



SCOTTS VALLEY
WATER DISTRICT

Scotts Valley Water District

Annual Financial Report

For the Fiscal Years Ended June 30, 2016 and 2015



Mission Statement

The mission of the Scotts Valley Water District is to deliver a sustainable, high quality water supply in an environmentally responsible and sound financial manner while providing outstanding customer service.

Scotts Valley Water District

Board of Directors as of June 30, 2016

<u>Name</u>	<u>Title</u>	<u>Elected/ Appointed</u>	<u>Current Term</u>
Danny Reber	President	Elected	11/12-11/16
Ruth Stiles	Vice President	Appointed	12/15-11/16
Ken Kannegaard	Director	Elected	11/14-11/18
Chris Perri	Director	Elected	11/12-11/16
David Hodgkin	Director	Elected	10/14-11/18

**Scotts Valley Water District
Piret Harmon, General Manager
2 Civic Center Drive
Scotts Valley, California 95066
(831) 438-2363 – www.svwd.org**

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Annual Financial Report

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Table of Contents

	<u>Page No.</u>
Table of Contents	i
Introductory Section	
Letter of Transmittal	1-8
Financial Section	
Independent Auditor’s Report	9-11
Management’s Discussion and Analysis	12-17
Basic Financial Statements:	
Statements of Net Position	18-19
Statements of Revenues, Expenses and Change in Net Position	20
Statements of Cash Flow	21-22
Notes to the Basic Financial Statements	23-49
Required Supplementary Information Section	
Schedules of the District’s Proportionate Share of the Net Pension Liability	50
Schedules of Pension Plan Contributions	51
Schedule of Funding Status – Other Post-Employment Benefits	52
Supplemental Information Section	
Combining Schedule of Net Position	53-54
Combining Schedule of Revenues, Expenses and Change Net Position	55
Schedules of Customer Account and General and Administrative Expense	56
Report on Internal Controls and Compliance	
Independent Auditor’s Report on Internal Control Over Financial Reporting And on Compliance and Other Matters Based on an Audits of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>	57-58

Introductory Section



December 8, 2016

The Honorable Board of Directors of
the Scotts Valley Water District

Introduction

It is my pleasure to submit the Annual Financial Report for the Scotts Valley Water District (District) for the fiscal year ending June 30, 2016 (FY 2016). The District staff prepared this financial report following guidelines set forth by the Governmental Accounting Standards Board (GASB). The District is ultimately responsible for both the accuracy of the data and the completeness and fairness of the presentation, including all disclosures in this financial report. I believe that the data presented is accurate in all material respects. This report is designed in a manner that helps to enhance your understanding of the District's financial position and activities.

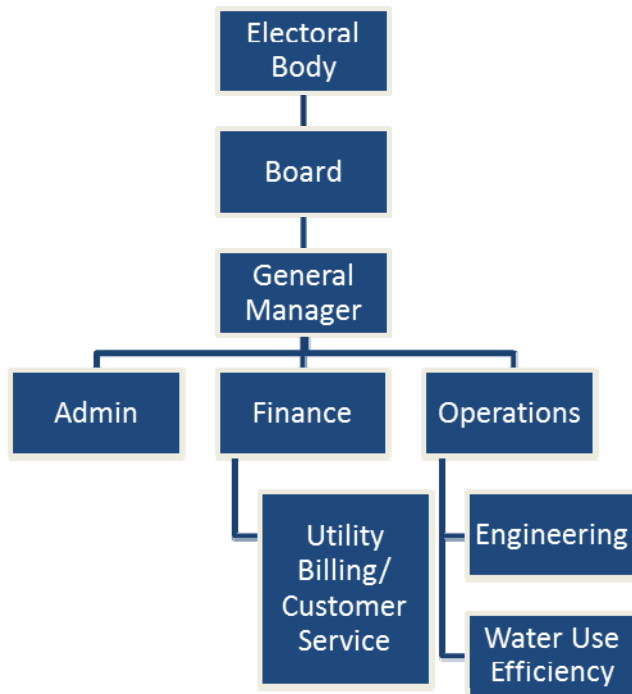
This report is organized into three sections: (1) Introductory, (2) Financial, and (3) Supplemental. The Introductory section offers general information about the District's organization and water system, the economic environment, current District activities, and presents a summary of significant financial results, as well as the major initiatives and accomplishments. The Financial section includes the Independent Auditor's Report, Management's Discussion and Analysis (MD&A) of the District's financial statements, and the District's audited financial statements with accompanying notes. The Supplemental section contains selected financial information in greater detail than presented in the District's financial statements.

Generally Accepted Accounting Principles (GAAP) requires that the management provides a narrative introduction, overview, and analysis to accompany the financial statements in the form of a Management's Discussion and Analysis section. This letter of transmittal is designed to complement the MD&A and should be read in conjunction with it. The District's MD&A is located immediately following the Independent Auditor's Report.

District Structure and Leadership

The Scotts Valley Water District is an independent special district, which operates under the authority of Division 12: County Water District Act of the California Water Code. The District was formed in 1961 and is governed by a five- member Board of Directors, elected at-large from within the District's service area. The General Manager administers the day-to-day operations of the District in accordance with policies established by the Board of Directors. The District employs 18 regular employees organized in 3 divisions: Administration, Operations and Finance. The District's Board of Directors meets on the second Thursday of each month. Meetings are publicly noticed and the public is encouraged to attend.

An organizational chart is presented below.



The District provides water service to approximately 4,200 connections, covering most of the City of Scotts Valley and several unincorporated neighborhoods. The City of Scotts Valley, which occupies approximately 6 square miles, is located 6 miles north of the City of Santa Cruz on Highway 17 in Santa Cruz County.

Water Use Efficiency was transferred to the Operations Division in FY 2016.

District Services

Residential customers represent approximately 91% of the District’s customer base and consume approximately 71% of the potable water produced annually by the District. The District currently has a total of 6 groundwater wells with a maximum production capacity of 1,400 gallons per minute. Additionally, the District is the permitted distributor of the recycled water from the Tertiary Treatment Plant of the City of Scotts Valley. As of June 30, 2016, there were 61 connections with an annual billable demand of 51.1 million gallons.

Potable water connection portfolio and potable water consumption by customer type are presented:

Potable Water Connections

3,694 connections as of 6/30/2016:

	6/30/2016	6/30/2015	Incr/(Decr)
Residential	3,333	3,362	-29
CII*	282	280	2
Landscape	79	81	-2
	<u>3,694</u>	<u>3,723</u>	<u>-29</u>

* CII: Commercial, Industrial and Institutions

Potable Water Consumption

FY 2016

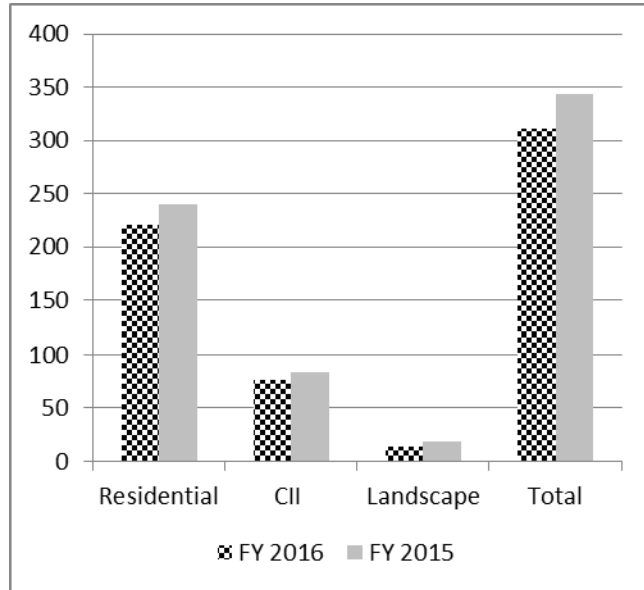
311 million gallons (MG):

- Residential: 221 MG
- CII: 76 MG
- Landscape: 14 MG

FY 2015

343 million gallons (MG):

- Residential: 240 MG
- CII: 84 MG
- Landscape: 19 MG



Total consumption decreased by 32 MG/9.3% due to a further cut-back on water consumption and also possibly due to a consumer behavior change to a lower level of consumption. Residential decreased by 19 MG/7.9%, CII (Commercial, Industrial and Institutions) decreased by 8 MG/9.5%, and Landscape decreased by 5 MG/26.3%. Percentage wise, Landscape had the greatest decrease owing to elasticity in demand.

Economic Condition and Outlook

Santa Cruz County’s unemployment rate had an average of 6.2% in June 2016, remaining unchanged from a year ago in June 2015 per the statistics released by the State Employment Development Division. The unemployment rate was slightly higher than that of the State’s which fell to 5.7% in June 2016.

The District’s main office is located in the City of Scotts Valley in Santa Cruz County. The number of service connections is closely impacted by the local economy and by the City’s economic development policies, especially the housing development policy. The City has a population of approximately 12,140 per the January 2016 news release by the State Department of Finance, an increase of 4.8% from 11,580 per the 2010 census. The number of households grew from 4,273 in the 2000 census to 4,426 in the 2010 census, a growth of 3.6%. As the City’s remaining buildable space is limited, growths in population and the number of households are likely to remain moderate.

The City’s Planning Department has been facilitating several large commercial and residential developments. However, development projects had not progressed as anticipated and the projects slated to be completed in FY 2016 were delayed.

Major Initiatives and Significant Projects

The District's sole source for potable water is the Santa Margarita groundwater basin. The treated water meets or exceeds all State and Federal water quality standards.

The District's water supply continues to be a concern due to a prolonged statewide drought that began in 2012, and the aging water infrastructure. The monster El Nino in FY 2016 brought the annual precipitation back to the historical average, providing much needed drought relief. However, drought remains a concern and the District continues the pursuit of a recycled water recharge project to replenish the aquifer.

The District is implementing a multi-year effort to address the aging infrastructure, including the completion of the Water System Master Plan by June 30, 2017, and the inclusion of an appropriate capital budget in subsequent years to systematically upgrade or replace its infrastructure.

Annual water sales revenue, including potable water and recycled water, has been decreasing for two consecutive years from \$3.3 million in FY 2014 to \$2.7 million in FY 2015 and further down to \$2.6 million in FY 2016 for a total loss of \$1.3 million in two years. As the declining revenue could not sustain ongoing operations, debt service covenants and a responsible capital improvement program, the District engaged a consultant to do a comprehensive fee/rate study in January 2016. The study calculated cost of service, redesigned rate structures, established financial policies, and eventually produced a rate increase plan in October 2016. The new rate plan will be implemented following completion of the Prop 218 requirements and Board approval.

Major Accomplishments

The activities of the District are driven by its Mission Statement: *"To deliver a sustainable, high quality water supply in an environmentally responsible and sound financial manner while providing outstanding customer service"*. The accomplishments in each of the Strategic Goal areas for FY 2016 included:

Water Resource Management:

1. Pasatiempo Golf Club Supplemental Supply Project: Issued a letter of intent from the District to Pasatiempo to support supplying either tertiary or secondary water to the golf course. Spearheaded and facilitated negotiations with Pasatiempo GC and City of Scotts Valley to arrive at mutually beneficial terms and conditions. Executed an amendment to the 2013 Recycled Water Agreement between District and City.
2. Successfully launched and administered Recycled Water Fill Station program in August 2015 and reopened in April 2016. Negotiated with the City to allow all District customers (outside City) to be eligible.
3. Regional Emergency Interties Project (Prop 50): Worked cooperatively with RWMF and SLVWD on the grant reimbursement submittals and funds disbursements on a timely basis. Obtained additional \$391,000 funding bringing the total grant amount to \$4,308,000. Made \$1 million available to SLVWD at 2% per annum to bridge the SLVWD cash flow needs for the Regional Emergency Interties project. Completed and submitted to CDPH draft Standard Operating Procedures for Emergency Intertie 2 (will be finalized in Sep 2016). Assumed maintenance responsibilities for the Intertie in December 2015.

Projects currently under way to recharge groundwater, expand recycled water use and sales, and reduce water waste include:

- Scotts Valley Transit Center LID Retrofit Project: Obtained all necessary agreements and easements, facilitated the process with the Department of Finance regarding property transfer. Construction was delayed due to lack of responsiveness from contractors to the initial bid advertisement. Timely responded and acted on Prop 84 reimbursement requests. Obtained a monitoring program proposal from KJ to be implemented at the Transit Center and used for all other sites. Staff continues to monitor and download data from Woodside and Library and will do so at Transit Center.
- Groundwater Recharge Project: Feasibility study original schedule was extended due to additional scope of work - final report expected to be completed late summer 2016. The findings and recommendations will most likely support an alternate location using District owned facilities and properties that will result in lower cost.
- Conversion of existing potable irrigation accounts: Developed generic conversion costs from potable to recycled services - full cost/benefit analysis still be conducted. Completed cross connection control tests for 15 remaining sites using recycled water.

Infrastructure Integrity:

1. Office Building Renovation and Modernization Project: Board Room and staff office space renovation completed in November 2015 - the project achieved its goal of providing a modernized, ergonomic, functional work space that meets the operational needs of 21st century water utility.

Projects currently under way to expand or maintain the District's infrastructure include:

- Lompico Formation New Production Well Project: Currently working with hydrologist on investigating and sampling water quality around our well 9 site for redevelopment. Second round of water quality sampling at skate park monitoring well is scheduled for July 2016.
- El Pueblo Pumps Reconfiguration Project: Design nearly completed and plans reviewed, materials have been procured, currently seeking bids for concrete work with construction anticipated to begin in August 2016.
- Orchard Run WTP Esthetic: Work in progress on developing conceptual design with more detailed project framework for construction to become available in FY 2017.
- MacDorsa Tank Rehabilitation Project: Contract has been awarded and construction will begin in August. Project is scheduled to be completed in November 2016.

Financial Stewardship:

1. The Utility Billing and the Core Finance modules of the new financial management system were up and running by September 2015. The new system automates and streamlines financial operations and reporting. Peripheral modules will be implemented as schedule permits.
2. Redeemed the 2003 Refunding Revenue Bonds in January 2016 to save interest and therefore to improve the debt service coverage ratio for the remaining two outstanding debts.

Projects currently underway to provide greater financial stewardship include the comprehensive fee/rate study and the refunding of the 2011 Wells Fargo Loan and the 2004 COPs.

Public Outreach:

1. Participated in SV Art Wine Beer Festival as a sponsor and received an extremely positive response from the community to the District's presence and contributions (offering free tap water) to the festival goers. Co-hosted a networking mixer with SLV Chamber of Commerce, SV Chamber of Commerce, and SLVWD - well attended and informative event.
2. Received "Organization of the Year" award at the SV Chamber Annual Awards Gala - remarkable recognition from the community.
3. Transformed District's Board Room into Community Room (Santa Margarita Community Room dedication in Feb 2016) to maximize the use of the vacant space.
4. Conducted a Special Joint Meeting with SLVWD Board of Directors to present SVWD 2015 UWMP Update. Strengthened operational interactions with SLVWD - staff worked side by side during the intertie testing/start up and activation.
5. Prepared and submitted SGMA Boundary Modification request to DWR on behalf of the 3 public agencies (County, SLVWD, SVWD) by the required due date. Facilitated discussions with stakeholders in the proposed Santa Margarita Basin resulting in assembling and leading a GSA Formation Committee.
6. Actively participated in County Conservation Coalition by attending meetings and organizing and staffing booth for the SV Garden Faire. Contributed to Monterey Bay Friendly Stakeholder's meetings with input from field. Helped with shared budget allocations to group, provided editing for selected pages on shared website (watersavingtips.org). The District continues to be an active participant in all coalition activities.

Organizational Vitality:

1. Conducted a "light" study for MOU classifications including Santa Cruz County agencies, conducted a full study for at-will positions.
2. Played a crucial role in the negotiations with employees being represented by AFSCME resulting in a 3-year mutually amenable contract. Managed the implementation of the changes resulting from the MOU.
3. Hosted ACWA JPIA Safety Training sessions with participation from SqCWD and CWD staff. Participated in the joint regulatory maintenance training put on by City of SV WWTP.
4. Ensured that all staff and Directors had opportunities to attend professional conferences and participate in trainings using virtual settings. Streamlined the registration process for Directors by listing upcoming events in the Board packets and encouraging Directors to utilize staff assistance.
5. Conducted a Board Retreat including Directors and executive staff to discuss District's long term strategic direction and course of action. Held 1-on-1 meetings between General Manager and all Directors.
6. Reorganized the inventory space at El Pueblo by removing unused office space in storage bay, constructed new work bench and tool storage shelving.
7. Conducted a thorough review and update of the Emergency Response Plan and adopted an Emergency Management Policy. Organized 4 OSHA required safety trainings for staff through JPIA and held weekly safety meetings for operations staff using AWWA training materials.
8. Conducted bi-monthly Lunch & Learn meetings with topics focused on money management skills, health care updates and current District activities. Held regular office and field staff meetings to provide an update on Board meetings and ongoing District activities.

9. Co-hosted networking mixer with SLV Chamber of Commerce, SV Chamber of Commerce and SLVWD focused on local and regional water issues. Supported and participated in the County wide Water Forum 2016 "Connecting the Drops".

Projects currently under way to promote greater organization vitality include updating the Standard Operating Procedures (SOP).

All programs and projects of the District were developed and performed to provide the highest level of services to its customers in a cost effective manner.

Recycled Water

Scotts Valley boasts the only recycled water treatment plant (Tertiary Treatment Plant) in the North Santa Cruz County area. The District's policy to use the recycled water wherever feasible by installing recycled irrigation services at the new development projects and converting existing potable landscape connections to recycled water has resulted in the total number of recycled water connections reaching 61 since the inception of the Tertiary Treatment Plant in 2002.

In August 2015, the District launched and administered Recycled Water Fill Station program and reopened in April 2016. Successfully negotiated with the City to allow all District customers (outside City) to be eligible.

Water Rates and District Revenues

On July 1, 2015, the Connection Charges and Water Replenishment Impact Fees were increased by 2.5% based on the ENR construction cost index (April to April). Effective December 15, 2015 the meter service charges were increased by 1% and commodity charges ranging from 3.7% to 3.93% based on a five-year rate schedule approved in December 2012.

Water Conservation and Water Use Efficiency Programs

The District has always been committed to water use efficiency and conservation through rebates, educational workshops, home inspections and consultations. In FY 2016, the District exceeded the State mandate of 16% and the District's goal of 20%, with a 25% reduction in water demand from July 2015 to June 2016, as compared to 2013 baseline. Additionally, the District implemented all emergency regulations and new rebate programs; submitted timely monthly demand reports to the State to comply with Emergency Drought Regulations; completed self-certification assessment as required by SWRCB in June 2016; met internal goals of a 40,000 square foot reduction in turf and a 20,000 square foot reduction in landscapes irrigated with high volume spray heads, promoted alternative water supply sources of greywater, rainwater and downspout diversion; and provided 83 House Calls to help detect leaks, do preventative adjustments and distribute water-saving devices.

Internal Control Structure

The District management is responsible for the establishment and maintenance of the internal control structure that ensures that the assets of the District are protected from loss, theft or misuse. The internal control structure also warrants that adequate accounting data is compiled to allow for the preparation of financial statements in conformity with generally accepted accounting principles. The District's internal control structure is designed to provide reasonable assurance that these objectives are met. The concept of reasonable assurance recognizes that (1) the cost of a control should not exceed the benefits likely to be derived, and (2) the valuation of costs and benefits requires estimates and judgments by management.

Budgetary Control

The District Board of Directors annually adopts an operating and capital budget prior to the new fiscal year. The budget authorizes and provides the basis for reporting and control of financial operations and accountability for the District's enterprise operations and capital projects. The budget and reporting treatment applied to the District is consistent with the accrual basis of accounting and the financial statement basis.

Each division manager is responsible for his/her division budget; the General Manager is responsible for the overall District budget.

Investment Policy

The Board of Directors has adopted an investment policy that conforms to state law, District ordinance and resolutions, prudent money management, and the "prudent person" standards. The objective of the Investment Policy is safety, liquidity and yield. District funds are invested in the State Treasurer's Local Agency Investment Fund (LAIF), certificate of deposits (CDs) and institutional savings and checking accounts.

Independent Audit and Financial Reporting

The State Law and Bond covenants require the District to obtain an annual audit of its financial statements by an independent certified public accountant. The accounting firm of Fedak & Brown, LLP has conducted the audit of the District's financial statements. Their unqualified Independent Auditor's Report appears in the Financial Section.

Risk Management

The District is a member of the Association of California Water Agencies Joint Power Insurance Authority (Authority). The purpose of the Authority is to arrange and administer programs of insurance for the pooling of self-insured losses and to purchase excess insurance coverage, as necessary.

Excellent Customer Service with a Strong Connection to the Community

Customer Service is the face of the organization. The District's friendly representatives have a strong local connection and a broad knowledge of the District water services and programs. We strive to provide excellent customer service while promoting awareness of water conservation and water use efficiency.

Other References

More information is contained in the Management's Discussion and Analysis and in the Notes to the Basic Financial Statements found in the Financial Section of the report.

Acknowledgement

Preparation of this report was accomplished by the combined efforts of the District staff. I appreciate the dedication and professionalism that our staff members bring to the District. I would also like to thank the members of the Board of Directors for their continued support in the planning and implementation of the Scotts Valley Water District's fiscal policies.

Respectfully submitted,



Piret Harmon
General Manager

Financial Section



Charles Z. Fedak, CPA, MBA
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Fedak & Brown LLP

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Independent Auditor's Report

Board of Directors
Scotts Valley Water District
Scotts Valley, California

Report on the Financial Statements

We have audited the accompanying financial statements of the Scotts Valley Water District (District), which comprises the statements of net position as of June 30, 2016 and 2015, and the related statements of revenues, expenses, and changes in net position, and cash flows for the years then ended, and the related notes to the financial statements, which collectively comprise the District's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audits. We conducted our audits 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; and the State Controller's Minimum Audit Requirements for California Special Districts. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the District, as of June 30, 2016 and 2015, and the respective changes in financial position, and, where applicable, cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Independent Auditor's Report, continued

Emphasis of matter

As described in note 1 to the financial statements, the District adopted the provisions of Governmental Accounting Standards Board (GASB) Statement No. 72 – *Fair Value Measurement and Application*, GASB Statement No. 79 – *Certain External Investment Pools and Pool Participants*, for the year ended June 30, 2016, GASB Statement No. 68 – *Accounting and Financial Reporting for Pensions*, and GASB Statement No. 71 – *Pension Transition for Contributions made Subsequent to the Measurement Date – An Amendment of GASB Statement No. 68*, for the year ended June 30, 2015. Our opinions are not modified with respect to these matters.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 12 through 17 and the required supplementary information on pages 50 through 52 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 audits of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audits were conducted for the purpose of forming opinions on the financial statements that collectively comprise the District's basic financial statements. The introductory section on pages 1 through 8, and the supplemental information schedule on pages 53 through 56, are presented for purposes of additional analysis and are not a required part of the basic financial statements.

The supplemental information schedules are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the supplemental information schedules are fairly stated in all material respects in relation to the basic 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.

Independent Auditor's Report, continued

Other Reporting Required by Government Auditing Standards

In accordance with Government Auditing Standards, we have also issued our report dated December 8, 2016, 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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards in considering the District's internal control over financial reporting and compliance. This report can be found on pages 57 and 58.

Fedak & Brown LLP

Fedak & Brown LLP

Cypress, California

December 8, 2016

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Scotts Valley Water District
Management's Discussion and Analysis
For the Fiscal Years Ended June 30, 2016 and 2015

The following Management's Discussion and Analysis (MD&A) of activities and financial performance of the Scotts Valley Water District (District) provides an introduction to the financial statements of the District for the fiscal years ended June 30, 2016 and 2015. We encourage readers to consider the information presented here in conjunction with the transmittal letter in the Introductory Section and with the basic financial statements and related notes, which follow this section.

Financial Highlights

- The District's net position decreased 2.48% or \$412,641 to \$16,214,003 in 2016. In 2015, the District's net position decreased 7.67% or \$1,380,728 to \$16,626,644.
- The District's operating revenues decreased 10.02% or \$450,896 to \$4,048,964 in 2016. In 2015, the District's operating revenues decreased 12.53% or \$644,738 to \$4,499,860.
- The District's non-operating revenues increased 66.21% or \$522,965 to \$1,312,856 in 2016. In 2015, the District's non-operating revenues increased 6.23% or \$46,295 to \$789,891.
- The District's operating expenses increased 14.22% or \$594,777 to \$4,778,414 in 2016. In 2015, the District's operating expenses decreased 23.17% or \$1,261,934 to \$4,183,637.
- The District's non-operating expenses increased 15.57% or \$56,283 to \$417,796 in 2016. In 2015, the District's non-operating expenses decreased 4.42% or \$16,727 to \$361,513.

Required Financial Statements

This annual report consists of a series of financial statements. The Statements of Net Position, Statements of Revenues, Expenses and Changes in Net Position and Statements of Cash Flows provide information about the activities and performance of the District using accounting methods similar to those used by private sector companies.

The Statements of Net Position include all of the District's investments in resources (assets), deferred outflows of resources, the obligations to creditors (liabilities), and deferred inflows of resources. They also provide the basis for computing a rate of return, evaluating the capital structure of the District and assessing the liquidity and financial flexibility of the District. All of the current year's revenue and expenses are accounted for in the Statements of Revenues, Expenses and Changes in Net Position. These statements measure the success of the District's operations over the past years and can be used to determine if the District has successfully recovered all of its costs through its rates and other charges. These statements can also be used to evaluate profitability and credit worthiness.

The final required financial statement is the Statements of Cash Flows, which provide information about the District's cash receipts and cash payments during the reporting period.

The Statements of Cash Flows report cash receipts, cash payments and net changes in cash resulting from operations, investing, non-capital financing, and capital and related financing activities and provide answers to such questions as where did cash come from, what was cash used for, and what was the change in cash balance during the reporting period.

Scotts Valley Water District
Management's Discussion and Analysis, continued
For the Fiscal Years Ended June 30, 2016 and 2015

Financial Analysis of the District

One of the most important questions asked about the District's finances is, "Is the District better off or worse off as a result of this year's activities?" The Statements of Net Position and the Statements of Revenues, Expenses and Changes in Net Position report information about the District in a way that helps answer this question. These statements include all assets, deferred outflows of resources, liabilities, and deferred inflows of resources using the accrual basis of accounting, which is similar to the accounting method used by most private sector companies. All of the current year's revenues and expenses are taken into account regardless of when the cash is received or paid.

These two statements report the District's net position and changes in it. The District's net position – the difference between assets plus deferred outflows of resources less liabilities and deferred inflows of resources – is one way to measure the District's financial health, or financial position. Over time, increases or decreases in net position is one indicator of whether its financial health is improving or deteriorating. However, it is also necessary to consider other non-financial factors such as changes in economic conditions, population growth, zoning and new or changed government legislation, such as changes in Federal and State water quality standards.

Notes to the Basic Financial Statements

The notes provide additional information that is essential to a full understanding of the data provided in the basic financial statements. The notes to the basic financial statements can be found on pages 23 through 49.

Statements of Net Position

	Condensed Statements of Net Position				
	<u>2016</u>	<u>2015</u>	<u>Change</u>	<u>2014</u>	<u>Change</u>
Assets:					
Current assets	\$ 5,080,585	8,080,225	(2,999,640)	8,591,288	(511,063)
Non-current assets	715,853	118,023	597,830	129,535	(11,512)
Capital assets, net	<u>20,027,733</u>	<u>19,521,856</u>	<u>505,877</u>	<u>19,622,309</u>	<u>(100,453)</u>
Total assets	<u>25,824,171</u>	<u>27,720,104</u>	<u>(1,895,933)</u>	<u>28,343,132</u>	<u>(623,028)</u>
Deferred outflows of resources	<u>669,858</u>	<u>1,223,345</u>	<u>(553,487)</u>	<u>663,598</u>	<u>559,747</u>
Liabilities:					
Current liabilities	940,689	1,818,498	(877,809)	1,726,212	92,286
Non-current liabilities	<u>8,927,869</u>	<u>10,051,375</u>	<u>(1,123,506)</u>	<u>9,273,146</u>	<u>778,229</u>
Total liabilities	<u>9,868,558</u>	<u>11,869,873</u>	<u>(2,001,315)</u>	<u>10,999,358</u>	<u>870,515</u>
Deferred inflows of resources	<u>411,468</u>	<u>446,932</u>	<u>(35,464)</u>	<u>-</u>	<u>446,932</u>
Net position:					
Net investment in capital assets	13,665,884	12,154,452	1,511,432	11,822,421	332,031
Restricted	749,404	932,329	(182,925)	918,709	13,620
Unrestricted	<u>1,798,715</u>	<u>3,539,863</u>	<u>(1,741,148)</u>	<u>5,266,242</u>	<u>(1,726,379)</u>
Total net position	<u>\$ 16,214,003</u>	<u>16,626,644</u>	<u>(412,641)</u>	<u>18,007,372</u>	<u>(1,380,728)</u>

Scotts Valley Water District
Management's Discussion and Analysis, continued
For the Fiscal Years Ended June 30, 2016 and 2015

Statements of Net Position, continued

As noted earlier, net position may serve over time as a useful indicator of a government's financial position. In the case of the District, assets and deferred outflows of resources of the District exceeded liabilities and deferred inflows of resources by \$16,214,003 and \$16,626,644 as of June 30, 2016 and 2015, respectively.

By far the largest portion of the District's net position (84.28% and 73.10% as of June 30, 2016 and 2015, respectively) reflects the District's investment in capital assets (net of accumulated depreciation) less any related debt used to acquire those assets that is still outstanding. The District uses these capital assets to provide services to customers within the District's service area; consequently, these assets are not available for future spending.

At the end of fiscal years 2016 and 2015, the District showed a positive balance in its unrestricted net position of \$1,798,715 and \$3,539,863, respectively, which may be utilized in future years. See note 12 for the amount of spendable net position that may be utilized in future years.

Statements of Revenues, Expenses and Changes in Net Position

Condensed Statements of Revenues, Expenses and Changes in Net Position					
	<u>2016</u>	<u>2015</u>	<u>Change</u>	<u>2014</u>	<u>Change</u>
Revenues:					
Operating revenues	\$ 4,048,964	4,499,859	(450,895)	5,144,598	(644,739)
Non-operating revenues	1,312,856	789,891	522,965	743,598	46,293
Total revenues	<u>5,361,820</u>	<u>5,289,750</u>	<u>72,070</u>	<u>5,888,196</u>	<u>(598,446)</u>
Expenses:					
Operating expenses	4,778,414	4,183,637	594,777	5,445,573	(1,261,936)
Depreciation and amortization	913,955	883,615	30,340	1,023,055	(139,440)
Non-operating expenses	417,796	361,513	56,283	378,240	(16,727)
Total expenses	<u>6,110,165</u>	<u>5,428,765</u>	<u>681,400</u>	<u>6,846,868</u>	<u>(1,418,103)</u>
Net loss before capital contributions	(748,345)	(139,015)	(609,330)	(958,672)	819,657
Capital contributions	<u>335,704</u>	<u>399,554</u>	<u>(63,850)</u>	<u>435,964</u>	<u>(36,410)</u>
Change in net position	<u>(412,641)</u>	<u>260,539</u>	<u>(673,180)</u>	<u>(522,708)</u>	<u>783,247</u>
Net position, beginning of period, as previously stated	16,626,644	18,007,372	(1,380,728)	18,384,030	(376,658)
Prior period adjustment (note 11)	<u>-</u>	<u>(1,641,267)</u>	<u>1,641,267</u>	<u>146,050</u>	<u>(1,787,317)</u>
Net position, beginning of period, as restated	<u>16,626,644</u>	<u>16,366,105</u>	<u>260,539</u>	<u>18,530,080</u>	<u>(2,163,975)</u>
Net position, end of period	<u>\$ 16,214,003</u>	<u>16,626,644</u>	<u>(412,641)</u>	<u>18,007,372</u>	<u>(1,380,728)</u>

The statements of revenues, expenses and changes in net position show how the District's net position changed during the fiscal years.

A closer examination of the sources of changes in net position reveals that:

The District's net position decreased 2.48%, or \$412,641 to \$16,214,003 as a result of ongoing operations. In 2015, the District's net position decreased 7.67% or \$1,380,728 to \$16,626,644, which is comprised of an increase from operations of \$260,539, which was offset by a decrease from prior period adjustment in the amount of \$1,641,267. Please see note 11 of the basic financial statements for further discussion.

Scotts Valley Water District
Management's Discussion and Analysis, continued
For the Fiscal Years Ended June 30, 2016 and 2015

Statements of Revenues, Expenses and Changes in Net Position, continued

The District's operating revenues decreased 10.02%, or \$450,895 to \$4,048,964, primarily due to decreases of \$107,521 in potable water sales, \$218,261 in service charges, and \$189,553 in other revenue; which was offset by an increase of \$64,440 in recycled water sales. In 2015, the District's operating revenues decreased 12.53% or \$644,739 to \$4,499,859, primarily due to decreases of \$711,281 in water sales revenues related to decrease water consumption and \$71,982 in other revenue; which were offset by an increase of \$138,524 in service charges and recycled water sales.

The District's non-operating revenues increased 66.21%, or \$522,965 to \$1,312,856, primarily due to increases of \$467,913 in gain on disposal of capital assets, which includes a \$497,928 gain on sale of entitlement resulting from an agreement between the District and the City of Scotts Valley and \$51,246 in property tax revenue. In 2015, the District's non-operating revenues increased 6.23% or \$46,293 to \$789,891, primarily due to increases of \$14,196 in property tax revenues, \$11,512 in investment earnings, and \$19,822 in the gain on disposal of fixed assets.

The District's operating expenses increased 14.22%, or \$594,777 to \$4,778,414 primarily due to increases of \$103,554 in source of supply, \$85,721 in pumping, \$182,755 in water treatment, \$444,416 in recycled water, \$39,371 in conservation, \$19,498 in customer accounts, and \$28,072 in general and administrative expenses; which were offset by a decrease of \$308,610 in transmission and distribution expenses. Increases in source of supply, pumping, water treatment and recycled water were attributed to feasibility studies for new projects, electric utilities, and major maintenance programs. In 2015, the District's operating expenses decreased 23.17% or \$1,261,936 to \$4,183,637, primarily due to decreases of \$665,215 in source of supply, \$123,975 in pumping, \$228,468 in conservation, and \$257,969 in general and administrative expenses.

The District's non-operating expenses increased 15.57%, or \$56,283 to \$417,796 primarily due to a \$30,645 decrease in interest expense related to the District's long-term debt, which was offset by an \$86,928 increase of costs associated with the retirement of the 2003 refunding bonds during the year. In 2015, the District's non-operating expenses decreased 4.42% or \$16,727 to \$361,513, primarily due to a decrease in \$16,727 in interest expense related to the District's long-term debt.

Capital Asset Administration

At the end of fiscal years 2016 and 2015, the District's investment in capital assets amounted to \$20,027,733 and \$19,521,856 (net of accumulated depreciation), respectively. The District's investment in capital assets includes land, transmission and distribution systems, tanks, pumps, buildings, equipment, vehicles and construction-in-process.

Changes in capital asset amounts for 2016 were as follows:

	<u>Balance</u> <u>2015</u>	<u>Additions</u>	<u>Transfers/ Deletions</u>	<u>Balance</u> <u>2016</u>
Capital assets:				
Non-depreciable assets	\$ 1,752,402	1,554,922	(121,608)	3,185,716
Depreciable assets	37,338,298	260,450	(501,404)	37,097,344
Accumulated depreciation	<u>(19,568,844)</u>	<u>(913,955)</u>	<u>227,472</u>	<u>(20,255,327)</u>
Total capital assets, net	<u>\$ 19,521,856</u>			<u>20,027,733</u>

Scotts Valley Water District
Management's Discussion and Analysis, continued
For the Fiscal Years Ended June 30, 2016 and 2015

Capital Asset Administration, continued

Changes in capital asset amounts for 2015 were as follows:

	<u>Balance 2014</u>	<u>Additions</u>	<u>Transfers/ Deletions</u>	<u>Balance 2015</u>
Capital assets				
Non-depreciable assets	\$ 1,310,905	791,501	(350,004)	1,752,402
Depreciable assets	37,201,917	367,869	(231,488)	37,338,298
Accumulated depreciation	<u>(18,890,513)</u>	<u>(883,616)</u>	<u>205,285</u>	<u>(19,568,844)</u>
Total capital assets, net	<u>\$ 19,622,309</u>			<u>19,521,856</u>

See note 4 for further capital asset information.

Debt Administration

Changes in long-term debt amounts for 2016, were as follows:

	<u>Balance 2015</u>	<u>Additions</u>	<u>Transfers/ Deletions</u>	<u>Balance 2016</u>
Long-term debt:				
2003 Refunding Bonds	\$ 785,000	-	(785,000)	-
Discount on debt	<u>(4,231)</u>	<u>-</u>	<u>4,231</u>	<u>-</u>
	<u>780,769</u>	<u>-</u>	<u>(780,769)</u>	<u>-</u>
2004 COP	2,680,000	-	(160,000)	2,520,000
Discount on debt	<u>(24,551)</u>	<u>-</u>	<u>1,964</u>	<u>(22,587)</u>
	<u>2,655,449</u>	<u>-</u>	<u>(158,036)</u>	<u>2,497,413</u>
2011 Note Payable	<u>4,535,000</u>	<u>-</u>	<u>(210,000)</u>	<u>4,325,000</u>
Total loans payable	<u>\$ 7,971,218</u>	<u>-</u>	<u>(1,148,805)</u>	<u>6,822,413</u>

Changes in long-term debt amounts for 2015, were as follows:

	<u>Balance 2014</u>	<u>Additions</u>	<u>Transfers/ Deletions</u>	<u>Balance 2015</u>
Long-term debt:				
2003 Refunding Bonds	\$ 925,000	-	(140,000)	785,000
Discount on debt	<u>(4,999)</u>	<u>-</u>	<u>768</u>	<u>(4,231)</u>
	<u>920,001</u>	<u>-</u>	<u>(139,232)</u>	<u>780,769</u>
2004 COP	2,830,000	-	(150,000)	2,680,000
Discount on debt	<u>(26,515)</u>	<u>-</u>	<u>1,964</u>	<u>(24,551)</u>
	<u>2,803,485</u>	<u>-</u>	<u>(148,036)</u>	<u>2,655,449</u>
2011 Note Payable	<u>4,740,000</u>	<u>-</u>	<u>(205,000)</u>	<u>4,535,000</u>
Total loans payable	<u>\$ 8,463,486</u>	<u>-</u>	<u>(492,268)</u>	<u>7,971,218</u>

In 2016, long-term debt decreased by \$1,148,805, primarily due to principal payments, including the full payment of its 2003 refunding bonds of \$785,000. In 2015, long-term debt decreased by \$492,268, primarily due to principal payments. See further detailed information in Note 9.

Scotts Valley Water District
Management's Discussion and Analysis, continued
For the Fiscal Years Ended June 30, 2016 and 2015

Debt Service Coverage Ratio

	<u>2016</u>	<u>2015</u>
Total revenues	\$ 5,697,524	5,689,304
Less: capital contributions - grants	<u>(335,704)</u>	<u>(399,554)</u>
Operating revenue:	<u>5,361,820</u>	<u>5,289,750</u>
Total expenses	6,110,165	5,428,765
Less: Non- cash expenses	(1,329,039)	(954,957)
Less: Interest expense on debt service	<u>(268,352)</u>	<u>(298,989)</u>
Total operating expenses	\$ <u>4,512,774</u>	<u>4,174,819</u>
Net operating revenue	\$ 849,046	1,114,931
Debt service (due in fiscal year)	\$ 788,351	793,989
Debt service coverage ratio	1.08	1.40

In fiscal year 2016, the District was out of compliance with the Rate Covenant requirements for the 2004 Refunding Certificate and the 2011 Loan to maintain a debt service coverage of at least 1.20. The 2004 Refunding Certificate requires remedial action in the succeeding year to hire an independent consultant to conduct a rate study, and to implement the new rate plan within 60 days of its adoption. As water sales revenue continued to decline, the District proactively hired an independent rate consultant to conduct a comprehensive fee/rate study in January 2016. The new rate plan will be implemented following completion of the Prop 218 requirements and Board approval.

Conditions Affecting Current Financial Position

Management is unaware of any conditions which could have a significant impact on the District's current financial position, net assets or operating results based on past, present and future events.

Requests for Information

This financial report is designed to provide the District's funding sources, customers, stakeholders and other interested parties with an overview of the District's financial operations and financial condition. Should the reader have questions regarding the information included in this report or wish to request additional financial information, please contact the District's General Manager, Piret Harmon at Scotts Valley Water District, 2 Civic Center Drive, Scotts Valley, CA 95066 or (831) 438-2363.

Basic Financial Statements

Scotts Valley Water District
Statements of Net Position
June 30, 2016 and 2015

	2016	2015
Current assets:		
Cash and cash equivalents (note 2)	\$ 2,924,816	5,251,395
Cash & cash equivalents – restricted (note 2)	749,404	932,329
Accrued interest receivable	6,467	6,221
Accounts receivable, net	848,798	763,700
Accounts receivable – property tax	42,991	17,905
Accounts receivable – other	53,734	840,565
Materials and supplies inventory	201,758	180,040
Prepaid expenses and deposits	92,278	76,558
Note receivable – due in one year (note 3)	160,339	11,512
Total current assets	5,080,585	8,080,225
Non-current assets:		
Note receivable – due in more than one year (note 3)	715,853	118,023
Capital assets – not being depreciated (note 4)	3,185,716	1,752,402
Capital assets – being depreciated (note 4)	16,842,017	17,769,454
Total non-current assets	20,743,586	19,639,879
Total assets	25,824,171	27,720,104
Deferred outflows of resources:		
Deferred pension outflows (note 5 and 10)	209,294	619,531
Loss on defeasance of debt (note 5)	460,564	603,814
Total deferred outflows of resources	\$ 669,858	1,223,345

Continued on next page

See accompanying notes to the basic financial statements

Scotts Valley Water District
Statements of Net Position, continued
June 30, 2016 and 2015

	2016	2015
Current liabilities:		
Accounts payable and accrued expense	\$ 325,292	988,052
Accrued wages and related payables	53,896	39,293
Accrued interest payable	125,557	147,430
Customer deposits	33,893	105,468
Long-term liabilities – due in one year:		
Compensated absences (note 6)	22,051	18,255
Note payable (note 9)	215,000	210,000
Certificates of Participation (note 9)	165,000	160,000
Bonds payable (note 9)	-	150,000
Total current liabilities	940,689	1,818,498
Non-current liabilities:		
Unearned revenue	1,770	3,542
Long-term liabilities – due in more than one year:		
Compensated absences (note 6)	66,154	54,764
Other post-employment benefits payable (note 7)	1,184,517	1,211,880
Net pension liability (note 10)	1,233,015	1,329,971
Note payable (note 9)	4,110,000	4,325,000
Certificates of Participation (note 9)	2,332,413	2,495,449
Bonds payable (note 9)	-	630,769
Total non-current liabilities	8,927,869	10,051,375
Total liabilities	9,868,558	11,869,873
Deferred inflows of resources:		
Deferred pension inflows (note 8 and 10)	411,468	446,932
Total deferred inflows of resources	411,468	446,932
Net position: (note 12)		
Net investment in capital assets	13,665,884	12,154,452
Restricted for debt service	749,404	932,329
Unrestricted	1,798,715	3,539,863
Total net position	\$ 16,214,003	16,626,644

See accompanying notes to the basic financial statements

Scotts Valley Water District
Statements of Revenues, Expenses and Change in Net Position
For the Fiscal Years Ended June 30, 2016 and 2015

	2016	2015
Operating revenues:		
Water sales	\$ 2,242,642	2,350,163
Service charges	1,348,590	1,566,851
Water sales – recycled	382,366	317,926
Other revenue	75,366	264,919
Total operating revenues	4,048,964	4,499,859
Operating expenses:		
Source of supply	105,192	1,638
Pumping	564,632	478,911
Water treatment	741,746	558,991
Recycled water	546,568	102,152
Transmission and distribution	820,443	1,129,053
Conservation	241,892	202,521
Customer accounts	207,833	188,335
General and administrative expenses	1,550,108	1,522,036
Total operating expenses	4,778,414	4,183,637
Operating income before depreciation	(729,450)	316,222
Depreciation expense	(913,955)	(883,615)
Operating loss	(1,643,405)	(567,393)
Non-operating revenue (expense):		
Property tax revenues	775,679	724,433
Investment earnings	39,106	24,848
Interest expense	(417,796)	(361,513)
Gain on disposal of fixed assets, net	487,735	19,822
Other non-operating revenue	10,336	20,788
Total non-operating revenues, net	895,060	428,378
Net loss before capital contributions	(748,345)	(139,015)
Capital contributions:		
Capital contributions	89,000	-
Capital grants – state	246,704	399,554
Total capital contributions	335,704	399,554
Change in net position	(412,641)	260,539
Net position, beginning of period, as previously stated	16,626,644	18,007,372
Prior period adjustment (note 11)	-	(1,641,267)
Net position, beginning of period, as restated	16,626,644	16,366,105
Net position, end of period	\$ 16,214,003	16,626,644

See accompanying notes to the basic financial statements

Scotts Valley Water District
Statements of Cash Flows
For the Fiscal Years Ended June 30, 2016 and 2015

	2016	2015
Cash flows from operating activities:		
Cash received from customers	\$ 4,677,350	4,223,123
Cash paid to employees for salaries	(1,414,543)	(1,431,848)
Payments to vendors for materials and services	(3,783,826)	(3,058,748)
Net cash used in operating activities	(521,019)	(267,473)
Cash flows from non-capital financing activities:		
Proceeds from property taxes	750,593	737,989
Other non-operating revenue, net	10,336	20,788
Net cash provided by non-capital financing activities	760,929	758,777
Cash flows from capital and related financing activities:		
Cash paid to acquire capital assets	(1,693,764)	(809,364)
Proceeds from the sale of capital assets	3,500	46,024
Principal paid on long-term debt	(1,155,000)	(495,000)
Proceeds from capital grant	335,704	399,554
Interest paid	(290,226)	(307,474)
Principal payments received on note receivable	11,512	11,512
Net cash used in capital and related financing activities	(2,788,274)	(1,154,748)
Cash flows from investing activities:		
Investment earnings	38,860	24,921
Net cash provided by investing activities	38,860	24,921
Net decrease in cash and cash equivalents	(2,509,504)	(638,523)
Cash and cash equivalents – beginning of year	6,183,724	6,822,247
Cash and cash equivalents – end of year	\$ 3,674,220	6,183,724
Reconciliation of cash and cash equivalents to statements of net position:		
Cash and cash equivalents	\$ 2,924,816	5,251,395
Cash and cash equivalents – restricted	749,404	932,329
Total cash and cash equivalents	\$ 3,674,220	6,183,724

Continued on next page

See accompanying notes to the basic financial statements

Scotts Valley Water District
Statements of Cash Flows, continued
For the Fiscal Years Ended June 30, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Reconciliation of operating loss to net cash used in operating activities:		
Operating loss	\$ <u>(1,643,405)</u>	<u>(567,393)</u>
Adjustments to reconcile operating income to net cash used in operating activities:		
Depreciation and amortization	913,955	883,615
Changes in assets, deferred outflows of resources, liabilities and deferred inflows of resources:		
(Increase) decrease in assets and deferred outflows of resources:		
Customer accounts receivable	(85,098)	128,811
Accounts receivable – other	786,831	(262,791)
Materials and supplies inventory	(21,718)	(4,631)
Prepaid expenses and deposits	(15,720)	(2,478)
Deferred outflows of resources	410,237	(443,581)
Increase (decrease) in liabilities and deferred inflows of resources:		
Accounts payable and accrued expense	(662,760)	215,958
Accrued wages and related payables	14,603	9,294
Customer deposits	(71,575)	(140,984)
Compensated absences	15,186	(34,022)
Other post-employment benefits obligation	(27,363)	(7,185)
Net pension liability	(96,956)	(487,246)
Unearned revenue	(1,772)	(1,772)
Deferred inflows of resources	<u>(35,464)</u>	<u>446,932</u>
Total adjustments	<u>1,122,386</u>	<u>299,920</u>
Net cash used in operating activities	<u>\$ <u>(521,019)</u></u>	<u>(267,473)</u>

See accompanying notes to the basic financial statements

Scotts Valley Water District
Notes to the Financial Statements
For the Fiscal Years Ended June 30, 2016 and 2015

(1) Reporting Entity and Summary of Significant Accounting Policies

A. Reporting Entity and Component Unit

Scotts Valley Water District (District) was created in 1961 by a vote of the people within the proposed District. It is formed by under the County Water District Act with the purpose of providing water for domestic, commercial, municipal and firefighting purposes. Beginning in 1962, the District acquired and consolidated several small mutual water supply systems. The District is located six miles north of the City of Santa Cruz, along State Highway 17 and covers approximately six square miles including most of the incorporated area of the City of Scotts Valley (City) and a portion of the unincorporated area north of the City.

The financial statements of the District include the financial activities of the District as well as transactions made by (1) the fiscal agent under authority granted by the District in various resolutions authorizing the issuance of revenue bonds, and (2) the Scotts Valley Water District Public Facilities Corporation, a component unit (see below). The District is incorporated as a water district in the State of California and is exempt from federal income and state franchise taxes under Internal Revenue Code Section 115 and corresponding California Revenue and Taxation Code provisions.

The Scotts Valley Water District Public Facilities Corporation (Public Facilities Corporation), a California nonprofit corporation, was formed in April 1997, to finance the construction of a one million gallon per day reclaimed water treatment plant and related distribution system. The District's directors serve as directors of the Public Facilities Corporation; the District's General Manager serves as its executive officer. The assets and liabilities of the Public Facilities Corporation are blended with those of the District in the financial statement.

B. Basis of Accounting and Measurement Focus

The District reports its activities as an enterprise fund, which is used to account for operations that are financed and operated in a manner similar to a private business enterprise, where the intent of the District is that the costs of providing water to its service area on a continuing basis be financed or recovered primarily through user charges (water sales), capital grants and similar funding. Revenues and expenses are recognized on the full accrual basis of accounting. Revenues are recognized in the accounting period in which they are earned and expenses are recognized in the period incurred, regardless of when the related cash flows take place.

Operating revenues and expenses, such as water sales and water purchases, result from exchange transactions associated with the principal activity of the District. Exchange transactions are those in which each party receives and gives up essentially equal values. Management, administration and depreciation expenses are also considered operating expenses. Other revenues and expenses not included in the above categories are reported as non-operating revenues and expenses.

C. Financial Reporting

The District's basic financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP), as applied to enterprise funds. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The District solely operates as a special-purpose government which means it is only engaged in business-type activities; accordingly, activities are reported in the District's proprietary fund.

Scotts Valley Water District
Notes to the Financial Statements, continued
For the Fiscal Years Ended June 30, 2016 and 2015

(1) Summary of Significant Accounting Policies, continued

C. Financial Reporting, continued

The District has adopted the following GASB pronouncements in the current year:

In February 2015, the GASB issued Statement No. 72 – *Fair Value Measurement and Application*, effective for financial statements for periods beginning after June 15, 2015. The objective of this Statement is to enhance comparability of financial statements among governments by measurement of certain assets and liabilities at their fair value using a consistent and more detailed definition of fair value and accepted valuation techniques. The definition of *fair value* is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This Statement establishes a hierarchy of inputs to valuation techniques used to measure fair value.

In June 2015, the GASB issued Statement No. 73 – *Accounting and Financial Reporting for Pensions and Related Assets that are not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statement 67 and 68*, effective for fiscal years beginning after June 15, 2015. The objective of this Statement is to improve the usefulness of information about pensions included in the general purpose external financial reports of state and local governments for making decisions and assessing accountability. This Statement establishes requirements for defined benefit pensions that are not within the Scope of Statement No. 68, *Accounting and Financial Reporting for Pensions*, as well as for the assets accumulated for purposes of providing those pensions.

In June 2015, the GASB issued Statement No. 76 – *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*, effective for financial statements for periods beginning after June 15, 2015. This Statement replaces the requirements of Statement No. 55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*. The objective of this Statement is to identify – in the context of the current governmental financial reporting environment – the hierarchy of generally accepted accounting principles (GAAP). The “GAAP hierarchy” consists of the sources of accounting principles used to prepare financial statements of local governmental entities in conformity with GAAP and the framework for selecting those principles. This statement reduces the GAAP hierarchy to two categories of authoritative GAAP and addresses the use of authoritative and non-authoritative literature in the event that the accounting treatment is not specified within the source of authoritative GAAP.

In December 2015, the GASB issued Statement No. 79 – *Certain External Investment Pools and Pool Participants*, effective for financial statements for periods beginning after June 15, 2015. This Statement enhances comparability of financial statements among governments by establishing specific criteria used to determine whether a qualifying external investment pool may elect to use an amortized cost exception to fair value measurement. Those criteria will provide qualifying external investment pools and participants in those pools with consistent application of an amortized cost-based measurement for financial reporting purposes. That measurement approximates fair value and mirrors the operations of external investment pools that transact with participants at a stable net asset value per share.

D. Assets, Deferred Outflows, Liabilities, Deferred Inflows and Net Position

1. Use of Estimates

The preparation of the basic financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets, deferred outflows, liabilities, deferred inflows and disclosures of contingent assets and liabilities at the date of the financial statements and the reported changes in net position during the reporting period. Actual results could differ from those estimates.

Scotts Valley Water District
Notes to the Financial Statements, continued
For the Fiscal Years Ended June 30, 2016 and 2015

(1) Summary of Significant Accounting Policies, continued

D. Assets, Deferred Outflows, Liabilities, Deferred Inflows and Net Position, continued

2. Cash and Cash Equivalents

For the purpose of the statements of cash flows, cash and cash equivalents include time deposits, certificates of deposit, investment in Local Agency Investment Fund (LAIF), and all highly liquid debt instruments.

3. Investments and Investment Policy

The District has adopted an investment policy for the prudent investment of the District's surplus cash, reserves, trust funds and restricted monies in a manner that will provide the highest investment return with the maximum security while meeting the cash flow demands of the District and conforming to all provisions of California Government Code Section 53600.

Changes in fair value that occur during a fiscal year are recognized as investment income reported for that fiscal year. Investment income includes interest earnings, changes in fair value, and any gains or losses realized upon the liquidation or sale of investments.

4. Fair Value Measurements

The District categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. The hierarchy is based on valuation inputs used to measure the fair value of the asset, as follows:

- **Level 1** – Valuation is based on quoted prices in active markets for identical assets.
- **Level 2** – Valuation is based on directly observable and indirectly observable inputs. These inputs are derived principally from or corroborated by observable market data through correlation or market-corroborated inputs. The concept of market-corroborated inputs incorporates observable market data such as interest rates and yield curves that are observable at commonly quoted intervals.
- **Level 3** – Valuation is based on unobservable inputs where assumptions are made based on factors such as prepayment rates, probability of defaults, loss severity and other assumptions that are internally generated and cannot be observed in the market.

5. Accounts Receivable and Allowance for Uncollectible Accounts

The District extends credit to customers in the normal course of operations. When management deems customer accounts uncollectible, the District uses the allowance method for the reservation and write-off of those accounts.

6. Property Taxes and Assessments

The Santa Cruz County Assessor's Office assesses all real and personal property within the County each year. The Santa Cruz County Tax Collector's Offices bills and collects the District's share of property taxes and assessments. The Auditor-Controller's Office remits current and delinquent property tax collections to the District throughout the year. Property tax in California is levied in accordance with Article 13A of the State Constitution at one percent (1%) of countywide assessed valuations.

Scotts Valley Water District
Notes to the Financial Statements, continued
For the Fiscal Years Ended June 30, 2016 and 2015

(1) Summary of Significant Accounting Policies, continued

D. Assets, Deferred Outflows, Liabilities, Deferred Inflows and Net Position, continued

6. Property Taxes and Assessments, continued

Property taxes receivable at year-end are related to property taxes collected by the Santa Cruz County which have not been credited to the District's cash balance as of June 30. The property tax calendar is as follows:

Lien date	March 1
Levy date	July 1
Due dates	November 1 and March 1
Collection dates	December 10 and April 10

7. Supplies Inventory

Supplies inventory consists primarily of water meters, pipe and pipefittings for construction and repair to the District's water transmission and distribution system. Supplies inventory is carried at the lower of cost (first-in, first-out) or market.

8. Prepaid Expenses

Certain payments to vendors reflect costs or deposits applicable to future accounting periods and are recorded as prepaid items in the basic financial statements.

9. Capital Assets

District capital assets, purchased or constructed, are recorded at cost. The cost of assets built by the District includes direct costs and eligible capitalized interest. Contributed assets are recorded at fair market value at the date of contribution. That value is generally the developer's cost.

The amount of interest capitalized as part of the District constructed assets is the difference between the interest the District must pay on the tax-exempt bonds issued to finance improvements, and the interest the District earns on bond proceeds not yet expended.

District policy is to capitalize all assets that cost \$5,000 or more with a life greater than two years, and to charge to current operations all additions under that cost limit. The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend lives are also expensed in the current period.

Depreciation expense is computed using the straight-line method over the estimated useful lives of the capital asset, which range from five to fifty years.

10. Deferred Outflows of Resources

Deferred outflows of resources represent the consumption of resources applicable to future periods.

11. Compensated Absences

The District records employees' vacation and sick leave benefits in the period in which they accumulate and become vested.

12. Deferred Inflows of Resources

Deferred inflows of resources represent the acquisition of resources applicable to future periods.

Scotts Valley Water District
Notes to the Financial Statements, continued
For the Fiscal Years Ended June 30, 2016 and 2015

(1) Summary of Significant Accounting Policies, continued

D. Assets, Deferred Outflows, Liabilities, Deferred Inflows and Net Position, continued

13. Net Position

The District follows the financial reporting requirements of the GASB and reports net position under the following classifications:

- **Net Investment in Capital Assets** – This component of net position consists of capital assets, net of accumulated depreciation and amortization, and reduced by outstanding balances of any debt, or other long-term borrowings that are attributable to the acquisition, construction, or improvement of those assets.
- **Restricted** – This component of net position consists of constraints placed on net position use through external constraints imposed by creditors, contributors, or laws or regulations of other governments or constraints imposed by law through constitutional provisions or enabling legislation.
- **Unrestricted** – This component of net position consists of net position that does not meet the definition of “restricted” or “net investment in capital assets”.

14. Water Sales

Potable water sales are billed on a bi-monthly cyclical basis. Recycled water sales and bulk water sales are billed on a monthly basis.

15. Capital Contributions

Capital contributions represent cash and capital asset additions contributed to the District by property owners, granting agencies or real estate developers desiring services that require capital expenditures or capacity commitment.

16. Pensions

For purposes of measuring the net pension liability and deferred outflows/inflows of resources related to pensions, and pension expense, information about the fiduciary net position of the District’s California Public Employees’ Retirement System (CalPERS) plan (Plan) and addition to/deduction from the Plan’s fiduciary net position have been determined on the same basis as they are reported by CalPERS. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value.

GASB 68 requires that the reported results must pertain to liability and asset information within certain defined timeframes. For this report, the following timeframes are used:

- Valuation Date: June 30, 2014 and 2013
- Measurement Date: June 30, 2015 and 2014
- Measurement Period: July 1, 2014 to June 30, 2015 and July 1, 2013 to June 30, 2014

17. Budgetary Policies

The District adopts an annual non-appropriated budget for planning, control, and evaluation purposes. Budgetary control and evaluation are affected by comparisons of actual revenues and expenses with planned revenues and expenses for the period. Encumbrance accounting is not used to account for commitments related to unperformed contracts for construction and services.

18. Reclassification of prior year comparative figures

Certain prior year comparatives have been reclassified to conform to the current year’s presentation.

Scotts Valley Water District
Notes to the Financial Statements, continued
For the Fiscal Years Ended June 30, 2016 and 2015

(2) Cash and Investments

Cash and cash equivalents as of June 30, are classified in the accompanying financial statements as follows:

	<u>2016</u>	<u>2015</u>
Cash and cash equivalents	\$ 2,924,816	5,251,395
Cash & cash equivalents – restricted	<u>749,404</u>	<u>932,329</u>
Total cash and cash equivalents	<u>\$ 3,674,220</u>	<u>6,183,724</u>

Cash and equivalents as of June 30 consist of the following:

	<u>2016</u>	<u>2015</u>
Petty cash	\$ 195	400
Deposits with financial institutions	1,546,489	3,861,603
Investments	<u>2,127,536</u>	<u>2,321,721</u>
Total cash and cash equivalents	<u>\$ 3,674,220</u>	<u>6,183,724</u>

As of June 30, the District’s authorized deposits had the following maturities:

	<u>2016</u>	<u>2015</u>
Deposits held with California Local Agency Investment Fund (LAIF)	167 days	239 days

Investments Authorized by the California Government Code and the District’s Investment Policy

The table below identifies the investment types that are authorized by the District in accordance with the California Government Code (or the District’s investment policy, where more restrictive). 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, credit risk, and concentration of credit risk.

<u>Authorized Investment Type</u>	<u>Maximum Maturity</u>	<u>Maximum Percentage Of Portfolio</u>	<u>Maximum Investment in One Issuer</u>
U.S Treasury and Agency securities	5 years	None	None
Certificates-of-deposit (negotiable or placed)	5 years	30%	50%
Passbook savings account	None	None	None
Investment Trust of California (CalTRUST)	5 years	None	None
California Local Agency Investment Fund (LAIF)	N/A	None	None

Custodial Credit Risk

Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The California Government Code and the District’s investment policy 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 governmental units by pledging securities in an undivided collateral pool held by a depository regulated under state law (unless so waived by the governmental unit).

Scotts Valley Water District
Notes to the Financial Statements, continued
For the Fiscal Years Ended June 30, 2016 and 2015

(2) Cash and Investments, continued

Custodial Credit Risk, continued

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. Of the bank balances, up to \$250,000 held at each institution were federally insured and the remaining balance is collateralized in accordance with the Code; however, the collateralized securities are not held in the District's name.

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

Investment in State Investment Pool

The District is a voluntary participant in the Local Agency Investment Fund (LAIF) that is regulated by the California Government Code under the oversight of the Treasurer of the State of California. The fair value of the District's investment in this pool is reported in the accompanying financial statements at amounts based upon the District's pro-rata share of the fair value provided by LAIF for the entire LAIF portfolio (in relation to the amortized cost of that portfolio). The balance available for withdrawal is based on the accounting records maintained by LAIF, which are recorded on an amortized cost basis.

The District's deposit and withdrawal restrictions and limitations are as follows:

- Same day transaction processing occurs for orders received before 10:00 a.m.
- Next day transactions processing occurs for orders received after 10:00 a.m.
- Maximum limit of 15 transactions (combination of deposits and withdrawals) per month.
- Minimum transaction amount requirement of \$5,000, in increments of a \$1,000 dollars.
- Withdrawals of \$10,000,000 or more require 24 hours advance.
- Prior to funds transfer, an authorized person must call LAIF to do a verbal transaction.

Interest Rate Risk

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

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.

Concentration of Credit Risk

The District's investment policy contains no limitations on the amounts that can be invested in any one issuer as beyond that stipulated by the California Government Code. There were no investments in any one issuer (other than for U.S. Treasury securities, mutual funds, and external investment pools) that represent 5% or more of total District's investments at June 30, 2016 and 2015.

Scotts Valley Water District
Notes to the Financial Statements, continued
For the Fiscal Years Ended June 30, 2016 and 2015

(3) Note Receivable

Changes in note receivable amounts for 2016, were as follows:

	<u>Balance 2015</u>	<u>Additions</u>	<u>Transfers/ Deletions</u>	<u>Balance 2016</u>
Note receivable:				
City of Scotts Valley - RCW	\$ -	758,169	-	758,169
City of Scotts Valley - 97-1 Bonds	110,000	-	(5,000)	105,000
Vineyards HOA MOU	<u>19,535</u>	<u>-</u>	<u>(6,512)</u>	<u>13,023</u>
Total note receivable	129,535	<u>758,169</u>	<u>(11,512)</u>	876,192
Less: current portion	<u>(11,512)</u>			<u>(160,339)</u>
Long-term portion	<u>\$ 118,023</u>			<u>715,853</u>

Changes in note receivable amounts for 2015, were as follows:

	<u>Balance 2015</u>	<u>Additions</u>	<u>Transfers/ Deletions</u>	<u>Balance 2016</u>
Note receivable:				
City of Scotts Valley - 97-1 Bonds	\$ 115,000	-	(5,000)	110,000
Vineyards HOA MOU	<u>26,047</u>	<u>-</u>	<u>(6,512)</u>	<u>19,535</u>
Total note receivable	141,047	<u>-</u>	<u>(11,512)</u>	129,535
Less: current portion	<u>(11,512)</u>			<u>(11,512)</u>
Long-term portion	<u>\$ 129,535</u>			<u>118,023</u>

Vineyards HOA MOU

On October 15, 2008, the District entered into a Memorandum of Understanding with the Vineyards Homeowners Association (Association) where the Association agreed to pay the District for installation of backflow protective devices on the Association's premises totaling \$65,116. The Association will make 10 equal annual payments of \$6,511.60 on November 30th each year. At June 30, 2016 and 2015, the balance of the note with the Association amounted to \$13,023 and \$19,535, respectively.

City of Scotts Valley - RCW

On September 4, 2013, the District entered into a Recycled Water Supply Use, Maintenance and Operation Agreement (Agreement) setting forth terms and conditions between the parties concerning the relationship of the parties with respect to the City of Scotts Valley's (City) Waste Water Treatment Plant (WWTP) and the Tertiary Treatment Plant and Pump Station that was constructed at the City's Waste Water Facility by the District. The District and the City have agreed for the District to release a portion of its guaranteed entitlement in exchange for compensation from the City. The District agreed to reduce its entitlement to waste water for tertiary treatment to the City. In exchange, the City agrees to pay the District \$758,169 over five (5) equal annual payments of \$155,817 with annual interest rate of 0.91% each year commencing on June 1, 2017.

Scotts Valley Water District
Notes to the Financial Statements, continued
For the Fiscal Years Ended June 30, 2016 and 2015

(3) Note Receivable, continued

City of Scotts Valley - RCW, continued

Principal and estimated interest receivable payments on the note are as follows:

<u>Fiscal Year</u>	<u>Principal</u>	<u>Amortized Interest</u>	<u>Total</u>
2017 \$	148,827	6,990	155,817
2018	150,272	5,545	155,817
2019	151,639	4,178	155,817
2020	153,019	2,798	155,817
2021	154,412	1,405	155,817
Total	758,169	20,916	779,085
Less: Current portion	<u>(148,827)</u>		
Total non-current \$	<u><u>609,342</u></u>		

City of Scotts Valley - 97-1 bonds

The City of Scotts Valley (City) entered into an agreement with the District on June 4, 1997, for the construction of the water main extension into the Gateway South vicinity (Extension) in order to furnish water facilities to supply sufficient water and pressure for adequate fire suppression and to assist a project known as the Inn at Scotts Valley (Project). Total cost of the extension amounted to \$277,000. The owner of the Project is contributing \$112,000, as its share of the Extension, and the City will be contributing, as a result of the District's bond issuance, \$165,000.

Terms of the agreement call for principal payable semi-annually on January 1st and July 1st of each year maturing in 2027, with variable annual interest rates ranging from 5.3% to 7%. At June 30, 2016 and 2015, the balance of the note with the City regarding the 97-1 Bonds amounted to \$105,000 and \$110,000, respectively.

Principal and estimated interest receivable payments on the note are as follows:

<u>Fiscal Year</u>	<u>Principal</u>	<u>Amortized Interest</u>	<u>Total</u>
2017 \$	5,000	6,150	11,150
2018	5,000	5,850	10,850
2019	10,000	5,400	15,400
2020	10,000	4,800	14,800
2021	5,000	4,350	9,350
2022-2026	45,000	14,850	59,850
2027-2028	25,000	1,650	26,650
Total	105,000	43,050	148,050
Less: Current portion	<u>(5,000)</u>		
Total non-current \$	<u><u>100,000</u></u>		

Scotts Valley Water District
Notes to the Financial Statements, continued
For the Fiscal Years Ended June 30, 2016 and 2015

(4) Capital Assets

Changes in capital assets for 2016, were as follows:

	<u>Balance 2015</u>	<u>Additions/ Transfers</u>	<u>Deletions/ Transfers</u>	<u>Balance 2016</u>
Non-depreciable assets:				
Land & land rights	\$ 641,798	-	-	641,798
Construction-in-process	1,110,604	1,554,922	(121,608)	2,543,918
Total non-depreciable assets	<u>1,752,402</u>	<u>1,554,922</u>	<u>(121,608)</u>	<u>3,185,716</u>
Depreciable assets:				
Water rights – recycled water	5,629,279	-	(361,445)	5,267,834
Water treatment	5,539,378	-	-	5,539,378
Transmission and distribution	8,781,015	76,540	-	8,857,555
Resserviors and tanks	5,863,804	-	-	5,863,804
Source of supply - wells	5,609,973	-	-	5,609,973
Pumping	1,253,482	84,374	(37,997)	1,299,859
Buildings	877,967	-	-	877,967
Recycled water	2,455,616	12,460	-	2,468,076
Equipment and tools	703,613	-	-	703,613
Office equipment	130,376	-	(64,807)	65,569
Transportation	493,795	87,076	(37,155)	543,716
Total depreciable assets	<u>37,338,298</u>	<u>260,450</u>	<u>(501,404)</u>	<u>37,097,344</u>
Accumulated depreciation:				
Water rights – Recycled water	(1,485,226)	(112,586)	101,206	(1,496,606)
Water treatment	(4,344,891)	(134,922)	-	(4,479,813)
Transmission and distribution	(5,049,289)	(184,077)	-	(5,233,366)
Resserviors and tanks	(2,523,635)	(143,588)	-	(2,667,223)
Source of supply - wells	(3,270,633)	(137,357)	-	(3,407,990)
Pumping	(929,919)	(44,190)	24,304	(949,805)
Buildings	(439,592)	(28,968)	-	(468,560)
Recycled water	(556,968)	(61,996)	-	(618,964)
Equipment and tools	(513,647)	(40,195)	-	(553,842)
Office equipment	(122,872)	(1,407)	64,807	(59,472)
Transportation	(332,172)	(24,669)	37,155	(319,686)
Total accumulated depreciation	<u>(19,568,844)</u>	<u>(913,955)</u>	<u>227,472</u>	<u>(20,255,327)</u>
Total depreciable assets, net	<u>17,769,454</u>	<u>(653,505)</u>	<u>(273,932)</u>	<u>16,842,017</u>
Total capital assets, net	<u>\$ 19,521,856</u>			<u>20,027,733</u>

In fiscal year 2016, major capital assets additions include upgrades as follows: transmission and distribution systems \$76,540, pumping system \$84,374, transportation equipment \$87,076 and recycled water system \$12,460.

Scotts Valley Water District
Notes to the Financial Statements, continued
For the Fiscal Years Ended June 30, 2016 and 2015

(4) Capital Assets, continued

Changes in capital assets for 2015, were as follows:

	<u>Balance 2014</u>	<u>Additions/ Transfers</u>	<u>Deletions/ Transfers</u>	<u>Balance 2015</u>
Non-depreciable assets:				
Land & land rights	\$ 641,798	-	-	641,798
Construction-in-process	669,107	791,501	(350,004)	1,110,604
Total non-depreciable assets	<u>1,310,905</u>	<u>791,501</u>	<u>(350,004)</u>	<u>1,752,402</u>
Depreciable assets:				
Water rights – recycled water	5,629,279	-	-	5,629,279
Water treatment	5,539,378	-	-	5,539,378
Transmission and distribution	8,755,998	25,017	-	8,781,015
Resserviors and tanks	5,863,804	-	-	5,863,804
Source of supply - wells	5,609,973	-	-	5,609,973
Pumping	1,253,482	-	-	1,253,482
Buildings	646,872	231,095	-	877,967
Recycled water	2,455,616	-	-	2,455,616
Equipment and tools	825,653	-	(122,040)	703,613
Office equipment	199,104	-	(68,728)	130,376
Transportation	422,758	111,757	(40,720)	493,795
Total depreciable assets	<u>37,201,917</u>	<u>367,869</u>	<u>(231,488)</u>	<u>37,338,298</u>
Accumulated depreciation:				
Water rights – Recycled water	(1,372,640)	(112,586)	-	(1,485,226)
Water treatment	(4,227,791)	(117,100)	-	(4,344,891)
Transmission and distribution	(4,866,867)	(182,422)	-	(5,049,289)
Resserviors and tanks	(2,384,764)	(138,871)	-	(2,523,635)
Source of supply - wells	(3,133,161)	(137,472)	-	(3,270,633)
Pumping	(884,252)	(45,667)	-	(929,919)
Buildings	(419,125)	(20,467)	-	(439,592)
Recycled water	(495,232)	(61,736)	-	(556,968)
Equipment and tools	(561,792)	(47,692)	95,837	(513,647)
Office equipment	(189,990)	(1,610)	68,728	(122,872)
Transportation	(354,899)	(17,993)	40,720	(332,172)
Total accumulated depreciation	<u>(18,890,513)</u>	<u>(883,616)</u>	<u>205,285</u>	<u>(19,568,844)</u>
Total depreciable assets, net	<u>18,311,404</u>	<u>(515,747)</u>	<u>(26,203)</u>	<u>17,769,454</u>
Total capital assets, net	<u>\$ 19,622,309</u>			<u>19,521,856</u>

In fiscal year 2015, major capital assets additions include upgrades as follows: transmission and distribution system \$25,017, buildings \$231,095 and office equipment \$111,757.

Scotts Valley Water District
Notes to the Financial Statements, continued
For the Fiscal Years Ended June 30, 2016 and 2015

(4) Capital Assets, continued

Construction-In-Process

The District is involved in various construction projects throughout the year. Once completed, projects are capitalized and depreciated over the life of the asset. Additions to construction in process during the year amounted to \$1,554,922 consisted of Office renovation \$659,968, Intertie projects \$460,026, Sandhill project \$188,071, Transit center \$58,125 and various miscellaneous projects \$188,732.

At June 30, 2015, additions to construction in process during the year amounted to \$791,501 consisted of Intertie projects \$526,984, Corporate Yard projects \$127,982 and various miscellaneous projects \$136,535.

(5) Deferred Outflows of Resources

Changes in deferred outflows of resources for 2016, were as follows:

	<u>Balance</u> <u>2015</u>	<u>Additions</u>	<u>Amortization</u>	<u>Balance</u> <u>2016</u>
Loss on defeasance of debt	\$ 603,814		(143,250)	460,564
Deferred pension outflows	619,531	245,214	(655,451)	209,294
Total deferred outflows	<u>\$ 1,223,345</u>	<u>245,214</u>	<u>(798,701)</u>	<u>669,858</u>

Changes in deferred outflows of resources for 2015, were as follows:

	<u>Balance</u> <u>2014</u>	<u>Additions</u>	<u>Amortization</u>	<u>Balance</u> <u>2015</u>
Loss on defeasance of debt	\$ 663,598	-	(59,784)	603,814
Deferred pension outflows	-	795,481	(175,950)	619,531
Total deferred outflows	<u>\$ 663,598</u>	<u>795,481</u>	<u>(235,734)</u>	<u>1,223,345</u>

(6) Compensated Absences

Changes in compensated absences for 2016 were as follows:

	<u>Balance</u> <u>2015</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance</u> <u>2016</u>	<u>Due within</u> <u>One Year</u>	<u>Due in more</u> <u>than one year</u>
\$	<u>73,019</u>	<u>79,221</u>	<u>(64,035)</u>	<u>88,205</u>	<u>22,051</u>	<u>66,154</u>

Changes in compensated absences for 2015 were as follows:

	<u>Balance</u> <u>2014</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance</u> <u>2015</u>	<u>Due within</u> <u>One Year</u>	<u>Due in more</u> <u>than one year</u>
\$	<u>107,041</u>	<u>54,961</u>	<u>(88,983)</u>	<u>73,019</u>	<u>18,255</u>	<u>54,764</u>

(7) Other Post-Employment Benefits Payable

Effective July 1, 2014, the District discontinued providing other post-employment medical benefits and in lieu offered active employees a District contribution to the employee's Health Savings Account (HSA) or to their 457 Deferred Compensation Plan (457 Plan). Please see Note 11 for the details of the deferred compensation savings plan. As of June 30, 2016 and 2015, only one (1) active employee remained in the other post-employment benefits program.

Scotts Valley Water District
Notes to the Financial Statements, continued
For the Fiscal Years Ended June 30, 2016 and 2015

(7) Other Post-Employment Benefits Payable, continued

The reporting requirements for these benefit programs as they pertain to the District are set forth below.

Plan Description – Eligibility

The District pays a portion of the cost of health insurance for retirees under any group plan offered by CalPERS, subject to certain restrictions as determined by the District. Membership in the OPEB plan consisted of the following members as of June 30:

	2016	2015	2014
Active plan members	1	1	19
Retirees and beneficiaries receiving benefits	18	18	12
Separated plan members entitled to but not yet receiving benefits	-	-	-
Total plan membership	19	19	31

Plan Description – Benefits

The District offers post-employment medical benefits to retired employees who satisfy the eligibility rules. Spouses and surviving spouses are also eligible to receive benefits. Retirees may enroll in any plan available through the District’s Plan provider. The contribution requirements of Plan members and the District are established and may be amended by the District’s Board.

Funding Policy

The District is required to contribute the *Annual Required Contribution (ARC) of the Employer*, an amount actuarially determined in accordance with the parameters of GASB Statement No. 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover the normal cost each fiscal year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years. The current ARC rate is 12.8% of the annual covered payroll.

The District will pay the percentage of the cost of the post-employment benefit plan based on the cost sharing ratio at the time the employee retires. The District funds the plan on a pay-as-you-go basis and maintains reserves (and records a liability) for the difference between pay-as-you-go and the actuarially determined ARC cost.

Annual OPEB Cost and Net OPEB Obligation

For the fiscal year ended June 30, 2016, the District’s ARC cost is \$181,265. The District’s net OPEB payable obligation amounted to \$1,184,517 for the fiscal year ended June 30, 2016. The District contributed \$189,316 in age adjusted contributions for current retiree OPEB premiums for the fiscal year ended June 30, 2016.

Scotts Valley Water District
Notes to the Financial Statements, continued
For the Fiscal Years Ended June 30, 2016 and 2015

(7) Other Post-Employment Benefits Payable, continued

Annual OPEB Cost and Net OPEB Obligation, continued

The balance at June 30 consists of the following:

	<u>2016</u>	<u>2015</u>	<u>2014</u>
Annual OPEB expense:			
Annual required contribution (ARC)	\$ 181,265	180,580	447,176
Interest on net OPEB obligation	48,475	48,763	27,350
Adjustment to annual required contribution	<u>(67,787)</u>	<u>(67,787)</u>	<u>(30,388)</u>
Total annual OPEB expense	161,953	161,556	444,138
Change in net OPEB payable obligation:			
Age adjusted contributions made	<u>(189,316)</u>	<u>(168,741)</u>	<u>(136,706)</u>
Total change in net OPEB payable obligation	(27,363)	(7,185)	307,432
OPEB payable - beginning of year	<u>1,211,880</u>	<u>1,219,065</u>	<u>911,633</u>
OPEB payable - end of year	<u>\$ 1,184,517</u>	<u>1,211,880</u>	<u>1,219,065</u>

The District's annual OPEB cost, the percentage of the annual OPEB cost contributed to the Plan, and the net OPEB obligation for fiscal year 2016 and the two preceding years, were as follows:

<i>Three-Year History of Net OPEB Obligation</i>					
<u>Fiscal Year Ended</u>	<u>Annual OPEB Cost</u>	<u>Age Adjusted Contribution</u>	<u>Percentage of Annual OPEB Cost Contributed</u>	<u>Net OPEB Obligation Payable</u>	
2016	\$ 161,953	189,316	116.90%	\$ 1,184,517	
2015	161,556	168,741	104.45%	1,211,880	
2014	444,138	136,706	30.78%	1,219,065	

The most recent valuation (dated July 1, 2015) includes an Actuarial Accrued Liability and Unfunded Actuarial Accrued Liability of \$2,939,783. There are no plan assets because the District funds on a pay-as-you-go basis. The covered payroll (annual payroll of active employees covered by the plan) for the fiscal year ended June 30, 2015, was \$1,407,120. The ratio of the unfunded actuarial accrued liability to annual covered payroll is 208.9%.

See page 52 for the Schedule of Funding Status.

Actuarial Methods and Assumptions

Actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of events far into the future. Actuarially determined amounts are subject to continual revision as actual results are compared to past expectations and new estimates are made about the future. Calculations are based on the types of benefits provided under the terms of the substantive plan at the time of each valuation and the pattern of sharing of costs between the employer and plan members to that point.

Consistent with the long-term perspective of actuarial calculations, actuarial methods and assumptions used include techniques that are designed to reduce short-term volatility in actuarial accrued liabilities for benefits.

Scotts Valley Water District
Notes to the Financial Statements, continued
For the Fiscal Years Ended June 30, 2016 and 2015

(7) Other Post-Employment Benefits Payable, continued

Actuarial Methods and Assumptions, continued

The following is a summary of the actuarial assumptions and methods:

Valuation date	July 1, 2015
Actuarial cost method	Entry age normal cost method
Amortization method	Level dollar basis
Amortization period	Initial 30 years on a closed basis
Asset valuation method	N/A
Actuarial assumptions:	
Discount rate	4.00%
Projected salary increase	3.00% per annum, in aggregate
Inflation - discount rate	2.75% per annum

(8) Deferred Inflows of Resources

Changes in deferred inflows of resources for 2016 were as follows:

	Balance 2015	Additions	Amortization	Balance 2016
Deferred inflows of resources:				
Deferred pension inflows	446,932	179,396	(214,860)	411,468
Total deferred inflows	\$ 446,932	179,396	(214,860)	411,468

Changes in deferred inflows of resources for 2015 were as follows:

	Balance 2014	Additions	Amortization	Balance 2015
Deferred inflows of resources:				
Deferred pension inflows	-	558,665	(111,733)	446,932
Total deferred inflows	\$ -	558,665	(111,733)	446,932

Scotts Valley Water District
Notes to the Financial Statements, continued
For the Fiscal Years Ended June 30, 2016 and 2015

(9) Long-Term Debt

Changes in long-term debt amounts for 2016 were as follows:

	<u>Balance 2015</u>	<u>Additions</u>	<u>Transfers/ Deletions</u>	<u>Balance 2016</u>
Long-term debt:				
2003 Refunding Bonds	\$ 785,000	-	(785,000)	-
Discount on debt	(4,231)	-	4,231	-
	<u>780,769</u>	<u>-</u>	<u>(780,769)</u>	<u>-</u>
2004 COP	2,680,000	-	(160,000)	2,520,000
Discount on debt	(24,551)	-	1,964	(22,587)
	<u>2,655,449</u>	<u>-</u>	<u>(158,036)</u>	<u>2,497,413</u>
2011 Note Payable	4,535,000	-	(210,000)	4,325,000
Total loans payable	7,971,218	-	<u>(1,148,805)</u>	6,822,413
Less: current portion	<u>(520,000)</u>			<u>(380,000)</u>
Long-term portion	<u>\$ 7,451,218</u>			<u>6,442,413</u>

Changes in long-term debt amounts for 2015 were as follows:

	<u>Balance 2014</u>	<u>Additions</u>	<u>Transfers/ Deletions</u>	<u>Balance 2015</u>
Long-term debt:				
2003 Refunding Bonds	\$ 925,000	-	(140,000)	785,000
Discount on debt	(4,999)	-	768	(4,231)
	<u>920,001</u>	<u>-</u>	<u>(139,232)</u>	<u>780,769</u>
2004 COP	2,830,000	-	(150,000)	2,680,000
Discount on debt	(26,515)	-	1,964	(24,551)
	<u>2,803,485</u>	<u>-</u>	<u>(148,036)</u>	<u>2,655,449</u>
2011 Note Payable	4,740,000	-	(205,000)	4,535,000
Total loans payable	8,463,486	-	<u>(492,268)</u>	7,971,218
Less: current portion	<u>(495,000)</u>			<u>(520,000)</u>
Long-term portion	<u>\$ 7,968,486</u>			<u>7,451,218</u>

2003 Refunding Bonds

In 2003, the District issued revenue bonds of \$2,240,000 to, among other things, refund all of the outstanding Scotts Valley Water District 1994 Water Revenue Refunding Bonds which were originally issued in the aggregate principal amount of \$2,640,000. The debt service schedule provides for principal payable annually on January 1st of each year maturing in 2020. Interest is calculated at the rate between 2.0% and 4.1% payable semi-annually by January 1st and July 1st. In fiscal year 2016, the District paid off the bond in full.

Scotts Valley Water District
Notes to the Financial Statements, continued
For the Fiscal Years Ended June 30, 2016 and 2015

(9) Long-Term Debt, continued

2004 Refunding Certificates of Participation

In 2004, the District issued certificates of participation of \$4,010,000 to, among other things, refund all of the outstanding Scotts Valley Water District Public Facilities Corporation 1997-1 Certificates of Participation issued November 13, 1997. The debt service schedule provides for principal payable annually on July 1st of each year maturing in 2027. Interest is calculated at the rate between 1.8% and 4.75% payable semi-annually by January 1st and July 1st.

Principal and estimated interest payments on the loan are as follows:

<u>Fiscal Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2017	\$ 165,000	107,358	272,358
2018	175,000	100,810	275,810
2019	180,000	93,753	273,753
2020	185,000	86,269	271,269
2021	195,000	78,286	273,286
2022-2026	1,105,000	252,460	1,357,460
2027-2028	515,000	24,756	539,756
Total	2,520,000	<u>743,692</u>	<u>3,263,692</u>
Less: Current portion	(165,000)		
Discount on debt	<u>(22,587)</u>		
Total non-current	<u>\$ 2,332,413</u>		

2011 Refunding Certificates of Participation

In December 2011, the District entered into a loan agreement of \$5,120,000 with Wells Fargo Bank, National Association to, among other things; refinance all of the outstanding 2002 certificates which were originally issued for an aggregate principal amount of \$5,475,000. Terms of the agreement provide for principal payable semi-annually on January 1st and July 1st of each year maturing in 2027. Interest is fixed at 3.25%.

Principal and estimated interest payments on the loan are as follows:

<u>Fiscal Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2017	\$ 215,000	138,856	353,856
2018	225,000	131,788	356,788
2019	230,000	124,394	354,394
2020	240,000	116,838	356,838
2021	335,000	108,956	443,956
2022-2026	2,305,000	337,025	2,642,025
2027-2028	775,000	21,044	796,044
Total	4,325,000	<u>978,901</u>	<u>5,303,901</u>
Less: Current portion	<u>(215,000)</u>		
Total non-current	<u>\$ 4,110,000</u>		

Scotts Valley Water District
Notes to the Financial Statements, continued
For the Fiscal Years Ended June 30, 2016 and 2015

(10) Defined Benefit Pension Plan

Plan Description

All qualified permanent and probationary employees are eligible to participate in the Public Agency Cost-Sharing Multiple-Employer Defined Pension Plan (Plan or PERF C) administered by the California Public Employees' Retirement System (CalPERS). The Plan consists of a miscellaneous risk pool and a safety risk pool, which are comprised of individual employer miscellaneous and safety plans, respectively. Benefit provisions under the Plan are established by State statute and the District's resolution. CalPERS issues publicly available reports that include a full description of the pension plan regarding benefit provisions, assumptions and membership information that can be found on CalPERS website or may be obtained from their executive office at 400 P Street, Sacramento, California 95814.

Benefits Provided

CalPERS provide service retirement and disability benefits, annual cost of living adjustments and death benefits to plan members, who must be public employees and beneficiaries. Benefits are based on years of credited service, equal to one year of full time employment. Members with five years of total service are eligible to retire at age 50 with statutorily reduced benefits. All members are eligible for non-duty disability benefits after 10 years of service. The death benefit is one of the following: The Basic Death Benefit, the 1957 Survivor Benefit, or the Optional Settlement 2W Death Benefit. The cost of living adjustments for each plan are applied as specified by the Public Employees' Retirement Law.

On September 12, 2012, the California Governor signed the California Public Employees' Pension Reform Act of 2013 (PEPRA) into law. PEPRA took effect January 1, 2013. The new legislation closed the District's CalPERS 2.0% at 60 Risk Pool Retirement Plan to new employee entrants, not previously employed by an agency under CalPERS, effective December 31, 2012. All employees hired after January 1, 2013 are eligible for the District's CalPERS 2.0% at 62 Retirement Plan under PEPRA.

The District participates in the Plan's miscellaneous risk pool. The provisions and benefits for the Plan's miscellaneous pool in effect as June 30, 2016 and 2015, are summarized as follows:

	Miscellaneous Risk Pool		
	Classic	New Classic	PEPRA
		On or after January 1,	
	Prior to January 1, 2011	2011 - December 31, 2012	On or after January 1, 2013
Hire date			
Benefit formula	2.7% @ 55	2.0% @ 60	2.0% @ 62
Benefit vesting schedule	5 service years	5 service years	5 service years
Benefit payments	monthly for life	monthly for life	monthly for life
Retirement age	50 - 55	50 - 55	52 - 67
Monthly benefits, as a % of eligible compensation	2.0% to 2.5%	1.1% to 2.4%	1.0% to 2.5%
Required employee contribution rates	8.00%	7.00%	6.25%
Required employer contribution rates	11.478%	8.003%	6.237%

Scotts Valley Water District
Notes to the Financial Statements, continued
For the Fiscal Years Ended June 30, 2016 and 2015

(10) Defined Benefit Pension Plans, continued

Contributions

Section 20814(c) of the California Public Employees' Retirement Law requires that the employer contribution rates for all public employers be determined on an annual basis by the actuary and shall be effective on July 1, following notice of a change in rate. Funding contribution for the Plan is determined annually on an actuarial basis as of June 30, by CalPERS. The actuarially determined rate is the estimated amount necessary to finance the costs of benefits earned by employees during the year, with an additional amount to finance any unfunded accrued liability. The District is required to contribute the difference between the actuarially determined rate and the contribution rate of employees.

For the years ended June 30, the contributions recognized as part of pension expense for the Plan was as follows:

	2016	2015
Contributions – employer	\$ 570,843	141,599

Net Pension Liability

As of the fiscal years ended June 30, the District reported net pension liabilities for its proportionate share of the net pension liability of the Plan as follows:

	2016	2015
Proportionate share of net pension liability	\$ 1,233,015	1,329,971

The District's net pension liability for the Plan is measured as the proportionate share of the net pension liability for the miscellaneous risk pool. As of June 30, 2016 and 2015, the net pension liability of the Plan is measured as of June 30, 2015 and 2014 (the measurement date), respectively. The total pension liability for the Plan's miscellaneous risk pool used to calculate the net pension liability was determined by an actuarial valuation as of June 30, 2014 and 2013 (the valuation date), rolled forward to June 30, 2015 and 2014, respectively, using standard update procedures. The District's proportion of the net pension liability was based on a projection of the District's long-term share of contributions to the pension plan relative to the projected contributions of all participating employers, actuarially determined. The District's changes in proportionate share of the net pension liability for the Plan's miscellaneous risk pool as of the measurement dates June 30, 2016 and 2015, were as follows:

	<u>Miscellaneous Plan</u>
Proportion – June 30, 2013	0.02254%
Decrease in proportion	-0.00116%
Proportion – June 30, 2014	0.02138%
Decrease in proportion	-0.00342%
Proportion – June 30, 2015	0.01796%

Scotts Valley Water District
Notes to the Financial Statements, continued
For the Fiscal Years Ended June 30, 2016 and 2015

(10) Defined Benefit Pension Plan, continued

Deferred Pension Outflows (Inflows) of Resources

For the years ended June 30, 2016 and 2015, the District recognized pension expense of \$386,536 and \$86,948, respectively.

At June 30, 2016 and 2015, the District reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

<u>Description</u>	<u>2016</u>		<u>2015</u>	
	<u>Deferred Outflows of Resources</u>	<u>Deferred Inflows of Resources</u>	<u>Deferred Outflows of Resources</u>	<u>Deferred Inflows of Resources</u>
Pension contributions subsequent to measurement date	\$ 108,719	-	570,843	-
Differences between actual and expected experience	4,933	-	-	-
Changes in assumptions	-	(46,672)	-	-
Net differences between projected and actual earnings on plan investments	-	(23,398)	-	(446,932)
Differences between actual contribution and proportionate share of contribution	95,642	-	-	-
Net adjustment due to differences in proportions of net pension liability	-	(341,398)	48,688	-
Total	<u>\$ 209,294</u>	<u>(411,468)</u>	<u>619,531</u>	<u>(446,932)</u>

For the year ended June 30, 2016 and 2015, employer pension contributions reported as deferred outflows of resources related to contributions subsequent to the measurement date of \$108,719 and \$570,843 will be recognized as a reduction of the net pension liability in the fiscal year ended June 30, 2017 and 2016, respectively.

At June 30, 2016, other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized as pension expense as follows:

<u>Fiscal Year Ending June 30,</u>	<u>Deferred Net Inflows of Resources</u>
2017	\$ (130,252)
2018	(133,725)
2019	(124,868)
2020	77,951
2021	-
Remaining	-

Scotts Valley Water District
Notes to the Financial Statements, continued
For the Fiscal Years Ended June 30, 2016 and 2015

(10) Defined Benefit Pension Plan, continued

Actuarial Assumptions

The total pension liability in the June 30, 2014, actuarial valuation report was determined using the following actuarial assumptions:

The following is a summary of the actuarial assumptions and methods:

Valuation Date	June 30, 2014
Measurement Date	June 30, 2015
Actuarial cost method	Entry Age Normal in accordance with the requirements of GASB Statement No. 68
Actuarial assumptions:	
Discount rate	7.50%
Inflation	2.75%
Salary increases	Varies by Entry Age and Service
Investment Rate of Return	7.50 % Net of Pension Plan Investment and Administrative Expenses; includes inflation
Retirement	The probabilities of retirement are based on the 2010 CalPERS Experience Study for the period from 1997 to 2007
Mortality	The probabilities of mortality are based on the 2010 CalPERS Experience Study for the period from 1997 to 2007. Pre-retirement and Post-retirement mortality rates include 5 years of projected mortality improvement using Scale AA published by the Society of Actuaries.

The underlying mortality assumptions and all other actuarial assumptions used in the June 30, 2014, valuation were based upon the most recent CalPERS Experience Study (covering the period June 30, 1997 through June 30, 2011) that was completed and adopted in April 2014. Further details of the Experience Study can found on the CalPERS website.

Discount Rate

The discount rate used to measure the total pension liability was 7.50% for the Plan. To determine whether the municipal bond rate should be used in the calculation of a discount rate for the Plan, CalPERS stress tested plans that would most likely result in a discount rate that would be different from the actuarially assumed discount rate. Based on the testing, none of the tested plans run out of assets. Therefore, the current 7.50% discount rate is adequate and the use of the municipal bond rate calculation is not necessary. The long term expected discount rate of 7.50% will be applied to all plans in the Public Employees Retirement Fund (PERF). The stress test results are presented in a detailed report that can be obtained from the CalPERS website.

According to Paragraph 30 of Statement 68, the long-term discount rate should be determined without reduction for pension plan administrative expense. The 7.50% investment return assumption used in this accounting valuation is net of administrative expenses. Administrative expenses are assumed to be 15 basis points. An investment return excluding administrative expenses would have been 7.65%. Using this lower discount rate has resulted in a slightly higher Total Pension Liability and Net Pension Liability. CalPERS confirmed the materiality threshold for the difference in the calculation and did not find it to be a material difference.

Scotts Valley Water District
Notes to the Financial Statements, continued
For the Fiscal Years Ended June 30, 2016 and 2015

(10) Defined Benefit Pension Plan, continued

Discount Rate, continued

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

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

In determining the long-term expected rate of return, CalPERS took into account both short-term and long-term market return expectations as well as the expected pension fund cash flows. Using historical returns of all the funds' asset classes, expected compound returns were calculated over the short-term (first 10 years) and the long-term (11-60 years) using a building-block approach. Using the expected nominal returns for both short-term and long-term, the present value of benefits was calculated for each fund. The expected rate of return was set by calculating the single equivalent return that arrived at the same present value of benefits for cash flows as the one calculated using both short-term and long-term returns. The expected rate of return was then set equivalent to the single equivalent rate calculated above and rounded down to the nearest one quarter of one percent.

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

As of June 30, 2016, the target allocation and the long-term expected real rate of return by asset class were as follows:

<u>Asset Class</u>	<u>New Strategic Allocation</u>	<u>Real Return Years 1-10*</u>	<u>Real Return Year 11+**</u>
Global Equity	47.0%	5.25%	5.71%
Global Fixed Income	19.0	0.99	2.43
Inflation Sensitive	6.0	0.45	3.36
Private Equity	12.0	6.83	6.95
Real Estate	11.0	4.50	5.13
Infrastructure and Forestland	3.0	4.50	5.09
Liquidity	2.0	(0.55)	(1.05)
Total	<u>100.0%</u>		

* An expected inflation of 2.5% used for this period

** An expected inflation of 3.0% used for this period

Scotts Valley Water District
Notes to the Financial Statements, continued
For the Fiscal Years Ended June 30, 2016 and 2015

(10) Defined Benefit Pension Plan, continued

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

The following presents the District's proportionate share of the net pension liability for the Plan, calculated using the discount rate for the Plan, as well as what the District's proportionate share of the net pension liability would be if it were calculated using a discount rate that is one-percentage point lower or one-percentage point higher than the current rate.

As of June 30, 2016, the District's net pension liability at the current discount rate, using a discount rate that is one-percentage point lower, and using a discount rate that is one-percentage point higher, is as follows:

	Discount Rate - 1% 6.65%	Current Discount Rate 7.65%	Discount Rate + 1% 8.65%
District's Net Pension Liability*	\$ 2,067,852	1,233,015	543,760

As of June 30, 2015, the District's net pension liability at the current discount rate, using a discount rate that is one-percentage point lower, and using a discount rate that is one-percentage point higher, is as follows:

	Discount Rate - 1% 6.50%	Current Discount Rate 7.50%	Discount Rate + 1% 8.50%
District's Net Pension Liability*	\$ 2,369,596	1,329,971	467,180

*Data Source: CalPERS GASB 68 Accounting Valuation Report and Schedules of Employer Allocations by Rate Plan and Collective Pension Amounts.

Pension Plan Fiduciary Net Position

Detailed information about the pension plan's fiduciary net position is available in separately issued CalPERS financial reports. See pages 50 through 51 for the Required Supplementary Schedules.

(11) Prior Year Restatement of Net Position

In fiscal year 2015, the District implemented GASB pronouncements 68 and 71 to recognize its proportionate share of the net pension liability. As a result of the implementation, the District recognized the pension liability and recorded a prior period adjustment, a decrease in net position, of \$1,817,217 at July 1, 2014. The District recorded a prior period adjustment, an increase in net position, to reclassify from expense to deferred outflows of resources, the prior year's proportionate share of employer pension contribution totaling \$175,950 at July 1, 2014.

Net position at June 30, 2014, as previously stated	\$ 18,007,372
Effect of adjustment to record net pension liability	(1,817,217)
Effect of adjustment to deferred pension outflows	175,950
Total adjustments	(1,641,267)
Net position at July 1, 2014, as restated	\$ 16,366,105

Scotts Valley Water District
Notes to the Financial Statements, continued
For the Fiscal Years Ended June 30, 2016 and 2015

(12) Net Position

Calculation of net position as of June 30, were as follows:

	2016	2015
Net investment in capital assets:		
Capital assets, net	\$ 20,027,733	19,521,856
Loss on defeasance of debt	460,564	603,814
Note payable – current	(215,000)	(210,000)
Note payable – long-term	(4,110,000)	(4,325,000)
Certificates of Participation – current	(165,000)	(160,000)
Certificates of Participation – long-term	(2,332,413)	(2,495,449)
Bonds payable – current	-	(150,000)
Bonds payable – long-term	-	(630,769)
Total net investment in capital assets	13,665,884	12,154,452
Restricted net position:		
Restricted for debt service	749,404	932,329
Unrestricted net position:		
Non-spendable net position:		
Materials and supplies inventory	201,758	180,040
Prepaid expenses and deposits	92,278	76,558
Total non-spendable net position	294,036	256,598
Spendable net position are designated as follows:		
Total spendable net position	1,504,679	3,283,265
Total unrestricted net position	1,798,715	3,539,863
Total net position	\$ 16,214,003	16,626,644

(13) Risk Management

The District is exposed to various risks of loss related to torts, theft of, damage to and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The District is insured for a variety of potential exposures. The following is a summary of the insurance policies carried by the District as of June 30, 2016:

- Property coverage: Liability limits varying by property type with a \$500-\$5,000 deductible and a premium of \$12,854.
- Liability coverage: \$72,492 deposit premium.
- Crime coverage: Limit of coverage \$100,000 with a deductible of \$1,000.
- Workers compensation: \$2,000,000 each accident or each employee by disease.

Scotts Valley Water District
Notes to the Financial Statements, continued
For the Fiscal Years Ended June 30, 2016 and 2015

(14) Deferred Compensation Savings Plan

For the benefit of its employees, the District participates in a 457 Deferred Compensation Program (Program) administered by Nationwide Retirement Solutions through administrative service agreements. The purpose of this program is to provide deferred compensation for public employees that elect to participate in the Program. Employees with at least 10 years of service at June 30, 2014, were given a one-time election to continue their other post-employment medical benefits as described in Note 5. Generally, eligible employees may defer receipt of a portion of their salary until termination, retirement, death, or unforeseen emergency. Until the funds are paid or otherwise made available to the employee, the employee is not obligated to report the deferred salary for income tax purposes.

Federal law requires deferred compensation assets to be held in trust for the exclusive benefit of the participants. Accordingly, the District is in compliance with this legislation; therefore, these assets are not the legal property of the District, and are not subject to claims of the District's general creditors. Market value of all plan assets held in trust by the District plan amounted to \$295,914 and \$241,995 in fiscal years 2016 and 2015, respectively.

The District has implemented GASB Statement No. 32, Accounting for Financial Reporting for Internal Revenue code Section 457 Deferred Compensation Plans. Since the District has little administrative involvement and does not perform the investing function of this plan, the assets and related liabilities are not shown on the Statements of Net Position.

(15) Governmental Accounting Standards Board Statements Issued, Not Yet Effective

The Governmental Accounting Standards Board (GASB) has issued several pronouncements prior to June 30, 2016, that has effective dates that may impact future financial presentations.

Governmental Accounting Standards Board Statement No. 74

In June 2015, the GASB issued Statement No. 74 – *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*. The objective of this Statement is to improve the usefulness or information about postemployment benefits other than pensions (other postemployment benefits of OPEB) included in the general purpose external financial reports of state and local governmental OPEB plans for making decisions and assessing accountability.

This Statement replaces Statements No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, as amended, and No. 57, *OPEB Measurements by Agent Employers and Multiple-Employer Plans*. It also includes requirements for defined contribution OPEB plans that replace the requirements for those OPEB plans in Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, as amended, Statement 43, and Statement No.50, *Pension Disclosures*.

The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2016. The impact of the implementation of this Statement to the District's financial statements has not been assessed at this time.

Governmental Accounting Standards Board Statement No. 75

In June 2015, the GASB issued Statement No. 75 – *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*. The objective of this Statement is to improve accounting and financial reporting by state and local governments for postemployment benefits other than pensions (OPEB). It also improves information provided by state and local governmental employers about financial support for OPEB that is provided by other entities.

Scotts Valley Water District
Notes to the Financial Statements, continued
For the Fiscal Years Ended June 30, 2016 and 2015

(15) Governmental Accounting Standards Board Statements Issued, Not Yet Effective, continued

Governmental Accounting Standards Board Statement No. 75, continued

This Statement replaces the requirements of Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, as amended, and No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*, for OPEB.

The provisions of this Statement are effective for financial statements for periods beginning after December 15, 2017. The impact of the implementation of this Statement to the District's financial statements has not been assessed at this time.

Governmental Accounting Standards Board Statement No. 77

In August 2015, the GASB issued Statement No. 77 – *Tax Abatement Disclosures*. The objective of this Statement is to improve financial reporting by giving users of financial statements essential information that is not consistently or comprehensively reported to the public at present. Financial statement users need information about certain limitations on a government's ability to raise resources. This includes limitations on revenue-raising capacity resulting from governmental programs that use tax abatements to induce behavior by individuals and entities that is beneficial to the government or its citizens. Tax abatements are widely used by state and local governments, particularly to encourage economic development. This Statement is effective for financial statements for periods beginning after December 15, 2015. It is believed that the implementation of this Statement will not have a material effect to the Agency's financial statements.

Governmental Accounting Standards Board Statement No. 78

In December 2015, the GASB issued Statement No. 78 – *Pensions Provided through Certain Multiple-Employer Defined Benefit Pension Plans*. The objective of this Statement is to address a practice issue regarding the scope and applicability of Statement No. 68, *Accounting and Financial Reporting for Pensions*. This issue is associated with pensions provided through certain multiple-employer defined benefit pension plans and to state or local governmental employers whose employees are provided with such pensions. This Statement amends the scope and applicability of Statement 68 to exclude pensions provided to employees of state or local governmental employers through a cost-sharing multiple-employer defined benefit pension plan that meet certain criteria. This Statement is effective for financial statements for periods beginning after December 15, 2015. It is believed that the implementation of this Statement will not have a material effect to the District's financial statements.

Governmental Accounting Standards Board Statement No. 80

In January 2016, the GASB issued Statement No. 80 – *Blending Requirements for Certain Component Units – An Amendment of GASB Statement No. 14*. The objective of this Statement is to improve financial reporting for irrevocable split-interest agreements by providing recognition and measurement guidance for situations in which a government is a beneficiary of the agreement. The additional criterion requires blending of a component unit incorporated as a not-for-profit corporation in which the primary government is the sole corporate member. The additional criterion does not apply to component units included in the financial reporting entity pursuant to the provisions of Statement No. 39, *Determining Whether Certain Organizations Are Component Units*.

This Statement is effective for financial statements for periods beginning after June 15, 2016. It is believed that the implementation of this Statement will not have a material effect to the Agency's financial statements.

Scotts Valley Water District
Notes to the Financial Statements, continued
For the Fiscal Years Ended June 30, 2016 and 2015

(15) Governmental Accounting Standards Board Statements Issued, Not Yet Effective, continued

Governmental Accounting Standards Board Statement No. 81

In March 2016, the GASB issued Statement No. 81 – *Irrevocable Split-Interest Agreements*. The objective of this Statement is to improve accounting and financial reporting for irrevocable split-interest agreements by providing recognition and measurement guidance for situations in which a government is a beneficiary of the agreement. This Statement requires that a government that receives resources pursuant to an irrevocable split-interest agreement recognize assets, liabilities, and deferred inflows of resources at the inception of the agreement. Furthermore, this Statement requires that a government recognize assets representing its beneficial interests in irrevocable split-interest agreements that are administered by a third party, if the government controls the present service capacity of the beneficial interests.

This Statement requires that a government recognize revenue when the resources become applicable to the reporting period. This Statement is effective for financial statements for periods beginning after December 15, 2016. It is believed that the implementation of this Statement will not have a material effect to the Agency's financial statements.

Governmental Accounting Standards Board Statement No. 82

In March 2016, the GASB issued Statement No. 82 – *Pension Issues – An Amendment of GASB Statements No. 67, No. 68, and No. 73*. This Statement addresses issues regarding (1) the presentation of payroll-related measures in required supplementary information, (2) the selection of assumptions and the treatment of deviations from the guidance in an Actuarial Standard of Practice for financial reporting purposes, and (3) the classification of payments made by employers to satisfy employee (plan member) contribution requirements.

The requirements of this Statement are effective for reporting periods beginning after June 15, 2016, except for the requirements of this Statement for the selection of assumptions in a circumstance in which an employer's pension liability is measured as of a date other than the employer's most recent fiscal year-end. In that circumstance, the requirements for the selection of assumptions are effective for that employer in the first reporting period in which the measurement date of the pension liability is on or after June 15, 2017. The impact of the implementation of this Statement to the District's financial statements has not been assessed at this time.

(16) Commitments and Contingencies

Grant Awards

Grant funds received by the District are subject to audit by the grantor agencies. Such audit could lead to requests for reimbursements to the grantor agencies for expenditures disallowed under terms of the grant. Management of the District believes that such disallowances, if any, would not be significant.

Litigation

In the ordinary course of operations, the District is subject to claims and litigation from outside parties. After consultation with legal counsel, the District believes the ultimate outcome of such matters, if any, will not materially affect its financial condition.

(17) Subsequent Events

Events occurring after June 30, 2016, have been evaluated for possible adjustment to the financial statements or disclosure as of December 8, 2016, which is the date the financial statements were available to be issued.

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Required Supplementary Information

Scotts Valley Water District
Schedules of the District's Proportionate Share of the Net Pension Liability
As of June 30, 2016
Last Ten Years*

	Measurement Dates	
	<u>6/30/15</u>	<u>6/30/14</u>
District's Proportion of the Net Pension Liability (Asset)	<u>0.01796%</u>	<u>0.02138%</u>
District's Proportionate Share of the Net Pension Liability (Asset)	\$ <u>1,233,015</u>	<u>1,329,971</u>
District's Covered-Employee Payroll	\$ <u>1,169,390</u>	<u>817,020</u>
District's proportionate share of the net pension liability (asset) as a Percentage of its Covered-Employee Payroll	<u>105.44%</u>	<u>162.78%</u>
Plan's Fiduciary Net Position as a Percentage of the Total Pension Liability	<u>81.15%</u>	<u>81.15%</u>
Plan's Proportionate Share of Aggregate Employer Contributions	\$ <u>238,519</u>	<u>175,950</u>

Notes to the Schedule of the District's Proportionate Share of Net Pension Liability

Changes in Benefit Terms – The figures above do not include any liability impact that may have resulted from Plan changes which occurred after the June 30, 2014, valuation date.

Changes of Assumptions – For the June 30, 2015, measurement date, the discount rate was changed from 7.50% (net of administrative expense) to 7.65% percent to correct for an adjustment to exclude administrative expense.

* The District has presented information for those years for which information is available until a full 10-year trend is compiled.

Scotts Valley Water District
Schedules of Pension Plan Contributions
As of June 30, 2016
Last Ten Years*

<u>Description</u>	<u>Measurement Dates</u>	
	<u>6/30/15</u>	<u>6/30/14</u>
Actuarially determined contribution	\$ 179,072	141,599
Contributions in relation to the actuarially determined contribution	<u>(570,843)</u>	<u>(141,599)</u>
Contribution deficiency (excess)	\$ <u>(391,771)</u>	<u>-</u>
District's covered payroll	\$ <u>1,169,390</u>	<u>817,020</u>
Contribution's as a percentage of covered-employee payroll	<u>48.82%</u>	<u>17.33%</u>

Notes to the Schedule of Pension Plan Contributions

The actuarial methods and assumptions used to set the actuarially determined contributions from June 30, 2014 through June 30, 2015 (the measurement period), were derived from the June 30, 2012, funding valuation report.

There were no changes in methods or assumptions used to determine the legally required contributions, which are actuarially determined, from the June 30, 2011 to the June 30, 2012, funding valuation report.

* The District has presented information for those years for which information is available until a full 10-year trend is compiled.

Scotts Valley Water District
Schedule of Funding Status – Other Post-Employment Benefits
As of June 30, 2016

Required Supplementary Information - Schedule of Funding Progress

Actuarial Valuation Date	Actuarial Value of Plan Assets (a)	Actuarial Accrued Liability (b)	Unfunded Actuarial Accrued Liability (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
July 1, 2015	\$ -	2,939,783	2,939,783	0.00%	\$ 1,407,120	208.9%
July 1, 2012	\$ -	3,819,364	3,819,364	0.00%	\$ 1,173,791	325.4%
July 1, 2009	\$ -	2,274,339	2,274,339	0.00%	\$ 1,270,665	179.0%

Funding progress is presented for the years that an actuarial study has been prepared since the effective date of GASB Statement 45. Actuarial review and analysis of the post-employment benefits liability and funding status is performed every three years or annually if there are significant changes in the plan. The next scheduled actuarial review and analysis of the post-employment benefits liability and funding status will be performed in fiscal year 2019 based on the year ending June 30, 2018.

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Supplemental Information

Scotts Valley Water District
Combining Schedule of Net Position
June 30, 2016

	<u>Water Fund</u>	<u>Recycled Water Fund</u>	<u>Total</u>
Current assets:			
Cash and cash equivalents	\$ 2,924,816	-	2,924,816
Cash & cash equivalents – restricted	529,156	220,248	749,404
Accrued interest receivable	3,317	3,150	6,467
Accounts receivable, net	781,762	67,036	848,798
Accounts receivable – property tax	42,991	-	42,991
Accounts receivable – other	16,234	37,500	53,734
Materials and supplies inventory	201,075	683	201,758
Prepaid expenses and deposits	92,278	-	92,278
Note receivable – due in one year	-	160,339	160,339
Total current assets	<u>4,591,629</u>	<u>488,956</u>	<u>5,080,585</u>
Non-current assets:			
Note receivable – due in more than one year	-	715,853	715,853
Capital assets – not being depreciated	3,044,466	141,250	3,185,716
Capital assets – being depreciated	<u>11,221,678</u>	<u>5,620,339</u>	<u>16,842,017</u>
Total non-current assets	<u>14,266,144</u>	<u>6,477,442</u>	<u>20,743,586</u>
Total assets	<u>18,857,773</u>	<u>6,966,398</u>	<u>25,824,171</u>
Deferred outflows of resources:			
Deferred pension outflows	188,364	20,930	209,294
Loss on defeasance of debt	<u>228,377</u>	<u>232,187</u>	<u>460,564</u>
Total deferred outflows of resources	<u>\$ 416,741</u>	<u>253,117</u>	<u>669,858</u>

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Scotts Valley Water District
Combining Schedule of Net Position, continued
June 30, 2016

	<u>Water Fund</u>	<u>Recycled Water Fund</u>	<u>Total</u>
Current liabilities:			
Accounts payable and accrued expense	\$ 285,798	39,494	325,292
Accrued wages and related payables	53,896	-	53,896
Accrued interest payable	70,310	55,247	125,557
Due to (from) funds	(293,413)	293,413	-
Customer deposits	30,893	3,000	33,893
Long-term liabilities – due in one year:			
Compensated absences	19,846	2,205	22,051
Note payable	215,000	-	215,000
Certificates of participation	-	165,000	165,000
Total current liabilities	<u>382,330</u>	<u>558,359</u>	<u>940,689</u>
Non-current liabilities:			
Unearned revenue	1,770	-	1,770
Long-term liabilities – due in more than one year:			
Compensated absences	59,538	6,616	66,154
Other post-employment benefits payable	1,066,065	118,452	1,184,517
Net pension liability	1,109,713	123,302	1,233,015
Note payable	4,110,000	-	4,110,000
Certificates of Participation	-	2,332,413	2,332,413
Total non-current liabilities	<u>6,347,086</u>	<u>2,580,783</u>	<u>8,927,869</u>
Total liabilities	<u>6,729,416</u>	<u>3,139,142</u>	<u>9,868,558</u>
Deferred inflows of resources:			
Deferred pension inflows	370,323	41,145	411,468
Total deferred inflows of resources	<u>370,323</u>	<u>41,145</u>	<u>411,468</u>
Net position:			
Net investment in capital assets	10,169,521	3,496,363	13,665,884
Restricted for debt service	529,156	220,248	749,404
Unrestricted	1,476,098	322,617	1,798,715
Total net position	<u>\$ 12,174,775</u>	<u>4,039,228</u>	<u>16,214,003</u>

Scotts Valley Water District
Combining Schedule of Revenues, Expenses and Changes in Net Position
For the Fiscal Year Ended June 30, 2016

	<u>Water Fund</u>	<u>Recycled Water Fund</u>	<u>Total</u>
Operating revenues:			
Water sales	\$ 2,242,642	-	2,242,642
Service charges	1,348,590	-	1,348,590
Water sales – recycled	-	382,366	382,366
Other revenue	18,270	57,096	75,366
Total operating revenues	<u>3,609,502</u>	<u>439,462</u>	<u>4,048,964</u>
Operating expenses:			
Source of supply	105,192	-	105,192
Pumping	564,632	-	564,632
Water treatment	741,746	-	741,746
Recycled water	-	546,568	546,568
Transmission and distribution	820,443	-	820,443
Conservation	241,892	-	241,892
Customer accounts	207,833	-	207,833
General and administrative expenses	1,550,108	-	1,550,108
Total operating expenses	<u>4,231,846</u>	<u>546,568</u>	<u>4,778,414</u>
Operating income before depreciation	(622,344)	(107,106)	(729,450)
Depreciation expense	(739,373)	(174,582)	(913,955)
Operating loss	<u>(1,361,717)</u>	<u>(281,688)</u>	<u>(1,643,405)</u>
Non-operating revenue (expense):			
Property tax revenues	775,679	-	775,679
Investment earnings	32,137	6,969	39,106
Interest expense	(285,859)	(131,937)	(417,796)
Gain on disposal of fixed assets	(10,193)	497,928	487,735
Other non-operating revenue (expense), net	11,147	(811)	10,336
Total non-operating revenues, net	<u>522,911</u>	<u>372,149</u>	<u>895,060</u>
Net loss before capital contributions	<u>(838,806)</u>	<u>90,461</u>	<u>(748,345)</u>
Capital contributions:			
Capital contributions	76,540	12,460	89,000
Capital grants – State	209,204	37,500	246,704
Total capital contributions	<u>285,744</u>	<u>49,960</u>	<u>335,704</u>
Change in net position	(553,062)	140,421	(412,641)
Net position – beginning of period	<u>12,727,837</u>	<u>3,898,807</u>	<u>16,626,644</u>
Net position, end of period	<u>\$ 12,174,775</u>	<u>4,039,228</u>	<u>16,214,003</u>

Scotts Valley Water District
Schedules of Customer Account and
General and Administrative Expense
For the Fiscal Years Ended June 30, 2016 and 2015

	<u>2016</u>	<u>2015</u>
Customer accounts:		
Collection	\$ 25,626	88,733
Customer service	<u>182,207</u>	<u>99,602</u>
Total customer accounts	<u>\$ 207,833</u>	<u>188,335</u>
 General and administrative:		
Office	\$ 170,853	86,981
General maintenance	67,917	145,948
Salaries and benefits	940,864	902,354
Education	40,780	50,520
Management	-	4,254
Outside services	323,914	284,607
Other	<u>5,780</u>	<u>47,372</u>
Total general and administrative expense	<u>\$ 1,550,108</u>	<u>1,522,036</u>

Report on Internal Controls and Compliance



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Independent Auditor's Report on Internal Controls Over Financial Reporting And on Compliance and Other Matters Based on an Audits of Financial Statements Performed in Accordance with *Government Auditing Standards*

Board of Directors
Scotts Valley Water District
Scotts Valley, California

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audit contained in Government Auditing Standards issued by the Comptroller General of the United States, the financial statements of the Scotts Valley Water District (District), as of and for the years ended June 30, 2016 and 2015, and the related notes to the financial statements, which collectively comprises the District's basic financial statements, and have issued our report thereon dated December 8, 2016.

Internal Control Over Financial Reporting

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

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

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

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

**Independent Auditor's Report on Internal Controls Over Financial Reporting
And on Compliance and Other Matters Based on an Audits of Financial Statements
Performed in Accordance with Government Auditing Standards, (continued)**

Purpose of this Report

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

Fedak & Brown LLP

Fedak & Brown LLP
Cypress, California
December 8, 2016