

CENTRAL COAST WATER AUTHORITY

Annual Financial Report

June 30, 1992

(With Independent Auditors' Report Thereon)

December 7, 1992

CONFIDENTIAL

The Member Agencies of the
Central Coast Water Authority:

We have audited the financial statements of the Central Coast Water Authority (the Authority) for the year ended June 30, 1992, and have issued our report thereon dated September 11, 1992. In planning and performing our audit of the financial statements of the Central Coast Water Authority, we considered its internal control structure in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control structure. We have not considered the internal control structure since the date of our report.

During our audit we noted certain matters involving the internal control structure and other operational matters that are presented for your consideration. Our comments and recommendations have been discussed with the appropriate members of management and are intended to improve the internal control structure or result in other operating efficiencies. Such comments are summarized as follows:

INVESTMENT POLICY

During our audit, we noted that the Authority does not have a formalized investment policy which has been approved by the Board of Directors. We recommend that formal, written investment policies and procedures be implemented in order to maximize interest earnings as well as provide for the safeguarding of assets.

CAPITALIZATION POLICY

During our audit, we noted that the Authority does not have a formalized capitalization policy which has been approved by the Board of Directors. We recommend that a minimum dollar amount be established as a formal policy to provide consistent guidance to the capitalization of assets. All items less than this specified dollar amount would be expensed currently. Implementation of this policy would reduce the time needed to account for fixed assets and depreciation and simplify account analysis.

LEGAL DOCUMENTS

In May 1992, the Authority issued notes payable. As of the final day of our audit fieldwork (September 11, 1992), the Authority still had not yet received the closing documents from bond counsel. We recommend that all legal documents be obtained on a timely basis. This will provide an easy reference and timely access of information.

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This report is intended solely for the use of the Board of Directors, management, and others within the organization. We would like to take this opportunity to acknowledge the courtesy and assistance extended to us by all of the City's personnel during the course of our audit.

Very truly yours,

KPMG Peat Marwick

Certified Public Accountants

725 South Figueroa Street
Los Angeles, CA 90017

INDEPENDENT AUDITORS' REPORT

**The Member Agencies of the
Central Coast Water Authority:**

We have audited the accompanying balance sheet of the Central Coast Water Authority as of June 30, 1992 and the related statements of revenues, expenses, changes in retained earnings and cash flows for the period from September 23, 1991 (inception) to June 30, 1992. These financial statements are the responsibility of the management of the Central Coast Water Authority. Our responsibility is to express an opinion on the financial statements based upon our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Central Coast Water Authority, as of June 30, 1992, and the results of its operations and its cash flows for the period from September 23, 1991 (inception) to June 30, 1992 in conformity with generally accepted accounting principles.

September 11, 1992

**Central Coast Water Authority
Balance Sheet
June 30, 1992**

Assets

Current Assets:	
Cash and investments (note 2)	\$ 515,152
Cash with fiscal agent (note 2)	25,501,344
Accrued interest receivable	<u>512,858</u>
Total current assets	26,529,354
Property, plant and equipment (note 3)	4,031,498
Less: accumulated depreciation	<u>(1,626)</u>
Net property, plant and equipment	4,029,872
Unamortized issuance costs	<u>326,937</u>
Total assets	<u>\$ 30,886,163</u>

Liabilities & Fund Equity

Current liabilities:	
Accounts payable	\$ 640,721
Deposits	283,561
Accrued interest payable	186,398
Due to member agencies	114,310
Notes payable (note 4)	<u>23,545,000</u>
Total current liabilities	<u>24,769,990</u>
Fund equity:	
Contributed capital, net (note 5)	5,621,708
Retained earnings	<u>494,465</u>
Total fund equity	<u>6,116,173</u>
Total liabilities and fund equity	<u>\$ 30,886,163</u>

See accompanying notes to the financial statements

Central Coast Water Authority
Statement of Revenues, Expenses and
Changes in Retained Earnings
For the Period from September 23, 1991 (inception) to June 30, 1992

Operating revenues:	
Operating reimbursements from member agencies	\$ 912,390
Other revenues	<u>63,384</u>
Total operating revenues	<u>975,774</u>
Operating expenses:	
Legal	352,496
Administration	98,424
Consultants	35,665
Insurances	7,139
Office	6,787
Communications	1,143
Transportation and travel	976
Depreciation	<u>1,626</u>
Total operating expenses	<u>504,256</u>
Operating income	471,518
Non-operating revenue - interest income	<u>22,947</u>
Net Income	494,465
Retained earnings, September 23, 1991	<u>-</u>
Retained earnings, June 30, 1992	<u>\$ 494,465</u>

See accompanying notes to the financial statements

**Central Coast Water Authority
Statement of Cash Flows
Year ended June 30, 1992**

Cash flows from operating activities:	
Cash received from member agencies	\$ 912,390
Cash payments for goods and services	(341,468)
Other operating revenues	63,384
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Net cash provided by operating activities	634,306
Cash flows from non-capital financing activities:	
Cash received for deposits	283,561
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Net cash provided by non-capital finance activities	283,561
Cash flows from capital and related financing activities:	
Proceeds from issuance of notes payable	23,545,000
Acquisition of capital assets	(3,437,629)
Increase in contributed capital	5,621,708
(Increase) in unamortized bond issuance cost	(326,937)
Increase in accrued interest payable	186,398
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Net cash used for capital and related financing activities	25,588,540
Cash flows from investing activities:	
Increase in cash with fiscal agent	(25,501,344)
Interest and dividends on investments	22,947
Increase in accrued interest receivable	(512,858)
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Net cash used for investing activities	(25,991,255)
Net increase in cash and cash equivalents	515,152
Cash and cash equivalents at July 1, 1991	<hr/>
Cash and cash equivalents at June 30, 1992	\$ 515,152
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Reconciliation of operating income to net cash provided by operating activities:	
Operating income (loss)	\$ 471,518
Adjustments to reconcile operating income to net cash provided by operating activities:	
Depreciation	1,626
Changes in assets and liabilities:	
Increase in accounts payable	46,852
Increase in due to member agencies	114,310
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Net cash provided (used) by operating activities	\$ 634,306
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See accompanying notes to the financial statements

CENTRAL COAST WATER AUTHORITY
Notes to the Financial Statements
June 30, 1992

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting policies of the Central Coast Water Authority ("Authority") conform to generally accepted accounting principles. The following summary of the Authority's more significant accounting policies is presented to assist the reader in interpreting the financial statements and other data in this report. These policies should be viewed as an integral part of the accompanying financial statements.

A. Reporting entity

The primary purpose of the Central Coast Water Authority is to provide for the development, financing, construction, operation and maintenance of certain local (non-state owned) facilities required to deliver water from the State Water Project (the "SWP") to certain water purveyors and users in Santa Barbara County.

The Central Coast Water Authority was created by its members in September, 1991. The Authority is presently composed of nine members, all of which are public agencies, as follows: The cities of Santa Maria, Santa Barbara, and Guadalupe, the Buellton Community Services District (whose interests are to be transferred to the newly formed city of Buellton on July 1, 1992), the Santa Ynez River Water Conservation District - Improvement District No. 1, the Goleta Water District, the Montecito Water District, the Summerland County Water District and the Carpinteria County Water District. In addition, the Authority has one associate member, the La Cumbre Mutual Water Company (together with the members, the "Purveyor Participants"). Each of the Purveyor Participants has entered into a Water Supply Agreement with the Authority, as have two non-member, private water users: Santa Barbara Research Company and Morehart Land Company (the "Consumer Participants").

The Purveyor Participants are located in three different geographic areas of Santa Barbara County: North County (Santa Maria and Guadalupe); the Santa Ynez Valley (Buellton and Santa Ynez River Water Conservation District, Improvement District No. 1); and the South Coast (Santa Barbara, Goleta, Montecito, Summerland, Carpinteria, La Cumbre Mutual Water Company, Santa Barbara Research Company and Morehart Land Company). Historically, the North County has been an agricultural area that has seen significant urban development in the last ten years and expects additional urban development in the future; the Santa Ynez Valley is a rural agricultural area and tourist destination; and the South Coast is a generally developed urban area which does not expect significant growth in the future.

Facilities To Be Constructed

The facilities to be constructed by the Authority include a water treatment plant to be located in the Santa Maria Valley in northern Santa Barbara County or at Polonio Pass in northern San Luis Obispo County and two pipeline extensions: (1) the Mission Hills Extension, which would be a buried pipeline up to 23 miles long running from the terminus of the Coastal Branch (Phase II) southerly to the vicinity of the Lompoc Valley and which is expected to include a pumping plant in northern Santa Barbara County and three water storage tanks located at two separate tank sites, and (2) the Santa Ynez Extension, which would be a buried pipeline approximately 32 miles long running from the terminus of the Mission Hills Extension easterly, up the Santa Ynez Valley, to terminus at or near Cachuma Lake and which is expected to include one pumping plant near

CENTRAL COAST WATER AUTHORITY
Notes to the Financial Statements
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Santa Ynez and one additional storage tank. Water will be transported from that point through the existing Tecolote Tunnel, which traverses the Santa Ynez Mountains, to the South Coast of Santa Barbara County.

The water treatment plant would receive raw water from the SWP and deliver treated water to purveyors and users located in the two counties (if it is located at Polonio Pass) or only to purveyors in Santa Barbara County (if it is located in the Santa Maria Valley).

Contractual Relationships

The State of California Department of Water Resources (DWR) entered into contracts with San Luis Obispo (SLO) and Santa Barbara County (SBC) in 1963 pursuant to which SLO and SBC received entitlement to water from the SWP (the "State Water Supply Contracts"). SLO's entitlement was for 25,000 acre-feet per year and SBC's was for 57,700 acre-feet per year. In 1981, SBC amended its contract to reduce its entitlement to 45,486 acre-feet per year. As a result of a settlement agreement, SBC has the right to reacquire all or a portion of the 12,214 acre-feet per year relinquished in 1981 until December 31, 1992.

Between 1983 and 1986, SBC entered into a series of Water Supply Retention Agreements ("WSRAs") with local water purveyors and users within Santa Barbara County, initially granting the purveyors and users an option to obtain an assignment of SBC's State Water Supply Contract rights, and, as of July 1, 1989, actually granting the full assignment of those rights. Thereafter, on September 26, 1991, certain of the local water purveyors and users holding the WSRA rights transferred those rights to the Authority, a newly formed joint powers authority, in consideration for Water Supply Agreements which provide for the delivery of SWP water by the Authority and the payment of required costs by the transferors. These transfers have been consented to by DWR.

The Water Supply Agreements

Each Project Participant has entered into a Water Supply Agreement in order to provide for the development, financing, construction, operation and maintenance of the Project. The purpose of the Water Supply Agreements is to assist in carrying out the purposes of the Authority with respect to the Project by: (i) requiring the Authority to sell, and the Project Participants to buy, a specified amount of water from the project, and (ii) assigning the Project Participants' entitlement rights in the Project to the Authority.

In accordance with the provisions of each Water Supply Agreement, the Authority will establish charges for each Project Participant in order to produce revenues from the Project equal to the amounts anticipated to be needed by the Authority to deliver to each Project Participant its pro rata share of water from the Project as set forth in each Water Supply Agreement. Each Project Participant is required to pay to the Authority an amount equal to its share of the total Fixed Project Costs and certain other costs in the proportion established in accordance with the applicable Water Supply Agreement. Such obligation is to be honored by each Project Participant whether or not water is furnished to it from the Project at all times or at all and whether or not the Project is completed, operable, operated or retired. Such payments are not subject to any reduction and are not conditioned upon performance by the Authority or any other

CENTRAL COAST WATER AUTHORITY
Notes to the Financial Statements
June 30, 1992

Project Participant under any agreement.

The Water Supply Agreements set forth detailed provisions concerning the time and method of payment by each Contractor of certain costs, including Fixed Project Costs and other operation and maintenance costs, as well as the method of allocation of such costs and expenses and the remedies available to the Authority in the event a Contractor defaults in its payments to the Authority.

B. Basis of Accounting

The authority maintains its records on the accrual basis of accounting. As such, the Authority's financial records are accounted for on a flow of economic resources measurement focus. Under this measurement focus, all assets and liabilities associated with the operation of these funds are included on the balance sheet. Where appropriate, net total assets (i.e., fund equity) is segregated into contributed capital and retained earnings. Proprietary fund-type operating statements present increases (revenues) and decreases (expenses) in net total assets. Proprietary fund-types utilize the accrual basis of accounting. Revenues for these fund types are recognized when they are earned, and expenses are recognized at the time the related liabilities are incurred.

C. Investments

The Authority has a more restrictive investment policy than the minimum requirements established by the State of California. The Authority believes that it has adhered to established policies for all investment activities. Investments are stated at lower of cost or market.

D. Property, Plant, and Equipment

Property, plant and equipment purchased or constructed by the Authority is stated at cost. Depreciation has been provided over the estimated useful life of each asset using the straight-line method. Interest costs incurred during construction in excess of related interest earned on proceeds from notes have been capitalized. In addition, certain technical and engineering related studies associated with the Project have also been capitalized and are being amortized. The estimated useful life of depreciated assets is as follows:

Improvements	10-100 years
Equipment	3-12 years

E. Unamortized Issuance Costs

Unamortized issuance costs are deferred and amortized over the period from the date of issuance to the refunding of the notes (see Note 4).

CENTRAL COAST WATER AUTHORITY
Notes to the Financial Statements
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(2) CASH AND INVESTMENTS

The Authority follows the practice of pooling cash and investments for all funds under its direct daily control. Funds held by outside fiscal agents under provisions of the note agreement are maintained separately. Interest income from cash and investments with fiscal agents is credited directly to the related accounts.

Cash and investments at June 30, 1992 consisted of the following:

	<u>Carrying Amount</u>	<u>Market Value</u>
Cash and Investments.		
Cash in bank	\$ 1,152	\$ 1,152
State Treasurer's Local Agency Investment Fund	<u>514,000</u>	<u>514,000</u>
Total Cash and Investments	515,152	515,152
Funds with Fiscal Agents		
Money market funds	923,326	923,326
Government issues.....	<u>24,578,018</u>	<u>24,578,018</u>
Total funds with fiscal agents.....	<u>25,501,344</u>	<u>25,501,344</u>
Total cash and investments	\$ <u>26,016,496</u>	\$ <u>26,016,496</u>

A. Deposits

At fiscal year-end, the carrying amount and bank balance of the Authority's deposits with financial institutions was \$1,152, and was fully insured by the Federal Deposit Insurance Corporation (FDIC).

B. Investments

The Authority is authorized by its investment policy, in accordance with Section 53601 of the California Government Code, to invest in the following instruments: Securities issued or guaranteed by the Federal Government or its agencies, and State Treasurer's Local Agency Investment Funds (LAIF).

Based upon categories established to measure the level of custodial risk assumed by the Authority in its investments, the Authority's government securities are considered category three investments. These are uninsured and unregistered investments for which the securities are held by the counterparty trust department or agent, but not specifically in the Authority's name.

C. Funds with Fiscal Agent

The Authority has moneys held by trustees or fiscal agents pledged to the payment or security of the notes payable. The California Government Code provides that these moneys, in absence of specific statutory provisions governing the issuance of bonds or certificates, may be invested in accordance with the indentures specifying the types of investments the trustees or fiscal agents may make.

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D. Cash Equivalents

The Authority considers all pooled cash and investments, except funds with fiscal agents, to be cash equivalents.

(3) PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment at June 30, 1992 is as follows:

Equipment	\$ 16,265
Construction in progress	<u>4,015,233</u>
Total property, plant and equipment	4,031,498
Accumulated depreciation	<u>(1,626)</u>
Net property, plant and equipment	<u>\$ 4,029,872</u>

(4) NOTES PAYABLE

On June 11, 1992, the Authority issued development notes, dated May 1, 1992, at an interest rate of 4.75%, for the benefit of its participants for temporary financing of a portion of the costs of developing a pipeline and water treatment plant, reimburse certain project participants for costs incurred in connection with the State Water Project, and to finance certain other facilities. Each of the participants in the note financing held elections authorizing the issuance of revenue bonds to provide permanent financing for the construction of the Authority's portion of the State Water Project (see Note 7). In order to reduce issuance costs and insure the proceeds are available on a timely basis, the Authority issued the notes for all the participants requiring financing. The City of Santa Maria contributed cash for their proportionate share of the costs. Under the Water Supply Agreements, each Project Participant is obligated to make payments to the Authority, which are pledged to secure the payment of the principal and interest of the Notes. The notes payable are backed by an irrevocable letter of credit issued by the Union Bank of Switzerland.

The annual requirement to pay all debt outstanding, as of June 30, 1992, including interest payments of \$3,355,164 are as follows:

<u>Fiscal Year</u>	<u>Interest</u>	<u>Principal</u>	<u>Total</u>
1993	\$ 1,118,388	-	\$ 1,118,388
1994	1,118,388	-	1,118,388
1995	<u>1,118,388</u>	<u>23,545,000</u>	<u>24,663,388</u>
Total	<u>\$ 3,355,164</u>	<u>\$ 23,545,000</u>	<u>\$ 26,900,164</u>

The notes were repaid, with interest in the amount of \$559,194, in conjunction with the bond offering described in Note 7.

CENTRAL COAST WATER AUTHORITY
Notes to the Financial Statements
June 30, 1992

(5) CONTRIBUTED CAPITAL

Each agency was required to make a capital contribution for their portion of the project costs. In order to facilitate this capital requirement, the Agency issued notes for those members requiring financing. Contributed capital displayed on the Agency's balance sheet represents cash contributions made by members not participating in the financing.

(6) LITIGATION

The Authority is presently not involved in any matters of litigation.

(7) SUBSEQUENT EVENTS

On October 29, 1992, the Agency issued \$177,120,000 of revenue bonds dated October 1, 1992. The bonds were sold to finance the costs of constructing certain water treatment and distribution facilities, defease the Authority's \$23,545,000 Development Notes (see Note 4), fund a debt service reserve fund and to pay certain costs of issuing the bonds. The bonds were issued at interest rates ranging from 4.85% to 6.60% with a final maturity of October 1, 2022. The source of repayment for the bonds is the "take or pay" Water Supply Agreements signed by each of the member agencies.