

LOS OSOS COMMUNITY SERVICES DISTRICT
FINANCIAL STATEMENTS
FOR THE YEAR ENDED
JUNE 30, 2011
WITH INDEPENDENT AUDITOR'S REPORT
AND
SUPPLEMENTARY INFORMATION

**LOS OSOS COMMUNITY SERVICES DISTRICT
FOR THE YEAR ENDED JUNE 30, 2011**

TABLE OF CONTENTS

	<u>Page</u>
INTRODUCTORY SECTION	
Table of Contents	i
The District	iii
Board of Directors	vii
Organizational Chart	viii
 FINANCIAL SECTION	
Independent Auditor's Report	1
Management's Discussion and Analysis.....	3
Basic Financial Statements:	
Government-Wide Financial Statements	
Statement of Net Assets	10
Statement of Activities	11
Fund Financial Statements	
Balance Sheet – Governmental Funds	12
Reconciliation of the Balance Sheet of the Governmental Funds to the Statement of Net Assets.....	13
Statement of Revenues, Expenditures, and Changes in Fund Balances – Governmental Funds	14
Reconciliation of the Statement of Revenues, Expenditures, and Changes in Fund Balances to the Statement of Activities – Governmental Funds	15
Statement of Net Assets – Proprietary Funds	16
Statement of Revenues, Expenses, and Changes in Net Assets – Proprietary Funds	17
Statement of Cash Flows – Proprietary Funds.....	18
Notes to Basic Financial Statements	20

	<u>Page</u>
Required Supplementary Information	
Schedule of Revenues, Expenditures, and Changes in Fund Balances Budget and Actual – General Fund	45
Schedule of Revenues, Expenditures, and Changes in Fund Balances Budget and Actual – Fire Fund	46
Supplementary Information	
Non-Major Governmental Funds	
Combining Balance Sheets	47
Combining Statements of Revenues, Expenditures, and Changes in Fund Balances	48
Other Reports	
Independent Auditor’s Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>	49
Schedule of Findings and Recommendations	51
Status of Prior Year Audit Findings.....	53

**LOS OSOS COMMUNITY SERVICES DISTRICT
FOR THE YEAR ENDED JUNE 30, 2011**

THE DISTRICT

The Los Osos Community Services District (District), a political subdivision of the State of California, was formed on January 1, 1999, pursuant to Ballot Measure K-98 to provide services previously provided by the County in specific benefits zones of what was formerly County Service Area 9. After formation, the District added solid waste services providing service to all properties in the District. It operates pursuant to Section 61000 of the California Government Code. It is currently authorized to provide Fire Protection, Water, Street Lighting, Drainage, Solid Waste and Parks and Recreation Services. It is governed by a five-member Board of Directors with an operations staff headed by a general manager.

The District comprises an area of approximately 3,443 acres or 5.38 square miles. The area is more commonly known as the communities of Los Osos and Baywood Park. It is located by a coastline adjoining the Montana de Oro State park on its southwesterly boundary and the Morro Bay National Estuary and the Morro Bay State Park at its northern boundary. With such an idyllic location, the community has some exposure to tourism. However, absent accommodations and other facilities in the District that cater to the tourism industry, the District receives no significant economic benefit from tourism. The adjoining communities have the structures that fill the void.

The following is a summary of the funds the District maintains to deliver the services it is authorized to provide:

Funds Maintained by the District and Their Specific Functions

Fund 100 – Administration

The Administrative Fund provides centralized inter-fund services to all the other funds of the District such as management, accounting, payroll, insurance management, information and financial systems and equipment and District legal services.

Fund 200 – Bayridge

Bayridge is a subdivision in Los Osos that has a dedicated residential community septic system. The fund provides septic management, street lighting, and open space management.

Fund 301 – Fire and Emergency Services

Fire and Emergency Services are provided through a contract with Cal Fire for the entire community. Reserve Fire Fighters and administrative operational costs are paid by the District outside the Cal Fire contract.

Fund 400 – Vista de Oro

Vista de Oro is a subdivision in Los Osos that has a dedicated residential community septic system. The fund provides septic management, street lighting, and open space management.

Fund 500 – Water

The Water Utility Department is responsible for the operation and maintenance of five groundwater supply wells providing treatment, monitoring and distribution services to approximately 2,750 connections, through a network that consists of 27 miles of pipelines and includes 162 fire hydrants and 558 valves, 3 tanks and one pump station. These services not only assure delivery of pure, wholesome and potable drinking water, but also water for fire flow protection in the communities of Los Osos and Baywood Park.

Fund 600 – Wastewater

This fund was used to account for the construction of a sewage treatment plant which was stopped. Under special legislation AB2701, the project was transferred to the County of San Luis Obispo which formally accepted the project on March 15, 2011. This fund currently functions to service the debt associated with the aborted project and to account for expenses related to the District's bankruptcy filing which resulted from the aborted project. Once the bankruptcy case is closed, this fund will be officially named a debt service fund for the Wastewater Assessment District No. 1.

Fund 650 – Solid Waste

Solid Waste provides trash cleanup and recycling services to the community. Actual trash and recycling services are provided by Mission Country Disposal and the District receives a Franchise Fee. The District provides additional recycling opportunities to the community through Chipping Days.

Fund 800 – Drainage

This fund provides drainage services for the whole community. It maintains five pump station sites, monitors and mitigate as necessary the impact of storm run offs, clears channels of obstructions and manages five drainage basins.

Fund 900 – Park and Recreation

The long-term function of this fund is to provide recreation opportunities for the community of Los Osos/Baywood Park. However, the fund is not actively providing any recreational activities. Before the creation of the District, the County collected assessments for a pool and recreational activities. However, a subsequent vote to continue these assessments failed to pass. These assessments were turned over by the County to the District. The funds are invested and are restricted for the purpose of the original assessments which is to build a swimming pool. There has been some preliminary discussions as to whether partnering in a regional pool that will be constructed in the adjoining community, some seven miles away, is a feasible or authorized use of these funds.

SIGNIFICANT EVENT THAT HAS A MAJOR IMPACT ON THE ECONOMIC AND FINANCIAL WELL BEING OF THE DISTRICTChapter 9 Bankruptcy filing

The District filed for protection under Chapter 9 of the United States Bankruptcy Code on August 25, 2006. The purpose of Chapter 9 is to provide a financially distressed municipality protection from its creditors while it develops and negotiates a plan for adjusting its debts.

In addition, Chapter 9 grants the District an automatic stay to stop all collection actions against it and its property upon filing the petition. At the time of filing, all debts up until the bankruptcy date were frozen pending the District's reorganization plan (see Notes 5 and 11 for additional details) The following describes the events that led to the District's decision to file for Chapter 9 bankruptcy protection.

Current status of the bankruptcy filing

On August 8, 2011, the Bankruptcy Court entered an Order Confirming the LOCSD Debt Adjustment Plan (the "Plan"). The Plan as confirmed resolved all the claims under the jurisdiction of the Bankruptcy Court which included approximately \$11.4 million in unsecured creditor claims. The confirmed Plan provided approximately \$4.5 million to satisfy the claims of the unsecured creditors. The sources of these funds are:

- The remaining State Revolving Fund Loan related to the prior Wastewater Project (approximately \$1.7 million as of September 10, 2010, the filing date of the Debt Adjustment Plan). As of June 30, 2011, it had a balance of \$1,584 million; and
- \$2.8 million from San Luis Obispo County resulting from the proposed transfer of the Solid Waste Franchise Agreement to them.

On August 22, 2011, Monterey Mechanical, a bankruptcy creditor, filed a Notice of Appeal challenging the Court Order confirming the Plan. A Hearing date has not been established for the Appeal. District legal counsel estimates the Appeal process will take between 18 and 24 months.

Background of the bankruptcy filing

In August of 2005, the District began construction on a wastewater treatment plant (the "project") at a location known as the Tri-W site and also purchased mitigation property known as the Broderson site. Project construction began with initial funding coming from a low-interest State Revolving Fund loan. The location and type of system planned to be constructed were very contentious.

In the fall election of 2005, three members of the board of directors who were in favor of the newly started project were recalled and were replaced by three new directors who then subsequently voted to stop the project. In the same election, a measure called Measure B was placed on the ballot to reverse the decision of the former board on the location of a project and to vest that power to locate a sewer facility with the voters. Measure B passed and litigation to invalidate it was soon filed in the State Superior Court by a pro-project group. The litigation was successful but was followed by an appeal by the District. A special legislation, AB 2701, effectively mooted the controversy because it gave the County the option to design, locate and construct a wastewater system.

After the project was stopped, various lawsuits against the District were filed. The State Water Resources Control Board filed a claim for \$8.6 million to recover funds it had already released to the District. The State Regional Water Quality Control Board filed a claim for \$6.6 million which is a levy of fines for the District's failure to remediate pollution of groundwater and a nearby bay estuary. Major contractors and other contractors who were already working on the project filed for breach of contract for a total claim of more than \$28 million. There were other peripheral lawsuits that followed. A lot of these claims were mediated to much smaller amounts or settled under certain conditions.

The District lacked the funds to litigate or to pay these claims and therefore it sought bankruptcy protection under Chapter 9.

Status of the sewer project

On January 1, 2007, AB 2701 became effective. This special legislation (codified as GC sections 25825.5 & 61105) transferred the responsibility for constructing a wastewater collection and treatment system to the County of San Luis Obispo. It provides that after the County completes a due diligence review of the various aspects of the project, the County has to adopt a resolution declaring its intention to proceed or not to proceed with the construction and operation of a project. After several exhaustive proceedings that spanned over a number of years and that included several hearings and appeals process before the California Coastal Commission to obtain a development permit, the County passed a resolution on March 15, 2011 to proceed with the project. After completion, the sewer system will be operated by the County for three years and after that time, the County will decide whether to turn it over to the District if funding agencies will approve the action.

IMPACTS OF THE BANKRUPTCY ON THE FINANCIAL STATEMENTS

Impact on the Capital Assets

The value of the Construction in Progress (CIP) shown at \$22,067,856 in the Statement of Net Assets is highly questionable. These costs represent all costs in the Wastewater Fund that included costs of studies, costs of support staff, and all other support costs. It also included \$1.9 million paid to three contractors who installed underground pipes and facilities or did preparatory groundwork. The major contractors have an outstanding mediated claim of \$11.4 million pending in Bankruptcy Court which are not recorded and therefore are not included in the \$22 million CIP in the books.

AB 2701 dictated that all assets acquired by the District intended for the sewer project have to be transferred to the County when requested for use in the County's successor project without any financial remuneration. In addition, any assets so acquired by the District in the aborted project could not be disposed of without the County's approval.

As of October 2011, the County has requested land parcels and easements to be transferred to them. The request does not include any pipes or other infrastructures that they will be taking over for their project. The cost of land acquired by the District for the original project totals \$7.8 million. Not all land parcels are requested by the County for transfer. The total cost of assets to be transferred has not yet been determined.

Impact on Liabilities

Mediated claims against the District pending in Bankruptcy Court total about \$12 million. Other than the amount of \$950,719, the rest of the claims are not reflected in the accompanying financial statements. Two claims by the State as described below are not in the report either.

The State filed two claims for a total of \$15,263,566 which the State agreed to settle in the prior year subject to certain conditions. The claims and current status of the conditions are as follows:

1. The State Regional Water Quality Control Board (RWQCB) agreed to settle its claim of \$6,627,000 to be subordinated to all other unsecured claims based upon the following conditions: (1) Court approval of a Bankruptcy Plan; Status: the Bankruptcy Court confirmed the District's Debt Adjustment Plan on August 8, 2011. However, this was appealed by a creditor on August 22, 2011. No hearing dates have as yet been set; (2) the County adopting the Due Diligence Resolution to proceed with the Wastewater Project; Status: the County adopted this resolution on March 15, 2011; and (3) the District will provide RWQCB a draft of a Water Conservation Plan; Status: the State accepted the 2011 Water Demand Analysis and Water Conservation Evaluation draft report referred to as the Maddaus Report as adequate in fulfilling this condition.
2. The State Water Resource Control Board agreed to settle its claim for \$8,636,566 subject to the following conditions: (1) the County adopts a Due Diligence Resolution to proceed with the Wastewater Project; Status: this was fulfilled with the County adopting this resolution on March 15, 2011; (2) the County applies for a SRF loan to either fully or partially finance the project; Status: this has been fulfilled with the County signing a financing agreement with the agency on June 30, 2011; and (3) the Court approves a Debt Adjustment Plan; Status: the Court approved the Plan on August 8, 2011 but was appealed on August 22, 2011.

Impact on the District's Future Financial Viability

The approval of the District's Debt Adjustment Plan by the Bankruptcy Court on August 8, 2011 was a major development that would have allowed the District to move forward without financial or legal constraints. The appeal of that decision two weeks later returned the District to a position of uncertainty. Legal advisors predict that the appeal process may take up to two years for a final resolution to be reached. As of the end of October 2011, the first hearing date has yet to be scheduled. Until the bankruptcy case is finally closed, it cannot be declared with utmost certainty that the District will be able to continue as a going concern.



LOS OSOS COMMUNITY SERVICES DISTRICT

BOARD OF DIRECTORS

Marshall E. Ochylski, President

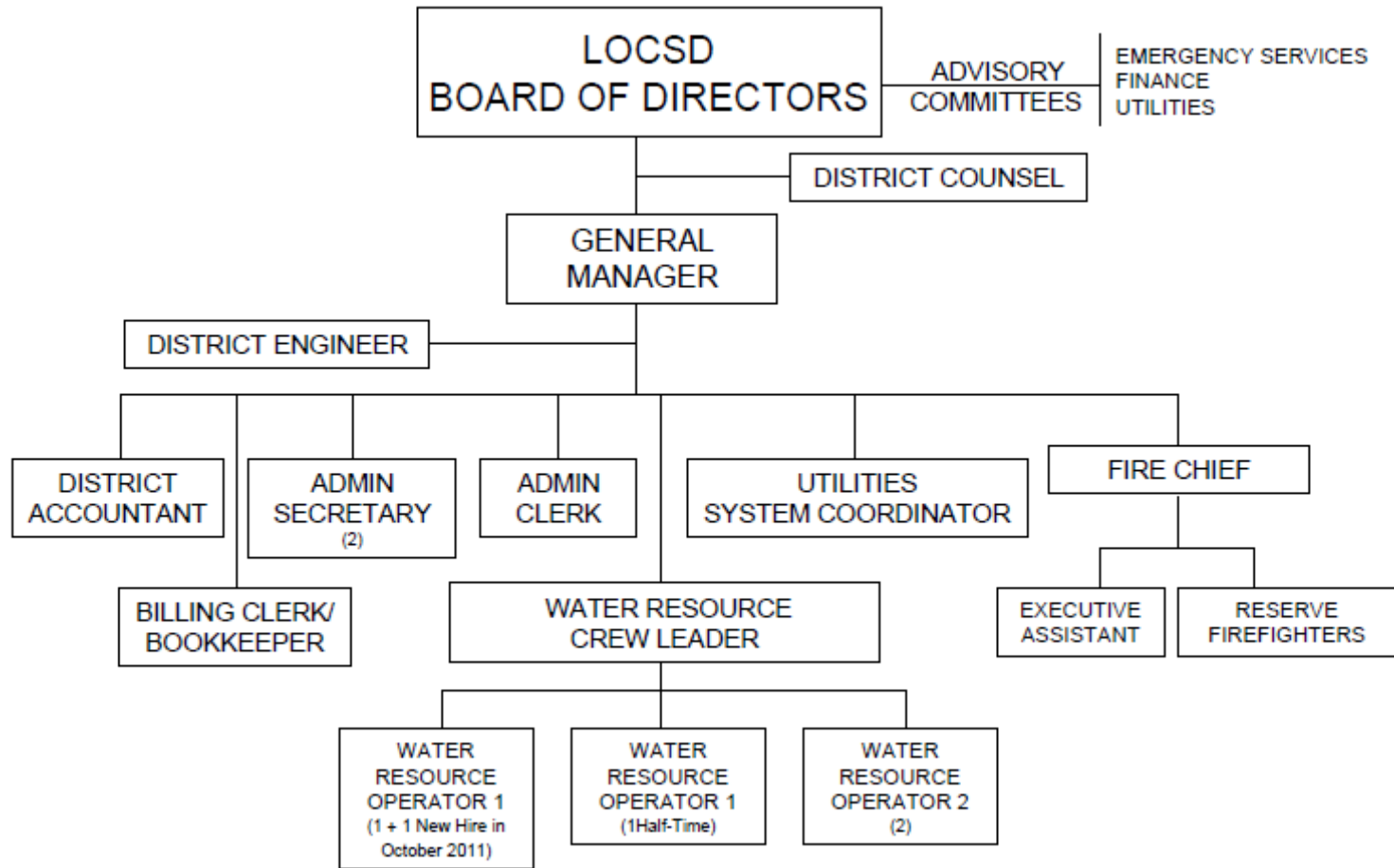
Leonard A. Moothart, Vice-President

Craig V. Baltimore, Director

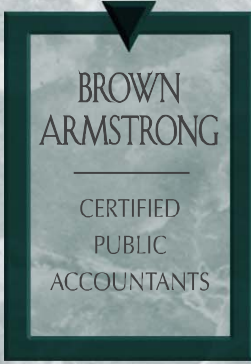
David S. Vogel, Director

R. Michael Wright, Director

LOS OSOS COMMUNITY SERVICES DISTRICT
ORGANIZATIONAL CHART



FINANCIAL SECTION



BROWN ARMSTRONG
Certified Public Accountants

INDEPENDENT AUDITOR'S REPORT

To the Board of Directors of
Los Osos Community Services District
Los Osos, California

We have audited the accompanying basic financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the Los Osos Community Services District (the District) as of and for the year ended June 30, 2011, which collectively comprise the District's basic financial statements as listed in the table of contents. These basic financial statements are the responsibility of the District's management. Our responsibility is to express an opinion on these basic financial statements based on our audit.

Except as discussed in the following paragraph, 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 misstatements. 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. We believe that our audit provides a reasonable basis for our opinion.

The value of the Construction in Progress in the enterprise Wastewater Project Fund shown in the amount of \$22,067,856 may be materially impaired due to the permanent cancellation of the wastewater treatment project. This value represents construction costs recorded up to the bankruptcy filing but it does not include about \$11 million of claims filed with the Bankruptcy Court.

In our opinion, except for the effect of an adjustment to reflect the true value of business-type activities Construction in Progress and to recognize all liabilities that the District may be subject to in bankruptcy proceedings, the basic financial statements referred to above, present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the Los Osos Community Services District as of June 30, 2011, and the respective changes in the financial position and cash flows, where applicable, thereof for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

The appeal by a creditor of the favorable decision of the Bankruptcy Court on the District's Debt Adjustment Plan leaves the District under substantial financial uncertainty that may jeopardize its ability to continue as a going concern.

MAIN OFFICE

4200 TRUXTUN AVENUE

SUITE 300
BAK RSFIELD, CA 93309
TEL 661.324.4971
FAX 661.324.4997
EMAIL info@bacpas.com

560 CENTRAL AVENUE

SHAFTER, CALIFORNIA 93263
TEL 661.746.2145
FAX 661.746.1218

8050 N. PALM AVENUE

SUITE 300
FRESNO, CALIFORNIA 93711
TEL 559.476.3592
FAX 559.476.3593

790 E. COLORADO BLVD.

SUITE 908B
PASADENA, CALIFORNIA 91101
TEL 626.240.0920
FAX 626.240.0922



REGISTERED with the Public Company
Accounting Oversight Board and
MEMBER of the American Institute of
Certified Public Accountants

In accordance with *Government Auditing Standards*, we have also issued our report dated November 22, 2011, 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* and should be considered in assessing the results of our audit.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and budgetary comparison information on pages 3 through 9 and 45 through 46 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the District's financial statements as a whole. The introductory section and combining and individual non-major fund financial statements and schedules are presented for purposes of additional analysis and are not a required part of the financial statements. The combining and individual non-major fund financial statements and schedules are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole. The introductory section has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we do not express an opinion or provide any assurance on it.

BROWN ARMSTRONG
ACCOUNTANCY CORPORATION



Bakersfield, California
November 22, 2011

**LOS OSOS COMMUNITY SERVICES DISTRICT
MANAGEMENT'S DISCUSSION AND ANALYSIS
JUNE 30, 2011**

BACKGROUND

The Los Osos Community Services District (the District), a political subdivision of the State of California, was formed on January 1, 1999, pursuant to Ballot Measure K-98 to provide services previously provided by the County of San Luis Obispo (County) in specific benefits zones of what was formerly County Service Area 9. After formation, the District added solid waste services providing service to all properties in the District. It operates pursuant to Section 61000 of the California Government Code. It is currently authorized to provide Fire Protection, Water, Street Lighting, Drainage, Solid Waste, and Parks and Recreation Services. It is governed by a five-member Board of Directors with an operations staff headed by a general manager.

This section offers some key financial information and a narrative overview of the financial status and financial activities of the District for the fiscal year ended June 30, 2011.

OVERVIEW OF THE BASIC FINANCIAL STATEMENTS

The District's financial statements are prepared in conformity with accounting principles generally accepted in the United States of America and may include in some cases amounts that are based upon reliable estimates and judgments.

The basic financial statements include four components: 1) government-wide financial statements, 2) fund financial statements, 3) notes to the basic financial statements, and 4) required supplementary information. This report also contains other supplementary information in addition to the basic financial statements. The government-wide statements consist of the *Statement of Net Assets and the Statement of Activities*.

Government-Wide Financial Statements

The *Government-Wide Financial Statements* are designed to provide readers with a broad overview of the District's finances, in a manner similar to a private-sector business.

The *Statement of Net Assets* presents information on all of the District's assets and liabilities, with the difference between the two reported as *net assets*. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the District is improving or deteriorating.

The *Statement of Activities* presents information showing how the District's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods (e.g., uncollected taxes and earned and unused employee vacation balances).

Both of the government-wide financial statements distinguish functions of the District that are principally supported by taxes and intergovernmental revenues (*governmental activities*) from other functions that are intended to recover all or a significant portion of their cost through user fees and charges (*business-type activities*). The governmental activities of the District include public safety, parks and recreation, public works, general government, street lighting, and health and sanitation. The business-type activities of the District include water, wastewater, and solid waste.

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 funds of the District are in two categories, namely, governmental and proprietary.

MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

In a few instances where trust accounts are held, trust liability accounts are used in the related fund instead of being held in a separate fiduciary category of funds.

Governmental Funds

Governmental funds are used to account for essentially the same functions reported as *governmental activities* in the government-wide financial statements. However, unlike the government-wide financial statements, governmental fund financial statements focus on near-term inflows and outflows of spendable resources, as well as on the balances of spendable resources available at the end of the fiscal year. Such information may be useful in evaluating a government's near-term financing requirements.

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for *governmental funds* with similar information presented for *governmental activities* in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions.

Both the governmental fund balance sheet and the governmental fund statements of revenues, expenditures, and changes in fund balances provide a reconciliation to facilitate this comparison between *governmental funds* and *governmental activities*.

The District maintains ten individual governmental funds organized according to their type: *general and special revenue*. The District does not currently have *debt service and capital projects* types in the *governmental funds*. Information is presented separately in the governmental funds' balance sheet and in the governmental funds' statement of revenues, expenditures, and changes in fund balances for the General Fund and the Fire Fund with all other funds presented into an aggregate column. Individual fund data for each of the non-major governmental funds is provided in the form of combining statements found in the other supplementary information section of this report.

A budgetary comparison statement has been provided for the General Fund and the Fire Fund to demonstrate compliance with budgetary laws of the State of California and policies and ordinances approved by the District's Board of Directors. This statement is shown under the required supplementary section of the report. Individual budgetary data for each of the non-major governmental funds is not presented.

Proprietary Funds

There are two types of funds classified as proprietary, namely, *enterprise* and *internal service funds*. The District only maintains the enterprise type of proprietary funds. The District uses three *enterprise funds* to account for its water, wastewater, and solid waste activities. These three *enterprise funds* are presented in individual columns in the *fund financial statements*.

Proprietary funds provide the same type of information as the *government-wide financial statements*, only in more detail.

Notes to the Basic Financial Statements

The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements.

Required Supplementary Information

The statements are followed by a section of *required supplementary information* (RSI) that further explains and supports the information in the financial statements. Comparison of *Budget to Actual* for major governmental funds is shown under this caption.

MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

Other Supplementary Information

Other supplementary information presents data that, although not required, is necessary to provide the reader of the basic financial statements more details to promote understanding of the statements as a whole. The combining statements for the non-major governmental funds are presented here.

GOVERNMENT-WIDE FINANCIAL STATEMENTS

In accordance with changes in governmental accounting standards, the District applied Governmental Accounting Standards Board (GASB) Statement No. 34 to these financial statements.

Changes in net assets may serve over time as a useful indicator of a government's financial position.

Table A
Statement of Net Assets
June 30, 2011

	June 30, 2011			June 30, 2010			2010-11
	Governmental Activities	Business- Type Activities	Total Primary Government	Governmental Activities	Business- Type Activities	Total Primary Government	Total % Chg
Assets:							
Current assets	\$ 986,029	\$ 2,490,959	\$ 3,476,988	\$ 897,582	\$ 2,149,729	\$ 3,047,311	14.1%
Other long-term assets	353,117	3,677,772	4,030,889	300,092	3,954,406	4,254,498	-5.3%
Capital assets	467,934	35,819,031	36,286,965	358,733	36,103,427	36,462,160	-0.5%
Total assets	1,807,080	41,987,762	43,794,842	1,556,407	42,207,562	43,763,969	0.1%
Liabilities:							
Long-term liabilities	24,142	26,102,955	26,127,097	63,390	20,137,181	20,200,571	29.3%
Other liabilities	341,639	1,696,360	2,037,999	326,453	8,220,695	8,547,148	-76.2%
Internal balances	-	-	-	-	-	-	-
Total liabilities	365,781	27,799,315	28,165,096	389,843	28,357,876	28,747,719	-2.0%
Net assets:							
Invested in capital assets, net related debt	467,934	9,211,866	9,679,800	336,151	8,999,761	9,335,912	3.7%
Legally restricted	352,313	2,996,688	3,349,001	300,092	3,164,703	3,464,795	-3.3%
Unrestricted	621,052	1,979,893	2,600,945	530,321	1,685,222	2,215,543	17.4%
Total net assets	\$ 1,441,299	\$ 14,188,447	\$ 15,629,746	\$ 1,166,564	\$ 13,849,686	\$ 15,016,250	4.1%

MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

**Table B
Statement of Activities
For the Year Ended June 30, 2011**

	June 30, 2011			June 30, 2010			2010-11
	Governmental Activities	Business- Type Activities	Total Primary Government	Governmental Activities	Business- Type Activities	Total Primary Government	Total % Chg
Revenues:							
Program revenues:							
Charges for services	\$ 204,001	\$ 1,765,980	\$ 1,969,981	\$ 221,209	\$ 1,643,084	\$ 1,864,293	5.7%
Operating grants and contributions	4,792	500	5,292	-	3,995	3,995	-
General revenues:							
Property taxes	1,586,719	182,356	1,769,075	1,616,028	185,939	1,801,967	-1.8%
Other taxes	469,428	1,157,594	1,627,022	468,794	1,160,009	1,628,803	-0.1%
Interest and investment income	9,468	14,631	24,099	14,159	8,675	22,834	5.5%
Other revenues	27,121	32,522	59,643	23,340	37,746	61,086	-2.4%
Total revenues	2,301,529	3,153,583	5,455,112	2,343,530	3,039,448	5,382,978	1.3%
Expenses:							
General government	(13,868)	-	(13,868)	34,490	-	34,490	-140.2%
Public safety	1,977,812	-	1,977,812	2,022,289	-	2,022,289	-2.2%
Health and sanitation	74,308	-	74,308	58,423	-	58,423	27.2%
Street lighting	5,272	-	5,272	5,623	-	-	-
Interest on long-term debt	870	-	870	1,707	-	1,707	-49.0%
Water	-	1,711,618	1,711,618	-	1,873,487	1,873,487	-8.6%
Wastewater treatment	-	1,011,946	1,011,946	-	960,300	960,300	5.4%
Solid waste	-	73,658	73,658	-	106,578	106,578	-30.9%
Total expenses	2,044,394	2,797,222	4,841,616	2,122,532	2,940,365	5,062,897	-4.4%
Transfers	17,600	(17,600)	-	(229,589)	229,589	-	-
Change in net assets	274,735	338,761	613,496	(8,591)	328,672	320,081	91.7%
Net assets - July 1, 2010	1,166,564	13,849,686	15,016,250	1,192,878	13,606,843	14,799,721	1.5%
Prior period adjustments	-	-	-	(17,723)	(85,829)	(103,552)	-100.0%
Net assets - June 30, 2011	<u>\$ 1,441,299</u>	<u>\$ 14,188,447</u>	<u>\$ 15,629,746</u>	<u>\$ 1,166,564</u>	<u>\$ 13,849,686</u>	<u>\$ 15,016,250</u>	<u>4.1%</u>

Analysis of Overall Financial Position & Results of Operations

Statement of Net Assets

The total assets of the District exceeded its liabilities at June 30, 2011, by \$15,629,746. The bulk of the Net Assets is in Investment in Capital Assets, net of related debt, which is \$9,679,800. This represents 61.9% of the District's total Net Assets. This is however a misleading data due to the questionable value of the Construction in Progress carried in the Wastewater Treatment Fund in the amount of \$22,067,856 (see Note 4).

MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

The key component of Net Assets that indicates the health of the District is the Unrestricted Net Assets in the amount of \$2,600,945. This translates to an increase of 17.4%. This growth is mainly due to the Water Fund being able to fund its target Reserves and Designations. All other funds show some growth also. Although all funds still have a long way to go as far as setting Reserves and Designation, the trend is very positive.

Restricted net assets declined by 3.3%. This is mainly due to releases from the balance of the State Revolving Fund loan spent on legal expenditures related to the bankruptcy proceedings.

Statement of Activities

Total revenues slightly increased by 1.3%. This is mainly due to the increase in Water revenues of 8.4%. A tier billing that was anticipated to increase water sales by 10% became effective at the beginning of the fiscal year. The reduction in water consumption that followed the increase slightly dampened the anticipated increase. Property taxes decreased by 1.8% which is indicative of the continuing turmoil in the real estate market. This is a marked improvement from the year before when the decrease was 4.4%. Investment income increased by 5.5% as a result of the switch to a public money market account with certain guarantees on the earnings rate. The earnings rates however continue to be very low.

Expenses in General Government and Solid Waste show relatively material variations. This is mainly due to the change in the method Solid Waste funds its support to the General Fund. Solid Waste is intended to fund one whole position in the General Fund that is involved in Solid Waste functions. In the prior year, this was all funded in Salaries and Benefits and therefore shown in the expenses grouping. In the current year, the funding in Salaries and Benefits is only for one third of the position to reflect time actually spent on Solid Waste functions. The rest are funded as Operating Transfers. Inter-fund transfers are presented as a separate line among the non-program items.

The variations in Public Safety and Health and Sanitation are due to the effect of Capital Outlay. Capital Outlay is not presented as expenditures in the Government-Wide Statements. When resources are dedicated for these in a given budget year, the budget year that has a high Capital Outlay will show a favorable variation when the resources in the budget are practically the same. Thus, in Public Safety, the 2.2% reduction is due to higher Capital Outlay of net \$67,400 compared to the year before. This factor when taken for all funds correspondingly affected the over-all decrease in total expenses of 4.4%. In addition to this factor, Depreciation Expense can materially affect the net variation. The Water Fund did exactly that with reduction in Depreciation Expense of \$129,411. There are assets that reached their projected useful lives but continue to be used.

Capital Assets and Long-Term Debt:

Capital Assets

Capital assets are categorized by land, construction in progress, buildings, structures, and improvements, and plant and equipment. Table C presents these categories and the amount associated with each one, less Accumulated Depreciation. The total capital assets shown in Table C, net of Accumulated Depreciation of \$36,286,965 reflect a total reduction of \$175,195. This is due to continuing Depreciation Expense. Please see Note 4 for details and a note explaining the possible value impairment of the Construction in Progress in business-type activities as shown below at \$22,067,856.

MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

	Governmental Activities	Business-Type Activities	Total
Land	\$ 50,000	\$ 8,190,132	\$ 8,240,132
Construction in Progress	-	22,067,856	22,067,856
Buildings, Structures, and Improvements	515,117	-	515,117
Plant and Equipment	<u>1,844,052</u>	<u>8,507,855</u>	<u>10,351,907</u>
Total Cost	2,409,169	38,765,843	41,175,012
Less Accumulated Depreciation	<u>(1,941,235)</u>	<u>(2,946,812)</u>	<u>(4,888,047)</u>
Total	<u>\$ 467,934</u>	<u>\$ 35,819,031</u>	<u>\$ 36,286,965</u>

Long-Term Debt

A total of \$26,666,240 is presented below as long-term debt. Reductions represent payments on principal as per amortization tables. The note payable due to the California Resources Control Board of \$6,486,144 is a claim that has been filed in bankruptcy court and which the State agreed to settle based on certain conditions. These conditions are discussed in the Introductory Section 'Impact on Liabilities'. The conditions have all been fulfilled other than the final approval of the District's Debt Adjustment Plan.

The two other debts shown below are secured by specific resources that are deemed stable. See Note 6 for other details.

Description	Total	
	2011	2010
Improvement bonds - 2002 issue	\$ 15,605,000	\$ 15,975,000
Note payable - CIEDB loan	4,516,021	4,642,522
Note payable - CA Resources Control Board	6,486,144	6,486,144
Note payable vehicle loan	-	22,582
Compensated absences	<u>55,756</u>	<u>65,353</u>
Total	<u>\$ 26,662,921</u>	<u>\$ 27,191,601</u>

Significant Events or Disclosures

The Bankruptcy Court approved the District's Debt Adjustment Plan on August 8, 2011. However, this was appealed by a creditor two weeks later. The Debt Adjustment Plan calls for cost reductions to compensate the possible loss of Franchise Fees of about \$155,000 to \$160,000 annually. As part of cost reductions, personnel costs have been studied and any action recommended is currently the subject of discussions.

MANAGEMENT'S DISCUSSION AND ANALYSIS (Continued)

The sewer project is now in progress under the independent management of the County. They have requested the transfer of land parcels and easements for use in their successor project. Any assets acquired under the original project are directed by AB2701 to be transferred to the County when so requested and identified as needed for their project without any remuneration. The project is expected to be completed in three years.

The conditions placed by the State to settle their claims filed in court that total \$15 million have all been fulfilled other than the final approval of the Debt Adjustment Plan. The favorable decision on the plan on August 8, 2011, was appealed on August 22, 2011, and may take up to two years to resolve.

The audit recommendations are gradually being worked on. The recommendation on Cash, which is to backfill the deficit in the General Fund of \$1.3 million (after adding in liabilities that need Cash outflow in the current year), was just resolved. The resolution is to make other funds contribute to the deficit in a way that would allow each fund to continue operating and fulfill its mandated functions. There have been steps taken to fulfill the other audit recommendations but are not totally complete.

**LOS OSOS COMMUNITY SERVICES DISTRICT
STATEMENT OF NET ASSETS
JUNE 30, 2011**

	Governmental Activities	Business-Type Activities	Total
<u>ASSETS</u>			
Cash and investments (Note 2)	\$ 882,500	\$ 2,097,652	\$ 2,980,152
Accounts receivable	98,852	356,583	455,435
Prepaid expenses	4,677	4,842	9,519
Inventory	-	31,882	31,882
Deferred charges, net of accumulated amortization (Note 6)	-	588,956	588,956
Restricted assets			
Cash and investments legally restricted (Note 2)	353,117	1,675,675	2,028,792
Cash and investments held by bond trustee (Note 2)	-	1,413,141	1,413,141
Capital assets (Note 4)			
Land and construction in progress	50,000	30,257,988	30,307,988
Other capital assets, net of depreciation	417,934	5,561,043	5,978,977
	<u>467,934</u>	<u>35,819,031</u>	<u>36,286,965</u>
Total capital assets			
	<u>467,934</u>	<u>35,819,031</u>	<u>36,286,965</u>
Total Assets	<u>\$ 1,807,080</u>	<u>\$ 41,987,762</u>	<u>\$ 43,794,842</u>
<u>LIABILITIES</u>			
Accounts payable	\$ 290,064	\$ 730,305	\$ 1,020,369
Accrued liabilities	39,028	21,097	60,125
Accrued interest payable	-	321,550	321,550
Trust and deposit payable	1,159	95,222	96,381
Other post employment benefit liability (Note 8)			
Due in more than one year	3,750	-	3,750
Accrued compensated absences			
Due within one year	11,388	12,827	24,215
Due in more than one year	20,392	11,149	31,541
Long-term debt (Note 6)			
Due within one year	-	515,359	515,359
Due in more than one year	-	26,091,806	26,091,806
	<u>365,781</u>	<u>27,799,315</u>	<u>28,165,096</u>
Total Liabilities			
	<u>365,781</u>	<u>27,799,315</u>	<u>28,165,096</u>
<u>NET ASSETS</u>			
Invested in capital assets, net of related debt	467,934	9,211,866	9,679,800
Restricted for:			
Debt service (Note 9)	-	1,413,140	1,413,140
Legally restricted (Note 9)	352,313	1,583,548	1,935,861
Unrestricted	621,052	1,979,893	2,600,945
	<u>1,441,299</u>	<u>14,188,447</u>	<u>15,629,746</u>
Total Net Assets			
	<u>1,441,299</u>	<u>14,188,447</u>	<u>15,629,746</u>
Total Liabilities and Net Assets	<u>\$ 1,807,080</u>	<u>\$ 41,987,762</u>	<u>\$ 43,794,842</u>

See accompanying notes to the basic financial statements.

**LOS OSOS COMMUNITY SERVICES DISTRICT
STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2011**

Functions/Programs	Program Revenues				Net (Expense) Revenue and Changes in Net Assets		
	Expenses	Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Primary Government		Total
					Governmental Activities	Business- Type Activities	
PRIMARY GOVERNMENT							
Governmental activities:							
General government	\$ (13,868)	\$ -	\$ -	\$ -	\$ 13,868	\$ -	\$ 13,868
Public safety	1,977,812	158,686	4,792	-	(1,814,334)	-	(1,814,334)
Health and sanitation	74,308	40,043	-	-	(34,265)	-	(34,265)
Street lighting	5,272	5,272	-	-	-	-	-
Interest and fiscal charges	870	-	-	-	(870)	-	(870)
Total governmental activities	2,044,394	204,001	4,792	-	(1,835,601)	-	(1,835,601)
Business-type activities:							
Water	1,711,618	1,614,768	500	-	-	(96,350)	(96,350)
Refuse	73,658	151,212	-	-	-	77,554	77,554
Wastewater treatment project	1,011,946	-	-	-	-	(1,011,946)	(1,011,946)
Total business-type activities	2,797,222	1,765,980	500	-	-	(1,030,742)	(1,030,742)
Total primary government	<u>\$ 4,841,616</u>	<u>\$ 1,969,981</u>	<u>\$ 5,292</u>	<u>\$ -</u>	<u>(1,835,601)</u>	<u>(1,030,742)</u>	<u>(2,866,343)</u>
General revenues:							
Property taxes					1,586,719	182,356	1,769,075
Special taxes					469,428	-	469,428
Other taxes					-	1,157,594	1,157,594
Unrestricted investment earnings					9,468	14,631	24,099
Gain on sale of capital assets					-	4,250	4,250
Miscellaneous					27,121	28,272	55,393
Transfers					17,600	(17,600)	-
Total general revenues and transfers					2,110,336	1,369,503	3,479,839
Change in net assets					274,735	338,761	613,496
Net assets - July 1, 2010					1,166,564	13,849,686	15,016,250
Net assets - June 30, 2011					<u>\$ 1,441,299</u>	<u>\$ 14,188,447</u>	<u>\$ 15,629,746</u>

See accompanying notes to the basic financial statements.

**LOS OSOS COMMUNITY SERVICES DISTRICT
BALANCE SHEET
GOVERNMENTAL FUNDS
JUNE 30, 2011**

	General Fund 100	Fire Fund 301	Other Governmental Funds	Total Governmental Funds
ASSETS				
Cash and cash equivalents	\$ 12,300	\$ 1,576,404	\$ 523,130	\$ 2,111,834
Restricted cash	1,159	50,336	301,621	353,116
Accounts Receivable	10,448	84,389	4,015	98,852
Prepaid expenses	609	4,068	-	4,677
Other assets	-	-	-	-
Total Assets	<u>\$ 24,516</u>	<u>\$ 1,715,197</u>	<u>\$ 828,766</u>	<u>\$ 2,568,479</u>
LIABILITIES AND FUND BALANCES				
LIABILITIES				
Cash overdraft	\$ 1,229,334	\$ -	\$ -	\$ 1,229,334
Accounts payable	267,706	20,389	1,968	290,063
Accrued liabilities	30,055	8,960	13	39,028
Note Payable	-	-	-	-
Trust and deposit payable	1,159	-	-	1,159
Accrued compensated absences	11,388	-	-	11,388
Total Liabilities	<u>1,539,642</u>	<u>29,349</u>	<u>1,981</u>	<u>1,570,972</u>
FUND BALANCES (DEFICITS)				
Nonspendable	3,909	4,468	-	8,377
Restricted	-	787,307	726,374	1,513,681
Committed	9,013	866,498	69,140	944,651
Assigned	20,000	27,575	31,271	78,846
Unassigned	<u>(1,548,048)</u>	<u>-</u>	<u>-</u>	<u>(1,548,048)</u>
Total Fund Balances (Deficits)	<u>(1,515,126)</u>	<u>1,685,848</u>	<u>826,785</u>	<u>997,507</u>
Total Liabilities and Fund Balances	<u>\$ 24,516</u>	<u>\$ 1,715,197</u>	<u>\$ 828,766</u>	<u>\$ 2,568,479</u>

See accompanying notes to the basic financial statements.

**LOS OSOS COMMUNITY SERVICES DISTRICT
RECONCILIATION OF THE BALANCE SHEET OF THE GOVERNMENTAL
FUNDS TO THE STATEMENT OF NET ASSETS
JUNE 30, 2011**

Total fund balances of governmental funds	\$	997,507
Amounts reported for governmental activities in the statement of net assets are different because:		
Capital assets used in governmental activities are not financial resources and, therefore, are not reported in governmental funds, net of accumulated depreciation of \$1,941,235.		467,934
Long-term liabilities and compensated absences are not due in the current period and, therefore, are not reported in the governmental funds.		
Other post employment benefit liability		(3,750)
Compensated absences		(20,392)
		(24,142)
Net assets of governmental activities	\$	1,441,299

See accompanying notes to the basic financial statements.

**LOS OSOS COMMUNITY SERVICES DISTRICT
STATEMENT OF REVENUES, EXPENDITURES, AND
CHANGES IN FUND BALANCES
GOVERNMENTAL FUNDS
FOR THE YEAR ENDED JUNE 30, 2011**

	General Fund 100	Fire Fund 301	Other Governmental Funds	Total Governmental Funds
REVENUES				
Property taxes	\$ -	\$ 1,576,565	\$ 10,154	\$ 1,586,719
Special taxes and assessments	-	469,428	-	469,428
Service charges and fees	-	-	140,760	140,760
Public services fees	-	62,530	-	62,530
Intergovernmental	-	5,503	-	5,503
Investment income	-	7,160	2,308	9,468
Other revenues	43	27,022	56	27,121
Total Revenues	43	2,148,208	153,278	2,301,529
EXPENDITURES				
Salaries and wages	297,000	91,862	21,739	410,601
Payroll taxes and benefits	88,938	17,501	8,349	114,788
Contract services	35,661	1,548,940	3,701	1,588,302
Insurance	27,032	18,967	-	45,999
License and fees	18,388	22,986	7,365	48,739
Maintenance and repairs	13,410	6,595	31,039	51,044
Meals and entertainment	669	292	-	961
Office support, publication, and dues	27,405	10,433	30	37,868
Tools and supplies	540	55,718	3,055	59,313
Rent	19,646	-	-	19,646
Professional services	123,530	-	-	123,530
Telephone and communications	3,896	5,381	1,234	10,511
Employee travel and training	8,554	1,481	354	10,389
Utilities	2,225	7,780	9,170	19,175
Director fees	10,375	-	-	10,375
Other expenses	10,434	4,224	71	14,729
Capital outlay	-	130,604	6,075	136,679
Other outgo - cost allocation from/(to) other funds	(702,036)	110,496	43,020	(548,520)
Debt service:				
Principal	-	22,581	-	22,581
Interest and fiscal charges	-	870	-	870
Total Expenditures	(14,333)	2,056,711	135,202	2,177,580
Excess of revenues over expenditures	14,376	91,497	18,076	123,949
OTHER FINANCING SOURCES (USES)				
Transfers in	42,600	-	-	42,600
Transfers out	(25,000)	-	-	(25,000)
Total other financing sources (uses)	17,600	-	-	17,600
Net change in fund balances	31,976	91,497	18,076	141,549
Fund balances (deficit) - July 1, 2010	(1,547,102)	1,594,351	808,709	855,958
Fund balances (deficit) - June 30, 2011	\$ (1,515,126)	\$ 1,685,848	\$ 826,785	\$ 997,507

See accompanying notes to the basic financial statements.

**LOS OSOS COMMUNITY SERVICES DISTRICT
RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES,
AND CHANGES IN FUND BALANCES TO THE STATEMENT OF
ACTIVITIES – GOVERNMENTAL FUNDS
FOR THE YEAR ENDED JUNE 30, 2011**

Reconciliation of the net change in fund balances - total governmental funds to the change in net assets of governmental activities:

Net change in fund balances - total governmental funds	\$	141,549
Governmental funds report capital outlays as expenditures while governmental activities report depreciation as expense to allocate those expenditures over the life of the assets:		
Capital assets additions		150,622
Depreciation expense		(41,421)
Repayment of debt principal is an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the statement of net assets:		
Principal payments		22,581
Other post employment benefit expenditures reported in the statement of activities do not require the use of current financial resources and, therefore, are not reported as expenditures in a governmental fund. This is the net annual required contribution for the current period.		
		(1,000)
Compensated absence expenditures reported in the statement of activities do not require the use of current financial resources and, therefore, are not reported as expenditures in a governmental fund. This is the net change in compensated absences for the current period.		
		<u>2,404</u>
Change in net assets of governmental activities	\$	<u><u>274,735</u></u>

See accompanying notes to the basic financial statements.

**LOS OSOS COMMUNITY SERVICES DISTRICT
STATEMENT OF NET ASSETS
PROPRIETARY FUNDS
JUNE 30, 2011**

	Business-Type Activities - Enterprise Funds			Totals
	Water Fund 500	Refuse Fund 650	Wastewater Treatment Project Fund 600	
ASSETS				
Current Assets				
Cash and cash equivalents	\$ 1,345,366	\$ 534,640	\$ 217,646	\$ 2,097,652
Accounts receivable	312,732	-	-	312,732
Accrued revenues receivable	6,925	5,848	32,978	45,751
Prepaid expenses	4,844	-	-	4,844
Inventory	31,882	-	-	31,882
Total Current Assets	1,701,749	540,488	250,624	2,492,861
Non Current Assets				
Advances to other funds	410,000	-	-	410,000
Restricted cash and investments held by bond trustee	-	-	1,413,140	1,413,140
Cash and investments legally restricted	-	-	1,675,674	1,675,674
Deferred issuance costs, net	33,374	-	553,682	587,056
Capital assets, net of accumulated depreciation	5,908,256	-	29,910,775	35,819,031
Total Non Current Assets	6,351,630	-	33,553,271	39,904,901
Total Assets	\$ 8,053,379	\$ 540,488	\$ 33,803,895	\$ 42,397,762
LIABILITIES				
Current Liabilities				
Cash overdraft	\$ -	\$ -	\$ -	\$ -
Accounts payable	43,779	1,361	685,165	730,305
Accrued liabilities	23,510	-	-	23,510
Accrued interest payable	57,391	-	257,210	314,601
Advances from other funds	-	-	410,000	410,000
Trust and deposits payable	5,045	2,586	92,127	99,758
Compensated absences - current portion	12,827	-	-	12,827
Notes payable - current portion	130,359	-	385,000	515,359
Total Current Liabilities	272,911	3,947	1,829,502	2,106,360
Non Current Liabilities				
Compensated absences	11,149	-	-	11,149
Notes payable	4,385,662	-	21,706,144	26,091,806
Total Non Current Liabilities	4,396,811	-	21,706,144	26,102,955
Total Liabilities	4,669,722	3,947	23,535,646	28,209,315
NET ASSETS				
Invested in capital assets, net of related debt	1,392,235	-	7,819,631	9,211,866
Restricted for debt service	-	-	1,413,140	1,413,140
Restricted for debt restructuring	-	-	1,583,548	1,583,548
Unrestricted (deficit)	1,991,422	536,541	(548,070)	1,979,893
Total Net Assets	\$ 3,383,657	\$ 536,541	\$ 10,268,249	\$ 14,188,447

See accompanying notes to the basic financial statements.

LOS OSOS COMMUNITY SERVICES DISTRICT
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
PROPRIETARY FUNDS
FOR THE YEAR ENDED JUNE 30, 2011

	Business-Type Activities - Enterprise Funds			Totals
	Water Fund 500	Refuse Fund 650	Wastewater Treatment Project Fund 600	
OPERATING REVENUES				
Utility revenue	\$ 1,614,768	\$ -	\$ -	\$ 1,614,768
Franchise revenue	-	151,212	-	151,212
Total Operating Revenues	<u>1,614,768</u>	<u>151,212</u>	<u>-</u>	<u>1,765,980</u>
OPERATING EXPENSES				
Salaries and wages	284,550	15,622	-	300,172
Payroll taxes and benefits	114,595	5,784	-	120,379
Contract services	25,460	-	-	25,460
Insurance	18,036	-	-	18,036
Maintenance and repairs	31,412	-	-	31,412
Office supplies, publications, and dues	24,030	24	-	24,054
License and fees	15,362	-	-	15,362
Professional services	12,339	1,060	210,264	223,663
Special department expenses and supplies	52,031	-	-	52,031
Rent	5,760	3,360	-	9,120
Employee travel and training	1,809	272	-	2,081
Telephone and communications	7,861	-	-	7,861
Utilities	94,743	-	-	94,743
Inter-agency contractual costs	30,698	-	-	30,698
Bad debt expense	35,549	-	-	35,549
Other expense	1,386	1,048	1,847	4,281
Other outgo - cost allocation from other funds	502,032	46,488	-	548,520
Depreciation	300,560	-	-	300,560
Total Operating Expenses	<u>1,558,213</u>	<u>73,658</u>	<u>212,111</u>	<u>1,843,982</u>
Operating Income (Loss)	<u>56,555</u>	<u>77,554</u>	<u>(212,111)</u>	<u>(78,002)</u>
NON-OPERATING REVENUES (EXPENSES)				
Grant income	500	-	-	500
Investment income, net of costs	4,525	1,018	9,088	14,631
Other revenue	13,468	30	14,774	28,272
Bond discount amortization	(1,417)	-	(25,954)	(27,371)
Interest expense	(151,988)	-	(773,881)	(925,869)
Gain on sale of capital assets	4,250	-	-	4,250
Property taxes and assessment	182,356	-	1,157,594	1,339,950
Total Non-Operating Revenues	<u>51,694</u>	<u>1,048</u>	<u>381,621</u>	<u>434,363</u>
Income (Loss) Before Transfers	<u>108,249</u>	<u>78,602</u>	<u>169,510</u>	<u>356,361</u>
TRANSFERS				
Transfers in	-	-	25,000	25,000
Transfers out	-	(42,600)	-	(42,600)
Total Transfers	<u>-</u>	<u>(42,600)</u>	<u>25,000</u>	<u>(17,600)</u>
Change in Net Assets	<u>108,249</u>	<u>36,002</u>	<u>194,510</u>	<u>338,761</u>
Net Assets - July 1, 2010, as previously reported	3,275,408	500,539	10,073,739	13,849,686
Prior Period Adjustments (Note 14)	-	-	-	-
Net Assets - July 1, 2010, as restated	<u>3,275,408</u>	<u>500,539</u>	<u>10,073,739</u>	<u>13,849,686</u>
Total Net Assets - June 30, 2011	<u>\$ 3,383,657</u>	<u>\$ 536,541</u>	<u>\$ 10,268,249</u>	<u>\$ 14,188,447</u>

See accompanying notes to the basic financial statements.

**LOS OSOS COMMUNITY SERVICES DISTRICT
STATEMENT OF CASH FLOWS
PROPRIETARY FUNDS
FOR THE YEAR ENDED JUNE 30, 2011**

	Business-Type Activities - Enterprise Funds			Totals
	Water Fund 500	Refuse Fund 650	Wastewater Treatment Project Fund 600	
CASH FLOWS FROM OPERATING ACTIVITIES				
Cash received from customers and users	\$ 1,537,055	\$ 151,574	\$ -	\$ 1,688,629
Cash paid for goods and services	(339,734)	(4,403)	(187,101)	(531,238)
Cash paid to employees	(387,809)	(21,406)	-	(409,215)
Cash paid for administrative costs	(502,032)	(46,488)	(1,847)	(550,367)
Net Cash Provided (Used) by Operating Activities	<u>307,480</u>	<u>79,277</u>	<u>(188,948)</u>	<u>197,809</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES				
Property tax proceeds	179,450	-	-	179,450
Other revenue	13,968	30	14,774	28,772
Proceeds of special tax and assessment	-	-	1,169,476	1,169,476
Transfers from other funds	-	-	25,000	25,000
Transfers to other funds	-	(42,600)	-	(42,600)
Trust receipts	-	1,920	(81,248)	(79,328)
Net Cash Provided (Used) by Noncapital Financing Activities	<u>193,418</u>	<u>(40,650)</u>	<u>1,128,002</u>	<u>1,280,770</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES				
Proceeds on sale of capital assets	4,250	-	-	4,250
Acquisition of capital assets	(16,164)	-	-	(16,164)
Principal and interest paid on capital debt	(280,097)	-	(1,148,383)	(1,428,480)
Net Cash Used by Capital and Related Financing Activities	<u>(292,011)</u>	<u>-</u>	<u>(1,148,383)</u>	<u>(1,440,394)</u>
CASH FLOWS FROM INVESTING ACTIVITIES				
Interest and dividends	<u>4,568</u>	<u>1,036</u>	<u>9,088</u>	<u>14,692</u>
Net Cash Provided by Investing Activities	<u>4,568</u>	<u>1,036</u>	<u>9,088</u>	<u>14,692</u>
Net Increase (Decrease) in Cash and Cash Equivalents	213,455	39,663	(200,241)	52,877
Cash and Cash Equivalents - July 1, 2010	<u>1,131,911</u>	<u>494,977</u>	<u>3,506,702</u>	<u>5,133,590</u>
Cash and Cash Equivalents - June 30, 2011	<u>\$ 1,345,366</u>	<u>\$ 534,640</u>	<u>\$ 3,306,461</u>	<u>\$ 5,186,467</u>

See accompanying notes to the basic financial statements.

**LOS OSOS COMMUNITY SERVICES DISTRICT
STATEMENT OF CASH FLOWS (Continued)
PROPRIETARY FUNDS
FOR THE YEAR ENDED JUNE 30, 2011**

	Business-Type Activities - Enterprise Funds			
	Water Fund 500	Refuse Fund 650	Wastewater Treatment Project Fund 600	Totals
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES:				
Operating Income (Loss)	\$ 56,555	\$ 77,554	\$ (212,111)	\$ (78,002)
Adjustments to reconcile operating income (loss) to net cash provided (used) by operating activities:				
Depreciation expense	300,560	-	-	300,560
Changes in assets and liabilities:				
(Increase) Decrease in accounts receivable	(41,884)	362	-	(41,522)
Decrease in prepaid expense	(4,844)	-	-	(4,844)
Increase in inventory	(6,908)	-	-	(6,908)
Increase (Decrease) in accounts payables	7,599	1,361	23,163	32,123
Increase in deposits payable	(280)	-	-	(280)
Increase in compensated absences	(3,318)	-	-	(3,318)
Net Cash Provided (Used) by Operating Activities	<u>\$ 307,480</u>	<u>\$ 79,277</u>	<u>\$ (188,948)</u>	<u>\$ 197,809</u>

See accompanying notes to the basic financial statements.

**LOS OSOS COMMUNITY SERVICES DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2011**

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. The Financial Reporting Entity

The Los Osos Community Services District (District), a political subdivision of the State of California, was formed on January 1, 1999, pursuant to Ballot Measure K-98 to provide services previously provided by the County in specific benefits zones of what was formerly County Service Area 9. After formation, the District added solid waste services providing service to all properties in the District. It operates pursuant to Section 61000 of the California Government Code. It is currently authorized to provide Fire Protection, Water, Street Lighting, Drainage, Solid Waste, and Parks and Recreation Services. It is governed by a five-member Board of Directors with an operations staff headed by a general manager.

B. Chapter 9 Bankruptcy

The District is currently under bankruptcy protection. The background, status, and impacts of the filing are discussed in the Introductory Section.

C. The Financial Statements

The accompanying financial statements consist of the following:

- Government-wide financial statements
- Fund financial statements, and
- Notes to the financial statements.

New Accounting Pronouncement

Governmental Accounting Standards Board Statement No. 54

This new statement is effective for years after June 30, 2010. This new statement basically classifies fund balance into five categories according to the constraints and the source of these constraints placed on the funds. It also clarifies the definitions of the five traditional governmental five types.

The District adopted a resolution on November 3, 2011, stating that Governmental Accounting Standards Board (GASB) Statement No. 54 be complied with as of June 30, 2011. It also affirmed that the Board of Directors alone can create, change, and eliminate fund balances under the categories of 'committed' and 'assigned.' The details of fund balances under the new categories are in the footnote on Equity, Note 9.

Basis of Presentation

The District's basic financial statements are prepared in conformity with accounting principles generally accepted in the United States of America. GASB is the acknowledged standard setting body for establishing accounting and financial reporting standards followed by governmental entities in the U.S.A.

Government-Wide Financial Statements:

The statement of net assets and statement of activities display information about the reporting government as a whole. They include the activities of the overall District government except for fiduciary activities. Eliminations have been made to minimize the double counting of internal activities. The statements distinguish between governmental and business-type activities of the District. The District's net assets are reported in three parts - invested in capital assets, net of related debt; restricted net assets; and unrestricted net assets. The District first utilizes restricted resources to finance qualifying activities. Governmental activities generally are financed through taxes, intergovernmental revenues, and other non-exchange revenues. Business-type activities are financed in whole or in part by fees charged to external parties for goods or services.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

C. The Financial Statements (Continued)

Government-Wide Financial Statements: (Continued)

The statement of activities presents a comparison between direct expenses and program revenues for each segment of the business-type activities of the District and for each function of the District's governmental activities. Direct expenses are those that are specifically associated with a program or function and, therefore, are clearly identifiable to a particular function. Program revenues include (a) charges paid by the recipients of goods or services offered by the programs, (b) grants and contributions that are restricted to meeting the operational needs of a particular program, and (c) fees, grants, and contributions that are restricted to financing the acquisition or construction of capital assets. Revenues that are not classified as program revenues, including all taxes, are presented as general revenues.

Fund Financial Statements:

The fund financial statements provide information about the District's funds. Each fund is accounted for by providing a separate set of self-balancing accounts that constitute its assets, liabilities, fund equity, revenues, and expenditures/expenses. Funds are organized into three major categories: governmental, proprietary, and fiduciary. The District does not have fiduciary funds. An emphasis is placed on major funds within the governmental and proprietary categories with each major fund displayed in a separate column. A fund is considered major if it is the primary operating fund of the District or meets the following criteria:

- a. Total assets, liabilities, revenues, or expenditures/expenses of that individual governmental or proprietary fund are at least 10 percent of the corresponding total for all funds of that category or type; and
- b. Total assets, liabilities, revenues, or expenditures/expenses of the individual governmental fund or proprietary fund are at least 5 percent of the corresponding total for all governmental and proprietary funds combined.

All remaining governmental funds are aggregated and reported as non-major funds in a single column, regardless of their fund type.

The funds of the financial reporting entity are described below:

Governmental Funds

General Fund - The General Fund, more commonly referred to as the Administrative Fund, is the general operating fund of the District and is always classified as a major fund. It is used to account for all other activities except those legally or administratively required to be accounted for in other funds.

Special Revenue Funds - Special revenue funds are used to account for the proceeds of specific revenue sources that are legally restricted to expenditures for specified purposes. The following are Special Revenue Funds:

- 301 – Fire Fund
- 200 – Bayridge (a subdivision where lighting and septic system maintenance are provided)
- 400 – Vista de Oro (a subdivision where lighting and septic system maintenance are provided)
- 800 – Drainage
- 900 – Parks and Recreation

Capital Project Funds - Capital project funds are used to account for financial resources used for the acquisition or construction of major capital facilities other than those financed by enterprise funds. The District does not maintain a Capital Project Fund.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

C. The Financial Statements (Continued)

Proprietary Funds

Enterprise Funds - Enterprise funds are used to account for business-like activities provided to the general public. These activities are financed primarily by user charges and the measurement of financial activity focuses on net income measurement similar to the private sector.

Proprietary Funds are as follows:

500 – Water

600 – Wastewater Fund (This is for the aborted sewer system project; once the bankruptcy case is closed, this fund will function as a Debt Service Fund and may at that point be reclassified to the Governmental category.)

650 – Solid Waste or Refuse Fund

Major Funds

The District reported the following major governmental funds in the accompanying financial statements:

General Fund - This is the District's primary operating fund and is more commonly referred to as the Administrative Fund. It accounts for all financial resources of the general government, except those required to be accounted for in another fund. The fund provides for public administration, overall management, occupancy, computer systems, accounting, legal, consulting, communication, and insurance as it pertains to the District as a whole.

Fire Fund - This fund accounts for activities of Fire Station 15 - South Bay. The fire department provides fire suppression, emergency paramedic services, and fire prevention including public education. Services are provided through a contract with Cal Fire for the entire community. Reserve firefighters and administrative operational costs are paid by the District outside the Cal Fire contract.

The District reports the following major proprietary funds in the accompanying financial statements:

Water Fund - This fund accounts for the operation and maintenance of the District's water distribution system. The water department is responsible for the operation and maintenance of five groundwater supply wells providing treatment, monitoring, and distribution services.

Refuse Fund - This fund provides trash cleanup and recycling services for the community through a franchise agreement with a private company.

Wastewater Treatment Project Fund - This fund originally accounted for projects relating to the District's wastewater treatment project. Since the wastewater project was stopped, this fund now mainly reflects functions relative to bankruptcy proceedings and debt service on the aborted sewer project.

D. Measurement Focus and Basis of Accounting

Measurement focus is a term used to describe "which" transactions are recorded within the various financial statements. Basis of accounting refers to "when" revenues and expenditures or expenses are recognized in the accounts and reported in the financial statements regardless of the measurement focus applied.

Measurement Focus

On the government-wide statement of net assets and the statement of activities, both governmental and business-type activities are presented using the economic resources measurement focus as defined in item "b" below.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

D. Measurement Focus and Basis of Accounting (Continued)

Measurement Focus (Continued)

In the fund financial statements, the “current financial resources” measurement focus or the “economic resources” measurement focus is used as appropriate:

- a. All governmental funds are accounted for using a “current financial resources” measurement focus. With this measurement focus, only current assets and current liabilities generally are included on their balance sheets. Their operating statements present sources and uses of available spendable financial resources during a given period. These funds use fund balance as their measure of available spendable financial resources at the end of the period.
- b. All proprietary funds utilize an “economic resources” measurement focus. The accounting objectives of this measurement focus are the determination of operating income, changes in net assets (or cost recovery), financial position, and cash flows. All assets and all liabilities (whether current or non current) associated with the operation of these funds are reported. Proprietary fund equity is classified as net assets.

Basis of Accounting

In the government-wide statement of net assets and statement of activities, both governmental and business-type activities are presented using the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recorded when the liability is incurred or economic asset is used. Revenues, expenses, gains, losses, assets, and liabilities resulting from exchange and exchange-like transactions are recognized when the exchange takes place.

In the fund financial statements, governmental funds and agency funds are presented on the modified accrual basis of accounting. Under the modified accrual basis of accounting, revenues are recognized when “measurable and available.” Measurable means knowing or being able to reasonably estimate the amount. Available means collectible within the current period or soon enough thereafter to pay current liabilities. The District defines available to be within 60 days of year-end. Expenditures (including capital outlay) are recorded when the related fund liability is incurred, except for general obligation bond principal and interest which are reported when due. Governmental capital asset acquisitions are reported as expenditures in governmental funds. Proceeds for governmental long-term debt and acquisitions under capital leases are reported as other financing sources.

Those revenues susceptible to accrual include taxes, intergovernmental revenues, interest, and charges for services. Certain indirect costs are included in program expenses reported for individual functions and activities.

Grant revenues are recognized in the fiscal year in which all eligibility requirements are met. Under the terms of grant agreements, the District may fund certain programs with a combination of cost-reimbursement grants, categorical block grants, and general revenues. Thus, both restricted and unrestricted net assets are available to finance program expenditures. The District’s policy is to first apply restricted grant resources to such programs, followed by general revenues if necessary.

The District follows Statements and Interpretations of the Financial Accounting Standards Board and its predecessors that were issued on or before November 30, 1989, in accounting for its business-type activities, which do not conflict with GASB Pronouncements.

All proprietary funds utilize the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recorded when the liability is incurred or economic asset is used. Proprietary funds distinguish operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with a proprietary fund’s principal revenues and expenses. When both restricted and unrestricted resources are available for use, it is the District’s policy to use restricted resources first, then unrestricted resources as they are needed.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

E. Property Taxes

The County levies, bills, and collects property taxes and special assessments for the District. Property taxes levied are recorded as revenue in the fiscal year of levy, due to the adoption of the “alternate method of property tax distribution,” known as the Teeter Plan, by the District and the County. The Teeter Plan authorizes the Auditor/Controller of the County to allocate 100% of the secured property taxes billed, excluding unitary tax (whether paid or unpaid). The County remits tax monies to the District every month and twice a month in December and April. The final amount which is “teetered” is remitted in August each year.

Tax collections are the responsibility of the County Tax Collector. Taxes and assessments on secured and utility rolls, which constitute a lien against the property, may be paid in two installments; the first is due November 1 of the fiscal year and is delinquent if not paid by December 10; and the second is due on March 1 of the fiscal year and is delinquent if not paid by April 10. Unsecured personal property taxes do not constitute a lien against real property unless the tax becomes delinquent. Payment must be made in one installment, which is delinquent if not paid by August 31 of the fiscal year. Significant penalties are imposed by the County for late payment.

Property valuations are established by the Assessor of the County for the secured and unsecured property tax rolls. Under the provisions of Article XIII A of the State Constitution, properties are assessed at 100% of purchase price or value in 1978 whichever is later. From this base assessment, subsequent annual increases in valuation are limited to a maximum of 2 percent. However, increases to full value are allowed for property improvements or upon change in ownership. Personal property is excluded from these limitations, and is subject to annual reappraisal.

Tax levy dates are attached annually on January 1 preceding the fiscal year for which the taxes are levied. The fiscal year begins July 1 and ends June 30 of the following year. Taxes are levied on both real and unsecured personal property, as it exists at that time. Liens against real estate, as well as the tax on personal property, are not relieved by subsequent renewal or change in ownership.

F. Cash and Investments

The District pools the cash of all funds, except for monies deposited with fiscal agent in accordance with related bond indentures. The cash and investments balance in each fund represents that fund’s equity share of the District’s cash and investment pool.

Interest income earned on pooled cash and investments is allocated quarterly to the various funds based on month-end balances. Interest income on restricted cash and investments with fiscal agents is credited directly to the related fund.

The District’s investments are carried at fair value. The fair value of equity and debt securities is determined based on sales prices or bid-and-asked quotations from SEC-registered securities exchanges or NASDAQ dealers. LAIF determines the fair value of their portfolio quarterly and reports a factor to the District. Changes in fair value are allocated to each participating fund.

For purposes of the statement of cash flows, the District has defined cash and cash equivalents to be change and petty cash funds, equity in the District’s cash and investment pool, and restricted non-pooled investments with initial maturities of three months or less.

G. Accounts and Interest Receivable

In the government-wide statements, receivables consist of all revenues earned at year-end and not yet received. Receivables are recorded in the financial statements net of any allowance for doubtful accounts if applicable, and estimated refunds due. Major receivable balances for the governmental activities may include sales taxes, franchise taxes, grants, and other fees, if any. Business-type activities report utilities and franchise fees as their major receivables.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

G. Accounts and Interest Receivable (Continued)

In the fund financial statements, material receivables in governmental funds may include revenue accruals such as franchise tax, grants, service charges and other similar intergovernmental revenues that are both measurable and available. Non-exchange transactions collectible but not available are deferred in the fund financial statements in accordance with modified accrual, but not deferred in the government-wide financial statements in accordance with the accrual basis. Interest and investment earnings are recorded when earned and if paid within 60 days since they would be considered both measurable and available. Proprietary fund material receivables consist of all revenues earned at year-end and not yet received. Utility accounts receivable and interest earnings comprise the majority of proprietary fund receivables.

H. Prepaid Expenses and Inventory

Inventory is valued at the lower of cost or market using the first-in, first-out (FIFO) method. The cost is recorded as an expenditure/expense in the funds at the time individual inventory items are purchased rather than when consumed. This is then adjusted by physical inventory at year-end. Inventory in the enterprise funds consist principally of materials and supplies for utility operations.

Payments to vendors that reflect costs applicable to future accounting periods are recorded as prepaid items in both government-wide and fund financial statements.

I. Restricted Assets

Certain debt proceeds of the Wastewater Treatment Project Fund, as well as certain resources set aside for the repayment of the associated debt, are classified as restricted assets on the balance sheet because their use is limited by applicable bond covenants and they are maintained in separate bank accounts. Funds that are under the control of external parties are also restricted.

J. Capital Assets

The accounting treatment over property, plant, and equipment depends on whether the assets are used in governmental fund operations or proprietary fund operations. The presentation and recording of governmental assets are described below.

Government-Wide Statements

In the government-wide financial statements, capital assets with a historical cost of \$5,000 or more are accounted for as capital assets. All capital assets are valued at historical cost, or estimated historical cost if actual is unavailable, except for donated capital assets, if any, which are recorded at their estimated fair value at the date of donation. Estimated historical cost was used to value the majority of the assets.

With the implementation of GASB Statement No. 34, the District has recorded all its public domain (infrastructure) capital assets on the government-wide statements.

Depreciation of all exhaustible capital assets is recorded as an allocated expense in the statement of activities, with accumulated depreciation reflected in the statement of net assets. Depreciation is provided over the assets' estimated useful lives using the straight-line method of depreciation. The range of estimated useful lives by type of asset is as follows:

Buildings	40 years
Improvements other than buildings	5-25 years
Other equipment and furnishings	5-30 years

Fund Financial Statements

In the fund financial statements, capital assets used in governmental fund operations are accounted for as capital outlay expenditures of the governmental fund upon acquisition. Capital assets used in proprietary fund operations are capitalized when purchased.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

K. Accumulated Compensated Absences

Compensated absences comprise unused vacation leave, sick leave and compensatory time off, which are accrued as earned. Vacation can be accrued to a maximum of 40 days or 320 hours. Upon termination, all accumulated vacation hours up to 320 hours can be paid. Sick leave can be accrued up to 180 days or 1,440 hours. Only half of accumulated sick leave hours can be paid on termination. Payments will be based on the pay rate at the time of termination. The District's liability for the current and long-term portions of compensated absences is shown in the government-wide Statement of Net Assets for both governmental funds and propriety funds. Only propriety funds reflect the long-term portion in the fund financials report, Statement of Net Assets. The short-term portion is reflected for both governmental and proprietary funds in the fund financial statements. Computation was based on rates in effect as of the year-end.

L. Long-Term Liabilities

In the government-wide financial statements, long-term liabilities are presented for both governmental and proprietary fund types. In the fund financial statements, only the proprietary funds show long-term liabilities. Initial issue bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds using the straight-line method. Bond issuance costs, including deferred refunding amounts, if any and underwriters' discounts, are reported as deferred bond issuance costs. Amortization of bond premiums or discounts, issuance costs, and deferred amounts on refunding is included in interest expense.

In the fund financial statements, governmental fund types recognize bond premiums, discounts, and issuance costs during the period when the debt is issued. The face amount of debt issued is reported as other financing sources. Premiums received are reported as other financing sources, while discounts are reported as other financing uses. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service expenditures.

M. Interfund Transactions

Following is a description of the four basic types of interfund transactions that can be made during the year and the related accounting policies:

1. Interfund services provided and used - transactions for services rendered or facilities provided. These transactions are recorded as revenues in the receiving fund and expenditures in the disbursing fund.
2. Reimbursements (expenditure transfers) - transactions to reimburse a fund for specific expenditures incurred for the benefit of another fund. These transactions are recorded as expenditures in the disbursing fund and a reduction of expenditures in the receiving fund.
3. Residual equity transfers - transactions recording equity contributions and distributions between funds. This is presented as a separate caption just before the Fund Balance caption.
4. Operating transfers - all other interfund transactions which allocate resources from one fund to another fund. These transactions are recorded as operating transfers in and out.

N. Equity Classifications

Government-Wide Statements

Net assets are the excess of all the District's assets over all its liabilities, regardless of fund. Net assets are divided into three categories under GASB Statement No. 34. These categories apply only to net assets, which is determined at the government-wide level, and are described below:

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

N. Equity Classifications (Continued)

- a. Invested in capital assets, net of related debt - Consists of capital assets, including restricted capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets.
- b. Restricted net assets - Consists of net assets with constraints place on the use either by (1) external groups such as creditors, grantors, contributors, or laws or regulations of other governments; or (2) law through constitutional provisions or enabling legislation.
- c. Unrestricted net assets - All other net assets that do not meet the definition of “restricted” or “invested in capital assets, net of related debt.”

Fund Statements

Equity of governmental funds is presented in accordance with the new GASB Statement No. 54. Proprietary funds are presented the same as in Government-Wide Statements.

GASB issued Statement No. 54 which is effective for fiscal years after June 30, 2010. This classifies fund balances into five categories depending on the degree of constraints and source of these constraints placed on the funds.

The five categories of equity under GASB Statement No. 54 are as follows:

- *Non-spendable fund balance* – amounts cannot be spent because they are either (a) not spendable in form or (b) are legally or contractually required to be maintained intact.
- *Restricted fund balance* – amounts with constraints placed on their use that are either (a) externally imposed by creditors, grantors, contributors, or laws or regulations of other governments; or (b) imposed by laws through constitutional provisions or enabling legislation.
- *Committed fund balance* – amounts that can only be used for specific purposes determined by formal action of the highest level of decision-making authority (Board of Directors) and that remain binding unless removed in the same manner. The underlying action that imposed the limitation needs to occur no later than the close of the reporting period.
- *Assigned fund balance* – amounts that are constrained by the District’s intent to be used for specific purposes. The intent can be established at either the highest level of decision making or by a body or an official designated for that purpose. Residual funds in special revenue funds are classified under this category.
- *Unassigned fund balance* – this represents residual fund balance in the General Fund that is not otherwise classified in the other categories. For other funds, this represents the excess of actual expenditures over the amounts restricted, committed or assigned for the specific purposes.

The District’s Board of Directors adopted a resolution affirming compliance with GASB Statement No. 54 and also affirming that only the Board can create, change or cancel Committed and Assigned fund balances.

O. General Budget Policies

The District requires that all funds adopt an annual budget. The annual budget is prepared by the General Manager and submitted to the District Board of Directors for adoption. A budget has been prepared for both the governmental funds and proprietary funds utilizing the modified accrual basis of accounting. All unencumbered appropriations in the budget lapse at the end of the fiscal year.

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

P. Use of Estimates

The preparation of financial statements in accordance 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 these estimates.

Q. Reclassifications

Reclassifications of prior year data may at times be necessary to conform to a new method of presentation.

NOTE 2 – CASH AND INVESTMENTS

Investments of the District are governed by the California Government Code and by the District's investment policy. The General Manager of the District acts as the District Finance Officer and Treasurer who is tasked to perform investment functions in accordance with the investment policy. The objectives of the policy are safety, liquidity, yield, and compliance with State and Federal laws and regulations.

Investments of the District as of June 30, 2011

The table below identifies the investment types the District has that are authorized for the District by the California Government Code or the District's investment policy, where more restrictive, that addresses interest rate risk, credit risk and concentration of credit risk. This table does not address investments of debt proceeds held by bond trustees that are governed by the provisions of debt agreements of the District, rather than the general provisions of the California Government Code or the District's investment policy.

Authorized Investment Type	Maximum Maturity	Maximum Percentage of Portfolio **	Maximum Investment in One Issuer
Local Agency Investment Fund (LAIF)	N/A - Available on demand	20%	N/A
FDIC Insured Savings & Loan Associations	3 years	1%	5%
Money Market Mutual Funds	N/A - Available on demand	79%	N/A

** Excluding funds held by bond trustee

Cash and Investments as of June 30, 2011, are Classified in the Accompanying Financial Statements as Follows:

	Cash and Investments	Cash and Investments Held by Bond Trustee	Restricted Cash	Total
Governmental activities	\$ 882,500	\$ -	\$ 353,117	\$ 1,235,617
Business-type activities	2,097,652	1,413,141	1,675,675	5,186,468
Total Cash and Investments	<u>\$ 2,980,152</u>	<u>\$ 1,413,141</u>	<u>\$ 2,028,792</u>	<u>\$ 6,422,085</u>

NOTE 2 – CASH AND INVESTMENTS (Continued)

Cash and Investments are Carried at Fair Value as of June 30, 2011, and Consist of the Following:

Deposits with financial institutions	\$	238,814
Imprest funds		12,900
Bank time deposits		50,336
State investment pool		969,950
Money market investment		3,736,944
U.S. Treasury bills, notes, and bonds		<u>1,413,141</u>
Total cash and investments	\$	<u>6,422,085</u>

Disclosure Relating to Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment is, the greater the sensitivity of its fair value to changes in market interest rates. One of the ways that the District's interest rate risk is mitigated 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 (including investments held by bond trustee) to market rate fluctuations is provided by the following table that shows the distribution of the District's investments by maturity as of June 30, 2011:

	Remaining Maturity		
	12 Months or Less	1-5 Years	Fair Value
Deposits with financial institutions	\$ 238,814	\$ -	\$ 238,814
Bank time deposits	-	50,336	50,336
State investment pool	969,950	-	969,950
Money market investment	3,736,943	-	3,736,943
Held by bond trustee:			
U.S. Treasury bills, notes, and bonds	<u>1,413,141</u>	<u>-</u>	<u>1,413,141</u>
	<u>\$ 6,358,848</u>	<u>\$ 50,336</u>	<u>\$ 6,409,184</u>

Investments with Fair Values Highly Sensitive to Interest Rate Fluctuations

The District has no investments (including investments held by bond trustees) that are highly sensitive to interest rate fluctuations.

NOTE 2 – CASH AND INVESTMENTS (Continued)

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 nationally recognized statistical rating organizations. Presented below is the minimum rating required by (where applicable) the California Government Code, the investment policy, or debt agreements, and the actual rating as of the fiscal year ended June 30, 2011, for each investment type.

	Total	Rating as of Fiscal Year-End		
		S&P	Moody's	N/A
Deposits with financial institutions	\$ 238,814	AAA	Aaa	
Bank time deposits	50,336			Not rated
State investment pool	969,950			Not rated
Money market investment	3,736,943	AAA	Aaa	
Held by bond trustee:				
U.S. Treasury bills, notes, and bonds	<u>1,413,141</u>	AA+	Aaa	
	<u>\$ 6,409,184</u>			

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. The District minimizes its credit risk by investing only in the safest types of securities or investments.

The biggest investment of the District is in money market funds, comprising seventy nine percent (79%) of all investments. This is managed by the District's bank. This investment is indexed to earn ten basis points above that earned monthly by the State Investment Pool. This translates to more than 25% percentage premium. These are collateralized up to 110% in compliance with State law with the collaterals held by a separate trustee bank.

The next major investment of the District, not considering those held by bond trustee, is investment in the State Investment Pool, more commonly known as LAIF. Investment in LAIF comprises twenty percent (20%) of all invested funds. This fund is not registered with the Securities and State Commission as an investment company but is required to invest according to California State Code. The fund is under the oversight of the Treasurer of the State of California through the Local Investment Advisory Board that consists of five members as designated by statute. Market valuation is conducted quarterly by the State Treasurer's office. In addition, it also conducts monthly a fair market valuation of all securities held against carrying costs. The fair value of the District's investment in this pool is reported in the accompanying financial statements at amounts based on the District's pro-rata share of the fair value of the entire portfolio net of any amortized costs as provided by LAIF.

Investment of funds held by bond trustee is governed by provisions of the debt agreements rather than the general provisions of the California Government Code or the District's investment policy. Current agreement of the District with bond trustee directs trustee to invest in money market funds duly registered under the Federal Securities Act of 1933 and under the Investment Company Act of 1940 and having a rating by S&P of AAAm-G or AAAm or in any other investment acceptable to the bond insurer.

NOTE 2 – CASH AND INVESTMENTS (Continued)

Custodial Credit Risk

Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The California Government Code and the District 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 government 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's deposits by pledging first trust deed mortgage notes having a value of 150% of the secured public deposits.

The investment in the State Investment Pool is not required to be collateralized. The fair value of securities in the pool is based on quoted market prices. The State Treasurer's Office performs a monthly fair market valuation of all securities held against carrying costs. Reports of valuations and financial statements are available to participants in the State Treasurer's website.

Restricted Cash

Cash and investments that are restricted as of June 30, 2011, consist of the following:

Restricted Cash and Funds Held by Bond Trustee

Governmental activities

Funds held in trust for community group	\$ 1,159
Development fees restricted for facilities	50,336
Assessments collected for a specific purpose	<u>301,621</u>
Total Governmental Restricted Cash	<u>353,116</u>

Enterprise activities

Restricted by a Court pending bankruptcy proceedings	1,583,548
Prepaid assessments restricted for debt service	<u>92,127</u>
Total Restricted Cash excluding funds held by bond trustee	1,675,675
Funds held by bond trustee	<u>1,413,141</u>
Total Enterprise Restricted Cash	<u>3,088,816</u>
Total Restricted Cash, including funds held by bond trustee	<u><u>\$ 3,441,932</u></u>

NOTE 3 – INTERFUND TRANSACTIONS

Transfers between funds during the fiscal year ended June 30, 2011, were as follows:

<u>Transfer from</u>	<u>Transfer to</u>	<u>Description of Transfer</u>	<u>Amount</u>
<u>Major Governmental Funds</u>			
General Fund	Wastewater Project Fund	Restoration of reserves	\$ 25,000
Total Major Governmental Interfund Transfers			<u>25,000</u>
<u>Non-Major Governmental Funds</u>			
Solid Waste	General Fund	Administrative support	42,600
Total Non-Major Governmental Interfund Transfers			<u>42,600</u>
Total Interfund Transfers			<u><u>\$ 67,600</u></u>

NOTE 4 – CAPITAL ASSETS

Governmental activities:

	<u>Balance at July 1, 2010</u>	<u>Additions</u>	<u>Retirements</u>	<u>Transfers and Adjustments</u>	<u>Balance at June 30, 2011</u>
Capital assets not being depreciated					
Land	\$ 50,000	\$ -	\$ -	\$ -	\$ 50,000
Construction in progress	5,403	-	-	(5,403)	-
Total	<u>55,403</u>	<u>-</u>	<u>-</u>	<u>(5,403)</u>	<u>50,000</u>
Capital assets being depreciated					
Buildings, structures, and improvements	402,406	107,308	-	5,403	515,117
Plant and equipment	1,808,873	43,314	(8,135)	-	1,844,052
Total	<u>2,211,279</u>	<u>150,622</u>	<u>(8,135)</u>	<u>5,403</u>	<u>2,359,169</u>
Less accumulated depreciation					
Buildings, structures, and improvements	(272,720)	(21,428)	-	-	(294,148)
Plant and equipment	(1,635,229)	(19,993)	8,135	-	(1,647,087)
Total accumulated depreciation	<u>(1,907,949)</u>	<u>(41,421)</u>	<u>8,135</u>	<u>-</u>	<u>(1,941,235)</u>
Total capital assets, net	<u><u>\$ 358,733</u></u>	<u><u>\$ 109,201</u></u>	<u><u>\$ -</u></u>	<u><u>\$ -</u></u>	<u><u>\$ 467,934</u></u>

Depreciation expense was charged to functions based on their usage of the related assets as follows:

Governmental Activities:	
General administration	\$ 465
Public safety	34,986
Health and sanitation	5,970
Total governmental activities depreciation expense	<u><u>\$ 41,421</u></u>

NOTE 4 – CAPITAL ASSETS (Continued)

Business-type activities:

	Balance at July 1, 2010	Additions	Retirements	Transfers and Adjustments	Balance at June 30, 2011
Capital assets not being depreciated					
Land	\$ 8,190,132	\$ -	\$ -		\$ 8,190,132
Construction in progress	22,067,856	-	-		22,067,856
Total	30,257,988	-	-	-	30,257,988
Capital assets being depreciated					
Plant and equipment	8,496,691	16,164	(5,000)	-	8,507,855
Total	8,496,691	16,164	(5,000)	-	8,507,855
Less accumulated depreciation					
Plant and equipment	(2,651,252)	(300,560)	5,000	-	(2,946,812)
Total accumulated depreciation	(2,651,252)	(300,560)	5,000	-	(2,946,812)
Total capital assets being depreciated, net	5,845,439	(284,396)	-	-	5,561,043
Total capital assets, net	\$ 36,103,427	\$ (284,396)	\$ -	\$ -	\$ 35,819,031

Construction in progress

	Balance at June 30, 2011
Governmental activities	\$ -
Business-type activities	22,067,856
Total construction-in-progress	\$ 22,067,856

Business-type activities

This construction-in-progress represents the total construction costs recorded and expended on a wastewater treatment project that was stopped in November 2005 by a new Board of Directors elected at that time. The stoppage was mainly due to the contentious location and type of the project. Contractors' claims with a total mediated amount of \$11,427,814 are not included above. These claims were filed with the bankruptcy court and are currently pending.

The costs recorded and shown above were funded by a combination of a State Revolving Fund loan and the issuance of limited obligation improvement bonds. Due to the stoppage of the project and with the responsibility for a new successor project having been transferred to the County of San Luis Obispo under special legislation, AB 2701, the amount shown above may no longer represent its true value and may be materially impaired. Under AB 2701, the District is obligated to transfer to the County any assets acquired by the District for the original project when the County requests a transfer for use in their successor sewer project. At this point, infrastructures that may be included in the construction-in-progress amount shown above have not been determined nor valued. The County has not as yet requested the District the use or transfer of any infrastructures it may need for its successor project.

(Also refer to Note 12.)

NOTE 5 – ACCOUNTS PAYABLE

Total claims against the District in Bankruptcy Court total about \$12 million, excluding two claims by the State with a total of \$15 million which they agreed to settle based on certain conditions. These conditions are discussed in the Introductory Section, Impact on Liabilities. Of the \$12 million, only \$950,719 has been recorded in the books. This represents claims that were submitted to the District by the time of filing the bankruptcy case. In addition to these, about 95%, or \$11,427,814, represents mediated claims by three major contractors who worked on the aborted sewer project. These are not recorded in the books and are not reflected in these statements. The current status of the bankruptcy case is discussed in the Introductory Section.

NOTE 6 – LONG-TERM LIABILITIES

The following is a summary of changes in the District's long-term liabilities for the fiscal year ended June 30, 2011:

	Balance at July 1, 2010	Additions	Reductions	Balance at June 30, 2011	Current Portion
Governmental Activities:					
Compensated Absences	\$ 38,058	\$ -	\$ (6,278)	\$ 31,780	\$ 11,388
Notes Payable:					
William and Anja Morton (assignees)	22,582	-	(22,582)	-	-
Total Governmental Activities	<u>\$ 60,640</u>	<u>\$ -</u>	<u>\$ (28,860)</u>	<u>\$ 31,780</u>	<u>\$ 11,388</u>
Business-Type Activities:					
Compensated Absences	\$ 27,295	\$ -	\$ (3,319)	\$ 23,976	\$ 12,827
Water Fund:					
Notes Payable	4,642,522	-	(126,501)	4,516,021	130,359
Wastewater Treatment Project Fund:					
Notes Payable	6,486,144	-	-	6,486,144	-
Improvement Bonds (US Bank Trustee)	15,975,000	-	(370,000)	15,605,000	385,000
Total Business-Type Activities	<u>\$ 27,130,961</u>	<u>\$ -</u>	<u>\$ (499,820)</u>	<u>\$ 26,631,141</u>	<u>\$ 528,186</u>

A description of the long-term liabilities related to governmental activities at June 30, 2011, follows:

A. Governmental Activities

There is no governmental long-term debt payable to external parties.

B. Business-Type Activities

California State Resources Control Board

On August 8, 2005, the District entered into an agreement with the California State Resources Control Board to finance the construction of the wastewater treatment project. The initial award of the contract amounted to \$134,761,390; however, principal amounts received to the point when the project was stopped totaled only \$6,486,144. This is the amount that is reflected in the financial statements of June 30, 2011. Installment payments, together with all interest accruing thereon, were to be repaid in annual installments at a rate of 2.3%. Interest on this loan is not accrued in the books due to the uncertainty with the bankruptcy proceedings. Total interest to June 30, 2011 would be \$745,906.

The rights and obligations of the parties relating to the California State Resources Control Board loan have been the subject of litigations between the District and the State. The State filed a demand for immediate repayment of the loan and accrued interest plus a \$2 million grant after the stoppage of the project thus making the loan due and payable. Repayment by the District as per demand is not feasible given its financial status. These claims were submitted to the bankruptcy court in FY 2009/10. The State agreed to settle this liability without cash outflow by the District if certain conditions are fulfilled. These conditions and their current status are discussed in the Introductory Section, Impact on Liabilities.

NOTE 6 – LONG-TERM LIABILITIES (Continued)

B. Business-Type Activities (Continued)

California State Resources Control Board (Continued)

On April 1, 2008, the Bankruptcy Court approved an agreement between the District and the County to restrict the use of any remaining loan proceeds limiting its use only for those authorized in a confirmed plan of adjustment in the District's Chapter 9 bankruptcy proceedings or otherwise agreed to by the County and the District. At the time of the agreement, the balance was \$2,141,973. As of June 30, 2011, the remaining balance is \$1,583,548. The County has authorized the use of these funds for legal expenses and other professional services relating to the bankruptcy proceedings and up to \$10,000 a month for legal representation in behalf of the Official Committee of Unsecured Creditors.

Wastewater Improvement Bonds

On November 7, 2002, the District issued \$17,990,000 of limited obligation improvement bonds to (i) finance the construction of a wastewater collection, treatment and disposal facility referred to as the "Wastewater Project" benefiting properties located within the District's boundaries and is referred to as the District's Wastewater Assessment District No. 1 (the "Assessment District"), (ii) to fund a reserve fund for the bonds, (iii) to fund capitalized interest on the bonds until September 2, 2003, and (iv) to pay costs of issuing the bonds. The bonds were issued at a discount of \$4,091 and issuance costs were \$782,707. Principal is payable on September 2 each year through September 2033, beginning in 2004. Interest on the bonds is payable on September 2 and March 2 of each year through September 2033, beginning March 2, 2003. Interest rates on the bond vary between 1.8 and 4.0 percent. The bonds are secured by assessments against the properties within the Assessment District and are further secured by the monies in the Redemption Fund and the Reserve Fund created pursuant to the assessment proceedings. The outstanding principal balance of the bonds at June 30, 2011, was \$15,605,000.

Deferred issuance cost on this loan has a balance of \$553,682 as of June 30, 2011. This is amortized over the life of the bonds at a rate of \$25,954 per annum.

California Infrastructure and Economic Development Bank

On December 6, 2004, the District entered into a loan agreement with the California Infrastructure and Economic Development Bank (CIEDB) for a principal amount of \$5 million for the purpose of constructing and upgrading water delivery facilities. The loan is for a term of thirty years ending in August 2034 with an interest rate of 3.05% per annum. Annual payments average \$278,000 per year including interest. Debt service payments are due in August and February each year. Water revenues were pledged to guarantee the loan. All projects covered by the loan were completed and closed out in January 2009. The outstanding principal balance of the loan at June 30, 2011, was \$4,516,021.

Deferred issuance cost on this loan has a balance of \$33,374 as of June 30, 2011, which is amortized over the life of the bonds at a rate of \$1,441 per year.

Business-Type Long-Term Liabilities Amortization Schedules Follow:

California State Resources Control Board			
For the Year Ending June 30	Principal	Interest * Rate = 2.3%	Total
2011	\$ 6,486,144	\$ -	\$ 6,486,144
Total	\$ 6,486,144	\$ -	\$ 6,486,144

* Interest related to the California State Resources Control Board loan is not accrued due to the uncertainty with the bankruptcy proceedings. Total interest to June 30, 2011, would be \$745,906.

NOTE 6 – LONG-TERM LIABILITIES (Continued)**B. Business-Type Activities** (Continued)

Business-Type Long-Term Liabilities Amortization Schedules Follow: (Continued)

Wastewater Improvement Bonds			
For the Year Ending June 30	Principal	Interest	Total
2012	\$ 385,000	\$ 764,315	\$ 1,149,315
2013	400,000	749,000	1,149,000
2014	415,000	730,625	1,145,625
2015	435,000	709,375	1,144,375
2016	455,000	687,125	1,142,125
2017-2021	2,655,000	3,059,875	5,714,875
2022-2026	3,390,000	2,307,500	5,697,500
2027-2031	4,320,000	1,348,750	5,668,750
2032-2035	3,150,000	241,250	3,391,250
Total	<u>\$ 15,605,000</u>	<u>\$ 10,597,815</u>	<u>\$ 26,202,815</u>

California Infrastructure and Economic Development Bank				
For the Year Ending June 30	Principal	Interest	Annual Administrative Fee	Total
2012	\$ 130,359	\$ 135,751	\$ 13,548	\$ 279,658
2013	134,335	131,714	13,157	279,206
2014	138,432	127,554	12,754	278,740
2015	142,654	123,268	12,339	278,261
2016	147,005	118,851	11,911	277,767
2017-2021	805,080	523,131	52,663	1,380,874
2022-2026	935,576	390,645	39,827	1,366,048
2027-2031	1,087,224	236,684	24,911	1,348,819
2032-2035	995,355	61,856	7,577	1,064,788
Total	<u>\$ 4,516,020</u>	<u>\$ 1,849,454</u>	<u>\$ 188,687</u>	<u>\$ 6,554,161</u>

NOTE 7 – OPERATING LEASES

The District has commitments to lease certain office equipment and facilities. The District leases its administrative facilities for \$2,000 a month. The lease was extended by one year to April 30, 2012, under the same terms. The District leases a copier at \$454 a month. This lease expires in September 2012.

NOTE 8 – EMPLOYEE RETIREMENT BENEFITS

Defined Benefit Pension Plan

Plan Description

The 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 the participating public entities within the State of California. Member agencies total over 3,000, representing about 1.6 million public sector employees.

Funding Policy

Participants are required to contribute 7 percent of their annual covered salary. The District is required to contribute an actuarially determined rate calculated as a percentage of covered payroll. The employer contribution rate for the fiscal year ended June 30, 2011, was 10.923 percent. Benefit provisions and all other requirements are established by State statute and District contracts with employee bargaining groups.

Annual Pension Cost

For the fiscal year ended June 30, 2011, the District paid to CALPERS a total of \$82,250 for its regular contribution of the pension cost for miscellaneous employees. This is over the projected contribution used by CALPERS in its actuarial calculations below partly due to increase in covered payroll with new employees. Required contributions rates are projected by CALPERS using actuarial valuations done two fiscal years before the effective date. Hence for the fiscal year 2010-11, the contribution rate of 10.923% percent was projected using actuarial valuation done at June 30, 2008. For the ensuing fiscal year 2011-12, the contribution rate was computed using actuarial valuation as of June 30, 2009. The rate for 2011-12 increased to 11.978%.

The assumptions used to determine required contributions in 2010-11 remained the same as in the prior year. The actuarial assumptions included (a) 7.75% investment rate of return (net of administrative expenses), (b) projected annual salary increases from 3.25% to 14.45% depending on age, service, and type of employment, (c) 3.0% inflation rate, and (d) 3.25% payroll growth. 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 four-year period (smoothed market value). The CALPERS unfunded actuarial accrued liability is being amortized as a level percentage of projected payroll on a closed basis. CALPERS has combined the prior service unfunded liability and current service unfunded liability into a single initial unfunded liability.

Three-Year Trend Information for CALPERS

<u>Fiscal Year</u>	<u>Annual Pension Cost (APC)</u>	<u>Percentage of APC Contributed</u>	<u>Net Pension Obligation</u>
2009	\$ 83,595	100%	\$ -
2010	\$ 77,628	100%	\$ -
2011	\$ 78,166	100%	\$ -

NOTE 8 – EMPLOYEE RETIREMENT BENEFITS (Continued)

Schedule of Funding Progress for CALPERS
Risk Pool of Small Employers (with active employees less than 100)

Actuarial Valuation Date	Accrued Liabilities (AL)	Actuarial Value of Assets (AVA)	Unfunded Liabilities (UL)	Funded Ratio	Annual Covered Payroll	UL* % of Covered Payroll
6/30/07**	\$ 2,611,746,790	\$ 2,391,434,447	\$ 220,312,343	91.6%	\$ 665,522,859	33.1%
6/30/08**	\$ 2,780,280,768	\$ 2,547,323,278	\$ 232,957,490	91.6%	\$ 688,606,681	33.8%
6/30/09**	\$ 3,104,798,222	\$ 2,758,511,101	\$ 346,287,121	88.9%	\$ 742,981,488	46.6%

* UL - Unfunded liability

** A State Law authorized the creation of risk pools by CALPERS which was implemented on June 30, 2006. This required mandatory participation of small employers to help reduce large fluctuations in their contribution rates. As an employer with less than 100 active members, the District is now required to participate in the risk pool. Under this pooling method, assets and liabilities of the participant employers are aggregated. As such, retirement data is no longer available for an individual employer.

Other Post Employment Benefits (OPEB)

Other post employment benefits pertains to the share of the District of the medical premium as required in the agreement with the CALPERS to provide health benefits to active and retired employees. Currently, the required employer's share is \$108 per month.

GASB Statement No. 45, a statement issued by the Governmental Accounting Standards Board that mainly directs governmental accounting standards and practices, required that the employer's liability for these benefits be estimated, recorded, or disclosed. The implementation was phased out starting in fiscal year 2007-08 depending on the number of active and retired employees, with the smallest governments implementing it in fiscal year 2009-10.

For the District, this liability was estimated using the Alternative Measurement Method which essentially avoids the hiring of an actuary to do the computation. This liability as of June 30, 2011, is estimated to be \$26,000. This estimate is based on certain assumptions and employee demographics that may only be pertinent to the District's situation. One key assumption that was done was that only twenty five percent (30%) of the District's retirees will use the CALPERS supplemental medical program after becoming Medicare eligible. The reason for this is the premium for the supplemental program may be beyond the financial reach of most retirees who may therefore opt to use Medicare's medical plan that does not require a supplemental premium. If this assumption is not done, the full liability would be \$60,000. Changes in Medicare health benefit rules will change this assumption and will then correspondingly change the computation of this liability.

Funding

Ideally this OPEB liability is funded annually and invested separately from other District funds or even transferred to a trust manager that will be responsible for investing and paying out these funds. The total unfunded may be amortized for funding over a number of years. Currently, there is only one retiree who is currently covered by this benefit so, for now, the pay-as-you-go method is used and does not materially impact current year resources. Over time however, as more employees retire, this method may not be the best option. The liability increased by \$1,000 from the prior year bringing estimated total liability to \$26,000. Of this, the cumulative annual required contribution (ARC) is \$3,750. The difference of \$22,250 is amortized over fifteen years to be included in the ARC each year. The cumulative ARC of \$3,750 is shown in the Statement of Net Assets as of June 30, 2011.

NOTE 9 – NET ASSETS/FUND BALANCES

NET ASSETS

The government-wide and business-type activities fund financial statements utilize a net assets presentation. Net assets are categorized as invested capital assets (net of related debt), restricted, and unrestricted.

Investment in Capital Assets, Net of Related Debt – This category groups all capital assets, including infrastructure, into one component of net assets.

Net assets invested in capital assets, net of related debt as of June 30, 2011, are as follows:

	<u>Amount</u>
Governmental activities	\$ 467,934
Business-type activities	<u>9,211,866</u>
	<u>\$ 9,679,800</u>

Restricted Net Assets – This category presents external restrictions imposed by creditors, grantors, contributors, or laws or regulations of other governments and restrictions imposed by law through constitutional provisions or enabling legislation.

Restricted Net Assets at June 30, 2011, are as follows:

Governmental activities	
Public Facilities Fees	\$ 50,336
Assessments for a pool	<u>301,977</u>
	<u>352,313</u>
Business-type activities	
Restricted for 2002 Bond Payable	1,413,140
Legally restricted	<u>1,583,548</u>
	<u>2,996,688</u>
Total Restricted Net Assets	<u>\$ 3,349,001</u>

Unrestricted net assets – This category represents net assets of the District, not restricted as described above in Restricted Net Assets. Included in this category are reserves and designations approved by the Board of Directors for specific purposes as follows. In the fund financials, governmental equity accounts are classified according to GASB Statement No. 54. This statement is discussed in Note 1-B. In the Statement of Net Assets, *the Unrestricted Net Assets* are comprised of the following:

	<u>Amount</u>
<u>Governmental Activities:</u>	
Designation for fire capital outlay and capital replacement	\$ 859,329
Designation for fire contingencies	27,575
Designation for drainage capital outlay	69,140
Designation for drainage contingencies	17,076
Committed for outstanding purchase agreements	9,013
Committed for technology upgrade	<u>20,000</u>
Total designations - governmental activities	1,002,133
Undesignated (Deficit)	<u>(381,081)</u>
Total - governmental activities	<u>\$ 621,052</u>

NOTE 9 – NET ASSETS/FUND BALANCES (Continued)

Business-Type Activities:

Designation for water capital outlay and capital replacement	\$ 300,161
Designation for water quality remediation and enhancement	126,222
Designation for water contingencies	97,774
Designation for water debt repayment to the State	280,983
Designation for water rate stabilization	64,185
Designation for solid waste contingencies	162,654
Committed for outstanding purchase agreements	<u>14,825</u>
Total designations - business-type activities	1,046,804
Undesignated	<u>933,089</u>
Total - business-type activities	<u>\$ 1,979,893</u>

Fund Balances of Governmental Funds in the Fund Financials

Equity accounts used for governmental funds in the fund financial statements are presented differently from the Statement of Net Assets as described above. The presentation follows statements of the Governmental Accounting Standards Board (GASB). Presentation has changed several times in the past with the latest change effective in fiscal year 2010/11. This change is implemented according to GASB Statement No. 54. This statement categorizes governmental equities mainly based on the constraints and source of the constraints placed on the funds. The District has adopted a resolution affirming its compliance with GASB Statement No. 54 and also affirming that the Board of Directors alone can create, change and dispose of RESTRICTED AND COMMITTED fund balances.

In summary, the following are the fund balance categories under this statement:

NONSPENDABLE	Resources are not in spendable form or are legally required to remain intact.
RESTRICTED	The constraint to spend the funds are imposed or legally enforced by external parties.
COMMITTED	Constraint is created by and can only be changed by the the legislative body pursuant to a formal action.
ASSIGNED	The constraint is a merely an expression of intent by the the legislative body or by an authorized official.
UNASSIGNED	No constraints

NOTE 9 – NET ASSETS/FUND BALANCES (Continued)

As of June 30, 2011, the following fund balances are presented in the fund financial statements:

	General Fund 100	Fire Fund 301	Total Non-Major Funds	Total Fund Balances
Nonspendable				
Petty cash	\$ 300	\$ 400	\$ -	\$ 700
Prepayments	609	4,068	-	4,677
Deposits	3,000	-	-	3,000
Total nonspendable fund balance	3,909	4,468	-	8,377
Restricted				
Public facilities fees	-	50,336	-	50,336
Assessments held for a pool	-	-	301,977	301,977
Balance restricted for the fund's purpose	-	736,971	424,397	1,161,368
Total restricted fund balance	-	787,307	726,374	1,513,681
Committed to:				
Encumbrances	9,013	7,168	-	16,181
Vehicle and equipment replacement	-	591,784	-	591,784
Other capital outlay	-	267,546	69,140	336,686
Total committed fund balance	9,013	866,498	69,140	944,651
Assigned				
Used to fund budget in subsequent year	-	-	14,195	14,195
Fund reservation for technology	20,000	-	-	20,000
Designation for contingency	-	27,575	17,076	44,651
Total assigned fund balance	20,000	27,575	31,271	78,846
Unassigned fund balance	(1,548,048)	-	-	(1,548,048)
Total fund balances	<u>\$1,515,126</u>	<u>\$ 1,685,848</u>	<u>\$ 826,785</u>	<u>\$ 997,507</u>

NOTE 9 – NET ASSETS/FUND BALANCES (Continued)

Details of non-major funds as presented above are as follows:

	Bayridge 200	Vista de Oro 400	Drainage 800	Parks and Recreation 900	Total Non-Major
Nonspendable					
Petty cash	\$ -	\$ -	\$ -	\$ -	\$ -
Prepayments	-	-	-	-	-
Deposits	-	-	-	-	-
Total nonspendable fund balance	-	-	-	-	-
Restricted					
Public facilities fees	-	-	-	-	-
Assessments held for a pool	-	-	-	301,977	301,977
Balance restricted for the fund's purpose	13,474	23,693	387,021	209	424,397
Total restricted fund balance	13,474	23,693	387,021	302,186	726,374
Committed to:					
Encumbrances	-	-	-	-	-
Vehicle and equipment replacement	-	-	-	-	-
Other capital outlay	-	-	69,140	-	69,140
Total committed fund balance	-	-	69,140	-	69,140
Assigned					
Used to fund budget in subsequent year	6,295	7,900	-	-	14,195
Fund reservation for technology	-	-	-	-	-
Designation for contingency	-	-	17,076	-	17,076
Total assigned fund balance	6,295	7,900	17,076	-	31,271
Unassigned fund balance	-	-	-	-	-
Total fund balances	\$ 19,769	\$ 31,593	\$ 473,237	\$ 302,186	\$ 826,785

NOTE 10 – RISK MANAGEMENT

The District is exposed to various risks of loss related to torts, property loss and damage, errors and omissions, and employee injury. The District carries various commercial policies with private corporations to cover property damage, third party liabilities, and professional liabilities. In the subsequent year, the District switched to Special District Risk Management Authority (SDRMA) for these coverages essentially making this agency the only carrier the District uses in the FY 2011/12. For the FY 2011/12 however, the District had to obtain "tail-end" coverages from the former providers for specific risks covered under the old policies.

As in prior years, the coverage for the workers' compensation for fiscal year 2010/11 was obtained from SDRMA. This agency is a Joint Powers Authority (JPA) consisting of special districts in the State of California. It is governed by a seven-member Board of Directors. All seven are elected at large from the membership to serve four year terms.

The SDRMA is self-insured up to \$350,000 per workers' compensation claim and carries an excess insurance coverage in excess of the self-insured limit. It provides a maximum coverage to the District of \$5 million for workers compensation liability.

Should there be excess losses not covered by an insurer, the District shall accrue the loss, if probable and can be reasonably estimated. As of June 30, 2011, the District has no uninsured occurrences related to uninsured losses and has never incurred any uninsured losses since its inception.

NOTE 11 – CONTINGENCIES AND COMMITMENTS

Bankruptcy Case Litigation and Going Concern

The history of the bankruptcy case is discussed in the Introductory Section. The current status of the case is reprised here.

Current Status of the Bankruptcy Filing

On August 8, 2011, the Bankruptcy Court entered an Order Confirming the LOCSD Debt Adjustment Plan (the “Plan”). The Plan as confirmed resolved all the claims under the jurisdiction of the Bankruptcy Court which included approximately \$11.4 million in unsecured creditor claims. The confirmed Plan provided approximately \$4.5 million to satisfy the claims of the unsecured creditors. The sources of these funds are:

- The remaining State Revolving Fund Loan related to the prior Wastewater Project (approximately \$1.7 million as of September 10, 2010, the filing date of the Debt Adjustment Plan). As of June 30, 2011, it had a balance of \$1,584,000; and
- \$2.8 million from San Luis Obispo County resulting from the proposed transfer of the Solid Waste Franchise Agreement to them.

On August 22, 2011, Monterey Mechanical, a bankruptcy creditor, filed a Notice of Appeal challenging the Court Order confirming the Plan. A Hearing date has not been established for the Appeal. District Counsel estimates the Appeal process will take between 18 and 24 months.

Going Concern Issue

Until the bankruptcy case is totally resolved, there are doubts as to the financial stability of the District to continue as a going concern. In the meantime, the sewer system project that was the cause of all the legal and financial issues the District is now facing is progressing under the County’s independent management which was directed by special legislation, AB 2701. It is estimated that the project will be completed in three years.

Commitment to Pay into the 2002 Bond Reserve

On September 2, 2006, the District prematurely used \$714,268 of bond reserves in order to complete the debt service payment due on that date. These reserves are required to be replenished within one year unless an extended payback schedule was negotiated. The District has committed to pay at least \$25,000 per year. This amount plus any investment income earned by all funds held by bond trustee will be used to bring the reserve account to its required level of \$1,158,523. As of June 30, 2011, \$485,000 is still needed to restore the reserve to its required level.

Other Commitments

Note 6 summarizes long-term debts. Two debts, including the 2002 Wastewater Improvement Bond and one due the State for Water Infrastructure upgrades, are current and are secured by specific sources. These sources are considered safe and stable and are not affected by the District’s bankruptcy case. The other debt due to the State of \$6,486,144 has been settled under three conditions requiring no cash outflow with the only unfulfilled condition tied to the final resolution of the appeal of the favorable decision of the Bankruptcy Court confirming the District’s Debt Adjustment Plan. (See Introductory Section for discussion of the bankruptcy case and its current status.)

Loss of Revenue Source and Possible Closure of a Fund

The District may lose its Franchise Fee revenue which averages at least \$155,000 annually to the County. This is due to an agreement with the County that in return for them contributing \$2.8 million to the District’s Debt Adjustment Plan, the District gives up its Solid Waste function to them. A clarification of the relationship with regard to this transaction has to still be established. A permanent loss of this revenue source may lead to the closure of the Solid Waste Fund. There are no documents that have been drawn to support a debtor/creditor relationship although discussions to this effect have been initiated.

NOTE 12 – SUBSEQUENT EVENTS

On August 8, 2011, the Bankruptcy Court confirmed the District's Debt Administration Plan. A creditor appealed this decision on August 22, 2011. The appeal process may take up to two years to be resolved.

The sewer system project is now on track to be completed in about three years under the independent management of the County. In October 2011, the County submitted the first request for assets to be transferred to them for use in their successor sewer project as authorized under AB 2701. The transfer allowed under the legislation is for those assets the District acquired under the original project and will not involve any cash exchange. These assets requested for transfer consist mainly of parcels of land and easements and do not include any infrastructures. It is expected that the transfer request will be finalized in November 2011.

REQUIRED SUPPLEMENTARY INFORMATION

**LOS OSOS COMMUNITY SERVICES DISTRICT
SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES
IN FUND BALANCES – BUDGET AND ACTUAL
GENERAL FUND – 100
FOR THE YEAR ENDED JUNE 30, 2011**

	Original Budget	Final Budget	Actual Amounts	Variance with Final Budget
REVENUES				
Investment income	\$ -	\$ -	\$ -	\$ -
Other revenues	-	-	43	43
Total Revenues	-	-	43	43
EXPENDITURES				
Salaries and wages	300,883	300,883	297,000	3,883
Payroll taxes and benefits	105,277	105,277	88,938	16,339
Bank charges contract services	-	-	-	-
Contract services	36,000	36,000	35,661	339
Insurance	30,200	30,200	27,032	3,168
License and fees	16,500	16,500	18,388	(1,888)
Maintenance and repairs	16,440	12,338	13,410	(1,072)
Meals and entertainment	1,000	1,000	669	331
Office support, publication, and dues	17,610	31,552	27,405	4,147
Tools and supplies	500	500	540	(40)
Rent	21,880	21,880	19,646	2,234
Professional services	148,800	148,800	123,530	25,270
Telephone and communications	5,500	5,500	3,896	1,604
Employee travel and training	13,400	13,400	8,554	4,846
Utilities	3,800	3,800	2,225	1,575
Director fees	17,000	12,457	10,375	2,082
Other expenses	10,200	10,200	10,434	(234)
Other outgo - cost allocation to other funds	(702,035)	(702,035)	(702,036)	1
Total Expenditures	42,955	48,252	(14,333)	62,585
Excess (deficiency) of revenues over (under) expenditures	(42,955)	(48,252)	14,376	62,628
OTHER FINANCING SOURCES (USES)				
Transfers in	-	-	42,600	42,600
Transfers out	-	-	(25,000)	(25,000)
Total other financing sources (uses)	-	-	17,600	17,600
Net change in fund balance	(42,955)	(48,252)	31,976	80,228
Fund balance (deficit) - July 1, 2010, as previously reported	(1,547,102)	(1,547,102)	(1,547,102)	-
Prior period adjustment (Note 14)	-	-	-	-
Fund balance (deficit) - July 1, 2010, as restated	(1,547,102)	(1,547,102)	(1,547,102)	-
Fund balance (deficit) - June 30, 2011	<u>\$ (1,590,057)</u>	<u>\$ (1,595,354)</u>	<u>\$ (1,515,126)</u>	<u>\$ 80,228</u>

**LOS OSOS COMMUNITY SERVICES DISTRICT
SCHEDULE OF REVENUES, EXPENDITURES AND CHANGES
IN FUND BALANCES – BUDGET AND ACTUAL
FIRE FUND – 301
FOR THE YEAR ENDED JUNE 30, 2011**

	Original Budget	Final Budget	Actual Amounts	Variance with Final Budget
<u>REVENUES</u>				
Property taxes	\$ 1,582,500	\$ 1,582,500	\$ 1,576,565	\$ (5,935)
Special taxes and assessments	469,209	469,209	469,428	219
Public services fees	62,111	62,111	62,530	419
Intergovernmental	19,000	19,000	5,503	(13,497)
Investment income	-	-	7,160	7,160
Other revenues	22,500	22,500	27,022	4,522
Total Revenues	2,155,320	2,155,320	2,148,208	(7,112)
<u>EXPENDITURES</u>				
Salaries and wages	121,050	121,050	91,862	29,188
Payroll taxes and benefits	32,431	32,431	17,501	14,930
Contract services	1,548,940	1,548,940	1,548,940	-
Insurance	20,000	20,000	18,967	1,033
License and fees	23,100	23,100	22,986	114
Maintenance and repairs	15,160	15,160	6,595	8,565
Meals and entertainment	1,310	1,310	292	1,018
Office support, publication, and dues	19,150	19,150	10,433	8,717
Tools and supplies	37,560	60,212	55,718	4,494
Professional services	1,300	1,300	-	1,300
Telephone and communications	11,870	11,870	5,381	6,489
Employee travel and training	7,150	7,150	1,481	5,669
Utilities	10,813	10,813	7,780	3,033
Other expenses	3,500	3,500	4,224	(724)
Capital outlay	57,224	151,821	130,604	21,217
Other outgo - cost allocation from other funds	103,262	103,262	110,496	(7,234)
Debt service:				
Principal	23,451	23,451	22,581	870
Interest and fiscal charges	-	-	870	(870)
Total Expenditures	2,037,271	2,154,520	2,056,711	97,809
Excess (deficiency) of revenues over (under) expenditures	118,049	800	91,497	90,697
<u>OTHER FINANCING SOURCES (USES)</u>				
Transfers in	-	-	-	-
Total other financing sources (uses)	-	-	-	-
Net change in fund balance	118,049	800	91,497	90,697
Fund balance - July 1, 2010	1,411,642	1,594,351	1,594,351	-
Fund balance - June 30, 2011	\$ 1,529,691	\$ 1,595,151	\$ 1,685,848	\$ 90,697

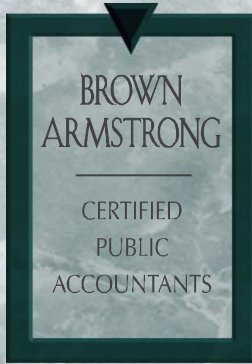
SUPPLEMENTARY INFORMATION

**LOS OSOS COMMUNITY SERVICES DISTRICT
COMBINING BALANCE SHEETS
NON-MAJOR GOVERNMENTAL FUNDS
JUNE 30, 2011**

	Bayridge 200	Vista de Oro 400	Drainage 800	Parks and Recreation 900	Total Non-Major Governmental Funds
<u>ASSETS</u>					
Cash and cash equivalents	\$ 20,254	\$ 31,802	\$ 470,865	\$ 209	\$ 523,130
Restricted cash	-	-	-	301,621	301,621
Accrued revenues receivable	647	109	2,903	356	4,015
Total Assets	\$ 20,901	\$ 31,911	\$ 473,768	\$ 302,186	\$ 828,766
<u>LIABILITIES AND FUND BALANCES</u>					
LIABILITIES					
Accounts payable	\$ 1,132	\$ 318	\$ 518	\$ -	\$ 1,968
Accrued expenditures	-	-	13	-	13
Total Liabilities	1,132	318	531	-	1,981
FUND BALANCES (DEFICITS)					
Nonspendable	-	-	-	-	-
Restricted	13,474	23,693	387,021	302,186	726,374
Committed	-	-	69,140	-	69,140
Assigned	6,295	7,900	17,076	-	31,271
Unassigned	-	-	-	-	-
Total Fund Balances (Deficits)	19,769	31,593	473,237	302,186	826,785
Total Liabilities and Fund Balances	\$ 20,901	\$ 31,911	\$ 473,768	\$ 302,186	\$ 828,766

**LOS OSOS COMMUNITY SERVICES DISTRICT
COMBINING STATEMENTS OF REVENUES, EXPENDITURES,
AND CHANGES IN FUND BALANCES
NON-MAJOR GOVERNMENTAL FUNDS
FOR THE YEAR ENDED JUNE 30, 2011**

	Bayridge 200	Vista de Oro 400	Drainage 800	Parks and Recreation 900	Total Non-Major Governmental Funds
REVENUES					
Property taxes	\$ 6,688	\$ -	\$ 3,466	\$ -	\$ 10,154
Service charges and fees	29,547	15,768	95,445	-	140,760
Investment income	28	37	776	1,467	2,308
Other revenues	-	-	56	-	56
Total Revenues	36,263	15,805	99,743	1,467	153,278
EXPENDITURES					
Salaries and wages	6,931	4,712	10,096	-	21,739
Payroll taxes and benefits	2,710	1,842	3,797	-	8,349
Contract services	2,490	328	883	-	3,701
License and fees	866	631	5,868	-	7,365
Maintenance and repairs	20,016	9,412	1,611	-	31,039
Office supplies, publication, and dues	-	-	30	-	30
Supplies	537	269	2,249	-	3,055
Telephone and communications	154	154	926	-	1,234
Employee travel and training	-	-	354	-	354
Utilities	6,472	1,806	892	-	9,170
Other expenses	-	-	71	-	71
Capital outlay	-	-	6,075	-	6,075
Other outgo - cost allocation from other funds	9,948	4,332	28,740	-	43,020
Total Expenditures	50,124	23,486	61,592	-	135,202
Excess (deficiency) of revenues over (under) expenditures	(13,861)	(7,681)	38,151	1,467	18,076
OTHER FINANCING SOURCES (USES)					
Transfers in	-	-	-	-	-
Transfers out	-	-	-	-	-
Total other financing sources (uses)	-	-	-	-	-
Net change in fund balance	(13,861)	(7,681)	38,151	1,467	18,076
Fund balances - July 1, 2010, as previously reported	33,630	39,274	435,086	300,719	808,709
Prior period adjustment (Note 14)	-	-	-	-	-
Fund balances (deficit) - July 1, 2010, as restated	33,630	39,274	435,086	300,719	808,709
Fund balances (deficit) - June 30, 2011	<u>\$ 19,769</u>	<u>\$ 31,593</u>	<u>\$ 473,237</u>	<u>\$ 302,186</u>	<u>\$ 826,785</u>



BROWN ARMSTRONG

Certified Public Accountants

INDEPENDENT AUDITOR’S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

To the Board of Directors of
Los Osos Community Services District
Los Osos, California

MAIN OFFICE

4200 TRUXTUN AVENUE

SUITE 300
BAK RSFIELD, CA 93309
TEL 661.324.4971
FAX 661.324.4997
EMAIL info@bacpas.com

560 CENTRAL AVENUE

SHAFTER, CALIFORNIA 93263
TEL 661.746.2145
FAX 661.746.1218

8050 N. PALM AVENUE

SUITE 300
FRESNO, CALIFORNIA 93711
TEL 559.476.3592
FAX 559.476.3593

790 E. COLORADO BLVD.

SUITE 908B
PASADENA, CALIFORNIA 91101
TEL 626.240.0920
FAX 626.240.0922

We have audited the basic financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the Los Osos Community Services District (the District) as of and for the year ended June 30, 2011, which collectively comprise the District’s basic financial statements and have issued our report thereon dated November 22, 2011. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying Schedule of Findings and Recommendations, we identified certain deficiencies in internal control over financial reporting that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies.

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 entity’s financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies 2011-02 and 2011-03 described in the accompanying Schedule of Findings and Recommendations to be material weaknesses.



REGISTERED with the Public Company Accounting Oversight Board and MEMBER of the American Institute of Certified Public Accountants

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. We consider the deficiency 2011-01 described in the accompanying Schedule of Findings and Recommendations to be a significant deficiency.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the District's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, 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 instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* and which are described in the accompanying Schedule of Findings and Recommendations as Findings 2011-01 through 2011-03.

The District's response to the findings identified in our audit is described in the accompanying Schedule of Findings and Recommendations. We did not audit the District's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of management, the Board of Directors, federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

BROWN ARMSTRONG
ACCOUNTANCY CORPORATION



Bakersfield, California
November 22, 2011

**LOS OSOS COMMUNITY SERVICES DISTRICT
SCHEDULE OF FINDINGS AND RECOMMENDATIONS
JUNE 30, 2011**

FINANCIAL STATEMENT FINDINGS

Finding 2011-01 – Cash Deficit in the General Fund

Condition

The overdraft in the General Fund should be made good by transferring from other funds. Not doing so makes it difficult for all funds to move forward since as a whole, the District only has so much cash.

Recommendation

Adjustments should be done to bring cash balances for all funds to a positive balance.

Management Response

Management agrees with the finding since the cash deficit has lingered on for more than five years. On November 14, 2011, the Board's Financial Advisory Committee recommended a solution to this issue which essentially will require transfers from other funds to the General Fund. The Board will take the formal action to adopt the solution on December 1, 2011.

Finding 2011-02 – Adjust and Reconcile Capital Assets Values to Results of Physical Inventory for Funds other than the Wastewater Project Fund

Condition

Physical inventory for capital assets has just been completed for all funds other than the Wastewater Project Fund. However, the value of capital assets showing in the books has not been reconciled to the result of physical inventory.

Recommendation

The inventory list has to be valued and agreed to the values carried in the books. Adjustments, if any, will then be brought to the Board of Directors for approval.

Management Response

The Water Fund physical inventory has recently been completed. The reconciliation process will soon be undertaken.

Finding 2011-03 – The Construction in Progress (CIP) in the Wastewater Fund of About \$22 Million has to be Either Written Off or Capitalized to any Specific Assets.

Condition

The CIP of \$22 million has been in the books for as long as five years after it has been determined that the Wastewater Project will no longer go forward.

Recommendation

Any specific assets that may have been constructed should be capitalized, if any, or written off if no assets exists. A value to the District has to be assessed as to whether any can be sold or used by the District in its operations in the future.

**OSOS COMMUNITY SERVICES DISTRICT
SCHEDULE OF FINDINGS AND RECOMMENDATIONS (Continued)
JUNE 30, 2011**

Management Response

Management agrees with the recommendation. An item has been submitted to write off the value but action was deferred until the County completes the process of requesting all assets it may need for their successor project as directed by AB 2701.

**LOS OSOS COMMUNITY SERVICES DISTRICT
STATUS OF PRIOR YEAR AUDIT FINDINGS
JUNE 30, 2011**

FINANCIAL STATEMENT FINDINGS

Finding 2010-01 – Cash Deficit in the General Fund

Condition

The overdraft in the General Fund should be made good by transferring from other funds. Not doing so makes it difficult for all funds to move forward since as a whole, the District only has so much cash.

Recommendation

Adjustments should be done to bring cash balances for all funds to a positive balance.

Management Response

Management agrees with the finding since the cash deficit has lingered on for so long starting in FY 2003-04.

Current Year Status

Discussions are ongoing.

Finding 2010-02 – Adjust and Reconcile Capital Assets Values to Results of Physical Inventory

Condition

Physical inventory for capital assets has been taken for all funds. However, the value of capital assets has not been reconciled to the result of physical inventory.

Recommendation

The inventory list has to be valued and agreed to the values carried in the books. Adjustments, if any, will then be brought to the Board of Directors for approval.

Management Response

This should be done by the FY 2010-11 audit.

Current Year Status

The reconciliation process is taking longer because it has never been done for all the years the District existed.