# FINANCIAL REPORT

FOR THE YEAR ENDED
JUNE 30, 2017

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# INDEPENDENT AUDITORS' REPORT

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# Report of Independent Auditors

**The Honorable Members of the Board of Directors**
**Municipal Water District of Orange County**

## Report on the Financial Statements

We have audited the accompanying financial statements of the Municipal Water District of Orange County (the District) as of and for the year ended June 30, 2017, and the related notes to the financial statements, which collectively comprise the District's basic financial statements as listed in the table of contents.

## Management's Responsibility for the Financial Statements

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

## Auditors' Responsibility

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

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

## Opinion

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

**Other Matters**

*Required Supplementary Information*

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis, Schedule of Funding Progress for the Other Post-Employment Benefit Plan, Schedule of the District's Proportionate Share of the Net Pension Liability and Schedule of Contributions for the Cost Sharing Retirement Plan on pages 3 through 9 and 33 through 35 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.

*Prior Year Comparative Information*

The financial statements of the District, as of and for the year ended June 30, 2016, were audited by other auditors, whose report, dated November 2, 2016, expressed an unmodified opinion on those statements. The financial statements include summarized prior year comparative information. Such information does not include all of the information required to constitute a presentation in accordance with accounting principles generally accepted in the United States of America. Accordingly, such information should be read in conjunction with the District's financial statements for the year ended June 30, 2016, from which such summarized information was derived.

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

In accordance with *Government Auditing Standards*, we have also issued our report dated October 26, 2017 on our consideration of the District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the District's internal control over financial reporting and compliance.

Vasquez + Company LLP

**Los Angeles, California**
**October 26, 2017**

# MANAGEMENT'S DISCUSSION AND ANAYLSIS

(Unaudited)

The following is a brief discussion of the Municipal Water District of Orange County's (District) activities and financial performance for the year ended June 30, 2017. Please read in conjunction with the District's basic financial statements and accompanying notes which follow this section.

## FINANCIAL HIGHLIGHTS

- The District's revenues were $163.4 million in FY 2016-17, compared to $183.6 million in the prior fiscal year, an 11.0% decrease.
- The District's expenses were $162.3 million in FY 2016-17, compared to $181.7 million in the prior fiscal year, a 10.7% decrease.
- The District's assets at June 30, 2017 were $46.7 million, a 7.3% decrease compared to total assets of $50.4 million at June 30, 2016.
- The District's liabilities at June 30, 2017 were $38.7 million, a 10.0% decrease compared to total liabilities of $43.0 million at June 30, 2016.
- The District's net position at June 30, 2017 was $8.6 million, a 15.0% increase compared to net position of $7.5 million at June 30, 2016.

## MEASUREMENT FOCUS AND BASIS OF ACCOUNTING

Measurement focus is a term used to describe which transactions are recorded within the various financial statements. Basis of accounting refers to when transactions are recorded regardless of the measurement focus applied. The accompanying financial statements are reported using the economic resources measurement focus, and the accrual basis of accounting.

Under the economic resources measurement focus all assets, deferred inflows and outflows of resources, and liabilities (whether current or noncurrent) associated with these activities 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, revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

## OVERVIEW OF THE BASIC FINANCIAL STATEMENTS

The District's financial statements, prepared in accordance with generally accepted accounting principles (GAAP), offer key, high-level financial information about District activities during the reporting period. The financial statements of the District consist of three interrelated statements designed to provide the reader with relevant information on the District's financial condition and operating results. These statements offer short-term and long-term financial information about the District's activities utilizing the full accrual basis of accounting.

The *Statement of Net Position* includes all of the District's assets and deferred outflows of resources, less liabilities and deferred inflows of resources, with the difference being reported as Net Position. It also provides the basis for computing rate of return, evaluating the capital structure of the District, and assessing the liquidity and financial flexibility of the District.

All of the current year's revenues and expenses are accounted for in the *Statement of Revenues, Expenses, and Changes in Net Position*. This statement measures the District's operations over the past year and can be used to determine whether the District has successfully recovered all its projected costs through its rates and other service related charges.

The final required financial statement is the *Statement of Cash Flows* which presents information about the District's cash receipts and cash payments during the reporting period classified as cash receipts, cash payments, and net changes in cash resulting from operations, and investing, non-capital financing, and capital and related financing activities. This statement also provides comparative information on the sources and uses of the District's cash during the reporting period.

## FINANCIAL ANALYSIS OF THE DISTRICT

One of the most important questions asked about the District's finances is: "Is the District, as a whole, financially better off or worse off as a result of the year's activities?" The Statement of Net Position and the Statement of Revenues, Expenses, and Changes in Net Position report information about the District's activities in a way that will help answer this question. These two statements report the net position of the District and changes in them. You can think of the District's net position (the difference between assets plus deferred outflows of resources and liabilities plus deferred inflows of resources) as one way to measure financial health or financial position. Over time, increases or decreases in the District's Net Position are one indicator of whether its financial health is improving or deteriorating. However, you will need to consider other non-financial factors, such as changes in economic conditions, population growth, changes in rates and charges and new or changed government legislation or accounting standards.

## STATEMENT OF NET POSITION

Net position is the difference between assets plus deferred outflows of resources, and liabilities plus deferred inflows of resources, and may serve over time as a useful indicator of a government's financial position. The following is a summary of the District's Statement of Net Position.

**Table 1**
**Condensed Statements of Net Position**
**(In thousands of dollars)**
**June 30:**

| | 2017 | 2016 | Variance | Total Percent Change |
|---|---|---|---|---|
| Current Restricted Assets | $ 3,160 | $ 4,783 | $ (1,623) | (33.9%) |
| Current Unrestricted Assets | 41,664 | 44,264 | (2,600) | (5.9%) |
| Capital Assets | 1,364 | 1,209 | 155 | 12.8% |
| Other Assets | 483 | 117 | 366 | 312.8% |
| **Total Assets** | **46,671** | **50,373** | **(3,702)** | **(7.3%)** |
| **Deferred Outflows of Resources** | **890** | **454** | **436** | **96.0%** |
| Liabilities Payable from Restricted Current Assets | 2,046 | 3,719 | (1,673) | (45.0%) |
| Liabilities Payable from Unrestricted Current Assets | 34,814 | 37,935 | (3,121) | (8.2%) |
| Noncurrent Unrestricted Liabilities | 1,871 | 1,377 | 494 | 35.9% |
| **Total Liabilities** | **38,731** | **43,031** | **(4,300)** | **(10.0%)** |
| **Deferred Inflows of Resources** | **231** | **320** | **(89)** | **(27.8%)** |
| **Net Position:** | | | | |
| Net Investment in Capital Assets | 1,364 | 1,209 | 155 | 12.8% |
| Restricted for Trustee Activities | 1,114 | 1,064 | 50 | 4.7% |
| Unrestricted | 6,121 | 5,202 | 919 | 17.7% |
| **Total Net Position** | **$ 8,599** | **$ 7,475** | **$ 1,124** | **15.0%** |

The decreases in Restricted Assets and Liabilities were caused by the following:

- Both Current Restricted and Unrestricted Assets and Liabilities Payable from Restricted and Unrestricted Current Assets are lower due to the Turf Removal Program having lower costs due to lower number of rebates this fiscal year.

## STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION

While the Statement of Net Position shows the financial position at year-end, the Statement of Revenues, Expenses, and Changes in Fund Net Position provides information as to the nature and source of these changes in Net Position. The District reported an increase in net position of $1,124 thousand for the year ended June 30, 2017, as compared to an increase of $1,872 thousand for the year ended June 30, 2016. The following is a summary of the change in the District's net position.

**TABLE 2**
**Condensed Statements of Revenues**
**Expenses, and Changes in Net Assets**
**(In thousands of dollars)**

| | FY 2017 | FY 2016 | Variance | Total Percent Change |
|---|---|---|---|---|
| Operating Revenues | $ 159,287 | $ 154,568 | $ 4,719 | 3.1% |
| Special Projects Revenue | 3,927 | 28,674 | $ (24,747) | (86.3%) |
| Nonoperating Revenues | 199 | 341 | (142) | (41.6%) |
| **Total Revenues** | **163,413** | **183,583** | **(20,170)** | **(11.0%)** |
| Operating Expense | 158,214 | 152,903 | 5,311 | 3.5% |
| Special Projects Expense | 3,927 | 28,674 | (24,747) | (86.3%) |
| Depreciation Expense | 148 | 134 | 14 | 10.4% |
| **Total Expenses** | **162,289** | **181,711** | **(19,422)** | **(10.7%)** |
| **Change in Net Position** | **1,124** | **1,872** | **(748)** | **(40.0%)** |
| **Beginning Net Position** | **7,475** | **5,603** | **1,872** | **33.4%** |
| **Ending Net Position** | **$ 8,599** | **$ 7,475** | **$ 1,124** | **15.0%** |

The primary change in revenue and expense accounts was caused by the lower level of rebates paid and reimbursed through the Turf Removal Program.

## CAPITAL ASSETS

The following is a summary of the District's capital assets at June 30, 2017 and June 30, 2016.

**Table 3**
**Capital Assets**
**(In thousands of dollars)**
**June 30:**

| | 2017 | 2016 | Variance | Total Percent Change |
|---|---|---|---|---|
| Leasehold Improvements | $ 3,696 | $ 3,415 | $ 281 | 8.2% |
| Furniture & Fixtures | 457 | 448 | 9 | 2.0% |
| **Subtotal** | **4,153** | **3,863** | **290** | **7.5%** |
| **Less Accumulated Depreciation** | **(2,789)** | **(2,653)** | **(136)** | **5.1%** |
| **Net Capital Assets** | **$ 1,364** | **$ 1,210** | **$ 154** | **12.7%** |

The District refurbished five offices, remodeled a hallway, purchased carpet, designed entryway displays and contributed to an upgrade and remodel of the HVAC and the entry way remodel of the common area shared with Orange County Water District. Additional information regarding capital assets can be found in Notes 1 and 4 of the notes to financial statements.

## DEBT ADMINISTRATION

The District had no debt outstanding as of June 30, 2017. No new long-term debt was incurred in the year ended June 30, 2017, and the District does not plan to issue new debt in the year ending June 30, 2018.

## BUDGETARY HIGHLIGHTS

The District is governed by a Board of Directors consisting of seven elected members. The Board adopts an annual appropriated budget prior to the start of the fiscal year. The Budget may be revised by Board action during the fiscal year. All amendments to the budget, or transfers of operating budget appropriations to or from reserve accounts, require Board notification. The General Manager is authorized to transfer budget amounts within programs. The legal level of budgetary control is at the total fund level. An actual vs. budget comparison statement for FY 2016-17 is presented in Table 4 to demonstrate compliance with the adopted budget.

**TABLE 4**
**FY 2017 Actual vs FY 2017 Budget**
**(In thousands of dollars)**

| | Actual | Budget | Variance | Total Percent Change |
|---|---|---|---|---|
| **Revenues:** | | | | |
| From Operations | $ 163,214 | $ 152,973 | $ 10,241 | 6.7% |
| Nonoperating Revenues | 199 | 131 | 68 | 51.9% |
| **Total Revenues** | **163,413** | **153,104** | **10,309** | **6.7%** |
| **Expenses:** | | | | |
| From Operations | | | | |
| Cost of Water | 150,877 | 139,751 | (11,126) | (8.0%) |
| Other Operating | 11,264 | 13,877 | 2,613 | 18.8% |
| Depreciation | 148 | 135 | (13) | (9.6%) |
| **Total Expenses** | **162,289** | **153,763** | **(8,526)** | **(5.5%)** |
| **Change In Net Assets** | **$ 1,124** | **$ (659)** | **$ 1,783** | **(270.6%)** |

The variances on the budget to actual are as follows:

- Revenues from Operations were $10.2 million more than budget due to an increase in water sales.

- Expenses from Cost of Water purchased were $11.1 million higher than budget due to increase in water sales.

- Other Operating expenses were $2.6 million lower due to projects taking longer which reduced engineering expense by $300 thousand, professional services by $1.5 million, and building expense by $210 thousand. In addition two open positions were staffed halfway through the year which reduced salaries and benefits by $313 thousand. Also, our anticipated legal expenses were less by $164 thousand and miscellaneous expense by $111 thousand.

## ECONOMIC FACTORS AND NEXT YEAR'S BUDGET AND RATES

The District's Board of Directors and management considered many factors during preparation and approval of the annual budget for FY 2017-18. The budgeted operating expenses total $178.5 million and operating and non-operating revenues total $178.4 million.

Historically, the District has recouped the cost of water purchased from the resale of imported water to the District's 28 water agencies located in Orange County. In addition MWDOC has charged both a per acre-foot surcharge and a per retail meter charge to cover its operating budget. In past history, the District's operating revenue has been approximately 65% from per retail connection charges, and 35% from per acre-foot charges. Beginning in 2011-12, MWDOC began transitioning from the two-component rate structure to one involving only a single component. Over a five year period, ending in 2015-16, MWDOC had been transitioning from a water rate structure involving a per acre-foot charge and a fixed per retail meter charge to a 100% on the per retail meter charge. Beginning FY 2016-17 MWDOC has established two classes of customers, a retail meter and a groundwater customer. The District's budget is now allocated between retail meter customer and groundwater customer. In addition MWDOC's agencies will also pay for the resale cost of imported water.

## CONTACTING THE DISTRICT'S FINANCIAL MANAGEMENT

This financial report is intended to provide the Board of Directors, customers, taxpayers, creditors, and other interested parties with a general overview of the District's financial operations and condition at the year ended June 30, 2017, and to demonstrate the District's accountability for the funds it receives. If you have questions about this report or need additional information, you may contact the Municipal Water District of Orange County, Finance Dept., at 18700 Ward Street, Fountain Valley, CA 92708, (714) 963-3058, www.mwdoc.com.

# BASIC FINANCIAL STATEMENTS

Statement of Net Position
Statement of Revenues, Expenses and Changes in Net Position
Statement of Cash Flows

# MUNICIPAL WATER DISTRICT OF ORANGE COUNTY

Statement of Net Position

June 30, 2017

(with comparative data as of June 30, 2016)

| | 2017 | 2016 |
|---|---|---|
| ***ASSETS*** | | |
| **Current Assets:** | | |
| **Restricted Assets:** | | |
| Cash and Cash Equivalents (Note 2) | $ 901,769 | $ 2,949,837 |
| Accounts Receivable Other | 2,254,756 | 1,830,906 |
| Accrued Interest Receivable | 3,038 | 1,887 |
| Total Restricted Assets | 3,159,563 | 4,782,630 |
| **Unrestricted Assets:** | | |
| Cash and Cash Equivalents (Note 2) | 5,936,806 | 5,169,438 |
| Investments (Note 2) | 3,012,987 | 3,144,608 |
| Accounts Receivable: | | |
| Water Sales | 32,368,203 | 31,613,865 |
| Other | 138,348 | 4,159,609 |
| Accrued Interest Receivable | 31,259 | 36,428 |
| Deposits and Prepaid Expenses | 176,431 | 139,782 |
| Total Unrestricted Assets | 41,664,034 | 44,263,730 |
| Total Current Assets | 44,823,597 | 49,046,360 |
| **Noncurrent Assets:** | | |
| **Unrestricted Assets:** | | |
| Capital Assets, Net (Note 4) | 1,363,604 | 1,209,464 |
| Net Other Post Employment Benefits (OPEB) Asset (Note 6) | 483,546 | 117,085 |
| Total Noncurrent Assets | 1,847,150 | 1,326,549 |
| ***TOTAL ASSETS*** | 46,670,747 | 50,372,909 |
| ***DEFERRED OUTFLOWS OF RESOURCES*** | | |
| Deferred Amount Related to Pensions (Note 8) | 890,291 | 453,547 |
| ***TOTAL DEFERRED OUTFLOWS OF RESOURCES*** | 890,291 | 453,547 |

See accompanying notes to basic financial statements.

## MUNICIPAL WATER DISTRICT OF ORANGE COUNTY

Statement of Net Position (Continued)

June 30, 2017

(with the comparative data as of June 30, 2016)

| | 2017 | 2016 |
|---|---|---|
| ***LIABILITIES*** | | |
| **Current Liabilities:** | | |
| **Payable from Restricted Assets** | | |
| Accrued Liabilities | 331,323 | 1,637,376 |
| Advances from Participants | 1,714,186 | 1,967,473 |
| Unearned Revenue | - | 109,305 |
| Due to Participants | - | 4,823 |
| Total Payable from Restricted Assets | 2,045,509 | 3,718,977 |
| **Unrestricted Liabilities:** | | |
| Accounts Payable, Metropolitan Water District of Southern California | 33,029,534 | 35,825,894 |
| Accrued Liabilities | 1,784,818 | 2,109,579 |
| Total Unrestricted Liabilities | 34,814,352 | 37,935,473 |
| Total Current Liabilities | 36,859,861 | 41,654,450 |
| **Noncurrent Liabilities:** | | |
| **Unrestricted Liabilities:** | | |
| Net Pension Liability (Note 8) | 1,871,472 | 1,376,955 |
| Total Noncurrent Liabilities | 1,871,472 | 1,376,955 |
| ***TOTAL LIABILITIES*** | 38,731,333 | 43,031,405 |
| ***DEFERRED INFLOWS OF RESOURCES*** | | |
| Deferred Amount Related to Pensions (Note 8) | 231,079 | 319,906 |
| ***TOTAL DEFERRED INFLOWS OF RESOURCES*** | 231,079 | 319,906 |
| ***NET POSITION*** | | |
| Net Investment in Capital Assets | 1,363,604 | 1,209,464 |
| Restricted | 1,114,054 | 1,063,653 |
| Unrestricted | 6,120,968 | 5,202,028 |
| ***TOTAL NET POSITION*** | $ 8,598,626 | $ 7,475,145 |

**MUNICIPAL WATER DISTRICT OF ORANGE COUNTY**

Statement of Revenues, Expenses and
Changes in Net Position
For the Fiscal Year Ended June 30, 2017
(with comparative data for the Year Ended June 30, 2016)

| | 2017 | 2016 |
|---|---|---|
| **Operating Revenues:** | | |
| Water Sales | $ 159,287,030 | $ 154,567,913 |
| Special Projects Revenue | 3,093,169 | 26,801,114 |
| Federal Grant Revenue | 450,748 | 556,037 |
| State Grant Revenue | 382,823 | 1,317,104 |
| Total Operating Revenues | 163,213,770 | 183,242,168 |
| **Operating Expenses:** | | |
| Cost of Water Sold | 150,877,118 | 146,210,635 |
| Salaries and Employee Benefits | 4,256,280 | 3,861,895 |
| General and Administrative | 3,080,916 | 2,830,610 |
| Special Project Expenses | 3,926,740 | 28,674,255 |
| Depreciation | 148,020 | 133,911 |
| Total Operating Expenses | 162,289,074 | 181,711,306 |
| Operating Income | 924,696 | 1,530,862 |
| **Nonoperating Revenues:** | | |
| Investment Income | 147,183 | 179,964 |
| Other Income | 51,602 | 161,396 |
| Total Nonoperating Revenues | 198,785 | 341,360 |
| **Change in Net Position** | 1,123,481 | 1,872,222 |
| **NET POSITION - BEGINNING OF YEAR** | 7,475,145 | 5,602,923 |
| **NET POSITION - END OF YEAR** | $ 8,598,626 | $ 7,475,145 |

See accompanying notes to basic financial statements.

**MUNICIPAL WATER DISTRICT OF ORANGE COUNTY**

Statement of Cash Flows

For the Fiscal Year Ended June 30, 2017

(with comparative data for the Year Ended June 30, 2016)

| | 2017 | 2016 |
|---|---|---|
| **Cash Flows from Operating Activities:** | | |
| Cash Received from Member Agencies-Water Deliveries | $ 158,532,692 | $ 149,363,866 |
| Cash Payments to Metropolitan Water District of Southern California | (153,673,478) | (139,705,039) |
| Cash Payments for Salaries and Employee Benefits | (4,653,795) | (4,181,548) |
| Cash Payments for General and Administrative Expenses | (3,442,326) | (351,108) |
| Cash Received from Special projects | 6,108,793 | 28,292,093 |
| Cash Payments for Special Projects | (4,180,027) | (27,829,947) |
| Other income | 51,602 | 161,396 |
| Net Cash (Used) Provided by Operating Activities | (1,256,539) | 5,749,714 |
| **Cash Flows from Non-capital and Related Financing Activities:** | | |
| (Proceeds from)/Payments to Revised Percentage of Investment Participants | (4,823) | 77 |
| Net Cash Provided by Non-capital and Related Financing Activities | (4,823) | 77 |
| **Cash Flows from Capital and Related Financing Activities:** | | |
| Acquisition of Capital Assets | (302,160) | (414,132) |
| Net Cash used by Capital and Related Financing Activities | (302,160) | (414,132) |
| **Cash Flows from Investment Activities:** | | |
| Investment Income | 147,183 | 179,964 |
| Investments Matured/(Purchased) | 135,639 | (36,112) |
| Net Cash Provided by Investment Activities | 282,822 | 143,852 |
| Net Increase/(Decrease) in Cash and Cash Equivalents | (1,280,700) | 5,479,511 |
| Cash and Cash Equivalents at Beginning of Year | 8,119,275 | 2,639,764 |
| Cash and Cash Equivalents at End of Year | $ 6,838,575 | $ 8,119,275 |
| **Financial Statement Presentation:** | | |
| Cash and Cash Equivalents (Restricted) | $ 901,769 | $ 2,949,837 |
| Cash and Cash Equivalents (Unrestricted) | 5,936,806 | 5,169,438 |
| Totals | $ 6,838,575 | $ 8,119,275 |

See accompanying notes to basic financial statements.

# MUNICIPAL WATER DISTRICT OF ORANGE COUNTY

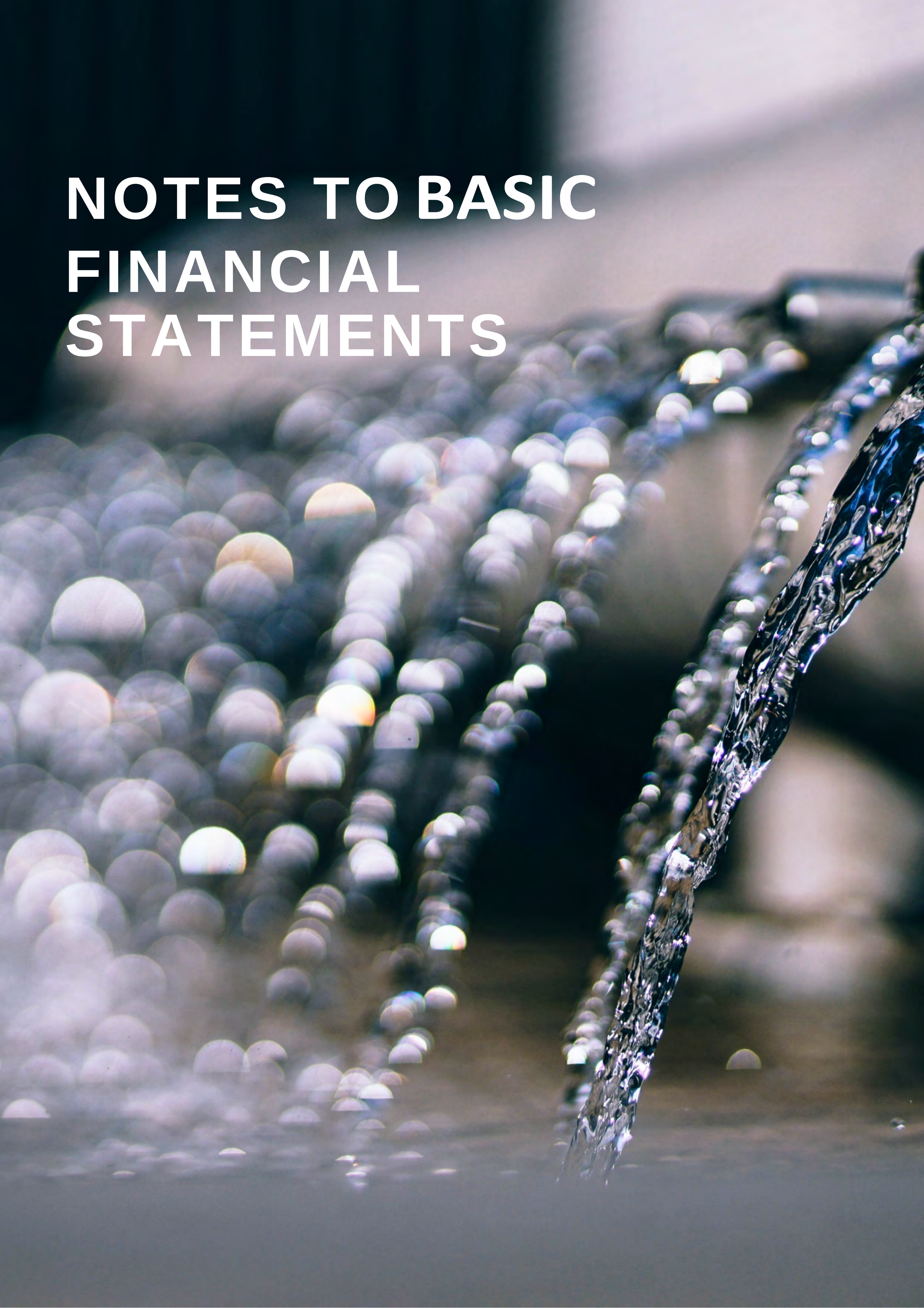
Statement of Cash Flows (Continued)

For the Fiscal Year Ended June 30, 2017

(with comparative data for the Year Ended June 30, 2016)

| | 2017 | 2016 |
|---|---|---|
| **Reconciliation of Operating Income to Net Cash Provided (Used) for Operating Activities** | | |
| Operating Income | $ 924,696 | $ 1,530,862 |
| Adjustments to Reconcile Operating Income to Net Cash Provided (Used) for Operating Activites: | | |
| Depreciation | 148,020 | 133,911 |
| Pension Expense | - | (74,857) |
| Other Income | 51,602 | 161,396 |
| Change in Assets and Liabilities: | | |
| (Increase) in accounts receivable - water sales | (754,338) | (5,204,047) |
| Decrease in accounts receivable - other | 4,021,261 | 1,463,245 |
| (Increase)/Decrease in deposits and prepaid expenses | (36,649) | 16,619 |
| (Increase) in OPEB asset | (366,461) | (24,279) |
| (Increase) in accounts receivable - special projects | (423,850) | (430,534) |
| (Increase) in deferred outflows - pension related | (436,744) | (220,517) |
| Increase/(Decrease) in accrued and other liabilities | (324,761) | 999,639 |
| Increase/(Decrease) in restricted accrued liabilities | (1,306,053) | 1,118,163 |
| Increase/(Decrease) in advances from participants | (253,287) | 844,307 |
| (Decrease) in unearned revenue for special projects | (109,305) | (1,069,790) |
| Increase/(Decrease) in accounts payable to Metropolitan Water District of Southern California | (2,796,360) | 6,505,597 |
| Increase in net pension liability | 494,517 | - |
| (Decrease) in deferred inflows - pension related | (88,827) | - |
| Total Adjustments | (2,181,235) | 4,218,852 |
| Net Cash Provided (Used) for Operating Activities | $ (1,256,539) | $ 5,749,714 |
| Noncash investing activities: | | |
| Unrealized gain (loss) on investments | $ (44,012) | $ 32,281 |
| Total noncash investing activities | $ (44,012) | $ 32,281 |

# NOTES TO BASIC FINANCIAL STATEMENTS



## (1) Organization and Summary of Significant Accounting Policies

### Reporting Entity

The Municipal Water District of Orange County (the District) was formed as a municipal water district on January 11, 1951 under the Municipal Water District Act of 1911. The District is a wholesale water supplier and resource planning agency that serves all of Orange County through 28 cities and water agencies (except the Cities of Anaheim, Fullerton, and Santa Ana which are independent member agencies of Metropolitan Water District of Southern California (Metropolitan). As a public agency member of Metropolitan, the District purchases imported water from Metropolitan and provides water to the District's 28 member agencies, which provide retail or wholesale water services to approximately 2.3 million residents within the District's service area of approximately 600 square miles. The District's primary sources of water from Metropolitan are the California State Water Project (SWP) and the Colorado River Aqueduct.

The District is an independent special district of the State of California governed by an elected seven-member board. On January 2001, the District merged with the Coastal Municipal Water District (Coastal) under the recommendation of the Local Agency Formation Commission of Orange County (LAFCO) as part of an effort to streamline local government. The consolidation of the two agencies allows the new district to more efficiently provide wholesale water services for the benefit of residents living throughout the service area.

The District's reporting entity includes the accounts of the District and the Municipal Water District of Orange County Water Facilities Corporation (WFC). Formed as a separate California nonprofit corporation on April 20, 1978 to assist in the financing of the Allen-McColloch Pipeline (AMP) and the Flow Augmentation Project (FAP), the WFC has no employees. The WFC is governed by a seven-member board comprised of the District's board members. The WFC had no activity or balances for the year ended June 30, 2017 and is kept active for potential future financing arrangements. WFC is a blended component unit of the District and the District has operational responsibility for WFC.

### Basic Financial Statements

The District's basic financial statements consist of the Statement of Net Position, the Statement of Revenues, Expenses and Changes in Net Position, the Statement of Cash Flows, and the Notes to the Basic Financial Statements.

### Basis of Presentation

The District accounts for its activities as an enterprise fund. An enterprise fund is a proprietary type fund used to account for operations (a) that are financed and operated in a manner similar to private business enterprises - where the intent of the governing body is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges; or (b) where the governing body has decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability or other purposes.

The District's basic financial statements have been prepared on the accrual basis of accounting, and are presented on an economic measurement focus reporting all economic resources and obligations for the year ended June 30, 2017.

**Net Position**

In the Statement of Net Position, net position is classified in the following categories:

- Net investment in capital assets – This amount consists of capital assets, net of accumulated depreciation, reduced by the outstanding balances of bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets as applicable.

- Restricted net position – This amount consists of restricted assets reduced by liabilities. Generally, a liability relates to restricted assets if the asset results from a resource flow that also results in the recognition of a liability or if the liability will be liquidated with the restricted assets reported or a resource subject to constraints that are externally imposed by creditors, grantors, contributors, or laws or regulations of other governments, or imposed by law through constitutional provisions or enabling legislation.

- Unrestricted net position – This amount is the net amount of the assets, deferred outflows of resources, liabilities, and deferred inflows of resources that are not included in the determination of investment in capital assets or the restricted component of net position.

When both restricted and unrestricted resources are available, it is the District's policy to use restricted resources first and then unrestricted resources as they are needed.

**Operating and Nonoperating Revenues and Expenses**

The District's primary purpose is to provide a dependable wholesale supply of imported water for its 28 member agencies. Accordingly, operating revenues such as water sales, result from exchange transactions associated with the principal activity of the District, which is the purchase and resale of imported water to the District's member agencies.

Revenues from federal and state grants, reimbursements from participants and special projects, as well as special project expenses are defined as operating revenues and expenses, respectively. Nonoperating revenues consist of investment income and other miscellaneous income.

**Water Sales and Cost of Water Sold**

Historically, the District's primary source of revenue has been from the resale of imported water to the District's 28 member agencies located in Orange County. Based on Metropolitan's cost of water, each year Metropolitan's Board of Directors approves water rates comprised of a capacity charge, readiness to serve charge and a per acre-foot charge. Metropolitan's rates are based on cost of service studies performed on a biennial basis. Water rates are not subject to regulation by the California Public Utilities Commission or by any other local, state, or federal agency. Revenue from sales of water is recognized on the accrual basis as water is delivered.

The District's revenue is from a per retail meter connection charge and a groundwater customer charge. Choice services are charged directly to the agencies as a "fee for service" on a subscription basis. The member agencies also pay for the resale of imported water in addition to the other charges noted.

### Investments

Fair Value Measurements

The District categorizes the fair value measurements of its investments based on the hierarchy established by generally accepted accounting principles. The fair value hierarchy, which has three levels, is based on the valuation inputs used to measure an asset's fair value: Level 1 inputs are quoted prices in active markets for identical assets; Level 2 inputs are significant other observable inputs; Level 3 inputs are significant unobservable inputs.

The District's investment policy and delegation of investment authority, is reviewed and approved each year by the Board of Directors. The investment policy authorizes the Treasurer to invest, reinvest, sell or exchange permitted fixed income securities in accordance with the California Government Code. Investment income from restricted assets remains restricted.

### Cash and Cash Equivalents

Cash and cash equivalents are defined as cash and short-term, highly liquid investments (i.e., Local Agency Investment Fund and Orange County Investment Pool) which are readily convertible to cash and mature within ninety (90) days of original purchase.

### Accounts Receivable

The District extends credit to customers in the normal course of operations. Management believes all accounts receivable are collectible. In the event any accounts receivable are determined they are uncollectible, an allowance is recorded.

### Capital Assets

Capital assets are defined by the District as assets with an initial, individual cost of more than $5,000 and a useful life greater than one (1) year. Upon retirement, sale or other disposition of capital assets, the cost and related accumulated depreciation are removed from their respective accounts and any gains or losses are recognized. Depreciation is computed using the straight-line method over the estimated useful life of the asset, which range from 3 to 10 years for furniture, fixtures, and equipment, and up to 30 years for leasehold improvements.

### Deposits and Prepaid Expenses

Certain payments to vendors reflect costs or deposits applicable to future accounting periods and are recorded as Deposits and Prepaid Expenses in the basic financial statements.

### Deferred Outflows and Inflows of Resources

The District reported deferred outflows and inflows of resources related to pensions. A deferred outflow of resources is a consumption of net position by the District that is applicable to a future reporting period. A deferred inflow of resources represents an acquisition of net position by the district that is applicable to a future period. Refer to Note 8 for items identified as deferred inflows and outflows as of June 30, 2017.

### Compensated Absences

As vacation leave is a vested employee benefit, the District is obligated to compensate employees for all earned but unused vacation days. Employee vacation days are accrued each pay period and reported as accrued liabilities. Depending on the length of employment, employees earn a minimum of 10 up to a maximum of 21 vacation days per year. Accumulated vacation days may not exceed 2 times the number of days earned per year without prior approval of the General Manager. Sick leave time is a non-vested employee benefit (i.e. accumulated sick leave is not payable in the event of employee termination) and is considered a contingent liability and is not reflected in the accompanying financial statements.

### Unearned Revenue

Unearned revenue represents grant revenues received in advance of the recognition of the related expense.

### Pensions

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

### Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that could affect certain reported amounts in the financial statements and accompanying notes. Actual results could differ from those estimates. Also, the preparation of the financial statements inherently requires rounding of amounts and estimates. Management believes that any differences due to rounding are not material

## (2) Cash and Investments

Cash and investments at June 30, 2017, are classified in the accompanying financial statements as follows:

Statement of net position:

| | |
|---|---|
| Cash and cash equivalents (restricted) | $ 901,769 |
| Cash and cash equivalents (unrestricted) | 5,936,806 |
| Investments (unrestricted) | 3,012,987 |
| Total Cash and Investments | $ 9,851,562 |

Cash and investments as of June 30, 2017 consist of the following:

| | |
|---|---|
| Cash on hand | $ 500 |
| Deposits with financial institutions | 350,313 |
| Investments | 9,500,749 |
| Total Cash and Investments | $ 9,851,562 |

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

The table below identifies the investment types that are authorized for the District by the California Government Code (or the District's investment policy, where more restrictive). The table also identifies certain provisions of the California Government Code (or the District's investment policy, where more restrictive) that address interest rate risk and concentration of credit risk. The District's investment policy allows for funds to be divided into two categories. The Operating and Fiduciary Funds authorized investments are below:

| Authorized Investment Type | Maximum Maturity | Maximum Percentage of Portfolio | Maximum Investment in One |
|---|---|---|---|
| U.S. Treasuries | 5 years | 100% | 100% |
| U.S. Government Agencies | 5 years | 100% | 50% |
| Corporate Securities | 5 years | 30% | 5% |
| Commercial Paper | 270 days | 25% | 5% |
| Negotiable Certificates of Deposit | 5 years | 30% | 5% |
| Bankers' Acceptances | 180 days | 40% | 5% |
| Repurchase Agreements | 1 year | 20% | 10% |
| Money Market Mutual Funds | N/A | 20% | 20% |
| Collective Investment Pool | N/A | 20% | 10% |
| County Investment Pool | N/A | 100% | 100% |
| State Investment Pool | N/A | 100% | 100% |

### Disclosures Relating to Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair market value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair market value to changes in market interest rates. One of the ways that the District 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 flow and liquidity needed for operations. Information about the sensitivity of the fair market values of the District's investments to market interest rate fluctuations is provided by the following table that shows the distribution of the District's investments by maturity:

| | | Remaining Maturity (in Months) | | |
|---|---|---|---|---|
| Investment Type | | 12 Months or Less | 13 to 24 Months | 25-60 Months |
| Negotiable Certificate of Deposits | $ 2,258,570 | $ 750,407 | $ 501,088 | $1,007,075 |
| Corporate Securities | 754,418 | - | - | 754,418 |
| Orange County Investment Pool | 5,629,766 | 5,629,766 | - | - |
| State Investment Pool | 857,995 | 857,995 | - | - |
| | $ 9,500,749 | $7,238,168 | $ 501,088 | $1,761,493 |

### 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 or District's investment policy, or debt agreements, and the actual rating by Standard and Poor's (S&P) as of the year end of each investment type. The District purchases all investments at the minimum rating but some investments' ratings may downgrade during its life but it is the District's policy to hold investments until their maturity.

| | | | Ratings as of Year End | | | |
|---|---|---|---|---|---|---|
| Investment Type | | Minimum Legal Rating | AAAm | A | ** A- | Not Rated |
| Negotiable Certificate of Deposits | $ 2,258,570 | N/A | $ - | $ - | $ - | $2,258,570 |
| Corporate Securities | 754,418 | A | - | 252,868 | 501,550 | - |
| Orange County Investment Pool | 5,629,766 | N/A | 5,629,766 | - | - | - |
| State Investment Pool | 857,995 | N/A | - | - | - | 857,995 |
| | $ 9,500,749 | | $5,629,766 | $252,868 | $ 501,550 | $3,116,565 |

** Investments conformed to District's investment Policy at time of acquisition

### Disclosures Relating to Fair Value Measurement and Application

Fair value measurements are categorized based on the valuation inputs used to measure fair value: Level 1 inputs are quoted prices in active markets for identical assets, Level 2 inputs are significant other observable inputs; Level 3 inputs are significant unobservable inputs. Investments categorized as Level 2 are valued using a market approach using quoted market prices. Values are determined using pricing models and discounted cash flow models and includes management judgement and estimation. Uncategorized investments include investments in a non 2a-7 like pool, such as the Local Agency Investment Fund (LAIF) and the Orange County Investment Pool (OCIP). These investments do not have a legally binding guarantee for their share price. The fair value of the investments can be calculated by multiplying LAIF's and OCIP's fair value per share factor times the District's pool balance. LAIF and OCIP value participant shares on an amortized cost basis during the year and adjust to fair value at year-end.

The District had the following recurring fair value measurements as of June 30, 2017:

| | | Fair Value Application | | | |
|---|---|---|---|---|---|
| Investment Type | | 1 | 2 | 3 | Uncategorized |
| Negotiable Certificate of Deposits | $ 2,258,570 | $ - | $ 2,258,570 | $ - | $ - |
| Corporate Securities | 754,418 | - | 754,418 | - | - |
| Orange County Investment Pool | 5,629,766 | - | - | - | 5,629,766 |
| State Investment Pool | 857,995 | - | - | - | 857,995 |
| | $ 9,500,749 | $ - | $ 3,012,988 | $ - | $ 6,487,761 |

Investments in LAIF and OCIP are uncategorized as deposits and withdrawals are made on the basis of $1 and not fair value. Accordingly, under the fair value hierarchy, these investments are uncategorized.

### Concentration of Credit Risk

The District's investment policy contains limitations on the amount that can be invested in any one issuer as stipulated by the California Government Code. At June 30, 2017 the District did not have investments in more than one issuer (other than U.S. Treasury securities, mutual funds, external investment pools) that represented 5% or more of total District investments.

### 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 District'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 market value of the pledged securities in the collateral pool must equal at least 110% of the total amount deposited by the public agency. The Government Code also allows financial institutions to secure public agency deposits by pledging first trust deed mortgage notes having a value of 150% of the secured public deposits. As of June 30, 2017 the District's deposits with financial institutions are covered by the Federal Deposit Insurance Corporation up to $250,000, the remaining amounts of $381,292 were collateralized as described above.

**Investment in State and County Investment Pool**

The District is a voluntary participant in LAIF that is regulated by California Government Code Section 16429 under the oversight of the Treasurer of the State of California, and in the OCIP under the oversight of the Orange County Treasurer. The fair market value of the District's investment in these pools are reported in the accompanying financial statements at amounts based upon the District's pro-rata share of the fair market value provided by LAIF and OCIP for the entire LAIF and OCIP portfolios (in relation to the amortized cost of that portfolio). The balance available for withdrawal is based on the accounting records maintained by LAIF and OCIP, which are recorded on an amortized cost basis.

LAIF is a governmental investment pool managed and directed by the California State Treasurer and is not registered with the Securities and Exchange Commission. An oversight committee comprised of California State officials and various participants provides oversight to the management of the fund. The daily operations and responsibilities of LAIF fall under the auspices of the State Treasurer's office.

The Agency is a participant in the OCIP. The OCIP is an external investment pool, and is not registered with the Securities Exchange Commission (SEC). The County Treasury Oversight Committee conducts OCIP oversight. The OCIP values participant shares on an amortized cost basis during the year and adjusts to fair value at year-end. For further information regarding the OCIP, refer to the County of Orange Comprehensive Annual Financial Report.

## (3) Restricted Assets

Restricted assets are monies held in restricted funds or accounts by the District for the benefit of member agencies, including a rate stabilization fund. As of June 30, 2017, $3,159,563 was reported as restricted assets related to trustee and member agency activities.

## (4) Capital Assets

The following is a summary of capital assets at June 30, 2017 with changes therein:

| | 2016 | Additions | Deletions | 2017 |
|---|---|---|---|---|
| Furniture,Fixtures and Equipmen | $ 447,720 | $ 22,143 | $ (12,553) | $ 457,310 |
| Leasehold Improvements | 3,415,059 | 280,541 | - | 3,695,600 |
| | 3,862,779 | 302,684 | (12,553) | 4,152,910 |
| Less accumulated depreciation: | | | | |
| Furniture,Fixtures and Equipmen | (421,469) | (5,833) | 12,553 | $ (414,749) |
| Leasehold Improvements | (2,231,846) | (142,711) | - | (2,374,557) |
| | (2,653,315) | (148,544) | 12,553 | (2,789,306) |
| Net Capital Assets | $ 1,209,464 | $ 154,140 | $ - | $ 1,363,604 |

## (5) Pension Plan

The District sponsors a Money Purchase Pension Plan (the Pension Plan), a defined contribution plan, under Internal Revenue Code Section 401(a) for the benefit of its Board of Directors. The Directors contribute 7.5 percent of their covered compensation to the Pension Plan. The Directors' contributions to the Pension Plan totaled $25,101 for the year ended June 30, 2017. Participants become vested in the Pension Plan at a rate of 20% per year of service until they are fully vested after five (5) years.

District employees were previously part of the Pension Plan until March 2013 when they became members of the CalPERS plan. See Note 8.

## (6) Retiree Medical Plan – Other-Post-Employment Benefits (OPEB)

### (a) Plan Description:

Effective October 1, 2011, the District established a Post-Retirement Healthcare Plan (Health Plan), and has contributed to a Section 115 Irrevocable Exclusive Benefit Trust for the pre-funding of post-employment health care costs and these monies are not included in the financial statements. Currently, the District provides health insurance for its retired employees and their dependent spouses (if married and covered on the District's plan at time of retirement), or survivors in accordance with Board resolutions. Medical coverage is provided for retired employees who are age 55 or over and who have a minimum of 10 consecutive years of full-time service with the District. The District pays 100% of the premium for the lowest cost single retiree plan plus 90% of the difference to the plan actually selected. Plus 80% of the combined retiree and spouse's medical premium until age 65. If a retiree in receipt of these benefits dies before reaching age 65, the surviving spouse will continue to receive coverage that the retiree would have been entitled to until age 65 only. When a retiree reaches age 65 and/or is eligible for Medicare, the District reimburses the retiree up to $1,800 per calendar year for the cost of Supplemental Medical Insurance and Medicare Prescription Drug (Part D) Insurance for the lifetime of the retiree only. Retirees who complete at least 25 consecutive years of full-time service receive District-paid dental and vision benefits along with the above-mentioned medical coverage and post-age 65 coverage includes Medicare Part B premium reimbursements until the time of the retiree and spouse's death. Employees hired on or after July 1, 2012 are ineligible for District-paid retiree health benefits.

Plan benefits and contribution requirements of Health Plan members and the District are established, and may be amended, by the District's Board of Directors.

The following parties are responsible for administration of the Health Plan:

- Public Agency Retirement Services (PARS) serves as Trust Administrator and Consultant
- US Bank serves as Trustee, and
- HighMark Capital Management (HighMark) serves as Investment Manager

PARS issues monthly account reports to the District and HighMark publishes quarterly performance reports.

### (b) Funding Policy:

The contribution requirements of Health Plan members and the District are established, and may be amended, by the District's Board of Directors. Currently, contributions are not required from Health Plan members. The District has fully funded the OPEB obligation with the addition of an OPEB Designated Reserve account. For the year ended June 30, 2017, the District made a total contribution of $436,769 of which $36,769 were for actual health care costs for its retirees and their covered dependents.

### (c) Annual OPEB Cost and Net OPEB Obligation:

The District's annual OPEB cost (expense) is calculated based on the Annual Required Contribution of the employer (ARC), an amount actuarially determined in accordance with Governmental Accounting Standard Board (GASB) Statement 45. The most recent GASB Statement 45 actuarial valuation is dated July 1, 2016. The ARC represents a level of funding that, if paid on an on-going basis, is projected to cover normal costs each year and to amortize any unfunded liabilities of the Plan over a period not-to-exceed 30 years.

The following table shows the components of the District's annual OPEB costs for the year ended June 30, 2017, the amount actually contributed to the Health Plan and changes in the District's net OPEB Asset.

| | | |
|---|---|---|
| Annual Required Contributions (ARC) | $ | 71,249 |
| Interest on Net OPEB Obligation (Asset) | | (7,025) |
| Adjustment to ARC | | 6,084 |
| Annual OPEB Cost | | 70,308 |
| Contribution made | | (436,769) |
| (Increase)/Decrease in Net OPEB Obligation (Asset) | | (366,461) |
| Net OPEB (Asset) at June 30, 2016 | | (117,085) |
| Net OPEB (Asset) at June 30, 2017 | $ | (483,546) |

**(d) Three-Year Trend Information:**

For fiscal year 2017, the District's annual OPEB cost (expense) of $70,308 was equal to the ARC including adjustments. Information on the annual OPEB cost, Percentage of Annual OPEB Cost Contributed, and Net OPEB Obligation (Asset) are presented below:

| Fiscal Year Ended | Annual OPEB Cost | Actual Contribution (Net of Adjustments) | Percentage of Annual OPEB Cost Contributed | Net OPEB Obligation (Asset) |
|---|---|---|---|---|
| 6/30/2015 | $ 130,586 | $ 186,351 | 142.70% | $ (92,806) |
| 6/30/2016 | 131,291 | 155,570 | 118.49% | (117,085) |
| 6/30/2017 | 70,308 | 436,769 | 621.22% | (483,546) |

**(e) Funded Status and Funding Progress:**

As of July 1, 2016, the most recent actuarial valuation date, the Health Plan was 69.59% percent funded. The actuarial accrued liability for benefits was $2,002,333, and the actuarial value of assets was $1,393,327, resulting in an Unfunded Actuarial Accrued Liability (UAAL) of $609,006. The covered payroll (annual payroll of active employees covered by the Health Plan) was $2,006,692 and the ratio of the UAAL to the covered payroll was 30.35%.

Actuarial valuations of an on-going 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 trends. Amounts determined regarding the funded status of the Health Plan and the annual required contributions of the District are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information following the notes to the basic financial statements, presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

**(f) 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 the plan members at 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.

In the July 1, 2016 actuarial valuation report, the entry age, level percent of pay cost method was used. The actuarial assumptions included a 6.00% investment rate of return (net of administrative expenses), a trend rate for healthcare costs increased to 8%, and an inflation rate of 6.00%. The District's unfunded actuarial accrued liability was paid to 89.6% fully funded in September 2016 with the difference being set aside in a designated reserve account in the amount of $209,006.

### (7) Risk Management

The District is a member of the Association of California Water Agencies Joint Powers Insurance Authority (JPIA) (Insurance Authority). The Insurance Authority is a risk-pooling self-insurance authority, created under provisions of California Government Code Sections 6500 et. seq. The purpose of the Insurance Authority is to arrange and administer programs of insurance for the pooling of self- insured losses and to purchase excess insurance coverage for participating member agencies.

The Insurance Authority bills the District a deposit premium at the beginning of each year, which is placed in a reserve fund to cover the self-insurance portion of any claim. Settlements and/or expenses related to claims during the year are then charged to the reserve. If the balance of the reserve at the end of the year is deemed too low in relation to the amount of outstanding claims, the District is billed for additional premiums. When the claims are fully settled, any amounts remaining in the reserve are refunded to the District.

At June 30, 2017, the District participated in the self-insurance programs as follows:

Property Loss - The Insurance Authority has pooled self-insurance up to $100,000 per occurrence and has purchased excess insurance coverage up to $150 million. The District has a $1,000 deductible for buildings, personal property and fixed equipment.

General, Auto and Public Officials Liability - The Insurance Authority has pooled self-insurance up to $5 million per occurrence, and has purchased excess insurance coverage up to $60 million.

Crime Policy/Fidelity Bond - The Insurance Authority has pooled self-insurance up to $100,000 per occurrence and has purchased excess insurance coverage up to $2 million. The District has a $1,000 deductible.

The District pays annual premiums to the Insurance Authority for all coverages. There were no instances in the past three years when a settlement exceeded the District’s coverage.

Workers’ Compensation – This Plan is administered through the Special District Risk Management Authority (SDRMA).The SDRMA is self-insured up to the statutory limit per occurrence.

Employer’s liability is insured up to a $5 million limit per occurrence. SDRMA maintains a Self-Insured Retention that is periodically adjusted based on market conditions.

The District pays annual premiums for all coverages. There were no instances in the past three years when a settlement exceeded the District’s coverage and the District did not file any claims against any of the policies.

## (8) Cost-Sharing Defined Benefit Plan

### (a) General Information about the Pension Plan

**Plan Descriptions** – Effective March 1, 2013, all qualified regular full-time employees working over 1,000 hours in a fiscal year are eligible to participate in the District's employee pension plan, a cost-sharing multiple employer defined benefit pension plan administered by CalPERS. The CalPERS Plans (the Plans) consists of a miscellaneous pool and a safety pool (referred to as "risk pools"), which are comprised of individual employer miscellaneous and safety rate plans, respectively. The risk pools are included within the Public Employees' Retirement Funds C (PERF C). Benefit provisions under the Plans are established and may be amended by State statute and the District's resolution. CalPERS issues publicly available reports that include a full description of the pension plans regarding benefit provisions, assumptions, membership information, and related financial information can be found on the CalPERS website at: http://www.calpers.ca.gov.

**Benefits Provided** – CalPERS provides retirement and disability benefits, annual cost of living adjustments and death benefits to plan members, who must be public employees and beneficiaries. Benefits are based on years of credited service, equal to one year of full time employment. Members with five years of total service are eligible to retire at age 50 with statutorily reduced benefits. All members are eligible for non-duty disability benefits after 10 years of service. The death benefit is one of the following: the Basic Death Benefit, the 1959 Survivor Benefit or the Optional Settlement 2W Death Benefit. The cost of living adjustments for each plan are applied as specified by the Public Employees' Retirement Law.

The Plans' provisions and benefits in effect at June 30, 2017, are summarized as follows:

| | Miscellaneous | |
|---|---|---|
| Hire Date | Prior to January 1, 2013 | On or after January 1, 2013 |
| Formula | 2.0% @55 | 2.0% @62 |
| Benefit vesting schedule | 5 years of service | 5 years of service |
| Benefit payments | monthly for life | monthly for life |
| Retirement age | 50-63 | 52-67 |
| Monthly benefits, as a % of annual salary | 1.426% to 2.418% | 1.0% to 2.5% |
| Required employee contribution rates | 7% | 6.250% |
| Required employer contribution rates | 10.880% | 6.555% |
| Pensionable Compensation Cap* | No Cap | $140,424 |

* Will increase to reflect changes in the Consumer Price Index

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

Contributions recognized by the Plans from the employer for the year ended June 30, 2017 were $252,815. The District also contributed 2% of the Classic Plan employee's contribution, or $40,886, on behalf of employees during the year. The District is phasing out contributions paid on behalf of employees by 1% per year, until completely eliminated by July 2018.

### (b) Pension Liabilities, Pension Expenses and Deferred Outflows / Inflows of Resources Related to Pensions

As of June 30, 2017, the District's reported net pension liabilities for its proportionate share of the net pension liability of the Plan is as follows:

| | Proportionate Share of Net Pension Liability |
|---|---|
| Miscellaneous | $ 1,871,472 |

The District's net pension liability was measured as the proportionate share of the net pension liability of the collective cost-sharing plan. The District's net pension liability was measured as of June 30, 2016, and the total pension liability for the Plan was used to calculate the net pension liability determined by an actuarial valuation as of June 30, 2015 rolled forward to June 30, 2016 using standard update procedures. The District's proportion of the net pension liability was based on a projection of the District's long-term share of contributions to the pension plan relative to the projected contributions of all participating employers, actuarially determined. The District's proportionate share of the net pension liability for the Plan as of June 30, 2015 and 2016 were as follows:

| | Miscellaneous |
|---|---|
| Proportion - June 30, 2015 | 0.05019% |
| Proportion - June 30, 2016 | 0.05387% |
| Change - Increase (Decrease) | 0.00368% |

At the year ended June 30, 2017, the District's recognized pension expense/(credit) of $221,761. At June 30, 2017, the District reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

| | Deferred Outflows of Resources | Deferred Inflows of Resources |
|---|---|---|
| Differences between Expected and Actual Experience | $ 14,196 | $ 2,217 |
| Changes of Assumptions | - | 134,310 |
| Differences between Projected and Actual Investment Earnings | 468,324 | - |
| Change in Employer's Proportion | 118,276 | 61,722 |
| Differences between District Contributions and Proportionate Share of Contributions | 36,680 | 32,830 |
| Pension Contributions Made Subsequent to Measurement Date | 252,815 | - |
| Total | $ 890,291 | $ 231,079 |

The amount of $252,815 reported as deferred outflows of resources related to contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended June 30, 2018. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized as pension expense as follows:

| Year ended June 30, | |
|---|---|
| 2018 | $ 22,029 |
| 2019 | 23,080 |
| 2020 | 237,908 |
| 2021 | 123,381 |
| | $ 406,398 |

**Actuarial Assumptions** – The total pension liabilities in the June 30, 2015 actuarial valuation were determined using the following actuarial assumptions.

| | Miscellaneous |
|---|---|
| Valuation Date | June 30, 2015 |
| Measurement Date | June 30, 2016 |
| Actuarial Cost Method | Entry-Age Normal Cost Method |
| Actuarial Assumptions: | |
| Discount Rate | 7.65% |
| Inflation | 2.75% |
| Salary Increases | Varies by Entry Age and Service |
| Mortality Rate Table[1] | Derived using CalPERS' Membership Data for all funds |
| Post Retirement Benefit Increase | Contract COLA up to 2.75% until Purchasing Power Protection Allowance Floor on Purchasing Power applies, 2.75% thereafter |

(1) The mortality table used was developed based on CalPERS' specific data. The table includes 20 years of mortality improvements using Society of Actuaries Scale BB. For more details on this table, please refer to the 2014 experience study report.

All other actuarial assumptions used in the June 30, 2015 valuation were based on the results of an actuarial experience study for the period from 1997 to 2011, including updates to salary increase, mortality and retirement rates. The Experience Study report may be accessed on the CalPERS website at www.calpers.ca.gov under Forms and Publications.

**Discount Rate** – The discount rate used to measure the total pension liability was 7.65 percent. To determine whether the municipal bond rate should be used in the calculation of the discount rate for each plan, CalPERS stress tested plans that would most likely result in a discount rate that would be different from the actuarially assumed discount rate. The tests revealed the assets would not run out. Therefore, the current 7.65 percent discount rate is appropriate and the use of the municipal bond rate calculation is not deemed necessary. The long-term expected discount rate of 7.65 percent is applied to all plans in the Public Employees' Retirement Fund (PERF). The cash flows used in the testing were developed assuming that both members and employers will make their required contributions on time and as scheduled in all future years. The stress test results are presented in a detailed report called "GASB Crossover Testing Report" that can be obtained at CalPERS website under the GASB 68 section.

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

In determining the long-term expected rate of return, staff took into account both short-term and long-term market return expectations as well as the expected pension fund (PERF) cash flows. Taking into account historical returns of all the Public Employees Retirement Funds' asset classes (which includes the agent plan and two cost-sharing plans or PERF A, B, and C funds), expected compound (geometric) returns were calculated over the short-term (first 10 years) and the long-term (11-60 years) using a building-block approach. Using the expected nominal returns for both short-term and long-term, the present value of benefits was calculated for each PERF fund. The expected rate of return was set by calculating the single equivalent expected return that arrived at the same present value of benefits for cash flows as the one calculated using both short-term and long-term returns. The expected rate of return was then set equal to the single equivalent rate calculated above and rounded down to the nearest one quarter of one percent.

The table below reflects long-term expected real rate of return by asset class. The rate of return was calculated using the capital market assumptions applied to determine the discount rate and asset allocation. The target allocation shown was adopted by the Board effective on July 1, 2015.

| Asset Class | Target Allocation | Long-term Expected Real Rate of Return Years 1-10 [1] | Long-term Expected Real Rate of Return Years 11 + [2] |
|---|---|---|---|
| Global Equity | 51% | 5.25% | 5.71% |
| Global Fixed Income | 20% | 0.99% | 2.43% |
| Inflation Sensitive | 6% | 0.45% | 3.36% |
| Private Equity | 10% | 6.83% | 6.95% |
| Real Estate | 10% | 4.50% | 5.13% |
| Infrastructure and Forestland | 2% | 4.50% | 5.09% |
| Liquidity | 1% | (0.55%) | (1.05%) |
| Total | 100% | | |

[1] An expected inflation of 2.5% used for this period
[2] An expected inflation of 3.0% used for this period

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

| | 1% Decrease (6.65%) | Discount Rate (7.65%) | 1% Increase (8.65%) |
|---|---|---|---|
| District's Net Pension Liability/(Asset) | $ 3,083,318 | $ 1,871,472 | $ 869,942 |

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

**Amortization of Deferred Outflows and Deferred Inflows of Resources**
Under GASB 68, gains and losses related to changes in total pension liability and fiduciary net position are recognized in pension expense systematically over time.

The first amortized amounts are recognized in pension expense for the year the gain or loss occurs. The remaining amounts are categorized as deferred outflows and deferred inflows of resources related to pensions and are to be recognized in future pension expense.

The amortization period differs depending on the source of the gain or loss:

| | |
|---|---|
| Net Difference between projected and actual earnings on pension plan investments | 5 year straight-line amortization |
| All other amounts | Straight-line amortization over the expected average remaining service lifetime (EARSL) of all members that are provided with benefits (active, inactive, and retired) as of the beginning of the measurement period |

## (9) Commitments and Contingencies

The District is involved in various litigation from time to time arising from the normal course of business. In the opinion of management and legal counsel, the District is not involved in any litigation that is expected to have a material adverse effect on the overall financial position of the District at June 30, 2017.

## (10) Subsequent Events

The District has evaluated events or transactions through October 26, 2017, the date on which the financial statements were available to be issued, for potential recognition or disclosure in the financial statements and determined no other subsequent matters require disclosure or adjustment to the accompanying financial statements.

# REQUIRED SUPPLEMENTARY INFORMATION

(Unaudited)

**Municipal Water District of Orange County**
Required Supplementary Information (Unaudited)
For the Year Ended June 30, 2017

**Other Post-Employment Benefit Plan**
**Schedule of Funding Progress**

**Retiree Healthcare Plan**

| Actuarial Valuation Date (1) | Actuarial Accrued Liability (a) | Actuarial Value of Plan Assets (AVA) (b) | Unfunded Actuarial Accrued Liability (UAAL) (a)-(b) | Funded Ratio ((b)/(a) | Annual Covered Payroll (C) | UAAL as a % of Payroll Percentage of Covered Payroll [(a)-(b)/(c)] |
|---|---|---|---|---|---|---|
| 7/1/2011 | $ 1,610,754 | $ - | $ 1,610,754 | 0.00% | $ 2,634,657 [1] | 61.14% |
| 7/1/2014 | 1,740,686 | 1,116,390 | 624,296 | 64.14% | 2,214,598 [1] | 28.19% |
| 7/1/2016 | 2,002,333 | 1,393,327 | 609,006 | 69.59% | 2,006,692 | 30.35% |

[1] Restated Annual Covered Payroll

**Municipal Water District of Orange County**
Required Supplementary Information (Unaudited)
For the Year Ended June 30, 2017

**Cost Sharing Retirement Plan**
**Schedule of the District's Proportionate Share of the Net Pension Liability**
**Last Ten Years***

| | 2017 | 2016 | 2015 |
|---|---|---|---|
| Proportion of the net pension liability | 0.05387% | 0.05019% | 0.02186% |
| Proportionate share of the net pension liability | $ 1,871,472 | $ 1,376,955 | $ 1,360,017 |
| Covered Payroll | $ 3,022,872 | $ 2,748,796 | $ 2,640,576 |
| Proportionate Share of the net pension liability as a percentage of covered payroll | 61.91% | 50.09% | 51.50% |
| Plan fiduciary net position as a percentage of the total pension liability | 75.87% | 78.40% | 79.82% |

* Fiscal year 2015 was the first year of implementation, therefore only three years are shown.

**Changes in assumptions.** The discount rate was changed from 7.5 percent (net of administrative expense) to 7.65 percent to correct for an adjustment to exclude administrative expense.

**Notes to Schedule**

| | | | |
|---|---|---|---|
| Fiscal Year End: | 6/30/2017 | 6/30/2016 | 6/30/2015 |
| Valuation Date: | 6/30/2014 | 6/30/2013 | 6/30/2012 |

Methods and assumptions used to determine contribution rates:

| | | | |
|---|---|---|---|
| Actuarial Cost Method | Entry Age | Entry Age | Entry Age |
| Amortization Method | Level Percent of Payroll | Level Percent of Payroll | Level Percent of Payroll |
| Asset Valuation Method | Market Value | Market Value | Market Value |
| Discount Rate | 7.65% | 7.65% | 7.50% |
| Projected Salary Increase | 3.30% to 14.20% depending on Age, Service, and type of employment | 3.30% to 14.20% depending on Age, Service, and type of employment | 3.30% to 14.20% depending on Age, Service, and type of employment |
| Inflation | 2.75% | 2.75% | 2.75% |
| Payroll Growth | 3.00% | 3.00% | 3.00% |
| Individual Salary Growth | A merit scale varying by duration of employment coupled with an assumed annual inflation growth of 2.75% and an annual production growth of 0.25%. | A merit scale varying by duration of employment coupled with an assumed annual inflation growth of 2.75% and an annual production growth of 0.25%. | A merit scale varying by duration of employment coupled with an assumed annual inflation growth of 2.75% and an annual production growth of 0.25%. |

## Cost Sharing Retirement Plan
## Schedule of Contributions
## Last Ten Years*

| | 2017 | 2016 | 2015 |
|---|---|---|---|
| Actuarially determined contributions | $ 252,815 | $ 220,517 | $ 288,065 |
| Contributions in relation to the actuarially determined contribution | (252,815) | (220,517) | (288,065) |
| Contribution deficiency (excess) | $ - | $ - | $ - |
| Covered Payroll | $ 3,022,872 | $ 2,748,796 [1] | $ 2,640,576 [1] |
| Contributions as a percentage of covered-employee payroll | 8.36% | 8.02% | 10.91% |

* Fiscal year 2015 was the first year of implementation, therefore only three years are shown.

[1] Restated Covered Payroll