

EMERALD BAY SERVICE DISTRICT

Annual Financial Report

For the Year Ended June 30, 2011

MGC Certified Public Accountants.

EMERALD BAY SERVICE DISTRICT
Annual Financial Report
June 30, 2011

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The Board of Directors
of the Emerald Bay Service District

INDEPENDENT AUDITOR'S REPORT

We have audited the accompanying financial statements of the governmental activities and the major fund of the Emerald Bay Service District (District) as of and for the year ended June 30, 2011, which collectively comprise the District's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the District's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit 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 opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities and the major fund of the District as of June 30, 2011, and the respective changes in financial position thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1(d) 4. to the basic financial statements, effective July 1, 2010, the District adopted the provisions of Governmental Accounting Standards Board (GASB) Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*.

Management has omitted the management's discussion and analysis that accounting principles generally accepted in the United States of America require to be presented to supplement the basic financial statements. Such missing information, although not a part of the basic financial statements, is required by the GASB, 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. Our opinion on the basic financial statements is not affected by this missing information.

Accounting principles generally accepted in the United States of America require that the budgetary comparison schedule on page 21 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the GASB, 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.

Macias Jini & O'Connell LLP

Newport Beach, California
December 6, 2011

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EMERALD BAY SERVICE DISTRICT
Statement of Net Assets
June 30, 2011

	<u>Governmental Activities</u>
Assets:	
Cash and investments	\$ 2,796,325
Taxes receivable	38,364
Interest receivable	20,718
Capital assets, net	<u>3,929,766</u>
Total assets	<u>6,785,173</u>
Liabilities:	
Accounts payable	82,799
Due to Emerald Bay Community Association	<u>34,139</u>
Total liabilities	<u>116,938</u>
Net assets:	
Invested in capital assets	3,929,766
Unrestricted	<u>2,738,469</u>
Total net assets	<u><u>\$ 6,668,235</u></u>

See Accompanying Notes to Basic Financial Statements.

EMERALD BAY SERVICE DISTRICT
Statement of Activities
For the Year Ended June 30, 2011

<u>Functions/Programs</u>	<u>Expenses</u>	<u>Net (Expenses) and Changes in Net Assets</u>
Governmental activities:		
General government	\$ 617,768	\$ (617,768)
Public services	438,695	(438,695)
Recreation and safety	157,120	(157,120)
Total governmental activities	\$ 1,213,583	(1,213,583)
General revenues:		
Property taxes		1,674,826
Investment income		20,512
Miscellaneous		15,930
Total general revenues		1,711,268
Change in net assets		497,685
Net assets - beginning of year		6,170,550
Net assets - end of year		\$ 6,668,235

See Accompanying Notes to Basic Financial Statements.

EMERALD BAY SERVICE DISTRICT
Balance Sheet
Governmental Fund
June 30, 2011

	<u>General</u>
Assets:	
Cash and investments	\$ 2,796,325
Taxes receivable	38,364
Interest receivable	<u>20,718</u>
Total assets	<u>\$ 2,855,407</u>
Liabilities:	
Accounts payable	\$ 82,799
Due to Emerald Bay Community Association	<u>34,139</u>
Total liabilities	116,938
Fund balance:	
Unassigned	<u>2,738,469</u>
Total liabilities and fund balance	<u>\$ 2,855,407</u>

See Accompanying Notes to Basic Financial Statements.

EMERALD BAY SERVICE DISTRICT
Reconciliation of the Balance Sheet - Governmental Fund
to the Statement of Net Assets
June 30, 2011

Fund balance for governmental fund	\$ 2,738,469
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 the funds.	
Capital assets, net of depreciation	<u>3,929,766</u>
Net assets of governmental activities	<u><u>\$ 6,668,235</u></u>

See Accompanying Notes to Basic Financial Statements.

EMERALD BAY SERVICE DISTRICT
Statement of Revenues, Expenditures and Changes in Fund Balance
Governmental Fund
For the Year Ended June 30, 2011

	General
Revenues:	
Taxes	\$ 1,674,826
Interest earnings	84,565
Net decrease in the fair value of investments	(64,053)
Other	15,930
Total revenues	1,711,268
Expenditures:	
Current:	
General government	617,768
Public services	262,350
Recreation and safety	157,120
Capital outlay	702,444
Total expenditures	1,739,682
Net change in fund balance	(28,414)
Fund balance - beginning of year	2,766,883
Fund balance - end of year	\$ 2,738,469

See Accompanying Notes to Basic Financial Statements.

EMERALD BAY SERVICE DISTRICT
Reconciliation of the Statement of Revenues, Expenditures and
Changes in Fund Balance - Governmental Fund
to the Statement of Activities
For the Year Ended June 30, 2011

Amounts reported for governmental activities in the statement of activities are different because:

Net change in fund balance - governmental fund: \$ (28,414)

Governmental funds report capital outlays as expenditures. However, in the statement of activities, the cost of these assets is allocated over their estimated useful lives and reported as depreciation expense. This is the amount by which capital outlays exceeded depreciation expense in the current period.

Additions to capital assets	\$ 702,444	
Depreciation expense	<u>(176,345)</u>	
		<u>526,099</u>

Change in net assets of governmental activities	<u><u>\$ 497,685</u></u>
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See Accompanying Notes to Basic Financial Statements.

EMERALD BAY SERVICE DISTRICT
Notes to Basic Financial Statements
June 30, 2011

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Reporting Entity

The Emerald Bay Service District (District) was organized on November 20, 1961, under the Community Service District Law, for the purpose of fresh water supply, sewage and storm water collection and disposal, water runoff management, fire protection and community emergency response protection (CERT), public recreation, and police protection to the residents of the Emerald Bay Community, County of Orange, California. The District was authorized by an election held on November 14, 1961, and subsequently approved by a resolution of the Board of Supervisors of Orange County. In February 1969, the power and purpose of this District were amended to include the conversion of existing overhead electric and communication facilities to underground locations.

The District is governed by a five member Board of Directors and officers.

(b) Government-wide and Fund Financial Statements

The government-wide financial statements (i.e., the statement of net assets and the statement of activities) report information on all of the nonfiduciary activities of the primary government.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment is offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function or segment. Program revenues include 1) charges to customers or applicants who purchase, use or directly benefit from goods, services, or privileges provided by a given function or segment and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. Taxes and other items not properly included among program revenues are reported, instead, as general revenues.

Separate financial statements are provided for the governmental fund.

(c) Measurement Focus, Basis of Accounting, and Financial Statement Presentation

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned, and expenses are recorded when the liability is incurred, regardless of the timing of the related cash flows. Property taxes are recognized as revenues in the year for which they are levied. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

EMERALD BAY SERVICE DISTRICT
Notes to Basic Financial Statements (Continued)
June 30, 2011

Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Under this method, revenues are recognized when measurable and available. Revenues are considered to be available when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the District considers revenues to be available if they are collected within 60 days of the end of the current fiscal year. Expenditures are generally recorded when a liability is incurred, as under accrual accounting.

Property taxes and interest associated with the current fiscal period are all considered to be susceptible to accrual and have been recognized as revenues in the current fiscal period. All other revenue items are considered to be measurable and available only when cash is received by the District.

The District reports the following major governmental fund:

The General Fund is the general operating fund of the District. All general tax revenues and other receipts that are not allocated by law or contractual agreement to some other fund are accounted for in this fund. From this fund are paid the general operating expenses not paid through other funds.

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.

(d) Assets, Liabilities, and Net Assets or Equity

1. Capital Assets

Capital assets, which include only infrastructure and equipment, are reported in the applicable governmental activities column in the government-wide financial statements. As a phase 3 government under GASB Statement 34, the District has elected to report only major general infrastructure assets acquired subsequent to June 30, 2003. Such assets are recorded at historical cost, or estimated historical cost, if purchased or constructed. Donated assets are valued at the fair value of the assets on the date on which they were contributed. The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend asset lives are not capitalized. The District utilizes a capitalization threshold of \$5,000. Depreciation is provided using the straight-line method over the estimated useful lives of the asset as follows:

	Years
Infrastructure	15 - 30
Equipment	3 - 5

EMERALD BAY SERVICE DISTRICT
Notes to Basic Financial Statements (Continued)
June 30, 2011

2. *Property Taxes*

Secured property taxes attach as an enforceable lien on real property as of January 1 of each year. Property taxes are levied by the County in September. The first installment of taxes is due on November 1 and becomes delinquent on December 10. The second installment of taxes is due February 1 and becomes delinquent on April 10.

District property taxes are recognized when levied, to the extent that they result in current receivables and are collected within an availability period of 60 days after year end. The District participates in the County of Orange Teeter Plan guaranteed payments. The County of Orange collects an administration fee from the District for its services. The District receives a percentage of the basic 1% ad valorem tax rate allowed on property within the Emerald Bay Service District. Property taxes are remitted to the District from the County of Orange at various times throughout the year. Property taxes are recognized as revenue in the General Fund in the year for which they are levied, in accordance with the modified accrual basis of accounting.

3. *Investments*

Investments are stated at fair value based on quoted market prices (the value at which financial instruments could be exchanged in a current transaction between willing parties, other than in a forced liquidation sale).

4. *Fund Equity*

Effective July 1, 2010, the District implemented GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definition*, to which the District is bound to honor constraints on the specific purposes for which amounts in the funds can be spent. Fund balance for governmental funds is classified as follows:

- Nonspendable – includes amounts that are (a) not in spendable form, or (b) legally or contractually required to be maintained intact. The “not in spendable form” criterion includes items that are not expected to be converted to cash, for example: inventories, prepaid amounts, and long-term notes receivable.
- Restricted – includes amounts that can be spent only for the specific purposes stipulated by external resource providers, constitutionally or through enabling legislation. Restrictions may effectively be changed or lifted only with the consent of resource providers.
- Committed – includes amounts that can only be used for the specific purposes determined by a formal action of the District’s highest level of decision-making authority, the District’s Board of Directors (Board). Commitments may be changed or lifted only by the Board taking the same formal action that imposed the constraint originally (for example: resolution).

EMERALD BAY SERVICE DISTRICT
Notes to Basic Financial Statements (Continued)
June 30, 2011

- Assigned – comprises amounts intended to be used by the Board for specific purposes that are neither restricted nor committed. Intent is expressed by (a) the Board or (b) a body (for example: a budget or finance committee) or official to which the Board has delegated the authority to assign amounts to be used for specific purposes.
- Unassigned – is the residual classification for the General Fund and includes all amounts not contained in the other classifications. Unassigned amounts are technically available for any purpose.

The District does not currently have any nonspendable, restricted, committed or assigned fund balance. In circumstances when an expenditure is made for a purpose for which amounts are available in multiple fund balance classifications, fund balance is depleted in the order of restricted, committed, assigned, and unassigned.

5. *Classification of Net Assets*

On the statement of net assets, net assets are classified into three components which are defined as follows:

- Invested in capital assets, net of related debt - This component of net assets consists of 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. The District does not currently have any debt related to capital assets.
- Restricted net assets - This component of net assets consists of constraints placed on net assets use through external constraints imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments or constraints imposed by law through constitutional provisions or enabling legislation. The District does not currently have any restricted net assets.
- Unrestricted net assets - This component of net assets consists of net assets that do not meet the definition of “restricted” or “invested in capital assets, net of related debt.”

6. *Estimates*

The preparation of financial statements in conformity with generally accepted accounting principles includes the use of estimates that affect the financial statements. Accordingly, actual results could differ from those estimates.

EMERALD BAY SERVICE DISTRICT
Notes to Basic Financial Statements (Continued)
June 30, 2011

(2) DETAILED NOTES ON ALL FUNDS

(a) Cash and Investments

Cash and investments at June 30, 2011, consist of the following:

Deposits with financial institutions	\$ 1,226,802
U.S. Treasury Obligations	<u>1,569,523</u>
Total cash and investments	<u>\$ 2,796,325</u>

Authorized Investments

The table below identifies the investment types that are authorized for the District by the California Government Code. The table also identifies certain provisions of the California Government Code (or the District's investment policy, where more restrictive) that address interest rate risk and concentration of credit risk.

Investment Types Authorized by State Law	Authorized by Investment Policy	*Maximum Maturity	*Maximum Percentage of Portfolio	*Maximum Investment in One Issuer
Local Agency Bonds	No	5 years	None	None
U.S. Treasury Obligations	Yes	5 years	None	None
U.S. Agency Securities	Yes	5 years	None	None
Banker's Acceptances	Yes	180 days	40%	30%
Commercial Paper	Yes	180 days	15%	10%
Negotiable Certificates of Deposit	Yes	5 years	30%	None
Repurchase Agreements	Yes	1 year	None	None
Reverse Repurchase Agreements	No	92 days	20% of base value	None
Medium-Term Notes	Yes	5 years	30%	None
Mutual Funds	Yes	N/A	15%	10%
Money Market Mutual Funds	Yes	N/A	20%	10%
Mortgage Pass-Through Securities	No	5 years	None	None
County Pooled Investment Funds	No	N/A	None	None
Local Agency Investment Fund (LAIF)	Yes	N/A	None	None
JPA Pools (other Investment Pools)	No	N/A	None	None

* Based on state law requirements or investment policy requirements, whichever is more restrictive.

EMERALD BAY SERVICE DISTRICT
Notes to Basic Financial Statements (Continued)
June 30, 2011

Disclosures 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, the greater the sensitivity of its fair value to changes in market interest rates. Information about the sensitivity of the fair values of the District's investments to market interest rate fluctuations is provided by the following table that shows the distribution of the District's investment by maturity.

<u>Investment Type</u>	<u>Total</u>	<u>Remaining Maturity (in months)</u>		
		<u>12 months or Less</u>	<u>13 to 24 Months</u>	<u>25 to 60 Months</u>
U.S Treasury Obligations	\$ 1,569,523	\$ 614,248	\$ 631,461	\$ 323,814

Disclosures Relating to Credit Risk:

Credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. All U.S. Treasury Obligations held by the District are exempt from this disclosure, because they are backed by the full faith and credit of the United States.

However, on August 5, 2011, Standard & Poor's lowered its long-term credit rating on debt of the U.S. government from AAA to AA+. That action affected Standard & Poor's view of U.S. public finance debt instruments that are directly or indirectly backed by the U.S. government. As a result, on August 8, 2011, Standard & Poor's lowered its long-term credit ratings of U.S. government-sponsored enterprises and public debt issues that have credit enhancement guarantees by those government-sponsored enterprises to AA+. These credit downgrades relate to the credit risk associated with the District's investment in U.S. Treasury Obligations.

Custodial Credit Risk:

Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, the District will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The California Government Code does not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits, other than the following provision for deposits: The California Government Code requires that a financial institution secure deposits made by state or local government 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 deposits by

EMERALD BAY SERVICE DISTRICT
Notes to Basic Financial Statements (Continued)
June 30, 2011

pledging first trust deed mortgage notes having a value of 150% of the secured public deposits. The District deposits are not exposed to custodial credit risk at June 30, 2011.

The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty (e.g. broker-dealer) to a transaction, the District will not be able to recover the value of its investment or collateral securities that are in the possession of another party. The California Government Code does not contain legal or policy requirements that would limit the exposure to custodial risk for investments. With respect to investments, custodial credit risk generally applies only to direct investments in marketable securities. Custodial credit risk does not apply to the District's indirect investments in securities. The District investments in marketable securities are not exposed to custodial credit risk at June 30, 2011.

(b) Capital Assets

A summary of changes in capital assets for the District's governmental activities for the year ended June 30, 2011, is as follows.

	Balance at July 1, 2010	Increases	Decreases	Balance at June 30, 2011
Capital assets, being depreciated:				
Infrastructure	\$ 3,633,766	\$ 701,918	\$ -	\$ 4,335,684
Equipment	71,756	526	-	72,282
Total capital assets, being depreciated	<u>3,705,522</u>	<u>702,444</u>	<u>-</u>	<u>4,407,966</u>
Less accumulated depreciation:				
Infrastructure	(282,549)	(161,994)	-	(444,543)
Equipment	(19,306)	(14,351)	-	(33,657)
Total accumulated depreciation	<u>(301,855)</u>	<u>(176,345)</u>	<u>-</u>	<u>(478,200)</u>
Capital assets, net	<u>\$ 3,403,667</u>	<u>\$ 526,099</u>	<u>\$ -</u>	<u>\$ 3,929,766</u>

Depreciation expense of \$176,345 was charged to the public services function.

EMERALD BAY SERVICE DISTRICT
Notes to Basic Financial Statements (Continued)
June 30, 2011

(3) OTHER INFORMATION

Insurance Coverage:

The District is exposed to various risks of loss related to property and general liability. These risks are addressed through commercial insurance.

The District is subject to various deductible amounts in addition to payment of premiums for insurance coverage. The total risk financing limit is \$2 million combined, with a single limit of \$1 million per occurrence, subject to a \$5,000 deductible per occurrence for general liability and property damage.

Settled claims have not exceeded any of the District's coverage amounts in the last three fiscal years, and there were no reductions in the coverage during the year ended June 30, 2011.

Related Party Transactions:

The Board of Directors of the Emerald Bay Service District entered into a management service agreement with Emerald Bay Community Association (Association), a legally separate, but geographically related entity. The term of this management service agreement expires December 31, 2012. Fees are charged at a fixed rate of \$8,680 per month, plus a percentage of the Association's general manager and administrative assistant's salaries.

Affiliated Organizations:

As indicated in Note 1(a) *Reporting Entity* the District's purpose includes providing fresh water supply and fire protection to the residents of the District. Currently, the Laguna Beach County Water District (LBCWD) provides the District's residents with its fresh water supply on behalf of the District. For the fiscal year ended June 30, 2011, District residents were charged \$529,842 for their consumption of 11,712,900 cubic feet (87,612,492 gallons) of fresh water. Furthermore, the Orange County Fire Authority (OCFA) currently provides fire protection services to District residents. For the fiscal year ended June 30, 2011, the County apportioned and paid to OCFA approximately \$1.3 million in property taxes to provide these services.

REQUIRED SUPPLEMENTARY INFORMATION

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EMERALD BAY SERVICE DISTRICT
General Fund
Budgetary Comparison Schedule
For the Year Ended June 30, 2011

	<u>Original and Final Budget</u>	<u>Actual</u>	<u>Variance Over (Under)</u>
Revenues:			
Taxes	\$ 1,779,892	\$ 1,674,826	\$ (105,066)
Interest earnings	87,439	84,565	(2,874)
Net decrease in the fair value of investments	-	(64,053)	(64,053)
Other	25,200	15,930	(9,270)
 Total revenues	 <u>1,892,531</u>	 <u>1,711,268</u>	 <u>(181,263)</u>
Expenditures:			
Current:			
General government	726,500	617,768	(108,732)
Public services (sewer services)	344,400	262,350	(82,050)
Recreation and safety	183,500	157,120	(26,380)
Capital expenditures	<u>2,161,500</u>	<u>702,444</u>	<u>(1,459,056)</u>
 Total expenditures	 <u>3,415,900</u>	 <u>1,739,682</u>	 <u>(1,676,218)</u>
 Net change in fund balance	 <u>(1,523,369)</u>	 <u>(28,414)</u>	 <u>1,494,955</u>
 Fund balance - beginning of year	 <u>2,766,883</u>	 <u>2,766,883</u>	 <u>-</u>
 Fund balance - end of year	 <u>\$ 1,243,514</u>	 <u>\$ 2,738,469</u>	 <u>\$ 1,494,955</u>

See Accompanying Note to Required Supplementary Information.

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NOTES TO REQUIRED SUPPLEMENTARY INFORMATION

EMERALD BAY SERVICE DISTRICT
Notes to Required Supplementary Information
June 30, 2011

(1) *Budgets and Budgetary Accounting*

The District budget for the General Fund is prepared annually and approved and adopted in accordance with the provisions of the Board of Directors. The level at which expenditures may not legally exceed appropriations is the financial statement line item. Any deficiency of budgeted revenues compared to budgeted expenditures is financed from beginning unrestricted fund balance.

(2) *Appropriations and Encumbrances*

Unexpended and unencumbered appropriations of the governmental fund automatically lapse at the end of the fiscal year for noncapital projects.