

Mission Hills Community Services District

Financial Statements

Year Ended June 30, 2013

**Mission Hills Community Services District
Financial Statements
Year Ended June 30, 2013**

Table of Contents

	Page
Independent Auditors' Report	3-5
Management's Discussion and Analysis	6-10
Statement of Net Position	11
Statement of Revenues, Expenses and Changes in Net Position	12
Statement of Cash Flows	13
Notes to Financial Statements	14-21
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>	22-23
Schedule of Findings and Recommendations	24-25
<i>Supplemental Information</i>	
Schedule of Directors	27
Combining Enterprise Funds Statement of Net Position (Deficit)	28
Combining Enterprise Funds Statement of Revenues, Expenses and Changes in Net Position (Deficit)	29
Combining Enterprise Funds Statement of Cash Flows	30

Independent Auditors' Report

To the Board of Directors
Mission Hills Community Services District

Report on the Financial Statements

We have audited the accompanying financial statements of the business-type activities of Mission Hills Community Services District (the District) as of and for the year ended June 30, 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.

Managements' 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; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America, 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 financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' 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 entity'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 entity'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.

SAN LUIS OBISPO

1150 Palm Street
San Luis Obispo, CA 93401
p 805 544 1441
f 805 544 4351

PASO ROBLES

102 South Vine Street, Ste. A
Paso Robles, CA 93446
p 805 237 3995
f 805 239 9332

SANTA MARIA

2222 South Broadway, Ste. A
Santa Maria, CA 93454
p 805 922 4010
f 805 922 4286

**Board of Directors of
Mission Hills Community Services District
Page 2**

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

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the business-type activities of the Mission Hills Community Services District as of June 30, 2013, and the changes in its net position and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis be presented to supplement the basic financial statements. Such information, although not 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.

Other Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Mission Hills Community Services District's basic financial statements. The combining financial statements are presented for purposes of additional analysis and are not a required part of the basic financial statements.

The combining financial statements are the responsibility of management and were derived from and relate 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 combining financial statements are fairly stated in all material respects in relation to the basic financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated October 3, 2013, on our consideration of the District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Mission Hills Community Services District's internal control over financial reporting and compliance.

A handwritten signature in black ink that reads "GLENN BURDETTE ATTEST CORPORATION". The letters are somewhat irregular and stylized, with the word "CORPORATION" written in smaller, more uniform capital letters at the end.

Glenn Burdette Attest Corporation
San Luis Obispo, California

October 3, 2013

**Mission Hills Community Services District
Management's Discussion and Analysis
For the Fiscal Year Ended June 30, 2013**

Our Management's Discussion and Analysis of the Mission Hills Community Services District's (District) financial performance provides an overview of the District's financial activities for the year ended June 30, 2013. It should be considered in conjunction with the information within the body of the audited financial statements.

Mission Statement

The Mission Hills Community Services District is committed to providing the residents within the District reliable, high quality water and wastewater services in an efficient, cost-effective and environmentally safe manner.

Financial Statements

The financial statements provide readers with a broad overview of the District's finances, combining the water, sewer, and street sweeping enterprise fund data.

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 Financial Statements

The Statement of Net Position includes all of the District's assets and liabilities, with the difference between the two reported as net position. The Statement of Net Position provides the basis for evaluating the capital structure of the District and assessing its liquidity and financial flexibility.

The Statement of Revenue, Expenses and Changes in Net Position presents information, which shows how the District's net position changed during the year. All of the year's revenues and expenses are recorded when the underlying transaction occurs, regardless of the timing of the related cash flows. The Statement of Revenue, Expenses and Changes in Net Position measures the success of the District's operations during the year and determines whether the District has recovered its costs through user fees and others 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 three categories:

- Operating
- Capital and Related Financing
- Investing

**Mission Hills Community Services District
Management's Discussion and Analysis
For the Fiscal Year Ended June 30, 2013
Page 2**

This statement differentiates from the Statement of Revenues, Expenses and Changes in Net Position by only accounting for transactions that result in cash receipts or cash disbursements.

The financial statements can be found on pages 11 to 13.

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.

The notes to the financial statements can be found on pages 14 to 21.

Financial Highlights

- Combined net position were \$9,713,166 on June 30, 2013. There was a change of \$(567,366) in the General Fund, \$334,351 in the Water Fund, \$67,645 in the Sewer Fund and \$1,052 in the Street Sweeping Fund.
- Combined revenue was \$1,524,512, which consisted of Water Charges, Wastewater Charges, Street Sweeping Charges, and various Service Charges.
- Combined Expenses were \$1,695,363, which consisted primarily of Salaries, Benefits, Depreciation, Insurance, Office Expenses, Operating Expenses, Professional Services, Travel, Utilities, Chemicals and Repairs and Maintenance.

Financial Analysis

Net Position

Net position may serve over time as a useful indicator of the District's financial position. Assets exceeded liabilities by \$9,713,166 as of June 30, 2013.

The largest portion of net position reflect net investment in capital assets (i.e. land, easements, wells and pumping, mains and distribution systems, buildings and improvements, vehicles, furniture, and equipment). The District uses these capital assets to provide services to the residences of the District; consequently, these assets are not available for future spending.

The next largest portion of net position is reserved for future spending. This portion includes cash and investments.

**Mission Hills Community Services District
Management’s Discussion and Analysis
For the Fiscal Year Ended June 30, 2013
Page 3**

Please see Table A below for a current year to previous year comparison of the Districts assets and liabilities.

**Table A
Statement of Net Position
June 30, 2013 and 2012**

	<u>2013</u>	<u>2012</u>	<u>% Change</u>
Assets:			
Current assets	\$ 4,101,478	\$ 3,994,287	2.7%
Capital assets	<u>5,751,541</u>	<u>6,028,199</u>	-4.6%
Total assets	<u>9,853,019</u>	<u>10,022,486</u>	-1.7%
Liabilities:			
Current liabilities	77,843	94,776	-17.9%
Long-term liabilities	<u>62,010</u>	<u>50,226</u>	23.5%
Total liabilities	<u>139,853</u>	<u>145,002</u>	-3.6%
Net position:			
Net investment in capital assets	5,751,541	6,028,199	-4.6%
Unrestricted	<u>3,961,625</u>	<u>3,849,285</u>	2.9%
Total net position	<u>\$ 9,713,166</u>	<u>\$ 9,877,484</u>	-1.7%

The following are significant current fiscal year transactions that have an impact on the statement of net position:

- Total liabilities have decreased primarily due to a \$14,475 decrease in accounts payable, and long-term liabilities have increased \$13,791 due to increased accrued vacation/sick leave.
- Regular straight-line depreciation for the fiscal year ending June 30, 2013 decreased capital assets by \$301,379.

Revenues, Expenses, and Changes in Net Position

The District’s financial position results from operating activities, investment activities, the acquisition and disposal of capital assets, and the depreciation of capital assets.

**Mission Hills Community Services District
Management's Discussion and Analysis
For the Fiscal Year Ended June 30, 2013
Page 4**

Please see Table B below for a current year to previous year comparison of the Districts revenues, expenses and changes in net position.

**Table B
Statement of Revenues, Expenses and Changes in Net Position
Years ended June 30, 2013 and 2012**

	<u>2013</u>	<u>2012</u>	<u>% Change</u>
Operating revenues	\$ 1,524,512	\$ 1,281,178	19.0%
Nonoperating revenues	6,533	19,515	-66.5%
Total revenues	1,531,045	1,300,693	17.7%
Depreciation expense	301,379	300,147	0.4%
Operating expense	1,393,984	1,364,466	2.2%
Total expenses	1,695,363	1,664,613	1.8%
Change in net position	(164,318)	(363,920)	-54.8%
Beginning net position	9,877,484	10,241,404	-3.6%
Ending net position	\$ 9,713,166	\$ 9,877,484	-1.7%

The following are significant current fiscal year transactions that have had an impact on the statement of revenues, expenses and changes in net position:

- Water revenues fell short of projections by \$42,933 and Wastewater revenues were short of projections by \$29,822.
- Total expenses were \$30,750 greater than last fiscal year, and \$106,618 higher than projected.

Economic Outlook

Currently the District is increasing its revenue while the customer base remains constant. The District is land locked and unable to experience any large growth in customer base, although Summit View Homes is tentatively scheduled to begin construction in 2014 (42 Homes). The general economic trend has been in a slightly positive direction. In response to these positive conditions, an engineering study was conducted by Penfield & Smith to determine the true cost to provide services. Based on this study, the District has instituted a rate increase to the connection fees, of approximately 24.9%. This action has been required due to the increase in the Engineering News Construction Cost Index for the Central Coast Region.

**Mission Hills Community Services District
Management's Discussion and Analysis
For the Fiscal Year Ended June 30, 2013
Page 5**

The major economic events of this fiscal year were the removal of excess dripper oil from Wells #5 thru #7, and the continued regulator action (Notice of Violation) from the California Regional Water Quality Control Board (RWQCB) concerning the Waste Water Treatment Plant. This has resulted in large ongoing maintenance costs to replace and upgrade the failed infrastructure, as well as increased legal fees required in order to respond to the requirements of the RWQCB. These increased funding requirements have caused the District to reevaluate all expenditures in order to reduce costs to an absolute minimum. The District was able to recover \$12,262 from contractors who performed substandard work. Also the District received an additional \$5,404 from SoCal Gas for efficiency improvements to the 1197 Waukesha engine. Additional savings were realized with the hiring of a new Street Sweeping contractor.

The District has continued to upgrade its infrastructure by replacing 150 linear feet (lf) of column piping and shaft bearings as well as purchasing a new angle drive unit for Well #6. The District completed a project to reline 1,275 lf of 10" sewer line, (14) lateral, and (8) manhole repairs on Calle Primera at a total cost of \$125,000. Currently, these costs are under review by our insurance carrier for possible reimbursement.

In February of 2013 a 12' water line failed causing extensive damage to an 8' sewer line, and the surrounding road structure. The total cost of this emergency repair was approximately \$90,000.00 of which our insurance carrier reimbursed about \$85,500.

Approximately half of the water meters currently in operation at the District are in excess of 14 years old, while the industry standard for meter life is 10 years. A replacement program was continued this fiscal year to replace 15% of the meters with Automatic Meter Reading type meters. The District has completed 56% of the replacement program to date. This project is anticipated to improve revenue collection as well as reducing the labor cost required to do monthly meter reading.

In addition, the District has completed the following projects: painted two 800,000 gallon reservoirs using District employees at a savings of \$45,000, completed a District Wide Leak Survey and repaired all discovered leaks, and replaced a 12" valve in Pond 7; returning pond 7 to normal operations.

The District continued to utilize the services of H & S Environmental to improve the operations and ensure compliance with the requirements of the Notice of Violation received in December 2010. The District has replaced the corrosion inhibitor utilized within the water distribution system, greatly improving the Lead and Copper sampling results. The District continues negotiations with California State Parks in order to provide two alternate well sites required for future use.

Contacting the District

This financial report is designed to provide the District's customers and other interested parties with an overview of the District's financial operations and financial condition. Questions concerning any of the information in this report or requests for additional information should be addressed to the General Manager, Mission Hills Community Services District, 1550 Burton Mesa Boulevard, Lompoc, CA 93436.

Mission Hills Community Services District
Statement of Net Position
June 30, 2013

Assets

Current assets:

Cash and cash equivalents	\$ 4,037,459
Services receivable, net of allowance	34,755
Interest receivable	2,519
Prepays and deposits	26,745
Total current assets	4,101,478

Property and equipment, net of accumulated depreciation	5,751,541
--	------------------

Total assets	9,853,019
---------------------	------------------

Liabilities

Current liabilities:

Accounts payable and accrued liabilities	18,768
Accrued payroll	187
Compensated absences, current portion	39,136
Customer deposits and advances	19,752
Total current liabilities	77,843

Long-term liabilities:

Compensated absences, net of current portion	62,010
--	--------

Total liabilities	139,853
--------------------------	----------------

Net Position

Net investment in capital assets	5,751,541
Unrestricted	3,961,625

Total net position	\$ 9,713,166
---------------------------	---------------------

The accompanying notes are an integral part of these financial statements.

Mission Hills Community Services District
Statement of Revenues, Expenses and Changes in Net Position
Year Ended June 30, 2013

Operating revenues:	
Service charges	\$ 1,482,137
Late charges and other revenue	42,375
Total operating revenues	<u>1,524,512</u>
Operating expenses:	
Chemicals	40,476
Contractual services	52,263
Depreciation	301,379
Directors' fees	13,495
Engineering services	3,674
Government charges	21,292
Insurance	24,088
Memberships and dues	8,826
Miscellaneous expense	1,648
Office expense	17,463
Operating supplies	8,870
Printing and publications	2,927
Professional services	60,212
Repairs and maintenance	258,358
Research and monitoring	14,185
Safety expense	5,510
Salaries, benefits and payroll taxes	671,643
Travel and meetings	14,758
Utilities	157,257
Vehicle expense	17,039
Total operating expenses	<u>1,695,363</u>
Operating loss	<u>(170,851)</u>
Nonoperating revenues and (expenses):	
Unrealized loss on investments	(7,540)
Interest income	14,073
Total nonoperating revenues and (expenses)	<u>6,533</u>
Decrease in net position	(164,318)
Net position - beginning of year	<u>9,877,484</u>
Net position - end of year	<u>\$ 9,713,166</u>

The accompanying notes are an integral part of these financial statements.

Mission Hills Community Services District
Statement of Cash Flows
Year Ended June 30, 2013

Cash flows from operating activities:		
Cash received from customers	\$ 1,519,129	
Cash payments to suppliers for goods and services	(733,201)	
Cash payments to employees for services	<u>(657,665)</u>	
Net cash provided by operating activities		\$ 128,263
Cash flows from capital and related financing activities:		
Purchases of property and equipment	<u>(24,721)</u>	
Net cash used in capital and financing activities		(24,721)
Cash flows from investing activities:		
Unrealized loss on investments	(7,540)	
Interest on cash and cash equivalents	<u>16,058</u>	
Net cash provided by investing activities		<u>8,518</u>
Net increase in cash		112,060
Cash and cash equivalents - beginning of year		<u>3,925,399</u>
Cash and cash equivalents - end of year		<u><u>\$ 4,037,459</u></u>
Reconciliation of operating loss to net cash provided by operating activities:		
Operating loss		(170,851)
Adjustments to reconcile operating loss to net cash provided by operating activities:		
Depreciation	301,379	
Changes in operating assets and liabilities:		
Services receivable, net of allowance	(731)	
Prepays and deposits	3,615	
Accounts payable and accrued liabilities	(14,475)	
Accrued payroll	187	
Compensated absences	13,791	
Customer deposits and advances	<u>(4,652)</u>	
Total adjustments		<u>299,114</u>
Net cash provided by operating activities		<u><u>\$ 128,263</u></u>

The accompanying notes are an integral part of these financial statements.

Mission Hills Community Services District
Notes to Financial Statements
June 30, 2013

Note 1: Nature of Business

The Mission Hills Community Services District (the District) began operations in November of 1979, under the authorization of Section 61000, et. seq., of the Government Code of the State of California, for the purpose of providing water and wastewater disposal services. Prior to the formation of the District, these services were provided by Park Water Company. The District is a political subdivision of the State of California and operates under a Board of Directors – Manager form of government.

Note 2: Summary of Significant Accounting Policies

Basis of Presentation

For financial reporting purposes, the District is considered a special-purpose government engaged only in business-type activities. The accompanying financial statements have been prepared using the economic resources measurement focus and the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB). Under the accrual basis, revenues are recognized when earned and expenses are recognized when incurred.

The principal operating revenues of the District are sewer and water usage charges and other related income. Interest income is considered non-operating revenue. When both restricted and unrestricted revenues are available for an expense, the District's policy is to use restricted revenues first, and then unrestricted fees as they are needed.

Budgets and Budgetary Accounting

An annual budget is adopted by the Board of Directors at the start of each fiscal year. Any changes or revisions to that budget throughout the year must be approved by the Board of Directors.

Estimates

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

Cash and Cash Equivalents

The District considers all demand deposits in banks and in the Santa Barbara County and Local Agency Investment Fund pooled investment account to be cash and cash equivalents.

Mission Hills Community Services District

Notes to Financial Statements

June 30, 2013

Page 2

Note 2: Summary of Significant Accounting Policies (Continued)

Services and Interest Receivable

The District's services receivable is comprised of water, wastewater, and street sweeping fees billed on a monthly basis. Customer receivables are written off in full when the receivable is deemed uncollectible. The allowance for uncollectible services is based on prior experience and management's analysis of possible bad debts. At June 30, 2013, the allowance for uncollectible services receivable was \$43,008.

Interest receivable represents interest due to the District for the quarter ended June 30, 2013 from Santa Barbara County and the Local Agency Investment Fund.

Prepays and Deposits

Payments made to vendors for services that will benefit any period beyond June 30, 2013 are recorded as prepaid expenses or deposits. Prepaid expenses and deposits at June 30, 2013 was \$25,083.

Property and Equipment

Depreciation is provided for on a straight-line basis over the estimated useful lives of the assets. The estimated useful lives of the assets are as follows:

Office furniture and fixtures	5-15 years
Machinery and equipment	2-25 years
Supply distribution system	10-75 years
Building and improvements	10- 40 years
Treatment collection system	10-100 years
Vehicles	7 years

All purchased fixed assets are valued at historical cost. Donated fixed assets were recorded at their estimated net book value when the District was formed. Other donated fixed assets are valued at their estimated fair value on the date received. It is the policy of the District to capitalize assets that have a unit cost of more than \$5,000.

Net Position

The District's net position is required to be classified for accounting and reporting purposes into the following net position categories:

Mission Hills Community Services District

Notes to Financial Statements

June 30, 2013

Page 3

Note 2: Summary of Significant Accounting Policies (Continued)

- Net investment in capital assets includes, capital assets net of accumulated depreciation and amortization, deferred outflows of resources, less the outstanding principal balances of debt attributable to the acquisition, construction, or improvement of those assets.
- Restricted consists of net position which is restricted as to use by the terms and conditions of agreements with outside parties, governmental regulations, laws, or other restrictions which the District cannot unilaterally alter. The District does not have any assets in this category.
- Unrestricted consists of all other categories of net position. Unrestricted may be designated for use by management of the District. These designations limit the area of operations for which expenditures of net position may be made and require that unrestricted net position be used to support future operations in these areas.

The District has adopted a policy of utilizing restricted, expendable funds, when available, prior to unrestricted funds.

Subsequent Events

Events subsequent to June 30, 2013, have been evaluated through October 3, 2013, which is the date the financial statements were available to be issued. Management did not identify any subsequent events that required disclosure.

Note 3: Cash and Cash Equivalents

District cash at June 30, 2013, consisted of the following:

Deposits	
Cash in bank	<u>\$ 301,233</u>

Custodial Credit Risk-Deposits

Custodial credit risk is the risk that in the event of a bank failure, the District's deposits may not be returned to it. The District does not have a formal deposit policy for custodial credit risk in addition to the California Government Code collateral requirements. Cash balances held in bank are insured up to \$250,000 by the National Credit Union Association. All deposits held by financial institutions are fully insured or collateralized with securities, held by pledging financial institutions' trust departments in the District's name.

Mission Hills Community Services District

Notes to Financial Statements

June 30, 2013

Page 4

Note 3: Cash and Cash Equivalents (Continued)

District pooled investments at June 30, 2013, consisted of the following:

Pooled Investment Funds:	
Cash in Santa Barbara County Treasury	\$ 1,335,907
Cash in Local Agency Investment Fund (LAIF)	<u>2,400,319</u>
	<u>\$ 3,736,226</u>

The Board has established certain restrictions on cash for purposes including replacement, emergency and development reserves. Total cash restricted by board designation at June 30, 2013 was approximately \$2,866,500.

Cash in County Treasury

The District maintains a portion of its cash in the Santa Barbara County Treasury, an external investment pool. The County pools these funds with those of other governmental entities in the county and invests the cash. These pooled funds are carried at fair value. Interest is earned based on average daily balance and is deposited quarterly into the participating funds. Any investment gains and losses are proportionately shared by all funds in the pool. The County is restricted by the California Government Code to invest in obligations issued by the United States Treasury; obligations, participations, or other instruments of or issued by a federal agency or a United States government sponsored enterprise; obligations of State and local agencies of this State; bankers acceptances; commercial paper; negotiable certificates of deposit; repurchase agreements; medium-term corporate notes; as well as other investments established by the California Government Code. The County's report discloses the required information in accordance with Governmental Accounting Standards Board Statements No. 3 and 40. Pooled investments are not required to be categorized by risk category.

Local Agency Investment Fund (LAIF)

The District maintained investments with the State of California Local Agency Investment Fund (LAIF). The LAIF is an external investment pool sponsored by the State of California. These pooled funds approximate fair value. The administration of the LAIF is provided by the California State Treasurer and regulatory oversight is provided by the Pooled Money Investment Board and the Local Investment Advisory Board. State statutes, bond resolutions, and LAIF investment policy resolutions allow investments in United States government securities, negotiable certificates of deposit, bankers' acceptances, commercial paper, corporate bonds, bank notes, mortgage loans and notes, other debt securities, repurchase agreements, reverse repurchase agreements, equity securities, real estate, mutual funds and other investments. The LAIF's report discloses the required information in accordance with Governmental Accounting Standards Board Statements No. 3 and 40. Pooled investments are not required to be categorized by risk category.

Mission Hills Community Services District

Notes to Financial Statements

June 30, 2013

Page 5

Note 3: Cash and Cash Equivalents (Continued)

Interest Rate Risk

The District does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

Credit Risk

The District investment policy allows the District to have monies invested in the Santa Barbara County pooled investment fund and the LAIF. Both the Santa Barbara County Treasury pooled investment fund and the LAIF are unrated.

Concentration of Credit Risk

The risk that an issuer of an investment may not fulfill its obligation to the holder of the investment is called credit risk. The investment policy of the District allows the District to maintain an operating account at a commercial bank, maintaining approximately one month's average expenditures in the account. District funds not specified for deposit or investment elsewhere are held in various accounts with the Santa Barbara County Treasurer's office. The policy also directs the District to establish and maintain an account with LAIF and provides guidelines for allocation of funds. At June 30, 2013, the District's investment in the Santa Barbara County Treasury represented 36% and the LAIF represented 64% of the total amount invested in pooled investment funds.

Note 4: Property and Equipment

At June 30, 2013, property and equipment consisted of the following:

	Balance June 30, 2012	Increases	Decreases	Balance June 30, 2013
Land	\$ 431,163	\$	\$	\$ 431,163
Plant and equipment	9,600,782	24,720		9,625,502
	10,031,945	24,720		10,056,665
Less accumulated depreciation	(4,003,746)	(301,378)		(4,305,124)
Property and equipment, net	<u>\$ 6,028,199</u>	<u>\$ (276,658)</u>	<u>\$ -</u>	<u>\$ 5,751,541</u>

Mission Hills Community Services District

Notes to Financial Statements

June 30, 2013

Page 6

Note 5: Long-Term Liabilities - Compensated Absences

At June 30, 2013, long-term liabilities consisted of the following:

	<u>Balance</u> <u>June 30, 2012</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance</u> <u>June 30, 2013</u>	<u>Current</u> <u>Portion</u>
Compensated absences	\$ 87,355	\$ 57,052	\$ (43,261)	\$ 101,146	\$ 39,136

Note 6: Service Revenues

The operations of the District are primarily funded through the collection of service fees for connection fees, water, wastewater, and street sweeping services provided for by the District. Revenues earned by type during the year ended June 30, 2013, were as follows:

Water charges	\$ 917,242
Wastewater charges	546,706
Street sweeping charges	<u>18,189</u>
Total	<u>\$ 1,482,137</u>

Note 7: Employee Benefit Plan

The District is currently participating in a FTJ FundChoice governmental eligible 457 plan administered by Bayhill Advisors, Inc, effective January 1, 2007. The Mission Hills CSD 457 Plan is a defined contribution plan and covers all employees of the District. Employees elect to contribute a portion of their salary to the plan with no limitations other than those legally imposed. An employee can also elect to contribute their social security taxes in lieu of paying into social security and the District contributes the employer portion as well. All other District contributions are discretionary and all contributions are vested 100% immediately. Assets are held separately from the District's funds. The total pension expense was \$37,739 for the year ended June 30, 2013. Contributions by plan members were \$50,829 for the year ended June 30, 2013.

Note 8: Risk Management

The District is a member of the Association of California Water Agencies Joint Powers Insurance Authority (ACWA/JPIA), which was organized for the purpose of providing general liability, automobile, errors and omission, and property loss insurance coverage to water agencies. The ACWA/JPIA is financed through premium charges to each member. The ACWA/JPIA does not meet the reporting entity criteria and is therefore not included in the accompanying financial statements.

Mission Hills Community Services District

Notes to Financial Statements

June 30, 2013

Page 7

Note 8: Risk Management (Continued)

The ACWA/JPIA is administered by a board of directors, consisting of one member of each participating water agency. In addition, the water agencies' board members and staff are eligible to participate on the various committees and subcommittees of the ACWA/JPIA. The board is responsible for establishing premium rates and making budgeting decisions.

Coverage under current policies provide for the District to pay for the first \$2,500 of property loss for buildings, personal property, fixed equipment, and mobile equipment and the agency to pay for the next \$497,500. There is a \$1,000 deductible for licensed vehicles. The auto and general liability program has no deductible. Property losses are limited to the value of the property as assessed by the ACWA/JPIA. The ACWA/JPIA is self-insured for the first \$500,000. Claims over the self-insured amounts are covered by a group purchased commercial insurance policy. Each member district is assessed a premium in accordance with the JPIA agreement, creating the ACWA/JPIA.

Condensed financial information of the ACWA/JPIA was as follows:

	<u>September 30, 2012*</u>
Total assets	\$ 188,033,750
Total liabilities	<u>100,670,416</u>
Net assets	<u>\$ 87,363,334</u>
Total operating revenues	\$ 58,436,313
Total nonoperating revenues	1,699,881
Net assets acquired from merger	34,986,207
Total operating expenses	<u>(55,071,111)</u>
Net increase in net assets	<u>\$ 40,051,290</u>

* Latest information available.

Note 9: Commitments and Contingencies

On December 2, 2010, the District received a Notice of Violations from the Regional Water Quality Control Board (RWQCB) for alleged non-compliances associated with its Waste Discharge Requirement Order 97-035 for the Wastewater Treatment Plant. The Notice of Violations required the District to take immediate actions necessary to ensure compliance with Order No. 97-035 and to submit a report addressing the violations described in the Notice of Violations. The Notice of Violations states that the District may be subject to civil liability of up to \$1,000 per day for each day in which the violation occurs.

Mission Hills Community Services District

Notes to Financial Statements

June 30, 2013

Page 8

Note 9: Commitments and Contingencies (Continued)

The District submitted a Corrective Action Plan and Implementation Schedule to the RWQCB on February 28, 2011. The District has substantially followed up with the RWQCB updating them on the status of the District's efforts made consistent with its Corrective Action Plan, which has been completed. The District is still awaiting a formal written response from the RWQCB. As such there is no estimate of the potential financial impact to the District and nothing has been recorded for this potential contingency in these financial statements. The District estimates that the potential liability will not be significant, but it could be material to these financial statements.

The District also received a claim from a customer whose home was damaged as a result of a sewage intrusion. Insurance defense liability claims are handled through the District's ACWA/JPIA administrator. As such, the District estimates that the potential liability will not be significant and would be covered by the insurance company. No provisions have been made for this damage in these financial statements.

The District completed a project to re-line 1,275 lf of 10" sewer line, (14) lateral, and (8) manhole repairs on Calle Primera after a pipe burst at a total cost of \$125,000. Currently, these costs are under review by the insurance carrier for possible reimbursement. Nothing was recorded in these financial statements for this possible reimbursement.

From time to time, in the normal course of operations, the District may become involved in litigation for which the District has insurance coverage. Management does not believe this will result in a material impact to the financial statements.

**Report on Internal Control Over Financial Reporting and on Compliance
and Other Matters Based on an Audit of Financial Statements Performed
in Accordance with *Government Auditing Standards***

To the Board of Directors of
Mission Hills Community Services District

We have audited, in accordance with the auditing standards generally accepted in the United States of America, 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*, the business-type activities of Mission Hills Community Services District (a nonprofit organization), as of and for the year ended June 30, 2013, and the related notes to the financial statements, which collectively comprise Mission Hills Community Services District's basic financial statements and have issued our report thereon dated October 3, 2013.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Mission Hills Community Services District's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Mission Hills Community Services District's internal control. Accordingly, we do not express an opinion on the effectiveness of Mission Hills Community Services District's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying schedule of findings and recommendations, we identified certain deficiencies in internal control that we consider to be material weaknesses.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatement on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying schedule of findings and questioned costs as 13.01 and 13.02 to be material weaknesses.

Board of Directors
Mission Hills Community Services District
Page 2

A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Compliance and Other Matters

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

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose

A handwritten signature in black ink that reads "GLENN BURDETTE ATTEST CORPORATION". The letters are in all caps and have a slightly irregular, cursive-like appearance.

Glenn Burdette Attest Corporation
San Luis Obispo, California

October 3, 2013

Mission Hills Community Services District
Schedule of Findings and Recommendations
Year Ended June 30, 2013

Finding 13.01: Restricted Reserves (Material Weakness)

Criteria:

In order to fund the future of the District, the Board established a policy to establish reserves in order to maintain proper levels of funding.

Condition:

The Board passed Board of Directors Resolution #102 in November 1991, titled "Depreciation, Restricted Reserves, Allocation of Interest Income" that details, among other things, the reserves that should be set up by the District on a regular basis to ensure there will be proper cash assets available to replace systems as required. These reserves include: replacement reserves, established at least quarterly; development reserves, established when connection fees are received from developers; and emergency reserves, established annually. The policy also describes how interest on these funds should be allocated.

At June 30, 2013, there were some investment funds set aside in Board restricted accounts, however, management has not been reviewing these reserves in accordance with the policy. Management was made aware of this issue in fiscal year 2009 and a decision was made to prioritize the property and equipment physical observation in fiscal year 2010 before assessing the needs of the restricted reserves, believing that they needed to have a proper accounting of their assets before establishing the reserves.

In 2010, the District felt they needed to address a previous investment policy recommendation before establishing the restricted reserve accounts. In the prior year, the investment policy was addressed and management is aware that this issue is still unresolved. As this finding has not been addressed by the District for the past four years, it is again included as a material weakness.

Effect:

By not establishing following the established policies and reviewing them periodically to make sure they meet the needs of the District, the District may not be fully funding the future needs of the District.

Recommendation:

We recommend that the Board review the existing reserve requirements and determine the appropriate level of required reserves, setting these aside in restricted accounts. We also recommend that they establish a policy for reviewing and setting these reserves and follow it going forward. The policy should include a methodology for establishing the reserves, the required frequency of review, and an annual evaluation, documented in the Board of Director minutes, of existing reserves.

Finding 13.02: Inadequate Segregation of Duties (Material Weakness)

Criteria:

There are generally four phases for an accounting process or operation: authorization, custody, record keeping and reconciliation. A well-designed system of internal control contemplates the allocation of duties among personnel such that each of these four functions would be performed by a different person.

Condition:

During our audit, we noticed that, due to the small size of the District staff, many of these duties are being performed by the same individuals and that the majority of the employees have access to the cash drawer.

Management has informed us that based upon the size of the District, they believe the cost to employ a sufficient number of employees with sufficient education and training to accomplish this would be cost prohibitive. While the District does not have all four phases of their accounting processes segregated, they have designed their controls to limit the potential of a material misstatement by having mitigating controls in place to detect any material misstatements that might occur. This includes detail oversight review of the trial balance on a monthly basis by both the District Manager and District Bookkeeper.

Effect:

The effect on the District of not fully segregating these functions could be to have a misappropriation of assets, although the District has mitigated the impact by the controls discussed above.

Recommendation:

We recommend that the District continue to evaluate the assignment of responsibilities and authority in the accounting department and segregate duties to the best of their ability given the size of the District and the resources available.

Supplemental Information

**Mission Hills Community Services District
Schedule of Directors
June 30, 2013**

James Mac Kenzie	President
Bernard Jones	Vice President
Tim Naughton	Finance Officer
Danny Hayes	Alternate Finance Officer
Walter Fasold	Director

Mission Hills Community Services District
Combining Enterprise Funds Statement of Net Position (Deficit)
June 30, 2013

	<u>Operations Fund</u>	<u>Water Fund</u>	<u>Wastewater Fund</u>	<u>Street Sweeping Fund</u>	<u>Total</u>
Assets					
Current assets:					
Cash and cash equivalents	\$ 840,942	\$ 1,574,668	\$ 1,618,291	\$ 3,558	\$ 4,037,459
Services receivable, net of allowance	945	19,957	13,305	548	34,755
Interest receivable	554	857	1,108		2,519
Prepays and deposits	14,848	11,121	776		26,745
Total current assets	<u>857,289</u>	<u>1,606,603</u>	<u>1,633,480</u>	<u>4,106</u>	<u>4,101,478</u>
Property and equipment, net of accumulated depreciation	<u>188,265</u>	<u>3,224,371</u>	<u>2,338,905</u>		<u>5,751,541</u>
Total assets	<u>1,045,554</u>	<u>4,830,974</u>	<u>3,972,385</u>	<u>4,106</u>	<u>9,853,019</u>
Liabilities					
Current liabilities:					
Accounts payable and accrued liabilities	8,254	7,484	3,030		18,768
Accrued payroll		187			187
Compensated absences, current portion	32,654	4,837	1,645		39,136
Customer deposits		19,752			19,752
Total current liabilities	<u>40,908</u>	<u>32,260</u>	<u>4,675</u>		<u>77,843</u>
Long-term liabilities:					
Compensated absences, net of current portion	<u>51,741</u>	<u>7,664</u>	<u>2,605</u>		<u>62,010</u>
Total liabilities	<u>92,649</u>	<u>39,924</u>	<u>7,280</u>		<u>139,853</u>
Net Position					
Net investment in capital assets	188,265	3,224,371	2,338,905		5,751,541
Unrestricted	<u>(2,361,605)</u>	<u>2,798,708</u>	<u>3,497,592</u>	<u>26,930</u>	<u>3,961,625</u>
Total net position (deficit)	<u>\$ (2,173,340)</u>	<u>\$ 6,023,079</u>	<u>\$ 5,836,497</u>	<u>\$ 26,930</u>	<u>\$ 9,713,166</u>

Mission Hills Community Services District
Combining Enterprise Funds Statement of Revenues,
Expenses and Changes in Net Position
Year Ended June 30, 2013

	<u>Operations</u>	<u>Water</u>	<u>Wastewater</u>	<u>Street</u> <u>Sweeping</u>	<u>Total</u>
	<u>Fund</u>	<u>Fund</u>	<u>Fund</u>	<u>Fund</u>	
Operating revenues:					
Service charges	\$	\$ 917,242	\$ 546,706	\$ 18,189	\$ 1,482,137
Late charges and other revenue	36,970	5,405			42,375
Total operating revenues	<u>36,970</u>	<u>922,647</u>	<u>546,706</u>	<u>18,189</u>	<u>1,524,512</u>
Operating expenses:					
Chemicals		12,156	28,320		40,476
Contractual services	21,375	13,123	628	17,137	52,263
Depreciation	27,435	189,038	84,906		301,379
Directors' fees	13,495				13,495
Engineering services			3,674		3,674
Government charges	1,781	14,188	5,323		21,292
Insurance	24,088				24,088
Memberships and dues	405	7,671	750		8,826
Miscellaneous expense	1,648				1,648
Office expense	16,971	343	149		17,463
Operating supplies	233	8,008	629		8,870
Printing and Publication	2,927				2,927
Professional services	56,438	1,547	2,227		60,212
Repairs and maintenance	911	60,732	196,715		258,358
Research and monitoring		3,726	10,459		14,185
Safety expense	1,491	2,263	1,756		5,510
Salaries, benefits and payroll taxes	417,107	164,494	90,042		671,643
Travel and meetings	10,990	3,644	124		14,758
Utilities	11,991	99,310	45,956		157,257
Vehicle expense	1,583	8,053	7,403		17,039
Total operating expenses	<u>610,869</u>	<u>588,296</u>	<u>479,061</u>	<u>17,137</u>	<u>1,695,363</u>
Operating income (loss)	<u>(573,899)</u>	334,351	67,645	1,052	<u>(170,851)</u>
Nonoperating revenues and (expenses):					
Unrealized loss on investments	(7,540)				(7,540)
Interest income	14,073				14,073
Total nonoperating revenues and (expenses)	<u>6,533</u>				<u>6,533</u>
Change in net position	(567,366)	334,351	67,645	1,052	(164,318)
Net position (deficit) - beginning of year	<u>(1,605,974)</u>	<u>5,688,728</u>	<u>5,768,852</u>	<u>25,878</u>	<u>9,877,484</u>
Net position (deficit) - end of year	<u>\$ (2,173,340)</u>	<u>\$ 6,023,079</u>	<u>\$ 5,836,497</u>	<u>\$ 26,930</u>	<u>\$ 9,713,166</u>

Mission Hills Community Services District
Combining Enterprise Funds Statement of Cash Flows
Year Ended June 30, 2013

	<u>Operations Fund</u>	<u>Water Fund</u>	<u>Wastewater Fund</u>	<u>Street Sweeping Fund</u>	<u>Total</u>
Cash flows from operating activities:					
Cash received from customers	\$ 37,111	\$ 917,539	\$ 546,401	\$ 18,078	\$ 1,519,129
Cash payments to suppliers for goods and services	(171,237)	(235,952)	(308,875)	(17,137)	(733,201)
Cash payments to employees for services	(398,282)	(166,452)	(92,931)		(657,665)
Net cash provided by (used in) operating activities	<u>(532,408)</u>	<u>515,135</u>	<u>144,595</u>	<u>941</u>	<u>128,263</u>
Cash flows from capital and related financing activities:					
Purchases of property and equipment	(3,553)	(21,168)			(24,721)
Net cash used in capital and related financing activities	<u>(3,553)</u>	<u>(21,168)</u>			<u>(24,721)</u>
Cash flows from investing activities:					
Unrealized loss on investments	(7,540)				(7,540)
Interest on cash and cash equivalents	14,537	606	915		16,058
Net cash provided by investing activities	<u>6,997</u>	<u>606</u>	<u>915</u>		<u>8,518</u>
Net increase (decrease) in cash	(528,964)	494,573	145,510	941	112,060
Cash and cash equivalents - beginning of year	<u>762,558</u>	<u>1,543,712</u>	<u>1,615,571</u>	<u>3,558</u>	<u>3,925,399</u>
Cash and cash equivalents - end of year	<u>\$ 233,594</u>	<u>\$ 2,038,285</u>	<u>\$ 1,761,081</u>	<u>\$ 4,499</u>	<u>\$ 4,037,459</u>
Reconciliation of operating income (loss) to net cash provided by (used in) operating activities:					
Operating income (loss)	\$ (573,899)	\$ 334,351	\$ 67,645	\$ 1,052	\$ (170,851)
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities:					
Depreciation	27,435	189,038	84,906		301,379
Changes in operating assets and liabilities:					
Services receivable, net of allowance	141	(456)	(305)	(111)	(731)
Prepays and deposits	3,904	(139)	(150)		3,615
Accounts payable and accrued liabilities	(8,814)	(1,049)	(4,612)		(14,475)
Accrued payroll		187			187
Compensated absences	18,825	(2,145)	(2,889)		13,791
Customer deposits and advances		(4,652)			(4,652)
Total adjustments	<u>41,491</u>	<u>180,784</u>	<u>76,950</u>	<u>(111)</u>	<u>299,114</u>
Net cash provided by (used in) operating activities	<u>\$ (532,408)</u>	<u>\$ 515,135</u>	<u>\$ 144,595</u>	<u>\$ 941</u>	<u>\$ 128,263</u>