# COASTAL WATER AUTHORITY
# PENSION PLAN

## Management's Discussion
## and Analysis,
## Independent Auditors' Report
## and Financial Statements

## September 30, 2014 and 2013

**COASTAL WATER AUTHORITY PENSION PLAN**
**Table of Contents**
**September 30, 2014 and 2013**

## COASTAL WATER AUTHORITY PENSION PLAN
## Management's Discussion and Analysis
## Years Ended September 30, 2014 and 2013

As management of the Coastal Water Authority Pension Plan (the Plan), we offer readers of the Plan's financial statements this narrative overview and analysis of the financial activities of the Plan for the fiscal years ended September 30, 2014 and 2013. Please read this discussion and analysis in conjunction with the Plan's basic financial statements, which follow this section.

### OVERVIEW OF THE FINANCIAL STATEMENTS

The financial section of this annual report consists of two parts: Management's Discussion and Analysis and the basic financial statements.

The financial statements provide both long-term and short-term information about the Plan's financial status. The financial statements also include notes that explain some of the information in the financial statements and provide more detailed data.

The Plan's financial statements are prepared in conformity with accounting principles generally accepted in the United States of America (US GAAP) as applied to governmental units on an accrual basis. Under this basis, contributions and investment income are recognized in the period in which they are earned, expenses and investment losses are recognized in the period in which they are incurred, and benefit payments are recognized in the period in which payments are made.

The Statements of Net Assets Available for Benefits include all assets and liabilities associated with the operations of the Plan. The Statements of Changes in Net Assets Available for Benefits report the Plan's net assets and how they have changed. Net assets are the differences between the Plan's assets and liabilities.

### FINANCIAL ANALYSIS OF THE PLAN

**TABLE A-1**

**Coastal Water Authority Pension Plan's Summarized Financial Information**

| | 2014 | 2013 |
|---|---|---|
| **Assets** | | |
| Investments, at fair value | $ 11,015,108 | $ 9,991,987 |
| Employer's contribution receivable | 15,540 | 18,384 |
| **Net assets available for benefits** | $ 11,030,648 | $ 10,010,371 |

## COASTAL WATER AUTHORITY PENSION PLAN
## Management's Discussion and Analysis
## Years Ended September 30, 2014 and 2013

### TABLE A-2

### Changes in Coastal Water Authority Pension Plan's Net Assets

| | 2014 | 2013 |
|---|---|---|
| **Additions** | | |
| **Investment income** | | |
| Net appreciation in fair value of investments | $ 114,013 | $ - |
| **Contributions** | | |
| Employer | 708,128 | 713,049 |
| Participants | 354,627 | 351,800 |
| | 1,062,755 | 1,064,849 |
| Total additions | 1,176,768 | 1,064,849 |
| **Deductions** | | |
| Net depreciation in fair value of investments | - | 74,635 |
| Benefits paid directly to participants | 156,491 | 1,430,517 |
| Total deductions | 156,491 | 1,505,152 |
| **Net increase (decrease)** | 1,020,277 | (440,303) |
| **Net assets available for benefits, beginning of year** | 10,010,371 | 10,450,674 |
| **Net assets available for benefits, end of year** | $ 11,030,648 | $ 10,010,371 |

During 2014, the increase in net assets was due to the excess of contributions and investment income over benefit payments. The substantial decrease in benefit payments was due to participants receiving lesser amounts of benefit payments in 2014 compared to 2013.

McCONNELL & JONES LLP
CERTIFIED PUBLIC ACCOUNTANTS

# Independent Auditors' Report

To the Board of Directors of Coastal Water Authority:

***Report on the Financial Statements***

We have audited the accompanying financial statements of the Coastal Water Authority Pension Plan (the Plan), a component unit of Coastal Water Authority, which comprise the Statements of Net Assets Available for Benefits as of September 30, 2014 and 2013, and the related Statements of Changes in Net Assets Available for Benefits for the years then ended, and the related Notes to Financial Statements.

***Plan Management's Responsibility for the Financial Statements***

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

***Auditors' Responsibility***

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with the auditing standards generally accepted in the United States of America (US GAAS). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement.

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

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

***Opinion***

In our opinion, the financial statements referred to above present fairly, in all material respects, the net assets available for benefits of the Plan as of September 30, 2014 and 2013, and the

3040 Post Oak Blvd., Suite 1600
Houston, TX 77056
Phone: 713.968.1600
Fax: 713.968.1601

WWW.MCCONNELLJONES.COM

changes in net assets available for benefits for the years then ended, in accordance with US GAAP.

***Report on Supplementary Information***

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The Management's Discussion and Analysis on pages 1 through 2 is presented for the purpose of additional analysis and is not a required part of the basic financial statements but is supplementary information required by US GAAP. Such information is the responsibility of Plan management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. We have applied certain limited procedures, which consisted principally of inquiries of Plan management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the supplementary information and express no opinion on it.

McConnell & Jones LLP

Houston, Texas
January 14, 2015

**Coastal Water Authority Pension Plan**
**Statements of Net Assets Available for Benefits**
**September 30, 2014 and 2013**

| | 2014 | 2013 |
|---|---|---|
| **Assets** | | |
| Investments in U.S., local government and agency securities, at fair value | $ 11,015,108 | $ 9,991,987 |
| Employer's contribution receivable | 15,540 | 18,384 |
| **Net Assets Available for Benefits** | $ 11,030,648 | $ 10,010,371 |

*See Notes to Financial Statements*

## Coastal Water Authority Pension Plan
## Statements of Changes in Net Assets Available for Benefits
## Years Ended September 30, 2014 and 2013

| | 2014 | 2013 |
|---|---|---|
| **Additions** | | |
| **Investment income** | | |
| Net appreciation in fair value of investments in U.S., local government and agency securities | $ 114,013 | $ - |
| **Contributions** | | |
| Employer | 708,128 | 713,049 |
| Participants | 354,627 | 351,800 |
| | 1,062,755 | 1,064,849 |
| Total additions | 1,176,768 | 1,064,849 |
| **Deductions** | | |
| Net depreciation in fair value of investments in U.S., local government and agency securities | - | 74,635 |
| Benefits paid directly to participants | 156,491 | 1,430,517 |
| Total deductions | 156,491 | 1,505,152 |
| **Net increase (decrease)** | 1,020,277 | (440,303) |
| **Net assets available for benefits, beginning of year** | 10,010,371 | 10,450,674 |
| **Net assets available for benefits, end of year** | $ 11,030,648 | $ 10,010,371 |

*See Notes to Financial Statements*

## Note 1: Description of the Plan

The following description of Coastal Water Authority Pension Plan (the Plan) provides only general information. Participants should refer to the Plan agreement for a more complete description of the Plan's provisions.

### *General*

The Plan is a single-employer defined contribution pension plan for the benefit of Coastal Water Authority (the Authority) employees. The Authority is the plan sponsor and a governmental organization. Accordingly, the Plan is not subject to the requirements of the Employee Retirement Income Security Act of 1974.

Employees are eligible to participate in the Plan on the entry date coincident with or next following the completion of 90 days of service. The entry date is the first day of the subsequent pay period following eligibility.

### *Contributions*

Participants are required to contribute 4% of their annual compensation and may make additional voluntary contributions up to a maximum of 10% of compensation. All newly eligible participants may contribute an additional contribution in an amount equal to 4% of the compensation received during their initial 90 days of service. Pursuant to the Plan document, the Authority contributed 11.8% of a participant's gross compensation to the Plan for Plan years' 2014 and 2013. For a participant that reaches the Federal Insurance Contributions Act (FICA) salary limit of $117,000 and $113,700 for 2014 and 2013, respectively, during a Plan year, an additional 6.2% of the participant's gross wages in excess of the FICA salary limit is contributed by the Authority to the participant's account. The Plan is not participant directed.

### *Participant Accounts*

At the end of each Plan quarter, earnings on contributions and prior earnings are allocated to participant accounts based on the quarter's beginning account balance for the participant to the quarter's total beginning Plan balance. Each participant account is credited with the participant's contribution, the Authority's contribution, and the allocation of the Plan's earnings. The benefit to which a participant is entitled is the benefit that can be provided from the participant's vested account.

***Vesting***

Participants are at all times fully vested in their contributions and the appreciation or depreciation thereon. For vesting purposes, a participant must be credited with at least 1,000 hours of service during the Plan year to qualify as one year of service. Vesting in the Authority's contributions plus earnings thereon is based on years of continuous service. Participants vest 20% per year after one year of service and are 100% vested after five years of service. Participants are immediately vested upon death, retirement, or termination of employment due to permanent disability. Normal retirement age under the Plan is 65.

***Forfeited Accounts***

Forfeitures of non-vested Authority contributions are used to reduce the Authority's contributions in the pay period subsequent to the date a participant received the distribution of his or her vested interest. For the year ended September 30, 2014 and 2013, employer contributions were reduced by $9,570 and $6,402, respectively. There are no outstanding forfeitures at September 30, 2014 and 2013.

***Payment of Benefits***

Benefits are payable to participants or to a designated beneficiary upon the occurrence of a participant's retirement, disability, death, termination of service, or voluntary contribution withdrawal election.

A voluntary contribution withdrawal election is requested from the Plan's administrative committee. Upon approval and disbursement, a participant may not make another voluntary contribution withdrawal election for twenty-four months, but may continue to make voluntary contributions to the Plan.

Distributions, other than voluntary contribution withdrawals, are made in a lump-sum amount or a two to ten year annuity amount equivalent to the vested value of the participant's account.

***Plan Termination***

Although it has not expressed any intent to do so, the Authority has the right to terminate the Plan at any time. In the event of termination, all participants become fully vested in their accounts. No part of the Plan's assets will revert to the Authority.

## Note 2: Significant Accounting Policies

***Basis of Accounting***

The financial statements are presented on the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America (US GAAP).

***Use of Estimates***

The preparation of financial statements in conformity with US GAAP requires Plan management to make estimates and assumptions that affect the reported amounts of assets and liabilities and changes therein and disclosure of contingent assets and liabilities at the date of the financial statements. Actual results could differ from those estimates.

***Reporting Entity***

The Plan is a component unit of the Authority. In evaluating how to define the Plan for financial reporting purposes, management determined there are no component units for which the Plan has financial accountability. As such, these financial statements present only the Plan and are not intended to present the financial position and results of operations of the Authority in conformity with US GAAP.

***Investment Valuation and Income Recognition***

The Plan's investments are stated at fair value. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. See Note 4 for discussion of fair value measurements.

Purchases and sales of securities are recorded on a trade-date basis. Interest income is recorded on the accrual basis. Dividends are recorded on the ex-dividend date. Net appreciation includes the Plan's gains and losses on investments bought and sold as well as held during the year.

***Payment of Benefits***

Benefits paid directly to participants are recorded when paid.

***Administrative Expenses***

For the years ended September 30, 2014 and 2013, Plan administrative expenses of $29,022 and $18,042, respectively, were paid by the Authority.

***Plan Management's Review of Subsequent Events***

In preparing the accompanying financial statements, Plan management has reviewed all known events that have occurred after September 30, 2014, and through January 14, 2015, the date when these financial statements were available to be issued, for inclusion in the financial statements and footnotes.

## Note 3: Investments

The Plan's investments in U.S., local government and agency securities were held by Frost National Bank. The following tables present the Plan's investments as of September 30, 2014 and 2013:

| September 30, 2014 | Face Value | Fair Value | Amortized Cost |
|---|---|---|---|
| Federal Home Loan Banks dated 4/16/2014 0.090% due 1/16/2015* | $ 1,000,000 | $ 999,870 | $ 1,000,328 |
| Federal Home Loan Banks dated 1/17/2014 0.120% due 10/17/2014* | 1,250,000 | 1,250,000 | 1,250,317 |
| Federal Home Loan Mortgage Corp dated 3/26/2013 1.000% due 3/26/2018 Callable on 3/26/2014 @ 100* | 1,500,000 | 1,477,365 | 1,500,267 |
| Federal Home Loan Mortgage Corp dated 6/20/2012 1.000% due 6/20/2017 Callable Quarterly Starting 6/20/2014 @100* | 3,000,000 | 2,994,390 | 3,008,428 |
| Federal National Mortgage Assoc dated 5/30/2013 1.125% due 5/25/2018 Callable Quarterly Starting 11/25/2013 @ 100* | 1,500,000 | 1,474,620 | 1,505,964 |
| Federal National Mortgage Assoc dated 11/14/2012 0.900% due 11/14/2017 Callable Quarterly Starting 5/14/2013 @ 100* | 1,000,000 | 987,390 | 1,003,406 |
| Federal National Mortgage Assoc Discount Note dated 4/14/2014 0.100% due 4/9/2015* | 1,501,000 | 1,500,685 | 1,500,208 |
| Cash Equivalents; SEI Daily Income TR Treasury II | 330,788 | 330,788 | 330,788 |
| | $ 11,081,788 | $ 11,015,108 | $ 11,099,706 |

| September 30, 2013 | Face Value | Fair Value | Amortized Cost |
|---|---|---|---|
| Federal Home Loan Mortgage Corp dated 3/26/2013 1.00% due 3/26/2018 Callable on 3/26/2014 @ 100* | $ 1,500,000 | $ 1,465,875 | $ 1,500,267 |
| Federal Home Loan Mortgage Corp dated 6/20/2012 1.00% due 6/20/2017 Callable Quarterly Starting 6/20/2014 @100* | 3,000,000 | 2,969,160 | 3,008,445 |
| Federal National Mortgage Assoc dated 5/30/2013 1.125% due 5/25/2018 Callable Quarterly Starting 11/25/2013 @ 100* | 1,500,000 | 1,462,440 | 1,505,733 |
| Federal National Mortgage Assoc dated 11/14/2012 0.90% due 11/14/2017 Callable Quarterly Starting 5/14/2013 @ 100* | 1,000,000 | 982,720 | 1,003,411 |
| Houston Hotel Occupancy Tax Commercial Paper Series A dated 9/5/2013 0.11% due 10/3/2013* | 1,500,000 | 1,500,000 | 1,500,118 |
| Cash Equivalents; SEI Daily Income TR Treasury II* | 1,611,792 | 1,611,792 | 1,611,792 |
| | $ 10,111,792 | $ 9,991,987 | $ 10,129,766 |

*Represents 5% or more of the Plan's net assets

The Plan is authorized to invest in direct obligations of, or obligations guaranteed by, the United States of America, obligations of certain Federal agencies, certain obligations of public housing authorities and related institutions, and interest bearing time deposits. Any cash balances and time deposits are required to be collateralized and secured by pledges of direct obligations of, or obligations guaranteed by, the United States of America, obligations of such Federal agencies, and certain obligations of public housing authorities and related institutions. Investments typically mature in three years or less, and are held to maturity or to the stated call date if such action is taken by the issuer.

## Note 4: Fair Value Measurements

The Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 820, *Fair Value Measurements and Disclosures,* (FASB ASC 820) establishes a framework for measuring fair value. That framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in an active market for identical assets or liabilities (level 1 measurement) and the lowest priority to unobservable inputs (level 3 measurement). The three levels of the fair value hierarchy under FASB ASC 820 are described as follows:

*Level 1*
Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities.

*Level 2*
Inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

*Level 3*
Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

A financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement.

Following is a description of the valuation methodologies used for investments measured at fair value. There have been no changes in the methodologies used at September 30, 2014 and 2013.

*U.S., local government and agency securities* – Valued at fair value using the closing price reported on the active market on which the individual securities are traded. Callable agency issued debt securities are valued by benchmarking model-derived prices to quoted market prices and trade data for identical or comparable securities. Callable agency issued debt securities and mortgage pass-through certificates are generally categorized in Level 2 of the fair value hierarchy.

The preceding method described may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although the Plan believes its valuation method is appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

The following table sets forth by level, within the fair value hierarchy, the Plan's investments at fair value as of September 30, 2014 and 2013:

| | | 2014 | | 2013 |
|---|---|---|---|---|
| **Level 1:** | | | | |
| SEI Daily Income | $ | 330,788 | $ | 1,611,792 |
| Houston Hotel Occupancy Tax Commercial Paper Series A | | - | | 1,500,000 |
| | | 330,788 | | 3,111,792 |
| **Level 2:** | | | | |
| Federal Home Loan Mortgage Corporation | | 4,471,755 | | 4,435,035 |
| Federal National Mortgage Association | | 3,962,695 | | 2,445,160 |
| Federal Home Loan Banks | | 2,249,870 | | - |
| | | 10,684,320 | | 6,880,195 |
| Total investments at fair value | $ | 11,015,108 | $ | 9,991,987 |

## Note 5: Federal Income Taxes

The Plan obtained its latest determination letter dated June 24, 2014, in which the Internal Revenue Service (IRS) stated that the Plan, as then designed, was in compliance with the applicable requirements of the Internal Revenue Code (IRC). The Plan has been amended since receiving the determination letter. However, the plan administrator and the Plan's tax counsel believe that the plan is currently designed and being operated in compliance with the applicable requirements of the IRC.

US GAAP requires the plan administrator to evaluate uncertain tax positions taken by the Plan. The financial statement effects of a tax position are recognized when the position is more likely than not, based on the technical merits, to be sustained upon examination by the IRS. The plan administrator has analyzed the tax positions taken by the Plan, and has concluded that as of September 30, 2014, there are no uncertain positions taken or expected to be taken. The Plan has recognized no interest or penalties related to uncertain tax positions. The Plan is subject to routine audits by taxing jurisdictions; however, there are currently no audits for any tax periods in progress. The plan administrator believes it is no longer subject to income tax examinations for years prior to 2010.

## Note 6: Risks and Uncertainties

The Plan invests in various investment securities that are exposed to various risks such as interest rates, market and credit risks. Market values of investments may decline for a number of reasons, including changes in prevailing market and interest rates, increases in defaults and credit rating downgrades. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that change in values of investment securities will occur in the near term and that some changes could materially affect participant account balances and the assets reported in the Statements of Net Assets Available for Benefits.

MJ

www.mcconnelljones.com