



***CITY OF HERCULES
CALIFORNIA***

**ANNUAL FINANCIAL REPORT
For the fiscal year ended
June 30, 2011**

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CITY OF HERCULES

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For the fiscal year ended June 30, 2011

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FINANCIAL SECTION

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INDEPENDENT AUDITOR'S REPORT

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

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, 2011, which collectively comprise the City's basic financial statements, as listed in the table of contents. These financial statements are the responsibility of the City's management. 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* as 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 of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the basic 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 of Hercules, California, as of June 30, 2011, and the respective changes in financial position and cash flows, where applicable thereof, for the fiscal year then ended, in conformity with accounting principles generally accepted in the United States of America.

The accompanying financial statements have been prepared assuming that the City and Redevelopment Agency will continue as going concerns, that is, the presumption that the City and Agency will be able to pay their expenses and debt service as they become due. As discussed in Note 21, there are conditions which raise doubts about this presumption, including the following:

- As of June 30, 2011, the City has experienced a 45% decrease in its operating cash balances, down from \$31.7 million to \$14.7 million. General fund expenditures exceeded revenues by \$2.5 million in 2011 and \$4.2 million in 2010. The Redevelopment Agency negotiated the subordination of pass through claims totaling \$1.3 million to various taxing entities in 2011. The subordination allowed the Redevelopment Agency to use the \$1.3 million towards its debt service obligations. The City defaulted on repayment of a \$3.9 million loan to the California Housing Finance Agency and is working with the Agency to modify repayment terms.
- As disclosed in Note 20, the State of California adopted ABX1 26 on June 28, 2011, which suspended all new redevelopment activities except for limited specified activities as of that date and dissolved Redevelopment Agencies. However, on August 11, 2011, the California Supreme Court issued a partial stay on ABX1 26 and on December 28, 2011 validated its provisions. As a result, the Redevelopment Agency was dissolved on January 31, 2012 and its non-housing activities assumed by a Successor Agency.

Management's plans regarding these matters are also described in Note 20. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

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

Management has omitted the Management's Discussion and Analysis that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing information, although not 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. Our opinion on the basic financial statements is not affected by this missing information.

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

In accordance with the *Government Auditing Standards*, we have also issued a report dated August 9, 2013, on our consideration of the City's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.



Roseville, California
August 9, 2013

BASIC FINANCIAL STATEMENTS

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GOVERNMENT-WIDE FINANCIAL STATEMENTS

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CITY OF HERCULES

Statement of Net Assets
June 30, 2011

	Primary Government		Totals
	Governmental Activities	Business-Type Activities	
ASSETS			
Cash and investments	\$ 12,086,788	5,583,478	\$ 17,670,266
Cash with fiscal agent	18,817,662	16,398,191	35,215,853
Accounts receivable	2,748,094	499,579	3,247,673
Interest receivable	429,916	1,406	431,322
Prepaid expenses	6,264	--	6,264
Inventories	19,028	262,156	281,184
Loans receivable	14,665,097	--	14,665,097
Lease receivable	9,492,840	--	9,492,840
Land held for resale	22,267,474	13,774,145	36,041,619
Accumulated project costs	40,094,199	--	40,094,199
Internal balances	1,321,057	(1,321,057)	--
Deferred charges - net of accumulated amortization	3,995,636	611,618	4,607,254
Other post employment benefit asset	221,686	--	221,686
Capital assets:			
Nondepreciable	34,483,167	2,953,440	37,436,607
Depreciable, net of accumulated depreciation	76,531,503	18,480,433	95,011,936
Total Assets	<u>237,180,411</u>	<u>\$ 57,243,389</u>	<u>\$ 294,423,800</u>
LIABILITIES			
Accounts payable	\$ 11,009,901	\$ 2,399,547	\$ 13,409,448
Accrued wages	577,851	77,044	654,895
Accrued interest payable	3,798,300	480,958	4,279,258
Deposits payable	93,825	--	93,825
Claims and judgments payable	131,670	--	131,670
Noncurrent liabilities:			
Due within one year	8,050,026	260,072	8,310,098
Due in more than one year	148,446,891	23,958,437	172,405,328
Total Liabilities	<u>172,108,464</u>	<u>27,176,058</u>	<u>199,284,522</u>
NET ASSETS			
Invested in capital assets, net of related debt	110,726,108	13,643,827	124,369,935
Restricted for:			
Debt service	2,200,570	--	2,200,570
Public safety	64,384	--	64,384
Streets and roads	3,401,761	--	3,401,761
Development	72,073,893	--	72,073,893
Unrestricted	(123,394,769)	16,423,504	(106,971,265)
Total Net Assets	<u>65,071,947</u>	<u>30,067,331</u>	<u>95,139,278</u>
Total Liabilities and Net Assets	<u>\$237,180,411</u>	<u>\$ 57,243,389</u>	<u>\$ 294,423,800</u>

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

CITY OF HERCULES

Statement of Activities
For the Year Ended June 30, 2011

Functions/Programs	Expenses	Program Revenues		
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions
Primary Government:				
Governmental activities:				
General government	\$ 6,269,958	\$ 682,349	\$ 60,929	--
Public safety	6,320,275	312,130	118,307	--
Public works	5,118,202	1,213,020	1,088,331	--
Parks and recreation	2,923,255	1,639,623	--	--
Community development	11,148,193	337,561	--	--
Interest on long term debt	10,086,698	--	--	--
Total governmental activities	41,866,581	4,184,683	1,267,567	--
Business-Type Activities:				
Sewer	3,522,905	4,687,549	--	--
Hercules Municipal Utility	3,671,524	2,814,936	--	--
Total business-type activities	7,194,429	7,502,485	--	--
Total government	\$ 49,061,010	\$11,687,168	\$ 1,267,567	\$ --

General revenues, transfers and special items

Taxes:

Secured and unsecured property taxes

Sales and use taxes

Other taxes

Unrestricted motor vehicle taxes in-lieu

Use of money and property

Miscellaneous revenue

Transfers

Special items

Total general revenues, transfers and special items

Change in net assets

Net Assets - Beginning of Year, Restated

Net Assets - End of Year

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

Net (Expense) Revenue and
Changes in Net Assets

Primary Government		
Governmental Activities	Business-Type Activities	Total
\$ (5,526,680)		\$ (5,526,680)
(5,889,838)		(5,889,838)
(2,816,851)		(2,816,851)
(1,283,632)		(1,283,632)
(10,810,632)		(10,810,632)
(10,086,698)		(10,086,698)
<u>(36,414,331)</u>	--	<u>(36,414,331)</u>
	1,164,644	1,164,644
	(856,588)	(856,588)
--	<u>308,056</u>	<u>308,056</u>
<u>(36,414,331)</u>	308,056	<u>(36,106,275)</u>
11,887,015	--	11,887,015
1,243,835	--	1,243,835
2,471,349	--	2,471,349
1,567,903		1,567,903
3,481,783	728,643	4,210,426
2,716,016	16,063	2,732,079
1,908	(1,908)	--
2,874,410	(2,874,410)	--
<u>26,244,219</u>	<u>(2,131,612)</u>	<u>24,112,607</u>
(10,170,112)	(1,823,556)	(11,993,668)
<u>75,242,059</u>	<u>31,890,887</u>	<u>107,132,946</u>
<u>\$ 65,071,947</u>	<u>\$ 30,067,331</u>	<u>\$ 95,139,278</u>

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

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FUND FINANCIAL STATEMENTS

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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.

Redevelopment Agency Special Revenue Fund – This fund is used to account for the operating costs of the Redevelopment Agency and for the tax increment monies to be expended for low and moderate income housing purposes.

Redevelopment Agency Debt Service Fund – This fund is used to account for the accumulation of resources used for the payment of principal and interest on the Redevelopment Agency tax allocation bonds and notes payable.

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.

Redevelopment Agency Capital Projects Fund – This fund is used to account for major capital projects undertaken by the Redevelopment Agency.

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.

CITY OF HERCULES

Balance Sheet
Governmental Funds
June 30, 2011

	General Fund	Redevelopment Agency Special Revenue Fund	Redevelopment Agency Debt Service Fund
	<u> </u>	<u> </u>	<u> </u>
ASSETS			
Cash and investments	\$ 2,358,183	\$ --	\$ 51,419
Cash and investments with fiscal agent	--	--	16,355,949
Accounts receivable	1,164,312	357,931	5,742
Interest receivable	15,328	414,588	--
Prepays	6,264	--	--
Due from other funds	281,702	803,439	--
Inventories	8,015	--	--
Loans receivable	2,511,199	12,153,898	--
Lease receivable	--	--	--
Land held for resale	9,243,352	739,059	--
Accumulated project costs	--	--	--
Advances to other funds	13,895,004	--	--
Total Assets	<u><u>\$ 29,483,359</u></u>	<u><u>\$ 14,468,915</u></u>	<u><u>\$ 16,413,110</u></u>
 LIABILITIES			
Accounts payable	\$ 351,197	\$ 7,350,092	\$ 65,876
Accrued wages	492,108	51,412	--
Deposits payable	93,825	--	--
Claims and judgments payable	131,670	--	--
Deferred revenue	2,511,199	12,568,486	--
Due to other funds	753,631	--	1,361,575
Advances from other funds	--	11,622,856	--
Total Liabilities	<u><u>4,333,630</u></u>	<u><u>31,592,846</u></u>	<u><u>1,427,451</u></u>
 FUND BALANCES			
Nonspendable	9,257,631	739,059	--
Restricted	--	--	14,985,659
Assigned	2,100,604	--	--
Unassigned	13,791,494	(17,862,990)	--
Total Fund Balances	<u><u>25,149,729</u></u>	<u><u>(17,123,931)</u></u>	<u><u>14,985,659</u></u>
 Total Liabilities and Fund Balances	<u><u>\$ 29,483,359</u></u>	<u><u>\$ 14,468,915</u></u>	<u><u>\$ 16,413,110</u></u>

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

Hercules Public Financing Authority Debt Service Fund	Redevelopment Agency Capital Projects Fund	Other Governmental Funds	Total
\$ --	\$ --	\$ 7,798,908	\$ 10,208,510
2,461,713	--	--	18,817,662
--	--	1,219,278	2,747,263
--	--	--	429,916
--	--	--	6,264
--	1,683,631	1,813,558	4,582,330
--	--	11,013	19,028
--	--	--	14,665,097
9,492,840	--	--	9,492,840
5,545,919	3,862,040	2,877,104	22,267,474
--	40,094,199	--	40,094,199
--	--	1,940,012	15,835,016
<u>\$ 17,500,472</u>	<u>\$ 45,639,870</u>	<u>\$ 15,659,873</u>	<u>\$139,165,599</u>
\$ --	\$ 2,801,489	\$ 289,665	\$ 10,858,319
--	--	26,908	570,428
--	--	--	93,825
--	--	--	131,670
9,492,840	--	653,221	25,225,746
261,143	2,282,782	676,830	5,335,961
--	2,891,103	--	14,513,959
<u>9,753,983</u>	<u>7,975,374</u>	<u>1,646,624</u>	<u>56,729,908</u>
5,545,919	43,956,239	2,888,117	62,386,965
2,200,570	--	11,187,937	28,374,166
--	--	--	2,100,604
--	(6,291,743)	(62,805)	(10,426,044)
<u>7,746,489</u>	<u>37,664,496</u>	<u>14,013,249</u>	<u>82,435,691</u>
<u>\$ 17,500,472</u>	<u>\$ 45,639,870</u>	<u>\$ 15,659,873</u>	<u>\$139,165,599</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 Assets - Governmental Activities June 30, 2011

Fund Balance - total governmental funds (page 9)	\$ 82,435,691
Amounts reported for governmental activities in the statement of net assets are different because:	
Other long-term assets are not available to pay for current-period expenditures and, therefore, are deferred in the governmental funds.	
Other post employment benefit asset	221,686
Deferred costs	3,995,636
Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the governmental funds.	110,156,779
Deferred revenues represent amounts that are not available to fund current expenditures and, therefore, are not reported in the governmental funds.	25,225,746
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 assets.	3,321,722
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	(3,798,300)
Revenue bonds payable	(17,302,995)
Bonds payable	(131,187,068)
Notes payable	(5,697,070)
Capital leases payable	(1,803,229)
Compensated absences	<u>(496,651)</u>
Net assets of governmental activities (page 3)	<u>\$ 65,071,947</u>

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

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CITY OF HERCULES

Statement of Revenues, Expenditures and Changes in Fund Balances
Governmental Funds
For the Year Ended June 30, 2011

	General Fund	Redevelopment Agency Special Revenue Fund	Redevelopment Agency Debt Service Fund
Revenues:			
Taxes and assessments	\$ 5,363,244	\$ 9,768,553	\$ --
Licenses and permits	467,194	--	--
Fines and forfeitures	57,548	--	--
Use of money and property	1,355,086	(223,075)	41,571
Intergovernmental	1,628,832	--	--
Program income	--	1,182,986	--
Charges for services	1,999,799	2,039	--
Other revenues	951,373	340,139	--
Total Revenues	<u>11,823,076</u>	<u>11,070,642</u>	<u>41,571</u>
Expenditures:			
Current:			
General government	4,693,937	173,910	--
Public safety	6,409,105	--	--
Streets and public works	538,560	--	--
Community development	1,114,363	5,708,416	4,066,174
Recreation and culture	2,695,844	--	--
Lease expense	780,504	--	--
Capital outlay	--	--	--
Debt service:			
Principal	--	--	3,275,000
Interest and fiscal agent fees	--	--	7,419,293
Total Expenditures	<u>16,232,313</u>	<u>5,882,326</u>	<u>14,760,467</u>
Excess (Deficiency) of Revenues Over (Under) Expenditures	<u>(4,409,237)</u>	<u>5,188,316</u>	<u>(14,718,896)</u>
Other Financing Sources (Uses):			
Transfers in	579,722	40,000	9,860,617
Transfers out	(57,839)	(12,113,676)	(16,300,014)
Total Other Financing Sources (Uses)	<u>521,883</u>	<u>(12,073,676)</u>	<u>(6,439,397)</u>
Special items	<u>(1,928,917)</u>	<u>--</u>	<u>11,206,237</u>
Net Changes in Fund Balances	<u>(5,816,271)</u>	<u>(6,885,360)</u>	<u>(9,952,056)</u>
Fund Balances, Beginning of Year - Restated	<u>30,966,000</u>	<u>(10,238,571)</u>	<u>24,937,715</u>
Fund Balances, End of Year	<u>\$ 25,149,729</u>	<u>\$ (17,123,931)</u>	<u>\$ 14,985,659</u>

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

Hercules Public Financing Authority Debt Service Fund	Redevelopment Agency Capital Projects Fund	Other Governmental Funds	Total
\$ --	\$ --	\$ 2,241,464	\$ 17,373,261
--	--	--	467,194
--	--	--	57,548
1,657,637	2,799	631,826	3,465,844
--	--	1,244,212	2,873,044
--	--	--	1,182,986
--	--	--	2,001,838
--	--	1,884	1,293,396
<u>1,657,637</u>	<u>2,799</u>	<u>4,119,386</u>	<u>28,715,111</u>
--	--	--	4,867,847
--	--	--	6,409,105
--	--	2,173,970	2,712,530
--	--	32,034	10,920,987
--	--	--	2,695,844
--	--	--	780,504
--	3,377,811	2,036,321	5,414,132
365,000	--	115,686	3,755,686
1,182,765	1,148,332	89,413	9,839,803
<u>1,547,765</u>	<u>4,526,143</u>	<u>4,447,424</u>	<u>47,396,438</u>
<u>109,872</u>	<u>(4,523,344)</u>	<u>(328,038)</u>	<u>(18,681,327)</u>
--	19,363,358	1,366,544	31,210,241
(260,642)	--	(2,499,691)	(31,231,862)
<u>(260,642)</u>	<u>19,363,358</u>	<u>(1,133,147)</u>	<u>(21,621)</u>
<u>(1,157,331)</u>	<u>(4,645,180)</u>	<u>(600,399)</u>	<u>2,874,410</u>
<u>(1,308,101)</u>	<u>10,194,834</u>	<u>(2,061,584)</u>	<u>(15,828,538)</u>
<u>9,054,590</u>	<u>27,469,662</u>	<u>16,074,833</u>	<u>98,264,229</u>
<u>\$ 7,746,489</u>	<u>\$ 37,664,496</u>	<u>\$ 14,013,249</u>	<u>\$ 82,435,691</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, 2011

Net change to fund balance - total governmental funds (page 13) \$ (15,828,538)

Amounts reported for governmental activities in the
statement of activities are different because:

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.

Expenditures for general capital assets, infrastructure, and other related capital assets adjustments	\$ 5,387,417	
Less: current year depreciation	<u>(3,591,078)</u>	1,796,339

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		122,109
--	--	---------

Long-term debt proceeds provide current resources to governmental
funds, but issuing debt increases long-term liabilities in the statements of
net asset. Repayment of bond principal is an expenditure in the
governmental funds, but the repayment reduced long-term liabilities
in the statement of net assets. Also governmental funds report the effect
issuance costs and pension assets when debt is first issued, whereas
these amounts are deferred and amortized in the statement of activities.

Principal repayments	3,810,639	
Amortization of bond issuance costs, premiums and discounts	<u>(110,718)</u>	3,699,921

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.

Change in compensated absences		187,464
Change in accrued interest payable		<u>(136,177)</u>

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.		33,074
--	--	--------

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.		<u>(44,304)</u>
--	--	-----------------

Change in net assets of governmental activities (page 5) \$ (10,170,112)

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 Pinoie 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.

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CITY OF HERCULES

Statement of Fund Net Assets
Proprietary Funds
June 30, 2011

	Business-Type Activities - Enterprise Funds			Governmental
	Sewer Fund	Hercules Municipal Utility Fund	Totals	Internal Service Funds
ASSETS				
Current Assets:				
Cash and investments	\$ 4,384,130	\$ 1,199,348	\$ 5,583,478	\$ 1,878,278
Cash with fiscal agent	9,140,352	7,257,839	16,398,191	--
Accounts receivable - net	4,886	494,693	499,579	831
Interest receivable	--	1,406	1,406	--
Due from other funds	--	--	--	753,631
Inventory	--	262,156	262,156	--
Land held for resale	8,500,651	5,273,494	13,774,145	--
Total Current Assets	22,030,019	14,488,936	36,518,955	2,632,740
Noncurrent Assets:				
Deferred bond issuance costs	345,251	266,367	611,618	--
Advances to other funds	313,047	--	313,047	--
Capital assets:				
Non-depreciable :				
Land	150,000	--	150,000	--
Construction in progress	2,203,028	600,412	2,803,440	--
Total Nondepreciable Capital Assets	2,353,028	600,412	2,953,440	--
Depreciable:				
Buildings and improvements	11,335,199	--	11,335,199	--
Infrastructure	8,286,603	8,988,621	17,275,224	--
Machinery and equipment	117,117	89,187	206,304	3,128,749
Total Depreciable Capital Assets	19,738,919	9,077,808	28,816,727	3,128,749
Less Accumulated Depreciation	(9,084,149)	(1,252,145)	(10,336,294)	(2,270,858)
Net Depreciable Capital Assets	10,654,770	7,825,663	18,480,433	857,891
Net Capital Assets	13,007,798	8,426,075	21,433,873	857,891
Total Noncurrent Assets	13,666,096	8,692,442	22,358,538	857,891
Total Assets	\$ 35,696,115	\$ 23,181,378	\$ 58,877,493	\$ 3,490,631

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

continued

CITY OF HERCULES

Statement of Fund Net Assets (continued)
Proprietary Funds
June 30, 2011

	Business-Type Activities - Enterprise Funds			Governmental
	Sewer Fund	Hercules Municipal Utility Fund	Totals	Internal Service Funds
LIABILITIES				
Current Liabilities:				
Accounts payable	\$ 1,194,987	\$ 1,204,560	\$ 2,399,547	151,582
Salaries and benefits payable	33,609	43,435	77,044	7,423
Accrued interest payable	201,603	279,355	480,958	--
Compensated absences	18,531	11,541	30,072	9,904
Long term debt, due within one year	230,000	--	230,000	--
Total Current Liabilities	<u>1,678,730</u>	<u>1,538,891</u>	<u>3,217,621</u>	<u>168,909</u>
Noncurrent Liabilities:				
Advances from other funds	--	1,634,104	1,634,104	--
Long term debt, due in more than one year	11,324,118	12,634,319	23,958,437	--
Total Noncurrent Liabilities	<u>11,324,118</u>	<u>14,268,423</u>	<u>25,592,541</u>	<u>--</u>
Total Liabilities	<u>13,002,848</u>	<u>15,807,314</u>	<u>28,810,162</u>	<u>168,909</u>
NET ASSETS				
Invested in capital assets, net of related debt	10,594,232	3,049,595	13,643,827	857,891
Unrestricted	12,099,035	4,324,469	16,423,504	2,463,831
Total Net Assets	<u>22,693,267</u>	<u>7,374,064</u>	<u>30,067,331</u>	<u>3,321,722</u>
Total Liabilities and Net Assets	<u>\$ 35,696,115</u>	<u>\$ 23,181,378</u>	<u>\$ 58,877,493</u>	<u>\$ 3,490,631</u>

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

CITY OF HERCULES

Statement of Revenues, Expenses and Changes in Fund Net Assets
Proprietary Funds
For the Year Ended June 30, 2011

	Business-Type Activities - Enterprise Funds			Governmental
	Sewer Fund	Hercules Municipal Utility Fund	Totals	Internal Service Funds
Operating Revenues:				
Sales and charges for services	\$ 4,687,549	\$ 2,814,936	\$ 7,502,485	\$ 624,043
Other operating revenue	--	16,063	16,063	112,959
Total Operating Revenues	<u>4,687,549</u>	<u>2,830,999</u>	<u>7,518,548</u>	<u>737,002</u>
Operating Expenses:				
Salaries and benefits	467,855	500,337	968,192	414,271
Services and supplies	2,227,941	564,608	2,792,549	43,241
Purchase of electricity	--	1,644,526	1,644,526	--
Depreciation	363,404	215,746	579,150	330,254
Total Operating Expenses	<u>3,059,200</u>	<u>2,925,217</u>	<u>5,984,417</u>	<u>787,766</u>
Operating Income (Loss)	<u>1,628,349</u>	<u>(94,218)</u>	<u>1,534,131</u>	<u>(50,764)</u>
Non-Operating Revenue (Expenses):				
Interest income	688,534	40,109	728,643	(7,681)
Interest expense	(463,705)	(522,922)	(986,627)	--
Gain (loss) on sale of capital assets	--	--	--	(9,388)
Fees and taxes	--	(223,385)	(223,385)	--
Total Non-Operating Revenue (Expenses)	<u>224,829</u>	<u>(706,198)</u>	<u>(481,369)</u>	<u>(17,069)</u>
Income (Loss) Before Transfers and Special Item	<u>1,853,178</u>	<u>(800,416)</u>	<u>1,052,762</u>	<u>(67,833)</u>
Transfers:				
Transfers in	--	--	--	23,529
Transfers out	--	(1,908)	(1,908)	--
Special item	<u>(1,773,929)</u>	<u>(1,100,481)</u>	<u>(2,874,410)</u>	<u>--</u>
Change in Net Assets	<u>79,249</u>	<u>(1,902,805)</u>	<u>(1,823,556)</u>	<u>(44,304)</u>
Net Assets - Beginning of Year, Restated	<u>22,614,018</u>	<u>9,276,869</u>	<u>31,890,887</u>	<u>3,366,026</u>
Net Assets - End of Year	<u>\$22,693,267</u>	<u>\$ 7,374,064</u>	<u>\$30,067,331</u>	<u>\$ 3,321,722</u>

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

CITY OF HERCULES

Statement of Cash Flows
Proprietary Funds
For the Year Ended June 30, 2011

	Business-Type Activities - Enterprise Funds			Governmental
	Sewer Fund	Hercules Municipal Utility Fund	Total Enterprise Funds	Internal Service Funds
CASH FLOWS FROM OPERATING ACTIVITIES:				
Cash receipts from customers	\$ 4,683,118	\$ 2,665,163	\$ 7,348,281	\$ --
Cash receipts from internal fund services provided	--	--	--	736,653
Cash paid to suppliers for goods and services	(1,523,655)	(1,972,067)	(3,495,722)	(81,770)
Cash paid to employees for services	(438,694)	(485,201)	(923,895)	(436,014)
Net Cash Provided (Used) by Operating Activities	2,720,769	207,895	2,928,664	218,869
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:				
Interfund loans	--	(22,440)	(22,440)	(753,631)
Advances to other funds	(894,627)	--	(894,627)	--
Fees and taxes	--	(223,385)	(223,385)	--
Transfers in	--	--	--	23,529
Transfers out	--	(1,908)	(1,908)	--
Net Cash Provided (Used) by Noncapital Financing Activities	(894,627)	(247,733)	(1,142,360)	(730,102)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:				
Proceeds from issuance of debt	11,208,867	5,425,280	16,634,147	--
Payments related to the acquisition of capital assets	(2,829,374)	(332,431)	(3,161,805)	(41,574)
Interest repayments related to capital purposes	(262,102)	(387,556)	(649,658)	--
Net Cash Provided (Used) by Capital and Related Financing Activities	8,117,391	4,705,293	12,822,684	(41,574)
CASH FLOWS FROM INVESTING ACTIVITIES				
Interest received (paid)	688,534	38,703	727,237	(7,681)
Net Cash Provided (Used) by Investing Activities	688,534	38,703	727,237	(7,681)
Net Increase (Decrease) in Cash and Cash Equivalents	10,632,067	4,704,158	15,336,225	(560,488)
Cash and Cash Equivalents, Beginning of Year, restated	2,892,415	3,753,029	6,645,444	2,438,766
Cash and Cash Equivalents, End of Year	\$ 13,524,482	\$ 8,457,187	\$ 21,981,669	\$ 1,878,278
Reconciliation of Cash and Cash Equivalents to the Statement of Fund Net Assets				
Cash and investments	\$ 4,384,130	\$ 1,199,348	\$ 5,583,478	\$ 1,878,278
Cash with fiscal agent	9,140,352	7,257,839	16,398,191	--
Total Cash and Cash Equivalents	\$ 13,524,482	\$ 8,457,187	\$ 21,981,669	\$ 1,878,278
Noncash Investing, Capital, and Financing Activities:				
Transfer of land from the City's Redevelopment Agency	\$ 8,500,651	\$ 5,273,494	\$ 13,774,145	\$ --

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, 2011

	Business-Type Activities - Enterprise Funds			Governmental
	Sewer Fund	Hercules Municipal Utility Fund	Total Enterprise Funds	Internal Service Funds
Reconciliation of Operating Income (Loss) to Net Cash Provided (Used) by Operating Activities:				
Operating income (loss)	\$ 1,628,349	\$ (94,218)	\$ 1,534,131	\$ (50,764)
Adjustments to reconcile operating income (loss) to net cash provided (used) by operating activities:				
Depreciation	363,404	215,746	579,150	330,254
Changes in assets and liabilities:				
(Increase) decrease in:				
Receivables	(4,431)	(165,836)	(170,267)	(349)
Inventory	--	(2,512)	(2,512)	--
Other assets	--	--	--	--
Increase (decrease) in:				
Accounts payable	704,286	239,579	943,865	(38,529)
Accrued salaries and benefits	22,062	24,565	46,627	(13,877)
Compensated absences	7,099	(9,429)	(2,330)	(7,866)
Net Cash Provided (Used) by Operating Activities	\$ 2,720,769	\$ 207,895	\$ 2,928,664	\$ 218,869

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

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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 police officers.

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.

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CITY OF HERCULES

**Statement of Fiduciary Net Assets
June 30, 2011**

	<u>OPEB Trust Fund</u>	<u>Agency Funds</u>
ASSETS		
Cash and investments	\$ 39,871	\$ 7,221,021
Cash and investments with fiscal agent	923,822	1,445,515
Accounts receivable	--	646,205
Prepays	--	6,763
	<hr/>	<hr/>
Total Assets	\$ 963,693	\$ 9,319,504
	<hr/>	<hr/>
LIABILITIES		
Accounts payable	\$ 6,867	\$ 66,888
Compensated absences	--	17,286
Deposits payable	--	9,235,330
	<hr/>	<hr/>
Total Liabilities	6,867	9,319,504
	<hr/>	<hr/>
NET ASSETS		
Held in trust for others	956,826	--
	<hr/>	<hr/>
Total Net Assets	\$ 956,826	\$ --
	<hr/>	<hr/>

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

CITY OF HERCULES

**Statement of Changes in Fiduciary Net Assets
For the Year Ended June 30, 2011**

	<u>OPEB Trust Fund</u>
Additions	
Contributions from City	\$ 216,000
Investment income	<u>123,310</u>
Total Additions	<u>339,310</u>
Deductions	
Employee benefits	<u>35,464</u>
Total Deductions	<u>35,464</u>
Change in net assets	303,846
Net Assets - Beginning of Year	<u>652,980</u>
Net Assets - End of Year	<u><u>\$ 956,826</u></u>

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

CITY OF HERCULES

Notes to Basic Financial Statements
June 30, 2011

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 Redevelopment Agency

The Hercules Redevelopment Agency (Agency) was established in 1981. It is responsible for the rehabilitation and economic revitalization of certain areas within the City. The Agency provides services entirely for the benefit of the City of Hercules. The governing body is substantially the same as the primary government and the City and the component unit are financially interdependent; hence, the unit is blended with the primary government.

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 units from the City's Finance Department.

CITY OF HERCULES

Notes to Basic Financial Statements
June 30, 2011

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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 Assets 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.

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 Assets. The Statement of Activities presents changes in net assets. 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 Assets 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

The City applies all applicable GASB pronouncements (including all NCGA Statements and Interpretations currently in effect) as well as the following pronouncements issued on or before November 30, 1989, to the business-type activities, unless those pronouncements conflict with or contradict GASB pronouncements; Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board (APB) Opinions, and Accounting Research Bulletins (ARB) of the Committee on Accounting Procedure. The City applies all applicable FASB Statements and Interpretations issued after November 30, 1989, except those that conflict with or contradict GASB pronouncements.

CITY OF HERCULES

Notes to Basic Financial Statements
June 30, 2011

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

B. Basis of Accounting and Measurement Focus (continued)

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 assets as presented in these statements to the net assets 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.

Redevelopment Agency Special Revenue Fund accounts for the operating costs of the Redevelopment Agency and for the tax increment monies to be expended for low and moderate income housing purposes.

Redevelopment Agency Debt Service Fund accounts for the accumulation of resources used for the payment of principal and interest on the Redevelopment Agency tax allocation bonds and notes payable.

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.

Redevelopment Agency Capital Projects Fund accounts for major capital projects undertaken by the Redevelopment Agency.

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.

CITY OF HERCULES

Notes to Basic Financial Statements
June 30, 2011

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

B. Basis of Accounting and Measurement Focus (continued)

Governmental Fund Financial Statements (continued)

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 Assets, a Statement of Revenues, Expenses, and Changes in Net Assets, 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.

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 Assets. The Statement of Revenues, Expenses, and Changes in Net Assets presents increases (revenues) and decreases (expenses) in total net assets. 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 Assets. 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.

CITY OF HERCULES

Notes to Basic Financial Statements
June 30, 2011

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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.

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

CITY OF HERCULES

Notes to Basic Financial Statements
June 30, 2011

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

E. Capital Assets (continued)

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

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. 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, as well as issuance costs, 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. Issuance costs are reported as deferred charges.

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.

CITY OF HERCULES

Notes to Basic Financial Statements June 30, 2011

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

G. 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.

H. Net Assets

In the Government-wide Financial Statements, net assets are classified in the following categories:

Invested in Capital Assets, Net of Related Debt – 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 Assets – This amount is all net assets that do not meet the definition of "invested in capital assets, net of related debt" or "restricted net assets" as defined above.

Included in total restricted net assets at June 30, 2011 are net assets restricted by enabling legislation of \$5,277,798.

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, 2011, 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.

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.

CITY OF HERCULES

Notes to Basic Financial Statements
June 30, 2011

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

I. Use of Restricted/Unrestricted Net Assets

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

J. 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

K. 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.

L. New Accounting Pronouncements

The City implemented the requirements of GASB Statements No. 54 during the fiscal year ended June 30, 2011.

Governmental Accounting Standards Board Statement No. 54

For the fiscal year ended June 30, 2011, the City implemented Governmental Accounting Standards Board No. 54 (GASB 54), *Fund Balance Reporting and Governmental Fund Type Definitions*. The requirements of this statement are effective for financial statement periods beginning after June 15, 2010.

GASB 54 establishes new accounting and financial reporting standards for all governments that report governmental funds. The statement enhances the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied and it clarifies the existing governmental fund type definitions to improve the comparability of governmental fund statements. GASB 54 establishes fund balance classifications that are hierarchy based on the extent to which a government is bound to observe constraints imposed upon the use of the resources reporting in governmental funds.

CITY OF HERCULES

Notes to Basic Financial Statements
June 30, 2011

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 Assets:

Cash and investments	\$ 17,670,266
Cash and investments with fiscal agents	35,215,853

Statement of Fiduciary Net Assets:

Cash and investments	7,260,892
Cash and investments with fiscal agents	2,369,337

Total	<u>\$ 62,516,348</u>
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Cash and investments as of June 30, 2011 consist of the following:

Cash on hand	\$ 2,655
Deposits with financial institutions	3,042,743
Investments	<u>59,470,950</u>
Total	<u>\$ 62,516,348</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	None
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 Basic Financial Statements
June 30, 2011

NOTE 2: CASH AND INVESTMENTS (CONTINUED)

At June 30, 2011, the City held two negotiable certificates of deposit which were in excess of their investment policy's \$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 Basic Financial Statements
June 30, 2011

NOTE 2: CASH AND INVESTMENTS (CONTINUED)

Disclosures Relating to Interest Rate Risk (continued)

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	Totals	Remaining Maturity (in Months)					
		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	\$ 6,051,101	\$ 6,051,101	\$ -	\$ -	\$ -	\$ -	\$ -
Certificates of Deposit	699,861	-	204,325	-	-	495,536	-
U.S. Agency Securities	15,134,798	144,238	188,626	439,300	997,380	13,365,254	-
Held by Debt Trustees:							
Money Market Funds	34,618,004	34,618,004	-	-	-	-	-
Guaranteed Investment Contracts	1,782,430	-	-	-	-	-	1,782,430
State Investment Pool	1,184,756	1,184,756	-	-	-	-	-
Total	\$ 59,470,950	\$ 41,998,099	\$ 392,951	\$ 439,300	\$ 997,380	\$ 13,860,790	\$ 1,782,430

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 Basic Financial Statements
June 30, 2011

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	\$ 6,051,101	N/A	N/A	\$ -	\$ -	\$ -	\$ 6,051,101
Certificates of Deposit	699,861	N/A	N/A	-	-	-	699,861
U.S. Agency Securities Held by Debt Trustees:	15,134,798	N/A	N/A	7,228,533	-	-	7,906,265
Money Market Funds	34,618,004	N/A	N/A	-	-	-	34,618,004
Guaranteed Investment Contracts	1,782,430	N/A	N/A	891,452	-	-	890,978
State Investment Pool	1,184,756	N/A	N/A	-	-	-	1,184,756
Total	\$ 59,470,950			\$ 8,119,985	\$ -	\$ -	\$ 51,350,965

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:

Issuer	Investment Type	Reporting Amount
FHLMC	U.S. Agency Securities	\$ 2,485,998
FNMA	U.S. Agency Securities	12,648,800

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.

CITY OF HERCULES

Notes to Basic Financial Statements June 30, 2011

NOTE 2: CASH AND INVESTMENTS (CONTINUED)

Custodial Credit Risk (continued)

As of June 30, 2011, \$3,407,379 of the City's deposits with financial institutions in excess of federal depository insurance limits were 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.

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, 2011, consisted of the following:

Bridge Housing Corporation	\$ 1,814,188
Eden Housing	700,000
Sycamore by the Bay	300,000
Radston's Office Plus	240,239
First Time Homebuyers	4,274,890
Affordable Housing	4,687,917
Business Development Loans	1,540,354
Bio-Rad Loan	1,961,199
Home Emergency Loans	10,898
Employee Loans	250,000
Subtotal	<u>15,779,685</u>
Less: Reported as interest receivable	(414,588)
Allowance for uncollectible loan	<u>(700,000)</u>
Total	<u>\$ 14,665,097</u>

A. Bridge Housing Corporation

The City loaned the Bridge Housing Corporation (Corporation) \$1,400,000 to finance construction of a sixty unit senior citizen housing development next to City Hall. On September 8, 1998, the City approved an addition to the loan of \$114,600 for a total of \$1,514,600. On January 1, 1999, the loan began to accrue interest at the rate of 3.5% per year and is repayable in 2041, subject to certain conditions. The construction was completed in September 1999. On March 2, 2000, the Corporation repaid \$115,000 to the City. As of June 30, 2011, the Corporation's loan balance was \$1,814,188, which includes \$414,588 of interest reported as interest receivable.

CITY OF HERCULES

Notes to Basic Financial Statements June 30, 2011

NOTE 3: LOAN RECEIVABLE (CONTINUED)

B. Eden Housing Loan

On July 1, 2002, the City loaned Eden Housing, Inc. \$700,000 to assist in the development of low and moderate income housing for senior citizens. The loan does not bear interest. The repayment of the loan is only due and payable if a default has been declared by the City and the borrower fails to cure the default. Upon expiration of the 55-year Regulatory Agreement, the loan will be forgiven and the promissory note will be cancelled by the City. The balance outstanding as of June 30, 2011 was \$700,000. An allowance of \$700,000 has been established for this loan, due to its terms.

C. Radston's Office Plus

On December 5, 2000, the City entered into a promissory note agreement with the Radston's Office Plus (Payors) in the amount of \$250,000 with interest at 5% per annum. All principal and interest is deferred until December 5, 2010. Commencing on December 5, 2010, the Payors shall pay a lump-sum cash amount of \$125,000 which represents all deferred and unpaid interest only. The principal balance of \$250,000 will be fully amortized and paid over the next ten years at \$2,652 per month, principal and interest, commencing on December 5, 2010. The loan is secured by a Deed of Trust on real property. As of June 30, 2011, the outstanding balance of the loan was \$240,239.

D. First Time Homebuyers

The City has provided various loan programs for First Time Homebuyers. In general, they provide secondary financing for low and moderate buyers in the City of Hercules that have deferred payments in order to allow the buyer to maximize their purchasing capacity. The loan has a repayment period of 20 years and payment is deferred in the first 10 years of the loan. The loan has a simple interest rate is at 3%, which will not be accrued during the deferred period. The balance outstanding as of June 30, 2011 was \$4,274,890.

E. Affordable Housing Loans

The City has provided various loan programs for Affordable Housing assistance. The first is the Below Market Rate Program, which provides secondary financing for low to moderate income persons who currently earn less than one hundred twenty percent of the current annual median income for the Contra Costa County area. This is available to City employees as well. The repayment period varies from 10 to 30 years with a deferred period of 10 to 20 years and no interest will be accrued. The second is the Rehabilitation and Beautification Program, which provides financial assistance to rehabilitate properties.

Borrowers are individuals and families who currently earn less than one hundred twenty percent of the current annual median income for the Contra Costa County area. The loan has a repayment period of 20 years and payment is deferred for the first 10 years of the loan. The loan has a simple interest rate of 3%, which will not be accrued during the deferred period. The balance outstanding of the Affordable Housing Assistance loans as of June 30, 2011 was \$4,687,917.

F. 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, 2011 was \$250,000. Subsequent to June 30, 2011 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.

CITY OF HERCULES

Notes to Basic Financial Statements June 30, 2011

NOTE 3: LOAN RECEIVABLE (CONTINUED)

G. Home Emergency Loans

On September 19, 2002, the City entered into several home emergency loans in various amounts with interest at 5% per annum. The principal amount of the loans including interest is to be due and payable in one lump sum if the owners cease to occupy the property or upon any transfer, refinance, sale, or conveyance of all or a part of the property. The balance outstanding as of June 30, 2011 was \$10,898.

H. Business Development Loans

The City established the Business Development Loan Program (BDLP) to provide low cost financial assistance to businesses within the City of Hercules. The BDLP offers a secured loan of up to \$75,000, a term not greater than 20 years, and a simple interest rate of 3% per annum. All applicants are evaluated and prioritized according to established program criteria and if funded are subject to various terms, conditions, and fees. These fees will be deducted from the final loan award by the escrow administrator at the time of funding. The balance outstanding as of June 30, 2011 was \$1,540,354.

I. 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, 2011 was \$1,961,199.

J. Sycamore by the Bay

The City entered into a settlement agreement with Semik and Laura Oungouliau (Oungouliau) on April 6, 2006 concerning a dispute over development fees owed by Oungouliau for a 91 unit Senior Housing Project located at 1550 Sycamore Avenue, Hercules (Project). Under the settlement agreement, Oungouliau will pay the City the sum of \$550,000 to resolve all claims concerning development fees that Oungouliau owes to the City for the Project. Oungouliau paid \$250,000 to the City on May 22, 2008 prior to the final settlement agreement. The rest of the settlement amount, \$300,000, was setup as an installment note with the City with a 3.25% interest rate per annum. The balance outstanding as of June 30, 2011 was \$300,000.

CITY OF HERCULES

Notes to Basic Financial Statements
June 30, 2011

NOTE 4: DEFERRED REVENUE

Fund Financial Statements

At June 30, 2011, the following deferred revenues were recorded in the Governmental Fund Financial Statements because either the revenues had not been earned or the funds were not available to finance expenditures of the current period:

Loans Receivable:		
Bridge Housing Corporation	\$	1,814,188
Eden Housing		700,000
Sycamore by the Bay		300,000
Radston's Office Plus		240,239
First Time Homebuyers		4,274,890
Affordable Housing		4,687,917
Business Development Loans		1,540,354
Bio-Rad Loan		1,961,199
Home Emergency Loans		10,898
Employee Loans		250,000
Lease Receivable:		
Capital Lease - Sales Type		9,492,840
Accounts Receivable		653,221
Allowance for uncollectible loan		<u>(700,000)</u>
 Total	\$	<u><u>25,225,746</u></u>

NOTE 5: CAPITAL ASSETS

At June 30, 2011, the City's capital assets consisted of the following:

	<u>Governmental Activities</u>	<u>Business-Type Activities</u>	<u>Total</u>
Nondepreciable Assets:			
Land	\$ 4,313,376	\$ 150,000	\$ 4,463,376
Construction in progress	30,169,791	2,803,440	32,973,231
Total Nondepreciable Assets	<u>34,483,167</u>	<u>2,953,440</u>	<u>37,436,607</u>
 Depreciable Assets:			
Land improvements	9,997,112	-	9,997,112
Buildings and improvements	30,827,489	11,335,199	42,162,688
Machinery and equipment	4,335,813	206,304	4,542,117
Infrastructure	83,617,804	17,275,224	100,893,028
Total Depreciable Assets	<u>128,778,218</u>	<u>28,816,727</u>	<u>157,594,945</u>
 Less Accumulated Depreciation	<u>(52,246,715)</u>	<u>(10,336,294)</u>	<u>(62,583,009)</u>
 Total Depreciable Assets, Net	<u>76,531,503</u>	<u>18,480,433</u>	<u>95,011,936</u>
 Total Capital Assets, Net	<u>\$ 111,014,670</u>	<u>\$ 21,433,873</u>	<u>\$ 132,448,543</u>

CITY OF HERCULES

Notes to Basic Financial Statements
June 30, 2011

NOTE 5: CAPITAL ASSETS (CONTINUED)

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

<u>Governmental Activities</u>	Restated Balance July 1, 2010	Additions	Deletions	Transfers	Balance June 30, 2011
Nondepreciable Capital Assets:					
Land	\$ 4,313,376	\$ -	\$ -	\$ -	\$ 4,313,376
Construction in progress	31,410,184	4,616,407	-	(5,856,800)	30,169,791
Total Nondepreciable Capital Assets	<u>35,723,560</u>	<u>4,616,407</u>	<u>-</u>	<u>(5,856,800)</u>	<u>34,483,167</u>
Depreciable Capital Assets:					
Land improvements	9,661,951	335,161	-	-	9,997,112
Buildings and improvements	30,486,070	341,419	-	-	30,827,489
Machinery and equipment	4,317,569	41,574	(23,330)	-	4,335,813
Infrastructure	77,666,574	94,430	-	5,856,800	83,617,804
Total Depreciable Capital Assets	<u>122,132,164</u>	<u>812,584</u>	<u>(23,330)</u>	<u>5,856,800</u>	<u>128,778,218</u>
Accumulated Depreciation:					
Land improvements	(2,801,754)	(598,141)	-	-	(3,399,895)
Buildings and improvements	(5,806,438)	(765,027)	-	-	(6,571,465)
Machinery and equipment	(2,855,895)	(373,487)	13,942	-	(3,215,440)
Infrastructure	(36,875,238)	(2,184,677)	-	-	(39,059,915)
Total Accumulated Depreciation	<u>(48,339,325)</u>	<u>(3,921,332)</u>	<u>13,942</u>	<u>-</u>	<u>(52,246,715)</u>
Net depreciable capital assets	<u>73,792,839</u>	<u>(3,108,748)</u>	<u>(9,388)</u>	<u>5,856,800</u>	<u>76,531,503</u>
Net Capital Assets	<u>\$ 109,516,399</u>	<u>\$ 1,507,659</u>	<u>\$ (9,388)</u>	<u>\$ -</u>	<u>\$ 111,014,670</u>

The City restated the beginning balances for land and construction in progress by \$31,440,520 and \$21,052,996, respectively, to remove assets and projects that will not be used in operations of the City. These have been reported as property held for resale or accumulated project costs, as appropriate.

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	\$ 909,775
Public safety	36,108
Public works	2,391,583
Parks and recreation	271,034
Community development	312,832
Total Depreciation Expense - Governmental Activities	<u>\$ 3,921,332</u>

CITY OF HERCULES

Notes to Basic Financial Statements
June 30, 2011

NOTE 5: CAPITAL ASSETS (CONTINUED)

Depreciation Allocation (continued)

<u>Business-Type Activities</u>	Balance July 1, 2010	Additions	Deletions	Transfers	Balance June 30, 2011
<u>Sewer</u>					
Nondepreciable Capital Assets:					
Land	\$ 150,000	\$ -	\$ -	\$ -	\$ 150,000
Construction in progress	5,105,481	1,808,768	-	(4,711,221)	2,203,028
Total Nondepreciable Capital Assets	<u>5,255,481</u>	<u>1,808,768</u>	<u>-</u>	<u>(4,711,221)</u>	<u>2,353,028</u>
Depreciable Capital Assets:					
Buildings and improvements	11,335,199	-	-	-	11,335,199
Machinery and equipment	46,873	70,444	-	-	117,117
Infrastructure	2,625,220	950,162	-	4,711,221	8,286,603
Total Depreciable Capital Assets	<u>14,007,092</u>	<u>1,020,606</u>	<u>-</u>	<u>4,711,221</u>	<u>19,738,919</u>
Less accumulated depreciation	<u>(8,720,745)</u>	<u>(363,404)</u>	<u>-</u>	<u>-</u>	<u>(9,084,149)</u>
Net depreciable capital assets	<u>5,286,347</u>	<u>657,202</u>	<u>-</u>	<u>4,711,221</u>	<u>10,654,770</u>
Net Capital Assets	<u>\$ 10,541,828</u>	<u>\$ 2,465,970</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 13,007,798</u>
<u>Hercules Municipal Utility</u>					
Nondepreciable Capital Assets:					
Construction in progress	\$ 279,562	\$ 320,850	\$ -	\$ -	\$ 600,412
Total Nondepreciable Capital Assets	<u>279,562</u>	<u>320,850</u>	<u>-</u>	<u>-</u>	<u>600,412</u>
Depreciable Capital Assets:					
Machinery and equipment	89,187	-	-	-	89,187
Infrastructure	8,977,040	11,581	-	-	8,988,621
Total Depreciable Capital Assets	<u>9,066,227</u>	<u>11,581</u>	<u>-</u>	<u>-</u>	<u>9,077,808</u>
Less accumulated depreciation	<u>(1,036,399)</u>	<u>(215,746)</u>	<u>-</u>	<u>-</u>	<u>(1,252,145)</u>
Net depreciable capital assets	<u>8,029,828</u>	<u>(204,165)</u>	<u>-</u>	<u>-</u>	<u>7,825,663</u>
Net Capital Assets	<u>\$ 8,309,390</u>	<u>\$ 116,685</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 8,426,075</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:

Business-Type Activities:	
Sewer	\$ 363,404
Hercules Municipal Utility	<u>215,746</u>
Total Depreciation Expense - Business-Type Activities	<u>\$ 579,150</u>

CITY OF HERCULES

Notes to Basic Financial Statements
June 30, 2011

NOTE 6: LONG-TERM OBLIGATIONS

Governmental activities long-term liability activity for the fiscal year ended June 30, 2011, was as follows:

Governmental Activities	Balance July 1, 2010	Prior Period Adjustment	Additions	Reductions	Balance June 30, 2011	Due Within One Year
2005 Tax Allocation Bonds	\$ 50,860,000	\$ -	\$ -	\$ (1,575,000)	\$ 49,085,000	\$ 1,640,000
Premium on Issuance	1,813,308	-	-	(72,532)	1,740,776	-
Deferred Loss on Refunding	(242,635)	-	-	9,705	(232,930)	-
2007 Housing Tax Allocation Bonds, Series A	12,670,000	-	-	(255,000)	12,415,000	270,000
2007 Housing Tax Allocation Bonds, Series B	12,275,000	-	-	(260,000)	12,015,000	260,000
Premium on Issuance	72,368	-	-	(3,148)	69,222	-
2007 Tax Allocation Bonds	57,280,000	-	-	(1,185,000)	56,095,000	1,240,000
2003B PFA Lease Revenue Bonds	8,055,000	-	-	(200,000)	7,855,000	205,000
2009 PFA Taxable Lease Revenue Bonds	10,080,000	-	-	(165,000)	9,915,000	115,000
Discount on Issuance	(484,302)	-	-	17,297	(467,005)	-
2010 PFA Revenue Refunding Bonds	7,426,000	(7,425,000)	-	-	-	-
Discount on Issuance	(217,779)	217,779	-	-	-	-
Loss on Refunding	(213,306)	213,306	-	-	-	-
Long-Term Notes Payable	402,023	-	-	(54,953)	347,070	58,983
H.E.L.P. Loan	1,600,000	-	-	-	1,600,000	-
R.D.L.P. Loan	3,750,000	-	-	-	3,750,000	3,750,000
Suntrust Lease	1,918,915	-	-	(115,686)	1,803,229	121,223
Compensated absences	701,885	-	329,670	(525,000)	506,555	389,820
Total Long-Term Obligations	\$ 187,545,477	\$ (6,993,915)	\$ 329,670	\$ (4,384,315)	\$ 156,496,917	\$ 8,050,026

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.

2005 Tax Allocation Bonds

On August 5, 2005, the Redevelopment Agency issued Hercules Merged Project Area Tax Allocation Bonds, Series 2005, in the amount of \$56,260,000. The proceeds of the bonds will be used to finance certain public capital improvements within the Agency's Merged Project Area and refund the Agency's Subordinate Tax Allocation Bonds, Series 2001. The Bonds mature annually each August 1 from 2006 to 2035, in amounts ranging from \$740,000 to \$2,960,000 and bear interest at rates ranging from 3.50% to 5.00%. Interest is payable semiannually on February 1 and August 1. The Bonds maturing on or after August 1, 2016, are subject to optional redemption prior to maturity at the option of the Agency on or after August 1, 2015, as a whole or in part, on any interest payment date, at a price equal to the principal amount, plus accrued interest on the redemption date. The bonds are payable exclusively from pledged tax revenues to be derived from the project area and from the amounts on deposit in certain funds and accounts, including the reserve account and the revenue account. The balance at June 30, 2011 is \$49,085,000.

CITY OF HERCULES

Notes to Basic Financial Statements
June 30, 2011

NOTE 6: LONG-TERM OBLIGATIONS (CONTINUED)

Future debt service requirements on the 2005 Tax Allocation bonds are:

Fiscal Year Ended June 30,	Principal	Interest	Total
2012	\$ 1,640,000	\$ 2,327,265	\$ 3,967,265
2013	1,705,000	2,264,855	3,969,855
2014	1,765,000	2,199,535	3,964,535
2015	1,835,000	2,119,840	3,954,840
2016	1,925,000	2,028,450	3,953,450
2017-2021	9,445,000	8,683,715	18,128,715
2022-2026	9,140,000	6,538,169	15,678,169
2027-2031	11,650,000	3,971,900	15,621,900
2032-2036	9,980,000	941,881	10,921,881
Subtotal	49,085,000	31,075,610	80,160,610
Plus: Premium	1,740,776	-	1,740,776
Less: Deferred Loss on Refunding	(232,930)	-	(232,930)
Total	<u>\$ 50,592,846</u>	<u>\$ 31,075,610</u>	<u>\$ 81,668,456</u>

In connection with the issuance of the 2005 Tax Allocation Bonds, the Agency recorded a deferred loss on refunding of debt which is reported as part of long-term debt. This deferred loss was in connection with interest payments made to the escrow agent for future payments of interest. The total amount of the deferred loss was \$291,160 which will be amortized over the life of the bond. The amortization for the fiscal year 2010-2011 was \$9,705, and the accumulated amortization at June 30, 2011 was \$58,230.

2007 Housing Tax Allocation Bonds Series A and B

On July 26, 2007, the Redevelopment Agency issued Hercules Merged Project Area Housing Tax Allocation Bonds, 2007 Series A, in the amount of \$13,130,000 and 2007 Series B, in the amount of 12,760,000. The proceeds of the bonds will be used to finance certain public capital improvements within the Agency's Merged Project Area. The Bonds mature annually each August 1 from 2009 to 2033, in amounts ranging from \$220,000 to \$950,000 and bear interest at rates ranging from 3.50% to 6.125%. Interest is payable semi-annually on February 1 and August 1. The Bonds maturing on or after August 1, 2018, are subject to optional redemption prior to maturity at the option of the Agency on or after August 1, 2017, as a whole or in part, on any interest payment date, at a price equal to the principal amount, plus accrued interest on the redemption date. The bonds are payable exclusively from pledged tax revenues to be derived from the project area and from the amounts on deposit in certain funds and accounts, including the reserve account and the revenue account. The balance at June 30, 2011 for 2007 Series A and Series B are \$12,415,000 and \$12,015,000 respectively.

CITY OF HERCULES

Notes to Basic Financial Statements
June 30, 2011

NOTE 6: LONG-TERM OBLIGATIONS (CONTINUED)

2007 Housing Tax Allocation Bonds Series A and B (continued)

The annual debt service requirements to maturity at June 30, 2011 of the 2007 Series A are as follows:

Fiscal Year Ended June 30,	Principal	Interest	Total
2012	\$ 270,000	\$ 739,619	\$ 1,009,619
2013	285,000	724,356	1,009,356
2014	300,000	707,969	1,007,969
2015	315,000	690,441	1,005,441
2016	335,000	671,916	1,006,916
2017-2021	1,985,000	3,036,856	5,021,856
2022-2026	2,655,000	2,344,491	4,999,491
2027-2031	3,565,000	1,420,328	4,985,328
2032-2034	2,705,000	254,953	2,959,953
Total	\$ 12,415,000	\$ 10,590,929	\$ 23,005,929

The annual debt service requirements to maturity at June 30, 2011 of the 2007 Series B are as follows:

Fiscal Year Ended June 30,	Principal	Interest	Total
2012	\$ 315,000	\$ 553,241	\$ 868,241
2013	325,000	540,351	865,351
2014	340,000	526,775	866,775
2015	350,000	512,506	862,506
2016	365,000	497,722	862,722
2017-2021	2,075,000	2,238,060	4,313,060
2022-2026	2,585,000	1,712,662	4,297,662
2027-2031	3,285,000	999,955	4,284,955
2032-2034	2,375,000	180,612	2,555,612
Subtotal	12,015,000	7,761,884	19,776,884
Plus: Premium	69,222	-	69,222
Total	\$ 12,084,222	\$ 7,761,884	\$ 19,846,106

CITY OF HERCULES

Notes to Basic Financial Statements
June 30, 2011

NOTE 6: LONG-TERM OBLIGATIONS (CONTINUED)

2007 Tax Allocation Bonds Series A

On December 20, 2007, the Redevelopment Agency issued Hercules Merged Project Area Tax Allocation Bonds, 2007 Series A, in the amount of \$60,555,000. The proceeds of the bonds will be used to finance certain public capital improvements within the Agency's Merged Project Area. The Bonds mature annually each August 1 from 2009 to 2043, in amounts ranging from \$260,000 to \$3,315,000 and bear interest at rates ranging from 3.50% to 5.00%. Interest is payable semi-annually on February 1 and August 1. The Bonds maturing on or after August 1, 2018, are subject to optional redemption prior to maturity at the option of the Agency on or after February 1, 2018, as a whole or in part, on any interest payment date, at a price equal to the principal amount, plus accrued interest on the redemption date. The bonds are payable exclusively from pledged tax revenues to be derived from the project area and from the amounts on deposit in certain funds and accounts, including the reserve account and the revenue account. The balance at June 30, 2011 is \$56,095,000.

The annual debt service requirements to maturity at June 30, 2011, are as follows:

Fiscal Year Ended June 30,	Principal	Interest	Total
2012	\$ 1,240,000	\$ 2,610,359	\$ 3,850,359
2013	1,300,000	2,546,859	3,846,859
2014	1,360,000	2,480,359	3,840,359
2015	1,430,000	2,410,609	3,840,609
2016	270,000	2,370,134	2,640,134
2017-2021	2,980,000	11,632,951	14,612,951
2022-2026	5,855,000	10,553,431	16,408,431
2027-2031	6,615,000	9,067,271	15,682,271
2032-2036	12,270,000	7,206,211	19,476,211
2037-2041	16,295,000	3,339,237	19,634,237
2042-2043	6,480,000	316,794	6,796,794
Total	\$ 56,095,000	\$ 54,534,215	\$ 110,629,215

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, 2011 is \$7,855,000.

CITY OF HERCULES

Notes to Basic Financial Statements
June 30, 2011

NOTE 6: LONG-TERM OBLIGATIONS (CONTINUED)

2003B Public Financing Authority Lease Revenue Bonds (continued)

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

Fiscal Year Ended June 30,	Principal	Interest	Total
2012	\$ 205,000	\$ 367,698	\$ 572,698
2013	210,000	360,523	570,523
2014	220,000	352,648	572,648
2015	230,000	344,288	574,288
2016	235,000	335,088	570,088
2017-2021	1,345,000	1,511,415	2,856,415
2022-2026	1,700,000	1,161,345	2,861,345
2027-2031	2,150,000	716,250	2,866,250
2032-2034	<u>1,560,000</u>	<u>158,500</u>	<u>1,718,500</u>
Total	<u>\$ 7,855,000</u>	<u>\$ 5,307,755</u>	<u>\$ 13,162,755</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, 2011 is \$9,915,000.

CITY OF HERCULES

Notes to Basic Financial Statements
June 30, 2011

NOTE 6: 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,	Principal	Interest	Total
2012	\$ 115,000	\$ 801,365	\$ 916,365
2013	120,000	794,315	914,315
2014	130,000	786,815	916,815
2015	135,000	778,865	913,865
2016	145,000	769,740	914,740
2017-2021	885,000	3,675,250	4,560,250
2022-2026	1,285,000	3,252,544	4,537,544
2027-2031	1,910,000	2,601,491	4,511,491
2032-2036	2,845,000	1,621,410	4,466,410
2037-2039	2,345,000	305,970	2,650,970
Subtotal	9,915,000	15,387,765	25,302,765
Less: Discount	(467,005)	-	(467,005)
Total	<u>\$ 9,447,995</u>	<u>\$ 15,387,765</u>	<u>\$ 24,835,760</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 agreement the City of Hercules agrees 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. As of June 30, 2011, only \$1,600,000 has been provided to the City.

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 agreement, the City of Hercules agrees to repay the Agency \$3,750,000, 4 years from February 2007 at 3% simple per annum interest. In August 2010, the repayment date was extended to August 15, 2011. The balance at June 30, 2011 is \$3,750,000.

CITY OF HERCULES

Notes to Basic Financial Statements
June 30, 2011

NOTE 6: LONG-TERM OBLIGATIONS (CONTINUED)

R.D.L.P. Loan Payable (continued)

Future debt service requirements on the R.D.L.P. loan are:

Fiscal Year Ended June 30,	Principal	Interest	Total
2012	\$ 3,750,000	\$ 187,500	\$ 3,937,500
Total	<u>\$ 3,750,000</u>	<u>\$ 187,500</u>	<u>\$ 3,937,500</u>

Long-term Notes Payable

In 1987, the Redevelopment Agency entered into Owner Participation Agreements with certain property owners in the Redevelopment Area. Under the terms of these agreements, the Agency signed notes under which it promised to reimburse the owners by the year 2016 for incremental assessments levied on their properties, up to the cost of constructing public improvements. Payment on these notes is contingent on the property taxes and special assessments levied on these owners.

As of June 30, 2011, the City's long-term notes payables are as follows.

East Group	\$ 130,911
Bio Rad Laboratories	<u>216,159</u>
Total	<u>\$ 347,070</u>

The annual debt service requirements to maturity for the East Group Note Payable as of June 30, 2011 are as follows:

Fiscal Year Ended June 30,	Principal	Interest	Total
2012	\$ 22,112	\$ 10,018	\$ 32,130
2013	23,887	8,304	32,191
2014	25,661	6,453	32,114
2015	27,709	4,464	32,173
2016	<u>31,542</u>	<u>2,317</u>	<u>33,859</u>
Total	<u>\$ 130,911</u>	<u>\$ 31,556</u>	<u>\$ 162,467</u>

CITY OF HERCULES

Notes to Basic Financial Statements
June 30, 2011

NOTE 6: LONG-TERM OBLIGATIONS (CONTINUED)

Long-term Notes Payable (continued)

The annual debt service requirements to maturity for the Bio Rad Laboratories Notes Payable as of June 30, 2011 are as follows:

Fiscal Year Ended June 30,	Principal	Interest	Total
2012	\$ 36,871	\$ 16,704	\$ 53,575
2013	39,830	13,847	53,677
2014	42,788	10,760	53,548
2015	46,203	7,443	53,646
2016	50,467	3,863	54,330
Total	\$ 216,159	\$ 52,617	\$ 268,776

SunTrust Lease

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, 2011, the outstanding balance of the master lease agreement is \$1,803,229.

The annual debt service requirements to maturity for the SunTrust master lease agreement as of June 30, 2011 are as follows:

Fiscal Year Ended June 30,	Principal	Interest	Total
2012	\$ 121,223	\$ 83,876	\$ 205,099
2013	127,025	78,074	205,099
2014	133,104	71,995	205,099
2015	139,474	65,625	205,099
2016	146,149	58,950	205,099
2017-2021	842,604	182,889	1,025,493
2022-2023	293,650	13,998	307,648
Total	\$ 1,803,229	\$ 555,407	\$ 2,358,636

CITY OF HERCULES

Notes to Basic Financial Statements
June 30, 2011

NOTE 6: LONG-TERM OBLIGATIONS (CONTINUED)

Business-Type Activities

Long-term liability activity for the fiscal year ended June 30, 2011, was as follows:

<u>Business-Type Activities</u>	<u>Balance July 1, 2010</u>	<u>Prior Period Adjustment</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance June 30, 2011</u>	<u>Due Within One Year</u>
2010 PFA Wastewater Revenue Bonds	\$ -	\$ -	\$ 11,765,000	\$ -	\$ 11,765,000	\$ 230,000
Discount on Issuance	-	-	(218,154)	7,272	(210,882)	-
2010 PFA Electric System Project	-	-	5,775,000	-	5,775,000	-
Discount on Issuance	-	-	(155,164)	5,172	(149,992)	-
2010 PFA Revenue Refunding Bonds	-	7,425,000	-	-	7,425,000	-
Discount on Issuance	-	(217,779)	-	7,778	(210,001)	-
Loss on Refunding	-	(213,306)	-	7,618	(205,688)	-
Compensated absences	32,402	-	30,072	(32,402)	30,072	30,072
Total Long-Term Obligations	\$ 32,402	\$ 6,983,915	\$ 17,198,754	\$ (4,582)	\$ 24,218,509	\$ 280,072

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, 2011 is \$11,765,000.

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

<u>Year Ended June 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2012	\$ 230,000	\$ 507,012	\$ 737,012
2013	230,000	502,413	732,413
2014	235,000	497,762	732,762
2015	240,000	493,013	733,013
2016	245,000	487,856	732,856
2017-2021	1,335,000	2,331,806	3,666,806
2022-2026	1,590,000	2,064,069	3,654,069
2027-2031	1,970,000	1,664,750	3,634,750
2032-2036	2,505,000	1,121,375	3,626,375
2037-2041	3,185,000	413,875	3,598,875
Subtotal	11,765,000	10,083,931	21,848,931
Less: Discount	(210,882)	-	(210,882)
Total	\$ 11,554,118	\$ 10,083,931	\$ 21,638,049

CITY OF HERCULES

Notes to Basic Financial Statements
June 30, 2011

NOTE 6: LONG-TERM OBLIGATIONS (CONTINUED)

2010 Public Financing Authority Electric System Project Revenue Bonds

The Public Financing Authority issued revenue bonds, series 2010, dated August 1, 2010, totaling \$5,775,000. The purpose of the bonds was to finance improvements to the City's electric system, fund a reserve fund for the bonds, and pay the costs of issuance of the bonds. The interest rates on the bonds range from 2.00% to 5.58%. Principal is due annually beginning August 1, 2012 in amounts ranging from \$105,000 to \$370,000. The bonds mature on August 1, 2040. The balance at June 30, 2011 is \$5,775,000.

Future debt service requirements on the 2010 Public Authority Electric System Project Revenue Bonds are:

Year Ended June 30,	Principal	Interest	Total
2012	\$ -	\$ 279,637	\$ 279,637
2013	105,000	278,587	383,587
2014	110,000	276,300	386,300
2015	110,000	273,688	383,688
2016	115,000	270,588	385,588
2017-2021	625,000	1,289,844	1,914,844
2022-2026	285,000	1,181,737	1,466,737
2027-2031	1,045,000	1,031,875	2,076,875
2032-2036	1,140,000	751,625	1,891,625
2037-2041	2,240,000	541,800	2,781,800
Subtotal	5,775,000	6,175,681	11,950,681
Less: Discount	(149,992)	-	(149,992)
Total	<u>\$ 5,625,008</u>	<u>\$ 6,175,681</u>	<u>\$ 11,800,689</u>

2010 Public Financing Authority Revenue Refunding Bonds (Electric System Project)

The Authority issued revenue refunding bonds, series 2010, dated June 28, 2010, totaling \$7,425,000. The purpose of the bonds was to refund the Hercules Public Financing Authority Lease Revenue Bonds Series 2003A currently outstanding in the principal amount of \$6,495,000, fund a reserve fund for the Bonds, and pay the costs of issuance of the Bonds. The interest rates on the bonds range from 2.500% to 5.375%. The interest is payable semiannually on February 1 and August 1, commencing February 1, 2011. The bonds are subject to special mandatory redemption, mandatory sinking fund redemption, and redemption from optional prepayment of Installment Payments prior to maturity. The bonds are payable from and secured by installment payments to be paid by the City under the Installment Sale Agreement and the City's advance payments under the Cooperation Agreement. Principal is due annually beginning on August 1, 2011, in amounts ranging from \$160,000 to \$495,000. The bonds mature on August 1, 2038. The balance at June 30, 2011 is \$7,425,000.

CITY OF HERCULES

Notes to Basic Financial Statements
June 30, 2011

NOTE 6: LONG-TERM OBLIGATIONS (CONTINUED)

2010 Public Financing Authority Revenue Refunding Bonds (Electric System Project) (continued)

Future debt service requirements on the 2010 Public Financing Authority Revenue Refunding bonds are:

Fiscal Year Ended June 30,	Principal	Interest	Total
2012	\$ -	\$ 361,775	\$ 361,775
2013	-	361,775	361,775
2014	160,000	359,775	519,775
2015	165,000	355,506	520,506
2016	170,000	350,688	520,688
2017-2021	945,000	1,653,950	2,598,950
2022-2026	1,175,000	1,525,344	2,700,344
2027-2031	4,810,000	788,794	5,598,794
Subtotal	7,425,000	5,757,607	13,182,607
Less: Discount	(210,001)	-	(210,001)
Less: Deferred Loss on Refunding	(205,688)	-	(205,688)
Total	\$ 7,009,311	\$ 5,757,607	\$ 12,766,918

In connection with the issuance of the 2010 PFA Revenue Refunding Bonds, the Authority recorded a deferred loss on refunding of debt which is reported as part of long-term debt. This deferred loss was in connection with interest payments made to the escrow agent for future payments of interest and the write-off of the cost of issuance of the defeased 2003A Public Financing Authority Lease Revenue Bonds. The total amount of the deferred loss was \$213,306 which will be amortized over the life of the bond.

NOTE 7: 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.

Description	Original Issuance	Balance as of June 30, 2011
Reassessment District 2001-01 (Alfred Nobel)	\$ 9,810,000	\$ 4,435,000
Reassessment District 2005-1 (John Muir Parkway)	6,550,345	5,990,000

NOTE 8: 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.

CITY OF HERCULES

Notes to Basic Financial Statements
June 30, 2011

NOTE 8: RISK MANAGEMENT (CONTINUED)

Workers' Compensation

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

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

As of June 30, 2011, the City's estimated claims liabilities were as follows.

General Liability	\$ 127,733
Workers Compensation	<u>3,937</u>
 Total	 <u>\$ 131,670</u>

Changes in the claims liabilities for the fiscal years ended June 30, 2009, 2010, and 2011 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>
2008-2009	\$ 64,979	\$ 385,455	\$ (480,763)	\$ (30,329)
2009-2010	(30,329)	696,923	(455,626)	210,968
2010-2011	210,968	559,583	(638,881)	131,670

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	5,000	500,000,000
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.

CITY OF HERCULES

Notes to Basic Financial Statements
June 30, 2011

NOTE 9: FUND BALANCES

Details of the fund balance classifications of the governmental funds as of June 30, 2011 are as follows:

	General Fund	Redevelopment Agency Special Revenue Fund	Redevelopment Agency Debt Service Fund	Hercules Public Financing Authority Debt Service Fund	Redevelopment Agency Capital Projects Fund	Other Governmental Funds	Total
Nonspendable:							
Accumulated project costs/land held for resale	\$ 9,243,352	\$ 739,059	\$ -	\$ 5,545,919	\$ 43,956,239	\$ 2,877,104	\$ 62,361,673
Prepays and inventory	14,279	-	-	-	-	11,013	25,292
Total Nonspendable	9,257,631	739,059	-	5,545,919	43,956,239	2,888,117	62,386,965
Restricted for:							
Streets and roads	-	-	-	-	-	3,401,761	3,401,761
Public safety	-	-	-	-	-	64,384	64,384
Development	-	-	14,985,659	-	-	7,721,792	22,707,451
Debt service	-	-	-	2,200,570	-	-	2,200,570
Total Restricted	-	-	14,985,659	2,200,570	-	11,187,937	28,374,168
Assigned for:							
Economic uncertainty	2,100,604	-	-	-	-	-	2,100,604
Total Assigned	2,100,604	-	-	-	-	-	2,100,604
Unassigned	13,791,494	(17,862,990)	-	-	(6,291,743)	(62,805)	(10,426,044)
Total Fund Balance	\$ 25,149,729	\$ (17,123,931)	\$ 14,985,659	\$ 7,746,489	\$ 37,664,496	\$ 14,013,249	\$ 82,435,691

NOTE 10: 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).

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.

CITY OF HERCULES

Notes to Basic Financial Statements
June 30, 2011

NOTE 10: CAPITAL LEASE – SALES TYPE (CONTINUED)

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

Fiscal Year Ended June 30,	<u>Amounts</u>
2012	\$ 727,962
2013	750,678
2014	773,394
2015	796,110
2016	818,826
2017-2021	4,390,966
2022-2026	4,604,890
2027-2031	4,797,460
2032-2036	4,950,440
2037-2041	<u>2,171,598</u>
	24,782,324
Less: Unearned Income	<u>(15,289,784)</u>
Net Investment in Lease Receivable	<u>\$ 9,492,840</u>

NOTE 11: INTERFUND TRANSACTIONS

Long-Term Advances

At June 30, 2011, the City had the following long-term advances:

	<u>Interfund Receivables</u>	<u>Interfund Payables</u>
Major Funds:		
General Fund	\$ 13,895,004	\$ -
Redevelopment Agency Special Revenue Fund	-	11,622,856
Redevelopment Agency Capital Projects Fund	-	2,891,103
Major Proprietary Funds:		
Sewer Fund	313,047	-
Hercules Municipal Utility Fund	-	1,634,104
Nonmajor Governmental Fund:		
DIF Special Revenue Fund	1,776,812	-
Community Development Fund	<u>163,200</u>	<u>-</u>
	<u>\$ 16,148,063</u>	<u>\$ 16,148,063</u>

Advances to the General Fund were to provide for the construction of the Hercules Municipal Utility electric system.

CITY OF HERCULES

Notes to Basic Financial Statements
June 30, 2011

NOTE 11: INTERFUND TRANSACTIONS (CONTINUED)

Long-Term Advances (continued)

Advances to the Redevelopment Agency from the General Fund, the Public Financing Authority, DIF Special Revenue Fund, and the Sewer Fund were for the New Town Center project, Hercules Municipal Utility electric system, construction of the community library, a park and teen center, and upgrades to the wastewater treatment plant.

Advances to the Hercules Municipal Utility from the General Fund were to provide funding for the Hercules Municipal Utility's operations

Due To/From Other Funds

Due to/from other funds as of June 30, 2011 were as follows:

	<u>Interfund Receivables</u>	<u>Interfund Payables</u>
Major Funds:		
General Fund	\$ 281,702	\$ 753,631
Redevelopment Agency Special Revenue Fund	803,439	-
Redevelopment Agency Debt Service Fund	-	1,361,575
Hercules Public Financing Authority Debt Service Fund	-	261,143
Redevelopment Agency Capital Projects Fund	1,683,631	2,282,782
Nonmajor Governmental Funds:		
AB 3229 COPS Program Special Revenue Fund	-	11,316
State Gas Tax Special Revenue Fund	69,796	-
Grant Special Revenue Fund	-	527,650
DIF Special Revenue Fund	124,522	-
Community Development Fund	13,342	-
Development Fee Fund	1,479,343	-
City Capital Projects Fund	126,555	124,522
Stormwater Assessment Fund	-	13,342
Internal Service Funds:		
Vehicle Replacement Fee	753,631	-
	<u>\$ 5,335,961</u>	<u>\$ 5,335,961</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.

CITY OF HERCULES

Notes to Basic Financial Statements
June 30, 2011

NOTE 11: INTERFUND TRANSACTIONS (CONTINUED)

Transfers

	<u>Transfers In</u>	<u>Transfers Out</u>
Major Funds:		
General Fund	\$ 579,722	\$ 57,839
Redevelopment Agency Special Revenue Fund	40,000	12,113,676
Redevelopment Agency Debt Service Fund	9,860,617	16,300,014
Hercules Public Finance Authority Debt Service Fund	-	260,642
Redevelopment Agency Capital Projects Fund	19,363,358	-
Major Proprietary Funds:		
Hercules Municipal Utility Fund	-	1,908
Nonmajor Governmental Fund:		
AB 3229 COPS Program Special Revenue Fund	-	100,000
DIF Special Revenue Fund	-	1,386,600
Community Development Special Revenue Fund	-	20,197
State Gas Tax Special Revenue Fund	69,796	200,000
Measure C Street Special Revenue Fund	-	200,000
Grant Special Revenue Fund	-	592,894
City Capital Project Fund	1,296,748	-
Internal Service Funds:		
IT Equipment Replacement Fund	23,529	-
	<u>\$ 31,233,770</u>	<u>\$ 31,233,770</u>

The transfers are to reimburse expenditures made on behalf of another fund, to fund capital projects or for debt service payments.

NOTE 12: 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 Basic Financial Statements
June 30, 2011

NOTE 12: 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 10.817% for miscellaneous employees and 29.936% for safety employees. For the year ended June 30, 2011, the City contributed \$2,175,603 on employees' behalf and for their account.

Annual Pension Cost

For fiscal year 2010-2011, the City's annual pension cost of \$2,175,603 for PERS was equal to the City's required and actual contributions. The required contribution was determined as part of the June 30, 2007 actuarial report. The assumptions included 7.75% investment rate of return (net of administrative expenses) and projected annual salary increases of 3.55% to 14.45%, depending on age, service, and type of employment, and included an inflation component of 3.0%. 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>Annual Pension Cost (APC)</u>	<u>Percentage of APC Contributed</u>	<u>Net Pension Obligation</u>
6/30/2009	\$ 1,408,489	100%	\$ -
6/30/2010	1,596,456	100%	-
6/30/2011	2,175,603	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 13: 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 Basic Financial Statements
June 30, 2011

NOTE 13: 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. For unrepresented group, the City also contributes 4% with a maximum contribution of \$4,000 per year. In addition both groups can contribute to the group plan.

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 14: 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 \$108 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 \$272.14/month, 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 2010-2011, the City contributed \$29,074, which covered current premiums, and also transferred \$216,000 to the Public Agency Retirement Services. Currently, there are 7 retirees who are receiving benefits.

CITY OF HERCULES

Notes to Basic Financial Statements
June 30, 2011

NOTE 14: 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	\$ 212,000
Annual OPEB cost (expense)	<u>212,000</u>
Contributions made	<u>(245,074)</u>
Change in net OPEB obligation (asset)	<u>(33,074)</u>
Net OPEB obligation (asset) - beginning of fiscal year	<u>(188,612)</u>
Net OPEB obligation (asset) - end of fiscal year	<u><u>\$ (221,686)</u></u>

The City's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for 2009, 2010, and 2011 were as follows:

<u>Fiscal Year Ended</u>	<u>Annual OPEB Cost</u>	<u>Percentage of Annual OPEB Cost Contribution</u>	<u>Net OPEB Obligation (Asset)</u>
6/30/2009	\$ 216,000	3%	\$ 209,641
6/30/2010	216,000	285%	(188,612)
6/30/2011	212,000	116%	(221,686)

Funded Status and Funding Progress

As of June 30, 2011, the most recent actuarial valuation date, the plan was 41% funded. The actuarial accrued liability for benefits was \$2,155,000, and the actuarial value of assets was \$884,000, resulting in an unfunded actuarial accrued liability (UAAL) of \$1,271,000. 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 26.5 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 Basic Financial Statements June 30, 2011

NOTE 14: 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, 2011 was seventeen years.

NOTE 15: COMMITMENTS AND CONTINGENCIES

A. Lawsuits

Hercules LLC – The Redevelopment Agency audited the Hercules, LLC's reimbursement requests as stated in Note 9 in 2007 and discovered that Hercules, LLC had substantially inflated its reimbursement requests. Hercules, LLC was unable to provide justification for its action. The Redevelopment Agency ceased making any tax increment reimbursements to Hercules, LLC. Hercules LLC protested and filed a lawsuit claiming entitlement to those reimbursements.

The Redevelopment Agency and Hercules, LLC participated in mediation on September 10, 2008 and again on February 2, 2009, but were unable to reach a settlement of their differences or the lawsuit at any time. The case was scheduled for trial commencing January 25, 2010, but the parties voluntarily submitted the case to additional mediation.

The final round of mediation was successful and the case was settled. Under the settlement agreement, Hercules, LLC will be paid nothing more out of the housing portion of project tax increment, and will receive seventy five percent (75%) of the unrestricted portion of project tax increment until February, 2024 with fifty percent (50%) thereafter. Hercules, LLC will also be paid \$3 million on or before June 22, 2011, none of which is to be paid during the 2009-10 fiscal year. Finally Hercules, LLC will be paid \$968,816 as the balance of project tax increment funds due for the fiscal year 2009-2010, which funds were being held by the Redevelopment Agency pending the settlement. The Agency has recorded the amount as a liability as of June 30, 2011.

SERAF Contingency – During the fiscal year 2008-2009, the State of California experienced a severe budgetary crisis. Various "budget trailer bills" were passed by the state legislature to balance the state's budget, including bills that required California redevelopment agencies to transfer funds to the Educational Revenue Augmentation Fund (ERAF) and Supplemental Educational Revenue Augmentation Fund (SERAF) administered by the various county auditor-controllers. Noted below is a general explanation of the SERAF legislation, together with the effect of this legislation on the City of Hercules and its Redevelopment Agency (the Agency).

Pursuant to AB 264x, a budget trailer bill, California redevelopment agencies were required to make SERAF contributions totaling \$1.7 billion for the fiscal year 2009-2010 and \$350 million for the fiscal year 2010-2011. Under AB 264x, agencies may borrow portions of the required contributions from their low and moderate income housing fund. Alternatively, sponsoring governmental agencies (the cities or counties) may elect to pay the SERAF contributions on behalf of their redevelopment agencies. On October 20, 2009, the CRA filed a class action lawsuit on behalf of all California redevelopment agencies challenging the SERAF obligations as unconstitutional.

CITY OF HERCULES

Notes to Basic Financial Statements June 30, 2011

NOTE 15: COMMITMENTS AND CONTINGENCIES (CONTINUED)

A. Lawsuits (continued)

The Agency's SERAF contributions are \$4,992,984 for the fiscal year 2009-2010 and \$1,027,967 for 2010-2011. It is the position of Agency officials that the SERAF contributions required by AB 264x are unconstitutional, and that the Agency is not obligated to make these contributions. The Agency has not made the contribution for 2009-2010 and 2010-2011, but has recorded the payments as a liability as of June 30, 2011.

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 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 fund for any other purpose. The City, Agency and Council members intend to vigorously oppose 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. The hearing on February 21, 2012 was continued by stipulation of the Parties to March 20, 2012.

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 are to be sold to satisfy what is owed to AMBAC.

NOTE 16: 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.

CITY OF HERCULES

Notes to Basic Financial Statements
June 30, 2011

NOTE 16: JOINT POWERS AGREEMENTS (CONTINUED)

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 \$42,772 for fiscal year 2010-2011.

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 Basic Financial Statements June 30, 2011

NOTE 17: RESTATEMENT OF FUND EQUITY/NET ASSETS FUND RECLASSIFICATIONS

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 equity or net assets.

	Government-wide Statements		Governmental Fund Statements				Enterprise Fund Statements
	Governmental Activities	Business-type Activities	General Fund	Hercules Public Financing Authority Debt Service Fund	Redevelopment Agency Capital Projects Fund	Other Governmental Funds	Hercules Municipal Utility Fund
Fund balance as of June 30, 2010, as previously reported	\$ 76,982,026	\$ 30,783,294	\$ 28,868,156	\$ 17,193,134	\$ (25,023,854)	\$ 18,172,677	\$ 8,169,276
Reclassifications:							
The Fiscal Neutrality Fee Fund no longer qualifies as Special Revenue Funds under GASB Statement No. 54	-	-	2,087,844	-	-	(2,097,844)	-
Restatements:							
The Sycamore Downtown project, a redevelopment project, does not qualify as a capital asset since it will not be used in the operations of the City. Accordingly, the accumulated project costs are now reported as an asset in the fund statements.	-	-	-	-	21,052,996	-	-
Land reported as capital asset was reclassified as land held for resale and reported on fund statements.	-	-	-	-	31,440,520	-	-
Accrued interest on the HELP and RDLP loans was not accrued in prior years.	(632,375)	-	-	-	-	-	-
Account balances related to the Hercules Municipal District's revenue bonds were transferred from a governmental debt service fund to the enterprise fund.	(8,138,544)	8,138,545	-	(8,138,544)	-	-	8,138,545
Revenue bonds and related accounts for the Hercules Municipal District were transferred from governmental activities to the enterprise fund.	7,030,952	(7,030,952)	-	-	-	-	(7,030,952)
Total prior period adjustment	(1,739,987)	1,107,593	2,087,844	(8,138,544)	52,493,516	(2,097,844)	1,107,593
Fund balance as of July 1, 2010, restated	\$ 75,242,059	\$ 31,890,887	\$ 30,966,000	\$ 9,054,590	\$ 27,469,662	\$ 16,074,833	\$ 9,276,869

CITY OF HERCULES

Notes to Basic Financial Statements June 30, 2011

NOTE 18: STEWARDSHIP, COMPLIANCE, AND ACCOUNTABILITY

Deficit Fund Balances/Net Assets

As of June 30, 2011, the following funds had a deficit fund balance:

	<u>Deficit Fund Balances</u>
Major Governmental Funds:	
Redevelopment Agency Special Revenue Fund	\$ 17,123,931
Nonmajor Governmental Funds:	
Stormwater Assessment Sepcial Revenue Fund	3,719
Grant Special Revenue Fund	13,533
City Capital Projects Fund	45,553

The Redevelopment Agency Special Revenue Fund's deficit fund balances are expected to be eliminated in future years through tax increment revenue and the increase of tax increment over the additional life of ten years.

Expenditures in Excess of Appropriations

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

	<u>Excess of Appropriations</u>
Major Governmental Funds:	
Public Financing Authority Debt Service Fund	\$ 49,053
Nonmajor Governmental Funds	
Measure C Street Fund	305,320

NOTE 19: RELATED PARTY TRANSACTIONS

During the reporting period, the City paid a total of \$580,500 to NEO Consulting Inc. for consulting services in relation to the affordable housing program. As of June 30, 2010, NEO Consulting Inc.'s ownership was acquired by the McKinney Group, LLC from the two adult children of the City Manager. The City has contracted with NEO Consulting Inc. since July, 2005. In February 2011, the contract with NEO Consulting Inc. was cancelled.

NOTE 20: SUBSEQUENT EVENTS

Redevelopment Agency Dissolution Act

On June 28, 2011, the California Legislature adopted Assembly Bill X1 26 (Dissolution Act) and Assembly Bill X1 27 (Voluntary Program Act) which taken together are known as the Redevelopment Restructuring Act. The Dissolution Act provides for the elimination of redevelopment agencies by appointing successor agencies to direct the orderly distribution of a redevelopment agency's assets and liabilities. The Voluntary Program Act provides a voluntary alternative for local governments to continue redevelopment activities by the enactment of an ordinance agreeing to comply with the program requirements and agreeing to make certain annual "Community Remittance" payments into a special fund established for the benefit of other governments.

CITY OF HERCULES

Notes to Basic Financial Statements
June 30, 2011

NOTE 20: SUBSEQUENT EVENTS (CONTINUED)

Redevelopment Agency Dissolution Act (continued)

The Redevelopment Restructuring Act requires the Agency and its sponsoring government (the City) to take several legislative actions to implement the various provisions of each assembly bill.

The California Redevelopment Association along with others has filed suit challenging the constitutionality of Assembly Bill X1 26 (Dissolution Act) and Assembly Bill X1 27 (Voluntary Program Act). In August 2011, the Court agreed to hear the case on an expedited basis so that a decision could be reached before January 15, 2012, when the first payments under the Voluntary Program Act were due. Until a decision was reached, the California Supreme Court issued a partial stay of AB X1 26, delaying the effectiveness of the statute. Because the stay only affects enforcement, each agency was required to adopt an Enforceable Obligation Payment Schedule and draft Recognized Obligation Schedule prior to September 30, as required by the statute. Enforceable obligations include bonds, loans and payments required by the federal or state government; legally binding and enforceable agreements or contracts; and contracts or agreements necessary for the continued administration or operation of the agency that are permitted for purposes set forth in the Dissolution Act.

On December 29, 2011, the Supreme Court issued its opinion largely upholding as constitutional ABX1 26, invalidating as unconstitutional ABX1 27, and holding that ABX1 26 may be severed from ABX1 27 and enforced independently. The Supreme Court generally reformed and revised the effective dates and deadlines for performance of obligations under Health and Safety Code Part 1.85 of ABX1 26 arising before May 1, 2012, to take effect four months later, while leaving the effective dates or deadlines for performance of obligations under Health and Safety Code Part 1.8 of AB 26 unchanged. The effective date of Agency dissolution was delayed until February 1, 2012.

The suspension provisions of ABX1 26 prohibit all redevelopment agencies from a wide range of activities, including incurring new indebtedness or obligations, entering into or modifying agreements or contracts, acquiring or disposing of real property, taking actions to adopt or amend redevelopment plans and other similar actions, except actions required by law or to carry out existing enforceable obligations, as defined in ABX1 26. During the suspension period, an agency is required to prepare an Enforceable Obligation Payment Schedule no later than August 29, 2011, that allows it to continue to pay certain obligations. The Agency adopted its Enforceable Obligation Payment Schedule (EOPS) on August 23, 2011.

In addition, the suspension provisions require the State Controller to review the activities of all redevelopment agencies to determine whether an asset transfer between an agency and any public agency occurred on or after January 1, 2011. If an asset transfer did occur and the public agency that received the asset is not contractually committed to a third party for the expenditure or encumbrance of the asset, the State Controller is required to order the asset returned to the successor agency. The State Controller's Office has completed this asset transfer review. Asset transfers of \$31 million from the Redevelopment Agency to the City in 2011 will be reversed in 2012 in response to the State Controller's Office Asset Transfer Review disallowing the asset transfers.

Management has evaluated subsequent events to determine if events or transactions through the date of the financial statements require adjustment to, or disclosure in the financial statements.

Loan Default

The City defaulted on repayment of a \$3.9 million dollar loan to the California Housing Finance Agency due on August 15, 2011 and is working with the Agency to modify repayment terms.

CITY OF HERCULES

Notes to Basic Financial Statements
June 30, 2011

NOTE 20: SUBSEQUENT EVENTS (CONTINUED)

Sale of Hercules Municipal Utility Assets

On May 28, 2013, the Hercules City Council approved an agreement with Pacific Gas and Electric Company (PG&E) to purchase the assets of Hercules Municipal Utility (HMU). On June 5, 2012, residents of the City voted to pass Measure N, authorizing the sale of HMU. Measure N was approved by 77% of voters. On August 28, 2012, the Hercules City Council adopted procedures for accepting bids for sale of the HMU assets, as required by the California Public Utilities Code. Representatives of the City solicited bid proposals and ultimately determined that 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. The City intends to retire the HMU bond debt with the proceeds from the sale.

NOTE 21: FINANCIAL CONDITION

The City and Redevelopment Agency's stand-alone financial statements have been prepared assuming that they will continue as going concerns, that is, the presumption that the City and Agency will be able to pay their expenses and debt service as they become due. The Redevelopment Agency Special Revenue Fund has fund balance deficit of \$18,532,916 at June 30, 2011.

The Redevelopment Agency negotiated the subordination of pass through claims totaling \$1.3 million to various taxing entities in 2011. The subordination allowed the Redevelopment Agency to use the \$1.3 million towards its debt service obligations. The liability to the various taxing entities is reflected in the Redevelopment Agency's financial statements.

As noted in Note 20, the City defaulted on repayment of a \$3.9 million dollar loan to the California Housing Finance Agency on August 15, 2011 and is working with the Agency to modify repayment terms.

NOTE 22: SPECIAL ITEMS

The City of Hercules Redevelopment Agency approved the transfer of land held for resale in lieu of repayment for various advances owed to several funds on March 8, 2011 through the adoption of Resolution 11-027. Total advances owed were greater than the value of the land transferred and the difference is reported as a special item on the financial statements. A recap of the advances receivable and advances payable and the land transfers follows:

	<u>Advance Receivable</u>	<u>Advance Payable</u>	<u>Land Held for Resale Transfer</u>	<u>Special Item</u>
General Fund	\$ 11,172,269		\$ 9,243,352	\$ (1,928,917)
Nonmajor Governmental Fund	3,477,503		2,877,104	(600,399)
Public Financing Authority	6,703,250		5,545,919	(1,157,331)
Water Fund	10,274,580		8,500,651	(1,773,929)
Hercules Municipal Utility	6,373,975		5,273,494	(1,100,481)
	<u>\$ 38,001,577</u>		<u>\$ 31,440,520</u>	<u>\$ (6,561,057)</u>
RDA Debt Service		\$ 11,206,237	\$ -	\$ 11,206,237
RDA Capital Projects		26,795,340	(31,440,520)	(4,645,180)
		<u>\$ 38,001,577</u>	<u>\$ (31,440,520)</u>	<u>\$ 6,561,057</u>

REQUIRED SUPPLEMENTARY INFORMATION

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CITY OF HERCULES

Required Supplementary Information
June 30, 2011

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>(a) Entry Age Actuarial Accrued Liability</u>	<u>(b) Actuarial Value of Assets (AVA)</u>	<u>(a)-(b) Unfunded Actuarial Accrued Liability (UAAL)</u>	<u>(b)/(a) Funded Ratio</u>	<u>(c) Covered Payroll</u>	<u>[(a)-(b)/(c)] UAAL as a % of Payroll</u>
6/30/2007	\$ 1,116,000	\$ -	\$ 1,116,000	0.0%	\$ 6,830,000	16.3%
6/30/2011	2,155,000	884,000	1,271,000	41.0%	4,798,000	26.5%

CITY OF HERCULES

Notes to Required Supplementary Information June 30, 2011

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, 2011, 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.

CITY OF HERCULES

**Budgetary Comparison Schedule
General Fund
For the Year Ended June 30, 2011**

	Budgeted Amounts		Actual	Variance with Final Budget
	Original	Final		
Revenues:				
Taxes	\$ 5,939,352	\$ 5,919,852	\$ 5,363,244	\$ (556,608)
Licenses and permits	1,271,039	973,389	467,194	(506,195)
Fines, forfeits and penalties	70,000	70,000	57,548	(12,452)
Revenue from use of money and property	2,720,947	2,729,947	1,297,819	(1,432,128)
Aid from other governments	1,771,996	1,672,496	1,628,832	(43,664)
Charges for services	2,183,059	2,446,603	1,999,799	(446,804)
Miscellaneous revenue	9,030,911	9,175,017	951,373	(8,223,644)
Total Revenues	22,987,304	22,987,304	11,765,809	(11,221,495)
Expenditures:				
Current:				
General government:				
City Council	205,417	310,254	317,780	(7,526)
Community events	305,556	209,791	130,684	79,107
City manager	1,087,976	1,152,697	736,372	416,325
Legal services	22,373	322,000	198,956	123,044
Management services	571,211	363,976	390,342	(26,366)
City clerk	214,807	90,010	68,458	21,552
Cable TV	8,897	36,389	27,150	9,239
Risk management	970,687	925,221	838,528	86,693
Recruitment	285,118	323,952	363,828	(39,876)
Operations	1,450,860	1,173,458	1,360,128	(186,670)
Total general government	3,523,953	4,907,748	4,432,226	475,522
Public safety:				
Police administration	3,064,803	2,862,221	2,634,519	227,702
Police patrol	4,071,309	4,172,434	3,774,587	397,847
Total public safety	7,136,112	7,034,655	6,409,106	625,549
Streets and public works:				
Street facilities	328,946	342,291	291,478	50,813
Engineering	338,291	348,699	247,081	101,618
Total streets and public safety	667,237	690,990	538,559	152,431
Parks and recreation:				
Library	235,777	216,024	107,411	108,613
Administration	--	--	720	(720)
Facility rental	220,851	220,851	208,654	12,197
Day camp	296,304	296,304	243,184	53,120
Child care	921,202	930,059	714,024	216,035
Recreation classes	131,835	122,978	126,990	(4,012)
Senior citizens	136,437	145,700	147,876	(2,176)
Tiny tots	212,784	223,404	207,028	16,376
Swim center	507,671	507,028	450,863	56,165
Sports program	211,861	189,621	166,706	22,915
Teen program	125,709	138,776	108,235	30,541
Community center	9,067	--	1,423	(1,423)
Youth and teen resource center	244,680	250,082	212,729	37,353
Total parks and recreation	3,254,178	3,240,827	2,695,843	544,984

continued

CITY OF HERCULES

Budgetary Comparison Schedule (continued)
 General Fund
 For the Year Ended June 30, 2011

	Budgeted Amounts		Actual	Variance with Final Budget
	Original	Final		
Expenditures (continued):				
Current (continued):				
Community development:				
Business and regional planning	\$ 637,062	\$ 568,557	\$ 562,475	\$ 6,082
Building inspection	728,706	699,086	551,887	147,199
Total community development	<u>1,365,768</u>	<u>1,267,643</u>	<u>1,114,362</u>	<u>153,281</u>
Lease expense	785,996	1,249,578	780,504	469,074
Total Expenditures	<u>16,733,244</u>	<u>18,391,441</u>	<u>15,970,600</u>	<u>2,420,841</u>
Excess (Deficiency) of Revenues Over (Under) Expenditures	<u>6,254,060</u>	<u>4,595,863</u>	<u>(4,204,791)</u>	<u>(8,800,654)</u>
Other Financing Sources (Uses):				
Transfers in	1,377,500	1,377,500	579,722	(797,778)
Transfers out	<u>(7,490,997)</u>	<u>(7,490,997)</u>	<u>(219,332)</u>	<u>7,271,665</u>
Total Other Financing Sources (Uses)	<u>(6,113,497)</u>	<u>(6,113,497)</u>	<u>360,390</u>	<u>6,473,887</u>
Net Change in Fund Balances	140,563	(1,517,634)	(3,844,401)	(2,326,767)
Budgetary Fund Balances - Beginning of Year, restated	<u>30,966,000</u>	<u>30,966,000</u>	<u>30,966,000</u>	<u>--</u>
Budgetary Fund Balances - End of Year	<u>\$ 31,106,563</u>	<u>\$ 29,448,366</u>	<u>27,121,599</u>	<u>\$ (2,326,767)</u>

CITY OF HERCULES

**Budgetary Comparison Schedule
Redevelopment Agency Special Revenue Fund
For the year Ended June 30, 2011**

	Budgeted Amounts		Actual	Variance with Final Budget
	Original	Final		
Revenues:				
Taxes and assessments	\$ 10,504,083	\$ 10,504,082	\$ 9,768,553	\$ (735,529)
Use of money and property	(160,000)	(160,000)	(223,075)	(63,075)
Program income	768,751	773,636	1,182,986	409,350
Charges for services	--	33,225	2,039	(31,186)
Other revenues	7,139,111	101,000	340,139	239,139
Total Revenues	18,251,945	11,251,943	11,070,642	(181,301)
Expenditures:				
Current:				
General government	--	--	173,910	(173,910)
Community development	7,896,723	7,975,261	5,708,416	2,266,845
Total Expenditures	7,896,723	7,975,261	5,882,326	2,092,935
Excess (Deficiency) of Revenues Over (Under) Expenditures	10,355,222	3,276,682	5,188,316	1,911,634
Other Financing Sources (Uses):				
Transfers in	--	464,000	40,000	(424,000)
Transfers out	(14,968,935)	(14,968,935)	(12,113,676)	2,855,259
Total Other Financing Sources (Uses)	(14,968,935)	(14,504,935)	(12,073,676)	2,431,259
Net Change in Fund Balances	(4,613,713)	(11,228,253)	(6,885,360)	4,342,893
Fund Balances - Beginning of Year	(10,238,571)	(10,238,571)	(10,238,571)	--
Fund Balances - End of Year	\$ (14,852,284)	\$ (21,466,824)	\$ (17,123,931)	\$ 4,342,893

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OTHER REPORT

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**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, 2011, which collectively comprise the City's basic financial statements and have issued our report thereon dated August 9, 2013. 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.

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 significant deficiencies, or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying schedule of findings and responses, we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses.

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. We consider the deficiencies described in the accompanying schedule of findings and responses to be material weaknesses. (2011-1, 2011-2, 2011-3, 2011-4, and 2011-5).

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

We noted certain matters that we reported to management of the City in a separate letter dated August 9, 2013.

The City's responses to the findings identified in our audit is described in the accompanying schedule of findings and responses. We did not audit the City's responses and, accordingly, we express no opinion on them.

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, appearing to read "Gallina" followed by a stylized flourish.

Roseville, California
August 9, 2013

SCHEDULE OF FINDINGS AND RESPONSES

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CITY OF HERCULES

Schedule of Findings and Responses For the Year Ended June 30, 2011

Reference Number: 2011-1

CONSTRUCTION IN PROGRESS

Condition

During our review of construction in progress, we noted a cancellation fee of \$277,292 that was improperly capitalized.

Criteria

Construction in progress should only include costs incurred to construct or develop a tangible or intangible capital asset before it is substantially ready to be placed into service.

Cause of Condition

The City did not reverse the cancellation fee, which was recorded in an account used for tracking project expenditures, from the project's total expenditures when compiling the capital asset schedules at year-end.

Potential Effect of Condition

Capitalizing expenses not eligible for capitalization results in overstatement of capital assets and understatement of expenses.

Recommendation

We recommend the City review all transactions recorded in the project expenditure accounts at year-end prior to recording them as construction in progress to ensure they qualify as capital asset additions.

Management Response

As part of the reconciliation process, the City of Hercules Finance Department staff along with the appropriate project manager or other department staff, will review all transactions recorded in the project expenditure accounts at year-end prior to recording them as construction in progress to ensure they qualify as capital asset additions.

CITY OF HERCULES

Schedule of Findings and Responses For the Year Ended June 30, 2011

Reference Number: 2011-2

ACCUMULATED PROJECT COSTS/LAND HELD FOR RESALE

Condition

During our review of capital assets, we noted the City inadvertently included \$38 million of accumulated project costs related to the Sycamore Downtown project and \$31.4 million of land held for resale related to various land parcels held by the Redevelopment Agency in its year-end capital assets balance at June 30, 2011. Included in the total adjustment, we proposed a prior period audit adjustment for \$52.5 million to restate the land held for resale and accumulated project costs that were incorrectly reported as capital assets in the prior year audited financial statements.

Criteria

Construction projects, such as the Sycamore Downtown Project, and land parcels that are not intended to be used in the entity's operations do not qualify as capital assets, regardless of their form.

Cause of Condition

In prior years, the City's financial statements did not distinguish between capital assets and land held for resale/accumulated project costs.

Potential Effect of Condition

By improperly classifying land held for resale and accumulated project costs of an asset the City is intending to sell as capital assets, the City is significantly understating its assets in the fund financial statements and overstating its capital asset balances in the government-wide financial statements.

Recommendation

We recommend the City's Finance Department review all its projects at year-end to determine whether all projects are properly classified for financial reporting as either construction in progress or accumulated project costs, based on its intended use of the completed assets. In addition, we recommend the City's Finance department review all of its land and other completed capital assets for proper classification based on the asset's usage.

Management Response

As part of the year-end reconciliation process, the City of Hercules Finance Department staff along with the appropriate project manager or other department staff, will review all projects to determine the proper classification for financial reporting as either construction in progress or accumulated project costs based on the intended use of the completed asset. The City of Hercules Finance Department staff will also review all land and other completed capital assets for proper classification based on the assets usage.

CITY OF HERCULES

Schedule of Findings and Responses For the Year Ended June 30, 2011

Reference Number: 2011-3

ENTERPRISE FUND ACCOUNTING

Condition

During our review of the prior year financial statements, we noted the City was reporting long-term debt of \$7,425,000 and related account balances of the Electric System Project in a governmental fund despite the Hercules Municipal Utility Fund activity being reported as an enterprise fund or business-type activity.

Criteria

To determine the entity's ability to recover costs for an activity through fees charged to external users, the financial statements of the activity or fund should include all related assets and liabilities associated with that activity or fund, including long-term debt.

Cause of Condition

The City felt it was appropriate to report the long-term debt and related account balances of the Electric System Project in a governmental fund since the revenue bonds for this Project were issued by the Hercules Public Financing Authority, a governmental fund of the City.

Potential Effect of Condition

The City may not be able to accurately determine whether its fees and charges are sufficient to recover the costs of the activity when excluding long-term debt and other significant account balances from the enterprise fund's financial statements.

Recommendation

The City agreed with our recommendation to reclassify long-term debt and related account balances for enterprise fund activities from a governmental fund to the appropriate enterprise fund, despite the debt being issued by the Hercules Public Financing Authority, a governmental fund of the City. We further recommend that the City's Finance Department analyze all future debt issued by the Hercules Public Financing Authority for proper reporting based on the activity being financed.

Management Response

For all future debt issues, the City of Hercules Finance Department will analyze all debt issued by the Hercules Public Financing Authority for proper reporting based on the activity being financed.

CITY OF HERCULES

Schedule of Findings and Responses For the Year Ended June 30, 2011

Reference Number: 2011-4

RETENTION PAYABLE

Condition

During the audit, we noted that the City did not accrue a project retention of \$2.2 million for the Sycamore Downtown Project at year-end despite the services being provided through June 30.

Criteria

Costs incurred to construct an asset should be recognized in the year the services have been provided and not when the payment has been made.

Cause of Condition

The City was likely planning to record the accumulated costs held in retention as expenses at the time of payment.

Potential Effect of Condition

By not accruing outstanding retentions at year-end, the City could be understating assets such as capital assets and accumulated project costs and understating liabilities and expenses.

Recommendation

We recommend the City's Finance Department review all open projects at year-end to determine if they have significant retentions that should be accrued.

Management Response

The City of Hercules Finance Department will review all open projects at year-end to determine if they have significant retentions that should be accrued.

CITY OF HERCULES

**Schedule of Findings and Responses
For the Year Ended June 30, 2011**

Reference Number: 2011-5

ALLOWANCE FOR DOUBTFUL ACCOUNTS

Condition

During our review of the governmental fund statements, we noted the City did not record a \$700 thousand allowance to offset a loan receivable for the development of low and moderate income housing that will likely not be repaid due to the terms of the loan.

Criteria

Receivables should be reported net of any allowance for uncollectible or doubtful accounts.

Cause of Condition

The City adjusted deferred revenue by the allowance instead of the receivable.

Potential Effect of Condition

Receivables are overstated when not adjusted by the allowance.

Recommendation

We recommend the City report its receivables net of any allowance for uncollectible or doubtful accounts.

Management Response

The City of Hercules Finance Department will report its receivables net of any allowance for uncollectible or doubtful accounts or for loans that will not be repaid due to the terms of the loan.

