MONTECITO SANITARY DISTRICT

June 30, 2014 and 2013

FINANCIAL STATEMENTS

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

MONTECITO SANITARY DISTRICT

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

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors of
Montecito Sanitary District

Report on the Financial Statements

We have audited the accompanying basic financial statements of the Montecito Sanitary District (the "District") as of and for the years ended June 30, 2014 and 2013, and the related notes to the financial statements, which collectively comprise the District's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America as well as the accounting systems prescribed by the State Controller's Office and state regulations governing special districts; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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 from material misstatement.

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the District as of June 30, 2014 and 2013, and the respective changes in its financial position and cash flows for the years then ended in accordance 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.

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Emphasis of Matters

As discussed in Note 1 and Note 11 to the basic financial statements, the District has changed its method for accounting and reporting certain items previously reported as assets or liabilities during fiscal years 2013 and 2014 due to the adoption of Governmental Accounting Standards Board's Statement No. 65, "*Items Previous Reported as Assets and Liabilities*". The adoption of this standard required retrospective application resulting in a $324,899 and $338,437 reduction of previously reported net position as of July 1, 2013 and 2012, respectively. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 3 through 12 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.

Supplementary Information

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 the board of directors and the Schedule of Operating Expenses – By Department on pages 34 and 35 are presented for purposes of additional analysis and are not a required part of the basic financial statements.

The Schedule of Operating Expenses – By Department is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the Schedule of Operating Expenses – By Department is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

The list of board of directors on page 34 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.

Bartlett, Pringle + Wolf, LLP

Santa Barbara, California
December 8, 2014

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) 2013-2014 and 2012-2013. We encourage readers to consider the information presented here in conjunction with the District's financial statements 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 1,500 feet offshore) and trunk sewer system.

In 1981 the voters approved $3.1 million in revenue bonds to incorporate new technology, and double the plant's capacity to 1.5 million gallons per day. The plant's capacity remains at 1.5 million gallons per day (mgd). The average daily flows for FY 13-14 were approximately .9 million gallons per day (mgd). In March 2007 the District issued Certificates of Participation (COPs) in the amount of $14,765,000. These funds are being used for capital replacement projects. The District's mission has always been and continues to be "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 84 properties using on-site septic systems that have sewer available. The current number of residential connections is 3048 and there are 39 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 a District Administrator who is the chief administrator, an Operations Manager, and a Lab and Pretreatment Manager. The District had 14 full-time authorized positions in FY 2013-14 and FY 2012-13.

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

The statement of net position includes all the District's assets and deferred outflows and liabilities and deferred inflows, with the difference reported as net position. Net position is categorized as follows:

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

The statement of net position 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 position presents information which shows how the District's net position 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 position 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

This statement differs from the statement of revenues, expenses and changes in net position 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 position increased 4.23% or $985,082 to $24,248,109 in fiscal year 2014 as a result of operations. In the prior year, the District's net position increased 7.39% or $1,601,166 to $23,263,027 as a result of operations.
- The District's operating revenues decreased by 3.31% and operating expenses increased by 7.29% in FY 2013-2014. In the prior year, operating revenues increased by 4.55% and operating expense increased by 3.91%.

Financial Analysis of the District

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

	June 30, 2014	June 30, 2013	June 30, 2012	% Change FY 2013-2014 and 2012-2013	% Change FY 2012-2013 and 2011-2012
Assets:					
Current assets	$ 10,850,949	9,725,098	$ 8,394,185	11.58%	15.86%
Noncurrent assets:					
Other assets	-	-	33,028	0.00%	-100.00%
Restricted assets	3,478,012	4,915,480	6,404,002	-29.24%	-23.24%
Capital assets	24,276,443	23,317,716	22,001,754	4.11%	5.98%
Total Assets	38,605,404	37,958,294	36,832,969	1.70%	3.06%
Liabilities:					
Current liabilities	846,961	826,312	922,869	2.50%	-10.46%
Long term liabilities	13,510,334	13,868,955	14,248,239	-2.59%	-2.66%
Total Liabilities	14,357,295	14,695,267	15,171,108	-2.30%	-3.14%
Net Position:					
Net investment in capital assets	12,757,836	13,565,960	13,986,065	-5.96%	-3.00%
Restricted	979,026	954,212	404,874	2.60%	135.68%
Unrestricted	10,511,247	8,742,855	7,270,922	20.23%	20.24%
Total Net Position	$ 24,248,109	$ 23,263,027	$ 21,661,861	4.23%	7.39%

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

The following is a summary of the District's statement of revenues, expense and changes in net position for the years ended June 30, 2014, 2013, and 2012:

	June 30, 2014	June 30, 2013	June 30, 2012	% Change FY 2013-2014 and 2012-2013	% Change FY 2012-2013 and 2011-2012
Operating Revenues	$ 4,730,900	$ 4,892,758	$ 4,679,859	-3.31%	4.55%
Operating Expenses	4,055,293	3,779,925	3,637,539	7.29%	3.91%
Operating income (loss)	675,607	1,112,833	1,042,320	-39.29%	6.77%
Nonoperating revenue	565,271	446,586	500,795	26.58%	-10.82%
Nonoperating expense	295,164	457,121	363,586	-35.43%	25.73%
Non-operating income	270,107	(10,535)	137,209	-2663.90%	-107.68%
Excess of revenue over expenses	945,714	1,102,298	1,179,529	-14.21%	-6.55%
Capital contributions	39,368	498,868 *	136	-92.11%	>1000%
Change in Net Position	985,082	1,601,166	1,179,665	-38.48%	35.73%
Net position, beginning of year	23,263,027	21,661,861	20,482,196	7.39%	5.76%
Net position, end of year	$ 24,248,109	$ 23,263,027	$ 21,661,861	4.23%	7.39%

*Capital contributions from the Sewer Main Facility on Riven Rock Road, East Mountain Drive and Cima del Mundo Road.

Sources of Revenue

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

Revenue Category	2013-14	2012-13	2011-12	% Change FY 2013-2014 and 2012-2013	% Change FY 2012-2013 and 2011-2012
Service Charges	$ 4,467,496	$ 4,508,116	$ 4,481,939	-0.9%	0.6%
Connection Fees	226,979	300,324	163,370	-24.4%	83.8%
Other Services	36,425	84,318	34,550	-56.8%	144.0%
Operating Revenue	4,730,900	4,892,758	4,679,859	-3.3%	4.5%
Investment Income	72,465	(3,060)	64,867	-2468.1%	-104.7%
Property Taxes	475,861	450,793	440,651	5.6%	2.3%
Other Revenue/Expense	16,945	(1,147)	(4,723) *	-1577.3%	-75.7%
Nonoperating Revenue	565,271	446,586	500,795	26.6%	-10.8%
Total Revenue	$ 5,296,171	$ 5,339,344	$ 5,180,654	-0.8%	3.1%

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

Sewer Service Charge (SSC)

The major source of revenue for the District is the Sewer Service Charge(s) (SSC). The 2013-2014 service charges revenue decreased approximately .9% from the prior (2012-2013) fiscal year (FY). The District's total annual SSC revenue for FY 2013-2014 was $4,467,496; which amounted to 84.4% of the total revenues and 94.4% of the total operating revenue. SSC revenue for FY 2012-2013 was $4,508,116; which amounted to 84.4% of total revenues and 92.1% of the total operating revenue, and SSC revenue for FY 2011-2012 was $4,481,939; which amounted to 86.5% of total revenues and 95.8% 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. The rates in FY 2012-2013 remained the same as the previous year, and continue to remain the same in FY 2013-2014. 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 2013-2014 were $226,979 and for FY 2012-2013 were $300,324. The number of new connections decreased from 46 in FY 2012-2013 to 25 in FY 2013-2014.

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. Those fees remain the same for FY 2012-2013 and FY 2013-2014.

Investment Income

The District's current approved investment policy, under Resolution No. 2013-883, 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.

Interest revenues received, excluding those earned from the Certificates of Participation (COP) monies; within the 2013-14 FY from the two investment pools was $35,600. Interest earned from the COP monies was $9,854. Minor checking account interest in the amount of $97 was earned for the Running Expense account at Union Bank. Investment income for the 2013-2014 FY also reflects a fair market value adjustment of $26,914 from the two investment pools.

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 6) is inclusive of secure, unsecured, unitary, and supplemental property taxes.

Operating Expenses

The District's operating expenses (not including depreciation) for FY 2013-2014 were $3,116,296 and for FY 2012-2013 they were $2,931,802. This is an overall increase for FY 2013-2014 in actual operating expenses of 6.3%. For FY 2012-2013 there was an increase in actual operating expenses of 3.6%. Depreciation expense for FY 2013-2014 was $938,997 and for FY 2012-2013 depreciation expenses were $848,123. A tabular summary of the expenditure increases or decreases versus the previous fiscal year is presented on the following pages.

Expenditure increases or decreases in fiscal year 2013-14 versus fiscal year 2012-13 were as follows:

Expense Category	Expenses FY 2013/2014	Expenses FY 2012/2013	FY 2013/14 Expense Increase (Decrease)	Difference	Comments/Justification
Personnel (Salaries, Payroll Taxes, WC Insurance, and Benefits)	$ 2,039,318	$ 1,904,937	$ 134,381	7.1%	Increase in health premiums, payout of vacation upon separation for long term employees
Pooled Liability and Other CSRMA Insurance Programs	46,565	50,926	(4,361)	-8.6%	Decrease in insurance dividend
Maintenance, Repairs, Operating Supplies/Equip, and Contracted Services	569,247	523,874	45,373	8.7%	Increase in plant maintenance, chemicals, and temporary staffing for collections position
Utilities, Telephone, Fuel and Oil	184,516	159,423	25,093	15.7%	Increase in utility charges
Research & Monitoring	28,771	17,379	11,392	65.6%	New lab equipment
Office Expenses, and Misc. Administrative Costs	20,316	21,664	(1,348)	-6.2%	Comparable
Professional Services, Administrative Fees, and Memberships	196,145	179,214	16,931	9.4%	Increase in contracted engineering services, NPDES permit
Training, Safety and Travel Expenses	31,418	74,385	(42,967)	-57.8%	Safety officer position eliminated, handled by inhouse managers
Subtotals	**3,116,296**	**2,931,802**	**184,494**	**6.3%**	
Depreciation and Amortization	938,997	848,123	90,874	10.7%	Increase in depreciable assets FY 13-14, CIP completed
Totals	**$ 4,055,293**	**$ 3,779,925**	**$ 275,368**	**7.3%**	

Expenditure increases or decreases in fiscal year 2012-13 versus fiscal year 2011-12 were as follows:

Expense Category	Expenses FY 2012/2013	Expenses FY 2011/2012	FY 2012/13 Expense Increase (Decrease)	Difference	Comments/Justification
Personnel (Salaries, Payroll Taxes, WC Insurance, and Benefits)	$ 1,904,937	$ 1,931,168	$ (26,231)	-1.4%	Adjust Long Term Accrued Vac/Sick for current staff-retirees paid out upon separation; staff vacancies
Pooled Liability and Other CSRMA Insurance Programs	50,926	48,908	2,018	4.1%	Decrease in insurance dividend
Maintenance, Repairs, Operating Supplies/Equip, and Contracted Services	523,874	442,498	81,376	18.4%	Hypo tank repairs, clean digester, temp services to cover staff vacancies
Utilities, Telephone, Fuel and Oil	159,423	150,751	8,672	5.8%	Increase in utility charges
Research & Monitoring	17,379	9,402	7,977	84.8%	New lab equipment
Office Expenses, and Misc. Administrative Costs	21,664	28,104	(6,440)	-22.9%	$9,500 one time reconciling item in FY 11-12 recorded as misc expense
Professional Services, Administrative Fees, and Memberships	179,214	159,896	19,318	12.1%	Additional testing; HACH WIMS software programming
Training, Safety and Travel Expenses	74,385	59,582	14,803	24.8%	Increase in training and travel; increase in safety officer expense
Subtotals	**2,931,802**	**2,830,309**	**101,493**	**3.6%**	
Depreciation and Amortization	848,123	807,230	40,893	5.1%	Increase in depreciable assets FY 12-13
Totals	**$ 3,779,925**	**$ 3,637,539**	**$ 142,386**	**3.9%**	

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 which the District serves. The Acquisition Fund began with $10,533,493 in 2007. As of June 30, 2014 the District has spent $9,913,479 of the Acquisition Fund on Board approved Mission Critical Projects. Capital expenditures of the COP funds from July 1, 2013 through June 30, 2014 total $1,456,952. The balance of available funds from the Acquisition Fund monies at June 30, 2014 was $1,889,684. In addition to the withdrawals made for District projects, this remaining balance also includes original principal plus dividends earned throughout the year, and any contributed capital amounts reimbursed to the Acquisition Fund by the District.

During FY 2013-2014 some significant projects were completed with the COP funds. These projects included modifications to and refurbishment of the belt press, a new plant maintenance truck with hoist and generator, new chlorine analyzers, construction of a covered walkway at the treatment facility, and finishing the rehabilitation/relining of 3.68 miles of existing sewer pipeline.

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 Position, Statement of Revenues, Expenses and Changes in Net Position, 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 2013-2014 continued at the same rate as FY 2012-2013 and 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, 2014, there was $55,332 in this account. Additional monies are deposited in July of each Fiscal Year. Retirement Medical Benefits are only available to employees hired prior to July 1, 2010. There are only 3 current and 3 former employees eligible for this benefit. See financial statement Note 9 regarding Post-Employment Health Care Benefits.

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, 2014 there was $5,124,187 in this fund. Additional 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 Toni M. McDonald, District Administrator/Board Clerk, at 1042 Monte Cristo Lane, Santa Barbara, CA 93108, or by telephone at (805) 969-4200.

MONTECITO SANITARY DISTRICT
STATEMENT OF NET POSITION
June 30, 2014 and 2013

	2014	(As Restated) 2013
ASSETS		
Current Assets:		
Cash and investments (Note 2 and 3)	$ 10,763,758	$ 9,690,040
Interest receivable	20,288	6,529
Prepaid insurance	66,903	28,529
Total current assets	10,850,949	9,725,098
Restricted Assets:		
Cash and investments (Note 2 and 3)	3,476,403	4,911,594
Interest receivable	1,609	3,886
Total restricted assets	3,478,012	4,915,480
Capital Assets:		
Depreciable:		
Plant and equipment	40,505,414	37,981,890
Less accumulated depreciation	(16,442,337)	(15,628,488)
	24,063,077	22,353,402
Non-depreciable:		
Construction in progress	106,866	857,814
Land and improvements	106,500	106,500
Net capital assets (Note 2 and 4)	24,276,443	23,317,716
Total Assets	$ 38,605,404	$ 37,958,294

See accompanying notes

MONTECITO SANITARY DISTRICT
STATEMENT OF NET POSITION
June 30, 2014 and 2013

	2014	(As Restated) 2013
LIABILITIES		
Current Liabilities:		
Accounts payable	$ 51,102	$ 44,344
Accrued salaries and benefits	94,811	63,891
Accrued interest	300,139	306,639
Customer deposits	60,909	86,438
Current portion of long-term debt (Note 6)	340,000	325,000
Total current liabilities	846,961	826,312
Long-Term Liabilities:		
Compensated absences payable (Note 5)	142,740	156,031
Long-term debt, net of current portion (Note 6)	13,367,594	13,712,924
Total long-term liabilities	13,510,334	13,868,955
Total Liabilities	14,357,295	14,695,267
NET POSITION		
Net investment in capital assets	12,757,836	13,565,960
Restricted	979,026	954,212
Unrestricted, designated for retirement benefits obligation	55,332	24,840
Unrestricted, designated for capital replacement	5,124,187	4,250,527
Unrestricted	5,331,728	4,467,488
Total Net Position	$ 24,248,109	$ 23,263,027

See accompanying notes

MONTECITO SANITARY DISTRICT
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION
For the Fiscal Years Ended June 30, 2014 and 2013

	2014	(As Restated) 2013
Operating Revenues:		
Service charges	$ 4,467,496	$ 4,508,116
Connection fees	226,979	300,324
Other services	36,425	84,318
Total operating revenues	4,730,900	4,892,758
Operating Expenses:		
Sewage collection	1,332,596	1,274,581
Sewage treatment	1,835,003	1,571,746
Sewage disposal	63,200	68,662
Administrative	824,494	864,936
Total operating expenses	4,055,293	3,779,925
Income from operations	675,607	1,112,833
Nonoperating Revenue (Expense):		
Investment income	72,465	(3,060)
Property taxes	475,861	450,793
Other income (expense)	16,945	(1,147)
Interest expense	(295,164)	(457,121)
Total non-operating revenue (expense)	270,107	(10,535)
Excess of revenue over expenses	945,714	1,102,298
Capital contributions	39,368	498,868
Change in net position	985,082	1,601,166
Net position, beginning of year, as previously stated		22,000,298
Effect of prior period adjustment as a result of a change in accounting policy (Note 11)	-	(338,437)
Net position, beginning of year, as restated	23,263,027	21,661,861
Net position, end of year	$ 24,248,109	$ 23,263,027

See accompanying notes

MONTECITO SANITARY DISTRICT
STATEMENT OF CASH FLOWS
For the Fiscal Years Ended June 30, 2014 and 2013

	2014	2013
Cash Flows from Operating Activities:		
Cash received from customers	$ 4,695,426	$ 4,780,535
Cash payments to vendors for goods and services	(1,115,094)	(1,017,786)
Cash payments to employees for services	(2,021,689)	(1,933,500)
Net cash provided by operating activities	1,558,643	1,829,249
Cash Flows from Noncapital Financing Activities:		
Property taxes	475,861	450,793
Other	7,000	1,906
Net cash provided by noncapital financing activities	482,861	452,699
Cash Flows from Capital and Related Financing Activities:		
Purchase of capital assets	(1,597,939)	(2,031,309)
Proceeds on disposal	9,945	15,000
Interest payments	(600,279)	(613,278)
Extension reimbursements	39,368	498,868
Principal payments on long term debt	(325,000)	(310,000)
Net cash used by capital and related financing activities	(2,473,905)	(2,440,719)
Cash Flows from Investing Activities:		
Investment income received	70,928	6,825
Net cash provided by investing activities	70,928	6,825
Net decrease in cash and restricted cash	(361,473)	(151,946)
Cash and restricted cash – beginning of year	14,601,634	14,753,580
Cash and restricted cash – end of year	$ 14,240,161	$ 14,601,634
Reconciliation to Statement of Net Position:		
Cash and investments	$ 10,763,758	$ 9,690,040
Restricted cash and investments	3,476,403	4,911,594
	$ 14,240,161	$ 14,601,634

See accompanying notes

MONTECITO SANITARY DISTRICT
STATEMENT OF CASH FLOWS
For the Fiscal Years Ended June 30, 2014 and 2013

	2014	2013
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	$ 675,607	$ 1,112,833
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation expense	938,997	848,123
Change in assets and liabilities:		
Prepaids	(38,374)	(4,344)
Accounts receivable	(9,945)	122
State loan receivable	-	33,028
Accounts payable	6,758	19,623
Accrued salaries and benefits	30,920	20,391
Accrued interest	(6,500)	(6,200)
Customer deposits	(25,529)	(145,373)
Compensated absences	(13,291)	(48,954)
Net cash provided by operating activites	$ 1,558,643	$ 1,829,249

See accompanying notes

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/District Engineer and such other personnel as are required to meet its responsibilities.

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 statement of net position.

The District distinguishes operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and the producing and delivering of goods in connection with the District's principal ongoing operations. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

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.

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.

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.

Note 2 - Summary of Significant Accounting Policies (continued)

H) Property Taxes (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 Position

Net position represents the difference between assets and deferred outflows, and liabilities and deferred inflows, and is classified into three components as follows:

Net investment in capital assets – This component of net position consists of capital assets, net of accumulated depreciation and reduced by the outstanding balances of any borrowings used for the acquisition, construction or improvement of those assets. Net investment in capital assets excludes unspent debt proceeds.

Note 2 - <u>Summary of Significant Accounting Policies</u> (continued)

J) <u>Net Position</u> (continued)

Restricted – This component of net position consists of assets which are legally restricted by outside parties for use for a specific purpose.

Unrestricted – This component of net position consists of net position that does not meet the definition of "restricted" or "net investment in capital assets." Dedicated net position represents unrestricted assets which are segregated by the Board of Directors for specific future uses.

When an expense is incurred for purposes for which both unrestricted and restricted resources are available for use, it is the District's policy to apply restricted assets first, then unrestricted resources.

K) <u>Use of Estimates</u>

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.

Significant estimates used in preparing these financial statements include useful lives of capitalized assets and the liability for postretirement healthcare benefits. It is at least reasonably possible that the significant estimates used will change within the next year.

L) <u>New Accounting Pronouncements</u>

For the year ended June 30, 2014, the District implemented the following Governmental Accounting Standards Board (GASB) Pronouncements:

GASB Statement No. 65 – *Items Previously Reported as Assets and Liabilities*—an amendment of Concept Statement No. 4, Elements of Financial Statements. This statement amends or supersedes accounting and financial reporting standards to reclassify certain items that were previously reported as assets and liabilities and recognizes them as deferred outflows of resources or deferred inflows of resources. Due to the implementation of this statement, debt issuance costs were eliminated and are recognized as an expense in the period incurred. Accounting changes adopted to conform to the provisions of this statement should be applied retroactively. The result of this implementation of this standard was to decrease the Net Position at June 30, 2013 and 2012 by $324,899 and $338,437, respectively, which is the amount of unamortized debt issuance costs.

Statement No. 66 *Technical Corrections—2012—an amendment of GASB Statements No. 10 and No. 62.* This Statement removes the provision that limits fund-based reporting of a state and local government's risk financing activities to the general fund and the internal service fund type. The adoption of this statement did not have a material impact on the District's financial statements.

Note 2 - Summary of Significant Accounting Policies (continued)

L) Implementation of New Accounting Pronouncements (Continued)

The GASB Statement listed below will be implemented in future financial statements and will be evaluated by the District to determine if it will have a material impact to the financial statements once effective.

GASB Statement No. 68 – *Accounting and Financial Reporting for Pensions* – An Amendment of GASB Statement No. 27. The primary objective of this Statement is to improve accounting and financial reporting by state and local governments for pensions. This Statement results from a comprehensive review of the effectiveness of existing standards of accounting and financial reporting for pensions with regard to providing decision-useful information, supporting assessments of accountability and interperiod equity, and creating additional transparency. This Statement establishes a definition of a pension plan that reflects the primary activities associated with the pension arrangement – determining pensions, accumulating and managing assets dedicated for pensions, and paying benefits to plan members as they come due. In addition, this Statement details the recognition and disclosure requirements for employers with liabilities to a defined benefit pension plan. The effect of the implementation of GASB 68 has yet to be determined as of June 30, 2014.

Note 3 - Cash and Investments

Cash and investments are classified in the accompanying financial statements, at fair value, at June 30, 2014 and 2013 as follows:

	June 30, 2014	June 30, 2013
Unrestricted:		
Cash and investments, undesignated	$ 5,584,239	$ 5,414,673
Cash designated for retirement benefits	55,332	24,840
Cash designated for capital replacement	5,124,187	4,250,527
Restricted cash from bond proceeds	3,476,403	4,911,594
Total cash and investments	$ 14,240,161	$ 14,601,634

Investments are carried at fair value as determined by the external investment pool sponsor. Cash and investments as of June 30, 2014 and 2013 consist of the following:

	June 30, 2014	June 30, 2013
Cash on hand	$ 250	$ 250
Deposits held with financial institutions	236,061	215,295
Cash with fiscal agent	640,895	632,447
Deposits held in pooled investment funds	13,362,955	13,753,642
Total cash and investments	$ 14,240,161	$ 14,601,634

Note 3 - Cash and Investments (continued)

Investments Authorized by the District's Investment Policy

The District's investment policy authorizes investments selected on the basis of credit worthiness, financial strength, experience, and minimal capitalization. The District shall select only licensed brokers and dealers in good standing with the California Department of Securities, the Securities and Exchange Commission, the National Association of Securities Dealers, or other applicable self-regulatory organizations. The District is prohibited from investing in any funds in inverse floaters, range notes, interest-only strips derived from mortgage pools, or any investment which may result in a zero interest accrual if held to maturity. It is the District policy to diversify its investment portfolio to eliminate the risk of loss resulting from over concentration of assets in a specific maturity, a specific issuer, or a specific class of securities.

The primary objectives of the District's investment activities in priority order are: safety, liquidity, and return on investments. Investments shall be chosen with judgment and care, considering the probable safety of their capital as well as the probable income to be derived. Although the District has pre-authorized investment categories per Resolution No. 2013-883, the only investments in practice are those in the local government investment pool administered by the State of California (LAIF) and the Santa Barbara County Investment Pool.

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, 2014:

		Remaining Maturity (in Months)			
Investment Type	Carrying Amount	12 Months or Less	13-24 Months	25-60 Months	More than 60 Months
LAIF	$ 4,483,032	$ 4,483,032	$ -	$ -	$ -
Santa Barbara County Investment Pool	8,879,923	8,879,923	-	-	-
Total	$ 13,362,955	$ 13,362,955	$ -	$ -	$ -

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, 2014 for each investment type.

Note 3 - Cash and Investments (continued)

	Carrying Amount	Minimum Legal Rating	Exempt From Disclosure	Rating as of Fiscal Year End AAA	Aa	Not Rated
LAIF	$ 4,483,032	N/A	$ 4,483,032	$ -	$ -	$ -
Santa Barbara County Investment Pool	8,879,923	N/A	8,879,923	-	-	-
Total	$13,362,955		$13,362,955	$ -	$ -	$ -

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).

Note 3 - Cash and Investments (continued)

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.

Note 4 - Schedule of Capital Assets

A schedule of changes in capital assets and depreciation for the fiscal year ended June 30, 2014, is shown below:

	Balance July 1, 2013	Additions	Deletions	Transfers	Balance June 30, 2014
Subsurface Lines	$22,143,324	$ -	$ -	$ 850,813	$22,994,137
Collection Facilities	3,648,618	101,226	(76,327)	125,277	3,798,794
Treatment Facilities	10,541,634	35,439	(48,821)	1,532,391	12,060,643
Disposal Facilities	532,466	-	-	-	532,466
Administrative Facilities	1,115,848	3,526	-	-	1,119,374
	37,981,890	140,191	(125,148)	2,508,481	40,505,414
Accumulated Depreciation	(15,628,488)	(938,997)	125,148	-	(16,442,337)
	22,353,402	(798,806)	-	2,508,481	24,063,077
Construction in Progress	857,814	1,757,533		(2,508,481)	106,866
Land and Improvements	106,500				106,500
Net capital assets	$23,317,716	$ 958,727	$ -	$ -	$24,276,443

Note 4 - Schedule of Capital Assets (continued)

A schedule of changes in capital assets and depreciation for the fiscal year ended June 30, 2013, is shown below:

	Balance July 1, 2012	Additions	Deletions	Transfers	Balance June 30, 2013
Subsurface Lines	$21,387,220	$ 372,669	$ -	$ 383,435	$22,143,324
Collection Facilities	3,606,322	177,476	(135,180)	-	3,648,618
Treatment Facilities	9,967,180	531,290	-	43,164	10,541,634
Disposal Facilities	532,466	-	-	-	532,466
Administrative Facilities	1,115,848	-	-	-	1,115,848
	36,609,036	1,081,435	(135,180)	426,599	37,981,890
Accumulated Depreciation	(14,897,492)	(848,123)	117,127	-	(15,628,488)
	21,711,544	233,312	(18,053)	426,599	22,353,402
Construction in Progress	183,710	1,100,703	-	(426,599)	857,814
Land and Improvements	106,500	-	-		106,500
Net capital assets	$22,001,754	$1,334,015	$ (18,053)	$ -	$23,317,716

Note 5 - 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.

Eligible employees may request the option of selecting compensatory time off (CTO) for overtime hours worked during any workweek in lieu of overtime pay. Any employee having CTO banked hours is entitled to convert such hours to pay at their regular rate at any time. All CTO hours will be subject to payout at the time of employment separation.

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

Note 6 - Long-Term Debt

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

	Balance June 30, 2013	Additions	Retirements/ Amortization	Balance June 30, 2014
Series 2007 Certificates of Participation	$ 13,910,000	$ -	$ (325,000)	$ 13,585,000
Unamortized premiums	127,924		(5,330)	122,594
Net long-term debt	$ 14,037,924	$ -	$ (330,330)	$ 13,707,594

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
6/30/2015	$ 340,000	$ 593,478	$ 933,478
6/30/2016	350,000	579,678	929,678
6/30/2017	365,000	565,378	930,378
6/30/2018	380,000	550,478	930,478
6/30/2019	395,000	534,978	929,978
2020-2024	2,220,000	2,419,788	4,639,788
2025-2029	2,725,000	1,903,419	4,628,419
2030-2034	3,430,000	1,172,450	4,602,450
2035-2038	3,380,000	298,202	3,678,202
Total	$ 13,585,000	$ 8,617,849	$ 22,202,849

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

Note 7 - 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 8 - 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. Effective January 1, 2013, the District began to contribute to the PERS Miscellaneous 2% at 62 Risk Pool in accordance with the Public Employees' Pension Reform Act (PEPRA). 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 Miscellaneous 2% at 55 Risk Pool are required to contribute 7% of their annual covered salary, which the District makes on their behalf. Active plan members in the PERS Miscellaneous 2% at 62 Risk Pool are required to contribute at least 50% of their annual covered salary, which resulted in active members and the District contributing 6.25% each to the newly adopted plan. 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 9.301% and 8.813% for fiscal years 2014 and 2013, 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.

Note 8 - Defined Benefit Pension Plan (continued)

Annual Pension Cost

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

Valuation Date	June 30, 2011
Actuarial Cost Method	Entry Age Normal Cost Method
Amortization Method	Level Percent of Payroll
Average Remaining Period	20 Years as of the Valuation Date
Asset Valuation Method	15 Year Smoothed Market
Actuarial Assumptions	
Investment Rate of Return	7.50% (net of administrative expenses)
Projected Salary Increases	3.3% to 14.20% depending on Age, Service, and type of employment
Inflation	2.75%
Payroll Growth	3.00%
Individual Salary Growth	A merit scale varying by duration of employment coupled with an assumed annual inflation growth of 2.75% and an annual production growth of 0.25%

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

Fiscal Year Ending	Annual Pension Cost (APC)	Percentage of APC Contribution	Net Pension Obligation
6/30/12	$ 107,953	100%	$ 0
6/30/13	115,611	100%	0
6/30/14	120,745	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.

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)
6/30/2010	$ 3,309,064,934	$ 2,946,408,106	$ 362,656,828	89.0%	$ 748,401,352	48.5%
6/30/2011	$ 3,619,835,876	$ 3,203,214,899	$ 416,620,977	88.5%	$ 759,263,518	54.9%
6/30/2012	$ 4,175,139,166	$ 3,686,598,343	$ 488,540,823	88.3%	$ 757,045,663	64.5%

Note 9 - 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 $55,332 of unrestricted net position 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 District accrued the net OPEB obligation of $60,136 and $38,814 as of June 30, 2014 and 2013, respectively, which is included on the Statement on Net Position with accrued salaries and benefits. 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	$ 63,147
Contributions made	(41,825)
Increase in net OPEB	21,322
Net OPEB obligation - beginning of year	38,814
Net OPEB obligation - end of year	$ 60,136

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 2014 and the two preceding fiscal years were as follows:

Fiscal Year Ending	Annual OPEB Cost	Percentage Annual OPEB Cost Contributed	Net OPEB Obligation
06/30/12	$ 61,401	81%	$ 21,814
06/30/13	63,533	73%	38,814
06/30/14	63,147	66%	60,136

Note 9 - Post-Employment Health Care Benefits (continued)

Funded Status and Funding Progress

As of June 30, 2014, 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% based on the valuation date of March 1, 2012.

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.

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.

Note 9 - Post-Employment Health Care Benefits (continued)

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%
3/1/2012	$ 0	$ 411,233	$ 411,233	0%	$1,362,539	30%

Note 10 - 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 11 - Prior Period Adjustment as a Result of a Change in Accounting Policy

Note 1 describes the GASB pronouncements the District is adopting for this and the prior fiscal years. There is a financial impact for the adoption of GASB Statement No. 65, *"Items Previously Reported as Assets and Liabilities"*.

Bond Issuance Costs

Implementation of GASB Statement 65 recognizes cost of issuance as an expense therefore the adoption of this statement resulted in the write off of the bond issuance costs as of the fiscal year ended June 30, 2012. The effect of this adjustment was to decrease July 1, 2012 net position by $338,437, decrease bond issuance costs of $324,899 at June 30, 2013 and decrease amortization by $13,538 for the year ended June 30, 2013.

Note 11 - Prior Period Adjustment as a Result of a Change in Accounting Policy (continued)

The following table presents the effect of the prior period adjustment on the June 30, 2013 financial statement balances.

	(As Restated) 2013
Total assets, as previously stated	$ 38,283,193
Decrease in bond issuance costs	(324,899)
Total assets, restated	$ 37,958,294
Net position, beginning of the year, as previously stated	$ 22,000,298
Decrease in net position due to bond issuance cost	(338,437)
Net position, beginning of the year, restated	$ 21,661,861

Note 12 - Subsequent Events

Subsequent events have been evaluated through December 8, 2014, the date that the financial statements were available to be issued.

SUPPLEMENTARY INFORMATION

MONTECITO SANITARY DISTRICT

BOARD OF DIRECTORS

NAME	POSITION	TERM EXPIRES
Thomas Kern	President	December 2016
Judith M. Ishkanian	Vice President	December 2018
Jeff Kerns	Treasurer	December 2016
Warner Owens	Secretary	December 2018
Deirdre M. Cannata	Director	December 2014

MONTECITO SANITARY DISTRICT
SCHEDULE OF OPERATING EXPENSES - BY DEPARTMENT
For the Year Ended June 30, 2014 with Comparative Totals for the Year Ended June 30, 2013

	Collection	Treatment	Disposal	Administration	2014	2013
Salaries and Benefits:						
Salaries	$ 419,114	$ 503,854	$ -	$ 405,231	$ 1,328,199	$ 1,250,577
Stand-by pay	28,725	30,575	-	-	59,300	48,759
Overtime	903	8,433	-	-	9,336	13,439
Retirement contribution	69,325	68,824	-	62,900	201,049	193,803
Payroll tax	1,896	2,114	-	99,390	103,400	102,089
Group insurance	142,652	146,954	-	48,428	338,034	296,270
Total Salaries and Benefits	662,615	760,754	-	615,949	2,039,318	1,904,937
Supplies and Services:						
Insurance	24,218	29,316	-	(6,969)	46,565	50,926
Maintenance	61,439	143,051	-	3,927	208,417	180,491
Operating supplies	3,154	163,544	52,189	408	219,295	208,887
Office supplies	2,171	2,232	-	10,514	14,917	14,778
Memberships	840	1,995	-	21,711	24,546	20,103
Employee/Community goodwill	192	921	-	2,159	3,272	4,844
Miscellaneous	-	-	-	-	-	113
Office expense	620	147	-	615	1,382	981
Legal services	-	0	-	16,477	16,477	15,223
Consulting services	-	-	-	28,851	28,851	37,174
NPDES permit expenses	-	60,700	-	-	60,700	55,967
Other professional services	20,855	-	-	26,586	47,441	34,510
Administrative fees	2,251	1,066	-	14,813	18,130	16,237
Research and monitoring	-	28,771	-	-	28,771	17,379
Contract services	39,800	80,815	-	11,776	132,391	127,167
Publications and notices	-	-	-	745	745	948
Minor equipment purchases	3,408	5,500	-	236	9,144	7,329
Training and safety	6,041	9,961	-	3,632	19,634	28,940
Safety Specialist	-	-	-	-	-	34,663
Travel and meeting costs	2,460	2,160	-	7,164	11,784	10,782
Fuel and oil	13,114	4,428	-	80	17,622	13,779
Utilities and telephone	25,805	129,364	-	11,725	166,894	145,644
Amortization	-	-	-	-	-	-
Depreciation	463,613	410,278	11,011	54,095	938,997	848,123
Total Supplies and Services	669,981	1,074,249	63,200	208,545	2,015,975	1,874,988
Totals, June 30, 2014	$ 1,332,596	$ 1,835,003	$ 63,200	$ 824,494	$ 4,055,293	
Totals, June 30, 2013	$ 1,274,581	$ 1,571,746	$ 68,662	$ 864,936		$ 3,779,925