

**EMERALD BAY SERVICE DISTRICT
ANNUAL FINANCIAL REPORT**

With Independent Auditor's Report Thereon

**AS OF AND FOR THE YEAR ENDED
JUNE 30, 2014**

EMERALD BAY SERVICE DISTRICT

**ANNUAL FINANCIAL REPORT
FOR THE YEAR ENDED
JUNE 30, 2014**

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Emerald Bay Service District

We have audited the accompanying financial statements of the governmental activities and each major fund, of the Emerald Bay Service District (the District), as of and for the year ended June 30, 2014, which collectively comprise the District's basic financial statements as listed in the table of contents, and the related notes to the financial statements.

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

An audit 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.

To the Board of Directors
Emerald Bay Service District

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, and each major fund, of Emerald Bay Service District, as of June 30, 2014, and the respective changes in financial position for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and budgetary comparison information on pages 3 through 8 and 26 through 28 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Fechter & Company,
Certified Public Accountants



Sacramento, California
November 10, 2014

EMERALD BAY SERVICE DISTRICT

Management's Discussion and Analysis

June 30, 2014

As management of the Emerald Bay Service District (District), we offer readers of the statements, this narrative overview and analysis of the financial activities of the District ended June 30, 2014. We encourage readers to consider the information presented here in conjunction with the District's basic financial statements, which can be found on pages 9 to 14 of this report.

Operational Overview

The Emerald Bay Service District (District) was organized on November 20, 1961, under the Community Service District Law by resolution of the Board of Supervisors of the County of Orange, California to provide services to the residents living in the unincorporated area of Orange County know as Emerald Bay. Its founding Directors were Vic Andrews, Tom Swanson, Paul Dodds, Paul Beemer, and Laurence Reynolds. Currently, the District has been authorized by the Orange County Local Formation Commission to provide sewage, water, fire protection, infrastructure, health and safety, emergency response and other services to the residents of the Emerald Bay Community.

The residents have a long history of volunteerism. Under the Orange County Fire Authority the Emerald Bay Fire Station continues to be one of the three remaining level 1 stations that are serviced by volunteers.

The District is a non-enterprise special district, which means that the revenues are derived from property taxes and no fees are charges for the services provided. The sphere of influence for the District is directly related to the Emerald Bay Community Association (EBCA).

The District has one employee, the General Manager, who provides supervision for the day to day operation of the District's facilities. The District contracts the services of a registered professional engineer who provides project plans and equipment specifications. It also contracts for financial, administrative and field support from the EBCA employees and rents office space in the EBCA's Community Center. Additionally, the District leases from the EBCA the property needed to support the District's sewer and water facilities. The District's attorney is the law firm of Stradling, Yocca, Carlson, and Rauth.

Financial Highlights

- The assets of the District exceeded its liabilities at the close of the most recent fiscal year by \$8,430,309 (net position). Of this amount, \$2,292,096 (unrestricted net position) may be used to meet the District's ongoing obligations to citizens and creditors.
- The District's total net position increased by \$658,990. This increase is attributable to the investment in capital assets and expenditures being under budget and includes an adjustment to the prior year for various prepaid expenses.
- Cash and investments available to the District increased by approximately \$24,000. During the year the District invested \$1,500,000 in the Local Agency Investment Fund by transferring the money it had invested in money market and certificates of deposit.

EMERALD BAY SERVICE DISTRICT

Management's Discussion and Analysis

June 30, 2014

- As of the close of the current fiscal year, the District's Governmental Fund reported an ending fund balance of \$2,292,096, a decrease of \$201,895 in comparison with the prior year. The decrease is a result of the Governmental Fund recording capital outlay as expense in the year of occurrence. At June 30, 2014, \$2,270,296 is available for spending at the District's discretion and \$21,800 has been committed to completing a capital improvement project which was in process at June 30, 2014.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the District's basic financial statements. The District's basic financial statements are comprised of three components:

1. Government-wide financial statements
2. Fund financial statements
3. Notes to the basic financial statements

This report also contains other supplementary information in addition to the basic financial statements.

Government-wide financial statements - The government-wide financial statements are designed to provide readers with a broad overview of the District's finances, in a manner similar to a private-sector business.

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

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

The government-wide financial statements can be found on pages 9 and 10 of this report.

Fund financial statements - A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. The District, like other state and local governments, uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

EMERALD BAY SERVICE DISTRICT

Management's Discussion and Analysis

June 30, 2014

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

Because the focus of governmental funds is narrower than that of the government-wide financial statements, it is useful to compare the information presented for governmental funds with similar information presented for governmental activities in the government-wide financial statements. By doing so, readers may better understand the long-term impact of the government's near-term financing decisions. Both the governmental fund balance sheet and the governmental fund statement of revenues, expenditures, and changes in fund balance provide a reconciliation to facilitate this comparison between governmental funds and governmental activities.

The District adopts an annual appropriated budget for its general fund. A budgetary comparison statement has been provided for the general fund to demonstrate compliance with this budget.

The fund financial statements can be found on pages 11 to 14 of this report.

Notes to the financial statements - The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes to the basic financial statements can be found on pages 15 to 25 of this report.

Government-Wide Financial Analysis

As noted earlier, net position may serve, over time, as a useful indicator of a District's financial position. In the case of the District, assets exceeded liabilities by \$8,430,309 at the close of the most recent fiscal year.

Approximately 70% percent of the District's net position reflects its investment in capital assets (e.g., infrastructure and equipment). The District uses these capital assets to provide services to citizens; consequently, these assets are not available for future spending.

EMERALD BAY SERVICE DISTRICT

Management's Discussion and Analysis
June 30, 2014

Emerald Bay Service District
Net Assets – Governmental Activities

| | <u>June 30, 2014</u> | <u>June 30, 2013</u> |
|----------------------------|----------------------|----------------------|
| Assets | | |
| Current and other assets | \$ 2,713,162 | \$ 2,588,383 |
| Capital assets | <u>6,186,234</u> | <u>5,291,860</u> |
| Total Assets | \$ <u>8,899,396</u> | \$ <u>7,880,243</u> |
| Current liabilities | \$ 421,066 | \$ 94,392 |
| Noncurrent liabilities | <u>48,021</u> | <u>14,532</u> |
| Total Liabilities | <u>469,087</u> | <u>108,924</u> |
| Net Position: | | |
| Invested in capital assets | 6,138,213 | 5,277,328 |
| Unrestricted | <u>2,292,096</u> | <u>2,493,991</u> |
| Total Net Position | \$ <u>8,430,309</u> | \$ <u>7,771,319</u> |

None of the District's net position are subject to external restrictions on how they may be used. The balance of unrestricted net position may be used to meet the District's ongoing obligations.

Emerald Bay Service District
Statement of Activities – Governmental Activities

| | <u>June 30, 2014</u> | <u>June 30, 2013</u> | <u>Change</u> |
|---|----------------------|----------------------|-------------------|
| General revenues: | | | |
| Property tax | \$ 1,809,157 | \$ 1,747,149 | \$ 62,008 |
| Investment earnings | 4,537 | 1,957 | 2,580 |
| Miscellaneous | <u>40,632</u> | <u>24,905</u> | <u>15,727</u> |
| Total revenues | <u>1,854,326</u> | <u>1,774,011</u> | <u>80,315</u> |
| Expenses: | | | |
| General government | 862,972 | 817,377 | 45,595 |
| Public services | 177,921 | 182,150 | (4,229) |
| Recreation and safety | <u>188,008</u> | <u>179,779</u> | <u>8,229</u> |
| Total expenses | <u>1,228,901</u> | <u>1,179,306</u> | <u>49,595</u> |
| Change in net position | 625,425 | 594,705 | 30,720 |
| Net position – beginning of year | <u>7,771,319</u> | <u>7,176,614</u> | <u>594,705</u> |
| Prior period adjustment | 33,565 | - | 33,565 |
| Restated net position – beginning of year | <u>7,804,884</u> | <u>-</u> | <u>-</u> |
| Net position – end of year | \$ <u>8,430,309</u> | \$ <u>7,771,319</u> | \$ <u>658,990</u> |

EMERALD BAY SERVICE DISTRICT

Management's Discussion and Analysis

June 30, 2014

Financial Analysis of the Government's Funds

As noted earlier, the District uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements.

Governmental funds. The focus of the District's governmental funds is to provide information on near-term inflows, outflows and balances of spendable resources. Such information is useful in assessing the District's financing requirements. In particular, unassigned fund balance may serve as a useful measure of a government's net resources available for spending at the end of the fiscal year.

At June 30, 2014, the District's governmental fund reported an ending balance of \$2,292,096, a decrease of \$199,082 in comparison with the prior year. This entire amount constitutes unassigned fund balance, which is available for spending at the District's discretion.

The fund balance of the District's general fund decreased by \$199,082 during the current fiscal year this decrease can be compared to a decrease of \$45,396 in the prior fiscal year. Key factors in the changes are as follows:

- Capital expenditures for infrastructure and equipment increased from \$994,127 in prior year to \$1,178,781 in the current fiscal year.
- Interest earnings and change in fair value of investments increased by \$2,580. This increase is primarily the result of changing from money market and treasury investments in 2013 to LAIF in 2014.

General Fund Budgetary Highlights

There were no differences between the original budget and the final budget. Current year revenues and expenditures were less than budgeted revenues and expenditures in the following areas:

- Property taxes exceeded budget as the general market decline in the real estate market over the past few years begins to reverse.
- Interest earnings were less than budgeted revenues, primarily due to a general decline in money market rates paid by financial institutions. The change in fair value of investments is not budgeted, though there was a decline in the market value of held treasury notes during the fiscal year.
- Capital expenditures for infrastructure and equipment were more than budgeted, as expenses for capital expenses that were either cancelled or deferred in previous years were completed this fiscal year.

EMERALD BAY SERVICE DISTRICT

Management's Discussion and Analysis

June 30, 2014

Capital Asset and Debt Administration

Capital Assets - The District spent \$1,178,781 on infrastructure assets and equipment.

Additional information on the District's capital assets can be found in Note 3 on page 22 of the notes to the financial statements.

Long-term debt - At the end of the current fiscal year, the District had two loans related to the purchase of equipment with an outstanding balance of \$48,021 at June 30, 2014.

Economic Factors and Next Year's Budgets and Rates

The Mihaylo College of Business and Economic at the California State University Fullerton reported that Orange County real estate has had a remarkable recovery, noting that the median price of Orange County properties sold in 2014 showed sales prices returning to May 2005 levels. The sales prices are now only 11% below the peak in July 2007. Although the rate of home-price increases appear to be showing signs of slowing down decreases in home prices are not predicted.

Assessed property values continue to increase for the addresses included within the District property tax allocations. The last time the Emerald Bay Community realized declining property value assessments was in the Fiscal Year Ended June 30, 2010 (-1.8%). Since 2010 the County of Orange, including Emerald Bay, has seen a steady appreciation in real estate pricing, which in turn, has a direct effect on assessed valuations of properties within the District. Consequently, the District has experience an 18% increase in assessed values from Fiscal Year Ended June 30, 2010 to the current Fiscal Year Ended June 30, 2014.

The District's Board of Directors and staff relied on this information during the development of the Fiscal Year 2014-15 annual budget. Increases in estimated property taxes remain conservative at 2%.

This financial report is designed to provide a general overview of the Emerald Bay Service District's finances for all those with an interest in the government's finances. Questions concerning any of the information provided in this report, or requests for additional financial information, should be addressed to the District's Office: Emerald Bay Service District, 600 Emerald Bay, Laguna Beach, CA 92651.

EMERALD BAY SERVICE DISTRICT
Statement of Net Position
June 30, 2014

| | <u>Governmental Activities</u> |
|--|------------------------------------|
| ASSETS | |
| Cash and investments | \$ 2,573,435 |
| Taxes receivable | 33,383 |
| Due from Emerald Bay Community Association | 25,607 |
| Other assets | 80,737 |
| Capital assets, net | <u>6,186,234</u> |
| Total Assets | <u><u>\$ 8,899,396</u></u> |
| LIABILITIES | |
| Accounts payable and accrued expenses | \$ 391,940 |
| Accrued payroll liabilities | 2,955 |
| Due to Emerald Bay Community Association | 26,171 |
| Current portion notes payable | <u>17,965</u> |
| Total Current Liabilities | <u>439,031</u> |
| Non-current portion notes payable | <u>30,056</u> |
| Total liabilities | 469,087 |
| NET POSITION | |
| Invested in capital assets | 6,156,178 |
| Unrestricted | <u>2,274,131</u> |
| Total Net Position | <u><u>\$ 8,430,309</u></u> |

The accompanying notes are an integral part of these financial statements

EMERALD BAY SERVICE DISTRICT
Statement of Activities
For the Year Ended June 30, 2014

| Functions/Programs | Expenses | Net (Expenses) and Changes in Net Position |
|---|--------------|--|
| Governmental activities: | | |
| General government | \$ 783,537 | \$ (783,537) |
| Public services water and sewer services | 254,699 | (254,699) |
| Recreation and safety | 190,665 | (190,665) |
| Total governmental activities | \$ 1,228,901 | (1,228,901) |
| General revenues: | | |
| Property taxes | | 1,809,157 |
| Investment income | | 4,537 |
| Gain on disposal of assets | | 8,600 |
| Miscellaneous | | 32,032 |
| Total general revenues | | 1,854,326 |
| Changes in net position | | 625,425 |
| Net position - beginning of year | | 7,771,319 |
| Prior Period adjustment | | 33,565 |
| Restated net position - beginning of year | | 7,804,884 |
| Net position - end of year | | \$ 8,430,309 |

The accompanying notes are an integral part of these financial statements

EMERALD BAY SERVICE DISTRICT
Balance Sheet
Governmental Fund
June 30, 2014

| | <u>General</u> |
|--|---------------------|
| ASSETS | |
| Cash and investments | \$ 2,573,435 |
| Taxes receivable | 33,383 |
| Due from Emerald Bay Community Association | 25,607 |
| Other assets | 80,737 |
| Total Assets | \$ 2,713,162 |
| LIABILITIES AND FUND BALANCE | |
| Liabilities: | |
| Accounts payable and accrued expenses | \$ 391,940 |
| Accrued payroll liabilities | 2,955 |
| Due to Emerald Bay Community Association | 26,171 |
| Total Liabilities | 421,066 |
| Fund Balance: | |
| Committed | 20,800 |
| Unassigned | 2,271,296 |
| | 2,292,096 |
| Total Liabilities and Fund Balance | \$ 2,713,162 |

The accompanying notes are an integral part of these financial statements

EMERALD BAY SERVICE DISTRICT
Reconciliation of the Balance Sheet - Governmental Fund
to the Statement of Net Position
June 30, 2014

| | |
|---|----------------------------|
| Fund balance for Governmental Funds | \$ 2,271,296 |
| Amounts reported for governmental activities in the statement of net position are different because: | |
| Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds. | |
| Capital assets, net of depreciation | 6,186,234 |
| Debt does not require current resources and is excluded from the Government Fund Financial Statements | <u>(48,021)</u> |
| Net position of Governmental Activities | <u><u>\$ 8,409,509</u></u> |

The accompanying notes are an integral part of these financial statements

EMERALD BAY SERVICE DISTRICT
Statement of Revenues, Expenditures and Changes in Fund Balance
Governmental Fund
For the Year Ended June 30, 2014

| | <u>General</u> |
|--|----------------|
| REVENUES | |
| Taxes | \$ 1,809,157 |
| Investment earnings | 4,537 |
| Gain on disposal of assets | 8,600 |
| Proceeds from issues debt | 43,922 |
| Other | 32,032 |
| Total revenues | 1,898,248 |
| EXPENDITURES | |
| General government | 534,983 |
| Public services water and sewer services | 236,920 |
| Recreation and safety | 190,665 |
| Debt service | 10,433 |
| Capital outlay | 1,178,781 |
| Total expenditures | 2,151,782 |
| Net change in fund balance | (253,534) |
| Fund balance - beginning of year | 2,493,991 |
| Prior period adjustment | 51,639 |
| Restated fund balance - beginning of year | 2,545,630 |
| Fund balance - end of year | \$ 2,292,096 |

The accompanying notes are an integral part of these financial statements

EMERALD BAY SERVICE DISTRICT
Reconciliation of the Statement of Revenues, Expenditures and
Changes in Fund Balance of the Governmental Fund
to the Statement of Activities
For the Year Ended June 30, 2014

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

Net change in fund balance - governmental fund: \$ (253,534)

Governmental funds report capital outlays as expenditures. However in the statement of activities, the cost of these assets is allocated over their estimated useful lives and reported as depreciation expense. The following is the activity related to capital assets

Additions to capital assets 1,178,781

Depreciation expense (266,333)

Proceeds from debt are excluded from revenue in the Governmental statements (43,922)

Debt service payments are excluded from expenditures in the Governmental statements 10,433

Change in net position of governmental activities \$ 625,425

The accompanying notes are an integral part of these financial statements

EMERALD BAY SERVICE DISTRICT

Notes to Basic Financial Statements
June 30, 2014

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Reporting Entity

The Emerald Bay Service District (District) was organized on November 20, 1961, under the Community Service District Law to provide services to the residents living in the unincorporated area of Orange County known as Emerald Bay. The District was authorized by an election held on November 14, 1961, and subsequently approved by a resolution of the Board of Supervisors of Orange County. Currently, the District has been authorized by the Orange County Local Formation Commission to provide sewage, water, infrastructure, health and safety, emergency response (CERT) and other services to the Emerald Bay Community.

The District is governed by a five member Board of Directors. The members of the Board of Directors of Emerald Bay Service District serve without compensation, benefits or reimbursement of out of pocket expenses.

B. Government-Wide and Fund Financial Statements

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

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

Separate financial statements are provided for the governmental fund.

C. Measurement Focus, Basis of Accounting, and Financial Statement Presentation

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

EMERALD BAY SERVICE DISTRICT

Notes to Basic Financial Statements
June 30, 2014

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

C. Measurement Focus, Basis of Accounting, and Financial Statement Presentation (continued)

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

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

The District reports the following major governmental fund:

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

When both restricted and unrestricted resources are available for use, it is the District's policy to use restricted resources first, then unrestricted resources as they are needed.

D. Assets, Liabilities, and Net Position or Fund Equity

Capital Assets

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

EMERALD BAY SERVICE DISTRICT

Notes to Basic Financial Statements
June 30, 2014

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

D. Assets, Liabilities, and Net Position or Fund Equity (continued)

Capital Assets – continued

Depreciation is provided using the straight-line method over the estimated useful lives of the asset as follows:

| | <u>Years</u> |
|----------------|--------------|
| Infrastructure | 15 - 30 |
| Equipment | 3 - 5 |

Property Taxes

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

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

Investments

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

Fund Equity

Effective July 1, 2013, the District implemented GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definition*, to which the District is bound to honor constraints on the specific purposes for which amounts in the funds can be spent. Fund balance for governmental funds is classified as follows:

EMERALD BAY SERVICE DISTRICT

Notes to Basic Financial Statements
June 30, 2014

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

D. Assets, Liabilities, and Net Position or Fund Equity (continued)

Fund Equity (continued)

- Nonspendable – includes amounts that are (a) not in spendable form, or (b) legally or contractually required to be maintained intact. The “not in spendable form” criterion includes items that are not expected to be converted to cash, for example: inventories, prepaid amounts, and long-term notes receivable.
- Restricted – includes amounts that can be spent only for the specific purposes stipulated by external resource providers, constitutionally or through enabling legislation. Restrictions may effectively be changed or lifted only with the consent of resource providers.
- Committed – includes amounts that can only be used for the specific purposes determined by a formal action of the District’s highest level of decision-making authority, the District’s Board of Directors (Board). Commitments may be changed or lifted only by the Board taking the same formal action that imposed the constraint originally (for example: resolution).
- Assigned – comprises amounts intended to be used by the Board for specific purposes that are neither restricted nor committed. Intent is expressed by (a) the Board or (b) a body (for example: a budget or finance committee) or official to which the Board has delegated the authority to assign amounts to be used for specific purposes.
- Unassigned – is the residual classification for the General Fund and includes all amounts not contained in the other classifications. Unassigned amounts are technically available for any purpose.

The District does not currently have any nonspendable, restricted, or assigned fund balance. The District has \$20,800 committed for completion of a construction project in process at year end. In circumstances when an expenditure is made for a purpose for which amounts are available in multiple fund balance classifications, fund balance is depleted in the order of restricted, committed, assigned, and unassigned.

EMERALD BAY SERVICE DISTRICT

Notes to Basic Financial Statements
June 30, 2014

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

D. Assets, Liabilities, and Net Position or Fund Equity (continued)

Classification of Net Position

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

- Invested in capital assets, net of related debt – This component of net position consists of capital assets, net of accumulated depreciation, and reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets.
- Restricted net position – This component of net position consists of constraints placed on net assets use through external restrictions imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments or constraints imposed by law through constitutional provisions or enabling legislation. The District does not currently have any restricted net position.
- Unrestricted net position – This component of net position represents the unencumbered net position and consists of fund equity that do not meet the definition of “restricted” or “invested in capital assets, net of related debt.”

Implementation of New Accounting Principles

- The District adopted the provisions of GASB Statement No. 63 (GASB 63), *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. GASB 63 provides financial reporting guidance for deferred outflows of resources, deferred inflows of resources, and net position in a statement of financial position and related disclosures. It also identifies net position as the residual of all other elements presented in a statement of financial position, or the difference between (a) assets and deferred outflows of resources and (b) liabilities and deferred inflows of resources. As implied above, GASB 63 changes the previous classification of net assets to net position, and consequently, the statement of net assets to the statement of net position. The District had no deferred inflows or outflows of resources as of June 30, 2014

Estimates

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

EMERALD BAY SERVICE DISTRICT

Notes to Basic Financial Statements June 30, 2014

NOTE 2: CASH AND INVESTMENTS

Cash and investments at June 30, 2014, consist of the following:

| | |
|--------------------------------------|------------|
| Deposits with financial institutions | \$ 668,289 |
| Short term money market | 405,146 |
| Local Agency Investment Fund | 1,500,000 |

| | |
|----------------------------|--------------|
| Total cash and investments | \$ 2,573,435 |
|----------------------------|--------------|

Authorized Investments

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

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

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

EMERALD BAY SERVICE DISTRICT

Notes to Basic Financial Statements
June 30, 2014

NOTE 2: CASH AND INVESTMENTS (continued)

Disclosures Relating to Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment the greater the sensitivity of its fair value to changes in market interest rates. Information about the sensitivity of the fair values of the District's investments to market interest rate fluctuations is provided by the following table that shows the distribution of the District's investment by maturity.

| <u>Investment Type</u> | <u>Total</u> | <u>12 Months or Less</u> | <u>13 to 24 Months</u> | <u>25 to 60 Months</u> |
|------------------------|--------------|------------------------------|----------------------------|----------------------------|
| Money market | \$ 405,146 | \$405,146 | - | - |

Disclosures Relating to Credit Risk

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

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

Custodial Credit Risk

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

EMERALD BAY SERVICE DISTRICT

Notes to Basic Financial Statements
June 30, 2014

NOTE 2: CASH AND INVESTMENTS (continued)

state law (unless so waived by the government unit). The market value of the pledged securities in the collateral pool must equal at least 110% of the total amount deposited by the public agencies. California law also allows financial institutions to secure District deposits by pledging first trust deed mortgage notes having a value of 150% of the secured public deposits. The District deposits are not exposed to custodial credit risk at June 30, 2014.

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

Custodial Credit Risk

The District investments in marketable securities are not exposed to custodial credit risk at June 30, 2014.

NOTE 3: CAPITAL ASSETS

A summary of changes in capital assets for the District's governmental activities for the year ended June 30, 2014, is as follows.

| | <u>June 30, 2013</u> | <u>Additions</u> | <u>Deletions</u> | <u>June 30, 2014</u> |
|---|----------------------|-------------------|------------------|----------------------|
| Capital assets, not being depreciated: | | | | |
| Construction in progress | \$ <u>1,222,449</u> | \$ <u>201,450</u> | <u>-</u> | \$ <u>1,423,899</u> |
| Capital assets, being depreciated | | | | |
| Water | 754,859 | 264,815 | - | 1,019,674 |
| Sewer | 2,056,593 | 113,083 | - | 2,169,676 |
| General | 2,020,862 | 552,137 | - | 2,572,999 |
| Equipment | <u>109,511</u> | <u>47,296</u> | <u>-</u> | <u>156,807</u> |
| Total capital assets, being depreciated | <u>4,941,825</u> | <u>977,331</u> | <u>-</u> | <u>5,919,156</u> |
| Less accumulated depreciation: | | | | |
| Net assets being depreciated | <u>(872,414)</u> | <u>(284,407)</u> | <u>-</u> | <u>(1,156,821)</u> |
| | <u>4,069,411</u> | <u>692,924</u> | <u>-</u> | <u>4,762,335</u> |
| Total capital assets, net | <u>\$ 5,291,860</u> | <u>\$ 894,374</u> | <u>-</u> | <u>\$ 6,186,234</u> |

Depreciation expense of \$266,333 was charged to the public services functions. Prior years depreciation expense was corrected through a prior period adjustment in the amount of \$18,074.

EMERALD BAY SERVICE DISTRICT

Notes to Basic Financial Statements
June 30, 2014

NOTE 4: NOTE PAYABLE

The District has the following notes payable outstanding at June 30, 2014.

| | |
|--|------------------|
| Note payable with an original principal balance of \$27,528. The note is secured by a pickup truck. The note bears interest at 6.54% and is payable in monthly principal and interest payment of \$643 through July 2015 | \$ 7,503 |
| Note payable with an original principal amount of \$43,922. The note bears interest at 4% and is payable in monthly principal and interest payments of \$993 through February 2018. | <u>40,518</u> |
| Total | <u>\$ 48,021</u> |

The terms of the debt listed above require principal and interest payments as follows:

| | <u>Principal</u> | <u>Interest</u> | <u>Total</u> |
|----------------------------|------------------|-----------------|------------------|
| Fiscal Year Ended June 30: | | | |
| 2015 | \$ 17,965 | \$ 1,759 | \$ 19,724 |
| 2016 | 10,896 | 1,021 | 11,917 |
| 2017 | 11,347 | 569 | 11,916 |
| 2018 | 7,813 | 120 | 7,933 |
| | <u>\$ 48,021</u> | <u>\$ 3,469</u> | <u>\$ 51,490</u> |

EMERALD BAY SERVICE DISTRICT

Notes to Basic Financial Statements
June 30, 2014

NOTE 5: OTHER INFORMATION

Insurance Coverage

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

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

Settled claims have not exceeded any of the District's coverage amounts in the last three fiscal years, and there were no reductions in the coverage during the year ended June 30, 2014.

Related Party Transactions

The Board of Directors of the Emerald Bay Service District (EBSD) entered into a Management Services Agreement (approved and adopted at a Special Meeting of the Board of Directors on July 16, 2013) with the Emerald Bay Community Association (EBCA), a legally separate, but geographically related entity. The term of the agreement is to December 31, 2016 with yearly extensions. Fees are charged at a fixed rate of \$8,680 per month (office rent administrative expenses and lease of Association property upon which the District facilities are located), plus specific percentages of designated employees of EBCA.

Affiliated Organizations

As indicated in Note 1(a) *Reporting Entity*, the District's purpose includes providing fresh water supply and fire protection to the residents of the District. Currently, the Laguna Beach County Water District (LBCWD) provides the District's residents with its fresh water supply on behalf of the District. For the fiscal year ended June 30, 2014, District residents were charged approximately \$603,000 for their consumption of 279 acre feet (approx. 91 million gallons) of fresh water. Furthermore, the Orange County Fire Authority (OCFA) currently provides fire protection services to District residents. For the fiscal year ended June 30, 2014, the County apportioned and paid to OCFA approximately \$1.5 million in property taxes to provide these services.

EMERALD BAY SERVICE DISTRICT

Notes to Basic Financial Statements
June 30, 2014

NOTE 6: FIRE STATION LEASE

In exchange for receiving fire protection services the District has provided the Orange County Fire Authority (OCFA) a rent free lease of the fire station located with-in the District's boundaries. The lease is for a term of 5 years with 10 automatic 5 year renewal periods up to 55 years through 2068.

NOTE 7: PRIOR PERIOD ADJUSTMENT

During the year it was determined that costs related to the District's fireworks program and insurance, should have been recorded as prepaid at June 30, 2013. In addition a mathematical error in the prior years' accumulated depreciation was corrected. A prior period adjustment has been recorded to reflect the effect of these amounts on the current year.

NOTE 8: SUBSEQUENT EVENTS

On October 15, 2014, Plaintiffs Steve Rebeil, Jilly Rebeil and Cary Bren ("Plaintiffs"), filed a first amended complaint for declaratory relief against the Emerald Bay Community Association ("Association") and Emerald Bay Service District ("District") based on allegations that (i) the Architectural Committee of the Association is improperly organized, (ii) both defendants violated the CC&Rs due to, among other things, an inconsistent and unfair review process, and (iii) both defendants violated Civil Code section 4765 due to, among other things, arbitrary and capricious procedure and making decisions in bad faith. In particular, Plaintiffs assert that the District colluded and conspired with the Association to unfairly deny Plaintiffs' design plans. In support, Plaintiffs allege that (a) Plaintiffs' design plans do not interfere or impede any right of the District and (b) the District's enforcement of its easement interest is inconsistent and unreasonable. While the outcome of this litigation is presently unknown, if unsuccessful, the District could be liable for attorneys' fees and/or costs of suit the amount of which is currently unknown and not reasonably estimable.

The District has evaluated subsequent events through November 10, 2014 the date the financial statements were available for release.

REQUIRED SUPPLEMENTARY INFORMATION

EMERALD BAY SERVICE DISTRICT
General Fund
Budgetary Comparison Schedule
For the Year Ended June 30, 2014

| | Original and Final Budget | Actual | Variance Over (Under) |
|---|---------------------------------|----------------------------|-----------------------------|
| Revenues | | | |
| Taxes | \$ 1,770,000 | \$ 1,809,157 | \$ 39,157 |
| Interest earnings | 30,000 | 4,537 | (25,463) |
| Net decrease in the fair value of investments | - | 32,032 | 32,032 |
| | <u>1,800,000</u> | <u>1,845,726</u> | <u>45,726</u> |
| Total revenues | | | |
| Expenditures | | | |
| Current: | | | |
| General government | 533,000 | 534,983 | 1,983 |
| Public services water and sewer services | 341,000 | 236,920 | (104,080) |
| Recreation and safety | 199,000 | 190,665 | (8,335) |
| Capital expenditures | 809,000 | 1,178,781 | 369,781 |
| | <u>1,882,000</u> | <u>2,141,349</u> | <u>259,349</u> |
| Total expenditures | | | |
| | <u>(82,000)</u> | <u>(295,623)</u> | <u>(213,623)</u> |
| Net change in fund balance | | | |
| Fund balance - beginning of year | <u>2,493,991</u> | <u>2,493,991</u> | <u>-</u> |
| Fund balance - end of year | <u><u>\$ 2,411,991</u></u> | <u><u>\$ 2,198,368</u></u> | <u><u>\$ (213,623)</u></u> |

See Accompanying Notes to Required Supplementary Information

EMERALD BAY SERVICE DISTRICT
General Fund
Functional Expenditures Budgetary Comparison Schedule
For the Year Ended June 30, 2014

| | Original Budget | Final Budget | Actual | Variance Over (Under) |
|---|---------------------|--------------------|---------------------|-----------------------------|
| General government | | | | |
| Staff salary | \$ 86,000 | \$ 86,000 | \$ 88,000 | 2,000 |
| Payrol taxes | 7,000 | 7,000 | 6,905 | (95) |
| Retirement contributions | 4,000 | 4,000 | - | (4,000) |
| Workers compensation | 4,000 | 4,000 | 2,616 | (1,384) |
| Employee benefits | 4,000 | 4,000 | 3,704 | (296) |
| Personnel administration | 1,000 | 1,000 | 551 | (449) |
| Insurance | 75,000 | 75,000 | 41,739 | (33,261) |
| Professional services - other | - | - | - | - |
| Professional services - engineering | - | - | 4,725 | 4,725 |
| Professional services - personnel search | 6,000 | 6,000 | 201 | (5,799) |
| County of Orange - tax administration charge | 18,000 | 18,000 | 15,683 | (2,317) |
| Legal fees | 16,000 | 16,000 | 39,175 | 23,175 |
| Accounting fees | 17,000 | 17,000 | 8,125 | (8,875) |
| Audit | 8,000 | 8,000 | 7,000 | (1,000) |
| District website | - | - | 4,255 | - |
| Management services | 245,000 | 245,000 | 246,577 | 1,577 |
| Memberships and contributions | 8,000 | 8,000 | 4,556 | (3,444) |
| Admininstration miscellaneous expense | 3,000 | 3,000 | 4,250 | 1,250 |
| Computer services | 1,000 | 1,000 | 86 | (914) |
| Office and collection expenses | - | - | 3,552 | 3,552 |
| LAFCO annual contribution | 10,000 | 10,000 | 8,979 | (1,021) |
| Runoff management/storm drain | - | - | 42,375 | 42,375 |
| Interest expense | - | - | 1,929 | 1,929 |
| Storm drain | - | - | - | - |
| Maintance yard | - | - | - | - |
| Total general government | <u>513,000</u> | <u>513,000</u> | <u>534,983</u> | <u>17,728</u> |
| Public services water and sewer services | | | | |
| Engineer surveys and expenses | 1,000 | 1,000 | 2,625 | 1,625 |
| Routine maintenance and supplies | 45,000 | 45,000 | 16,145 | (28,855) |
| Electricity | 15,000 | 15,000 | 12,116 | (2,884) |
| Telephone | 4,000 | 4,000 | 3,597 | (403) |
| Water | 4,000 | 4,000 | 979 | (3,021) |
| Maintenance Equipment | 7,000 | 7,000 | 10,911 | 3,911 |
| Maintenance vehicle fuel and repairs | 20,000 | 20,000 | 10,891 | (9,109) |
| Monthly inspections | 6,000 | 6,000 | 2,195 | (3,805) |
| Sewage treatment services | 104,000 | 104,000 | 103,925 | (75) |
| Supplies and chemicals | 3,000 | 3,000 | 800 | (2,200) |
| Office and collection expenses | - | - | 869 | 869 |
| Water conservation | - | - | (4) | (4) |
| Sewer relining | 20,000 | 20,000 | - | (20,000) |
| Sewer/Water Maps | - | - | - | - |
| Improvements Pump stations | - | - | - | - |
| Sewer Repair | - | - | 49,732 | 49,732 |
| Emergency expenses and repairs | - | - | 22,139 | 22,139 |
| Pump Stations Motors | - | - | - | - |
| Reseviouir Reserve | - | - | - | - |
| Emergency Sewer line Protection project | 25,000 | 25,000 | - | (25,000) |
| Total public services water and sewer servi | <u>254,000</u> | <u>254,000</u> | <u>236,920</u> | <u>(17,080)</u> |
| Recreation and safety | | | | |
| Fuel mod./weed abatement | 20,000 | 20,000 | 16,751 | (3,249) |
| Training Classes-Workshops | - | - | 529 | 529 |
| Communications | - | - | 12,651 | 12,651 |
| Fireworks | 51,000 | 51,000 | 51,639 | 639 |
| Beach Lifeguards | 110,000 | 110,000 | 106,194 | (3,806) |
| Miscellaneous/CERT Expense | - | - | 2,128 | 2,128 |
| Emergency Prep & CERT | 18,000 | 18,000 | 773 | (17,227) |
| Total Recreation and safety | <u>199,000</u> | <u>199,000</u> | <u>190,665</u> | <u>(8,335)</u> |
| Debt service | - | - | 10,433 | 10,433 |
| Capital outlay | <u>809,000</u> | <u>809,000</u> | <u>1,178,781</u> | <u>369,781</u> |
| Total expenditures | <u>\$ 1,775,000</u> | <u>\$1,775,000</u> | <u>\$ 2,141,349</u> | <u>\$ 366,349</u> |

See Accompanying Notes to Required Supplementary Information

EMERALD BAY SERVICE DISTRICT

Notes to Required Supplementary Information
June 30, 2014

NOTE 1: BUDGETS AND BUDGETARY ACCOUNTING

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

NOTE 2: APPROPRIATIONS AND ENCUMBRANCES

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