



**Montecito Water District
Annual Financial Report**

For the Fiscal Years Ended June 30, 2011 and 2010



Our Mission Statement

“To provide an adequate and reliable supply of high quality water to the residents of Montecito and Summerland, at the most reasonable cost.”

Montecito Water District Board of Directors as of June 30, 2011

<u>Name</u>	<u>Title</u>	<u>Elected/ Appointed</u>	<u>Term Expires</u>
Sam Frye	President	Elected	12/14
Douglas Morgan	Vice-President	Elected	12/14
Jan E. Abel	Director	Elected	12/12
Darlene Bierig	Director	Appointed	12/12
Richard Shaikewitz	Director	Elected	12/14

**Montecito Water District
Tom Mosby, General Manager
583 San Ysidro Road
Montecito, California 93108
(805) 969-2271 – www.montecitowater.com**

Montecito Water District

Annual Financial Report

For the Fiscal Years Ended June 30, 2011 and 2010

**Montecito Water District
Annual Financial Report
For the Fiscal Years Ended June 30, 2011 and 2010**

Table of Contents

	<u>Page No.</u>
Table of Contents	i
Financial Section	
Independent Auditor's Report	1-2
Management's Discussion and Analysis	3-6
Basic Financial Statements:	
Statements of Net Assets	7
Statements of Revenues, Expenses and Changes in Net Assets	8
Statements of Cash Flows	9-10
Notes to the Basic Financial Statements	11-30
Required Supplementary Information:	
Schedule of Funding Status – Other Post-Employment Benefits Obligation	31
Report on Internal Controls and Compliance	
Independent Auditor's Report on Internal Control Over Financial Reporting And on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>	32

Financial Section



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Independent Auditor's Report

Board of Directors
Montecito Water District
Montecito, California

We have audited the accompanying financial statements of the Montecito Water District (District) as of and for the year ended June 30, 2011, which collectively comprise the District's basic financial statements as listed in the table of contents. These basic financial statements are the responsibility of the District's management. Our responsibility is to express an opinion on these basic financial statements based on our audit. The comparative financial information as of June 30, 2010 was audited by other auditors whose report dated October 7, 2010, expressed an unqualified opinion on those basic financial statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the State Controller's Minimum Audit Requirements for California Special Districts. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the basic financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the basic financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall basic financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the respective financial position of the Montecito Water District as of June 30, 2011, and the respective changes in net assets and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated October 31, 2011, on our consideration of the District's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit. That report can be found on page 32.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 6 and the required supplemental information on page 31 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.

Independent Auditor's Report, continued

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.

Charles Z Fedak and Company CPAs - An Accountancy Corporation

Charles Z. Fedak and Company, CPA's – An Accountancy Corporation
Cypress, California
October 31, 2011

Montecito Water District
Management's Discussion and Analysis
For the Year Ended June 30, 2011
With Comparative Information for the Fiscal Year Ended June 30, 2010

The following Management's Discussion and Analysis (MD&A) of activities and financial performance of the Montecito Water District (District) provides an introduction to the financial statements of the District for the years ended June 30, 2011 and 2010. We encourage readers to consider the information presented here in conjunction with the basic financial statements and related notes, which follow this section.

Financial Highlights

- In 2011, the District's net assets decreased 4.15% or \$1,321,010 from \$31,860,436 to \$30,539,426.
- The District's 2011 operating revenues decreased 8.07% or \$1,034,810 due to a decrease in water sales. In the fiscal year ending June 30, 2010, the District sold 5,274 Acre Feet for \$9,429,322 in water sales revenue. The District sold 4,715 Acre Feet in the Fiscal Year ending June 30, 2011 for \$8,401,945 water sales revenue. This decrease in water sales is attributable to a combination of wet weather and a conservation block rate structure.
- The District's total expenses increased 3.75% or \$489,282 due primarily to previously capitalized interest now being expensed and adjustments to the estimated lives of some fixed assets which increased depreciation expense. The interest on the 1998A Project Bonds was capitalized while the projects were in progress. The projects were complete in 2010 and the interest on the 2010A Refunding Revenue Certificates of Participation bonds is not capitalized. The estimated life of some infrastructure assets was accelerated to reflect the fact that their useful life is shorter than originally estimated.

Required Financial Statements

This annual report consists of a series of financial statements. The Statement of Net Assets, Statement of Revenues, Expenses and Changes in Net Assets and Statement of Cash Flows provide information about the activities and performance of the District using accounting methods similar to those used by private sector companies.

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 a rate of return, evaluating the capital structure of the District and assessing the liquidity and financial flexibility of the District. All of the current year's revenue and expenses are accounted for in the Statement of Revenues, Expenses and Changes in Net Assets. This statement measures the success of the District's operations over the past year and can be used to determine if the District has successfully recovered all of its costs through its rates and other charges. This statement can also be used to evaluate profitability and credit worthiness. The final required financial statement is the Statement of Cash Flows, which provides information about the District's cash receipts and cash payments during the reporting period. The Statement of Cash Flows reports cash receipts, cash payments and net changes in cash resulting from operations, investing, non-capital financing, and capital and related financing activities and provides answers to such questions as where did cash come from, what was cash used for, and what was the change in cash balance during the reporting period.

Montecito Water District
Management's Discussion and Analysis
For the Year Ended June 30, 2011
With Comparative Information for the Fiscal Year Ended June 30, 2010

Financial Analysis of the District

One of the most important questions asked about the District's finances is, "Is the District better off or worse off as a result of this year's activities?" The Statement of Net Assets and the Statement of Revenues, Expenses and Changes in Net Assets report information about the District in a way that helps answer this question. These statements include all assets and liabilities using the *accrual basis of accounting*, which is similar to the accounting used by most private sector companies. All of the current year's revenues and expenses are taken into account regardless of when the cash is received or paid.

These two statements report the District's *net assets* and changes in them. You can think of the District's net assets – the difference between assets and liabilities – as one way to measure the District's financial health, or *financial position*. Over time, *increases or decreases* in the District's net assets are one indicator of whether its *financial health* is improving or deteriorating. However, one will need to consider other non-financial factors such as changes in economic conditions, population growth, zoning and new or changed government legislation, such as changes in Federal and State water quality standards.

Notes to the Basic Financial Statements

The notes provide additional information that is essential to a full understanding of the data provided in the basic financial statements. The notes to the basic financial statements can be found on pages 11 through 30.

Statement of Net Assets

Condensed Statements of Net Assets

	2011	2010	Change
Assets:			
Current assets	\$ 16,454,248	18,475,273	(2,021,025)
Non-current assets	1,739,242	610,449	1,128,793
Capital assets, net	40,944,671	42,100,534	(1,155,863)
Total assets	59,138,161	61,186,256	(2,048,095)
Liabilities:			
Current liabilities	2,000,664	1,944,961	55,703
Non-current liabilities	26,598,071	27,380,859	(782,788)
Total liabilities	28,598,735	29,325,820	(727,085)
Net assets:			
Net investment in capital assets	14,055,676	14,291,488	(235,812)
Restricted (Note 7)	4,149,284	4,010,572	138,712
Unrestricted	12,334,466	13,558,376	(1,223,910)
Total net assets	30,539,426	31,860,436	(1,321,010)
Total liabilities and net assets	\$ 59,138,161	61,186,256	(2,048,095)

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. In the case of the District, assets exceeded liabilities by \$30,539,426 and \$31,860,436 as of June 30, 2011 and 2010, respectively.

A portion of the District's net assets, 46% and 45% as of June 30, 2011 and 2010, respectively, reflects the District's investment in capital assets (net of accumulated depreciation) less any related debt used to acquire those assets that is still outstanding. The District uses these capital assets to provide services to customers within the District's service area; consequently, these assets are *not* available for future spending.

Montecito Water District
Management's Discussion and Analysis
For the Year Ended June 30, 2011
With Comparative Information for the Fiscal Year Ended June 30, 2010

At the end of years 2011 and 2010, the District showed a positive balance in its unrestricted net assets of \$12,334,466 and \$13,558,376, respectively, which may be utilized in future years.

Statement of Revenues, Expenses and Changes in Net Assets

Condensed Statements of Revenues, Expenses and Changes in Net Assets			
	2011	2010	Change
Revenues:			
Operating revenues	\$ 11,786,504	12,821,314	(1,034,810)
Non-operating revenues	243,930	155,540	88,390
Total revenues	12,030,434	12,976,854	(946,420)
Expenses:			
Operating expenses	10,699,323	11,010,188	(310,865)
Depreciation and amortization	1,834,008	1,499,657	334,351
Non-operating expenses	1,011,805	546,009	465,796
Total expenses	13,545,136	13,055,854	489,282
Net income before capital contributions	(1,514,702)	(79,000)	(1,435,702)
Capital contributions	193,692	1,579,111	(1,385,419)
Change in net assets	(1,321,010)	1,500,111	(2,821,121)
Net assets, beginning of year	31,860,436	30,360,325	1,500,111
Net assets, end of year	\$ 30,539,426	31,860,436	(1,321,010)

The statement of revenues, expenses and changes of net assets shows how the District's net assets changed during the years. In the case of the District, net assets decreased by \$1,321,010 and increased by \$1,500,111 for the years ended June 30, 2011 and 2010, respectively.

A closer examination of the sources of changes in net assets reveals that:

The District's 2011 operating revenues decreased 8.07% or \$1,034,810 due to a decrease in water sales. For the fiscal year ending June 30, 2010, the District sold 5,274 acre feet of water for a total of \$9,429,322 in water sales revenue. For the fiscal year ending June 30, 2011, the District sold 4,715 acre feet of water for a total of \$8,401,945 in water sales revenue. This decrease in water sales is attributable to a combination of wet weather and a conservation block rate structure.

The District's total expenses increased 3.75% or \$489,282 due primarily to previously capitalizing interest expense that is now being expensed and adjustments to the estimated lives of some fixed assets which increased depreciation expense. The interest on the 1998A Project Bonds was capitalized while the projects were in progress. The projects were complete in 2010 and the interest on the 2010A Refunding Revenue Certificates of Participation bonds is not being capitalized. The estimated life of some infrastructure assets was accelerated to reflect the fact that their useful life is shorter than originally estimated.

Montecito Water District
Management's Discussion and Analysis
For the Year Ended June 30, 2011
With Comparative Information for the Fiscal Year Ended June 30, 2010

Capital Asset Administration

At the end of year 2011, the District's investment in capital assets amounted to \$40,944,671 (net of accumulated depreciation and amortization). This investment in capital assets includes land, land rights, transmission and distribution systems, wells, tanks, reservoirs, pumps, buildings and structures, equipment, vehicles, State Water Project entitlement, and construction-in-process. There were numerous capital asset additions in the year 2011 (See Note 4).

Changes in capital assets amounts for 2011 were as follows:

	<u>Balance 2010</u>	<u>Additions</u>	<u>Transfers/ Deletions</u>	<u>Balance 2011</u>
Capital assets:				
Non-depreciable assets	\$ 12,780,844	800,365	(1,438,620)	12,142,589
Depreciable assets	49,956,858	1,316,400	(758,393)	50,514,865
Accumulated depreciation and amortization	<u>(20,637,168)</u>	<u>(1,834,008)</u>	<u>758,393</u>	<u>(21,712,783)</u>
Total capital assets ,net	<u>\$ 42,100,534</u>	<u>282,757</u>	<u>(1,438,620)</u>	<u>40,944,671</u>

Changes in capital assets amounts for 2010 were as follows:

	<u>Balance 2009</u>	<u>Additions</u>	<u>Transfers/ Deletions</u>	<u>Balance 2010</u>
Capital assets:				
Non-depreciable assets	\$ 13,190,459	1,142,920	(1,552,535)	12,780,844
Depreciable assets	48,386,579	1,644,666	(74,387)	49,956,858
Accumulated depreciation and amortization	<u>(19,771,694)</u>	<u>(939,861)</u>	<u>74,387</u>	<u>(20,637,168)</u>
Total capital assets ,net	<u>\$ 41,805,344</u>	<u>1,847,725</u>	<u>(1,552,535)</u>	<u>42,100,534</u>

Debt Administration

In 2011, long-term debt decreased by \$920,051, due to regular principal payments and amortization on the District's outstanding debts and debt refunding. In 2010, long-term debt decreased by \$759,720, due to regular principal payments and a refunding of the District's outstanding debts (See Note 6).

Changes in long-term debt amounts for 2011 were as follows:

	<u>Balance 2010</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance 2011</u>
Long-term debt:				
Bonds payable	\$ 14,475,481	-	(127,923)	14,347,558
Loan payable	<u>13,333,565</u>	<u>-</u>	<u>(792,128)</u>	<u>12,541,437</u>
Total long-term debt	<u>\$ 27,809,046</u>	<u>-</u>	<u>(920,051)</u>	<u>26,888,995</u>

Changes in long-term debt amounts for 2010 were as follows:

	<u>Balance 2009</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance 2010</u>
Long-term debt:				
Bonds payable	\$ 14,814,301	13,360,000	(13,698,820)	14,475,481
Loan payable	<u>13,754,465</u>	<u>-</u>	<u>(420,900)</u>	<u>13,333,565</u>
Total long-term debt	<u>\$ 28,568,766</u>	<u>13,360,000</u>	<u>(14,119,720)</u>	<u>27,809,046</u>

Requests for Information

This financial report is designed to provide the District's funding sources, customers, stakeholders and other interested parties with an overview of the District's financial operations and financial condition. Should the reader have questions regarding the information included in this report or wish to request additional financial information, please contact the District's Business Manager at 583 San Ysidro Road, Santa Barbara, California, 93108 – (805) 969-2271.

Basic Financial Statements

Montecito Water District
Statements of Net Assets
June 30, 2011 with Comparative Information as of June 30, 2010

<i>Assets</i>	2011	2010
Current assets:		
Cash and cash equivalents (note 2)	\$ 5,957,891	5,906,927
Restricted – cash and cash equivalents (note 2)	3,444,659	4,296,433
Accrued interest receivable	9,557	11,717
Accounts receivable – water sales and services, net	1,163,636	1,330,852
Accounts receivable – reimbursements	490,466	1,555,653
Materials and supplies inventory	187,950	176,863
Prepaid water charges	5,168,348	5,165,748
Prepaid expenses and other deposits	31,741	31,080
Total current assets	16,454,248	18,475,273
Non-current assets:		
Restricted – investments (note 2)	1,167,566	-
Deferred charges, net (note 3)	571,676	610,449
Capital assets – not being depreciated (note 4)	12,142,589	12,780,844
Capital assets, net – being depreciated (note 4)	28,802,082	29,319,690
Total non-current assets	42,683,913	42,710,983
Total assets	\$ 59,138,161	61,186,256
<i>Liabilities and Net Assets</i>		
Current liabilities:		
Accounts payable and accrued expenses	\$ 470,816	571,595
Accrued wages and related payables	106,613	86,697
Deferred revenue and other deposits	102,854	88,945
Accrued interest payable	462,941	285,861
Long-term liabilities – due within one year:		
Compensated absences (note 5)	91,040	84,737
Bonds payable (note 6)	35,000	35,000
Loans payable (note 6)	731,400	792,126
Total current liabilities	2,000,664	1,944,961
Non-current liabilities:		
Long-term liabilities – due in more than one year:		
Compensated absences (note 5)	273,119	254,210
Other post-employment benefits payable (note 10)	202,357	144,729
Bonds payable (note 6)	14,312,558	14,440,482
Loans payable (note 6)	11,810,037	12,541,438
Total non-current liabilities	26,598,071	27,380,859
Total liabilities	28,598,735	29,325,820
Net assets: (note 7)		
Net investment in capital assets	14,055,676	14,291,488
Restricted	4,149,284	4,010,572
Unrestricted	12,334,466	13,558,376
Total net assets	30,539,426	31,860,436
Total liabilities and net assets	\$ 59,138,161	61,186,256

See accompanying notes to the basic financial statements

Montecito Water District
Statements of Revenues, Expenses and Changes in Net Assets
For the Year Ended June 30, 2011
With Comparative Information for the Fiscal Year Ended June 30, 2010

	<u>2011</u>	<u>2010</u>
Operating revenues:		
Water consumption sales	\$ 8,401,945	9,429,322
Monthly service fee	3,323,831	3,318,129
Other charges for services	60,728	73,863
Total operating revenues	<u>11,786,504</u>	<u>12,821,314</u>
Operating expenses:		
Source of supply – water purchases	5,744,110	5,899,687
Source of supply – operational costs	113,182	130,280
Pumping	308,660	272,086
Water treatment – Cater treatment plant	809,802	1,046,443
Water treatment – operational costs	690,253	653,968
Transmission and distribution	1,168,942	1,120,571
Customer service and meter reading	345,634	368,366
General and administrative	1,518,740	1,518,787
Total operating expenses	<u>10,699,323</u>	<u>11,010,188</u>
Operating income before depreciation	1,087,181	1,811,126
Depreciation and amortization	(1,834,008)	(1,499,657)
Operating income(loss)	<u>(746,827)</u>	<u>311,469</u>
Non-operating revenue(expense)		
Rental revenue	34,365	29,438
Picay hydroelectric power	45,124	42,406
Interest earnings	65,445	80,436
Amortization of debt premium	52,923	80,179
Interest expense	(1,015,679)	(578,696)
Amortization of deferred charges	(43,795)	(47,492)
Annexation costs	(5,254)	-
Other non-operating revenues, net	98,996	3,260
Total non-operating, net	<u>(767,875)</u>	<u>(390,469)</u>
Net loss before capital contributions	<u>(1,514,702)</u>	<u>(79,000)</u>
Capital contributions:		
Capital contributions	166,370	107,368
Connection fees	27,322	21,743
Ortega reservoir settlement	-	1,450,000
Total capital contributions	<u>193,692</u>	<u>1,579,111</u>
Change in net assets	<u>(1,321,010)</u>	<u>1,500,111</u>
Net assets, beginning of year	<u>31,860,436</u>	<u>30,360,325</u>
Net assets, end of year	<u>\$ 30,539,426</u>	<u>\$ 31,860,436</u>

See accompanying notes to the basic financial statements

Montecito Water District
Statements of Cash Flows
For the Year Ended June 30, 2011
With Comparative Information for the Fiscal Year Ended June 30, 2010

	<u>2011</u>	<u>2010</u>
Cash flows from operating activities:		
Cash receipts from customers for water sales and services	\$ 13,117,903	12,941,363
Cash paid to employees for salaries and wages	(1,921,871)	(1,951,959)
Cash paid to vendors and suppliers for materials and services	(8,775,914)	(9,052,001)
Net cash provided by operating activities	<u>2,420,118</u>	<u>1,937,403</u>
Cash flows from non-capital financing activities:		
Rental revenue	34,365	29,438
Picay hydroelectric power	45,124	42,406
Annexation costs	(5,254)	-
Net cash provided by non-capital financing activities	<u>74,235</u>	<u>71,844</u>
Cash flows from capital and related financing activities:		
Acquisition and construction of capital assets	(678,145)	(1,633,206)
Capital contributions	193,692	1,579,111
Loan proceeds	-	14,449,226
Cost of issuance	-	(121,460)
Principal paid	(867,128)	(14,110,900)
Interest paid	(838,599)	(697,306)
Net cash used in capital and related financing activities	<u>(2,190,180)</u>	<u>(534,535)</u>
Cash flows from investing activities:		
Purchase of investments	(1,191,328)	-
Interest earnings	86,345	154,056
Net cash provided(used) by investing activities	<u>(1,104,983)</u>	<u>154,056</u>
Net increase(decrease) in cash and cash equivalents	(800,810)	1,628,768
Cash and cash equivalents, beginning of year	<u>10,203,360</u>	<u>8,574,592</u>
Cash and cash equivalents, end of year	<u>\$ 9,402,550</u>	<u>10,203,360</u>
Reconciliation of cash and cash equivalents to statement of financial position:		
Cash and cash equivalents	\$ 5,957,891	5,906,927
Restricted assets – cash and cash equivalents	<u>3,444,659</u>	<u>4,296,433</u>
Total cash and cash equivalents	<u>\$ 9,402,550</u>	<u>10,203,360</u>

Continued on next page

See accompanying notes to the basic financial statements

Montecito Water District
Statements of Cash Flows, continued
For the Year Ended June 30, 2011
With Comparative Information for the Fiscal Year Ended June 30, 2010

	2011	2010
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ (746,827)	311,469
Adjustments to reconcile operating income to net cash provided by operating activities:		
Deprecation	1,834,008	1,499,657
Other non-operating income, net	98,996	3,260
Changes in assets and liabilities:		
(Increase)decrease in assets:		
Accounts receivable – water sales and services, net	167,216	177,554
Accounts receivable – reimbursements	1,065,187	(60,765)
Materials and supplies inventory	(11,087)	(3,144)
Prepaid water charges	(2,600)	(30,407)
Prepaid expenses and other deposits	(661)	(572)
Increase(decrease) in liabilities:		
Accounts payable and accrued expenses	(100,779)	(108,405)
Accrued wages and related payables	19,916	51,022
Deferred revenue and other deposits	13,909	(6,596)
Compensated absences	25,212	48,525
Other post-employment benefits payable	57,628	55,805
Total adjustments	3,166,945	1,625,934
Net cash provided by operating activities	\$ 2,420,118	1,937,403

See accompanying notes to the basic financial statements

Montecito Water District
Notes to the Basic Financial Statements
For the Year Ended June 30, 2011
With Comparative Information for the Fiscal Year Ended June 30, 2010

(1) Reporting Entity and Summary of Significant Accounting Policies

A. Organization and Operations of the Reporting Entity

The Montecito Water District was incorporated on November 10, 1921 as the Montecito County Water District under the provisions of Chapter 387, Statutes of 1913 of the State of California. The 1913 Act was superseded by the present County Water District Act found in Division 12 of the State of California Water Code. Montecito County Water District changed its name to "Montecito Water District" pursuant to Section 31006 of the Water Code. The District was formed for the purposes of furnishing potable water within the District. The District is located in the southern coastal portion of Santa Barbara County and includes the unincorporated communities of Montecito and Summerland. It has a population of approximately 13,100 and currently provides water to approximately 4,500 customers.

The criteria used in determining the scope of the financial reporting entity is based on the provisions of Governmental Accounting Statements No. 14, *The Financial Reporting Entity*, and No. 39, *Determining Whether Certain Organizations Are Component Units* (an amendment of No. 14). The District is the primary governmental unit based on the foundation of a separately elected governing board that is elected by the citizens in a general popular election. Component units are legally separate organizations for which the elected officials of the primary government are financially accountable. The District is financially accountable if it appoints a voting majority of the organization's governing body and: 1) It is able to impose its will on that organization, or 2) There is a potential for the organization to provide specific financial benefits to, or impose specific financial burdens on, the primary government. The District has no blended or discretely-presented component units.

B. Basis of Accounting and Measurement Focus

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 a private business enterprise, where the intent of the District is that the costs of providing water to its customers on a continuing basis be financed or recovered primarily through user charges (water sales and services), capital grants and similar funding. Revenues and expenses are recognized on the full accrual basis of accounting. Revenues are recognized in the accounting period in which they are earned and expenses are recognized in the period incurred, regardless of when the related cash flows take place.

Operating revenues, such as water sales and service fees, result from exchange transactions associated with the principal activities of the District. Exchange transactions are those in which each party receives and gives up essentially equal values. Non-operating revenues, such as grant funding and investment income, result from non-exchange transactions, in which, the District gives (receives) value without directly receiving (giving) value in exchange.

C. Financial Reporting

The District's basic financial statements are presented in conformance with the provisions of Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments* (GASB No. 34). This statement established revised financial reporting requirements for state and local governments throughout the United States for the purpose of enhancing the understandability and usefulness of financial reports.

GASB No. 34 and its related GASB pronouncements provide for a revised view of financial information and restructure the format of financial information provided prior to its adoption. A statement of net assets replaces the balance sheet and reports assets, liabilities, and the difference between them as net assets, not equity. A statement of revenues, expenses and changes in net assets replaces both the income statement and the statement of changes in retained earnings and contributed capital. GASB No. 34 also requires that the statement of cash flows be prepared using the direct method. Under the direct method, cash flows from operating activities are presented by major categories.

Montecito Water District
Notes to the Basic Financial Statements, continued
For the Year Ended June 30, 2011
With Comparative Information for the Fiscal Year Ended June 30, 2010

(1) Reporting Entity and Summary of Significant Accounting Policies, continued

C. Financial Reporting, continued

Under GASB No. 34, enterprise funds, such as the District, have the option of consistently following or not following pronouncements issued by the Financial Accounting Standards Board (FASB) subsequent to November 30, 1989. The District has elected not to follow FASB standards issued after that date, unless such standards are specifically adopted by GASB.

D. Assets, Liabilities and Net Assets

1. Use of Estimates

The preparation of the basic financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported changes in net assets during the reporting period. Actual results could differ from those estimates.

2. Cash and Cash Equivalents

Substantially all of the District's cash is invested in interest bearing accounts. The District considers all highly liquid investments with a maturity of three months or less to be cash equivalents.

3. Investments and Investment Policy

The District has adopted an investment policy directing management to deposit funds in financial institutions.

Changes in fair value that occur during a fiscal year are recognized as investment income reported for that fiscal year. Investment income includes interest earnings, changes in fair value, and any gains or losses realized upon the liquidation or sale of investments.

4. Accounts Receivable

The District extends credit to customers in the normal course of operations. No allowance for doubtful accounts has been established since management believes that substantially all amounts are collectible.

5. Inventory

Inventory is valued at the lower of cost (first-in, first-out) or market.

6. Prepaid Expenses

Certain payments to vendors reflects costs or deposits applicable to future accounting periods and are recorded as prepaid items in the basic financial statements.

7. Deferred Charges

The deferred charges are from bond issuance costs that will be amortized using the straight-line method over the remaining life of the respective debt service.

8. Restricted Assets

Certain assets of the District are restricted for use by ordinance or debt covenant and, accordingly are shown as restricted assets on the accompanying statement of net assets. The District uses restricted resources, prior to using unrestricted resources, to pay expenditures meeting the criteria imposed on the use of restricted resources by a third party.

Montecito Water District
Notes to the Basic Financial Statements, continued
For the Year Ended June 30, 2011
With Comparative Information for the Fiscal Year Ended June 30, 2010

(1) Reporting Entity and Summary of Significant Accounting Policies, continued

D. Assets, Liabilities and Net Assets, continued

9. Capital Assets

Capital assets acquired and/or constructed are capitalized at historical cost. District policy has set the capitalization threshold for reporting capital assets at \$1,000. Donated assets are recorded at estimated fair market value at the date of donation. Upon retirement or other disposition of capital assets, the cost and related accumulated depreciation are removed from the respective balances and any gains or losses are recognized. Depreciation is recorded on a straight-line basis over the estimated useful lives of the assets as follows:

Water supply & sources	5 - 50 years
Treatment plants	25 - 50 years
Distribution system	25 - 70 years
Reservoirs	25 - 100 years
Buildings & improvements	5 - 50 years
Office	5 - 25 years
Equipment	5 - 20 years

10. Compensated Absences

The District's personnel policies provide for accumulation of vacation and sick leave. Liabilities for vacation and sick leave are recorded when benefits are earned. Cash payment of unused vacation is available to those qualified employees when retired or terminated.

11. Net Assets

The financial statements utilize a net assets presentation. Net assets are categorized as follows:

- **Net Investment in Capital Assets** – This component of net assets consists of capital assets, net of accumulated depreciation and reduced by any debt outstanding against the acquisition, construction or improvement of those assets.
- **Restricted Net Assets** – This component of net assets consists of constraints placed on net assets use through external constraints imposed by creditors, grantors, contributors, or laws or regulations of other governments or constraints imposed by law through constitutional provisions or enabling legislation.
- **Unrestricted Net Assets** – This component of net assets consists of net assets that do not meet the definition of *restricted* or *net investment in capital assets*.

12. Water Sales

Most water sales are billed on a monthly cyclical basis. Estimated unbilled water revenue through year-end has been accrued.

13. Reclassification

The District has reclassified certain prior year information to conform to current year presentations.

Montecito Water District
Notes to the Basic Financial Statements, continued
For the Year Ended June 30, 2011
With Comparative Information for the Fiscal Year Ended June 30, 2010

(2) Cash and Investments

Cash and investments as of June 30, are classified in the accompanying financial statements as follows:

	<u>2011</u>	<u>2010</u>
Cash and cash equivalents	\$ 5,957,891	5,906,927
Restricted – cash and cash equivalents	3,444,659	4,296,433
Restricted – investments	<u>1,167,566</u>	<u>-</u>
Total cash and investments	<u>\$ 10,570,116</u>	<u>10,203,360</u>

Cash and investments as of June 30, consist of the following:

	<u>2011</u>	<u>2010</u>
Cash on hand	\$ 350	350
Deposits with financial institutions	761,123	354,710
Investments	<u>9,808,643</u>	<u>9,848,300</u>
Total cash and investments	<u>\$ 10,570,116</u>	<u>10,203,360</u>

Investments Authorized by the California Government Code and the District's Investment Policy

The following table identifies the investment types that are authorized by the District in accordance with the California Government Code (or the District's investment policy, where more restrictive). The table also identifies certain provisions of the California Government Code (or the District's investment policy, where more restrictive) that address interest rate risk, credit risk, and concentration of credit risk. This table does not address investments of debt proceeds held by bond trustees that are governed by the provisions of debt agreements of the District, rather than the general provisions of the California Government Code or the District's investment policy.

<u>Authorized Investment Type</u>	<u>Maximum Maturity</u>	<u>Maximum Percentage Of Portfolio *</u>	<u>Maximum Investment in One Issuer</u>
State and Local Agency Bonds	5 years	100%	None
U.S. Treasury Notes	5 years **	100%	None
Federal Agency Obligations	5 years **	100%	None
Banker's Acceptances	180 days	40%	30%
Commercial Paper	270 days	40%	10%
Non-negotiable Certificates of Deposit	1 year	30%	None
Negotiable Certificates of Deposit	5 years	30%	None
Medium-Term Notes	5 years	30%	None
Repurchase agreements	30 days	100%	None
Money Market Mutual Funds	N/A	20%	None
California Local Agency Investment Fund (LAIF)	N/A	100%	10%

* Excluding amounts held by bond trustee that are not subject to California Government Code restrictions.

** Except when authorized by the District's legislative body in accordance with Government Code Section 53601

Montecito Water District
Notes to the Basic Financial Statements, continued
For the Year Ended June 30, 2011
With Comparative Information for the Fiscal Year Ended June 30, 2010

(2) Cash and Investments, continued

Custodial Credit Risk

Custodial credit risk for *deposits* is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for *investments* is the risk that, in the event of the failure of the counterparty (e.g., broker-dealer) to a transaction, a government will not be able to recover the value of its investment or collateral securities that are in the possession of another party. 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).

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 or investments, other than the following provision for deposits: The California Government Code requires that a financial institution secure deposits made by state or local governmental units by pledging securities in an undivided collateral pool held by a depository regulated under state law (unless so waived by the governmental unit). The market value of the pledged securities in the collateral pool must equal at least 110% of the total amount deposited by the public agencies. California law also allows financial institutions to secure District deposits by pledging first trust deed mortgage notes having a value of 150% of the secured public deposits. Of the bank balances, up to \$250,000 is federally insured and the remaining balance is collateralized in accordance with the Code; however, the collateralized securities are not held in the District's name.

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 financial statements at 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.

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 matures or comes close to maturity evenly over time as necessary to provide requirements for 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 date:

Montecito Water District
Notes to the Basic Financial Statements, continued
For the Year Ended June 30, 2011
With Comparative Information for the Fiscal Year Ended June 30, 2010

(2) Cash and Investments, continued

Interest Rate Risk, continued

Investments at June 30, 2011, consisted of the following:

<u>Investment Type</u>	<u>Amount</u>	<u>Remaining Maturity (in Months)</u>		
		<u>12 months or less</u>	<u>13 to 24 months</u>	<u>25-60 months</u>
Local Agency Investment Fund	\$ 5,196,418	5,196,418	-	-
CCWA Investment Pool	1,868,892	1,868,892	-	-
Held by bond trustee:				
Money market funds	1,575,767	1,575,767	-	-
U.S. Treasury Notes	1,167,566	382,620	388,721	396,225
Total	\$ 9,808,643	9,023,697	388,721	396,225

Investments at June 30, 2010, consisted of the following:

<u>Investment Type</u>	<u>Amount</u>	<u>Remaining Maturity (in Months)</u>		
		<u>12 months or less</u>	<u>13 to 24 months</u>	<u>25-60 months</u>
Local Agency Investment Fund	\$ 5,555,082	5,555,082	-	-
CCWA Investment Pool	1,764,860	1,764,860	-	-
Held by bond trustee:				
Money market funds	2,528,358	2,528,358	-	-
Total	\$ 9,848,300	9,848,300	-	-

Credit Risk

Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. Presented below is the minimum rating required by (where applicable) the California Government Code, the District's investment policy, or debt agreements, and the actual rating as of year end for each investment type.

Credit ratings at June 30, 2011, consisted of the following:

<u>Investment Type</u>	<u>Amount</u>	<u>Minimum</u>	<u>Exempt</u>	<u>Ratings</u>
		<u>Legal</u>	<u>From</u>	<u>AAA</u>
		<u>Rating</u>	<u>Disclosure</u>	
Local Agency Investment Fund	\$ 5,196,418	N/A	5,196,418	-
CCWA Investment Pool	1,868,892	N/A	1,868,892	-
Held by bond trustee:				
Money market funds	1,575,767	N/A	1,575,767	-
U.S. Treasury Notes	1,167,566	AAA	-	1,167,566
Total	\$ 9,808,643		8,641,077	1,167,566

Credit ratings at June 30, 2010, consisted of the following:

<u>Investment Type</u>	<u>Amount</u>	<u>Minimum</u>	<u>Exempt</u>	<u>Ratings</u>
		<u>Legal</u>	<u>From</u>	<u>AAA</u>
		<u>Rating</u>	<u>Disclosure</u>	
Local Agency Investment Fund	\$ 5,555,082	N/A	5,555,082	-
CCWA Investment Pool	1,764,860	N/A	1,764,860	-
Held by bond trustee:				
Money market funds	2,528,358	N/A	2,528,358	-
Total	\$ 9,848,300		9,848,300	-

Montecito Water District
Notes to the Basic Financial Statements, continued
For the Year Ended June 30, 2011
With Comparative Information for the Fiscal Year Ended June 30, 2010

(3) Deferred Charges

The balance consists of the following issuance costs, net:

	<u>2011</u>	<u>2010</u>
2010A COPs	\$ 520,192	545,341
DWR (BVTP) loan issuance	49,878	62,019
2004 COMB bond issuance	<u>1,606</u>	<u>3,089</u>
Total	<u>\$ 571,676</u>	<u>610,449</u>

(4) Capital Assets

Changes in capital assets for the year were as follows:

	<u>Balance 2010</u>	<u>Additions/</u>	<u>Deletions/ Transfers</u>	<u>Balance 2011</u>
Non-depreciable assets:				
Land	\$ 101,352	-	-	101,352
Construction-in-process	12,679,492	800,365	(1,438,620)	12,041,237
Total non-depreciable assets	<u>12,780,844</u>	<u>800,365</u>	<u>(1,438,620)</u>	<u>12,142,589</u>
Depreciable assets:				
Transmission and distribution system	24,006,093	1,413,221	-	25,419,314
Juncal dam	2,071,075	12,072	-	2,083,147
Wells and water sources	3,541,123	2,290	-	3,543,413
Water rights	142,234	-	-	142,234
Bella Vista treatment plant	5,280,446	3,161	-	5,283,607
Cater treatment plant	8,574,312	(294,802)	-	8,279,510
Other treatment plants and facilities	395,099	-	-	395,099
Reservoirs and storage tanks	1,919,460	4,412	-	1,923,872
Meters and meter boxes	1,583,877	43,571	(418,560)	1,208,888
Structures and improvements	340,217	39,320	(19,058)	360,479
Machinery and equipment	<u>2,102,922</u>	<u>93,155</u>	<u>(320,775)</u>	<u>1,875,302</u>
Total depreciable assets	<u>49,956,858</u>	<u>1,316,400</u>	<u>(758,393)</u>	<u>50,514,865</u>
Accumulated depreciation:				
Transmission and distribution system	(5,990,687)	(408,572)	-	(6,399,259)
Juncal dam	(1,320,089)	(23,955)	-	(1,344,044)
Wells and water sources	(2,407,526)	(108,566)	-	(2,516,092)
Water rights	-	(142,234)	-	(142,234)
Bella Vista treatment plant	(3,088,167)	(225,094)	-	(3,313,261)
Cater treatment plant	(3,726,986)	(552,872)	-	(4,279,858)
Other treatment plants and facilities	(327,726)	(15,873)	-	(343,599)
Reservoirs and storage tanks	(1,003,149)	(27,233)	-	(1,030,382)
Meters and meter boxes	(944,808)	(75,671)	418,560	(601,919)
Structures and improvements	(277,127)	(13,167)	19,058	(271,236)
Machinery and equipment	<u>(1,550,903)</u>	<u>(240,771)</u>	<u>320,775</u>	<u>(1,470,899)</u>
Total accumulated depreciation	<u>(20,637,168)</u>	<u>(1,834,008)</u>	<u>758,393</u>	<u>(21,712,783)</u>
Total depreciable assets, net	<u>29,319,690</u>	<u>(517,608)</u>	<u>-</u>	<u>28,802,082</u>
Total capital assets, net	<u>\$ 42,100,534</u>	<u>282,757</u>	<u>(1,438,620)</u>	<u>40,944,671</u>

Montecito Water District
Notes to the Basic Financial Statements, continued
For the Year Ended June 30, 2011
With Comparative Information for the Fiscal Year Ended June 30, 2010

(4) Capital Assets, continued

Construction-In-Process

The District has been involved in various construction projects throughout the year. The balances of the various construction projects that comprise the construction-in-process balances at June 30 are as follows:

The balance at June 30, consists of the following projects:

	<u>2010</u>	<u>2011</u>
Water Avail Chrg/Initial Plan	\$ 211,243	-
Pressure Regulators	180,722	180,722
Olive Rd. Main Replacement	106,390	-
Ortega Reservoir Project	10,177,775	10,156,157
Doulton TP Expansion	120,464	120,464
GIS Distribution System	462,618	473,465
Alder Flume Rehab/Replacement	74,219	77,452
Jameson Lake Auxlry Ridge	96,728	73,674
Barker Pass Pump Elec Upgrade	10,960	227,810
Ortega Leak Repairs	-	257,327
Birnam Wood Deep Well	-	106,716
Capitalized interest	1,072,469	-
Various Projects	165,904	367,450
	<u>\$ 12,679,492</u>	<u>12,041,237</u>

(5) Compensated Absences

The changed to compensated absences balances at June 30, were as follows:

<u>Balance 2010</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance 2011</u>	<u>Current Portion</u>	<u>Long-term Portion</u>
\$ 338,947	173,049	(147,837)	364,159	91,040	273,119
<u>338,947</u>	<u>173,049</u>	<u>(147,837)</u>	<u>364,159</u>	<u>91,040</u>	<u>273,119</u>
<u>Balance 2009</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance 2010</u>	<u>Current Portion</u>	<u>Long-term Portion</u>
\$ 343,637	190,331	(195,021)	338,947	84,737	254,210
<u>343,637</u>	<u>190,331</u>	<u>(195,021)</u>	<u>338,947</u>	<u>84,737</u>	<u>254,210</u>

Montecito Water District
Notes to the Basic Financial Statements, continued
For the Year Ended June 30, 2011
With Comparative Information for the Fiscal Year Ended June 30, 2010

(6) Long-term Debt

Changes in long-term debt amounts for 2011 were as follows:

	<u>Balance 2010</u>	<u>Additions/ Adjustments</u>	<u>Principal Payments</u>	<u>Balance 2011</u>
Long-term debt:				
2010A COPs	\$ 13,360,000	-	-	13,360,000
2010A COPs premium	1,005,481	-	(52,923)	952,558
COMB 2004 Revenue Bonds	110,000	-	(75,000)	35,000
DWR Bella Vista Loan	1,294,384	-	(275,635)	1,018,749
DWR Cater Loan	2,802,521	-	(155,957)	2,646,564
DWR Ortega Loan	9,236,660	-	(360,536)	8,876,124
Total long-term debt	\$ 27,809,046	-	(920,051)	26,888,995
Less current portion	(827,126)			(766,400)
Non-current portion	\$ 26,981,920			26,122,595

Changes in long-term debt amounts for 2010 were as follows:

	<u>Balance 2009</u>	<u>Additions/ Adjustments</u>	<u>Principal Payments</u>	<u>Balance 2010</u>
Long-term debt:				
1998A COPs	\$ 13,690,000	-	(13,690,000)	-
2010A COPs	-	13,360,000	-	13,360,000
2010A COPs premium	-	1,085,660	(80,179)	1,005,481
COMB 2004 Revenue Bonds	110,000	-	-	110,000
DWR Bella Vista Loan	1,563,174	-	(268,790)	1,294,384
DWR Cater Loan	2,954,631	-	(152,110)	2,802,521
DWR Ortega Loan	9,236,660	-	-	9,236,660
Total long-term debt	\$ 27,554,465	14,445,660	(14,191,079)	27,809,046
Less current portion	(811,735)			(827,126)
Non-current portion	\$ 26,742,730			26,981,920

1998 Certificates of Participation

In 1998, \$13,690,000 1998A revenue certificates of participation were issued. Payments of interest only are due through 2010. Annual principal payments of \$340,000 to \$1,290,000 plus interest are due beginning for the year ending June 30, 2013 and end June 30, 2027 with a true interest cost of 5.37% over the life of the bonds. On April 8, 2010, the District refinanced the 1998 COPs with the 2010A COPs.

Montecito Water District
Notes to the Basic Financial Statements, continued
For the Year Ended June 30, 2011
With Comparative Information for the Fiscal Year Ended June 30, 2010

(6) Long-term Debt, continued

2010A Refunding Revenue Certificates of Participation

In 2010, \$13,360,000 2010A refunding revenue certificates of participation were issued for the purpose of refinancing the 1998A Revenue Certificates of Participation. Scheduled annual interest payments are \$690,463 for the years ending June 30, 2011 through June 30, 2022. Annual principal payments of \$1,385,000 to \$1,990,000 plus interest are due beginning for fiscal year 2023 and end in fiscal year 2030 with a true interest cost of 5.25% over the life of the bonds. Annual debt service payments are as follows:

<u>Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2012	\$ -	690,462	690,462
2013	-	690,463	690,463
2014	-	690,462	690,462
2015	-	690,463	690,463
2016	-	690,462	690,462
2017-2021	-	3,452,313	3,452,313
2022-2026	5,990,000	2,870,293	8,860,293
2027-2030	<u>7,370,000</u>	<u>799,313</u>	<u>8,169,313</u>
Total	\$ 13,360,000	<u>10,574,231</u>	<u>23,934,231</u>
Less current:	<u>-</u>		
Long-term	<u>\$ 13,360,000</u>		

2004 Cachuma Operations and Maintenance Board Revenue Refunding Bonds

On August 18, 2004, \$260,000 Cachuma Operations and Maintenance Board (COMB) Revenue Refunding Bonds were issued. These bonds are due in annual installments beginning on January 1, 2006 and ending on July 1, 2012 with a rate of interest of 4%. Interest expense of \$3,000 and \$4,400 was reported for the year ending June 30, 2011 and 2010, respectively. The remaining installment of the bonds is \$35,000 due on July 1, 2012.

Montecito Water District
Notes to the Basic Financial Statements, continued
For the Year Ended June 30, 2011
With Comparative Information for the Fiscal Year Ended June 30, 2010

(6) Long-term Debt, continued

Department of Water Resources – Bella Vista Treatment Plant Contract

In December 1993, the District entered into a loan agreement with the Department of Water Resources (DWR) for a loan of \$3,990,000, which was increased to \$4,818,450 in August 1994, including a 5% administrative fee. The proceeds from this loan were used to refinance the District's construction loan and pay other costs related to the Bella Vista Treatment Plant construction. California Bank & Trust is the fiscal agent responsible for acting as trustee for the loan repayment with semi-annual payments of \$152,634 including principal and interest at the rate of 2.4175% per annum. Loan payments commenced when the loan became fully funded, and the first payment was made April 1, 1995.

The loan is due October 2014, and is secured by real property and water sales. The contract between the DWR and the District requires a reserve fund of two semi-annual payments to be accumulated within ten years. Annual debt service payments are as follows:

<u>Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2012	\$ 282,295	22,974	305,269
2013	289,539	15,730	305,269
2014	296,238	9,031	305,269
2015	<u>150,677</u>	<u>1,826</u>	<u>152,503</u>
Total	\$ 1,018,749	<u>49,561</u>	<u>1,068,310</u>
Less current:	<u>(282,295)</u>		
Long-term	<u>\$ 736,454</u>		

Department of Water Resources – Cater Treatment Plant Contract

The District currently obtains approximately 50% of its water supplies from the Cachuma Project. These surface water supplies are treated at the City of Santa Barbara's Cater Water Filtration Plant. The District entered into a joint powers agreement with the City of Santa Barbara, effective November 1, 2003, in which the District agreed to participate in a California Drinking Water State Revolving Fund contract financing totaling \$19.2 million to fund improvements required at the Cater Treatment plant. The District's share is estimated to be 19.7% or \$3.8 million to be financed over 20 years. Interest is payable semiannually at a rate of 2.5132% per annum. The District's annual payments for its share of the debt service are \$225,416 per year. In December 2004, the Cater Treatment Plant project was complete and principal payments on the loan began on January 1, 2006. Annual debt service payments are as follows:

<u>Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2012	\$ 79,452	33,256	112,708
2013	161,911	63,505	225,416
2014	166,005	59,411	225,416
2015	170,203	55,213	225,416
2016	174,508	50,908	225,416
2017-2021	941,014	186,066	1,127,080
2022-2026	<u>953,471</u>	<u>60,901</u>	<u>1,014,372</u>
Total	\$ 2,646,564	<u>509,260</u>	<u>3,155,824</u>
Less current:	<u>(79,452)</u>		
Long-term	<u>\$ 2,567,112</u>		

Montecito Water District
Notes to the Basic Financial Statements, continued
For the Year Ended June 30, 2011
With Comparative Information for the Fiscal Year Ended June 30, 2010

(6) Long-term Debt, continued

Department of Water Resources – Ortega Reservoir Improvement Project Contract

In December of 2003, the District entered into a funding agreement, along with Carpentaria Valley Water District, with the Department of Water Resources (DWR) for a loan of \$10,800,000, which was increased to \$19,900,000 in July of 2006. The District's share of this loan is 50% of the total amount, which is a total of \$9,950,000. The proceeds from this loan were being used to refinance the construction of a roof on the Ortega Reservoir which will enable the District to meet safe drinking water standards established pursuant to Chapter 4, commencing with Section 116270, of Part 12, of Division 104 of the Health and Safety Code and California Code of Regulations. California Bank & Trust is the fiscal agent responsible for acting as trustee for the loan repayment with semi-annual payments of \$295,210 including principal and interest at an annual rate of 2.5132%. The District will be required to fund its share of a reserve fund equal to two semiannual payments. The funds are to be accumulated within a ten year period and be held by a trustee. Annual debt service payments are as follows:

<u>Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2012	\$ 369,653	220,767	590,420
2013	379,002	211,418	590,420
2014	388,586	201,834	590,420
2015	398,414	192,006	590,420
2016	408,489	181,931	590,420
2017-2021	2,202,728	749,372	2,952,100
2022-2026	2,495,716	456,384	2,952,100
2027-2030	2,233,536	128,144	2,361,680
Total	\$ 8,876,124	2,341,856	11,217,980
Less current:	(369,653)		
Long-term	\$ 8,506,471		

Montecito Water District
Notes to the Basic Financial Statements, continued
For the Year Ended June 30, 2011
With Comparative Information for the Fiscal Year Ended June 30, 2010

(7) Net Assets

Calculation of net assets as of June 30, were as follows:

	<u>2011</u>	<u>2010</u>
Net investment in capital assets:		
Capital assets, not being depreciated	\$ 12,142,589	12,780,844
Depreciable capital assets, net	28,802,082	29,319,690
Current:		
Bonds payable	(35,000)	(35,000)
Loans payable	(811,848)	(792,126)
Non-current:		
Bonds payable	(14,312,558)	(14,440,482)
Loans payable	(11,729,589)	(12,541,438)
Total net investment in capital assets	<u>14,055,676</u>	<u>14,291,488</u>
Restricted net assets:		
Restricted - cash and cash equivalents	3,444,659	4,296,433
Restricted - investments	1,167,566	-
Accrued interest payable	(462,941)	(285,861)
	<u>4,149,284</u>	<u>4,010,572</u>
Unrestricted net assets:		
Non-spendable net assets:		
Deferred charges, net	571,676	610,449
Materials and supplies inventory	187,950	176,863
Prepaid water charges	5,168,348	5,165,748
Prepaid expenses and other deposits	31,741	31,080
Total non-spendable net assets	<u>5,959,715</u>	<u>5,984,140</u>
Spendable net assets are designated as follows:		
Operating reserve	<u>6,374,751</u>	<u>7,574,236</u>
Total spendable net assets	<u>6,374,751</u>	<u>7,574,236</u>
Total unrestricted net assets	<u>12,334,466</u>	<u>13,558,376</u>
Total net assets	<u>\$ 30,539,426</u>	<u>31,860,436</u>

Montecito Water District
Notes to the Basic Financial Statements, continued
For the Year Ended June 30, 2011
With Comparative Information for the Fiscal Year Ended June 30, 2010

(8) Deferred Compensation Savings Plan

For the benefit of its employees, the District participates in a 457 Deferred Compensation Program (Program). The purpose of this Program is to provide deferred compensation for public employees that elect to participate in the Program. Generally, eligible employees may defer receipt of a portion of their salary until termination, retirement, death or unforeseeable emergency. Until the funds are paid or otherwise made available to the employee, the employee is not obligated to report the deferred salary for income tax purposes.

Federal law requires deferred compensation assets to be held in trust for the exclusive benefit of the participants. Accordingly, the District is in compliance with this legislation. Therefore, these assets are not the legal property of the District, and are not subject to claims of the District's general creditors. Market value of all plan assets held in trust are \$2,008,631 and \$1,794,638 as of June 30, 2011 and 2010, respectively.

The District has implemented GASB Statement No. 32, *Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans*. Since the District has little administrative involvement and does not perform the investing function for this plan, the assets and related liabilities are not shown on the statement of net assets.

(9) Defined Benefit Pension Plan

Plan Description

The District contributes to the California Public Employees Retirement System (CalPERS), a cost-sharing multiple-employer defined benefit pension plan. CalPERS provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. CalPERS acts as a common investment and administrative agent for participating public agencies within the State of California. Benefit provisions and all other requirements are established by state statute and the District. Copies of CalPERS annual financial report may be obtained from their executive Office: 400 P Street, Sacramento, CA, 95814.

Funding Policy

The contribution rate for plan members in the CalPERS 2.0% at 55 Risk Pool Retirement Plan is 7% of their annual covered salary. The District makes these contributions required of District employees on their behalf and for their account. Also, the District is required to contribute the actuarially determined remaining amounts necessary to fund the benefits for its members. The required employer contribution rates are equal to the annual pension cost (APC) percentage of payroll for fiscal years 2011, 2010 and 2009 as noted below. The contribution requirements of the plan members are established by State statute, and the employer contribution rate is established and may be amended by CalPERS. For fiscal years 2011, 2010 and 2009, the District's annual contributions for the CalPERS plan were equal to the District's required and actual contributions for each fiscal year as follows:

Three Years CalPERS Funding Information

Fiscal Year	Annual Pension cost (APC)	Percentage of APC Contributed	Net Pension Obligation	APC Percentage of Payroll
2008-2009	\$ 234,781	100%	-	12.626%
2009-2010	225,663	100%	-	12.486%
2010-2011	237,454	100%	-	12.896%

Montecito Water District
Notes to the Basic Financial Statements, continued
For the Year Ended June 30, 2011
With Comparative Information for the Fiscal Year Ended June 30, 2010

(10) Other Post Employment Benefits Payable

During the year ended June 30, 2009, the District implemented GASB Statement No. 45, which changed the accounting and financial reporting used by local government employers for post employment benefits. Previously, the costs of such benefits were generally recognized as expenses of local government employers on a pay-as-you-go basis. The new reporting requirements for these benefit programs as they pertain to the District are set forth below.

Plan Description – Eligibility

The District administers its post-employment benefits plan, a single-employer defined benefit plan (Plan). The following requirements must be satisfied in order to be eligible for post employment medical, dental and vision benefits: (1) Attainment of age 55, and 20 years for full-time service, and (2) Retirement from the District (the District must be the last employer prior to retirement).

Membership in the OPEB plan consisted of the following members as of June 30:

	2011	2010	2009
Active employees	24	24	25
Retirees receiving benefits	6	7	6
	30	31	31

Plan Description – Benefits

The District offers post employment medical, dental and vision benefits to retired employees who satisfy the eligibility rules. Retirees may enroll in any plan available through CalPERSD medical, dental and vision programs. The contribution requirements of Plan members and the District are established and may be amended by the Board of Directors.

Funding Policy

The District is required to contribute the *Annual Required Contribution (ARC) of the Employer*, an amount actuarially determined in accordance with the parameters of GASB Statement No. 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover the normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years. The current ARC rate is 4.3% for 2011 and 7.4% for 2010 of the annual covered payroll.

The District will pay 100% of the cost of the post-employment benefit plan. The District funds the plan on a pay-as-you-go basis and maintains reserves (and records a liability) for the difference between pay-as-you-go and the actuarially determined ARC cost.

Annual Cost

For the years ended June 30, 2011 and 2010, the ARC cost is \$85,285, and \$28,104, or 32.9%, in contributions were made and the ARC cost is \$85,518, and \$15,314, or 17.9%, in contributions were made, respectively. The net other post-employment payable as of June 30, 2011 and 2010 are \$202,357 and \$144,729, respectively.

Montecito Water District
Notes to the Basic Financial Statements, continued
For the Year Ended June 30, 2011
With Comparative Information for the Fiscal Year Ended June 30, 2010

(10) Other Post Employment Benefits Payable, continued

Annual Cost, continued

The balance at June 30, consists of the following:

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Annual OPEB expense:			
Annual required contribution (ARC)	\$ 84,285	84,285	84,285
Interest on net OPEB obligation	7,236	4,214	-
Adjustment to annual required contribution	<u>(5,789)</u>	<u>(2,981)</u>	<u>-</u>
Total annual OPEB expense	85,732	85,518	84,285
Change in net OPEB payable obligation:			
Age adjusted contributions made	<u>(28,104)</u>	<u>(15,314)</u>	<u>(9,760)</u>
Total change in net OPEB payable obligation	57,628	70,204	74,525
OPEB payable - beginning of year	<u>144,729</u>	<u>74,525</u>	<u>-</u>
OPEB payable - end of year	<u>\$ 202,357</u>	<u>144,729</u>	<u>74,525</u>

The District's annual OPEB cost, the percentage of the annual OPEB cost contributed to the Plan, and the net OPEB obligation for fiscal year 2011 and the two preceding years were as follows:

<i>Three-Year History of Net OPEB Obligation</i>				
<u>Fiscal Year Ended</u>	<u>Annual OPEB Cost</u>	<u>Age Adjusted Contribution</u>	<u>Percentage of Annual OPEB Cost Contributed</u>	<u>Net OPEB Obligation Payable</u>
2011	\$ 85,732	28,204	32.9%	\$ 202,357
2010	85,518	15,314	17.9%	144,729
2009	84,285	9,760	11.6%	74,525

(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 disasters. The District is a member of the Association of California Water Agencies/Joint Powers Insurance Authority (ACWA/JPIA), an intergovernmental risk sharing joint powers authority created to provide self-insurance programs for California water agencies. The purpose of the ACWA/JPIA is to arrange and administer programs of self-insured losses and to purchase the appropriate amount of insurance coverage. At June 30, 2011, the District participated in the liability and property programs of the ACWA/JPIA as follows:

- General and auto liability: The District has a zero deductible for general and auto liability. The District purchased additional excess coverage layers: \$60 million for general, auto and public officials liability, which increases the limits on the insurance coverage noted above.
- In addition to the above, the District also has the following insurance coverage:
- Employee dishonesty coverage and public officials' liability up to \$2,000,000 per loss includes public employee dishonesty, forgery or alteration and theft, computer fraud coverage's.

Montecito Water District
Notes to the Basic Financial Statements, continued
For the Year Ended June 30, 2011
With Comparative Information for the Fiscal Year Ended June 30, 2010

(11) Risk Management, continued

- Property loss/Boiler & Machinery is paid based on the replacement cost or actual cash value for the property on file. If the property is replaced within two years after the loss or otherwise paid on an actual cash value basis, to a combined total of \$100 million subject to a \$1,000 deductible per occurrence.
- Workers' compensation insurance provides coverage with a self-insured retention limit of \$2 million for all work related injuries/illnesses covered by California law.

Settled claims have not exceeded any of the coverage amounts in any of the last three fiscal years and there were no reductions in the District's insurance coverage during the years ending June 30, 2011, 2010 and 2009. Liabilities are recorded when it is probable that a loss has been incurred and the amount of the loss can be reasonably estimated net of the respective insurance coverage. Liabilities include an amount for claims that have been incurred but not reported (IBNR). There were no IBNR claims payable as of June 30, 2011, 2010 and 2009.

(12) Governmental Accounting Standards Board Statements Issued, Not Yet Effective

The Governmental Accounting Standards Board (GASB) has issued several pronouncements prior to June 30, 2011, that have effective dates that may impact future financial presentations.

Governmental Accounting Standards Board Statement No. 60

In November 2010, the GASB issued Statement No.60, *Accounting and Financial Reporting for Service Concession Arrangements*. This standard address how to account for and report service concession arrangements (SCAs), a type of public-private or public-public partnership that state and local governments are increasingly entering into. This statement is effective for financial statements for periods beginning after December 15, 2011. The impact of the implementation of this Statement to the District's financial statements has not been assessed at this time.

Governmental Accounting Standards Board Statement No. 61

In November 2010, the GASB issued Statement No.61, *The Financial Reporting Entity, Omnibus*. This standard is designed to improve financial reporting for governmental entities by amending the requirements of GASB Statement No. 14, *The Financial Reporting Entity*, and GASB Statement No. 34, *Basic Financial Statement and Management's Discussion and Analysis for State and local Governments*. This statement is effective for financial statements for periods beginning after December 15, 2011. The impact of the implementation of this Statement to the District's financial statements has not been assessed at this time.

Governmental Accounting Standards Board Statement No. 63

In June 2011, the GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. This standard is designed to improve financial reporting by standardizing the presentation of deferred outflows of resources and deferred inflows of resources into the definitions of the required components of the residual measure and by renaming that measure as net position, rather than net assets. This statement is effective for financial statements for periods beginning after December 15, 2011. The impact of the implementation of this Statement to the District's financial statements has not been assessed at this time.

Governmental Accounting Standards Board Statement No. 64

In June 2011, the GASB issued Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions – an amendment of GASB Statement No. 53*. This standard is designed to improve financial reporting by clarifying the circumstances in which hedge accounting should continue when a swap counterparty, or swap counterparty's credit support provider, is replaced. This statement is effective for financial statements for periods beginning after December 15, 2011. The impact of the implementation of this Statement to the District's financial statements has not been assessed at this time.

Montecito Water District
Notes to the Basic Financial Statements, continued
For the Year Ended June 30, 2011
With Comparative Information for the Fiscal Year Ended June 30, 2010

(13) Commitments and Contingencies

State Water Contract

On June 4, 1991, the voters of the District approved participation in the California State Water Project (WP). As a result the District joined in the formation of the Central Coast Water Authority (CCWA) in September 1991. The purpose of the CCWA is to provide for the financing, construction, operation and maintenance of certain local (non-state owned) facilities required to deliver water from the SWP to certain water purveyors and users in Santa Barbara County.

Each Santa Barbara County State Water Project participant, including the District, has entered into a Water Supply Agreement in order to provide for the development, financing, construction, operation and maintenance of the CCWA Project. The purpose of the Water Supply Agreements is to assist in carrying out the purposes of CCWA with respect to the CCWA Project by: (1) requiring CCWA to sell, and the Santa Barbara County State Water Project participants to buy, a specified amount of water from CCWA (“take or pay”); and (2) assigning the Santa Barbara County State Water Project participant’s entitlement rights in the SWP to CCWA. Although the District does have an ongoing financial responsibility pursuant to the Water Supply Agreement between the District and CWA, the District does not have an equity interest as defined by FASB Code Sec. J50.105.

Each Santa Barbara State Water Project participant is required to pay to CCWA an amount equal to its share of total cost of “fixed project costs” and certain other costs in the proportion established in the Water Supply Agreement. This includes the Santa Barbara Project participant’s share of payments to the State Department of Water Resources (DWR) under the State Water Supply Contract (including capital, operation, maintenance, power and replacement costs of the DWR facilities), debt service on CCWA bonds and all CCWA operating and administrative costs.

Each Santa Barbara County Project participant is required to make payments under its Water Supply Agreement solely from the revenues of its water system. Each participant has agreed in its Water Supply Agreement to fix, prescribe and collect rates and charges for its water system which will be at least sufficient to yield each fiscal year net revenues equal to 125% of the sum of (1) the payments required pursuant to the Water Supply Agreement, and (2) debt service on any existing participant obligation for which revenues are also pledged.

CCWA is composed of eight members, all of which are public agencies. CCWA was organized and exists under a joint exercise of powers agreement among the various participating public agencies. The Board of Directors is made up of one representative from each participating entity. Votes on the Board are apportioned between the entities based upon each entity’s pro-rata share of the water provided by the project. The District’s share of the project based upon number of acre-feet of water is 7.78% and entitles the District to 3,000 acre-feet of water per year from the SWP plus 300 acre-feet of drought capacity. Operating and capital expenses are allocated among the members based upon various formulas recognizing the benefits of the various project components to each member.

On October 1, 1992, CCWA sold \$177.1 million in revenue bonds at a true interest cost of 6.64% to enable CCWA to finance a portion of the costs of constructing a water treatment plant to treat State water for use by various participating water purveyors and users within Santa Barbara and San Luis Obispo Counties, a transmission system to deliver such water to the participating water purveyors and users within Santa Barbara County, and certain local improvements to the water systems of some of the participating purveyors. The District’s share of bonds issued for this project is \$27.1 million.

Montecito Water District
Notes to the Basic Financial Statements, continued
For the Year Ended June 30, 2011
With Comparative Information for the Fiscal Year Ended June 30, 2010

(13) Commitments and Contingencies, continued

State Water Contract, continued

In November 1996, CCWA sold \$198.0 million of revenue bonds at a true interest cost of 5.55% to defease CCWA's \$177.1 million 1992 revenue bonds and to pay certain costs of issuing the bonds. The 1996 bonds were issued in two series: Series A of \$173.0 million and Series B of \$25.0 million. The Series B bonds are subject to mandatory redemption from amounts transferred from the Construction and Reserve Funds upon completion of the construction of CCWA facilities. On June 25, 1998, the project was deemed complete and the Series B bonds were redeemed in October 1998. The District's share of the Series A bonds issued is \$28.7 million.

On September 28, 2006 the Central Coast Water Authority (CCWA) issued Series 2006A refunding revenue bonds in the amount of \$123,190,000. This refunded the outstanding \$142,985,000 Series 1996A revenue bonds. The 2006A revenue bonds were issued at a true interest cost of 4.24% and were issued to reduce the Authority's total debt service payments over the next 15 years by \$4.4 million, and to obtain an economic gain (difference between the present values of the old and new debt service payments) of \$3.4 million. The District's share of the Series 2006A refunding revenue bonds issued is \$20.3 million.

<u>Fiscal Year</u>	<u>Fixed Costs</u>	<u>Variable Costs</u>	<u>Debt Service</u>	<u>Total</u>
2012	\$ 2,836,027	881,735	2,036,339	5,754,101
2013	2,886,633	881,736	2,044,306	5,812,675
2014	2,998,713	848,904	2,034,336	5,881,953
2015	3,125,762	-	2,033,299	5,159,061
2016 - 2020	15,474,418	-	10,143,660	25,618,078
2021 - 2025	15,791,541	-	4,040,573	19,832,114
2026 - 2030	15,459,010	-	-	15,459,010
2031 - 2035	14,240,100	-	-	14,240,100
2035 - 2036	1,646,452	-	-	1,646,452
	<u>\$ 74,458,656</u>	<u>2,612,375</u>	<u>22,332,513</u>	<u>99,403,544</u>

The above numbers are estimated based upon the following assumptions. The fixed costs after 2011 are estimated to increase 3% annually and are projected to the year 2036. No variable costs are assumed after 2012 because delivery requests are not made beyond that year. The debt service payments are based upon estimated final debt service schedules and are subject to change.

The projected required costs of State Water Project for the District do not reflect the effects of prepayments and credits held at CCWA. The Districts and credits lower the future of payments to CCWA for the State Water Project.

Montecito Water District
Notes to the Basic Financial Statements, continued
For the Year Ended June 30, 2011
With Comparative Information for the Fiscal Year Ended June 30, 2010

(13) Commitments and Contingencies, continued

State Water Contract, continued

Estimates of the District's share of the project fixed costs of the State Water Project (SWP) are provided annually by the State. The estimates are subject to future increases or decreases resulting from changes in planned facilities, refinements in cost estimates and inflation. During the next four years payments under the State Water Contract, exclusive of variable power costs, are currently estimated by the State to be as follows:

<u>Fiscal Year</u>	<u>Amount</u>
2012	\$ 5,352,201
2013	5,774,062
2014	5,756,304
2015	<u>5,859,538</u>
Total	<u>\$ 22,742,105</u>

Additional information and complete financial statements for the CCWA are available for public inspection at 255 Industrial Way, Buellton, CA, between the hours of 8 a.m. and 5 p.m., Monday through Friday.

Cachuma Project

The United States Department of the Interior, Bureau of Reclamation ("USBR") entered into an agreement on September 12, 1949 with the Santa Barbara County Water Agency (the "County") and constructed the Cachuma Project on the Santa Ynez River. The District entered into an agreement with the County to purchase water from those facilities. The agreement fixes charges for water furnished to repay the capital costs, and to pay the costs to operate and maintain works and facilities at Lake Cachuma and Bradbury Dam. Both these contracts were renewed in 1995.

Construction Contracts

The District has a variety of agreements with private parties relating to the installation, improvement or modification of water facilities and distribution systems within its service area.

Litigation

In the ordinary course of operations, the District is subject to claims and litigation from outside parties. After consultation with legal counsel, the District believes that there are no legal matters that will materially affect its financial condition.

(14) Subsequent Events

Events occurring after June 30, 2011 have been evaluated for possible adjustment to the financial statements or disclosure as of October 31, 2011, which is the date the financial statements were available to be issued.

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Required Supplementary Information

Montecito Water District
Schedule of Funding Status – Other Post-Employment Benefits Obligation
For the Year Ended June 30, 2011
With Comparative Information for the Fiscal Year Ended June 30, 2010

Funded Status and Funding Progress of the Plan

Required Supplemental Information - Schedule of Funding Progress

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (b)	Unfunded Actuarial Accrued Liability (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
2/28/2009	-	1,228,344	1,228,344	0.00%	1,951,959	62.93%

The most recent valuation (dated February 28, 2009) includes an Actuarial Accrued Liability and Unfunded Actuarial Accrued Liability of \$1,228,344. The covered payroll (annual payroll of active employees covered by the plan) for the year ended June 30, 2009 was estimated at \$1,951,959. The ratio of the unfunded actuarial accrued liability to annual covered payroll is 62.93%.

Actuarial Methods and Assumptions

Actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of events far into the future. Actuarially determined amounts are subject to continual revision as actual results are compared to past expectations and new estimates are made about the future. Calculations are based on the types of benefits provided under the terms of the substantive plan at the time of each valuation and the pattern of sharing of costs between the employer and plan members to that point. Consistent with the long-term perspective of actuarial calculations, actuarial methods and assumptions used include techniques that are designed to reduce short-term volatility in actuarial accrued liabilities for benefits.

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

Valuation date	2/28/2009
Actuarial cost method	Entry age normal cost method
Amortization method	Level percent of payroll amortization
Remaining amortization period	30 Years as of the valuation date
Asset valuation method	30 Year smoothed marked
Actuarial assumptions:	
Investment rate of return	5.00%
Projected salary increase	3.00%
Inflation - discount rate	4.00%
Individual salary growth	District annual COLA

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Report on Internal Controls and Compliance



Charles Z. Fedak, CPA, MBA
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Independent Auditor's Report on Internal Control Over Financial Reporting And on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

Board of Directors
Montecito Water District
Montecito, California

We have audited the basic financial statements of the Montecito Water District (District) as of and for the year ended June 30, 2011, and have issued our report thereon dated October 31, 2011. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

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

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the District's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audits and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the Board of Directors and management and is not intended to be and should not be used by anyone other than these specified parties.

Charles Z. Fedak & Company CPAs - An Accountancy Corporation

Charles Z. Fedak and Company, CPA's – An Accountancy Corporation
October 31, 2011
Cypress, California