EAST PALO ALTO SANITARY DISTRICT
BASIC FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2016

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EAST PALO ALTO SANITARY DISTRICT
BASIC FINANCIAL STATEMENTS
For the Year Ended June 30, 2016

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INDEPENDENT AUDITOR'S REPORT

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

We have audited the accompanying financial statements of the East Palo Alto Sanitary District (District) as of and for the year ended June 30, 2016, and the related notes to the financial statements, which collectively comprise the District's basic financial statements as listed in the Table of Contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the 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 of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the 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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Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the District as of June 30, 2016 and changes in 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 a Matter

Management adopted the provisions of Governmental Accounting Standards Board Statement No. 72 – *Fair Value Measurement and Application*, which became effective during the year ended June 30, 2016 as discussed in Note 1(L) to the financial statements.

The emphasis of this matter does not constitute a modification to our opinion.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that Management's Discussion and Analysis and other Required Supplementary Information, 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.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated February 16, 2017 on our consideration of the District'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 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 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 District's internal control over financial reporting and compliance.

Maze + Associates

Pleasant Hill, California
February 16, 2017

EAST PALO ALTO SANITARY DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2016

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the District's basic financial statements. The District's basic financial statements are comprised of two components: 1) the financial statements and 2) notes to the financial statements that explain in more detail some of the information in the financial statements.

Required Financial Statements

The financial statements of the District report information about the District using accounting methods similar to those used by private-sector companies. These statements provide both long term and short-term information about the District's overall financial status.

The Statement of Net Position presents information on all of the District's assets deferred outflows and liabilities deferred inflows, with the difference between the four reported as net position. This statement provides information about the nature and the amounts of investments in resources (assets) and the obligations to District creditors (liabilities). It provides one way to measure the financial health of the District by providing the basis for evaluating the capital structure of the District and assessing the liquidity and financial flexibility of the District. However, there are several outside nonfinancial factors that need to be considered; such as changing economic conditions, population and customer growth, and new or changed rules and regulations.

All of the current year's revenue and expenses are accounted for in the Statement of Revenues, Expenses, and Changes in Net Position. This statement measures the success of the District's operations over the past year and can be used to determine whether the District has successfully recovered all its cost through its user fees.

The final required statement is the Statement of Cash Flows. The statement reports cash receipts, cash payments, and net changes in cash resulting from operations, investing, and financing activities. This statement provides answers to such questions as where did cash come from, what was cash used for, and what was the change in the cash balance during the reporting period.

Financial Analysis of the District

As previously noted, net position may serve over time as a useful indicator of an entity's financial position. In the case of the District, assets exceeded liabilities by $17,619,479 at the close of the most recent fiscal year. As can be seen in Table A , on the next page, the largest portion of the District's net position (26%) reflect its investment in capital assets (e.g., sewers, buildings, machinery and equipment), less any related debt used to acquire those assets that is still outstanding. These capital assets are used primarily in the collection and treatment of wastewater throughout the District's service area. The related debt will be repaid with resources provided by system users through rates and fees.

Table A
Summary of Net Position

A summary of the statements of net position as of June 30, 2016 and 2015 is shown in the following table:

	2016	2015	Change
Current assets	$ 14,378,509	$ 12,556,733	$ 1,821,776
Noncurrent assets	72,181	43,315	28,866
Net capital assets	6,118,211	6,298,834	(180,623)
Total assets	20,568,901	18,898,882	1,670,019
Deferred Outflows	151,874	136,392	15,482
Current liabilities	265,956	258,583	7,373
Noncurrent liabilities	2,574,928	2,436,734	138,194
Total liabilities	2,840,884	2,695,317	145,567
Deferred Inflows	260,412	269,172	(8,760)
Net Position	$ 17,619,479	$ 16,070,785	$ 1,548,694

Net position increased by $1,548,694 in 2016. The increases are a combination of income in the form of sewer service charges, connection fee charges and property taxes.

Current assets increased by $1,821,776 compared to the prior year primarily due to:

- An increase in cash of $1,821,054 as detailed in the statement of cash flows on page 7, an increase in accounts receivable of $2,142 and a decrease in prepaid insurance of $1,420.

Noncurrent assets increased by $28,866 primarily due a decrease in notes receivable of $4,993 and an increase in OPEB asset of $33,859.

Current liabilities increased by $7,373 due to an increase in accounts payable of $52,681, an increase in accrued liabilities of $1,463 and a decrease in current portion of long term debt of $46,771.

EAST PALO ALTO SANITARY DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2016

Table B
Summary of Revenues
Expenses and Changes in Net Position

	2016	2015	Change
Total operating revenues	$ 4,831,689	$ 4,583,888	$ 247,801
Total operating expenses	(4,142,986)	(3,744,231)	(398,755)
Operating Income (loss)	688,703	839,657	(150,954)
Total nonoperating revenues and expenses	859,991	787,353	72,638
Increase in net position	1,548,694	1,627,010	(78,316)
Net position , beginning of year	16,070,785	15,556,920	513,865
Prior period adjustment	-	(1,113,145)	1,113,145
Net position, end of year	$ 17,619,479	$ 16,070,785	$ 1,548,694

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

Table B shows that during 2016 total operating revenues increased by $247,801. Total operating expenses decreased by $398,755. Non operating revenue and expenses increased by $72,638. The major factors which contributed to these results include:

- The increase in operating revenues of $247,801 was due to an increase in sewer service charges of $266,004 and a decrease in other revenue of $83,786.
- The increase in operating expenses of $398,755 was due to an increase in personnel services of $278,279, a decrease in depreciation and amortization of $773, an increase in sewer service charges of $144,463, an increase in fuel and supplies of $3,649 and a decrease in other expenses of $26,863.
- The increase of $72,638 in non-operating revenues and expenses was due to an increase in interest income of $ 18,579, an increase in property tax collections of $15,868, a decrease in interest expense of $13,890, and a decrease in other revenue of $10,284.

BUDGETARY HIGHLIGHTS

The District has an annual operating budget that is approved by its Board of Directors. Capital projects are approved on a project by project basis within the annually approved capital budget. The 2016 expenses were under the approved budget.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

As of June 30, the District's investment in capital assets amounted to $6.12 million and $6.25 million (net of accumulated depreciation) as shown in Table C for 2016 and 2015, respectively. In 2016, the District spent $117,109 on camera system on Vactor truck and $3,108 on Buildings. Additional information on the District's capital assets can be found in Note 3 to the Financial Statements.

Table C
Capital Assets

	2016	2015	Change
Land	$ 184,601	$ 184,601	$ -
Cured in place pipe	1,474,518	1,474,518	-
Sewer collection facilities	6,080,224	6,080,224	-
Buildings	2,587,579	2,584,471	3,108
Furniture and equipment	2,039,196	1,918,902	120,294
Accumulated depreciation	(6,247,907)	(5,943,882)	(304,025)
Net capital assets	$ 6,118,211	$ 6,298,834	$ (180,623)

Debt Administration

The District has financed its construction program primarily through the issuance of revenue bonds. Additional information on the District's long-term debt can be found in Note 5 to the financial statements.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

The service area of the District is best described as mature. The District is not in a growth situation but one in which the system is continually televised, upgraded and repaired given budgetary constraints.

Requests for Information

The financial report is designed to provide a general overview of the District's finances and operations for all those with an interest in the District's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to:

Office of the General Manager
East Palo Alto Sanitary District
901 Weeks Street
East Palo Alto, CA 94303

EAST PALO ALTO SANITARY DISTRICT
STATEMENT OF NET POSITION
JUNE 30, 2016

ASSETS	
Current Assets:	
Cash and investments (Note 2)	$14,355,458
Accounts Receivable	2,142
Prepaid insurance	20,909
Total Current Assets	14,378,509
Noncurrent Assets:	
Notes receivable	22,394
OPEB asset (Note 7)	49,787
Capital assets (Note 3):	
Land	184,601
Sewer collection facilities	6,080,224
Cured in place pipe	1,474,518
Buildings	2,587,579
Furniture and equipment	2,039,196
Less accumulated depreciation	(6,247,907)
Total capital assets, net	6,118,211
Total Non-Current Assets	6,190,392
TOTAL ASSETS	20,568,901
DEFERRED OUTFLOW OF RESOURCES	
Pension Related (Note 6)	151,874
TOTAL DEFERRED OUTFLOW OF RESOURCES	151,874
LIABILITIES	
Current Liabilities	
Accounts payable	87,042
Accrued liabilities	77,426
Long-term debt, current portion (Note 5)	101,488
Total Current Liabilities	265,956
Noncurrent Liabilities	
Net pension liability (Note 6)	1,180,505
Long-term debt (Note 5)	1,394,423
Total Long-Term Liabilities	2,574,928
TOTAL LIABILITIES	2,840,884
DEFERRED INFLOW OF RESOURCES	
Pension Related (Note 6)	260,412
TOTAL DEFERRED INFLOW OF RESOURCES	260,412
NET POSITION (Note 8)	
Net investment in capital assets	4,622,300
Unrestricted	12,997,179
TOTAL NET POSITION	$17,619,479

See accompanying notes to financial statements

EAST PALO ALTO SANITARY DISTRICT
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION
FOR THE YEAR ENDED JUNE 30, 2016

OPERATING REVENUES:	
Sewer service charges	$4,822,749
Other revenues	8,940
Total Operating Revenues	4,831,689
OPERATING EXPENSES:	
Personnel services	1,753,236
Purchased services	1,838,249
Utilities, fuel and supplies	75,991
Depreciation (Note 3)	304,025
Other expenses	171,485
Total Operating Expenses	4,142,986
NET OPERATING INCOME	688,703
NONOPERATING REVENUE (EXPENSE)	
Property taxes	540,776
Pass through receipts	247,384
Interest income	94,020
Interest expense	(57,993)
Other revenue	35,804
Nonoperating revenue, net	859,991
CHANGE IN NET POSITION	1,548,694
NET POSITION AT BEGINNING OF YEAR	16,070,785
NET POSITION AT END OF YEAR	$17,619,479

See accompanying notes to financial statements

EAST PALO ALTO SANITARY DISTRICT
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2016

CASH FLOWS FROM OPERATING ACTIVITIES	
Receipts from customers and users	$4,829,547
Payments to suppliers	(2,030,161)
Payments to employees	(1,571,655)
Cash Flows provided by Operating Activities	1,227,731
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES	
Property taxes	540,776
Pass through receipts	247,384
Net Cash Flows provided by Noncapital Financing Activities	788,160
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES	
Acquisition and construction of capital assets	(123,503)
Loss on disposition of capital assets	101
Principal paid on debt	(148,259)
Interest paid on debt	(57,993)
Collections on note receivable	4,993
Other	35,804
Cash Flows provided (used) by Capital and Related Financing Activities	(288,857)
CASH FLOWS FROM INVESTING ACTIVITIES:	
Interest received	94,020
Cash Flows from Investing Activities	94,020
NET CASH FLOWS	1,821,054
Cash and cash equivalents at beginning of year	12,534,404
Cash and cash equivalents at end of year	$14,355,458
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED BY OPERATING ACTIVITIES	
Operating income	$688,703
Adjustment to reconcile operating income to net cash provided by operating activities:	
Depreciation and amortization expense	304,025
(Increase) decrease in assets and deferred outflows of resources:	
Accounts receivable	(2,142)
OPEB asset	(33,859)
Prepaid expenses	1,420
Pension related deferred outflows of resources	(15,482)
Increase (decrease) in liabilities and deferred inflows of resources:	
Accounts payable and accrued expenses	54,144
Net pension liability	239,682
Pension related deferred inflows of resources	(8,760)
Net cash provided by operating activities	$1,227,731

See accompanying notes to financial statements

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. *Description of the Reporting Entity*

The financial statements of East Palo Alto Sanitary District (District) include the financial activities of the District as well as the financial activity of the East Palo Alto Sanitary District Financing Corporation (Corporation), a component unit of the District. The Corporation is a nonprofit public benefit corporation established in fiscal year 1991 to provide financial assistance to the District by financing improvements to the District's sewer collection system and to refinance the purchase and renovation of the District's administration building. The Corporation has no employees. The District is governed by a five member Board of Directors elected at large to four year terms by residents within the District. These Directors also serve as Directors of the Corporation.

B. *Basis of Presentation and Accounting*

Basic Financial Statements are prepared in conformity with accounting principles generally accepted in the United States of America. The Governmental Accounting Standards Board is the acknowledged standard setting body for establishing accounting and financial reporting standards followed by governmental entities in the United States.

These Standards require that the financial statements described below be presented.

The Statement of Net Position and the Statement of Revenues, Expenses and Changes in Net Position display information about the East Palo Alto Sanitary District. Business-type activities are financed in whole or in part by fees charged to external parties.

Proprietary fund operating revenues, such as charges for services, result from exchange transactions associated with the principal activity of the fund. Exchange transactions are those in which each party receives and gives up essentially equal values. Nonoperating revenues, such as interest income and connection fees, result from nonexchange transactions or ancillary activities.

Enterprise funds are accounted for on the flow of economic resources measurement focus utilizing full accrual accounting. Under this method, assets and revenues are recorded when earned, and liabilities and expenses are recorded when the related obligations are incurred.

C. *Budgets and Budgetary Accounting*

East Palo Alto Sanitary District adopts an operating budget at the beginning of each year for the following fiscal year. The District General Manager is authorized to transfer any unencumbered amounts from one department to another within the same major account and to transfer any unencumbered appropriation from one line item account to another within the same major account. The major accounts are defined as salaries and employee benefits, maintenance and operation, capital outlay and reserves. Any additional appropriations require approval by the Board of Directors.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

D. Cash and Cash Equivalents

For purposes of the statement of cash flows, cash equivalents include time deposits, certificates of deposit, and all highly liquid debt instruments with original maturities of three months or less.

E. Compensated Absences

The District records the expense of employees' vacation and sick leave benefits in the period in which they accumulate and become vested. At June 30, 2016, the balance is $48,608 and is included in accrued liabilities on the Statement of Net Position.

F. Capital Assets

The cost of additions to utility plant and major replacements of property is capitalized. Costs include material, direct labor, transportation and indirect items such as interest, engineering, supervision and employee fringe benefits. Contributed property is recorded at estimated fair market value at time of acquisition. Capital assets are defined by the District as assets with an initial, individual cost of more than $500 and an estimated useful life in excess of one year.

Depreciation is computed on a straight-line basis over the estimated useful lives of the property as follows:

Sewer collection facilities	50 years
Building	30 years
Furniture and Equipment	10 years
Computers	5 years

G. Sewer Service Charges

Sewer service charges are billed and collected, on behalf of the District, by San Mateo County (the County) as a separate component of semi-annual property tax billings. The County assesses properties, bills for and collects property taxes on the following schedule:

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

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

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

H. Sewer Connection Fees

Connection fees represent a one-time contribution of resources to the District imposed on contractors and developers for the purpose of financing growth-related construction and improvements. Connection fees are recognized as other non-operating revenues in the Statement of Revenues, Expenses and Changes in Net Position. Any cumulative fees collected in excess of amounts expended are shown as restricted net position.

I. Bond Issuance Costs

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

J. Use of Estimates

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

K. Fair Value Measurements

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The District categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. The fair value hierarchy categorizes the inputs to valuation techniques used to measure fair value into three levels based on the extent to which inputs used in measuring fair value are observable in the market.

Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 inputs are inputs – other than quoted prices included within level 1 – that are observable for an asset or liability, either directly or indirectly.

Level 3 inputs are unobservable inputs for an asset or liability.

If the fair value of an asset or liability is measured using inputs from more than one level of the fair value hierarchy, the measurement is considered to be based on the lowest priority level input that is significant to the entire measurement.

L. Implementation of Governmental Accounting Standards Board (GASB) Statements

GASB Statement No. 72 – In February 2015, GASB issued Statement No. 72, *Fair Value Measurement and Application.* The intention of this Statement is to provide guidance for determining a fair value measurement for financial reporting by requiring measurement of certain assets and liabilities at fair value using a consistent and more detailed definition of fair value and accepted valuation techniques.

NOTE 2 – CASH AND INVESTMENTS

A. Policies and Classification

California Law requires banks and savings and loan institutions to pledge government securities with a market value of 110% of the District's cash on deposit, or first trust deed mortgage notes with a market value of 150% of the deposit, as collateral for these deposits. Under California Law this collateral is held in a separate investment pool by another institution in the District's name and places the District ahead of general creditors of the institution.

The District's investments are carried at fair value, as required by generally accepted accounting principles. The District adjusts the carrying value of its investments to reflect their fair value at each fiscal year end, and it includes the effects of these adjustments in income for that fiscal year.

The District's cash and investments consist of the following at June 30, 2016:

Deposits with financial institutions	$166,562
Cash and investments with San Mateo County Treasurer	14,188,896
Total cash and investments	$14,355,458

The District has authorized staff to invest cash with the San Mateo County Treasurer in a series of pooled accounts with cash from various other governmental entities within the County, for investment purposes. The County's investment policies are governed by State statutes.

In addition, the County has an investment committee, which prescribes written investment policies regarding the types of investments that may be made. The policies limit amounts that may be invested in any one financial institution or amounts, which may be invested in long-term instruments. Interest earned from such time deposits and investments is allocated quarterly to the District based on its average daily cash balances. The fair value of the account at June 30, 2016 was provided by the County Treasurer.

The District is a voluntary participant in the San Mateo County Investment Fund (SMCIF) that is regulated by California Government Code Section 53600 under the oversight of the treasurer of the County of San Mateo. The District reports its investment in SMCIF at the fair value amount provided by SMCIF. The balance available for withdrawal is based on the accounting records maintained by SMCIF, which are recorded on an amortized cost basis. Included in SMCIF's investment portfolio are U.S. Treasury Notes, obligations issued by agencies of the U.S. Government, LAIF, corporate notes, commercial paper, collateralized mortgage obligations, mortgage-backed securities, other asset-backed securities, and floating rate securities issued by federal agencies, government-sponsored enterprises, and corporations.

NOTE 2 – CASH AND INVESTMENTS (Continued)

B. Fair Value Hierarchy

The District categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. The hierarchy is based on the valuation inputs used to measure fair value of the assets. Level 1 inputs are quoted prices in an active market for identical assets; Level 2 inputs are significant other observable inputs; and Level 3 inputs are significant unobservable inputs.

As of June 30, 2016, the District had $14,188,896 of cash and investments pooled with the San Mateo County Treasurer that is classified in Level 2 of the fair value hierarchy. The fair value of the pooled investment fund is provided by the County Treasurer and is valued using quoted prices for identical instruments in markets that are not active. Fair value is defined as the quoted market value on the last trading day of the period. These prices are obtained from various pricing sources.

NOTE 3 – CAPITAL ASSETS

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

	Balance at June 30, 2015	Additions	Retirements/ Adjustments	Balance at June 30, 2016
Capital assets not being depreciated:				
Land	$184,601			$184,601
Total capital assets not being depreciated	184,601			184,601
Capital assets being depreciated:				
Sewer collection facilities	6,080,224			6,080,224
Cured in place pipe	1,474,518			1,474,518
Buildings	2,584,471	$3,108		2,587,579
Furniture and equipment	1,918,902	120,395	($101)	2,039,196
Total capital assets being depreciated:	12,058,115	123,503	(101)	12,181,517
Less accumulated depreciation for:				
Sewer collection facilities	2,706,583	121,604		2,828,187
Cured in place pipe	146,713	49,151		195,864
Buildings	1,533,808	105,754		1,639,562
Furniture and equipment	1,556,778	27,516		1,584,294
Total accumulated depreciation	5,943,882	$304,025		6,247,907
Net capital assets being depreciated	6,114,233			5,933,610
Total Capital Assets, net	$6,298,834			$6,118,211

NOTE 4 – CAPACITY RIGHTS IN TREATMENT PLANT

The District has a contract with the City of Palo Alto whereby the District has rights to a specified capacity (11.90%) of the capacity of their sewage treatment facilities. The carrying value of such rights represents the District's share of construction costs relating to expansion and improvements of the City's treatment plant, net of amortization. The District is amortizing such cost ($85,421 per year) over twenty five years, the approximate life of the treatment plant.

The District is also required to pay a portion of the operating cost on an annual basis for the treatment of the sewage. For the year ending June 30, 2016, such annual operating cost was $75,066.

NOTE 5 – LONG-TERM DEBT

A. *Current Year Transactions and Balances*

Long-term debt at June 30, 2016 is summarized as follows:

	Original Issue Amount	Balance June 30, 2015	Retirements	Balance June 30, 2016	Amount due within one year
Palo Alto 1990 Utility Revenue Bonds 5.75%, due 6/30/2024	$469,595	$233,982	$21,197	$212,785	$22,012
Palo Alto 2000 Utility Revenue Bonds 5.75%, due 6/30/2024	573,000	286,111	25,594	260,517	27,122
Vactor Truck Note 4.75%, due 3/31/2016	270,000	50,441	50,441		
State Revolving Fund Loan 2.60%, due 1/31/32	1,225,420	1,073,636	51,027	1,022,609	52,354
Total Long-Term Debt		1,644,170	$148,259	1,495,911	$101,488
Less:					
Amount due within one year		(148,259)		(101,488)	
Total Long-Term Debt, net		$1,495,911		$1,394,423	

B. *Palo Alto 1990 Utility Revenue Bonds*

Represents the District's portion of the City of Palo Alto's (City) debt related to the treatment plant (see Note 4). The District is liable to the City for this debt as long as the District utilizes the City's treatment plant. The bonds are payable from revenues of the District.

NOTE 5 – LONG-TERM DEBT (Continued)

C. *Palo Alto 2000 Utility Revenue Bonds*

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

D. *Vactor Truck Note*

Represents a note with Municipal Finance Corporation for the purchase of a sewer vacuum truck. This note is payable from revenues of the District.

E. *State Revolving Fund Loan*

Represents a loan from the State Water Resources Control Board to finance the construction of the Cured in Place Siphoning Project. This loan is payable from revenues of the District.

F. *Debt Service Requirements*

For The Year Ending June 30	Principal	Interest	Total
2017	$101,488	$51,370	$152,858
2018	105,590	47,432	153,022
2019	109,748	43,375	153,123
2020	113,550	39,074	152,624
2021	118,153	34,611	152,764
2022 - 2026	514,014	102,635	616,649
2027 - 2031	356,429	38,280	394,709
2032 - 2032	76,939	2,000	78,939
Total payments due	$1,495,911	$358,777	$1,854,688

NOTE 6 – DEFINED BENEFIT PENSION PLAN

A. *Plan Descriptions*

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

NOTE 6 – DEFINED BENEFIT PENSION PLAN (Continued)

B. Benefits Provided

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

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

	Miscellaneous	
	Tier 1	Tier 2
Hire Date	Prior to 1/1/13	On or after 1/1/13
Benefit vesting schedule	5 years service	5 years service
Benefit payments	monthly for life	monthly for life
Retirement age	50	52
Monthly benefits, as a % of eligible compensation	2.00% to 2.70%	1.00% to 2.50%
Required employee contribution rates	8.00%	6.25%
Required employer contribution rates	10.958%	6.237%

Beginning in fiscal year 2016, CalPERS collects employer contributions for the Plan as a percentage of payroll for the normal cost portion as noted in the rates above and as a dollar amount for contributions toward the unfunded liability and side fund. The dollar amounts are billed on a monthly basis. The District's required contribution for the unfunded liability and side fund was $66,672 in fiscal year 2016.

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

For the year ended June 30, 2016, the contributions to the Plan were as follows:

	Miscellaneous	
	Tier 1	Tier 2
Contributions - employer	$69,961	$6,938

NOTE 6 – DEFINED BENEFIT PENSION PLAN (Continued)

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

For purposes of measuring the net pension liability and deferred outflows/inflows of resources related to pensions and pension expense, information about the fiduciary net position of the Plan and additions to/deductions from the Plan's fiduciary net position have been determined on the same basis as they are reported by the CalPERS Financial Office. For this purpose, benefit payments (including refunds of employee contributions) are recognized when currently due and payable in accordance with the benefit terms. Investments are reported at fair value.

As of June 30, 2016, the District reported a net pension liability for its proportionate share of the net pension liability of the Plan as follows:

	Proportionate Share of Net Pension Liability
Miscellaneous Tier I	$1,181,215
Miscellaneous Tier II	(710)
Total Net Pension Liability	$1,180,505

The District's net pension liability for the Plan is measured as the proportionate share of the net pension liability. The net pension liability of the Plan is measured as of June 30, 2015, and the total pension liability for the Plan used to calculate the net pension liability was determined by an actuarial valuation as of June 30, 2014 rolled forward to June 30, 2015 using standard update procedures. The District's proportion of the net pension liability was based on a projection of the District's long-term share of contributions to the pension plan relative to the projected contributions of all participating employers, actuarially determined. The District's proportionate share of the net pension liability for the Plan as of June 30, 2014 and 2015 was as follows:

	Miscellaneous	
	Tier 1	Tier 2
Proportion - June 30, 2014	0.03807%	0.00000%
Proportion - June 30, 2015	0.04306%	-0.00003%
Change - Increase (Decrease)	0.00499%	0.00003%

NOTE 6 – DEFINED BENEFIT PENSION PLAN (Continued)

For the year ended June 30, 2016, the District recognized pension expense of $359,011. At June 30, 2016, the District reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Pension contributions subsequent to measurement date	$143,571	
Differences between actual and expected experience	8,303	
Changes in assumptions		($78,557)
Difference between proportional and actual contributions		(4,089)
Net differences between projected and actual earnings on plan investments		(39,382)
Adjustments due to differences in proportion		(138,384)
Total	$151,874	($260,412)

The $143,571 reported as deferred outflows of resources related to contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended June 30, 2016. 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	Annual Amortization
2017	($105,104)
2018	(105,539)
2019	(91,805)
2020	50,339
2021	
Thereafter	

NOTE 6 – DEFINED BENEFIT PENSION PLAN (Continued)

Actuarial Assumptions – The total pension liabilities in the June 30, 2014 actuarial valuation was determined using the following actuarial assumptions for both plans:

	Miscellaneous Plan
Valuation Date	June 30, 2014
Measurement Date	June 30, 2015
Actuarial Cost Method	Entry-Age Normal Cost Method
Actuarial Assumptions:	
Discount Rate	7.65%
Inflation	2.75%
Projected Salary Increase	3.3% - 14.2% (1)
Investment Rate of Return	7.65% (2)
Mortality	Derived using CalPERS Membership Data for all funds (3)
Post Retirement Benefit Increase	Contract COLA up to 2.75% until Purchasing Power Protection Allowance Floor on Purchasing Power applies, 2.75% thereafter

(1) Depending on age, service and type of employment
(2) Net of pension plan investment expenses, including inflation
(3) The mortality table used was developed based on CalPERS' specific data. The table includes 20 years of mortality improvements using Society of Actuaries Scale BB. For more details on this table, please refer to the CalPERS 2014 experience study report available on the CalPERS website.

Audited annual financial statements and ten-year trend information are available from CALPERS at P.O. Box 942709, Sacramento, CA 94229-2709.

The underlying mortality assumptions and all other actuarial assumptions used in the June 30, 2013 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.

Change of Assumptions – GASB 68, paragraph 68 states that the long-term expected rate of return should be determined net of pension plan investment expense, but without reduction for pension plan administrative expense. The discount rate of 7.50% used for the June 30, 2014 measurement date was net of administrative expenses. The discount rate of 7.65% used for the June 30, 2015 measurement date is without reduction of pension plan administrative expense. All other assumptions for the June 30, 2014 measurement date were the same as those used for the June 30, 2015 measurement date.

NOTE 6 – DEFINED BENEFIT PENSION PLAN (Continued)

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

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

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

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

Asset Class	New Strategic Allocation	Real Return Years 1 - 10(a)	Real Return Years 11+(b)
Global Equity	51.0%	5.25%	5.71%
Global Fixed Income	19.0%	0.99%	2.43%
Inflation Sensitive	6.0%	0.45%	3.36%
Private Equity	10.0%	6.83%	6.95%
Real Estate	10.0%	4.50%	5.13%
Infrastructure and Forestland	2.0%	4.50%	5.09%
Liquidity	2.0%	-0.55%	-1.05%
Total	100%		

(a) An expected inflation of 2.5% used for this period.
(b) An expected inflation of 3.0% used for this period.

NOTE 6 – DEFINED BENEFIT PENSION PLAN (Continued)

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

	Miscellaneous	
	Tier 1	Tier 2
1% Decrease	6.65%	6.65%
Net Pension Liability	$1,852,392	$4,343
Current Discount Rate	7.65%	7.65%
Net Pension Liability	$1,181,215	($710)
1% Increase	8.65%	8.65%
Net Pension Liability	$627,080	($4,881)

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

NOTE 7 – OTHER POST RETIREMENT BENEFITS

The District provides post-retirement benefits to eligible employees in the form of reimbursement for post-retirement health insurance premiums. Retired employees have a choice of remaining on the District's group health insurance plan or purchasing a plan of their choice. Reimbursement is made quarterly upon receipt of proof of payment. The District's contribution is capped at the amount of the Kaiser premium which was set at $1,493 per month per individual for fiscal year 2015-2016 and $1,429 per month per individual for fiscal year 2014-2015.

The obligation of the District to provide these benefits is determined annually by the Board of Directors.

In order to qualify for postemployment medical benefits, an employee must retire from the District with at least 5 years of service and be over 50 years of age.

The District follows the provisions of Governmental Accounting Standards Board Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. This Statement establishes uniform financial reporting standards for employers providing postemployment benefits other than pensions (OPEB). The provisions of this statement are applied prospectively and do not affect prior year's financial statements. Required disclosures are presented below.

NOTE 7 – OTHER POST RETIREMENT BENEFITS (Continued)

The District joined the California Employers' Retiree Benefit Trust (CERBT), an agent multiple-employer plan administered by CALPERS, consisting of an aggregation of single-employer plans.

Funding Policy and Actuarial Assumptions

The District's policy is to fund minimally the Annual Required Contribution (ARC) of these benefits by accumulating assets with CERBT discussed above pursuant to the District's annual budget approved by Board. The annual required contribution (ARC) was determined as part of the July 1, 2013 actuarial valuation using the entry age normal actuarial cost method. This is a projected benefit cost method, which takes into account those benefits that are expected to be earned in the future as well as those already accrued. The actuarial assumptions included (a) 7.28% investment rate of return, (b) 3% inflation rate, (c) 3.25% projected annual salary increase, and (d) health care cost trend rates of 4.50% to 6.00% for medical benefits. The actuarial methods and assumptions used include techniques that smooth the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets. Actuarial calculations reflect a long-term perspective and actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of events far into the future. Actuarially determined amounts are subject to revision at least tri-ennially as results are compared to past expectations and new estimates are made about the future. The District's OPEB unfunded actuarial accrued liability is being amortized as a level percentage of projected payroll using a 30 year amortization period on a closed basis.

Funding Progress and Funded Status

Generally accepted accounting principles permit contributions to be treated as OPEB assets and deducted from the Actuarial Accrued Liability when such contributions are placed in an irrevocable trust or equivalent arrangement. As a result, the District has calculated and recorded the Net OPEB Asset, representing the difference between the ARC, amortization and contributions, as presented below:

Annual OPEB expense:	
Annual required contribution (ARC)	$76,518
Interest on net OPEB obligation (asset)	(1,195)
Adjustment to annual required contribution	1,474
Total annual OPEB expense	76,797
Change in net OPEB payable obligation:	
Contributions paid to trust	(76,518)
Premiums paid	(34,138)
Total payments	(110,656)
Total change in net OPEB payable obligation	(33,859)
OPEB obligation (asset) - beginning of year	(15,928)
OPEB obligation (asset) - end of year	($49,787)

NOTE 7 – OTHER POST RETIREMENT BENEFITS (Continued)

The actuarial accrued liability (AAL) representing the present value of future benefits, included in the actuarial study dated July 1, 2015, amounted to $921,240. The AAL is partially funded since assets have been transferred into CERBT.

The Plan's annual required contributions and actual contributions for the last three fiscal years are set forth below:

Fiscal Year	Annual OPEB Cost (AOC)	Actual Contribution	Percentage of AOC Contributed	Net OPEB Obligation (Asset)
June 30, 2014	$76,612	$76,370	100%	($16,188)
June 30, 2015	74,923	74,663	100%	(15,928)
June 30, 2016	76,797	110,656	144%	(49,787)

The Schedule of Funding Progress below and the required supplementary information immediately following the notes to the financial statements presents trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits. Trend data from the most percent actuarial study is presented below:

Actuarial Valuation Date	Actuarial Value of Assets (A)	Entry Age Actuarial Accrued Liability (B)	Unfunded (Overfunded) Actuarial Accrued Liability (A – B)	Funded Ratio (A/B)	Covered Payroll (C)	Unfunded (Overfunded) Actuarial Liability as Percentage of Covered Payroll [(A – B)/C]
7/1/2015	$735,544	$921,240	$185,696	79.84%	$972,500	19.09%

NOTE 8 – NET POSITION

Net Position is the excess of all the District's assets and deferred outflows of resources, over all its liabilities and deferred inflows of resources, regardless of fund. The following captions apply only to Net Position, which is determined only at the Government-wide level, and are described below:

Net investment in capital assets describes the portion of Net Position which is represented by the current net book value of the District's capital assets, less the outstanding balance of any debt issued to finance these assets.

Unrestricted describes the portion of Net Position which is not restricted to use.

NOTE 9 – RISK MANAGEMENT

The District is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees and natural disaster. The District joined together with other entities to form the Special District Risk Management Authority (SDRMA), a public entity risk pool currently operating a common risk management and insurance program for 60 member entities. The purpose of SDRMA is to spread the adverse effects of losses among the member entities and to purchase excess insurance as a group, thereby reducing its cost. The District pays annual premiums to SDRMA for its general liability, property damage, workers compensation insurance and automobile coverage. Settled claims for SDRMA have not exceeded coverage in any of the past three fiscal years.

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

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

NOTE 10 – SUBSEQUENT EVENT

In December 2016, CalPERS' Board of Directors voted to lower the discount rate used in its actuarial valuations from 7.5% to 7.0% over three fiscal years, beginning in fiscal year 2018. The change in the discount rate will affect the contribution rates for employers beginning in fiscal year 2019, and result in increases to employers' normal costs and unfunded actuarial liabilities.

REQUIRED SUPPLEMENTAL INFORMATION

East Palo Alto Sanitary District Miscellaneous Plan, a Cost-Sharing Multiple Employer Defined Benefit Pension Plan
Last 10 Years*

SCHEDULE OF THE DISTRICT'S PROPORTIONATE SHARE OF THE NET PENSION LIABILITY

Measurement Date	6/30/2014	6/30/2015
Plan's proportion of the Net Pension Liability (Asset)	0.03807%	0.04306%
Plan's proportion share of the Net Pension Liability (Asset)	$940,823	$1,180,505
Plan's Covered Employee Payroll	606,526	669,086
Plan's Proportionate Share of the Net Pension Liability/(Asset) as a Percentage of its Covered-Employee Payroll	155.11%	176.43%
Plan's Proportionate Share of the Fiduciary Net Position as a Percentage of the Plan's Total Pension Liability	0.02934%	0.02775%

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

East Palo Alto Sanitary District Miscellaneous Plan, a Cost-Sharing Multiple Employer Defined Benefit Pension Plan
Last 10 Years*
SCHEDULE OF CONTRIBUTIONS

For the Year Ended June 30	2015	2016
Actuarially determined contribution	$101,470	$143,571
Contributions in relation to the actuarially determined contributions	(125,376)	(143,571)
Contribution deficiency (excess)	($23,906)	$0
Covered-employee payroll	$606,526	$669,086
Contributions as a percentage of covered-employee payroll	20.67%	21.46%

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

EAST PALO ALTO SANITARY DISTRICT
Other Post Employment Benefits
As of fiscal year ending June 30, 2016
SCHEDULE OF FUNDING PROGRESS - LAST THREE VALUATIONS

Actuarial Valuation Date	Actuarial Value of Assets (A)	Entry Age Actuarial Accrued Liability (B)	Unfunded (Overfunded) Actuarial Accrued Liability (A – B)	Funded Ratio (A/B)	Covered Payroll (C)	Unfunded (Overfunded) Actuarial Liability as Percentage of Covered Payroll [(A – B)/C]
7/1/2011	$227,878	$560,420	$332,542	40.66%	$758,410	43.85%
7/1/2013	494,957	689,923	194,966	71.74%	676,728	28.81%
7/1/2015	735,544	921,240	185,696	79.84%	972,500	19.09%

MAZE
& ASSOCIATES

INDEPENDENT AUDITOR'S 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*

Board of Directors
East Palo Alto Sanitary District
East Palo Alto, 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 basic financial statements of the East Palo Alto Sanitary District (District), as of and for the year ended June 30, 2016 the related notes to the financial statements, and have issued our report thereon dated February 16, 2017. Our report included an emphasis of a matter paragraph disclosing the implementation of new accounting principles.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the District'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 District's internal control. Accordingly, we do not express an opinion on the effectiveness of the District'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 District'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.

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Compliance and Other Matters

As part of obtaining reasonable assurance about whether the District'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*.

We have also issued a separate Memorandum on Internal Control dated February 16, 2017 which is an integral part of our audit and should be read in conjunction with this report.

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 District'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 District's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Maze & Associates

Pleasant Hill, California
February 16, 2017

EAST PALO ALTO SANITARY DISTRICT

MEMORANDUM ON INTERNAL CONTROL
AND
REQUIRED COMMUNICATIONS

FOR THE YEAR ENDED
JUNE 30, 2016

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EAST PALO ALTO SANITARY DISTRICT
MEMORANDUM ON INTERNAL CONTROL
AND
REQUIRED COMMUNICATIONS

For the Year Ended June 30, 2016

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REQUIRED COMMUNICATIONS

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

We have audited the basic financial statements of the East Palo Alto Sanitary District for the year ended June 30, 2016. Professional standards require that we communicate to you the following information related to our audit under generally accepted auditing standards and *Government Auditing Standards.*

Significant Audit Findings

Accounting Policies

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the District are described in Note 1 to the financial statements. No new accounting policies were adopted and the application of existing polices was not changed during the year, except as follows:

GASB Statement No. 72 – *Fair Value Measurement and Application*

This Statement addresses accounting and financial reporting issues related to fair value measurements. The definition of *fair value* is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This Statement provides guidance for determining a fair value measurement for financial reporting purposes. This Statement also provides guidance for applying fair value to certain investments and disclosures related to all fair value measurements.

This Statement establishes a hierarchy of inputs to valuation techniques used to measure fair value. That hierarchy has three levels:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2 inputs are inputs—other than quoted prices—included within Level 1 that are observable for the asset or liability, either directly or indirectly.
- Level 3 inputs are unobservable inputs, such as management's assumption of the default rate among underlying mortgages of a mortgage-backed security.

This Statement requires disclosures to be made about fair value measurements, the level of fair value hierarchy, and valuation techniques. Governments should organize these disclosures by type of asset or liability reported at fair value. It also requires additional disclosures regarding investments in certain entities that calculate net asset value per share (or its equivalent).

The pronouncement became effective and affected the notes to the financial statements, but did not have a material effect on the financial statements. See Notes 1K and 2B to the financial statements for current year disclosures.

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MEMORANDUM ON INTERNAL CONTROLS

STATUS OF PRIOR YEAR OTHER MATTERS

2015-01 Credit Card Usage

The use of District credit cards presents a higher risk of misappropriation than normal disbursement procedures. As such, it is important to have a solid policy that provides the necessary convenience for minor purchases, while maintaining enough security and restrictions to prevent abuse and misappropriation. Employees should not use the credit card to circumvent the normal purchasing process.

Bypassing of the District's normal purchasing policy may limit the District's budgetary control over appropriated expenditures.

We recommend that the credit cards usage for normal items should be limited. Approval of purchases should be done before purchase.

Current Status:

The Interim General Manager is the only person that is authorized to use the District's credit card; all other credit cards were cancelled.

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MAZE & ASSOCIATES

MEMORANDUM ON INTERNAL CONTROL

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

In planning and performing our audit of the basic financial statements of the East Palo Alto Sanitary District (District) as of and for the year ended June 30, 2016, in accordance with auditing standards generally accepted in the United States of America, we considered the District's internal control over financial reporting (internal control) as a basis for designing 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 District's internal control. Accordingly, we do not express an opinion on the effectiveness of the District'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 District's financial statements will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control was for the limited purpose described in the first paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses. In addition, because of inherent limitations in internal control, including the possibility of management override of controls, misstatements due to error or fraud may occur and not be detected by such controls. 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.

Included in the Schedule of Other Matters are recommendations not meeting the above definitions that we believe are opportunities for strengthening internal controls and operating efficiency.

Management's written responses included in this report have not been subjected to the audit procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

This communication is intended solely for the information and use of management, Board of Directors, others within the organization, and agencies and pass-through entities requiring compliance with *Government Auditing Standards*, and is not intended to be and should not be used by anyone other than these specified parties.

Maze + Associates

Pleasant Hill, California
February 16, 2017

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GASB 76 - ***The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments***

The objective of this Statement is to identify, in the context of the current governmental financial reporting environment, the hierarchy of generally accepted accounting principles (GAAP). The "GAAP hierarchy" consists of the sources of accounting principles used to prepare financial statements of state and local governmental entities in conformity with GAAP and the framework for selecting those principles. This Statement reduces the GAAP hierarchy to two categories of authoritative GAAP and addresses the use of authoritative and non-authoritative literature in the event that the accounting treatment for a transaction or other event is not specified within a source of authoritative GAAP. This Statement supersedes Statement No. 55, The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments.

The requirements in this Statement improve financial reporting by (1) raising the category of GASB Implementation Guides in the GAAP hierarchy, thus providing the opportunity for broader public input on implementation guidance; (2) emphasizing the importance of analogies to authoritative literature when the accounting treatment for an event is not specified in authoritative GAAP; and (3) requiring the consideration of consistency with the GASB Concepts Statements when evaluating accounting treatments specified in nonauthoritative literature. As a result, governments will apply financial reporting guidance with less variation, which will improve the usefulness of financial statement information for making decisions and assessing accountability and enhance the comparability of financial statement information among governments.

The pronouncement became effective, but did not have a material effect on the financial statements.

GASB 79 – ***Certain External Investment Pools and Pool Participants***

The requirements of this Statement are effective for reporting periods beginning after June 15, 2015, except for certain provisions on portfolio quality, custodial credit risk, and shadow pricing. Those provisions are effective for reporting periods beginning after December 15, 2015.

This Statement addresses accounting and financial reporting for certain external investment pools and pool participants. Specifically, it establishes criteria for an external investment pool to qualify for making the election to measure all of its investments at amortized cost for financial reporting purposes. An external investment pool qualifies for that reporting if it meets all of the applicable criteria established in this Statement. The specific criteria address (1) how the external investment pool transacts with participants; (2) requirements for portfolio maturity, quality, diversification, and liquidity; and (3) calculation and requirements of a shadow price. Significant noncompliance prevents the external investment pool from measuring all of its investments at amortized cost for financial reporting purposes. Professional judgment is required to determine if instances of noncompliance with the criteria established by this Statement during the reporting period, individually or in the aggregate, were significant.

If an external investment pool does not meet the criteria established by this Statement, that pool should apply the provisions in paragraph 16 of Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, as amended. If an external investment pool meets the criteria in this Statement and measures all of its investments at amortized cost, the pool's participants also should measure their investments in that external investment pool at amortized cost for financial reporting purposes. If an external investment pool does not meet the criteria in this Statement, the pool's participants should measure their investments in that pool at fair value, as provided in paragraph 11 of Statement 31, as amended.

This Statement establishes additional note disclosure requirements for qualifying external investment pools that measure all of their investments at amortized cost for financial reporting purposes and for governments that participate in those pools. Those disclosures for both the qualifying external investment pools and their participants include information about any limitations or restrictions on participant withdrawals.

The pronouncement became effective, but did not have a material effect on the financial statements.

Unusual Transactions, Controversial or Emerging Areas

We noted no transactions entered into by the District during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

Accounting Estimates

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimates affecting the District's financial statements were:

Estimated Fair Value of Investments: As of June 30, 2016, the District held approximately $14 million of cash and investments as measured by fair value as disclosed in Note 2 to the financial statements. Fair value is essentially market pricing in effect as of June 30, 2016. These fair values are not required to be adjusted for changes in general market conditions occurring subsequent to June 30, 2016.

Estimate of Depreciation: Management's estimate of the depreciation is based on useful lives determined by management. These lives have been determined by management based on the expected useful life of assets as disclosed in Note 1F to the financial statements. We evaluated the key factors and assumptions used to develop the depreciation estimate and determined that it is reasonable in relation to the basic financial statements taken as a whole.

Estimate of Compensated Absences: Accrued compensated absences which are comprised of accrued vacation, holiday, and certain other compensating time is estimated using accumulated unpaid leave hours and hourly pay rates in effect at the end of the fiscal year as disclosed in Note 1E to the financial statements. We evaluated the key factors and assumptions used to develop the accrued compensated absences and determined that it is reasonable in relation to the basic financial statements taken as a whole.

Estimated Net Pension Liabilities and Pension-Related Deferred Outflows and Inflows of Resources: Management's estimate of the net pension liabilities and deferred outflows/inflows of resources are disclosed in Note 6 to the financial statements and are based on actuarial studies determined by a consultant, which are based on the experience of the District. We evaluated the key factors and assumptions used to develop the estimate and determined that it is reasonable in relation to the basic financial statements taken as a whole.

Estimated Net OPEB Asset: Management's estimate of the net OPEB Asset is disclosed in Note 7 to the financial statements and is based on actuarial study determined by a consultant, which is based on the experience of the District. We evaluated the key factors and assumptions used to develop the estimate and determined that it is reasonable in relation to the basic financial statements taken as a whole.

Disclosures

The financial statement disclosures are neutral, consistent, and clear.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing and completing our audit.

Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are clearly trivial, and communicate them to the appropriate level of management. Management has corrected all/certain such misstatements. In addition, none of the misstatements detected as a result of audit procedures and corrected by management were material, either individually or in the aggregate, to each opinion unit's financial statements taken as a whole.

Disagreements with Management

For purposes of this letter, a disagreement with management is a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

Management Representations

We have requested certain representations from management that are included in a management representation letter dated February 16, 2017.

Management Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the District's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Other Audit Findings or Issues

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the District's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

Other Matters

__**Other Information Accompanying the Financial Statements**__

We applied certain limited procedures to the required supplementary information that accompanies and supplements the basic financial statements. Our procedures consisted of inquiries of management regarding 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 did not audit the required supplementary information and do not express an opinion or provide any assurance on the required supplementary information.

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This information is intended solely for the use of the Board of Directors and management and is not intended to be, and should not be, used by anyone other than these specified parties.

Maze & Associates

Pleasant Hill, California
February 16, 2017

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