginning of year, as previously stated	61,155,916	16,350,495	77,506,411
Prior Period Adjustment	(245,887)	-	(245,887)
Net position at beginning of year, as restated	60,910,029	16,350,495	77,260,524
Net position at end of year	$ 61,281,104	$ 17,005,735	$ 78,286,839

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

STATEMENT OF CASH FLOWS
For the Year Ended June 30, 2013

	Water Operations & Capital	Sewer Operations & Capital	Total
Cash Flows from Operating Activities:			
Cash received from water and sewer customers	$ 16,144,523	$ 3,427,241	$ 19,571,764
Cash received from other operating receipts	208,589	-	208,589
Cash payments for water purchases	(5,328,589)	-	(5,328,589)
Cash payments for sewer collection and maintenance	-	(2,569,362)	(2,569,362)
Cash payments for services and supplies	(1,066,048)	-	(1,066,048)
Cash payments to employees for services	(6,180,385)	-	(6,180,385)
Net Cash Provided (Used) by Operating Activities	3,778,090	857,879	4,635,969
Cash Flows from Noncapital and Related Financing Activities:			
Property taxes received	285,575	-	285,575
Advances from/to other funds	(237,352)	237,352	-
Net Cash Provided (Used) by Noncapital and Related Financing Activities	48,223	237,352	285,575
Cash Flows from Capital and Related Financing Activities:			
Acquisition and construction of capital assets	(2,099,013)	(30,022)	(2,129,035)
Unrestricted system improvement and replacement receipts	157,211	-	157,211
Proceeds from sale of assets	662,109	-	662,109
Cash received from bondholders	8,189	-	8,189
Cash payment on loan payable to HCRA	(1,200,000)	-	(1,200,000)
Interest payments on long-term debt	(941,980)	-	(941,980)
Principal payments on long-term debt	(820,000)	-	(820,000)
Net Cash Provided (Used) by Capital and Related Financing Activities	(4,233,484)	(30,022)	(4,263,506)
Cash Flows from Investing Activities:			
Rents received	408,399	-	408,399
Interest received	6,961	7,566	14,527
Net Cash Provided by Investing Activities	415,360	7,566	422,926
Net Increase (Decrease) in Cash and Cash Equivalents	8,189	1,072,775	1,080,964
Cash and cash equivalents at beginning of year	2,288,187	2,125,760	4,413,947
Cash and cash equivalents at end of year	$ 2,296,376	$ 3,198,535	$ 5,494,911

(continued)

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

STATEMENT OF CASH FLOWS
For the Year Ended June 30, 2013

	Water Operations & Capital	Sewer Operations & Capital	Total
Reconciliation of Operating Income to Net Cash Flows Provided by Operating Activities:			
Operating income (Loss)	$ 8,763	$ 647,641	$ 656,404
Adjustments to Reconcile Operating Income to Net Cash Provided by Operating Activities:			
Depreciation and amortization	3,548,133	193,550	3,741,683
Changes in operating assets and liabilities:			
(Increase) decrease in accounts receivable	(311,235)	(62,213)	(373,448)
(Increase) decrease in deposits	145,606	15,154	160,760
(Increase) decrease in inventory	(13,669)	-	(13,669)
(Increase) decrease in prepaid expenses	-	-	-
(Increase) decrease in due from other governments	7,308	(11,536)	(4,228)
Increase (decrease) in accounts payable	257,643	62,756	320,399
Increase (decrease) in accrued personnel costs	(13,244)	1,710	(11,534)
Increase (decrease) in customer deposits	29,939	(53)	29,886
Increase (decrease) in due to other governments	-	-	-
Increase (decrease) in claims and judgments payable	-	-	-
Increase (decrease) in net OPEB obligation	116,171	-	116,171
Increase (decrease) in deferred revenue	-	-	-
Increase (decrease) in compensated absences	2,675	10,870	13,545
Total Adjustments	3,769,327	210,238	3,979,565
Net Cash Provided (Used) by Operating Activities	$ 3,778,090	$ 857,879	$ 4,635,969

Supplemental Disclosures:

Noncash Capital and Financing Activities			
Amortization Related to Long-Term Debt	$ 84,243		

See accompanying independent auditors' report and notes to basic 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:

<u>Water Operations & Capital</u> - 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.

<u>Sewer Operations & Capital</u> - 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):

e. 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.

. Measurement focus, basis of accounting, and financial statement presentation (Continued):

New Accounting Pronouncements:

Implemented

In fiscal year 2012-2013, the District implemented Governmental Accounting Standards Board (GASB) Statement No. 63, "*Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position"*. This statement incorporates deferred outflows of resources and deferred inflows of resources, as defined by GASB Concepts Statement No. 4, *"Elements of Financial Statements"* into the definitions of the required components of the residual measure of net position, formerly net assets. This statement also provides a new Statement of Net Position format to report all assets, deferred outflows of resources, liabilities, deferred inflows of resources, and net position.

In fiscal year 2012-2013, the District early implemented GASB Statement No. 65, "*Items Previously Reported as Assets and Liabilities"*. This statement established accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities. Due to the early implementation of this statement, bond issue costs, which should be recognized as an expense in the period incurred, were eliminated. Accounting changes adopted to conform to the provisions of this statement should be applied retroactively. The result of the implementation of this standard decreased the net position at July 1, 2012 of the District's activities by $245,887.

Pending Accounting Standards

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

- GASB 66 - "*Technical Corrections, an amendment of GASB Statement No. 10 and Statement No. 62",* effective for periods beginning after December 15, 2012.
- GASB 67 - *"Financial Reporting for Pension Plans, an amendment of GASB Statement No. 25"*, effective for the fiscal years beginning after June 15, 2013.
- 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 70 - "*Accounting and Financial Reporting for Nonexchange Financial Guarantees"*, effective for the periods beginning after June 15, 2013.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued):

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.

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.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued):

k. Property Taxes (continued):

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.

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).

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued):

n. Deferred Outflows/Inflows of Resources (continued):

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, 2013.

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, 2013, 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.

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, 2013.

r. Interest Expense:
The District incurs interest charges on long-term debt. Interest expenses for the year ended June 30, 2013 was $1,019,817. No amounts were capitalized as a cost of construction projects.

2. CASH, CASH EQUIVALENTS, AND INVESTMENTS:

Cash and investments at June 30, 2013 are classified in the accompanying financial statements as follows:

STATEMENT OF NET POSITION:	
Current Assets:	
Cash and cash equivalents	$ 3,198,535
Restricted assets:	
Cash and investments with fiscal agent	1,890,305
Cash held for bondholders	406,071
Total cash and investments	$ 5,494,911

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

See accompanying independent auditors' report.

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

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 $5,494,911 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.

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, 2013 was as follows:

	Balance at June 30, 2012	Increases	Decreases	Balance at June 30, 2013
Capital assets, not being depreciated:				
Land	$ 3,174,528	$ -	$ (2,400)	$ 3,172,128
Water rights	1,699,000	-	-	1,699,000
Construction in progress	3,387,152	1,997,759	(2,887,981)	2,496,930
Total capital assets, not being depreciated	8,260,680	1,997,759	(2,890,381)	7,368,058
Capital assets being depreciated:				
Land improvements	790,727	-	-	790,727
Vehicles	2,347,121	-	-	2,347,121
Machinery and equipment	4,314,012	131,276	(198,436)	4,246,852
Buildings and improvements	7,889,838	-	(464,631)	7,425,207
Water facilities	116,171,340	2,887,981	(247,433)	118,811,888
Sewer facilities	7,137,408	-	-	7,137,408
Total capital assets, being depreciated	138,650,446	3,019,257	(910,500)	140,759,203
Less accumulated depreciation for:				
Land improvements	(591,001)	(20,857)	-	(611,858)
Vehicles	(1,750,690)	(188,747)	-	(1,939,437)
Machinery and equipment	(3,727,903)	(101,915)	88,290	(3,741,528)
Buildings and improvements	(6,385,381)	(237,979)	454,380	(6,168,980)
Water facilities	(43,413,342)	(3,013,276)	232,096	(46,194,522)
Sewer facilities	(3,346,685)	(178,909)	-	(3,525,594)
Total accumulated depreciation	(59,215,002)	(3,741,683)	774,766	(62,181,919)
Total capital assets, being depreciated,net	79,435,444	(722,426)	(135,734)	78,577,284
Total capital assets, net	$ 87,696,124	$ 1,275,333	$ (3,026,115)	$ 85,945,342

Depreciation expense for the year ended June 30, 2013 was $3,548,133 for Water operating and capital and $193,550 for Sewer operating and capital.

See accompanying independent auditors' report.

4. LONG-TERM DEBT:

Following is a summary of the changes in principal balance of long-term debt for the year ended June 30, 2013:

	Principal Balance at June 30, 2012	Additions	Deductions	Principal Balance at June 30, 2013	Due Within One Year
Loans	$ 3,600,000	$ -	$ (1,200,000)	$ 2,400,000	$1,200,000
Certificates of Participation	885,000	-	(60,000)	825,000	65,000
Revenue Bonds	12,770,000	-	(760,000)	12,010,000	790,000
Less deferred amounts:					
Bond discounts	(98,825)	-	7,306	(91,519)	-
Total Revenue Bonds	12,671,175	-	(752,694)	11,918,481	790,000
Compensated absences	174,111	191,414	(177,868)	187,657	180,150
Claims Payable	132,773	-	-	132,773	-
Total Long-term Debt	$ 17,463,059	$ 191,414	$ (2,190,562)	$ 15,463,911	$2,235,150

Long-term debt at June 30, 2013 is comprised of the following issues:

	Balance at June 30, 2013
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, 2013 had a rate of 0.24%. 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 responsibility of this loan.	$ 2,400,000
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 through the year 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.	825,000

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 can be fixed at 5.96%. The amount fixed with the counterparty decreases over time to $6,910,000 at June 20, 2020. At June 30, 2013 the amount fixed was $10,000,000.	11,005,000

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.	1,005,000
Compensated Absences	187,657
Claims Payable	132,773
Subtotal	15,555,430
Less: Bond Discounts	(91,520)
Total Long-Term Debt Before Current Portion	15,463,911
Less: Current Portion – Due Within One Year	(2,235,150)
Total Long-Term Portion of Long-Term Debt	$13,228,761

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
2014	$ 1,200,000	$ 5,760	$ 1,205,760
2015	1,200,000	2,880	1,202,880
	$ 2,400,000	$ 8,640	$ 2,408,640

Variable interest rate used for the 2010 Hesperia Community Redevelopment Agency Loan was 0.24% at June 30, 2013.

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

Fiscal Year Ending	Principal	Interest	Total
2014	$ 790,000	$ 600,310	$ 1,390,310
2015	820,000	598,221	1,418,221
2016	855,000	572,766	1,427,766
2017	885,000	527,909	1,412,909
2018	920,000	481,263	1,401,263
2019-2023	4,800,000	1,655,121	6,455,121
2024-2027	2,940,000	355,216	3,295,216
	$ 12,010,000	$ 4,790,806	$ 16,800,806

Variable interest rate used for the 1998A Variable Rate Lease Revenue Refunding Bonds above the $10,000,000 fixed amounts was 0.28% at June 30, 2013. Variable interest rate used for the 1998B Variable rate Lease revenue Refunding Bonds was 0.15% at June 30, 2013.

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

Fiscal Year Ending	Principal	Interest	Total
2014	$ 65,000	$ 74,250	$ 139,250
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
2019-2022	445,000	103,950	548,950
	$ 825,000	$ 412,200	$ 1,237,200

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 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 contribute 50% of the normal cost, 6.25% of their annual covered salary and the employer contribute 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, 2013 the District has one (1) 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 2012/13, ended June 30, 2013 was 13.391%, 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 $368,428, $358,057, and $270,670 for the years ended June 30, 2013, 2012, and 2011 respectively. CalPERS does not provide individual plan trend information for risk pools.

6. OTHER POST EMPLOYMENT BENEFITS:

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 2013 was $115 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 4.2% of the annual covered payroll.

The following table shows the components of the District's annual OPEB cost for the year ending June 30, 2013, the amount actually contributed to the plan, and changes in the District's net OPEB obligation:

Annual Required Contribution (ARC)	$ 122,980
Interest on net OPEB obligation	16,066
Adjustment to Annual Required Contribution (ARC)	(17,156)
Annual OPEB cost (expense)	121,890
Contributions made	(5,719)
Increase in net OPEB obligation	116,171
Net OPEB obligation - beginning of year	372,074
Net OPEB obligation - end of year	$ 488,245

See accompanying independent auditors' report.

6. OTHER POST EMPLOYMENT BENEFITS (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 2013, 2012 and 2011 were as follows:

THREE-YEAR TREND INFORMATION FOR CERBT

Fiscal Year	Annual OPEB Cost (AOC)	Percentage of OPEB Cost Contributed	Net OPEB Obligation
6/30/2013	$ 121,890	4.7%	$ 488,245
6/30/2012	118,728	7.1%	372,074
6/30/2011	111,000	5.1%	261,800

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 (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 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 and premiums are paid quarterly. 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 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 coverage.

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%.

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

Details on the swap agreement are as follows:

Notional Amount	Interest Rate	Issue	Termination Date	Intial 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, 2012	Change In Fair Value	Fair Value At June 30, 2013
$ 10,000,000	$ (3,263,053)	$ 797,589	$ (2,465,464)

Due to the implementation of GASB 63, the June 30, 2013 negative fair value of $2,465,464 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, 2013, 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, 2013 the swap had a negative fair value of $2,465,464.

Swap Payments and Associated Debt:

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, 2013, 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 0.28% are as follows. As rates vary, the variable rate interest payments and net swap payments will vary.

	Variable Rate Debt					
Year Ending June 30,	Outstanding Swap Balance	Principal	Interest	Total	Interest Rate Swap, Net	Fixed Debt Service
2014	10,000,000	-	28,000	28,000	568,000	568,000
2015	10,000,000	-	26,852	26,852	544,712	544,712
2016	9,340,000	-	24,752	24,752	502,112	502,112
2017	8,560,000	-	22,568	22,568	457,808	457,808
2018	7,750,000	-	20,300	20,300	411,800	411,800
2019	6,910,000	-	17,948	17,948	364,088	364,088
2020	-	-	15,498	15,498	314,388	314,388

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%

n/a – The Water District is only required to perform actuarial valuations biannually. An actuarial valuation was not performed for the year ending June 30, 2009 and June 30, 2011.

See accompanying independent auditors' report.