

***CITY OF HERCULES
CALIFORNIA***

**ANNUAL FINANCIAL REPORT
For the fiscal year ended
June 30, 2014**

THIS PAGE INTENTIONALLY LEFT BLANK

CITY OF HERCULES

TABLE OF CONTENTS
For the fiscal year ended June 30, 2014

FINANCIAL SECTION

Independent Auditor's Report	1-2
Management's Discussion and Analysis	3-11
Basic Financial Statements:	
Government-wide Financial Statements:	
Statement of Net Position	13
Statement of Activities	14-15
Fund Financial Statements:	
Governmental Funds:	
Balance Sheet	18-19
Reconciliation of the Governmental Funds – Balance Sheet to the Statement of Net Position	20
Statement of Revenues, Expenditures, and Changes in Fund Balances	22-23
Reconciliation of the Statement of Revenues, Expenditures, and Changes in Fund Balances of Governmental Funds to the Statement of Activities	24
Proprietary Funds:	
Statement of Net Position	26-27
Statement of Revenues, Expenses, and Change in Net Position	28
Statement of Cash Flows	30-31
Fiduciary Funds:	
Statement of Fiduciary Net Position	35
Statement of Changes in Fiduciary Net Position	36
Notes to Basic Financial Statements	37-71
Required Supplementary Information:	
Post-employment Benefits Other Than Pensions	73
Budgetary Comparison Schedule – General Fund	74-75
Budgetary Comparison Schedule – State Gas Tax Special Revenue Fund	76
Budgetary Comparison Schedule – Measure “C” Street Fund	77
Notes to Required Supplementary Information	78
Other Report:	
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 <i>Government Auditing Standards</i>	79-80

THIS PAGE INTENTIONALLY LEFT BLANK

FINANCIAL SECTION

THIS PAGE INTENTIONALLY LEFT BLANK



INDEPENDENT AUDITOR'S REPORT

To the 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 governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Hercules (City), California, as of and for the fiscal year ended June 30, 2014, and the related notes to the financial statements, which collectively comprise the City'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 financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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

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

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

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City, as of June 30, 2014, and the respective changes in financial position, and where applicable, cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

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

Emphasis of Matter

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

As described in Note 18 to the financial statements, the City's General Fund has outstanding loans of \$27.8 million owed by the former redevelopment agency (Agency), now a private purpose trust fund of the City. This outstanding loan represents approximately 78 percent of the City's General Fund's assets. The City is also reporting significant advances to the Agency in other funds. 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 valid. 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.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management discussion and analysis, budgetary comparison schedules and the trend information of the post-employment benefits other than pensions, 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.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated December 9, 2014 on our consideration of the City'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 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 City's internal control over financial reporting and compliance.



Roseville, California
December 9, 2014

MANAGEMENT'S DISCUSSION AND ANALYSIS

THIS PAGE INTENTIONALLY LEFT BLANK

CITY OF HERCULES

Management's Discussion and Analysis June 30, 2014

Within this section of the City of Hercules' annual financial report, the City's management provides narrative discussion and analysis of the financial activities of the City for the fiscal year ended June 30, 2014. Readers are encouraged to consider the information presented here in conjunction with the accompanying financial statements and disclosures following this section. The discussion focuses on the City's primary government and, unless otherwise noted, does not include separately reported component units.

FINANCIAL HIGHLIGHTS

- The assets of the City exceeded liabilities at the close of the most recent fiscal year by \$142,718,838 (*net position*). Net position of \$13,670,630 are restricted for specific purposes (*restricted net position*), and \$72,485,971 represents net investment in capital assets. Unrestricted net position was \$56,562,237. The government's total net position, as adjusted, decreased by \$506,503 in comparison with the prior year.
- The City's net investment in capital assets, decreased by \$3,418,010.
- The City's governmental funds reported combined fund balances of \$54,078,035, a decrease of \$3,397,913 in comparison with the prior year, as adjusted. The unassigned portion of those fund balances was \$4,532,055.

OVERVIEW OF THE FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to the City's basic financial statements. The City's basic financial statements comprise three components 1) **Government-wide** financial statements; 2) **Fund** financial statements and 3) **Notes** to the basic financial statements. This report also contains other **Supplementary Information** in addition to the basic financial statements.

Government-wide Financial Statements are designed to provide readers with a broad overview of City finances, in a manner similar to a private-sector business.

- The *statement of net position* presents information on all City assets and liabilities, with the difference between the two reported as *net position*. Over time, increases or decreases in net position may serve as a useful indicator of whether the financial position of the City is improving or deteriorating.
- The *statement of activities* presents information showing how net position changed during the most recent fiscal year. All changes in net position are reported as soon as the underlying event giving rise to the change occurs, *regardless of the timing of related cash flows*. Thus, revenues and expenditures are reported in this statement for some items that will result in cash flows in future fiscal periods (e.g., uncollected taxes and earned but unused vacation leave).

Both of these government-wide financial statements distinguish functions of the City that are principally supported by taxes and intergovernmental revenues (*governmental activities*) from other functions that are intended to recover all or a portion of their costs through user fees and charges (*business-type activities*). The governmental activities of the City include general government, public safety, streets and public works, parks and recreation, and community development. The business-type activities of the City consist of the Wastewater Fund and the Hercules Municipal Utility (HMU) Fund. The City sold HMU to PG&E during the fiscal year 2013/14. Fiduciary activities are not included in the government-wide statements since these assets are not available to fund City programs.

The City's financial reporting includes the funds of the City (primary government) and organizations for which the City is accountable (component units). Most of these legally separated organizations operate like City departments, serve as financing vehicles for City services (revenue bond issuers), or are governed by a board that is substantively identical to the City's board. An example of this is the Hercules

CITY OF HERCULES

Management's Discussion and Analysis June 30, 2014

Public Finance Authority, which while legally separate is in substance an extension of the City operations. Financial data for the Hercules Public Finance Authority are combined with the presentation of the primary government's financial data and thus it is referred to as a "blended" component unit. A "discretely presented" component unit is one that is presented separately in the financial statements to emphasize its independence from the primary government. Hercules City has no discretely presented component units.

Fund Financial Statements A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The City, like other state and local governments, uses fund accounting to ensure and demonstrate finance-related legal compliance. All of the funds of the City can be divided into three categories: *governmental funds*, *proprietary funds* and *fiduciary funds*.

Governmental funds are used to account for essentially the same functions reported as *governmental activities* in the government-wide financial statements. However, unlike the government-wide financial statements, governmental funds financial statements focus on *near-term inflows and outflows of spendable resources*, as well as on *balances of spendable resources* available at the end of the fiscal year. Such information may be useful in evaluating a City's near-term financing requirements. *Governmental activities* use a current financial resources measurement focus and modified accrual basis of accounting.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for *governmental funds* with similar information presented for *governmental activities* in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the governmental funds balance sheet and the governmental funds statement of revenues, expenditures and changes in fund balances provide a reconciliation to facilitate this comparison between *governmental funds* and *governmental activities*.

The City maintains individual governmental funds. Information is presented separately in the governmental funds balance sheet and in the governmental funds statement of revenues, expenditures and changes in fund balances for the General Fund, Hercules Public Financing Authority Debt Service Fund, State Gas Tax Fund, Measure "C" Street Fund and the other governmental funds combined into a single, aggregated column. Government Accounting Standards Board (GASB) Statement No. 34 defines major governmental funds as those with revenues, expenditures, assets or liabilities that make up at least 10% of the total fund category or type (governmental or business type) and at least 5% of the aggregate amount of all governmental and enterprise funds. Individual fund data for each of these non-major governmental funds is provided in the form of *combining statements* in the supplementary information.

Proprietary funds are maintained two ways. *Enterprise funds* are used to report the same functions presented as *business-type activities* in the government-wide financial statements. The City uses enterprise funds to account for the operations of the Wastewater Fund and the HMU Fund. *Internal services funds* are an accounting device used to accumulate and allocate costs internally among the City's various functions. The City uses three internal service funds to account for its vehicle replacement, IT equipment replacement and facilities maintenance functions. Because internal service funds predominantly benefit governmental rather than business-type functions, they have been included within *governmental activities* in the government-wide financial statements.

Proprietary funds provide the same type of information as the government-wide financial statements, only in more detail.

CITY OF HERCULES

Management's Discussion and Analysis June 30, 2014

Fiduciary funds are used to account for resources held for the benefit of parties outside the government. Fiduciary funds are not reflected in the government-wide financial statements because the resources of those funds are not available to support the City's own programs. The City is responsible for ensuring that the assets reported in these funds are used for their intended purposes. As of February 1, 2012 the activities of the Successor Agency to the former Hercules Redevelopment Agency are reported with the City's Fiduciary Fund as a Private Purpose Trust Fund because they are under the control of an Oversight Board.

Notes to the Financial Statements provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements.

Required Supplementary Information provides the schedule of funding progress for the City Employees Retirement Plan and Other Post-Employment Benefits other than pensions. Also presented are the budgetary comparison schedules for the City's General Fund and Major Special Revenue Funds, and notes to required supplementary information.

Other Report section includes the 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. After the Other Report section is the Schedule of Findings and Responses.

GOVERNMENT-WIDE FINANCIAL ANALYSIS

Net position may serve over time as a useful indicator of a government's financial position. In the case of the City, combined assets exceeded liabilities by \$142,718,838 at the close of the most recent fiscal year. Of these combined net position 51% reflects the City's investment in capital assets, net of related debt. Another 10% of the City's net position is subject to external restrictions on how they may be used.

The City's Net Position

	Governmental Activities		Business-Type Activities		Total Activities	
	FY 2014	FY 2013	FY 2014	FY 2013	FY 2014	FY 2013
Current and Other Assets	\$ 70,185,145	\$ 62,339,079	\$ 28,221,361	\$ 39,822,564	\$ 98,406,506	\$ 102,161,643
Capital Assets	69,082,117	71,922,242	13,411,371	20,936,231	82,493,488	92,858,473
Total Assets	139,267,262	134,261,321	41,632,732	60,758,795	180,899,994	195,020,116
Current Liabilities	3,250,513	2,177,851	621,488	1,948,814	3,872,001	4,126,665
Long-Term Liabilities	23,406,731	23,955,840	10,902,424	23,712,270	34,309,155	47,668,110
Total Liabilities	26,657,244	26,133,691	11,523,912	25,661,084	38,181,156	51,794,775
Net investment in capital assets	62,588,422	65,157,839	9,897,549	10,746,142	72,485,971	75,903,981
Restricted	13,670,630	22,334,668	--	--	13,670,630	22,334,668
Unrestricted	36,350,966	20,635,123	20,211,271	24,351,569	56,562,237	44,986,692
Total Net Position	\$ 112,610,018	\$ 108,127,630	\$ 30,108,820	\$ 35,097,711	\$ 142,718,838	\$ 143,225,341

A significant portion of the City's net position, \$72,485,971, reflects the amount invested in capital assets (e.g. land and easements, structures and improvements, infrastructure, and equipment), less any related debt used to acquire those assets. The City uses these capital assets to provide services to citizens; consequently, these assets are not available for future spending. Although the City's investment in capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

The restricted portion of the City's net position, \$13,670,630, represents resources that are subject to external restrictions by grantors and other governments on how they may be used.

CITY OF HERCULES

Management's Discussion and Analysis June 30, 2014

The unrestricted portion of the City's net position due to governmental activities is \$56,562,237. It is to be noted that GASB 54 classifies long-term payroll liabilities to the unrestricted category. These reclassifications include liabilities for other post-employment benefits (OPEB) and compensated absences. These liabilities accumulate over decades as part of the City's employment agreements and the timing for their translation into current year expense is not precisely subject to projection.

The City's net position, as adjusted, decreased by \$506,503 during the current fiscal year. The decrease in net position represents the degree to which ongoing expenses exceeded ongoing revenues.

The City's Changes in Net Position

	Governmental Activities		Business-Type Activities		Total Activities	
	FY 2014	FY 2013	FY 2014	FY 2013	FY 2014	FY 2013
Revenues						
Program Revenues:						
Fees, fines and charges for services	\$ 4,815,901	\$ 4,521,763	\$ 7,690,524	\$ 8,039,251	\$ 12,506,425	\$ 12,561,014
Operating grants/contributions	1,371,396	1,176,617	--	--	1,371,396	1,176,617
Capital grants/contributions	1,066,000	--	--	--	1,066,000	--
General Revenues:						
Property taxes	992,934	1,233,335	--	--	992,934	1,233,335
Sales taxes	2,593,675	2,153,244	--	--	2,593,675	2,153,244
Franchise taxes	799,180	669,723	--	--	799,180	669,723
Other taxes	3,265,624	2,284,442	--	--	3,265,624	2,284,442
Motor vehicle taxes in-lieu	1,323,651	1,312,179	--	--	1,323,651	1,312,179
Interest and investment income	1,002,389	993,098	45,822	44,326	1,048,211	1,037,424
Miscellaneous	1,397,677	758,854	86,637	101,207	1,484,314	860,061
Special item	--	3,686,647	561,703	2,874,410	561,703	6,561,057
Total Revenues	18,628,427	18,789,902	8,384,686	11,059,194	27,013,113	29,849,096
Expenses						
General government	4,350,428	3,900,757	--	--	4,350,428	3,900,757
Public safety	4,905,837	4,560,766	--	--	4,905,837	4,560,766
Streets and public works	5,761,359	5,244,823	--	--	5,761,359	5,244,823
Parks and recreation	2,147,560	2,087,597	--	--	2,147,560	2,087,597
Community development	3,295,068	1,275,685	--	--	3,295,068	1,275,685
Interest and long-term debt	1,073,240	1,284,713	--	--	1,073,240	1,284,713
Sewer	--	--	3,494,287	3,336,974	3,494,287	3,336,974
Utility	--	--	2,491,837	3,369,406	2,491,837	3,369,406
Total Expenses	21,533,492	18,354,341	5,986,124	6,706,380	27,519,616	25,060,721
Increase(decrease) in net position before transfers	(2,905,065)	435,561	2,398,562	4,352,814	(506,503)	4,788,375
Transfers	7,387,453	--	(7,387,453)	--	--	--
Change in Net Position	4,482,388	435,561	(4,988,891)	4,352,814	(506,503)	4,788,375
Net Position - Beginning	108,127,630	107,692,069	35,097,711	30,744,897	143,225,341	138,436,966
Prior period adjustments	--	--	--	--	--	--
Net Position - Ending	\$ 112,610,018	\$ 108,127,630	\$ 30,108,820	\$ 35,097,711	\$ 142,718,838	\$ 143,225,341

FINANCIAL ANALYSIS OF THE CITY'S FUNDS

As described earlier, the City uses **fund accounting** to ensure and demonstrate compliance with finance-related legal requirements.

Governmental funds. The general government functions are contained in the General, Special Revenue, and Debt Service Funds. The focus of the City's *governmental funds* is to provide information on near-term inflows, outflows, and balances of *spendable* resources. Such information is useful in assessing the City's financing requirements.

CITY OF HERCULES

Management's Discussion and Analysis
June 30, 2014

At June, 30, 2014, the City's governmental funds reported combined fund balances of \$54,078,035. Of these combined fund balances, \$4,532,055 constitutes unassigned fund balance of the General Fund, which is available to meet the City's current and future needs. The restricted fund balance, \$8,253,115 consists of amounts with constraints put on their use by externally imposed creditors, grantors, laws, regulations, or enabling legislation.

The General Fund is the chief operating fund of the City. At June 30, 2014, unassigned fund balance was \$5,389,258, while total fund balance was \$34,550,345. As a measure of the General Fund's liquidity, it may be useful to compare both unassigned and total fund balance to total fund expenditures. Unassigned fund balance represents 48% of total General Fund expenditures, while the total fund balance represents 308% of total General Fund expenditures.

Total governmental funds Fund Balance decreased by \$3,397,913 in comparison with the prior year. The major governmental funds had changes in fund balance as follows:

General Fund increased \$8,231,824. Due to the sale of the HMU to PG&E any remaining assets and liabilities of the HMU were transferred to the General Fund. This is the primary reason for the increase in Fund Balance for the General Fund.

Hercules Public Financing Authority Debt Service Fund decreased \$9,643,777. There was a reclassification of \$9,553,471 from Fund Balance to the Liabilities section of the Balance Sheet to account for the Deferred Revenue for the 2009 Taxable Lease Revenue Bond.

Measure "C" Fund decreased by \$108,403 and State Gas Tax Fund increased \$477,521. The non-major (other) governmental funds decreased by \$5,478,540. The primary reason for the decrease in the non-major governmental funds is that the Measure "C" Fund and the State Gas Tax Fund are now major governmental funds instead of non-major (other) governmental funds per Government Accounting Standards Board (GASB) Statement No. 34.

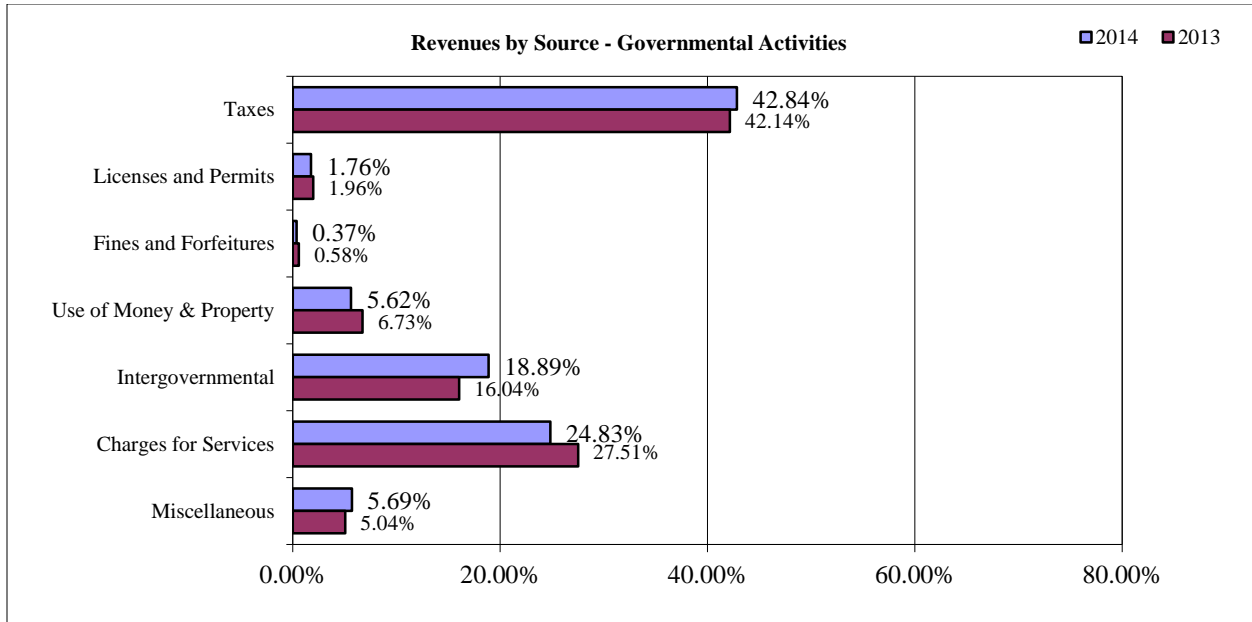
The following table presents the amount of revenues from various sources as well as increases or decreases from the prior year.

	FY 2014		FY 2013		Increase (Decrease)	
	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Change
Taxes	\$ 7,651,413	42.84%	\$ 6,340,744	42.14%	\$ 1,310,669	20.67%
Licenses and Permits	315,086	1.76%	294,737	1.96%	20,349	6.90%
Fines and Forfeitures	66,488	0.37%	87,128	0.58%	(20,640)	-23.69%
Use of Money & Property	1,003,729	5.62%	1,012,177	6.73%	(8,448)	-0.83%
Intergovernmental	3,374,022	18.89%	2,413,531	16.04%	960,491	39.80%
Charges for Services	4,434,327	24.83%	4,139,898	27.51%	294,429	7.11%
Miscellaneous	1,015,728	5.69%	758,854	5.04%	256,874	33.85%
Total Revenue by Source	\$ 17,860,793	100.00%	\$ 15,047,069	100.00%	\$ 2,813,724	

CITY OF HERCULES

Management's Discussion and Analysis
June 30, 2014

The following graph shows an illustrative picture of where the City funds come from.



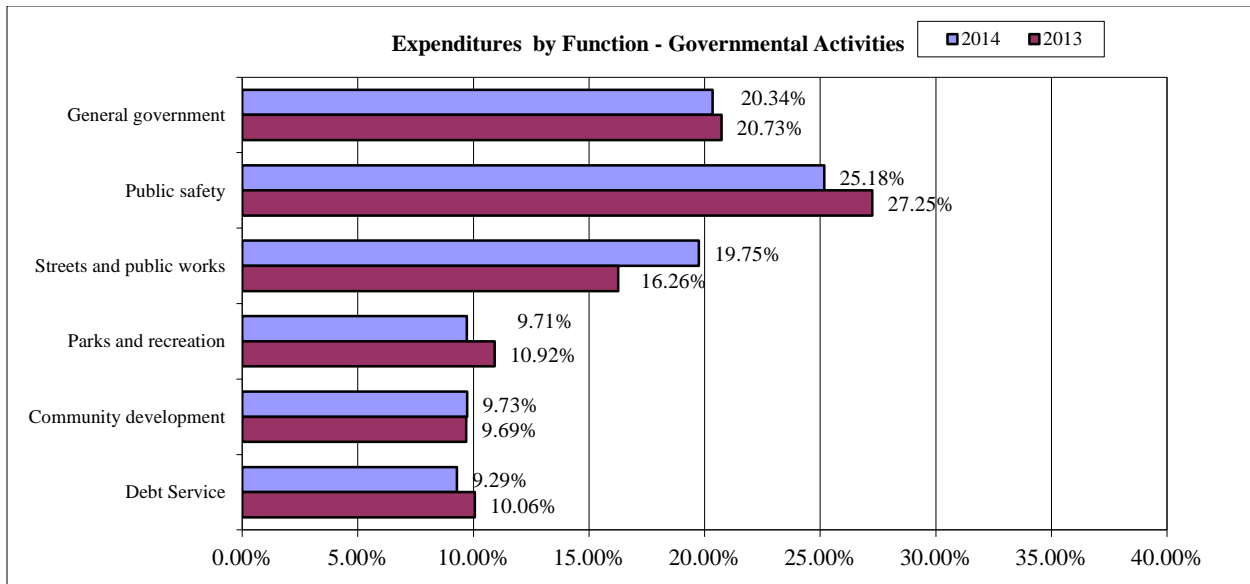
The following table presents expenditures by function compared to prior year amounts.

	FY 2014		FY 2013		Increase (Decrease)	
	Amount	Percent of Total	Amount	Percent of Total	Amount	Percent of Change
General government	\$ 3,934,402	20.34%	\$ 3,482,323	20.73%	\$ 452,079	12.98%
Public safety	4,869,782	25.18%	4,578,363	27.25%	291,419	6.37%
Streets and public works	3,820,523	19.75%	2,731,992	16.26%	1,088,531	39.84%
Parks and recreation	1,878,925	9.71%	1,833,902	10.92%	45,023	2.46%
Community development	1,882,181	9.73%	1,628,258	9.69%	253,923	15.59%
Debt Service	1,796,142	9.29%	1,690,200	10.06%	105,942	6.27%
Capital outlay	1,161,622	6.01%	853,299	5.08%	308,323	
Total by Function	\$ 19,343,577	100.00%	\$ 16,798,337	100.00%	\$ 2,545,240	

CITY OF HERCULES

Management's Discussion and Analysis June 30, 2014

The following graph shows an illustrative picture of how City funds were spent.



Proprietary funds reporting focuses on determining operating income, changes in net position (or cost recovery), financial position, and cash flows using the full accrual basis of accounting.

Enterprise funds report the business-type activities of the City. Enterprise funds are used to account for the operations of the Wastewater Fund and HMU.

Enterprise fund net position net investment in capital assets at fiscal year-end was \$9,897,549. Unrestricted net position of the enterprise funds at fiscal year-end was \$20,211,271. The net position of the enterprise funds decreased \$4,988,891 from the prior fiscal year. Due to the sale of the HMU to PG&E any remaining assets and liabilities of the HMU were transferred to the General Fund. This resulted in a Net Position of zero for the HMU on the Statement of Net Position of the Proprietary Funds and this is the primary reason for the decrease in Net Position for the Enterprise Fund.

Internal service funds are an accounting device to accumulate and allocate costs internally among the City's various functions. Internal service funds are used to account for its vehicle replacement, IT replacement and facilities maintenance functions.

Total net position of the internal service funds at fiscal year-end were \$2,824,278 and include \$549,709 invested in capital assets. The net position of the internal service funds increased \$129,866 over the prior fiscal year.

CAPITAL ASSETS

The City's investment in capital assets for its governmental and business type activities as of June 30, 2014, amounted to \$82,493,488 (net of accumulated depreciation). This investment in capital assets includes land, structures and improvements, leasehold improvements, equipment, and infrastructure (roads and bridges).

CITY OF HERCULES

Management's Discussion and Analysis June 30, 2014

The following table shows the City's total investment in capital assets for governmental and proprietary funds.

	Capital Assets					
	Governmental Activities		Business-Type Activities		Total	
	2014	2013	2014	2013	2014	2013
Land	\$ 1,601,636	\$ 4,096,336	\$ 150,000	\$ 150,000	\$ 1,751,636	\$ 4,246,336
Construction In Progress	7,171,848	4,415,643	2,454,200	2,983,634	9,626,048	7,399,277
Land Improvements	9,985,733	9,985,733	--	--	9,985,733	9,985,733
Buildings & Improvements	25,861,711	25,861,711	11,335,199	11,335,199	37,196,910	37,196,910
Equipment	4,275,404	4,159,847	187,925	264,231	4,463,329	4,424,078
Infrastructure	79,462,448	79,462,448	9,513,058	17,735,929	88,975,506	97,198,377
Total	128,358,780	127,981,718	23,640,382	32,468,993	151,999,162	160,450,711
Accumulated Depreciation	(59,276,663)	(56,059,476)	(10,229,011)	(11,532,762)	(69,505,674)	(67,592,238)
Net Capital Assets	<u>\$ 69,082,117</u>	<u>\$ 71,922,242</u>	<u>\$ 13,411,371</u>	<u>\$ 20,936,231</u>	<u>\$ 82,493,488</u>	<u>\$ 92,858,473</u>

Additional information regarding capital assets is presented in note 4.

DEBT ADMINISTRATION

At the end of the current fiscal year, the City had total outstanding debt obligations of \$33,063,224. Of this amount, \$20,620,000 comprise bonds that are secured by the City's lease rental payments and other dedicated sources of revenue.

The following table shows the composition of the City's bonds and notes outstanding for governmental and proprietary funds.

	Long-Term Debt Obligations					
	Governmental Activities		Business-Type Activities		Total	
	2014	2013	2014	2013	2014	2013
Bonds payable	\$ 16,770,000	\$ 17,120,000	\$ 11,070,000	\$ 24,400,000	\$ 27,840,000	\$ 41,520,000
Unamortized discount/refunding	(415,114)	(432,411)	(189,066)	(720,883)	(604,180)	(1,153,294)
Lease payable	1,421,878	1,554,982	-	-	1,421,878	1,554,982
Loans payable	5,250,000	5,350,000	-	-	5,250,000	5,350,000
Total Debt	23,026,764	23,592,571	10,880,934	23,679,117	33,907,698	47,271,688
Less Current Portion	(604,474)	(583,104)	(240,000)	(505,000)	(844,474)	(1,088,104)
Net Long-Term Debt	<u>\$ 22,422,290</u>	<u>\$ 23,009,467</u>	<u>\$ 10,640,934</u>	<u>\$ 23,174,117</u>	<u>\$ 33,063,224</u>	<u>\$ 46,183,584</u>

Other obligations include compensated absences (accrued vacation and sick leave), workers' compensation and general liability insurance claims liability. More detailed information about the City's long-term liabilities is presented in note 5.

HIGHLIGHTS

During the fiscal year ending June 30, 2014, the City of Hercules not only sold the HMU to PG&E (as mentioned in prior paragraphs), the City also completed the sale of Town Centrale to UC-BNB Partners and Victoria Crescent to City Venture Partners in February 2014. In August 2014 the City sold Parcel C to LD Hercules Land LLC and the City has a Purchase and Sale Agreement for the Sycamore Crossing project. These parcels will generate fees for the City and ongoing utility user tax and sales tax upon build-out and completion of the projects. These activities are contributing to the City of Hercules ongoing financial sustainability.

CITY OF HERCULES

Management's Discussion and Analysis
June 30, 2014

REQUEST FOR INFORMATION

This financial report is designed to provide a general overview of the City's finances for all those with an interest in the government's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Department of Finance at 111 Civic Drive, Hercules, California, 94547.

THIS PAGE INTENTIONALLY LEFT BLANK

BASIC FINANCIAL STATEMENTS

THIS PAGE INTENTIONALLY LEFT BLANK

GOVERNMENT-WIDE FINANCIAL STATEMENTS

THIS PAGE INTENTIONALLY LEFT BLANK

CITY OF HERCULES

Statement of Net Position
June 30, 2014

	Primary Government		
	Governmental Activities	Business-Type Activities	Totals
ASSETS			
Cash and investments	\$ 13,022,046	10,265,818	\$ 23,287,864
Cash with fiscal agent	2,148,183	7,367,112	9,515,295
Accounts receivable	3,385,013	804	3,385,817
Interest receivable	38,534	--	38,534
Prepaid expenses	6,107	--	6,107
Inventories	19,028	--	19,028
Loans receivable	2,093,355	--	2,093,355
Lease receivable	9,553,471	--	9,553,471
Due from private purpose trust fund	39,586,347	10,587,627	50,173,974
Other post employment benefit asset	333,061	--	333,061
Capital assets:			
Nondepreciable	8,773,484	2,604,200	11,377,684
Depreciable, net of accumulated depreciation	60,308,633	10,807,171	71,115,804
Total Assets	<u>139,267,262</u>	<u>41,632,732</u>	<u>180,899,994</u>
LIABILITIES			
Accounts payable	1,885,174	409,514	2,294,688
Accrued wages	261,016	5,552	266,568
Accrued interest payable	438,536	206,422	644,958
Deposits with others	450,676	--	450,676
Claims and judgments payable	215,111	--	215,111
Noncurrent liabilities:			
Due within one year	889,449	261,490	1,150,939
Due in more than one year	22,517,282	10,640,934	33,158,216
Total Liabilities	<u>26,657,244</u>	<u>11,523,912</u>	<u>38,181,156</u>
NET POSITION			
Net investment in capital assets	62,588,422	9,897,549	72,485,971
Restricted for:			
Public safety	58,532	--	58,532
Streets and roads	4,743,117	--	4,743,117
Development	6,965,059	--	6,965,059
Debt service	1,903,922	--	1,903,922
Unrestricted	36,350,966	20,211,271	56,562,237
Total Net Position	<u>\$112,610,018</u>	<u>\$ 30,108,820</u>	<u>\$ 142,718,838</u>

The accompanying notes are an integral part of these financial statements.

CITY OF HERCULES

Statement of Activities
For the Year Ended June 30, 2014

Functions/Programs	Expenses	Program Revenues		
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions
Primary Government:				
Governmental activities:				
General government	\$ 4,350,428	\$ 161,547	\$ 120,965	--
Public safety	4,905,837	462,899	113,446	--
Streets and public works	5,761,359	2,373,889	1,130,295	1,066,000
Parks and recreation	2,147,560	1,623,655	--	--
Community development	3,295,068	193,911	6,690	--
Interest on long term debt	1,073,240	--	--	--
Total governmental activities	<u>21,533,492</u>	<u>4,815,901</u>	<u>1,371,396</u>	<u>1,066,000</u>
Business-Type Activities:				
Sewer	3,494,287	5,619,601	--	--
Hercules Municipal Utility	2,491,837	2,070,923	--	--
Total business-type activities	<u>5,986,124</u>	<u>7,690,524</u>	<u>--</u>	<u>--</u>
 Total City	 <u>\$ 27,519,616</u>	 <u>\$12,506,425</u>	 <u>\$ 1,371,396</u>	 <u>\$ 1,066,000</u>

General Revenues and Special Items:

Taxes:

 Secured and unsecured property taxes

 Sales and use taxes

 Franchise taxes

 Other taxes

 Unrestricted motor vehicle taxes in-lieu

 Use of money and property

 Miscellaneous revenue

Special items - sale of HMU

Transfers

 Total general revenues, transfers and special item

Change in net position

 Net Position - Beginning of Year

 Net Position - End of Year

The accompanying notes are an integral part of these financial statements.

Net (Expense) Revenue and
Changes in Net Position

Primary Government		
Governmental Activities	Business-Type Activities	Total
\$ (4,067,916)		\$ (4,067,916)
(4,329,492)		(4,329,492)
(1,191,175)		(1,191,175)
(523,905)		(523,905)
(3,094,467)		(3,094,467)
(1,073,240)		(1,073,240)
<u>(14,280,195)</u>	--	<u>(14,280,195)</u>
--	\$ 2,125,314	2,125,314
--	(420,914)	(420,914)
--	<u>1,704,400</u>	<u>1,704,400</u>
<u>(14,280,195)</u>	<u>1,704,400</u>	<u>(12,575,795)</u>
992,934	--	992,934
2,593,675	--	2,593,675
799,180	--	799,180
3,265,624	--	3,265,624
1,323,651	--	1,323,651
1,002,389	45,822	1,048,211
1,397,677	86,637	1,484,314
--	561,703	561,703
7,387,453	(7,387,453)	--
<u>18,762,583</u>	<u>(6,693,291)</u>	<u>12,069,292</u>
4,482,388	(4,988,891)	(506,503)
<u>108,127,630</u>	<u>35,097,711</u>	<u>143,225,341</u>
<u>\$ 112,610,018</u>	<u>\$ 30,108,820</u>	<u>\$ 142,718,838</u>

The accompanying notes are an integral part of these financial statements.

THIS PAGE INTENTIONALLY LEFT BLANK

FUND FINANCIAL STATEMENTS

THIS PAGE INTENTIONALLY LEFT BLANK

GOVERNMENTAL FUND FINANCIAL STATEMENTS

General Fund – This fund is used to account for all revenues and expenditures necessary to carry out basic governmental activities of the City that are not accounted for through other funds. For the City, the General Fund includes such activities as police, planning, engineering, public works, operations and maintenance, and legal and administrative services.

Hercules Public Financing Authority Debt Service Fund – This fund is used to account for the accumulation of resources for, and the payment of, principal and interest on various Lease Revenue Bonds issued to cover the refinancing of the original City Hall debt issue and to generate additional resources to assist in the construction of a new library building and other general government projects.

Other Governmental Funds – These funds are special revenue funds, a capital projects fund, and a debt service fund that have not been determined to be major funds, as defined by GASB Statement No. 34.

State Gas Tax Fund – This fund accounts for revenue apportioned by the City from State-collected gasoline taxes primarily on the basis of population, to be expended for construction and maintenance of City streets.

Measure “C” Street Fund – This fund accounts for revenue allocated by the Contra Costa County Transportation Authority to the City from the State collected sales tax to be expended for growth management planning and local street maintenance and improvement.

CITY OF HERCULES

Balance Sheet
Governmental Funds
June 30, 2014

	General Fund	Hercules Public Financing Authority Debt Service Fund	State Gas Tax Fund
	<u> </u>	<u> </u>	<u> </u>
ASSETS			
Cash and investments	\$ 4,859,113	\$ --	\$ 2,999,669
Cash and investments with fiscal agent	65	2,148,118	--
Accounts receivable	1,443,849	--	--
Interest receivable	17,887	20,647	--
Prepays	6,107	--	--
Due from other funds	274,086	--	69,797
Inventories	8,015	--	--
Loans receivable	2,093,355	--	--
Lease receivable	--	9,553,471	--
Advances to other funds	27,787,637	6,703,250	--
Total Assets	<u>\$ 36,490,114</u>	<u>\$ 18,425,486</u>	<u>\$ 3,069,466</u>
LIABILITIES			
Accounts payable	\$ 950,563	\$ --	\$ 13,080
Accrued wages	236,880	--	2,290
Deposits payable	450,676	--	--
Claims and judgments payable	215,111	--	--
Due to other funds	--	264,843	--
Total Liabilities	<u>1,853,230</u>	<u>264,843</u>	<u>15,370</u>
DEFERRED INFLOWS OF RESOURCES			
Unavailable revenue	<u>86,539</u>	<u>9,553,471</u>	<u>--</u>
FUND BALANCES			
Nonspendable	27,801,759	6,703,250	--
Restricted	--	1,903,922	3,054,096
Assigned	1,359,328	--	--
Unassigned	5,389,258	--	--
Total Fund Balances	<u>34,550,345</u>	<u>8,607,172</u>	<u>3,054,096</u>
 Total Liabilities, Deferred Inflows of Resources, and Fund Balances	 <u>\$ 36,490,114</u>	 <u>\$ 18,425,486</u>	 <u>\$ 3,069,466</u>

The accompanying notes are an integral part of these financial statements.

Measure "C" Street Fund	Other Governmental Funds	Total
\$ 494,825	\$ 2,199,945	\$ 10,553,552
--	--	2,148,183
749,446	1,191,611	3,384,906
--	--	38,534
--	--	6,107
--	126,555	470,438
11,013	--	19,028
--	--	2,093,355
--	--	9,553,471
--	5,417,515	39,908,402
<u>\$ 1,255,284</u>	<u>\$ 8,935,626</u>	<u>\$ 68,175,976</u>
\$ 65,065	\$ 691,503	\$ 1,720,211
2,289	14,209	255,668
--	--	450,676
--	--	215,111
--	527,650	792,493
<u>67,354</u>	<u>1,233,362</u>	<u>3,434,159</u>
<u>749,446</u>	<u>274,326</u>	<u>10,663,782</u>
11,013	5,417,515	39,933,537
427,471	2,867,626	8,253,115
--	--	1,359,328
--	(857,203)	4,532,055
<u>438,484</u>	<u>7,427,938</u>	<u>54,078,035</u>
<u>\$ 1,255,284</u>	<u>\$ 8,935,626</u>	<u>\$ 68,175,976</u>

The accompanying notes are an integral part of these financial statements.

CITY OF HERCULES

Reconciliation of the Governmental Funds Balance Sheet
to the Government-Wide Statement of Net Position - Governmental Activities
June 30, 2014

Fund Balance - total governmental funds (pages 18 and 19)	\$ 54,078,035
Amounts reported for governmental activities in the statement of net position are different because:	
Other long-term assets are not available to pay for current-period expenditures and, therefore, are not reported in the governmental funds.	
Other post employment benefit asset	333,061
Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the governmental funds.	68,532,408
Unavailable revenues represent amounts that are not available to fund current expenditures and, therefore, are not reported in the governmental funds.	10,663,782
Internal service funds are used by the City to charge the cost of its vehicle replacement, IT replacement and facilities maintenance activities to individual funds. The assets and liabilities of the internal service funds are included in governmental activities in the statement of net position.	2,824,278
Long-term liabilities, including capital leases, are not due and payable in the current period, and therefore are not reported in the governmental funds.	
Accrued interest	(438,536)
Revenue bonds payable	(16,354,886)
Notes payable	(5,250,000)
Capital leases payable	(1,421,878)
Compensated absences	<u>(356,246)</u>
Net position of governmental activities (page 13)	<u>\$ 112,610,018</u>

The accompanying notes are an integral part of these financial statements.

THIS PAGE INTENTIONALLY LEFT BLANK

CITY OF HERCULES

Statement of Revenues, Expenditures and Changes in Fund Balances
Governmental Funds
For the Year Ended June 30, 2014

	General Fund	Hercules Public Financing Authority Debt Service Fund	State Gas Tax Fund
	<u> </u>	<u> </u>	<u> </u>
Revenues:			
Taxes and assessments	\$ 7,651,413	\$ --	\$ --
Licenses and permits	315,086	--	--
Fines and forfeitures	66,488	--	--
Use of money and property	158,954	831,129	10,995
Intergovernmental	1,358,077	--	752,612
Charges for services	2,074,050	--	--
Other revenues	1,013,991	--	--
Total Revenues	<u>12,638,059</u>	<u>831,129</u>	<u>763,607</u>
Expenditures:			
Current:			
General government	3,934,402	--	--
Public safety	4,869,782	--	--
Streets and public works	232,286	--	286,086
Parks and recreation	1,878,925	--	--
Community development	285,387	--	--
Capital outlay		--	--
Debt service:			
Principal	--	350,000	--
Interest and fiscal agent fees	--	1,141,043	--
Total Expenditures	<u>11,200,782</u>	<u>1,491,043</u>	<u>286,086</u>
Excess (Deficiency) of Revenues Over (Under) Expenditures	<u>1,437,277</u>	<u>(659,914)</u>	<u>477,521</u>
Other Financing Sources (Uses):			
Transfers in	7,521,241	570,668	--
Transfers out	(1,108,643)	--	--
Sale of capital assets	381,949	--	--
Total Other Financing Sources (Uses)	<u>6,794,547</u>	<u>570,668</u>	<u>--</u>
Net Changes in Fund Balances	8,231,824	(89,246)	477,521
Fund Balances, Beginning of Year	26,318,521	18,250,949	2,576,575
Prior Period Adjustment	<u>--</u>	<u>(9,554,531)</u>	<u>--</u>
Fund Balances, End of Year	<u>\$ 34,550,345</u>	<u>\$ 8,607,172</u>	<u>\$ 3,054,096</u>

The accompanying notes are an integral part of these financial statements.

Measure "C" Street Fund	Other Governmental Funds	Total
\$ --	\$ --	\$ 7,651,413
--	--	315,086
--	--	66,488
(108)	2,759	1,003,729
348,717	914,616	3,374,022
--	2,360,277	4,434,327
--	1,737	1,015,728
<u>348,609</u>	<u>3,279,389</u>	<u>17,860,793</u>
--	--	3,934,402
--	--	4,869,782
335,675	2,966,476	3,820,523
--	--	1,878,925
--	1,596,794	1,882,181
--	1,161,622	1,161,622
--	233,104	583,104
--	71,995	1,213,038
<u>335,675</u>	<u>6,029,991</u>	<u>19,343,577</u>
<u>12,934</u>	<u>(2,750,602)</u>	<u>(1,482,784)</u>
--	529,312	8,621,221
(121,337)	(133,788)	(1,363,768)
--	--	381,949
<u>(121,337)</u>	<u>395,524</u>	<u>7,639,402</u>
(108,403)	(2,355,078)	6,156,618
546,887	9,783,016	57,475,948
--	--	(9,554,531)
<u>\$ 438,484</u>	<u>\$ 7,427,938</u>	<u>\$ 54,078,035</u>

The accompanying notes are an integral part of these financial statements.

CITY OF HERCULES

Reconciliation of the Statement of Revenues, Expenditures, and
Changes in Fund Balances of Governmental Funds to the
Government-Wide Statement of Activities - Governmental Activities
For the Year Ended June 30, 2014

Net change to fund balance - total governmental funds (pages 22 and 23)		\$ 6,156,618
Amounts reported for governmental activities in the statement of activities are different because:		
<p>Governmental funds report capital outlay as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense.</p>		
Expenditures for general capital assets, infrastructure, and other related capital assets adjustments	\$ 261,505	
Less: current year depreciation	<u>(3,204,942)</u>	(2,943,437)
<p>Governmental fund revenues deferred at year end due to unavailability, under the modified accrual method of accounting, are recognized as revenue on the full accrual method of accounting</p>		
		385,965
<p>Long-term debt proceeds provide current resources to governmental funds, but issuing debt increases long-term liabilities in the statement of net position. Repayment of bond principal is an expenditure in the governmental funds, but the repayment reduced long-term liabilities in the statement of net position.</p>		
Principal repayments	583,104	
Amortization of bond premiums and discounts	<u>(17,297)</u>	565,807
<p>Some expenses reported in the statement of activities do not require the use of current financial resources and, therefore, are not reported as expenditures in governmental funds.</p>		
Change in compensated absences		(11,119)
Change in accrued interest payable		157,095
<p>Other post employment benefits are reported as an expenditure when contributions are made in the governmental funds, but are deferred assets for contributions made in excess of required amounts.</p>		
		41,593
<p>Internal service funds are used by management to charge the costs of certain activities to individual funds. The net revenue of certain activities of the internal service funds is reported with governmental activities.</p>		
		<u>129,866</u>
Change in net position of governmental activities (pages 14 and 15)		<u><u>\$ 4,482,388</u></u>

The accompanying notes are an integral part of these financial statements.

PROPRIETARY FUNDS FINANCIAL STATEMENTS

Sewer Fund – This fund accounts for wastewater treatment to the cities of Hercules and Pinole and for the maintenance of the City's sewer lines and related facilities. It is a self-supporting activity which provides services on a user charge basis to residences and businesses.

Hercules Municipal Utilities Fund – This fund accounts for the operations of the City's electric utility that provides electrical power to areas of new development within Hercules' city limits.

Internal Service Funds – These funds account for activities related to vehicle replacement, IT equipment replacement, and facilities maintenance.

CITY OF HERCULES

Statement of Net Position
Proprietary Funds
June 30, 2014

	Business-Type Activities - Enterprise Funds			Governmental Activities
	Sewer Fund	Hercules Municipal Utility Fund	Totals	Internal Service Funds
ASSETS				
Current Assets:				
Cash and investments	\$ 10,265,818	\$ --	\$ 10,265,818	\$ 2,468,494
Cash with fiscal agent	7,367,112	--	7,367,112	--
Accounts receivable - net	804	--	804	107
Total Current Assets	<u>17,633,734</u>	<u>--</u>	<u>17,633,734</u>	<u>2,468,601</u>
Noncurrent Assets:				
Advances to other funds	<u>10,587,627</u>	<u>--</u>	<u>10,587,627</u>	<u>--</u>
Capital assets:				
Non-depreciable :				
Land	150,000	--	150,000	--
Construction in progress	2,454,200	--	2,454,200	--
Total Nondepreciable Capital Assets	<u>2,604,200</u>	<u>--</u>	<u>2,604,200</u>	<u>--</u>
Depreciable:				
Buildings and improvements	11,335,199	--	11,335,199	--
Infrastructure	9,513,058	--	9,513,058	--
Machinery and equipment	187,925	--	187,925	3,174,790
Total Depreciable Capital Assets	<u>21,036,182</u>	<u>--</u>	<u>21,036,182</u>	<u>3,174,790</u>
Less Accumulated Depreciation	<u>(10,229,011)</u>	<u>--</u>	<u>(10,229,011)</u>	<u>(2,625,081)</u>
Net Depreciable Capital Assets	<u>10,807,171</u>	<u>--</u>	<u>10,807,171</u>	<u>549,709</u>
Net Capital Assets	<u>13,411,371</u>	<u>--</u>	<u>13,411,371</u>	<u>549,709</u>
Total Noncurrent Assets	<u>23,998,998</u>	<u>--</u>	<u>23,998,998</u>	<u>549,709</u>
Total Assets	<u>\$ 41,632,732</u>	<u>\$ --</u>	<u>\$ 41,632,732</u>	<u>\$ 3,018,310</u>

continued

The accompanying notes are an integral part of these financial statements.

CITY OF HERCULES

Statement of Fund Net Assets (continued)
 Proprietary Funds
 June 30, 2014

	Business-Type Activities - Enterprise Funds			Governmental Activities
	Sewer Fund	Hercules Municipal Utility Fund	Totals	Internal Service Funds
LIABILITIES				
Current Liabilities:				
Accounts payable	\$ 409,514	\$ --	\$ 409,514	164,963
Salaries and benefits payable	5,552	--	5,552	5,348
Accrued interest payable	206,422	--	206,422	--
Compensated absences	21,490	--	21,490	23,721
Long term debt, due within one year	240,000	--	240,000	--
Total Current Liabilities	<u>882,978</u>	<u>--</u>	<u>882,978</u>	<u>194,032</u>
Noncurrent Liabilities:				
Long term debt, due in more than one year	10,640,934	--	10,640,934	--
Total Noncurrent Liabilities	<u>10,640,934</u>	<u>--</u>	<u>10,640,934</u>	<u>--</u>
Total Liabilities	<u>11,523,912</u>	<u>--</u>	<u>11,523,912</u>	<u>194,032</u>
NET POSITION				
Net investment in capital assets	9,897,549	--	9,897,549	549,709
Unrestricted	20,211,271	--	20,211,271	2,274,569
Total Net Position	<u>\$ 30,108,820</u>	<u>\$ --</u>	<u>\$ 30,108,820</u>	<u>\$ 2,824,278</u>

The accompanying notes are an integral part of these financial statements.

CITY OF HERCULES

Statement of Revenues, Expenses and Changes in Net Position
Proprietary Funds
For the Year Ended June 30, 2014

	Business-Type Activities - Enterprise Funds			Governmental
	Sewer Fund	Hercules Municipal Utility Fund	Totals	Internal Service Funds
Operating Revenues:				
Sales and charges for services	\$ 5,619,601	\$ 2,070,923	\$ 7,690,524	\$ 1,129,165
Other operating revenue	--	86,637	86,637	13,945
Total Operating Revenues	<u>5,619,601</u>	<u>2,157,560</u>	<u>7,777,161</u>	<u>1,143,110</u>
Operating Expenses:				
Salaries and benefits	349,679	157,791	507,470	284,537
Services and supplies	2,272,743	711,692	2,984,435	652,399
Purchase of electricity	--	1,183,622	1,183,622	--
Depreciation	367,789	157,707	525,496	206,028
Total Operating Expenses	<u>2,990,211</u>	<u>2,210,812</u>	<u>5,201,023</u>	<u>1,142,964</u>
Operating Income (Loss)	<u>2,629,390</u>	<u>(53,252)</u>	<u>2,576,138</u>	<u>146</u>
Non-Operating Revenue (Expenses):				
Interest income	37,158	8,664	45,822	(280)
Interest expense	(504,076)	(372,944)	(877,020)	--
Fees and taxes	--	91,919	91,919	--
Total Non-Operating Revenue (Expenses)	<u>(466,918)</u>	<u>(272,361)</u>	<u>(739,279)</u>	<u>(280)</u>
Income (Loss) Before Transfers and Special Item	2,162,472	(325,613)	1,836,859	(134)
Transfers:				
Transfers in	--	--	--	130,000
Transfers out	--	(7,387,453)	(7,387,453)	--
Special item - Disposal of HMU operations	--	561,703	561,703	--
Change in Net Position	2,162,472	(7,151,363)	(4,988,891)	129,866
Net Position - Beginning of Year	<u>27,946,348</u>	<u>7,151,363</u>	<u>35,097,711</u>	<u>2,694,412</u>
Net Position - End of Year	<u>\$30,108,820</u>	<u>\$ --</u>	<u>\$ 30,108,820</u>	<u>\$ 2,824,278</u>

The accompanying notes are an integral part of these financial statements.

THIS PAGE INTENTIONALLY LEFT BLANK

CITY OF HERCULES

Statement of Cash Flows
Proprietary Funds
For the Year Ended June 30, 2014

	Business-Type Activities - Enterprise Funds			Governmental
	Sewer Fund	Hercules Municipal Utility Fund	Totals	Internal Service Funds
CASH FLOWS FROM OPERATING ACTIVITIES:				
Cash receipts from customers	\$ 5,619,024	\$ 2,647,702	\$ 8,266,726	\$ --
Cash receipts from internal fund services provided	--	--	--	1,143,049
Cash paid to suppliers for goods and services	(2,119,317)	(2,837,092)	(4,956,409)	(632,434)
Cash paid to employees for services	(349,355)	(173,240)	(522,595)	(278,052)
Net Cash Provided (Used) by Operating Activities	3,150,352	(362,630)	2,787,722	232,563
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:				
Transfers in	--	--	--	130,000
Transfers out	--	(2,905,671)	(2,905,671)	--
Disposal of operations	--	1,335,658	1,335,658	--
Fees and taxes	--	91,919	91,919	--
Net Cash Provided (Used) by Noncapital Financing Activities	--	(1,478,094)	(1,478,094)	130,000
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:				
Payments related to the acquisition of capital assets	(868,581)	--	(868,581)	(309,340)
Net payments to refunded escrow agent	--	(5,219,774)	(5,219,774)	--
Principal repayments related to capital purposes	(235,000)	(270,000)	(505,000)	--
Interest repayments related to capital purposes	(498,762)	(372,944)	(871,706)	--
Net Cash Provided (Used) by Capital and Related Financing Activities	(1,602,343)	(5,862,718)	(7,465,061)	(309,340)
CASH FLOWS FROM INVESTING ACTIVITIES				
Interest received (paid)	37,158	8,664	45,822	(280)
Net Cash Provided (Used) by Investing Activities	37,158	8,664	45,822	(280)
Net Increase (Decrease) in Cash and Cash Equivalents	1,585,167	(7,694,778)	(6,109,611)	52,943
Cash and Cash Equivalents, Beginning of Year	16,047,763	7,694,778	23,742,541	2,415,551
Cash and Cash Equivalents, End of Year	\$ 17,632,930	\$ --	\$ 17,632,930	\$ 2,468,494
Reconciliation of Cash and Cash Equivalents to the Statement of Fund Net Assets				
Cash and investments	\$ 10,265,818	\$ --	\$ 10,265,818	\$ 2,468,494
Cash with fiscal agent	7,367,112	--	7,367,112	--
Total Cash and Cash Equivalents	\$ 17,632,930	\$ --	\$ 17,632,930	\$ 2,468,494
Noncash Investing, Capital and Financing Activities:				
Transfer of assets and liabilities to the General Fund after sale	\$ --	\$ (4,481,782)	\$ (4,481,782)	\$ --

continued

The accompanying notes are an integral part of these financial statements.

CITY OF HERCULES

Statement of Cash Flows (continued)
 Proprietary Funds
 For the Year Ended June 30, 2014

	Business-Type Activities - Enterprise Funds			Governmental
				Activities
	Sewer Fund	Hercules Municipal Utility Fund	Totals	Internal Service Funds
Reconciliation of Operating Income (Loss) to Net Cash Provided (Used) by Operating Activities:				
Operating income (loss)	\$ 2,629,390	\$ (53,252)	\$ 2,576,138	\$ 146
Adjustments to reconcile operating income (loss) to net cash provided (used) by operating activities:				
Depreciation	367,789	157,707	525,496	206,028
Changes in assets and liabilities:				
(Increase) decrease in:				
Receivables	(577)	490,142	489,565	(61)
Inventories	--	262,156	262,156	--
Deposits from others	--	(527,860)	(527,860)	--
Increase (decrease) in:				
Accounts payable	153,426	(676,074)	(522,648)	19,965
Accrued salaries and benefits	258	(3,720)	(3,462)	906
Compensated absences	66	(11,729)	(11,663)	5,579
Net Cash Provided (Used) by Operating Activities	\$ 3,150,352	\$ (362,630)	\$ 2,787,722	\$ 232,563

The accompanying notes are an integral part of these financial statements.

THIS PAGE INTENTIONALLY LEFT BLANK

FIDUCIARY FUND FINANCIAL STATEMENTS

OPEB Trust Fund is used to account for funds set aside by the City each year to pre-fund future medical expenses for retired employees.

Agency Funds are used to account for assets held by the government in a trustee capacity. Agency funds are used to account for assets held by the government as an agent for individuals, private organizations, other governments, and/or other funds.

The *Private Purpose Trust Fund* is a fiduciary fund type used by the City to report trust arrangements under which principal and income benefit other governments. This fund reports the assets, liabilities and activities of the Hercules Redevelopment Successor Agency. The sole purpose of this fund is to retire debt of the former redevelopment agency.

THIS PAGE INTENTIONALLY LEFT BLANK

CITY OF HERCULES

Statement of Fiduciary Net Position
June 30, 2014

	OPEB Trust Fund	Private Purpose Trust Fund	Agency Funds
	<u> </u>	<u> </u>	<u> </u>
ASSETS			
Cash and investments	\$ 1,802,511	\$ 2,316,091	\$ 6,445,943
Cash and investments with fiscal agent	--	11,003,597	1,463,875
Accounts receivable	--	375,714	137,406
Interest receivable	--	506,353	--
Due from City of Hercules	--	322,055	--
Loans receivable	--	11,594,594	--
Land held for resale	--	29,864,878	--
Capital assets:			
Depreciable	--	28,192,473	--
Nondepreciable	--	5,303,193	--
	<u> </u>	<u> </u>	<u> </u>
Total Assets	<u>1,802,511</u>	<u>89,478,948</u>	<u>8,047,224</u>
 LIABILITIES			
Accounts payable	12,903	20,631,664	64,055
Advances from City of Hercules	--	50,496,029	--
Deposits payable	--	--	7,925,008
Unearned revenue	--	--	44,221
Compensated absences	--	--	13,940
Long-term debt			
Due within one year	--	3,880,000	--
Due in more than one year	--	115,051,219	--
	<u> </u>	<u> </u>	<u> </u>
Total Liabilities	<u>12,903</u>	<u>190,058,912</u>	<u>8,047,224</u>
 NET POSITION			
Held in trust for others	<u>1,789,608</u>	<u>(100,579,964)</u>	<u>--</u>
	<u> </u>	<u> </u>	<u> </u>
Total Net Position	<u>\$ 1,789,608</u>	<u>\$ (100,579,964)</u>	<u>\$ --</u>

The accompanying notes are an integral part of these financial statements.

CITY OF HERCULES

Statement of Changes in Fiduciary Net Position For the Year Ended June 30, 2014

	OPEB Trust Fund	Private Purpose Trust Fund
Additions		
Contributions from City	\$ 228,000	\$ --
Taxes and assessments	--	8,782,254
Investment income	165,167	649
Other revenue	--	559,077
	<u>393,167</u>	<u>9,341,980</u>
Deductions		
Employee benefits	49,375	--
Community development	--	10,992,419
Loss on disposal of land and accumulated project costs	--	40,612,332
Debt service	--	5,856,390
	<u>49,375</u>	<u>57,461,141</u>
Change in net position	343,792	(48,119,161)
Net Position - Beginning of Year	<u>1,445,816</u>	<u>(52,460,803)</u>
Net Position - End of Year	<u>\$ 1,789,608</u>	<u>\$ (100,579,964)</u>

The accompanying notes are an integral part of these financial statements.

CITY OF HERCULES

Notes to Financial Statements
June 30, 2014

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Reporting Entity

The City of Hercules (City) was incorporated under the General Laws of the State of California and enjoys all the rights and privileges pertaining to such "General Law" cities. The City uses the City Council/Manager form of government. The financial reporting entity consists of (a) the primary government, the City, (b) organizations for which the primary government is financially accountable, and (c) other organizations for which the primary government is not accountable, but for which the nature and significance of their relationship with the primary government are such that exclusion would cause the reporting entity's financial statements to be misleading or incomplete.

Component units are legally separate organizations for which the elected officials of the primary government are financially accountable. In addition, component units can be other organizations for which the primary government's exclusion would cause the reporting entity's basic financial statements to be misleading or incomplete.

The following is a brief review of the component units included in the accompanying basic financial statements of the City.

Hercules Public Financing Authority

The Hercules Public Financing Authority (Authority) was established July 24, 2001, by and between the City and the Agency, pursuant to the State of California Government Code. The purpose of the Authority is to finance the acquisition, construction and improvement of public capital improvements, working capital requirements or insurance programs.

The criteria used in determining the scope of the reporting entity are based on the provisions of GASB Statement No. 14 as amended by GASB Statement No. 39. The City is the primary government unit. Component units are those entities which are financially accountable to the primary government, either because the City appoints a voting majority of the component unit's board, or because the component unit will provide a financial benefit or impose a financial burden on the City. The Agency and the Authority have been accounted for as "blended" component units of the City. Despite being legally separate, the entities are so intertwined with the City that they are, in substance, part of the City's operations. Accordingly, the balances and transactions of these component units are reported within the funds of the City.

Separate detailed financial statements are available for the above component unit from the City's Finance Department.

B. Basis of Accounting and Measurement Focus

The accounts of the City are organized and operated on the basis of funds, each of which is defined as a separate fiscal and accounting entity with a self-balancing set of accounts. These funds are established for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions or limitations.

Government-wide Financial Statements

The Government-wide Financial Statements include a Statement of Net Position and a Statement of Activities. These statements present summaries of Governmental and Business-type Activities for the City accompanied by a total column. Fiduciary Activities of the City are not included in these statements.

CITY OF HERCULES

Notes to Financial Statements
June 30, 2014

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

B. Basis of Accounting and Measurement Focus (continued)

Government-wide Financial Statements (continued)

The basic financial statements are presented on an “*economic resources*” measurement focus and the accrual basis of accounting. Accordingly, all of the City’s assets and liabilities, including capital assets, as well as infrastructure assets, and long-term liabilities, are included in the accompanying Statement of Net Position. The Statement of Activities presents changes in net position. Under the accrual basis of accounting, revenues are recognized in the period in which they are earned while expenses are recognized in the period in which the liability is incurred. The types of transactions reported as program revenues for the City are reported in three categories:

- Charges for services
- Operating grants and contributions
- Capital grants and contributions

Certain eliminations have been made as prescribed by GASB Statement No. 34 in regards to interfund activities, payables and receivables, All internal balances in the Statement of Net Position have been eliminated except those representing balances between the governmental activities and the business-type activities, which are presented as internal balances and eliminated in the total primary government column. In the Statement of Activities, internal service fund transactions have been eliminated. However, transactions between governmental and business-type activities have not been eliminated. The following interfund activities have been eliminated:

- Advances to/from other funds
- Transfers in/out
- Due to/from

Governmental Fund Financial Statements

Governmental Fund Financial Statements include a Balance Sheet and a Statement of Revenues, Expenditures, and Changes in Fund Balances for all major governmental funds and nonmajor funds aggregated. An accompanying schedule is presented to reconcile and explain the differences in net position as presented in these statements to the net position presented in the Government-wide financial statements. The City has presented all major funds that met the qualifications for major fund reporting.

The following are the description of the major funds:

General Fund accounts for all revenues and expenditures necessary to carry out basic governmental activities of the City that are not accounted for through other funds, For the City, the General Fund includes such activities as police, planning, engineering, public works, operations and maintenance, and legal and administrative services.

Hercules Public Financing Authority Debt Service Fund accounts for the accumulation of resources for, and the payment of, principal and interest on the Lease Revenue Bonds, Series 2003A issued to cover capital costs for the Hercules Municipal Utility and principal and interest on the Lease Revenue Bonds, Series 2003B issued to cover the financing of the original City Hall debt issue and to generate additional resources to assist in the construction of a new library building, Series 2009 issued for the purpose of financing the acquisition of certain commercial condominium property (BioRad).

CITY OF HERCULES

Notes to Financial Statements
June 30, 2014

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

B. Basis of Accounting and Measurement Focus (continued)

Governmental Fund Financial Statements (continued)

State Gas Tax Fund accounts for revenue apportioned by the City from State-collected gasoline taxes primarily on the basis of population, to be expended for construction and maintenance of City streets.

Measure "C" Street Fund accounts for revenue allocated by the Contra Costa County Transportation Authority to the City from the State collected sales tax to be expended for growth management planning and local street maintenance and improvement.

All Governmental Funds are accounted for on a spending or "current financial resources" measurement focus and the modified accrual basis of accounting. Accordingly, only current assets and current liabilities are included on the Balance Sheets. The Statement of Revenues, Expenditures, and Changes in Fund Balances present increases (revenues and other financing sources) and decreases (expenditures and other financing uses) in net current assets. Under the modified accrual basis of accounting, revenues are recognized in the accounting period in which they become both measurable and available to finance expenditures of the current period. Accordingly, revenues are recorded when received in cash, except that revenues subject to accrual (generally 60 days after yearend) are recognized when due.

Non-exchange transactions, in which the City gives or receives value without directly receiving or giving equal value in exchange, include property taxes, grants, entitlements, and donations. On an accrual basis, revenues from property taxes are recognized in the fiscal year for which the taxes are levied. Revenues from grants, entitlements, and donations are recognized in the fiscal year in which all eligibility requirements have been satisfied.

Other revenues susceptible to accrual include other taxes, intergovernmental revenues, interest, and charges for services.

Reconciliations of the Governmental Fund Financial Statements to the Government-wide Financial Statements are provided to explain the differences created by the integrated approach.

Proprietary Fund Financial Statements

Proprietary Fund Financial Statements include a Statement of Net Position, a Statement of Revenues, Expenses, and Changes in Net Position, and a Statement of Cash Flows for each proprietary fund. A column representing internal service funds is also presented in these statements. However, internal service balances and activities have been combined with the governmental activities in the Government-wide Financial Statements.

Sewer Fund accounts for wastewater treatment to the cities of Hercules and Pinole and for the maintenance of the City's sewer lines and related facilities. It is a self-supporting activity which provides services on a user charge basis to residences and businesses.

Hercules Municipal Utility Fund accounts for the operations of the City's electric utility that provides electrical power to areas of new development within Hercules' city limits.

Internal Service Funds accounts for activities related to vehicle replacement, IT equipment replacement, and facilities maintenance.

CITY OF HERCULES

Notes to Financial Statements
June 30, 2014

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

B. Basis of Accounting and Measurement Focus (continued)

Proprietary Fund Financial Statements (continued)

All proprietary fund types are accounted for on an "economic resources" measurement focus and accrual basis of accounting. Accordingly, all assets and all liabilities (whether current or noncurrent) associated with their activity are included on the Statement of Net Position. The Statement of Revenues, Expenses, and Changes in Net Position presents increases (revenues) and decreases (expenses) in total net position. Under the accrual basis of accounting wherein revenues are recognized in the accounting period in which they are earned and expenses are recognized in the accounting period incurred.

Operating revenues in the proprietary funds are those revenues that are generated from the primary operations of the funds. All other revenues are reported as non-operating revenues. Operating expenses are those expenses that are essential to the primary operations of the fund. All other expenses are reported as non-operating expenses.

Fiduciary Fund Financial Statements

Fiduciary Fund Financial Statements include a Statement of Net Position. The City's Fiduciary funds are used to account for assets held by the City in a trustee capacity or as an agent for individuals, private organizations and other governmental units. When these assets are held under the terms of a formal trust agreement, a trust fund is used.

The Other Postemployment Benefits (OPEB) trust fund is accounted for using the "economic resources" measurement focus. The OPEB trust fund is used to account for resources legally held in trust for special purposes. The Agency funds are custodial in nature (assets equal liabilities) and do not involve measurement of results of operations. The OPEB trust fund is accounted for using the accrual basis of accounting.

The City maintains ten fiduciary funds — OPEB Trust Fund, Westcat Transit Fund, West Contra Costa Integrated Waste Management Authority Fund, Reassessment District 91-1 Debt Service Fund, Reassessment District 05-1 Debt Service Fund, A. Nobel Reassessment Debt Service Fund, Taylor Woodrow Maintenance LMOD Fund, Hercules Community Library Fund, Hercules Golf Club Fund, and Pinole/Hercules Wastewater Treatment Plant Fund.

The Private Purpose Trust Fund is a fiduciary fund type used by the City to report trust arrangements under which principal and income benefit other governments. This fund reports the assets, liabilities and activities of the Hercules Redevelopment Successor Agency. The sole purpose of this fund is to retire debt of the former redevelopment agency.

C. Cash and Investments

The City pools cash resources from all funds in order to facilitate the management of cash. The balance in the pooled cash account is available to meet current operating requirements. Cash in excess of current requirements is invested in various interest-bearing accounts and other investments for varying terms.

In accordance with GASB Statement No. 40, *Deposit and Investment Disclosures (Amendment of GASB Statement No. 3)*, certain disclosure requirements for Deposits and Investment Risks were made in the following areas: Interest Rate Risk, Credit Risk, Custodial Credit Risk, and Concentrations of Credit Risk.

CITY OF HERCULES

Notes to Financial Statements
June 30, 2014

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

C. Cash and Investments (continued)

In addition, other disclosures are specified including use of certain methods to present deposits and investments, highly sensitive investments, credit quality at year-end, and other disclosures.

The City has implemented GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*. Highly liquid market investments with maturities of one year or less at time of purchase are stated at amortized cost. All other investments are stated at fair value. Market value is used as fair value for those securities for which market quotations are not readily available. Interest earned on investments is allocated using the Local Agency Investment Fund (LAIF) factor to selected funds by the City.

The City participates in an investment pool LAIF, which has invested a portion of the pooled funds in Structured Notes and Asset-Backed Securities. LAIF's investments are subject to credit risk with the full faith and credit of the State of California collateralizing these investments. In addition, these Structured Notes and Asset-Backed Securities are subject to market risk as to change in interest rates.

Cash equivalents are considered amounts in demand deposits and short-term investments with a maturity date within three months of the date acquired by the City and are presented as "Cash and Investments" in the accompanying basic financial statements.

D. Inventory, Property Held for Resale, and Accumulated Project Costs

Inventories consist of materials and supplies held for future consumption and are priced at average cost using the first-in, first-out method. Property held for resale and accumulated project costs consists of land and project costs relating to property acquired or constructed which is available to be sold and is not used in City operations. The property held for resale is recorded at the lower of cost or estimated net realizable value.

E. Capital Assets

Capital assets including infrastructure capital assets were reported using the Basic Approach whereby accumulated depreciation and depreciation expense have been recorded.

Capital assets, which include land, buildings, improvements, equipment, and infrastructure assets (e.g., roads, bridges, sidewalks, and similar items), are reported in the applicable governmental or business-type activities in the Government-wide Financial Statements. Capital assets are recorded at historical cost or estimated historical cost if actual cost is not available. Donated assets are valued at their estimated, fair value on the date donated. City policy has set the capitalization thresholds for reporting capital assets at the following:

General Capital Assets	\$ 2,500
Infrastructure Capital Assets	\$ 5,000

Depreciation is recorded on a straight-line method (with half-year convention applied to the first year of acquisition and final year of useful life) over the useful lives of the assets as follows:

Buildings and improvements	15 – 50 years
Land improvements	20 years
Machinery and equipment	5 – 20 years
Infrastructure	15 – 50 years

CITY OF HERCULES

Notes to Financial Statements
June 30, 2014

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

E. Capital Assets (continued)

The Governmental Accounting Standards Board (GASB) Statement No. 34 requires the inclusion of infrastructure capital assets in local governments' basic financial statements. In accordance with Statement No. 34, the City has included the value of all infrastructure capital assets into its Basic Financial Statements.

The City defines infrastructure assets as the basic physical assets that allow the City to function. The assets include:

- Street system
- Site amenities such as parking and landscaped areas used by the City in the conduct of its business.

Each major infrastructure system can be divided into subsystems. For example, the street system can be subdivided into pavement, curb and gutters, sidewalks, medians, streetlights, traffic control devices (signals), and land. These subsystems were not delineated in the Basic Financial Statements. The appropriate operating department maintains information regarding the subsystems.

The accumulated depreciation, defined as the total depreciation from the date of construction/acquisition to the current date was computed on a straight-line method using industry accepted life expectancies for each infrastructure subsystem. The book value was then computed by deducting the accumulated depreciation from the original cost.

Interest accrued during capital assets construction, if any, is capitalized for the business-type activities and proprietary funds as part of the asset cost.

Capital assets are not capitalized in the governmental funds used to acquire or construct them. Capital assets acquired or constructed for proprietary funds are capitalized in their respective individual funds.

F. Deferred Outflows/Inflows of Resources

In addition to assets, the statement of financial position will sometimes report a separate section for deferred outflows of resources. This separate financial statement element, *deferred outflows or resources*, represents a consumption of net position that applies to a future period(s) and so will *not* be recognized as an outflow of resources (expense/expenditure) until then.

In addition to liabilities, the statement of financial position will sometimes report a separate section for deferred inflows of resources. This separate financial statement element, *deferred inflows of resources*, represents an acquisition of net position that applies to a future period(s) and so will *not* be recognized as an inflow of resources (revenue) until that time. The government has only one type of item, which arises only under a modified accrual basis of accounting, that qualifies for reporting in this category. Accordingly, the item, *unavailable revenue*, is reported only in the governmental funds balance sheet. The governmental funds report unavailable revenues from two sources: intergovernmental revenue and use of money. These amounts are deferred and recognized as an inflow of resources in the period that the amounts become available.

G. Long-Term Obligations

In the Government-wide Financial Statements, long-term debt and other long-term obligations are reported as liabilities in the appropriate activities. 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.

CITY OF HERCULES

Notes to Financial Statements
June 30, 2014

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

G. Long-Term Obligations (continued)

In the Governmental Fund Financial Statements, governmental fund types recognize bond premiums and discounts, as well as bond issuance costs, during the current period. The face amount of debt issued is reported as other financing sources. Premiums received on debt issuance are reported as other financing sources while discounts on debt issuance are reported as other financing uses. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures.

H. Compensated Absences

Compensated absences are comprised of unpaid vacation and compensated time off. The City accrues the costs of these absences when they are earned. For governmental funds, compensated absences are recorded as current and non-current liabilities only on the government-wide financial statements. For proprietary funds, current and noncurrent liabilities for compensated absences are recorded as expenses in both the Government-wide Financial Statements and the Fund Financial Statements.

I. Net Position/Fund Balance

In the Government-wide Financial Statements, net position is classified in the following categories:

Net Investment in Capital Assets – This amount consists of capital assets net of accumulated depreciation and reduced by outstanding debt that attributed to the acquisition, construction, or improvement of the assets.

Restricted – This represents amounts restricted by external creditors, grantors, contributors, or laws or regulations of other governments.

Unrestricted Net Position – This amount is all net position that do not meet the definition of "invested in capital assets, net of related debt" or "restricted net position" as defined above.

Included in total restricted net position at June 30, 2014 are net position restricted by enabling legislation of \$1,944,791.

As prescribed by GASB Statement No. 54, governmental funds report fund balance in classifications that comprise a hierarchy based primarily on the extent to which the government is bound to honor constraints on the specific purpose for which amounts in the funds can be spent. As of June 30, 2014, fund balances for governmental funds consist of the following categories:

Nonspendable Fund Balance – includes amounts that are not in a spendable form or are legally or contractually required to be maintained intact (such as inventories or prepaid amounts).

Restricted Fund Balance – includes amounts that can be spent only for specific purposes stipulated by external parties (such as creditors, grant providers, or contributors) or by law.

Committed Fund Balance – includes amounts that can be used only for the specific purpose determined by the City Council. Commitments may be changed or lifted only by the City Council taking the same formal action. The formal action must occur prior to the end of the reporting period. The amount which will be subject to the constraint may be determined in the subsequent period.

CITY OF HERCULES

Notes to Financial Statements
June 30, 2014

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

I. Net Position/Fund Balance (continued)

Assigned Fund Balance – is comprised of amounts intended to be used by the City for specific purposes that are neither restricted nor committed. Intent can be expressed by the City Council or by an official or body to which the Council delegates the authority. Assigned fund balance can be used to eliminate a projected budgetary deficit in the subsequent year’s budget.

Unassigned Fund Balance – is the residual classification for the General Fund and includes all amounts not contained in the other classifications. Unassigned amounts are technically available for any purpose.

The City Council establishes, modifies or rescinds fund balance commitments and assignments by passage of a resolution or an ordinance. This can be done through the adoption of the budget and subsequent budget amendments that occur throughout the year.

J. Use of Restricted/Unrestricted Net Position

When an expense is incurred for purposes for which both restricted and unrestricted net position are available, the City’s policy is to apply restricted net position first.

K. Property Taxes, Tax Increment and Special Assessment Revenue

Revenue is recognized in the fiscal year for which the tax and assessment is levied. The County of Contra Costa levies, bills and collects property taxes and special assessments for the City and remits the full assessment regardless of the amounts received under a Teeter plan arrangement.

	<u>Secured Property Tax</u>	<u>Unsecured Property Tax</u>
Lien Date	January 1 preceding fiscal year	January 1 preceding fiscal year
Due Date	November 1 & February 1	August 31
Delinquent Date	December 10 & April 10	September 1

L. Use of Estimates

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

M. New Accounting Pronouncements – Future Years

Governmental Accounting Standards Board Statement No. 68

GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*, is effective for periods beginning after June 15, 2014. The principal objective of this statement is to improve the usefulness of information for decisions made by the various users of the general purpose external financial reports of governments whose employees – both active employees and inactive employees – are provided with pensions. An additional objective is to improve the information provided in government financial reports about pension-related financial support provided by certain nonemployer entities that make contributions to pension plans that are used to provide benefits to the employees of other entities.

CITY OF HERCULES

Notes to Financial Statements
June 30, 2014

NOTE 2: CASH AND INVESTMENTS

The City maintains a cash and investment pool for all funds. Certain restricted funds, which are held and invested by independent outside custodians through contractual agreements, are not pooled.

Statement of Net Position:

Cash and investments	\$ 23,287,864
Cash and investments with fiscal agents	9,515,295

Statement of Fiduciary Net Position:

Cash and investments	10,564,545
Cash and investments with fiscal agents	<u>12,467,472</u>
 Total	 <u>\$ 55,835,176</u>

Cash and investments as of June 30, 2014 consist of the following:

Cash on hand	\$ 2,255
Deposits with financial institutions	14,628,499
Investments	<u>41,204,422</u>
 Total	 <u>\$ 55,835,176</u>

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

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

Authorized Investment Type	Maximum Maturity	Maximum Percentage of Portfolio	Maximum Investment in One Issuer
Local Agency Investment Fund (State Pool)	N/A	\$50 million	\$50 million
U.S. Treasury Obligations	5 years	None	None
U.S. Government Agency Issues	5 years	None	None
Insured Deposits with Banks and Savings and Loans	N/A	None	None
Bankers Acceptance (must be dollar denominated)	180 days	40%	30%
Commercial Paper	270 days	15%	10%
Negotiable Time Certificates of Deposits	5 years	30%	\$100,000
Non-negotiable Time Certificates of Deposits	5 years	30%	\$100,000
Federally Insured Time Deposits	5 years	None	\$100,000
Repurchase Agreements	30 days	None	10%
Reverse Repurchase Agreements	92 days	20%	None
Medium-Term Notes	5 years	30%	15%
Money Market Mutual Funds	N/A	20%	10%
Insured or Passbook Savings Accounts	N/A	None	\$100,000

CITY OF HERCULES

Notes to Financial Statements
June 30, 2014

NOTE 2: CASH AND INVESTMENTS (CONTINUED)

Investments Authorized by the California Government Code and the City's Investment Policy j(continued)

At June 30, 2014, the City held two negotiable certificates of deposit which were in excess of the City's investment policy of \$100,000 per issuer limit. The City was in compliance with state law.

Investments Authorized by Debt Agreements

Investment of debt proceeds held by trustees is governed by provisions of the debt agreements, rather than the general provisions of the California Government Code or the City's investment policy. The table below identifies the investment types that are authorized for investments held by trustee. The table also identifies certain provisions of the debt agreements that address interest rate risk, credit risk, and concentration of credit risk.

Authorized Investment Type	Maximum Maturity	Maximum Percentage of Portfolio	Maximum Investment in One Issuer
Local Agency Investment Fund (State Pool)	N/A	\$50 million	\$50 million
U.S. Treasury Obligations	30 years	20%	None
U.S. Government Agency Issues	30 years	20%	None
Insured Deposits with Banks and Savings and Loans	N/A	None	None
Bankers Acceptance (must be dollar denominated)	6 months	40%	30%
Commercial Paper	6 months	15%	10%
Negotiable Time Certificates of Deposits	5 years	30%	\$100,000
Non-negotiable Time Certificates of Deposits	5 years	30%	\$100,000
Federally Insured Time Deposits	1 year	20%	None
Repurchase Agreements	30 days	None	None
Reverse Repurchase Agreements	92 days	20%	None
Medium-Term Notes	5 years	30%	15%
Mutual Funds	N/A	20%	None
Money Market Funds	N/A	None	None
Insured or Passbook Savings Accounts	N/A	None	\$100,000
Guaranteed Investment Contracts	N/A	None	None

Disclosures Relating to Interest Rate Risk

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

CITY OF HERCULES

Notes to Financial Statements
June 30, 2014

NOTE 2: CASH AND INVESTMENTS (CONTINUED)

Disclosures Relating to Interest Rate Risk

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

Investment Type	Interest Rates	Totals	12 Months or Less	13 to 24 Months	25 to 36 Months	37 to 48 Months	49 to 60 Months	More Than 60 Months
State Investment Pool	0.23%	\$ 15,247,520	\$ 15,247,520	\$ --	\$ --	\$ --	\$ --	\$ --
Certificates of Deposit	1.910% - 1.970%	508,975	--	508,975	--	--	--	--
Fed Nat Mortgage Assn	1.840% - 1.470%	2,036,160	--	2,036,160	--	--	--	--
OPEB Trust Mutual Fund	--	1,429,000	1,429,000	--	--	--	--	--
Held by Debt Trustees:								
Money Market Funds	--	20,387,603	20,387,603	--	--	--	--	--
Guaranteed Investment Contracts	--	1,595,112	--	--	--	--	--	1,595,112
State Investment Pool	--	52	52	--	--	--	--	--
Total		<u>\$ 41,204,422</u>	<u>\$ 37,064,175</u>	<u>\$ 2,545,135</u>	<u>\$ --</u>	<u>\$ --</u>	<u>\$ --</u>	<u>\$ 1,595,112</u>

Investments with Fair Values Highly Sensitive to Interest Rate Fluctuations

Interest rate risk is the market value fluctuation due to overall changes in the interest rates. It is mitigated by limiting the average maturity of the City's portfolio, not to exceed three years.

As a means of maintaining liquidity and minimizing interest rate risk, the City's investment policy limits are as follows:

<u>Maturity</u>	<u>% of Portfolio</u>
Up to one year	10% (Minimum)
one year to five years	60% (Maximum)
more than five years	30% (Maximum)

Disclosures Relating to Credit Risk

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

CITY OF HERCULES

Notes to Financial Statements
June 30, 2014

NOTE 2: CASH AND INVESTMENTS (CONTINUED)

Disclosures Relating to Credit Risk (continued)

Investment Type	Amounts	Minimum Legal Rating	Exempt from Disclosure	Rating at Fiscal Year End			
				AAA	AA	A	Not Rated
State Investment Pool	\$ 15,247,520	N/A	N/A	\$ --	\$ --	\$ --	\$ 15,247,520
Certificates of Deposit	508,975	N/A	N/A	--	--	--	508,975
Fed Nat Mortgage Assn	2,036,160	N/A	N/A	2,036,160	--	--	--
OPEB Trust Mutual Fund	1,429,000	N/A	N/A	--	--	--	1,429,000
Held by Debt Trustees:							
Money Market Funds	20,387,603	N/A	N/A	20,387,603	--	--	--
Guaranteed Investment Contracts	1,595,112	N/A	N/A	920,000	--	--	675,112
State Investment Pool	52	N/A	N/A	--	--	--	52
Total	\$ 41,204,422			\$ 23,343,763	\$ --	\$ --	\$ 17,860,659

Concentration of Credit Risk

The investment policy of the City contains limitations on the amount that can be invested in any one issuer. Investments in any one issuer (other than U.S. Treasury securities, mutual funds, and external investment pools) that represent more than 5% of total City investments are as follows:

Investment Type	Reporting Amount	% of Pool
Federal National Mortgage Association	\$ 2,036,160	7.4%

Custodial Credit Risk

Custodial credit risk for *deposits* is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for *investments* is the risk that, in the event of the failure of the counterparty (e.g. broker-dealer) to a transaction, a government will not be able to recover the value of its investment or collateral securities that are in the possession of another party. The California Government Code and the City's investment policy do not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits or investments, other than the following provision for deposits. The California Government Code requires that a financial institution secure deposits made by state or local governmental units by pledging securities in an undivided collateral pool held by a depository regulated under state law (unless so waived by the governmental unit). The fair value of the pledged securities in the collateral pool must equal at least 110% of the total amount deposited by the public agencies. California law also allows financial institutions to secure City deposits by pledging first trust deed mortgage notes having a value of 150% of the secured public deposits.

As of June 30, 2014, \$9,797,841 of the City's deposits with financial institutions in excess of federal depository insurance limits was held in collateralized accounts.

The City's investments are carried at fair value as required by accounting principles generally accepted in the United States of America. The City 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 investment income for that fiscal year.

CITY OF HERCULES

Notes to Financial Statements
June 30, 2014

NOTE 2: CASH AND INVESTMENTS (CONTINUED)

Investment in State Investment Pool

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

NOTE 3: LOANS RECEIVABLE

Loans Receivable

Loans receivable at June 30, 2014, consisted of the following:

Bio-Rad Loan	\$ 1,843,355
Employee Loans	<u>250,000</u>
Total	<u><u>\$ 2,093,355</u></u>

A. Employee Loan (Related Party)

The City loaned \$250,000 to the City Manager for the purchase of a residence within the City of Hercules. The loan is to be repaid from the proceeds of the sale of the house with no interest when the contract between the City and the City Manager is terminated. The balance outstanding as of June 30, 2014 was \$250,000. In December 2010, the City Manager terminated his employment with the City and signed a separation agreement that extends the repayment of the loan to January 9, 2016.

B. Bio-Rad Loan

The City advanced Bio-Rad Laboratories, Inc. \$2,000,000 in order to construct various tenant improvements in one or more of the buildings located at 203-295 Linus Pauling Drive. The terms of the loan call for monthly payments of \$10,418, at an interest rate of 4.5% per annum, with repayments commencing May 15, 2010 through September 14, 2038. The balance outstanding as of June 30, 2014 was \$1,843,355.

CITY OF HERCULES

Notes to Financial Statements
June 30, 2014

NOTE 4: CAPITAL ASSETS

At June 30, 2014, the City's capital assets consisted of the following:

	Governmental Activities	Business-Type Activities	Total
Nondepreciable Assets:			
Land	\$ 1,601,636	\$ 150,000	\$ 1,751,636
Construction in progress	7,171,848	2,454,200	9,626,048
Total Nondepreciable Assets	8,773,484	2,604,200	11,377,684
Depreciable Assets:			
Land improvements	9,985,733	--	9,985,733
Buildings and improvements	25,861,711	11,335,199	37,196,910
Machinery and equipment	4,275,404	187,925	4,463,329
Infrastructure	79,462,448	9,513,058	88,975,506
Total Depreciable Assets	119,585,296	21,036,182	140,621,478
Less Accumulated Depreciation	(59,276,663)	(10,229,011)	(69,505,674)
Total Depreciable Assets, Net	60,308,633	10,807,171	71,115,804
Total Capital Assets, Net	\$ 69,082,117	\$ 13,411,371	\$ 82,493,488

CITY OF HERCULES

Notes to Financial Statements
June 30, 2014

NOTE 4: CAPITAL ASSETS (CONTINUED)

The following is a summary of capital assets for governmental activities:

<u>Governmental Activities</u>	<u>Balance July 1, 2013</u>	<u>Additions</u>	<u>Retirements</u>	<u>Balance June 30, 2014</u>
Nondepreciable Capital Assets:				
Land	\$ 4,096,336	\$ 65,300	\$ (2,560,000)	\$ 1,601,636
Construction in progress	4,415,643	2,756,205	-	7,171,848
Total Nondepreciable Capital Assets	<u>8,511,979</u>	<u>2,821,505</u>	<u>(2,560,000)</u>	<u>8,773,484</u>
Depreciable Capital Assets:				
Land improvements	9,985,733	-	-	9,985,733
Buildings and improvements	25,861,711	-	-	25,861,711
Machinery and equipment	4,159,847	309,624	(194,067)	4,275,404
Infrastructure	79,462,448	-	-	79,462,448
Total Depreciable Capital Assets	<u>119,469,739</u>	<u>309,624</u>	<u>(194,067)</u>	<u>119,585,296</u>
Accumulated Depreciation:				
Land improvements	(4,583,916)	(597,569)	-	(5,181,485)
Buildings and improvements	(5,633,354)	(658,627)	-	(6,291,981)
Machinery and equipment	(3,607,558)	(226,535)	193,783	(3,640,310)
Infrastructure	(42,234,648)	(1,928,239)	-	(44,162,887)
Total Accumulated Depreciation	<u>(56,059,476)</u>	<u>(3,410,970)</u>	<u>193,783</u>	<u>(59,276,663)</u>
Net depreciable capital assets	<u>63,410,263</u>	<u>(3,101,346)</u>	<u>(284)</u>	<u>60,308,633</u>
Net Capital Assets	<u>\$ 71,922,242</u>	<u>\$ (279,841)</u>	<u>\$ (2,560,284)</u>	<u>\$ 69,082,117</u>

Depreciation Allocation

Depreciation expense was charged to functions and programs based on their usage of the related assets. The amounts allocated to each function or program were as follows:

Governmental Activities:	
General government	\$ 456,408
Public safety	30,333
Public works	2,449,624
Parks and recreation	267,038
Community development	1,539
Capital assets held by internal services funds are charged to the various functions based on usage of the assets	<u>206,028</u>
Total Depreciation Expense - Governmental Activities	<u>\$ 3,410,970</u>

CITY OF HERCULES

Notes to Financial Statements
June 30, 2014

NOTE 4: CAPITAL ASSETS (CONTINUED)

Depreciation Allocation (continued)

<u>Business-Type Activities</u>	Balance July 1, 2013	Additions	Retirements	Balance June 30, 2014
<u>Sewer</u>				
Nondepreciable Capital Assets:				
Land	\$ 150,000	\$ --	\$ --	\$ 150,000
Construction in progress	2,383,222	70,978	--	2,454,200
Total Nondepreciable Capital Assets	<u>2,533,222</u>	<u>70,978</u>	<u>--</u>	<u>2,604,200</u>
Depreciable Capital Assets:				
Buildings and improvements	11,335,199	--	--	11,335,199
Machinery and equipment	156,072	31,853	--	187,925
Infrastructure	8,747,308	765,750	--	9,513,058
Total Depreciable Capital Assets	<u>20,238,579</u>	<u>797,603</u>	<u>--</u>	<u>21,036,182</u>
Less accumulated depreciation	<u>(9,861,222)</u>	<u>(367,789)</u>	<u>--</u>	<u>(10,229,011)</u>
Net depreciable capital assets	<u>10,377,357</u>	<u>429,814</u>	<u>--</u>	<u>10,807,171</u>
Net Capital Assets	<u>\$ 12,910,579</u>	<u>\$ 500,792</u>	<u>\$ --</u>	<u>\$ 13,411,371</u>
<u>Business-Type Activities</u>	Balance July 1, 2013	Additions	Retirements	Balance June 30, 2014
<u>Hercules Municipal Utility</u>				
Nondepreciable Capital Assets:				
Construction in progress	\$ 600,412	\$ --	\$ (600,412)	\$ --
Total Nondepreciable Capital Assets	<u>600,412</u>	<u>--</u>	<u>(600,412)</u>	<u>--</u>
Depreciable Capital Assets:				
Machinery and equipment	108,159	--	(108,159)	--
Infrastructure	8,988,621	--	(8,988,621)	--
Total Depreciable Capital Assets	<u>9,096,780</u>	<u>--</u>	<u>(9,096,780)</u>	<u>--</u>
Less accumulated depreciation	<u>(1,671,540)</u>	<u>(157,707)</u>	<u>1,829,247</u>	<u>--</u>
Net depreciable capital assets	<u>7,425,240</u>	<u>(157,707)</u>	<u>(7,267,533)</u>	<u>--</u>
Net Capital Assets	<u>\$ 8,025,652</u>	<u>\$ (157,707)</u>	<u>\$ (7,867,945)</u>	<u>\$ --</u>

CITY OF HERCULES

Notes to Financial Statements
June 30, 2014

NOTE 4: CAPITAL ASSETS (CONTINUED)

Depreciation Allocation (continued)

<u>Private Purpose Trust Fund</u>	Balance July 1, 2013	Additions	Retirements	Balance June 30, 2014
Nondepreciable Capital Assets:				
Land	\$ 217,040	\$ --	\$ --	\$ 217,040
Construction in progress	27,975,433	--	--	27,975,433
Total Nondepreciable Capital Assets	<u>28,192,473</u>	<u>--</u>	<u>--</u>	<u>28,192,473</u>
Depreciable Capital Assets:				
Land improvements	11,379	--	--	11,379
Buildings and improvements	4,965,778	--	--	4,965,778
Machinery and equipment	116,445	--	--	116,445
Infrastructure	4,232,722	--	--	4,232,722
Total Depreciable Capital Assets	<u>9,326,324</u>	<u>--</u>	<u>--</u>	<u>9,326,324</u>
Accumulated Depreciation:				
Land improvements	(11,379)	--	--	(11,379)
Buildings and improvements	(2,447,276)	(99,437)	--	(2,546,713)
Machinery and equipment	(23,240)	(5,810)	--	(29,050)
Infrastructure	(1,231,078)	(204,911)	--	(1,435,989)
Total Accumulated Depreciation	<u>(3,712,973)</u>	<u>(310,158)</u>	<u>--</u>	<u>(4,023,131)</u>
Net depreciable capital assets	<u>5,613,351</u>	<u>(310,158)</u>	<u>--</u>	<u>5,303,193</u>
Net Capital Assets	<u>\$ 33,805,824</u>	<u>\$ (310,158)</u>	<u>\$ --</u>	<u>\$ 33,495,666</u>

Depreciation expense was charged to functions and programs based on their usage of the related assets. The amounts allocated to each function or program were as follows:

Business-Type Activities:	
Sewer	\$ 367,789
Hercules Municipal Utility	<u>157,707</u>
Total Depreciation Expense - Business-Type Activities	<u>\$ 525,496</u>

CITY OF HERCULES

Notes to Financial Statements
June 30, 2014

NOTE 5: LONG-TERM OBLIGATIONS

Governmental activities long-term liability activity for the fiscal year ended June 30, 2014, was as follows:

<u>Governmental Activities</u>	<u>Balance July 1, 2013</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance June 30, 2014</u>	<u>Amount Due Within One Year</u>
2003B PFA Lease Revenue Bonds	\$ 7,440,000	\$ -	\$ (220,000)	\$ 7,220,000	\$ 230,000
2009 PFA Taxable Lease Revenue Bonds	9,680,000	-	(130,000)	9,550,000	135,000
Discount on issuance	(432,411)	-	17,297	(415,114)	-
H.E.L.P. Loan	1,600,000	-	(50,000)	1,550,000	50,000
R.D.L.P. Loan	3,750,000	-	(50,000)	3,700,000	50,000
Suntrust Lease	1,554,982	-	(133,104)	1,421,878	139,474
Compensated absences	363,269	320,677	(303,979)	379,967	284,975
 Total Long-Term Obligations	 <u>\$ 23,955,840</u>	 <u>\$ 320,677</u>	 <u>\$ (869,786)</u>	 <u>\$ 23,406,731</u>	 <u>\$ 889,449</u>

Compensated Absences

Compensated absences are comprised of unpaid vacation and compensated time off. The City accrues the cost of these absences when they are earned. The City expects the liability for compensated absences to be utilized and records this liability in the Government-Wide Financial Statements. The City liquidates the majority of governmental activities portion of the liability in the general fund.

2003B Public Financing Authority Lease Revenue Bonds

The Public Financing Authority issued lease revenue bonds, series 2003B, dated October 15, 2003, totaling \$9,150,000. The purpose of the bonds was to refinance the 1994 Refunding Certificates of Participation and to finance a portion of the construction for a public library. The interest rate on the bonds ranges from 2.00% to 5.00%. The interest is payable semiannually on June 1 and December 1, commencing December 1, 2003. The bonds are subject to optional and mandatory early redemption provisions. The bonds are payable from and secured by revenues consisting primarily of the base rental payments of the facility lease. Principal is due annually beginning on December 1, 2005, in amounts ranging from \$170,000 to \$2,480,000. The bonds mature on December 1, 2033. The balance at June 30, 2014 is \$7,220,000.

CITY OF HERCULES

Notes to Financial Statements
June 30, 2014

NOTE 5: LONG-TERM OBLIGATIONS (CONTINUED)

Future debt service requirements on the 2003B Public Financing Authority Lease Revenue bonds are:

Fiscal Year Ended June 30,	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2015	\$ 230,000	\$ 339,688	\$ 569,688
2016	235,000	330,153	565,153
2017	245,000	320,073	565,073
2018	255,000	309,509	564,509
2019	270,000	297,340	567,340
2020-2024	1,550,000	1,274,799	2,824,799
2025-2029	1,955,000	861,181	2,816,181
2030-3034	<u>2,480,000</u>	<u>322,000</u>	<u>2,802,000</u>
Total	<u>\$ 7,220,000</u>	<u>\$ 4,054,743</u>	<u>\$ 11,274,743</u>

2009 Public Financing Authority Taxable Lease Revenue Bonds (Bio-Rad Project)

The Authority issued taxable lease revenue bonds, series 2009, dated July 29, 2009, totaling \$10,080,000. The purpose of the bonds was to finance the acquisition of certain commercial condominium properties, consisting of approximately 96,847 square feet located at 203-295 Linus Pauling Drive within the City from the City, funding a reserve fund for the Bonds and to paying the costs of issuance of the Bonds. The interest rates on the bonds range from 6.00% to 8.40%. The interest is payable semiannually on January 1 and July 1, commencing January 1, 2010. The bonds are subject to optional special mandatory redemption, and mandatory sinking account redemption provisions. The bonds are payable from and secured by revenues consisting primarily of the base rental payments of the property lease, Principal is due annually beginning on July 1, 2010, in amounts ranging from \$165,000 to \$845,000. The bonds mature on July 1, 2038. The balance at June 30, 2014 is \$9,550,000.

CITY OF HERCULES

Notes to Financial Statements
June 30, 2014

NOTE 5: LONG-TERM OBLIGATIONS (CONTINUED)

2009 Public Financing Authority Taxable Lease Revenue Bonds (Bio-Rad Project) (continued)

Future debt service requirements on the 2009 Public Financing Authority Taxable Lease Revenue bonds are:

Fiscal Year Ended June 30,	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2015	\$ 135,000	\$ 778,865	\$ 913,865
2016	145,000	769,740	914,740
2017	155,000	759,240	914,240
2018	165,000	748,040	913,040
2019	175,000	736,140	911,140
2020-2024	1,100,000	3,447,500	4,547,500
2025-2029	1,630,000	2,893,463	4,523,463
2030-2034	2,420,000	2,062,733	4,482,733
2035-2039	<u>3,625,000</u>	<u>809,550</u>	<u>4,434,550</u>
Subtotal	9,550,000	13,005,271	22,555,271
Less: Discount	<u>(415,114)</u>	<u>-</u>	<u>(415,114)</u>
Total	<u>\$ 9,134,886</u>	<u>\$ 13,005,271</u>	<u>\$ 22,140,157</u>

H.E.L.P. Loan Payable

In April 2005 the City of Hercules entered into an agreement with the California Housing Finance Agency (Agency), a public instrumentality and political subdivision of the State of California to develop a 50-unit multifamily rental project that is a component to a mixed-used development, also consisting of 26,825 square feet of ground-floor commercial space. The Agency has authorized the making of a loan in the amount of \$1,600,000 known as the Housing Enabled by Local Partnerships (HELP) to the City of Hercules for the purpose of assisting in operating a local housing program. Under the terms of this original agreement the City of Hercules agreed to reimburse the Agency \$1,600,000, 10 years from April 11, 2005 at a 3% simple per annum interest. Interest is to be charged only on funds disbursed. In October 2013, the City and Agency amended the agreement to extend the due date of the loan and accumulated interest until April 2027 and to reduce the interest rate to 1.5 percent simple interest effective October 31, 2013. The balance at June 30, 2014 is \$1,550,000.

CITY OF HERCULES

Notes to Financial Statements
June 30, 2014

NOTE 5: LONG-TERM OBLIGATIONS (CONTINUED)

H.E.L.P. Loan Payable (continued)

Fiscal Year Ended June 30,	Principal	Interest	Total
2015	\$ 50,000	\$ -	\$ 50,000
2016	50,000	-	50,000
2017	50,000	-	50,000
2018	100,000	-	100,000
2019	100,000	-	100,000
2020-2024	500,000	-	500,000
2025-2027	700,000	307,988	1,007,988
Total	<u>\$ 1,550,000</u>	<u>\$ 307,988</u>	<u>\$ 1,857,988</u>

R.D.L.P. Loan Payable

In February 2007, the City of Hercules entered into a loan agreement with the California Housing Finance Agency (Agency) in the amount of \$3,750,000 (\$1,750,000 for predevelopment costs and \$2,000,000 for construction costs). The funds will be used to assist with site acquisition, predevelopment, and construction costs for 23 affordable ownership units within a 52-unit condominium project, which is a component to the Sycamore Downtown Street project, a mixed-use, mixed-income development. Under the terms of the original agreement, the City of Hercules agreed to repay the Agency \$3,750,000, 4 years from February 2007 at 3% simple per annum interest. In October 2013, the City and Agency amended the agreement to extend the due date of the loan and accumulated interest until August 2026 and to reduce the interest rate to 1.5 percent simple interest effective October 31, 2013. The balance at June 30, 2014 is \$3,700,000.

Fiscal Year Ended June 30,	Principal	Interest	Total
2015	\$ 50,000	\$ -	\$ 50,000
2016	50,000	-	50,000
2017	50,000	-	50,000
2018	100,000	-	100,000
2019	100,000	-	100,000
2020-2024	500,000	-	500,000
2025-2027	2,850,000	440,759	3,290,759
Total	<u>\$ 3,700,000</u>	<u>\$ 440,759</u>	<u>\$ 4,140,759</u>

CITY OF HERCULES

Notes to Financial Statements
June 30, 2014

NOTE 5: LONG-TERM OBLIGATIONS (CONTINUED)

On September 27, 2007, the City entered into master lease agreements with SunTrust Leasing Corporation in order to provide funds for the financing of the EMS Project performed by Siemens Building Technologies in the amount of \$2,185,538. Payments are due semiannually on September 27 and March 27, at an interest rate of 4.73%. The Master Lease Agreement matures on September 27, 2022. As of June 30, 2014, the outstanding balance of the master lease agreement is \$1,421,878.

The annual debt service requirements to maturity for the SunTrust master lease agreement as of June 30, 2014 are as follows:

Fiscal Year Ended June 30,	Principal	Interest	Total
2015	\$ 139,474	\$ 65,625	\$ 205,099
2016	146,149	58,950	205,099
2017	153,144	51,955	205,099
2018	160,473	44,626	205,099
2019	168,153	36,946	205,099
2020-2024	<u>654,485</u>	<u>63,361</u>	<u>717,846</u>
Total	<u>\$ 1,421,878</u>	<u>\$ 321,463</u>	<u>\$ 1,743,341</u>

Business-Type Activities

Long-term liability activity for the fiscal year ended June 30, 2014, was as follows:

Business-Type Activities	Balance July 1, 2013	Additions	Reductions	Balance June 30, 2014	Due Within One Year
2010 PFA Wastewater Revenue Bonds	\$ 11,305,000	\$ -	\$ (235,000)	\$ 11,070,000	\$ 240,000
Discount on Issuance	(196,338)	-	7,272	(189,066)	-
2010 PFA Electric System Project	5,670,000	-	(5,670,000)	-	-
Discount on Issuance	(139,648)	-	139,648	-	-
2010 PFA Revenue Refunding Bonds	7,425,000	-	(7,425,000)	-	-
Discount on Issuance	(194,445)	-	194,445	-	-
Loss on Refunding	(190,452)	-	190,452	-	-
Compensated absences	33,153	11,543	(23,206)	21,490	21,490
Total Long-Term Obligations	<u>\$ 23,712,270</u>	<u>\$ 11,543</u>	<u>\$ (12,821,389)</u>	<u>\$ 10,902,424</u>	<u>\$ 261,490</u>

CITY OF HERCULES

Notes to Financial Statements
June 30, 2014

NOTE 5: LONG-TERM OBLIGATIONS (CONTINUED)

2010 Public Financing Authority Wastewater Revenue Bonds

The Public Financing Authority issued revenue bonds, series 2010, dated August 1, 2010, totaling \$11,765,000. The purpose of the bonds was to finance improvements to the City's wastewater system, fund a reserve fund for the bonds, and pay the costs of issuances of the bonds. The interest rates on the bonds range from 2.00% to 5.130%. Principal is due annually beginning August 1, 2011, in amounts ranging from \$230,000 to \$700,000. The bonds mature on August 1, 2040. The balance at June 30, 2014 is \$11,070,000.

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

Year Ended June 30,	Principal	Interest	Total
2015	\$ 240,000	\$ 493,013	\$ 733,013
2016	245,000	487,856	732,856
2017	250,000	481,975	731,975
2018	260,000	474,950	734,950
2019	265,000	467,075	732,075
2020-2024	1,475,000	2,186,072	3,661,072
2025-2029	1,805,000	1,841,178	3,646,178
2030-2034	2,270,000	1,357,875	3,627,875
2035-2039	2,890,000	717,500	3,607,500
2040-2041	1,370,000	69,250	1,439,250
Subtotal	11,070,000	8,576,744	19,646,744
Less: Discount	<u>(189,066)</u>	<u>-</u>	<u>(189,066)</u>
Total	<u>\$ 10,880,934</u>	<u>\$ 8,576,744</u>	<u>\$ 19,457,678</u>

Defeasance of Debt – Hercules Municipal Utility Fund

During April 2014, the City defeased revenue bonds by placing the proceeds of the new bonds in an irrevocable trust account to provide for all future debt service payments on the old bonds. Accordingly, the trust account assets and the liability for the defeased bonds are not included in the City's financial statements. At June 30, 2014, \$3,990,000 of defeased bonds remain outstanding.

CITY OF HERCULES

Notes to Financial Statements
June 30, 2014

NOTE 6: NON-CITY OBLIGATIONS

The District Bonds are not general obligations of the City nor any other political subdivision and the full faith and credit of the City is not pledged for repayment thereof since these debts do not constitute an obligation of the City and the City is not obligated to make payment beyond the available bond reserves, these bonds have not been reflected in the long-term debt in the accompanying financial statements.

<u>Description</u>	<u>Original Issuance</u>	<u>Balance as of June 30, 2014</u>
Reassessment District 2001-01 (Alfred Nobel)	\$ 9,810,000	\$ 2,405,000
Reassessment District 2005-1 (John Muir Parkway)	6,550,345	5,580,000

NOTE 7: RISK MANAGEMENT

General Liability Insurance

Coverage is maintained with the Municipal Pooling Authority (MPA) with coverage limits of \$10,000,000 per occurrence. The City maintains a deductible of \$5,000 per occurrence.

Workers' Compensation

The City has coverage limits for the following without a deductible:

MPA	\$0 to \$500,000
American Safety Insurance	\$500,000
CSAC-EIA	\$1,000,000 to \$4,000,000
ACE American Insurance Company	\$5,000,000 to \$45,000,000

As of June 30, 2014, the City's estimated claims liabilities were as follows.

General Liability	\$ 198,330
Workers Compensation	<u>16,781</u>
Total	<u><u>\$ 215,111</u></u>

Changes in the claims liabilities for the fiscal years ended June 30, 2013 and 2014 are as follows:

<u>Fiscal Year</u>	<u>Balance at Beginning of Fiscal Year</u>	<u>Current Year Claims and Changes in Estimates</u>	<u>Claim Payments</u>	<u>Balance at End of Fiscal Year</u>
2012-2013	\$ 123,671	\$ 584,444	\$ (542,248)	\$ 165,867
2013-2014	165,867	766,413	(717,169)	215,111

CITY OF HERCULES

Notes to Financial Statements
June 30, 2014

NOTE 7: RISK MANAGEMENT (CONTINUED)

Miscellaneous Coverages

The MPA provides additional coverage for the following risks incurred by the City:

<u>Coverage Type</u>	<u>Deductibles</u>	<u>Coverage Limits</u>
Auto - Physical damage:		
Police vehicles	\$ 3,000	\$ 250,000
All other vehicles	2,000	250,000
All risk fire & property	25,000	1,000,000,000
Boiler & machinery	5,000	100,000,000

The MPA is governed by a Board consisting of representatives from member municipalities. The Board controls the operations of the MPA, including selection of management and approval of operating budgets, independent of any influence by member municipalities beyond their representation on the Board.

The City's deposits with the MPA are in accordance with formulas established by the MPA. Actual surpluses or losses are shared according to a formula developed from overall loss costs and spread to member entities on a percentage basis after a retrospective rating.

Audited financial statements can be obtained from the Municipal Pooling Authority, 1911 San Miguel Drive, #200, Walnut Creek, California 94596.

NOTE 8: NET POSITION/FUND BALANCES

Details of the fund balance classifications of the governmental funds as of June 30, 2014 are as follows:

	General Fund	Hercules Public Financing Authority Debt Service Fund	State Gas Tax Fund	Measure "C" Fund	Other Governmental Funds	Total
Nonspendable:						
Advances to other funds	\$ 27,787,637	\$ 6,703,250	\$ --	\$ --	\$ 5,417,515	\$ 39,908,402
Prepays and inventory	14,122	--	--	11,013	--	25,135
Total Nonspendable	<u>27,801,759</u>	<u>6,703,250</u>	<u>--</u>	<u>11,013</u>	<u>5,417,515</u>	<u>39,933,537</u>
Restricted for:						
Streets and roads	--	--	3,054,096	427,471	1,261,550	4,743,117
Public safety	--	--	--	--	58,532	58,532
Development	--	--	--	--	1,547,544	1,547,544
Debt service	--	1,903,922	--	--	--	1,903,922
Total Restricted	<u>--</u>	<u>1,903,922</u>	<u>3,054,096</u>	<u>427,471</u>	<u>2,867,626</u>	<u>8,253,115</u>
Assigned for:						
Economic uncertainty	1,359,328	--	--	--	--	1,359,328
Total Assigned	<u>1,359,328</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>--</u>	<u>1,359,328</u>
Unassigned	5,389,258	--	--	--	(857,203)	4,532,055
Total Fund Balance	<u>\$ 34,550,345</u>	<u>\$ 8,607,172</u>	<u>\$ 3,054,096</u>	<u>\$ 438,484</u>	<u>\$ 7,427,938</u>	<u>\$ 54,078,035</u>

CITY OF HERCULES

Notes to Financial Statements
June 30, 2014

NOTE 8: NET POSITION/FUND BALANCES (CONTINUED)

Restatement of Fund Balance/Net Position

Adjustments resulting from errors or changes to comply with provisions of the accounting standards are treated as adjustments to prior periods. Accordingly, the City reports these changes as restatements of beginning fund balance or net position.

	Governmental Fund Statements Hercules Public Financing Authority Debt Fund
Fund balance as of June 30, 2013, as previously reported	<u>\$ 18,250,949</u>
<u>Restatement</u>	
Portion of Bio-Rad lease receivable that is not available to pay current period expenditures.	<u>(9,554,531)</u>
Total prior period adjustment	<u>(9,554,531)</u>
Fund balance as of July 1, 2013, restated	<u><u>\$ 8,696,418</u></u>

NOTE 9: CAPITAL LEASE – SALES TYPE

On August 14, 2008, the City of Hercules and Bio-Rad Laboratories, Inc. entered in to a lease agreement, which Bio-Rad agreed to lease from the City of Hercules, the premises, consisting of the land located in the City of Hercules, County of Contra Costa, State of California, commonly known as the Venture Commerce Center located at 203-295 Linus Pauling Drive, including five (5) buildings consisting of approximately 96,847 rentable square feet, together with the parking lot and associated improvements serving the buildings.

The term of this lease shall be for thirty (30) years, commencing on September 15, 2008 and ending on September 14, 2038, or terminated sooner pursuant to the terms of this lease. Bio-Rad Laboratories, Inc. has the option to terminate this lease anytime on or after the fifteenth (15th) anniversary date as to a portion or the entire premises by delivering to the City of Hercules not later than three (3) months prior to said fifteenth (15th) anniversary date or any applicable later termination date, a notice of such election.

The City of Hercules granted to Bio-Rad Laboratories, Inc. the option to purchase the premises, Bio-Rad Laboratories, Inc. may elect to exercise the Purchase Option by delivering to the City of Hercules written notice of such election within 30 days prior to either of the following dates: (i) the fifteenth (15th) anniversary date; (ii) the twentieth (20th) anniversary date; or (iii) the twenty-fifth (25th) anniversary date, If Bio-Rad Laboratories, Inc. has not elected to exercise the Purchase Option during the time period said above, then the Purchase Option shall automatically be deemed elected by Bio-Rad Laboratories, Inc. as of the expiration date unless Bio-Rad Laboratories, Inc., provides prior written notice to the City of Hercules within fifteen (15) days prior to the expiration date electing not to pursue the Purchase Option, If Bio-Rad Laboratories, Inc. elects to exercise the Purchase Option on the expiration date, the purchase price for the premises shall be one dollar (\$1.00).

CITY OF HERCULES

Notes to Financial Statements
June 30, 2014

NOTE 9: CAPITAL LEASE – SALES TYPE (CONTINUED)

Total lease revenue of \$26,723,100 will be received from the Bio-Rad Laboratories, Inc. during the term of lease. The interest rate on the lease payments is 8.0381%. Monthly lease payments vary from \$55,300 to \$83,699 will be received on the first day of each month without notice, offset, deduction or demand, in advance, during the lease term.

Future estimated minimum lease payments to be received are as follows:

Fiscal Year Ended June 30,	Amounts
2015	\$ 796,110
2016	818,826
2017	841,542
2018	864,258
2019	886,974
2020-2024	4,542,370
2025-2029	4,704,270
2030-2034	4,913,870
2035-2039	4,162,070
	<u>22,530,290</u>
Less: Unearned Income	<u>(12,976,819)</u>
Net Investment in Lease Receivable	<u><u>\$ 9,553,471</u></u>

NOTE 10: INTERFUND TRANSACTIONS

Long-Term Advances

At June 30, 2014, the City had the following long-term advances:

Advances from/to other funds

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
General Fund	Private Purpose Trust Fund	\$ 27,787,636
Nonmajor Governmental Funds	Private Purpose Trust Fund	5,417,516
Sewer Fund	Private Purpose Trust Fund	10,587,627
Public Financing Authority Debt Service	Private Purpose Trust Fund	6,703,250
Total		<u><u>\$ 50,496,029</u></u>

The advances represent outstanding loans to the former redevelopment agency of the City, now a private purpose trust fund.

CITY OF HERCULES

Notes to Financial Statements
June 30, 2014

NOTE 10: INTERFUND TRANSACTIONS (CONTINUED)

Due To/From Other Funds

Due to/from other funds as of June 30, 2014 were as follows:

<u>Receivable Fund</u>	<u>Payable Fund</u>	<u>Amount</u>
General Fund	Nonmajor Governmental Funds	\$ 9,243
General Fund	Hercules Public Financing Authority Debt Service Fund	264,843
State Gas Tax Fund	Nonmajor Governmental Funds	69,797
Nonmajor Governmental Funds	Nonmajor Governmental Funds	126,555
Private Purpose Trust Fund	Nonmajor Governmental Funds	322,055
Total		<u>\$ 792,493</u>

The due to/from other funds are to provide cash flow for the funds with negative cash and for other short-term borrowings between funds.

Transfers

<u>Transfer from</u>	<u>Transfer to</u>	<u>Amount</u>	<u>Description</u>
General Fund	Hercules Public Financing Authority Debt Service Fund	\$ 875,767	Debt service.
	Nonmajor Governmental Funds	102,876	Development impact fees.
	Internal service funds	130,000	Equipment replacement.
		<u>1,108,643</u>	
Measure C	Nonmajor Governmental Funds	<u>121,337</u>	Capital projects.
Nonmajor Governmental Funds	General Fund	<u>133,788</u>	COPS program.
Hercules Municipal Utility	General Fund	630,000	Finance equipment and fund emergency operating reserve.
			Transfer of remaining assets and liabilities after sale to PG&E.
	General Fund	<u>6,757,453</u>	
		<u>7,387,453</u>	
		<u>\$ 8,751,221</u>	

NOTE 11: PUBLIC EMPLOYEES' RETIREMENT SYSTEM

Plan Description

The City contributes to the California Public Employees' Retirement System (PERS), a cost sharing multiple-employer public employee defined benefit pension plan. PERS provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. PERS acts as a common investment and administrative agent for participating public entities within the State of California. Benefit provisions and all other requirements are established by state statute and City ordinance. Copies of PERS' annual financial reports may be obtained from their Executive Office located at 400 Q Street, Sacramento, California 95811.

CITY OF HERCULES

Notes to Financial Statements
June 30, 2014

NOTE 11: PUBLIC EMPLOYEES' RETIREMENT SYSTEM (CONTINUED)

Funding Policy

The City makes the contribution required of City employees on their behalf and for their account in the amount of 7% for miscellaneous employees and 9% for safety employees. The employee rates are set by statute and therefore generally remain unchanged from year to year. The present employer actuarially determined rates of annual covered payroll were 15.638% for miscellaneous employees and 47.307% for safety employees.

Annual Pension Cost

For fiscal year 2013-2014, the City's annual pension cost of \$1,050,975 for PERS was equal to the City's required and actual contributions. The required contribution was determined as part of the June 30, 2010 actuarial report. The assumptions included 7.5% investment rate of return (net of administrative expenses) and projected annual salary increases of 3.3% to 14.2%, depending on age, service, and type of employment, and included an inflation component of 2.75%. The actuarial value of PERS assets was determined using techniques that smooth the effects of short-term volatility in the market value of investments over a three year period. PERS unfunded actuarial accrued liability (or surplus) is being amortized as a level percentage of projected payroll on a closed basis.

THREE-YEAR TREND INFORMATION FOR PERS

<u>Fiscal Year Ended</u>	<u>Pension Cost (APC)</u>	<u>of APC Contributed</u>	<u>Net Pension Obligation</u>
6/30/2012	\$ 1,245,457	100%	\$ -
6/30/2013	998,970	100%	-
6/30/2014	1,050,975	100%	-

Funding Status

This information is no longer available for the Miscellaneous and Safety Plans, which are only available on a pooled basis and can be obtained from CalPERS.

The schedule of funding progress presented as required supplementary information (RSI) immediately following the notes to the financial statements, presents multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the AAL for benefits.

NOTE 12: DEFERRED COMPENSATION PLAN

457 Plan

The City offers its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The Plan is available to full-time employees. The Internal Revenue Service regulations allow an employer to designate a 457(b) Deferred Compensation Plan as an alternative to social security. The plan permits employees to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death or unforeseeable emergency.

CITY OF HERCULES

Notes to Financial Statements
June 30, 2014

NOTE 12: DEFERRED COMPENSATION PLAN (CONTINUED)

457 Plan (continued)

All amounts of compensation deferred under the plan, all property and rights purchased with those amounts, and all income attributable to those amounts, property, or rights are (until paid or made available to the employee or other beneficiary) held in trust by a third party administrator (ICMA) for the exclusive benefit of the plan participants and their beneficiaries as prescribed by Internal Revenue Code Section 457(g). Accordingly, these assets have been excluded from the City's Comprehensive Annual Financial Report.

401A Plan

The City contributes 4% of total gross salary to the plan for senior managers.

PARS

Part-time employees who do not participate in the Public Employees Retirement System are covered through the City's participation in Public Alternative Retirement System (PARS). Employees contribute 6.2% and the City contributes 1.3%.

NOTE 13: POST-EMPLOYMENT BENEFITS OTHER THAN PENSIONS

Plan Description

The City provides certain health insurance benefits to retired employees in accordance with memorandums of understanding with each employee group as follows:

For employees who retire from the City of Hercules after at least five (5) years of service with the City and who have reached the age of fifty (50) years old, and who continue health insurance through a City-sponsored health insurance plan, the City will contribute the minimum monthly amount of \$115 of the health insurance premium. For police and police management retirees who have at least ten (10) years of service, or twenty (20) years of service if they retire on disability and continue receiving health insurance through a City-sponsored health insurance plan, the City will contribute a percentage of \$288.72/month for police and \$217.22/month for senior managers, based on the retirees accumulated sick leave and years of service, at retirement. As soon as the retiree is eligible for Medicare, the City will contribute a percentage of the retirees' Kaiser Medicare supplement.

Funding Policy

The City's policy is to contribute an amount sufficient to pay the current year's premiums and set-aside an amount equal to the annual required contribution, based on a twenty (20) year amortization. For fiscal year 2013-2014, the City contributed \$42,593, which covered current premiums, and also transferred \$228,000 to the Public Agency Retirement Services. Currently, there are 7 retirees who are receiving benefits.

CITY OF HERCULES

Notes to Financial Statements
June 30, 2014

NOTE 13: POST-EMPLOYMENT BENEFITS OTHER THAN PENSIONS (CONTINUED)

Annual OPEB and Net OPEB Obligation

The City's annual other postemployment benefit (OPEB) cost (expense) is calculated based on the annual required contribution of the employer (ARC), and an amount actuarially determined in accordance with the parameters of GASB Statement No. 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years (the City has elected a twenty year amortization period). The following table shows the components of the City's annual OPEB cost for the fiscal year, the amount actually contributed to the plan, and changes in the City's net OPEB obligation.

Annual required contribution	\$ 228,000
Interest on net OPEB obligation (asset)	(19,000)
Amortization of net OPEB obligation (asset)	20,000
Annual OPEB cost (expense)	229,000
Contributions made	(270,593)
Increase in net OPEB obligation	(41,593)
Net OPEB obligation (asset) - beginning of fiscal year	(291,468)
Net OPEB obligation (asset) - end of fiscal year	\$ (333,061)

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

Fiscal Year Ended	Annual OPEB Cost	Percentage of Annual OPEB Cost Contribution	Net OPEB Obligation (Asset)
6/30/2012	\$ 214,000	117%	\$ (258,336)
6/30/2013	224,000	116%	(291,468)
6/30/2014	229,000	118%	(333,061)

Funded Status and Funding Progress

As of June 30, 2011, the most recent actuarial valuation date, the plan was 48% funded. The actuarial accrued liability for benefits was \$2,155,000, and the actuarial value of assets based on the June 30, 2014 Public Agency Retirement Services statement was \$1,429,000, resulting in an unfunded actuarial accrued liability (UAAL) of \$726,000. The covered payroll (annual payroll of active employees covered by the plan) was \$4,798,000, and the ratio of the UAAL to the covered payroll was 15.1 percent.

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future.

Actuarial Methods and Assumptions

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and the plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

CITY OF HERCULES

Notes to Financial Statements
June 30, 2014

NOTE 13: POST-EMPLOYMENT BENEFITS OTHER THAN PENSIONS (CONTINUED)

Actuarial Methods and Assumptions (continued)

In the June 30, 2011 actuarial valuation, the entry age normal cost method was used. The actuarial assumptions included a 6.5 percent investment rate of return, which is the expected long-term investment returns on plan assets, a projected salary increase assumption rate of 3.25 percent, and an annual healthcare cost trend rate of 5 percent. The actuarial value of asset gains or losses are recognized over five years. The UAAL is being amortized as a level percentage of covered payroll over twenty years. The remaining amortization period at June 30, 2014 was 15 years.

NOTE 14: COMMITMENTS AND CONTINGENCIES

A. Lawsuits

The City is presently involved in certain matters of litigation that have arisen in the normal course of conducting City business. City management believes, based upon consultation with the City Attorney, that these cases, in the aggregate, will not have a material adverse effect on the City's Annual Financial Statements. Additionally, City management believes that the City's insurance programs are sufficient to cover any potential losses should an unfavorable outcome materialize.

B. Commitments

AMBAC Litigation – On January 30, 2012, AMBAC filed an action in the Contra Costa County Superior Court against the City, the former Redevelopment Agency, and each individual member of the City Council, seeking to, among other things, compel the City to transfer \$4,100,000 from the Pooled Cash Account, which AMBAC alleges constitute the December 2011 tax increment receipts, to the Trustee, and in the alternative to impose a constructive trust on such funds and prevent the City from using those funds for any other purpose. The City, Agency and Council members have vigorously opposed this action. The City believes that, unless the \$4,100,000 of December receipts are allowed to be accounted for to reimburse the temporary advance from the Pooled Cash Account made on August 1, 2011 to the Trustee, that advance will have been an unlawful diversion of legally restricted funds which itself would need to be reversed in order to avoid violation of various state statutory and constitutional restrictions on the use of those funds. On January 31, 2012, AMBAC filed an ex parte application seeking, among other thing, a temporary restraining order effectively freezing \$4,100,000 of City funds and, in the alternative, a writ of attachment on certain real estate owned by the City. The court denied AMBAC's request for immediate relief on all points, but issued an order to show cause why a preliminary injunction freezing the funds should not issue against the City in several weeks. The City and AMBAC briefed the issue for the court and at a hearing on February 21, 2012, the Court was to evaluate whether AMBAC had demonstrated sufficient urgency to warrant issuing a preliminary injunction against the City, which injunction would have compelled the City in some way to set aside \$4,100,000.

On March 8, 2012, a stipulation and Writ of Attachment was signed between AMBAC and the Hercules Redevelopment Agency and the City of Hercules. It was agreed that as consideration for AMBAC's forbearance on seeking an immediate writ of mandate and preliminary injunction on March 20, 2012, AMBAC received a Writ of Attachment on the real property commonly known as "Parcel C" (Contra Costa County Assessor's Parcel No. 404-020-076-0) (Property "A") and the real property commonly known as "Victoria Crescent" (Contra Costa County Assessor's Parcel No. 404-040-062-6)(Property "B"). These properties were to be sold in 2014 to satisfy what is owed to AMBAC.

CITY OF HERCULES

Notes to Financial Statements
June 30, 2014

NOTE 14: COMMITMENTS AND CONTINGENCIES (CONTINUED)

B. Commitments (continued)

On February 24, 2014, the City of Hercules sold the real property commonly known as "Victoria Crescent" (Contra Costa County Assessor's Parcel No. 404-040-062-6)(Property "B") and on August 26, 2014, the City of Hercules sold the real property commonly known as "Parcel C" (Contra Costa County Assessor's Parcel No. 404-020-076-0)(Property "A"), net proceeds from both properties were paid to AMBAC.

In August 2014, the City, and the City as Successor Agency to the Redevelopment Agency entered into a stipulation with Ambac that resulted in a dismissal of the litigation against the City and Agency that confirms that Ambac will receive the unencumbered proceeds from the sale of Victoria Crescent and Parcel C, and does not obligate the City's general fund.

NOTE 15: JOINT POWERS AGREEMENTS

The City is a member of the joint powers agencies described below. Each of these agencies is governed by a Board, which controls their operation, including selection of management and approval of operating budgets, independent of influence by member municipalities beyond their representation on the Board.

A. West Contra Costa Transportation Advisory Committee (WCCTAC)

WCCTAC was established in 1990 to develop regional strategies and meet regional requirements established by Measure "C" and to cooperatively address West Contra Costa County transportation issues.

The City's payments to WCCTAC are in accordance with a formula under which each member Agency pays a proportionate share of the expenditures based on the number of voting members representing each agency. Audited financial statements can be obtained from the WCCTAC, One Alvarado Square, San Pablo, California 94806. The City has one voting member on the WCCTAC and pays 10% of expenditures, which amounted to \$25,482 for fiscal year 2013-2014.

B. West Contra Costa Integrated Waste Management Authority (WCCIWMA)

WCCIWMA was established in 1991 to coordinate landfill use reduction in the West Contra Costa County Area as mandated by the State of California. The City is represented by one Director. Funding for WCCIWMA is provided for through a surcharge collected from the ratepayers within WCCIWMA's jurisdiction.

Audited financial statements can be obtained from the WCCIWMA, One Alvarado Square, San Pablo, California 94806.

C. Pinole/Hercules Wastewater Treatment Plant

On January 23, 2001, the cities of Pinole and Hercules entered into a joint powers agreement for the operation and ownership of the Pinole/Hercules Wastewater Treatment Plant (Plant). The City retains responsibility for the operation and maintenance of its wastewater collection system. The City of Hercules has an undivided fifty percent (50%) ownership interest in the Plant. The City of Pinole has the right and responsibility to manage and operate the Plant. Also, the City of Pinole maintains the records and accounts for all the transactions.

The records are available and can be obtained from the City of Pinole, 2131 Pear Street, Pinole, California 94564.

CITY OF HERCULES

Notes to Financial Statements
June 30, 2014

NOTE 16: STEWARDSHIP, COMPLIANCE, AND ACCOUNTABILITY

Deficit Fund Balances/Net Position

As of June 30, 2014, the following funds had a deficit fund balance/net position:

	Deficit Fund Balances
Nonmajor Governmental Funds:	
Stormwater Assessment Special Revenue Fund	\$ 85,011
Grants Special Revenue Fund	504,433
Capital Projects Fund	267,759
Fiduciary Fund:	
Private Purpose Trust Fund	\$ 100,579,964

Private Purpose Trust Fund negative net position of \$100,579,964 will be financed through future revenues. Stormwater negative fund balance of \$85,011 will be financed through future revenues. Grants Special Revenue negative fund balance of \$504,433 will be finance through grants awarded to the City of Hercules. Capital Projects negative fund balance of \$267,759 will be financed through revenues from local funding sources.

Expenditures in Excess of Appropriations

The following funds had expenditures in excess of budget. Sufficient revenues were available to fund these expenditures:

	Excess of Appropriations
Major Governmental Funds:	
General Fund:	
General Government	\$ 398,106
Streets and Public Works	23,121
Parks and Recreation	63,794
Nonmajor Governmental Funds:	
Debt Service	99,599
Development Impact Fees (DIF)	11,444
Development Fee	884,070

NOTE 17: SPECIAL ITEM

Sale of Hercules Municipal Utility Assets

On June 5, 2012, residents of the City voted to pass Measure N, authorizing the sale of Hercules Municipal Utility (HMU). Measure N was approved by 77% of the voters. On August 28, 2012, the Hercules City Council adopted procedures for accepting bids for the sale of the HMU assets, as required by the California Public Utilities Code. Representatives of the City solicited bid proposals and ultimately determined that Pacific Gas & Electric (PG&E) offered the highest and best bid. Hercules and PG&E then engaged in negotiations to prepare the Asset Purchase Agreement containing all of the necessary terms and conditions for the sale. On May 28, 2013, the Hercules City Council approved an agreement with PG&E to purchase the assets of HMU. A critical component of the sale to PG&E was that all of the HMU bonds be either retired or defeased at or prior to closing the transaction. In addition, the transaction required approval from the California Public Utilities Commission.

CITY OF HERCULES

Notes to Financial Statements
June 30, 2014

NOTE 17: SPECIAL ITEM (CONTINUED)

Sale of Hercules Municipal Utility Assets (continued)

On January 14, 2014, the California Public Utilities Commission approved the Asset Purchase Agreement and directed PG&E to initiate the closing process for the purchase transaction. On March 5, 2014 the City of Hercules issued a Tender Offer memorandum for the bonds. On April 10, 2014 all of the HMU bonds were tendered or defeased and PG&E started to supply power and service to former HMU customers.

After the sale, the remaining assets and liabilities of HMU were absorbed by the City's General Fund, including the advance of \$6,373,975 to the former Redevelopment Agency of the City, now a Private Purpose Trust Fund of the City.

NOTE 18: FINANCIAL CONDITION

Of the \$36.49 million reported as assets in the General Fund, 76.15 percent of the balance represents interfund loans with the former Redevelopment Agency (Agency), now a private purpose trust fund of the City. The City is also reporting significant advances to the Agency in other funds.

A recap of the funds with outstanding loans due from the Agency at June 30, 2014 is below:

	Total Assets	Advances to Agency	Percentage of Assets Representing Advances to Agency
General Fund	\$ 36,490,114	\$ 27,787,637	76.2%
Hercules Public Financing Authority Debt Service Fund	18,425,486	6,703,250	36.4%
Nonmajor Governmental Funds:			
Developer Impact Fees	6,459,571	5,254,315	81.3%
Community Development	296,936	163,200	55.0%
Sewer Fund	41,632,732	10,587,627	25.4%
Total	\$ 103,304,839	\$ 50,496,029	48.9%

With the dissolution of the redevelopment agency on February 1, 2012 there is uncertainty as to whether the City's General Fund will be repaid the accumulated \$27.8 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 valid. 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.

THIS PAGE INTENTIONALLY LEFT BLANK

REQUIRED SUPPLEMENTARY INFORMATION

THIS PAGE INTENTIONALLY LEFT BLANK

CITY OF HERCULES

Required Supplementary Information
June 30, 2014

1. SCHEDULE OF FUNDING PROGRESS – PENSION

FUNDED STATUS OF MISCELLANEOUS PLAN

This information is no longer available for the Miscellaneous Plan. Information is available on a pooled basis only and can be obtained from Cal PERS, P.O. Box 942709, Sacramento, CA 94229-2709.

FUNDED STATUS OF SAFETY PLAN

This information is no longer available for the Safety Plan. Information is available on a pooled basis only and can be obtained from Cal PERS, P.O. Box 942709, Sacramento, CA 94229-2709.

2. SCHEDULE OF FUNDING PROGRESS – OTHER POST EMPLOYMENT BENEFITS PLAN (OPEB)

The table below shows an analysis of the actuarial value of assets as a percentage of the actuarial accrued liability and the unfunded actuarial accrued liability as a percentage of the annual covered payroll as of June 30:

<u>Actuarial Valuation Date</u>	<u>Actuarial Accrued Liability</u>	<u>Actuarial Value of Assets (AVA)</u>	<u>Actuarial Accrued Liability (UAAL)</u>	<u>Funded Ratio</u>	<u>Covered Payroll</u>	<u>UAAL as a % of Payroll</u>
6/30/2012*	\$ 2,155,000	\$ 935,713	\$ 1,219,287	43.4%	\$ 4,798,000	25.4%
6/30/2013*	2,155,000	1,044,621 **	1,110,379	48.5%	4,798,000	23.1%
6/30/2014*	2,155,000	1,429,000 **	726,000	66.3%	4,798,000	15.1%

* Source: 6/30/11 Retiree Healthcare Plan Actuarial Valuation

** Source: 6/30 Public Agency Retirement Services (PARS) statement

CITY OF HERCULES

Budgetary Comparison Schedule
General Fund
For the Year Ended June 30, 2014

	Budgeted Amounts		Actual	Variance with Final Budget
	Original	Final		
Revenues:				
Taxes	\$ 6,755,157	\$ 6,755,157	\$ 7,651,413	\$ 896,256
Licenses and permits	327,650	327,650	315,086	(12,564)
Fines, forfeits and penalties	25,000	25,000	66,488	41,488
Revenue from use of money and property	1,119,310	1,119,310	156,107	(963,203)
Aid from other governments	1,423,300	1,423,300	1,358,077	(65,223)
Charges for services	2,182,500	2,182,500	2,074,050	(108,450)
Miscellaneous revenue	672,258	672,258	709,911	37,653
Total Revenues	12,505,175	12,505,175	12,331,132	(174,043)
Expenditures:				
Current:				
General government:				
City Council	265,305	265,305	275,147	(9,842)
City manager	286,257	286,257	228,235	58,022
Legal services	576,715	576,715	818,122	(241,407)
Management services	223,450	223,450	239,327	(15,877)
City clerk	--	--	183	(183)
Cable TV	110,168	110,168	115,932	(5,764)
Risk management	775,301	775,301	546,365	228,936
Recruitment	193,647	193,647	172,184	21,463
Finance/operations	899,728	900,354	941,359	(41,005)
Miscellaneous	205,099	205,099	597,548	(392,449)
Total general government	3,535,670	3,536,296	3,934,402	(398,106)
Public safety:				
Police administration	2,219,366	2,219,366	1,907,553	311,813
Police patrol	2,786,563	2,786,563	2,962,229	(175,666)
Total public safety	5,005,929	5,005,929	4,869,782	136,147
Streets and public works:				
Street facilities	181,142	181,142	195,427	(14,285)
Engineering	28,023	28,023	36,859	(8,836)
Total streets and public works	209,165	209,165	232,286	(23,121)
Parks and recreation:				
Library	104,565	104,565	96,705	7,860
Facility rental	162,274	162,274	138,229	24,045
Day camp	154,154	154,154	181,793	(27,639)
Child care	498,967	498,967	569,941	(70,974)
Recreation classes	87,189	87,189	93,123	(5,934)
Senior citizens	36,255	36,255	53,338	(17,083)
Tiny tots	152,643	152,643	144,678	7,965
Swim center	348,626	348,626	325,221	23,405
Sports program	126,232	126,232	140,016	(13,784)
Teen program	37,131	37,131	37,067	64
Youth and teen resource center	107,095	107,095	98,814	8,281
Total parks and recreation	1,815,131	1,815,131	1,878,925	(63,794)

continued

CITY OF HERCULES

Budgetary Comparison Schedule (continued)
General Fund
For the Year Ended June 30, 2014

	Budgeted Amounts		Actual	Variance with Final Budget
	Original	Final		
Expenditures (continued):				
Current (continued):				
Community development:				
Business and regional planning	\$ 250,412	\$ 250,412	\$ 193,795	\$ 56,617
Building inspection	106,405	106,405	91,592	14,813
Total community development	<u>356,817</u>	<u>356,817</u>	<u>285,387</u>	<u>71,430</u>
Total Expenditures	<u>10,922,712</u>	<u>10,923,338</u>	<u>11,200,782</u>	<u>(277,444)</u>
Excess (Deficiency) of Revenues Over (Under) Expenditures	<u>1,582,463</u>	<u>1,581,837</u>	<u>1,130,350</u>	<u>(451,487)</u>
Other Financing Sources (Uses):				
Transfers in	100,000	100,000	7,521,241	7,421,241
Transfers out	<u>(1,462,382)</u>	<u>(1,462,382)</u>	<u>(1,108,643)</u>	<u>353,739</u>
Total Other Financing Sources (Uses)	<u>(1,362,382)</u>	<u>(1,362,382)</u>	<u>6,412,598</u>	<u>7,774,980</u>
Net Change in Fund Balances	220,081	219,455	7,542,948	7,323,493
Budgetary Fund Balances - Beginning of Year			<u>26,318,521</u>	
Budgetary Fund Balances - End of Year			<u><u>\$ 33,861,469</u></u>	

Explanation of differences between statement of revenues, expenditures and changes in fund balance:

	Budgetary Comparison Schedule	Trust Funds Not Budgeted	Statement of Revenues, Expenditures and Changes in Fund Balance
Total revenues	\$ 12,331,132	\$ 306,927	\$ 12,638,059
Total expenditures	<u>11,200,782</u>	<u>--</u>	<u>11,200,782</u>
Revenues over (under) expenditures	1,130,350	306,927	1,437,277
Total other financing sources (uses)	<u>6,412,598</u>	<u>381,949</u>	<u>6,794,547</u>
Net change in fund balances	<u><u>\$ 7,542,948</u></u>	<u><u>\$ 688,876</u></u>	<u><u>\$ 8,231,824</u></u>

CITY OF HERCULES

Budgetary Comparison Schedule
 State Gas Tax Special Revenue Fund
 For the Year Ended June 30, 2014

	Budgeted Amounts		Actual	Variance with Final Budget
	Original	Final		
Revenues:				
Use of money and property	\$ 7,000	\$ 7,000	\$ 10,995	\$ 3,995
Intergovernmental revenues	344,472	344,472	752,612	408,140
Total Revenues	<u>351,472</u>	<u>351,472</u>	<u>763,607</u>	<u>412,135</u>
Expenditures:				
Current:				
Streets and public works	722,858	722,858	286,086	436,772
Total Expenditures	<u>722,858</u>	<u>722,858</u>	<u>286,086</u>	<u>436,772</u>
Excess (Deficiency) of Revenues Over (Under) Expenditures	<u>(371,386)</u>	<u>(371,386)</u>	<u>477,521</u>	<u>848,907</u>
Other Financing Sources (Uses):				
Transfers out	(494,500)	(494,500)	--	494,500
Total Other Financing Sources (Uses)	<u>(494,500)</u>	<u>(494,500)</u>	<u>--</u>	<u>494,500</u>
Net Change in Fund Balances	(865,886)	(865,886)	477,521	1,343,407
Fund Balances - Beginning of Year	<u>2,576,575</u>	<u>2,576,575</u>	<u>2,576,575</u>	<u>--</u>
Fund Balances - End of Year	<u>\$ 1,710,689</u>	<u>\$ 1,710,689</u>	<u>\$ 3,054,096</u>	<u>\$ 1,343,407</u>

CITY OF HERCULES

Budgetary Comparison Schedule
Measure "C" Street Fund
For the Year Ended June 30, 2014

	Budgeted Amounts		Actual	Variance with Final Budget
	Original	Final		
Revenues:				
Use of money and property	\$ 5,000	\$ 5,000	\$ (108)	\$ (5,108)
Intergovernmental revenues	225,652	225,652	348,717	123,065
Total Revenues	<u>230,652</u>	<u>230,652</u>	<u>348,609</u>	<u>117,957</u>
Expenditures:				
Current:				
Streets and public works	554,638	683,807	335,675	348,132
Total Expenditures	<u>554,638</u>	<u>683,807</u>	<u>335,675</u>	<u>348,132</u>
Excess (Deficiency) of Revenues Over (Under) Expenditures	<u>(323,986)</u>	<u>(453,155)</u>	<u>12,934</u>	<u>466,089</u>
Other Financing Sources (Uses):				
Transfers out	(299,000)	(299,000)	(121,337)	177,663
Total Other Financing Sources (Uses)	<u>(299,000)</u>	<u>(299,000)</u>	<u>(121,337)</u>	<u>177,663</u>
Net Change in Fund Balances	(622,986)	(752,155)	(108,403)	643,752
Fund Balances - Beginning of Year	<u>546,887</u>	<u>546,887</u>	<u>546,887</u>	<u>--</u>
Fund Balances - End of Year	<u>\$ (76,099)</u>	<u>\$ (205,268)</u>	<u>\$ 438,484</u>	<u>\$ 643,752</u>

CITY OF HERCULES

Notes to Required Supplementary Information June 30, 2014

BUDGETARY PRINCIPLES

The City follows these procedures in establishing the budgetary data reflected in the financial statements:

1. In June, the City Manager submits to the City Council a proposed operating budget for the following fiscal year. This budget includes proposed expenditures, by fund and department, and the revenues expected to finance them.
2. Public hearings are conducted to obtain taxpayer comments.
3. The budget is legally enacted through passage of a resolution before July 1.
4. The City Manager is authorized to transfer budgeted amounts between objects within the same department; however, any revisions, which alter total expenditures of any fund, must be approved by the City Council.
5. Formal budgetary integration is employed as a management control device. Special Revenue Fund budgets are adopted on a basis consistent with accounting principles generally accepted in the United States (USGAAP) and are consistent with the basis used for financial reporting. Accordingly, actual revenues and expenditures can be compared with related budget amounts without any reconciliation. The General Fund budget is adopted on the budgetary basis, which is not consistent with accounting principles generally accepted in the United States of America. Commitments for material and services, such as purchase orders and contracts, are recorded during the year as encumbrances to assist in controlling expenditures. Appropriations, which are encumbered at year-end lapse, then are added to the following year's budgeted appropriations. However, encumbrances at year-end are reported as reservations of fund balance.
6. Under Article XIII B of the California Constitution (the Gann Spending Limitation Initiative), the City is restricted as to the amount of annual appropriations from the proceeds of taxes, and if proceeds of taxes exceed allowed appropriations, the excess must either be refunded to the State Controller, returned to the taxpayers through revised tax rates or revised fees schedules, or an excess in one year may be offset against a deficit in the following year. For the fiscal year ended June 30, 2014, based on the calculations by City Management, proceeds of taxes did not exceed the appropriations limit.
7. Budget revenue amounts represent the original budget modified by adjustments authorized during the year. Budgeted expenditure amounts represent original appropriations adjusted for supplemental appropriations during the year, which were contingent upon new or additional revenue sources and reappropriated amounts for prior year encumbrances. The City Manager must approve adjustments to departmental budgets; however, management may amend the budgeted amounts within departmental expenditure classifications, with approval of the Finance Director,
8. Certain appropriations carryover and are rebudgeted for the subsequent year.
9. Budget appropriations for the various governmental funds become effective July 1. The City Council may amend the budget during the fiscal year. The legal level of budgetary control has been established at the fund level.

OTHER REPORT

THIS PAGE INTENTIONALLY LEFT BLANK



**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***

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

We have audited the financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Hercules (City), as of and for the year ended June 30, 2014, which collectively comprise the City's basic financial statements and have issued our report thereon dated December 9, 2014. 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.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the City's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the City's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the City's internal control over financial reporting.

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 combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the City's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the City's financial statements are free of 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*.

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

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 City's internal control or in compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the City's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

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

Roseville, California
December 9, 2014