



September 4, 2019

Sativa Los Angeles County Water District  
Compton, California

**RE: Audit of the Sativa Los Angeles County Water District  
For the Fiscal Year Ended June 30, 2018**

### **Executive Summary**

The Pun Group, LLP was retained through DRP Engineering, Inc. by the County of Los Angeles (“County”), to perform a financial audit of the financial statements of the Sativa Los Angeles County Water District (“District”), which comprise the statement of net position as of June 30, 2018, and the related statements of revenues, expenses, and changes in net position, and cash flows for the year then ended, and the related notes to financial statements.

Effective October 31, 2018, the State of California has removed the District's Board of Directors and appointed the County as Interim Administrator of the District.

The Pun Group, LLP is **not able to form an opinion** on these financial statements due to limited supporting documents (purchase orders, invoices, etc.), and lack of sufficient internal controls in place during the audit period. County staff have not been able to obtain and provide sufficient appropriate audit evidence to support the fair presentation of the financial statements in conformity with the Generally Accepted Accounting Principles in the United States of America.

The County, current Interim Administrator of the District, realized the past financial short comings of the District and took steps to reconstruct the accounting records for the fiscal year ended June 30, 2018 based on the available information, including but not limited to, the bank statements and credit card statements.

It has been our pleasure to work with all the personnel at the County Public Works Department. Everyone whom we dealt with gave his or her full cooperation and assisted in every way possible. We shall be pleased to discuss the issues raised in this audit.

Respectfully Submitted,

A handwritten signature in black ink that reads 'The Pun Group, LLP'. The signature is written in a cursive, flowing style.

Santa Ana, California

**Financial Summary**

*Revenues*

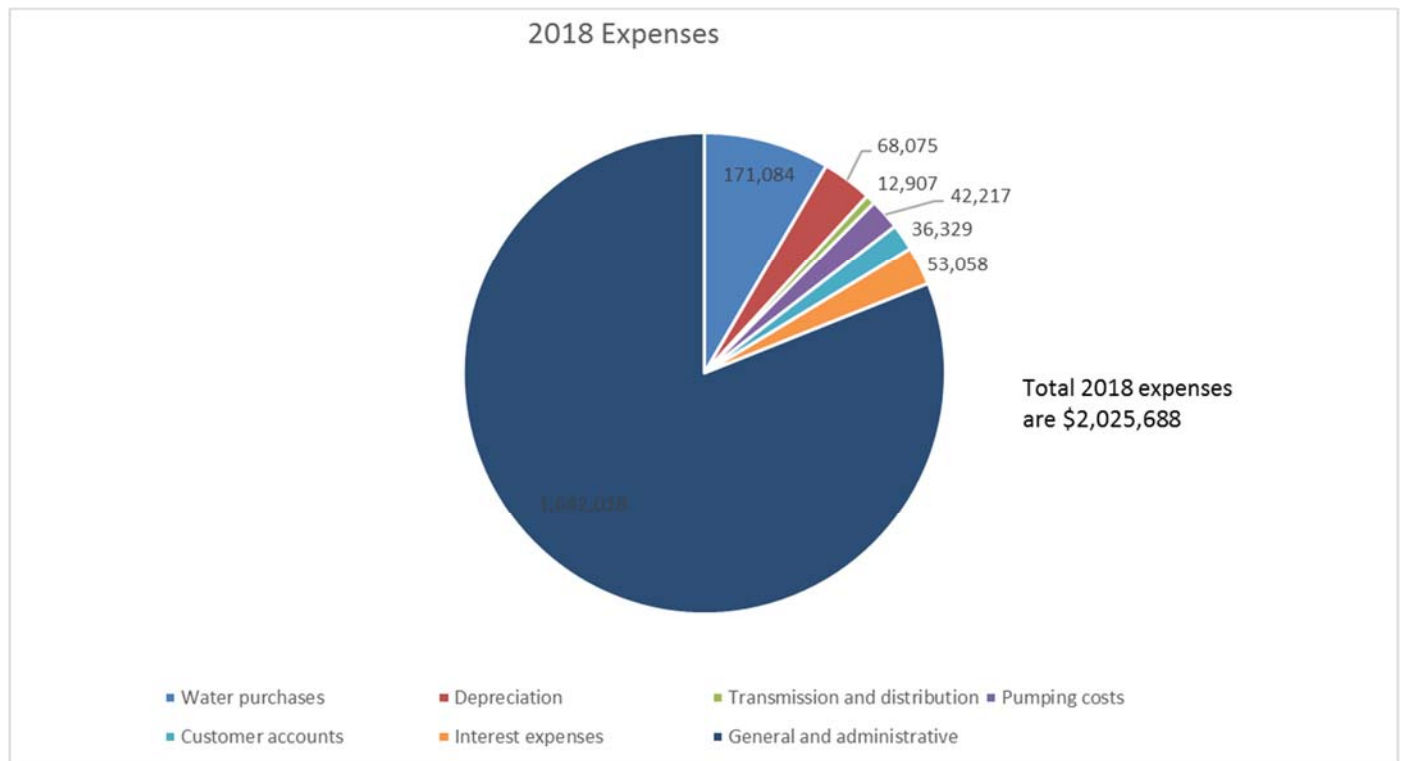
During the fiscal year ended June 30, 2018, the District recognized \$1,302,129 of total sales of water and other services provided to the water users. The District is a public water agency that serves approximately 6,800 people in the unincorporated community of Willowbrook and a portion of the City of Compton. The District is charging its users based on a flat water rate instead of charging its users based on consumption. As a result, the District did not recover costs for the services provided to the water users and created significant financial/operating deficits. (See Matters on Internal Control finding 2018-002 *Failing to Establish Proper Charges and Fees* for further details.)

In addition, the District has recognized \$9,183 in interest income and \$1,500 of other nonoperating revenues.

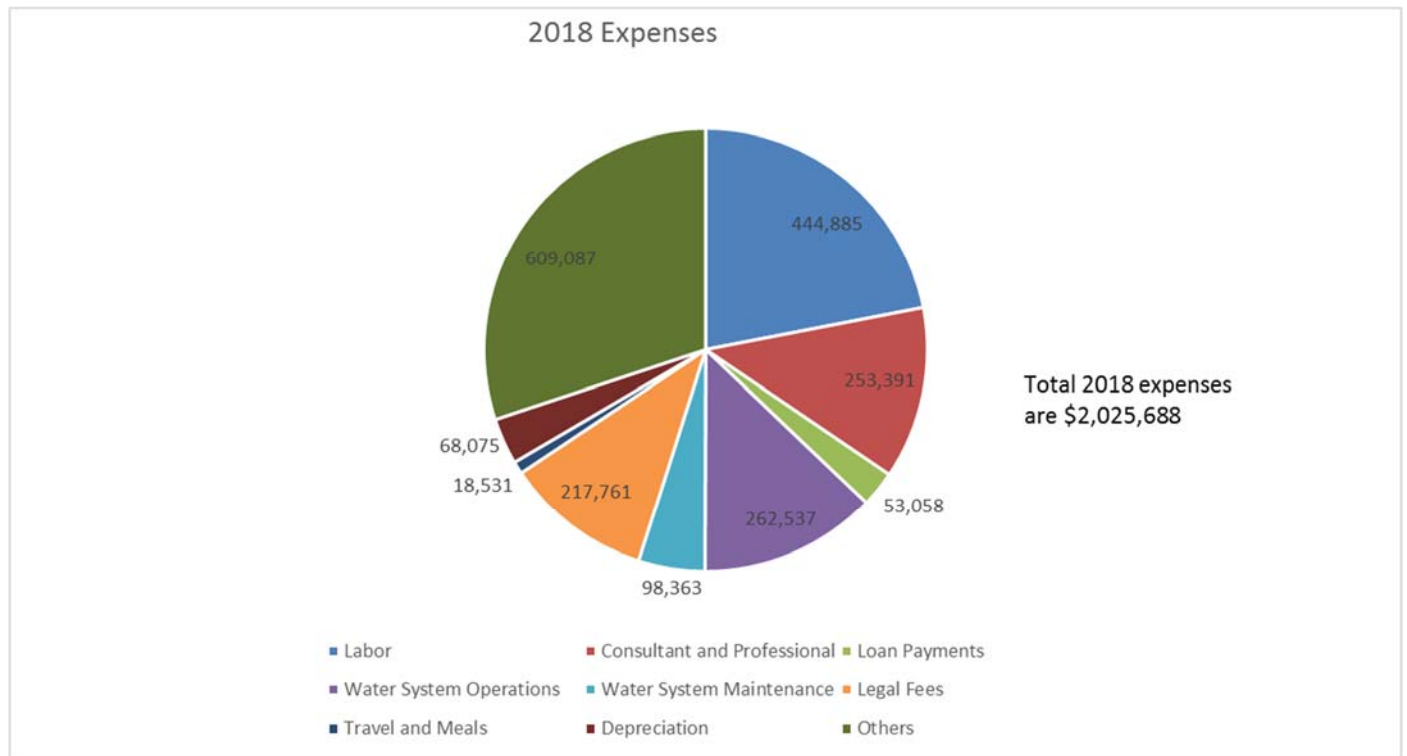
*Expenses*

During the fiscal year ended June 30, 2018, the District has expended \$2,025,688.

The following chart presents its expenses based on the financial statement categories.



The following chart presents its expenses based on the major categories set forth by the District.



During our audit, we selected all expenses that exceeded \$4,000, which is ninety (90) transactions. Thirty-six (36) out of ninety (90) selected or forty percent (40%) cash disbursement transactions totaling \$385,656 were not substantiated by any supporting documents. This is highly unusual and raises serious concern of the District’s record keeping practices.

In addition, the District could not identify the purpose of approximately 200 cash disbursement transactions totaling \$84,223. These transactions appear to be non-legitimate expenses of the District and could possibly involve improper and/or unlawful actions.

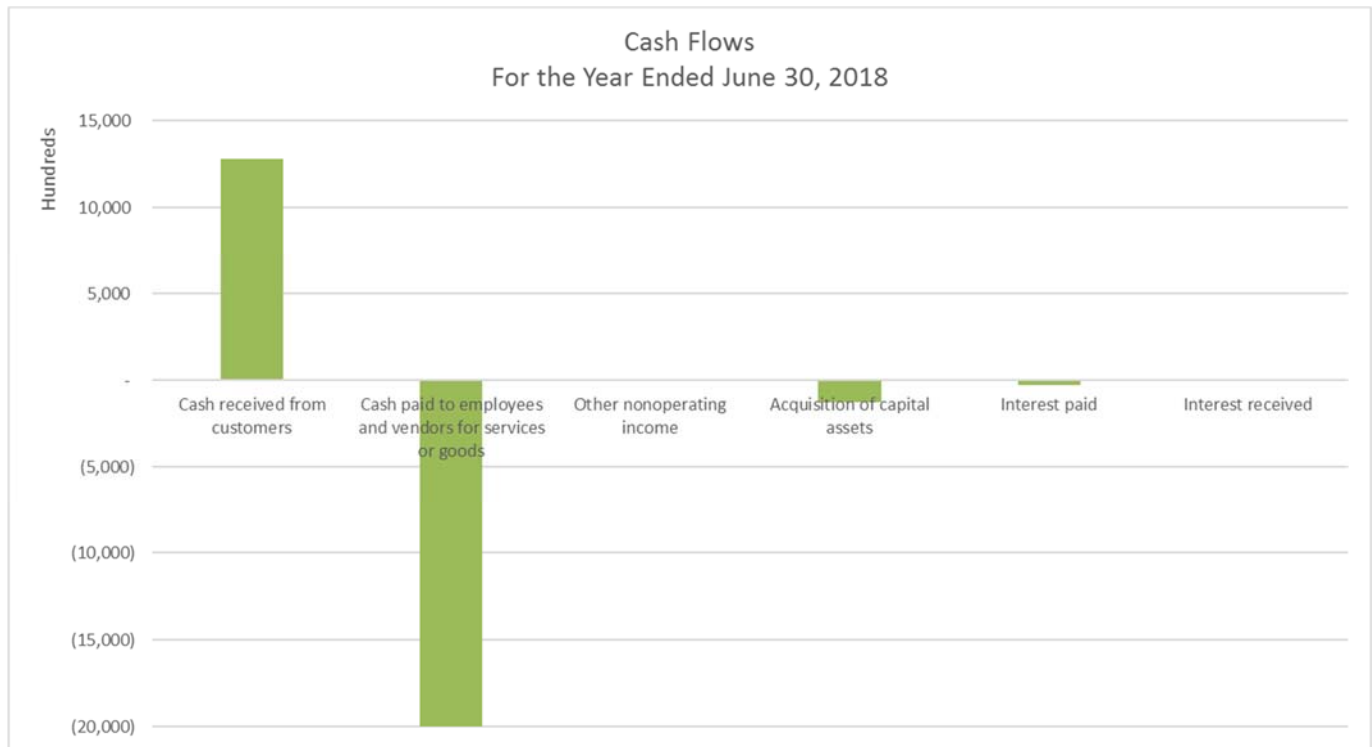
In addition, there was \$92,941 in charges to three credit cards issued to District representatives or employees during the audit period whose purpose was not substantiated by supporting documents. These credit card charges were paid from the District operating funds. This is highly unusual and raises serious concern of the District’s record keeping practices, and such charges could possibly involve improper and/or unlawful actions.

On June 22, 2017, the District received a loan containing bond-like characteristics issued from City National Bank in the amount of \$1,620,000 to finance the acquisition and construction of Well #6 of the District. During the fiscal year ended June 30, 2018, the District had transferred \$361,338 from the Bond Trust account to the District’s main operating account. Based on the account analysis, none of the loan proceeds were spent on Well #6 during the audit period. It appears the District may have spent proceeds from the loan for day-to-day operations. As a result, the District may have violated loan agreement provisions which limit use of the loan proceeds, although it is possible that the lender was aware of and consented to these uses. We have no opinion regarding the legal implications of these facts. Moreover, the District was likely funding its operations in a financially unsustainable manner.

In addition, the District incurred \$53,058 of interest expense related to its 2017 City National Bank Bond payable.

*Cash Flows*

The following chart presents the cash flows for the year ended June 30, 2018.



**Deliverables:**

1. Financial Statements and Independent Auditors' Report for the Year Ended June 30, 2018
2. Matters on Internal Control
3. AU-C 260 Communication with Those Charged with Governance

# **Sativa Los Angeles County Water District**

Compton, California

## **Financial Statements and Independent Auditors' Report**

*For the Year Ended June 30, 2018*



**Sativa Los Angeles County Water District  
Financial Statements  
For the Year Ended June 30, 2018**

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## INDEPENDENT AUDITORS' REPORT

Sativa Los Angeles County Water District  
Compton, California

### **Report on the Financial Statements**

We were engaged to audit the accompanying financial statements of Sativa Los Angeles County Water District (the "District"), which comprise the statement of net position as of June 30, 2018, and the related statements of revenues, expenses, and changes in net position, and cash flows for the year then ended, and the related notes to financial statements.

### **Management's Responsibility for the Financial Statements**

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

### **Auditor's Responsibility**

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our disclaimer audit opinion.

**Basis for Disclaimer of Opinion**

The District is unable to provide sufficient appropriate audit evidence to support the amounts and disclosures of the District’s financial statements including cash and investments, capital assets, accounts payable, accrued liabilities, customer deposits, and compensated absences.

Effective October 31, 2018, the State of California has removed the District's Board of Directors and appointed the County of Los Angeles (the “County”) as Interim Administrator of the District.

Due to limited supporting documents (purchase orders, invoices, etc.), and lack of sufficient internal controls in place during the audit period, the County has not been able to obtain, and provide to us, sufficient appropriate audit evidence to support the fair presentation of the financial statements in conformity with generally accepted accounting principles. Therefore, the County does not assume responsibility that the District’s financial statements are free from material misstatement, whether due to fraud or error.

**Disclaimer of Opinion**

Because of the significance of the matters described in the Basis for Disclaimer of Opinion paragraph, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on the District’s financial statements.

**Emphasis of Matter**

*Going Concern*

As discussed in Note 8 to the Financial Statements, on July 11, 2018, the Local Agency Formation Commission voted unanimously to begin the process of dissolving the District. Effective March 19, 2019, the District was formally dissolved and the operation has been consolidated to the County.

Our opinion is not modified with respect to this matter.

**Required Supplementary Information**

*Management’s Discussion and Analysis*

Management has omitted the Management’s Discussion and Analysis that accounting principles generally accepted in the United States of America require to be presented to supplement the financial statements. Such missing information, although not a part of the financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the financial statements in an appropriate operational, economical, or historical context. Our opinion on the financial statements are not affected by this missing information.



Santa Ana, California  
September 4, 2019

## **FINANCIAL STATEMENTS**

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**Sativa Los Angeles County Water District**  
**Statement of Net Position**  
(See Independent Auditors' Report on Disclaimer of Opinion)  
**June 30, 2018**

**ASSETS**

**Current assets:**

Cash and investments (Note 2)	\$ 1,185,685
Accounts receivable	110,332
Prepaid expenses	22,000
<b>Total current assets</b>	<b>1,318,017</b>

**Non-current assets:**

Capital assets – not being depreciated (Note 3)	154,511
Capital assets – being depreciated, net (Note 3)	1,103,407
<b>Total non-current assets</b>	<b>1,257,918</b>
<b>Total assets</b>	<b>2,575,935</b>

**LIABILITIES**

**Current liabilities:**

Accrued liabilities	4,968
Accrued interest payable	27,945
Customer deposits	154,692
Long-term liabilities – due in one year:	
Bonds payable (Note 5)	115,000
<b>Total current liabilities</b>	<b>302,605</b>

**Non-current liabilities:**

Long-term liabilities – due in more than one year:	
Bonds payable (Note 5)	1,505,000
<b>Total non-current liabilities</b>	<b>1,505,000</b>
<b>Total liabilities</b>	<b>1,807,605</b>

**NET POSITION (Note 8)**

Investment in capital assets	1,257,918
Restricted	1,141,443
Unrestricted (deficit)	(1,631,031)
<b>Total net position</b>	<b>\$ 768,330</b>

**Sativa Los Angeles County Water District**  
**Statement of Revenues, Expenses, and Changes in Net Position**  
**(See Independent Auditors' Report on Disclaimer of Opinion)**  
**For the Year Ended June 30, 2018**

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<b>Operating revenues:</b>	
Water sales and services	\$ 1,277,761
Other operating revenues	24,368
<b>Total operating revenues</b>	<u>1,302,129</u>
<b>Operating expenses:</b>	
Water purchases	171,084
Depreciation	68,075
Transmission and distribution	12,907
Pumping costs	42,217
Customer accounts	36,329
General and administrative	1,642,018
<b>Total expenditures</b>	<u>1,972,630</u>
<b>Operating (loss)</b>	(670,501)
<b>Nonoperating revenues (expenses)</b>	
Interest expenses	(53,058)
Interest income	9,183
Other income	1,500
<b>Total nonoperating revenue</b>	<u>(42,375)</u>
<b>Change in net position</b>	(712,876)
<b>Net Position:</b>	
Beginning of year, as restated (Note 8)	<u>1,481,206</u>
End of year	<u>\$ 768,330</u>

**Sativa Los Angeles County Water District**  
**Statement of Cash Flows**  
**(See Independent Auditors' Report on Disclaimer of Opinion)**  
**For the Year Ended June 30, 2018**

<b>Cash Flows From Operating Activities:</b>	
Cash received from customers	\$ 1,282,589
Cash paid to employees and vendors for services or goods	<u>(1,933,568)</u>
<b>Net cash (used in) operating activities</b>	<u>(650,979)</u>
<b>Cash Flows From Noncapital Financing Activities:</b>	
Other nonoperating income	<u>1,500</u>
<b>Net cash provided by noncapital financing activities</b>	<u>1,500</u>
<b>Cash Flows From Capital And Related Financing Activities:</b>	
Acquisition of capital assets	(126,007)
Interest paid	<u>(25,113)</u>
<b>Net cash (used in) capital related financing activities</b>	<u>(151,120)</u>
<b>Cash Flows From Investing Activities</b>	
Interest received	<u>9,841</u>
<b>Net cash provided by investing activities</b>	<u>9,841</u>
<b>Net decrease in cash and cash equivalents</b>	(790,758)
<b>Cash and cash equivalents:</b>	
Beginning of year	<u>1,976,443</u>
End of year	<u><u>\$ 1,185,685</u></u>
<b>Reconciliation of Operating (Loss) to Net Cash (Used In)</b>	
<b>Operating Activities:</b>	
Operating (loss)	\$ (670,501)
Adjustments to reconcile operating (loss) to net cash (used in) operating activities:	
Depreciation	68,075
Changes in assets and liabilities:	
Accounts receivable	(16,296)
Prepaid expenses	(22,000)
Accrued liabilities	(7,013)
Customer deposits	<u>(3,244)</u>
Total adjustments	<u>19,522</u>
<b>Net cash (used in) operating activities</b>	<u><u>\$ (650,979)</u></u>

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**Sativa Los Angeles County Water District**  
**Notes to the Financial Statements**  
**For the Year Ended June 30, 2018**

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**Note 1 – Summary of Significant Accounting Policies**

**A. Description of Reporting Entity**

The District was incorporated on December 30, 1938 in the State of California. The District supplies domestic water services to a portion of the Willowbrook area, an unincorporated area of the County of Los Angeles and a portion of the City of Compton. The service area is approximately one-half square mile, in which the District provides service to approximately 1,600 service connections. The District maintains two active wells and one off-line well at three plant locations.

For the fiscal year ended June 30, 2018, the District was governed by a five-member elected Board of Directors, which had no oversight responsibility over any other entities, and no component units within its reporting entity structure. The criteria used to determine the reporting entity included, but was not limited to: (a) financial independence, (b) selection of the governing authority, (c) designation of management, (d) ability to significantly influence operations, and (e) accountability for fiscal matters.

**B. Basis of Presentation**

The District's financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (U.S. GAAP). The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The District solely operates as a special-purpose government which means it is only engaged in business-type activities; accordingly, activities are reported in the District's enterprise fund.

**Please see “Basis for Disclaimer of Opinion” in the Independent Auditors’ Report.**

**C. Basis of Accounting**

The District accounts for its operations in an enterprise fund. An enterprise fund is used to account for operations that are financed and operated in a manner similar to private business enterprises, where the intent of the governing body is that the costs of providing goods or services to the general public are financed or recovered primarily through user charges. The financial statements are accounted for using the “economic resources” measurement focus and the accrual basis of accounting. Revenues are recognized in the accounting period in which they are earned and expenses are recognized in the period incurred, regardless of when the related cash flows take place.

Operating revenues and expenses are generated and incurred through the water sales activities to the District's customers. Management, administration, and depreciation expenses are also considered operating expenses. Other revenues and expenses not included in the above categories are reported as non-operating revenues and expenses.

**D. Cash and Investment**

Cash and cash equivalents include all highly liquid investments with original maturities of 90 days or less and are carried at cost, which approximates fair value.

**Sativa Los Angeles County Water District**  
**Notes to the Financial Statements (Continued)**  
**For the Year Ended June 30, 2018**

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**Note 1 – Summary of Significant Accounting Policies (Continued)**

**D. Cash and Investment (Continued)**

U.S. GAAP defines fair value, establishes a framework for measuring fair value and establishes disclosures about fair value measurement. Investments, unless otherwise specified, recorded at fair value in the Statements of Net Position, are categorized based upon the level of judgment associated with the inputs used to measure their fair value. Levels of inputs are as follows:

Level 1 – Inputs are unadjusted, quoted prices for identical assets and/or liabilities in active markets at the measurement date.

Level 2 – Inputs, other than quoted prices included in Level 1 that are observable for the assets or liabilities through corroboration with market data at the measurement date.

Level 3 – Unobservable inputs that reflect management’s best estimate of what market participants would use in pricing the assets or liabilities at the measurement date.

**E. Receivables and Allowance for Doubtful Accounts**

Accounts receivable consist of amounts owed by customers for services rendered in the regular course of business operations. Uncollectable accounts are based on prior experience and management’s assessment of the collectability of existing accounts. As of June 30, 2018, no allowance for doubtful accounts has been recorded.

**F. Capital Assets**

Capital assets are valued at historical cost, or estimated historical cost, if actual historical cost was not available. Donated capital assets are valued at their estimated acquisition value on the date donated rather than fair market value. The District policy has set the capitalization threshold for reporting capital assets at \$500, all of which must have an estimated useful life in excess of one year. Depreciation is recorded on a straight-line basis over estimated useful lives of the assets as follows:

Water utility plant and office improvements	10 to 30 years
Plant maintenance equipment, vehicles, office furniture and equipment	5 to 10 years

Major outlays for capital assets are capitalized as construction in progress until fully constructed. Once the construction is completed the capital asset is transferred and depreciated based on its useful life.

**G. Compensated Absences**

Accumulated unpaid employee vacation leave benefits are recognized as liabilities of the District when vested. Full-time employees are granted two to seven weeks of vacation per year depending on length of service. The District's vacation leave policy limits accrued vacation leave to a maximum of 30 days.

District employees are granted one day of sick leave per month. The District's sick leave policy stipulates that each employee can accrue up to a maximum of 12 sick days; any sick time earned after the 12-day accrual shall be lost and no sick leave is payable upon employees leaving the District's employment.

**Sativa Los Angeles County Water District**  
**Notes to the Financial Statements (Continued)**  
**For the Year Ended June 30, 2018**

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**Note 1 – Summary of Significant Accounting Policies (Continued)**

**H. Net Position**

Net position represents the difference between all other elements in the statement of net position and should be displayed in the following three components:

**Investment in Capital Assets** – This component of net position consists of capital assets, net of accumulated depreciation.

**Restricted** – This component of net position consists of restricted assets reduced by liabilities related to those assets.

**Unrestricted** – This component of net position is the amount of the assets, and liabilities, that are not included in the determination of investment in capital assets or the restricted component of net position.

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

**I. Use of Estimates**

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of the contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

**Note 2 – Cash and Investments**

As of June 30, 2018, cash and investments consist of:

Description	Balance
Imprest cash	\$ 24
Demand deposit accounts	32,761
California Local Agency Investment Fund (LAIF)	11,457
Deposit with fiscal agent	1,141,443
<b>Total cash and investments</b>	<b>\$ 1,185,685</b>

**Sativa Los Angeles County Water District**  
**Notes to the Financial Statements (Continued)**  
**For the Year Ended June 30, 2018**

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**Note 2 – Cash and Investments (Continued)**

**Demand Deposits**

The California Government Code requires California banks and savings and loan associations to secure an entity's deposits by pledging government securities with a value of 110% of an entity's deposits. California law also allows financial institutions to secure entity deposits by pledging first trust deed mortgage notes having a value of 150% of an entity's total deposits. The entity's Treasurer may waive the collateral requirement for deposits which are fully insured up to \$250,000 by the FDIC.

The collateral for deposits in federal and state-chartered banks is held in safekeeping by an authorized agent of depository recognized by the State of California Department of Banking. The collateral for deposits with savings and loan associations is generally held in safekeeping by the Federal Home Loan Bank in San Francisco, California as an agent of depository. These securities are physically held in an undivided pool for all California public agency depositors. Under Government Code Section 53655, the placement of securities by a bank or savings and loan association with an agent of depositor has the effect of perfecting the security interest in the name of the local governmental agency. Accordingly, all collateral held by California agents of depository are considered to be held for, and in the name of, the local government.

**Investment in California Local Agency Investment Fund (LAIF)**

The District is a voluntary participant in LAIF which is regulated by California Government Code Section 16429 under the oversight of the Treasurer of the State of California. The fair value of the District's investment in this pool is reported in the accompanying financial statements at amounts based upon the District's pro-rata share of the fair value provided by LAIF for the entire LAIF portfolio (in relation to the amortized cost of that portfolio). The balance available for withdrawal is based on the accounting records maintained by LAIF, which are recorded on an amortized cost basis. Further information about LAIF is available on the California State Controller's website: [www.treasurer.ca.gov/pmia-laif/](http://www.treasurer.ca.gov/pmia-laif/)

The District's investments with LAIF at June 30, 2018 included a portion of the pool funds invested in Structured Notes and Asset-Backed Securities:

**Structured Notes:** debt securities (other than asset-backed securities) whose cash flow characteristics (coupon rate, redemption amount, or stated maturity) depend upon one or more indices and/or that have embedded forwards or options.

**Asset-Backed Securities:** generally, mortgage-backed securities that entitle their purchasers to receive a share of the cash flows from a pool of assets such as principal and interest repayments from a pool of mortgages (for example, Collateralized Mortgage Obligations) or credit card receivables.

The District had \$11,457 invested in LAIF, which had invested 2.67% of the pooled investment funds as of June 30, 2018, in structured notes and medium-term asset-backed securities.

**Sativa Los Angeles County Water District**  
**Notes to the Financial Statements (Continued)**  
**For the Year Ended June 30, 2018**

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**Note 2 – Cash and Investments (Continued)**

**Risk Disclosure Relating to Interest Rate Risk**

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

<u>Investments</u>	<u>Fair Value</u>	<u>Maturity</u>
	<u>June 30, 2018</u>	<u>12 Months or Less</u>
California Local Agency Investment Fund (LAIF)	\$ 11,457	\$ 11,457
Deposit with fiscal agent	1,141,443	1,141,443
<b>Total investments</b>	<b>\$ 1,152,900</b>	<b>\$ 1,152,900</b>

**Risk Disclosure 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. LAIF does not have a rating provided by a nationally recognized statistical rating organization.

**Risk Disclosure Relating to Concentration of Credit Risk**

The investment policy of the District contains no limitation on the amount that can be invested in any one issuer beyond that stipulated by the California Government Code. There are no investments in any one issuer that represent 5% or more of total District investments (other than external investment pools).

**Risk Disclosure Relating to Custodial Credit Risk**

Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The California Government Code and the District's investment policy do not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits or investments, other than the following provision for deposits: The California Government Code requires that a financial institution secure deposits made by state or local government units by pledging securities in an undivided collateral pool held by a depository regulated under state law (unless so waived by the governmental unit). The market value of the pledged securities in the collateral pool must equal at least 110% of the total amount deposited by the public agencies. California law also allows financial institutions to secure District deposits by pledging first trust deed mortgage notes having a value of 150% of the secured public deposits.

**Fair Value Measurements Disclosure**

The District's investment in the LAIF of \$11,457 is not subject to categorize under the GASB Statement No. 72 fair value hierarchy.

**Sativa Los Angeles County Water District**  
**Notes to the Financial Statements (Continued)**  
**For the Year Ended June 30, 2018**

**Note 3 – Capital Assets**

Summary of changes in capital assets for the year ended June 30, 2018 is as follows:

	<u>Balance</u> <u>July 1, 2017</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance</u> <u>June 30, 2018</u>
Non-depreciable capital assets:				
Land	\$ 154,511	\$ -	\$ -	\$ 154,511
Total non-depreciable capital assets	154,511	-	-	154,511
Depreciable capital assets:				
Water utility plant	2,167,315	-	-	2,167,315
Office improvements	203,541	126,007	-	329,548
Plant maintenance equipment	179,390	-	-	179,390
Office furniture and equipment	83,422	-	-	83,422
Vehicles	77,315	-	-	77,315
Total depreciable capital assets	2,710,983	126,007	-	2,836,990
Accumulated depreciation:				
Water utility plant	(1,318,529)	(53,871)	-	(1,372,400)
Office improvements	(145,904)	(8,053)	-	(153,957)
Plant maintenance equipment	(61,551)	(5,941)	-	(67,492)
Office furniture and equipment	(62,209)	(210)	-	(62,419)
Vehicles	(77,315)	-	-	(77,315)
Total accumulated depreciation	(1,665,508)	(68,075)	-	(1,733,583)
Total depreciable capital assets, net	1,045,475	57,932	-	1,103,407
Total capital assets, net	\$ 1,199,986	\$ 57,932	\$ -	\$ 1,257,918

**Sativa Los Angeles County Water District**  
**Notes to the Financial Statements (Continued)**  
**For the Year Ended June 30, 2018**

**Note 4 – Joint Powers Authority**

The District is a member of the Special District Risk Management Authority (SDRMA). The SDRMA was formed under a joint powers agreement pursuant to California Government Code Sections 6500 et seq. and 900 et seq. to provide a general liability, automotive liability and property damage, and errors and omissions risk financing for the member districts. Contribution development is based on the particular characteristics of the member districts.

The following audited financial data is presented as of and for the fiscal year ended June 30, 2018 for SDRMA (most recent data available):

Total Assets	\$ 112,001,700
Total Deferred Outflows of Resources	823,568
Total Liabilities	57,903,143
Total Deferred Inflows of Resources	337,392
Total Net Position	\$ 54,584,733
Total Operating Revenues	\$ 68,937,153
Total Operating Expenses	64,541,691
Total Nonoperating Income	96,961
Changes in Net Position	\$ 4,492,423

The District's precise share of SDRMA's assets, liabilities, risk margin and changes therein during the fiscal year are not available.

Adequacy of Protection

During the past three fiscal years, none of the above programs of protection have had settlements or judgments that exceeded pooled or insured coverage. There have been no significant reductions in pooled or insured liability coverage from coverage in the prior year.

**Note 5 – Bonds Payable**

Summary of changes in bonds payable for the year ended June 30, 2018 is as follows:

<b>Long-term Debt</b>	<b>Balance</b>	<b>Additions</b>	<b>Payments</b>	<b>Balance</b>	<b>Current</b>
	<b>July 1, 2017</b>			<b>June 30, 2018</b>	<b>Portion</b>
Bonds Payable	\$ 1,620,000	\$ -	\$ -	\$ 1,620,000	\$ 115,000

On June 22, 2017, the District issued bonds in the amount of \$1,620,000, to mature on June 1, 2037, to finance the acquisition and construction of Well #6 of the District. This is a special, limited obligation of the District and is secured solely by and payable from a pledge of the Net Water Revenues, which is defined as, for any fiscal year, an amount equal to all of the gross water revenues minus the amount required to pay all direct costs becoming payable with respect to such fiscal year.

**Sativa Los Angeles County Water District**  
**Notes to the Financial Statements (Continued)**  
**For the Year Ended June 30, 2018**

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**Note 5 – Bonds Payable (Continued)**

The bond purchaser retained \$120,000 to pay for costs of issuance. The costs of issuance were expensed when incurred. Debt service requirements on long-term debt at June 30, 2018 are as follows:

<u>Fiscal Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2019	\$ 115,000	\$ 53,992	\$ 168,992
2020	60,000	51,923	111,923
2021	65,000	49,852	114,852
2022	65,000	47,610	112,610
2023-2027	370,000	202,169	572,169
2028-2032	435,000	134,205	569,205
2033-2037	510,000	53,993	563,993
Total	<u>\$ 1,620,000</u>	<u>\$ 593,744</u>	<u>\$ 2,213,744</u>

**Note 6 – Contingencies**

The District is subject to various claims and legal proceedings covering a wide range of matters that arise in the ordinary course of its business activities. Management believes that any liability that may ultimately result from the resolution of these matters may have a material adverse effect on the financial condition or results of operations of the District.

**Note 7 – Going Concern**

On July 11, 2018, the Local Agency Formation Commission voted unanimously to begin the process of dissolving the District. Effective March 19, 2019, the District was formally dissolved and the operation has been then consolidated with the County of Los Angeles.



**Sativa Los Angeles County Water District**  
**Notes to the Financial Statements (Continued)**  
**For the Year Ended June 30, 2018**

**Note 8 – Prior Period Adjustments**

An adjustment was recorded to correct an error made in the prior fiscal year regarding the deferred charges. Deferred charges recorded in the prior year were related to the cost of issuance of the bonded debt. According to U.S. GAAP, cost of issuance should be expensed when incurred.

In addition, due to limited supporting documents (purchase orders, invoices, etc.), and lack of sufficient internal controls in place, the District was unable to substantiate the beginning balance as stated in the District’s 2017 audited financial statements. Therefore, the District adjusted the beginning balances of multiple elements, including but not limited to, cash and investments, accounts receivable, accounts payable, accrued liabilities and compensated absences as of July 1, 2017.

Accordingly, net position as of July 1, 2017 was restated as follows:

Beginning Net Position, as originally reported	\$	1,535,527
Prior Period Adjustments		
Deferred charges		(171,261)
Cash and investments		36,229
Accounts receivable		(1,347)
Accounts payable		49,356
Accrued liabilities		22,863
Compensated absences		9,839
Beginning Net Position, as restated	<u>\$</u>	<u>1,481,206</u>

As of July 1, 2017, unrestricted net position was overstated by \$1,500,000 due to the fact that the amount is restricted for the acquisition and construction of Well #6. Table below summarizes all the reclassifications of net position as of July 1, 2017:

	As Originally Reported	As Restated	Adjustments
Investment in capital assets	\$ 1,371,246	\$ 1,199,985	\$ 171,261
Restricted	-	1,500,000	(1,500,000)
Unrestricted (deficit)	164,281	(1,218,779)	1,383,060
<b>Total net position</b>	<u>\$ 1,535,527</u>	<u>\$ 1,481,206</u>	<u>\$ 54,321</u>

**Note 9 – Subsequent Events**

The District board members were removed effective October 31, 2018 when the State appointed the County of Los Angeles to act as Interim Administrator.

On December 18, 2018, the County of Los Angeles Board of Supervisors approved a loan in the amount of \$1.4 million to Sativa to be used “for the sole purpose of funding expenses related to the administration, operation, and infrastructure repairs of the District”.

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# **Sativa Los Angeles County Water District**

Compton, California

## **Matters of Internal Control**

*For the Year Ended June 30, 2018*





**Sativa Los Angeles County Water District  
Matters on Internal Control  
For the Year Ended June 30, 2018**

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Sativa Los Angeles County Water District  
Compton, California

The Pun Group, LLP was retained through DRP Engineering, Inc. by the County of Los Angeles (the “County”), to perform a financial audit of the financial statements of the Sativa Los Angeles County Water District (the “District”), which comprise the statement of net position as of June 30, 2018, and the related statements of revenues, expenses, and changes in net position, and cash flows for the year then ended, and the related notes to financial statements.

During our planning phase of the audit, we noted that the State of California has removed the District's Board of Directors and appointed the County as Interim Administrator of the District, effective October 31, 2018.

### **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 opinions 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 have not been identified.

**We have identified certain deficiencies in internal control as items 2018-001, 2018-002 and 2018-003 in the accompanying Matters on Internal Control. We consider these items are material weaknesses.**

This communication is intended solely for the information and use of District’s management, the Los Angeles County Board of Supervisors, and others within the District, and is not intended to be, and should not be, used by anyone other than these specified parties.

Santa Ana, California  
September 4, 2019

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**Sativa Los Angeles County Water District**  
**Matters on Internal Control**  
**For the Year Ended June 30, 2018**

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**Findings 2018-001      Lack of Financial Policies and Procedures (Material Weakness)**

The District does not have sufficient policies and procedures to ensure consistency, compliance, and transparency in its financial practices. The Government Finance Officers Association (GFOA) recommends that governments implement specific financial, accounting, reporting, and budgeting policies and procedures, including those intended to facilitate the review, discussion, modification, and adoption of a proposed budget. Because of the lack of policies and procedures over the budget, the District does not have sufficient monitoring and risk assessment control to prevent and detect material misstatement of financial statements.

**Recommendations:**

The District should establish and follow fiscal policies and procedures for budgeting, preparing its financial statements at the end of each fiscal year, and approving expenditures based on the GFOA guidelines and other best practices.

Key Budgeting Policies and Procedures includes:

- **Fees and Charges:** Adopt policies that identify the manner in which fees and charges are set. These policies may address the frequency with which cost-of-services studies will be undertaken.
- **Balancing the Budget:** Develop a policy that defines a balanced budget and provides for disclosure when a deviation occurs.
- **Revenue Diversification:** Adopt a policy that encourages a diversity of revenue sources. A diversity of revenue sources can improve a government's ability to handle fluctuations in revenue.
- **One-Time Revenue:** Adopt a policy limiting the use of one-time revenue for ongoing expenditures. A government should explicitly define one-time revenue and allowable uses for that revenue.
- **Debt Management:** Adopt policies to help ensure that the government issues and manages debt prudently to maintain a sound fiscal position.
- **Budget Review:** Develop a set of procedures that facilitate the review, discussion, modification, and adoption of a proposed budget.
- **Adjusting the Budget:** Have procedures in place to determine when deviations from the budget plan merit adjustments to the budget.
- **Communication:** Institute a process that includes an examination of strengths and weaknesses of the organizational structure and of the communication of goals and directives.

To ensure that the District complies with its purchasing policy, the Administrator should immediately develop and implement procedures for staff to obtain and document the required approval from the Administrator or the Board before committing District resources.

The District should also develop and follow a process to ensure that the District accurately and promptly records all year-end closing entries in its general ledger and issues its financial statements within the period that state law requires.

**Sativa Los Angeles County Water District**  
**Matters on Internal Control (Continued)**  
**For the Year Ended June 30, 2018**

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**Finding 2018-002      Failing to Establish Proper Charges and Fees (Material Weakness)**

The District is a public water agency that serves about 6,800 people in the unincorporated community of Willowbrook and a portion of the City of Compton.

During our audit, we noted that the District is charging its users base on a flat water rate instead of charging its users base on consumption. As a result, the District did not recover costs for the services provided to the users and created significant financial/operating deficits.

**Recommendation:**

The District should consider adopting charges and fees based on consumption. The District should:

1. Consider applicable laws and statutes before implementation of specific fees and charges
2. Adopt a sound policy regarding fee development. The policy should:
  - Identify the factors (affordability, pricing history, inflation, service delivery alternatives, and available efficiencies) to be taken into account when pricing goods and services.
  - State whether the jurisdiction intends to recover the full cost of providing goods and services.
  - Set forth under what circumstances the jurisdiction might set a charge or fee at more or less than 100 percent of full cost. If the full cost of a good or service is not recovered, then an explanation of the government's rationale for this deviation should be provided.
  - Outline the considerations that might influence governmental pricing decisions. Such policy concerns might include the need to regulate demand, the desire to subsidize a certain product, competition with private businesses, economic development, elasticity of demand for the particular service, and visibility of the service to the community.
  - Include the specifics of how the fees and charges will be levied and collected.
3. Calculate the full cost of providing water services in order to provide a basis for setting the charge or fee:
  - Full cost incorporates direct and indirect costs (including operations and maintenance), overhead, and charges for the use of capital facilities. Examples of overhead costs include: payroll processing, accounting services, computer usage, and other central administrative services.
  - One useful tool for calculating service costs is Activity Based Costing (ABC). ABC assigns costs to the activities required to deliver a service and can be more accurate than traditional costing methods.
  - The associated costs of collection need to be addressed.
4. Review and update charges and fees periodically based on factors such as the impact of inflation, other cost increases, adequacy of cost recovery, use of services, and the competitiveness of current rates.
  - Updating fees on a periodic basis may help smooth charges and fees over several years rather than having uneven impacts. Periodic review of the service demand and competition is also recommended to ensure that the appropriate quality and price point of the service continues to meet actual demand. The review should be performed in conjunction with a look at alternatives for cost reduction.
  - Benchmarking individual fees and charges with those charged by comparable or neighboring jurisdictions can guide a governing body when setting rates; it can also differentiate service levels to reveal service or pricing options.

**Sativa Los Angeles County Water District**  
**Matters on Internal Control (Continued)**  
**For the Year Ended June 30, 2018**

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**Finding 2018-002      Failing to Establish Proper Charges and Fees (Material Weakness) (Continued)**

**Recommendation (Continued):**

5. Utilize long-term forecasting to ensure that charges and fees anticipate future costs in providing the service.
  - If the charges will recover costs associated with other long-term plans, such as a multi-year capital plan, a longer-term service fee plan should be consistent, recognizing the plan may be amended to reflect changing conditions in the future.
  
6. Provide information on charges and fees to the public.
  - There should be opportunities for citizen feedback, particularly when new rates are introduced or when existing rates are changed. This includes the government's policy regarding full cost recovery, subsidies, and information about the amounts of charges and fees (current and proposed), both before and after adoption, and the anticipated impact of the new fee on providing the service in future years.

**Sativa Los Angeles County Water District**  
**Matters on Internal Control (Continued)**  
**For the Year Ended June 30, 2018**

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**Finding 2018-003      Internal Control over Financial Reporting (Material Weakness)**

During the course of the audit, we noted material weaknesses in the District’s internal controls over the management of the financial affairs of the District.

The District has not maintained adequate internal control and accounting records for the year ended June 30, 2018. Internal control is defined as a process – effected by the District Board, management, and other personnel – designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- reliability of financial reporting
- effectiveness and efficiency of operations, and
- compliance with applicable laws and regulations.

These would include establishing or enhancing guidance in the following areas:

- **Control environment** sets the tone of an organization, influencing the control consciousness of its people. It is the foundation for all other components of internal control, providing discipline and structure.
- **Risk assessment** is the entity’s identification and analysis of relevant risks to achievement of its objectives, forming a basis for determining how the risks should be managed.
- **Control activities** are the policies and procedures that help ensure that management directives are carried out.
- **Information and communication systems** support the identification, capture, and exchange of information in a form and time frame that enable people to carry out their responsibilities.
- **Monitoring** is a process that assesses the quality of internal control performance over time.

In additional to the findings as noted in 2018-001, *lack of policies and procedures*, we identified numerous internal controls that were not designed properly or implemented which resulted in numerous errors in the financial statement closing process. Pursuant to the Committee of Sponsoring Organizations of Treadway Commission (“COSO”) Internal Control Integrated Framework, management should design appropriate types of control activities for the entity’s internal control system. Control activities help management fulfill responsibilities and address identified risk responses in the internal control system. Control activities include physical control over vulnerable assets, access restrictions to and accountability for resources and records, appropriate documentation of transactions and internal control.

Management is responsible for the preparation of financial statements that are correct in all material matters, including reconciliations, working paper support and the application of appropriate accounting principles. **This was not achieved for the year ended June 30, 2018**, as we noted several account balances that were misstated or were not substantiated by sufficient supporting documentation.

**Because of the significance of the matters described in this finding, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.**

**Sativa Los Angeles County Water District**  
**Matters on Internal Control (Continued)**  
**For the Year Ended June 30, 2018**

**Finding 2018-003      Internal Control over Financial Reporting (Material Weakness) (Continued)**

Deficiencies were noted as follows:

**Financial Reporting**

During our audit, adjustment was recorded to correct an error made in the prior fiscal year regarding the deferred charges. Deferred charges recorded in the prior year was related to the cost of issuance of the bonded debt. According to U.S. GAAP, cost of issuance should be expensed when incurred.

In addition, due to limited supporting documents (purchase orders, invoices, etc.), and lack of sufficient internal controls in place, the District was unable to substantiate the beginning balance as stated in the District's 2017 audited financial statements. Therefore, the District adjusted the beginning balances of multiple elements, including but not limited to, cash and investments, accounts receivable, accounts payable, accrued liabilities and compensated absences as of July 1, 2017.

Accordingly, net position as of July 1, 2017 was restated as follows:

Beginning Net Position, as originally reported	\$	1,535,527
Prior Period Adjustments		
Deferred charges		(171,261)
Cash and investments		36,229
Accounts receivable		(1,347)
Accounts payable		49,356
Accrued liabilities		22,863
Compensated absences		9,839
Beginning Net Position, as restated	<u>\$</u>	<u>1,481,206</u>

In addition, unrestricted net position was overstated by \$1,500,000 as of July 1, 2017. Accordingly, net position as of July 1, 2017 was reclassified as follows:

	As Originally Reported	As Restated	Adjustments
Investment in capital assets	\$ 1,371,246	\$ 1,199,985	\$ 171,261
Restricted	-	1,500,000	(1,500,000)
Unrestricted (deficit)	164,281	(1,218,779)	1,383,060
<b>Total net position</b>	<u>\$ 1,535,527</u>	<u>\$ 1,481,206</u>	<u>\$ 54,321</u>

**Cash and Cash Equivalents**

During our audit, we noted that the District did not account for 668 pre-numbered checks. We were unable to identify whether these checks are issued and outstanding or these checks are missing and unused. As a result, we are unable to confirm the completeness of the transactions for the fiscal year ended June 30, 2018.

**Sativa Los Angeles County Water District**  
**Matters on Internal Control (Continued)**  
**For the Year Ended June 30, 2018**

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**Finding 2018-003      Internal Control over Financial Reporting (Material Weakness) (Continued)**

**Purchasing and Accounts Payable**

The District did not follow the District purchasing policy and also did not have adequate internal control over its contract management. Through inquiries of the Los Angeles County Public Works Department Personnel, the District did not utilize the Purchasing Order System nor follow any procurement procedures in dealing with vendor contracts. Due to the lack of control over purchasing and accounts payable, we are not able to identify and/or quantify the outstanding encumbrances or liabilities as of June 30, 2018.

During our audit, we selected all expenditures that exceeded \$4,000, which is 90 transactions. 36 out of 90 selected cash disbursement transactions totaling \$385,656 were not substantiated by any supporting documents. This is highly unusual and raises serious concern of the District's record keeping practices.

In addition, the District could not identify the purpose of approximately 200 cash disbursement transactions totaling \$84,223. These transactions appear to be non-legitimate expenses of the District and could possibly involve improper and/or unlawful actions.

In addition, there was \$92,941 charged to three credit cards issued to District representatives or employees during the audit period whose purpose was not substantiated by supporting documents. These credit card charges were paid from District operations funds. This is highly unusual and raises serious concern of the District's record keeping practices, and such charges could possibly involve improper and/or unlawful actions.

As a result, we are unable to validate the existence, occurrence, completeness, and the cutoff for the accounts payable as of June 30, 2018.

**Capital Assets**

The District does not have a formal capital assets policy. We noted that the District capitalized an unidentifiable loan cost in the amount of \$51,261 and the 2016 bond issuance cost in the amount of \$120,000 as part of the capital assets. In accordance with GASB Statement No. 65, all bond issuance cost are expensed when incurred. As a result, a prior period adjustment was recorded to correct this misstatement and restated the net position as of July 1, 2017.

**Long-Term Debt**

On June 22, 2017, the District received a loan containing bond-like characteristics issued from City National Bank in the amount of \$1,620,000 to finance the acquisition and construction of Well #6 of the District. During the fiscal year ended June 30, 2018, the District has transferred \$361,338 from the Bond Trust account to the District's main operating account. Based on the account analysis, none of the loan bond proceeds were spent on Well #6 during the audit period. It appears the District may have spent proceeds from the loan proceeds for day-to-day operations. As a result, the District may have violated loan agreement provisions which limit use of the loan proceeds, although it is possible that the lender was aware of and consented to these uses. We have no opinion regarding the legal implications of these facts. Moreover, the District was likely funding its operations in a financially unsustainable manner.

In addition, the District incurred \$53,058 of interest expense and related to its 2017 City National Bank Bond payable.

**Sativa Los Angeles County Water District**  
**Matters on Internal Control (Continued)**  
**For the Year Ended June 30, 2018**

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**Finding 2018-003      Internal Control over Financial Reporting (Material Weakness) (Continued)**

**Recommendation**

The District should consider remedies to strengthen its financial condition. Because the financial statements are the responsibility of the District, it is in their own best interest to closely monitor and assess its financial condition prior to making financial commitments.

**Financial Reporting**

We recommended the District establish a well-structured Finance Department. The District should hire permanent employees with strong governmental accounting backgrounds for the Finance Department and clearly define responsibilities among Finance staff and properly supervise their work.

The District should immediately establish effective monthly and year-end closing procedures to reduce the risk of accounting errors. These procedures would include timely review and approval by management of account reconciliations, sub-ledger transactions, cutoff review for account balances, and revenue and expense review. Revenue and expenses should be compared to the prior year or prior year's budget.

**Cash and Cash Equivalents**

We recommended the District establish internal control for overall check usage, issuance, and record keeping controls. The District should develop, implement, and maintain internal control over the storage and the use of blank check stock

**Purchasing and Accounts Payable**

We recommended the District adopt a formal policy regarding procurement and cash disbursements processes. The District should procure projects with purchase orders to prevent the District from making unauthorized purchases. Furthermore, the District should limit the use of credit cards for emergency purpose only. Credit card purchases should be substantiated by detail itemized receipts and timely reconciled to the credit card statements. These processes will eliminate the risk of making unauthorized purchased.

**Capital Assets**

We recommended the District adopt a capital assets policy. In addition, the District should perform capital asset expenditure analysis on an annual basis to determine whether the capital-related disbursements should be expensed or capitalized in order to fairly present the financial statements. We also recommended the District perform a comprehensive review of historical records of capital assets.

**Long-Term Debt**

We recommended the District adopt a debt policy. This need is recognized by bond rating agencies, and development of a debt policy is a recommended practice by the Government Finance Officers Association. A debt policy establishes the parameters for issuing debt and managing the debt portfolio. It provides guidance to the administration regarding purposes for which debt may be issued, types and amounts of permissible debt and method of sale that may be used.

In addition, we recommend the District assign qualified personnel who are familiar with debt management in order to monitor the compliance of debt covenants.

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Board of Supervisors of Los Angeles County  
Sativa Los Angeles County Water District  
Compton, California

The Pun Group, LLP was retained through DRP Engineering, Inc. by the County of Los Angeles, were engaged to perform an audit of the financial statements of the Sativa Los Angeles County Water District (“District”), which comprise the statement of net position as of June 30, 2018, and the related statements of revenues, expenses, and changes in net position, and cash flows for the year then ended, and the related notes to financial statements.

Professional standards require that we provide you with the following information related to our audit. We would also appreciate the opportunity to meet with you to discuss this information further since a two-way dialogue can provide valuable information for the audit process.

#### **Our Responsibility under U.S. Generally Accepted Auditing Standards**

As stated in our engagement letter dated April 28, 2019, our responsibility, as described by professional standards, is to express opinions about whether the financial statements prepared by management with your oversight are fairly presented, in all material respects, in conformity with U.S. generally accepted accounting principles. Our audit of the financial statements does not relieve you or management of your responsibilities.

#### **Planned Scope, Timing of the Audit, and Other**

An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements; therefore, our audit will involve judgment about the number of transactions to be examined and the areas to be tested.

Our audit will include obtaining an understanding of the entity and its environment, including internal control, sufficient to assess the risks of material misstatement of the financial statements and to design the nature, timing, and extent of further audit procedures. Material misstatements may result from (1) errors, (2) fraudulent financial reporting, (3) misappropriation of assets, or (4) violations of laws or governmental regulations that are attributable to the entity or to acts by management or employees acting on behalf of the entity. We will generally communicate our significant findings at the conclusion of the audit. However, some matters could be communicated sooner, particularly if significant difficulties are encountered during the audit where assistance is needed to overcome the difficulties or if the difficulties may lead to a modified opinion. We will also communicate any internal control related matters that are required to be communicated under professional standards.

Kenneth H. Pun is the engagement partner and is responsible for supervising the engagement and signing the report or authorizing another individual to sign it.

## Significant Audit Matters

### *Qualitative Aspects of Accounting Practices*

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the District are described in Note 1 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during the fiscal year ended June 30, 2018. We noted no transactions entered into by the District during the year for which there is a lack of authoritative guidance or consensus.

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimate affecting the District's financial statements was:

- Management's estimate of the valuation and depreciation on capital assets, including infrastructure, is based on the industry standard and past experience on estimated historical cost, actual useful life of the asset groups or system and subsystem of assets.

Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users. The most sensitive disclosures affecting the financial statements were:

- Note 1 – Summary of Significant Accounting Policies
- Note 4 – Joint Powers Authority
- Note 6 – Contingencies
- Note 7 – Going Concern

The financial statement disclosures are neutral, consistent, and clear.

### *Difficulties Encountered in Performing the Audit*

Effective October 31, 2018, the State of California has removed the District's Board of Directors and appointed County of Los Angeles as Interim Administrator of the District.

We identified numerous internal controls that were not designed properly or implemented which resulted in numerous errors in the financial statement closing process.

Because of the significance of the matters described in the Matters on Internal Control, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

*Corrected and Uncorrected Misstatements*

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are clearly trivial, and communicate them to the appropriate level of management.

Management is responsible for the preparation of financial statements that are correct in all material matters, including reconciliations, working paper support and the application of appropriate accounting principles. **This was not achieved for the year ended June 30, 2018**, as we noted several account balances that were misstated or were not substantiated by sufficient supporting documentation.

*Disagreements with Management*

For purposes of this letter, a disagreement with management is a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

*Management Representations*

We have requested certain representations from management that are included in the management representation letter dated September 4, 2019.

*Management Consultations with Other Independent Accountants*

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to District's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

*Other Audit Findings or Issues*

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the District's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

This information is intended solely for the use of County of Los Angeles and management of the Sativa Los Angeles County Water District and is not intended to be, and should not be, used by anyone other than these specified parties.

Very truly yours,

*The PwC Group, LLP*

Santa Ana, California