

SANTA ANA WATERSHED ASSOCIATION
FINANCIAL STATEMENTS
AND
REQUIRED SUPPLEMENTARY INFORMATION
YEAR ENDED
DECEMBER 31, 2017

SANTA ANA WATERSHED ASSOCIATION
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December 31, 2017

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Santa Ana Watershed Association
Riverside, California

We have audited the accompanying basic financial statements of Santa Ana Watershed Association ("SAWA") as of and for the year ended December 31, 2017 and the related notes to the 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. 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 auditors' 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 SAWA'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 SAWA'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 financial position of the Santa Ana Watershed Association as of December 31, 2017, and the changes in financial position and its cash flows for the year then ended, in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

Uncertain Net Position Restrictions

As discussed in Note 12 to the financial statements, SAWA is currently reviewing costs allocated to specific projects and contemplating a retroactive change to its cost allocations which would change its expendable restricted net position. These issues have not been resolved and could potentially have significant effects on SAWA's unrestricted net position. Our opinion is not modified with respect to this matter.

Report on Summarized Comparative Information

We have previously audited the Santa Ana Watershed Association's 2016 financial statements, and we expressed an unmodified audit opinion on those audited financial statements in our report dated September 20, 2017. In our opinion, the summarized comparative information presented herein as of and for the year ended December 31, 2016 is consistent, in all material respects, with the audited financial statements from which it has been derived.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis information on pages 3 to 7 be presented to supplement the basic financial statements. Such information, although not part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audits of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.


September 19, 2018

MANAGEMENT'S DISCUSSION AND ANALYSIS - UNAUDITED

SANTA ANA WATERSHED ASSOCIATION
MANAGEMENT'S DISCUSSION AND ANALYSIS - UNAUDITED
December 31, 2017

As management of the Santa Ana Watershed Association ("SAWA"), we offer readers of SAWA's financial statements this narrative overview and analysis of SAWA's financial activities during the fiscal year ended December 31, 2017. Please read it in conjunction with SAWA's financial statements and accompanying notes to those financial statements.

Financial Highlights

- Total net position decreased by \$317,221 or 4.8 percent.
- Capital assets increased by \$6,791 or 3.4 percent.
- Current assets decreased by \$89,590 or 4.5 percent.
- Total revenues were \$1,850,719 and total expenses were \$2,167,940.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction of SAWA's financial statements. SAWA operates as a nonprofit public benefit corporation. SAWA's Board of Directors is composed of, or appointed by, selected officials of local government agencies. Accordingly, SAWA is subject to governmental accounting principles and is accounted for as an enterprise fund, using the full accrual basis of accounting. As an enterprise fund, SAWA's financial statements are comprised of two components: financial statements and notes to the financial statements.

In accordance with GASB Statement No. 34, SAWA's financial statements include a statement of net position, statement of revenues, expenses and changes in net position, and a statement of cash flows.

The statement of net position presents information on all of SAWA's assets and liabilities, with the differences 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 SAWA is improving or deteriorating.

The statement of revenues, expenses, and changes in net position presents information showing how SAWA's net position changed during the year. All changes in net position are reported as soon as the underlying event giving rise to the change occurs, regardless of timing of the related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flow in future fiscal periods.

The statement of cash flows conveys to financial statement users how SAWA managed cash resources during the year. This statement converts the change in net position presented on the statement of revenues, expenses, and changes in net position into actual cash provided by and used for operations. The statement of cash flows also details how SAWA obtains cash through financing and investing activities, and how cash is spent for these purposes.

The notes to the financial statements provide additional information that is essential to a full understanding of the financial statements.

SANTA ANA WATERSHED ASSOCIATION
MANAGEMENT'S DISCUSSION AND ANALYSIS - UNAUDITED
December 31, 2017

Summary Financial Information and Analysis

Table 1

Condensed Statements of Net Position

| | December 31, | | |
|----------------------------|----------------------------|----------------------------|----------------------------|
| | 2017 | 2016 | Change |
| Current assets | \$ 1,888,232 | \$ 1,977,822 | \$ (89,590) |
| Noncurrent assets | | | |
| Restricted assets | 4,405,869 | 4,626,430 | (220,561) |
| Deposits | 9,532 | 9,532 | - |
| Capital assets | <u>208,793</u> | <u>202,002</u> | <u>6,791</u> |
| Total assets | <u>6,512,426</u> | <u>6,815,786</u> | <u>(303,360)</u> |
| Current liabilities | 179,495 | 160,889 | 18,606 |
| Noncurrent liabilities | <u>46,472</u> | <u>51,217</u> | <u>(4,745)</u> |
| Total liabilities | 225,967 | 212,106 | 13,861 |
| Net position | | | |
| Invested in capital assets | 208,793 | 202,002 | 6,791 |
| Nonexpendable restricted | 38,981 | 38,981 | - |
| Expendable restricted | 4,366,888 | 4,587,449 | (220,561) |
| Unrestricted | <u>1,671,797</u> | <u>1,775,248</u> | <u>(103,451)</u> |
| Total net position | <u>\$ 6,286,459</u> | <u>\$ 6,603,680</u> | <u>\$ (317,221)</u> |

Net position decreased by \$317,221, as seen in Table 1. The decrease in current assets and restricted assets is due to the outflow of cash exceeding the amounts of cash received in the current year. Some of the cash expended in the current year was for ongoing projects. Revenues related to these ongoing projects were recognized in prior years when the cash was received. The increase in capital assets relates to the acquisition of field equipment and the purchase of a truck. The increase in total liabilities is due to normal variances in year-end accounts payable and accrued liabilities and a decrease in the compensated absences accrual.

While the Statement of Net Position shows changes in financial position, the Statement of Revenues, Expenses, and Changes in Net Position provides answers as to the nature and source of these changes. As can be seen in Table 2, the decrease in net position of \$317,221 in the current year is the result of excess expenses over revenues.

SANTA ANA WATERSHED ASSOCIATION
MANAGEMENT'S DISCUSSION AND ANALYSIS - UNAUDITED
December 31, 2017

Table 2

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

| | December 31, | | |
|--|----------------------------|----------------------------|----------------------------|
| | 2017 | 2016 | Change |
| Operating revenues | \$ 1,114,182 | \$ 1,130,113 | \$ (15,931) |
| Operating expenses | <u>(2,161,121)</u> | <u>(2,048,114)</u> | <u>(113,007)</u> |
| Net operating loss | <u>(1,046,939)</u> | <u>(918,001)</u> | <u>(128,938)</u> |
| Nonoperating revenues | 67,679 | 129,521 | (61,842) |
| Gain/(loss) on disposal of capital assets | (1,819) | - | (1,819) |
| Investment income/(loss) | 668,858 | 280,814 | 388,044 |
| Nonoperating expenses | <u>(5,000)</u> | <u>(5,000)</u> | <u>-</u> |
| Net nonoperating revenues (expenses) | <u>729,718</u> | <u>405,335</u> | <u>324,383</u> |
| Change in net position | (317,221) | (512,666) | 195,445 |
| Net position, beginning of year | <u>6,603,680</u> | <u>7,116,346</u> | <u>(512,666)</u> |
| Net position, end of year | <u>\$ 6,286,459</u> | <u>\$ 6,603,680</u> | <u>\$ (317,221)</u> |

SAWA's operating revenues less operating expenses net to a loss of \$1,046,939. A significant portion of this operating loss is a budgeted intended loss based on mitigation fees from developers and biological monitoring revenue recognized in prior periods while corresponding costs related to these projects are incurred in the current year and in subsequent years based on the agreement period.

The net nonoperating revenues are attributed to dividends earnings of \$243,341, the unrealized gain on the investment portfolio of \$405,954 and the realized gain on the sale of investments of \$19,563. SAWA recognized no pension forfeitures during the year ended December 31, 2017. SAWA recognized \$44,339 in pension forfeitures during the year ended December 31, 2016.

SANTA ANA WATERSHED ASSOCIATION
MANAGEMENT'S DISCUSSION AND ANALYSIS - UNAUDITED
December 31, 2017

Capital Assets

As can be seen in Table 3, as of December 31, 2017, SAWA has \$208,793 invested in capital assets (net of accumulated depreciation).

Table 3

Capital Assets

| | December 31, | | |
|---------------------------|-------------------|-------------------|-----------------|
| | 2017 | 2016 | Change |
| Field equipment | \$ 75,097 | \$ 73,977 | \$ 1,120 |
| Vehicles | 107,814 | 73,931 | 33,883 |
| Office equipment | 48,324 | 48,324 | - |
| Leasehold improvements | 2,585 | 2,585 | - |
| Land improvements | 2,785 | - | 2,785 |
| | 236,605 | 198,817 | 37,788 |
| Accumulated depreciation | (121,549) | (90,552) | (30,997) |
| Conservation easement | 93,737 | 93,737 | - |
| Net capital assets | \$ 208,793 | \$ 202,002 | \$ 6,791 |

The increase of \$6,791 can be summarized as follows:

- Current year purchases amounted to \$39,912.
- Current year depreciation expense amounted to \$31,302.
- Current year disposals of capital assets at a loss of \$1,819.

Long-term Debt

Currently SAWA has no long-term debt obligations, other than compensated absences payable. The long-term portion of compensated absences decreased by \$4,745 from the prior year. This decrease is related to payouts of accrued vacation time for employees that left or retired during the year ended December 31, 2017.

SANTA ANA WATERSHED ASSOCIATION
MANAGEMENT'S DISCUSSION AND ANALYSIS - UNAUDITED
December 31, 2017

Economic Factors and Next Year's Budget

SAWA entered into a \$340,000 agreement with U.S. Fish and Wildlife Service to provide Vireo Monitoring and Cowbird Trapping in the Santa Ana Watershed through December 2019. We are in negotiations to extend this agreement an additional four years.

The Riverside County Flood Control and Water Conservation District has approved a five year On-Call contract for invasive plant removal and maintenance and biological monitoring not to exceed \$4,000,000 in the Santa Ana River mainstream and tributaries. Work under this contract will begin in September 2018.

SAWA is working on a Memorandum of Understanding with Temecula Elsinore Anza Murrieta Resource Conservation District (TEAM RCD) to undertake vegetation management in Riverside County Flood Control channels in the Santa Margarita River Watershed for \$250,000 beginning in October 2018.

SAWA also has entered into a 5 year agreement which provides for payment of \$1,217,006 a fiscal year beginning July 1st, 2018 for biological monitoring services with the Western Riverside Regional Conservation Authority to support their Multiple Species Habitat Conservation Plan.

Our goal for 2018 is to preserve mitigation funds in the investment pool and to not use them to support the overhead burden of running the Association. Through including an overhead charge in SAWA's billable rates, SAWA is able to recover most of its overhead in the services performed for third parties.

Contacting SAWA's Financial Management

This financial report is designed to provide SAWA's contributors, member agencies, the public, and creditors with a general overview of SAWA's finances and to show SAWA's accountability for the money it receives. If you have any questions about this report or need additional financial information, contact Brian J. Brady, P.E., Executive Director, Santa Ana Watershed Association, 1835 Chicago Avenue, Suite C, Riverside, California, 92507.

FINANCIAL STATEMENTS

SANTA ANA WATERSHED ASSOCIATION

STATEMENTS OF NET POSITION

December 31, 2017

(with Comparative Totals for December 31, 2016)

| | ASSETS | |
|---|----------------------------|----------------------------|
| | 2017 | 2016 |
| Current assets | | |
| Cash and investments | \$ 1,622,199 | \$ 1,495,822 |
| Accounts receivable | 29,661 | 19,455 |
| Due from governments | 199,156 | 421,422 |
| Dividends receivable | 1,372 | 2,049 |
| Herbicide inventory | 10,164 | 12,506 |
| Prepaid expenses | 25,680 | 26,568 |
| Total current assets | <u>1,888,232</u> | <u>1,977,822</u> |
| Noncurrent assets | | |
| Restricted cash and investments | 4,405,869 | 4,626,430 |
| Deposits | 9,532 | 9,532 |
| Capital assets not being depreciated | 93,737 | 93,737 |
| Capital assets, net of accumulated depreciation | <u>115,056</u> | <u>108,265</u> |
| Total noncurrent assets | <u>4,624,194</u> | <u>4,837,964</u> |
| Total assets | <u>\$ 6,512,426</u> | <u>\$ 6,815,786</u> |
| | LIABILITIES | |
| Current liabilities | | |
| Accounts payable and accrued liabilities | 46,431 | \$ 48,619 |
| Accrued compensation and benefits | 72,828 | 80,854 |
| Compensated absences payable | 19,916 | 21,950 |
| Related parties payable | <u>40,320</u> | <u>9,466</u> |
| Total current liabilities | <u>179,495</u> | <u>160,889</u> |
| Noncurrent liabilities | | |
| Compensated absences payable | <u>46,472</u> | <u>51,217</u> |
| Total noncurrent liabilities | <u>46,472</u> | <u>51,217</u> |
| Total liabilities | <u>\$ 225,967</u> | <u>\$ 212,106</u> |
| | NET POSITION | |
| Invested in capital assets | \$ 208,793 | \$ 202,002 |
| Nonexpendable restricted net position | 38,981 | 38,981 |
| Expendable restricted net position | 4,366,888 | 4,587,449 |
| Unrestricted | <u>1,671,797</u> | <u>1,775,248</u> |
| Total net position | <u>\$ 6,286,459</u> | <u>\$ 6,603,680</u> |

The accompanying notes are an integral part of these financial statements.

SANTA ANA WATERSHED ASSOCIATION
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION
Year Ended December 31, 2017
(with Comparative Totals for Year Ended December 31, 2016)

| | 2017 | 2016 |
|--|---------------------|---------------------|
| Operating revenues | | |
| Wildlife and habitat management services | \$ 516,845 | \$ 454,204 |
| Habitat restoration services | 452,052 | 352,021 |
| Mitigation fees | - | 170,000 |
| Brown headed cowbird trapping | 145,285 | 153,888 |
| Total operating revenues | 1,114,182 | 1,130,113 |
| Operating expenses | | |
| Personnel services | 1,325,019 | 1,196,898 |
| Administration and overhead | 369,590 | 331,069 |
| Project expenses | 357,964 | 403,179 |
| Travel, mileage and conferences | 61,607 | 69,113 |
| Depreciation | 31,302 | 25,188 |
| Field testing and supplies | 14,972 | 18,819 |
| Educational supplies | 667 | 3,848 |
| Total operating expenses | 2,161,121 | 2,048,114 |
| Operating loss | (1,046,939) | (918,001) |
| Nonoperating revenues (expenses) | | |
| Investment income | 668,858 | 280,814 |
| Other income | 67,679 | 129,521 |
| Loss on disposal of capital assets | (1,819) | - |
| Contributions to others | (5,000) | (5,000) |
| Nonoperating revenues (expenses) | 729,718 | 405,335 |
| Changes in net position | (317,221) | (512,666) |
| Net position - beginning of year | 6,603,680 | 7,116,346 |
| Net position - end of year | \$ 6,286,459 | \$ 6,603,680 |

The accompanying notes are an integral part of these financial statements.

SANTA ANA WATERSHED ASSOCIATION
STATEMENTS OF CASH FLOWS
Year Ended December 31, 2017
(with Comparative Totals for Year Ended December 31, 2016)

| | 2017 | 2016 |
|---|-------------------|-------------------|
| Cash flows from operating activities | | |
| Cash received from customers | \$ 1,393,921 | \$ 1,176,821 |
| Cash payments to employees | (1,338,587) | (1,156,333) |
| Cash payments to suppliers for goods and services | (779,141) | (826,839) |
| Net cash used in operating activities | (723,807) | (806,351) |
| Cash flows from capital and related financing activities | | |
| Cash paid to acquire capital assets | (39,912) | (81,164) |
| Net cash used in capital and related financing activities | (39,912) | (81,164) |
| Cash flows from investing activities | | |
| Sale of investments | 700,000 | 747,593 |
| Purchase of investments | (176,905) | (2,797,792) |
| Dividends received on investments | 244,018 | 158,573 |
| Net cash provided by (used in) investing activities | 767,113 | (1,891,626) |
| Change in cash and cash equivalents | 3,394 | (2,779,141) |
| Cash and cash equivalents, beginning of year | 104,509 | 2,883,650 |
| Cash and cash equivalents, end of year | \$ 107,903 | \$ 104,509 |
| Reconciliation of cash and cash equivalents to the statement of net position | | |
| Cash and investments | 1,622,199 | 1,495,822 |
| Restricted cash and investments | 4,405,869 | 4,626,430 |
| Less mutual funds | (5,920,165) | (6,017,743) |
| Total cash and cash equivalents | \$ 107,903 | \$ 104,509 |

The accompanying notes are an integral part of these financial statements.

SANTA ANA WATERSHED ASSOCIATION
STATEMENTS OF CASH FLOWS
Year Ended December 31, 2017
(with Comparative Totals for Year Ended December 31, 2016)

| | 2017 | 2016 |
|---|---------------------|---------------------|
| Reconciliation of operating loss to net cash used in operating activities | | |
| Operating loss | \$ (1,046,939) | \$ (918,001) |
| Adjustments to reconcile operating loss to net cash used in operating activities: | | |
| Depreciation | 31,302 | 25,188 |
| Contributions to others | (5,000) | (5,000) |
| Other income (expense) | 67,679 | 129,521 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (10,206) | (2,407) |
| Due from governments | 222,266 | (80,406) |
| Herbicide inventory | 2,342 | 2,525 |
| Prepaid expenses | 888 | (5,392) |
| Deposits | - | (9,532) |
| Accounts payable and accrued liabilities | (2,188) | 15,908 |
| Accrued compensation and benefits | (8,026) | 21,697 |
| Compensated absences payable | (6,779) | 15,849 |
| Related party payable | 30,854 | 3,699 |
| Total adjustments | 323,132 | 111,650 |
| Net cash used in operating activities | \$ (723,807) | \$ (806,351) |
| Noncash capital, financing, and investing activities | | |
| Noncash investing activities: | | |
| Net unrealized gain/(loss) | \$ 405,954 | \$ 133,726 |

The accompanying notes are an integral part of these financial statements.

SANTA ANA WATERSHED ASSOCIATION
NOTES TO THE FINANCIAL STATEMENTS
December 31, 2017

NOTE 1 – REPORTING ENTITY

The Santa Ana Watershed Association (“SAWA”) was founded in 1996 as an unincorporated association known as the Santa Ana Watershed Association of Resource Conservation Districts. SAWA incorporated as a nonprofit public benefit corporation in 2003. SAWA’s purpose is to promote a healthy Santa Ana River Watershed for wildlife and people. SAWA develops, coordinates and implements natural resource programs which support a sustainable ecosystem and social benefits from the San Bernardino Mountains to the Pacific Ocean. SAWA’s Board is comprised of appointed representatives from the following governments: Orange County Water District, Inland Empire Resource Conservation District, San Jacinto Basin Resource Conservation District, Riverside-Corona Resource Conservation District, and Temecula-Elsinore-Anza-Murrieta Resource Conservation District.

Although legally established as a nonprofit public benefit corporation, SAWA’s Board is composed of or appointed by selected officials of government agencies. Accordingly, SAWA is subject to governmental accounting principles (as applicable to enterprise funds).

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Fund Accounting

The accounts of SAWA are organized and operated on the basis of a fund. A fund is an independent fiscal and accounting entity with a self-balancing set of accounts. Fund accounting segregates funds according to their intended purpose and uses them to aid management in demonstrating compliance with finance-related legal and contractual provisions. SAWA’s financial statements include an enterprise fund, which is a proprietary fund type. Enterprise funds are used to account for those operations that are financed and operated in a manner similar to a private business or where the board of directors has decided that the determination of revenues earned, costs incurred and/or net income is necessary for management.

Basis of Accounting

Enterprise funds are reported using the economic resources measurement focus and the accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred. SAWA follows the reporting requirements for enterprise funds, in accordance with Governmental Accounting Standards Board (GASB) Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, establishing accounting and financial reporting standards for the financial statements of state and local governments. The standard incorporates into the GASB’s authoritative literature the applicable guidance previously only found in certain Financial Accounting Standards Board (FASB) and American Institute of Certified Public Accountants (AICPA) pronouncements issued before November 30, 1989.

SANTA ANA WATERSHED ASSOCIATION
NOTES TO THE FINANCIAL STATEMENTS
December 31, 2017

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Basis of Accounting (Continued)

An enterprise fund distinguishes operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with SAWA's principal ongoing operations. The principal operating revenues of SAWA are from mitigation fees, habitat restoration projects, and biological monitoring services including wildlife habitat management and brown headed cowbird trapping associated with the Santa Ana River and adjacent watersheds. The principal operating expenses of SAWA are for invasive weed removal projects, specifically the removal of non-native species, including *Arundo Donax*, from the Santa Ana River and adjacent watersheds.

Revenues received from investment earnings and contributions are considered nonoperating revenue.

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

Use of Estimates

The presentation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Comparative Data

Prior year data has been included where practical for comparison purposes only. The prior year data does not represent a complete presentation in accordance with accounting principles generally accepted in the United States of America. Certain minor reclassifications of prior year data have been made in order to enhance their comparability with current year figures.

Cash and Cash Equivalents

For purposes of the statement of cash flows, SAWA considers cash and cash equivalents to be cash on hand, demand deposits, and money market funds from which funds can be effectively deposited or withdrawn at any time without prior notice or penalty.

Investments

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

Receivables

SAWA considers receivables to be fully collectible at period end. Accordingly, accounts receivable are not shown net of an allowance for uncollectible accounts based on management's estimate. Actual collected amounts could differ.

SANTA ANA WATERSHED ASSOCIATION
NOTES TO THE FINANCIAL STATEMENTS
December 31, 2017

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Inventory

Inventory consists of herbicides carried at the lower of cost, which approximates market, using first-in, first-out (FIFO) method.

Capital Assets

Capital assets are recorded at cost. Donated capital assets are recorded at fair value on the date of donation plus any ancillary costs. SAWA's policy is to capitalize all property having a value of \$500 or more and a life expectancy of one year or more. Depreciation has been provided for using the straight-line method over estimated useful lives of the related assets. Useful lives for depreciation purposes range from 2 to 10 years depending on the asset being capitalized. The cost of normal maintenance and repairs that do not add to the value of the asset or materially extend assets' lives are not capitalized.

Compensated Absences

Employees gain a vested right to accumulated unpaid vacation based on years of service but cannot accumulate more than 200 hours of accrued vacation. Employee vacation benefits are recognized as a liability of SAWA. For leased employees, an offsetting receivable is recorded to recognize the leasing agency's obligation to reimburse SAWA for this expense. This amount is included in due from governments on the statement of net position.

Income Taxes

SAWA is a charitable not-for-profit organization and is exempt from federal income taxes under the provisions of Section 501(c)(3) of the Internal Revenue Code and Code Section 23701(d) of the California Revenue and Taxation Code.

Net Position

Net position represents the difference between assets and liabilities. Net investment in capital assets consists of capital assets, net of accumulated depreciation. Net position is reported as restricted when there are limitations imposed on their use either through the external restrictions imposed by grantors or laws, or regulations of other governments. Nonexpendable restricted net position is an endowment fund required to be held in perpetuity. Expendable restricted funds are restricted by various entities for program use. Unrestricted net position represents the net position that is not restricted for any project or other purpose.

Recently Issued Accounting Standards

In June 2017, the GASB issued Statement No. 87, Leases. The statement requires 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. The requirements of this statement are effective for financial statements for reporting periods beginning after December 15, 2019. SAWA expects that the adoption of this standard will have a material impact on its financial statements.

SANTA ANA WATERSHED ASSOCIATION
NOTES TO THE FINANCIAL STATEMENTS
December 31, 2017

NOTE 3 – CASH AND INVESTMENTS

Cash and investments as of December 31, 2017 are classified in the accompanying financial statements as follows:

| | |
|-----------------------------------|----------------------------|
| Statement of net position | |
| Cash and investments | \$ 1,622,199 |
| Cash and investments – restricted | <u>4,405,869</u> |
| Total cash and investments | <u>\$ 6,028,068</u> |

Cash and investments as of December 31, 2017 consist of the following:

| | |
|--|----------------------------|
| Deposits with financial institutions | \$ 107,903 |
| Mutual funds invested into debt securities | 3,188,787 |
| Mutual funds invested into equity securities | <u>2,731,378</u> |
| Total cash and investments | <u>\$ 6,028,068</u> |

At December 31, 2017 cash and investments were restricted for the following purposes:

| | |
|---|----------------------------|
| Riparian/wetland habitat along San Timoteo Creek | \$ 948,841 |
| In-lieu fee mitigation program | 2,715,000 |
| Orange County Water District Projects | 703,047 |
| Mockingbird II Conservation Easement Endowment Fund | <u>38,981</u> |
| Total restricted cash and investments | <u>\$ 4,405,869</u> |

In order to obtain economies of scale, SAWA manages its investments on a commingled basis. SAWA maintains the necessary sub-accounting of all commingled funds, dividing the portfolio into short-term investments for operating needs and long-term investments as determined by the Board, with consultation from staff. The portfolio of SAWA is diversified using the tenets of modern portfolio theory. The basic approach to optimize risk return utilizes a globally diverse portfolio made up of low correlating assets along with the discipline of regular rebalancing.

Investments Authorized by SAWA's Investment Policy

The portfolio is managed in a balanced manner to the Income and Growth asset allocation (45 percent equities, 45 percent fixed income, and 10 percent cash) as economic conditions subject to board approval. Deviation of these allocations can be in a range of within 10 percent +/- depending on the operating needs of SAWA. Investments in any one security may not exceed 10 percent of the portfolio, unless in an exchange traded fund (ETF) or mutual fund. No investments may be made on margin. In addition, no short sales, noninvestment grade securities, futures contracts or leverage are permitted unless held in an ETF or actively managed fund. The investments in these strategies are for risk management and not for speculation.

SANTA ANA WATERSHED ASSOCIATION
NOTES TO THE FINANCIAL STATEMENTS
December 31, 2017

NOTE 3 – 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. One of the ways that SAWA manages its exposure to interest rate risks is by investing in mutual funds which can be accessed at any time to provide the cash flow and liquidity needed for operations.

Disclosures Relating to Credit Risk

Generally, 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. Presented below is the minimum rating required by (where applicable) SAWA’s investment policy, and the actual rating as of year-end for each investment type.

As of December 31, 2017:

| <u>Investment Type</u> | <u>Minimum Rating</u> | <u>Standard & Poor Ratings as of Year-end</u> | | | <u>Not Rated</u> |
|------------------------|-----------------------|---|-----------------|-----------------|----------------------------|
| | | <u>AAAm</u> | <u>AAA</u> | <u>aa+</u> | |
| Mutual funds - debt | N/A | \$ _____ | \$ _____ | \$ _____ | \$ <u>3,188,787</u> |
| Total | N/A | \$ _____ | \$ _____ | \$ _____ | \$ <u>3,188,787</u> |

Concentration of Credit Risk

SAWA’s investment policy states that an investment in any one security may not exceed 10 percent of the entire portfolio. There were no investments in any one issuer (other than mutual funds) that represent 10 percent or more of SAWA’s total portfolio. United States of America generally accepted accounting principles also require disclosure in the notes to the financial statements of any investment in an issuer (other than U.S. Treasury securities and mutual funds) that represents 5 percent or more of SAWA’s total investments. As of December 31, 2017, there were no such concentrations.

Custodial Credit Risk

Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, an entity will not be able to recover its deposits. 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, an entity will not be able to recover the value of its investment. SAWA’s investment policy does not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits or investments.

SANTA ANA WATERSHED ASSOCIATION
NOTES TO THE FINANCIAL STATEMENTS
December 31, 2017

NOTE 3 – CASH AND INVESTMENTS (Continued)

Custodial Credit Risk (Continued)

SAWA maintains its cash and investments at one financial institution. The balance at this financial institution is insured by the Securities Investor Protection Corporation (SIPC) up to \$500,000 per client for securities, inclusive of up to \$250,000 per client for cash. This financial institution has obtained private insurance coverage from a Lloyd's of London syndicate to provide additional protection for very large client accounts. For clients who have received the full SIPC limits, further protection, including up to \$1.9 million for cash, is provided by this policy, subject to an aggregate loss limit of \$1 billion for all customer claims. At December 31, 2017, SAWA's investments held at the financial institution exceeded the SIPC limit by \$5,420,165, which would be protected under the Lloyd's of London syndicate policy subject to its aggregate limit. SAWA had a balance of \$107,903 in cash deposits with a bank balance of \$165,018 and no uninsured cash balances at December 31, 2017.

Investments

Fair Value of Investments

GASB Statement No. 72, *Fair Value Measurement and Application* (GASB 72), provides the framework for measuring fair value. That framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurements) and the lowest priority to unobservable inputs (level 3 measurements). The three levels of the fair value hierarchy under GASB 72 are described as follows:

- Level 1 Inputs to the valuation methodology are unadjusted quoted prices for identical assets as of the measurement date in active markets that SAWA has the ability to access. Fair values are determined using fund manager estimates.

- Level 2 Inputs to the valuation methodology include quoted prices for similar assets in active markets; quoted prices for identical or similar assets in inactive markets; and model based valuation techniques for which all significant assumptions are observable in the market or can be corroborated by observable market data for substantially the full term of the assets.

- Level 3 Inputs to the valuation methodology are unobservable and include situations where there is little, if any, market activity for the investment.

The asset's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

SANTA ANA WATERSHED ASSOCIATION
NOTES TO THE FINANCIAL STATEMENTS
December 31, 2017

NOTE 3 – CASH AND INVESTMENTS (Continued)

Following is a description of the valuation methodologies used for assets measured at fair value.

Mutual funds: Valued at the closing price reported in the active market on which the individual funds are traded.

The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair value. Furthermore, while SAWA believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

The following table sets forth by level, within the fair value hierarchy, SAWA's investment assets at fair value as of December 31, 2017:

| | <u>Level 1</u> | <u>Level 2</u> | <u>Level 3</u> | <u>Total</u> |
|--|----------------------------|------------------|------------------|----------------------------|
| Mutual funds invested into debt securities | \$ 3,188,787 | \$ | \$ | \$ 3,188,787 |
| Mutual funds invested into equity securities | <u>2,731,378</u> | | | <u>2,731,378</u> |
| | <u>\$ 5,920,165</u> | <u>\$</u> | <u>\$</u> | <u>\$ 5,920,165</u> |

At December 31, 2017, SAWA had no investments in repurchase and reverse repurchase agreements and did not invest in such during the years then ended.

NOTE 4 – RISK MANAGEMENT

SAWA purchases various insurances through Nonprofit's Insurance Alliance of California (NIAC). The following table presents the coverages along with the applicable limits:

| <u>Type of Insurance</u> | <u>Each Occurrence Limit</u> | <u>Aggregate Limit</u> |
|--------------------------|------------------------------|------------------------|
| Commercial liability | \$ 1,000,000 | \$ 3,000,000 |
| Automobile liability | 1,000,000 | N/A |
| Umbrella liability | 1,000,000 | 1,000,000 |
| Professional liability | 1,000,000 | 3,000,000 |

SAWA purchases commercial workers' compensation insurance from the State Compensation Insurance Fund (State Fund). Under this policy, State Fund provides workers' compensation coverage of up to \$1,000,000 per claim.

SANTA ANA WATERSHED ASSOCIATION
NOTES TO THE FINANCIAL STATEMENTS
December 31, 2017

NOTE 4 – RISK MANAGEMENT (Continued)

During the year ended December 31, 2017, SAWA had no settlements exceeding insurance coverage for these categories of risk. For the past three years, settlement or judgment amounts have not exceeded insurance coverage.

NOTE 5 – CAPITAL ASSETS

The following is a summary of changes in capital assets for SAWA at December 31, 2017:

| | Balance Beginning of Year | Additions | Deletions | Balance End of Year |
|------------------------------------|---------------------------------|------------------------|--------------------------|---------------------------|
| Capital assets being depreciated: | | | | |
| Field equipment | \$ 73,977 | \$ 3,244 | \$ (2,124) | \$ 75,097 |
| Vehicles | 73,931 | 33,883 | - | 107,814 |
| Office equipment | 48,324 | - | - | 48,324 |
| Leasehold improvements | 2,585 | - | - | 2,585 |
| Land Improvements | - | 2,785 | - | 2,785 |
| | <u>198,817</u> | <u>39,912</u> | <u>(2,124)</u> | <u>236,605</u> |
| Less accumulated depreciation for: | | | | |
| Field equipment | (47,452) | (8,504) | 305 | (55,651) |
| Vehicles | (27,666) | (15,349) | - | (43,015) |
| Office equipment | (15,305) | (6,864) | - | (22,169) |
| Leasehold improvements | (129) | (516) | - | (645) |
| Land improvements | - | (69) | - | (69) |
| | <u>(90,552)</u> | <u>(31,302)</u> | <u>305</u> | <u>(121,549)</u> |
| Net assets being depreciated | <u>108,265</u> | <u>8,610</u> | <u>(1,819)</u> | <u>115,056</u> |
| Capital assets not depreciated: | | | | |
| Conservation easement | <u>93,737</u> | - | - | <u>93,737</u> |
| Net assets not being depreciated | <u>93,737</u> | - | - | <u>93,737</u> |
| Total capital assets, net | <u>\$ 202,002</u> | <u>\$ 8,610</u> | <u>\$ (1,819)</u> | <u>\$ 208,793</u> |

Depreciation expense was \$31,302 for the year ended December 31, 2017.

SANTA ANA WATERSHED ASSOCIATION
NOTES TO THE FINANCIAL STATEMENTS
December 31, 2017

NOTE 6 – DEFINED CONTRIBUTION PENSION PLAN

SAWA provides pension benefits for all of its permanent employees through a 403(b) defined contribution plan administered by Lincoln Financial Services. The plan was adopted in July 2004 by the Board of Directors. In a defined contribution plan, benefits depend solely on amounts contributed to the plan plus investment earnings. Employees are required to participate after achieving permanent status. SAWA contributes 6 percent of each eligible employee's compensation up to a maximum annual compensation allowed by law. The plan is a standardized plan which can be amended due to changes in law or by the Board of Directors. Employees voluntarily contribute to the plan. Employee contributions are limited to the maximum allowed by law. SAWA's contributions for each employee and the related allocated investment earnings vest in accordance to the plan document. Employees are fully vested after three years of participation. The employees are vested immediately in their contributions and any related allocated investment earnings. During the fiscal year ended December 31, 2017, SAWA contributed \$99,566 to the plan while SAWA employees contributed \$103,584, to the plan inclusive of amounts reimbursed and withheld for leased employees.

NOTE 7 – ADMINISTRATIVE OFFICE LEASE

In September 2016, SAWA entered into a ten-year lease for office space. This agreement is noncancellable for the first five years and cancellable with twelve months written notice thereafter. Monthly rent under this agreement is \$5,652 with a 2.5 percent annual increase for the first five years and a 3.5 percent annual increase thereafter. Payment of SAWA's share of operating expenses is also required. For the year ended December 31, 2017, SAWA incurred \$68,253 in costs under the lease agreement. The following is a schedule of minimum payments over the next four years excluding operating expenses:

| <u>Year ended December 31</u> | <u>Amount</u> |
|-------------------------------|--------------------------|
| 2018 | \$ 69,624 |
| 2019 | 71,364 |
| 2020 | 73,149 |
| 2021 | <u>56,153</u> |
| Total | <u>\$ 270,290</u> |

SANTA ANA WATERSHED ASSOCIATION
NOTES TO THE FINANCIAL STATEMENTS
December 31, 2017

NOTE 8 – WAREHOUSE LEASE

In November 2016, SAWA entered into a five-year noncancellable lease for warehouse space. Monthly rent, common area maintenance and parking fees under this agreement total \$1,314 with a 3.0 percent annual increase of rent and common area maintenance. For the year ended December 31, 2017, SAWA incurred \$15,201 in costs under the lease agreement.

The following is a schedule of minimum payments over the next four years excluding operating expenses:

| <u>Year ended December 31</u> | <u>Amount</u> |
|-------------------------------|-------------------------|
| 2018 | 16,316 |
| 2019 | 16,800 |
| 2020 | 17,306 |
| 2021 | <u>14,780</u> |
| Total | <u>\$ 65,202</u> |

NOTE 9 – RELATED PARTY TRANSACTIONS

As described in Note 1, SAWA’s board is comprised of representatives from Orange County Water District (OCWD), Inland Empire Resource Conservation District (IERCD), San Jacinto Basin Resource Conservation District (SJBRC D), Riverside-Corona Resource Conservation District (RCRCD), and Temecula-Elsinore-Anza-Murrieta Resource Conservation District (TEAM RCD). The following related party assets (liabilities) are included in the statement of net position for the year ended December 31, 2017:

| | <u>OCWD</u> | <u>IERCD</u> | <u>SJBRC D</u> | <u>TEAM RCD</u> | <u>RCRCD</u> | <u>Total</u> |
|-------------------------|-------------------------|---------------------------|--------------------|------------------------|--------------------|-------------------------|
| Due from governments | \$ 32,578 | \$ 18,051 | \$ - | \$ 2,771 | \$ - | \$ 53,400 |
| Related parties payable | <u>(8,529)</u> | <u>(31,791)</u> | <u>-</u> | <u>-</u> | <u>-</u> | <u>(40,320)</u> |
| | <u>\$ 24,049</u> | <u>\$ (13,740)</u> | <u>\$ -</u> | <u>\$ 2,771</u> | <u>\$ -</u> | <u>\$ 13,080</u> |

The following related party revenues (expenses) are included in the statement of revenues, expenses, and changes in net position for the year ended December 31, 2017:

| | <u>OCWD</u> | <u>IERCD</u> | <u>SJBRC D</u> | <u>TEAM RCD</u> | <u>RCRCD</u> | <u>Total</u> |
|-------------------------------|-------------------------|--------------------------|--------------------------|---------------------------|---------------------------|--------------------------|
| Habitat restoration fees | \$ 12,578 | \$ 184,130 | \$ 12,544 | \$ - | \$ - | \$ 209,252 |
| Biological monitoring revenue | 173,859 | 92,377 | - | 4,512 | - | 270,748 |
| Project expense | (123,672) | (97,070) | - | - | - | (220,742) |
| Other expenses | <u>-</u> | <u>-</u> | <u>(18,252)</u> | <u>(23,046)</u> | <u>(18,252)</u> | <u>(59,550)</u> |
| | <u>\$ 62,765</u> | <u>\$ 179,437</u> | <u>\$ (5,708)</u> | <u>\$ (18,534)</u> | <u>\$ (18,252)</u> | <u>\$ 199,708</u> |

SANTA ANA WATERSHED ASSOCIATION
NOTES TO THE FINANCIAL STATEMENTS
December 31, 2017

NOTE 10 – EXPENDABLE RESTRICTED FUNDS

Riparian/Wetland Habitat along San Timoteo Creek

In October 2004, SAWA received \$1,620,000 from the United States Army Corps of Engineers to be used for riparian and wetland habitat restoration along San Timoteo Creek. These funds are restricted for program use. As of December 31, 2017, \$948,841 was reflected on the financial statement as part of restricted cash and investments and as a component of expendable restricted net position.

Orange County Water District Projects

At December 31, 2016, SAWA held \$805,743 in funding received from the Orange County Water District (“OCWD”), to be used for projects pre-approved by the OCWD Executive Director of Planning and Natural Resources and OCWD Natural Resources Directors. SAWA must provide the OCWD CFO and Natural Resources Director with quarterly reports on the expenditures of those funds. As of December 31, 2017, \$703,047 was reflected on the financial statement as part of restricted cash and investments and as a component of expendable restricted net position.

In-lieu Fee Mitigation Program

The United States Army Corps of Engineers (USACE) has required SAWA to establish a separate restricted cash account that is FDIC insured to hold in-lieu fee mitigation monies received but not placed as of June 30, 2013. This account was established in April 2014 and \$2,715,000 was transferred to the account. During 2016, SAWA received permission from USACE to hold these funds with its existing investments rather than in a separate account and the separate cash account was closed. At December 31, 2017, \$2,715,000 was reflected, on the financial statement as part of restricted cash and investments and as a component of expendable restricted net position.

NOTE 11 – NONEXPENDABLE RESTRICTED FUNDS

Mockingbird II Conservation Easement and Endowment Fund

The Mockingbird II Conservation Easement Endowment Fund was established in November 2009 when Mockingbird II Conservation Easement and the related endowment fund were transferred to SAWA from The Environmental Trust. The conservation easement is reflected as a capital asset at its estimated fair value plus ancillary costs, totaling \$93,737.

The endowment fund received a total of \$38,981 and is required to be held in perpetuity with only the investment earnings available for use in the maintenance of the conservation easement. This fund is reflected on the statement of net position in restricted cash and investments as a component of nonexpendable restricted net position.

SANTA ANA WATERSHED ASSOCIATION
NOTES TO THE FINANCIAL STATEMENTS
December 31, 2017

NOTE 12 – ANTICIPATED CHANGES TO NET POSITION

Administrative Cost Reallocation

SAWA has identified that administrative costs were not properly allocated in the past for the Reach 3B project and is currently negotiating to reallocate prior costs. The effect of these potential reallocations on unrestricted and expendable restricted net position has not been determined.

In-lieu Fee Mitigation Requirements

SAWA has also identified that in-lieu fee mitigation requirements may have been satisfied to a greater extent than originally reported. This would result in a reduction in expendable restricted net position for these funds, with an offsetting increase in unrestricted net position, or other expendable restricted funds, or both. Research to determine the extent of the reclassification has not been completed, and changes to net position could not be estimated at this time.

Due to the unresolved nature of these issues, potential changes to unrestricted and expendable restricted balances were considered by management to be un-estimable as of September 19, 2018, the date these financial statements were available to be issued.

NOTE 13 - CONCENTRATION

A significant portion of SAWA's operating revenue came from three organizations which represent 75 percent of all operating revenue for the year ended December 31, 2017. As of December 31, 2017, 28 percent of accounts receivable were due from these organizations. As of December 31, 2017, an additional 46 percent of accounts receivable were due from a fourth organization, to whom SAWA leases biological staff.

NOTE 14 – RISKS AND UNCERTAINTIES

SAWA invests in various investment securities. Investment securities are exposed to various risks such as interest rate, market, and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term. The volatility of the market and credit institutions after December 31, 2017, could have a significant, negative effect on SAWA's investments.

NOTE 15 – SUBSEQUENT EVENTS

In the preparation of these financial statements, SAWA considered subsequent events through September 19, 2018 which is the date these financial statements were issued.