

NIPOMO COMMUNITY SERVICES DISTRICT

TUESDAY, OCTOBER 2, 2012

10:00 A.M.

SPECIAL MEETING NOTICE & AGENDA FINANCE AND AUDIT COMMITTEE

COMMITTEE MEMBERS

LARRY VIERHEILIG, CHAIRMAN
DAN GADDIS, MEMBER

PRINCIPAL STAFF

MICHAEL S. LEBRUN, GENERAL MANAGER
LISA BOGNUDA, ASST GM/FINANCE DIRECTOR
JON SEITZ, GENERAL COUNSEL

**MEETING LOCATION - District Board Room
148 S. Wilson Street, Nipomo, California**

- 1. CALL TO ORDER, FLAG SALUTE AND ROLL CALL**
- 2. REVIEW DRAFT AUDIT REPORT FOR FISCAL YEAR ENDING JUNE 30, 2012**

ACTION RECOMMENDED: Review report and provide direction to Staff
- 3. REVIEW DRAFT CASH RESERVE POLICY**

ACTION RECOMMENDED: Provide direction to Staff
- 4. ADJOURN**

TO: MICHAEL S. LEBRUN *MSL*
GENERAL MANAGER

FROM: LISA BOGNUDA *LB*
FINANCE DIRECTOR

DATE: SEPTEMBER 27, 2012



**REVIEW DRAFT AUDIT REPORT FOR FISCAL YEAR ENDING
JUNE 30, 2012**

ITEM

Review draft audit report for fiscal year ending June 30, 2012.

BACKGROUND

Bob Crosby, Certified Public Accountant of Crosby Company, will review the draft audit report with the Committee.

Mr. Crosby is scheduled to present the final audit report to the Board of Directors at the October 10, 2012, Board Meeting.

RECOMMENDATION

It is recommended that the Committee forward its recommendation to the Board of Directors.

ATTACHMENT

- A. Draft Audit Report

OCTOBER 2, 2012

ITEM 2

ATTACHMENT A

**NIPOMO
COMMUNITY SERVICES DISTRICT**

**Independent Auditor's Report
and
Financial Statements**

For the Year Ended
June 30, 2012

3rd Draft

NIPOMO COMMUNITY SERVICES DISTRICT
INDEPENDENT AUDITOR'S REPORT AND FINANCIAL STATEMENTS
For the Year Ended June 30, 2012

TABLE OF CONTENTS

	<u>PAGE</u>
MANAGEMENT'S DISCUSSION AND ANALYSIS	i-viii
SCHEDULE OF DIRECTORS	1
INDEPENDENT AUDITOR'S REPORT	2
FINANCIAL STATEMENTS	
Statements of Net Assets	3
Statements of Revenues, Expenses and Changes in Fund Net Assets.....	4
Statements of Cash Flows	5
NOTES TO THE FINANCIAL STATEMENTS	6-20
SUPPLEMENTAL INFORMATION	
Combining Statements of Net Assets – Proprietary Funds	21-22
Combining Statements of Revenues, Expenses and Change in Net Assets – Proprietary Funds.....	23-24
Combining Statement of Other Supplies and Expenses – Proprietary Funds.....	25-26
Required Disclosure under Government Code Section 66013.....	27-29

3rd Draft

NIPOMO COMMUNITY

BOARD MEMBERS

JAMES HARRISON, PRESIDENT
LARRY VIERHEILIG, DIRECTOR
MICHAEL WINN, DIRECTOR
ED EBY, DIRECTOR
DAN GADDIS, DIRECTOR



SERVICES DISTRICT

STAFF

MICHAEL S. LEBRUN, GENERAL MANAGER
LISA BOGNUDA, FINANCE DIRECTOR
JON SEITZ, GENERAL COUNSEL

148 SOUTH WILSON STREET POST OFFICE BOX 326 NIPOMO, CA 93444 - 0326
(805) 929-1133 FAX (805) 929-1932 ncsd.ca.gov

MANAGEMENT DISCUSSION AND ANALYSIS FISCAL YEAR ENDING JUNE 30, 2012

The Nipomo Community Services District's Management Discussion and Analysis is an overview of the most recent completed fiscal year's activities designed to:

- Assist the reader in identifying significant financial issues
- Provide an overview of the District's fiscal year financial activity
- Identify changes in the District's financial position
- Identify any material deviations from the financial plan (approved budget)
- Identify individual fund issues or concerns

Since the Management's Discussion and Analysis (MD & A) is designed to focus on the most recent completed fiscal year's activities, resulting changes and currently known facts, please read it in conjunction with the Independent Auditor's Report (beginning on page 2) and the District's financial statements (beginning on page 3).

A. DESCRIPTION OF THE BASIC FINANCIAL STATEMENTS

The Nipomo Community Services District's enabling legislation is found in §61000 et seq. of the Government Code and is commonly referred to as Community Services District law. Pursuant to Government Code §§61100 the District supplies water, sewer, solid waste, street lighting, street landscape maintenance and drainage within the District boundaries.

Pursuant to Community Services District law, the District:

- On or before July 1st of each year, adopts a preliminary budget or final budget that conforms to generally accepted accounting and budgeting procedures for Special Districts (Government Code §61110);
- On or before July 1st of each year, adopts a Resolution establishing the District's appropriations limit, if any, and makes other necessary determinations for the following fiscal year, pursuant to Article XIII B of the California Constitution;
- Annually provides for audits of the District's accounts and records (Government Code §61118);
- Provides annual financial reports to the State Controller (Government Code §61118);
- Adopts rates and charges to cover costs reasonably borne by the District in providing water, sewer, solid waste collection, street lighting and street landscape maintenance services within the District boundaries pursuant to the guidelines identified in Water Code §71616 and Article XIII D of the California Constitution (Government Code Section §61123).

NIPOMO COMMUNITY SERVICES DISTRICT
MANAGEMENT DISCUSSION AND ANALYSIS
FISCAL YEAR ENDING JUNE 30, 2012

District Staff performs the accounting functions of the District. The District utilizes the Fund Accounting method. The National Council on Government defines the term **fund** as follows:

A fund is defined as a fiscal and accounting entity with a self-balancing set of accounts recording cash and other financial resources, together with all related liabilities and residual equities, or balances, and changes therein, which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions or limitations.

The following is the list of Funds used by the District:

#110	Administration Fund
#125	Water Fund
#130	Sewer Fund-Town Division
#150	Sewer Fund-Blacklake Division
#200	Blacklake Street Lighting Fund
#250	Street Landscape Maintenance District Fund
#300	Solid Waste Fund
#400	Drainage Fund
#500	Supplemental Water Fund
#600	Property Tax Fund
#700	Water Capacity Charges Fund
#710	Sewer Capacity Charges Fund-Town Division
#805	Funded Replacement-Water Fund
#810	Funded Replacement-Town Sewer Fund
#830	Funded Replacement-Blacklake Sewer Fund
#880	Town Sewer Sinking fund

The Administration Fund accounts for all of the assets and resources used for the general administration of the District. The remaining operating funds are "enterprise funds". The purpose of enterprise funds is to account for operations in a manner similar to private business enterprises. The policy defined by the elected Board of Directors is that the costs of providing service (expenses, including depreciation of providing goods and services) be financed or recovered primarily through user charges.

Financial statements (Consolidated Balance and Income Statements) are presented and reviewed quarterly by the Board of Directors, and confirmed annually by an outside independent audit. The footnotes, contained as supplemental information in the annual Audit Report, provide specific accounting details about Nipomo Community Services District such the basis of accounting, capital assets, and long-term debt. There were no significant accounting process changes during the fiscal year.

NIPOMO COMMUNITY SERVICES DISTRICT
MANAGEMENT DISCUSSION AND ANALYSIS
FISCAL YEAR ENDING JUNE 30, 2012

CONDENSED FINANCIAL INFORMATION

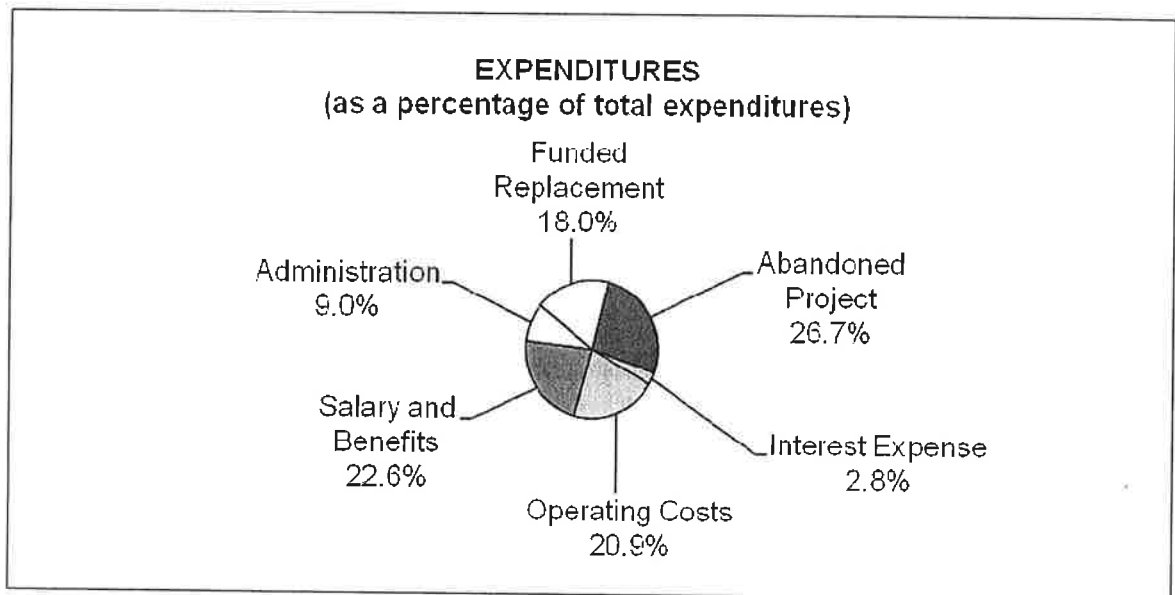
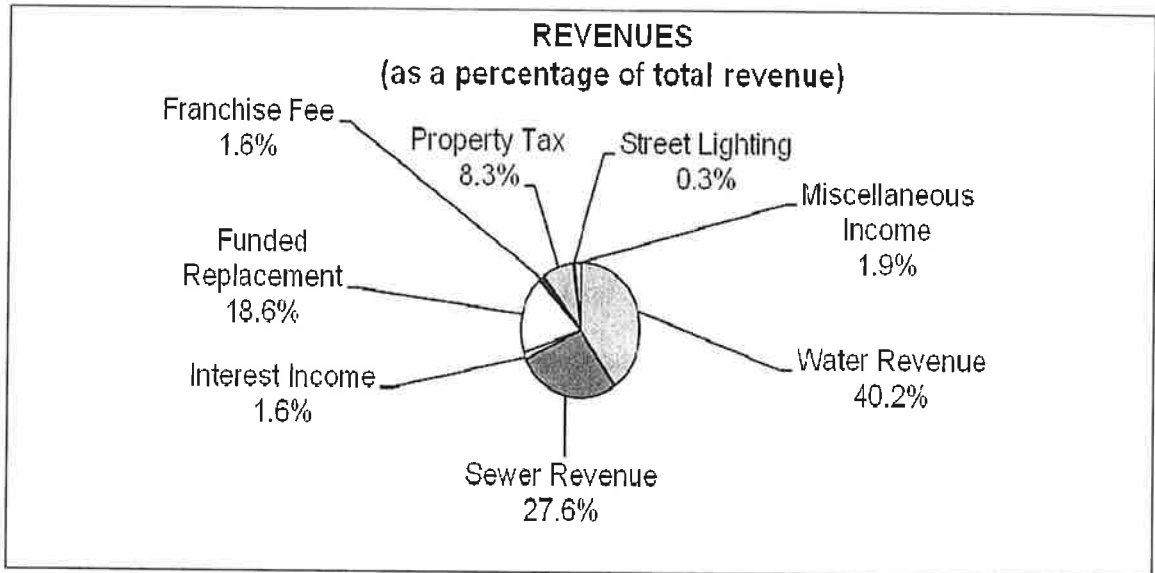
STATEMENT OF NET ASSETS

<u>Assets</u>	<u>Fiscal Year</u> <u>7/1/11 – 6/30/12</u>	<u>Fiscal Year</u> <u>7/1/10 – 6/30/11</u>
Current and other assets	\$ 33,988,748	\$ 25,358,844
Capital assets, net	33,233,604	32,611,674
Total Assets	67,222,352	57,970,518
 <u>Liabilities</u>		
Other liabilities	680,120	653,202
Long-term debt outstanding	14,017,323	4,674,988
Total Liabilities	14,697,443	5,328,190
 <u>Net Assets</u>		
Invested in capital assets, net of debt	19,736,453	28,120,434
Restricted	12,721,267	14,429,872
Unrestricted	12,067,189	10,092,022
Total Net Assets	\$ 44,524,909	\$ 52,642,328

STATEMENT OF REVENUE, EXPENSES AND CHANGES IN NET ASSETS

<u>Operating Revenues</u>		
Charges for services	\$ 5,210,119	\$ 4,952,837
Miscellaneous	221,853	208,228
Total Operating Revenues	5,431,972	5,161,065
 <u>Operating Expenses</u>		
Water	2,822,240	3,197,163
Sewer	1,457,090	1,424,512
Other	139,596	109,085
Total Operating Expenses	4,418,926	4,730,760
 <u>Non-Operating Revenues and (Expenses)</u>		
Interest income	98,657	125,994
Miscellaneous revenues	536,105	609,449
Miscellaneous expense	(3,264)	
Interest expense	(178,647)	(181,873)
Abandoned Project	(1,671,990)	
Total Non-operating revenues (expenses)	(1,219,139)	553,570
Income Before Contributions	(206,093)	983,875
Capital Contributions	88,674	226,462
Change in Net Assets	(117,419)	1,210,337
Total Net Assets - Beginning of fiscal year	52,642,328	51,431,991
Total Net Assets – End of fiscal year	\$ 52,524,909	\$ 52,642,328

NIPOMO COMMUNITY SERVICES DISTRICT
MANAGEMENT DISCUSSION AND ANALYSIS
FISCAL YEAR ENDING JUNE 30, 2012



NIPOMO COMMUNITY SERVICES DISTRICT
MANAGEMENT DISCUSSION AND ANALYSIS
FISCAL YEAR ENDING JUNE 30, 2012

B. ANALYSIS OF OVERALL FINANCIAL POSITION AND RESULTS OF OPERATION
(Comparison of Fiscal Year 2010-11 to Fiscal Year 2009-10)

- Overall operating revenues increased 5.2%.
- Overall operating expenditures decreased 6.6%.
- Total assets increased 15.9%.
- Total liabilities increased 275% due to issuance of Revenue Certificates of Participation in the amount of \$9,795,000.
- Capital contributions, including water and sewer capacity fees and developer donated assets decreased 61%.

C. ANALYSIS OF BALANCES AND TRANSACTIONS OF INDIVIDUAL FUNDS

- Water revenues increased 8.3% for the fiscal year. The increase is attributable a rate increase that went into effect November 1, 2011.
- Sewer revenues for the Town Division increased 0.6% and the Blacklake Division increased 9.7%. The increase in the Town Division is attributable to new sewer connections and the increase in the Blacklake Division is attributable to a rate increase that went into effect on January 1, 2012.

D. ANALYSIS OF SIGNIFICANT VARIATIONS BETWEEN THE BUDGET AND ACTUAL YEAR END RESULTS

COMPARISON OF BUDGET AMOUNTS TO ACTUAL

	2011-12 <u>BUDGET</u>	2011-12 <u>ACTUAL</u>	% ACTUAL IS OVER(+)/UNDER(-) <u>BUDGET</u>	POSITIVE (+) OR NEGATIVE (-) IMPACT ON <u>BUDGET</u>
Total Operating Revenues	\$ 5,613,216	\$ 5,431,972	-3.3%	-
Total Operating Expenditures	\$ 4,729,733	\$ 4,418,926	-7.0%	+
Net Non Operating Income (Expenses) (excluding Abandoned Project)	\$ 442,931	\$ 452,851	+2.2%	+

NIPOMO COMMUNITY SERVICES DISTRICT
MANAGEMENT DISCUSSION AND ANALYSIS
FISCAL YEAR ENDING JUNE 30, 2012

DESCRIPTION OF SIGNIFICANT CAPITAL ASSETS AND LONG-TERM DEBT ACTIVITY

All assets purchased by the District are valued at historical cost. Donated fixed assets are valued at their estimated fair market value on the date received by the District. There were no donated or contributed fixed assets from developers this year.

The total long-term debt as of June 30, 2012 is as follows (for more detail, see Note 6 of the Notes to the Financial Statements found on Pages 13 and 14):

Water Division	Eureka Well development and Inter-Fund loan for the Blacklake Buy-In	\$162,403
Town Division Sewer	Sewer plant expansion, lease purchase of sewer vacuum truck and Inter-Fund Loan for Blacklake Sewer	10,524,920
Property Tax Secured	Water improvements and Supplemental Water	3,330,000
Total Long-term debt		\$14,017,323

E. DISCUSSION OF USE OF THE MODIFIED APPROACH TO REPORT INFRASTRUCTURE ASSETS

Not applicable. Nipomo Community Services District does not use the modified approach.

DESCRIPTION OF FACTS OR CONDITIONS THAT ARE EXPECTED TO HAVE A SIGNIFICANT EFFECT ON FINANCIAL POSITION OR RESULTS OF OPERATION

- The Supplemental Water Assessment District ballot measure failed in May 2012. As a result, \$1,671,990 in related assessment district expenditures has been written off. Those expenditures include, but are not limited to, assessment district formation, bond counsel and financial consultant.
- On June 21, 2012, the District issued \$9,795,000 of Revenue Certificate of Participation (COP's). The proceeds will be used to fund the upgrade to the Southland Wastewater Treatment Facility. It is estimated that construction will take 18 months to complete.

NIPOMO COMMUNITY SERVICES DISTRICT
MANAGEMENT DISCUSSION AND ANALYSIS
FISCAL YEAR ENDING JUNE 30, 2012

F. ECONOMIC FACTORS

The Nipomo Community Services District's water and sewer operations rely solely on user fees. The last water rate increases was on November 1, 2011. New water rates will go into effect November 1, 2012.

The sewer rates for the Blacklake Division will increase on January 1, 2013.

The following table represents a seven year summary of water and sewer rates for a single-family residence with a one-inch meter:

WATER RATES AND CHARGES

As of June 30,	Bi-Monthly Availability Charge	Bi-Monthly Usage Rates (4 Tiers effective November 1, 2011)			
		0-24 Units	25-40 Units	41-100 Units	101+ Units
2012	\$33.17	\$1.64	\$2.05	\$2.88	\$4.93

As of June 30,	Bi-Monthly Availability Charge	Bi-Monthly Usage Rates	
		0 – 40 Units	41 + Units
2011	\$30.84	\$1.64	\$2.80
2010	\$30.84	\$1.64	\$2.80
2009	\$30.84	\$1.64	\$2.80
2008	\$29.03	\$1.52	\$2.59
2007	\$26.96	\$1.38	\$2.35
2006	\$24.75	\$1.23	\$2.10

TOWN DIVISION- SEWER CHARGES

As of June 30,	Bi-Monthly Sewer Charge
2012	\$88.32
2011	\$88.32
2010	\$88.32
2009	\$70.66
2008	\$56.53
2007	\$43.27
2006	\$41.60

BLACKLAKE DIVISION- SEWER CHARGES

As of June 30,	Bi-Monthly Sewer Charge
2012	\$138.58
2011	\$131.98
2010	\$118.90
2009	\$107.12
2008	\$77.55
2007	\$74.56
2006	\$71.70

NIPOMO COMMUNITY SERVICES DISTRICT
MANAGEMENT DISCUSSION AND ANALYSIS
FISCAL YEAR ENDING JUNE 30, 2012

G. REQUESTS FOR INFORMATION

This financial report is designed to provide a general overview of the Nipomo Community Services District's finances for all those with an interest in the District's finances. Questions concerning any of the information provided in this report or requests for additional information should be addressed to the Finance Director, Nipomo Community Services District, P. O. Box 326, Nipomo, CA 93444.

NIPOMO COMMUNITY SERVICES DISTRICT
SCHEDULE OF DIRECTORS
June 30, 2012

BOARD OF DIRECTORS

NAME

TERM EXPIRES

James Harrison, President

December 5, 2014

Larry Vierheilig, Vice-President

December 5, 2014

Michael Winn, Director

December 7, 2012

Ed Eby, Director

December 7, 2012

Dan Gaddis, Director

December 5, 2014

3rd Draft

Independent Auditor's Report

Board of Directors
Nipomo Community Services District
Nipomo, California

I have audited the accompanying financial statements of the business-type activities of the Nipomo Community Services District as of and for the year ended June 30, 2012 and 2011, which collectively comprise the Organization's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the District's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audits in accordance with U.S. Generally Accepted Auditing Standards. Those standards require that I plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. I believe that my audits provide a reasonable basis for my opinion.

In my opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities of the Nipomo Community Services District as of June 30, 2012 and 2011, and the respective changes in financial position and cash flows, where applicable, thereof for the years then ended in conformity with U.S. generally accepted accounting principles.

The Management's Discussion and Analysis on pages i through viii, are not a required part of the basic financial statements but are supplementary information required by U.S. Generally Accepted Accounting Principles. I have applied certain limited procedures, which consisted principally of management regarding the methods of measurement and presentation of the required supplementary information. However, I did not audit the information and express no opinion on it.

My audits were conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Nipomo Community Services District basic financial statements. The combining financial statement schedules listed in the table of contents are presented for the purposes of additional analysis and are not a required part of the basic financial statements. The combining financial statements have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in my opinion, are fairly stated in all material respects in relation to the financial statements taken as a whole. The introductory section and statistical tables have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, I express no opinion on them.

CROSBY COMPANY
Certified Public Accountant

August 19, 2012

3rd Draft

NIPOMO COMMUNITY SERVICES DISTRICT
STATEMENTS OF NET ASSETS
PROPRIETARY FUNDS
As of June 30, 2012

(With Comparative Totals for the Year Ended June 30, 2011)

	Enterprise Funds	
	2012	2011
ASSETS		
Current assets		
Cash and cash equivalents	\$ 32,089,754	\$ 23,856,776
Accounts receivable	220,354	208,515
Unbilled utilities receivable	761,000	680,000
Accrued interest receivable	18,832	26,376
Prepaid expenses	3,698	41,362
Accrued franchise fees	12,636	11,820
Notes receivable (current portion)	40,740	39,445
Total current assets	33,147,014	24,864,294
Non-current assets		
Capital assets:		
Land and construction in progress	7,093,217	7,454,032
Property, plant and equipment, net accumulated depreciation	26,140,387	25,157,642
Total noncurrent assets	33,233,604	32,611,674
Other assets		
Loan fees, net accumulated amortization	520,172	183,748
Notes receivable (less current portion)	270,062	310,802
Deposits and other assets	51,500	
Total other assets	841,734	494,550
Total assets	\$ 67,222,352	\$ 57,970,518
LIABILITIES		
Current liabilities		
Accounts payable	\$ 311,319	\$ 396,289
Accrued liabilities	239,894	159,315
Deposits	122,607	91,298
Current portion long term debt	372,789	257,089
Total current liabilities	1,046,609	903,991
Noncurrent liabilities		
Long term debt	13,644,534	4,417,899
Deferred revenues	6,300	6,300
Total noncurrent liabilities	13,650,834	4,424,199
Total liabilities	\$ 14,697,443	\$ 5,328,190
NET ASSETS		
Invested in capital assets, net of related debt	\$ 19,736,453	\$ 28,120,434
Restricted for system expansion and replacement	12,721,267	14,429,872
Unrestricted	20,067,189	10,092,022
Total net assets	\$ 52,524,909	\$ 52,642,328

The accompanying notes are an integral part of these financial statements

-3-
3rd Draft

NIPOMO COMMUNITY SERVICES DISTRICT
STATEMENTS OF REVENUES, EXPENSES AND
CHANGES IN FUND NET ASSETS
PROPRIETARY FUNDS
June 30, 2012

(With Comparative Totals for the Year Ended June 30, 2011)

	Enterprise Funds	
	2012	2011
Operating revenues		
Charges for services	\$ 5,210,119	\$ 4,952,837
Miscellaneous	221,853	208,228
Total operating revenues	5,431,972	5,161,065
Operating expenses		
Personnel	1,420,129	1,475,273
Contractual services	288,956	518,736
Utilities	652,296	556,145
Repairs and maintenance	225,362	316,935
Other supplies and expenses	642,025	624,970
Insurance	77,796	79,754
Depreciation and amortization	1,112,362	1,158,947
Total operating expenses	4,418,926	4,730,760
Operating income (loss)	1,013,046	430,305
Non-operating revenues (expenses)		
Interest	98,657	125,994
Property taxes	501,739	557,041
Cell site income	33,824	32,838
Miscellaneous income	542	19,570
Miscellaneous expense	(3,264)	
Abandoned project	(1,671,990)	
Interest expense	(178,647)	(181,873)
Total non-operating revenues (expenses)	(1,219,139)	553,570
Income before contributions	(206,093)	983,875
Capital contributions	88,674	226,462
Changes in net assets	(117,419)	1,210,337
Net assets-beginning of year	52,642,328	51,431,991
Net assets-end of year	\$ 52,524,909	\$ 52,642,328

The accompanying notes are an integral part of these financial statements

-4-
3rd Draft

NIPOMO COMMUNITY SERVICES DISTRICT
STATEMENTS OF CASH FLOWS
PROPRIETARY FUNDS
As of June 30, 2012

(With Comparative Totals for the Year Ended June 30, 2011)

	Enterprise Funds	
	2012	2011
<i>Cash flows from operating activities</i>		
Cash received from operating revenue	\$ 5,420,133	\$ 5,249,956
Payments to suppliers	(1,908,180)	(1,924,920)
Payments to employees	(1,420,129)	(1,475,273)
Net cash provided by operating activities	2,091,824	1,849,763
<i>Cash flows from non-capital financing activities</i>		
Property tax revenues	501,739	557,041
Other cash flows	31,102	52,408
Net cash provided by non-capital financing activities	532,841	609,449
<i>Cash flows from capital and related financing activities</i>		
Capital contributions	88,674	226,462
Acquisition of capital assets	(3,389,345)	(2,427,642)
Additional loan fees	(353,360)	
Proceeds from capital debt	9,795,000	
Principal paid on capital debt	(452,666)	(267,619)
Interest paid on capital debt	(178,647)	(181,873)
Net cash provided (used) by capital and related financing activities	5,509,656	(2,650,672)
<i>Cash flows from investing activities</i>		
Interest income	98,657	125,994
Net cash provided by investing activities	98,657	125,994
<i>Net change in cash</i>	8,232,978	(65,466)
<i>Cash and cash equivalents-beginning</i>	23,856,776	23,922,242
<i>Cash and cash equivalents-ending</i>	\$ 32,089,754	\$ 23,856,776
<i>Reconciliation of operating income to net cash provided by operating activities:</i>		
Operating income	\$ 1,013,046	\$ 430,305
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	1,112,362	1,158,947
Loss on disposal of capital assets		17,930
Net changes in assets and liabilities		
Accounts receivable	(11,839)	88,891
Unbilled utility receivable	(81,000)	45,000
Accrued interest receivable	7,544	5,500
Prepaid expenses	37,664	17,316
Accrued franchise fees	(816)	290
Notes receivable	39,445	38,790
Deposits and other assets	(51,500)	
Accounts payable	(84,970)	45,682
Accrued liabilities	80,579	(2,679)
Deposits	31,309	3,791
Net cash provided by operating activities	\$ 2,091,824	\$ 1,849,763

The accompanying notes are an integral part of these financial statements

NIPOMO COMMUNITY SERVICES DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2012

NOTE 1: ORGANIZATION

The Nipomo Community Services District (District) is a multi-purpose special district and was formed on January 28, 1965 and began operations in November 1966. The District is a political subdivision of the State of California and operates under a Board of Directors – General Manager form of government. The District provides water, sewer, street lighting, solid waste, street landscape maintenance, drainage and general administrative services.

The District complies with U.S. Generally Accepted Accounting Principles (GAAP) and all relevant U.S. Governmental Accounting Standards Board (GASB) pronouncements. These technical pronouncements establish criteria for determining the organization's activities and functions that are included in the financial statements of a governmental unit. The proprietary funds apply Financial Accounting Standards Board (FASB) pronouncements and Accounting Principles Board (APB) opinions issued unless those pronouncements conflict with or contradict GASB pronouncements, in which case GASB prevails.

The financial statements include certain prior-year summarized comparative information in total but not by net asset class. Such information is presented for comparative purposes only. Additional detailed information is presented in the prior year financial statements from which the summarized information was derived.

Reporting Entity

For financial reporting purposes, the District would include in this report all funds and account groups of all agencies and boards that are controlled by, or dependent upon, the District's legislative body. The criteria of control is determined on the basis of financial accountability, imposition of will, and financial benefit or burden.

The Nipomo Community Services District Public Facilities Corporation is a component unit of the District. This Corporation was formed to issue Revenues Certificates of Participation (COP'S) in May of 2003 and June of 2012. The financial activity of the corporation is blended into the financial statements of the District.

The District is a member of the Special District Authority Risk Management Joint Powers Agency, which was organized for the purpose of providing general liability, automobile, errors and omissions, and property loss insurance coverage to special districts. This organization is financed through premium charges to each member. This organization does not meet the aforementioned reporting entity criteria and therefore is not included in the accompanying financial statements.

NIPOMO COMMUNITY SERVICES DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2012

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Proprietary Fund Financial Statements

The accounts of the District are organized into proprietary/enterprise funds. Enterprise funds use the economic resources measurement focus. The accounting objectives are a determination of net income, financial position, and cash flows. All assets and liabilities associated with an enterprise fund's activities are included on the balance sheet.

Basis of Accounting

The enterprise funds of the District are accounted for using the accrual basis of accounting. Revenues, including user fees and service charges, are recognized when earned, and expenses are recognized when incurred.

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 U.S. Generally Accepted Accounting Principles require 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

For purposes of the statements of cash flows, the District considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents.

Accounts Receivable

Water and sewer charges are billed bi-monthly for all residential and commercial customers. Customer accounts receivable are placed on the tax roll when the receivable is deemed uncollectible by the District. The District did not experience any significant bad debt losses and therefore a zero provision has been made for doubtful accounts. Accounts receivable is shown at full value.

See Auditor's Report

3rd Draft⁷

NIPOMO COMMUNITY SERVICES DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2012

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Property, Plant and Equipment

All fixed assets are valued at historical cost or estimated historical cost if actual costs are not available. Other donated fixed assets are valued at their estimated fair market value on the date received. Depreciation has been provided over the estimated useful life of the asset using the straight-line method. The estimated useful lives are as follows:

Wastewater Treatment Plant and Collection System	50 years
Water Supply/Distribution System	20-50 years
Buildings/Blowers	20 years
General Plant Machinery and Equipment	5-10 years

Compensated Absences

Depending on the length of continuous services, a range of 10-20 vacation and 12 days of sick leave per year may be accumulated by each employee. The District accrues a liability for compensated absences which meet the following criteria:

1. The District's obligation relating to employee's rights to receive compensation for future absences is attributable to employee's services already rendered.
2. The obligation relates to rights that vest or accumulate.
3. Payment of the compensation is probable.
4. The amount can be reasonable estimated.

In accordance with above criteria, the District has accrued a liability for vacation and sick pay which has been earned, but not taken by District employees, and is recorded as a liability.

Capital Contributions

Capital contributions are recorded when cash for capacity fees or fixed assets are received from developers, customers, or other governmental entities, and the purpose is for other than operating expenses.

Property Taxes

The County of San Luis Obispo bills and collects property taxes for the District. The County charges the District for these services. Tax revenues are recognized by the District in the year received.

See Auditor's Report

3rd Draft

NIPOMO COMMUNITY SERVICES DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2012

NOTE 3: CASH AND CASH EQUIVALENTS

The values of cash and cash equivalents at June 30, 2012 are summarized as follows:

Cash on hand	\$	350
Bank deposits		38,452
Certificate of deposit		1,473,591
Deposits with bond trustees		9,788,007
Cash and investments in pooled funds		20,890,325
Less: Cash held in Trust in pooled funds		<u>(100,971)</u>
 Total	 \$	 <u>32,089,754</u>

The California Government Code requires California banks and savings and loan associations to secure a district's deposits by pledging government securities as collateral. The market value of pledged securities must equal at least 110% of a district's deposits. California law also allows financial institutions to secure district deposits by pledging first trust deed mortgage notes having a value of 150% of a district's total deposits. The District may waive collateral requirements for deposits which are fully insured up to \$250,000 by the Federal Deposit Insurance Corporation (FDIC). Effective October 3, 2008, the FDIC temporarily increased insured deposits up to \$250,000 and is scheduled to return to \$100,000 after December 31, 2013.

Credit Risk, Carrying Amount, and Market Value

Cash is classified in three categories of credit risk as follows:

- Category 1 -insured or collateralized with securities held by the entity or by its agent in the entity's name;
- Category 2 -collateralized with securities held by the pledging financial institution's trust department or agent in the entity's name; and
- Category 3 -uncollateralized.

Investments in pools managed by other governments Local Agency Investment Fund (LAIF) or in mutual funds are not required to be categorized.

As of June 30, 2012, the carrying amount of the District's cash deposits was \$11,199,429. The bank's balance was \$11,305,409. This difference is due to the normal deposits in transit and outstanding checks. District cash deposits by category as of June 30, 2012, are as follows:

	<u>1</u>	<u>Category</u> <u>2</u>	<u>3</u>	<u>Bank</u> <u>Balance</u>	<u>Carrying</u> <u>Amount</u>
Bank accounts	\$ 11,305,409	\$ -0-	\$ -0-	\$ 11,305,409	\$ 11,199,429

See Auditor's Report

3rd Draft

NIPOMO COMMUNITY SERVICES DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
 June 30, 2012

NOTE 4: INVESTMENTS

Investments Authorized by the District's Investment Policy

The District is authorized to invest in the following institutions:

1. County pooled funds (California Government Code Section 61730)
2. The Local Agency Investment Fund (LAIF) created by the California State Treasury (California Government Code Section 16429.1)
3. One or more FDIC insurance banks and/or savings and loan associations that are designated as District depositories by resolution of the Board of Directors (California Government Code Section 61737.02)
4. Such other financial institutions or securities that may be designated by the Board of Directors from time to time in compliance with California and Federal law.

The District's investment policy does contain specific provisions intended to limit the District's exposure to interest rate risk, credit risk, and concentration of credit risk.

Investments Authorized by Debt Agreements

Investment of debt proceeds held by bond trustee and governed by provisions of the debt agreements, rather than the general provisions of the California Government Code or the District's investment policy. The table below identifies certain provisions of these debt agreements that address interest rate risk, credit risk, and concentration of credit risk.

<u>Authorized Investment Type</u>	<u>Maximum Maturity</u>
Money Market Mutual Funds	N/A

Disclosure Relating to Interest Rate Risk

Interest rate risk is the risk that changes in the 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. The weighted average maturity of the investment contained in the LAIF investment pool is approximately 7 months.

Information about the sensitivity of the fair values of the District's investment to market interest rate fluctuations is provided by the following table that shows the maturity date of each investment:

State investment pool	\$ <u>20,890,325</u>	<u>Maturity Date</u> 7 months average maturity
-----------------------	----------------------	---

See Auditor's Report

10-
3rd Draft

NIPOMO COMMUNITY SERVICES DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2012

NOTE 4: INVESTMENTS (continued)

Investment in State Investment Pool

The District is a voluntary participant in the Local Agency Investment Fund (LAIF) that is regulated by California Government Code Section 16429 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 entity'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 costs basis.

Disclosures Relating to Credit Risk

Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. LAIF does not have a rating provided by a nationally recognized statistical rating organization.

Custodial Credit Risk

Custodial credit risk for deposits is the risk that in the event of the failure of a depository financial institution, a government will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The California Government Code and the District's investment policy do not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits, other than the following provision for deposits: The California Government Code requires that a financial institution secure deposits made by the 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 mortgages notes having a value of 150% of the secured public deposits.

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

See Auditor's Report

11-
3rd Draft

NIPOMO COMMUNITY SERVICES DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2012

NOTE 5: PROPERTY, PLANT, EQUIPMENT AND CONSTRUCTION IN PROGRESS

A summary of fixed assets by major classifications is as follows:

	June 30, <u>2011</u>	<u>Additions</u>	<u>(Deletions)</u>	June 30, <u>2012</u>
Collection and treatment Facilities	\$ 18,404,156	\$ 1,972,286		\$ 20,376,442
Source of supply and Pumping	4,795,282			4,795,282
Transmission and distribution lines	13,651,065			13,651,065
Machinery and equipment	1,000,070	57,619		1,057,689
Vehicles	280,965		(24,448)	256,517
Building	1,257,252	13,460		1,270,712
Computer equipment	405,725	21,645		427,370
Office furniture and fixtures	184,382	13,160		197,542
Land and land rights	735,401			735,401
Construction in progress	<u>6,718,631</u>	<u>3,255,717</u>	<u>(3,616,532)</u>	<u>6,357,816</u>
Subtotal	47,432,929	\$ <u>5,333,887</u>	\$ <u>(3,640,980)</u>	49,125,836
Less: Accumulated depreciation	<u>14,821,255</u>	\$ <u>1,095,425</u>	\$ <u>(24,448)</u>	<u>15,892,232</u>
Totals	\$ <u>32,611,674</u>			\$ <u>33,233,604</u>

Depreciation expense for the period ended June 30, 2012 was \$1,095,425.

See Auditor's Report

12-
3rd Draft

NIPOMO COMMUNITY SERVICES DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2012

NOTE 6: LONG TERM DEBT

Long term debt consisted of the following:

	Balance at <u>June 30, 2011</u>	Balance at <u>June 30, 2012</u>
In August 1978, the District issued and sold Water Revenue Bonds amounting to \$270,000. The loan is payable over 40 years and bear interest at 5% per annum. Interest is paid semi-annually.	\$ 76,000	\$ -
The District entered into a loan contract for \$697,367 on April 30, 1998, with the State Water Resources Control Board for the construction of the Southland Wastewater Treatment Plant Expansion – Phase I. The loan was funded during the year ended June 30, 1999. Loan interest is zero percent, however, a loan fee of 16.667% was charged. The loan is payable over 20 years. It calls for annual payments of \$34,868 starting May 1, 2000.	278,947	244,079
The District entered into a loan contract for \$843,605 on February 24, 1999, with the State Water Resources Control Board for the construction of the Southland Wastewater Treatment Plant Expansion–Phase II. The loan was funded during the year ended June 30, 2000. The loan interest is zero percent, however, a loan fee of 16.667% was charged. The loan is payable over 20 years. It calls for annual payments of \$42,180 starting March 1, 2001.	379,622	337,442
The District issued \$4,000,000 of Revenue Certificate of Participation (COP'S) on May 1, 2003. The proceeds are to be used for pipeline and storage facility project costs. The COP'S bear interest ranging from 3.00% to 4.93% per annum. Principal is to be paid annually starting September 1, 2004 through September 1, 2033. Annual principal payments range from \$75,000 to \$225,000.	3,420,000	3,330,000
The District issued \$9,795,000 of Revenue Certificate of Participation (COP'S) on June 21, 2012. The proceeds are to be used for Southland Wastewater Treatment Facility Upgrade. The COP'S bear interest ranging from 2.00% to 4.125% per annum. Principal is to be paid annually starting June 1, 2013 through June 1, 2042. Annual principal payments range from \$145,000 to \$225,000.	-	9,795,000

See Auditor's Report

13-
3rd Draft

NIPOMO COMMUNITY SERVICES DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2012

NOTE 6: LONG TERM DEBT (continued)

Long term debt consisted of the following:

	<u>Balance at</u> <u>June 30, 2011</u>	<u>Balance at</u> <u>June 30, 2012</u>
<p>The District entered into a lease purchase agreement of \$207,952 on October 20, 2009, with the Municipal Finance Corporation for a sewer vacuum truck. Installment payments in the amount of \$23,607 are due in ten consecutive semi-annual payments and includes interest at the rate of 4.75% per annum on the principal component of the unpaid installment payments.</p>	170,172	-
<p>The District adopted a water rate adjustment and Buy-In Charge of \$277,742 for the merger of Blacklake and Town Water Division on June 1, 2009, for the purposes of meeting operation, maintenance and capital replacement expenses for providing water service for the merged water systems. Prepayments in the amount of \$55,499 from Blacklake water customers was applied to the total Buy-In Charge. A loan of \$222,243 shall be repaid through a bi-monthly surcharge applied to Blacklake customers' water utility bills for a ten-year period with interest rate at 3%.</p>	\$ 182,949	\$ 162,403
<p>The District entered into an Inter-Fund Loan for \$275,000 on April 1, 2009, with the Blacklake Division for the operation, maintenance and the replacement of existing sewer facilities. Prepayments in the amount of \$68,949 from Blacklake sewer customers was applied to the total. A loan of \$206,501 shall be repaid through a bi-monthly surcharge applied to Blacklake customers' sewer utility bills for a ten-year period with interest rate at 3.5%.</p>	<u>167,298</u>	<u>148,399</u>
<p>Total long-term debt</p>	4,674,988	14,017,323
<p>Less current maturities</p>	<u>257,089</u>	<u>372,789</u>
<p>Total long-term maturities</p>	<u>\$ 4,417,899</u>	<u>\$ 13,644,534</u>

See Auditor's Report

14-
3rd Draft

NIPOMO COMMUNITY SERVICES DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2012

NOTE 6: LONG TERM DEBT (continued)

Future required principal and interest payments are as follows:

<u>Years ending June 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2013	\$ 372,789	\$ 517,723	\$ 890,512
2014	364,127	530,720	894,847
2015	365,509	521,213	886,722
2016	376,938	511,462	888,400
2017	388,413	501,185	889,598
2018 – 2022	1,894,547	2,325,665	4,220,212
2023 – 2027	2,250,000	1,942,542	4,192,542
2028 – 2032	2,760,000	1,432,095	4,192,095
2033 – 2037	2,605,000	838,369	3,443,369
2038 – 2043	<u>2,640,000</u>	<u>335,569</u>	<u>2,975,569</u>
Totals	<u>\$ 14,017,323</u>	<u>\$ 9,456,543</u>	<u>\$ 23,473,866</u>

NOTE 7: RESTRICTED NET ASSETS

Restricted cash and investments were provided by, and are to be used for the following as of June 30, 2012:

<u>Funding Source</u>	<u>Use</u>	
Water capacity charges	For the expansion of the water system	\$ 3,302,878
Water sales	Funded replacement	4,573,183
Town Sewer capacity charges	For the expansion of sewer system	536,844
Town Sewer sales	Funded replacement	4,081,449
Blacklake sewer sales	Funded replacement	<u>226,913</u>
	Totals	<u>\$ 12,721,267</u>

See Auditor's Report

15-
3rd Draft

NIPOMO COMMUNITY SERVICES DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2012

NOTE 8: JOINT POWERS AUTHORITY

The District is a member of the Special District Risk Management Authority (S.D.R.M.A.), an intergovernmental risk sharing joint powers authority, created pursuant to California Government Code Sections 6500 et.seq. In becoming a member of the S.D.R.M.A., the District elected to participate in the risk financing program(s) listed below for the program periods July 1, 2011 through June 30, 2012 and July 1, 2010 through June 30, 2011.

General Liability: Special District Risk Management Authority, coverage number LCA SDRMA 201112. This covers \$10,000,000 per occurrence.

Public Officials and Employees Errors: Special District Risk Management Authority, coverage number LCA SDRMA 201112. This covers \$10,000,000 per occurrence/general aggregate.

Personal Liability Coverage for Board Members: Special District Risk Management Authority, coverage number LCA SDRMA 201112. This covers \$500,000 per occurrence/general aggregate.

Employment Practices Liability: Special District Risk Management Authority, coverage number LCA SDRMA 201112. This covers \$10,000,000 per wrongful employment practice/aggregate limits per member.

Employee Benefits Liability: Special District Risk Management Authority, coverage number LCA SDRMA 201112. This covers \$10,000,000 per occurrence/general aggregate.

Employee Dishonesty Coverage: Special District Risk Management Authority, coverage number EDC SDRMA 201112. This policy includes a \$400,000 Public Employees Dishonesty Blanket Coverage.

Auto Liability: Special District Risk Management Authority, coverage number LCA SDRMA 201112. This policy covers \$10,000,000 per occurrence with personal injury and property damage.

Automobile Physical Damage: Special District Risk Management Authority, coverage number LCA SDRMA 201112. The coverage is on file with SDRMA.

Uninsured/Under Insured Motorist: Special District Risk Management Authority, coverage number UMI SDRMA 201112. This covers \$750,000 each accident.

Trailer Coverage: District Risk Management Authority, coverage number LCA SDRMA 201112. The coverage is on file with SDRMA.

See Auditor's Report

16-
3rd Draft

NIPOMO COMMUNITY SERVICES DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2012

NOTE 8: JOINT POWERS AUTHORITY (continued)

Property Coverage: Special District Risk Management Authority, coverage number PPC SDRMA 201112. This policy covers the replacement cost for scheduled property, \$1,000,000,000 per occurrence. Deductible is on file with SDRMA.

Boiler and Machinery: Special District Risk Management Authority, coverage number BMC SDRMA 201112. This covers the replacement cost for scheduled property, \$100,000,000 per occurrence. Deductible is on file with SDRMA.

Workers Compensation Coverage and Employer's Liability: Special District Risk Management Authority, coverage number WCP SDRMA 201112. This coverage is statutory per occurrence, respectively for workers' compensation and \$5,000,000 for employers' liability coverage.

The annual member contribution was \$68,010 for the Package Program, \$8,095 for the Comp/Collision Program and \$19,765 for the worker's compensation program. Members are subject to dividends and/or assessments, in accordance with Fourth Amended Joint Powers Agreement and amendments thereto, on file with the District. No such dividends have been declared, nor have any assessments been levied. Presently, there are no known refunds or credits due to the District. There has been no reduction in insurance coverage from the prior year. Insurance settlements have not exceeded insurance coverage for each of the past three fiscal years.

Condensed financial information for S.D.R.M.A. for the most recent year available is as follows:

		<u>June 30, 2011</u>
Total assets	\$	98,259,108
Total liabilities		<u>47,376,526</u>
Risk margin	\$	<u>50,882,582</u>
Total revenues	\$	42,293,914
Total expenses		<u>36,497,656</u>
Net income	\$	<u>5,796,258</u>

Complete audited financial statements on the S.D.R.M.A. are on file with the general manager of the District.

See Auditor's Report

17-
3rd Draft

NIPOMO COMMUNITY SERVICES DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2012

NOTE 9: DEFINED BENEFIT PENSION PLAN

Plan Description

The Nipomo Community Services District contributes to the California Public Employees' Retirement System (CALPERS), an agent multiple-employer public employee 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 entities within the State of California. Benefit provisions and all other requirements are established by state statute and District ordinance. Copies of CALPERS' annual financial report may be obtained from their Executive Office – 400 P Street, Sacramento, CA 95814.

Employee membership in CALPERS is compulsory for all regular full-time and part-time employees except those specifically excluded.

Benefits fully vest on reaching five years of service. Employees who retire at or after age 60 with five years of credited service, are entitled to a retirement benefit payable monthly for life. An employee's monthly service benefit is determined by computing the product: years of credited service multiplied by three percent multiplied by final-average monthly compensation for employees hired prior to June 18, 2011 and three year final compensation for employees hired on or after June 18, 2011. Final-average monthly compensation is the employee's average monthly salary during the last year of credited services, or the last three years, whichever is greater. Vested employees may retire at or after age 50 and receive reduced retirement benefits. CALPERS also provides death and disability benefits. These benefit provisions and all other requirements are established by State statute. Employees are required to contribute to the plan based upon the funding policy outlined below. The District is required to contribute the remaining amounts necessary to fund CALPERS, using the actuarial basis specified by statute.

Funding Policy

Employees hired prior to June 18, 2011

Participants are required to contribute eight percent of their annual covered salary. The District makes the contribution required of District employees on their behalf and for their account. The District is required to contribute at an actuarially determined rate; the current rate is 20.296% of annual covered payroll. The contribution requirements of plan members and the District are established and may be amended by CALPERS.

NIPOMO COMMUNITY SERVICES DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2012

NOTE 9: DEFINED BENEFIT PENSION PLAN (continued)

Funding Policy

Employees hired on or after June 18, 2011

Participants are required to contribute eight percent of their annual covered salary. The District does not make the required contribution of District employees on their behalf and for their account. The District is required to contribute at an actuarially determined rate; the current rate is 15.187% of annual covered payroll. The contribution requirements of plan members and the District are established and may be amended by CALPERS.

Actual Pension Cost

For the fiscal year ending June 30, 2012, the District's annual pension cost of \$215,945 for CALPERS was equal to the District's required and actual contributions. The required contribution was determined as part of the June 30, 2010, actuarial valuation using the entry age normal actuarial cost method. The actuarial assumptions included (a) 7.75% investment rate of return (net of administrative expenses), (b) projected annual salary increases. The actuarial value of CALPERS assets was determined using techniques that smooth the effects of short-term volatility in the market value of investments over a two to three year period (smoothed market value).

Actuarial information concerning this pension plan is now combined with several other local districts and individual district information and three year trend information is no longer made available to the Nipomo Community Services District.

Post-employment Benefits

In addition to pension benefits, the District provides post-retirement health care benefits through the California Public Employees' Retirement System. Employees who retire on or after attaining age 50 and are vested, are eligible for District paid health insurance.

For employees hired prior to February 1, 2006, the District's financial obligation is to pay 100% of the cost of coverage for the eligible retiree and any eligible dependents. For employees hired on or after February 1, 2006, the District's contribution percentage is based on the employee's years of CalPERS eligible service at retirement starting at 50% for employees with 10 years increasing by 5% per year of service up to 100%.

On July 1, 2011, the District conducted an actuarial valuation based on the Alternative Measurement Method to determine the required funding for this health care benefits program.

NIPOMO COMMUNITY SERVICES DISTRICT
NOTES TO THE FINANCIAL STATEMENTS
June 30, 2012

NOTE 9: DEFINED BENEFIT PENSION PLAN (continued)

The actuarial accrued liability for the District's retiree health benefits program on this measurement date was determined to be \$1,328,814. This value is based on a discount rate of 7.61%. The District's funding policy is to fund 100% of the annual required contribution determined through the California Employers' Retiree Benefit Trust (CERBT). Based on this valuation, the District contributed \$103,000 to an irrevocable trust to meet the current obligations of this program and to fully fund the annual liability. Currently, five retired employees are receiving 100% paid health care benefits totaling \$4,762 per month.

Below are the required disclosures for this plan:

Number of active participants		12
Employer's actuarially required contributions	\$	114,406
Employer's actual contributions	\$	103,000
Actuarial Accrued Liability(AAL)	\$	1,328,814
Actuarial Valuation of Assets(AVA)	\$	415,459
Unfunded Actuarial Accrued Liability(UAAL)=(AAL less AVL)	\$	913,355
Funded Ratio(AVA/AAL)		31%
Estimated Payroll	\$	761,000
UAAL as a Percentage of Covered Payroll		120%

SUPPLEMENTAL INFORMATION

3rd Draft

NIPOMO COMMUNITY SERVICES DISTRICT
COMBINING STATEMENTS OF NET ASSETS
PROPRIETARY FUNDS
As of June 30, 2012

Business Type Activities - Enterprise Funds

ASSETS

Current Assets	<u>Water</u>	<u>Town Sewer</u>	<u>Blacklake Sewer</u>	<u>Blacklake Lighting</u>
Cash and cash equivalents	\$ 11,178,522	\$ 17,595,677	\$ 493,485	\$ 27,209
Accounts receivable	120,019	58,293	42,042	
Unbilled utilities receivable	518,000	206,000	37,000	
Accrued interest receivable	9,093	7,106	434	26
Prepaid expenses	1,843			
Accrued franchise fees				
Notes receivable (current portion)	21,170			
Total current assets	<u>11,848,647</u>	<u>17,867,076</u>	<u>572,961</u>	<u>27,235</u>
Noncurrent Assets				
Capital assets:				
Land and construction in progress	4,219,972	2,868,455	4,790	
Property, plant and equipment, net	10,177,080	12,600,501	1,714,418	
Total noncurrent assets	<u>14,397,052</u>	<u>15,468,956</u>	<u>1,719,208</u>	<u>-</u>
Other Assets				
Loan fees, net accumulated amortization		396,243		
Notes receivable (less current portion)	141,233			
Deposits and other	37,500	14,000		
Total other assets	<u>178,733</u>	<u>410,243</u>	<u>-</u>	<u>-</u>
Total assets	<u>\$ 26,424,432</u>	<u>\$ 33,746,275</u>	<u>\$ 2,292,169</u>	<u>\$ 27,235</u>

LIABILITIES

Current Liabilities				
Accounts payable	\$ 205,056	\$ 95,078	\$ 8,175	\$ 10
Accrued liabilities	74,311	105,650	8,974	
Deposits	118,949			
Current portion long term debt	21,170	237,049	19,570	
Total current liabilities	<u>419,486</u>	<u>437,777</u>	<u>36,719</u>	<u>10</u>
Noncurrent Liabilities				
Long term debt	141,233	10,139,472	128,829	
Deferred revenue		6,300		
Total noncurrent liabilities	<u>141,233</u>	<u>10,145,772</u>	<u>128,829</u>	<u>-</u>
Total liabilities	<u>\$ 560,719</u>	<u>\$ 10,583,549</u>	<u>\$ 165,548</u>	<u>\$ 10</u>

NET ASSETS

Invested in capital assets, net of related debt	\$ 14,234,649	\$ 5,488,678	\$ 1,570,809	\$ -
Restricted for system expansion and replacement	7,876,061	4,618,293	226,913	
Unrestricted	3,753,003	13,055,755	328,899	27,225
Total net assets	<u>\$ 25,863,713</u>	<u>\$ 23,162,726</u>	<u>\$ 2,126,621</u>	<u>\$ 27,225</u>

NIPOMO COMMUNITY SERVICES DISTRICT
COMBINING STATEMENTS OF NET ASSETS
PROPRIETARY FUNDS
 As of June 30, 2012

Business Type Activities - Enterprise Funds

	<u>Solid Waste</u>		<u>Drainage</u>		<u>Landscape Maintenance District</u>		<u>Property Taxes</u>		<u>Total</u>
\$	259,396	\$	5,000	\$	20,942	\$	2,509,523	\$	32,089,754
									220,354
	231		14		16		1,912		761,000
							1,855		18,832
	12,636								3,698
							19,570		12,636
	<u>272,263</u>		<u>5,014</u>		<u>20,958</u>		<u>2,532,860</u>		<u>40,740</u>
									<u>33,147,014</u>
									7,093,217
	3,111						1,645,277		26,140,387
	<u>3,111</u>		<u>-</u>		<u>-</u>		<u>1,645,277</u>		<u>33,233,604</u>
									520,172
							123,929		270,062
							128,829		51,500
	<u>-</u>		<u>-</u>		<u>-</u>		<u>252,758</u>		<u>841,734</u>
\$	<u>275,374</u>	\$	<u>5,014</u>	\$	<u>20,958</u>	\$	<u>4,430,895</u>	\$	<u>67,222,352</u>
\$	537	\$	-	\$	2,463	\$	-	\$	311,319
	272						50,687		239,894
							3,658		122,607
							95,000		372,789
	<u>809</u>		<u>-</u>		<u>2,463</u>		<u>149,345</u>		<u>1,046,609</u>
									13,644,534
							3,235,000		6,300
	<u>-</u>		<u>-</u>		<u>-</u>		<u>3,235,000</u>		<u>13,650,834</u>
\$	<u>809</u>	\$	<u>-</u>	\$	<u>2,463</u>	\$	<u>3,384,345</u>	\$	<u>14,697,443</u>
\$	3,111	\$	-	\$	-	\$	(1,560,794)	\$	19,736,453
									12,721,267
	<u>271,454</u>		<u>5,014</u>		<u>18,495</u>		<u>2,607,344</u>		<u>20,067,189</u>
\$	<u>274,565</u>	\$	<u>5,014</u>	\$	<u>18,495</u>	\$	<u>1,046,550</u>	\$	<u>52,524,909</u>

NIPOMO COMMUNITY SERVICES DISTRICT
COMBINING STATEMENT OF REVENUES, EXPENSES AND CHANGE IN NET ASSETS
PROPRIETARY FUNDS
As of June 30, 2012

Business Type Activities - Enterprise Funds

	<u>Water</u>	<u>Town Sewer</u>	<u>Blacklake Sewer</u>	<u>Blacklake Lighting</u>
Operating Revenues				
Charges for services	\$ 2,978,557	\$ 1,771,347	\$ 441,311	\$ 18,904
Miscellaneous	91,602	3,164	24,457	
Total operating revenues	<u>3,070,159</u>	<u>1,774,511</u>	<u>465,768</u>	<u>18,904</u>
Operating expenses				
Personnel	1,020,748	291,156	108,225	
Contractual services	265,436	21,798	1,616	
Utilities	459,011	128,616	41,362	23,177
Repairs and maintenance	125,572	82,860	16,930	
Other supplies and expenses	386,764	122,853	69,097	47
Insurance	59,217	13,751	2,328	500
Depreciation and amortization	505,492	478,580	77,918	
Total operating expenses	<u>2,822,240</u>	<u>1,139,614</u>	<u>317,476</u>	<u>23,724</u>
Operating income (loss)	<u>247,919</u>	<u>634,897</u>	<u>148,292</u>	<u>(4,820)</u>
Non operating revenues (expenses)				
Interest	45,773	33,380	1,613	113
Property taxes				
Cell site	33,824			
Miscellaneous income	371	122	49	
Miscellaneous expense		(3,264)		
Abandoned project	(1,671,990)			
Interest expense	(6,173)	(14,337)	(5,582)	
Total non operating revenues	<u>(1,598,195)</u>	<u>15,901</u>	<u>(3,920)</u>	<u>113</u>
Income (loss) before contributions	<u>(1,350,276)</u>	<u>650,798</u>	<u>144,372</u>	<u>(4,707)</u>
Transfers (to) from other funds	143,248	(92,814)	(50,434)	
Capital contributions	17,898	70,776		
Change in net assets	<u>(1,189,130)</u>	<u>628,760</u>	<u>93,938</u>	<u>(4,707)</u>
Total net assets - beginning	<u>27,052,843</u>	<u>22,533,966</u>	<u>2,032,683</u>	<u>31,932</u>
Total net assets - ending	<u>\$ 25,863,713</u>	<u>\$ 23,162,726</u>	<u>\$ 2,126,621</u>	<u>\$ 27,225</u>

See Auditor's Report

23-
3rd Draft

NIPOMO COMMUNITY SERVICES DISTRICT
COMBINING STATEMENT OF REVENUES, EXPENSES AND CHANGE IN NET ASSETS
PROPRIETARY FUNDS
As of June 30, 2012

Business Type Activities - Enterprise Funds

<u>Solid Waste</u>	<u>Drainage</u>	<u>Landscape Maintenance District</u>	<u>Property Taxes</u>	<u>Totals</u>
\$ -	\$ -	\$ -	\$ -	5,210,119
94,130	-	8,500	-	221,853
<u>94,130</u>	<u>-</u>	<u>8,500</u>	<u>-</u>	<u>5,431,972</u>
106	-	-	-	1,420,129
-	-	130	-	288,956
-	-	-	-	652,296
52,581	-	8,563	2,120	225,362
2,000	-	-	-	642,025
1,696	-	-	48,676	77,796
<u>56,383</u>	<u>-</u>	<u>8,693</u>	<u>50,796</u>	<u>1,112,362</u>
<u>37,747</u>	<u>-</u>	<u>(193)</u>	<u>(50,796)</u>	<u>4,418,926</u>
927	45	70	16,736	98,657
-	13,406	-	488,333	501,739
-	-	-	-	33,824
-	-	-	-	542
-	-	-	-	(3,264)
-	-	-	-	(1,671,990)
<u>-</u>	<u>-</u>	<u>-</u>	<u>(152,555)</u>	<u>(178,647)</u>
927	13,451	70	352,514	(1,219,139)
<u>38,674</u>	<u>13,451</u>	<u>(123)</u>	<u>301,718</u>	<u>(206,093)</u>
-	(13,456)	-	13,456	-
<u>38,674</u>	<u>(5)</u>	<u>(123)</u>	<u>315,174</u>	<u>(117,419)</u>
<u>235,891</u>	<u>5,019</u>	<u>18,618</u>	<u>731,376</u>	<u>52,642,328</u>
<u>\$ 274,565</u>	<u>\$ 5,014</u>	<u>\$ 18,495</u>	<u>\$ 1,046,550</u>	<u>\$ 52,524,909</u>

NIPOMO COMMUNITY SERVICES DISTRICT
COMBINING STATEMENT OF OTHER SUPPLIES AND EXPENSES
PROPRIETARY FUNDS
As of June 30, 2012

Business Type Activities - Enterprise Funds

	<u>Water</u>	<u>Town Sewer</u>	<u>Blacklake Sewer</u>
<i>Other supplies and expenses</i>			
Chemicals	\$ 17,171	\$ 7,958	\$ 27,528
Lab testing	22,142	36,527	16,324
Operating supplies	35,437	21,565	6,473
Outside services	58,495	3,588	674
Permits and operating fees	12,402	12,015	6,091
Fuel	19,260	6,420	3,502
Paging service	5,696	1,899	1,036
Meters - replacement program	49,359	2,842	1,550
Uniforms	4,782	1,596	871
Solid waste rate deferral			
Clean up costs			
Conservation program	9,260		
Bank charges and fees	6,436		
Computer expenses	45,699	10,062	1,443
Director fees	7,240	1,539	272
Dues and subscriptions	13,782	4,462	337
Education and training	6,634	1,350	375
Landscape and janitorial	9,650	2,051	362
LAFCO funding	20,649		
Miscellaneous	4,457	20	
Newsletters and mailers	2,039		
Office supplies	7,716	1,089	190
Postage	11,825	5,279	967
Public notices	3,819		188
Property taxes	1,033		
Telephone	5,693	1,210	690
Travel and mileage	6,088	1,381	224
Bond administration			
Total other supplies and expenses	\$ 386,764	\$ 122,853	\$ 69,097

NIPOMO COMMUNITY SERVICES DISTRICT
COMBINING STATEMENT OF OTHER SUPPLIES AND EXPENSES
PROPRIETARY FUNDS
 As of June 30, 2012

Business Type Activities - Enterprise Funds

<u>Blacklake Lighting</u>	<u>Solid Waste</u>	<u>Landscape Maintenance District</u>	<u>Property Taxes</u>	<u>Total</u>
\$ -	\$ -	\$ -	\$ -	\$ 52,657
				74,993
				63,475
				62,757
				30,508
				29,182
				8,631
				53,751
	49,947			7,249
	2,458			49,947
				2,458
				9,260
				6,436
				57,204
				9,051
				18,581
		8,288		8,359
				20,351
				20,649
				4,477
				2,039
				8,995
47	176	275		18,071
				4,505
				1,033
				7,593
				7,693
			2,120	2,120
\$ 47	\$ 52,581	\$ 8,563	\$ 2,120	\$ 642,025

See Auditor's Report

NIPOMO COMMUNITY SERVICES DISTRICT
REQUIRED DISCLOSURE UNDER GOVERNMENT CODE SECTION 66013
FOR THE YEAR ENDED JUNE 30, 2012

FUND 500 – SUPPLEMENTAL WATER FUND

Beginning balance July 1, 2011	\$2,094,583
Ending balance June 30, 2012	\$1,258,485
Interest Earned	\$4,308
Amount of charges collected in fiscal year	\$14,605

Public improvements on which charges were expended and the amount of the expenditure for each improvement:

Public Improvement	Amount of the expenditure for each improvement	Percentage of the total cost that was funded from Fund #500	Project completed during fiscal year
Supplemental Water Project	\$905,403	100%	NO

Anticipated projects for 2012-2013 fiscal year

None

A budget amendment may be proposed by the Board of Directors during fiscal year 2012-2013.

Note: Methodology of calculating capacity charges is included in Section V of the Nipomo Community Services District Water and Sewer Financial Plans, User Rates and Capacity Charges Report. The report is available on the District web site at ncsd.ca.gov.

NIPOMO COMMUNITY SERVICES DISTRICT
REQUIRED DISCLOSURE UNDER GOVERNMENT CODE SECTION 66013
FOR THE YEAR ENDED JUNE 30, 2012

FUND 700 – WATER CAPACITY FUND (TOWN DIVISION)

Beginning balance July 1, 2011	\$3,408,053
Ending balance June 30, 2012	\$3,302,878
Interest Earned	\$12,517
Amount of charges collected in fiscal year	\$3,293

Public improvements on which charges were expended and the amount of the expenditure for each improvement:

Public Improvement	Amount of the expenditure for each improvement	Percentage of the total cost that was funded from Fund #700	Project completed during fiscal year
Willow Road Phase 1	\$12,215	100%	NO
Willow Road Phase 2	\$57,633	100%	NO
SCADA Upgrades	\$18,390	100%	NO
Blacklake Well #4	\$24,879	100%	NO

Anticipated projects for 2012-2013 fiscal year

SCADA Upgrade
Standpipe Mixing
Willow Road Water Line (Phase 1 and 2)
Water Tank Site

Note: Methodology of calculating capacity charges is included in Section V of the Nipomo Community Services District Water and Sewer Financial Plans, User Rates and Capacity Charges Report. The report is available on the District web site at ncsd.ca.gov.

NIPOMO COMMUNITY SERVICES DISTRICT
REQUIRED DISCLOSURE UNDER GOVERNMENT CODE SECTION 66013
FOR THE YEAR ENDED JUNE 30, 2012

FUND 710 – SEWER CAPACITY FUND (TOWN DIVISION)

Beginning balance July 1, 2011	\$2,462,527
Ending balance June 30, 2012	\$536,844
Interest Earned	\$6,010
Amount of charges collected in fiscal year	\$70,776

Public improvements on which charges were expended and the amount of the expenditure for each improvement:

Public Improvement	Amount of the expenditure for each improvement	Percentage of the total cost that was funded from Fund #710	Project completed during fiscal year
SCADA Upgrades	\$15,160	100%	NO
Work In Process--Southland WWTF Upgrade	\$366,213	100%	NO
Frontage Road Sewer Main Upgrade/Replacement	\$981,047	53%	YES

Anticipated projects for 2012-2013 fiscal year

Southland WWTF Upgrades
 Bio-Solids Removal
 SCADA Upgrades

Note: Methodology of calculating capacity charges is included in Section V of the Nipomo Community Services District Water and Sewer Financial Plans, User Rates and Capacity Charges Report. The report is available on the District web site at ncsd.ca.gov.

TO: MICHAEL S. LEBRUN *ML*
GENERAL MANAGER

FROM: LISA BOGNUDA *LB*
FINANCE DIRECTOR

DATE: SEPTEMBER 27, 2012



REVIEW DRAFT CASH RESERVE POLICY

ITEM

Review draft Cash Reserve Policy

BACKGROUND

A reserve policy is an integral part of the overall District financial plan to ensure that sufficient funding is available for current operating, capital, and debt service needs as well as providing for unanticipated or unforeseen events. It is the District's responsibility to prudently accumulate, manage and maintain its reserves.

At the recommendation of the rate consultant in 1996, the District informally adopted cash reserve goals for the Water and Sewer Funds. The consultant recommended the cash reserve for the water fund be set at six months (180 days) of operating costs (not including funded replacement) and the cash reserve for the sewer funds be set at three months (90 days) of operating costs (not including funded replacement). The District continues to follow these reserve goals for the Water and Sewer Funds and are meeting and/or exceeding them today.

Bond Counsel for the Southland WWTF Upgrade 2012 Certificate of Participation (COP) issuance requested the District adopt a Debt Management Policy prior to the issuance. This was completed in February 2012. In addition, Bond Counsel suggested the District consider a Reserve Policy.

California Special Districts Association (CSDA) prepared Special District Reserve Guidelines (Attachment A) that address the principles for a reserve policy. In addition, Staff has reviewed various reserve policies from special districts and water districts throughout the State. What can be concluded from the review of these policies is that no two policies are alike and each district's policy is tailored to fit their needs. As stated in the City of San Luis Obispo Setting Reserves Levels article (Attachment B), *"In comparing reserve levels between government agencies, it is important to recognize that "one size does not fit all." In short, other than having a reserve at all, there is no "right" level: it depends on the circumstances in each agency."*

Staff has prepared a first draft of the Cash Reserve Policy (Attachment C). Each operating fund is listed with a stated purpose and target criteria section. In most cases, the target criteria have not been completed and Staff is requesting input from your Committee. Staff is also proposing that a rate stabilization fund be established for the Water Fund and the Blacklake Sewer Fund similar to the Town Sewer Rate Stabilization Fund that was required pursuant to the Bond Indenture adopted by the Board this past June. Non-operating funds are included in the proposed Reserve Policy to state their purposes; however, there are no target funding criteria established for these funds since they are funded from development fees and are used to offset new development related capital improvements.

Staff has prepared a summary of the Operating Funds (Attachment D) which provides the status of each Fund based on the proposed Reserve Policy. This summary will be completed once the Reserve Policy has been established.

In addition, Staff has included a flow chart of the Fund Structure and Cash Flows (Attachment E) to provide a visual to aid in the discussions.

RECOMMENDATION

It is recommended that your Committee review and discuss the proposed Cash Reserve Policy and provide direction to Staff.

ATTACHMENT

- A. Special District Reserve Guidelines
- B. City of San Luis Obispo Setting Reserve Levels
- C. Draft Cash Reserve Policy
- D. Summary of Operating Funds
- E. Fund Structure and Cash Flows

OCTOBER 2, 2012

ITEM 3

ATTACHMENT A



Special District Reserve Guidelines



CSDA
Providing value for
special districts.



Table of Contents

Acknowledgements	2
The Formation of Special District Reserve Guidelines	3
Prudent Accumulation and Management of Reserves	5
Capital Planning	8
Fund Equity and Retained Earnings	13
Glossary	17
Resources	20

Acknowledgements

In preparing the *Special District Reserve Guidelines*, the California Special Districts Association (CSDA) greatly benefited from individuals who were very generous with their time and insightful with their views. Our task force consisted of finance staff and general managers from independent special districts and professional financial consultants.

CSDA extends its appreciation to its district task force members:

- ◆ Dewey Ausmus of North County Cemetery District
- ◆ Ward Winchell of Southgate Recreation & Park District
- ◆ Rainy Selamat of Olivenhain Municipal Water District
- ◆ Ray Waletzko of Contra Costa Mosquito & Vector Control District
- ◆ Janice Simcoe of Sacramento Metropolitan Fire District
- ◆ John Martin of Bear Valley Community Services District
- ◆ Jeff Ramos of Elk Grove Community Services District

To the finance professionals on our task force, who significantly contributed to the development of the treatises, in addition to the drafting of the principles and guidelines, CSDA extends its sincere gratitude. The contributions of the following were invaluable:

- ◆ Jim Marta, CPA, of James Marta & Company
- ◆ Tim Schaefer of the public financial advisory firm, Fieldman, Rolapp & Associates
- ◆ Saul Rosenbaum of the investment banking firm, Prager, McCarthy & Sealy
- ◆ Steven Northcote, CPA, of Leaf & Cole

The Formation of Special District Reserve Guidelines

Answering a Call, Fulfilling a Need

The genesis for CSDA's *Special District Reserve Guidelines* was a 2000 Little Hoover Commission report entitled, "Special Districts: Relics of the Past or Resources for the Future?" The report includes a section on special district reserves with an introductory finding that states: "*Hundreds of independent special districts have banked multi-million dollar reserves that are not well publicized and often not considered in regional or statewide infrastructure planning.*"

The section raises a number of issues relating to special district reserves including:

- ◆ Lack of guidelines and consistency
- ◆ Lack of visibility, and publication of, district financial information
- ◆ Lack of understanding among constituents and policymakers of district finances
- ◆ Lack of districts incorporating reserve information into infrastructure planning

The Commission's report claimed that, statewide, independent special districts have over \$19.4 billion in reserves and many special districts have excess retained earnings (reserves). The report recommends that guidelines for prudent reserves be established, and that investment policies and practices be reviewed to determine if additional oversight is warranted.

The Little Hoover Commission report generated significant media coverage with banner headlines claiming that "obscure" public agencies have "hoarded" billions in reserves. Legislative hearings on special district finances were held and interest was spiked among grand juries, leading them to investigate how special districts within their counties handle reserves. The Sacramento Grand Jury report of 2000-2001 states: "*Few of the enterprise districts have an easily understood, board-approved and documented plan describing the development and use of undesignated retained earnings.*"

CSDA Forms Task Force

Although special district advocacy organizations have concerns with some of the report's findings and data interpretation, CSDA believes that the establishment of reserve guidelines will assist special district governing officials and administrators in fulfilling their fiduciary responsibilities. To accomplish this, CSDA formed a task force in 2001 to identify both the essential elements of a reserve policy and the issues to be discussed during policy development.

The *Special District Reserve Guidelines* were developed by the task force as a tool for special district governing officials and administrators to assist them in fulfilling their commitment to provide cost-effective and efficient public services for the communities they serve. The guidelines may be used to evaluate an existing reserve policy, develop a new reserve policy, and/or promote comprehensive and easily understood policies within a special district. CSDA encourages district officials to incorporate guideline elements into their policies that are applicable to their district based on its size and the services it offers.

These guidelines are general in nature and should not be reviewed as legal or financial opinions. Prior to a district's adoption of any policy, the agency should seek review by its legal counsel, accountant and/or auditor to ensure compliance with all applicable rules and regulations.

In developing the guidelines, the task force recognized that many independent special districts already have established reserve policies and most, if not all, special districts officials recognize their fiduciary responsibilities and take them very seriously. What may have generated the concern regarding special district reserves is not lack of policy, but lack of outreach to constituents and others regarding district operations. It is essential that special districts increase the level of understanding outside their boardroom and initiate an outreach program on district financial management to increase the level of understanding among the public, media and legislators.

To assist special districts in their effort to either launch or enhance their community outreach efforts, CSDA introduced a new member benefit – “Public Outreach Assistance Service”. CSDA’s outreach assistance program is a fee-based copy editing/writing and graphic design service developed to encourage districts to increase their visibility and the level of understanding among constituents, the media and other decision-makers. Additional information on this program can be obtained by calling CSDA at (877) 924-CSDA.

Prudent Accumulation and Management of Reserves

The principles and guidelines that follow reflect the common belief among special districts that there should be clear and well-articulated rationale for the accumulation and management of reserve funds. Individual districts should formulate and adopt a reserve policy, as it is an integral part of the prudent accumulation and management of reserves. The public has a general lack of understanding regarding the purpose of special district reserves and appropriate reserve levels. Districts can make great strides in dispelling misperceptions related to reserve levels--while building stronger bonds with the communities they represent--through the adoption of a well-developed reserve policy and efforts to educate and inform the public of reserve particulars.

While it is essential that districts adopt reserve policies, it is critical to understand that a reserve policy must be developed in a manner consistent with other financial policies, budgetary practices, district programs, and legal requirements. Three foundational elements are essential prerequisites to the development of any reserve policy:

1. A clear, organizational philosophy/mission
2. A well-developed capital improvement plan, as a critical element of regular strategic-planning efforts
3. Use of a standardized method of financial reporting, such as GASB 34

Principles and Guidelines

1. Identify the uniqueness of the district.
 - a) Consider district goals, needs, and constraints.
 - b) Utilize life-cycle analysis if district is capital intensive. Regularly measure condition of assets.
2. Have a complete understanding of the district's core business.
3. Develop and maintain a strategic plan, including a well-developed capital improvement plan.
4. Make communicating with customers and constituents a priority.
 - a) Seek input through customer surveys, community meetings, and other means.
 - b) Inform customers and constituents of output and seek their input in evaluating policies.
5. Recognize that a good reserve policy must be consistent with other financial policies, such as balanced operating budget or investment policies.*

*An excellent resource on this point is "Recommended Budget Practices: A Framework for Improved State and Local Government Budgeting," available from the Government Finance Officers Association. For more information, log onto www.gfoa.org.

6. Clearly identify reserves, both categories and purposes. Set target level for reserves that are consistent with district's mission, the district's uniqueness, and the philosophy of the district's board and community.
7. A broad reserve policy may include many elements or sub-policies. Some areas that may need sub-policies include:
 - a) rate-stabilization funds
 - b) fees and charges
 - c) debt issuance and management
 - d) deferred maintenance
 - e) contingency funds
8. Engage in strategic planning.
 - a) By developing, regularly evaluating and, when necessary, modifying strategic plans, districts can more efficiently plan and shape their futures. Strategic planning can help district boards anticipate and adapt to changing environmental, regulatory and demographic conditions. This assists districts in establishing appropriate reserve funds and adopting adequate target levels.
 - b) Seek community input in the strategic planning process, i.e., ratepayers, business groups, community organizations, etc.
 - c) While a district might invite some community members to participate in a formal strategic planning meeting with the board, a more likely scenario is for the district to engage various stakeholders through surveys, focus groups, or a series of neighborhood meetings.
9. Make communicating with customers and constituents an integral part of the district's financial practices. Whether through a quarterly newsletter or a condensed annual report, it is critical for districts to explain their financial position to their customers in layman's terms. If a district needs assistance or new ideas on how to effectively communicate with its constituents or customers, CSDA is available to assist through its Public Outreach Assistance Service or other means.

Specific Considerations for Budgeting and Allocating Fund Balance or Retained Earnings

1. Define organization's objectives:
 - ◆ Short-term
 - ◆ Long-term
 - ◆ Operating
 - ◆ Capital

2. Identify where funds are used:

- ◆ Operating revenues
These are the general-purpose funds through which ongoing activities are funded.
- ◆ Special-purpose revenues
Most often these are legally restricted for a particular use. For example, a special assessment for infrastructure must be separately accounted for and spent on the designated infrastructure costs.
- ◆ Debt proceeds
These should be used to fund costs that provide a benefit across fiscal years. The issuance of debt allows the district to allocate these costs by spreading the debt service to these periods. Debt proceeds should never be used for short-term operating costs because this would entail allocating current operating costs to future periods.
- ◆ Other one-time revenues
One-time revenues should be used for one-time expenses. If a special district gets one-time revenues and uses it to provide additional full-time positions or to fund on-going operating costs, there may be a budget crisis when the one-time funding runs out.

Capital Planning

A Capital Improvement Program (CIP) exists to identify and prioritize a district's need for capital goods. A CIP should prioritize the importance and timing of the various assets to be acquired. In addition, a CIP should contemplate how those goods will be paid for – cash (equity) or debt. A capital plan is a strategic or comprehensive plan for the acquisition and implementation of the district's capital assets as a group, or over time. In that sense, it is different from a finance plan, which focuses on individual acquisitions and how to pay for them.

To fulfill its mission, the district must make capital investments. Debt -- especially tax-exempt debt -- is recognized as an important and continuing source of a district's capital to fund improvements necessary to achieve its mission and strategic objectives. A CIP provides the framework by which decisions will be made regarding the use of cash and debt to finance capital projects. Debt is defined to include all short- and long-term obligations, guarantees and instruments that have the effect of committing the district to future payments. The assumption of debt, both direct and indirect, will be subject to the district's approval. Any debt issued by subsidiary entities is subject to these policies. In satisfying their fiduciary responsibilities, it is critical that the district's board and management know the extent of debt obligations.

CIP Objectives

1. To provide guidelines to management on the use of reserves and debt to support the district's capital needs while achieving the lowest overall cost of capital.
2. To provide selected financial measures, with specific targets, to ensure that the district continues to operate within appropriate financial parameters while allowing the agency to maintain financial stability and the highest acceptable credit rating that permits it to issue debt at favorable rates.
3. To bridge the cash flow gap between the district's available funds and its capital needs when the assumption of debt is deemed prudent.

Debt Allocation

Given that a district has limited debt capacity, management must prioritize debt resources among all uses, including capital projects, equipment financing, real estate investment, financial opportunities, and other projects. In allocating debt, the following guidelines may be used:

- ◆ **Core mission:** Only projects which relate to the core mission of the district will be considered for tax-exempt debt financing.
- ◆ **New revenue stream or budgetary savings:** A project that has a related revenue stream or can create budgetary savings will receive priority consideration. However, this is not meant to exclude other projects that are key to the district's mission. For these projects, the use of debt must be supported by an achievable financial plan that includes servicing the debt and meeting any new or increased operating costs. These costs could include the funding of a replacement and renovation reserve. For projects that can create budgetary savings, the budget may be reduced to fund the debt service and any additional savings may be invested into other critical capital projects.
- ◆ **Length of useful life:** The useful life of a project needs to be taken into account when considering long-term debt for capital investment.
- ◆ **Capacity to attract outside funds:** Project-generating revenues, federal and state grants, expendable reserves, and other sources are expected to finance a portion of the cost of a project. Debt is to be used conservatively and strategically.
- ◆ **Other considerations:** The above factors are not intended to be all-inclusive. Management's judgment ultimately will determine the use and amount of debt.

Debt Portfolio

No undue restriction should be imposed on the nature of a debt instrument as long as it can be appropriate and advantageous for the purpose of limiting interest-rate exposure and reducing debt-service costs. Fixed-rate debt provides more long-term interest rate stability than variable-rate debt, however, variable-rate debt can be a desirable component of the debt portfolio because it is typically issued at lower interest rates. Because the use of variable debt exposes the debt portfolio to interest rate fluctuations, the district should limit the use of variable-rate debt, and use it only when it is clearly advantageous.

Credit-rating Maintenance

Maintaining the highest acceptable credit rating is a primary objective of a CIP. This permits the district to continue to issue debt and to finance capital projects at favorable interest rates, while meeting its strategic objectives. The district should limit its overall debt to a level that maintains an acceptable credit rating with the bond-rating agencies.

Creating a Capital Plan

Creating a capital plan takes six basic steps:

1. Establish goals
2. Assess needs
3. Develop strategic cash vs. borrow approach
4. Identify methods available for funding
5. Design the loan or secure financing
6. Organize approach

Establish Goals

The key elements in setting clear capital plan goals include:

1. Understanding the role of the planning horizon.
2. Integrating the use (or lack thereof) of reserves.
3. Understanding the repetitive nature of implementing the CIP.

Planning horizons are important considerations in well-developed capital plans. For example, it makes little sense to try to plan for a 10- or 20-year horizon if innovation, technology, demographics or legislative threats to the plan occur often or on short notice. Conversely, agencies that are in low-technology businesses and stable demographic circumstances can afford to (and probably should) plan for long periods.

The extent to which a particular district has accumulated reserves will dramatically impact the capital plan. The development of, and adherence to, strong reserve policies can greatly simplify funding choices for the capital plan. But, blind adherence to arbitrary reserve levels can be just as inhibiting as no reserves at all. The key is to make the reserve accumulation, or depletion, work in harmony with the capital plan, the operating budget and the risk management of the district.

The last point is worth emphasizing. The capital plan is by its nature repetitive. For that reason, many districts choose to review and update it annually, usually as an adjunct to deliberation of the operating budget. This keeps the capital plan current and tempered by current information on the financial and political priorities of the district.

Assess Needs

Every capital plan starts with a needs assessment. The assessment should rely on a comprehensive inventory of capital assets already owned, an estimate of their remaining useful lives, and a good understanding of future requirements. While a detailed review of the steps necessary for an effective needs assessment are beyond the scope of the *Special District Reserve Guidelines*, the needs assessment is the foundation for virtually all of the decisions that will arise in the capital planning process. As a result, it pays big dividends to emphasize this element of the plan.

Useful tools in the operation of the needs assessment may include: community focus groups or commissions, local and regional planning agency studies, staff input, and reviews by engineering, accounting and legal experts.

A Strategic Decision – Pay-as-you-go or Borrow?

Once major acquisition needs are identified and service goals established, the district faces the decision of whether to pay cash or borrow to acquire capital assets. There are two theories as to which is the best approach to take. Those who believe that paying cash is the most desirable way of funding capital assets point to the inherent fiscal conservatism of such an approach. This approach is often referred to as “pay-as-you-go” or “pay-as-you-acquire.” Use of this approach produces cash equity in capital assets and is often promoted because a dollar not borrowed is a dollar on which interest need not be paid.

On the other side of the spectrum are the “pay-as-you-use” proponents, who usually argue that accumulation or creation of major amounts of equity in capital assets is economically inefficient, particularly for those districts that are capital intense and whose capital goods are “used up” over long periods of time. The rationale behind this approach is that the district’s stakeholders should “pay” for the assets required to deliver the goods or services of the agency over a time period that more closely mirrors the useful life of those assets.

Most districts use a blended approach. Often, a district’s approach is dictated as much by affordability as by philosophy, as few public bodies can afford (either in a political sense or economic one) to pay cash for all capital assets. Similarly, financing of smaller capital goods, or those with short or uncertain useful lives, is also inefficient.

Identify Methods Available for Financing

Once the goals have been set, the needs assessed and the decision whether to pay cash or finance the asset has been made, some thought must be given to the method of financing. For example, even if an asset is to be procured for cash, and the cash is on hand in a reserve set aside for that purpose, a decision still must be made on whether to replenish or restore that reserve, and over what time period and from what source it will be replenished.

Choosing to issue debt means that the following choices must be made: form of debt, mode (fixed or variable rate), repayment terms, and method of sale. These are the tactical decisions that often blur the understanding of the strategic elements of the capital plan.

Designing the Loan – The Tactical Plan

If a decision is made to borrow, there is a dizzying array of choices to be made. Some districts choose to borrow from banks or private lenders; others choose public offerings of debt. Lease financing may be considered as an alternate to bond financing. Some districts pool their needs with other similarly situated districts in order to reduce costs through efficiencies of scale.

Regardless of the choice of lenders or approach, important considerations of this element include matching the useful life of the financed asset to the borrowing term. Common sense tells us that we should hesitate to finance automobiles with 30-year bonds. By the same token, a water treatment plant with a design life of 50 years can be safely and prudently financed over long periods of time.

This element of the capital plan should also carefully consider other needs within the strategic plan when pledging assets or revenues to lenders. A generous package to a lender on today's asset may make tomorrow's asset financing problematic or impossible. The key is to ensure that each tactical financing plan within the capital plan works harmoniously with other elements of the plan and is flexible enough to allow for the inherently changing nature of the capital plan.

Organizing the Approach

The successful capital planning process looks a great deal like the successful budgeting process. The end-result articulates the goals and objectives of the organization to all stakeholders and relies on accurate and unbiased assessment of needs. It provides for an evaluation of the desired assets to distinguish between "wants" and "needs." It is written and shared with the district's stakeholders.

The capital plan is revisited often and provisions for changing or amending it are straightforward. Finally, it incorporates periodic analysis of results and achievements for management and governing bodies.

Summary

A capital plan need not be elaborate or weighty to be effective. Many effective capital plans consist of a single spreadsheet and several paragraphs of supporting text. The development of the plan is vital to the efficient use of capital. It is a key ingredient in a lender's assessment of management's effectiveness and control. It is among the most important tools an elected official possesses to discharge the duties of office.

Readers who are interested in additional information about the development of capital plans should consider a variety of books, and other information sources, on the topic. Some suggested examples are shown in the attached resource listing at the back of this document.

Fund Equity and Retained Earnings

In a public entity, the board and management have to decide how much money is enough for the district's needs and how much is too much. Public entities such as utility districts collect fees from users to provide day-to-day services, as well as to maintain the corporate facilities. A water district has operating expenses such as water purchase and delivery costs, maintenance and operations and infrastructure costs. Fees collected by districts need to provide for day-to-day operations, as well as the anticipated repair and replacement of the infrastructure. The excess of the amount collected in fees and other revenues during the fiscal year over the amount expended during the same period go into the fund equity or retained earnings. Fund equity and retained earnings is the net excess of assets over liabilities.

Governmental-fund types use the terminology "fund balance" to describe the net excess of assets over liabilities. Enterprise-fund types (governmental organizations that are operated and account like a commercial enterprise) use the term "retained earnings" to describe the net excess of assets over liabilities.

To further understand the fund balance or retained earnings and how much is enough, review the following financial statement (*Exhibit 1*). Under the enterprise statement, the total assets are \$3.5 million dollars and the retained earnings are in excess of \$2.5 million dollars. Is this enough?

Exhibit 1

XYZ GOVERNMENT BALANCE SHEET

	<u>General</u>	<u>Enterprise</u>
Assets:		
Total Assets	<u>423,450</u>	<u>3,502,459</u>
Liabilities and Fund Equity:		
Total Liabilities	<u>136,000</u>	<u>935,000</u>
Total fund balance/retained earnings	<u>287,450</u>	<u>2,567,459</u>
Total liabilities and fund equity	<u>423,450</u>	<u>3,502,459</u>

In Exhibit 2, more detail shows that the assets are primarily invested in buildings and improvements. Analysis of the components of the retained earnings shows that over \$2.1 million of the \$2.5 million in retained earnings is a result of net investment in fixed (not spendable) assets.

Exhibit 2

XYZ GOVERNMENT BALANCE SHEET

	<u>General</u>	<u>Enterprise</u>
Assets:		
Cash	65,000	113,559
Cash with fiscal agent	25,000	-
Investments	258,000	1,178,400
Receivables	48,000	29,000
Inventory	7,200	24,000
Prepaid expenses	250	1,500
Restricted investments	20,000	-
Building and improvements		3,580,125
Accumulated depreciation		(1,424,125)
Total Assets	<u>423,450</u>	<u>3,502,459</u>
Liabilities and Fund Equity:		
Accounts payable	118,000	135,000
Deferred revenue	18,000	-
Bonds Payable		800,000
Total Liabilities	<u>136,000</u>	<u>935,000</u>
Fund Equity:		
Investment in fixed assets	-	2,156,000
Retained earnings:		
unreserved		7,459
Reserved for:		
inventory	7,200	24,000
Designated for:		
debt service	-	200,000
capital improvements	-	150,000
contingencies	100,000	30,000
Undesignated	180,250	
Total fund balance/retained earnings	<u>287,450</u>	<u>2,567,459</u>
Total liabilities and fund equity	<u>423,450</u>	<u>3,502,459</u>

Is this organization in good financial shape? That depends on the condition of the current assets and the short- and long-term needs of the organization as they relate to its resources. If there exists \$2 million dollars in current infrastructure needs, then financing may be required. Is enough set aside for contingencies? If water costs increase by 10 percent, how will that affect total retained earnings? If the federal government mandates high water-quality standards, then what will be the equipment costs related to meeting this new standard?

Governmental entities collect, hold and expend resources in public trust. If not enough is collected, they risk not being able to meet mandated needs. If too much is collected, then the government overburdens the public and ties up resources that taxpayers could use in the economy. Governments have not always done a good job budgeting and making long-term plans for capital needs and for contingencies. Historically, governments spend most of their resources each year. Governmental entities need to examine their operations and make long-term plans and budgets to ensure that expenses are anticipated and resources set aside.

Some governments, either through good fortune or good planning, have set aside retained earnings for future plans and needs. What most governments have failed to do, as emphasized in the Little Hoover Commission's report, is to effectively communicate their plans for the retained earnings and explain why the balance is appropriate.

Each district needs to:

1. Examine its financial position.
2. Examine its current and long-term needs.
3. Determine the need for a long-term capital plan.
4. Establish target fund balance or retained earnings.
5. Communicate its goals and needs through policy, budgets and enhanced financial statements note disclosures.
6. Anticipate public scrutiny of financial statements and disclose how finances are being used.

Summary

CSDA facilitated the Reserve Guidelines Task Force in response to the concerns outlined in the Little Hoover Commission's report "Special Districts: Relics of the Past or Resources for the Future?" Our goal was to prepare a document that could be used by all independent special districts as a map in the preparation or review of the district's reserve policy. We encourage you to have your financial and legal professionals review the final policy prior to adoption to ensure you are in compliance with all current laws and regulations. Districts should schedule a regular review of their reserve policy as the financial environment within which it operates may be dynamic as well as there may be applicable legislative or regulatory changes.

The report concluded that there is a disconnect between special districts and their constituents and other local government entities. Districts should consider preparation of a public outreach program to communicate financial and program information on a regular basis to affected or interested populations. How involved each respective public outreach program is for a district is typically determined by the size and complexity of the district. It may be as simple as adding the information to an agency's website or the development of an annual report. In response to the demand for help in effectively communicating this information, CSDA launched its Public Outreach Assistance Service. This program is a member service of CSDA and can be tailored to meet the various communication needs of both small and large districts. It is important that each agency not only develop a reserve policy, but ensure that your constituents and fellow local governments understand your financial position and decision-making tools.

We hope you find these guidelines helpful and if you have any comments or suggestions on how we can improve this document, please contact us at (877) 924-CSDA.

Glossary

Net assets: The amount of assets in excess of liabilities

For governmental-fund types, this excess is referred to as “fund balance.”

For enterprise-fund types, this excess is referred to as “retained earnings.”

The GASB has made a distinction between reserved equity and designated equity in accordance with NCGA-1 (Governmental Accounting and Financial Reporting Principles).

Designations v. Reservations

While cash set asides are popularly referred to as “reserves,” it is important and more accurate to identify them as designations or reservations. The two are distinctly different.

Designations: Net funds that are set aside based on board policy or tentative plans.

Discretionary.

Examples:

- ◆ Designated for cash-flow (to help cover operating expenses during shortfalls)
- ◆ Designated for capital improvements
- ◆ Designated for contingency
- ◆ Designated for rate stabilization

Fund-balance designations may be established to indicate tentative plans for financial resource utilization in a future period, such as for general contingencies or for equipment replacement. Such designations reflect tentative managerial plans, or intent, and should be clearly distinguished from reserves. Such plans, or intent, are subject to change and may never be legally authorized or result in expenditures. Designated portions of fund balance represent financial resources available to finance expenditures other than those tentatively planned. Designations should be reported as part of the unreserved fund balance, i.e., “Designated for ...” or disclosed parenthetically or in the notes to the financial statements.

(National Council on Governmental Accounting Statement: NCGAS-1, paragraph 120)

Reservations: Net funds that are not appropriable. Assets that cannot be spent or are limited by legal or contractual requirements.

The following are examples of reservations that may be made because the funds are not appropriable:

- ◆ Reserved for inventory
- ◆ Reserved for restricted cash or investments
- ◆ Reserved for investment in net fixed assets

Often debt covenants require that certain reserve balances be maintained to secure payment of the debt service. **Debt-service reserves** is an example of a contractual requirement to set-aside funds.

Many governments and their accountants have referred to the excess of assets over liabilities as “reserves,” however, preparers and users need to be careful with the terminology used in conjunction with financial information.

Reserves should be reported in the “Fund Balance” section of governmental fund balance sheets, not as liabilities or between liabilities and fund balance. The “Fund Balance” section may be subdivided between or among its reserved and unreserved components, or separate “Reserved Fund Balance” and “Unreserved Fund Balance” sections may be used. (NCGAS-1, paragraph 121)

Use of the term “reserve” in proprietary fund accounting should parallel commercial accounting and reporting. Thus, it should be limited to indicating “Reserved Retained Earnings.” (NCGAS-1, paragraphs 121)

Restricted Funds: Equivalent to reserved funds.

Some governments often need special funds for building projects or special funding. Resources restricted for expenditure for specific purposes may be accounted in the general fund, provided that any applicable legal requirements can be met and the use of a separate fund is not legally mandated. If this type of funding is accounted along with other general funding, any excess balances should be recorded as restricted funds in the “Fund Balance” section of the financial statements.

Fund Balance Reserves (Reservations) and Designations

In governmental-fund accounting and reporting, use of the term “reserve” should be limited to indicating that a portion of the fund balance is not appropriable for expenditure or is legally segregated for a specific future use.

An example of a portion of a fund balance that is not appropriable for expenditure is the Reserve for Inventories, which indicates that the portion of fund balance represented by inventories is not available for appropriation and expenditure at a balance sheet date.

An example of a reserve indicating that a portion of the fund balance is legally segregated is the Reserve for Encumbrances, which indicates that a portion of the fund balance has been segregated for expenditure on vendor performance.

In instances where part of the fund balance is reserved, the remainder should be reported as Unreserved Fund Balance. (NCGAS-1, paragraph 118)

GASB 34 Note:

Under GASB 34, the formal presentation of the report should not include use of the terms reservations, reserves, or designations. Funds are broadly classified as either restricted funds (equivalent to reserved funds) or unrestricted funds (designated or undesignated surpluses). In the footnotes to the financial report, however, these additional terms can be effectively employed to provide greater detail and full disclosure of plans for the district's fund balance/retained earnings, the importance of which cannot be overstated.

Resources

The Government Finance Officers Association (GFOA) is a great source for more information regarding various government financial matters, including fund balance and financial reporting. GFOA has an extensive publications department. View a list of their full offerings by logging onto their website at www.gfoa.org. The following publications may be useful:

- ◆ “Recommended Budget Practices: A Framework for Improved State and Local Government Budgeting”
- ◆ “An Elected Official’s Guide to Fund Balance”
- ◆ “An Elected Official’s Guide to Financial Reporting”
- ◆ “Governmental Accounting, Auditing, and Financial Reporting”

OCTOBER 2, 2012

ITEM 3

ATTACHMENT B

SETTING RESERVE LEVELS

What's the Right Amount?

In comparing reserve levels between government agencies, it is important to recognize that “one size does not fit all.” In short, other than having a reserve at all, there is no “right” level: it depends on the circumstances in each agency.

Strong Reserves Reflect Ability to Manage Risk, Not Fiscal Strength

Reserves (defined here as unreserved, undesignated fund balance) – whether large or small – do not *per se* reflect on an agency's financial capacity or underlying fiscal strength. There are much better indicators than fund balance for this, most notably the ability over time for ongoing revenues to adequately meet day-to-day service needs, capital improvements and debt service requirements.

Then what does retaining a prudent level of fund balance reflect?

It measures an agency's ability to manage risk. How much can things adversely turn-out differently than “usual,” and how much fiscal capacity (measured in time) does the organization think is prudent in developing and implementing plans to respond to unexpected circumstances?

First Step: Assess Risk in Determining Reserve Policy

Based on this, the first step in assessing an appropriate reserve level is to assess fiscal risks, which fall into six categories:

1. ***Economic.*** How dependent are the agency's key revenues on local economic performance? And how dependent is it on the fortunes of a few key taxpayers – or are revenue sources broadly distributed? In short, are all of the agency's revenue “eggs in one basket?” And if so, how large and strong is the basket?

For example, property taxes are usually viewed as stable, dependable revenue sources. As such, if this is a large part of a city's revenue base (as it is in most states, other than California), then its fiscal risks are lower, and accordingly, its reserve levels can be lower. However, sales tax is the most important revenue source for most California cities, including San Luis Obispo, and it can be highly volatile. So, where sales tax is a key revenue source, this argues for higher reserves.

And within any one revenue source, agencies also need to assess their vulnerability (the “eggs” thing). For example, if one or two key property owners account for a large part of property tax revenues, then any adverse circumstances for them will adversely affect the agency.

How likely is this to happen? And what's the consequence if it does? The same is true for sales taxes: already a variable revenue source, it's even worse if one or two outlets (like a

SETTING RESERVE LEVELS

single car dealership or major retailer) account for a large part of an agency's sales tax revenues.

2. **Cash Flow.** What cash resources does an agency need in balancing when it receives key revenues, and when it incurs expenses? Again, this requires each agency to review their own unique circumstances in evaluating "lumpy" receipts and disbursements. In short, every agency has a different cash flow story to tell.
3. **Expenditure Flexibility.** How much of an agency's costs are relatively "fixed" or ongoing, like debt service and regular staffing; versus more flexible costs, like capital projects or other "one-time" costs? The more "flexible" an agency's costs, the more flexibility it will have in not disrupting day-to-day services in responding to adverse circumstances while it figures out a longer-term strategy.
4. **General Contingencies.** What is the likelihood of a major, unanticipated cost?
5. **Disasters.** What is the likelihood (and frequency) of natural or human disasters like floods, fires or earthquakes in increasing response and recovery costs, or reducing revenues?
6. **Stability of State-Local Government Relationships.** How likely is it that the federal or state government will structurally change revenue sources, such as no longer providing a key subvention that it routinely provided to an agency in the past? Or no longer allowing an agency to set a key fee or a tax that it has relied upon for many years? Or assessing agencies for services that the state or federal agency has traditionally provided at no cost?

Placed in context, the past twenty years, until the passage of Proposition 1A in November 2004, State budget takeaways have consistently been the largest single fiscal threat to local government in California.

Summary

Reserves act as an insurance policy, a risk management tool. So, in setting appropriate reserve policies, an agency should ask itself:

- How much risk is it exposed to?
- And how much risk is it willing to take in the event that adverse circumstances emerge?

When adverse circumstances do arise, appropriate reserves provide agencies with the ability to:

- Absorb "one-time" problems without disrupting day-to-day operations and services.
- Or if the problems are more systemic and ongoing, then they provides the fiscal capacity to take the time needed to fully identify how big the problem is, and then develop and implement a thoughtful longer-term strategy tailored to the problem, without resorting to extreme crisis actions.

SETTING RESERVE LEVELS

Knowing how other agencies answer these questions can be helpful; but ultimately, each agency needs to be guided by its own circumstances. Eighteen years ago the City adopted the policy of maintaining a minimum unreserved, undesignated General Fund balance that is 20% of operating expenditures; and we were one of the first cities nation-wide to formally adopt this type of policy.

OCTOBER 2, 2012

ITEM 3

ATTACHMENT C

NIPOMO COMMUNITY SERVICES DISTRICT
CASH RESERVE POLICY

PURPOSE

A key element of prudent financial planning is to ensure that sufficient funding is available for current operating, capital and debt service needs. Additionally, fiscal responsibility requires anticipating the likelihood of, and preparing for, unforeseen events. Nipomo Community Services District (District) will strive at all times to have sufficient funding available to meet its operating, capital and debt service obligations as well as to protect its creditworthiness. The District is committed to maintaining a financial structure that provides adequate and predictable revenues at the lowest possible cost to meet the forecasted needs and operational objectives.

It should be noted that the District has a Debt Management Policy that establishes parameters for evaluating, issuing and managing the District's debt. The District's Debt Management Policy should be considered prior to committing to any new financial obligations.

The adequacy of the targeted cash reserve year-end balance ranges and/or annual contributions to each fund will be reviewed annually during the budgeting process or when a major change in conditions threatens the reserve levels established within this policy.

OPERATING FUNDS

WATER FUND (FUND #125)

Purpose: To ensure sufficient cash resources are available to fund daily administration, operations and maintenance of providing water services. (Funded from rates and charges)

Target Criteria: To meet the District's cash flow needs and unbudgeted expenses, the Water Fund cash reserves should be equal to or greater than six months (180 days) of annual budgeted operating expenses (not including Funded Replacement).

After adoption of the budget and within 90 days after the end of the fiscal year, the Board of Directors shall review the cash reserves, and if there is excess above the reserve requirement based on the cash reserve balance as of the fiscal year just completed, the Director's may approve a transfer of the excess to the Funded Replacement Water Fund #805.

TOWN SEWER FUND (FUND #130)

Purpose: To ensure sufficient cash resources are available to fund daily administration, operations and maintenance of providing water services. (Funded from rates and charges)

Target Criteria: To meet the District's cash flow needs and unbudgeted expenses, the Town Sewer Fund cash reserves should be equal to or greater than three/six months (90/180 days) of annual budgeted operating expenses (not including Funded Replacement).

After adoption of the budget and within 90 days after the end of the fiscal year, the Board of Directors shall review the cash reserves, and if there is excess above the reserve requirement based on the cash reserve balance as of the fiscal year just completed, the Director's may approve a transfer of the excess to the Funded Replacement Town Sewer Fund #810.

NIPOMO COMMUNITY SERVICES DISTRICT
CASH RESERVE POLICY

BLACKLAKE SEWER FUND (FUND #150)

Purpose: To ensure sufficient cash resources are available to fund daily administration, operations and maintenance of providing water services. (Funded from rates and charges)

Target Criteria: To meet the District's cash flow needs and unbudgeted expenses, the Blacklake Sewer Fund cash reserves should be equal to or greater than three/six months (90/180 days) of annual budgeted operating expenses (not including Funded Replacement).

After adoption of the budget and within 90 days after the end of the fiscal year, the Board of Directors shall review the cash reserves, and if there is excess above the reserve requirement based on the cash reserve balance as of the fiscal year just completed, the Director's may approve a transfer of the excess to the Funded Replacement Blacklake Sewer Fund #830.

WATER RATE STABILIZATION FUND (PROPOSED)

Purpose: To serve as a buffer to water rates during any period where there are unexpected increases in operating costs or decreases in revenues. In addition, in a severe drought or extremely wet conditions, it is reasonable to expect that water sales could fluctuate significantly. As such, this fund will absorb these types of fluctuations in operations and help stabilize rates and enable smooth or level increases to rates despite uneven increases in underlying costs or variations in annual revenues received. This fund should not be used to artificially suppress rates (i.e. to sustain rates at levels below the costs of service). (Funded by rates and charges)

Target Criteria: Reserves sufficient to cover reduced net sales by as much as ___% of annual budgeted commodity charges. (Note: 20% of annual budget of \$2,450,000 = \$490,000)

TOWN SEWER RATE STABILIZATION FUND (FUND #135)

Purpose: To serve as a buffer to sewer rates during any period where there are unexpected increases in operating costs or decreases in revenues. This fund should be used to enable smooth or level increases to rates despite uneven increases in underlying costs or variations in annual revenues received. This fund should not be used to artificially suppress rates (i.e. to sustain rates at levels below the costs of service). (Funded by rates and charges)

Target Criteria: Minimum reserve requirement of \$300,000 set by Bond Indenture Agreement for the Revenue of Certificates of Participation Series 2012. (Note: 20% of annual budget of \$1,765,000 = \$353,000 – Target criteria may be greater than bond requirements)

BLACKLAKE SEWER RATE STABILIZATION FUND (PROPOSED)

Purpose: To serve as a buffer to sewer rates during any period where there are unexpected increases in operating costs or decreases in revenues. This fund should be used to enable smooth or level increases to rates despite uneven increases in underlying costs or variations in annual revenues received. This fund should not be used to artificially suppress rates (i.e. to sustain rates at levels below the costs of service). (Funded by rates and charges)

NIPOMO COMMUNITY SERVICES DISTRICT
CASH RESERVE POLICY

Target Criteria: Reserves sufficient to cover ___% of annual budgeted charges. (Note: 20% of annual budget of \$463,500 = \$92,700)

BLACKLAKE STREET LIGHTING (FUND #200)

Purpose: To ensure sufficient cash resources are available to fund administration, operations and maintenance of providing street lighting services for Blacklake Village. (Funded by annual assessment to property owners in Blacklake Village)

Target Criteria: Reserves sufficient to cover _____

LANDSCAPE MAINTENANCE DISTRICT (FUND #250)

Purpose: To ensure sufficient cash resources are available to fund administration, operations and maintenance of providing landscape maintenance to the property owners of Tract 2409. (Funded by annual assessment to property owners in Tract 2409 aka Vista Verde Estates)

Target Criteria: Reserves sufficient to cover _____

SOLID WASTE (FUND #300)

Purpose: To ensure sufficient cash resources are available to fund solid waste programs, rate stabilization and to cover operating costs in the event that the District may find itself operating solid waste collection, disposal and recycling functions should its business partner now franchised to do these functions be unable to continue to provide these services due to an unforeseen event. This reserve provides assurance that solid waste services remain uninterrupted during an extended disruption to service provider. (Funded by Franchise Fees)

Target Criteria: Reserves sufficient to cover _____

DRAINAGE (FUND #400)

Purpose: To ensure sufficient cash resources are available to operate and maintain the Nipomo Drainage Maintenance District 76-02 (one basin located on Juniper Street). (Funded by a 1% ad valorem property tax rate)

Target Criteria: \$5,000.00 pursuant to Resolution 00-733 adopted on June 7, 2000, and excess may be transferred to the Property Tax Fund #600. (Need to consider amending Resolution and reserve requirement)

FUNDED REPLACEMENT – WATER (FUND #805)

Purpose: The reserves can be used for both short-term and long-term purposes. The objective of the Funded Replacement Fund is to provide monies for the current and future replacement of existing capital assets as they reach the end of their useful lives. The District recognizes that the Funded Replacement fund may only be sufficient to pay a portion of the full cost of future capital asset replacements and other sources of replacement funding may be needed, such as a bond issuance. This fund will also help normalize the impact of the capital asset replacements on future water rates. (Funded by water rates and charges and interest earnings)

NIPOMO COMMUNITY SERVICES DISTRICT
CASH RESERVE POLICY

Target Criteria: _____

Notes:

- FY 2012-2013 Budget Funded Replacement contribution = \$566,000
- Rate Study August 2011 Funded Replacement contribution = \$566,000 increase to \$571,000 in FY 2014-2015
- 2007 Replacement Study Funded Replacement based on 20-Year Savings Model, Funded Replacement contribution for FY 2012-13 would be \$1,839,000
- 2007 Replacement Study 20-Year Savings Model, Projected Cash Reserve Balance should be approximately \$12.8M

FUNDED REPLACEMENT – TOWN SEWER (FUND #810)

Purpose: The reserves can be used for both short-term and long-term purposes. The objective of the Funded Replacement Fund is to provide monies for the current and future replacement of existing capital assets as they reach the end of their useful lives. The District recognizes that the Funded Replacement fund may only be sufficient to pay a portion of the full cost of future capital asset replacements and other sources of replacement funding may be needed, such as a bond issuance. This fund will also help normalize the impact of the capital asset replacements on future town sewer rates. (Funded by Town sewer rates and charges and interest earnings)

Target Criteria: _____

Notes:

- FY 2012-2013 Budget Funded Replacement contribution = \$395,000
- Rate Study August 2007 Funded Replacement contribution = \$395,000
- 2007 Replacement Study Funded Replacement based on 20-Year Savings Model, Funded Replacement contribution for FY 2012-13 would be \$200,000
- 2007 Replacement Study 20-Year Savings Model, Projected Cash Reserve Balance should be approximately \$3.5M

FUNDED REPLACEMENT – BLACKLAKE SEWER (FUND #830)

Purpose: The reserves can be used for both short-term and long-term purposes. The objective of the Funded Replacement Fund is to provide monies for the current and future replacement of existing capital assets as they reach the end of their useful lives. The District recognizes that the Funded Replacement fund may only be sufficient to pay a portion of the full cost of future capital asset replacements and other sources of replacement funding may be needed, such as a bond issuance. This fund will also help normalize the impact of the capital asset replacements on future Blacklake sewer rates. (Funded by Blacklake sewer rates and charges and interest earnings)

Target Criteria: _____

Notes:

- FY 2012-2013 Budget Funded Replacement contribution = \$168,000
- Rate Study August 2007 Funded Replacement contribution = \$100,000

NIPOMO COMMUNITY SERVICES DISTRICT
CASH RESERVE POLICY

- 2007 Replacement Study Funded Replacement based on 20-Year Savings Model, Funded Replacement contribution for FY 2012-13 would be \$124,000
- 2007 Replacement Study 20-Year Savings Model, Projected Cash Reserve Balance should be approximately \$968,000

NON-OPERATING FUNDS

SUPPLEMENTAL WATER (FUND #500)

Purpose: The revenue generated from the Supplemental Water Capacity Charge accumulates in this fund and its use is restricted to projects, programs and expenditures that reduce the District's reliance on groundwater as its sole water supply. (Funded by development capacity charges and interest earnings)

Target Criteria: No minimum target is maintained.

PROPERTY TAX (FUND #600)

Purpose: District's share of the 1% ad valorem tax on real property collected by the County of San Luis Obispo and distributed to the District pursuant to Article XIII A of the California Constitution. (Funded by property taxes and interest earnings)

Target Criteria: No minimum target is maintained, however, a portion of the annual property tax revenue stream is pledged to pay the annual debt service for the 2003 Certificates of Participation Revenue Bond.

WATER CAPACITY CHARGES (FUND #700)

Purpose: The revenue generated from the Water Capacity Charge accumulates in this fund and is used to offset new development related capital improvements as outlined by the District's Capital Improvement Plan. (Funded by development capacity charges and interest)

Target Criteria: No minimum target is maintained.

TOWN SEWER CAPACITY CHARGES (FUND #710)

Purpose: The revenue generated from the Town Capacity Charge accumulates in this fund and is used to offset new development related capital improvements as outlined by the District's Capital Improvement Plan. (Funded by development capacity charges and interest earnings)

Target Criteria: No minimum target is maintained.

NIPOMO COMMUNITY SERVICES DISTRICT
CASH RESERVE POLICY

SINKING FUND – TOWN SEWER (FUND #880)

Purpose: The reserves may be used to pay annual debt service payments for the Revenue Certificates of Participation (Southland Wastewater Project) Series 2012. (Funded by Town sewer rates and charges in years 2008 – 2012 in anticipation of the Southland Wastewater Treatment Facility Upgrade)

Target Criteria: No minimum target is maintained. Once the reserves in this fund are depleted, the fund will be terminated.

DRAFT

OCTOBER 2, 2012

ITEM 3

ATTACHMENT D

NIPOMO COMMUNITY SERVICES DISTRICT

OPERATING FUNDS

(A) FUND NAME	(B) FUND NUMBER	(C) PROPOSED CASH RESERVE FORMULA	(D) ADOPTED OPERATING BUDGET 2012-2013	(E) PROPOSED CASH RESERVE REQUIREMENT (based on 2012-2013 Operating Budget)	(F) ACTUAL CASH BALANCE AS OF 6/30/12	(G) PROPOSED POLICY MET?
Water Fund	125	180 days (6 months) of operating expenses	\$2,860,269 (\$3,426,269 less Funded Replacement of \$566,000)	\$1,430,135 ((\$2,860,269 x 50%))	\$2,103,089	Yes
Town Sewer Fund	130	90 or 180 days (3 or 6 months) of operating expenses	\$897,042 (\$1,292,042 less Funded Replacement of \$395,000)	\$224,261 or \$448,521 ((\$897,042 x 25%) or (\$897,042 x 50%))	\$563,738	Yes/Yes
Blacklake Sewer Fund	150	90 or 180 days (3 or 6 months) of operating expenses	\$293,699 (\$461,699 less Funded Replacement of \$168,000)	\$73,425 or \$146,850 ((\$293,699 x 25%) or (\$293,699 x 50%))	\$266,573	Yes/Yes
Water Rate Stabilization Fund	Proposed		N/A		N/A	
Town Sewer Rate Stabilization Fund	135		N/A		\$300,000	
Blacklake Sewer Rate Stabilization Fund	Proposed		N/A		N/A	
Blacklake Street Lighting Fund	200		\$22,600		\$27,209	
Landscape Maintenance District Fund	250		\$11,000		\$20,941	
Solid Waste Fund	300		\$11,075		\$259,396	
Drainage Fund	400		\$0		\$5,000	
Funded Replacement-Water	805	Based on 2007 Replacement Study or Rate Study	\$0	\$12,800,000 (Based on 2007 Replacement Study)	\$4,573,183	No
Funded Replacement-Town Sewer	810	Based on 2007 Replacement Study or Rate Study	\$0	\$3,500,000 (Based on 2007 Replacement Study)	\$4,081,449	Yes
Funded Replacement – Blacklake Sewer	830	Based on 2007 Replacement Study or Rate Study	\$0	\$968,000 (Based on 2007 Replacement Study)	\$226,913	No

N/A = not applicable

OCTOBER 2, 2012

ITEM 3

ATTACHMENT E

Fund Structure and Cash Flows

