

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

**FINANCIAL STATEMENTS**

**YEAR ENDED JUNE 30, 2018**



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## 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 Hercules Wastewater Fund (Fund) of the City of Hercules (City), as of and for the year ended June 30, 2018, 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 opinion.

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 respective financial position of the Fund, as of June 30, 2018, and the respective changes in financial position and cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

### ***Emphasis of Matter***

#### ***An Uncertainty Relating to the Outcome of the Repayment of Outstanding Loans***

As described in Note 11 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. This outstanding loan represents approximately 15% 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.

#### ***Implementation of New Accounting Standards***

As disclosed in the notes to the financial statements, the Fund implemented GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other than Pensions*, during fiscal year 2018. Our opinion is not modified with respect to this matter.

As discussed in Note 1, the financial statements present only the Wastewater Fund and do not purport to and do not present fairly the financial position of the City of Hercules, as of June 30, 2018, 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. Our opinion is not modified with respect to this matter.

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

## ***Other Matters***

### ***Required Supplementary Information***

Accounting principles generally accepted in the United States of America require that the schedule of the Fund's proportionate share of OPEB liability, schedule of the Fund's proportionate share of the net pension liability and schedule of contributions, as listed in the table of contents, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Management has omitted the management's discussion and analysis schedules that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing information, although not part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. Our opinion on the basic financial statements is not affected by this missing information.

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

In accordance with *Government Auditing Standards*, we have also issued our report dated January 7, 2019 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  
January 7, 2019

**HERCULES WASTEWATER FUND  
STATEMENT OF NET POSITION  
JUNE 30, 2018**

**ASSETS**

Current Assets:	
Cash and Investments	\$ 19,152,186
Cash with Fiscal Agent	7,448,285
Due From Other Governments	<u>137,243</u>
Total Current Assets	26,737,714
Noncurrent Assets:	
Advances to Former Hercules Redevelopment Agency	10,587,627
Capital Assets:	
Nondepreciable:	
Land	191,700
Construction in Progress	<u>18,710,813</u>
Total Nondepreciable Capital Assets	18,902,513
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>(12,413,315)</u>
Net Depreciable Capital Assets	<u>12,901,729</u>
Net Capital Assets	<u>31,804,242</u>
Total Noncurrent Assets	<u>42,391,869</u>
Total Assets	69,129,583

**DEFERRED OUTFLOWS OF RESOURCES**

Deferred Outflows - OPEB	19,573
Deferred Outflows - Pension	<u>207,735</u>
Total Deferred Outflows of Resources	227,308

**LIABILITIES**

Current Liabilities:	
Accounts Payable	3,004,451
Retention Payable	408,281
Salaries and Benefits Payable	19,632
Accrued Interest Payable	440,868
Compensated Absences	38,793
Long Term Debt, Due Within One Year	<u>265,000</u>
Total Current Liabilities	4,177,025
Noncurrent Liabilities:	
Net Pension Liability	659,623
Net Other Postemployment Benefits Liability	75,521
Long Term Debt, Due in More Than One Year	<u>24,815,516</u>
Total Noncurrent Liabilities	<u>25,550,660</u>
Total Liabilities	29,727,685

**DEFERRED INFLOWS OF RESOURCES**

Deferred Inflows - OPEB	73
Deferred Inflows - Pension	<u>55,928</u>
Total Deferred Inflows of Resources	56,001

**NET POSITION**

Net Investment in Capital Assets	10,572,862
Unrestricted	<u>29,000,343</u>
Total Net Position	<u><u>\$ 39,573,205</u></u>

See accompanying Notes to Financial Statements.

**HERCULES WASTEWATER FUND**  
**STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION**  
**YEAR ENDED JUNE 30, 2018**

**OPERATING REVENUES**

Sales and Charges for Services	\$ 6,145,215
Total Operating Revenues	<u>6,145,215</u>

**OPERATING EXPENSES**

Salaries and Benefits	566,118
Services and Supplies	1,948,128
Depreciation	<u>507,945</u>
Total Operating Expenses	<u>3,022,191</u>

**OPERATING INCOME** 3,123,024

**NONOPERATING REVENUES (EXPENSES)**

Interest Income	200,280
Interest Expense	<u>(728,070)</u>
Total Nonoperating Revenues (Expenses)	<u>(527,790)</u>

**CHANGE IN NET POSITION** 2,595,234

Net Position - Beginning of Year, Restated 36,977,971

**NET POSITION - END OF YEAR** \$ 39,573,205

*See accompanying Notes to Financial Statements.*

**HERCULES WASTEWATER FUND  
STATEMENT OF CASH FLOWS  
YEAR ENDED JUNE 30, 2018**

**CASH FLOWS FROM OPERATING ACTIVITIES**

Cash Receipts from Customers	\$ 6,007,972
Cash Paid to Suppliers for Goods and Services	(584,128)
Cash Paid to Employees for Services	<u>(519,573)</u>
Net Cash Provided (Used) by Operating Activities	4,904,271

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

Proceeds from the Issuance of Debt	8,378,827
Payments Related to the Acquisition of Capital Assets	(9,199,956)
Principal Repayments Related to Capital Purposes	(260,000)
Interest Repayments Related to Capital Purposes	<u>(476,200)</u>
Net Cash Provided (Used) by Capital and Related Financing Activities	(1,557,329)

**CASH FLOWS FROM INVESTING ACTIVITIES**

Interest Received (Paid)	<u>200,280</u>
Net Cash Provided (Used) by Investing Activities	<u>200,280</u>

**NET INCREASE IN CASH AND CASH EQUIVALENTS**

3,547,222

Cash and Cash Equivalents - Beginning of Year

23,053,249

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

\$ 26,600,471

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

Cash and Investments	\$ 19,152,186
Cash with Fiscal Agent	<u>7,448,285</u>

Total Cash and Cash Equivalents

\$ 26,600,471

*See accompanying Notes to Financial Statements.*



**HERCULES WASTEWATER FUND  
STATEMENT OF CASH FLOWS (CONTINUED)  
YEAR ENDED JUNE 30, 2018**

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

Operating Income	\$ 3,123,024
Adjustments To Reconcile Operating Income to Net Cash Provided by Operating Activities:	
Depreciation	507,945
(Increase) Decrease in Assets:	
Due from other Governments	(137,243)
Increase (Decrease) in Liabilities:	
Accounts Payable	1,364,000
Accrued Salaries and Benefits	2,463
Net Pension Liability	96,722
Net Pension Liability and Related Deferred Inflows	(1,201)
Net Pension Liability and Related Deferred Outflows	(51,774)
Net OPEB Liability	20,238
Net OPEB Liability and Related Deferred Inflows	73
Net OPEB Liability and Related Deferred Outflows	(19,573)
Compensated Absences	(403)
	<hr/>
Net Cash Provided by Operating Activities	<u><u>\$ 4,904,271</u></u>

*See accompanying Notes to Financial Statements.*

**HERCULES WASTEWATER FUND  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2018**

**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, 2018**

**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 acquisition 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, 2018**

*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.

Required disclosures for the Hercules Wastewater Fund's deposit and investment risks at June 30, 2018, were as follows:

Credit Risk	Not Rated
Custodial Risk	Not Applicable
Concentration of Credit Risk	Not Applicable
Interest Rate Risk	Not Available

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, 2018 consisted of the following:

Cash and Investments Held with the City	\$ 19,152,186
Investments Held with Fiscal Agent	7,448,285
Total Cash and Investments	<u>\$ 26,600,471</u>

**HERCULES WASTEWATER FUND  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2018**

**NOTE 3 CAPITAL ASSETS**

At June 30, 2018, the Hercules Wastewater Fund's capital assets consisted of the following:

	Balance July 1, 2017	Additions	Deletions	Transfers/ Adjustments	Balance June 30, 2018
Nondepreciable Assets:					
Land	\$ 191,700	\$ -	\$ -	\$ -	\$ 191,700
Construction in Progress	9,510,857	9,199,956	-	-	18,710,813
Total Nondepreciable Assets	9,702,557	9,199,956	-	-	18,902,513
Depreciable Assets:					
Infrastructure	13,729,500	-	-	-	13,729,500
Structures and improvements	11,335,199	-	-	-	11,335,199
Equipment	250,345	-	-	-	250,345
Total Depreciable Assets	25,315,044	-	-	-	25,315,044
Less: Accumulated Depreciation	(11,905,370)	(507,945)	-	-	(12,413,315)
Total Depreciable Assets, Net	13,409,674	(507,945)	-	-	12,901,729
Total Capital Assets	<u>\$ 23,112,231</u>	<u>\$ 8,692,011</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 31,804,242</u>

**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, 2018:

	Balance July 1, 2017	Additions	Deletions	Balance June 30, 2018	Amounts Due Within One Year
Business-Type Activities:					
2010 PFA Wastewater Revenue Bonds	\$ 10,335,000	\$ -	\$ (260,000)	\$ 10,075,000	\$ 265,000
Discount on Issuance	(167,250)	-	7,272	(159,978)	-
WWPT Loan	6,786,667	8,378,827	-	15,165,494	-
Compensated Absences	39,196	10,958	(11,361)	38,793	38,793
Total Long-Term Liabilities	<u>\$ 16,993,613</u>	<u>\$ 8,389,785</u>	<u>\$ (264,089)</u>	<u>\$ 25,119,309</u>	<u>\$ 303,793</u>

**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, 2018 is \$10,075,000.

**HERCULES WASTEWATER FUND  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2018**

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>
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	305,000	426,288	731,288
2024-2028	1,725,000	1,921,088	3,646,088
2029-2033	2,165,000	1,466,156	3,631,156
2034-2038	2,755,000	858,625	3,613,625
2039-2042	2,005,000	153,625	2,158,625
Subtotal	10,075,000	6,638,951	16,713,951
Less: Discount	(159,978)	-	(159,978)
Total	<u>\$ 9,915,022</u>	<u>\$ 6,638,951</u>	<u>\$ 16,553,973</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 are 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, and is contingent on the total drawdowns at project completion. The loan matures on August 31, 2038. The City has drawn down \$15,165,494 of the loan principal including construction loan interest as of June 30, 2018.

Future debt service requirements on the Construction Loan are:

<u>Year Ended June 30</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2019	\$ -	\$ -	\$ -
2020	651,934	265,590	917,524
2021	662,474	255,050	917,524
2022	674,590	242,935	917,525
2023	686,217	231,308	917,525
2024-2028	3,612,032	975,592	4,587,624
2029-2033	3,934,090	653,534	4,587,624
2034-2038	4,285,639	301,984	4,587,623
2039	658,518	15,547	674,065
Total	<u>\$ 15,165,494</u>	<u>\$ 2,941,540</u>	<u>\$ 18,107,034</u>

**NOTE 5 ADVANCES TO THE FORMER HERCULES REDEVELOPMENT AGENCY**

The Hercules Wastewater Fund has advanced funds to the former Redevelopment Agency of the City. At June 30, 2018, the balance was \$10,587,627. There was no set repayment schedule as of June 30, 2018.

**HERCULES WASTEWATER FUND  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2018**

**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**

**Plan Descriptions**

All qualified permanent and probationary employees are eligible to participate in the City's separate Safety (police and fire) and Miscellaneous (all other) Employee Pension Plans, cost-sharing multiple employer defined benefit pension plans administered by the California Public Employees' Retirement System (CalPERS). All eligible Wastewater employees are covered under the Miscellaneous Plan. Benefit provisions under the Plans are established by state statute and City resolution. CalPERS issues publicly available reports that include a full description of the pension plans regarding benefit provisions, assumptions and membership information that can be found on the CalPERS website.

**Benefits Provided**

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

**HERCULES WASTEWATER FUND  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2018**

The Plans' provisions and benefits in effect at June 30, 2018, are summarized as follows:

	Miscellaneous	
	Prior to January 1, 2013	On or After January 1, 2013
<u>Hire Date</u>		
Benefit Formula	2.0 @ 55	2.0% @ 62
Benefit Vesting Schedule	5 Years Service	5 Years Service
Benefit Payments	Monthly for Life	Monthly for Life
Retirement Age	50 - 63	52 - 67
Monthly Benefits, as a Percent of Eligible Compensation	1.426 - 2.148%	1.0 - 2.5%
Required Employee Contribution Rates	7.0%	6.25%
Required Employer Contribution Rates	8.377%	6.555%

**Contributions**

Section 20814(c) of the California Public Employees' Retirement Law requires that the employer contribution rates for all public employers be determined on an annual basis by the actuary and shall be effective on the July 1 following notice of a change in the rate. Funding contributions for the Miscellaneous Plan is determined annually on an actuarial basis as of June 30 by CalPERS. The actuarially determined rate is the estimated amount necessary to finance the costs of benefits earned by employees during the year, with an additional amount to finance any unfunded accrued liability. The City is required to contribute the difference between the actuarially determined rate and the contribution rate of employees. The City contributed \$63,156 towards the Wastewater's share of the Miscellaneous Pension Plan during the year ended June 30, 2018.

For the year ended June 30, 2018, the contributions recognized as part of pension expense was \$60,243.

**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 is measured as of June 30, 2017, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of June 30, 2016 rolled forward to June 30, 2017 using standard update procedures. The Wastewater Fund's proportion of the net pension liability was based on a projection of the Fund's long-term share of contributions to the pension plans relative to the projected contributions of all participating employers, actuarially determined. The Fund's proportionate share of the net pension liability as of June 30, 2016 and 2017 was as follows:

	Plan's Proportion to Total Pool at June 30, 2016	Plan's Proportion to Total Pool at June 30, 2017	Proportionate Share of Net Pension Liability
Miscellaneous	0.01662 %	0.01673 %	\$ 659,623



**HERCULES WASTEWATER FUND**  
**NOTES TO FINANCIAL STATEMENTS**  
**JUNE 30, 2018**

**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 7.15%, as well as what the net pension liability would be if it were calculated using a discount rate that is 1 percentage-point lower (6.15%) or 1 percentage point higher (8.15%) than the current rate:

Net Pension Liability	Discount Rate		
	1% Discount 6.15%	Current Rate 7.15%	1% Increase 8.15%
Miscellaneous	<u>\$ 994,992</u>	<u>\$ 659,623</u>	<u>\$ 381,865</u>

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

For the year ended June 30, 2018, the Wastewater Fund recognized pension expense of \$61,897. At June 30, 2018, 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	\$ 62,597	\$ -
Changes of Assumptions	84,725	(13,156)
Differences Between Expected and Actual Experience	3,450	(10,866)
Change in Proportion	14,440	(17,361)
Change in Employer's Proportion and Differences Between the Employer's Contributions and the Employer's Proportionate Share of Contributions	23,732	(14,545)
Net Differences Between Projected and Actual Earnings on Plan Investments	18,792	-
Total	<u>\$ 207,735</u>	<u>\$ (55,928)</u>

Deferred outflows of resources of \$62,597 related to contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended June 30, 2018. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized as pension expense as follows:

Year Ended June 30	Amount
2019	\$ 26,269
2020	43,966
2021	27,376
2022	(8,401)

**HERCULES WASTEWATER FUND  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2018**

**E. Actuarial Assumptions**

The total pension liabilities in the June 30, 2016 actuarial valuations were determined using the following actuarial assumptions:

	Miscellaneous Hired Prior to 1/1/2013	Miscellaneous Hired After 1/1/2013	Miscellaneous PEPRA
Valuation Date	June 30, 2016	June 30, 2016	June 30, 2016
Measurement Date	June 30, 2017	June 30, 2017	June 30, 2017
Actuarial Cost Method	Entry-Age Normal Cost Method		
Actuarial Assumptions:			
Discount Rate	7.15%	7.15%	7.15%
Inflation	2.75%	2.75%	2.75%
Payroll Growth	3.00%	3.00%	3.00%
Projected Salary Increase	3.30 - 14.20% (1)	3.30 - 14.20% (1)	3.30 - 14.20% (1)
Investment Rate of Return	7.50% (2)	7.50% (2)	7.50% (2)
Mortality	Based on CALPERS Specific Data		

(1) Depending on age, service, and type of employment

(2) Net of pension plan investment expenses, including inflation

The underlying mortality assumptions and all other actuarial assumptions used in the June 30, 2016 valuation were based on the results of a January 2014 actuarial experience study for the period 1997 to 2011. Further details of the Experience Study can found on the CalPERS website.

**Discount Rate**

The discount rate used to measure the total pension liability as of June 30, 2017 was 7.15 percent. This differs from the discount rate used as of June 30, 2016, which was 7.65 percent, due to a decrease in the long term expected rate of return.

The financial reporting discount rates are not adjusted for administrative expenses and are consistent with the funding discount rates at the end of the three-year funding discount rate phase-in period. To determine whether the municipal bond rate should be used in the calculation of a discount rate, the amortization and smoothing periods adopted by the Board in 2013 were used.

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

**HERCULES WASTEWATER FUND**  
**NOTES TO FINANCIAL STATEMENTS**  
**JUNE 30, 2018**

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

The crossover test was performed for a miscellaneous agent plan selected as being more at risk of failing the crossover test and resulting in a discount rate that would be different from the long-term expected rate of return on pension investments.

Based on the testing of the plans, the tests revealed the assets would not run out. Therefore the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability for the pension plan

**Change of Assumptions and Methods**

In December 2016, the CalPERS Board approved lowering the discount rate from 7.50 percent to 7.00 percent, which is to be phased –in over a three –year period. The funding discount rate includes a 15 basis-point reduction for administrative expenses, and the remaining decrease is consistent with the change in the financial reporting discount rate.

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

<u>Asset Class</u>	<u>New Strategic Allocation</u>	<u>Real Return Years 1 - 10 (a)</u>	<u>Real Return Years 11+ (b)</u>
Global Equity	47.00 %	4.90 %	5.38 %
Fixed Income	19.00	0.80	2.27
Inflation Assets	6.00	0.60	1.39
Private Equity	12.00	6.60	6.63
Real Estate	11.00	2.80	5.21
Infrastructure and Forestland	3.00	3.90	5.36
Liquidity	2.00	(0.40)	(0.90)
Total	<u>100.00 %</u>		

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

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

**Pension Plan Fiduciary Net Position**

Detailed information about each pension plan's fiduciary net position is available in the separately issued CalPERS financial reports.

**HERCULES WASTEWATER FUND  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2018**

**NOTE 8 OTHER POSTEMPLOYMENT BENEFITS (OPEB)**

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

Hercules Wastewater Fund is a component unit of the City of Hercules and as such the employees of the Fund are covered under the postemployment benefit plan of the City of Hercules. The City Retiree Healthcare Plan (Plan) is a single-employer benefit healthcare plan administered by the City. The plan provides healthcare benefits to eligible retirees and their dependents. The Plan does not issue a financial report.

The City offers the same medical plans to its retirees and surviving spouses as to its active employees, with the exception that once a retiree becomes eligible for Medicare he or she must join a Medicare HMO or a Medicare Supplement plan, with Medicare becoming the primary payer.

The City has prefunded a portion of its OPEB benefits in a Public Agency Retirement Services (PARS) trust. The PARS Trust is a tax qualified irrevocable trusts, organized under Internal Revenue Code (IRC) Section 115, established to pre-fund OPEB as described in GASB Statement 75. PARS issues annual audited financial statements for each participating agency of the Trust. PARS is considered an agency agent multiple-employer plan, required to provide financial statements and required supplementary information (Schedule of Changes in Fiduciary Net Position by Plan) that are prepared in conformance with GASB statement 75.

These reports may be obtained by writing the plan at the following address: PARS 4350 Von Karman Ave., Suite 100, Newport Beach, CA 92660-2043.

Employees become eligible to retire and receive City-paid healthcare benefits upon attainment of age 50 and 5 years of service. The City contribution towards retiree health benefits is determined under the "Equal Contribution Method" under PEMHCA, under which the City's nominal contribution to PEMHCA is the same for active employees and retirees (\$128/month for 2017 and \$133/month for 2018, and scheduled to be indexed by medical inflation for years after 2018).

A portion of the City's postemployment benefit liabilities and related deferred inflows and outflows have been allocated to the Fund.

**Contributions**

The contributions are based on pay-go for premiums and contributions to the PARS OPEB trust. The pay-go amount is the actual amount of retiree premiums. Contributions (pay-go and trust contributions) allocated to the Wastewater Fund for the year ended June 30, 2018 were \$10,634.

**HERCULES WASTEWATER FUND  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2018**

**Actuarial Assumptions.**

The Net OPEB Liability was determined using an actuarial valuation as of July 1, 2017, using the following actuarial assumptions:

Inflation	2.25%
Salary increases	3.00% , average, including inflation
Discount rate	6.00%, net of investment expense, including inflation
Healthcare cost trend rates	8.00% for 2017-18, decreasing to 5.00% for 2020-21 and after
Retirees' share of costs	The City makes the statutory minimum contribution under PEMHCA, as well as the supplemental benefits based on a sick-leave conversion formula to retired Police and Executive Management.

Mortality rates were based on the RP-2014 Employee and Healthy Annuitant Mortality Tables for Males or Females, as appropriate, projected using a generational projection based on 100% of scale MP-2016 for years 2014 through 2029, 50% of MP-2016 for years 2030 through 2049, and 20% of MP-2016 for 2050 and thereafter.

The expected long-term rate of return on OPEB plan investments of 6.53%, gross of expenses, was determined by Highmark Capital Management using a building-block method in which best-estimate ranges of expected future real rates of return, net of inflation, are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation.

**B. Changes in Net OPEB Liability**

The Wastewater Fund's proportionate share of the City of Hercules' net OPEB liability is measured as the proportionate share of the total pension liability, less the proportionate share of the fiduciary net position. The net OPEB liability is measured as of June 30, 2018. The Fund's proportionate share of the net OPEB liability as of June 30, 2018 is as follows:

	Plan's Proportion to Total Pool at June 30, 2018	Proportionate Share of Net OPEB Liability
Net OPEB Liability	0.05187 %	\$ 75,521

**HERCULES WASTEWATER FUND  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2018**

**C. OPEB Expense and Deferred Outflows/Inflows of Resources Related to OPEB**

For the fiscal year ended June 30, 2018, the Fund recognized OPEB expense of \$11,370. As of fiscal year ended June 30, 2018, the Fund reported deferred outflows of resources related to OPEB from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Changes of Assumptions	\$ 19,573	\$ -
Differences Between Expected and Actual Experience	-	-
Net Differences Between Projected and Actual Earnings on Plan Investments	-	(73)
Total	<u>\$ 19,573</u>	<u>\$ (73)</u>

Amounts reported as deferred outflows and deferred inflows of resources related to OPEB expense will be recognized as follows:

Year Ended June 30	Amount
2019	\$ 3,244
2020	3,244
2021	3,244
2022	3,244
2023	3,262
2024	3,262
2025	-

**D. Sensitivity of the Net OPEB Liability to Changes in the Discount Rate**

The following presents the net OPEB liability of the Fund, as well as what the Fund's net OPEB liability would be if it were calculated using a discount rate that is 1-percentage-point lower or 1-percentage-point higher than the current discount rate.

	1% Decrease (4.00%)	Current Rate (5.00%)	1% Increase (6.00%)
Net OPEB Liability	\$ 103,669	\$ 75,521	\$ 52,808

The following presents the net OPEB liability of the Fund, as well as what the Fund's net OPEB liability would be if it were calculated using healthcare cost trend rates that are 1-percentage-point lower or 1-percentage-point higher than the current healthcare cost trend rates.

	1% Decrease (7.00% decreasing to 4%)	Current Rate (8.00% decreasing to 5%)	1% Increase (9.00% decreasing to 6%)
Net OPEB Liability	\$ 56,106	\$ 75,521	\$ 100,178

**HERCULES WASTEWATER FUND  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2018**

**NOTE 9 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, 2018. 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 10 NET POSITION RESTATEMENT**

Adjustments resulting from the implementation of new standards are treated as adjustments to prior periods. Accordingly, the Fund reports these changes as restatements of beginning net position. Restatements as of the beginning of the fiscal year were made to report the OPEB liability.

The impact of the restatements on the net position as previously reported is presented below:

Net position, June 30, 2017, as previously reported	\$ 37,033,254
Restatement:	
Recognize beginning balance of net OPEB liability and related deferred inflows and outflows for initial year of GASB 75 implementation.	<u>(55,283)</u>
Net position, June 30, 2017, as restated	<u><u>\$ 36,977,971</u></u>

**NOTE 11 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 \$10.6 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.

**HERCULES WASTEWATER FUND  
REQUIRED SUPPLEMENTARY INFORMATION  
JUNE 30, 2018**

**SCHEDULE OF THE FUND'S PROPORTIONATE SHARE OF NET PENSION LIABILITY**

\* Last 10 Fiscal Years

	Reporting Date (Measurement Date)			
	June 30, 2018 (June 30, 2017)	June 30, 2017 (June 30, 2016)	June 30, 2016 (June 30, 2015)	June 30, 2015 (June 30, 2014)
Proportion of the Net Pension Liability	\$ 659,623	\$ 562,902	\$ 481,238	\$ 462,583
Proportionate Share of the Net Pension Liability	0.17%	0.17%	0.18%	0.19%
Covered Payroll	\$ 258,966	\$ 251,715	\$ 265,380	\$ 319,046
Proportionate Share of the Net Pension Liability as a Percentage of Covered Payroll	254.71%	223.63%	181.34%	144.99%
Plan Fiduciary Net Position as a Percentage of the Total Pension Liability	75.39%	75.87%	79.89%	78.83%

\* Fiscal Year 2015 was the first year of implementation. Additional years will be presented as they become available.



**HERCULES WASTEWATER FUND  
REQUIRED SUPPLEMENTARY INFORMATION  
JUNE 30, 2018**

**SCHEDULE OF PENSION PLAN CONTRIBUTIONS**

\* Last 10 Fiscal Years

	Reporting Date (Measurement Date)			
	June 30, 2018 (June 30, 2017)	June 30, 2017 (June 30, 2016)	June 30, 2016 (June 30, 2015)	June 30, 2015 (June 30, 2014)
Contractually Required Contribution (Actuarially Determined)	\$ 63,156	\$ 52,105	\$ 52,884	\$ 34,760
Contributions Related to the Actuarially Determined Contribution	63,156	52,105	52,884	34,760
Contribution Deficiency (Excess)	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
City's Covered Payroll	\$ 258,966	\$ 251,715	\$ 265,380	\$ 319,046
Contributions as a Percentage of the Covered Payroll	24.39%	20.70%	19.93%	10.89%

\* Fiscal Year 2015 was the first year of implementation. Additional years will be presented as they become available.

**HERCULES WASTEWATER FUND  
REQUIRED SUPPLEMENTARY INFORMATION  
JUNE 30, 2018**

**OTHER POSTEMPLOYMENT BENEFITS (OPEB) PLAN – SCHEDULE OF THE FUND'S  
PROPORTIONATE SHARE OF THE NET OPEB LIABILITY**

\* Last 10 Fiscal Years

	<u>June 30, 2018</u>
Proportion of the Net OPEB Liability	\$ 75,521
Proportionate Share of the Net OPEB Liability	5.19%
Covered Payroll	\$ 258,966
Proportionate Share of the Net Pension Liability as a Percentage of Covered Payroll	29.16%
Plan Fiduciary Net Position as a Percentage of the Total OPEB Liability	59.11%

The City implemented Governmental Accounting Standards Board (GASB) Statement No. 75 in 2018. As information becomes available, additional information will be presented.

**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, 2018, and the related notes to the financial statements, and have issued our report thereon dated January 7, 2019.

**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 black ink that reads "CliftonLarsonAllen LLP". The signature is written in a cursive, flowing style.

**CliftonLarsonAllen LLP**

Roseville, California  
January 7, 2019