

South San Luis Obispo County Sanitation District

Financial Statements

Year Ended June 30, 2016

**South San Luis Obispo County Sanitation District
Financial Statements
Year Ended June 30, 2016**

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Independent Auditors' Report

To the Board of Directors
South San Luis Obispo County Sanitation District
Oceano, California

Report on the Financial Statements

We have audited the accompanying financial statements of the business-type activities of the South San Luis Obispo County Sanitation District (the District), as of and for the year ended June 30, 2016, and the related notes to the financial statements, which collectively comprise the District's basic financial statements as listed in the table of contents.

Managements' Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

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

Board of Directors
South San Luis Obispo County Sanitation District
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We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the business-type activities of the District as of June 30, 2016, and the changes in its net position and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and required supplementary information as listed in the table of contents be presented to supplement the basic financial statements. Such information, although not part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated May 11, 2018, on our consideration of the District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the District's internal control over financial reporting and compliance.



Glenn Burdette Attest Corporation
San Luis Obispo, California

May 11, 2018

South San Luis Obispo County Sanitation District
Management's Discussion and Analysis
Fiscal Year Ending June 30, 2016

The following is a discussion of the financial position and the results of operations of the South San Luis Obispo County Sanitation District (the District) for the fiscal year ending June 30, 2016. This discussion refers to and is qualified by information contained in the financial statements and in the notes to the financial statements. Thus, it should be read together with these statements in the Audit Report. The financial audit of the District has been performed by Glenn Burdette, CPAs, in accordance with accounting principles generally accepted in the United States of America.

Financial Highlights:

- At June 30, 2016, the District's total net position decreased by 3% or \$291 thousand from \$11.3 million to \$11.0 million. Of this amount, \$3.2 million may be used to meet the District's ongoing obligations to citizens and creditors.
- Total operating revenues increased by 2% or \$60 thousand from \$3.40 million to \$3.46 million.
- Total operating expenses increased by 19% or \$626 thousand from \$3.36 million to \$3.98 million.
- Depreciation expense increased from \$874 thousand to \$1.24 million for a 41% or \$363 thousand increase.
- Nonoperating revenues and expenses increased from a \$458 thousand loss to a \$43 thousand gain for a \$500k or 109% increase.
- Capital contributions from connection fees decreased by \$18 thousand or 9% from \$207 thousand to \$189 thousand.

Overview of the Financial Statements:

This annual report consists of a series of financial statements. The statement of net position, statement of revenues, expenses and changes in net position, and statement of cash flows all provide information about the District's activities and present a long-term view of its finances.

These statements are prepared using the accrual basis of accounting which recognizes expenses when incurred and revenue when earned rather than when payment is made or received and is widely used by most private sector companies. These statements also report on the District's net position as a whole and changes in it resulting from the current years' activity. Over time, increases or decreases in the District's net position is one indicator of whether its financial position is improving or declining.

Fund financial statements. A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The District, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements. The various funds are presented in the accompanying financial statements as a proprietary fund category, enterprise fund type.

South San Luis Obispo County Sanitation District
Management's Discussion and Analysis
Fiscal Year Ending June 30, 2016

Notes to the financial statements. The notes provide additional information that is essential to a full understanding of the data provided in the financial statements. The notes to the financial statements can be found on pages 16-34 of this report.

Other information. In addition to the basic financial statements and accompanying notes, this report also presents certain required supplementary information concerning the District's progress in funding its obligation to provide pension benefits to its employees.

Government-wide Financial Analysis:

As noted earlier, net position may serve over time as a useful indicator of a government's financial position. In the case of the District, assets and deferred outflows of resources exceeded liabilities and deferred inflows of resources by \$11 million at the close of June 30, 2016.

The largest portion of the District's net position, \$7.74 million (70.5%) as of June 30, 2016, reflects its investment in capital assets (e.g., land, buildings, machinery, and equipment), less any related debt used to acquire those assets that is still outstanding. The District uses these capital assets to provide services to citizens; consequently, these assets are not available for future spending. Although the District's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities

Condensed Statement of Net Position
as of June 30, 2016 and 2015

	FY 15/16	FY 14/15	Increase/Decrease	
			Amount	%
Assets				
Current assets	\$ 6,351,222	\$ 6,088,499	\$ 262,723	4%
Noncurrent assets	5,705	10,992	(5,287)	-48%
Property and equipment	7,888,310	8,144,560	(256,250)	-3%
Total assets	14,245,237	14,244,051	1,186	0%
Deferred Outflows of Resources	98,933	51,868	47,065	91%
Liabilities				
Current liabilities	1,506,058	1,343,842	162,216	12%
Long-term liabilities	1,724,881	1,479,905	244,976	17%
Total liabilities	3,230,939	2,823,747	407,192	14%
Deferred Inflows of Resources	130,639	198,116	(67,477)	-34%
Net Position				
Net investment in capital assets	7,748,041	7,939,423	(191,382)	-2%
Restricted for capital expansion	3,960,461	4,113,230	(152,769)	-4%
Unrestricted	(725,910)	(778,597)	52,687	-7%
Total net position	\$ 10,982,592	\$ 11,274,056	\$ (291,464)	-3%

South San Luis Obispo County Sanitation District
Management's Discussion and Analysis
Fiscal Year Ending June 30, 2016

The activities of the District decreased the District's net position by \$291,000. The key elements are as follows:

- Operating and non-operating expenses exceeded operating and non-operating revenues by \$291,464 as of June 30, 2016.
- Capital contributions to the District's system totaled \$189,155 as of June 30, 2016. This is a net decrease of \$18,180 in Capital contributions.

Condensed Statement of Revenues, Expenses and Changes in Net Position
as of June 30, 2016 and 2015

	FY 15/16	FY 14/15	Increase/Decrease	
			Amount	%
Revenues - sewer service fees	\$ 3,458,839	\$ 3,398,643	\$ 60,196	2%
Operating expenses				
Depreciation expense	1,237,139	874,378	362,761	41%
Other operating expenses	2,745,088	2,481,913	263,175	11%
Total operating expenses	3,982,227	3,356,291	625,936	19%
Nonoperating revenues and expenses				
Loss on disposal of assets		(494,844)	494,844	-100%
Other nonoperating revenues and expenses, net	42,769	37,318	5,451	15%
Total nonoperating revenues and expenses	42,769	(457,526)	500,295	-109%
Capital contributions - connection fees	189,155	207,335	(18,180)	-9%
Decrease in net position	(291,464)	(207,839)	(83,625)	40%
Net position - beginning of year	11,274,056	11,481,895	(207,839)	-2%
Net position - end of year	\$ 10,982,592	\$ 11,274,056	\$ (291,464)	-3%

**South San Luis Obispo County Sanitation District
Management's Discussion and Analysis
Fiscal Year Ending June 30, 2016**

Capital Asset and Debt Administration:

Capital Assets. The District's investments in capital assets for its business type activities as of June 30, 2016 amounts to \$7.9 million (net of accumulated depreciation). This investment in capital assets includes land, buildings and systems, improvements, machinery and equipment.

Additional information on the South San Luis Obispo County Sanitation District capital assets can be found in Note 4 on page 21 of this report.

Capital Assets (Net of Depreciation)	2017	2016
Nondepreciable capital assets	\$ 977,357	\$ 534,212
Depreciable capital assets (net of accumulated depreciation)	<u>6,910,953</u>	<u>7,610,348</u>
Total capital assets	<u>\$ 7,888,310</u>	<u>\$ 8,144,560</u>

Long-term debt. At June 30, 2016, the District held debt of loan payable and compensated absences.

Long-Term Debt	2017	2016
Loan payable	\$ 140,269	\$ 205,137
Compensated absences	<u>32,372</u>	<u>52,330</u>
Total long-term debt	<u>\$ 172,641</u>	<u>\$ 257,467</u>

The District's total debt decreased by \$85,000 (33%) during the year ended June 30, 2016, due to payment on the District's only note payable.

Additional information on the District's long-term debt can be found in Note 5 on page 21 of this report.

Economic Factors and Next Year's Budgets and Rates

Financial Plan. Bartle Wells has been engaged to evaluate evolving capital and maintenance needs and the District's ability to accommodate these needs within the existing rate structure. Upon completion of the Updated Financial Plan by Bartle Wells the District will consider financial strategies, including rate adjustments, to fulfill the financial demands of the District

Rate Increase. The District implemented a rate increase beginning July 1, 2016. The new rates are designed to meet the District's operational and capital funding needs, comply with legal requirements and be fair to all customers. Rate increases are phased in over approximately five years to minimize the annual impact on District customers.

**South San Luis Obispo County Sanitation District
Management's Discussion and Analysis
Fiscal Year Ending June 30, 2016**

Other Post-Employment Benefits. The District provides other post-employment benefits (OPEB) through the California Employers' Retiree Benefit fund which is administered by CalPERS. In 2000, the District joined the CalPERS medical program. An actuarial evaluation was performed in the 2015-16 fiscal year to determine the District's Annual Required Contribution (ARC) to the OPEB Fund in order to meet the obligation of providing retiree medical insurance.

Requests for Information:

This financial report is designed to provide a general overview of the District's finances for all those with an interest in the government's finances. Questions concerning any of the information should be addressed to the District Administrator, South San Luis Obispo County Sanitation District 1600 Aloha Place, Oceano, CA 93445.

South San Luis Obispo County Sanitation District
Statement of Net Position – Proprietary Fund
June 30, 2016

Assets

Current assets:

Cash and cash equivalents	\$ 5,575,929
Accounts receivable	745,908
Prepaid expenses	<u>29,385</u>
Total current assets	<u>6,351,222</u>

Noncurrent assets:

Deposits	5,705
Capital assets:	
Land	431,425
Property, plant, and equipment	22,834,764
Construction in progress	<u>545,932</u>
Total capital assets	<u>23,812,121</u>
Accumulated depreciation	<u>(15,923,811)</u>
Total capital assets, net of accumulated depreciation	<u>7,888,310</u>
Total noncurrent assets	<u>7,894,015</u>
Total assets	<u>14,245,237</u>

Deferred Outflows of Resources

Deferred pensions	<u>98,933</u>
Total deferred outflows of resources	<u>98,933</u>

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

South San Luis Obispo County Sanitation District
Statement of Net Position – Proprietary Fund
June 30, 2016
Page 2

Liabilities

Current liabilities:

Accounts payable	\$ 323,918
Accrued interest payable	4,009
Settlement payable	1,109,813
Loan payable, current portion	68,318
Total current liabilities	<u>1,506,058</u>

Long-term liabilities:

Compensated absences	32,372
Net pension liability	766,801
Other post employment benefits	853,757
Loan payable, net of current portion	71,951
Total long-term liabilities	<u>1,724,881</u>
Total liabilities	<u>3,230,939</u>

Deferred Inflows of Resources

Deferred pensions	<u>130,639</u>
Total deferred inflows of resources	<u>130,639</u>

Net Position

Net investment in capital assets	7,748,041
Restricted for capital expansion	3,960,461
Unrestricted	(725,910)
Total net position	<u>\$ 10,982,592</u>

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

South San Luis Obispo County Sanitation District
Statement of Revenues, Expenses and Changes in Net Position – Proprietary Fund
Year Ended June 30, 2016

Operating revenues:	
Sewer services fees	\$ 3,458,839
Total operating revenues	<u>3,458,839</u>
 Operating expenses:	
Accounting	11,495
Capital purchases	4,216
Communications	13,266
Depreciation expense	1,237,139
Employee benefits	303,243
Equipment rental	26,125
Fuel and oil	10,251
Gross wages	659,418
Insurance	28,090
Legal	299,099
Membership, permits, and license fees	73,103
Miscellaneous expenses	3,707
Office and supplies	24,606
OPEB expense	122,565
Payroll taxes and benefits	54,525
Plant chemicals, lab, and analysis	187,417
Professional services	177,014
Property tax	28,654
Repairs and maintenance	207,663
Retirement contribution	150,255
Small tools	16,615
Solids handling	40,853
Special services	81,074
Studies	48,373
Uniforms	13,365
Utilities	160,096
Total operating expenses	<u>3,982,227</u>
Operating loss	<u>(523,388)</u>

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

South San Luis Obispo County Sanitation District
Statement of Revenues, Expenses and Changes in Net Position – Proprietary Fund
Year Ended June 30, 2016
Page 2

Nonoperating revenues and expenses:	
Governmental agencies	\$ 3,276
Interest income	24,321
Lease income	25,098
Interest expense	<u>(9,926)</u>
Total nonoperating revenues and expenses	<u>42,769</u>
Capital contributions	
Connection fees	<u>189,155</u>
Total capital contributions	<u>189,155</u>
Decrease in net position	<u>(291,464)</u>
Net position - beginning of year	<u>11,274,056</u>
Net position - end of year	<u><u>\$ 10,982,592</u></u>

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

South San Luis Obispo County Sanitation District
Statement of Cash Flows
Year Ended June 30, 2016

Cash flows from operating activities:		
Cash received from customers	\$ 3,223,934	
Cash payments to suppliers for goods and services	(1,414,811)	
Cash payments to employees for services	<u>(974,054)</u>	
Net cash provided by operating activities		\$ 835,069
Cash Flows From noncapital financing activities		
Cash received from other governmental agencies	3,276	
Lease income	<u>25,098</u>	
Net cash provided by noncapital financing activities		28,374
Cash flows from capital and related financing activities:		
Capital contributions, connection fees	189,155	
Acquisition and construction of capital assets	(996,714)	
Disposition of capital assets	15,825	
Principal paid on debt financing	(64,868)	
Interest paid on debt financing	<u>(9,926)</u>	
Net cash used in capital and financing activities		(866,528)
Cash flows from investing activities:		
Interest received	<u>24,321</u>	
Net cash provided by investing activities		<u>24,321</u>
Net increase in cash		21,236
Cash and cash equivalents - beginning of year		<u>5,554,693</u>
Cash and cash equivalents - end of year		<u><u>\$ 5,575,929</u></u>

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

South San Luis Obispo County Sanitation District
Statement of Cash Flows
Year Ended June 30, 2016
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Reconciliation of operating loss to net cash

provided by operating activities:

Operating loss \$ (523,388)

Adjustments to reconcile operating loss to net cash
provided by operating activities:

Depreciation \$ 1,237,139

Changes in assets, deferred outflows of resources,
liabilities, and deferred inflows of resources:

Accounts receivable (240,192)

Prepaid expenses (1,295)

Customer deposits and advances 5,287

Accounts payable 190,566

Accrued liabilities (31,801)

Compensated absences (19,958)

Other post employment benefits 122,565

Deferred pensions and net pension liability 96,146

Total adjustments 1,358,457

Net cash provided by operating activities \$ 835,069

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

South San Luis Obispo County Sanitation District
Notes to Basic Financial Statements
June 30, 2016

Note 1: Description of the Reporting Entity

The reporting entity is the South San Luis Obispo County Sanitation District (the District). The District is responsible for trunk main and sewer pipes from the Cities of Arroyo Grande, Grover Beach, and the Oceano Community Services District and provides wastewater disposal services. The District is governed by a three-member body, known as the District Board, who are appointed by the respective member agencies on a yearly basis. The District Board includes one representative from each of its Member Agencies, specifically, the City of Arroyo Grande, City of Grover Beach, and the Oceano Community Services District.

The District has no component units that meet the requirements for presentation by the Governmental Accounting Standards Board (GASB).

Note 2: Summary of Significant Accounting Policies

Accounting Policy

For financial reporting purposes, the District is engaged only in business-type activities. The accompanying financial statements have been prepared using the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America as prescribed by the GASB. Under the accrual basis, revenues are recognized when earned and expenses are recognized when incurred.

The District accounts for its operations as an Enterprise Fund. Enterprise Funds are used to account for operations which are financed and operated in a manner similar to private business enterprises. The intent of the governing body is that the costs of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges or where the governing body has decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes..

Budgets and Budgetary Accounting

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

Use of Estimates

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

South San Luis Obispo County Sanitation District

Notes to Financial Statements

June 30, 2016

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Note 2: Summary of Significant Accounting Policies (Continued)

Cash and Cash Equivalents

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

Accounts Receivable

Accounts receivable are written off in full when the receivable is deemed uncollectible. Management assessed the need for an allowance for uncollectible accounts receivable based on prior experience and management's analysis of possible bad debts and determined that no allowance was necessary at June 30, 2016.

Capital Assets

All capital assets are valued at historical cost, or estimated historical cost if actual costs are not available. Depreciation has been provided over the estimated useful life (ranging from 5 – 40 years) of the asset using the straight-line method.

Deferred Outflows and Inflows of Resources

The District recognizes deferred outflows and inflows of resources in the Statement of Net Position. A deferred outflow of resources is defined as a consumption of net position by the District that is applicable to a future reporting period. A deferred inflow of resources is defined as an acquisition of net position by the District that is applicable to a future reporting period.

Compensated Absences

District employees are granted vacation and sick leave in varying amounts. In the event of termination, employees are reimbursed for the total value of their accumulated vacation days and for a portion of their accumulated sick leave. A liability for compensated absences is accrued for the District and included in noncurrent liabilities.

Net Pension Liability

The District recognizes a net pension liability, which represents the District's proportionate share of the excess of the total pension liability over the fiduciary net position of the pension reflected in the actuarial reports provided by the

South San Luis Obispo County Sanitation District

Notes to Financial Statements

June 30, 2016

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Note 2: Summary of Significant Accounting Policies (Continued)

California Public Employees' Retirement System (CalPERS) plan (the Plan). The net pension liability is measured as of the District's prior fiscal year-end. Changes in the net pension liability are recorded, in the period incurred, as pension expense or as deferred inflows of resources or deferred outflows of resources depending on the nature of the change.

The changes in the net pension liability that are recorded as deferred inflows of resources or deferred outflows of resources (that arise from changes in actuarial assumptions or other inputs and differences between expected or actual experience) are amortized over the weighted average remaining service life of all participants in the respective pension plan and are recorded as a component of pension expense beginning with the period in which they are incurred.

For purposes of measuring the net pension liability and deferred outflows/inflows of resources related to pensions, and pension expense, information about the fiduciary net position of the District's CalPERS Plans and additions to/deductions from the Plan's fiduciary net position have been determined on the same basis as they are reported by CalPERS. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value. Projected earnings on pension investments are recognized as a component of pension expense.

Net Position

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

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

South San Luis Obispo County Sanitation District

Notes to Financial Statements

June 30, 2016

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Note 3: Cash and Cash Equivalents

At June 30, 2016, the District had the following cash and investments on hand:

Cash and cash equivalents	\$	130,067
Cash and investments with County Treasurer		3,026,360
Local Agency Investment Fund (LAIF)		<u>2,419,502</u>
	\$	<u>5,575,929</u>

The District maintains the majority of its operating cash with the San Luis Obispo County Treasurer’s office in a pooled investment fund. Funds are pooled with other agencies throughout San Luis Obispo County. Investments are made in accordance with the California Government Code. The carrying value of pooled funds approximates fair value as required by GASB. Interest earned is deposited quarterly into participating funds. Investment gains and losses, if any, are proportionately shared by all funds in the pool. San Luis Obispo County’s report discloses the required information in accordance with GASB Statements No. 3 and 40. External investment pools are not required to provide custodial credit risk disclosures.

The fair value of the District’s position in the State LAIF pool is the same as the value of the pool shares. The State LAIF pool credit quality is unrated. LAIF is overseen by the Local Agency Investment Advisory Board, which consists of five members, in accordance with State statute. The State Treasurer’s Office audits the fund annually.

Custodial Credit Risk

Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, the District will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty (e.g., broker-dealer) to a transaction, the District 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 deposits or investments, other than the following provision for deposits: The California Government Code requires that a financial institution secure deposits made by state or local governmental units by pledging securities in an undivided collateral pool held by a depository regulated under state law (unless so waived by the governmental unit). The fair value of the pledged securities in the collateral pool must equal at least 110% of the total amount deposited by the public agencies. California law also allows financial institutions to secure the District’s deposits by pledging first trust deed mortgage notes having a value of 150% of the secured public deposits.

South San Luis Obispo County Sanitation District

Notes to Financial Statements

June 30, 2016

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Note 3: Cash and Cash Equivalents (Continued)

As of June 30, 2016, none of the District's deposits with financial institutions in excess of federal depository insurance limits were held in uncollateralized accounts.

Interest Rate Risk

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

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

Investment Type	Carrying Amount	12 Months or Less
Cash and investments with County Treasurer	\$ 3,026,360	\$ 3,026,360
Local Agency Investment Fund (LAIF)	2,419,502	2,419,502
	<u>\$ 5,445,862</u>	<u>\$ 5,445,862</u>

Credit Risk

This is the risk of loss due to the failure of the security issuer or backer. This is measured by the assignment of rating by a nationally recognized statistical rating organization. The District's investments were not rated as of fiscal year end.

Concentration of Credit Risk

The investment policy of the District contains no limitations on the amount that can be invested in any one issuer beyond that stipulated by the California Government Code. There are no investments in any one issuer that represent 5% or more of total District investments.

South San Luis Obispo County Sanitation District

Notes to Financial Statements

June 30, 2016

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Note 4: Capital Assets

Capital assets activity for the fiscal year ended June 30, 2016 was as follows:

	Balance June 30, 2015	Additions/ Transfers	Deletions/ Transfers	Balance June 30, 2016
Land	\$ 431,425	\$	\$	\$ 431,425
Property, plant, and equipment	22,387,764	537,744	(90,744)	22,834,764
Construction in progress	102,787	458,970	(15,825)	545,932
Total capital assets	22,921,976	996,714	(106,569)	23,812,121
Less accumulated depreciation	(14,777,416)	(1,237,139)	90,744	(15,923,811)
Net capital assets	<u>\$ 8,144,560</u>	<u>\$ (240,425)</u>	<u>\$ (15,825)</u>	<u>\$ 7,888,310</u>

Note 5: Note Payable

On October 19, 2009, the District received a loan from Municipal Finance Corporation in the amount of \$483,159. The purpose of the loan was to install a new electrical generator system. The District will make semi-annual payments under the loan agreement of \$37,398 through June 2017. The interest rate for the loan is 5.25%. At June 30, 2016, the principal amount outstanding was \$140,269.

At June 30, 2016 future debt service payments are as follows:

<u>For the Year Ended June 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2017	\$ 68,318	\$ 6,478	\$ 74,796
2018	71,951	2,845	74,796
	<u>\$ 140,269</u>	<u>\$ 9,323</u>	<u>\$ 149,592</u>

The following is a summary of the District's long-term debt transactions for the year ended June 30, 2016:

	Balance June 30, 2015	Additions	Deletions	Balance June 30, 2016
Compensated absences	\$ 52,330	\$ 29,697	\$ (49,655)	\$ 32,372
Loan payable	205,137		(64,868)	140,269
Total	<u>\$ 257,467</u>	<u>\$ 29,697</u>	<u>\$ (114,523)</u>	<u>\$ 172,641</u>

South San Luis Obispo County Sanitation District

Notes to Financial Statements

June 30, 2016

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Note 6: Pension Plan

Plan Description

All qualified permanent and probationary employees are eligible to participate in the Public Agency Cost-Sharing Multiple-Employer Defined Benefit Pension Plan (the Plan), administered by CalPERS. The Plan’s benefit provisions are established by statute. The Plan is included as a pension trust fund in the CalPERS Comprehensive Annual Financial Report, which is available on the CalPERS website.

The Plan consists of a miscellaneous pool and a safety pool (referred to as “risk pools”), which are comprised of individual employer miscellaneous and safety rate plans, respectively, including those of the District. The District’s employer rate plans in the miscellaneous risk pool include the Miscellaneous plan (Miscellaneous) and the Miscellaneous PEPRA plan (Miscellaneous PEPRA). The District does not have any rate plans in the safety risk pool.

Benefits Provided

The Plan provides service retirement and disability benefits, annual cost of living adjustments and death benefits to plan members, who must be public employees and beneficiaries. Benefits are based on years of credited service, equal to one year of full time employment. Classic members and PEPRA Safety members with five years of total service are eligible to retire at age 50 with statutorily reduced benefits. PEPRA Miscellaneous members with five years of total service are eligible to retire at age 52 with statutorily reduced benefits. All members are eligible for non-duty disability benefits after five years of service. The death benefit is one of the following: the Basic Death Benefit or the Optional Settlement 2W Death Benefit. The cost of living adjustments for each plan are applied as specified by the Public Employees’ Retirement Law.

The Plans’ provisions and benefits in effect at June 30, 2016, are summarized as follows:

	Miscellaneous	
	Prior to January 1, 2013	On or after January 1, 2013
Hire date		
Benefit formula	2.5% @ 55	2.0% @ 62
Benefit vesting schedule	5 years of service	5 years of service
Benefit payments	Monthly for life	Monthly for life
Retirement age	50	52
Monthly benefits, as a % of eligible compensation	2.0% to 2.5%	1.0% to 2.0%
Required employee contribution rates	7.892%	6.250%
Required employer contribution rates	9.067%	6.237%

South San Luis Obispo County Sanitation District

Notes to Financial Statements

June 30, 2016

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Note 6: Pension Plan (Continued)

Contributions

Section 20814(c) of the California Public Employees' Retirement Law requires that the employer contribution rates for all public employers be determined on an annual basis by the CalPERS actuary and shall be effective on July 1 following notice of a change in the rate. Contribution rates for the employer rate plans are determined through the CalPERS' annual actuarial valuation process. Each employer rate plan's actuarially determined rate is based on the estimated amount necessary to pay the employer rate plan's allocated share of the cost of benefits earned by employees during the year, and any unfunded accrued liability. The District is required to contribute the difference between the actuarially determined rate and the contribution rate of employees. The District's contributions to the risk pools in the Plan for the year ended June 30, 2016 were \$40,007.

Pension Liabilities, Pension Expenses and Deferred Outflows/Inflows of Resources Related to Pensions

As of June 30, 2016, the District reported net pension liability for its proportionate shares of the net pension liability of \$766,801.

The District's net pension liability for each Plan is measured as the proportionate share of the net pension liability. The net pension liability of each of the Plans is measured as of June 30, 2015, and the total pension liability for each Plan used to calculate the net pension liability was determined by an actuarial valuation as of June 30, 2014 rolled forward to June 30, 2015 using standard update procedures. The District's proportion of the net pension liability was based on a projection of the District's long-term share of contributions to the pension plans relative to the projected contributions of all participating employers, actuarially determined. The District's proportionate share of the net pension liability as of June 30, 2014 and 2015 was as follows:

	<u>Proportionate Share</u>
Percentage share at 6/30/14	0.028137%
Percentage share at 6/30/15	0.027950%
Change - increase/(decrease)	<u><u>-0.000187%</u></u>

South San Luis Obispo County Sanitation District

Notes to Financial Statements

June 30, 2016

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Note 6: Pension Plan (Continued)

For the year ended June 30, 2016, the District recognized pension expense of \$98,295. At June 30, 2016, the District reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	<u>Deferred Outflows of Resources</u>	<u>Deferred Inflows of Resources</u>
Pension contributions subsequent to measurement date	\$ 40,007	\$
Changes in assumptions		(32,047)
Differences between expected and actual experiences	3,387	
Change in employer's proportion and differences between the employer's contributions and the employer's proportionate share of contributions		(33,573)
Net differences between projected and actual earnings on plan investments		(65,019)
Adjustment due to differences in proportions	<u>55,539</u>	
	<u>\$ 98,933</u>	<u>\$ (130,639)</u>

The deferred outflows of resources related to contributions subsequent to the measurement date of \$40,007 will be recognized as a reduction of the net pension liability in the year ended June 30, 2017. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized as pension expense as follows:

<u>Measurement Period Ended June 30</u>	<u>Amount</u>
2016	\$ (31,204)
2017	(31,039)
2018	(30,000)
2019	<u>20,530</u>
Total	<u>\$ (71,713)</u>

South San Luis Obispo County Sanitation District

Notes to Financial Statements

June 30, 2016

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Note 6: Pension Plan (Continued)

Actuarial Assumptions

The total pension liabilities in the June 30, 2015 actuarial valuations were determined using the following actuarial assumptions:

Valuation Date	June 30, 2016
Measurement Date	June 30, 2015
Actuarial Cost Method	Entry Age Normal
Actuarial Assumptions:	
Discount Rate	7.65%
Inflation	2.75%
Payroll Growth	3.00%
Projected Salary Increase	Varies by Entry Age and Service (1)
Investment Rate of Return	(2)
Mortality Rate Table	(3)

- (1) Depending on age, service and type of employment.
- (2) Contract COLA up to 2.75% until Purchasing Power Protection Allowance Floor on Purchasing Power applies, 2.75% after
- (3) Derived using CalPERS' Membership Data for all Funds

The underlying mortality assumptions and all other actuarial assumptions used in the June 30, 2014 valuation were based on the results of a January 2015 actuarial experience study for the period 1997 to 2011. Further details of the Experience Study can be found on the CalPERS website.

Discount Rate

The discount rate used to measure the total pension liability was 7.65%. To determine whether the municipal bond rate should be used in the calculation of a discount rate for the Plan, CalPERS stress tested employer rate plans within the Plan that would most likely result in a discount rate that would be different from the actuarially assumed discount rate. Based on the testing, none of the tested employer rate plans run out of assets. Therefore, the current 7.65% discount rate is adequate and the use of the municipal bond rate calculation is not necessary. The stress test results are presented in a detailed report, GASB Statements 67 and 68 Crossover Testing Report for Measurement Date June 30, 2015 based on June 30, 2016 valuations, that can be obtained from the CalPERS website.

South San Luis Obispo County Sanitation District

Notes to Financial Statements

June 30, 2016

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Note 6: Pension Plan (Continued)

According to Paragraph 30 of GASB 68, the long-term discount rate should be determined without reduction for pension plan administrative expense. For the CalPERS Plan, the 7.65% investment return assumption used in this accounting valuation is net of administrative expenses. Administrative expenses are assumed to be 15 basis points. An investment return excluding administrative expenses would have been 7.65%. Using this lower discount rate has resulted in a slightly higher total pension liability and net pension liability. CalPERS checked the materiality threshold for the difference in calculation and did not find it to be a material difference.

CalPERS is scheduled to review all actuarial assumptions as part of its regular asset liability management review cycle that is scheduled to be completed in February 2018. Any changes to the discount rate will require Board action and proper stakeholder outreach. For these reasons, CalPERS expects to continue using a discount rate net of administrative expenses for GASB 67 and 68 calculations through at least the year ended 2017-18. CalPERS will continue to check the materiality of the difference in calculation until such time as CalPERS has changed their methodology.

The long-term expected rate of return on pension plan investments was determined using a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class.

In determining the long-term expected rate of return, CalPERS took into account both short-term and long-term market return expectations as well as the expected pension fund cash flows. Such cash flows were developed assuming that both members and employers will make their required contributions on time and as scheduled in all future years. Using historical returns of all the Plan's asset classes, expected compound (geometric) returns were calculated over the short-term (first 11 years) and the long-term (11-60 years) using a building-block approach. Using the expected nominal returns for both short-term and long-term, the present value of benefits was calculated for the Plan. The expected rate of return was set by calculating the single equivalent expected return that arrived at the same present value of benefits for cash flows as the one calculated using both short-term and long-term returns. The expected rate of return was then set equivalent to the single equivalent rate calculated above and rounded down to the nearest one quarter of one percent.

South San Luis Obispo County Sanitation District

Notes to Financial Statements

June 30, 2016

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Note 6: Pension Plan (Continued)

The table below reflects the long-term expected real rate of return by asset class. The rate of return was calculated using the capital market assumptions applied to determine the discount rate and asset allocation. These geometric rates of return are net of administrative expenses.

Asset Class	New Strategic Allocation	Real Return Years 1 - 10 (a)	Real Return Years 11+ (b)
Global Equity	51.00%	5.25%	5.71%
Global Fixed Income	19.00%	0.99%	2.43%
Inflation Sensitive	6.00%	0.45%	3.36%
Private Equity	10.00%	6.83%	6.95%
Real Estate	10.00%	4.50%	5.12%
Infrastructure and Forestland	2.00%	4.50%	5.09%
Liquidity	2.00%	-0.55%	-1.05%
	100.00%		

(a) - An expected inflation of 2.5% used for this period.

(b) - An expected inflation of 3.0% used for this period.

Sensitivity of the District’s Proportionate Share of the Net Pension Liability to Changes in the Discount Rate

The following presents the District’s proportionate share of the net pension liability of the each risk pool as of the measurement date, calculated using the discount rate, as well as what the District’s proportionate share of the net pension liability would be if it were calculated using a discount rate that is 1 percentage-point lower or 1 percentage-point higher than the current rate:

1% Decrease		6.65%
Net Pension Liability	\$	1,244,517
Current Discount Rate		7.65%
Net Pension Liability	\$	766,801
1% Increase		8.65%
Net Pension Liability	\$	372,390

South San Luis Obispo County Sanitation District

Notes to Financial Statements

June 30, 2016

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Note 7: Post-Employment Benefits Other than Pensions

The District’s primary OPEB cost obligation is for retiree health benefits under the election to participate in the California Public Employees’ Retirement System (CalPERS) Health Benefit Program, an agent multiple-employer defined benefit OPEB plan, under the “unequal contribution option.” The District entered the CalPERS medical insurance program in 1967 under the Public Employees’ Medical and Hospital Care Act (PEMHCA). The required employer contribution was \$125.00 per employee per month in 2015-16. Retirees pay the differential monthly amount of the premium, which varies depending on the health benefits they select.

Funding Policy

The District is required to contribute the annual required contribution (ARC) of the employer, an amount actuarially determined in accordance with the parameters of GASB Statement No. 45. The District’s ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover the normal cost each year and amortize the unfunded actuarial liability over a period of 30 years. The ARC for 2015-16 was \$145,751.

Annual OPEB Cost and Net OPEB Obligation

The following table shows the components of the District’s Annual OPEB Cost for the fiscal year ended June 30, 2016, the amount actually contributed to the plan (including administrative costs), and changes in the Net OPEB Obligation:

Annual Required Contribution	\$ 145,751
Interest on Net OPEB Obligation	32,904
Annual OPEB Cost/Expense	<u>178,655</u>
Contributions made	<u>56,090</u>
Increase in Net OPEB Obligation	122,565
Net OPEB Obligation - beginning of fiscal year	<u>731,192</u>
Net OPEB Obligation - end of fiscal year	<u><u>\$ 853,757</u></u>

The District’s Annual OPEB cost, the percentage of Annual OPEB Cost contributed to the plan, and the Net OPEB Obligation are as follows:

<u>Fiscal Year Ended</u>	<u>Annual OPEB Cost</u>	<u>Actual Contribution</u>	<u>Percentage of OPEB Cost Contributed</u>	<u>Net OPEB Obligation</u>
June 30, 2014	\$ 150,441	\$ 30,656	20%	\$ 611,233
June 30, 2015	\$ 155,232	\$ 35,273	23%	\$ 731,192
June 30, 2016	\$ 178,655	\$ 56,090	31%	\$ 853,757

South San Luis Obispo County Sanitation District

Notes to Financial Statements

June 30, 2016

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Note 7: Post-Employment Benefits Other than Pensions (Continued)

Funding Status and Funding Progress

The funded status of the Plan as of June 30, 2015, the Plan's most recent actuarial valuation, was as follows:

Actuarial accrued liability	\$ 1,309,970
Actuarial value of plan assets	152,497
Unfunded actuarial accrued liability (UAAL)	<u>1,157,473</u>
Funded ratio	12%
Covered payroll	512,061
UAAL as a percentage of covered payroll	226%

Actuarial valuations of an ongoing plan involve estimates of the reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the health care cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revisions as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information, following the notes to the financial statements, presents multiyear trend information about whether the actuarial value of Plan assets is increasing or decreasing over time relative to actuarial accrued liabilities for benefits.

Actuarial Methods and Assumptions

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

In the June 30 2015 actuarial valuation, the entry age normal actuarial cost method was used. The actuarial assumptions included a 4.5% investment rate of return (net of administrative expenses), which includes a 2.75% inflation assumption. The unfunded actuarial accrued liability (UAAL) is being amortized over 30 years based on a level percentage of payroll. The remaining amortization period at June 30, 2016 was 27 years.

South San Luis Obispo County Sanitation District

Notes to Financial Statements

June 30, 2016

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Note 8: Commitments and Contingencies

Litigation

The District is involved in litigation incurred in the normal course of conducting District business. Although the outcome of these lawsuits is not presently determinable, in the opinion of the District's board of directors, the resolution of these matters will not have a material adverse effect on the financial condition of the District.

Note 9: Settlement Payable

On October 3, 2012, the District was levied a penalty of \$1,109,813 from the Regional Water Quality Control Board for a sewage spill in December 2010. As of June 30, 2015, the settlement payable was \$1,109,813. In July 2016, the District made three payments on this settlement for a total payment of \$887,850. The remaining balance of \$221,963 represents funds that the District must use in the construction of a grit removal system at the treatment facility.

Note 10: New Accounting Standards

Accounting Standards Adopted

In February 2015, GASB issued Statement No. 72, *Fair Value Measurement and Application*, which addresses accounting and financial reporting issues related to fair value measurements. This Statement also provides guidance for applying fair value to certain investments and disclosures related to all fair value measurements. The provisions of Statement No. 72 are effective for fiscal years beginning after June 15, 2015. Implementation of this statement resulted in additional fair value measurement disclosures. See Note 2 to the financial statements for further discussion.

In June 2015, GASB issued Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68*. The requirements of this Statement extend the approach to accounting and financial reporting established in Statement 68 to all pensions, with modifications as necessary to reflect that for accounting and financial reporting purposes, any assets accumulated for pensions that are provided through pension plans that are not administered through trusts that meet the criteria specified in Statement 68 should not be considered pension plan assets. The provisions of Statement No. 73 are effective for fiscal years beginning after June 15, 2015. Implementation of this statement did not have a material impact on the District's financial statements.

South San Luis Obispo County Sanitation District

Notes to Financial Statements

June 30, 2016

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Note 10: New Accounting Standards (Continued)

In June 2015, GASB issued Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*. The objective of this Statement is to identify—in the context of the current governmental financial reporting environment—the hierarchy of generally accepted accounting principles. The “GAAP hierarchy” consists of the sources of accounting principles used to prepare financial statements of state and local governmental entities in conformity with GAAP and the framework for selecting those principles. This Statement reduces the GAAP hierarchy to two categories of authoritative GAAP and addresses the use of authoritative and nonauthoritative literature in the event that the accounting treatment for a transaction or other event is not specified within a source of authoritative GAAP. The provisions of Statement No. 76 are effective for fiscal years beginning after June 15, 2015. Implementation of this statement did not have a material impact on the District’s financial statements.

New Accounting Standards

In June 2015, GASB issued Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, which establishes financial reporting standards for state and local governmental OPEB plans—defined benefit OPEB plans and defined contribution OPEB plans—that are administered through trusts or equivalent arrangements. The provisions of Statement No. 74 are effective for fiscal years beginning after June 15, 2016. Management has not yet determined the impact of this Statement on its financial statements.

Additionally, in June 2015, GASB issued Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefit Plans Other Than Pensions*. Statement No. 75 establishes new accounting and financial reporting requirements for governments whose employees are provided with OPEB, as well as for certain nonemployer governments that have a legal obligation to provide financial support for OPEB provided to the employees of other entities. The provisions of Statement No. 75 are effective for fiscal years beginning after June 15, 2017. Management has not yet determined the impact of this Statement on its financial statements.

In August 2015, GASB issued Statement No. 77, *Tax Abatement Disclosures*. Statement No. 77 requires disclosure of tax abatement information about (1) a reporting government’s own tax abatement agreements and (2) those that are entered into by other governments and that reduce the reporting government’s tax revenues. The provisions of Statement No. 77 are effective for fiscal years beginning after December 15, 2015. Management has not yet determined the impact of this Statement on its financial statements.

In December 2015, GASB issued Statement No. 78, *Pensions Provided through Certain Multiple-Employer Defined Benefit Pension Plans*. Statement No. 78 addresses a practice issue regarding the scope and applicability of Statement No. 68 for pensions provided through certain multiple-employer defined benefit pension plans and to state or local

South San Luis Obispo County Sanitation District

Notes to Financial Statements

June 30, 2016

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Note 10: New Accounting Standards (Continued)

governmental employers whose employees are provided with such pensions. The provisions of Statement No. 78 are effective for fiscal years beginning after December 15, 2015. Management has not yet determined the impact of this Statement on its financial statements.

In December 2015, GASB issued Statement No. 79, *Certain External Investment Pools and Pool Participants*. Statement No. 79 addresses accounting and financial reporting for certain external investment pools and pool participants. The provisions of Statement No. 79 are effective for reporting periods beginning after June 15, 2016. Management has not yet determined the impact of this Statement on its financial statements.

In January 2016, GASB issued Statement No. 80, *Blending Requirements for Certain Component Units – an amendment of GASB Statement No. 14*. Statement No. 80 amends the blending requirements established in paragraph 53 of Statement No. 14, *The Financial Reporting Entity*, as amended. The provisions of Statement No. 80 are effective for fiscal years beginning after December 15, 2015. Management has not yet determined the impact of this Statement on its financial statements.

In March 2016, GASB issued Statement No. 81, *Irrevocable Split-Interest Agreements*. Statement No. 81 requires that a government that receives resources pursuant to an irrevocable split-interest agreement recognize assets, liabilities, and deferred inflows of resources at the inception of the agreement. The Statement also provides additional recognition and measurement guidance for situations in which a government is a beneficiary of the agreement. The provisions of Statement No. 81 are effective for fiscal years beginning after December 15, 2016. Management has not yet determined the impact of this Statement on its financial statements.

In March 2016, GASB issued Statement No. 82, *Pension Issues—an amendment of GASB Statements No. 67, No. 68, and No. 73*. Statement No. 82 addresses issues regarding (1) the presentation of payroll-related measures in required supplementary information, (2) the selection of assumptions and the treatment of deviations from the guidance in an Actuarial Standard of Practice for financial reporting purposes, and (3) the classification of payments made by employers to satisfy employee (plan member) contribution requirements. The provisions of Statement No. 82 are effective for fiscal years beginning after June 15, 2016. Management has not yet determined the impact of this Statement on its financial statements.

In November 2016, GASB issued Statement No. 83, *Capital Asset Retirement Obligations*. Statement No. 83 provides financial statement users with information about asset retirement obligations that were not addressed in GASB standards by establishing uniform accounting and financial reporting requirements for these obligations. The provisions of Statement No. 83 are effective for reporting periods beginning after June 15, 2018. Management has not yet determined the impact of this Statement on its financial statements.

South San Luis Obispo County Sanitation District

Notes to Financial Statements

June 30, 2016

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Note 10: New Accounting Standards (Continued)

In January 2017, GASB issued Statement No. 84, *Fiduciary Activities*. Statement No. 84 establishes criteria for identifying fiduciary activities of all state and local governments. The provisions of Statement No. 84 are effective for reporting periods beginning after December 15, 2018. Management has not yet determined the impact of this Statement on its financial statements.

In March 2017, GASB issued Statement No. 85, *Omnibus 2017*. Statement No. 85 addresses a variety of topics including issues related to blending component units, goodwill, fair value measurement and application, and postemployment benefits (pensions and other postemployment benefits [OPEB]). The provisions of Statement No. 85 are effective for reporting periods beginning after June 15, 2017. Management has not yet determined the impact of this Statement on its financial statements.

In May 2017, GASB issued Statement No. 86, *Certain Debt Extinguishment Issues*. Statement No. 86 improves consistency in accounting and financial reporting for in-substance defeasance of debt by providing guidance for transactions in which cash and other monetary assets acquired with only existing resources – resources other than the proceeds of refunding debt – are placed in an irrevocable trust for the sole purpose of extinguishing debt. This Statement also improves accounting and financial reporting for prepaid insurance on debt that is extinguished and notes to financial statements for debt that is defeased in substance. The provisions of Statement No. 86 are effective for reporting periods beginning after June 15, 2017. Management has not yet determined the impact of this Statement on its financial statements.

In June 2017, GASB issued Statement No. 87, *Leases*. Statement No. 87 increases the usefulness of governments' financial statements by requiring recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and recognized as inflows of resources or outflows of resources based on the payment provisions of the contract. It establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. Under this Statement, a lessee is required to recognize a lease liability and an intangible right-to-use lease asset, and a lessor is required to recognize a lease receivable and a deferred inflow of resources, thereby enhancing the relevance and consistency of information about governments' leasing activities. The provisions of Statement No. 87 are effective for reporting periods beginning after December 15, 2019. Management has not yet determined the impact of this Statement on its financial statements.

In April 2018, GASB issued Statement No. 88, *Certain Disclosures Related to Debt, Including Direct Borrowings and Direct Placements*. Statement No. 88 improves the information that is disclosed in notes to government financial statements related to debt, including direct borrowings and direct placements. It also clarifies which liabilities governments should include when disclosing information related to debt. The provisions of Statement No. 88 are effective for reporting periods beginning after June 15, 2018. Management has not yet determined the impact of this Statement on its financial statements.

South San Luis Obispo County Sanitation District

Notes to Financial Statements

June 30, 2016

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Note 11: Subsequent Events

Events subsequent to June 30, 2016, have been evaluated through May 11, 2018, which is the date the financial statements were available to be issued.

Subsequent to June 30, 2016, the District has been involved in several large projects and capital purchases with total expenditures of approximately \$1.8 million to date. These expenditures include the Cherry Avenue Bridge project, the purchase of a grit removal system and mechanical bar screen, and the digester cleanout and rehab project.

In November 2017 the District joined the Service Employees International Union (SEIU) Local Chapter 620. A benefit of joining this union was reduced medical expenses due to capped employer responsibility.

Required Supplementary Information

South San Luis Obispo County Sanitation District
Schedule of Funding Progress for
Other Post-Employment Benefits (OPEB)
For the Fiscal Year Ended June 30, 2016

The table below shows an analysis of the actuarial value of assets as a percentage of the actuarial accrued liability and the unfunded actuarial accrued liability (UAAL) as a percentage of the annual covered payroll as of the three most recent actuarial reports for the period ending June 30, 2016.

<u>Valuation Date</u>	<u>Value of Assets</u>	<u>Entry Age Actuarial Accrued Liability</u>	<u>Unfunded Actuarial Accrued Liability</u>	<u>Funded Ratio</u>	<u>Covered Payroll</u>	<u>UAAL as a Percentage of Covered Payroll</u>
June 30, 2015	-	\$ 1,309,970	\$ 1,157,473	0%	\$ 512,061	226%
June 30, 2014	-	1,295,363	1,295,363	0%	366,444	353%
June 30, 2013	-	1,017,897	1,017,897	0%	405,804	251%

See independent auditors' report.

South San Luis Obispo County Sanitation District
Schedule of the District's Proportionate Share of the Net Pension Liability
June 30, 2016
Last 10 Years*

Fiscal Year	2015-16	2014-15
Measurement Period	2014-15	2013-14
Employer's Proportion of the Collective Net Pension Liability	0.011172%	0.008940%
Employer's Proportionate Share of the Collective Net Pension Liability	\$ 766,801	\$ 556,113
Employer's Covered-Employee Payroll	\$ 512,061	\$ 496,070
Employer's Proportionate Share of the Net Pension Liability as a Percentage of its Covered-Employee Payroll	149.75%	112.10%
Plan's Share of the Fiduciary Net Position as a Percentage of the Employer's Total Pension Liability	78.14%	83.70%

*Fiscal year 2015 was the 1st year of implementation. Information is required only for measurement periods for which GASB 68 is applicable.

See independent auditors' report.

South San Luis Obispo County Sanitation District
Schedule of the District's Contributions
June 30, 2016
Last 10 Years*

Fiscal Year	<u>2015-16</u>	<u>2014-15</u>	<u>2013-14</u>
Actuarially Determined Contribution	\$ 150,255	\$ 52,637	\$ 50,379
Actual Contributions During the Measurement Period	<u>(150,255)</u>	<u>(52,637)</u>	<u>(50,379)</u>
Contribution Deficiency (Excess)	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
 Covered-Employee Payroll	 512,061	 \$ 496,070	 \$ 569,833
 Contributions as a Percentage of Covered-Employee Payroll	 29.34%	 10.61%	 8.84%

*Fiscal year 2015 was the 1st year of implementation. Information is required only for measurement periods for which GASB 68 is applicable. Contributions paid as of June 30, 2016 are deferred to June 30, 2017.

See independent auditors' report.

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

Board of Directors
South San Luis Obispo County Sanitation District
Oceano, California

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the South San Luis Obispo County Sanitation District (the District), as of and for the fiscal year ended June 30, 2016, and the related notes to the financial statements, which collectively comprise the District's basic financial statements, and have issued our report thereon dated May 11, 2018.

Internal Control Over Financial Reporting

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

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. *A material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the Organization's financial statements will not be prevented, or detected and corrected on a timely basis. *A significant deficiency* is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and, therefore, material weaknesses or significant deficiencies may exist that were not identified. We did identify certain deficiencies in internal control that we consider to be material weaknesses: 2016.100, 2016.200 and 2016.300.

**Board of Directors
South San Luis Obispo County Sanitation District
Oceano, California
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Compliance and Other Matters

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

South San Luis Obispo County Sanitation District’s Response to Findings

The District’s response to the findings identified in our audit is described below. The District’s response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

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



Glenn Burdette Attest Corporation
San Luis Obispo, California

May 11, 2018

South San Luis Obispo County Sanitation District
Schedule of Audit Findings
Year Ended June 30, 2016

Section I: Findings Relating to the Financial Statements which are Required to be Reported in Accordance with Government Auditing Standards

Finding 2016.100: Capital Assets (*Material Weakness*)

Condition: The District has established limited procedures to ensure that capital asset additions are properly capitalized, capital asset disposals are properly recorded, and current year depreciation expense for capital assets is recorded at the financial statement level. As a result, testwork in the current year discovered that the manual excel schedule maintained by the District to track capital asset activity was not properly updated to reflect all activity.

Criteria: Generally accepted accounting principles for state and local governments require governments to report capital assets, related accumulated depreciation and depreciation expense at the fund-financial level for proprietary funds.

Cause: Procedures are not in place to properly identify capital asset additions and disposals. In addition, the District's manual excel schedule is not updated in a timely manner in order to properly record depreciation expense.

Effect: As the District's manual excel schedule was not properly updated to reflect current year activity, this resulted in an adjustment to depreciation expense of \$1.2 million to record the current year expense, as well as an adjustment of \$1.4 million to properly capitalize current year fixed asset additions, record current year disposals, and record construction in progress activity. The net effect of these adjusting journal entries was a decrease to net assets by approximately \$256 thousand.

Recommendation: We recommend that the manual excel schedule maintained by the District to track capital asset activity be updated continuously throughout the year in order to reflect capital asset activity, including additions and disposals. Further, we recommend that the District utilize the excel schedule to calculate current year depreciation expense and to record the expense on a monthly, or quarterly, basis.

Views of Responsible Officials and Planned Corrective Actions: Management concurs with the auditor's recommendation. The bookkeeper will be directed to update the manual excel schedule maintained by the District to track capital asset activity continuously throughout the year in order to reflect capital asset activity including additions and disposals. The bookkeeper will be further directed to utilize the excel schedule to depreciation expense and to record the expense on a quarterly basis.

South San Luis Obispo County Sanitation District
Schedule of Audit Findings
Year Ended June 30, 2016
Page 2

Finding 2016.200: Lack of Expertise in Financial Accounting and Reporting (*Material Weakness*)

Condition: A system of internal control over financial reporting includes controls over accounting and preparation of financial statements, including footnote disclosures. During our audit we assisted in the preparation of generally accepted accounting principal (GAAP) financial statements, including various material adjustments to properly record fixed assets and depreciation. In addition, we prepared the financial statements, footnote disclosures, and disclosure checklist. However, management reviews the financial statements and disclosure checklist and has the ability to accept responsibility for the financial statements and adjusting journal entries.

Criteria: Generally accepted accounting principles for state and local governments require governments to have expertise in financial accounting and reporting.

Cause: Due to the limited number of accounting staff employed by the District as well as turnover in management positions, the District lacks expertise in financial accounting and reporting.

Effect: Lack of financial accounting expertise may lead to unreliable financial reporting throughout the year as many material adjustments were made at the time of the audit. This may lead to management decisions over the District's activities that are based on incomplete or inaccurate financial data.

Recommendation: We understand that the cost of employing a person with the skills and expertise to prepare all of the journal entries required and prepare the financial statements and footnotes for the audit may not be cost effective. Management is responsible for making decisions concerning costs to be incurred and related benefits, so there is no obligation to change this process. However, we recommend that the District evaluate the process periodically and continue to work toward including some of the required adjustments as part of their monthly reporting process as well as their process to close the accounting records at the end of the year.

Views of Responsible Officials and Planned Corrective Actions: Management concurs with the auditor's recommendation. The new District Administrator (DA) scheduled for hire later this spring will be advised to evaluate the process in which journal entries are prepared and the financial statements and footnotes are prepared for the audit. Management has included funding for employment of additional accounting expertise to aid the new DA as may be required. The DA will also be advised to continue to work toward including some of the required adjustments as part of the monthly reporting process as well as the close out of the accounting records at the end of the year.

South San Luis Obispo County Sanitation District
Schedule of Audit Findings
Year Ended June 30, 2016
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Finding 2016.300: Inadequate Segregation of Duties (*Material Weakness*)

Condition: There are generally four phases for an accounting process or operation: authorization, custody, record keeping and reconciliation. A well-designed system of internal control contemplates the allocation of duties among personnel such that each of these four functions would be performed by a different person. During our audit we noted that the bookkeeper generally performs custody, record keeping and reconciliation, for payroll, cash disbursements and cash receipts, including preparing the bank reconciliation, with limited review by other personnel.

Criteria: Generally accepted accounting principles for state and local governments require governments to have adequate segregation of duties as it relates to an accounting process or operation.

Cause: Due to the limited number of accounting staff employed by the District, the bookkeeper generally performs all accounting functions. In addition, the oversight positions that have historically been relied upon for detection of errors and additional controls was subject to turnover in key personnel.

Effect: Inadequate segregation of duties related to an accounting process or operation could lead to poor internal controls, accounting fraud and misappropriation of company assets. In addition, limited review of the bookkeeper's accounting transactions could mean a failure to catch mistakes and may lead to inaccurate financial reporting.

Recommendation: We recommend that the District evaluate the assignment of responsibilities and authority in the accounting department and segregate duties, where possible, involved in the four phases of an accounting process or operation. The segregation of accounting duties will not eliminate errors and fraud, but it can help reduce the possibility of occurrence.

Views of Responsible Officials and Planned Corrective Actions: Management concurs with the auditor's recommendation. The new District Administrator (DA) scheduled for hire later this spring will be advised to evaluate the assignment of responsibilities and authority in order to segregate duties, where possible, involved in the four phases of a typical accounting process or operation.