

# **LOS OSOS COMMUNITY SERVICES DISTRICT**

## **FINANCIAL STATEMENTS**

**FOR THE YEAR ENDED  
JUNE 30, 2012**

**WITH INDEPENDENT AUDITOR'S REPORT  
AND  
SUPPLEMENTARY INFORMATION**



**LOS OSOS COMMUNITY SERVICES DISTRICT  
FOR THE YEAR ENDED JUNE 30, 2012**

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**LOS OSOS COMMUNITY SERVICES DISTRICT  
FOR THE YEAR ENDED JUNE 30, 2012**

**THE DISTRICT**

The Los Osos Community Services District (District), a political subdivision of the State of California, was formed on January 1, 1999, pursuant to Ballot Measure K-98 to provide services previously provided by San Luis Obispo County (the County) in specific benefits zones of what was formerly County Service Area 9. After formation, the District added solid waste services providing service to all properties in the District. It operates pursuant to Section 61000 of the California Government Code. It is currently authorized to provide Fire Protection, Water, Street Lighting, Drainage, Solid Waste, and Parks and Recreation Services. It is governed by a five-member Board of Directors with an operations staff headed by a general manager.

The District comprises an area of approximately 3,443 acres or 5.38 square miles. The area is more commonly known as the communities of Los Osos and Baywood Park. It is located by a coastline adjoining the Montana de Oro State Park on its southwesterly boundary and the Morro Bay National Estuary and the Morro Bay State Park at its northern boundary. With such an idyllic location, the community has some exposure to tourism. However, absent accommodations and other facilities in the District that cater to the tourism industry, the District receives no significant economic benefit from tourism. The adjoining communities have the structures that fill the void.

The following is a summary of the funds the District maintains to deliver the services it is authorized to provide:

**Funds Maintained by the District and Their Specific Functions**

**Fund 100 – Administration**

The Administrative Fund provides centralized inter-fund services to all the other funds of the District such as management, accounting, payroll, insurance management, information and financial systems, equipment, and District legal services.

**Fund 200 – Bayridge**

Bayridge is a subdivision in Los Osos that has a dedicated residential community septic system. The fund provides septic management, street lighting, and open space management.

**Fund 301 – Fire and Emergency Services**

Fire and Emergency Services are provided through a contract with CAL FIRE for the entire community. Reserve Fire Fighters and administrative operational costs are paid by the District outside the CAL FIRE contract.

**Fund 400 – Vista de Oro**

Vista de Oro is a subdivision in Los Osos that has a dedicated residential community septic system. The fund provides septic management, street lighting, and open space management.

**Fund 500 – Water**

The Water Utility Department is responsible for the operation and maintenance of five groundwater supply wells providing treatment, monitoring, and distribution services to approximately 2,750 connections, through a network that consists of 27 miles of pipelines and includes 162 fire hydrants and 558 valves, 3 tanks, and one pump station. These services not only assure delivery of pure, wholesome and potable drinking water, but also water for fire flow protection in the communities of Los Osos and Baywood Park.

### **Fund 600 – Wastewater**

This fund was used to account for the construction of a sewage treatment plant which was stopped. Under special legislation Assembly Bill (AB) 2701, the project was transferred to the County of San Luis Obispo which formally accepted the project on March 15, 2011. This fund currently functions to service the debt associated with the aborted project and to account for expenses related to the District's bankruptcy filing which resulted from the aborted project. Once the bankruptcy case is closed, this fund will be officially named a debt service fund for the Wastewater Assessment District No. 1.

### **Fund 650 – Solid Waste**

Solid Waste provides trash cleanup and recycling services to the community. Actual trash and recycling services are provided by Mission Country Disposal and the District receives a Franchise Fee. The District provides additional recycling opportunities to the community through Chipping Days.

### **Fund 800 – Drainage**

This fund provides drainage services for the whole community. It maintains five pump station sites, monitors and mitigates as necessary the impact of storm run offs, clears channels of obstructions, and manages five drainage basins.

### **Fund 900 – Park and Recreation**

The long-term function of this fund is to provide recreation opportunities for the community of Los Osos/Baywood Park. However, the fund is not actively providing any recreational activities. Before the creation of the District, the County collected assessments for a pool and recreational activities. However, a subsequent vote to continue these assessments failed to pass. These assessments were turned over by the County to the District. The funds are invested and are restricted for the purpose of the original assessments, which is to build a swimming pool. There has been some preliminary discussions as to whether partnering in a regional pool that will be constructed in the adjoining community, some seven miles away, is a feasible or authorized use of these funds.

## **SIGNIFICANT EVENT THAT HAS A MAJOR IMPACT ON THE ECONOMIC AND FINANCIAL WELL-BEING OF THE DISTRICT**

### Chapter 9 Bankruptcy filing

The District filed for protection under Chapter 9 of the United States Bankruptcy Code on August 25, 2006. The purpose of Chapter 9 is to provide a financially distressed municipality protection from its creditors while it develops and negotiates a plan for adjusting its debts.

In addition, Chapter 9 grants the District an automatic stay to stop all collection actions against it and its property upon filing the petition. At the time of filing, all debts up until the bankruptcy date were frozen pending the District's reorganization plan (see Notes 5 and 11 for additional details) The following describes the events that led to the District's decision to file for Chapter 9 bankruptcy protection.

### Current status of the bankruptcy filing

On August 8, 2011, the Bankruptcy Court entered an Order Confirming the LOCSD Debt Adjustment Plan (the "Plan"). The Plan as confirmed resolved all the claims under the jurisdiction of the Bankruptcy Court which included approximately \$11.4 million in unsecured creditor claims. The confirmed Plan provided approximately \$4.5 million to satisfy the claims of the unsecured creditors. The sources of these funds are:

- The remaining State Revolving Fund Loan related to the prior Wastewater Treatment Project (approximately \$1.7 million as of September 10, 2010, the filing date of the Debt Adjustment Plan). As of June 30, 2012, it had a balance of \$1.448 million; and
- \$2.8 million from San Luis Obispo County resulting from the proposed transfer of the Solid Waste Franchise Agreement to the County.

On April 22, 2012, the favorable decision of the Bankruptcy Court was upheld by the U.S. District Court on the first appeal. On May 9, 2012, the same creditor filed a second appeal before the U.S. Court of Appeals, Ninth Circuit. First hearing is expected to be heard in late 2013.

### Background of the bankruptcy filing

In August of 2005, the District began construction on a wastewater treatment plant (the "project") at a location known as the Tri-W site and also purchased mitigation property known as the Broderson site. Project construction began with initial funding coming from a low-interest State Revolving Fund loan. The location and type of system planned to be constructed were very contentious.

In the fall election of 2005, three members of the Board of Directors who were in favor of the newly started project were recalled and were replaced by three new directors who then subsequently voted to stop the project. In the same election, a measure called Measure B was placed on the ballot to reverse the decision of the former Board of Directors on the location of a project and to vest that power to locate a sewer facility with the voters. Measure B passed and litigation to invalidate it was soon filed in the State Superior Court by a pro-project group. The litigation was successful but was followed by an appeal by the District. A special legislation, AB 2701, effectively mooted the controversy because it gave the County the option to design, locate, and construct a wastewater system.

After the project was stopped, various lawsuits against the District were filed. The State Water Resources Control Board filed a claim for \$8.6 million to recover funds it had already released to the District. The State Regional Water Quality Control Board filed a claim for \$6.6 million which is a levy of fines for the District's alleged failure to remediate pollution of groundwater and a nearby bay estuary. Major contractors and other contractors who were already working on the project filed for breach of contract for a total claim of more than \$28 million. There were other peripheral lawsuits that followed. A lot of these claims were mediated to much smaller amounts or settled under certain conditions.

The District lacked the funds to litigate or to pay these claims and therefore it sought bankruptcy protection under Chapter 9.

### Status of the sewer project

On January 1, 2007, AB 2701 became effective. This special legislation (codified as Government Code Sections 25825.5 and 61105) transferred the responsibility for constructing a wastewater collection and treatment system to the County of San Luis Obispo. It provides that after the County completes a due diligence review of the various aspects of the project, the County has to adopt a resolution declaring its intention to proceed or not to proceed with the construction and operation of a project. After several exhaustive proceedings that spanned over a number of years and that included several hearings and appeals process before the California Coastal Commission to obtain a development permit, the County passed a resolution on March 15, 2011, to proceed with the project. After completion, the sewer system will be operated by the County for three years and after that time, the County will decide whether to turn it over to the District if funding agencies will approve the action.

The County's sewer project is now proceeding actively. Contractors started digging in late October 2012. Stock of sewer pipes and equipment are visible in construction staging areas.

## **IMPACTS OF THE BANKRUPTCY ON THE FINANCIAL STATEMENTS**

### **Impact on the Capital Assets**

The value of the Construction in Progress (CIP) shown at \$22,067,856 in the Statement of Net Assets is highly questionable. These costs represent all costs in the Wastewater Fund that included costs of studies, costs of support staff, and all other support costs. It also included \$1.9 million paid to three contractors who installed underground pipes and facilities or did preparatory groundwork. The major contractors have an outstanding mediated claim of \$11.4 million filed in Bankruptcy Court which is not recorded and therefore is not included in the \$22 million CIP in the books.

AB 2701 dictated that all assets acquired by the District intended for the sewer project have to be transferred to the County when requested for use in the County's successor project without any financial remuneration. In addition, any assets so acquired by the District in the aborted project could not be disposed of without the County's approval.

The District approved the transfer of Land and Land Rights to the County as requested on November 17, 2011, with a total cost of \$8,070,977.

## **Impact on Liabilities**

Mediated claims against the District pending in Bankruptcy Court total about \$12 million. Other than the amount of \$950,719, which represents invoices received but unpaid as of the bankruptcy filing, the rest of the claims are not reflected in the accompanying financial statements. Two claims by the State as described below are not in the report either.

The State filed two claims for a total of \$15,263,566 which the State agreed to settle in fiscal year 2010-11 subject to certain conditions. The conditions have all been met other than the final approval of the District's Debt Adjustment Plan which, though favorably approved, had been appealed twice. The second appeal is pending. The claims and details of the conditions for each claim are as follows:

1. The State Regional Water Quality Control Board (RWQCB) agreed to settle its claim of \$6,627,000 to be subordinated to all other unsecured claims based upon the following conditions: (1) Court approval of a Bankruptcy Plan; Status: the Bankruptcy Court confirmed the District's Debt Adjustment Plan on August 8, 2011. However, this was appealed twice with the latest appeal filed on May 9, 2012. This is still pending. (2) the County adopting the Due Diligence Resolution to proceed with the Wastewater Treatment Project; Status: Construction has started with digging starting in October 2012.; and (3) the District will provide RWQCB a draft of a Water Conservation Plan; Status: the State accepted the 2011 Water Demand Analysis and Water Conservation Evaluation draft report referred to as the Maddaus Report as adequate in fulfilling this condition.
2. The State Water Resource Control Board agreed to settle its claim for \$8,636,566 subject to the following conditions: (1) the County adopts a Due Diligence Resolution to proceed with the Wastewater Treatment Project; Status: the County's project is proceeding actively with construction activity starting in October 2012; (2) the County applies for a State Revolving Fund loan to either fully or partially finance the project; Status: this has been fulfilled with the County signing a financing agreement with the agency on June 30, 2011; and (3) the Court approves a Debt Adjustment Plan; Status: the Court approved the Plan on August 8, 2011, but the Plan was appealed twice with the latest appeal filed on May 9, 2012. This appeal is pending.

## **Impact on the District's Future Financial Viability**

The approval of the District's Debt Adjustment Plan by the Bankruptcy Court on August 8, 2011, was a major development that would have allowed the District to continue as a going concern pursuant to the terms of the approved Debt Adjustment Plan. However, the bankruptcy court's order approving the Plan was appealed by the District's major creditor on August 22, 2011. This appeal was decided by the United States District Court in the District's favor on April 2, 2012, upholding the decision of the Bankruptcy Court to approve the Plan. Shortly afterward, on May 8, 2012, this decision was again appealed by the major creditor to the United States Court of Appeals for the Ninth Circuit. That appeal has yet not been set for hearing, but may be heard sometime in late 2013. Until the bankruptcy case is finally closed, it cannot be declared with absolute certainty that the District will be able to continue as a going concern.



## LOS OSOS COMMUNITY SERVICES DISTRICT

### BOARD OF DIRECTORS

Marshall E. Ochylski, President

Leonard A. Moothart, Vice-President

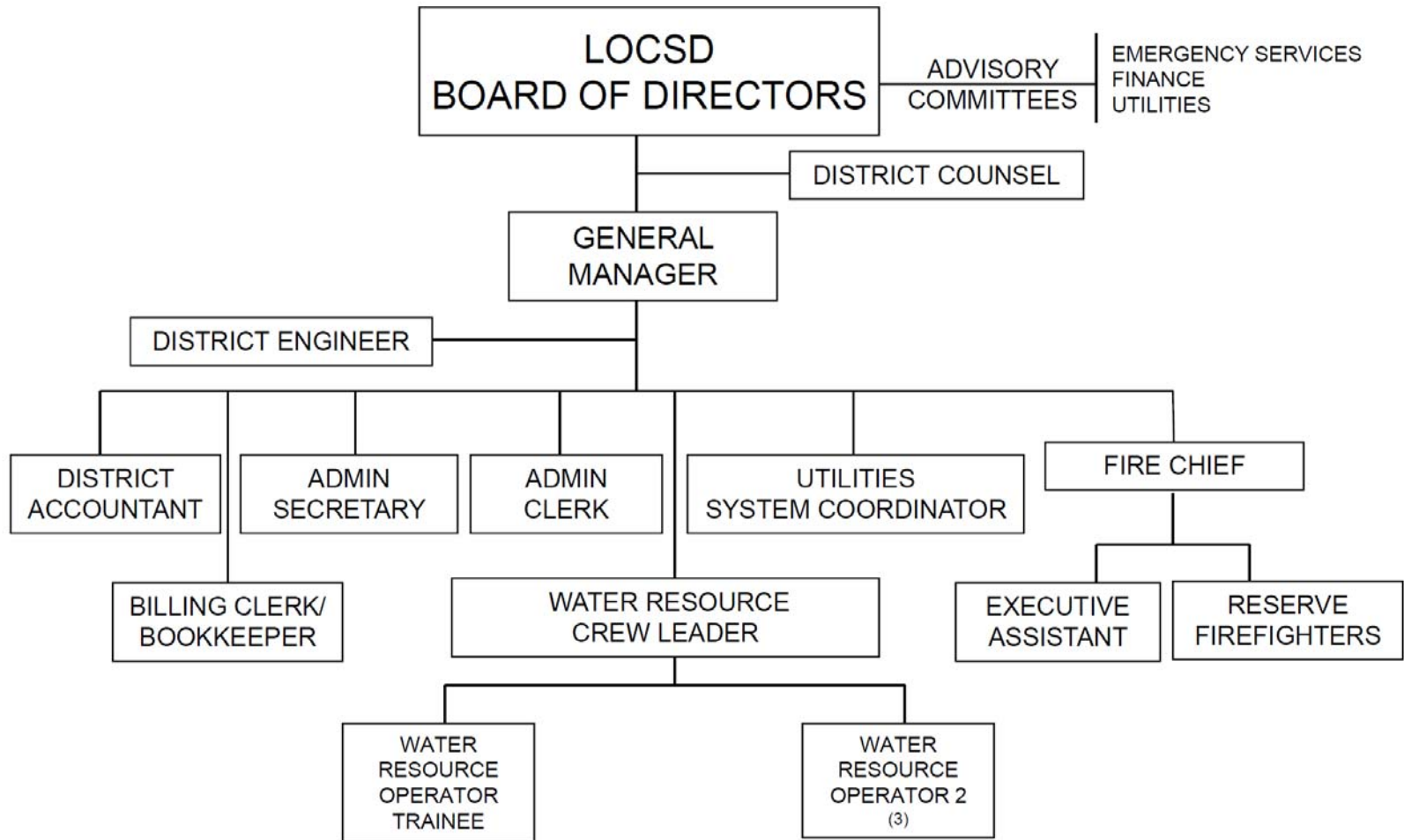
Craig V. Baltimore, Director

David S. Vogel, Director

R. Michael Wright, Director

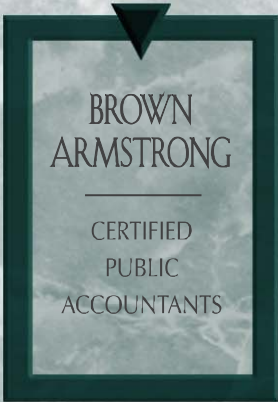


**LOS OSOS COMMUNITY SERVICES DISTRICT  
ORGANIZATIONAL CHART**



**LOS OSOS COMMUNITY SERVICES DISTRICT  
2012 ORGANIZATIONAL CHART  
REVISED 9/10/2012**

## **FINANCIAL SECTION**



# BROWN ARMSTRONG

*Certified Public Accountants*

## INDEPENDENT AUDITOR'S REPORT

To the Board of Directors of  
Los Osos Community Services District  
Los Osos, California

We have audited the accompanying basic financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the Los Osos Community Services District (the District) as of and for the year ended June 30, 2012, which collectively comprise the District's basic financial statements as listed in the table of contents. These basic financial statements are the responsibility of the District's management. Our responsibility is to express an opinion on these basic financial statements based on our audit.

Except as discussed in the following paragraph, we conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatements. 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 opinion.

The value of the Construction in Progress in the enterprise Wastewater Treatment Project Fund shown in the amount of \$22,067,856 may be materially impaired due to the permanent cancellation of the wastewater treatment project. This value represents construction costs recorded up to the bankruptcy filing but it does not include about \$11 million of claims filed with the Bankruptcy Court.

In our opinion, except for the effect of an adjustment to reflect the true value of business-type activities Construction in Progress and to recognize all liabilities that the District may be subject to in bankruptcy proceedings, 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 Los Osos Community Services District as of June 30, 2012, and the respective changes in the financial position and cash flows, where applicable, thereof for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

The second appeal by a creditor of the favorable decision of the Bankruptcy Court on the District's Debt Adjustment Plan leaves the District under substantial financial uncertainty that may jeopardize its ability to continue as a going concern.

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REGISTERED with the Public Company  
Accounting Oversight Board and  
MEMBER of the American Institute of  
Certified Public Accountants

In accordance with *Government Auditing Standards*, we have also issued our report dated December 7, 2012, on our consideration of the District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and budgetary comparison information on pages 3 through 8 and 44 through 45 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.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the District's financial statements as a whole. The introductory section and combining and individual non-major fund financial statements and schedules are presented for purposes of additional analysis and are not a required part of the financial statements. The combining and individual non-major fund financial statements and schedules are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole. The introductory section has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we do not express an opinion or provide any assurance on it.

BROWN ARMSTRONG  
ACCOUNTANCY CORPORATION

*Brown Armstrong*  
*Accountancy Corporation*

Bakersfield, California  
December 7, 2012

**LOS OSOS COMMUNITY SERVICES DISTRICT  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
JUNE 30, 2012**

**BACKGROUND**

The Los Osos Community Services District (the District), a political subdivision of the State of California, was formed on January 1, 1999, pursuant to Ballot Measure K-98 to provide services previously provided by the County of San Luis Obispo (County) in specific benefits zones of what was formerly County Service Area 9. After formation, the District added solid waste services providing service to all properties in the District. It operates pursuant to Section 61000 of the California Government Code. It is currently authorized to provide Fire Protection, Water, Street Lighting, Drainage, Solid Waste, and Parks and Recreation Services. The Parks and Recreation function is currently inactive and the only activity is holding in trust and investing funds representing assessments levied for a community pool more than five years ago. Discussions on activating this function occasionally occur informally but with the District still in legal proceedings (refer to introductory section), pursuance of this goal will need to be addressed in the future. It is governed by a five-member Board of Directors with an operations staff headed by a general manager.

This section offers some key financial information and a narrative overview of the financial status and financial activities of the District for the fiscal year ended June 30, 2012.

**OVERVIEW OF THE BASIC FINANCIAL STATEMENTS**

The District's financial statements are prepared in conformity with accounting principles generally accepted in the United States of America and may include in some cases amounts that are based upon reliable estimates and judgments.

The basic financial statements include four components: 1) government-wide financial statements, 2) fund financial statements, 3) notes to the basic financial statements, and 4) required supplementary information. This report also contains other supplementary information in addition to the basic financial statements. The government-wide statements consist of the *Statement of Net Assets and the Statement of Activities*.

**Government-Wide Financial Statements**

The *Government-Wide Financial Statements* are designed to provide readers with a broad overview of the District's finances, in a manner similar to a private-sector business.

The *Statement of Net Assets* presents information on all of the District's assets and liabilities, with the difference between the two reported as *net assets*. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the District is improving or deteriorating.

The *Statement of Activities* presents information showing how the District's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods (e.g., uncollected taxes and earned and unused employee vacation balances).

Both of the government-wide financial statements distinguish functions of the District that are principally supported by taxes and intergovernmental revenues (*governmental activities*) from other functions that are intended to recover all or a significant portion of their cost through user fees and charges (*business-type activities*). The governmental activities of the District include public safety, parks and recreation, public works, general government, street lighting, and health and sanitation. The business-type activities of the District include water, wastewater, and solid waste.

## MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

### Fund Financial Statements

A *fund* is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The District, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. The funds of the District are in two categories, namely, governmental and proprietary.

In a few instances where trust accounts are held, trust liability accounts are used in the related fund instead of being held in a separate fiduciary category of funds.

### Governmental Funds

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

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for *governmental funds* with similar information presented for *governmental activities* in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the District's near-term financing decisions.

Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between *governmental funds* and *governmental activities*.

The District maintains ten individual governmental funds organized according to their type: *general and special revenue*. The District does not currently have *debt service and capital projects* types in the *governmental funds*. Information is presented separately in the governmental funds' balance sheet and in the governmental funds' statement of revenues, expenditures, and changes in fund balances for the General Fund and the Fire Fund with all other funds presented into an aggregate column. Individual fund data for each of the non-major governmental funds is provided in the form of combining statements found in the other supplementary information section of this report.

A budgetary comparison statement has been provided for the General Fund and the Fire Fund to demonstrate compliance with budgetary laws of the State of California and policies and ordinances approved by the District's Board of Directors. This statement is shown under the required supplementary section of the report. Individual budgetary data for each of the non-major governmental funds is not presented.

### Proprietary Funds

There are two types of funds classified as proprietary, namely, *enterprise* and *internal service funds*. The District only maintains the enterprise type of proprietary funds. The District uses three *enterprise funds* to account for its water, wastewater, and solid waste activities. These three *enterprise funds* are presented in individual columns in the *fund financial statements*.

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

### Notes to the Basic Financial Statements

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

## MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

### Required Supplementary Information

The statements are followed by a section of *required supplementary information* (RSI) that further explains and supports the information in the financial statements. Comparison of *Budget to Actual* for major governmental funds is shown under this caption.

### Other Supplementary Information

Other supplementary information presents data that, although not required, is necessary to provide the reader of the basic financial statements more details to promote understanding of the statements as a whole. The combining statements for the non-major governmental funds are presented here.

## GOVERNMENT-WIDE FINANCIAL STATEMENTS

In accordance with changes in governmental accounting standards, the District applied Governmental Accounting Standards Board (GASB) Statement No. 34 to these financial statements.

Changes in net assets may serve over time as a useful indicator of the District's financial position.

**Table A**  
**Statement of Net Assets**  
**June 30, 2012**

	June 30, 2012			June 30, 2011			Total Change	
	Governmental Activities	Business-Type Activities	Total Primary Government	Governmental Activities	Business-Type Activities	Total Primary Government	Amount Change	Percent Change
<b>Assets:</b>								
Current assets	\$ 1,838,789	\$ 2,094,789	\$ 3,933,578	\$ 986,029	\$ 2,490,959	\$ 3,476,988	\$ 456,590	13.1%
Capital assets	487,445	27,656,668	28,144,113	467,934	35,819,031	36,286,965	(8,142,852)	-22.4%
Other non-current assets	354,873	3,574,168	3,929,041	353,117	3,677,772	4,030,889	(101,848)	-2.5%
<b>Total assets</b>	<b>2,681,107</b>	<b>33,325,625</b>	<b>36,006,732</b>	<b>1,807,080</b>	<b>41,987,762</b>	<b>43,794,842</b>	<b>(7,788,110)</b>	<b>-17.8%</b>
<b>Liabilities:</b>								
Current liabilities	327,120	1,696,954	2,024,074	341,639	1,696,360	2,037,999	(13,925)	-0.7%
Long-term liabilities	22,154	25,572,721	25,594,875	24,142	26,102,955	26,127,097	(532,222)	-2.0%
<b>Total liabilities</b>	<b>349,274</b>	<b>27,269,675</b>	<b>27,618,949</b>	<b>365,781</b>	<b>27,799,315</b>	<b>28,165,096</b>	<b>(546,147)</b>	<b>-1.9%</b>
<b>Net assets:</b>								
Invested in capital assets, net of related debt	487,445	1,564,862	2,052,307	467,934	9,211,866	9,679,800	(7,627,493)	-78.8%
Restricted	353,977	2,928,075	3,282,052	352,313	2,996,688	3,349,001	(66,949)	-2.0%
Unrestricted	1,490,411	1,563,013	3,053,424	621,052	1,979,893	2,600,945	452,479	17.4%
<b>Total net assets</b>	<b>\$ 2,331,833</b>	<b>\$ 6,055,950</b>	<b>\$ 8,387,783</b>	<b>\$ 1,441,299</b>	<b>\$ 14,188,447</b>	<b>\$ 15,629,746</b>	<b>\$ (7,241,963)</b>	<b>-46.3%</b>

## MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

**Table B**  
**Statement of Activities**  
**For the Year Ended June 30, 2012**

	June 30, 2012			June 30, 2011			Total Change	
	Governmental Activities	Business- Type Activities	Total Primary Government	Governmental Activities	Business- Type Activities	Total Primary Government	Amount Change	Percent Change
<b>Revenues:</b>								
<b>Program revenues:</b>								
Charges for services	\$ 835,845	\$ 1,774,156	\$ 2,610,001	\$ 810,592	\$ 1,765,980	\$ 2,576,572	\$ 33,429	1.3%
Operating grants and contributions	1,000	2,600	3,600	4,792	500	5,292	(1,692)	-32.0%
Capital grants and contributions	-	22,617	22,617	-	-	-	22,617	100.0%
<b>General revenues:</b>								
Property taxes	1,569,996	179,726	1,749,722	1,586,719	182,356	1,769,075	(19,353)	-1.1%
Other taxes	570,401	1,157,995	1,728,396	564,873	1,157,594	1,722,467	5,929	0.3%
Interest and investment income	7,920	13,158	21,078	9,468	14,631	24,099	(3,021)	-12.5%
Other revenues	88	28,279	28,367	27,121	32,522	59,643	(31,276)	-52.4%
<b>Total revenues</b>	<b>2,985,250</b>	<b>3,178,531</b>	<b>6,163,781</b>	<b>3,003,565</b>	<b>3,153,583</b>	<b>6,157,148</b>	<b>6,633</b>	<b>0.1%</b>
<b>Expenses:</b>								
General government as restated	669,007	-	669,007	688,168	-	688,168	(19,161)	-2.8%
Public safety	2,007,609	-	2,007,609	1,977,812	-	1,977,812	29,797	1.5%
Health and sanitation	55,594	-	55,594	74,308	-	74,308	(18,714)	-25.2%
Street lighting	7,615	-	7,615	5,272	-	5,272	2,343	44.4%
Interest on long-term debt	-	-	-	870	-	870	(870)	-100.0%
Water	-	1,625,579	1,625,579	-	1,711,618	1,711,618	(86,039)	-5.0%
Wastewater treatment	-	940,397	940,397	-	1,011,946	1,011,946	(71,549)	-7.1%
Solid waste	-	92,611	92,611	-	73,658	73,658	18,953	25.7%
<b>Total expenses</b>	<b>2,739,825</b>	<b>2,658,587</b>	<b>5,398,412</b>	<b>2,746,430</b>	<b>2,797,222</b>	<b>5,543,652</b>	<b>(145,240)</b>	<b>-2.6%</b>
Net transfers	645,109	(645,109)	-	17,600	(17,600)	-	-	0.0%
Change in net assets	890,534	(125,165)	765,369	274,735	338,761	613,496	151,873	24.8%
Net assets, beginning as restated	1,441,299	14,252,092	15,693,391	1,166,564	13,849,686	15,016,250	677,141	4.5%
Extraordinary item - distribution of sewer assets to County of San Luis Obispo	-	(8,070,977)	(8,070,977)	-	-	-	(8,070,977)	-100.0%
Net assets, ending	<u>\$ 2,331,833</u>	<u>\$ 6,055,950</u>	<u>\$ 8,387,783</u>	<u>\$ 1,441,299</u>	<u>\$ 14,188,447</u>	<u>\$ 15,629,746</u>	<u>\$ (7,241,963)</u>	<u>-46.3%</u>

### Analysis of Overall Financial Position and Results of Operations

#### Statement of Net Assets

The total assets of the District exceeded its liabilities at June 30, 2012, by \$8,387,783. This reflects a total reduction of 46.3% or \$7,241,963 from the prior year. This is due to the transfer of Land and Land Easements totaling \$8,070,977 to the County of San Luis Obispo in accordance with legislation, Assembly Bill (AB) 2701. This legislation mandated that assets previously acquired by the District for its now cancelled sewer project be transferred to the County as identified and requested for the successor sewer project which is independently managed by the County as per the legislation. With the County's sewer project in the District having passed through all the permitting and legal challenges, the County requested specific land parcels and land rights and the District formally approved a resolution for the transfer of these assets in November 2011. The transfer involved no remuneration. Construction activity is currently going on throughout the community.

It should be noted however that the Net Assets reflects Construction in Progress of \$22,067,856 recorded in the Wastewater Fund for all construction costs for the cancelled project incurred up to the date of filing for bankruptcy protection. In all indications, this value as reflected may be materially impaired.



## MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

The key component of Net Assets that indicates the health of the District is the Unrestricted Net Assets in the amount of \$3,053,424. This posted an increase of 17.4% or \$452,479 over the prior year. It is interesting to note that the rate of increase is the same as for the prior year. This positive trend is the result of continuing efforts to hold costs down. Any savings are funneled to Reserves and Designations. These are summarized in Note 9.

*Restricted net assets* declined by 2%. This is mainly due to releases from the balance of the State Revolving Fund loan spent on legal expenditures related to the bankruptcy proceedings. The decline is lower than the rate of 3.3% for the prior year and is indicative of lower legal costs. Legal costs being incurred now are related to the appeal process which is now in the second appeal of two court decisions that affirmed the District's Debt Adjustment Plan.

### Statement of Activities

Overall, the results of operations as shown in the Statement of Activities is very positive with an increase in Net Assets of 24.8% or \$151,873. This is mainly a result of the decrease in expenses of 2.6% or \$145,240. This trend is true with all funds and is the result of continuing cost control efforts. Total revenues edged over the prior year so very slightly by 0.1% or \$6,633. Property taxes decreased by 1.1% which is slightly better than the decrease of 1.8% from the prior year. This continuing decrease is contrary to the upward trend in the rest of the County. There is speculation that concerns on the cost of the new sewer project may be a factor for homeowners to give up their homes which are then sold for less value. There are indications however that the situation is settling down. The capital grant is the final reimbursement on major facilities repair in prior years due to earthquake damage. Returns on investment continue to be a very low average, no higher than half a percent.

Overall expenses in Governmental Activities decreased by a modest \$6,605, mainly due to a decrease in General Government. Total expenses in Business-Type Activities decreased by \$138,635, of which \$107,000 is due to the decrease in Water Fund depreciation as assets reach the end of their useful lives. The increase in Solid Waste expenses of \$18,953 is due to an outreach program to the community to lessen the full burden of a 4.51% rate increase that started in December 2011. This was undertaken under certain conditions. One of these conditions, a move to consider another rate increase, may very well end the outreach effort in the current year.

### Capital Assets and Long-Term Debt:

#### Capital Assets

**Table C**  
**Capital Assets**

	June 30, 2012			June 30, 2011			Total Change	
	Governmental Activities	Business-Type Activities	Total Primary Government	Governmental Activities	Business-Type Activities	Total Primary Government	Amount Change	Percent Change
Land and Land Rights	\$ 57,375	\$ 498,429	\$ 555,804	\$ 50,000	\$ 8,190,132	\$ 8,240,132	\$ (7,684,328)	-93.3%
Construction in Progress	-	22,086,422	22,086,422	-	22,067,856	22,067,856	18,566	0.1%
Buildings, Structures, and Improvements	515,116	5,000	520,116	515,117	-	515,117	4,999	1.0%
Infrastructure	232,299	8,397,190	8,629,489	-	-	-	8,629,489	100.0%
Equipment and Systems	1,116,328	408,228	1,524,556	1,844,052	8,507,855	10,351,907	(8,827,351)	-85.3%
Total Cost	1,921,118	31,395,269	33,316,387	2,409,169	38,765,843	41,175,012	(7,858,625)	-19.1%
Less Accumulated Depreciation	(1,433,673)	(3,738,601)	(5,172,274)	(1,941,235)	(2,946,812)	(4,888,047)	(284,227)	5.8%
<b>Total</b>	<b>\$ 487,445</b>	<b>\$ 27,656,668</b>	<b>\$ 28,144,113</b>	<b>\$ 467,934</b>	<b>\$ 35,819,031</b>	<b>\$ 36,286,965</b>	<b>\$ (8,142,852)</b>	-22.4%

In fiscal year 2011/12, assets were reconciled to physical inventory. In the process, assets were booked into new accounts that reflect the true category of the assets. The biggest reclassification was to Infrastructure for the assets of the Water Fund.

## MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

The overall decrease in assets of \$8,142,852 reflects the transfer of Land and Land Easements to the County of San Luis Obispo of \$8,070,977 as mandated by AB 2701 relating to the successor sewer project under the County of San Luis Obispo (see Note 4).

### Long-Term Debt

**Table D**  
**Outstanding Long-Term Debt**

	June 30, 2012			June 30, 2011			Total Change	
	Governmental Activities	Business- Type Activities	Total Primary Government	Governmental Activities	Business- Type Activities	Total Primary Government	Amount Change	Percent Change
Improvement bonds - 2002 issue	\$ -	\$ 15,220,000	\$ 15,220,000	\$ -	\$ 15,605,000	\$ 15,605,000	\$ (385,000)	-2.5%
Note payable - CIEDB loan	-	4,385,662	4,385,662	-	4,516,021	4,516,021	(130,359)	-2.9%
Note payable - CA Resources Control Board	-	6,486,144	6,486,144	-	6,486,144	6,486,144	-	0.0%
<b>Total</b>	<b>\$ -</b>	<b>\$ 26,091,806</b>	<b>\$ 26,091,806</b>	<b>\$ -</b>	<b>\$ 26,607,165</b>	<b>\$ 26,607,165</b>	<b>\$ (515,359)</b>	<b>-1.9%</b>

Long-term debt totals \$26,091,806. The decrease of \$515,359 represents principal payments as shown in amortization tables. The note payable due to the California Resources Control Board of \$6,486,144 is a claim that has been filed in bankruptcy court and which the State agreed to settle based on certain conditions. These conditions are discussed in the Introductory Section 'Impact on Liabilities.' The conditions have all been fulfilled other than the final approval of the District's Debt Adjustment Plan. Two courts have affirmed the District's Debt Adjustment Plan but it has been appealed a second time. This is still pending with an anticipated hearing date in late 2013. See the Introductory Section for more discussion on the bankruptcy case.

The two other debts are secured by specific resources that are deemed stable. See Note 6 for other details.

### Significant Events or Disclosures

The Bankruptcy Court approved the District's Debt Adjustment Plan on August 8, 2011. This was appealed by a key creditor on August 22, 2011. The United States District Court confirmed the decision of the Bankruptcy Court on April 2, 2012. On May 9, 2012, the same creditor filed a second appeal. This is currently pending before the United States Court of Appeals for the Ninth Circuit with an anticipated hearing date in late 2013.

Under the Debt Adjustment Plan, the County of San Luis Obispo will contribute \$2.8 million and in return the District has to transfer to the County the Solid Waste function along with its related annual Franchise Fee revenue of about \$155,000. This has caused great concerns within the community with some calling that a debtor/creditor relationship instead be pursued. However, at this time, the arrangement cannot be changed since this was filed with the Bankruptcy Court. Loss of the Franchise Revenue is a major loss of resources to the community.

The sewer project under the independent management of the County is now in progress with a lot of construction activity currently going on throughout the community. In November 2011, the District approved the transfer to the County of land parcels and easements as requested and as identified for use for the County's successor sewer project as per AB 2701. The transfer involved no remuneration. The project is expected to be completed in three years.

The audit recommendation regarding cash, which is to backfill the deficit in the General Fund of \$1.3 million has been implemented in this fiscal year with various funds transferring to the General Fund. These transfers are reflected in these statements (see Note 3).

The audit recommendation to reconcile assets to physical inventory has also been implemented which resulted in moving assets to their proper categories (see Note 4).

**LOS OSOS COMMUNITY SERVICES DISTRICT**  
**STATEMENT OF NET ASSETS**  
**JUNE 30, 2012**

	Governmental Activities	Business-Type Activities	Total
<b>ASSETS</b>			
Cash and investments (Note 2)	\$ 1,750,610	\$ 1,715,100	\$ 3,465,710
Accounts receivable	83,064	324,283	407,347
Prepaid expenses	5,115	17,095	22,210
Inventory	-	38,311	38,311
Deferred charges, net of accumulated amortization (Note 6)	-	559,685	559,685
Restricted assets			
Cash and investments legally restricted (Note 2)	354,873	1,565,954	1,920,827
Cash and investments held by bond trustee (Note 2)	-	1,448,529	1,448,529
Capital assets (Note 4)			
Land and construction in progress	-	22,584,851	22,584,851
Other capital assets, net of depreciation	487,445	5,071,817	5,559,262
 Total capital assets	 487,445	 27,656,668	 28,144,113
 Total Assets	 <u>\$ 2,681,107</u>	 <u>\$ 33,325,625</u>	 <u>\$ 36,006,732</u>
<b>LIABILITIES</b>			
Accounts payable	\$ 300,829	\$ 700,878	\$ 1,001,707
Accrued liabilities	17,130	13,728	30,858
Accrued interest payable	-	308,067	308,067
Trust and deposit payable	1,164	128,245	129,409
Other post employment benefits liability (Note 8)			
Due in more than one year	3,345	3,334	6,679
Accrued compensated absences			
Due within one year	7,997	11,701	19,698
Due in more than one year	18,809	11,916	30,725
Long-term debt (Note 6)			
Due within one year	-	534,335	534,335
Due in more than one year	-	25,557,471	25,557,471
 Total Liabilities	 349,274	 27,269,675	 27,618,949
<b>NET ASSETS</b>			
Invested in capital assets, net of related debt	487,445	1,564,862	2,052,307
Restricted for:			
Debt service (Note 9)	-	1,480,164	1,480,164
Legally restricted (Note 9)	353,977	1,447,911	1,801,888
Unrestricted	1,490,411	1,563,013	3,053,424
 Total Net Assets	 2,331,833	 6,055,950	 8,387,783
 Total Liabilities and Net Assets	 <u>\$ 2,681,107</u>	 <u>\$ 33,325,625</u>	 <u>\$ 36,006,732</u>

See accompanying notes to the basic financial statements.

**LOS OSOS COMMUNITY SERVICES DISTRICT  
STATEMENT OF ACTIVITIES  
FOR THE YEAR ENDED JUNE 30, 2012**

Functions/Programs	Program Revenues				Net (Expense) Revenue and Changes in Net Assets		
	Expenses	Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Primary Government		Total
					Governmental Activities	Business- Type Activities	
<b>PRIMARY GOVERNMENT</b>							
Governmental activities:							
General government	\$ 669,007	\$ 699,216	\$ -	\$ -	\$ 30,209	\$ -	\$ 30,209
Public safety	2,007,609	91,314	1,000	-	(1,915,295)	-	(1,915,295)
Health and sanitation	55,594	37,700	-	-	(17,894)	-	(17,894)
Street lighting	7,615	7,615	-	-	-	-	-
Interest and fiscal charges	-	-	-	-	-	-	-
Total governmental activities	2,739,825	835,845	1,000	-	(1,902,980)	-	(1,902,980)
Business-type activities:							
Water	1,625,579	1,620,718	2,600	22,617	-	20,356	20,356
Refuse	92,611	153,438	-	-	-	60,827	60,827
Wastewater treatment project	940,397	-	-	-	-	(940,397)	(940,397)
Total business-type activities	2,658,587	1,774,156	2,600	22,617	-	(859,214)	(859,214)
<b>Total primary government</b>	<b>\$ 5,398,412</b>	<b>\$ 2,610,001</b>	<b>\$ 3,600</b>	<b>\$ 22,617</b>	<b>(1,902,980)</b>	<b>(859,214)</b>	<b>(2,762,194)</b>
General revenues:							
Property taxes					1,569,996	179,726	1,749,722
Special taxes					570,401	-	570,401
Other taxes					-	1,157,995	1,157,995
Unrestricted investment earnings					7,920	13,158	21,078
Gain on sale of capital assets					-	-	-
Miscellaneous					88	28,279	28,367
Transfers					645,109	(645,109)	-
Total general revenues and transfers					2,793,514	734,049	3,527,563
Change in net assets before extraordinary item					890,534	(125,165)	765,369
Extraordinary item - Distribution of sewer assets to County of San Luis Obispo (Note 4)					-	(8,070,977)	(8,070,977)
Change in net assets					890,534	(8,196,142)	(7,305,608)
Net assets - July 1, 2011, as restated					1,441,299	14,252,092	15,693,391
Net assets - June 30, 2012					<u>\$ 2,331,833</u>	<u>\$ 6,055,950</u>	<u>\$ 8,387,783</u>

See accompanying notes to the basic financial statements.

**LOS OSOS COMMUNITY SERVICES DISTRICT  
BALANCE SHEET  
GOVERNMENTAL FUNDS  
JUNE 30, 2012**

	General Fund 100	Fire Fund 301	Other Governmental Funds	Total Governmental Funds
<u>ASSETS</u>				
Cash and cash equivalents	\$ 121,611	\$ 1,392,223	\$ 236,776	\$ 1,750,610
Restricted cash	1,164	50,868	302,841	354,873
Accounts receivable	7,448	71,187	4,429	83,064
Prepaid expenses	1,410	3,705	-	5,115
	<u>131,633</u>	<u>1,517,983</u>	<u>544,046</u>	<u>2,193,662</u>
Total Assets	<u>\$ 131,633</u>	<u>\$ 1,517,983</u>	<u>\$ 544,046</u>	<u>\$ 2,193,662</u>
<u>LIABILITIES AND FUND BALANCES</u>				
<u>LIABILITIES</u>				
Accounts payable	\$ 263,146	\$ 36,489	\$ 1,194	\$ 300,829
Accrued liabilities	18,574	1,901	-	20,475
Trust and deposit payable	1,164	-	-	1,164
Accrued compensated absences	7,997	-	-	7,997
	<u>290,881</u>	<u>38,390</u>	<u>1,194</u>	<u>330,465</u>
Total Liabilities	<u>290,881</u>	<u>38,390</u>	<u>1,194</u>	<u>330,465</u>
<u>FUND BALANCES (DEFICITS)</u>				
Nonspendable	21,358	4,105	-	25,463
Restricted	-	50,867	303,110	353,977
Committed	-	1,386,912	217,583	1,604,495
Assigned	20,000	37,709	22,159	79,868
Unassigned	(200,606)	-	-	(200,606)
	<u>(159,248)</u>	<u>1,479,593</u>	<u>542,852</u>	<u>1,863,197</u>
Total Fund Balances (Deficits)	<u>(159,248)</u>	<u>1,479,593</u>	<u>542,852</u>	<u>1,863,197</u>
Total Liabilities and Fund Balances	<u>\$ 131,633</u>	<u>\$ 1,517,983</u>	<u>\$ 544,046</u>	<u>\$ 2,193,662</u>

See accompanying notes to the basic financial statements.

**LOS OSOS COMMUNITY SERVICES DISTRICT  
RECONCILIATION OF THE BALANCE SHEET OF THE GOVERNMENTAL  
FUNDS TO THE STATEMENT OF NET ASSETS  
JUNE 30, 2012**

Total fund balances of governmental funds	\$ 1,863,197
Amounts reported for governmental activities in the statement of net assets are different because:	
Capital assets used in governmental activities are not financial resources and, therefore, are not reported in governmental funds, net of accumulated depreciation of \$1,433,673.	487,445
Long-term liabilities and compensated absences are not due in the current period and, therefore, are not reported in the governmental funds.	
Compensated absences	<u>(18,809)</u>
Net assets of governmental activities	<u><u>\$ 2,331,833</u></u>

See accompanying notes to the basic financial statements.

**LOS OSOS COMMUNITY SERVICES DISTRICT  
STATEMENT OF REVENUES, EXPENDITURES, AND  
CHANGES IN FUND BALANCES  
GOVERNMENTAL FUNDS  
FOR THE YEAR ENDED JUNE 30, 2012**

	General Fund 100	Fire Fund 301	Other Governmental Funds	Total Governmental Funds
<b>REVENUES</b>				
Property taxes	\$ -	\$ 1,559,912	\$ 10,084	\$ 1,569,996
Special taxes and assessments	-	474,977	95,424	570,401
Service charges and fees	-	-	45,315	45,315
Public services fees	-	63,798	-	63,798
Intergovernmental	-	4,909	-	4,909
Investment income	-	6,219	1,701	7,920
Other revenues	47	23,618	30	23,695
<b>Total Revenues</b>	<b>47</b>	<b>2,133,433</b>	<b>152,554</b>	<b>2,286,034</b>
<b>EXPENDITURES</b>				
Salaries and wages	288,171	105,789	23,104	417,064
Payroll taxes and benefits	81,942	20,882	9,209	112,033
Contract services	34,756	1,581,275	2,900	1,618,931
Insurance	31,804	20,725	-	52,529
License and fees	18,494	24,062	9,953	52,509
Maintenance and repairs	18,204	8,509	24,419	51,132
Meals and entertainment	364	140	-	504
Office support, publication, and dues	14,544	6,761	-	21,305
Tools and supplies	618	36,398	3,245	40,261
Rent	19,067	-	-	19,067
Professional services	123,915	2,765	-	126,680
Telephone and communications	4,192	34,186	1,193	39,571
Employee travel and training	7,291	2,061	217	9,569
Utilities	3,875	9,272	12,575	25,722
Director fees	18,850	-	-	18,850
Other expenses	1,714	5,827	105	7,646
Other outgo - cost allocation from (to) other funds	(699,216)	108,600	42,696	(547,920)
<b>Total Expenditures</b>	<b>(31,415)</b>	<b>1,967,252</b>	<b>129,616</b>	<b>2,065,453</b>
Excess of revenues over expenditures	31,462	166,181	22,938	220,581
<b>OTHER FINANCING SOURCES (USES)</b>				
Transfers in (Note 3)	1,349,418	-	-	1,349,418
Transfers out	(25,000)	(372,436)	(306,873)	(704,309)
<b>Total other financing sources (uses)</b>	<b>1,324,418</b>	<b>(372,436)</b>	<b>(306,873)</b>	<b>645,109</b>
Net change in fund balances	1,355,880	(206,255)	(283,935)	865,690
Fund balances (deficit) - July 1, 2011	(1,515,128)	1,685,848	826,787	997,507
Fund balances (deficit) - June 30, 2012	\$ (159,248)	\$ 1,479,593	\$ 542,852	\$ 1,863,197

See accompanying notes to the basic financial statements.

**LOS OSOS COMMUNITY SERVICES DISTRICT  
RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES,  
AND CHANGES IN FUND BALANCES TO THE STATEMENT OF  
ACTIVITIES – GOVERNMENTAL FUNDS  
FOR THE YEAR ENDED JUNE 30, 2012**

Reconciliation of the net change in fund balances - total governmental funds to the change in net assets of governmental activities:

Net change in fund balances - total governmental funds	\$	865,690
Governmental funds report capital outlays as expenditures while governmental activities report depreciation as expense to allocate those expenditures over the life of the assets:		
Capital assets additions		62,902
Depreciation expense		(43,391)
Other post employment benefit expenditures reported in the statement of activities do not require the use of current financial resources and, therefore, are not reported as expenditures in a governmental fund. This is the net annual required contribution for the current period.		
		3,750
Compensated absence expenditures reported in the statement of activities do not require the use of current financial resources and, therefore, are not reported as expenditures in a governmental fund. This is the net change in compensated absences for the current period.		
		1,583
Change in net assets of governmental activities	\$	890,534

See accompanying notes to the basic financial statements.



**LOS OSOS COMMUNITY SERVICES DISTRICT  
STATEMENT OF NET ASSETS  
PROPRIETARY FUNDS  
JUNE 30, 2012**

	Business-Type Activities - Enterprise Funds			Totals
	Water Fund 500	Refuse Fund 650	Wastewater Treatment Project Fund 600	
<b>ASSETS</b>				
<b>Current Assets</b>				
Cash and cash equivalents	\$ 1,346,190	\$ 185,614	\$ 183,296	\$ 1,715,100
Accounts receivable	281,025	-	-	281,025
Accrued revenues receivable	5,732	5,891	31,635	43,258
Prepaid expenses	17,095	-	-	17,095
Inventory	38,311	-	-	38,311
<b>Total Current Assets</b>	<b>1,688,353</b>	<b>191,505</b>	<b>214,931</b>	<b>2,094,789</b>
<b>Non-Current Assets</b>				
Advances to other funds	410,000	-	-	410,000
Restricted cash and investments held by bond trustee	-	-	1,448,529	1,448,529
Cash and investments legally restricted	-	-	1,565,954	1,565,954
Deferred issuance costs, net	31,957	-	527,728	559,685
Capital assets, net of accumulated depreciation	5,430,220	-	22,226,448	27,656,668
<b>Total Non-Current Assets</b>	<b>5,872,177</b>	<b>-</b>	<b>25,768,659</b>	<b>31,640,836</b>
<b>Total Assets</b>	<b>\$ 7,560,530</b>	<b>\$ 191,505</b>	<b>\$ 25,983,590</b>	<b>\$ 33,735,625</b>
<b>LIABILITIES</b>				
<b>Current Liabilities</b>				
Accounts payable	\$ 57,616	\$ -	\$ 643,262	\$ 700,878
Accrued liabilities	13,728	-	-	13,728
Accrued interest payable	55,734	-	252,333	308,067
Advances from other funds	-	-	410,000	410,000
Trust and deposits payable	3,897	6,306	118,042	128,245
Compensated absences - current portion	11,701	-	-	11,701
Notes payable - current portion	134,335	-	400,000	534,335
<b>Total Current Liabilities</b>	<b>277,011</b>	<b>6,306</b>	<b>1,823,637</b>	<b>2,106,954</b>
<b>Non-Current Liabilities</b>				
Compensated absences	11,916	-	-	11,916
Other post employment benefit liability (Note 8)	3,334	-	-	3,334
Notes payable	4,251,327	-	21,306,144	25,557,471
<b>Total Non-Current Liabilities</b>	<b>4,266,577</b>	<b>-</b>	<b>21,306,144</b>	<b>25,572,721</b>
<b>Total Liabilities</b>	<b>4,543,588</b>	<b>6,306</b>	<b>23,129,781</b>	<b>27,679,675</b>
<b>NET ASSETS</b>				
Invested in capital assets, net of related debt	1,044,558	-	520,304	1,564,862
Restricted for debt service	-	-	1,480,164	1,480,164
Restricted for debt restructuring (Note 9)	-	-	1,447,911	1,447,911
Unrestricted (deficit)	1,972,384	185,199	(594,570)	1,563,013
<b>Total Net Assets</b>	<b>\$ 3,016,942</b>	<b>\$ 185,199</b>	<b>\$ 2,853,809</b>	<b>\$ 6,055,950</b>

See accompanying notes to the basic financial statements.

**LOS OSOS COMMUNITY SERVICES DISTRICT**  
**STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS**  
**PROPRIETARY FUNDS**  
**FOR THE YEAR ENDED JUNE 30, 2012**

	Business-Type Activities - Enterprise Funds			Totals
	Water Fund 500	Refuse Fund 650	Wastewater Treatment Project Fund 600	
<b><u>OPERATING REVENUES</u></b>				
Utility revenue	\$ 1,620,718	\$ -	\$ -	\$ 1,620,718
Franchise revenue	-	153,438	-	153,438
Total Operating Revenues	<u>1,620,718</u>	<u>153,438</u>	<u>-</u>	<u>1,774,156</u>
<b><u>OPERATING EXPENSES</u></b>				
Salaries and wages	278,416	15,030	-	293,446
Payroll taxes and benefits	111,969	6,020	-	117,989
Bank charges	-	-	5,000	5,000
Contract services	63,663	-	-	63,663
Insurance	24,501	-	-	24,501
Maintenance and repairs	31,821	958	-	32,779
Office supplies, publications, and dues	22,100	44	-	22,144
License and fees	14,787	159	45	14,991
Professional services	26,028	1,100	148,887	176,015
Special department expenses and supplies	49,358	-	-	49,358
Rent	5,760	3,360	-	9,120
Employee travel and training	1,159	190	-	1,349
Telephone and communications	8,049	-	-	8,049
Utilities	93,500	-	-	93,500
Inter-agency contractual costs	37,581	-	-	37,581
Bad debt expense	-	-	-	-
Other expense	11,610	20,666	1,073	33,349
Other outgo - cost allocation from other funds	502,836	45,084	-	547,920
Depreciation	193,382	-	-	193,382
Total Operating Expenses	<u>1,476,520</u>	<u>92,611</u>	<u>155,005</u>	<u>1,724,136</u>
Operating Income (Loss)	<u>144,198</u>	<u>60,827</u>	<u>(155,005)</u>	<u>50,020</u>
<b><u>NON-OPERATING REVENUES (EXPENSES)</u></b>				
Grant income	22,617	-	-	22,617
Investment income, net of costs	4,942	687	7,529	13,158
Other revenue	11,104	15	19,760	30,879
Bond discount amortization	(1,417)	-	(25,954)	(27,371)
Interest expense	(147,642)	-	(759,438)	(907,080)
Gain on sale of capital assets	-	-	-	-
Property taxes and assessment	179,726	-	1,157,995	1,337,721
Total Non-Operating Revenues (Expenses)	<u>69,330</u>	<u>702</u>	<u>399,892</u>	<u>469,924</u>
Income Before Distributions and Transfers	<u>213,528</u>	<u>61,529</u>	<u>244,887</u>	<u>519,944</u>
<b><u>DISTRIBUTIONS AND TRANSFERS</u></b>				
Distribution of sewer assets to County of San Luis Obispo (Note 4)	-	-	(8,070,977)	(8,070,977)
Transfers in	-	-	25,000	25,000
Transfers out (Notes 3)	(257,239)	(412,870)	-	(670,109)
Total Distributions and Transfers	<u>(257,239)</u>	<u>(412,870)</u>	<u>(8,045,977)</u>	<u>(8,716,086)</u>
Change in Net Assets	<u>(43,711)</u>	<u>(351,341)</u>	<u>(7,801,090)</u>	<u>(8,196,142)</u>
Net Assets - July 1, 2011, as previously reported	3,383,658	536,540	10,268,250	14,188,448
Prior Period Adjustments (Note 13)	(323,005)	-	386,649	63,644
Net Assets - July 1, 2011, as restated	<u>3,060,653</u>	<u>536,540</u>	<u>10,654,899</u>	<u>14,252,092</u>
Total Net Assets - June 30, 2012	<u>\$ 3,016,942</u>	<u>\$ 185,199</u>	<u>\$ 2,853,809</u>	<u>\$ 6,055,950</u>

See accompanying notes to the basic financial statements.

**LOS OSOS COMMUNITY SERVICES DISTRICT  
STATEMENT OF CASH FLOWS  
PROPRIETARY FUNDS  
FOR THE YEAR ENDED JUNE 30, 2012**

	Business-Type Activities - Enterprise Funds			Totals
	Water Fund 500	Refuse Fund 650	Wastewater Treatment Project Fund 600	
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>				
Cash received from customers and users	\$ 1,653,333	\$ 153,619	\$ -	\$ 1,806,952
Cash paid for goods and services	(390,274)	(7,000)	(196,909)	(594,183)
Cash paid to/for employees	(390,744)	(21,050)	-	(411,794)
Cash paid for administrative costs	(502,836)	(45,084)	-	(547,920)
Community outreach	-	(18,116)	-	(18,116)
Net Cash Provided (Used) by Operating Activities	<u>369,479</u>	<u>62,369</u>	<u>(196,909)</u>	<u>234,939</u>
<b>CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES</b>				
Grants	22,617	-	-	22,617
Capital contribution	180,929	-	-	180,929
Other revenue	9,196	15	19,760	28,971
Proceeds of special tax and assessment	-	-	1,159,338	1,159,338
Transfers from other funds	-	-	25,000	25,000
Transfers to other funds	(257,238)	(412,871)	-	(670,109)
Trust receipts	-	747	25,915	26,662
Net Cash Provided (Used) by Noncapital Financing Activities	<u>(44,496)</u>	<u>(412,109)</u>	<u>1,230,013</u>	<u>773,408</u>
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b>				
Acquisition of capital assets	(49,443)	-	-	(49,443)
Principal and interest paid on capital debt	(279,658)	-	(1,149,315)	(1,428,973)
Net Cash Used by Capital and Related Financing Activities	<u>(329,101)</u>	<u>-</u>	<u>(1,149,315)</u>	<u>(1,478,416)</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>				
Interest and dividends	4,942	714	7,529	13,185
Net Cash Provided by Investing Activities	<u>4,942</u>	<u>714</u>	<u>7,529</u>	<u>13,185</u>
Net Increase (Decrease) in Cash and Cash Equivalents	824	(349,026)	(108,682)	(456,884)
Cash and Cash Equivalents - July 1, 2011	<u>1,345,366</u>	<u>534,640</u>	<u>3,306,461</u>	<u>5,186,467</u>
Cash and Cash Equivalents - June 30, 2012	<u>\$ 1,346,190</u>	<u>\$ 185,614</u>	<u>\$ 3,197,779</u>	<u>\$ 4,729,583</u>

See accompanying notes to the basic financial statements.

**LOS OSOS COMMUNITY SERVICES DISTRICT  
STATEMENT OF CASH FLOWS (Continued)  
PROPRIETARY FUNDS  
FOR THE YEAR ENDED JUNE 30, 2012**

	Business-Type Activities - Enterprise Funds			
	Water Fund 500	Refuse Fund 650	Wastewater Treatment Project Fund 600	Totals
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES:				
Operating Income (Loss)	\$ 144,198	\$ 60,827	\$ (155,005)	\$ 50,020
Adjustments to reconcile operating income (loss) to net cash provided (used) by operating activities:				
Depreciation expense	193,382	-	-	193,382
Changes in assets and liabilities:				
Decrease in accounts receivable	32,900	182	-	33,082
Increase in prepaid expense	(12,251)	-	-	(12,251)
Increase in inventory	(6,429)	-	-	(6,429)
Increase (Decrease) in accounts payables	14,367	1,360	(41,904)	(26,177)
Increase in deposits payable	(1,148)	-	-	(1,148)
Increase in compensated absences and other post employment benefit liability	4,460	-	-	4,460
Net Cash Provided (Used) by Operating Activities	<u>\$ 369,479</u>	<u>\$ 62,369</u>	<u>\$ (196,909)</u>	<u>\$ 234,939</u>

See accompanying notes to the basic financial statements.

**LOS OSOS COMMUNITY SERVICES DISTRICT  
NOTES TO BASIC FINANCIAL STATEMENTS  
JUNE 30, 2012**

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

A. The Financial Reporting Entity

The Los Osos Community Services District (District), a political subdivision of the State of California, was formed on January 1, 1999, pursuant to Ballot Measure K-98 to provide services previously provided by San Luis Obispo County (the County) in specific benefits zones of what was formerly County Service Area 9. After formation, the District added solid waste services providing service to all properties in the District. It operates pursuant to Section 61000 of the California Government Code. It is currently authorized to provide Fire Protection, Water, Street Lighting, Drainage, Solid Waste, and Parks and Recreation Services. It is governed by a five-member Board of Directors with an operations staff headed by a general manager.

B. Chapter 9 Bankruptcy

The District is currently under bankruptcy protection. The background, status, and impacts of the filing are discussed in the Introductory Section.

C. The Financial Statements

The accompanying financial statements consist of the following:

- Government-wide financial statements,
- Fund financial statements, and
- Notes to the financial statements.

New Accounting Pronouncements

Recently released standards by GASB affecting future fiscal years are as follows:

**GASB Statement No. 60** - *Accounting and Financial Reporting for Service Concession Arrangements* addresses accounting and financial reporting issues related to public-private and public-public partnerships. The statement is effective for periods beginning after December 15, 2011. The District has not fully judged the effect of the implementation of GASB Statement No. 60 as of the date of the basic financial statements.

**GASB Statement No. 61** - *The Financial Reporting Entity: Omnibus, an amendment of GASB Statements No. 14 and No. 34* modifies a number of provisions with regard to reporting of component units within a financial reporting entity. The statement is effective for periods beginning after June 15, 2012. As of the date of the basic financial statements, the District has not made an assessment of any changes that will occur upon this statement's implementation.

**GASB Statement No. 62** - *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989, FASB and AICPA Pronouncements* incorporates into the GASB's authoritative literature certain accounting and financial reporting guidance that is included in the following pronouncements issued on or before November 30, 1989, which does not conflict with or contradict GASB pronouncements: FASB Statements and Interpretations, APB Opinions, and ARBs of the American Institute of Certified Public Accountants' (AICPA) Committee on Accounting Procedure. The statement is effective for periods beginning after December 15, 2011. However, as the statement codifies what is in current practice, there is no net effect on the District's accounting or financial reporting upon the statement's implementation.

**GASB Statement No. 63** - *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position* modifies current financial reporting of those elements. The largest change will be the replacement of the current Statement of Net (Plan if retirement entity) Assets with a Statement of Net (Plan) Position and a Statement of Changes in Net Position instead of the current Statement of Changes in (Plan) Net Assets upon implementation for periods beginning after December 15, 2011. The District will implement this change for the fiscal year ended June 30, 2013.

## **NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

### New Accounting Pronouncements (Continued)

**GASB Statement No. 64** - *Derivative instruments: Application of Hedge Accounting Termination Provisions* amends current accounting and financial reporting related to terminations of swap agreements due to default or other termination events. In certain instances where swap counterparties or credit support providers are replaced, hedge accounting may continue, rather than cease. The provisions of GASB Statement No. 64 are effective for financial statements beginning after June 15, 2011. As of the date of the basic financial statements, the District has not made an assessment of any changes that will occur upon this statement's implementation.

**GASB Statement No. 65** – *Items Previously Reported as Assets and Liabilities*. The provisions of GASB Statement No. 65 are effective for financial statements beginning after December 15, 2012. The District will implement this change for the fiscal year ended June 30, 2013.

**GASB Statement No. 66** – *Items Technical Corrections- 2012- and amendment of GASB Statements No. 10 and No. 62*. The provisions of GASB Statement No. 66 are effective for financial statements beginning after December 15, 2012. As of the date of the basic financial statements, the District has not made an assessment of any changes that will occur upon this statement's implementation.

**GASB Statement No. 67** – *Financial Reporting for Pension Plans- an amendment of GASB Statement No. 25*. The provisions of GASB Statement No. 67 are effective for financial statements beginning after June 15, 2013. The District has not fully judged the effect of the implementation of GASB Statement No. 67 as of the date of the basic financial statements.

**GASB Statement No. 68** – *Accounting and Financial Reporting for Pensions- an amendment of GASB Statement No. 27*. The provisions of GASB Statement No. 68 are effective for financial statements beginning after June 15, 2014. The District has not fully judged the effect of the implementation of GASB Statement No. 68 as of the date of the basic financial statements.

### Basis of Presentation

The District's basic financial statements are prepared in conformity with accounting principles generally accepted in the United States of America. GASB is the acknowledged standard setting body for establishing accounting and financial reporting standards followed by governmental entities in the U.S.A.

### *Government-Wide Financial Statements:*

The statement of net assets and statement of activities display information about the reporting government as a whole. They include the activities of the overall District government except for fiduciary activities. Eliminations have been made to minimize the double counting of internal activities. The statements distinguish between governmental and business-type activities of the District. The District's net assets are reported in three parts - invested in capital assets, net of related debt; restricted net assets; and unrestricted net assets. The District first utilizes restricted resources to finance qualifying activities. Governmental activities generally are financed through taxes, intergovernmental revenues, and other non-exchange revenues. Business-type activities are financed in whole or in part by fees charged to external parties for goods or services.

The statement of activities presents a comparison between direct expenses and program revenues for each segment of the business-type activities of the District and for each function of the District's governmental activities. Direct expenses are those that are specifically associated with a program or function and, therefore, are clearly identifiable to a particular function. Program revenues include (a) charges paid by the recipients of goods or services offered by the programs, (b) grants and contributions that are restricted to meeting the operational needs of a particular program, and (c) fees, grants, and contributions that are restricted to financing the acquisition or construction of capital assets. Revenues that are not classified as program revenues, including all taxes, are presented as general revenues.

## **NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

### **C. The Financial Statements** (Continued)

#### *Fund Financial Statements:*

The fund financial statements provide information about the District's funds. Each fund is accounted for by providing a separate set of self-balancing accounts that constitute its assets, liabilities, fund equity, revenues, and expenditures/expenses. Funds are organized into three major categories: governmental, proprietary, and fiduciary. The District does not have fiduciary funds. An emphasis is placed on major funds within the governmental and proprietary categories with each major fund displayed in a separate column. A fund is considered major if it is the primary operating fund of the District or meets the following criteria:

- a. Total assets, liabilities, revenues, or expenditures/expenses of that individual governmental or proprietary fund are at least 10 percent of the corresponding total for all funds of that category or type; and
- b. Total assets, liabilities, revenues, or expenditures/expenses of the individual governmental fund or proprietary fund are at least 5 percent of the corresponding total for all governmental and proprietary funds combined.

All remaining governmental funds are aggregated and reported as non-major funds in a single column, regardless of their fund type.

The funds of the financial reporting entity are described below:

#### **Governmental Funds**

General Fund - The General Fund, more commonly referred to as the Administrative Fund, is the general operating fund of the District and is always classified as a major fund. It is used to account for all other activities except those legally or administratively required to be accounted for in other funds.

Special Revenue Funds - Special revenue funds are used to account for the proceeds of specific revenue sources that are legally restricted to expenditures for specified purposes. The following are Special Revenue Funds:

- 301 – Fire Fund
- 200 – Bayridge (a subdivision where lighting and septic system maintenance are provided)
- 400 – Vista de Oro (a subdivision where lighting and septic system maintenance are provided)
- 800 – Drainage
- 900 – Parks and Recreation

Capital Project Funds - Capital project funds are used to account for financial resources used for the acquisition or construction of major capital facilities other than those financed by enterprise funds. The District does not maintain a Capital Project Fund.

#### **Proprietary Funds**

Enterprise Funds - Enterprise funds are used to account for business-like activities provided to the general public. These activities are financed primarily by user charges and the measurement of financial activity focuses on net income measurement similar to the private sector.

Proprietary Funds are as follows:

- 500 – Water
- 600 – Wastewater Treatment Project Fund (This is for the aborted sewer system project; once the bankruptcy case is closed, this fund will function as a Debt Service Fund and may at that point be reclassified to the Governmental category.)
- 650 – Solid Waste or Refuse Fund

## **NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

### **C. The Financial Statements** (Continued)

#### **Major Funds**

The District reported the following major governmental funds in the accompanying financial statements:

General Fund - This is the District's primary operating fund and is more commonly referred to as the Administrative Fund. It accounts for all financial resources of the general government, except those required to be accounted for in another fund. The fund provides for public administration, overall management, occupancy, computer systems, accounting, legal, consulting, communication, and insurance as it pertains to the District as a whole.

Fire Fund - This fund accounts for activities of Fire Station 15 - South Bay. The fire department provides fire suppression, emergency paramedic services, and fire prevention including public education. Services are provided through a contract with Cal Fire for the entire community. Reserve firefighters and administrative operational costs are paid by the District outside the Cal Fire contract.

The District reports the following major proprietary funds in the accompanying financial statements:

Water Fund - This fund accounts for the operation and maintenance of the District's water distribution system. The water department is responsible for the operation and maintenance of five groundwater supply wells providing treatment, monitoring, and distribution services.

Refuse Fund - This fund provides trash cleanup and recycling services for the community through a franchise agreement with a private company.

Wastewater Treatment Project Fund - This fund originally accounted for projects relating to the District's wastewater treatment project. Since the wastewater treatment project was stopped, this fund now mainly reflects functions relative to bankruptcy proceedings and debt service on the aborted sewer project.

### **D. Measurement Focus and Basis of Accounting**

Measurement focus is a term used to describe "which" transactions are recorded within the various financial statements. Basis of accounting refers to "when" revenues and expenditures or expenses are recognized in the accounts and reported in the financial statements regardless of the measurement focus applied.

#### Measurement Focus

On the government-wide statement of net assets and the statement of activities, both governmental and business-type activities are presented using the economic resources measurement focus as defined in item "b" below.

In the fund financial statements, the "current financial resources" measurement focus or the "economic resources" measurement focus is used as appropriate:

- a. All governmental funds are accounted for using a "current financial resources" measurement focus. With this measurement focus, only current assets and current liabilities generally are included on their balance sheets. Their operating statements present sources and uses of available spendable financial resources during a given period. These funds use fund balance as their measure of available spendable financial resources at the end of the period.
- b. All proprietary funds utilize an "economic resources" measurement focus. The accounting objectives of this measurement focus are the determination of operating income, changes in net assets (or cost recovery), financial position, and cash flows. All assets and all liabilities (whether current or non-current) associated with the operation of these funds are reported. Proprietary fund equity is classified as net assets.



## **NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

### **D. Measurement Focus and Basis of Accounting** (Continued)

#### **Basis of Accounting**

In the government-wide statement of net assets and statement of activities, both governmental and business-type activities are presented using the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recorded when the liability is incurred or economic asset is used. Revenues, expenses, gains, losses, assets, and liabilities resulting from exchange and exchange-like transactions are recognized when the exchange takes place.

In the fund financial statements, governmental funds and agency funds are presented on the modified accrual basis of accounting. Under the modified accrual basis of accounting, revenues are recognized when “measurable and available.” Measurable means knowing or being able to reasonably estimate the amount. Available means collectible within the current period or soon enough thereafter to pay current liabilities. The District defines available to be within 60 days of year-end. Expenditures (including capital outlay) are recorded when the related fund liability is incurred, except for general obligation bond principal and interest which are reported when due. Governmental capital asset acquisitions are reported as expenditures in governmental funds. Proceeds for governmental long-term debt and acquisitions under capital leases are reported as other financing sources.

Those revenues susceptible to accrual include taxes, intergovernmental revenues, interest, and charges for services. Certain indirect costs are included in program expenses reported for individual functions and activities.

Grant revenues are recognized in the fiscal year in which all eligibility requirements are met. Under the terms of grant agreements, the District may fund certain programs with a combination of cost-reimbursement grants, categorical block grants, and general revenues. Thus, both restricted and unrestricted net assets are available to finance program expenditures. The District’s policy is to first apply restricted grant resources to such programs, followed by general revenues if necessary.

The District follows Statements and Interpretations of the Financial Accounting Standards Board and its predecessors that were issued on or before November 30, 1989, in accounting for its business-type activities, which do not conflict with GASB Pronouncements.

All proprietary funds utilize the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recorded when the liability is incurred or economic asset is used. Proprietary funds distinguish operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund’s principal revenues and expenses. When both restricted and unrestricted resources are available for use, it is the District’s policy to use restricted resources first, then unrestricted resources as they are needed.

### **E. Property Taxes**

The County levies, bills, and collects property taxes and special assessments for the District. Property taxes levied are recorded as revenue in the fiscal year of levy, due to the adoption of the “alternate method of property tax distribution,” known as the Teeter Plan, by the District and the County. The Teeter Plan authorizes the Auditor/Controller of the County to allocate 100% of the secured property taxes billed, excluding unitary tax (whether paid or unpaid). The County remits tax monies to the District every month and twice a month in December and April. The final amount which is “teetered” is remitted in August each year.

Tax collections are the responsibility of the County Tax Collector. Taxes and assessments on secured and utility rolls, which constitute a lien against the property, may be paid in two installments; the first is due November 1 of the fiscal year and is delinquent if not paid by December 10; and the second is due on March 1 of the fiscal year and is delinquent if not paid by April 10. Unsecured personal property taxes do not constitute a lien against real property unless the tax becomes delinquent. Payment must be made in one installment, which is delinquent if not paid by August 31 of the fiscal year. Significant penalties are imposed by the County for late payment.

## **NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

### **E. Property Taxes** (Continued)

Property valuations are established by the Assessor of the County for the secured and unsecured property tax rolls. Under the provisions of Article XIII A of the State Constitution, properties are assessed at 100% of purchase price or value in 1978 whichever is later. From this base assessment, subsequent annual increases in valuation are limited to a maximum of 2 percent. However, increases to full value are allowed for property improvements or upon change in ownership. Personal property is excluded from these limitations, and is subject to annual reappraisal.

Tax levy dates are attached annually on January 1 preceding the fiscal year for which the taxes are levied. The fiscal year begins July 1 and ends June 30 of the following year. Taxes are levied on both real and unsecured personal property, as it exists at that time. Liens against real estate, as well as the tax on personal property, are not relieved by subsequent renewal or change in ownership.

### **F. Cash and Investments**

The District pools the cash of all funds, except for monies deposited with fiscal agent in accordance with related bond indentures. The cash and investments balance in each fund represents that fund's equity share of the District's cash and investment pool.

Interest income earned on pooled cash and investments is allocated quarterly to the various funds based on month-end balances. Interest income on restricted cash and investments with fiscal agents is credited directly to the related fund.

The District's investments are carried at fair value. The fair value of equity and debt securities is determined based on sales prices or bid-and-asked quotations from Securities and Exchange Commission (SEC) registered securities exchanges or NASDAQ dealers. Local Agency Investment Fund (LAIF) determines the fair value of their portfolio quarterly and reports a factor to the District. Changes in fair value are allocated to each participating fund.

For purposes of the statement of cash flows, the District has defined cash and cash equivalents to be change and petty cash funds, equity in the District's cash and investment pool, and restricted non-pooled investments with initial maturities of three months or less.

### **G. Accounts and Interest Receivable**

In the government-wide statements, receivables consist of all revenues earned at year-end and not yet received. Receivables are recorded in the financial statements net of any allowance for doubtful accounts if applicable, and estimated refunds due. Major receivable balances for the governmental activities may include sales taxes, franchise taxes, grants, and other fees, if any. Business-type activities report utilities and franchise fees as their major receivables.

In the fund financial statements, material receivables in governmental funds may include revenue accruals such as franchise tax, grants, service charges and other similar intergovernmental revenues that are both measurable and available. Non-exchange transactions collectible but not available are deferred in the fund financial statements in accordance with the modified accrual basis of accounting, but not deferred in the government-wide financial statements in accordance with the accrual basis. Interest and investment earnings are recorded when earned and if paid within 60 days since they would be considered both measurable and available. Proprietary fund material receivables consist of all revenues earned at year-end and not yet received. Utility accounts receivable and interest earnings comprise the majority of proprietary fund receivables.

### **H. Prepaid Expenses and Inventory**

Inventory is valued at the lower of cost or market using the first-in, first-out (FIFO) method. The cost is recorded as an expenditure/expense in the funds at the time individual inventory items are purchased rather than when consumed. This is then adjusted by physical inventory at year-end. Inventory in the enterprise funds consist principally of materials and supplies for utility operations.

**NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

H. Prepaid Expenses and Inventory (Continued)

Payments to vendors that reflect costs applicable to future accounting periods are recorded as prepaid items in both government-wide and fund financial statements.

I. Restricted Assets

Certain debt proceeds of the Wastewater Treatment Project Fund, as well as certain resources set aside for the repayment of the associated debt, are classified as restricted assets on the balance sheet because their use is limited by applicable bond covenants and they are maintained in separate bank accounts. Funds that are under the control of external parties are also restricted.

J. Capital Assets

The accounting treatment over property, plant, and equipment depends on whether the assets are used in governmental fund operations or proprietary fund operations. The presentation and recording of governmental assets are described below.

*Government-Wide Statements*

In the government-wide financial statements, capital assets with a historical cost of \$5,000 or more are accounted for as capital assets. All capital assets are valued at historical cost, or estimated historical cost if actual is unavailable, except for donated capital assets, if any, which are recorded at their estimated fair value at the date of donation. Estimated historical cost was used to value the majority of the assets.

With the implementation of GASB Statement No. 34, the District has recorded all its public domain (infrastructure) capital assets on the government-wide statements.

Depreciation of all exhaustible capital assets is recorded as an allocated expense in the statement of activities, with accumulated depreciation reflected in the statement of net assets. Depreciation is provided over the assets' estimated useful lives using the straight-line method of depreciation. The range of estimated useful lives by type of asset is as follows:

Buildings	40-50 years
Improvements other than buildings	5-25 years
Infrastructure	5-60 years
Equipment and systems	5-30 years

*Fund Financial Statements*

In the fund financial statements, capital assets used in governmental fund operations are accounted for as capital outlay expenditures of the governmental fund upon acquisition. Capital assets used in proprietary fund operations are capitalized when purchased.

K. Accumulated Compensated Absences

Compensated absences comprise unused vacation leave, sick leave, and compensatory time off, which are accrued as earned. Vacation can be accrued to a maximum of 40 days or 320 hours. Upon termination, all accumulated vacation hours up to 320 hours can be paid. Sick leave can be accrued up to 180 days or 1,440 hours. Only half of accumulated sick leave hours can be paid on termination to eligible employees. Employees become eligible for sick leave pay-off after completing five years of service. Payments will be based on the pay rate at the time of termination. The District's liability for the current and long-term portions of compensated absences is shown in the government-wide Statement of Net Assets for both governmental funds and proprietary funds. Only proprietary funds reflect the long-term portion in the fund financials report, Statement of Net Assets. The short-term portion is reflected for both governmental and proprietary funds in the fund financial statements. Computation was based on rates in effect as of year-end.

## **NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

### **L. Long-Term Liabilities**

In the government-wide financial statements, long-term liabilities are presented for both governmental and proprietary fund types. In the fund financial statements, only the proprietary funds show long-term liabilities. Initial issue bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds using the straight-line method. Bond issuance costs, including deferred refunding amounts, if any and underwriters' discounts, are reported as deferred bond issuance costs. Amortization of bond premiums or discounts, issuance costs, and deferred amounts on refunding are included in interest expense.

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

### **M. Interfund Transactions**

Following is a description of the four basic types of interfund transactions that can be made during the year and the related accounting policies:

1. Interfund services provided and used - transactions for services rendered or facilities provided. These transactions are recorded as revenues in the receiving fund and expenditures in the disbursing fund.
2. Reimbursements (expenditure transfers) - transactions to reimburse a fund for specific expenditures incurred for the benefit of another fund. These transactions are recorded as expenditures in the disbursing fund and a reduction of expenditures in the receiving fund.
3. Residual equity transfers - transactions recording equity contributions and distributions between funds. This is presented as a separate caption just before the Fund Balance caption.
4. Operating transfers - all other interfund transactions which allocate resources from one fund to another fund. These transactions are recorded as operating transfers in and out.

### **N. Equity Classifications**

#### *Government-Wide Statements*

Net assets are the excess of all the District's assets over all its liabilities, regardless of fund. Net assets are divided into three categories under GASB Statement No. 34. These categories apply only to net assets, which is determined at the government-wide level, and are described below:

### **N. Equity Classifications** (Continued)

- a. Invested in capital assets, net of related debt - Consists of capital assets, including restricted capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets.
- b. Restricted net assets - Consists of net assets with constraints place on the use either by (1) external groups such as creditors, grantors, contributors, or laws or regulations of other governments; or (2) law through constitutional provisions or enabling legislation.
- c. Unrestricted net assets - All other net assets that do not meet the definition of "restricted" or "invested in capital assets, net of related debt."

## **NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

### *Fund Statements*

Equity of governmental funds is presented in accordance with the new GASB Statement No. 54. Proprietary funds are presented the same as in Government-Wide Statements.

GASB issued Statement No. 54 which is effective for fiscal years after June 30, 2010. This classifies fund balances into five categories depending on the degree of constraints and source of these constraints placed on the funds.

The five categories of equity under GASB Statement No. 54 are as follows:

- *Nonspendable fund balance* – amounts cannot be spent because they are either (a) not spendable in form or (b) are legally or contractually required to be maintained intact.
- *Restricted fund balance* – amounts with constraints placed on their use that are either (a) externally imposed by creditors, grantors, contributors, or laws or regulations of other governments; or (b) imposed by laws through constitutional provisions or enabling legislation.
- *Committed fund balance* – amounts that can only be used for specific purposes determined by formal action of the highest level of decision-making authority (Board of Directors) and that remain binding unless removed in the same manner. The underlying action that imposed the limitation needs to occur no later than the close of the reporting period.
- *Assigned fund balance* – amounts that are constrained by the District's intent to be used for specific purposes. The intent can be established at either the highest level of decision-making or by a body or an official designated for that purpose. Residual funds in special revenue funds are classified under this category.
- *Unassigned fund balance* – this represents residual fund balance in the General Fund that is not otherwise classified in the other categories. For other funds, this represents the excess of actual expenditures over the amounts restricted, committed, or assigned for the specific purposes.

The District's Board of Directors adopted a resolution affirming compliance with GASB Statement No. 54 and also affirming that only the Board of Directors can create, change, or cancel Committed and Assigned fund balances.

### O. General Budget Policies

The District requires that all funds adopt an annual budget. The annual budget is prepared by the General Manager and submitted to the District Board of Directors for adoption. A budget has been prepared for both the governmental funds and proprietary funds utilizing the modified accrual basis of accounting. All unencumbered appropriations in the budget lapse at the end of the fiscal year.

### P. Use of Estimates

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

### Q. Reclassifications

Reclassifications of prior year data may at times be necessary to conform to a new method of presentation.

## **NOTE 2 – CASH AND INVESTMENTS**

Investments of the District are governed by the California Government Code and by the District's investment policy. The General Manager of the District acts as the District Finance Officer and Treasurer who is tasked to perform investment functions in accordance with the investment policy. The objectives of the policy are safety, liquidity, yield, and compliance with State and Federal laws and regulations.

### Investments of the District as of June 30, 2012

The table below identifies the investment types the District has that are authorized for the District by the California Government Code or the District'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 trustees that are governed by the provisions of debt agreements of the District, rather than the general provisions of the California Government Code or the District's investment policy.

Authorized Investment Type	Maximum Maturity	Maximum Percentage of Portfolio **	Maximum Investment in One Issuer
Local Agency Investment Fund (LAIF)	N/A - Available on demand	14%	N/A
FDIC Insured Savings & Loan Associations	3 years	1%	N/A
Money Market Mutual Funds	N/A - Available on demand	57%	N/A

\*\* Excluding funds held by bond trustee

Cash and Investments as of June 30, 2012, are Classified in the Accompanying Financial Statements as Follows:

	Cash and Investments	Cash and Investments Held by Bond Trustee	Restricted Cash	Total
Governmental activities	\$ 1,750,610	\$ -	\$ 354,873	\$ 2,105,483
Business-type activities	1,715,100	1,448,529	1,565,954	4,729,583
Total cash and investments	<u>\$ 3,465,710</u>	<u>\$ 1,448,529</u>	<u>\$ 1,920,827</u>	<u>\$ 6,835,066</u>

Cash and Investments are Carried at Fair Value as of June 30, 2012, and Consist of the Following:

Deposits with financial institutions	\$ 435,159
Imprest funds	12,700
Bank time deposits	50,868
State investment pool	973,880
Money market investment	3,913,930
U.S. Treasury obligations	<u>1,448,529</u>
Total cash and investments	<u>\$ 6,835,066</u>

### Disclosure 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 is, the greater the sensitivity of its fair value to changes in market interest rates. One of the ways that the District's interest rate risk is mitigated is by purchasing a combination of shorter term and longer term investments and by timing cash flows from maturities so that a portion of the portfolio is maturing or coming close to maturity evenly over time as necessary to provide the cash flow and liquidity needed for operations.

**NOTE 2 – CASH AND INVESTMENTS** (Continued)Disclosure Relating to Interest Rate Risk (Continued)

Information about the sensitivity of the fair values of the District's investments (including investments held by bond trustee) to market rate fluctuations is provided by the following table that shows the distribution of the District's investments by maturity as of June 30, 2012:

	Remaining Maturity		
	12 Months or Less	1-5 Years	Fair Value
Deposits with financial institutions	\$ 435,159	\$ -	\$ 435,159
Bank time deposits	-	50,868	50,868
State investment pool	973,880	-	973,880
Money market investment Held by bond trustee:	3,913,930	-	3,913,930
U.S. Treasury obligations	1,448,529	-	1,448,529
	<u>\$ 6,771,498</u>	<u>\$ 50,868</u>	<u>\$ 6,822,366</u>

Investments with Fair Values Highly Sensitive to Interest Rate Fluctuations

The District has no investments (including investments held by bond trustees) that are highly sensitive to interest rate fluctuations.

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 nationally recognized statistical rating organizations. Presented below is the minimum rating required by (where applicable) the California Government Code, the investment policy, or debt agreements, and the actual rating as of the fiscal year ended June 30, 2012, for each investment type.

	Total	Rating as of Fiscal Year-End		
		S&P	Moody's	N/A
Deposits with financial institutions	\$ 435,159	AA	Aaa	
Bank time deposits	50,868			Not rated
State investment pool	973,880			Not rated
Money market investment Held by bond trustee:	3,913,930	AA	Aaa	
U.S. Treasury obligations	1,448,529	AAAm	Aaa-mf	
	<u>\$ 6,822,366</u>			

Concentration of Credit Risk

The investment policy of the District contains no limitations on the amount that can be invested in any one issuer beyond that stipulated by the California Government Code. The District minimizes its credit risk by investing only in the safest types of securities or investments.

The biggest investment of the District is in money market funds, comprising fifty seven percent (57%) of all investments. This is managed by the District's bank. This investment is indexed to earn ten basis points above that earned monthly by the State Investment Pool. These are collateralized up to 110% in compliance with State law with the collaterals held by a separate trustee bank.

## **NOTE 2 – CASH AND INVESTMENTS (Continued)**

### Concentration of Credit Risk (Continued)

The next major investment of the District, not considering those held by bond trustee, is investment in the State Investment Pool, more commonly known as LAIF. Investment in LAIF comprises fourteen percent (14%) of all invested funds. This fund is not registered with the Securities and State Commission as an investment company but is required to invest according to California State Code. The fund is under the oversight of the Treasurer of the State of California through the Local Investment Advisory Board that consists of five members as designated by statute. Market valuation is conducted quarterly by the State Treasurer's office. In addition, it also conducts a monthly fair market valuation of all securities held against carrying costs. The fair value of the District's investment in this pool is reported in the accompanying financial statements at amounts based on the District's pro-rata share of the fair value of the entire portfolio net of any amortized costs as provided by LAIF.

Investment of funds held by bond trustee is governed by provisions of the debt agreements rather than the general provisions of the California Government Code or the District's investment policy. Current agreement of the District with bond trustee directs the trustee to invest in money market funds duly registered under the Federal Securities Act of 1933 and under the Investment Company Act of 1940 and having a rating by Standard and Poor's (S&P) of AAAM-G or AAAM or in any other investment acceptable to the bond insurer.

### 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 California Government Code and the District 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 government unit). The market value of the pledged securities in the collateral pool must equal at least 110% of the total amount deposited by the public agencies. California law also allows financial institutions to secure District's deposits by pledging first trust deed mortgage notes having a value of 150% of the secured public deposits.

The investment in the State Investment Pool is not required to be collateralized. The fair value of securities in the pool is based on quoted market prices. The State Treasurer's Office performs a monthly fair market valuation of all securities held against carrying costs. Reports of valuations and financial statements are available to participants on the State Treasurer's website.



**NOTE 2 – CASH AND INVESTMENTS (Continued)**

Restricted Cash

Cash and investments that are restricted as of June 30, 2012, consist of the following:

Restricted Cash and Funds Held by Bond Trustee

Governmental activities

Funds held in trust for community group	\$ 1,164
Development fees restricted for facilities	50,868
Assessments collected for a specific purpose	<u>302,841</u>
<b>Total Governmental Restricted Cash</b>	<b><u>354,873</u></b>

Enterprise activities

Restricted by Court pending bankruptcy proceedings	1,447,912
Prepaid assessments restricted for debt service	<u>118,042</u>
<b>Total Restricted Cash excluding funds held by bond trustee</b>	<b>1,565,954</b>
Funds held by bond trustee	<u>1,448,529</u>
<b>Total Enterprise Restricted Cash</b>	<b><u>3,014,483</u></b>
<b>Total Restricted Cash, including funds held by bond trustee</b>	<b><u>\$ 3,369,356</u></b>

**NOTE 3 – INTERFUND TRANSACTIONS**

Transfers between funds during the fiscal year ended June 30, 2012, were as follows:

<u>Transfer from</u>	<u>Transfer to</u>	<u>Description of Transfer</u>	<u>Amount</u>
<u>Major Governmental Funds</u>			
	Wastewater Treatment		
General Fund	Project Fund	Restoration of reserves	\$ 25,000
Fire Fund	General Fund	Restore cash to positive balance	372,436
Water Fund	General Fund	Restore cash to positive balance	257,239
Refuse Fund	General Fund	Administrative support	44,832
Refuse Fund	General Fund	Restore cash to positive balance	<u>368,038</u>
		<b>Total Major Governmental Interfund Transfers</b>	<b><u>1,067,545</u></b>
<u>Non-Major Governmental Funds</u>			
Drainage Fund	General Fund	Restore cash to positive balance	<u>306,873</u>
		<b>Total Non-Major Governmental Interfund Transfers</b>	<b><u>306,873</u></b>
		<b>Total Interfund Transfers</b>	<b><u>\$ 1,374,418</u></b>

The General Fund has been showing a cash deficit for many years. This has been the result of poor accounting practices and structures in the past. These weaknesses were resolved in the early part of fiscal year 2008-09. However, the deficit remained open until this fiscal year until all parties concerned reached a consensus on which funds may contribute to the deficit. On December 1, 2011, the Board of Directors of the District adopted a resolution to transfer cash from other funds to the General Fund for a total of \$1,304,586. The contribution of each fund is shown above.

## NOTE 4 – CAPITAL ASSETS

### Governmental activities:

	Balance at July 1, 2011	Additions	Retirements	Transfers and Adjustments	Balance at June 30, 2012
Capital assets not being depreciated					
Land	\$ 50,000	\$ -	\$ -	\$ 7,375	\$ 57,375
Construction in progress	-	-	-	-	-
Total	55,403	-	-	7,375	57,375
Capital assets being depreciated					
Buildings, structures, and improvements	515,117	-	-	(1)	515,116
Infrastructure	-	-	-	232,299	232,299
Plant and equipment	1,844,052	-	-	(727,724)	1,116,328
Total	2,359,169	-	-	(495,426)	1,863,743
Less accumulated depreciation					
Buildings, structures, and improvements	(294,148)	(21,910)	-	(26,365)	(342,423)
Infrastructure	-	-	-	(212,922)	(212,922)
Plant and equipment	(1,647,087)	(21,481)	-	790,240	(878,328)
Total accumulated depreciation	(1,941,235)	(43,391)	-	550,953	(1,433,673)
Total capital assets, net	\$ 467,934	\$ (43,391)	\$ -	\$ 62,902	\$ 487,445

Depreciation expense was charged to functions based on their usage of the related assets as follows:

Governmental Activities:	
General administration	\$ 2,789
Public safety	38,413
Health and sanitation	2,189
Total governmental activities depreciation expense	\$ 43,391

### Business-type activities:

	Balance at July 1, 2011	Additions	Retirements	Transfers and Adjustments	Balance at June 30, 2012
Capital assets not being depreciated					
Land	\$ 8,190,132	\$ 386,649	\$ -	\$ (8,078,352)	\$ 498,429
Construction in progress	22,067,856	18,566	-	-	22,086,422
Total	30,257,988	405,215	-	(8,078,352)	22,584,851
Capital assets being depreciated					
Building and improvements	-	-	-	5,000	5,000
Infrastructure	-	-	-	8,397,190	8,397,190
Plant and equipment	8,507,855	30,879	-	(8,130,504)	408,230
Total	8,507,855	30,879	-	271,686	8,810,420
Less accumulated depreciation					
Building and improvements	-	-	-	(5,000)	(5,000)
Infrastructure	-	(189,196)	-	(3,148,513)	(3,337,709)
Plant and equipment	(2,946,812)	(4,186)	-	2,555,104	(395,894)
Total accumulated depreciation	(2,946,812)	(193,382)	-	(598,409)	(3,738,603)
Total capital assets being depreciated, net	5,561,043	(162,503)	-	(326,723)	5,071,817
Total capital assets, net	\$ 35,819,013	\$ 242,712	\$ -	\$ (8,405,075)	\$ 27,656,668

**NOTE 4 – CAPITAL ASSETS** (Continued)

In 2011-12, the books were reconciled to physical inventory. In addition, the classes or categories of assets were corrected to show Infrastructure and the existence of Land Easements. Most of the assets of the Water Fund are in Infrastructure which were reclassified from Equipment. The adjustments resulting from the process of reconciliation and reclassifications were approved by the Board of Directors on September 6, 2012, made retroactive to June 30, 2012, and are reflected in the adjustments shown above.

The adjustments shown above also include the transfer of Land and Land Rights of \$8,070,977 to the County. This is in accordance with special legislation, AB 2701, whereby the District has to convey assets acquired by the District for the original sewer project to the County upon their request and as identified for use in the successor sewer project of the County. The transfer involves no remuneration. The District adopted a resolution on November 17, 2011, to convey these assets.

**Construction in progress:**

	<u>Balance at June 30, 2012</u>
Governmental activities	\$ -
Business-type activities	<u>22,086,422</u>
Total construction in progress	<u>\$ 22,086,422</u>

Business-type activities

The construction in progress above includes \$22,067,856 which represents the total construction costs recorded and expended on a wastewater treatment project that was stopped in November 2005 by a new Board of Directors elected at that time. The stoppage was mainly due to the contentious location and type of the project. Contractors' claims with a total mediated amount of \$11,427,814 are not included in the cost shown above. These unrecorded claims were filed with the Bankruptcy Court. The bankruptcy case is currently pending in United States District Court awaiting the resolution of the second appeal of the favorable decision of the Bankruptcy Court on the District's debt adjustment plan.

The costs recorded and shown above were funded by a combination of a State Revolving Fund loan and the issuance of limited obligation improvement bonds. Due to the stoppage of the project and with the responsibility for a new successor project having been transferred to the County under special legislation AB 2701, the amount shown above may no longer represent its true value and may be materially impaired. Under AB 2701, the District is obligated to transfer to the County any assets acquired by the District for the original project when the County requests a transfer for use in their successor sewer project. At this point, infrastructure that may be included in the construction in progress amount shown above have not been determined nor valued. The County has not as yet requested the District the use or transfer of any infrastructure that may be included in this account, if any, that it may need for its successor project. It has however requested Land and Land easements that were conveyed by the District in November 2011.

(Also refer to Note 12.)

**NOTE 5 – ACCOUNTS PAYABLE**

Total claims against the District in Bankruptcy Court total about \$12 million, excluding two claims by the State with a total of \$15 million which the State agreed to settle based on certain conditions. These conditions are discussed in the Introductory Section, Impact on Liabilities. Of the \$12 million, only \$950,719 has been recorded in the books. This represents claims that were submitted to the District by the time of filing the bankruptcy case. In addition to these, about 95%, or \$11,427,814, represents mediated claims by three major contractors who worked on the aborted sewer project. These are not recorded in the books and are not reflected in these statements. The current status of the bankruptcy case is discussed in the Introductory Section.

## NOTE 6 – LONG-TERM LIABILITIES

The following is a summary of changes in the District's long-term liabilities for the fiscal year ended June 30, 2012:

	Balance at July 1, 2011	Additions	Reductions	Balance at June 30, 2012	Current Portion
Governmental Activities:					
Compensated Absences	\$ 31,780	\$ -	\$ (4,974)	\$ 26,806	\$ 7,997
Other Post Employment Benefits Obligation	-	3,345	-	3,345	-
Total Governmental Activities	<u>\$ 31,780</u>	<u>\$ 3,345</u>	<u>\$ (4,974)</u>	<u>\$ 30,151</u>	<u>\$ 7,997</u>
Business-Type Activities:					
Compensated Absences	\$ 23,976	\$ -	\$ (359)	\$ 23,617	\$ 11,701
Other Post Employment Benefits Obligation	-	3,334	-	3,334	-
Water Fund:					
Notes Payable	4,516,021	-	(130,359)	4,385,662	134,335
Wastewater Treatment Project Fund:					
Notes Payable	6,486,144	-	-	6,486,144	-
Improvement Bonds (US Bank Trustee)	15,605,000	-	(385,000)	15,220,000	400,000
Total Business-Type Activities	<u>\$ 26,631,141</u>	<u>\$ 3,334</u>	<u>\$ (515,718)</u>	<u>\$ 26,118,757</u>	<u>\$ 546,036</u>

A description of the long-term liabilities related to governmental activities at June 30, 2012, follows:

### A. Governmental Activities

There is no governmental long-term debt payable to external parties. Other Pension Obligation Benefits are discussed in Note 8.

### B. Business-Type Activities

#### California State Resources Control Board

On August 8, 2005, the District entered into an agreement with the California State Resources Control Board to finance the construction of the wastewater treatment project. The initial award of the contract amounted to \$134,761,390; however, principal amounts received to the point when the project was stopped totaled only \$6,486,144. This is the amount that is reflected in the financial statements of June 30, 2012, and in the schedule above. Installment payments, together with all interest accruing thereon, were to be repaid in annual installments at a rate of 2.3%. Interest on this loan is not accrued in the books because this loan and any interest thereon is part of the bankruptcy proceedings. Total simple interest to June 30, 2012, would be \$895,087.

The State has settled its claim for the immediate repayment of this loan and other associated obligations related to it after a number of legal processes. Of the three conditions imposed as part of the settlement, only one condition remains unfulfilled. This condition is that the Debt Adjustment Plan of the District submitted in its bankruptcy filing be settled. The Bankruptcy Court and then the U.S. District Court, acting upon an appeal of the favorable decision of the Bankruptcy Court, affirmed the District's Debt Adjustment Plan. However, a second appeal was filed and is now working its way through the legal processes. A hearing is tentatively set for March 2013. The bankruptcy case and its impact on these statements are also discussed in the Introductory Section.

On April 1, 2008, the Bankruptcy Court approved an agreement between the District and the County to restrict the use of any remaining loan proceeds limiting its use only for those authorized in a confirmed plan of adjustment in the District's Chapter 9 bankruptcy proceedings or otherwise agreed to by the County and the District. At the time of the agreement, the balance was \$2,141,973. As of June 30, 2012, the remaining balance is \$1,447,911. The County has authorized the use of these funds for legal expenses and other professional services relating to the bankruptcy proceedings and up to \$10,000 a month for legal representation in behalf of the Official Committee of Unsecured Creditors.

**NOTE 6 – LONG-TERM LIABILITIES** (Continued)

**B. Business-Type Activities** (Continued)

Wastewater Improvement Bonds

On November 7, 2002, the District issued \$17,990,000 of limited obligation improvement bonds to (i) finance the construction of a wastewater collection, treatment, and disposal facility referred to as the “Wastewater Treatment Project” benefiting properties located within the District’s boundaries and is referred to as the District’s Wastewater Assessment District No. 1 (the “Assessment District”), (ii) to fund a reserve fund for the bonds, (iii) to fund capitalized interest on the bonds until September 2, 2003, and (iv) to pay costs of issuing the bonds. The bonds were issued at a discount of \$4,091 and issuance costs were \$782,707. Principal is payable on September 2 each year through September 2033, beginning in 2004. Interest on the bonds is payable on September 2 and March 2 of each year through September 2033, beginning March 2, 2003. Interest rates on the bond vary between 1.8 and 4.0 percent. The bonds are secured by assessments against the properties within the Assessment District and are further secured by the monies in the Redemption Fund and the Reserve Fund created pursuant to the assessment proceedings. The outstanding principal balance of the bonds at June 30, 2012, was \$15,220,000.

Deferred issuance cost on this loan has a balance of \$527,728 as of June 30, 2012. This is amortized over the life of the bonds at a rate of \$25,954 per annum.

California Infrastructure and Economic Development Bank

On December 6, 2004, the District entered into a loan agreement with the California Infrastructure and Economic Development Bank (CIEDB) for a principal amount of \$5 million for the purpose of constructing and upgrading water delivery facilities. The loan is for a term of thirty years ending in August 2034 with an interest rate of 3.05% per annum. Annual payments average \$278,000 per year including interest. Debt service payments are due in August and February each year. Water revenues were pledged to guarantee the loan. All projects covered by the loan were completed and closed out in January 2009. The outstanding principal balance of the loan at June 30, 2012, was \$4,385,662.

Deferred issuance cost on this loan has a balance of \$31,957 as of June 30, 2012, which is amortized over the life of the bonds at a rate of \$1,441 per year.

Business-Type Long-Term Liabilities Amortization Schedules Follow:

California State Resources Control Board			
For the Year Ending June 30	Principal	Interest *	Total
2012	\$ 6,486,144	Rate = 2.3% \$ -	\$ 6,486,144
Total	\$ 6,486,144	\$ -	\$ 6,486,144

\* Interest related to the California State Resources Control Board loan is not accrued because this is part of bankruptcy proceeding. A settlement has been reached as discussed above. Total simple interest to June 30, 2012, would be \$895,087.

**NOTE 6 – LONG-TERM LIABILITIES** (Continued)**B. Business-Type Activities** (Continued)

Wastewater Improvement Bonds			
For the Year Ending June 30	Principal	Interest	Total
2013	\$ 400,000	\$ 749,000	\$ 1,149,000
2014	415,000	730,625	1,145,625
2015	435,000	709,375	1,144,375
2016	455,000	687,125	1,142,125
2017	480,000	663,750	1,143,750
2018-2022	2,790,000	2,923,750	5,713,750
2023-2027	3,555,000	2,133,875	5,688,875
2028-2032	4,540,000	1,127,250	5,667,250
2033-2035	2,150,000	108,750	2,258,750
Total	<u>\$ 15,220,000</u>	<u>\$ 9,833,500</u>	<u>\$ 25,053,500</u>

Business-Type Long-Term Liabilities Amortization Schedules Follow: (Continued)

California Infrastructure and Economic Development Bank				
For the Year Ending June 30	Principal	Interest	Annual Administrative Fee	Total
2013	\$ 134,335	\$ 131,714	\$ 13,157	\$ 279,206
2014	138,432	127,554	12,754	278,740
2015	142,654	123,268	12,339	278,261
2016	147,005	118,851	11,911	277,767
2017	151,489	114,298	11,470	277,257
2018-2022	829,635	498,202	50,248	1,378,085
2023-2027	964,111	361,675	37,021	1,362,807
2028-2032	1,120,384	203,018	21,650	1,345,052
2033-2035	757,617	35,124	4,591	797,332
Total	<u>\$ 4,385,662</u>	<u>\$ 1,713,704</u>	<u>\$ 175,141</u>	<u>\$ 6,274,507</u>

**NOTE 7 – OPERATING LEASES**

The District has commitments to lease certain office equipment and facilities. The District leases its administrative facilities for \$2,000 a month. The lease was extended by two years to April 30, 2014, under the same terms. The District leases a copier at \$487 a month. This lease is renewable annually at the District's option in September each year.

## **NOTE 8 – EMPLOYEE RETIREMENT BENEFITS**

### **Defined Benefit Pension Plan**

#### Plan Description

The District's pension plan is a defined benefits plan and is administered by the California Public Employees Retirement System (CALPERS). CALPERS acts as a common investment and administrative agent for the participating public entities within the State of California. Member agencies total over 3,000, representing about 1.6 million public sector employees. These defined benefit plans provide retirement and disability benefits, annual cost of living adjustments, and death benefits to plan members and their beneficiaries.

The District's plan is part of the Miscellaneous 2% at 55 Risk Pool, a cost-sharing multiple-employer defined benefits plan. Risk pools were created in 2006 pursuant to legislation and required mandatory participation of small employers to help reduce large fluctuations in their contribution rates. As an employer with less than 100 active members, the District was required to participate in the risk pool. Under this pooling method, assets and liabilities of the participant employers are aggregated. As such, individual employer's retirement data is not available.

#### Funding Policy

Participating employees are required to contribute seven percent (7%) of their annual covered salary. However, under the Memorandum of Understanding between the District and its employees, the District agreed to pick up 5.84% leaving 1.16% for the employees to contribute. The District is required to contribute an actuarially determined rate calculated as a percentage of covered payrolls. The employer contribution rate for the fiscal year ended June 30, 2012, was 11.978%.

#### Annual Pension Cost

For the fiscal year ended June 30, 2012, the District paid to CALPERS a total of \$62,981 for its regular contribution of 11.978% for miscellaneous employees. This is under the projected contribution used by CALPERS in its actuarial calculations of \$83,574. This is mainly due to the downward trend of actual payroll which runs counter to the actuarial assumptions as described below. It should be noted that required contributions rates are projected by CALPERS using actuarial valuations done two fiscal years before the effective date. Hence, for the fiscal year 2011-12, the contribution rate of 11.978% percent was projected using actuarial valuation done at June 30, 2009.

The assumptions used to determine required contributions in 2011-12 remained the same as in the prior year except the projected salary increase rate with a starting range slightly higher than last year. The actuarial assumptions included (a) 7.75% investment rate of return (net of administrative expenses), (b) projected annual salary increases from 3.55% to 14.45% depending on age, service, and type of employment, (c) 3.0% inflation rate, and (d) 3.25% payroll growth. The actuarial value of CALPERS assets was determined using techniques that smooth the effects of short-term volatility in the market value of investments over a four-year period (smoothed market value). The CALPERS unfunded actuarial accrued liability is being amortized as a level percentage of projected payroll on a closed basis. CALPERS has combined the prior service unfunded liability and current service unfunded liability into a single initial unfunded liability.

<u>Fiscal Year</u>	<u>Three-Year Trend Information for CALPERS</u>		
	<u>Annual Pension Cost (APC)</u>	<u>Percentage of APC Contributed</u>	<u>Net Pension Obligation</u>
2010	\$ 77,628	100%	\$ -
2011	\$ 78,166	100%	\$ -
2012	\$ 83,574	75%**	\$ 20,593

**NOTE 8 – EMPLOYEE RETIREMENT BENEFITS** (Continued)

**Defined Benefit Pension Plan** (Continued)

Schedule of Funding Progress for CALPERS  
Risk Pool of Small Employers (with active employees less than 100)

Actuarial Valuation Date	Accrued Liabilities (AL)	Actuarial Value of Assets (AVA)	Unfunded Liabilities (UL)	Funded Ratio	Annual Covered Payroll	UL* % of Covered Payroll
6/30/08**	\$ 2,780,280,768	\$ 2,547,323,278	\$ 232,957,490	91.6%	\$ 688,606,681	33.8%
6/30/09**	\$ 3,104,798,222	\$ 2,758,511,101	\$ 346,287,121	88.9%	\$ 742,981,488	46.6%
6/30/10**	\$ 3,309,064,934	\$ 2,946,408,106	\$ 362,656,828	89.0%	\$ 748,401,352	48.5%

\* UL - Unfunded liability

\*\* A State Law authorized the creation of risk pools by CALPERS which was implemented on June 30, 2006. This required mandatory participation of small employers to help reduce large fluctuations in their contribution rates. As an employer with less than 100 active members, the District is now required to participate in the risk pool. Under this pooling method, assets and liabilities of the participant employers are aggregated. As such, retirement data is no longer available for an individual employer.

**Other Post Employment Benefits (OPEB)**

Other post employment benefits (OPEB) reflects the share of the District of the medical premium as required in the agreement with CALPERS to provide health benefits to active and retired employees. Currently, the required employer's share is \$112 per month. It should be noted that if an employee ceases to participate in the CALPERS medical program, this benefit also terminates.

GASB Statement No. 45, a statement issued by the Governmental Accounting Standards Board, fully implementable in fiscal year 2009-10 required that the employer's liability for these benefits be estimated, recorded, or disclosed.

For the District, this liability was estimated using the Alternative Measurement Method which essentially avoids the hiring of an actuary to do the computation. District's staff performed the computation to estimate this liability. As with any actuarial computations, there were a number of assumptions used. One of the key assumptions is that only 40% of retiring employees who are eligible for Medicare benefits will be able to afford the CALPERS supplemental medical program and will then have no other post employment benefits. This assumption is based on employee demographics. This liability as of June 30, 2012, is estimated to be \$31,100. Of this amount, only \$ \$6,679 has been recorded in the books. This liability would be \$78,000 if 40% participation is not assumed.

Another assumption made is that employees will work up to the time they become eligible for Medicare benefits. Again, this assumption is based on employee demographics. There are currently two employees who retired before this age. Their OPEB is funded on a pay as you go basis and funded through the annual budget.

Funding

Ideally this OPEB liability is funded annually and invested separately from other District funds or even transferred to a trust manager that will be responsible for investing and paying out these funds. The estimated liability however is not that material and therefore can be managed easily by the District.



## NOTE 9 – NET ASSETS/FUND BALANCES

### A. Net Assets – Statement of Net Assets

The Statement of Net Assets utilizes a net assets presentation for both the governmental and business-type activities. Business-type activities also use this same presentation in the fund financial statements. Net assets are categorized as invested capital assets (net of related debt), restricted, and unrestricted. The following summarizes Net Assets for both governmental and business-type activities.

#### GOVERNMENTAL ACTIVITIES

	<u>General Fund 100</u>	<u>Fire Fund 301</u>	<u>Non-Major Funds</u>	<u>Total Fund Balances</u>
Invested in Capital Assets, Net of Related Debt	\$ 10,689	\$ 410,005	\$ 66,751	\$ 487,445
Restricted Net Assets	-	50,867	303,110	353,977
Unrestricted:				
Designated for fire capital outlay	-	581,737	-	581,737
Fire Replacement Reserve	-	121,281	-	121,281
Designation for fire contingencies	-	37,709	-	37,709
Designation for drainage capital outlay	-	-	170,799	170,799
Designation for drainage contingencies	-	-	22,159	22,159
Committed for open purchase agreements	-	582,824	-	582,824
Committed for technology upgrades	20,000	-	-	20,000
Undesignated	(154,666)	70,846	37,722	(46,098)
Total Unrestricted Net Assets	<u>(134,666)</u>	<u>1,394,397</u>	<u>230,680</u>	<u>1,490,411</u>
Total Net Assets-Governmental Activities	<u>\$ (123,977)</u>	<u>\$ 1,855,269</u>	<u>\$ 600,541</u>	<u>\$ 2,331,833</u>

#### BUSINESS-TYPE ACTIVITIES

	<u>Water Fund 500</u>	<u>Refuse Fund 650</u>	<u>Wastewater 600</u>	<u>Total Fund Balances</u>
Invested in Capital Assets, Net of Related Debt	\$ 1,044,558	\$ -	\$ 520,304	\$ 1,564,862
Restricted for:				
Debt Service	-	-	1,480,164	1,480,164
Debt restructuring	-	-	1,447,911	1,447,911
Restricted Net Assets	-	-	2,928,075	2,928,075
Unrestricted:				
Reserved for Advances to Other Funds	410,000	-	-	410,000
Designations for water quality enhancement	91,215	-	-	91,215
Designation for debt repayment	280,983	-	-	280,983
Designation for water rate stabilization	96,496	-	-	96,496
Designation for equipment replacement	24,277	-	-	24,277
Committed for open purchase agreements	152,702	-	-	152,702
Not available, tied up in Imprest Cash, Prepayments, and Inventory	88,464	-	-	88,464

#### Used or committed in 2012-13 budget:

To fund unfunded needs - replace billing system, legal services, water tests, new meters, and readers	107,500	-	-	107,500
To fund Capital Outlay appropriation in 2012-13	67,500	-	-	67,500
Increase - Equipment Replacement Designation	35,000	-	-	35,000
Increase - Capital Outlay designation	40,840	-	-	40,840
Increase - Contingencies designation	-	7,261	-	7,261
Create Designation for Water Conservation	25,000	-	-	25,000
Create Designation for Water Basin management	39,200	-	-	39,200
Available - Uncommitted	-	-	(594,570)	(594,570)
Total Unrestricted Net Assets	<u>1,972,384</u>	<u>185,199</u>	<u>(594,570)</u>	<u>1,563,013</u>
Total Net Assets	<u>\$ 3,016,942</u>	<u>\$ 185,199</u>	<u>\$ 2,853,809</u>	<u>\$ 6,055,950</u>

**NOTE 9 – NET ASSETS/FUND BALANCES** (Continued)

A. Net Assets – Statement of Net Assets (Continued)

*Investment in Capital Assets, Net of Related Debt* – This category groups all capital assets, including infrastructure, and then reduced by the associated debts.

*Restricted Net Assets* – This category presents external restrictions imposed by creditors, grantors, contributors, or laws or regulations of other governments and restrictions imposed by law through constitutional provisions or enabling legislation.

*Unrestricted net assets* – This category represents net assets of the District, not otherwise presented in the two categories described above. For governmental funds, this category includes all the reserves and designations approved by the Board of Directors for specific purposes. These are presented under Note 9-B which displays equity under the fund financial statements in accordance with GASB Statement No. 54.

B. Fund Balances of Governmental Funds in the Fund Financial Statements

Equity accounts used for governmental funds in the fund financial statements are presented differently from the Statement of Net Assets as described above. The presentation follows statements of the GASB. Presentation has changed several times in the past with the latest change effective in fiscal year 2010-11. This change is implemented according to GASB Statement No. 54. This statement categorizes governmental equities mainly based on the constraints and source of the constraints placed on the funds. The District has adopted a resolution affirming its compliance with GASB Statement No. 54 and also affirming that the Board of Directors alone can create, change, and dispose of RESTRICTED and COMMITTED fund balances.

In summary, the following are the fund balance categories under this statement:

NONSPENDABLE	Resources are not in spendable form or are legally required to remain intact.
RESTRICTED	The constraint to spend the funds is imposed or legally enforced by external parties.
COMMITTED	Constraint is created by and can only be changed by the the legislative body pursuant to a formal action.
ASSIGNED	The constraint is a merely an expression of intent by the the legislative body or by an authorized official.
UNASSIGNED	No constraints.

**NOTE 9 – NET ASSETS/FUND BALANCES** (Continued)**B. Fund Balances of Governmental Funds in the Fund Financial Statements** (Continued)

As of June 30, 2012, the following fund balances of governmental funds are presented in the fund financial statements:

	General Fund 100	Fire Fund 301	Total Non-Major Funds	Total Fund Balances
<b>Nonspendable</b>				
Petty cash	\$ 12,500	\$ 400	\$ -	\$ 12,900
Prepayments	1,410	3,705	-	5,115
Deposits and non-current receivables	7,448	-	-	7,448
Total nonspendable fund balance	<u>21,358</u>	<u>4,105</u>	<u>-</u>	<u>25,463</u>
<b>Restricted</b>				
Public facilities fees	-	50,867	-	50,867
Assessments held for a pool	-	-	303,110	303,110
Balance restricted for the fund's purpose	-	-	-	-
Total restricted fund balance	<u>-</u>	<u>50,867</u>	<u>303,110</u>	<u>353,977</u>
<b>Committed to:</b>				
Encumbrances	-	582,824	-	582,824
Vehicle and equipment replacement	-	121,281	-	121,281
Other capital outlay	-	581,737	170,799	752,536
Balance restricted for the fund's purpose	-	101,070	46,784	147,854
Total committed fund balance	<u>-</u>	<u>1,386,912</u>	<u>217,583</u>	<u>1,604,495</u>
<b>Assigned</b>				
Fund reservation for technology	20,000	-	-	20,000
Designation for contingency	-	37,709	22,159	59,868
Total assigned fund balance	<u>20,000</u>	<u>37,709</u>	<u>22,159</u>	<u>79,868</u>
<b>Unassigned fund balance</b>	<u>(200,606)</u>	<u>-</u>	<u>-</u>	<u>(200,606)</u>
<b>Total fund balances</b>	<u><u>\$ (159,248)</u></u>	<u><u>\$ 1,479,593</u></u>	<u><u>\$ 542,852</u></u>	<u><u>\$ 1,863,197</u></u>

**NOTE 10 – RISK MANAGEMENT**

The District is exposed to various risks of loss related to torts, property loss and damage, errors and omissions, and employee injury. The District carries all its insurance coverage over these risks and also for Workers' Compensation through the Special Districts Risk Management Authority (SDRMA). This agency is a Joint Powers Authority (JPA) consisting of special districts in the State of California. It is governed by a seven-member Board of Directors. All seven are elected at large from the membership to serve four year terms. It has about 442 public agencies participating in the Property/Liability program and 355 agencies in its Workers' Compensation program. SDRMA's audit report for the fiscal year 2010-11 shows it had Net Assets of almost \$51 million.

The District has never incurred any uninsured losses since its inception.

## **NOTE 11 – CONTINGENCIES AND COMMITMENTS**

### Bankruptcy Case Litigation

The history of the bankruptcy case is discussed in the Introductory Section. The current status of the case is reprised here.

### Current Status of the Bankruptcy Filing

On August 8, 2011, the Bankruptcy Court entered an Order Confirming the LOCSD Debt Adjustment Plan (the Plan). The Plan as confirmed resolved all the claims under the jurisdiction of the Bankruptcy Court which included approximately \$11.4 million in unsecured creditor claims. The confirmed Plan provided approximately \$4.5 million to satisfy the claims of the unsecured creditors. The sources of these funds are:

- The remaining State Revolving Fund Loan related to the prior Wastewater Treatment Project (approximately \$1.7 million as of September 10, 2010, the filing date of the Debt Adjustment Plan). As of June 30, 2012, it had a balance of \$1,447,912; and
- \$2.8 million from San Luis Obispo County; in exchange, the Solid Waste Franchise Agreement is transferred to the County.

However, the Bankruptcy Court's order approving the Plan was appealed by the District's major creditor on August 22, 2011. This appeal was decided by the United States District Court on the District's favor on April 2, 2012 upholding the decision of the Bankruptcy Court to approve the Plan. Shortly afterward, on May 8, 2012, this decision was again appealed by the major creditor to the United States Court of Appeals for the Ninth Circuit. That appeal has yet not been set for hearing, but may be heard sometime in late 2013.

### Commitment to Pay into the 2002 Bond Reserve

On September 2, 2006, the District prematurely used \$714,268 of bond reserves in order to complete the debt service payment due on that date. These reserves are required to be replenished within one year unless an extended payback schedule was negotiated. The District has committed to pay at least \$25,000 per year. This amount plus any investment income earned by all funds held by bond trustee will be used to bring the reserve account to its required level of \$1,158,523. As of June 30, 2012, \$459,456 is still needed to restore the reserve to its required level.

### Other Commitments

In September 2007, the District entered into an Interlocutory Stipulated Judgment (ISJ) with three other water purveyors in the community. The judgment was intended to provide a coordinated effort of all parties to manage the water basin by first preparing a comprehensive plan to address deficiencies that threaten the long-term viability of the water basin. The judgment provided for an equitable sharing of costs. The District's share is thirty nine percent (39%). The District is current on this commitment which is funded in its annual budget. The long-term financial impact of implementing the plan that the court will ultimately order is unknown at this point.

### Loss of Revenue Source and Possible Closure of a Fund

The District may lose its Franchise Fee revenue which averages at least \$155,000 annually to the County. This is due to an agreement with the County that in return for the County contributing \$2.8 million to the District's Debt Adjustment Plan, the District gives up its Solid Waste function to them. A clarification of the relationship with regard to this transaction has to still be established. A permanent loss of this revenue source may lead to the closure of the Solid Waste Fund. The District continues to pursue the possibility of a debtor-creditor relationship with the County rather than a transfer of function with its associated revenues.

**NOTE 11 – CONTINGENCIES AND COMMITMENTS** (Continued)

Going Concern Issue

Until the bankruptcy case is finally closed, it cannot be declared with absolute certainty that the District will be able to continue as a going concern.

**NOTE 12 – SUBSEQUENT EVENTS**

Subsequent events have been evaluated through December 7, 2012, which is the date the basic financial statements were available to be issued. There is no subsequent event that affects the District's operations directly. However, it should be noted that the County's sewer project for the community finally started in October 2012. A lot of construction activity is currently going on throughout the community. This was the project that led the District into bankruptcy when it was stopped by a "recall" Board of Directors and was subsequently given to the County of San Luis Obispo in accordance with special legislation that made the County the independent responsible entity for a successor project. The project is expected to be completed in three years.

**NOTE 13 – PRIOR PERIOD ADJUSTMENTS**

The Water Fund shows a Prior Period Adjustment of \$323,005 which resulted from the process of reconciling fixed assets per books to physical inventory. All these adjustments, which consist of various items, were identified and were approved by the Board of Directors in open session. The Wastewater Treatment Project Fund also shows an adjustment of \$386,649. This represents the addition to assets of land and land easements that were not added to assets but were paid for. In this process, expenditures for prior years were then overstated. This discovery happened in the process of transferring land and land easements to the County for its sewer project. The assets represented by this adjustment were transferred to the County (see Note 4 for the total assets transferred).

**REQUIRED SUPPLEMENTARY INFORMATION**

**LOS OSOS COMMUNITY SERVICES DISTRICT  
SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES  
IN FUND BALANCE – BUDGET AND ACTUAL  
GENERAL FUND – 100  
FOR THE YEAR ENDED JUNE 30, 2012**

	Original Budget	Final Budget	Actual Amounts	Variance with Final Budget
<b>REVENUES</b>				
Investment income	\$ -	\$ -	\$ -	\$ -
Other revenues	-	-	47	47
<b>Total Revenues</b>	<b>-</b>	<b>-</b>	<b>47</b>	<b>47</b>
<b>EXPENDITURES</b>				
Salaries and wages	300,105	300,105	288,171	11,934
Payroll taxes and benefits	104,043	104,043	81,942	22,101
Bank charges contract services	-	-	-	-
Contract services	36,000	36,000	34,756	1,244
Insurance	30,000	30,000	31,804	(1,804)
License and fees	19,500	19,500	18,494	1,006
Maintenance and repairs	14,810	14,810	18,204	(3,394)
Meals and entertainment	2,000	2,000	364	1,636
Office support, publication, and dues	15,800	15,800	14,544	1,256
Tools and supplies	500	500	618	(118)
Rent	21,880	21,880	19,067	2,813
Professional services	130,800	139,813	123,915	15,898
Telephone and communications	5,300	5,300	4,192	1,108
Employee travel and training	10,500	10,500	7,291	3,209
Utilities	3,800	3,800	3,875	(75)
Director fees	18,500	18,500	18,850	(350)
Other expenses	500	500	1,714	(1,214)
Capital outlay	5,000	25,000	-	25,000
Other outgo - cost allocation to other funds	(699,210)	(699,210)	(699,216)	6
<b>Total Expenditures</b>	<b>19,828</b>	<b>48,841</b>	<b>(31,415)</b>	<b>80,256</b>
Excess (deficiency) of revenues over (under) expenditures	(19,828)	(48,841)	31,462	80,303
<b>OTHER FINANCING SOURCES (USES)</b>				
Transfers in	44,828	1,349,414	1,349,418	4
Transfers out	(25,000)	(25,000)	(25,000)	-
<b>Total other financing sources (uses)</b>	<b>19,828</b>	<b>1,324,414</b>	<b>1,324,418</b>	<b>4</b>
Net change in fund balance	-	1,275,573	1,355,880	80,307
Fund balance (deficit) - July 1, 2011,	(1,515,128)	(1,515,128)	(1,515,128)	-
Fund balance (deficit) - June 30, 2012	<u>\$ (1,515,128)</u>	<u>\$ (239,555)</u>	<u>\$ (159,248)</u>	<u>\$ 80,307</u>

Note: The annual budget funds increases to Reserves and Designations where there is a positive Net Change and a deficit Net Change is funded by decreases in these accounts. This movement is not shown in the budgets above.

**LOS OSOS COMMUNITY SERVICES DISTRICT  
SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES  
IN FUND BALANCE – BUDGET AND ACTUAL  
FIRE FUND – 301  
FOR THE YEAR ENDED JUNE 30, 2012**

	<u>Original Budget</u>	<u>Final Budget</u>	<u>Actual Amounts</u>	<u>Variance with Final Budget</u>
<b><u>REVENUES</u></b>				
Property taxes	\$ 1,582,500	\$ 1,582,500	\$ 1,559,912	\$ (22,588)
Special taxes and assessments	475,509	475,509	474,977	(532)
Public services fees	62,111	62,111	63,798	1,687
Intergovernmental	34,749	34,749	4,909	(29,840)
Investment income	900	900	6,219	5,319
Other revenues	22,500	22,500	23,618	1,118
	<u>2,178,269</u>	<u>2,178,269</u>	<u>2,133,433</u>	<u>(44,836)</u>
<b><u>EXPENDITURES</u></b>				
Salaries and wages	111,050	111,050	105,789	5,261
Payroll taxes and benefits	25,501	25,501	20,882	4,619
Contract services	1,586,295	1,586,295	1,581,275	5,020
Insurance	20,000	20,000	20,725	(725)
License and fees	25,200	25,200	24,062	1,138
Maintenance and repairs	17,988	11,460	8,509	2,951
Meals and entertainment	1,300	1,300	140	1,160
Office support, publication, and dues	16,600	16,600	6,761	9,839
Tools and supplies	39,900	47,832	36,398	11,434
Professional services	1,000	1,000	2,765	(1,765)
Telephone and communications	28,150	33,086	34,186	(1,100)
Employee travel and training	7,200	7,200	2,061	5,139
Utilities	10,548	10,548	9,272	1,276
Other expenses	2,750	2,750	5,827	(3,077)
Capital outlay	15,368	589,368	-	589,368
Other outgo - cost allocation from other funds	108,598	109,426	108,600	826
	<u>2,017,448</u>	<u>2,598,616</u>	<u>1,967,252</u>	<u>631,364</u>
Excess (deficiency) of revenues over (under) expenditures	<u>160,821</u>	<u>(420,347)</u>	<u>166,181</u>	<u>586,528</u>
<b><u>OTHER FINANCING SOURCES (USES)</u></b>				
Contingency	(40,000)	(40,000)	-	40,000
Transfers out	-	(372,436)	(372,436)	-
	<u>(40,000)</u>	<u>(412,436)</u>	<u>(372,436)</u>	<u>40,000</u>
Net change in fund balance	120,821	(832,783)	(206,255)	626,528
Fund balance - July 1, 2010	<u>1,685,848</u>	<u>1,685,848</u>	<u>1,685,848</u>	<u>-</u>
Fund balance - June 30, 2011	<u>\$ 1,806,669</u>	<u>\$ 853,065</u>	<u>\$ 1,479,593</u>	<u>\$ 626,528</u>

Note: The annual budget funds increases to Reserves and Designations where there is a positive Net Change and a deficit Net Change is funded by decreases in these accounts. This movement is not shown in the budgets above.



**SUPPLEMENTARY INFORMATION**

**LOS OSOS COMMUNITY SERVICES DISTRICT  
COMBINING BALANCE SHEETS  
NON-MAJOR GOVERNMENTAL FUNDS  
JUNE 30, 2012**

	Bayridge 200	Vista de Oro 400	Drainage 800	Parks and Recreation 900	Total Non-Major Governmental Funds
<b><u>ASSETS</u></b>					
Cash and cash equivalents	\$ 10,515	\$ 23,308	\$ 202,744	\$ 209	\$ 236,776
Restricted cash	-	-	-	302,841	302,841
Accrued revenues receivable	1,098	436	2,626	269	4,429
Total Assets	<u>\$ 11,613</u>	<u>\$ 23,744</u>	<u>\$ 205,370</u>	<u>\$ 303,319</u>	<u>\$ 544,046</u>
<b><u>LIABILITIES AND FUND BALANCES</u></b>					
<b>LIABILITIES</b>					
Accounts payable	\$ 101	\$ 51	\$ 1,042	\$ -	\$ 1,194
Total Liabilities	<u>101</u>	<u>51</u>	<u>1,042</u>	<u>-</u>	<u>1,194</u>
<b>FUND BALANCES</b>					
Restricted	-	-	-	303,110	303,110
Committed	11,512	23,693	182,169	209	217,583
Assigned	-	-	22,159	-	22,159
Total Fund Balances	<u>11,512</u>	<u>23,693</u>	<u>204,328</u>	<u>303,319</u>	<u>542,852</u>
Total Liabilities and Fund Balances	<u>\$ 11,613</u>	<u>\$ 23,744</u>	<u>\$ 205,370</u>	<u>\$ 303,319</u>	<u>\$ 544,046</u>

**LOS OSOS COMMUNITY SERVICES DISTRICT  
COMBINING STATEMENTS OF REVENUES, EXPENDITURES,  
AND CHANGES IN FUND BALANCES  
NON-MAJOR GOVERNMENTAL FUNDS  
FOR THE YEAR ENDED JUNE 30, 2012**

	Bayridge 200	Vista de Oro 400	Drainage 800	Parks and Recreation 900	Total Non-Major Governmental Funds
<u>REVENUES</u>					
Property taxes	\$ 6,630	\$ -	\$ 3,454	\$ -	\$ 10,084
Special taxes and assessments	-	-	95,424	-	95,424
Service charges and fees	29,547	15,768	-	-	45,315
Investment income	-	-	570	1,131	1,701
Other revenues	-	-	30	-	30
<b>Total Revenues</b>	<b>36,177</b>	<b>15,768</b>	<b>99,478</b>	<b>1,131</b>	<b>152,554</b>
<u>EXPENDITURES</u>					
Salaries and wages	7,101	5,000	11,003	-	23,104
Payroll taxes and benefits	2,818	1,950	4,441	-	9,209
Contract services	500	500	1,900	-	2,900
License and fees	1,014	778	8,161	-	9,953
Maintenance and repairs	13,334	8,242	2,843	-	24,419
Office supplies, publication, and dues	-	-	-	-	-
Supplies	629	315	2,301	-	3,245
Telephone and communications	149	149	895	-	1,193
Employee travel and training	-	-	217	-	217
Utilities	8,666	2,282	1,627	-	12,575
Other expenses	11	-	94	-	105
Other outgo - cost allocation from other funds	10,212	4,452	28,032	-	42,696
<b>Total Expenditures</b>	<b>44,434</b>	<b>23,668</b>	<b>61,514</b>	<b>-</b>	<b>129,616</b>
Excess (deficiency) of revenues over (under) expenditures	<b>(8,257)</b>	<b>(7,900)</b>	<b>37,964</b>	<b>1,131</b>	<b>22,938</b>
<u>OTHER FINANCING SOURCES (USES)</u>					
Transfers out	-	-	(306,873)	-	(306,873)
<b>Total other financing sources (uses)</b>	<b>-</b>	<b>-</b>	<b>(306,873)</b>	<b>-</b>	<b>(306,873)</b>
Net change in fund balances	(8,257)	(7,900)	(268,909)	1,131	(283,935)
Fund balances - July 1, 2011	19,769	31,593	473,237	302,188	826,787
Fund balances - June 30, 2012	<u>\$ 11,512</u>	<u>\$ 23,693</u>	<u>\$ 204,328</u>	<u>\$ 303,319</u>	<u>\$ 542,852</u>

BROWN  
ARMSTRONG

CERTIFIED  
PUBLIC  
ACCOUNTANTS

# BROWN ARMSTRONG

*Certified Public Accountants*

## **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 Board of Directors of  
Los Osos Community Services District  
Los Osos, California

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We have audited the basic financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the Los Osos Community Services District (the District) as of and for the year ended June 30, 2012, which collectively comprise the District's basic financial statements and have issued our report thereon dated December 7, 2012. 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

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

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying Schedule of Findings and Recommendations, we identified a certain deficiency in internal control over financial reporting that we consider to be a material weakness.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiency 2012-01 described in the accompanying Schedule of Findings and Recommendations to be a material weakness.



REGISTERED with the Public Company  
Accounting Oversight Board and  
MEMBER of the American Institute of  
Certified Public Accountants

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the District'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 an instance of noncompliance or other matters that is required to be reported under *Government Auditing Standards* and which is described in the accompanying Schedule of Findings and Recommendations as Finding 2012-01.

The District's response to the finding identified in our audit is described in the accompanying Schedule of Findings and Recommendations. We did not audit the District's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of management, the Board of Directors, federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

BROWN ARMSTRONG  
ACCOUNTANCY CORPORATION

*Brown Armstrong  
Accountancy Corporation*

Bakersfield, California  
December 7, 2012

**LOS OSOS COMMUNITY SERVICES DISTRICT  
SCHEDULE OF FINDINGS AND RECOMMENDATIONS  
JUNE 30, 2012**

**FINANCIAL STATEMENT FINDINGS**

**Finding 2012-01 – The Construction in Progress (CIP) in the Wastewater Fund of About \$22 Million Should be Either Written Off or Capitalized.**

**Condition**

The CIP of \$22 million has been in the books for at least five years after it had been determined that the Wastewater Treatment Project would no longer continue.

**Recommendation**

Any specific assets that may have been constructed should be capitalized, if any, or, if no asset exists, written off. The District has to assess the value of any assets and determine whether any can be sold or used by the District in its future operations.

**Management Response**

Management agrees with the recommendation. An item has been submitted to write off the value but action was deferred until the County completes the process of requesting all assets it may need for its successor project as directed by AB 2701.

**LOS OSOS COMMUNITY SERVICES DISTRICT  
STATUS OF PRIOR YEAR AUDIT FINDINGS  
JUNE 30, 2012**

**FINANCIAL STATEMENT FINDINGS**

**Finding 2011-01 – Cash Deficit in the General Fund**

**Condition**

The overdraft in the General Fund should be made good by transferring from other funds. Not doing so makes it difficult for all funds to move forward since as a whole, the District only has so much cash.

**Recommendation**

Adjustments should be done to bring cash balances for all funds to a positive balance.

**Management Response**

Management agrees with the finding since the cash deficit has lingered on for more than five years. On November 14, 2011, the Board's Financial Advisory Committee recommended a solution to this issue which essentially will require transfers from other funds to the General Fund. The Board of Directors will take the formal action to adopt the solution on December 1, 2011.

**Current Year Status**

Implemented.

**Finding 2011-02 – Adjust and Reconcile Capital Assets Values to Results of Physical Inventory for Funds other than the Wastewater Treatment Project Fund**

**Condition**

Physical inventory for capital assets has just been completed for all funds other than the Wastewater Treatment Project Fund. However, the value of capital assets showing in the books has not been reconciled to the result of physical inventory.

**Recommendation**

The inventory list has to be valued and agreed to the values carried in the books. Adjustments, if any, will then be brought to the Board of Directors for approval.

**Management Response**

The Water Fund physical inventory has recently been completed. The reconciliation process will soon be undertaken.

**Current Year Status**

Implemented.

**LOS OSOS COMMUNITY SERVICES DISTRICT  
SCHEDULE OF FINDINGS AND RECOMMENDATIONS (Continued)  
JUNE 30, 2012**

**Finding 2011-03 – The Construction in Progress (CIP) in the Wastewater Fund of About \$22 Million Should be Either Written Off or Capitalized.**

**Condition**

The CIP of \$22 million has been in the books for at least five years after it had been determined that the Wastewater Treatment Project would no longer continue.

**Recommendation**

Any specific assets that may have been constructed should be capitalized, if any, or, if no asset exists, written off. The District has to assess the value of any assets and determine whether any can be sold or used by the District in its future operations.

**Management Response**

Management agrees with the recommendation. An item has been submitted to write off the value but action was deferred until the County completes the process of requesting all assets it may need for its successor project as directed by AB 2701.

**Current Year Status**

Please see current year Finding 2012-01.