

MONTECITO SANITARY DISTRICT

June 30, 2012 and 2011

FINANCIAL STATEMENTS



BARTLETT, PRINGLE & WOLF, LLP
CERTIFIED PUBLIC ACCOUNTANTS AND CONSULTANTS

MONTECITO SANITARY DISTRICT

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors of Montecito Sanitary District

We have audited the accompanying financial statements of Montecito Sanitary District (the "District") as of June 30, 2012 and 2011 and for the fiscal years then ended, as listed in the table of contents. These financial statements are the responsibility of the District's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the State Controller's Minimum Audit Requirements for California Special Districts. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit 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 audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Montecito Sanitary District, as of June 30, 2012 and 2011, and the changes in its financial position and its cash flows for the fiscal years then ended, in conformity with accounting principles generally accepted in the United States of America, as well as accounting systems prescribed by the State Controller's Office and State regulations governing special districts.

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 2 through 11 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 audits 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 an opinion on the financial statements that collectively comprise the Montecito Sanitary District's basic financial statements. The list of Board of Directors and Schedule of Operating Expenses – By Department on pages 32 and 33 are presented for the purposes of additional analysis and are not a required part of the basic financial statements. Such information 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 them.

Bartlett, Pringle + Wolf, LLP

October 29, 2012

MONTECITO SANITARY DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS

This Management's Discussion and Analysis (MD&A) is a key element of the District's annual audited financial statements that are prepared in accordance with the Governmental Accounting Standards Board Statement No. 34 (GASB 34). The purpose of the MD&A is to provide an overview of the District's financial condition and to highlight important changes and activities with fiscal implications that occurred during the fiscal years (FY) 2011-12 and 2010-11. We encourage readers to consider the information presented here in conjunction with the District's financial statement and related notes, which follow this section.

District Overview

Montecito Sanitary District (the District) provides wastewater collection, treatment, and disposal for most of the community of Montecito. The Montecito Sanitary District is an independent special district voted into existence in 1947, by the residents of Montecito to provide for the collection, treatment and disposal of wastewater. In 1961, the District constructed a secondary plant capable of processing 750,000 gallons per day, including an ocean outfall pipeline (located 1500 feet offshore) and trunk sewer system. In 1981 the voters approved \$3.1 million in revenue bonds to incorporate new technology, double the plant's capacity to 1.5 million gallons per day. The District's mission has always been "to protect public health and safety and to preserve the natural environment through the collection, treatment and disposal of wastewater in the most cost-effective way possible."

There are still areas that do not have sewer available but are within the District's boundaries, and there are currently 99 properties using on-site septic systems that have sewer available. The current number of residential connections is 3,027 and there are 42 commercial and/or institutional connections. Coast Village Road businesses are not within the boundaries of the District, they are served by the City of Santa Barbara.

Management and Governance

The District is governed by a five-member Board of Directors. The Directors are elected on an at-large basis for four-year terms. In 2001, the Board voted to align its elections with the Statewide General Elections to increase voter turnout and achieve a substantial cost savings. At the Board's discretion an Organizational Meeting is held at least every other year to assign officers' duties and to appoint the standing Committee Representatives. This process generally results in a rotation of duties among the Board members. The established Committees meet on an as-needed basis. If necessary, Ad Hoc Committees are formed for special projects. It is the Board that approves the annual operating and capital budgets and authorizes expenditures of the District's funds.

The District employs a General Manager as the chief executive. The General Manager reports directly to the Board of Directors and is responsible for the overall operation and administration of the District. The District's Management Staff also includes an Office Manager who is the chief administrator and an Operations & Maintenance Manager and a Collection System Manager. In FY 2011-12 the District had 14 full-time authorized positions and in FY 2010-11, there were 13 full-time authorized positions.

MONTECITO SANITARY DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS

Financial Statements

This discussion and analysis provides an introduction and a brief description of the District's financial statements, including the relationship of the statements to each other and the significant differences in the information they provide. The District's financial statements include four components:

- Statement of Net Assets
- Statement of Revenues, Expenses and Changes in Net Assets
- Statement of Cash Flows
- Notes to the Financial Statements

The statement of net assets includes all the District's assets and liabilities, with the difference between the two reported as net assets. Net assets are categorized as follows:

- Invested in Capital Assets
All property not easily converted to cash and held for a long period of time (real estate, equipment, etc.)
- Restricted Net Assets
Assets/Cash needed to pay liabilities and may be restricted according to law or regulation, i.e., Certificates of Participation proceeds.
- Unrestricted Net Assets
Any asset that is not restricted, i.e., cash

The statement of net assets includes all of the District's investments in resources (assets) and the obligations to creditors (liabilities). It also provides the basis for computing rate of return, evaluating the capital structure of the District and assessing the liquidity and financial flexibility of the District.

The statement of revenues, expenses and changes in net assets presents information which shows how the District's net assets changed during the year. All of the current year's revenues and expenses are recorded when the underlying transaction occurs, regardless of the timing of the related cash flows. The statement of revenues, expenses and changes in net assets measures the success of the District's operations over the past year and determines whether the District has recovered its costs through user fees and other charges.

The statement of cash flows provides information regarding the District's cash receipts and cash disbursements during the year. This statement reports cash activity in four categories:

- Operations
- Non-capital financing
- Capital and related financing
- Investing

MONTECITO SANITARY DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS

This statement differs from the statement of revenues, expenses and changes in net assets because the statement of cash flows accounts only for transactions that result in cash receipts or cash disbursements.

The notes to the financial statements provide a description of the accounting policies used to prepare the financial statements and present material disclosures required by generally accepted accounting principles that are not otherwise present in the financial statements.

Financial Highlights

- The District's net assets increased 5.60% or \$1,166,128 to \$22,000,298 in fiscal year 2012 as a result of operations. In the prior year, the District's net assets increased 4.93% or \$977,953 to \$20,834,170 as a result of operations.
- The District's operating revenues increased by 7.69% and operating expenses increased by 5.31% in FY 2011-2012. In the prior year, operating revenues increased by 9.10% and operating expense increased by 4.59%.

Financial Analysis of the District

The following is a summary of the District's statement of net assets:

	<u>June 30, 2012</u>	<u>June 30, 2011</u>	<u>June 30, 2010</u>	<u>% Change FY 2011- 2012 and 2010-2011</u>	<u>% Change FY 2010- 2011 and 2009-2010</u>
<u>Assets:</u>					
Current assets	\$ 8,427,213	\$ 6,803,877	\$ 5,614,617	23.86%	21.18%
Noncurrent assets:					
Other assets	338,437	385,003	398,540	-12.09%	-3.40%
Restricted assets	6,404,002	7,072,606	8,357,576	-9.45%	-15.37%
Capital assets	22,001,754	21,850,340	21,037,702	0.69%	3.86%
Total Assets	<u>37,171,406</u>	<u>36,111,826</u>	<u>35,408,435</u>	<u>2.93%</u>	<u>1.99%</u>
<u>Liabilities:</u>					
Current liabilities	922,869	744,949	701,860	23.88%	6.14%
Long term liabilities	14,248,239	14,532,707	14,850,358	-1.96%	-2.14%
Total Liabilities	<u>15,171,108</u>	<u>15,277,656</u>	<u>15,552,218</u>	<u>-0.70%</u>	<u>-1.77%</u>
<u>Net Assets:</u>					
Invested in capital assets, net of related debt	13,986,065	14,475,277	14,874,725	-3.38%	-2.69%
Restricted	404,874	141,060	2,151	187.02%	6457.88%
Unrestricted	7,609,359	6,217,833	4,979,341	22.38%	24.87%
Total Net Assets	<u>\$ 22,000,298</u>	<u>\$ 20,834,170</u>	<u>\$ 19,856,217</u>	<u>5.60%</u>	<u>4.93%</u>

*Variance calculated by current year less prior year number and divided by prior year number.

**MONTECITO SANITARY DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS**

The following is a summary of the District's statement of revenues, expense and changes in net assets for the years ended June 30, 2012, 2011 and 2010:

	<u>June 30, 2012</u>	<u>June 30, 2011</u>	<u>June 30, 2010</u>	<u>% Change FY 2011- 2012 and 2010-2011</u>	<u>% Change FY 2010- 2011 and 2009-2010</u>
Operating Revenues	\$ 4,679,859	\$ 4,345,625	\$ 3,983,024	7.69%	9.10%
Operating Expenses	3,651,076	3,467,142	3,315,016	5.31%	4.59%
Operating income (loss)	1,028,783	878,483	668,008	17.11%	31.51%
Nonoperating revenue	500,795	502,614	548,287	-0.36%	-8.33%
Nonoperating expense	363,586	442,109	429,219	-17.76%	3.00%
Non-operating income	137,209	60,505	119,068	126.77%	-49.18%
Excess of revenue over expenses	1,165,992	938,988	787,076	24.18%	19.30%
Capital contributions	136	38,965	68,282	-99.65%	-42.94%
Change in Net Assets	1,166,128	977,953	855,358	19.24%	14.33%
Net assets, beginning of year	20,834,170	19,856,217	19,000,859	4.93%	4.50%
Net assets, end of year	<u>\$ 22,000,298</u>	<u>\$ 20,834,170</u>	<u>\$ 19,856,217</u>	<u>5.60%</u>	<u>4.93%</u>

Sources of Revenue

The following is a table of the Districts revenues broken down by major source:

<u>Revenue Category</u>	<u>2011-12</u>	<u>2010-11</u>	<u>2009-10</u>	<u>% Change FY 2011- 2012 and 2010-2011</u>	<u>% Change FY 2010- 2011 and 2009-2010</u>
Service Charges	\$ 4,481,939	\$ 4,122,851	\$ 3,831,673	8.7%	7.6%
Connection Fees	163,370	175,449	127,601	-6.9%	37.5%
Other Services	34,550	47,325	23,750	-27.0%	99.3%
Operating Revenue	<u>4,679,859</u>	<u>4,345,625</u>	<u>3,983,024</u>	<u>7.7%</u>	<u>9.1%</u>
Investment Income	64,867	65,743	105,169	-1.3%	-37.5%
Property Taxes	440,651	436,007	431,216	1.1%	1.1%
Other Revenue/Expense	(4,723) *	864	11,902	-646.6%	-92.7%
Nonoperating Revenue	<u>500,795</u>	<u>502,614</u>	<u>548,287</u>	<u>-0.4%</u>	<u>-8.3%</u>
Total Revenue	<u>\$ 5,180,654</u>	<u>\$ 4,848,239</u>	<u>\$ 4,531,311</u>	<u>6.9%</u>	<u>7.0%</u>

*Cost of capital improvements constructed by District and contributed to HOA at Posilipo Lift Station No. 4.

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MANAGEMENT'S DISCUSSION AND ANALYSIS

Sewer Service Charge (SSC)

The major source of revenue for the District is the Sewer Service Charge(s) (SSC). The 2011-2012 service charges revenue increased approximately 8.7% from the prior (2010-2011) fiscal year (FY). The District's total annual SSC revenue for FY 2011-2012 was \$4,481,939; which amounted to 86.5% of the total revenues and 95.8% of the total operating revenue. SSC revenue for FY 2010-2011 was \$4,122,851; which amounted to 85% of total revenues and 94.9% of the total operating revenue, and SSC revenue for FY 2009-2010 was \$3,831,673; which amounted to 84.6% of total revenues and 96.2% of the total operating revenue.

The District maintains a Teeter Plan agreement with the County of Santa Barbara. Under this agreement, the District receives the total guaranteed amounts of SSC revenue reported to the County each year and the County collects these funds from the District's customers on their bi-annual property tax statements.

A 3-year planned and approved rate increase structure went into effect beginning with FY 2009-2010 and ran through FY 2011-2012 and will remain at the same rate for FY 2012-2013. The rate increases were validated and approved by following the procedures and requirements of Proposition 218. The rate increases were necessary to keep up with the rising operations and maintenance costs, debt service payments and depreciation funding of the District's capital assets.

Connection Permit Fees

The Connection Fee collected on District permits is the fee charged for connection to the District's sanitary sewer system, intended to cover or recoup infrastructure costs incurred to provide service. Connection fees collected for the FY 2011-2012 were \$163,370 and for FY 2010-2011 were \$175,449.

The District's Governing Board of Directors voted to increase the connection fees to \$7,300 per dwelling unit effective January 1, 2011 with Resolution No. 2010-861.

Investment Income

The District's current approved investment policy, under Resolution No. 2000-779, states that it shall be the policy of the District to invest funds, with maximum security through diversification and prudence, in a manner which will provide the highest investment return, while meeting the daily cash flow demands of the entity and conforming to all statutes governing the investments of District funds.

In keeping with that policy, the District Board chose to distribute the District's monies between two investment vehicles: the Santa Barbara County Investment Pool, and the Local Agency Investment Fund (LAIF) which is a State controlled investment pool. Funds are readily available from either pool, but the District has thus far used the Santa Barbara County Pool as its major source of operating funds since revenues from property taxes are part of that pool, as well as the District's sewer service charges that are collected by means of the County's tax roll.

MONTECITO SANITARY DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS

Interest revenues received, excluding those earned from the Certificates of Participation (COP) monies; within the 2011-12 FY from the two investment pools was \$45,277. Interest earned from the COP monies was \$22,724. Minor checking account interest in the amount of \$119 was earned for the Running Expense account at Santa Barbara Bank & Trust.

Property Tax

The District receives one half of 1% of the total property tax revenue that is collected by the County of Santa Barbara for parcels within its service area whether or not they are a customer of the District. The property tax revenue (shown on **Sources of Revenue** table on page 5) is inclusive of secure, unsecured, unitary, and supplemental property taxes.

Operating Expenses

The District's operating expenses (not including depreciation or amortization) for FY 2011-2012 were \$2,830,309 and for FY 2010-2011 they were \$2,683,001. This is an overall increase for FY 2011-2012 in actual operating expenses of 5.5%. For FY 2010-2011 there was a decrease in actual operating expenses of 3.9%. Depreciation expense for FY 2011-2012 was \$807,230 and for FY 2010-2011 depreciation expenses were \$770,604. Amortization expense for FY 2011-2012 was \$13,538 and for FY 2010-2011 it was \$13,537. A tabular summary of the expenditure increases or decreases versus the previous fiscal year is presented on the following pages.

**MONTECITO SANITARY DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS**

Expenditure increases or decreases in fiscal year 2011-12 versus fiscal year 2010-11 were as follows:

Expense Category	Expenses FY 2011/2012	Expenses FY 2010/2011	FY 2011/12 Expense Increase (Decrease)	Difference	Comments/Justification
Personnel (Salaries, Payroll Taxes, WC Insurance, and Benefits)	\$ 1,931,168	\$ 1,734,748	\$ 196,420	11.3%	Filled staff vacancies; COLA increases
Pooled Liability and Other CSRMA Insurance Programs	48,908	53,331	(4,423)	-8.3%	Dividend refunds
Maintenance, Repairs, Operating Supplies/Equip, and Contracted Services	442,498	437,635	4,863	1.1%	Landscaping (new Lab & LS #4), Tree maintenance, Roof repairs
Utilities, Telephone, Fuel and Oil	150,751	150,826	(75)	0.0%	Negligible change to this fiscal year from previous fiscal year
Research & Monitoring	9,402	15,040	(5,638)	-37.5%	No annual sampling or software/equipment upgrades
Office Expenses, and Misc. Administrative Costs	28,104	16,986	11,118	65.5%	General increase in cost of supplies, Purchased board room chairs, Cash account accounting adjustment
Professional Services, Administrative Fees, and Memberships	159,896	226,115	(66,219)	-29.3%	Decrease in legal and engineering services and no unforeseen ocean water sampling
Training, Safety and Travel Expenses	59,582	48,320	11,262	23.3%	Increase in safety supplies; Confined space & hearing training conducted
Subtotals	2,830,309	2,683,001	147,308	5.5%	
Depreciation and Amortization	820,767	784,141	36,626	4.7%	Depreciation expense
Totals	\$ 3,651,076	\$ 3,467,142	\$ 183,934	5.3%	

**MONTECITO SANITARY DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS**

Expenditure increases or decreases in fiscal year 2010-11 versus fiscal year 2009-10 were as follows:

Expense Category	Expenses FY 2010/2011	Expenses FY 2009/2010	FY 2010/11 Expense Increase (Decrease)	Difference	Comments/Justification
Personnel (Salaries, Payroll Taxes, WC Insurance, and Benefits)	\$ 1,734,748	\$ 1,776,319	\$ (41,571)	-2.3%	Gap between retirement of employees and new hires – used temporary staff
Pooled Liability and Other CSRMA Insurance Programs	53,331	51,207	2,124	4.1%	Insurance Premium increases
Maintenance, Repairs, Operating Supplies/Equip, and Contracted Services	437,635	370,552	67,083	18.1%	Rain damage to office; Repairs to locker room roof and hiring of temporary staff to fill vacant positions
Utilities, Telephone, Fuel and Oil	150,826	152,729	(1,903)	-1.2%	Electricity Costs decreased due to energy efficiency measures
Research & Monitoring	15,040	11,420	3,620	31.7%	Increase in Lab Testing fees
Office Expenses, and Misc. Administrative Costs	16,986	15,057	1,929	12.8%	General increase in cost of supplies
Professional Services, Administrative Fees, and Memberships	226,115	182,029	44,086	24.2%	Increase in legal and accounting fees
Training, Safety and Travel Expenses	48,320	23,290	25,030	107.5%	Filled vacant Safety Specialist position
Subtotals	2,683,001	2,582,603	100,398	3.9%	
Depreciation and Amortization	784,141	732,413	51,728	7.1%	Depreciation expense
Totals	\$ 3,467,142	\$ 3,315,016	\$ 152,126	4.6%	

**Certificates of Participation (COPs) – California Special Districts Association (CSDA)
Finance Corporation – 2007 Series UU**

Due to an urgent need for capital improvement project funds in FY 2006-07 the District worked with CSDA and CSDA's financial consultant, Mr. Saul Rosenbaum, at Prager, Sealey & Co. Inc. to seek funding through the issuance of COPs. The District contracted the services of Fieldman, Rolapp & Associates, independent financial advisors. The Board and General Manager saw this as a means to ensure the District would have the funds necessary to complete a list of capital projects deemed to be mission critical to the District's efforts to provide the kind of service expected and mandated by federal and state regulations, and to ensure the environmental health and safety of the community in

MONTECITO SANITARY DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS

which the District serves. The Acquisition Fund began with \$10,533,493 in 2007. As of June 30, 2012 the District has spent \$6,716,355 of the Acquisition Fund on Board approved Mission Critical Projects. Capital expenditures of the COP funds from July 1, 2011 through June 30, 2012 total \$706,647. The balance of available funds from the Acquisition Fund monies at June 30, 2012 was \$4,818,466. In addition to the withdrawals made for District projects, this remaining balance also includes original principal plus dividends earned throughout the year and is reported in the financial statements.

During FY 2011-2012 some significant projects were completed with the COP funds. One project was a new testing laboratory building. The lab project, approved by the Board in October 2010, was completed in December 2011. Another significant project was the rehabilitation of approximately 4 miles of District sewer main. This project was approved for construction in April 2009 and completed August 2011.

Annual Audited Financial Statements

At the end of each fiscal year, the District is audited by an independent certified public accounting firm qualified to perform government accounting audits. The financial statements consist of a series of financial statements and notes to those statements. The statements are organized so the reader can understand the District as a financial whole, an entire operating entity. These statements then proceed to provide a detailed look at specific financial activities. This annual report consists of two parts – management’s discussion and analysis (this section) and a series of basic financial statements.

The annual financial statements include the Statement of Net Assets, Statement of Revenues, Expenses and Changes in Net Assets, and a Statement of Cash Flows, followed by various and specific notes to those financial statements.

Additionally, the report provides supplemental information such as: Board of Directors names and titles and Schedules of Operating Expenses – by Department.

Future Rate Increases/Expenses

The District ended a 3-year approved rate increase plan with FY 2011-2012 (June 30, 2012). These increases from the previous years enabled the District to collect service-generated revenues to cover not only the daily operations and maintenance costs, but monies to fund future rehabilitation projects to maintain system integrity. The District’s sewer service charges for FY 2012-2013 will continue at the same rate as FY 2011-2012.

On June 14, 2010, the Board authorized the creation of a separate account fund for Retirement Medical Benefits and as of June 30, 2012, there was \$40,383 in this account. Additional monies are deposited in July of each Fiscal Year.

On May 26, 2009, the Board authorized the creation of a separate fund for depreciation. Effective July 1, 2009, the County-Auditor Controller’s office established a fund titled Montecito Sanitary Capital Replacement Fund and as of June 30, 2012 there was \$3,429,478 in this fund. Additional

MONTECITO SANITARY DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS

amounts may be contributed annually based on the annual depreciation expense as approved by the Board. The District may withdraw monies from the Capital Replacement Fund at any time to fund Capital projects or to meet operational, maintenance or any type of financial need of the District.

Contacting the District's Financial Management

This financial report is designed to provide the District's customers, creditors, and other interested parties with a general overview of the District's finances and to demonstrate the District's accountability of the money it receives. If you have any questions about this report or need additional financial information, contact Debbie Hughey, Office Manager/ Board Clerk, at 1042 Monte Cristo Lane, Santa Barbara, CA 93108, or by telephone at (805) 969-4200.

MONTECITO SANITARY DISTRICT
STATEMENT OF NET ASSETS
June 30, 2012 and 2011

ASSETS		
	2012	2011
Current Assets:		
Cash and investments (Note 2 and 3)	\$ 8,356,195	\$ 6,768,412
Interest receivable	13,805	12,395
State loan receivable	33,028	-
Prepaid insurance	24,185	23,070
Total current assets	8,427,213	6,803,877
Restricted Assets:		
Cash and investments (Note 2 and 3)	6,397,385	7,064,558
Interest receivable	6,617	8,048
Total restricted assets	6,404,002	7,072,606
Capital Assets:		
Depreciable:		
Plant and equipment	36,609,036	34,559,807
Less accumulated depreciation	(14,897,492)	(14,090,262)
	21,711,544	20,469,545
Non-depreciable:		
Construction in progress	183,710	1,274,295
Land and improvements	106,500	106,500
Net capital assets (Note 2 and 4)	22,001,754	21,850,340
Other Assets:		
State loan receivable, long-term portion	-	33,028
Bond issuance costs, net (Note 5)	338,437	351,975
Total other assets	338,437	385,003
Total Assets	\$ 37,171,406	\$ 36,111,826

See accompanying notes

MONTECITO SANITARY DISTRICT
STATEMENT OF NET ASSETS
June 30, 2012 and 2011

LIABILITIES

	2012	2011
Current Liabilities:		
Accounts payable	\$ 24,719	\$ 25,684
Accrued salaries and benefits	43,500	23,655
Accrued interest	312,839	318,839
Customer deposits	231,811	76,771
Current portion of long-term debt (Note 7)	310,000	300,000
Total current liabilities	922,869	744,949
Long-Term Liabilities:		
Compensated absences payable (Note 6)	204,985	174,123
Long-term debt, net of current portion (Note 7)	14,043,254	14,358,584
Total long-term liabilities	14,248,239	14,532,707
Total Liabilities	15,171,108	15,277,656

NET ASSETS

Invested in capital assets, net of related debt	13,986,065	14,475,277
Restricted net assets	404,874	141,060
Unrestricted, designated for retirement benefits obligation	41,383	60,535
Unrestricted	7,567,976	6,157,298
Total Net Assets	\$ 22,000,298	\$ 20,834,170

See accompanying notes

MONTECITO SANITARY DISTRICT
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
For the Fiscal Years Ended June 30, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Operating Revenues:		
Service Charges	\$ 4,481,939	\$ 4,122,851
Connection fees	163,370	175,449
Other services	34,550	47,325
Total operating revenues	<u>4,679,859</u>	<u>4,345,625</u>
Operating Expenses:		
Sewage collection	1,261,479	1,202,811
Sewage treatment	1,395,823	1,379,870
Sewage disposal	75,207	71,834
Administrative	918,567	812,627
Total operating expenses	<u>3,651,076</u>	<u>3,467,142</u>
Income from operations	<u>1,028,783</u>	<u>878,483</u>
Nonoperating Revenue (Expense):		
Investment income	64,867	65,743
Property taxes	440,651	436,007
Other revenue (expense)	(4,723)	864
Interest expense	(363,586)	(442,109)
Total non-operating revenue	<u>137,209</u>	<u>60,505</u>
Excess of revenue over expenses	<u>1,165,992</u>	<u>938,988</u>
Capital contributions	<u>136</u>	<u>38,965</u>
Change in net assets	1,166,128	977,953
Net assets at beginning of year	<u>20,834,170</u>	<u>19,856,217</u>
Net assets at end of year	<u><u>\$ 22,000,298</u></u>	<u><u>\$ 20,834,170</u></u>

See accompanying notes

MONTECITO SANITARY DISTRICT
STATEMENT OF CASH FLOWS
For the Fiscal Years Ended June 30, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Cash Flows from Operating Activities:		
Cash received from customers	\$ 4,834,898	\$ 4,353,506
Cash payments to vendors for goods and services	(907,220)	(952,138)
Cash payments to employees for services	(1,880,461)	(1,782,403)
Net cash provided by operating activities	<u>2,047,217</u>	<u>1,618,965</u>
Cash Flows from Noncapital Financing Activities:		
Property taxes	440,651	436,007
Other	41	864
Net cash provided by noncapital financing activities	<u>440,692</u>	<u>436,871</u>
Cash Flows from Capital and Related Financing Activities:		
Purchase of capital assets	(706,647)	(1,393,004)
Interest payments	(625,678)	(637,678)
Extension reimbursements	136	38,965
Principal payments on long term debt	(300,000)	(220,000)
Net cash used by capital and related financing activities	<u>(1,632,189)</u>	<u>(2,211,717)</u>
Cash Flows from Investing Activities:		
Investment income received	64,890	68,514
Net cash provided by investing activities	<u>64,890</u>	<u>68,514</u>
Net increase (decrease) in cash and restricted cash	920,610	(87,367)
Cash and restricted cash – beginning of year	<u>13,832,970</u>	<u>13,920,337</u>
Cash and restricted cash – end of year	<u>\$ 14,753,580</u>	<u>\$ 13,832,970</u>
Reconciliation to Statement of Net Assets:		
Cash and investments	\$ 8,356,195	\$ 6,768,412
Restricted cash and investments	6,397,385	7,064,558
	<u>\$ 14,753,580</u>	<u>\$ 13,832,970</u>

See accompanying notes

MONTECITO SANITARY DISTRICT
STATEMENT OF CASH FLOWS
For the Fiscal Years Ended June 30, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 1,028,783	\$ 878,483
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation expense	807,230	770,604
Amortization expense	13,538	13,537
Change in assets and liabilities:		
Prepays	(1,116)	5,573
Accounts payable	(965)	(5,058)
Accrued salaries and benefits	19,845	(35,334)
Accrued interest	(6,000)	(4,399)
Customer deposits	155,040	7,880
Compensated absences	30,862	(12,321)
Net cash provided by operating activities	<u>\$ 2,047,217</u>	<u>\$ 1,618,965</u>

See accompanying notes

MONTECITO SANITARY DISTRICT
NOTES TO THE FINANCIAL STATEMENTS

Note 1 - Reporting Entity

Montecito Sanitary District was organized in 1947, pursuant to the Sanitary District Act of 1923, to provide sewage collection and treatment for residents within the District's geographical boundaries.

The District is governed by a board of directors consisting of five members elected at large. The Directors receive fees for attendance at Board and Committee meetings. The Board employs a District Manager, Engineer, Office Manager and such other personnel as are required to meet its responsibilities.

There are no component units included in this report which meet the criteria of the Governmental Accounting Standards Board (GASB) Statement No. 14, *The Financial Reporting Entity*, as amended by GASB Statement No. 39.

Note 2 - Summary of Significant Accounting Policies

A) Accounting Policies

The accounting policies of the District conform to accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board and the American Institute of Certified Public Accountants (AICPA).

B) Accounting Basis

The District reports its activities as an enterprise fund, which is used to account for operations that are financed and operated in a manner similar to private business enterprise, where the intent of the District is that the costs, including depreciation, of providing goods and services to the general public on a continuing basis be financed or recovered primarily through user charges. The accounts are maintained and these financial statements are presented on the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when they are earned and expenses recognized when they are incurred.

An enterprise fund is accounted for on the "flow of economic resources" measurement focus. This means that all assets and liabilities, whether current or long term, are included on the balance sheet.

The financial statements of the District have been prepared in conformity with Generally Accepted Accounting Principles (GAAP) as applied to government units. The Governmental Accounting Standards Board (GASB) is the accepted standard setting body for establishing governmental accounting financial reporting principles. Additionally the District applies all Financial Accounting Standards Board (FASB) statements and interpretations, Accounting Principles Board (APB) opinions, and Accounting Research Bulletins (ARBs) issued on or before November 30, 1989 unless those pronouncements conflict with or contradict GASB pronouncements.

C) Budget

The District prepares an annual budget which estimates major sources of revenue to be received during the fiscal year, as well as estimated expenditures needed for operation of District facilities.

MONTECITO SANITARY DISTRICT
NOTES TO THE FINANCIAL STATEMENTS

Note 2 - Summary of Significant Accounting Policies (continued)

D) Cash and Cash Equivalents

For purposes of the statement of cash flows, cash and cash equivalents include restricted and unrestricted cash and restricted and unrestricted certificates of deposit with original maturities of three months or less.

E) Property, Plant and Equipment

Capital assets purchased by the District are recorded at cost. Contributed or donated capital assets are recorded at fair value when acquired. Interest incurred during the construction period of an asset is capitalized as part of the cost.

F) Depreciation

Capital assets purchased by the District are depreciated over their estimated useful lives (ranging from 5-80 years) under the straight-line method of depreciation.

G) Accumulated Vacation, Compensated Time Off and Sick Leave

Accumulated unpaid employee vacation, compensated time off, and sick leave benefits are recognized as liabilities of the District.

H) Property Taxes

Property taxes in the State of California are administered for all local agencies at the county level, and consist of secured, unsecured, and utility tax rolls. The following is a summary of major policies and practices relating to property taxes:

Property Valuations – are established by the Assessor of the County of Santa Barbara (County) for the secured and unsecured property tax rolls; the utility property tax roll is valued by the State Board of Equalization. Under the provisions of Article XIIA of the State Constitution (Proposition 13 adopted by the voters on June 6, 1978), properties are assessed at 100% of full value. From the base assessment, subsequent annual increases in valuation are limited to a maximum of 2%. 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 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 on 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 taxes become 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 payments.

MONTECITO SANITARY DISTRICT
NOTES TO THE FINANCIAL STATEMENTS

Note 2 - Summary of Significant Accounting Policies (continued)

During the fiscal year ended June 30, 1994, the District adopted the "Teeter Plan" as defined in the Revenue and Taxation Code. Under this plan, the District is guaranteed 99.6% of the secured property taxes each year. The District is also assured of receiving 95% of the unsecured property taxes for each fiscal year by July 31 of the following fiscal year. The remaining 5% is placed in a Tax Loss Reserve Fund which will be used to offset future tax sale losses incurred by the County. Additionally, the District is assured of receiving 100% of its sewer service charges for each fiscal year by July 31 of the following year.

Tax Levy Apportionments – Due to the nature of the District-wide maximum levy, it is not possible to identify general purpose tax rates for specific entities. Under State legislation adopted subsequent to the passage of Proposition 13, apportionments to local agencies are made by the county auditor-controller based primarily on the ratio that each agency represented of the total District-wide levy for the three years prior to fiscal year 1979.

Property Tax Administration Fees – The State of California FY 90-91 Budget Act, authorized counties to collect an administrative fee for collection and distribution of property taxes. Property taxes are recorded as net of administrative fees withheld during the fiscal year.

Tax Levies – are limited to 1% of full value which results in a tax rate of \$1.00 per \$100 assessed valuation, under the provisions of Proposition 13. Tax rates for voter-approved indebtedness are excluded from this limitation.

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 they exist 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.

I) Annual Appropriations Limit

The District is exempt from the annual appropriations limit required by Senate Bill 813 (Chapter 1025, Statutes of 1987) in accordance with California Constitution Article XIII B. This exemption is based on a tax rate not greater than 12-1/2 cents per \$100 of assessed valuation in 1978.

J) Net Assets

Net assets represent the difference between assets and liabilities. Net assets invested in capital assets, net of related debt, consists of capital assets, net of accumulated depreciation, reduced by the outstanding balances of any borrowings used for the acquisition, construction or improvement of those assets. Net assets invested in capital assets, net of related debt excludes unspent debt proceeds.

Net assets are reported as restricted when they are legally restricted by outside parties for use for a specific purpose. Dedicated net assets are unrestricted net assets the District records to recognize that certain portions are segregated for specific future uses. Unrestricted net assets consists of net assets that do not meet the definition of "restricted" or "invested in capital assets, net of related debt." When an expense is incurred for purposes for which both unrestricted and restricted assets are available, it is the District's policy to apply restricted assets first.

MONTECITO SANITARY DISTRICT
NOTES TO THE FINANCIAL STATEMENTS

Note 2 - Summary of Significant Accounting Policies (continued)

K) Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America, as prescribed by the GASB and the AICPA, requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported period. Actual results could differ from those estimates.

L) Government Accounting Standards Board Statement No.45

During the fiscal year ended June 30, 2010, the District implemented Government Accounting Standards Board (GASB) Statement No. 45, "Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pension."

This Statement requires that the District account for, and report, the annual cost of other postemployment benefits (OPEB) and the outstanding obligations and commitments related to OPEB in the same manner as it currently does for pensions. The Statement does not require that the District fund their OPEB plans, only that it accounts for them and reports them. OPEB generally consists of health insurance and dental, vision, prescription, or other healthcare benefits provided to eligible retirees, including their beneficiaries in some cases. See Note 10 for further details.

Note 3 - Cash and Investments

Cash and investments are classified in the accompanying financial statements, at fair value, at June 30, 2012 and 2011 as follows:

	<u>June 30, 2012</u>	<u>June 30, 2011</u>
Unrestricted:		
Cash and investments, undesignated	\$ 8,314,812	\$ 6,707,877
Cash designated for retirement benefits	41,383	60,535
Restricted cash from bond proceeds	<u>6,397,385</u>	<u>7,064,558</u>
Total cash and investments	<u>\$ 14,753,580</u>	<u>\$ 13,832,970</u>

Investments are carried at fair value as determined by the external investment pool sponsor. Cash and investments as of June 30, 2012 and 2011 consist of the following:

	<u>June 30, 2012</u>	<u>June 30, 2011</u>
Cash on hand	\$ 459	\$ 250
Deposits held with financial institutions	135,009	214,001
Cash with fiscal agent	631,330	618,986
Deposits held in pooled investment funds	<u>13,986,782</u>	<u>12,999,733</u>
Total cash and investments	<u>\$ 14,753,580</u>	<u>\$ 13,832,970</u>

MONTECITO SANITARY DISTRICT
NOTES TO THE FINANCIAL STATEMENTS

Note 3 - Cash and Investments (continued)

Investments Authorized by the District's Investment Policy

The District's investment policy only authorizes investment in the local government investment pool administered by the State of California (LAIF) and the Santa Barbara County Investment Pool. The District's investment policy does not contain any specific provisions intended to limit the District's exposure to interest rate risk, credit risk and concentration of credit risk.

Disclosures Relating to Interest Rate Risk

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

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

<u>Investment Type</u>	<u>Carrying Amount</u>	<u>Remaining Maturity (in Months)</u>			
		<u>12 Months or Less</u>	<u>13-24 Months</u>	<u>25-60 Months</u>	<u>More than 60 Months</u>
LAIF	\$ 7,405,636	\$ 7,405,636	\$ -	\$ -	\$ -
Santa Barbara County Investment Pool	6,581,146	6,581,146	-	-	-
Total	\$ 13,986,782	\$ 13,986,782	\$ -	\$ -	\$ -

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 rating by a nationally recognized statistical rating organization. Presented below is the minimum rating required by the California Government Code and the District's investment policy, and the actual rating as of June 30, 2012 for each investment type.

	<u>Carrying Amount</u>	<u>Minimum Legal Rating</u>	<u>Exempt From Disclosure</u>	<u>Rating as of Fiscal Year End</u>		
				<u>AAA</u>	<u>Aa</u>	<u>Not Rated</u>
LAIF	\$ 7,405,636	N/A	\$ -	\$ -	\$ -	\$ 7,405,636
Santa Barbara County Investment Pool	6,581,146	N/A	-	-	-	6,581,146
Total	\$13,986,782		\$ -	\$ -	\$ -	\$13,986,782

MONTECITO SANITARY DISTRICT
NOTES TO THE FINANCIAL STATEMENTS

Note 3 - Cash and Investments (continued)

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. There are no investments in any one issuer that represent 5% or more of total District investments.

Custodial Credit Risk

The 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's investment policy do not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits, other than the following provisions for deposits: The California Government Code requires that a financial institution secure deposits made by state or local governmental units by pledging securities in an undivided collateral pool held by a depository regulated under state law (unless so waived by the governmental unit). The fair value of the pledged securities in the collateral pool must equal at least 110% of the total amount deposited by the public agencies. California law also allows financial institutions to secure the District's deposits by pledging first trust deed mortgage notes having a value of 150% of the secured public deposits.

None of the District's deposits with financial institutions in excess of federal depository insurance limited were held in uncollateralized accounts.

The custodial credit risk for *investments* is the risk that, in the event of the failure of the counterparty (e.g., broker-dealer) to a transaction, a government will not be able to recover the value of its investment or collateral securities that are in the possession of another party. The California Government Code and the District's investment policy do not contain legal or policy requirements that would limit the exposure to custodial credit risk for investments. With respect to investments, custodial credit risk generally applies only to direct investments in marketable securities. Custodial credit risk does not apply to a local government's indirect investment in securities through the use of mutual funds or government investment pools (such as LAIF and the Santa Barbara County Investment Pool).

Investment in State Investment Pool

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

MONTECITO SANITARY DISTRICT
NOTES TO THE FINANCIAL STATEMENTS

Note 4 - Schedule of Capital Assets

A schedule of changes in capital assets and depreciation for the fiscal year ended June 30, 2012, is shown below:

	Balance July 1, 2011	Additions	Deletions	Transfers	Balance June 30, 2012
Subsurface Lines	\$20,869,030	\$ 73,701	\$ -	\$ 444,489	\$21,387,220
Collection Facilities	3,606,322	-	-	-	3,606,322
Treatment Facilities	8,455,112	89,271	-	1,422,797	9,967,180
Disposal Facilities	532,466	-	-	-	532,466
Administrative Facilities	1,096,877	18,971	-	-	1,115,848
	<u>34,559,807</u>	<u>181,943</u>	<u>-</u>	<u>1,867,286</u>	<u>36,609,036</u>
Accumulated Depreciation	(14,090,262)	(807,230)	-	-	(14,897,492)
	<u>20,469,545</u>	<u>(625,287)</u>	<u>-</u>	<u>1,867,286</u>	<u>21,711,544</u>
Construction in Progress	1,274,295	781,465	(4,764)	(1,867,286)	183,710
Land and Improvements	106,500	-	-	-	106,500
	<u>1,274,295</u>	<u>781,465</u>	<u>(4,764)</u>	<u>(1,867,286)</u>	<u>183,710</u>
Net capital assets	<u>\$21,850,340</u>	<u>\$ 156,178</u>	<u>\$ (4,764)</u>	<u>\$ -</u>	<u>\$22,001,754</u>

A schedule of changes in capital assets and depreciation for the fiscal year ended June 30, 2011, is shown below:

	Balance July 1, 2010	Additions	Deletions	Transfers	Balance June 30, 2011
Subsurface Lines	\$20,778,927	\$ 90,103	\$ -	\$ -	\$20,869,030
Collection Facilities	3,548,017	58,305	-	-	3,606,322
Treatment Facilities	8,327,787	127,325	-	-	8,455,112
Disposal Facilities	532,466	-	-	-	532,466
Administrative Facilities	967,830	78,792	-	50,255	1,096,877
	<u>34,155,027</u>	<u>354,525</u>	<u>-</u>	<u>50,255</u>	<u>34,559,807</u>
Accumulated Depreciation	(13,319,658)	(770,604)	-	-	(14,090,262)
	<u>20,835,369</u>	<u>(416,079)</u>	<u>-</u>	<u>50,255</u>	<u>20,469,545</u>
Construction in Progress	95,833	1,228,717	-	(50,255)	1,274,295
Land and Improvements	106,500	-	-	-	106,500
	<u>95,833</u>	<u>1,228,717</u>	<u>-</u>	<u>(50,255)</u>	<u>1,274,295</u>
Net capital assets	<u>\$21,037,702</u>	<u>\$ 812,638</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$21,850,340</u>

MONTECITO SANITARY DISTRICT
NOTES TO THE FINANCIAL STATEMENTS

Note 5 - Bond Issuance Costs

The District's intangible assets as of June 30, 2012 and 2011 consisted of:

	2012	2011
Unamortized debt issue costs:		
Certificates of participation, Series 2007 net of		
accumulated amortization of \$67,686 and \$54,149, respectively.	\$ 338,437	\$ 351,975

Debt issuance costs are being amortized over 30 years and will be fully amortized in 2037. Estimated amortization expense is as follows for the fiscal years ending June 30:

2013	\$	13,537
2014		13,537
2015		13,537
2016		13,537
2017		13,537
Thereafter		270,752
Total	\$	338,437

Note 6 - Compensated Absences

Employees are entitled to accumulate up to 120 working days of sick leave, at the rate of eight hours per month for full time employees, and pro-rated for part-time employees. If employees retire under the District's retirement program, or voluntarily resign after twenty or more years of service, they would receive full compensation for any unused sick leave, paid at their current salary level. If employees voluntarily resign with less than twenty years of service, they would receive one-half to three quarters of their unused sick leave, depending on the years of service completed.

Employees are also entitled to accumulate vacation leave at a rate of two to five weeks per year, depending on the number of years of service completed. Such accumulated leave cannot exceed two times the employee's annual entitlement. Vacation leave is fully vested at all times and will be paid to employees upon termination of employment.

In accordance with accounting principles generally accepted in the United States of America, the liability is reflected on the statement of net assets and the current fiscal year allocation has been expensed.

MONTECITO SANITARY DISTRICT
NOTES TO THE FINANCIAL STATEMENTS

Note 7 - Long-Term Debt

The long-term debt liabilities of the District are as follows:

	Balance June 30, 2011	Additions	Retirements/ Amortization	Balance June 30, 2012
Series 2007 Certificates of Participation	\$ 14,520,000	\$ -	\$ (300,000)	\$ 14,220,000
Unamortized premiums	138,584		(5,330)	133,254
Net long-term debt	<u>\$ 14,658,584</u>	<u>\$ -</u>	<u>\$ (305,330)</u>	<u>\$ 14,353,254</u>

CSDA Finance Corporation Certificates of Participation 2007 Series UU

The CSDA Finance Corporation Certificates of Participation 2007 Series UU were issued March 1, 2007 in the aggregate principal amount of \$14,765,000. The CSDA Finance Corporation Certificates of Participation consisted of serial certificates in the principal amount of \$4,750,000 bearing an average interest rate of 4%, with the final installment payment due July 1, 2022, term certificates in the amount of \$2,615,000 bearing interest of 4.25% due July 1, 2027, term certificates in the amount of \$4,020,000 bearing interest of 5% due July 1, 2033, and term certificates in the amount of \$3,380,000 bearing interest of 4.3% due July 1, 2037. Interest is payable semi-annually each January 1 and July 1, commencing July 1, 2007. The Certificates shall not be subject to optional prepayment prior to July 1, 2017. The District is required to use the proceeds from the certificates to finance the following expenditures:

1. The acquisition of certain sanitary sewer improvements, in connection with the District's wastewater system.
2. To prepay the District's obligations under the installment Note dated as of May 31, 2005, between the District and Santa Barbara Bank & Trust.
3. To fund in whole or in part, a Reserve Fund for the Certificates.
4. To fund certain capitalized interest with respect to the Certificates.
5. To pay certain costs of issuing the Certificates.

Total annual requirements to amortize the Certificates of Participation are as follows:

Fiscal Year End	Principal	Interest	Total
6/30/2013	\$ 310,000	\$ 619,478	\$ 929,478
6/30/2014	325,000	606,778	931,778
6/30/2015	340,000	593,478	933,478
6/30/2016	350,000	579,678	929,678
6/30/2017	365,000	565,378	930,378
2018 - 2022	2,055,000	2,591,288	4,646,288
2023 - 2027	2,505,000	2,127,331	4,632,331
2028 - 2032	3,115,000	1,497,188	4,612,188
2033 - 2037	3,955,000	644,160	4,599,160
2038	900,000	19,347	919,347
Total	<u>\$ 14,220,000</u>	<u>\$ 9,844,104</u>	<u>\$ 24,064,104</u>

The largest annual debt service payment during any fiscal year totals \$933,478.

MONTECITO SANITARY DISTRICT
NOTES TO THE FINANCIAL STATEMENTS

Note 8 - Deferred Compensation Plan

The District offers its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan, available to all District employees, permits them to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency.

All amounts of compensation deferred under the plan, all property and rights purchased with those amounts, and all income attributable to those amounts, property, or rights are (until paid or made available to the employee or other beneficiary) solely the property and rights of the employees.

Note 9 - Defined Benefit Pension Plan

Plan Description

The District's defined benefit pension plan, Public Employees' Retirement System (PERS), provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. The District contributes to the California Public Employees' Retirement System (PERS) Miscellaneous 2% at 55 Risk Pool, a cost-sharing multiple-employer defined benefit pension plan administered by PERS. A menu of benefit provisions, as well as other requirements, is established by State statutes within the Public Employees' Retirement Law. The District selects optional benefit provisions from the benefit menu by contract with PERS and adopts those benefits through local ordinance (other local methods). PERS issues a separate comprehensive annual financial report. Copies of the PERS' annual financial report may be obtained from the PERS Executive Office – 400 P Street – Sacramento, CA 95814.

Funding Policy

Active plan members in the PERS are required to contribute 7% of their annual covered salary. The District makes the contributions required of District employees on their behalf and for their account. In addition, the District is required to contribute the actuarially determined remaining amounts necessary to fund the benefits for its members. The actuarial methods and assumptions used are those adopted by the PERS Board of Administration. The required employer contribution rate was 8.615% and 7.552% for fiscal years 2012 and 2011, respectively. The contribution requirements of the plan members are established by State statute and the employer contribution rate is established and may be amended by PERS.

MONTECITO SANITARY DISTRICT
NOTES TO THE FINANCIAL STATEMENTS

Note 9 - Defined Benefit Pension Plan (continued)

Annual Pension Cost

The following is a summary of the actuarial assumptions and methods:

Valuation Date	June 30, 2009
Actuarial Cost Method	Entry Age Actuarial Cost Method
Amortization Method	Level Percent of Payroll
Average Remaining Period	18 Years as of the Valuation Date
Asset Valuation Method	15 Year Smoothed Market
Actuarial Assumptions	
Investment Rate of Return	7.75% (net of administrative expenses)
Projected Salary Increases	3.55% to 14.45% depending on Age, Service, and type of employment
Inflation	3.00%
Payroll Growth	3.25%
Individual Salary Growth	A merit scale varying by duration of employment coupled with an assumed annual inflation growth of 3.00% and an annual production growth of 0.25%

The actuarial value of the District's assets was determined using a technique that smoothes the effect of short-term volatility in the market value of investments over a three year period. PERS unfunded actuarial accrued liability is being amortized as a level percentage of projected payroll on a closed basis over 20 years.

Three Year Trend Information for Montecito Sanitary District Public Employees' Retirement Plan

<u>Fiscal Year</u> <u>Ending</u>	<u>Annual</u> <u>Pension</u> <u>Cost (APC)</u>	<u>Percentage</u> <u>of APC</u> <u>Contribution</u>	<u>Net</u> <u>Pension</u> <u>Obligation</u>
6/30/10	\$ 71,721	100%	\$ 0
6/30/11	92,445	100%	0
6/30/12	107,953	100%	0

Required Supplementary Information

The schedule for funding progress below represents the recent history of the risk pool's actuarial value of assets accrued liability, their relationship, and the relationship of the unfunded liability.

MONTECITO SANITARY DISTRICT
NOTES TO THE FINANCIAL STATEMENTS

Note 9 - Defined Benefit Pension Plan (continued)

Valuation Date	Accrued Liability (a)	Actuarial Value of Assets (b)	Unfunded Liability (a)-(b)	Funded Ratio (b)/(a)	Annual Covered Payroll (c)	UL As a % of Payroll [(a)-(b)]/(c)
6/30/2008	\$2,780,280,768	\$2,547,323,278	\$232,957,490	91.6%	\$688,606,681	33.8%
6/30/2009	\$3,104,798,222	\$2,758,511,101	\$346,287,121	88.8%	\$742,981,488	46.6%
6/30/2010	\$3,309,064,934	\$2,946,408,106	\$362,656,828	89.0%	\$748,401,352	48.5%

Note 10 - Post-Employment Health Care Benefits

Plan Description

For employees hired before July 1, 2010, the District provides retiree medical coverage to eligible current employees and one dependent as defined by the plan. Under the Plan, retired employees who attain age 55 with at least ten years of service are eligible to receive benefits until reaching age 65. The District pays 100% of the health insurance benefits' monthly premium. The spouse of an eligible retiree is also eligible to receive benefits from this plan, and benefits continue until they are Medicare eligible. When the retired employee reaches age 65 the retired employee and the spouse are no longer covered. In accordance with Montecito Sanitary District Board of Directors action taken on June 4, 2010, any employee hired by the District after July 1, 2010 is not eligible for post-employment health care benefits.

Funding Policy

The contribution requirements of plan members and the District are established and may be amended by the District and its board of directors. The required contribution is based on projected pay-as-you-go financing requirements. Currently, the District has \$41,383 of unrestricted net assets set aside to be used to fund the post-employment health care obligation, and plans to set aside \$30,000 each July until adequate funds have been established. The District pays 100% of costs on behalf of the eligible participants.

Annual OPEB Cost and Net OPEB Obligation

The District's OPEB cost is calculated based on the *annual required contribution of the employer* (ARC), an amount actuarially determined in accordance with the parameters of GASB Statement 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years. The following table shows the components of the District's annual OPEB cost for the year, the amount actually contributed to the plan, and the changes in the District's net OPEB obligation for plan benefits:

Annual required contribution	\$ 61,401
Contributions made	<u>(49,649)</u>
Increase in net OPEB	11,752
Net OPEB obligation - beginning of year	<u>10,062</u>
Net OPEB obligation - end of year	<u><u>\$ 21,814</u></u>

MONTECITO SANITARY DISTRICT
NOTES TO THE FINANCIAL STATEMENTS

Note 10 - Post-Employment Health Care Benefits (continued)

Annual OPEB Cost and Net OPEB Obligation (continued)

The District's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for the fiscal year 2012 and the two preceding fiscal years were as follows:

Fiscal Year Ending	Annual OPEB Cost	Percentage Annual OPEB Cost Contributed	Net OPEB Obligation
06/30/10	\$ 29,695	64%	\$ 10,819
06/30/11	30,236	103%	10,062
06/30/12	61,401	81%	21,814

Funded Status and Funding Progress

As of June 30, 2012, the actuarial accrued liability for benefits was \$411,233, all of which was unfunded. The covered payroll (annual payroll of active employees covered by the plan) was \$1,362,539, and the ratio of the unfunded actuarial accrued liability to the covered payroll was 30%.

The projection of future benefit payments for an ongoing plan involves estimates of the value of reported amounts and assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress is presented on the following page, and presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

Actuarial Methods and Assumptions

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

MONTECITO SANITARY DISTRICT
NOTES TO THE FINANCIAL STATEMENTS

Note 10 - Post-Employment Health Care Benefits (continued)

The following simplifying assumptions were made:

Retirement age for active employees – Based on the CalPERS retirement rates for the 2% at 55 pension formula.

Marital status – Marital status of members at the calculation date. To the extent not provided 80% of retirees were assumed to be married at retirement. After retirement, the percentage married is adjusted to reflect mortality.

Mortality – Life expectancies were based on CalPERS mortality for Miscellaneous employees.

Turnover – CalPERS turnover for Miscellaneous employees were used as the basis for assigning active members a probability of remaining employed until the assumed retirement age and for developing an expected future working lifetime assumption for purposes of allocating to periods the present value of total benefits to be paid.

Healthcare cost trend rate – The expected rate of increase in healthcare insurance premiums was assumed at 4 percent per year.

Inflation rate – The expected long-term inflation rate of 3 percent was used.

Payroll growth rate – The expected long-term payroll growth rate of 3 percent was used.

Discount rate – The expected long-term discount rate of 5 percent was used.

In addition, the entry age normal actuarial cost method was used. The unfunded actuarial accrued liability is being amortized as a level percentage of projected payroll. A closed thirty year amortization period was used in the 2010 valuation and a closed eleven year amortization period was used in the 2012 valuation.

Required Supplementary Information

The schedule for funding progress below represents the recent history of the actuarial value of assets, accrued liability, their relationship, and the relationship of the unfunded liability.

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL)- Simplified Entry Age (b)		Unfunded AAL (UAAL) (b - a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
3/1/2010	\$ 0	\$ 281,750		\$ 281,750	0%	\$1,273,160	22%
8/2/2012	\$ 0	\$ 411,233		\$ 411,233	0%	\$1,362,539	30%

MONTECITO SANITARY DISTRICT
NOTES TO THE FINANCIAL STATEMENTS

Note 11 - Risk Management

The District is exposed to various risks of loss related to torts, theft of, damage to, and destruction of assets, errors and omissions, injuries to employees, and natural disaster.

The District participates in the California Sanitation Risk Management Authority (CSRMA), which arranges for and provides general liability, property damage, workers' compensation and employee dishonesty liability insurance to its member agencies. The District pays a premium commensurate with the level of coverage requested.

Note 12 - Subsequent Events

Subsequent events have been evaluated through October 29, 2012, the date that the financial statements were available to be issued.

SUPPLEMENTARY INFORMATION

**MONTECITO SANITARY DISTRICT
BOARD OF DIRECTORS**

<u>NAME</u>	<u>POSITION</u>	<u>TERM EXPIRES</u>
Jeff Kerns	President	November 2012
Judith M. Ishkanian	Vice President	November 2014
Edward McAniff	Treasurer	November 2012
Deirdre M. Cannata	Secretary	November 2014
Charles C. Arnold	Director	November 2012

MONTECITO SANITARY DISTRICT
SCHEDULE OF OPERATING EXPENSES - BY DEPARTMENT
For the Year Ended June 30, 2012 with Comparative Totals for the Year Ended June 30, 2011

	<u>Collection</u>	<u>Treatment</u>	<u>Disposal</u>	<u>Administration</u>	<u>2012</u>	<u>2011</u>
Salaries and Benefits:						
Salaries	\$ 431,389	\$ 430,557	\$ -	\$ 447,748	\$1,309,694	\$1,181,171
Stand-by pay	22,152	22,202	-	-	44,354	44,502
Overtime	1,535	6,956	-	-	8,491	13,237
Retirement contribution	58,058	57,656	-	74,547	190,261	154,157
Payroll tax	5,840	5,958	-	83,543	95,341	95,991
Group insurance	123,417	93,911	-	65,699	283,027	245,690
Total Salaries and Benefits	<u>642,391</u>	<u>617,240</u>	<u>-</u>	<u>671,537</u>	<u>1,931,168</u>	<u>1,734,748</u>
Supplies and Services:						
Insurance	24,422	28,223	-	(3,737)	48,908	53,331
Maintenance	76,082	102,997	-	3,120	182,199	160,655
Operating supplies	3,719	138,383	64,196	515	206,813	202,651
Office supplies	600	458	-	12,547	13,605	12,501
Memberships	839	523	-	24,962	26,324	24,820
Employee/Community goodwill	36	86	-	2,301	2,423	2,322
Miscellaneous	-	-	-	9,520	9,520	32
Office expense	444	12	-	954	1,410	1,306
Legal services	-	1,325	-	13,947	15,272	23,660
Consulting services	-	-	-	39,410	39,410	40,158
NPDES permit expenses	-	36,948	-	-	36,948	85,128
Other professional services	-	-	-	25,605	25,605	31,330
Administrative fees	1,154	385	-	14,798	16,337	21,019
Research and monitoring	-	9,402	-	-	9,402	15,040
Contract services	18,849	24,391	-	3,702	46,942	69,365
Publications and notices	-	-	-	1,146	1,146	825
Minor equipment purchases	1,523	1,458	-	3,563	6,544	4,964
Training and safety	5,124	14,361	-	2,342	21,827	14,935
Safety Specialist	14,336	14,336	-	-	28,672	26,168
Travel and meeting costs	3,247	1,323	-	4,513	9,083	7,217
Fuel and oil	12,196	5,375	-	54	17,625	11,845
Utilities and telephone	20,269	103,256	-	9,601	133,126	138,981
Amortization	-	-	-	13,537	13,537	13,537
Depreciation	436,248	295,341	11,011	64,630	807,230	770,604
Total Supplies and Services	<u>619,088</u>	<u>778,583</u>	<u>75,207</u>	<u>247,030</u>	<u>1,719,908</u>	<u>1,732,394</u>
Totals, June 30, 2012	<u>\$1,261,479</u>	<u>\$1,395,823</u>	<u>\$ 75,207</u>	<u>\$ 918,567</u>	<u>\$3,651,076</u>	
Totals, June 30, 2011	<u>\$1,202,811</u>	<u>\$1,379,870</u>	<u>\$ 71,834</u>	<u>\$ 812,627</u>		<u>\$3,467,142</u>