# Palmdale Water District

# Annual Financial Report

# December 31, 2010 and 2009



**Palmdale Water District**

**Board of Directors as of December 31, 2010**

| Name | Division | Title | Elected/ Appointed | Term Expires |
|---|---|---|---|---|
| Jeff Storm | 1 | Director | Elected | 12/11 |
| Gordon Dexter | 2 | President | Elected | 12/13 |
| Linda Godin | 3 | Treasurer | Elected | 12/11 |
| Raul Figueroa | 4 | Secretary | Elected | 12/11 |
| Steve Cordova | 5 | Vice President | Elected | 12/13 |

**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, 2010 and 2009

**Palmdale Water District**
**Annual Financial Report**
**For the Years Ended December 31, 2010 and 2009**

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# Financial Section

Charles Z. Fedak & Company
Certified Public Accountants
An Accountancy Corporation

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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 years ended December 31, 2010 and 2009, 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 audits.

We conducted our audits 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 audits provide 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, 2010 and 2009, and the respective changes in net assets and cash flows for the years 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 8, 2011, 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 31.

Management's discussion and analysis on pages 2 through 5 and the other post employment benefits funded status and funding progress of the plan on page 26 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 8, 2011
Cypress, California

Charles Z. Fedak & Co. CPA's
An Accountancy Corporation

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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 years ended December 31, 2010 and 2009. 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

- In 2010, the District's net assets decreased 4.12% or $4,987,250 from $121,123,712 to $116,136,462. In 2009, the District's net assets increased 0.38% or $463,208 from $120,660,504 to $121,123,712.
- The District's 2010 operating revenues increased 2.93% or $615,963 due to an increase in water service revenues, while in 2009 the District's operating revenues increased 19.45% or $3,423,293 due to an increase in rates.
- The District's 2010 non-operating revenues increased 11.51% or $742,054 due primarily to an increase of $977,979 on the gain on the sale of a capital asset, netted against a decrease of $135,806 in property tax revenue. In 2009, non-operating revenues decreased 20.92% or $1,704,524 due to a decrease in investment earnings and from the sale of District property in 2008.
- The District's total expenses increased 15.83% or $4,629,934 due primarily to a $2.28 million increase in operating expenses, a $917,803 decrease in overhead absorption, a $1.34 million increase in depreciation and amortization expense, and a $394,688 increase in non-operating expenses, while in 2009 the District's total expenses decreased $716,920 or 2.39% due primarily to a $1.57 million decrease in operating expenses.

## 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.

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 30.

## Statement of Net Assets

**Condensed Statements of Net Assets**

| | 2010 | 2009 | Change | 2008 | Change |
|---|---|---|---|---|---|
| Assets: | | | | | |
| Current assets | $ 12,881,792 | 15,514,902 | (2,633,110) | 14,055,632 | 1,459,270 |
| Non-current assets | 2,398,807 | 2,326,026 | 72,781 | 7,596,563 | (5,270,537) |
| Capital assets, net | 162,458,761 | 164,783,602 | (2,324,841) | 161,232,309 | 3,551,293 |
| **Total assets** | 177,739,360 | 182,624,530 | (4,885,170) | 182,884,504 | (259,974) |
| Liabilities: | | | | | |
| Current liabilities | 10,051,718 | 10,580,126 | (528,408) | 10,697,121 | (116,995) |
| Non-current liabilities | 51,551,180 | 50,920,692 | 630,488 | 51,526,879 | (606,187) |
| **Total liabilities** | 61,602,898 | 61,500,818 | 102,080 | 62,224,000 | (723,182) |
| Net assets: | | | | | |
| Net investment in capital assets | 112,528,004 | 113,778,417 | (1,250,413) | 109,197,696 | 4,580,721 |
| Restricted for debt service | 1,449,982 | 1,361,890 | 88,092 | 2,625,838 | (1,263,948) |
| Unrestricted | 2,158,476 | 5,983,405 | (3,824,929) | 8,836,970 | (2,853,565) |
| **Total net assets** | 116,136,462 | 121,123,712 | (4,987,250) | 120,660,504 | 463,208 |
| **Total liabilities and net assets** | $ 177,739,360 | 182,624,530 | (4,885,170) | 182,884,504 | (259,974) |

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 $116,136,462 and $121,123,712 as of December 31, 2010 and 2009, respectively.

A portion of the District's net assets, 97% and 94% as of December 31, 2010 and 2009, respectively, 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 years 2010 and 2009, the District showed a positive balance in its unrestricted net assets of $2,158,476 and $5,983,405, respectively, which may be utilized in future years.

## Statement of Revenues, Expenses and Changes in Net Assets

**Condensed Statements of Revenues, Expenses and Changes in Net Assets**

| | 2010 | 2009 | Change | 2008 | Change |
|---|---|---|---|---|---|
| Revenues: | | | | | |
| Operating revenues | $ 21,640,582 | 21,024,619 | 615,963 | 17,601,326 | 3,423,293 |
| Non-operating revenues | 7,187,243 | 6,445,188 | 742,055 | 8,149,712 | (1,704,524) |
| **Total revenues** | 28,827,825 | 27,469,807 | 1,358,018 | 25,751,038 | 1,718,769 |
| Expenses: | | | | | |
| Operating expenses | 23,092,131 | 20,813,544 | 2,278,587 | 22,390,311 | (1,576,767) |
| Overhead absorption | (576,109) | (1,493,912) | 917,803 | (1,209,074) | (284,838) |
| Depreciation expense | 7,010,721 | 5,971,865 | 1,038,856 | 5,008,033 | 963,832 |
| Non-operating expenses | 4,344,299 | 3,949,611 | 394,688 | 3,768,758 | 180,853 |
| **Total expenses** | 33,871,042 | 29,241,108 | 4,629,934 | 29,958,028 | (716,920) |
| **Net loss before capital cont.** | (5,043,217) | (1,771,301) | (3,271,916) | (4,206,990) | 2,435,689 |
| Capital contributions | 55,967 | 2,234,509 | (2,178,542) | 649,845 | 1,584,664 |
| **Change in net assets** | (4,987,250) | 463,208 | (5,450,458) | (3,557,145) | 4,020,353 |
| **Net assets, beginning of year** | 121,123,712 | 120,660,504 | 463,208 | 124,217,649 | (3,557,145) |
| **Net assets, end of year** | $ 116,136,462 | 121,123,712 | (4,987,250) | 120,660,504 | 463,208 |

The statement of revenues, expenses and changes of net assets shows how the District's net assets changed during the years. In the case of the District, net assets decreased by $4,987,251 and increased by $463,208 for the years ended December 31, 2010 and 2009, respectively.

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

The District's 2010 operating revenues increased 2.93% or $615,963 due to an increase in water service revenues, while in 2009 the District's operating revenues increased 19.45% or $3,423,293 due to an increase in rates.

The District's 2010 non-operating revenues increased 11.51% or $742,054 due primarily to an increase of $977,979 on the gain on the sale of a capital asset, netted against a decrease of $135,806 in property tax revenue. In 2009, non-operating revenues decreased 20.92% or $1,704,524 due to a decrease in investment earnings and from the sale of District property in 2008.

The District's total expenses increased 15.83% or $4,629,934 due primarily to a $2.28 million increase in operating expenses, a $917,803 decrease in overhead absorption, a $1.34 million increase in depreciation and amortization expense, and a $394,688 increase in non-operating expenses, while in 2009 the District's total expenses decreased $716,920 or 2.39% due primarily to a $1.57 million decrease in operating expenses.

## Capital Asset Administration

At the end of year 2010, the District's investment in capital assets amounted to $162,458,761 (net of accumulated depreciation and amortization). This investment in capital assets includes land, land rights, transmission and distribution systems, wells, tanks, reservoirs, pumps, buildings and structures, equipment, vehicles, State Water Project entitlement, and construction-in-process. There were numerous capital asset additions in the year 2010 (See Note 6).

Changes in capital asset amounts for 2010 were as follows:

| | Balance 2009 | Additions | Transfers/ Deletions | Balance 2010 |
|---|---|---|---|---|
| Capital assets: | | | | |
| Non-depreciable assets | $ 11,042,477 | 3,084,276 | (1,983,622) | 12,143,131 |
| Depreciable assets | 234,540,652 | 4,949,320 | (102,704) | 239,387,268 |
| Accumulated depreciation and amortization | (80,799,527) | (8,374,815) | 102,704 | (89,071,638) |
| Total capital assets, net | $ 164,783,602 | (341,219) | (1,983,622) | 162,458,761 |

Changes in capital asset amounts for 2009 were as follows:

| | Balance 2008 | Additions | Transfers/ Deletions | Balance 2009 |
|---|---|---|---|---|
| Capital assets: | | | | |
| Non-depreciable assets | $ 78,185,661 | 5,472,198 | (72,615,382) | 11,042,477 |
| Depreciable assets | 157,874,310 | 76,666,342 | - | 234,540,652 |
| Accumulated depreciation and amortization | (74,827,662) | (5,971,865) | - | (80,799,527) |
| Total capital assets, net | $ 161,232,309 | 76,166,675 | (72,615,382) | 164,783,602 |

## Debt Administration

In 2010, long-term debt decreased by $1,074,428, due to regular principal payments and amortization on the District's outstanding debts. In 2009, long-term debt decreased by $1,029,428, due to regular principal payments and amortization on the District's outstanding debts (See Note 8).

Changes in long-term debt amounts for 2010 were as follows:

| | Balance 2009 | Additions/ Deletions | Principal Payments | Balance 2010 |
|---|---|---|---|---|
| Long-term debt: | | | | |
| 1998 COPs | $ 14,068,952 | 61,531 | (770,000) | 13,360,483 |
| 2004 COPs | 36,936,233 | (10,959) | (355,000) | 36,570,274 |
| Total long-term debt | $ 51,005,185 | 50,572 | (1,125,000) | 49,930,757 |

Changes in long-term debt amounts for 2009 were as follows:

| | Balance 2008 | Additions/ Deletions | Principal Payments | Balance 2009 |
|---|---|---|---|---|
| Long-term debt: | | | | |
| 1998 COPs | $ 14,737,421 | 61,531 | (730,000) | 14,068,952 |
| 2004 COPs | 37,297,192 | (10,959) | (350,000) | 36,936,233 |
| Total long-term debt | $ 52,034,613 | 50,572 | (1,080,000) | 51,005,185 |

## 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 Administrative Services Manager at 2029 East Avenue Q, Palmdale, CA 93550 or by phone (661) 947-4111.

# Basic Financial Statements

# Palmdale Water District
## Statements of Net Assets
## December 31, 2010 and 2009

| *Assets* | | 2010 | 2009 |
|---|---|---|---|
| Current assets: | | | |
| Cash and cash equivalents (note 2) | $ | 4,547,765 | 6,356,129 |
| Restricted – cash and cash equivalents (note 2) | | 131,357 | 80,607 |
| Investments – short-term (note 2) | | 1,948,571 | 760,312 |
| Accrued interest receivable | | 25,401 | 17,809 |
| Accounts receivable – water sales and services, net (note 3) | | 1,868,922 | 1,962,930 |
| Accounts receivable – property taxes | | 3,411,921 | 3,929,173 |
| Accounts receivable – state capital grants | | 2,463 | 1,295,634 |
| Accounts receivable – other | | 10,644 | 42,157 |
| Materials and supplies inventory | | 684,870 | 803,894 |
| Prepaid expenses and other deposits | | 249,878 | 266,257 |
| Total current assets | | 12,881,792 | 15,514,902 |
| Non-current assets: | | | |
| Restricted – investments (note 2) | | 1,494,938 | 1,466,500 |
| Note receivable – property taxes from state (note 4) | | 161,817 | 79,580 |
| Deferred charges, net (note 5) | | 742,052 | 779,946 |
| Capital assets – not being depreciated (note 6) | | 12,143,131 | 11,042,477 |
| Capital assets – being depreciated, net (note 6) | | 150,315,630 | 153,741,125 |
| Total non-current assets | | 164,857,568 | 167,109,628 |
| **Total assets** | $ | 177,739,360 | 182,624,530 |
| ***Liabilities and Net Assets*** | | | |
| Current liabilities – payable from unrestricted current assets: | | | |
| Accounts payable and accrued expenses | $ | 1,518,055 | 1,504,812 |
| Customer deposits for water service | | 2,215,256 | 2,100,093 |
| Construction and developer deposits | | 1,743,020 | 1,939,772 |
| Deferred property tax assessments | | 2,500,000 | 3,000,000 |
| Accrued interest payable | | 616,286 | 627,852 |
| Long-term liabilities – due in one year: | | | |
| Compensated absences (note 7) | | 289,101 | 282,597 |
| Certificates of participation (note 8) | | 1,170,000 | 1,125,000 |
| Total current liabilities | | 10,051,718 | 10,580,126 |
| Non-current liabilities: | | | |
| Long-term liabilities – due in more than one year: | | | |
| Compensated absences (note 7) | | 96,367 | 94,199 |
| Other post employment benefits payable (note 14) | | 2,694,056 | 946,308 |
| Certificates of participation (note 8) | | 48,760,757 | 49,880,185 |
| Total non-current liabilities | | 51,551,180 | 50,920,692 |
| **Total liabilities** | | 61,602,898 | 61,500,818 |
| Net assets: | | | |
| Net investment in capital assets (note 9) | | 112,528,004 | 113,778,417 |
| Restricted for debt service (note 10) | | 1,449,982 | 1,361,890 |
| Unrestricted (note 11) | | 2,158,476 | 5,983,405 |
| **Total net assets** | | 116,136,462 | 121,123,712 |
| **Total liabilities and net assets** | $ | 177,739,360 | 182,624,530 |

See accompanying notes to the basic financial statements

# Palmdale Water District
## Statements of Revenues, Expenses and Changes in Net Assets
## For the Years Ended December 31, 2010 and 2009

| | | 2010 | 2009 |
|---|---|---|---|
| Operating revenues: | | | |
| Water sales – commodity charge | $ | 7,841,545 | 10,265,064 |
| Monthly water service charge | | 10,049,688 | 7,931,635 |
| Water quality fees | | 1,567,034 | 1,093,953 |
| Elevation fees | | 801,877 | 543,458 |
| Other water service charges | | 1,380,438 | 1,190,509 |
| Total operating revenues | | 21,640,582 | 21,024,619 |
| Operating expenses: | | | |
| Source of supply – purchased water | | 4,752,425 | 3,484,933 |
| Operations and production | | 3,567,635 | 2,527,780 |
| Facilities | | 5,188,578 | 5,362,757 |
| Engineering | | 1,281,197 | 1,422,431 |
| Water conservation | | 313,260 | 263,376 |
| Administration | | 4,159,831 | 4,149,701 |
| Finance and customer service | | 3,829,205 | 3,602,566 |
| Total operating expenses | | 23,092,131 | 20,813,544 |
| Operating income(loss) before overhead absorption | | (1,451,549) | 211,075 |
| Overhead absorption | | 576,109 | 1,493,912 |
| Operating income(loss) before depreciation expense | | (875,440) | 1,704,987 |
| Depreciation expense | | (7,010,721) | (5,971,865) |
| **Operating loss** | | (7,886,161) | (4,266,878) |
| Non-operating revenue(expense): | | | |
| Property taxes | | 5,855,862 | 5,991,668 |
| Investment earnings | | 88,771 | 48,201 |
| Energy refunds and rebates | | 13,985 | 1,342 |
| Rental income | | 116,979 | 93,010 |
| Legal settlements | | (391,900) | 184,312 |
| Gain/(loss) on sale/disposition of capital assets | | 977,979 | - |
| State Water Project amortization expense | | (1,364,095) | (1,317,226) |
| Deferred charges amortization expense | | (37,894) | (37,894) |
| Interest expense – long-term debt | | (2,550,410) | (2,594,491) |
| Other non-operating revenues/(expenses), net | | 133,667 | 126,655 |
| Total non-operating revenues, net | | 2,842,944 | 2,495,577 |
| **Net loss before capital contributions** | | (5,043,217) | (1,771,301) |
| Capital contributions: | | | |
| Capital contributions | | (92,810) | 892,581 |
| Capital improvement fees | | 148,777 | 37,115 |
| State capital grants | | - | 1,304,813 |
| Total capital contributions | | 55,967 | 2,234,509 |
| **Change in net assets** | | (4,987,250) | 463,208 |
| Net assets, beginning of year | | 121,123,712 | 120,660,504 |
| Net assets, end of year | $ | 116,136,462 | 121,123,712 |

See accompanying notes to the basic financial statements

# Palmdale Water District
## Statements of Cash Flows
## For the Years Ended December 31, 2010 and 2009

| | 2010 | 2009 |
|---|---|---|
| Cash flows from operating activities: | | |
| Cash receipts from customers for water sales and services | $ 21,684,514 | 20,168,920 |
| Cash paid to vendors and suppliers for materials and services | (14,038,685) | (12,937,654) |
| Cash paid to employees for salaries and wages | (6,572,271) | (6,377,001) |
| Net cash provided by operating activities | 1,073,558 | 854,265 |
| Cash flows from non-capital financing activities: | | |
| Proceeds from property taxes and assessments | 5,790,877 | 5,677,001 |
| Energy refunds and rebates | 13,985 | 1,342 |
| Rental income | 116,979 | 93,010 |
| Other non-operating revenues/(expenses), net | 133,667 | 126,655 |
| Net cash provided by non-capital financing activities | 6,055,508 | 5,898,008 |
| Cash flows from capital and related financing activities: | | |
| Acquisition and construction of capital assets | (3,514,159) | (6,150,350) |
| Proceeds from capital contributions | (92,810) | 892,581 |
| Proceeds from capital improvement fees | 148,777 | 37,115 |
| Proceeds from state capital grants | 1,293,171 | 39,179 |
| Proceeds from the sale of capital assets | 977,979 | - |
| Cash payments for State Water Project entitlement capital costs | (2,535,815) | (4,690,034) |
| Principal paid on long-term debt | (1,125,000) | (1,080,000) |
| Interest paid on long-term debt | (2,561,976) | (2,554,756) |
| Net cash used in capital and related financing activities | (7,409,833) | (13,506,265) |
| Cash flows from investing activities: | | |
| Proceeds from sale (purchase) of investments | (1,558,026) | 5,745,283 |
| Interest and investment earnings | 81,179 | 108,387 |
| Net cash provided (used) by investing activities | (1,476,847) | 5,853,670 |
| **Net decrease in cash and cash equivalents** | (1,757,614) | (900,322) |
| Cash and cash equivalents, beginning of year | 6,436,736 | 7,337,058 |
| Cash and cash equivalents, end of year | $ 4,679,122 | 6,436,736 |

| Reconciliation of cash and cash equivalents to statement of financial position: | 2010 | 2009 |
|---|---|---|
| Cash and cash equivalents | $ 4,547,765 | 6,356,129 |
| Restricted – cash and cash equivalents | 131,357 | 80,607 |
| Total cash and cash equivalents | $ 4,679,122 | 6,436,736 |

Continued on next page

See accompanying notes to the basic financial statements

# Palmdale Water District
## Statements of Cash Flows, continued
## For the Years Ended December 31, 2010 and 2009

| | 2010 | 2009 |
|---|---|---|
| Reconciliation of operating loss to net cash provided by operating activities: | | |
| Operating loss | $ (7,886,161) | (4,266,878) |
| Adjustments to reconcile operating loss to net cash provided by operating activities: | | |
| Deprecation expense | 7,010,721 | 5,971,865 |
| Changes in assets and liabilities: | | |
| (Increase)Decrease in assets: | | |
| Accounts receivable – water sales and services, net | 94,008 | (784,364) |
| Accounts receivable – other | 31,513 | 25,432 |
| Materials and supplies inventory | 119,024 | 118,799 |
| Prepaid expenses and other deposits | 16,379 | 52,328 |
| Increase(Decrease) in liabilities: | | |
| Accounts payable and accrued expenses | 13,243 | (621,696) |
| Customer deposits for water service | 115,163 | 98,725 |
| Construction and developer deposits | (196,752) | (195,492) |
| Compensated absences | 8,672 | (16,927) |
| Other post employment benefits payable | 1,747,748 | 472,473 |
| Total adjustments | 8,959,719 | 5,121,143 |
| Net cash provided by operating activities | $ 1,073,558 | 854,265 |

See accompanying notes to the basic financial statements

## (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 service fees, 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.

## (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 (GASB) Statements

***Governmental Accounting Standards Board Statement No. 51***

In June 2008, the GASB issued Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*. This statement requires that all intangible assets not specifically excluded by its scope provisions be classified as capital assets. The District adopted GASB Statement No. 51 in 2010. See Note 6 for further details.

### 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.

#### 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. 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.

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

### E. Assets, Liabilities and Net Assets, continued

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 December 31. 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 |

#### 6. 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.

#### 7. 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.

#### 8. Restricted Assets

Certain assets of the District are restricted for use by ordinance or debt covenant and, accordingly are shown as restricted assets on the accompanying statement of net assets. 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.

#### 9. 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 |

#### 10. State Water Project – Participation Rights

The District participates in the State Water Project (Project) entitling it to certain participation 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 expense as incurred.

#### 11. 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.

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

### E. Assets, Liabilities and Net Assets, continued

#### 12. 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.

#### 13. 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.

#### 14. 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*.

#### 15. Water Sales

Most water sales are billed on a monthly cyclical basis. Estimated unbilled water revenue through year-end has been accrued.

#### 16. 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.

#### 17. 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.

#### 18. Reclassification

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

## (2) Cash and Investments

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

| | | 2010 | 2009 |
|---|---|---|---|
| Cash and cash equivalents | $ | 4,547,765 | 6,356,129 |
| Restricted – cash and cash equivalents | | 131,357 | 80,607 |
| Investments – short-term | | 1,948,571 | 760,312 |
| Restricted – investments | | 1,494,938 | 1,466,500 |
| Total cash and investments | $ | 8,122,631 | 8,663,548 |

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

| | | 2010 | 2009 |
|---|---|---|---|
| Cash on hand | $ | 3,700 | 3,700 |
| Deposits with financial institutions | | 1,979,495 | 1,979,495 |
| Investments | | 6,139,436 | 6,680,353 |
| Total cash and investments | $ | 8,122,631 | 8,663,548 |

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

The following table 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.

| Authorized Investment Type | Maximum Maturity | Maximum Percentage Of Portfolio | Maximum Investment in One Issuer |
|---|---|---|---|
| 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**.

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

## (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. Of the bank balances, up to $250,000 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:

## (2) Cash and Investments, continued

### *Interest Rate Risk, continued*

Investment maturities as of December 31, 2010, were as follows:

| Investment Type | Amount | Remaning Maturity (in Months) 12 Months Or Less | 13 to 24 Months | 25-60 Months | More than 60 Months |
|---|---|---|---|---|---|
| Federal Agency obligations | $ 1,948,571 | - | 527,505 | 1,421,066 | - |
| Money market funds | 2,552,993 | 2,552,993 | - | - | - |
| Local Agency Investment Fund (LAIF) | 11,577 | 11,577 | - | - | - |
| Cash with fiscal agent: | | | | | |
| Investment contracts | 1,626,295 | 131,357 | - | 1,494,938 | - |
| **Total** | $ 6,139,436 | 2,695,927 | 527,505 | 2,916,004 | - |

Investment maturities as of December 31, 2009, were as follows:

| Investment Type | Amount | Remaning Maturity (in Months) 12 Months Or Less | 13 to 24 Months | 25-60 Months | More than 60 Months |
|---|---|---|---|---|---|
| Federal Agency obligations | $ 760,312 | 760,312 | - | - | - |
| Money market funds | 4,361,421 | 4,361,421 | - | - | - |
| Local Agency Investment Fund (LAIF) | 11,513 | 11,513 | - | - | - |
| Cash with fiscal agent: | | | | | |
| Investment contracts | 1,547,107 | 80,607 | - | 1,466,500 | - |
| **Total** | $ 6,680,353 | 5,213,853 | - | 1,466,500 | - |

### *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 as of December 31, 2010, were as follows:

| Investment Type | Amount | Minimum Legal Rating | Exempt From Disclosure | Rating as of year-end AAA | Not Rated |
|---|---|---|---|---|---|
| Federal Agency obligations | $ 1,948,571 | AAA | - | 1,948,571 | - |
| Money market funds | 2,552,993 | N/A | - | - | 2,552,993 |
| Local Agency Investment Fund (LAIF) | 11,577 | N/A | - | - | 11,577 |
| Cash with fiscal agent: | | | | | |
| Investment contracts | 1,626,295 | AAA | - | 1,494,938 | 131,357 |
| **Total** | $ 6,139,436 | | $ - | 3,443,509 | 2,695,927 |

Credit ratings as of December 31, 2009, were as follows:

| Investment Type | Amount | Minimum Legal Rating | Exempt From Disclosure | Rating as of year-end AAA | Not Rated |
|---|---|---|---|---|---|
| Federal Agency obligations | $ 760,312 | AAA | - | 760,312 | - |
| Money market funds | 4,361,421 | N/A | - | - | 4,361,421 |
| Local Agency Investment Fund (LAIF) | 11,513 | N/A | - | - | 11,513 |
| Cash with fiscal agent: | | | | | |
| Investment contracts | 1,547,107 | AAA | - | 1,466,500 | 80,607 |
| **Total** | $ 6,680,353 | | $ - | 2,226,812 | 4,453,541 |

## (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 | Invested Amount 2010 | Invested Amount 2009 |
|---|---|---|---|
| Federal National Mortgage Association | Federal Agency obligations | $ 1,027,920 | 760,312 |
| Federal Home Loan Bank | Federal Agency obligations | 2,415,589 | 1,466,500 |
| **Total** | | $ 3,443,509 | 2,226,812 |

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

The balance at December 31, consists of the following:

| | | 2010 | 2009 |
|---|---|---|---|
| Accounts receivable – water sales and services | $ | 2,255,135 | 2,255,628 |
| Allowance for uncollectible accounts | | (386,213) | (292,698) |
| Accounts receivable – water sales and services, net | $ | 1,868,922 | 1,962,930 |

## (4) Note Receivable – Property Taxes from State

Under the provisions of the State of California Proposition 1A and as part of the 2010 fiscal year State of California budget package passed by the California State Legislature on July 28, 2009, the State of California borrowed 8.0% of the amount of property tax revenue apportioned to cities, counties and special districts. The State of California is required to repay this borrowing plus interest by June 30, 2013. After repayment of this initial borrowing, the California State Legislature may consider only one additional borrowing within a ten-year period. The borrowing by the State of California was recognized as a note receivable in the accompanying financial statements are as follows:

The balance at December 31, consists of the following:

| | | 2010 | 2009 |
|---|---|---|---|
| Property taxes from state | $ | 159,159 | 79,580 |
| Accrued interest | | 2,658 | - |
| Note receivable – property taxes from state | $ | 161,817 | 79,580 |

## (5) Deferred Charges

The deferred charges balance relates to the bond issuance costs for 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:

| | | 2010 | 2009 |
|---|---|---|---|
| 1998 Certificates of participation issuance costs, net | $ | 183,053 | 197,410 |
| 2004 Certificates of participation issuance costs, net | | 558,999 | 582,536 |
| Deferred charges, net | $ | 742,052 | 779,946 |

## (6) Capital Assets

| Changes in capital assets for 2010, were as follows: | | Balance 2009 | Additions/ Transfers | Deletions/ Transfers | Balance 2010 |
|---|---|---|---|---|---|
| Non-depreciable assets: | | | | | |
| Land and land rights | $ | 1,155,763 | - | - | 1,155,763 |
| Construction-in-process | | 9,886,714 | 3,084,276 | (1,983,622) | 10,987,368 |
| Total non-depreciable assets | | 11,042,477 | 3,084,276 | (1,983,622) | 12,143,131 |
| Depreciable assets: | | | | | |
| Buildings, wells and distribution system | | 192,579,050 | 2,176,239 | - | 194,755,289 |
| SWP – participation rights | | 46,943,271 | 2,535,815 | - | 49,479,086 |
| Machinery and equipment | | 9,030,958 | 237,266 | (102,704) | 9,165,520 |
| Total depreciable assets | | 248,553,279 | 4,949,320 | (102,704) | 253,399,895 |
| Accumulated depreciation & amortization: | | | | | |
| Buildings, wells and distribution system | | (75,067,707) | (6,187,794) | - | (81,255,501) |
| SWP – participation rights | | (14,012,627) | (1,364,094) | - | (15,376,721) |
| Machinery and equipment | | (5,731,820) | (822,927) | 102,704 | (6,452,043) |
| Total accumulated depreciation & amortization | | (94,812,154) | (8,374,815) | 102,704 | (103,084,265) |
| Total depreciable assets, net | | 153,741,125 | (3,425,495) | - | 150,315,630 |
| Total capital assets, net | $ | 164,783,602 | (341,219) | (1,983,622) | 162,458,761 |

| Changes in capital assets for 2009, were as follows: | | Balance 2008 | Additions/ Transfers | Deletions/ Transfers | Balance 2009 |
|---|---|---|---|---|---|
| Non-depreciable assets: | | | | | |
| Land and land rights | $ | 1,155,763 | - | - | 1,155,763 |
| Construction-in-process | | 77,029,898 | 6,150,350 | (73,293,534) | 9,886,714 |
| Total non-depreciable assets | | 78,185,661 | 6,150,350 | (73,293,534) | 11,042,477 |
| Depreciable assets: | | | | | |
| Buildings, wells and distribution system | | 119,663,041 | 72,916,009 | - | 192,579,050 |
| SWP – participation rights | | 42,253,237 | 4,690,034 | - | 46,943,271 |
| Machinery and equipment | | 8,653,433 | 377,525 | - | 9,030,958 |
| Total depreciable assets | | 170,569,711 | 77,983,568 | - | 248,553,279 |
| Accumulated depreciation & amortization: | | | | | |
| Buildings, wells and distribution system | | (69,997,986) | (5,069,721) | - | (75,067,707) |
| SWP – participation rights | | (12,695,401) | (1,317,226) | - | (14,012,627) |
| Machinery and equipment | | (4,829,676) | (902,144) | - | (5,731,820) |
| Total accumulated depreciation & amortization | | (87,523,063) | (7,289,091) | - | (94,812,154) |
| Total depreciable assets, net | | 83,046,648 | 70,694,477 | - | 153,741,125 |
| Total capital assets, net | $ | 161,232,309 | 76,844,827 | (73,293,534) | 164,783,602 |

## (6) Capital Assets, continued

### *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:

| The balance at December 31, consists of the following projects: | | 2008 | 2009 | 2010 |
|---|---|---|---|---|
| Water Treatment Plant improvements – Phase I | $ | 15,893,417 | - | - |
| Water Treatment Plant improvements – Phase II | | 42,525,261 | - | - |
| 3 - 4 M.G. Storage tanks | | 6,631,107 | - | - |
| Energy recovery system – Palmdale Lake | | 3,349,082 | - | - |
| Distribution telemetry upgrade | | 1,903,760 | 2,004,270 | 2,171,479 |
| 10 M.G.D. Treatment plant (New Facility) | | 908,827 | 908,827 | 913,674 |
| Replace water main (Lilacview) | | 732,439 | - | - |
| Energy bridge project | | 769,030 | 769,124 | - |
| Sediment removal – Littlerock Dam | | 518,222 | 538,505 | 588,134 |
| NaOCI onsite generators upgrade | | 508,000 | - | - |
| Palmdale ditch enclosure | | 393,864 | 2,642,564 | 2,663,891 |
| Well 24A drill and equipment | | 195,582 | 618,802 | 619,129 |
| Well 29 drill equipment and activation | | 613,240 | 614,085 | - |
| Distribution master plan | | 448,692 | 503,939 | 532,335 |
| Recycled facilities master plan | | 2,598 | 234,984 | 269,654 |
| 30th Street/Avenue Q main replacement | | 23,093 | 46,853 | 815,018 |
| 30th Street/Palm Blvd. main replacement | | 57,059 | 57,711 | 596,184 |
| Barrel Springs Road waterline replacement | | - | 1,276 | 325,105 |
| Well 36 drill and equipment | | 107,744 | 149,602 | 149,602 |
| Well 37 drill and equipment | | 148,634 | 148,634 | 148,634 |
| Well 2 rehabilitation | | - | 39,505 | 147,162 |
| Maintenance yard and building (New Facility) | | 117,961 | 124,197 | 124,197 |
| Q7/Standridge | | - | 11,457 | 115,227 |
| Various other minor projects >$100,000 | | 1,182,286 | 472,379 | 807,943 |
| Construction-in-process | $ | 77,029,898 | 9,886,714 | 10,987,368 |

### *State Water Project – Participation Rights*

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 distributes 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 Department of Water Resources (DWR) 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.

## (6) Capital Assets, continued

***State Water Project – Participation Rights, continued***

In addition to system on-aqueduct power facilities, the State has, either on its own or though joint venture, financed certain off-aqueduct power facilities (OAPF). The power generated is utilized by the system for water transportation and distribution 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 providers 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 the State water facilities when such costs are billed by the DWR. 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 as incurred.

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. GASB Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, requires that all intangible assets not specifically excluded by their scope provisions be classified as capital assets. Accordingly, the participation rights have been included with the District's capital assets as shown in the schedule of changes in capital assets.

## (7) Compensated Absences

Changes in compensated absences for 2010, were as follows:

| | Balance 2009 | Earned | Taken | Balance 2010 | Current Portion | Long-term Portion |
|---|---|---|---|---|---|---|
| $ | 376,796 | 739,274 | (730,602) | 385,468 | 289,101 | 96,367 |

Changes in compensated absences for 2009, were as follows:

| | Balance 2008 | Earned | Taken | Balance 2009 | Current Portion | Long-term Portion |
|---|---|---|---|---|---|---|
| $ | 393,723 | 714,708 | (731,635) | 376,796 | 282,597 | 94,199 |

## (8) Long-term Debt

***Certificates of Participation***

Changes in long-term debt amounts for 2010, were as follows:

| | | Balance 2009 | Additions/ Deletions | Principal Payments | Balance 2010 |
|---|---|---|---|---|---|
| Long-term debt: | | | | | |
| 1998 – Certificates of Participation | $ | 14,915,000 | - | (770,000) | 14,145,000 |
| 1998 – Discount | | (220,253) | 16,019 | - | (204,234) |
| 1998 – Loss on Defeasance | | (625,795) | 45,512 | - | (580,283) |
| 2004 – Certificates of Participation | | 36,665,000 | - | (355,000) | 36,310,000 |
| 2004 – Premium | | 271,233 | (10,959) | - | 260,274 |
| Total long-term debt | $ | 51,005,185 | 50,572 | (1,125,000) | 49,930,757 |
| Less: Current portion | | (1,125,000) | | | (1,170,000) |
| Total Non-current portion | $ | 49,880,185 | | | 48,760,757 |

## (8) Long-term Debt

### *Certificates of Participation, continued*

Changes in long-term debt amounts for 2009, were as follows:

| | | Balance 2008 | Additions/ Deletions | Principal Payments | Balance 2009 |
|---|---|---|---|---|---|
| Long-term debt: | | | | | |
| 1998 – Certificates of Participation | $ | 15,645,000 | - | (730,000) | 14,915,000 |
| 1998 – Discount | | (236,272) | 16,019 | - | (220,253) |
| 1998 – Loss on Defeasance | | (671,307) | 45,512 | - | (625,795) |
| 2004 – Certificates of Participation | | 37,015,000 | - | (350,000) | 36,665,000 |
| 2004 – Premium | | 282,192 | (10,959) | - | 271,233 |
| Total long-term debt | $ | 52,034,613 | 50,572 | (1,080,000) | 51,005,185 |
| Less: Current portion | | (1,080,000) | | | (1,125,000) |
| Total Non-current portion | $ | 50,954,613 | | | 49,880,185 |

### *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.

The advance refunding resulted in a different 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:

| Year | | Principal | Interest | Total |
|---|---|---|---|---|
| 2011 | $ | 800,000 | 705,250 | 1,505,250 |
| 2012 | | 840,000 | 667,250 | 1,507,250 |
| 2013 | | 880,000 | 625,250 | 1,505,250 |
| 2014 | | 925,000 | 581,250 | 1,506,250 |
| 2015 | | 970,000 | 535,000 | 1,505,000 |
| 2016-2020 | | 5,630,000 | 1,897,000 | 7,527,000 |
| 2021-2023 | | 4,100,000 | 416,750 | 4,516,750 |
| Total | $ | 14,145,000 | 5,427,750 | 19,572,750 |
| Less: current | | (800,000) | | |
| Total non-current | $ | 13,345,000 | | |

## (8) Long-Term Debt, continued

***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 2008 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:

| Year | Principal | Interest | Total |
|---|---|---|---|
| 2011 | $ 370,000 | 1,759,892 | 2,129,892 |
| 2012 | 380,000 | 1,746,942 | 2,126,942 |
| 2013 | 395,000 | 1,733,642 | 2,128,642 |
| 2014 | 410,000 | 1,718,830 | 2,128,830 |
| 2015 | 430,000 | 1,702,430 | 2,132,430 |
| 2015-2019 | 2,415,000 | 8,238,136 | 10,653,136 |
| 2020-2024 | 6,060,000 | 7,598,653 | 13,658,653 |
| 2025-2029 | 12,955,000 | 5,230,250 | 18,185,250 |
| 2030-2033 | 12,895,000 | 1,651,500 | 14,546,500 |
| Total | $ 36,310,000 | 31,380,275 | 67,690,275 |
| Less: current | (370,000) | | |
| Total non-current | $ 35,940,000 | | |

## (9) Net Investment in Capital Assets

| The balance at December 31, consists of the following: | 2010 | 2009 |
|---|---|---|
| Capital assets – not being depreciated | $ 12,143,131 | 11,042,477 |
| Capital assets – being depreciated, net | 150,315,630 | 153,741,125 |
| Certificates of participation – current portion | (1,170,000) | (1,125,000) |
| Certificates of participation – non-current portion | (48,760,757) | (49,880,185) |
| Net investment in capital assets | $ 112,528,004 | 113,778,417 |

## (10) Restricted Net Assets

| The balance at December 31, consists of the following: | 2010 | 2009 |
|---|---|---|
| Restricted – cash and cash equivalents | $ 131,357 | 80,607 |
| Restricted – investments | 1,494,938 | 1,466,500 |
| Accrued interest payable – 1998 COPs | (176,313) | (185,217) |
| Net investment in capital assets | $ 1,449,982 | 1,361,890 |

## (11) Reservations of Unrestricted Net Assets

| The balance at December 31, consists of the following: | | 2010 | 2009 |
|---|---|---|---|
| Non-spendable or long-term net assets: | | | |
| Materials and supplies inventory | $ | 684,870 | 803,894 |
| Prepaid expenses and other deposits | | 249,878 | 266,257 |
| Note receivable – property taxes from state | | 161,817 | 79,580 |
| Deferred charges, net | | 742,052 | 779,946 |
| Total prepaid net assets | | 1,838,617 | 1,929,677 |
| Board designated net assets: | | | |
| Operations and maintenance reserve | | - | 2,500,000 |
| Undesignated net assets | | 319,859 | 1,553,728 |
| Total unrestricted net assets | $ | 2,158,476 | 5,983,405 |

## (12) 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, 2010 and 2009 was $2,726,336 and $2,357,381, 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.

## (13) Defined Benefit Pension Plan

### *Plan Description*

The District contributes to the California Public Employees Retirement System (CalPERS), a cost-sharing multiple-employer 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 form their executive Office: 400 P Street, Sacramento, CA, 95814.

## (13) Defined Benefit Pension Plan, continued

***Funding Policy***

The contribution rate for plan members in the CalPERS 2.0% at 55 Risk Pool Retirement Plan 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 years 2010, 2009 and 2008 were as follows:

| Time Period | 2010 | 2009 | 2008 |
|---|---|---|---|
| Jan. 1 - June 30 | 10.392% | 10.287% | 9.817% |
| July 1 - Dec. 31 | 11.004% | 10.392% | 10.287% |

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. For fiscal years 2010, 2009 and 2008, the District's annual contribution was $968,147, $993,114, and $910,938, respectively, for CalPERS and was equal to the District's required and actual contributions for each year.

## (14) Other Post Employment Benefits Payable

During the year ended December 31, 2008, the District implemented GASB Statement No. 45, which changed the accounting and financial reporting used by local government employers for post employment benefits. Previously, the costs of such benefits were generally recognized as expenses of local government employers on a pay-as-you-go basis. The new reporting requirements for these benefit programs as they pertain to the District are set forth below.

***Plan Description – Eligibility***

The District administers its post-employment benefits plan, a single-employer defined benefit plan (Plan). The following requirements must be satisfied in order to be eligible for post employment medical, dental and vision benefits: (1) Attainment of age 55, and 20 years for full-time service, and (2) Retirement from the District (the District must be the last employer prior to retirement).

Membership in the OPEB plan consisted of the following members as of December 31:

| | 2010 | 2009 | 2008 |
|---|---|---|---|
| Active plan members | 90 | 81 | 87 |
| Retirees and beneficiaries receiving benefits | 10 | 8 | 5 |
| Separated plan members entitled to but not yet receiving benefits | - | - | - |
| Total plan membership | 100 | 89 | 92 |

***Plan Description – Benefits***

The District offers post employment medical, dental and vision benefits to retired employees who satisfy the eligibility rules. Spouses and surviving spouses are also eligible to receive benefits. Retirees may enroll in any plan available through the ACWA-JPIA medical, dental and vision programs. The contribution requirements of Plan members and the District are established and may be amended by the Board of Directors.

## (14) Other Post Employment Benefits Payable, continued

### *Funding Policy*

The District is required to contribute the *Annual Required Contribution (ARC) of the Employer*, an amount actuarially determined in accordance with the parameters of GASB Statement No. 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover the normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years. The current ARC rate is 3.22% for 2010 and 8.48% for 2009 of the annual covered payroll.

The District will pay 100% of the cost of the post-employment benefit plan. The District funds the plan on a pay-as-you-go basis and maintains reserves (and records a liability) for the difference between pay-as-you-go and the actuarially determined ARC cost.

### *Annual Cost*

For the years ended June 30, 2010 and 2009, the ARC cost is $1,945,603, and $197,855, or 10.17%, in contributions were made and the ARC cost is $535,321, and $62,848, or 11.74%, in contributions were made, respectively. The net other post-employment payable as of December 31, 2010 and 2009 are $2,694,056 and $946,308, respectively.

| The balance at December 31, consists of the following: | | 2010 | 2009 | 2008 |
|---|---|---|---|---|
| Annual OPEB expense: | | | | |
| Annual required contribution (ARC) | $ | 1,963,042 | 538,690 | 521,734 |
| Interest on net OPEB obligation | | 19,494 | 9,761 | - |
| Adjustment to annual required contribution | | (36,933) | (13,130) | - |
| Total annual OPEB expense | | 1,945,603 | 535,321 | 521,734 |
| Change in net OPEB payable obligation: | | | | |
| Age adjusted contributions made | | (197,855) | (62,848) | (47,899) |
| Total change in net OPEB payable obligation | | 1,747,748 | 472,473 | 473,835 |
| OPEB payable – beginning of year | | 946,308 | 473,835 | - |
| OPEB payable – end of year | $ | 2,694,056 | 946,308 | 473,835 |

The District's annual OPEB cost, the percentage of the annual OPEB cost contributed to the Plan, and the net OPEB obligation for fiscal year 2010 and the two preceding years were as follows:

***Three-Year History of Net OPEB Obligation***

| Fiscal Year Ended | | Annual OPEB Cost | Age Adjusted Contribution | Percentage of Annual OPEB Cost Contributed | | Net OPEB Obligation Payable |
|---|---|---|---|---|---|---|
| 2010 | $ | 1,945,603 | 197,855 | 10.17% | $ | 1,747,748 |
| 2009 | $ | 535,321 | 62,848 | 11.74% | $ | 472,473 |
| 2008 | $ | 521,734 | 47,899 | 9.18% | $ | 473,835 |

## (14) Other Post Employment Benefits Payable, continued

### *Funded Status and Funding Progress of the Plan*

***Required Supplemental Information – Schedule of Funding Progress***

| Actuarial Valuation Date | Actuarial Value of Plan Assets (a) | Actuarial Accrued Liability (b) | Unfunded Actuarial Accrued Liability (UAAL) (b-a) | Funded Ratio (a/b) | Covered Payroll (c) | UAAL as a Percentage of Covered Payroll ((b-a)/c) |
|---|---|---|---|---|---|---|
| 12/31/2010 | $ - | 16,234,820 | 16,234,820 | 0.00% | $ 6,572,271 | 247.02% |
| 12/31/2009 | $ - | 4,497,022 | 4,497,022 | 0.00% | $ 6,337,001 | 70.96% |
| 12/31/2008 | $ - | 4,497,022 | 4,497,022 | 0.00% | $ 6,311,893 | 71.25% |

The most recent valuation (dated December 31, 2010) includes an Actuarial Accrued Liability and Unfunded Actuarial Accrued Liability of $16,234,820. There are no plan assets because the District funds on a pay-as-you-go basis and maintains net assets equal to the remaining net post-employment benefits payable obligation. The covered payroll (annual payroll of active employees covered by the plan) for the years ended December 31, 2010 and 2009, were $6,572,271 and $6,337,001, respectively. The ratio of the unfunded actuarial accrued liability to annual covered payroll is 247.02% and 70.96% as of December 31, 2010 and 2009, respectively.

### *Actuarial Methods and Assumptions*

Actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of events far into the future. Actuarially determined amounts are subject to continual revision as actual results are compared to past expectations and new estimates are made about the future. Calculations are based on the types of benefits provided under the terms of the substantive plan at the time of each valuation and the pattern of sharing of costs between the employer and plan members to that point. Consistent with the long-term perspective of actuarial calculations, actuarial methods and assumptions used include techniques that are designed to reduce short-term volatility in actuarial accrued liabilities for benefits.

The following is a summary of the actuarial assumptions and methods:

| | |
|---|---|
| Valuation date | December 31, 2010 |
| Actuarial cost method | Entry age normal cost method |
| Amortization method | Level percent of payroll amortization |
| Remaining amortization period | 30 Years as of the valuation date |
| Asset valuation method | 15 Year smoothed market |
| Actuarial assumptions: | |
| Investment rate of return | 2.50% – Current LAIF rating (rounded) |
| Projected salary increase | 3.25% |
| Inflation - discount rate | 2.06% |
| Individual salary growth | District annual COLA |

## (15) 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 the appropriate amount of insurance coverage. At December 31, 2009, 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: $60 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, computer fraud coverage's.
- Property loss is paid based on the replacement cost or actual cash value 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 $100 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' liability coverage up to $1 million for each occurrence subject to the terms of the policy.
- Workers' compensation insurance provides coverage with a self-insured retention limit of $2 million for all work related injuries/illnesses covered by California law. The District has purchased an excess insurance policy for an additional $2 million to statutory limits.

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, 2010, 2009 and 2008. 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, 2010 and 2009.

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

The Governmental Accounting Standards Board (GASB) has issued several pronouncements prior to December 31, 2010, that have effective dates that may impact future financial presentations.

***Governmental Accounting Standards Board Statement No. 59***

In June 2010, the GASB issued Statement No. 59, *Financial Instruments Omnibus*. This statement improves existing standards regarding financial reporting and disclosure requirements of certain financial instruments and external investment pools. This statement is not effective for this District until the fiscal year ended December 31, 2010. This statement is not expected to have a significant impact on the presentation of the District's financial statements.

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

***Governmental Accounting Standards Board Statement No. 60***

In November 2010, the GASB issued Statement No.60, *Accounting and Financial Reporting for Service Concession Arrangement*s. This standard address how to account for and report service concession arrangements (SCAs), a type of public-private or public-public partnership that state and local governments are increasingly entering into. This statement is effective for financial statements for periods beginning after December 15, 2011. The impact of the implementation of this Statement to the District's financial statements has not been assessed at this time.

***Governmental Accounting Standards Board Statement No. 61***

In November 2010, the GASB issued Statement No.61, *The Financial Reporting Entity, Omnibus.* This standard is designed to improve financial reporting for governmental entities by amending the requirements of GASB Statement No. 14, *The Financial Reporting Entity,* and GASB Statement No. 34, *Basic Financial Statement and Management's Discussion and Analysis for State and local Governments*. This statement is effective for financial statements for periods beginning after December 15, 2011. The impact of the implementation of this Statement to the District's financial statements has not been assessed at this time.

## (17) 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. 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:

| Fiscal Year | | Amount |
|---|---|---|
| 2010 | $ | 5,473,964 |
| 2011 | | 6,073,518 |
| 2012 | | 5,607,282 |
| 2013 | | 5,337,270 |
| 2014 | | 5,177,060 |

As of December 31, 2010, the District has expended $77,150,315 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:

| Type of Long-Term Obligation | | Amount |
|---|---|---|
| State Water Project Contract: | | |
| Transportation facilities | $ | 95,718,991 |
| Conservation facilities | | 22,325,950 |
| Off-aqueduct power facilities | | 5,010,619 |
| Revenue bond surcharge | | 3,535,050 |
| Total | $ | 126,590,610 |

## (17) Commitments and Contingencies, continued

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 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.

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 $2,566,078 in open construction contracts as of December 31, 2010. These include the following:

| Project Name | | Estimated Costs to Complete |
|---|---|---|
| 10th – 20th Street/Avenue Q main replacement | $ | 625,000 |
| 9th – 12th Street/Avenue Q main replacement | | 500,000 |
| Storage tank recoating | | 360,000 |
| Well 11A Rehabilitation | | 300,000 |
| Avenue Q/32nd Street main replacement | | 229,187 |
| Littlerock Dam sediment removal | | 150,000 |
| Strategic water resources plan | | 125,000 |
| 30th Street/Palm Blvd. main replacement | | 107,807 |
| Various other minor projects | | 169,084 |
| Total | $ | 2,566,078 |

## (17) Commitments and Contingencies, continued

***City of Palmdale v. Palmdale Water District***

On May 13, 2009, the District's Board of Directors adopted a new water rate structure, known as the water budget rate structure. Under this new rate structure, which the California Legislature determined can be an effective tool to eliminate waste and prevent the unreasonable use of water, District customers are provided a monthly allocation of water determined by a mathematical formula which applies various factors. The percentage of usage that exceeds that allocation is placed in tiers, with increasing water rates. This pricing structure is consistent with what many other water agencies have adopted in their efforts to use limited water resources more efficiently.

On May 14, 2009, the City of Palmdale (City) filed a lawsuit, Los Angeles Superior Court Case No. BC413432 (Rate Litigation), to challenge the District's adoption of the new rate structure. The City contended the District violated Article XIIID, Section 6 of the California Constitution both procedurally and substantively.

In addition, the City contended that the new water rate structure results in rates that exceed the reasonable cost of the service the District provides, and that the resulting rates charged to a parcel are not proportional to the cost attributable to providing water service to that parcel.

The City also filed a separate lawsuit under Code of Civil Procedure Section 863, known as a reverse validation action (Los Angeles County Superior Court Case No. BC413907, the "Validation Action"), seeking to invalidate the District's new rate structure and the actions taken by the District and the Palmdale Water District Public Facilities Corporation to approve financing of the Certificates of Participation. The City based the Validation Action on the same alleged constitutional violations on which is based the Rate Litigation.

On March 12, 2010, the court issued its ruling that rejected the City's challenge in the Validation Action and validated the District's new rate structure and the actions taken in noticing, adopting and implementing the structure.

The City has appealed the trial court's ruling in the Validation Action. The Rate Litigation has been stayed while the appeal in the Validation Action is pending because the final judgment in the Validation Action should render the Rate Litigation moot.

In the event the trial court's decision in the Validation Action is reversed on appeal, it is likely the case would be remanded to the trial court for further proceedings to determine the nature of the relief to be granted, which could involve significant monetary obligations. As of the date of this report, the District has not budgeted for this contingency. The District feels it will ultimately prevail in this litigation.

***Other Litigation***

In the ordinary course of operations, the District is subject to claims and litigation from outside parties. Nevertheless, after consultation with legal counsel, the District believes that these actions, when finally concluded and determined are not likely to have a material adverse effect on the District's financial position, results of operations, or cash flows.

# Report on Internal Controls and Compliance

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

Board of Directors
Palmdale Water District
Palmdale, California

We have audited the basic financial statements of the Palmdale Water District (District) as of and for the years ended December 31, 2010 and 2009, and have issued our report thereon dated April 8, 2011. 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.

***Internal Control Over Financial Reporting***

In planning and performing our audits, we considered the District's internal control over financial reporting as a basis for designing our auditing procedures 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 over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the District's internal control over financial reporting.

A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the District's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the District's financial statements that is more than inconsequential will not be prevented or detected by the District's internal control. A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the District's internal control. Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

***Compliance and Other Matters***

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*.

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.

April 8, 2011
Cypress, California

Charles Z. Fedak & Co. CPA's
An Accountancy Corporation