

SANTA MARGARITA WATER DISTRICT
SINGLE AUDIT REPORT
FOR THE YEAR ENDED JUNE 30, 2017

SANTA MARGARITA WATER DISTRICT

FOR THE YEAR ENDED JUNE 30, 2017

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VAVRINEK, TRINE, DAY & CO., LLP
Certified Public Accountants

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INDEPENDENT AUDITORS' 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

Board of Directors
Santa Margarita Water District
Rancho Santa Margarita, 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 Water District (District), as of and for the year ended June 30, 2017, and the related notes to the financial statements, which collectively comprise the District's basic financial statements and have issued our report thereon dated December 4, 2017. Our report included an emphasis of matter regarding the District's restatement of net position related to the Community Facilities Districts' outstanding bonds and related assets, liabilities, and deferred inflows and outflows of resources, as of July 1, 2016. Our report also included an emphasis of matter regarding the District's adoption of Governmental Accounting Standards Board (GASB) Statement No. 82, *Pension Issues – An Amendment of GASB Statements No. 67, No. 68, and No. 73*, effective July 1, 2016.

Internal Control over Financial Reporting

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

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

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We did identify a certain deficiency in internal control, described in the accompanying schedule of findings and questioned costs as item 2017-001 that we consider to be a significant deficiency.

Compliance and Other Matters

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

Management's Response to Findings

The District's response to the findings identified in our audit is described in the accompanying schedule of findings and questioned costs. The District's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

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.

Yaurinek, Trine, Day & Co., LLP
Laguna Hills, California
December 4, 2017



VAVRINEK, TRINE, DAY & CO., LLP
Certified Public Accountants

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INDEPENDENT AUDITORS' REPORT ON COMPLIANCE FOR EACH MAJOR FEDERAL PROGRAM; REPORT ON INTERNAL CONTROL OVER COMPLIANCE; AND REPORT ON THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS REQUIRED BY THE UNIFORM GUIDANCE

Board of Directors
Santa Margarita Water District
Rancho Santa Margarita, California

Report on Compliance for Each Major Federal Program

We have audited the Santa Margarita Water District's (District) compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on each of the District's major federal programs for the year ended June 30, 2017. The District's major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with federal statutes, regulations, and the terms and conditions of its federal awards applicable to its federal programs.

Auditors' Responsibility

Our responsibility is to express an opinion on compliance for each of the District's major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the audit requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Those standards and the Uniform Guidance require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the District's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of the District's compliance.

Opinion on Each Major Federal Program

In our opinion, the District complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2017.

Report on Internal Control over Compliance

Management of the District is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the District's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the District's internal control over compliance.

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

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

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.

Report on Schedule of Expenditures of Federal Awards Required by the Uniform Guidance

We have audited the financial statements of the District, as of and for the year ended June 30, 2017, and the related notes to the financial statements, which collectively comprise the District's basic financial statements. We issued our report thereon dated December 4, 2017, which contained an unmodified opinion on those financial statements. Our report included an emphasis of matter regarding the District's restatement of net position related to the Community Facilities Districts' outstanding bonds and related assets, liabilities, and deferred inflows and the outflows of resources, as of July 1, 2016. Our report also included an emphasis of matter regarding the District's adoption of Governmental Accounting Standards Board (GASB) Statement No. 82, *Pension Issues – An Amendment of GASB Statements No. 67, No. 68, and No. 73*, effective July 1, 2016. Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by the Uniform Guidance and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedule of expenditures of federal awards is fairly stated in all material respects in relation to the basic financial statements as a whole.

Yaurinek, Trine, Day & Co., LLP
Laguna Hills, California
March 13, 2018

**SANTA MARGARITA WATER DISTRICT
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2017**

<u>Federal Grantor/Pass-Through Grantor/Program Title</u>	<u>Federal CFDA Number</u>	<u>Pass-Through Identification Number</u>	<u>Federal Expenditures</u>
U.S. Environmental Protection Agency Office of Water			
Passed through State Water Resources Control Board: Capitalization Grants for Clean Water State Revolving Funds	66.458	D1601026	<u>\$ 1,399,922</u>
U.S. Department of the Interior Bureau of Reclamation			
Title XVI Water Reclamation and Reuse Program	15.504	R14AC00073	<u>25,676</u>
Total Federal Awards			<u>\$ 1,425,598</u>

See accompanying notes to Schedule of Expenditures of Federal Awards.

**SANTA MARGARITA WATER DISTRICT
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE FISCAL YEAR ENDED JUNE 30, 2017**

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. General

The accompanying Schedule of Expenditures of Federal Awards presents the activity of federal award programs of the Santa Margarita Water District (District). The information in this schedule is presented in accordance with the requirements of *Title 2 U.S. Code of Federal Regulations Part 200, Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Because this schedule presents only a selected portion of the operations of the District, it is not intended to and does not present the financial position, changes in position, or cash flows of the District. All financial assistance received directly from the Federal agencies as well as Federal financial assistance passed through other government agencies to the District is included in the accompanying schedule. The District's reporting entity is defined in Note 1 of the notes to the District's financial statements.

B. Basis of Accounting

The accompanying Schedule of Expenditures of Federal Awards is presented using the accrual basis of accounting, which is described in Note 1 of the District's financial statements. Pass-through entity identifying numbers are presented where available. The District has elected not to use the 10-percent de minimis cost rate as allowed under the Uniform Guidance.

C. Relationship to Federal Financial Reports

Amounts reported in the accompanying Schedule of Expenditures of Federal Awards agree with the amounts reported in the related federal financial reports. However, certain federal financial reports are filed based on cash expenditures. As such, certain timing differences may exist in the recognition of revenues and expenditures between the Schedule of Expenditures of Federal Awards and the federal financial reports.

**SANTA MARGARITA WATER DISTRICT
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2017**

I. SUMMARY OF AUDITORS' RESULTS

FINANCIAL STATEMENTS

Type of auditors' report issued on whether the financial statements audited were prepared in accordance with GAAP:	<u>Unmodified</u>
Internal control over financial reporting:	
Material Weaknesses identified?	<u>No</u>
Significant Deficiencies identified?	<u>Yes</u>
Noncompliance material to financial statements noted?	<u>No</u>

FEDERAL AWARDS

Internal control over major federal programs:	
Material Weaknesses identified?	<u>No</u>
Significant Deficiencies identified?	<u>None reported</u>
Type of auditors' report issued on compliance for major federal programs:	<u>Unmodified</u>
Any audit findings disclosed that are required to be reported in accordance with 2 CFR Section 200.516(a)?	<u>No</u>
Identification of major federal programs:	

<u>CFDA Number</u>	<u>Name of Federal Program or Cluster</u>
<u>66.458</u>	<u>Capitalization Grants for Clean Water State Revolving Funds</u>

Dollar threshold used to distinguish between Type A and Type B programs:	<u>\$ 750,000</u>
Auditee qualified as low-risk auditee?	<u>No</u>

**SANTA MARGARITA WATER DISTRICT
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2017**

II. FINANCIAL STATEMENT FINDINGS

Finding Number 2017-001

COMMUNITY FACILITIES DISTRICTS

Criteria:

There should be sufficient accounting and reporting procedures to allow for the proper evaluation, accounting and reporting of special assessment debt and related activities.

Condition:

Significant Deficiency – We noted the District previously reported Community Facilities District (CFD) outstanding bonds and related assets, liabilities, and deferred inflows and outflows of resources as part of the District’s financial statements and reporting entity. The CFD outstanding bonds do not represent legal liabilities of the District but rather of the Community Facilities District, nor is the District legally obligated for repayment in any manner.

Context:

The condition was noted during our review of the CFDs’ outstanding bonds, which totaled \$139,270,000 as of July 1, 2016, including working with management to clarify the nature of the bonds.

Effect:

The District restated beginning net position as of July 1, 2016 by \$106.6 million to properly remove the CFDs’ outstanding bonds and related assets, liabilities and deferred inflows and outflows of resources.

Cause:

The District’s first CFD bonds, issued in 1999, were to refund outstanding general obligation bonds of the District. The District reported the initial CFD bonds, and all subsequent CFD bonds, as District debt on the balance sheet.

Recommendation:

We recommend the District develop procedures to assess the proper inclusions or exclusion of bonds, including CFD bonds, within the District’s financial statements.

Views of Responsible Officials and Planned Corrective Actions:

The District’s first Community Facilities District (CFD) bonds were issued in 1999, which refunded outstanding General Obligation (GO) bonds. The original GO bonds had a secondary pledge of District revenues, which meant that in the unlikely event of a default on the bonds, the District’s annual ad valorem tax revenues would be used to fund any remaining debt obligations. Unlike the refunded GO bonds, the District has no pledge of revenue on CFD debt, which are exclusively secured and paid for through assessments levied directly on benefiting properties. Consequently, the District has no obligation to pay debt service on the CFD bonds.

**SANTA MARGARITA WATER DISTRICT
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE FISCAL YEAR ENDED JUNE 30, 2017**

The District reported the initial and subsequent CFD bonds as District debt on the balance sheet to be consistent with the treatment of the refunded GO bonds. The District's management in conjunction with the District's current auditor determined that the CFD bonds should not be included as a District liability, which has otherwise resulted in the District overstating the liabilities on its financial records. The District's balance sheets have been audited since 2000 by external audit firms, with no previous findings or recommendations as to the treatment of the debt. Only debt obligations with either a primary or secondary pledge of District revenues should be included in the District's financial statements. This includes the General Obligation bonds which have a secondary pledge of the District's annual ad valorem tax revenues. The District has no pledge of revenue on CFD debt.

The District's current management worked closely with its auditors and diligently reviewed all documents since 1999 and related accounting pronouncements to determine proper inclusion or exclusion of the CFD liabilities in the District's financial statements. Management developed an evaluation process which includes references to bond documents and accounting pronouncement. Each future bond issuance will be evaluated for inclusion in the District's financial statements.

**SANTA MARGARITA WATER DISTRICT
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2017**

III. FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

None reported.

**SANTA MARGARITA WATER DISTRICT
SCHEDULE OF PRIOR YEAR AUDIT FINDINGS AND RECOMMENDATIONS
FOR THE FISCAL YEAR ENDED JUNE 30, 2017**

None reported.