



Santa Margarita Groundwater Agency

Annual Financial Report

For the Fiscal Year Ended June 30, 2018

Santa Margarita Groundwater Agency

Board of Directors as of June 30, 2018

<u>Name</u>	<u>Title</u>	<u>Member Agency</u>	<u>Current Term</u>
Chris Perri	Chair	Scotts Valley Water District	Undesignated
Chuck Baughman	Vice Chair	San Lorenzo Valley Water District	Undesignated
Angela Franklin	Secretary	Well Owner Representatives	8/30/17 - 8/30/2020
John Leopold	Director	County of Santa Cruz	Undesignated
Bruce McPherson	Director	County of Santa Cruz	Undesignated
Doug Engfer	Director	City of Santa Cruz	Undesignated
Donna Lind	Director	City of Scotts Valley	Undesignated
Gene Ratcliffe	Director	San Lorenzo Valley Water District	Undesignated
Ruth Stiles	Director	Scotts Valley Water District	Undesignated
Dale Pollock	Director	Mount Hermon Association	Undesignated
Nick Vrolyk	Director	Well Owner Representatives	8/30/17 - 8/30/2020

Santa Margarita Groundwater Agency
Stephanie Hill, Treasurer
2 Civic Center Drive,
Scotts Valley, CA 95066
(831) 430-4620
smgwa.org

Santa Margarita Groundwater Agency
Annual Financial Report
For the Fiscal Year Ended June 30, 2018

**Santa Margarita Groundwater Agency
Annual Financial Report
For the Fiscal Year Ended June 30, 2018**

Table of Contents

	<u>Page No.</u>
Table of Contents	i
Financial Section	
Independent Auditor's Report	1-2
Management's Discussion and Analysis	3-5
Basic Financial Statements:	
Statement of Net Position	6
Statement of Revenues, Expenditures and Changes in Net Position	7
Statement of Cash Flows	8
Notes to the Basic Financial Statements	9-14
Report on Internal Controls and Compliance	
Independent Auditor's Report on Internal Controls and Compliance Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance with <i>Government Auditing Standards</i>	15-16

Financial Section



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Independent Auditor's Report

Governing Board
Santa Margarita Groundwater Agency
Scotts Valley, California

Report on the Financial Statements

We have audited the accompanying financial statements of the Santa Margarita Groundwater Agency (Agency) as of and for the year ended June 30, 2018, which collectively comprise the Agency'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 an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free 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 opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Agency, as of June 30, 2018, and the respective changes in financial position, and, cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Independent Auditor's Report, continued

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 5 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.

Other Reporting Required by Government Auditing Standards

In accordance with Government Auditing Standards, we have also issued our report dated December 20, 2018 on our consideration of the Agency'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 Agency's internal control over financial reporting and compliance. This report can be found on pages 15 and 16.

Fedak & Brown LLP

Fedak & Brown LLP
Cypress, California
December 20, 2018

Santa Margarita Groundwater Agency
Management's Discussion and Analysis
For the Fiscal Year Ended June 30, 2018

As management of the Santa Margarita Groundwater Agency (Agency), we offer readers of the Agency's financial statements this narrative overview and analysis of the financial activities and performance of the Agency for the fiscal year ended June 30, 2018. Please read it in conjunction with additional information that we have furnished in the accompanying basic financial statements, which follow this section.

Financial Highlights

- In 2018, the Agency's net position amounted to \$77,219.
- In 2018, the Agency's total revenues amounted to \$180,000.
- In 2018, the Agency's total expenses amounted to \$102,781.

Using This Financial Report

This annual report consists of a series of financial statements. The Statement of Net Position and the Statement of Activities provide information about the activities and performance of the Agency using accounting methods similar to those used by private sector companies. The Statement of Net Position includes all of the Agency's investments in resources (assets), deferred outflows of resources, obligations to creditors (liabilities) and deferred inflows of resources. It also provides the basis for computing a rate of return, evaluating the capital structure of the Agency and assessing the liquidity and financial flexibility of the Agency. All of the current year's revenue and expenses are accounted for in the Statements of Activities. This statement measures the success of the Agency's operations and can be used to determine the Agency's profitability and credit worthiness.

Financial Analysis of the Agency

Statement of Net Position and Statement of Activities

One of the most important questions asked about the Agency's finances is, "Is the Agency better off or worse off as a result of this year's activities?" The Statement of Net Position and the Statement of Activities report information about the Agency in a way that helps answer this question.

These statements include all assets and deferred outflows of resources, liabilities and deferred inflows of resources, using the *accrual basis of accounting*, which is similar to the accounting 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 Agency's *net position* and changes in them. One can think of the Agency's net position – the difference between assets and deferred outflows of resources less liabilities and deferred inflows of resources – as one way to measure the Agency's financial health, or *financial position*. Over time, *increases or decreases* in the Agency's net position are one indicator of whether its *financial health* is improving or deteriorating. However, one will need to consider other non-financial factors, however, such as changes in the Agency's organizational agreements to assess the *overall health* of the Agency in future periods.

Santa Margarita Groundwater Agency
Management's Discussion and Analysis, continued
For the Fiscal Year Ended June 30, 2018

Notes to the Basic Financial Statements

The notes provide additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes to the basic financial statements can be found on pages 9 through 14.

Statement of Net Position

Condensed Statement of Net Position

	2018
Assets:	
Current assets	\$ <u>165,562</u>
Total assets	<u>165,562</u>
Liabilities:	
Current liabilities	<u>88,343</u>
Total liabilities	<u>88,343</u>
Net position:	
Unrestricted	<u>77,219</u>
Total net position	<u><u>\$ 77,219</u></u>

As noted earlier, net position may serve over time as a useful indicator of a government's financial position. In the case of the Agency, assets of the Agency exceeded liabilities by \$77,219 as of June 30, 2018.

Statement of Revenues, Expenses and Changes in Net Position

**Condensed Statement of Revenues, Expenses
and Changes in Net Position**

	2018
Revenues:	
Operating revenues	\$ <u>180,000</u>
Total revenues	<u>180,000</u>
Expenses:	
Operating expenses	<u>102,781</u>
Total expenses	<u>102,781</u>
Change in net position	77,219
Net position, beginning of period	<u>-</u>
Net position, end of period	<u><u>\$ 77,219</u></u>

The statement of revenues, expenses and changes in net position shows how the government's net position changed during the fiscal year. In the case of the Agency, net position shows a positive balance in its unrestricted net position of \$77,219.

Santa Margarita Groundwater Agency
Management's Discussion and Analysis, continued
For the Fiscal Year Ended June 30, 2018

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

The operating revenue of \$180,000 consists of the dues contributed by each member agency. Each member agency is invoiced a percentage of the projected budget for the fiscal year based on the following schedule:

<u>Member Agency</u>	<u>%</u>
Scotts Valley Water District	53%
San Lorenzo Valley Water District	39%
County of Santa Cruz	8%

Operating expenses of \$102,781 are comprised of the following: professional services of \$46,048; and administrative expense of \$42,153.

Conditions Affecting Current Financial Position

Management is unaware of any conditions which could have a significant impact on the Agency's current financial position, net position or operating results in terms of the present and future.

Requests for Information

The Agency's basic financial statements are designed to present users with a general overview of the Agency's finances and to demonstrate the Agency's accountability. If you have any questions about the report or need additional information, please contact the Agency's Treasurer, Stephanie Hill at Santa Margarita Groundwater Agency, 2 Civic Center Drive, Scotts Valley, CA 95066 or (831) 430-4620.

Basic Financial Statements

Santa Margarita Groundwater Agency
Statement of Net Position
June 30, 2018

	<u>2018</u>
Current assets:	
Cash and cash equivalents (note 2)	\$ <u>165,562</u>
Total current assets	<u>165,562</u>
Current liabilities:	
Accounts payable	<u>88,343</u>
Total current liabilities	<u>88,343</u>
Net position:	
Unrestricted	<u>77,219</u>
Total net position	<u>\$ <u>77,219</u></u>

See accompanying notes to the basic financial statements

**Santa Margarita Groundwater Agency
Statement of Revenues, Expenditures and Changes in Net Position
For the Fiscal Year Ended June 30, 2018**

	2018
Operating revenues:	
Membership revenue	\$ <u>180,000</u>
Total operating revenues	<u>180,000</u>
Operating expenses:	
General and administrative	<u>102,781</u>
Total operating expenses	<u>102,781</u>
Change in net position	77,219
Net position, beginning of period	<u>-</u>
Net position, end of period	<u><u>\$ 77,219</u></u>

See accompanying notes to the basic financial statements

**Santa Margarita Groundwater Agency
Statement of Cash Flows
For the Fiscal Year Ended June 30, 2018**

	2018
Cash flows from operating activities:	
Cash receipts from members	\$ 180,000
Payments to vendors for materials and services	(14,438)
Net cash provided by operating activities	165,562
Net increase in cash and cash equivalents	165,562
Cash and cash equivalents, beginning of year	-
Cash and cash equivalents, end of year	\$ 165,562
 Reconciliation of operating income to net cash provided by operating activities:	
Operating income	\$ 77,219
Changes in assets and liabilities:	
Increase in liabilities:	
Accounts payable	88,343
Net cash provided by operating activities	\$ 165,562

See accompanying notes to the basic financial statements

Santa Margarita Groundwater Agency
Notes to the Basic Financial Statements
For the Fiscal Year Ended June 30, 2018

(1) Reporting Entity and Summary of Significant Accounting Policies

A. Organization and Operations of the Reporting Entity

In June 1, 2017, Scotts Valley Water District, San Lorenzo Valley Water District, and the County of Santa Cruz (Members) entered into a joint powers agreement creating the Santa Margarita Groundwater Agency (Agency). Each Member is a local agency, as defined by the Sustainable Groundwater Management Act of 2014 (SGMA), duly organized and existing under and by virtue of the laws of the State of California, and each Member can exercise powers related to groundwater management. The purpose of the agreement is to adopt a groundwater sustainability plan by January 31, 2022 to manage groundwater basins designated by the California Department of Water Resources as medium and high priority basins. The Agency is a basin consolidation of all four common groundwater basins located in Santa Cruz County in the vicinity of Scotts Valley, Felton, Ben Lomond and Boulder Creek.

Under the Joint Exercise of Powers Act of 2000 (Act), including the Marks-Roos Local Bond Pooling Act of 1985 (Government Code sections 6584, et seq.), the Agency is authorized to issue bonds, and under certain circumstances, to purchase bonds issued by, or to make loans to, the Members for financing public capital improvements, working capital, liability and other insurance needs or projects whenever doing so results in significant public benefits, as determined by the Members. The Act further authorizes and empowers joint powers authorities to sell bonds that are issued or purchased to public or private purchasers at public or negotiated sales.

The term of the agreement shall remain in effect until terminated by unanimous written consent of all Members, except during the outstanding term of any Agency indebtedness. Upon termination of the agreement, the assets shall be distributed in proportion to the contributions of each Member agency.

B. Basis of Accounting and Measurement Focus

The Agency is accounted for as an enterprise fund in accordance with generally accepted accounting principles (GAAP) as applied to governmental units. Enterprise funds are used to account for operations (a) that are financed and operated in a manner similar to a private business enterprise, where the expenses, of providing goods and services to the general public are recovered through user charges, or where the governing body has decided that periodic determination of revenue earned, expenses incurred, and net income is appropriate for capital maintenance, public policy, management control, or other purposes. Because the Agency is accounted for as an enterprise fund, the Agency uses the economic resources measurement focus and the accrual basis of accounting for financial statement reporting purposes. 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. With the measurement focus, all assets and liabilities associated with the operation of these funds are included in the Statement of Net Position.

C. Financial Reporting

The Agency's basic financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP). The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles.

Santa Margarita Groundwater Agency
Notes to the Basic Financial Statements, continued
For the Fiscal Year Ended June 30, 2018

(1) Reporting Entity and Summary of Significant Accounting Policies, continued

C. Financial Reporting, continued

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

Government 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.

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.

Government 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.

Government Accounting Standards Board Statement No. 85

In March 2017, the GASB issued Statement No. 85 – *Omnibus 2017*. The objective of this Statement is to address practice issues that have been identified during implementation and application of certain GASB Statements. This Statement addresses a variety of topics including issues related to blending component units, goodwill, fair value measurement and application, and postemployment benefits (pensions and other postemployment benefits [OPEB]).

Government Accounting Standards Board Statement No. 86

In May 2017, the GASB issued Statement No. 86 – *Certain Debt Extinguishment Issues*. The primary objective of this Statement is to improve consistency in accounting and financial reporting for in-substance defeasance of debt by providing guidance for transactions in which cash and other monetary assets acquired with only existing resources—resources other than the proceeds of refunding debt—are placed in an irrevocable trust for the sole purpose of extinguishing debt. This Statement also improves accounting and financial reporting for prepaid insurance on debt that is extinguished and notes to financial statements for debt that is defeased in substance.

Santa Margarita Groundwater Agency
Notes to the Basic Financial Statements, continued
For the Fiscal Year Ended June 30, 2018

(1) Reporting Entity and Summary of Significant Accounting Policies, continued

D. Assets, Liabilities and Net Position

1. Use of Estimates

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

2. Cash and Cash Equivalents

Substantially, all of the Agency's cash is held in a financial institution bank account. The Agency considers all highly liquid investments with a maturity of three months or less to be cash equivalents.

3. Revenue Recognition

Membership dues are recognized as revenue at the time each member agency is invoiced or when a resolution is approved by the Board during the year.

4. Net Position/Fund Balances

The financial statements utilize a net position presentation. Net position categories are follows:

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

(2) Cash and Cash Equivalents

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

	2018
Cash and cash equivalents	\$ 165,562
Total cash and cash equivalents	\$ 165,562

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

	2018
Deposits with financial institutions	\$ 165,562
Total cash and cash equivalents	\$ 165,562

Santa Margarita Groundwater Agency
Notes to the Basic Financial Statements, continued
For the Fiscal Year Ended June 30, 2018

(2) Cash and Cash Equivalents, continued

Custodial Credit Risk

Custodial credit risk for *deposits* is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The California Government Code and the Agency'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). 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. The Agency had deposits with a bank balance of \$165,562 as of June 30, 2018. Of the bank balance, up to \$250,000 is federally insured and any remaining balance is collateralized in accordance with the Code; however, the collateralized securities are not held in the Agency's name.

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

The Governmental Accounting Standards Board (GASB) has issued several pronouncements prior to June 30, 2018, that has effective dates that may impact future financial presentations.

Governmental Accounting Standards Board Statement No. 83

In November 2016, the GASB issued Statement No. 83 – *Certain Asset Retirement Obligations*. This Statement (1) addresses accounting and financial reporting for certain asset retirement obligations (AROs), (2) establishes criteria for determining the timing and pattern of recognition of a liability and a corresponding deferred outflow of resources for AROs, (3) requires that recognition occur when the liability is both incurred and reasonably estimable, (4) requires the measurement of an ARO to be based on the best estimate of the current value of outlays expected to be incurred, (5) requires the current value of a government's AROs to be adjusted for the effects of general inflation or deflation at least annually, and (6) requires disclosure of information about the nature of a government's AROs, the methods and assumptions used for the estimates of the liabilities, and the estimated remaining useful life of the associated tangible capital assets.

The requirements of this Statement are effective for reporting periods beginning after June 15, 2018. Earlier application is encouraged.

Governmental Accounting Standards Board Statement No. 84

In January 2017, the GASB issued Statement No. 84 – *Fiduciary Activities*. The objective of this Statement is to improve guidance regarding the identification of fiduciary activities for accounting and financial reporting purposes and how those activities should be reported.

This Statement establishes criteria for identifying fiduciary activities of all state and local governments. The focus of the criteria generally is on (1) whether a government is controlling the assets of the fiduciary activity and (2) the beneficiaries with whom a fiduciary relationship exists. Separate criteria are included to identify fiduciary component units and postemployment benefit arrangements that are fiduciary activities.

This Statement describes four fiduciary funds that should be reported, if applicable: (1) pension (and other employee benefit) trust funds, (2) investment trust funds, (3) private-purpose trust funds, and (4) custodial funds. Custodial funds generally should report fiduciary activities that are not held in a trust or equivalent arrangement that meets specific criteria.

The requirements of this Statement are effective for reporting periods beginning after December 15, 2018. Earlier application is encouraged.

Santa Margarita Groundwater Agency
Notes to the Basic Financial Statements, continued
For the Fiscal Year Ended June 30, 2018

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

Governmental Accounting Standards Board Statement No. 87

In June 2017, the GASB issued Statement No. 87 – *Leases*. The objective of this Statement is to better meet the information needs of financial statement users by improving accounting and financial reporting for leases by governments. This Statement increases the usefulness of governments’ financial statements by requiring recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and recognized as inflows of resources or outflows of resources based on the payment provisions of the contract. It establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. Under this Statement, a lessee is required to recognize a lease liability and an intangible right-to-use lease asset, and a lessor is required to recognize a lease receivable and a deferred inflow of resources, thereby enhancing the relevance and consistency of information about governments’ leasing activities.

The requirements of this Statement are effective for reporting periods beginning after December 15, 2019. Earlier application is encouraged.

Governmental Accounting Standards Board Statement No. 88

In April 2018, the GASB issued Statement No. 88 – *Certain Disclosures Related to Debt Including Direct Borrowings and Direct Placements*. The primary objective of this Statement is to improve the information that is disclosed in notes to government financial statements related to debt, including direct borrowings and direct placements. It also clarifies which liabilities governments should include when disclosing information related to debt.

This Statement defines debt for purposes of disclosure in notes to financial statements as a liability that arises from a contractual obligation to pay cash (or other assets that may be used in lieu of cash) in one or more payments to settle an amount that is fixed at the date the contractual obligation is established.

This Statement requires that additional essential information related to debt be disclosed in notes to financial statements, including unused lines of credit; assets pledged as collateral for the debt; and terms specified in debt agreements related to significant events of default with finance-related consequences, significant termination events with finance-related consequences, and significant subjective acceleration clauses.

For notes to financial statements related to debt, this Statement also requires that existing and additional information be provided for direct borrowings and direct placements of debt separately from other debt.

The requirements of this Statement are effective for reporting periods beginning after June 15, 2018. Earlier application is encouraged.

Governmental Accounting Standards Board Statement No. 89

In June 2018, the GASB issued Statement No. 89 – *Accounting for Interest Cost Incurred Before the End of a Construction Period*. The objectives of this Statement are (1) to enhance the relevance and comparability of information about capital assets and the cost of borrowing for a reporting period and (2) to simplify accounting for interest cost incurred before the end of a construction period.

This Statement establishes accounting requirements for interest cost incurred before the end of a construction period. Such interest cost includes all interest that previously was accounted for in accordance with the requirements of paragraphs 5–22 of Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, which are superseded by this Statement.

Santa Margarita Groundwater Agency
Notes to the Basic Financial Statements, continued
For the Fiscal Year Ended June 30, 2018

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

Governmental Accounting Standards Board Statement No. 89, continued

This Statement requires that interest cost incurred before the end of a construction period be recognized as an expense in the period in which the cost is incurred for financial statements prepared using the economic resources measurement focus. As a result, interest cost incurred before the end of a construction period will not be included in the historical cost of a capital asset reported in a business-type activity or enterprise fund.

This Statement also reiterates that in financial statements prepared using the current financial resources measurement focus, interest cost incurred before the end of a construction period should be recognized as an expenditure on a basis consistent with governmental fund accounting principles.

The requirements of this Statement are effective for reporting periods beginning after December 15, 2019. Earlier application is encouraged. The requirements of this Statement should be applied prospectively.

(4) Contingencies

Litigation

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

(5) Subsequent Events

Events occurring after June 30, 2018 have been evaluated for possible adjustment to the financial statements or disclosure as of December 20, 2018, which is the date the financial statements were available to be issued.

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Report on Internal Controls and Compliance



Charles Z. Fedak, CPA, MBA
Christopher J. Brown, CPA, CGMA
Jonathan P. Abadesco, CPA
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Independent Auditor's Report on Internal Control Over Financial Reporting And on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

Governing Board
Santa Margarita Groundwater Agency
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 audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the Santa Margarita Groundwater Agency (Agency) as of and for the year ended June 30, 2018, and the related notes to the financial statements, which collectively comprises the Agency's basic financial statements, and have issued our report thereon dated December 20, 2018.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Agency'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 opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Agency's internal control. Accordingly, we do not express an opinion on the effectiveness of the Agency'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 Agency'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 Control over Financial Reporting
and on Compliance and Other Matters Based on an Audit 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 entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

A handwritten signature in black ink that reads "Fedak & Brown LLP". The signature is written in a cursive, slightly slanted style.

Fedak & Brown LLP

Cypress, California

December 20, 2018