

**HERCULES WASTEWATER FUND  
(AN ENTERPRISE FUND OF THE  
CITY OF HERCULES, CALIFORNIA)**

**FINANCIAL STATEMENTS**

**YEAR ENDED JUNE 30, 2017**



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**HERCULES WASTEWATER FUND  
TABLE OF CONTENTS  
YEAR ENDED JUNE 30, 2017**

Independent Auditors' Report	1
Financial Statements	
Statement of Net Position	3
Statement of Revenues, Expenses, and Changes in Net Position	4
Statement of Cash Flows	5
Notes to Financial Statements	7
Independent Auditors' Report on Internal Control Over Financial Reporting and On Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards	16

## INDEPENDENT AUDITORS' REPORT

Honorable Mayor and Members of the  
City Council of the City of Hercules  
Hercules, California

### **Report on the Financial Statements**

We have audited the accompanying financial statements of the Wastewater Fund (Fund) of the City of Hercules (City), as of and for the year ended June 30, 2017, and the related notes to the financial statements, as listed in the table of contents.

### ***Management's Responsibility for the Financial Statements***

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### ***Auditor's Responsibility***

Our responsibility is to express opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Honorable Mayor and Members of the  
City Council of the City of Hercules  
Hercules, California

***Opinion***

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Wastewater Fund, as of June 30, 2017, and the changes in its financial position and cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

***Emphasis of Matters***

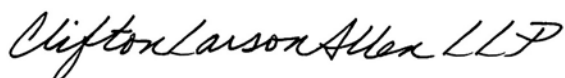
As discussed in Note 1, the financial statements present only the Wastewater Fund, an enterprise fund of the City, and do not purport to, and do not present fairly the financial position of the City of Hercules as of June 30, 2017, the changes in its financial position, or where applicable, its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

As described in Note 9 to the financial statements, the Hercules Wastewater Fund has outstanding loans of \$10.6 million owed by the former redevelopment agency (Agency), now a private purpose trust fund of the City. These outstanding loans represent approximately 19% of the Hercules Wastewater Fund's assets. The written agreement between the Agency and the Hercules Wastewater Fund to fund costs on behalf of the Agency was signed within two years of the creation of the Agency. Under Assembly Bill X1 26 (Redevelopment Dissolution Act), a written agreement between a redevelopment agency and the Fund that created it that provided loans or other startup funds for the redevelopment agency that were entered into within two years of the formation of the redevelopment agency are not invalid. The Hercules Wastewater Fund is currently working with the State Department of Finance to determine the outcome of these loans. The possible outcome of this matter cannot presently be determined. Accordingly, no provision for any allowance for doubtful accounts has been made in the financial statements for possible forgiveness of these loans.

Our opinion is not modified with respect to these matters.

***Other Reporting Required by Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated February 7, 2018 on our consideration of the Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Fund's internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Fund's internal control over financial reporting and compliance.



**CliftonLarsonAllen LLP**

Roseville, California  
February 7, 2018

**HERCULES WASTEWATER FUND**  
**STATEMENT OF NET POSITION**  
**JUNE 30, 2017**

**ASSETS**

Current Assets:	
Cash and Investments	\$ 16,164,274
Cash with Fiscal Agent	<u>6,888,975</u>
Total Current Assets	23,053,249
Noncurrent Assets:	
Due from Former Hercules Redevelopment Agency	10,587,627
Capital Assets:	
Nondepreciable:	
Land	191,700
Construction in Progress	<u>9,510,857</u>
Total Nondepreciable Capital Assets	9,702,557
Depreciable:	
Buildings and Improvements	11,335,199
Infrastructure	13,729,500
Machinery and Equipment	<u>250,345</u>
Total Depreciable Capital Assets	25,315,044
Less Accumulated Depreciation	<u>(11,905,370)</u>
Net Depreciable Capital Assets	<u>13,409,674</u>
Net Capital Assets	<u>23,112,231</u>
Total Noncurrent Assets	<u>33,699,858</u>
Total Assets	56,753,107

**DEFERRED OUTFLOWS OF RESOURCES**

Deferred Outflows - Pension	155,961
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**LIABILITIES**

Current Liabilities:	
Accounts Payable	1,640,451
Retention Payable	408,281
Salaries and Benefits Payable	17,169
Accrued Interest Payable	196,270
Compensated Absences	28,746
Long Term Debt, Due Within One Year	<u>260,000</u>
Total Current Liabilities	2,550,917
Noncurrent Liabilities:	
Net Pension Liability	562,901
Compensated Absences	10,450
Long Term Debt, Due in More Than One Year	<u>16,694,417</u>
Total Noncurrent Liabilities	<u>17,267,768</u>
Total Liabilities	19,818,685

**DEFERRED INFLOWS OF RESOURCES**

Deferred Inflows - Pension	<u>57,129</u>
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**NET POSITION**

Net Investment in Capital Assets	9,503,346
Unrestricted	<u>27,529,908</u>
Total Net Position	<u>\$ 37,033,254</u>

See accompanying Notes to Financial Statements.

**HERCULES WASTEWATER FUND**  
**STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION**  
**YEAR ENDED JUNE 30, 2017**

**OPERATING REVENUES**

Sales and Charges for Services	\$ 5,797,766
Total Operating Revenues	<u>5,797,766</u>

**OPERATING EXPENSES**

Salaries and Benefits	428,387
Services and Supplies	1,724,314
Depreciation	452,433
Total Operating Expenses	<u>2,605,134</u>

**OPERATING INCOME**

3,192,632

**NONOPERATING REVENUES (EXPENSES)**

Interest Income	47,424
Interest Expense	<u>(487,246)</u>
Total Nonoperating Revenues (Expenses)	<u>(439,822)</u>

**CHANGE IN NET POSITION**

2,752,810

Net Position - Beginning of Year

34,280,444

**NET POSITION - END OF YEAR**

\$ 37,033,254

*See accompanying Notes to Financial Statements.*

**HERCULES WASTEWATER FUND  
STATEMENT OF CASH FLOWS  
YEAR ENDED JUNE 30, 2017**

**CASH FLOWS FROM OPERATING ACTIVITIES**

Cash Receipts from Customers	\$ 5,798,221
Cash Paid to Suppliers for Goods and Services	(2,799,745)
Cash Paid to Employees for Services	(451,964)
Net Cash Provided (Used) by Operating Activities	<u>2,546,512</u>

**CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES**

Proceeds from the Issuance of Debt	6,786,667
Payments Related to the Acquisition of Capital Assets	(8,096,961)
Principal Repayments Related to Capital Purposes	(250,000)
Interest Repayments Related to Capital Purposes	(483,225)
Net Cash Provided (Used) by Capital and Related Financing Activities	<u>(2,043,519)</u>

**CASH FLOWS FROM INVESTING ACTIVITIES**

Interest Received (Paid)	<u>47,424</u>
Net Cash Provided (Used) by Investing Activities	<u>47,424</u>

**NET INCREASE IN CASH AND CASH EQUIVALENTS**

550,417

Cash and Cash Equivalents - Beginning of Year

22,502,832

**CASH AND CASH EQUIVALENTS - END OF YEAR**

\$ 23,053,249

**RECONCILIATION OF CASH AND CASH EQUIVALENTS TO STATEMENT  
OF NET POSITION**

Cash and Investments	\$ 16,164,274
Cash with Fiscal Agent	<u>6,888,975</u>

Total Cash and Cash Equivalents

\$ 23,053,249

*See accompanying Notes to Financial Statements.*



**HERCULES WASTEWATER FUND  
STATEMENT OF CASH FLOWS (CONTINUED)  
YEAR ENDED JUNE 30, 2017**

**RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH  
PROVIDED (USED) BY OPERATING ACTIVITIES**

Operating Income	\$ 3,192,632
Adjustments To Reconcile Operating Income to Net Cash Provided by Operating Activities:	
Depreciation	452,433
(Increase) Decrease in Assets:	
Receivables	455
Increase (Decrease) in Liabilities:	
Accounts Payable	(1,075,431)
Accrued Salaries and Benefits	4,107
Net Pension Liability and Related Deferred Inflows and Outflows	(38,134)
Compensated Absences	10,450
	<hr/>
Net Cash Provided by Operating Activities	<u><u>\$ 2,546,512</u></u>

**NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES**

Capital Asset Additions in Accounts Payable	<u><u>\$ 385,162</u></u>
Capital Asset Additions in Retentions Payable	<u><u>\$ 408,281</u></u>

*See accompanying Notes to Financial Statements.*

**HERCULES WASTEWATER FUND**  
**NOTES TO FINANCIAL STATEMENTS**  
**JUNE 30, 2017**

**NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

The Hercules Wastewater Fund was formed to account for the City's cost of providing wastewater and sewage treatment services to the residents of the City of Hercules.

**A. Reporting Entity**

The financial statements present information on the financial activities of the Wastewater Fund. The Fund is included as an enterprise fund of the City's financial statements. The financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The more significant of the accounting policies are described below.

**B. Measurement Focus and Basis of Accounting**

The accounting and reporting treatment applied to the Hercules Wastewater Fund is determined by its measurement focus. The Hercules Wastewater Fund is accounted for on an "*economic resources*" measurement focus, which means that all assets and liabilities (whether current or noncurrent) associated with the activity are included on the statement of net position. The statement of revenues, expenses, and changes in net position present increases (revenues) and decreases (expenses) in total net position.

The Hercules Wastewater Fund is accounted for using the accrual basis of accounting. Accordingly, revenues are recognized in the accounting period in which they are earned, while expenses are recognized in the period in which the liability is incurred.

Operating revenues are those revenues that are generated from the primary operations of the Hercules Wastewater Fund. All other revenues are reported as nonoperating revenues. Operating expenses are those expenses that are essential to the primary operations of the fund. All other expenses are reported as nonoperating expenses.

**C. Cash and Investments**

The Hercules Wastewater Fund pools cash resources with City funds in order to facilitate the management of cash.

Governmental Accounting Standards Board Statement No. 40 requires additional disclosures about a government's deposits and investments risks that include credit risk, custodial risk, concentration risk, and interest rate risk. The Fund adheres to the City's investment policy that addresses specific types of risk.

For additional information regarding the City's investments refer to the City's financial statements.

For purposes of the statement of cash flows the Wastewater Fund considers all highly liquid investments with an original maturity of three months or less when purchased, and its equity in the City's investment pool to be cash and cash equivalents.

**HERCULES WASTEWATER FUND  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2017**

**NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

**D. Cash and Investments with Fiscal Agents**

Cash and investments are held by fiscal agents for the redemption of bonded debt and maintaining required reserves.

**E. Receivables**

All receivables are shown net of an allowance for doubtful accounts. Wastewater revenues (wastewater disposal services) are recorded as billed to customers on a cyclical basis. All wastewater customers are billed annually by the Contra Costa County Treasurer-Tax Collector Office.

**F. Capital Assets**

Capital assets are capitalized at their historical costs if purchased. Contributed assets are recorded at the fair value as of the date of receipt. Depreciation has been provided on a straight-line basis over the following estimated useful lives:

Wastewater Structures	30 Years
Equipment and Furniture	4 Years
Infrastructure	15 – 20 Years

**G. Accounts Payable**

Accounts payable consists of general administration costs incurred and construction services performed during the fiscal year, but paid after the fiscal year.

**H. Long-Term Obligations**

Long-term debt and other long-term obligations are reported as liabilities. Bond premiums and discounts are deferred and amortized over the life of the bonds using the straight-line method. Bonds payable are reported net of the applicable premium or discount.

**I. Compensated Absences**

Compensated absences are comprised of unpaid vacation and compensated time off and are reported as a long-term liability when the benefits vest and are earned.

**J. Net Position**

In the financial statements, net position may be classified in the following categories:

Net Investment in capital assets – This category groups all capital assets, including infrastructure, into one component of net position. Accumulated depreciation and the outstanding balance of debt that are attributable to the acquisition, construction, or improvement of these assets reduce the balance in this category.

**HERCULES WASTEWATER FUND  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2017**

**NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)**

*Restricted Net Position* – This category presents external restrictions imposed by creditors, grantors, contributors or laws or regulations of other governments and restrictions imposed by law through constitutional provisions or enabling legislation.

*Unrestricted Net Position* – This category represents net position of the Hercules Wastewater Fund, not restricted for any project or other purpose.

When an expense is incurred for purposes for which both restricted and unrestricted net position is available, the Hercules Wastewater Fund's policy is to apply restricted net position first.

**K. Use of Estimates**

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

**NOTE 2 CASH AND INVESTMENTS**

The Hercules Wastewater Fund pools its cash and investments with the City in order to achieve a higher return on investment. Certain funds, which are held and invested by independent outside custodians through contractual agreements, are not pooled. Interest earned on investments is allocated using the LAIF factor and average quarterly balances. Required disclosure information regarding categorization of investments and other deposit and investment risk disclosures can be found in the City's financial statements. The City's financial statements may be obtained by contacting the City's Finance Department's office at 111 Civic Drive, Hercules, California.

Investments held in the City's investment pool are available on demand and are stated at cost plus accrued interest, which approximates fair value.

Cash and investments at June 30, 2017 consisted of the following:

Cash and Investments Held with the City	\$ 16,164,274
Investments Held with Fiscal Agent	6,888,975
Total Cash and Investments	<u>\$ 22,502,832</u>

**Disclosures Relating to Interest Rate Risk**

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. A method the Fund utilizes to manage its exposure to interest rate risk is by purchasing a combination of shorter term and longer term investments, thereby timing cash flows from maturities so that a portion of the portfolio is maturing or coming close to maturity evenly over time as necessary to provide the cash flows and liquidity needed for operations.

**HERCULES WASTEWATER FUND**  
**NOTES TO FINANCIAL STATEMENTS**  
**JUNE 30, 2017**

**NOTE 2 CASH AND INVESTMENTS (CONTINUED)**

Information about the sensitivity of the fair values of the Fund's investments (including investments held by bond trustees) to market interest rate fluctuations is provided by the following table, which shows the distribution of the Fund's investments by maturity:

Investment Type	Remaining Maturity (in Months)	
	Totals	12 Months or Less
Held by Debt Trustees:		
Money Market Funds	\$ 6,888,975	\$ 6,888,975
Totals	<u>\$ 6,888,975</u>	<u>\$ 6,888,975</u>

**Disclosures Relating to Credit Risk**

Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. Presented below is the minimum rating required by (where applicable) the California Government Code, the Fund's investment policy, or debt agreements, and the actual rating as of fiscal year end for each investment type.

Investment Type	Amount	Maximum Legal Rating	Exempt from Disclosure	S&P Rating as of Fiscal Year End	
				AAAm	Not Rated
Held by Debt Trustees:					
Money Market Funds	\$ 6,888,975	N/A	\$ -	\$ 6,888,975	\$ -
Total	<u>\$ 6,888,975</u>		<u>\$ -</u>	<u>\$ 6,888,975</u>	<u>\$ -</u>

**HERCULES WASTEWATER FUND**  
**NOTES TO FINANCIAL STATEMENTS**  
**JUNE 30, 2017**

**NOTE 3 CAPITAL ASSETS**

At June 30, 2017, the Hercules Wastewater Fund's capital assets consisted of the following:

	Balance July 1, 2016	Additions	Deletions	Transfers/ Adjustments	Balance June 30, 2017
Nondepreciable Assets:					
Land	\$ 191,700	\$ -	\$ -	\$ -	\$ 191,700
Construction in Progress	2,664,402	8,966,315	-	(2,119,860)	9,510,857
Total Nondepreciable Assets	2,856,102	8,966,315	-	(2,119,860)	9,702,557
Depreciable Assets:					
Infrastructure	10,161,008	201,182	-	3,367,310	13,729,500
Structures and improvements	12,876,281	-	-	(1,541,082)	11,335,199
Equipment	233,806	-	-	16,539	250,345
Total Depreciable Assets	23,271,095	201,182	-	1,842,767	25,315,044
Less Accumulated Depreciation for:					
Infrastructure	(1,442,353)	(250,706)	-	-	(1,693,059)
Structures and Improvements	(9,881,265)	(184,684)	-	-	(10,065,949)
Equipment	(129,319)	(17,043)	-	-	(146,362)
Total Accumulated Depreciation	(11,452,937)	(452,433)	-	-	(11,905,370)
Total Depreciable Assets, Net	11,818,158	(251,251)	-	1,842,767	13,409,674
Total Capital Assets	\$ 14,674,260	\$ 8,715,064	\$ -	\$ (277,093)	\$ 23,112,231

**NOTE 4 LONG-TERM LIABILITIES**

The following is a summary of long-term liabilities activity of Hercules Wastewater Fund for the fiscal year ended June 30, 2017:

	Balance July 1, 2016	Additions	Deletions	Balance June 30, 2017	Amounts Due Within One Year
Business-Type Activities:					
2010 PFA Wastewater Revenue Bonds	\$ 10,585,000	\$ -	\$ (250,000)	\$ 10,335,000	\$ 260,000
Discount on Issuance	(174,522)	-	7,272	(167,250)	-
Publicly Owned Treatment Works Construction Loan	-	6,786,667	-	6,786,667	-
Compensated Absences	28,746	20,831	(10,381)	39,196	28,746
Total Long-Term Liabilities	\$ 10,439,224	\$ 6,807,498	\$ (253,109)	\$ 16,993,613	\$ 288,746

**HERCULES WASTEWATER FUND  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2017**

**NOTE 4 LONG-TERM LIABILITIES (CONTINUED)**

**2010 Public Financing Authority Wastewater Revenue Bonds**

The Public Financing Authority issued revenue bonds, series 2010, dated August 1, 2010, totaling \$11,765,000. The purpose of the bonds was to finance improvements to the City's wastewater system, fund a reserve fund for the bonds, and pay the costs of issuances of the bonds. The interest rates on the bonds range from 2.00% to 5.130%. Principal is due annually beginning August 1, 2011, in amounts ranging from \$230,000 to \$700,000. The bonds mature on August 1, 2040. The balance at June 30, 2017 is \$10,335,000.

Future debt service requirements on the 2010 Public Financing Authority Wastewater Revenue Bonds are:

<u>Year Ended June 30</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2018	\$ 260,000	\$ 474,950	\$ 734,950
2019	265,000	467,075	732,075
2020	275,000	458,631	733,631
2021	285,000	449,175	734,175
2022	295,000	438,288	733,288
2023-2027	1,655,000	1,995,306	3,650,306
2028-2032	2,065,000	1,568,350	3,633,350
2033-2037	2,625,000	993,125	3,618,125
2038-2042	2,610,000	269,000	2,879,000
Subtotal	10,335,000	7,113,900	17,448,900
Less: Discount	(167,250)	-	(167,250)
Total	<u>\$ 10,167,750</u>	<u>\$ 7,113,900</u>	<u>\$ 17,281,650</u>

**Publicly Owned Treatment Works Construction Loan**

In June 2016, the City of Hercules entered into an installment sale agreement with the California State Water Resources Control Board in the amount of \$26,500,000. The funds will be used for construction costs for the Pinole-Hercules Wastewater Pollution Control Plant Improvement Project. The interest rate on the loan is 1.7%. The first principal and interest payment is due August 31, 2019, in the amount of \$1,347,202, and second on August 31, 2020 in the amount of \$1,539,216. Principal and interest payments are due annually beginning on August 31, 2021 in the amount of \$1,582,487. The loan matures on August 31, 2038. The City had drawn down \$6,786,667 of the loan principal as of June 30, 2017.

Future debt service requirements on the Publicly Owned Treatment Works Construction Loan are:

<u>Year Ended June 30</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2018	\$ -	\$ 157,281	\$ 157,281
2019	-	157,281	157,281
2020	993,143	157,281	1,150,424
2021	1,143,017	140,397	1,283,414
2022	1,169,581	120,966	1,290,547
2023-2027	3,480,926	299,960	3,780,886
Total	<u>\$ 6,786,667</u>	<u>\$ 1,033,166</u>	<u>\$ 7,819,833</u>

**HERCULES WASTEWATER FUND  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2017**

**NOTE 5 DUE FROM THE FORMER HERCULES REDEVELOPMENT AGENCY**

The Hercules Wastewater Fund has advanced funds to the former Redevelopment Agency of the City. At June 30, 2017, the balance was \$10,587,627. There was no set repayment schedule as of June 30, 2017.

**NOTE 6 RISK MANAGEMENT**

The Hercules Wastewater Fund is exposed to various risks of loss related to torts, theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disaster. The Fund participates in the City's insurance programs to insure against these losses. Complete information on risk management can be found in the City's audited financial statements.

**NOTE 7 PUBLIC EMPLOYEE RETIREMENT SYSTEM**

**A. General Information about the Pension Plan**

Hercules Wastewater Fund employees are covered under the retirement plan of the City of Hercules.

The City contributes to the California Public Employees Retirement System (PERS), a cost-sharing multiple employer defined benefit pension plan. PERS provides retirement and disability benefits, annual cost of living adjustments, and death benefits to plan members and beneficiaries. PERS acts as a common investment and administrative agent for participating public entities within the State of California. Benefit provisions and all other requirements are established by statute. Copies of PERS' annual financial report may be obtained from their executive office – 400 Q Street, Lincoln Plaza East, Sacramento, CA 95811 or [www.calpers.ca.gov](http://www.calpers.ca.gov).

Required disclosure information regarding employee's retirement plan can be found in the City's audited financial statements.

**B. Net Pension Liability**

The Wastewater Fund's proportionate share of the City of Hercules' net pension liability for the retirement plan is measured as the total pension liability, less the pension plan's fiduciary net position. The net pension liability of the retirement plan is measured as of June 30, 2015, rolled forward to June 30, 2016 using standard update procedures. The principal assumptions and methods used to determine the net pension liability are shown in the City's audited financial statements.



**HERCULES WASTEWATER FUND  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2017**

**NOTE 7 PUBLIC EMPLOYEE RETIREMENT SYSTEM (CONTINUED)**

**C. Sensitivity of Net Pension Liability to Changes in the Discount Rate**

The following presents the net pension liability of the Wastewater Fund's proportionate share of the Plan as of the measurement date, calculated using the discount rate of 7.65%, as well as what the net pension liability would be if it were calculated using a discount rate that is 1 percentage-point lower (6.65%) or 1 percentage point higher (8.65%) than the current rate:

	Discount Rate		
	1% Discount 6.65%	Current Rate 7.65%	1% Increase 8.65%
Net Pension Liability	<u>\$ 820,099</u>	<u>\$ 562,901</u>	<u>\$ 351,110</u>

**Pension Expense and Deferred Outflows/Inflows of Resources Related to Pensions**

For the year ended June 30, 2017, the Wastewater Fund recognized pension expense of \$25,970. At June 30, 2017, the Wastewater Fund reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Pension Contributions Subsequent to Measurement Date	\$ 55,693	\$ -
Changes of Assumptions	-	(39,077)
Differences Between Expected and Actual Experience	-	(4,913)
Change in Proportion	7,633	(13,139)
Change in Employer's Proportion and Differences Between the Employer's Contributions and the Employer's Proportionate Share of Contributions	9,020	-
Net Differences Between Projected and Actual Earnings on Plan Investments	83,615	-
Total	<u>\$ 155,961</u>	<u>\$ (57,129)</u>

**HERCULES WASTEWATER FUND  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2017**

**NOTE 7 PUBLIC EMPLOYEE RETIREMENT SYSTEM (CONTINUED)**

**C. Sensitivity of Net Pension Liability to Changes in the Discount Rate (Continued)**

Deferred outflows of resources of \$55,693 related to contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended June 30, 2018. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized as pension expense as follows:

<u>Year Ended June 30</u>	<u>Amount</u>
2018	\$ 4,077
2019	4,831
2020	21,876
2021	12,355

**NOTE 8 COMMITMENTS AND CONTINGENCIES**

The Hercules Wastewater Fund is not involved in any matters of litigation that have arisen in the normal course of conducting Hercules Wastewater Fund business as of June 30, 2017. Additionally, the Hercules Wastewater Fund management believes that the insurance coverage is sufficient to cover any potential losses should any litigation with an unfavorable outcome materialize in the future.

**NOTE 9 FINANCIAL CONDITION**

With the dissolution of the redevelopment agency on February 1, 2012 there is uncertainty as to whether the Hercules Wastewater Fund will be repaid the accumulated \$10.5 million loan owed by the Agency, now a private purpose trust fund of the City. However, the written agreement between the Agency and the City to fund costs on behalf of the Agency was signed within two years of the creation of the agency. Under Assembly Bill X1 26 (Redevelopment Dissolution Act), a written agreement between a redevelopment agency and the City that created it that provided loans or other startup funds for the redevelopment agency that were entered into within two years of the formation of the redevelopment agency are not invalid. The City is currently working with the State Department of Finance to determine the outcome of these loans. The possible outcome of this matter cannot presently be determined. Accordingly, no provision for any allowance for doubtful accounts has been made in the financial statements for possible forgiveness of these loans.

**INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL  
OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS  
BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED  
IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS***

Honorable Mayor and Members of the  
City Council of the City of Hercules  
Hercules, California

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the Hercules Wastewater Fund (Fund) of the City of Hercules as of and for the fiscal year ended June 30, 2017, and the related notes to the financial statements, and have issued our report thereon dated February 7, 2018.

**Internal Control Over Financial Reporting**

In planning and performing our audit of the financial statements, we considered the Fund's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control. Accordingly, we do not express an opinion on the effectiveness of the Fund's internal control.

A *deficiency* in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

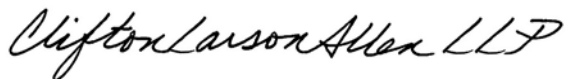
Honorable Mayor and Members of the  
City Council of the City of Hercules  
Hercules, California

### **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether the Fund's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

### **Purpose of this Report**

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

A handwritten signature in cursive script that reads "CliftonLarsonAllen LLP".

**CliftonLarsonAllen LLP**

Roseville, California  
February 7, 2018