



**Palmdale Water District
Annual Financial Report
December 31, 2005 and 2004**



Palmdale Water District
Board of Directors as of December 31, 2005

<u>Name</u>	<u>Title</u>	<u>Elected/ Appointed</u>	<u>Term Expires</u>
Raul Figueroa	President	Elected	12/07
Sheryl Sarna	Vice President	Elected	12/07
Dick Wells	Secretary	Elected	12/09
Gordon Dexter	Asst. Secretary	Elected	12/07
David Gomez	Director	Elected	12/09

Palmdale Water District
Dennis LaMoreaux, General Manager
2029 East Avenue Q
Palmdale, California 93550
(661) 947-4111 – www.palmdalewater.org

Palmdale Water District

Annual Financial Report

For the Years Ended December 31, 2005 and 2004

Palmdale Water District
Annual Financial Report
For the Years Ended December 31, 2005 and 2004

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Financial Section



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Independent Auditor's Report

Board of Directors
Palmdale Water District
Palmdale, California

We have audited the accompanying financial statements of the Palmdale Water District (District) as of and for the year ended December 31, 2005, which collectively comprise the District's basic financial statements as listed in the table of contents. These basic financial statements are the responsibility of the District's management. Our responsibility is to express an opinion on these basic financial statements based on our audit. The comparative financial information as of December 31, 2004, was audited by other auditors whose report dated June 1, 2005, expressed an unqualified opinion on that financial information.

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

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the respective financial position of the Palmdale Water District as of December 31, 2005, and the respective changes in net assets and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated April 20, 2006, on our consideration of the District's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit. This report can be found on page 30.

Management's discussion and analysis on pages 2 through 5 and the Schedule of Funding Progress on page 29 are not required parts of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted primarily of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit this information and express no opinion on it.

April 20, 2006
Cypress, California

Charles Z. Fedak & Company CPAs
An Accountancy Corporation

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Palmdale Water District
Management's Discussion and Analysis
For the Year Ended December 31, 2005

The following Management's Discussion and Analysis (MD&A) of activities and financial performance of the Palmdale Water District (District) provides an introduction to the financial statements of the District for the year ended December 31, 2005. We encourage readers to consider the information presented here in conjunction with the basic financial statements and related notes, which follow this section.

Financial Highlights

- The District's net assets increased 2.9% or \$3,176,867 from \$109,506,383 to \$112,683,250 in 2005.
- The District's operating revenues decreased 1.7% or \$287,601 due to above average rainfall early in the year.
- The District's operating expenses increased 21.8% or \$2,644,283 in 2005 primarily due to overall increases in departmental and operational expenses in the fiscal year.

Required Financial Statements

This annual report consists of a series of financial statements. The Statement of Net Assets, Statement of Revenues, Expenses and Changes in Net Assets and Statement of Cash Flows provide information about the activities and performance of the District using accounting methods similar to those used by private sector companies.

The Statement of Net Assets includes all of the District's investments in resources (assets) and the obligations to creditors (liabilities). It also provides the basis for computing a rate of return, evaluating the capital structure of the District and assessing the liquidity and financial flexibility of the District. All of the current year's revenue and expenses are accounted for in the Statement of Revenues, Expenses and Changes in Net Assets. This statement measures the success of the District's operations over the past year and can be used to determine if the District has successfully recovered all of its costs through its rates and other charges. This statement can also be used to evaluate profitability and credit worthiness. The final required financial statement is the Statement of Cash Flows, which provides information about the District's cash receipts and cash payments during the reporting period. The Statement of Cash Flows reports cash receipts, cash payments and net changes in cash resulting from operations, investing, non-capital financing, and capital and related financing activities and provides answers to such questions as where did cash come from, what was cash used for, and what was the change in cash balance during the reporting period.

Financial Analysis of the District

One of the most important questions asked about the District's finances is, "Is the District better off or worse off as a result of this year's activities?" The Statement of Net Assets and the Statement of Revenues, Expenses and Changes in Net Assets report information about the District in a way that helps answer this question. These statements include all assets and liabilities using the *accrual basis of accounting*, which is similar to the accounting used by most private sector companies. All of the current year's revenues and expenses are taken into account regardless of when the cash is received or paid.

Palmdale Water District
Management's Discussion and Analysis
For the Year Ended December 31, 2005

These two statements report the District's *net assets* and changes in them. You can think of the District's net assets – the difference between assets and liabilities – as one way to measure the District's financial health, or *financial position*. Over time, *increases or decreases* in the District's net assets are one indicator of whether its *financial health* is improving or deteriorating. However, one will need to consider other non-financial factors such as changes in economic conditions, population growth, zoning and new or changed government legislation, such as changes in Federal and State water quality standards.

Notes to the Basic Financial Statements

The notes provide additional information that is essential to a full understanding of the data provided in the basic financial statements. The notes to the basic financial statements can be found on pages 10 through 28.

Statement of Net Assets

Condensed Statements of Net Assets			
	2005	2004	Change
Assets:			
Current assets	\$ 37,051,270	37,553,817	(502,547)
Restricted assets	30,462,937	38,079,363	(7,616,426)
Non-current assets	28,654,665	28,179,008	475,657
Capital assets, net	79,813,447	67,715,294	12,098,153
Total assets	\$ 175,982,319	171,527,482	4,454,837
Liabilities:			
Current liabilities	\$ 8,594,069	6,346,099	2,247,970
Non-current liabilities	54,705,000	55,675,000	(970,000)
Total liabilities	63,299,069	62,021,099	1,277,970
Net assets:			
Net investment in capital assets	25,847,071	12,942,384	12,904,687
Restricted for debt service	30,462,937	38,079,363	(7,616,426)
Unrestricted	56,373,242	58,484,636	(2,111,394)
Total net assets	112,683,250	109,506,383	3,176,867
Total liabilities and net assets	\$ 175,982,319	171,527,482	4,454,837

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. In the case of the District, assets exceeded liabilities by \$112,683,250 as of December 31, 2005.

A portion of the District's net assets (23% as of December 31, 2005) reflects the District's investment in capital assets (net of accumulated depreciation) less any related debt used to acquire those assets that is still outstanding. The District uses these capital assets to provide services to customers within the District's service area; consequently, these assets are *not* available for future spending.

At the end of fiscal year 2005, the District showed a positive balance in its unrestricted net assets of \$56,373,241, which may be utilized in future years.

Palmdale Water District
Management's Discussion and Analysis
For the Year Ended December 31, 2005

Statement of Revenues, Expenses and Changes in Net Assets

Condensed Statements of Revenues, Expenses and Changes in Net Assets

	<u>2005</u>	<u>2004</u>	<u>Change</u>
Revenues:			
Operating revenues	\$ 16,512,663	16,800,264	(287,601)
Non-operating revenues	<u>5,270,957</u>	<u>3,591,724</u>	<u>1,679,233</u>
Total revenues	<u>21,783,620</u>	<u>20,391,988</u>	<u>1,391,632</u>
Expenses:			
Operating expenses	14,789,071	12,144,788	2,644,283
Depreciation and amortization	4,657,515	4,572,821	84,694
Non-operating expenses	<u>3,677,255</u>	<u>2,353,003</u>	<u>1,324,252</u>
Total expenses	<u>23,123,841</u>	<u>19,070,612</u>	<u>4,053,229</u>
Net income before capital contributions	(1,340,221)	1,321,376	(2,661,597)
Capital contributions	<u>4,517,088</u>	<u>3,642,961</u>	<u>874,127</u>
Change in net assets	3,176,867	4,964,337	(1,787,470)
Net assets, beginning of year	<u>109,506,383</u>	<u>104,542,046</u>	<u>4,964,337</u>
Net assets, end of year	<u>\$ 112,683,250</u>	<u>109,506,383</u>	<u>3,176,867</u>

The statement of revenues, expenses and changes of net assets shows how the District's net assets changed during the fiscal years. In the case of the District, net assets increased by \$3,176,867 for the year ended December 31, 2005.

A closer examination of the sources of changes in net assets reveals that:

In 2005, the District's total revenues increased by only \$1,391,632, primarily due to a decrease in water sales and an increase in property tax revenue. In addition, total expenses increased by \$4,053,229, primarily due to overall increases in departmental, operational and depreciation expenses in the fiscal year, as well as an increase in interest expense as a result of the issuance of the 2004 Certificates of Participation in the prior year.

Operating Revenues and Expenses

In 2005, water consumption sales decreased by \$287,601, primarily due to above average rainfall early in the year, which resulted in decreased demand.

Purchased water expenses increased by \$255,751, primarily due to increases in costs for the operation and maintenance expense of the State Water Project.

Palmdale Water District
Management's Discussion and Analysis
For the Year Ended December 31, 2005

Capital Asset Administration

At the end of fiscal year 2005, the District's investment in capital assets amounted to \$79,813,447 (net of accumulated depreciation). This investment in capital assets includes land, land rights, transmission and distribution systems, wells, tanks, reservoirs, pumps, buildings and structures, equipment, vehicles and construction-in-process. There were numerous capital asset additions in the year 2005.

Changes in capital asset amounts for the year were as follows:

	Balance 2004	Additions	Transfers/ Deletions	Balance 2005
Capital assets:				
Non-depreciable assets	10,798,700	16,046,811	-	26,845,511
Depreciable assets	112,441,852	713,743	(284,391)	112,871,204
Accumulated depreciation and amortization	(55,525,258)	(4,657,515)	279,505	(59,903,268)
Total capital assets, net	<u>67,715,294</u>	<u>12,103,039</u>	<u>(4,886)</u>	<u>79,813,447</u>

Debt Administration

In 2005, long-term debt decreased by \$895,000, due to regular principal payments on the District's outstanding debts.

Changes in long-term debt amounts for the year were as follows:

	Balance 2004	Additions	Principal Payments	Balance 2005
Long-term debt:				
1998 Certificates of Participation	18,285,000	-	(615,000)	17,670,000
2004 Certificates of Participation	38,285,000	-	(280,000)	38,005,000
Total long-term debt	<u>56,570,000</u>	<u>-</u>	<u>(895,000)</u>	<u>55,675,000</u>

Conditions Affecting Current Financial Position

In 1992, the State of California found itself in a serious deficit position. To meet its obligations to fund education at specified levels the State enacted legislation that shifted partial financial responsibility for funding education to local government (cities, counties, and special districts). The State did this by instructing county auditors to shift the allocation of local property tax revenues from local government to "educational revenue augmentation funds" (ERAFs), directing that specified amounts of city, county, and other local agency property taxes be deposited into these funds to support schools.

In the year 2004, the annual impact of the ERAF shift is \$5.2 billion from cities, counties, and special districts. The Governor's 2005 budget however, proposes to shift an additional \$1.34 trillion in property tax revenues from cities, counties, special districts and redevelopment agencies to the ERAF accounts in each county to help defer the state's obligation for K-12 education funding. This additional shift has impacted the District by reducing expected property tax revenue by approximately \$670,882 per year in the years 2005 and 2006.

Requests for Information

This financial report is designed to provide the District's funding sources, customers, stakeholders and other interested parties with an overview of the District's financial operations and financial condition. Should the reader have questions regarding the information included in this report or wish to request additional financial information, please contact the District's General Manager at 2029 East Avenue Q, Palmdale, CA 93550 or by phone (661) 947-4111.

Basic Financial Statements

Palmdale Water District
Statement of Net Assets
December 31, 2005
With comparative information at December 31, 2004

<i>Assets</i>	2005	2004
Current assets:		
Cash and cash equivalents (note 2)	\$ 6,445,051	13,132,577
Investments (note 2)	24,772,031	21,060,419
Accrued interest receivable	186,795	159,711
Accounts receivable – water sales and services, net (note 3)	764,941	806,948
Accounts receivable – property taxes	2,899,449	1,730,823
Materials and supplies	1,896,861	583,234
Prepaid expenses and other deposits	86,142	80,105
Total current assets	<u>37,051,270</u>	<u>37,553,817</u>
Restricted assets:		
Cash and cash equivalents (note 2)	<u>30,462,937</u>	<u>38,079,363</u>
Non-current assets:		
Capital assets, net (note 5)	79,813,447	67,715,294
State Water Project entitlement (note 4)	26,946,041	26,381,918
Deferred charges, net (note 6)	<u>1,708,624</u>	<u>1,797,090</u>
Total non-current assets	<u>108,468,112</u>	<u>95,894,302</u>
Total assets	<u><u>175,982,319</u></u>	<u><u>171,527,482</u></u>
<i>Liabilities and Net Assets</i>		
Current liabilities – payable from unrestricted current assets:		
Accounts payable and accrued expenses	2,047,476	1,185,841
Accrued wages and compensated absences	232,293	185,117
Customer deposits	1,608,985	1,429,515
Developer deposits	1,268,561	1,035,779
Interest payable	666,754	714,847
Deferred property tax assessments	1,800,000	900,000
Certificates of participation – current portion (note 7)	<u>970,000</u>	<u>895,000</u>
Total current liabilities	8,594,069	6,346,099
Non-current liabilities:		
Certificates of participation (note 7)	<u>54,705,000</u>	<u>55,675,000</u>
Total liabilities	<u>63,299,069</u>	<u>62,021,099</u>
Net assets:		
Net investment in capital assets (note 8)	25,847,071	12,942,384
Restricted for debt service	30,462,937	38,079,363
Unrestricted (note 9)	<u>56,373,242</u>	<u>58,484,636</u>
Total net assets	<u>112,683,250</u>	<u>109,506,383</u>
Total liabilities and net assets	<u><u>\$ 175,982,319</u></u>	<u><u>171,527,482</u></u>

See accompanying notes to the basic financial statements

Palmdale Water District
Statement of Revenues, Expenses and Changes in Net Assets
For the Year Ended December 31, 2005
With comparative information for the year ended December 31, 2004

	<u>2005</u>	<u>2004</u>
Operating revenues:		
Water sales and service fees	\$ 16,512,663	16,800,264
Operating expenses:		
Administration	3,397,424	2,885,066
Business	1,897,212	1,899,445
Engineering	1,459,313	878,138
Facilities	2,865,584	2,637,310
Operations and production	4,032,506	3,880,023
Purchased water	1,860,970	1,605,219
Total operating expenses	<u>15,513,009</u>	<u>13,785,201</u>
Operating income before overhead absorption	999,654	3,015,063
Overhead absorption	723,938	1,640,413
Operating income before depreciation and amortization	1,723,592	4,655,476
Depreciation expense	<u>(4,657,515)</u>	<u>(4,572,821)</u>
Operating income (loss)	<u>(2,933,923)</u>	<u>82,655</u>
Non-operating revenue(expense)		
Property taxes	3,539,705	2,981,140
Interest and investment earnings	1,560,947	474,654
Rental income	100,011	99,895
Gain/(loss) on sale/disposition of capital assets	23,779	20
State Water Project amortization	(898,201)	(874,956)
Deferred charges amortization	(88,466)	(88,466)
Interest expense – long-term debt	(2,690,588)	(1,389,581)
Other non-operating revenues/(expenses), net	46,515	36,015
Total non-operating revenues, net	<u>1,593,702</u>	<u>1,238,721</u>
Net income before capital contributions	<u>(1,340,221)</u>	<u>1,321,376</u>
Capital contributions:		
Capital improvement fees	4,517,088	3,642,961
Capital contributions	<u>4,517,088</u>	<u>3,642,961</u>
Change in net assets	3,176,867	4,964,337
Net assets, beginning of year	<u>109,506,383</u>	<u>104,542,046</u>
Net assets, end of year	<u>\$ 112,683,250</u>	<u>109,506,383</u>

See accompanying notes to the basic financial statements

Palmdale Water District
Statement of Cash Flows
For the Year Ended December 31, 2005
With comparative information for the year ended December 31, 2004

	2005	2004
Cash flows from operating activities:		
Cash receipts from customers for water sales and services	\$ 16,734,140	16,784,010
Cash paid to vendors and suppliers for materials and services	(10,584,533)	(4,992,474)
Cash paid to employees for salaries and wages	(4,615,391)	(6,653,466)
Net cash provided by operating activities	1,534,216	5,138,070
Cash flows from non-capital financing activities:		
Proceeds from property taxes and assessments	3,271,079	2,662,805
Rental income	100,011	99,895
Other non-operating revenues/(expenses), net	46,515	34,393
Net cash provided by non-capital financing activities	3,417,605	2,797,093
Cash flows from capital and related financing activities:		
Acquisition and construction of capital assets	(16,760,554)	(6,147,822)
Developer contributions received	4,749,870	3,642,961
Proceeds from sales of capital assets	28,665	-
Cash payments for State Water Project capital allocation	(1,439,079)	(1,597,231)
Issuance of long-term debt	-	38,613,767
Bond issuance costs	-	(706,104)
Principal paid on long-term debt	(895,000)	(595,000)
Interest paid on long-term debt	(2,738,681)	1,399,015
Net cash provided(used) in capital and related financing activities	(17,054,779)	34,609,586
Cash flows from investing activities:		
Proceeds from sales and maturities of investments	14,081,394	4,724,180
Purchases of investments	(17,816,251)	(45,854,335)
Interest and investment earnings	1,533,863	474,654
Net cash provided by investing activities	(2,200,994)	(40,655,501)
Net increase in cash and cash equivalents	(14,303,952)	1,889,248
Cash and cash equivalents, beginning of year	51,211,940	49,322,692
Cash and cash equivalents, end of year	\$ 36,907,988	51,211,940
Reconciliation of cash and cash equivalents to statement of financial position:		
Cash and cash equivalents	\$ 6,445,051	13,132,577
Restricted assets – cash and cash equivalents	30,462,937	38,079,363
Total cash and cash equivalents	\$ 36,907,988	51,211,940

Continued on next page

See accompanying notes to the basic financial statements

Palmdale Water District
Statements of Cash Flows, continued
For the Year Ended December 31, 2005
With comparative information for the year ended December 31, 2004

	2005	2004
Reconciliation of operating loss to net cash provided by operating activities:		
Operating loss	\$ (3,832,124)	(778,638)
Adjustments to reconcile operating loss to net cash provided by operating activities:		
Depreciation expense	4,657,515	4,572,821
State Water Project amortization	898,201	874,956
Changes in assets and liabilities:		
(Increase)Decrease in assets:		
Accounts receivable – water sales and services, net	42,007	(26,278)
Materials and supplies inventory	(1,313,627)	(3,235)
Prepaid expenses and other deposits	(6,037)	(252)
Increase(Decrease) in liabilities:		
Accounts payable and accrued expenses	861,635	498,696
Accrued wages and compensated absences	47,176	-
Customer deposits	179,470	-
Total adjustments	5,366,340	5,916,708
Net cash provided by operating activities	\$ 1,534,216	5,138,070

See accompanying notes to the basic financial statements

Palmdale Water District
Notes to the Basic Financial Statements
For the Year Ended December 31, 2005
With comparative information for the year ended December 31, 2004

(1) Reporting Entity and Summary of Significant Accounting Policies

A. Organization and Operations of the Reporting Entity

The Palmdale Water District (District) was formed as an Irrigation District under Division 11 of the California Water Code in 1918. The District provides potable water service to a portion of the City of Palmdale, California, and surrounding unincorporated areas of the County of Los Angeles. The District is operated under the direction of a five-member board of directors. The board members are elected by the public for staggered four-year terms.

The criteria used in determining the scope of the financial reporting entity is based on the provisions of Governmental Accounting Statements No. 14, *The Financial Reporting Entity*, and No. 39, *Determining Whether Certain Organizations Are Component Units* (an amendment of No. 14). The District is the primary governmental unit based on the foundation of a separately elected governing board that is elected by the citizens in a general popular election. Component units are legally separate organizations for which the elected officials of the primary government are financially accountable. The District is financially accountable if it appoints a voting majority of the organization's governing body and: 1) It is able to impose its will on that organization, or 2) There is a potential for the organization to provide specific financial benefits to, or impose specific financial burdens on, the primary government. The District has no blended or discretely-presented component units.

B. Basis of Accounting and Measurement Focus

The District reports its activities as an enterprise fund, which is used to account for operations that are financed and operated in a manner similar to a private business enterprise, where the intent of the District is that the costs of providing water to its customers on a continuing basis be financed or recovered primarily through user charges (water sales and services), capital grants and similar funding. Revenues and expenses are recognized on the full 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, such as water sales and recreational charges, result from exchange transactions associated with the principal activities of the District. Exchange transactions are those in which each party receives and gives up essentially equal values. Non-operating revenues, such as grant funding and investment income, result from non-exchange transactions, in which, the District gives (receives) value without directly receiving (giving) value in exchange.

C. Financial Reporting

The District's basic financial statements are presented in conformance with the provisions of Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments* (GASB No. 34). This statement established revised financial reporting requirements for state and local governments throughout the United States for the purpose of enhancing the understandability and usefulness of financial reports.

GASB No. 34 and its related GASB pronouncements provide for a revised view of financial information and restructure the format of financial information provided prior to its adoption. A statement of net assets replaces the balance sheet and reports assets, liabilities, and the difference between them as net assets, not equity. A statement of revenues, expenses and changes in net assets replaces both the income statement and the statement of changes in retained earnings and contributed capital. GASB No. 34 also requires that the statement of cash flows be prepared using the direct method. Under the direct method, cash flows from operating activities are presented by major categories.

Palmdale Water District
Notes to the Basic Financial Statements, continued
For the Year Ended December 31, 2005
With comparative information for the year ended December 31, 2004

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

C. Financial Reporting, continued

Under GASB No. 34, enterprise funds, such as the District, have the option of consistently following or not following pronouncements issued by the Financial Accounting Standards Board (FASB) subsequent to November 30, 1989. The District has elected not to follow FASB standards issued after that date, unless such standards are specifically adopted by GASB.

D. Implementation of New Governmental Accounting Standards Board Statements

Governmental Accounting Standards Board Statement No. 40

As of January 1, 2005, the District adopted the provisions of Governmental Accounting Standards Board (GASB) Statement No. 40, *Deposit and Investment Risk Disclosures, an amendment of GASB No 3*. This statement modifies the Deposit and Investment Risk Categorization Disclosures and requires additional information on an entity's cash and investment portfolio. Accordingly, certain footnote disclosures have been revised to conform to the provisions of GASB Statement No. 40.

Governmental Accounting Standards Board Statement No. 41

In May 2003, the GASB issued Statement No. 41, *Budgetary Comparison Schedules- Perspective Differences, an amendment of GASB No. 34*. This statement established guidance for governments with significant budgetary perspective differences to report budgetary comparison schedules within the GASB Statement No. 34 reporting model. Accordingly, the District considers the effects of this statement when presenting its financial statements in accordance with the GASB No. 34 financial reporting model.

Governmental Accounting Standards Board Statement No. 42

In November 2003, the GASB issued Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. This statement requires governmental agencies to measure, recognize, and disclose the effects of capital asset impairments in their financial statements when it occurs. Also, this statement clarifies and establishes accounting requirements for insurance recoveries, including those associated with capital asset impairment. Accordingly, the District has analyzed its capital assets that may be impaired or in need of an insurance recovery provision as of December 31, 2005 and determined that none of its assets are impaired or in need of an insurance recovery provision.

E. Assets, Liabilities and Net Assets

1. Use of Estimates

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

2. Cash and Cash Equivalents

Substantially all of the District's cash is invested in interest bearing accounts. The District considers all highly liquid investments with a maturity of three months or less to be cash equivalents.

Palmdale Water District
Notes to the Basic Financial Statements, continued
For the Year Ended December 31, 2005
With comparative information for the year ended December 31, 2004

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

E. Assets, Liabilities and Net Assets, continued

3. Investments and Investment Policy

The District has adopted an investment policy directing management to deposit funds in financial institutions.

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 or sale of investments.

4. Accounts Receivable and Allowance for Uncollectible Accounts

The District extends credit to customers in the normal course of operations. When management deems customer accounts uncollectible, the District uses the allowance method for the reservation and write-off of those accounts.

5. Federal and State Capital and Operating Grants

When a grant agreement is approved and eligible expenditures are incurred, the amount is recorded as a capital or operating grant receivable on the statement of net assets and as capital grant contribution or operating grant revenue, as appropriate, on the statement of revenues, expenses and changes in net assets.

6. Property Taxes and Assessments

The County of Los Angeles Assessor's Office assesses all real and personal property within the County each year. The County of Los Angeles Tax Collector's Office bills and collects the District's share of property taxes and assessments. The County of Los Angeles Treasurer's Office remits current and delinquent property tax collections to the District throughout the year. Property tax in California is levied in accordance with Article 13A of the State Constitution at one percent (1%) of countywide assessed valuations.

Property taxes receivable at year-end are related to property taxes collected by the County of Los Angeles, which have not been credited to the District's cash balance as of June 30. The property tax calendar is as follows:

Lien date	March 1
Levy date	July 1
Due dates	November 1 and March 1
Collection dates	December 10 and April 10

7. Materials and Supplies

Materials and supplies consist primarily of water meters, pipe and pipefittings for construction and repair to the District's water transmission and distribution system. Materials and supplies are valued at cost using a weighted average method. Materials and supplies items are charged to expense at the time that individual items are consumed.

8. Prepaid Expenses

Certain payments to vendors reflects costs or deposits applicable to future accounting periods and are recorded as prepaid items in the basic financial statements.

Palmdale Water District
Notes to the Basic Financial Statements, continued
For the Year Ended December 31, 2005
With comparative information for the year ended December 31, 2004

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

E. Assets, Liabilities and Net Assets, continued

9. Restricted Assets

Certain assets of the District are restricted in use by ordinance or debt covenant and, accordingly are shown as restricted assets on the accompanying statement of net assets. Special assessments, and related receivables, are set aside from other assets since they are collected solely for the repayment of the District's Special Assessment bonds. The District uses restricted resources, prior to using unrestricted resources, to pay expenditures meeting the criteria imposed on the use of restricted resources by a third party.

10. Capital Assets

Capital assets acquired and/or constructed are capitalized at historical cost. District policy has set the capitalization threshold for reporting capital assets at \$5,000. Donated assets are recorded at estimated fair market value at the date of donation. Upon retirement or other disposition of capital assets, the cost and related accumulated depreciation are removed from the respective balances and any gains or losses are recognized. Depreciation is recorded on a straight-line basis over the estimated useful lives of the assets as follows:

Littlerock Dam	50 years
Buildings, wells and distribution system	40 years
Machinery and equipment	3-20 years

11. State Water Project Participation Rights

The District participates in the State Water Project (Project) entitling it to certain water rights. The District's participation in the Project is through cash payments. Monies used for the construction of capital assets, such as pipelines, pumping facilities, storage facilities, etc., are recorded as participation rights and amortized over the life of the agreements. Certain projects also require payments for on-going maintenance; those payments are charged to expenses as incurred.

12. Deferred Charges

The deferred charges are from bond issuance costs that will be amortized using the straight-line method over the remaining life of the respective debt service.

13. Compensated Absences

The District's personnel policies provide for accumulation of vacation and sick leave. Liabilities for vacation and sick leave are recorded when benefits are earned. Cash payment of unused vacation is available to those qualified employees when retired or terminated.

14. Customer Deposits

Based on a customer's credit, the District may require a deposit deemed reasonable by the District. These deposits are held to pay off close out bills or to cover delinquent payments.

Palmdale Water District
Notes to the Basic Financial Statements, continued
For the Year Ended December 31, 2005
With comparative information for the year ended December 31, 2004

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

E. Assets, Liabilities and Net Assets, continued

15. Net Assets

The financial statements utilize a net assets presentation. Net assets are categorized as follows:

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

16. Water Sales

Most water sales are billed on a monthly cyclical basis. Water sales for some agricultural customers are billed monthly. Estimated unbilled water revenue through December 31 has been accrued at year-end.

17. Capital Improvement Fees

Capital improvement fees represent cash and capital asset additions contributed to the District by property owners, granting agencies or real estate developers desiring services that require capital expenditures or capacity commitment.

18. Budgetary Policies

The District adopts an annual non-appropriated budget for planning, control, and evaluation purposes. Budgetary control and evaluation are affected by comparisons of actual revenues and expenses with planned revenues and expenses for the period. Encumbrance accounting is not used to account for commitments related to unperformed contracts for construction and services.

19. Reclassification

The District has reclassified certain prior year information to conform to current year presentations.

Palmdale Water District
Notes to the Basic Financial Statements, continued
For the Year Ended December 31, 2005
With comparative information for the year ended December 31, 2004

(2) Cash and Investments

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

	<u>2005</u>	<u>2004</u>
Cash and cash equivalents	\$ 6,445,050	13,132,577
Restricted cash and cash equivalents	30,462,937	38,079,363
Investments	<u>24,772,031</u>	<u>21,060,419</u>
Total Cash and Investments	<u>\$ 61,680,018</u>	<u>72,272,359</u>

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

	<u>2005</u>	<u>2004</u>
Cash on hand	\$ 4,100	600
Deposits with financial institutions	43,851	1,480,430
Investments	<u>61,632,067</u>	<u>70,791,329</u>
Total cash and investments	<u>\$ 61,680,018</u>	<u>72,272,359</u>

Investments Authorized by the California Government Code and the District's Investment Policy

The table below identifies the investment types that are authorized by the District in accordance with the California Government Code (or the District's investment policy, where more restrictive). The table also identifies certain provisions of the California Government Code (or the District's investment policy, where more restrictive) that address interest rate risk, credit risk, and concentration of credit risk. This table does not address investments of debt proceeds held by bond trustees that are governed by the provisions of debt agreements of the District, rather than the general provisions of the California Government Code or the District's investment policy.

<u>Authorized Investment Type</u>	<u>Maximum Maturity</u>	<u>Maximum Percentage Of Portfolio</u>	<u>Maximum Investment in One Issuer</u>
U.S. Treasury Obligations	5 years	None	None
District Issued Bonds	5 years	None	None
Federal Agency Obligations	5 years	None	None
Negotiable Certificates of Deposit	5 years	30%	None
Money Market Mutual Funds	N/A	None	None
Local Agency Investment Fund (LAIF)	N/A	None	None

Investments Authorized by Debt Agreements

Investment of debt proceeds held by bond trustees are governed by provisions of the debt agreements, rather than the general provisions of the California Government Code or the District's investment policy. The table below identifies the **investment types** that are authorized for investments held by bond trustee. The table also identifies certain provisions of these debt agreements that address **interest rate risk, credit risk, and concentration of credit risk.**

<u>Authorized Investment Type</u>	<u>Maximum Maturity</u>	<u>Maximum Percentage Of Portfolio</u>	<u>Maximum Investment in One Issuer</u>
Investment Contracts	None	None	None
Money Market Mutual Funds	N/A	None	None

Palmdale Water District
Notes to the Basic Financial Statements, continued
For the Year Ended December 31, 2005
With comparative information for the year ended December 31, 2004

(2) Cash and Investments, continued

Custodial Credit Risk

Custodial credit risk for *deposits* is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The 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, a government will not be able to recover the value of its investment or collateral securities that are in the possession of another party. With respect to investments, custodial credit risk generally applies only to direct investments in marketable securities. Custodial credit risk does not apply to a local government's indirect investment in securities through the use of mutual funds or government investment pools (such as LAIF).

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 governmental units by pledging securities in an undivided collateral pool held by a depository regulated under state law (unless so waived by the governmental unit). The market value of the pledged securities in the collateral pool must equal at least 110% of the total amount deposited by the public agencies. 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. The District had deposits with bank balances of \$143,662 and \$1,480,430 as of December 31, 2005 and 2004, respectively. Of the bank balances, up to \$100,000 is federally insured and the remaining balance is collateralized in accordance with the Code; however, the collateralized securities are not held in the District's name.

Investment in State Investment Pool

The District is a voluntary participant in the Local Agency Investment Fund (LAIF) that is regulated by the California Government Code 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.

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 the District manages its exposure to interest rate risk is by purchasing a combination of shorter term and longer term investments and by timing cash flows from maturities so that a portion of the portfolio matures or comes close to maturity evenly over time as necessary to provide requirements for cash flow and liquidity needed for operations. 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 distribution of the District's investments by maturity date:

Palmdale Water District
Notes to the Basic Financial Statements, continued
For the Year Ended December 31, 2005
With comparative information for the year ended December 31, 2004

(2) Cash and Investments, continued

Investments at December 31, 2005:

Investment Type	Total Investment	Remaining Maturity (in Months)			
		12 Months Or Less	13 to 24 Months	25-60 Months	More than 60 Months
U.S. Treasury Obligations	\$ 2,361,011	-	-	2,361,011	-
Federal Agency Obligations	22,411,020	3,304,023	3,255,827	14,940,350	910,820
Money Market Mutual Funds	6,387,173	6,387,173	-	-	-
Local Agency Investment Fund (LAIF)	9,926	9,926	-	-	-
Cash with fiscal agent:					
Money Market Mutual Funds	69,291	69,291	-	-	-
Investment Contracts	30,393,646	30,393,646	-	-	-
Total	\$ 61,632,067	40,164,059	3,255,827	17,301,361	910,820

Investments at December 31, 2004:

Investment Type	Total Investment	Remaining Maturity (in Months)		
		12 Months Or Less	13 to 24 Months	25-60 Months
U.S. Treasury Obligations	\$ 12,880,094	11,461,244	1,008,440	410,410
Federal Agency Obligations	13,657,711	1,190,628	492,190	11,974,893
Money Market Mutual Funds	6,164,488	6,164,488	-	-
Local Agency Investment Fund (LAIF)	9,672	9,672	-	-
Cash with fiscal agent:				
Money Market Mutual Funds	63,926	63,926	-	-
Investment Contracts	38,015,438	38,015,438	-	-
Total	\$ 70,791,329	56,905,396	1,500,630	12,385,303

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) the California Government Code, the District's investment policy, or debt agreements, and the actual rating as of year end for each investment type.

Credit ratings of investments as of December 31, 2005, were as follows:

Investment Types	Total Investment	Minimum Legal Rating	Exempt From Disclosure	Rating as of Year End	
				AAA	Not Rated
U.S. Treasury Obligations	\$ 2,361,011	N/A	\$ 2,361,011	-	-
Federal Agency Obligations	22,411,020	AAA	-	22,411,020	-
Money Market Mutual Funds	6,387,173	N/A	-	-	6,387,173
Local Agency Investment Fund (LAIF)	9,926	N/A	-	-	9,926
Cash with fiscal agent:					
Money Market Mutual Funds	69,291	N/A	-	-	69,291
Investment Contracts	30,393,646	N/A	-	-	30,393,646
Total	\$ 61,632,067		\$ 2,361,011	22,411,020	36,860,036

Credit ratings of investments as of December 31, 2004, were as follows:

Investment Types	Total Investment	Minimum Legal Rating	Exempt From Disclosure	Rating as of Year End	
				AAA	Not Rated
U.S. Treasury Obligations	\$ 12,880,094	N/A	\$ 12,880,094	-	-
Federal Agency Obligations	13,657,711	AAA	-	13,657,711	-
Money Market Mutual Funds	6,164,488	N/A	-	-	6,164,488
Local Agency Investment Fund (LAIF)	9,672	N/A	-	-	9,672
Cash with fiscal agent:					
Money Market Mutual Funds	63,926	N/A	-	-	63,926
Investment Contracts	38,015,438	N/A	-	-	38,015,438
Total	\$ 70,791,329		\$ 12,880,094	13,657,711	44,253,524

Palmdale Water District
Notes to the Basic Financial Statements, continued
For the Year Ended December 31, 2005
With comparative information for the year ended December 31, 2004

(2) Cash and Investments, continued

Concentration of Credit Risk

The investment policy of the District contains no limitations on the amount that can be invested in any one issuer beyond that stipulated by the California Government Code. Investments in any one issuer (other than U.S. Treasury securities, mutual funds, and external investment pools) that represent 5% or more of **total District investments** are as follows:

Issuer	Investment Type	Reported Amount	
		2005	2004
Federal National Mortgage Association	Federal Agency Obligations	\$ 8,063,060	5,475,004
Federal Home Loan Mortgage	Federal Agency Obligations	7,089,337	-
Federal Home Loan Bank	Federal Agency Obligations	6,275,493	5,004,150
U.S. Treasury Notes	U.S. Treasury Obligations	-	5,871,545

(3) Accounts Receivable – Water Sales and Services, Net

The balance at December 31, consists of the following:

	2005	2004
Accounts receivable – water sales and services	\$ 786,227	829,887
Allowance for uncollectible accounts	(21,286)	(22,939)
Accounts receivable – water sales, net	<u>\$ 764,941</u>	<u>806,948</u>

(4) Participation Rights

Participation rights activity for the fiscal year ended December 31, 2005 was as follows:

	Balance 2004	Additions/ Transfers	Deletions/ Transfers	Balance 2005
State Water Project	\$ 35,106,368	1,462,324	-	36,568,692
Accumulated amortization	(8,724,450)	(898,201)	-	(9,622,651)
Participation rights, net	<u>\$ 26,381,918</u>	<u>564,123</u>	<u>-</u>	<u>26,946,041</u>

In 1963, the District contracted with the State of California (State) for 1,620 acre-feet per year of water from the State Water Project (SWP). In subsequent years, the annual entitlement increased to 21,300 acre feet. The SWP conveys water from Northern California to Southern California through a system of reservoirs, canals, pumps stations and power generation facilities. The District is one of many participants contracting with the State of California for a system to provide water throughout California. Under the terms of the State Water Contract, as amended, the District is obligated to pay allocable portions of the cost of construction of the system and ongoing operations and maintenance costs through at least the year 2035, regardless of the quantities of water available from the project. The District and the other contractors may also be responsible to the State for certain obligations by any contractor who defaults on its payments to the State.

Management's present intention is to exercise the District's option to extend the contractual period to at least 2052, under substantially comparable terms. This corresponds to an estimated 80-year service life for the original facilities. The State is obligated to provide specific quantities of water throughout the life of the contract, subject to certain conditions.

Palmdale Water District
Notes to the Basic Financial Statements, continued
For the Year Ended December 31, 2005
With comparative information for the year ended December 31, 2004

(4) Participation Rights, continued

In addition to system on-aqueduct power facilities, the State has, either on its own or through joint venture, financed certain off-aqueduct power facilities (OAPF). The power generated is utilized by the system for water transportation purposes. Power generated in excess of system needs is marketed to various utilities and California's power market. The District is entitled to a proportionate share of the revenues resulting from sales of excess power. The District and the other water contractors are responsible for repaying the capital and operating costs of the OAPF regardless of the amount of power generated.

The District capitalizes its share of system construction costs as participation rights in state water facilities when such costs are billed by the State. Unamortized participation rights essentially represent a prepayment for future water deliveries through the State system. The District's share of system operations and maintenance costs is charged to expense.

The District amortizes a portion of capitalized participation rights each year using a formula that considers the total estimated cost of the project, estimated useful life and estimated production capacity of the assets based upon information provided by the State of California. Amortization expense totaled \$898,201 for the fiscal year ended December 31, 2005.

(5) Capital Assets

Changes in capital assets for the year 2005 were as follows:

	Balance 2004	Additions/ Transfers	Deletions/ Transfers	Balance 2005
Non-depreciable assets:				
Land and land rights	\$ 1,155,928	4,835	-	1,160,763
Construction-in-process	9,642,772	16,041,976	-	25,684,748
Total non-depreciable assets	<u>10,798,700</u>	<u>16,046,811</u>	<u>-</u>	<u>26,845,511</u>
Depreciable assets:				
Buildings, wells and distribution system	107,647,250	-	(50,000)	107,597,250
Machinery and equipment	4,794,602	713,743	(234,391)	5,273,954
Total depreciable assets	<u>112,441,852</u>	<u>713,743</u>	<u>(284,391)</u>	<u>112,871,204</u>
Accumulated depreciation and amortization:				
Buildings, wells and distribution system	(52,480,252)	(4,090,050)	45,114	(56,525,188)
Machinery and equipment	(3,045,006)	(567,465)	234,391	(3,378,080)
Total accum depr. and amort.	<u>(55,525,258)</u>	<u>(4,657,515)</u>	<u>279,505</u>	<u>(59,903,268)</u>
Total depreciable assets, net	<u>56,916,594</u>	<u>(3,943,772)</u>	<u>(4,886)</u>	<u>52,967,936</u>
Total capital assets, net	<u>\$ 67,715,294</u>	<u>12,103,039</u>	<u>(4,886)</u>	<u>79,813,447</u>

In 2005, major capital assets additions during the year includes construction of storage facilities in order to increase the District's storage capacity to meet increased demand.

Palmdale Water District
Notes to the Basic Financial Statements, continued
For the Year Ended December 31, 2005
With comparative information for the year ended December 31, 2004

(5) Capital Assets, continued

Changes in capital assets for the year were as follows:

	<u>Balance 2003</u>	<u>Additions</u>	<u>Deletions/ Transfers</u>	<u>Balance 2004</u>
Non-depreciable assets:				
Land and land rights	1,155,928	-	-	1,155,928
Construction-in-process	6,261,031	5,796,539	(2,414,798)	9,642,772
Total non-depreciable assets	<u>7,416,959</u>	<u>5,796,539</u>	<u>(2,414,798)</u>	<u>10,798,700</u>
Depreciable assets:				
Littlerock Dam	-	-	-	-
Buildings, wells and distribution system	105,232,452	-	2,414,798	107,647,250
Machinery and equipment	4,581,554	351,283	(138,235)	4,794,602
Total depreciable assets	<u>109,814,006</u>	<u>351,283</u>	<u>2,276,563</u>	<u>112,441,852</u>
Accumulated depreciation and amortization:				
Littlerock Dam	(51,087,032)	(4,572,821)	134,595	(55,525,258)
Buildings, wells and distribution system	-	-	-	-
Machinery and equipment	-	-	-	-
Total accum. depr. and amort.	<u>(51,087,032)</u>	<u>(4,572,821)</u>	<u>134,595</u>	<u>(55,525,258)</u>
Total depreciable assets, net	<u>58,726,974</u>	<u>(4,221,538)</u>	<u>2,411,158</u>	<u>56,916,594</u>
Total capital assets, net	<u>66,143,933</u>	<u>1,575,001</u>	<u>(3,640)</u>	<u>67,715,294</u>

Construction-In-Process

The District has been involved in various construction projects throughout the year. The balances of the various construction projects that comprise the construction-in-process balances at December 31 are as follows:

	<u>2003</u>	<u>2004</u>	<u>2005</u>
The balance at December 31, consists of the following projects:			
2800'/2850' Zone Booster Station	\$ 6,992	255,876	3,260,499
3 - 4 M.G. Storage Tanks (2850' Zone)	57,852	128,360	3,072,036
10 M.G.D. Treatment Plant (New Facility)	10,921	522,652	546,786
24" Transmission Main (47th ST E)	63,211	83,080	1,435,543
Existing Treatment Plant (SCADA Retrofit)	557,732	1,105,968	1,211,049
Existing Treatment Plant Improvements - Phase I	-	1,059,101	8,739,267
Replacement Water Main (16th ST E & Q11)	19,539	449,818	626,038
Wind Turbine Project	456,613	2,179,205	1,204,740
Replacement Water Main (8th ST E & Q)	480,318	605,518	605,518
Various other projects	4,607,853	3,253,193	4,983,272
Construction-in-process	<u>\$ 6,261,031</u>	<u>9,642,772</u>	<u>25,684,748</u>

Palmdale Water District
Notes to the Basic Financial Statements, continued
For the Year Ended December 31, 2005
With comparative information for the year ended December 31, 2004

(6) Deferred Charges

The deferred charges balance relates to the bond issuance costs, unamortized discounts and premiums, and refunding costs relating to the District's 1998 and 2004 Certificates of Participation. The balance is being amortized over the lives of the respective debt issuances. The deferred charges net balances are as follows:

The balance at December 31, consists of the following:

	2005	2004
Deferred charges	\$ 2,396,163	2,396,163
Accumulated amortization	(687,539)	(599,073)
Deferred charges, net	\$ 1,708,624	1,797,090

(7) Long-term Debt

Changes in long-term debt amounts for the years were as follows:

	Balance 2004	Additions	Principal Payments	Balance 2005
Long-term debt:				
1998 Certificates of Participation	\$ 18,285,000	-	(615,000)	17,670,000
2004 Certificates of Participation	38,285,000	-	(280,000)	38,005,000
Total long-term debt	\$ 56,570,000	-	(895,000)	55,675,000
			Less: current portion	(970,000)
			Total non-current	54,705,000
	Balance 2003	Additions	Principal Payments	Balance 2004
Long-term debt:				
1998 Certificates of Participation	\$ 18,880,000	-	(595,000)	18,285,000
2004 Certificates of Participation	-	38,285,000	-	38,285,000
Total long-term debt	\$ 18,880,000	38,285,000	(595,000)	56,570,000
			Less: current portion	(895,000)
			Total non-current	55,675,000

Certificates of Participation:

1998 Certificates of Participation

In April 1998, the District issued \$21,925,000 of Refunding Revenue Certificates of Participation, Series 1998 (1998 COPs), with maturities from 1998 through 2023 and an average interest rate of 4.73%. The net proceeds of approximately \$21,150,000 (plus an additional \$2.9 million of District funds) were used to accomplish an advance refunding (an in-substance defeasance) of \$23,210,000 aggregate principal amount of the District's Certificates of Participation (Refunding and Water Facilities and Improvement Project) Series 1991 and Certificates of Participation (Littlerock Dam Project) Series 1993A, with an average interest rate of 5.78%. The initial escrow deposit was used to purchase state and local government securities. These securities were deposited in an irrevocable trust with an escrow agent to provide for all future debt service payments on the Series 1991 and Series 1993A Certificates of Participation.

Palmdale Water District
Notes to the Basic Financial Statements, continued
For the Year Ended December 31, 2005
With comparative information for the year ended December 31, 2004

(7) Long-Term Debt, continued

The advance refunding resulted in a difference between the reacquisition price and the net carrying value amount of the old debt of \$1,160,564. This difference is being amortized through 2023 (the life of the debt) using the straight-line method. The District completed the advance refunding to reduce its total debt service payments over the next 25 years by approximately \$6.5 million and to obtain an economic gain (the difference between the present values of the old and new debt service payments) of approximately \$3.4 million.

The future annual debt service requirements for the 1998 Certificates of Participation are as follows:

<u>Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2006	645,000	861,999	1,506,999
2007	675,000	834,264	1,509,264
2008	705,000	804,732	1,509,732
2009	730,000	773,713	1,503,713
2010	770,000	740,863	1,510,863
2011-2015	4,415,000	3,114,000	7,529,000
2016-2020	5,630,000	1,897,000	7,527,000
2021-2023	4,100,000	416,750	4,516,750
Total	\$ 17,670,000	<u>9,443,321</u>	<u>27,113,321</u>
Less current portion	<u>(645,000)</u>		
Total non-current	\$ <u>17,025,000</u>		

2004 Certificates of Participation

In August 2004, the District issued \$38,285,000 of Revenue Certificates of Participation, Series 2004 (2004 COPs), with maturities from 2005 through 2034 and an average interest rate of 4.90%. The net proceeds are to be used to finance the acquisition, construction and improvement of certain water facilities and to pay issuance costs of the debt. Issuance of the COP's resulted in a premium of \$328,767 which is being amortized over the life of the issue using the straight-line method. Annual debt service requirements for the 2004 Certificates of Participation are as follows:

<u>Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2006	325,000	1,805,017	2,130,017
2007	330,000	1,798,517	2,128,517
2008	335,000	1,791,092	2,126,092
2009	350,000	1,781,042	2,131,042
2010	355,000	1,770,542	2,125,542
2011-2015	1,985,000	8,661,736	10,646,736
2016-2020	2,415,000	8,238,136	10,653,136
2021-2025	6,060,000	7,598,653	13,658,653
2026-2030	12,955,000	5,230,250	18,185,250
2031-2034	12,895,000	1,651,500	14,546,500
Total	\$ 38,005,000	<u>40,326,485</u>	<u>78,331,485</u>
Less current portion	<u>(325,000)</u>		
Total non-current	\$ <u>37,680,000</u>		

Palmdale Water District
Notes to the Basic Financial Statements, continued
For the Year Ended December 31, 2005
With comparative information for the year ended December 31, 2004

(8) Net Investment in Capital Assets

The balance at December 31, consists of the following:

	<u>2005</u>	<u>2004</u>
Capital assets, net	\$ 79,813,447	67,715,294
Deferred charges, net	1,708,624	1,797,090
Certificates of participation – current portion	(970,000)	(895,000)
Certificates of participation – non-current portion	<u>(54,705,000)</u>	<u>(55,675,000)</u>
Net investment in capital assets	<u>\$ 25,847,071</u>	<u>12,942,384</u>

(9) Reservations of Unrestricted Net Assets

For internal purposes, the Board of Directors adopted a reserve policy to reserve unrestricted net assets. The reserves are meant to reflect the intentions of the Board for those net assets not legally restricted. The reserve balances for the years ending December 31, 2005 and 2004 are as follows:

	<u>2005</u>	<u>2004</u>
Rate stabilization	\$ 1,560,000	-
Operations and maintenance reserve – emergencies	3,446,000	-
Operations and maintenance reserve – operations	3,446,000	-
Capital improvements working fund	4,000,000	-
Emergency repair working fund	3,386,000	-
Littlerock Dam self insurance	5,000,000	-
Palmdale Dam self insurance	5,000,000	-
Undesignated net assets	<u>30,535,241</u>	<u>58,484,636</u>
Total unrestricted net assets	<u>\$ 56,373,241</u>	<u>58,484,636</u>

(10) Deferred Compensation Savings Plan

For the benefit of its employees, the District participates in a 457 Deferred Compensation Program (Program). The purpose of this Program is to provide deferred compensation for public employees that elect to participate in the Program. Generally, eligible employees may defer receipt of a portion of their salary until termination, retirement, death or unforeseeable emergency. Until the funds are paid or otherwise made available to the employee, the employee is not obligated to report the deferred salary for income tax purposes.

Federal law requires deferred compensation assets to be held in trust for the exclusive benefit of the participants. Accordingly, the District is in compliance with this legislation. Therefore, these assets are not the legal property of the District, and are not subject to claims of the District's general creditors. Market value of all plan assets held in trust by the Lincoln Financial Group at December 31, 2005 and 2004 was \$1,894,049 and \$1,739,571, respectively.

The District has implemented GASB Statement No. 32, *Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans*. Since the District has little administrative involvement and does not perform the investing function for this plan, the assets and related liabilities are not shown on the statement of net assets.

Palmdale Water District
Notes to the Basic Financial Statements, continued
For the Year Ended December 31, 2005
With comparative information for the year ended December 31, 2004

(11) Defined Benefit Pension Plan

Plan Description

The District contributes to the California Public Employees Retirement System (CalPERS), an agent multiple-employer public employee defined benefit pension plan. CalPERS provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. CalPERS acts as a common investment and administrative agent for participating public agencies within the State of California. Benefit provisions and all other requirements are established by state statute and the District. Copies of CalPERS annual financial report may be obtained from their executive Office: 400 P Street, Sacramento, CA, 95814.

Funding Policy

The contribution rate for participants is 7% of their annual covered salary. The District makes these contributions required of District employees on their behalf and for their account. Also, the District is required to contribute the actuarially determined remaining amounts necessary to fund the benefits for its members. The required employer contribution rates for fiscal years 2005 and 2004 were as follows:

<u>Time Period</u>	<u>2005</u>	<u>2004</u>
Jan. 1 - June 30	5.237%	1.206%
July 1 - Dec. 31	8.982%	5.237%

The contribution requirements of the plan members are established by State statute, and the employer contribution rate is established and may be amended by CalPERS.

Annual Pension Cost

For fiscal year 2005, the District's annual pension cost was \$328,131 for CalPERS and was equal to the District's required and actual contributions. The required contribution was determined as part of the June 30, 2004, actuarial valuation using the entry age normal actuarial cost method. The actuarial assumptions included (a) 7.75% investment rate of return (net of administrative expense), (b) projected annual salary increases that vary by duration of service, and (c) 3.25% per year cost of living adjustments to 14.45% depending on age. Both (a) and (b) included an inflation component of 3.00% and a payroll growth rate of 3.25%. The actuarial value of CalPERS assets was determined using techniques that smooth the effects of short-term volatility in the market value of investment over a three-year period (smoothed market value). Initial unfunded liabilities are amortized over a closed period that depends on the plan's date of entry into CalPERS. Subsequent plan amendments are amortized as a level percentage of pay over a closed 20-year period.

Gains and losses that occur in the operation of the plan are amortized over a rolling period, which results in an amortization of 10% of unamortized gains and losses each year. If the plan's accrued liability exceeds the actuarial value of plan assets, then the amortization payment on the total unfunded liability may not be lower than the payment calculated over a 30 year amortization period.

Trend information gives an indication of the progress made in accumulating sufficient assets to pay benefits when due. The District presents the most recent available three-year Annual Pension Cost (APC) information for the plan, along with required supplementary information as follows:

Three-Year Trend Information for CalPERS

<u>Fiscal Year</u>	<u>Annual Pension Cost (APC)</u>	<u>Percentage of APC Contributed</u>	<u>Net Pension Obligation</u>
2003	\$ -	100%	-
2004	117,478	100%	-
2005	328,131	100%	-

Palmdale Water District
Notes to the Basic Financial Statements, continued
For the Year Ended December 31, 2005
With comparative information for the year ended December 31, 2004

(12) Risk Management

The District is exposed to various risks of loss related to torts, theft of, damage to and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The District is a member of the Association of California Water Agencies/Joint Powers Insurance Authority (ACWA/JPIA), an intergovernmental risk sharing joint powers authority created to provide self-insurance programs for California water agencies. The purpose of the ACWA/JPIA is to arrange and administer programs of self-insured losses and to purchase excess insurance coverage. At June 30, 2005, the District participated in the liability and property programs of the ACWA/JPIA as follows:

- General and auto liability: The District has a zero deductible for general and auto liability. The District purchased additional excess coverage layers: \$40 million for general, auto and public officials liability, which increases the limits on the insurance coverage noted above.

In addition to the above, the District also has the following insurance coverage:

- Employee dishonesty coverage up to \$100,000 per loss includes public employee dishonesty, forgery or alteration and theft, disappearance and destruction coverage's.
- Property loss is paid based on the replacement cost for the property on file. If the property is replaced within two years after the loss or otherwise paid on an actual cash value basis, to a combined total of \$50 million per occurrence it is subject to a \$2,500 deductible per occurrence.
- Boiler and machinery coverage for the replacement cost up to \$50 million per occurrence, subject to various deductibles depending on the type of equipment.
- Public officials' personal liability coverage up to \$100,000 for each occurrence, with an annual aggregate of \$100,000 per each elected/appointed official to which this coverage applies is subject to the terms, with a deductible of \$1,000 per claim.
- Workers' compensation insurance provides coverage up to California statutory limit of \$2 million for all work related injuries/illnesses covered by California law. The District has purchased an additional policy for an additional \$2 million in coverage.

Settled claims have not exceeded any of the coverage amounts in any of the last three fiscal years and there were no reductions in the District's insurance coverage during the years ending December 31, 2005, 2004 and 2003. Liabilities are recorded when it is probable that a loss has been incurred and the amount of the loss can be reasonably estimated net of the respective insurance coverage. Liabilities include an amount for claims that have been incurred but not reported (IBNR). There were no IBNR claims payable as of December 31, 2005 and 2004.

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

The Governmental Accounting Standards Board (GASB) has issued several pronouncements prior to December 31, 2005, that have effective dates that may impact future financial presentations. Management has not currently determined what, if any, impact implementation of the following statements may have on the District's future financial statements.

Governmental Accounting Standards Board Statement No. 43

In April 2004, the GASB issued Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*. This statement establishes accounting and financial reporting standards for plans that provide postemployment benefits other than pension benefits (known as other postemployment benefits or OPEB). This statement is not effective until December 31, 2007. This statement is not expected to have a significant impact on the presentation of the District's financial statements.

Palmdale Water District
Notes to the Basic Financial Statements, continued
For the Year Ended December 31, 2005
With comparative information for the year ended December 31, 2004

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

Governmental Accounting Standards Board Statement No. 44

In May 2004, the GASB issued Statement No. 44, *Economic Condition Reporting: The Statistical Section-an amendment of NCGA Statement No.1*. This statement amends the portions of NCGA Statement 1, *Governmental Accounting and Financial Reporting Principles*, that guide the preparation of the statistical section. The statistical section presents detailed information, typically in ten-year trends, that assists users in utilizing the basic financial statements, notes to basic financial statements, and required supplementary information to assess the economic condition of a government. This statement is not effective until December 31, 2006. This statement is not expected to have a significant impact on the presentation of the District's financial statements.

Governmental Accounting Standards Board Statement No. 45

In June 2004, the GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. This Statement establishes standards for the measurement, recognition, and display of OPEB expense/expenditures and related liabilities (assets), note disclosures, and, if applicable, required supplementary information (RSI) in the financial reports of state and local government employers. This statement is not effective until December 31, 2009. This statement is not expected to have a significant impact on the presentation of the District's financial statements.

Governmental Accounting Standards Board Statement No. 46

In December 2004, GASB issued Statement No. 46, *Net Assets Restricted by Enabling Legislation, an amendment of GASB Statement No. 34*. GASB Statement No. 34 requires that limitations on the use of net assets imposed by enabling legislation be reported as restricted net assets. In the process of applying this provision, some governments have had difficulty interpreting the requirement that those restrictions be "legally enforceable." The confusion over this phrase has resulted in a diversity of practice that has diminished comparability. This statement clarifies that a legally enforceable enabling legislation restriction is one that a party external to a government – such as citizens, public interest groups, or the judiciary – can compel the government to honor. This statement also specifies the accounting and financial reporting requirements if new enabling legislation replaces existing enabling legislation or if legal enforceability is reevaluated. Finally, this statement requires governments to disclose the portion of net assets that are restricted by enabling legislation. This statement is not effective until December 31, 2006. The District has not determined the effect this statement will have on its financial statement.

Governmental Accounting Standards Board Statement No. 47

In June 2005, GASB issued Statement No. 47, *Accounting for Termination Benefits*. This statement establishes accounting standards for *voluntary* and *involuntary* termination benefits. This statement is not effective until December 31, 2006. The District has not determined the effect this statement will have on its financial statement presentation.

(14) Commitments and Contingencies

State Water Contract

Estimates of the District's share of the project fixed costs of the State Water Project (SWP) are provided annually by the State. The estimates are subject to future increases or decreases resulting from changes in planned facilities, refinements in cost estimates and inflation.

Palmdale Water District
Notes to the Basic Financial Statements, continued
For the Year Ended December 31, 2005
With comparative information for the year ended December 31, 2004

(14) Commitments and Contingencies, continued

State Water Contract, continued

During the next five years payments under the State Water Contract, exclusive of variable power costs, are currently estimated by the State to be as follows:

<u>Fiscal Year</u>	<u>Amount</u>
2006	\$ 4,583,123
2007	5,036,609
2008	4,920,209
2009	4,920,103
2010	5,063,471

As of December 31, 2005, the District has expended \$54,943,298 since the District started participating in the State Water Contract.

According to the State's latest estimates, the District's long-term obligations under the contract, for capital and minimum operations and maintenance costs, including interest to the year 2035, are as follows:

	<u>State Water Contract</u> <u>Long-term Obligations</u>
Transportation facilities	\$ 116,555,369
Conservation facilities	15,644,280
Off-aqueduct power facilities	6,981,798
Revenue bond surcharge	5,812,671
Total long-term SWP contract obligations	<u>\$ 144,994,118</u>

The amounts shown above do not contain any escalation for inflation and are subject to significant variation over time because the amounts are based on a number of assumptions and are contingent on future events. Accordingly, none of the estimated long-term obligations are recorded as liabilities in the accompanying basic financial statements.

Bay/Delta Regulatory and Planning Activities. The State Water Resources Control Board (State Board) is the agency responsible for setting water quality standards and administering water rights throughout California. Decisions of the State Board can affect the availability of water to the District and other water users by means of public proceedings leading to regulations and decisions. In 1995, the State Board adopted a Water Quality Control Plan establishing water quality standards and flow improvements in the Bay/Delta watershed.

In August 2000, the California Federal (CALFED) Bay/Delta Program Record of Decision (Decision) was approved with mandates to improve water quality, enhance water supply reliability, augment ecosystem restoration, and assure long-term protection for Delta levees. During its first three years, CALFED has invested more than \$2.0 billion in hundreds of local and regional projects to meet these program goals.

In May 2004, a Delta Improvement Package was proposed to facilitate implementation of the Decision. Funding is expected to be provided by state and federal appropriations and contributions from local users, including the District. CALFED's objective is to allocate project costs based on a beneficiaries pay policy, that is new costs would be commensurate with benefits received. At this time, the exact allocation of costs between the federal, state, and local users has not been determined, and therefore, the District cannot estimate the extent of timing of its contributions at this time.

Palmdale Water District
Notes to the Basic Financial Statements, continued
For the Year Ended December 31, 2005
With comparative information for the year ended December 31, 2004

(14) Commitments and Contingencies, continued

State Water Contract, continued

There are other pending actions that may adversely impact the District's ability to control the sale of water transported through the SWP into its service area. The impact on future revenues of such actions cannot be determined.

Construction Contracts

The District has a variety of agreements with private parties relating to the installation, improvement or modification of water facilities and distribution systems within its service area. The financing of such construction contracts is being provided primarily from the District's replacement reserves and advances for construction. The District has committed to approximately \$10,507,312 in open construction contracts as of December 31, 2005. These include the following:

<u>Project Name</u>	<u>Current Approved Contract(s)</u>	<u>Construction Costs to Date</u>	<u>Internal Costs and Closed Contracts</u>	<u>Balance to Complete</u>
2800'/2850' Zone Booster Station	\$ 2,860,886	3,260,499	(399,613)	-
3 - 4 M.G. Storage Tanks (2850' Zone)	5,427,308	3,072,036	(358,804)	2,714,076
10 M.G.D. Treatment Plant (New Facility)	161,600	546,786	(546,786)	161,600
24" Transmission Main (47th ST E)	1,358,750	1,435,543	(170,326)	93,533
Existing Treatment Plant (SCADA Retrofit)	834,370	1,211,049	(376,679)	-
Existing Treatment Plant Improvements - Phase I	13,916,105	8,739,267	(1,309,488)	6,486,326
Replacement Water Main (16th ST E & Q11)	509,550	626,038	(116,488)	-
Wind Turbine Project	2,147,339	1,204,740	(109,177)	1,051,776
Replacement Water Main (8th ST E & Q)	476,365	605,518	(129,153)	-
Various other projects	-	4,983,272	(4,983,272)	-
Total	<u>\$ 27,692,273</u>	<u>25,684,748</u>	<u>(8,499,787)</u>	<u>10,507,312</u>

Grant Awards

Grant funds received by the District are subject to audit by the grantor agencies. Such audit could lead to requests for reimbursements to the grantor agencies for expenditures disallowed under terms of the grant. Management of the District believes that such disallowances, if any, would not be significant.

Litigation

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

Required Supplementary Information

Palmdale Water District
Schedule of Funding Progress – CalPERS Pension Plan
For the Years Ended December 31, 2005 and 2004

Required Supplementary Information – *Funded Status of the CalPERS Pension Plan Risk Pool*

Actuarial Valuation Date	Entry Age Normal Accrued Liability [A]	Actuarial Value of Assets [B]	Unfunded Liability (Excess Assets) [A-B]	Funded Status [B/A]	Annual Covered Payroll [C]	UAAL/ (Excess Assets) as a % of Payroll [(A-B)/C]
June 30, 2003	2,596,966,545	2,372,879,034	224,087,511	91.4%	725,020,458	30.9%
June 30, 2004	2,746,095,668	2,460,944,656	285,151,012	89.6%	743,691,970	38.3%

The Schedule of Funding Progress above shows the District’s recent history of its CalPERS Pension Plan’s Risk Pool actuarial value of assets, actuarial accrued liability, their relationship, and the relationship of the unfunded actuarial accrued liability to payroll.

Following the creation of risk pools pursuant to Section 20840 of the Government Code, any existing contracting agency with a rate plan of less than 100 active members on any annual actuarial valuation date shall be required to participate in a risk pool. Participation shall be effective as of the valuation date for all members of that rate plan, but no earlier than June 30, 2003. Risk pool valuations will be used to set employer contribution rates for future fiscal years.

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Report on Compliance and Internal Controls



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Independent Auditor's Report on Compliance and on Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

Board of Directors
Palmdale Water District
Palmdale, California

We have audited the financial statements of the Palmdale Water District (District) as of and for the year ended December 31, 2005, and have issued our report thereon dated April 20, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

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

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the District's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the Board of Directors and management and is not intended to be and should not be used by anyone other than these specified parties. This restriction is not intended to limit the distribution of this letter, which is a matter of public record.

April 20, 2006
Cypress, California