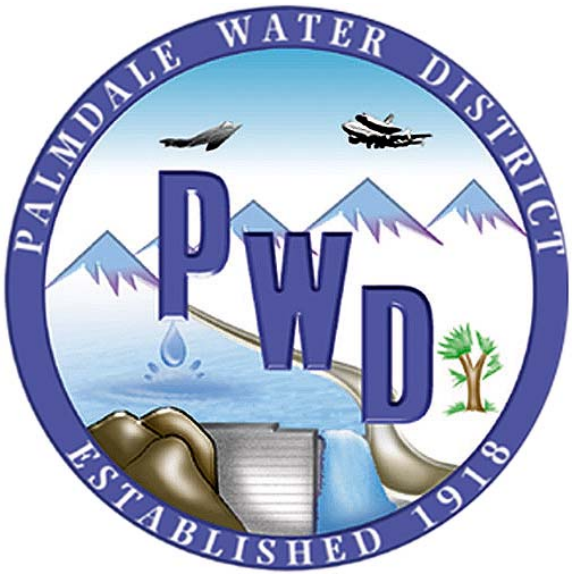


Palmdale Water District

Annual Financial Report

December 31, 2011 and 2010

Palmdale Water District
Board of Directors as of December 31, 2011

Director Name	Division	Title	Elected/ Appointed	Term Expires
Robert Alvarado	1	Secretary	Elected	12/15
Gordon Dexter	2	President	Elected	12/13
Gloria Dizmang	3	Vice President	Elected	12/15
Kathy Mac Laren	4	Treasurer	Elected	12/15
Steve Cordova	5	Director	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, 2011 and 2010

Palmdale Water District
Annual Financial Report
For the Years Ended December 31, 2011 and 2010

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Financial Section

LSL
CERTIFIED PUBLIC ACCOUNTANTS

- Brandon W. Burrows, CPA
- David E. Hale, CPA, CFP
  A Professional Corporation
- Donald G. Slater, CPA
- Richard K. Kikuchi, CPA
- Susan F. Matz, CPA
- Shelly K. Jackley, CPA
- Bryan S. Gruber, CPA
- Deborah A. Harper, CPA

INDEPENDENT AUDITORS' REPORTS

Board of Directors
Palmdale Water District
Palmdale, California

We have audited the accompanying financial statements of the Palmdale Water District (the "District") as of and for the years ended December 31, 2011, as listed in the table of contents. These financial statements are the responsibility of the District's management. Our responsibility is to express opinions on these financial statements based on our audit. The financial statements of the District as of December 31, 2010 were audited by other auditors whose report dated April 8, 2011, expressed an unqualified opinion on those statements.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the District as of December 31, 2011, and the respective changes in financial position, and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated May 8, 2012, on our consideration of the District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and 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 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 considered in assessing the results of our audit.

Board of Directors
Palmdale Water District
Palmdale, California

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

Lance, Soll & Lunghard, LLP

Brea, California
May 8, 2012

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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, 2011 and 2010. 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 2011, the District's net assets decreased 1.86% or $2,151,269 from $115,884,972 to $113,733,703. In 2010, the District's net assets decreased 4.12% or $4,987,250 from $121,123,712 to $116,136,462.

- The District's 2011 operating revenues increased 0.09% or $19,862 due to an increase in miscellaneous related water service fees, while in 2010 the District's operating revenues increased 2.93% or $615,963 due to an increase in water service revenues.

- The District's 2011 non-operating revenues (excluding capital contributions) decreased 8.08% or $(549,169) due primarily to no sale of capital assets and a decrease of $(293,797) in property tax revenue. In 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.

- The District's total expenses decreased 11.3% or $2,611,252 due primarily to a $2.83 million decrease in purchased water charges for the year, while in 2010 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.

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 25 through 47.

Statement of Net Assets

Condensed Statement of Net Assets

	2011	2010	Change	2009	Change
Assets:					
Current assets	$ 14,472,020	12,750,435	1,721,585	15,514,902	(2,764,467)
Non-current assets	2,530,409	2,530,165	244	2,326,026	204,139
Capital assets, net	158,808,157	162,207,271	(3,399,114)	164,783,602	(2,576,331)
Total assets	175,810,586	177,487,871	(1,677,285)	182,624,530	(5,136,659)
Liabilities:					
Current liabilities	10,022,294	10,051,718	(29,424)	10,580,126	(528,408)
Non-current liabilities	52,054,589	51,551,180	503,409	50,920,692	630,488
Total liabilities	62,076,883	61,602,898	473,985	61,500,818	102,080
Net assets:					
Net investments in capital assets	109,996,828	112,276,514	(2,279,686)	113,778,417	(1,501,903)
Restricted for debt service	1,494,919	1,449,982	44,938	1,361,890	88,092
Unrestricted	2,241,956	2,158,476	83,480	5,983,405	(3,824,929)
Total net assets	113,733,703	115,884,972	(2,151,268)	121,123,712	(5,238,740)
Total liabilities and net assets	$ 175,810,586	177,487,870	(1,677,283)	182,624,530	(5,136,660)

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 $113,733,703 and $115,884,972 as of December 31, 2011 and 2010, respectively.

A portion of the District's net assets, 98% and 96% as of December 31, 2011 and 2010, 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 2011 and 2010, the District showed a positive balance in its unrestricted net assets of $2,241,956 and $2,158,476, respectively, which may be utilized in future years.

Statement of Revenues, Expenses and Changes in Net Assets

Condensed Statement of Revenues, Expenses and Changes in Net Assets

	2011	2010	Change	2009	Change
Revenues:					
Operating revenues	21,660,444	21,640,582	19,862	21,024,619	615,963
Non-operating revenues	5,992,973	7,187,244	(1,194,271)	6,445,188	742,056
Total revenues	27,653,417	28,827,826	(1,174,409)	27,469,807	1,358,019
Expenses:					
Operating expenses	20,480,879	23,092,131	(2,611,252)	20,813,544	2,278,587
Overhead absorption	(476,966)	(576,109)	99,143	(1,493,912)	917,803
Depreciation expense	7,285,492	7,010,721	274,771	5,971,865	1,038,856
Non-operating expenses	3,817,000	4,344,299	(527,299)	3,949,611	394,688
Total expenses	31,106,405	33,871,042	(2,764,637)	29,241,108	4,629,934
Net loss before capital cont.	(3,452,988)	(5,043,216)	(3,939,045)	(1,771,301)	(3,271,915)
Capital contributions	1,225,519	55,967	1,169,551	2,234,509	(2,178,542)
Change in net assets	(2,227,469)	(4,987,249)	(2,769,494)	463,208	(5,450,457)
Net assets, beginning of year	115,884,973	121,123,712	(1,599,942)	120,660,504	463,208
Restatements	-	(251,490)	(4,369,436)	-	(251,490)
Net assets, beginning of year as restated	115,884,973	120,872,222	(5,969,378)	120,660,504	211,718
Net assets, end of year	113,657,504	115,884,973	(4,369,436)	121,123,712	(4,987,249)

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 $4,217,034 and decreased by $4,987,251 for the years ended December 31, 2011 and 2010, respectively.

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

The District's 2011 operating revenues increased 0.09% or $19,862 due to an increase in miscellaneous related water service fees, while in 2010 operating revenues increased 2.93% or $615,963 due to an increase in water service revenues.

The District's 2011 non-operating revenues (excluding capital contributions) decreased 8.08% or $(549,169) due primarily to no sale of capital assets and a decrease of $(293,797) in property tax revenue. In 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.

The District's total expenses decreased 11.3% or $2,764,637 due primarily to a $2.83 million decrease in purchased water charges for the year, while in 2010 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.

Capital Asset Administration

At the end of year 2011, the District's investment in capital assets amounted to $158,808,157 (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 2011 (See Note 6).

Changes in capital asset amounts for 2011 were as follows:

	Balance 2010	Additions	Deletions	Transfers	Balance 2011
Capital assets:					
Non-depreciable assets	$ 12,143,131	2,921,582	(140,559)	(8,598,695)	6,325,459
Depreciable assets	251,039,059	2,558,480	-	8,598,695	262,196,234
Accumulated depreciation and amortization	(100,974,919)	(8,738,617)	-	-	(109,713,536)
Total capital assets, net	$ 162,207,271	(3,258,555)	(140,559)	-	158,808,157

Changes in capital asset amounts for 2010 were as follows:

	Balance 2009	Adjustments	Additions	Deletions	Transfers	Balance 2010
Capital assets:						
Non-depreciable assets	$ 11,042,477	-	3,084,276	-	(1,983,622)	12,143,131
Depreciable assets	248,553,279	(2,360,836)	2,965,698	(102,704)	1,983,622	251,039,059
Accumulated depreciation and amortization	(94,812,154)	2,109,346	(8,374,815)	102,704	-	(100,974,919)
Total capital assets, net	$ 164,783,602	(251,490)	(2,324,841)	-	-	162,207,271

Debt Administration

In 2011, long-term debt decreased by $1,119,428, due to regular principal payments and amortization on the District's outstanding debts. In 2010, long-term debt decreased by $1,074,428, due to regular principal payments and amortization on the District's outstanding debts (See Note 8).

Changes in long-term debt amounts for 2011 were as follows:

	Balance 2010	Additions/ Deletions	Principal Payments	Balance 2011
Long-term debt:				
1998 COPs	$ 13,360,483	61,531	(800,000)	12,622,014
2004 COPs	36,570,274	(10,959)	(370,000)	36,189,315
Total long-term debt	$ 49,930,757	50,572	(1,170,000)	48,811,329

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

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

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Basic Financial Statements

Palmdale Water District
Statements of Net Assets
December 31, 2011 and 2010

Assets	2011	2010
Current assets		
Cash and cash equivalents (note 2)	$ 5,263,244	$ 4,547,765
Investments (note 2)	2,538,275	1,948,571
Accounts receivable -		
Water sales and services, net (note 3)	1,760,767	1,868,922
Property taxes	3,835,848	3,411,921
Interest	30,945	25,401
Other	10,296	13,107
Prepaid expenses	319,901	249,878
Materials and supplies	712,744	684,870
Total current assets	14,472,020	12,750,435
Non-current assets		
Restricted - investments (note 2)	1,661,732	1,626,295
Note receivable - property taxes from state (note 4)	164,519	161,817
Deferred charges, net (note 5)	704,158	742,052
Capital assets - not being depreciated (note 6)	6,325,459	12,143,131
Capital assets - being depreciated, net (note 6)	152,482,698	150,064,140
Total non-current assets	161,338,566	164,737,435
Total assets	$ 175,810,586	$ 177,487,870
Liabilities and Net Assets		
Current liabilities		
Accounts payable and accrued expenses	$ 1,289,084	$ 1,518,055
Customer deposits for water service	2,394,026	2,215,256
Construction and developer deposits	1,702,807	1,743,020
Deferred property tax assessments	2,500,000	2,500,000
Accrued interest payable	603,548	616,286
Long-term liabilities - current:		
Compensated absences (note 7)	312,829	289,101
Certificates of participation (note 8)	1,220,000	1,170,000
Total current liabilities	10,022,294	10,051,718
Non-current liabilities		
Long-term liabilities - non-current:		
Compensated absences (note 7)	104,276	96,367
Other post employment benefits payable (note 15)	4,358,984	2,694,056
Certificates of participation (note 8)	47,591,329	48,760,757
Total non-current liabilities	52,054,589	51,551,180
Total liabilities	62,076,883	61,602,898
Net assets		
Net investment in capital assets (note 9)	109,996,828	112,276,514
Restricted for debt service (note 10)	1,494,919	1,449,982
Unrestricted (note 11)	2,241,956	2,158,476
Total net assets	113,733,703	115,884,972
Total liabilities and net assets	$ 175,810,586	$ 177,487,870

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, 2011 and 2010

	2011	2010
Operating revenues:		
Water sales - commodity charge	$ 7,828,995	$ 7,841,545
Monthly water service charge	10,331,401	10,049,688
Water quality fees	1,544,001	1,567,034
Elevation fees	514,356	801,877
Other water service charges	1,441,691	1,380,438
Total operating revenues	21,660,444	21,640,582
Operating expenses:		
Purchased water	1,921,397	4,752,425
Operations and Production	5,141,790	3,567,635
Facilities	3,686,533	5,188,578
Engineering	1,366,272	1,281,197
Water conservation	368,826	313,260
Administration	4,608,946	4,159,831
Finance and customer service	3,387,115	3,829,205
Total operating expenses	20,480,879	23,092,131
Operating income(loss) before overhead absorption	1,179,565	(1,451,549)
Overhead absorption	476,966	576,109
Operating income(loss) before depreciation expense	1,656,531	(875,440)
Depreciation	(7,285,492)	(7,010,721)
Operating income/(loss)	(5,628,961)	(7,886,161)
Non-operating revenue (expense):		
Property taxes	5,562,065	5,855,862
Investment earnings	78,519	88,771
Rental income	123,406	116,979
Legal settlements	177,000	(391,900)
Gain/(loss) on sale/disposition of capital assets	-	977,979
State Water Project amortization expense	(1,453,125)	(1,364,095)
Interest expense - long-term debt	(2,502,981)	(2,550,410)
Deferred charges amortization expense	(37,894)	(37,894)
Other, net	228,982	147,652
Total non-operating revenues, net	2,175,973	2,842,944
Net loss before capital contributions	(3,452,988)	(5,043,217)
Capital Contributions:		
Capital contributions	-	(92,810)
Capital improvement fees	1,225,519	148,777
State capital grants	76,200	-
Total capital contributions	1,301,719	55,967
Change in net assets	(2,151,269)	(4,987,250)
Net assets, beginning of year	115,884,972	121,123,712
Restatements	-	(251,490)
Net assets, beginning of year as restated	115,884,972	120,872,222
Net assets, end of year	$ 113,733,703	$ 115,884,972

See accompanying notes to the basic financial statements

Palmdale Water District
Statements of Cash Flows
For the Years Ended December 31, 2011 and 2010

	2011	2010
Cash flows from operating activities:		
Cash received from customers	$ 21,768,599	$ 21,684,514
Cash payments to employees for services	(6,577,418)	(6,572,271)
Cash payments for services and goods	(12,347,303)	(14,038,685)
Net cash provided by operating activities	2,843,878	1,073,558
Cash flows from non capital financing activities:		
Property tax revenue	4,826,073	5,790,877
Other non-operating revenues (expense)	605,589	264,631
Cash provided by non-capital financing activities	5,431,662	6,055,508
Cash flows from capital and related financing activities:		
Cash paid for construction and acquisition of capital assets and state water project	(5,339,503)	(6,049,974)
Proceeds on sale of capital assets	-	977,979
Proceeds from capital contributions	1,225,519	55,967
Proceeds from state capital grants	-	1,293,171
Principal paid on long-term debt	(1,170,000)	(1,125,000)
Interest paid on long-term debt	(2,465,142)	(2,561,976)
Net cash used by capital and related financing activities	(7,749,126)	(7,409,833)
Cash flows from investing activities:		
Proceeds from and sale (purchase) of investments	116,090	(1,689,383)
Interest and investment earnings	72,975	81,179
Net cash provided (used) by investing activities	189,065	(1,608,204)
Net decrease in cash and cash equivalents	715,479	(1,888,971)
Cash and cash equivalents, beginning of the year	4,547,765	6,436,736
Cash and cash equivalents, end of the year	$ 5,263,244	$ 4,547,765
Reconciliation of cash and cash equilvalents to statement of financial position:		
Cash and cash equivalents	$ 5,263,244	$ 4,547,765
Total cash and cash equilvalents	$ 5,263,244	$ 4,547,765

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, 2011 and 2010

	2011	2010
Reconciliation of operating loss to net cash provided by operating activities:		
Operating loss	$ (5,628,961)	$ (7,886,161)
Adjustments to reconcile operating loss to net cash provided by operating activities:		
Depreciation Expense	7,285,492	7,010,721
Changes in assets and liabilities:		
(Increase)Decrease in assets:		
Accounts receivable - Water sales and services, net	108,155	94,008
Accounts receivable - Other	(429,362)	31,513
Prepaid expenses	(70,023)	16,379
Materials and supplies	(27,874)	119,024
Increase(Decrease) in liabilities		
Accounts payable and accrued expenses	(228,971)	13,243
Customer deposits for water service	179,070	115,163
Construction and developer deposits	(40,213)	(196,752)
Compensated absences	31,637	8,672
Other post employment benefits payable	1,664,928	1,747,748
Total adjustments	8,472,839	8,959,719
Net cash provided by operating activities	$ 2,843,878	$ 1,073,558

See accompanying notes to the basic financial statements

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.

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.

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

The District did not adopt any new GASB Statement pronouncements in 2011. See Note 17 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.

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

E. Assets, Liabilities and Net Assets, continued

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.

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.

E. Assets, Liabilities and Net Assets, continued

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:

	2011	2010
Cash and cash equivalents	$ 5,263,244	$ 4,547,765
Investments - short-term	2,538,275	1,948,571
Restricted - investments	1,661,732	1,626,295
Total cash and investments	$ 9,463,250	$ 8,122,631

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

	2011	2010
Cash on hand	$ 3,700	$ 3,700
Deposits with financial institutions	5,247,913	3,979,957
Investments	4,211,637	4,138,974
Total cash and investments	$ 9,463,250	$ 8,122,631

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	Percentage Of Portfolio	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, federally insured is unlimited for non-interest bearing accounts through December 31, 2012 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, 2011, were as follows:

Investment Type		Total Investment	Remaining Maturity (in Months) 12 Months Or Less	13 to 24 Months	25 to 60 Months	More than 60 Months
Federal Agency Obligations	$	2,425,116	506,250	-	1,918,866	-
Money Market Mutual Funds		113,159	113,159	-	-	-
Local Agency Investment Fund (LAIF)		11,630	11,630	-	-	-
Cash with fiscal agent:						
Investment Contracts		1,661,732	182,107	1,479,625	-	-
Total	$	4,211,637	813,146	1,479,625	1,918,866	-

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

Investment Type		Total Investment	Remaining Maturity (in Months) 12 Months Or Less	13 to 24 Months	25 to 60 Months	More than 60 Months
Federal Agency Obligations	$	1,948,571	-	527,505	1,421,066	-
Money Market Mutual Funds		552,531	552,531	-	-	-
Local Agency Investment Fund (LAIF)		11,577	11,577	-	-	-
Cash with fiscal agent:						
Investment Contracts		1,626,295	131,357	-	1,494,938	-
Total	$	4,138,974	695,465	527,505	2,916,004	-

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, 2011, were as follows:

Investment Type		Total Investment	Minimum Legal Rating	Exempt From Disclosure	Rating as of Year End AAA	Not Rated
Federal Agency Obligations	$	2,425,116	AAA	-	2,425,116	-
Money Market Mutual Funds		113,159	N/A	-	-	113,159
Local Agency Investment Fund (LAIF)		11,630	N/A	-	-	11,630
Cash with fiscal agent:						
Investment Contracts		1,661,732	AAA	-	1,479,625	182,107
Total	$	4,211,637		-	3,904,741	306,896

Credit ratings as of December 31, 2010, were as follows:

Investment Type		Total Investment	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 Mutual Funds		552,531	N/A	-	-	552,531
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	$	4,138,974		-	3,443,509	695,465

(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 2011	Invested Amount 2010
Federal National Mortgage Association	Federal Agency Obligation	$ 1,522,060	$ 1,027,920
Federal Home Loan Bank	Federal Agency Obligation	2,382,681	2,415,589
Total		$ 3,904,741	$ 3,443,509

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

The balance at December 31, consists of the following:

	2011	2010
Accounts receivable - water sales and services	$ 2,025,104	$ 2,255,135
Allowance for uncollectible accounts	(264,336)	(386,213)
Accounts receivable - water sales and services, net	$ 1,760,767	$ 1,868,922

(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:

	2011	2010
Property taxes from state	$ 161,817	$ 159,159
Accrued interest	2,702	2,658
Note receivable - property taxes from state	$ 164,519	$ 161,817

(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:

	2011	2010
1998 Certificates of participation issuance costs, net	$ 168,696	$ 183,053
2004 Certificates of participation issuance costs, net	535,462	558,999
Deferred charges, net	$ 704,158	$ 742,052

(6) Capital Assets

Changes in capital asset amounts for 2011 were as follows:

	Balance 2010	Additions	Deletions	Transfers	Balance 2011
Non-depreciable assets:					
Land and land rights	$ 1,155,763	$ 500	$ -	$ -	$ 1,156,263
Construction-in-process	10,987,368	2,921,082	(140,559)	(8,598,695)	5,169,196
Total non-depreciable assets	12,143,131	2,921,582	(140,559)	(8,598,695)	6,325,459
Depreciable assets:					
Buildings, wells and distribution system	192,394,453	114,849	-	6,427,216	198,936,518
SWP - participation rights	49,479,086	2,225,748	-	-	51,704,834
Machinery and equipment	9,165,520	217,883	-	2,171,479	11,554,882
Total depreciable assets	251,039,059	2,558,480	-	8,598,695	262,196,234
Accumulated depreciation & amortization:					
Buildings, wells and distribution system	(79,146,155)	(6,079,231)	-	-	(85,225,386)
SWP - participation rights	(15,376,721)	(1,453,125)	-	-	(16,829,846)
Machinery and equipment	(6,452,043)	(1,206,261)	-	-	(7,658,304)
Total accumulated depreciation & amortization	(100,974,919)	(8,738,617)	-	-	(109,713,536)
Total depreciable assets, net	150,064,140	(6,180,137)	-	8,598,695	152,482,698
Total capital assets, net	$ 162,207,271	$ (3,258,555)	$ (140,559)	$ -	$ 158,808,157

Changes in capital asset amounts for 2010 were as follows:

	Balance 2009	Adjustments	Additions	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	(2,360,836)	192,617	-	1,983,622	192,394,453
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	(2,360,836)	2,965,698	(102,704)	1,983,622	251,039,059
Accumulated depreciation & amortization:						
Buildings, wells and distribution system	(75,067,707)	2,109,346	(6,187,794)	-	-	(79,146,155)
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)	2,109,346	(8,374,815)	102,704	-	(100,974,919)
Total depreciable assets, net	153,741,125	(251,490)	(5,409,117)	-	1,983,622	150,064,140
Total capital assets, net	$ 164,783,602	$ (251,490)	$ (2,324,841)	$ -	$ -	$ 162,207,271

(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:

	2009	2010	2011
Energy bridge project	$ 769,124	-	-
Well 29 drill, equipment and activation	614,085	-	-
Palmdale ditch enclosure	2,642,564	2,663,891	-
Distribution telemetry upgrade	2,004,270	2,171,479	-
30th Street/Avenue Q main replacement	46,853	815,018	-
30th Street/Palmdale Blvd Q main replacement	57,711	596,184	-
Barrel Springs Road waterline replacement	1,276	325,105	-
Maintenance yard and building (New Facility)	124,197	124,197	-
Q7/Standridge waterline replacement	11,457	115,227	-
10 M.G.D. Treatment plant (New Facility)	908,827	913,674	913,674
Sediment removal - Littlerock Dam	538,505	588,134	706,875
Well 24A drill and equipment	618,802	619,129	619,129
12th Street/Avenue Q4 main replacement	-	-	598,923
Distribution master plan	503,939	532,335	532,335
Recycled facilities master plan	234,984	269,654	271,723
Well 2 rehabilitation	39,505	147,162	161,143
Avenue S10/40th Street waterline replacement	-	-	150,011
Well 36 drill and equipment	149,602	149,602	149,602
Well 37 drill and equipment	148,634	148,634	148,634
Garden Bar Study	92,187	92,187	148,069
Division Street/Avenue Q3 waterline replacement	22,040	50,599	108,756
Various other minor projects >$100,000	358,152	665,157	660,322
Construction-in-process	$ 9,886,714	10,987,368	5,169,196

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

In addition to system on-aqueduct power facilities, the State has, either on its own or through joint venture, financed certain off-aqueduct power facilities (OAPF). The power generated is utilized by the system for water transportation 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 to compensated absences for 2011, were as follows:

	Balance 2010	Earned	Taken	Balance 2011	Current Portion	Long-term Portion
$	385,468	494,403	(462,766)	417,105	312,829	104,276

Changes to 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

(8) Long-term Debt

Certificates of Participation

Changes in long-term debt amounts for 2011 were as follows:

	Balance 2010	Additions/ Deletions	Principal Payments	Balance 2011
Long-term debt:				
1998 - Certificates of Participation	$ 14,145,000	-	(800,000)	13,345,000
1998 - Discount	(204,235)	16,019	-	(188,216)
1998 - Loss on Defeasance	(580,283)	45,512	-	(534,770)
2004 - Certificates of Participation	36,310,000	-	(370,000)	35,940,000
2004 - Premium	260,274	(10,959)	-	249,315
Total long-term debt	$ 49,930,757	50,572	(1,170,000)	48,811,329
Less: Current portion	(1,170,000)			(1,220,000)
Total Non-current portion	$ 48,760,757			47,591,329

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	-	(204,235)
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

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.

(8) Long-term Debt, continued

1998 Certificates of Participation, continued

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

	Debt Service 1998		
Year	Principal	Interest	Total
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	1,020,000	486,500	1,506,500
2017-2021	5,910,000	1,615,500	7,525,500
2022-2023	2,800,000	211,750	3,011,750
Total	$ 13,345,000	4,722,500	18,067,500
Less: current	(840,000)		
Total non-current	$ 12,505,000		

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:

	Debt Service 2004		
Year	Principal	Interest	Total
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
2016	445,000	1,685,230	2,130,230
2017-2021	2,515,000	8,138,629	10,653,629
2022-2026	7,860,000	7,305,430	15,165,430
2027-2031	13,600,000	4,582,500	18,182,500
2032-2034	9,905,000	1,006,750	10,911,750
Total	$ 35,940,000	29,620,383	65,560,383
Less: current	(380,000)		
Total non-current	$ 35,560,000		

(9) Net Investment in Capital Assets

The balance at December 31, consists of the following:

	2011	2010
Capital assets - not being depreciated	$ 6,325,459	$ 12,143,131
Capital assets - being depreciated, net	152,482,698	150,064,140
Certificates of participation - current portion	(1,220,000)	(1,170,000)
Certificates of participation - non-current portion	(47,591,329)	(48,760,757)
Net investment in capital assets	$ 109,996,828	$ 112,276,514

(10) Restricted Net Assets

The balance at December 31, consists of the following:

	2011	2010
Restricted - investments	$ 1,661,732	$ 1,626,294
Accrued interest payable - 1998 COPs	(166,813)	(176,313)
Net investment in capital assets	$ 1,494,919	$ 1,449,982

(11) Reservations of Unrestricted Net Assets

The balance at December 31, consists of the following:

	2011	2010
Non-spendable or long-term net assets:		
Materials and supplies inventory	$ 712,744	$ 684,870
Prepaid expenses and other deposits	319,901	249,878
Note receivable - property taxes from state	164,519	161,817
Deferred charges, net	704,158	742,052
Total prepaid net assets	$ 1,901,322	$ 1,838,617
Board designated net assets:		
Operations and maintenance reserve	-	-
Undesignated net assets	340,634	319,859
Total unrestricted net assets	$ 2,241,956	$ 2,158,476

(12) Prior Year Restatement

The 2010 beginning balance for capital assets was adjusted for the prior year audit in an effort to clean up the financials. This change required the District to decrease the "Buildings, wells and distribution system" aggregate number by $2,360,836 and increase the accumulated depreciation and amortization to $2,109,346. The net difference of this restatement decreased the Total depreciable assets, net by $251,490, which was offset against net assets.

(13) 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.

(13) Deferred Compensation Savings Plan, continued

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, 2011 and 2010 was $2,830,944 and $2,726,336 and , 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.

(14) 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 from their executive Office: 400 P Street, Sacramento, CA, 95814.

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 2011, 2010 and 2009 were as follows:

Time Period	2011	2010	2009
Jan. 1 - June 30	11.004%	10.392%	10.287%
July 1 - Dec. 31	11.913%	11.004%	10.392%

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 2011, 2010 and 2009, the District's annual contribution was $1,086,497, $968,147 and $993,114, respectively, for CalPERS and was equal to the District's required and actual contributions for each year.

(15) 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.

(15) Other Post Employment Benefits Payable, continued

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:

	2011	2010	2009
Active plan members	90	90	81
Retirees and beneficiaries receiving benefits	10	10	8
Separated plan members entitled to but not yet receiving benefits	-	-	-
Total plan membership	100	100	89

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.

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 3.32% for 2011 and 3.22% for 2010 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

The balance at December 31, consists of the following:

		2011	2010	2009
Annual OPEB expense:				
Annual required contribution (ARC)	$	1,982,672	1,963,042	538,690
Interest on net OPEB obligation		55,498	19,494	9,761
Adjustment to annual required contribution		(105,146)	(36,933)	(13,130)
Total annual OPEB expense		1,933,024	1,945,603	535,321
Change in net OPEB payable obligation:				
Age adjusted contribution made		(268,096)	(197,855)	(62,848)
Total change in net OPEB payable obligation		1,664,928	1,747,748	472,473
OPEB payable - beginning of year		2,694,056	946,308	473,835
OPEB payable - end of year	$	4,358,984	2,694,056	946,308

(15) Other Post Employment Benefits Payable, continued

Annual Cost, continued

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 2011 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
2011	$ 1,933,024	268,096	13.87%	$ 1,664,928
2010	$ 1,945,603	197,855	10.17%	$ 1,747,748
2009	$ 535,321	62,848	11.74%	$ 472,473

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)
12/31/2011	$ -	16,234,820	16,234,820	0.00%	$ 6,577,418	246.83%
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%

The most recent valuation (dated December 31, 2011) 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, 2011 and 2010, were $6,577,418 and $6,572,271, respectively. The ratio of the unfunded actuarial accrued liability to annual covered payroll is 246.83% and 247.02% as of December 31, 2011 and 2010, respectively.

(15) Other Post Employment Benefits Payable, continued

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, 2011
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

(16) 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.

(16) Risk Management, continued

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, 2011, 2010 and 2009. 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, 2011 and 2010.

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

The Governmental Accounting Standards Board (GASB) has issued several pronouncements prior to December 31, 2011, that have effective dates that may impact future financial presentations.

Governmental Accounting Standards Board Statement No. 60

In November 2010, the GASB issued Statement No.60, Accounting and Financial Reporting for Service Concession Arrangements. 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.

Governmental Accounting Standards Board Statement No. 62

In December 2010, the GASB issued Statement No.62, Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30 1989 FASB and AICPA Pronouncements. The requirements in this Statement will improve financial reporting by contributing to the GASB's efforts to codify all sources of generally accepted accounting principles for state and local governments so that they derive from a single source. The requirements for Statement No. 62 are effective for financial statements 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. 63

In June 2011, the GASB issued Statement No. 63, Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position. This Statement provides financial reporting guidance which standardizes the presentation of deferred outflows of resources and deferred inflows of resources and their effects on a government's net position. The requirements of Statement No. 63 are 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) Governmental Accounting Standards Board Statements Issued, Not Yet Effective, continued

Governmental Accounting Standards Board Statement No. 64

In June 2011, the GASB issued Statement No. 64, Derivative Instruments: Application of Hedge Accounting Termination Provisions an amendment of GASB Statement No. 53. The objective of this Statement is to clarify whether an effective hedging relationship continues after the replacement of a swap counterparty or a swap counterparty's credit support provider. The requirements of Statement No. 64 are effective for financial statements for periods beginning after June 15, 2011. This statement is not expected to have a significant impact on the presentation of the District's financial statements.

(18) 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
2012	$	5,182,562
2013		5,114,024
2014		4,154,919
2015		4,096,977
2016		4,122,725

As of December 31, 2011, the District has expended $79,610,764 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	$	65,968,239
Conservation facilities		22,376,952
Off-aqueduct power facilities		4,606,332
Revenue bond surcharge		2,428,679
Total	$	95,380,202

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.

(18) Commitments and Contingencies, continued

State Water Contract, continued

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 $2,881,600 in open construction contracts as of December 31, 2011. These include the following:

Project Name		Estimated Costs to Complete
Ave Q3 / Division - Sumac Ave main replacement (Spec. No. 0902a)	$	525,000
9th/12th Street East main replacement (Spec. No. 0903)		683,000
Storage Tank Re-Coatings		360,000
Littlerock Dam Sediment Removal		270,000
Well 11A Rehabilitation		200,000
Avenue S & Downing waterline replacement		125,000
Various other minor projects		718,600
	$	2,881,600

(18) 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 a water budget rate structure. Under this new rate structure, District customers are provided with a monthly allocation of water, as determined by a mathematical formula that applies various factors, including, but not limited to, lot size, number of persons in the household and actual weather data. A customer's monthly usage is then measured against that customer' s water allocation for that month and the percentage of usage that exceeds that allocation is then placed in tiers, with increasing water rates applied to each higher tier of usage.

Also at the May 13,2009 Board meeting, the District and the Palmdale Water District Public Facilities Corporation adopted resolutions approving the issuance of Certificates of Participation (the "COPs") to finance various District capital projects and to replenish the District's reserves, which had been expended to pay for substantial improvements to the District' s water treatment plant. Those COPs were to be partially secured by the revenue stream derived from the District's new water rate structure.

On May 14,2009, the City of Palmdale (the "City") filed a lawsuit, Los Angeles County Superior Court Case No. BC413432 (the "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.

Among other things, 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 the COPs. The City based the Validation Action on the same alleged constitutional violations on which it based the Rate Litigation.

Trial of the Validation Action occurred on February 26, 2010 (the Rate Litigation was stayed, pending the outcome of the Validation Action). On that date, the court issued its tentative ruling, heard oral arguments from the parties and took the matter under submission. 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 that structure.

The City appealed the court's ruling in the Validation Action. On August 9, 2011, the Court of Appeal issued its decision that reversed the trial court's judgment and held that the District violated Article XIIID, Section 6 of the California Constitution. That ruling was based on the court's determination that the different widths of tiers among customer classes in the District's water budget rate structure violated the "proportionality of costs" requirement of Article XIIID, Section 6.

Based on the Court of Appeal's decision, the District cured the defect noted by the court by revising its water budget rate structure so that the tiers among the three customer classes are now equal. District staff has recalculated water charges using those equalized tiers from when the new structure took effect in June 2009 and has been issuing credits back to impacted District customers, including the City.

(18) Commitments and Contingencies, continued

City of Palmdale v. Palmdale Water District, continued

The City maintains the District's action to cure the defect in its rate structure is not permissible and that the District should apply the rate structure in effect prior to its action in May 2009 to adopt the new structure. The City has submitted a form of judgment in that regard for the trial court to consider. Further proceedings in this matter are currently stayed to allow the parties an opportunity to work on a global settlement of all litigation between them.

If this matter is not settled, the District will oppose the City's efforts to obtain a judgment in this case, and will attempt to further litigate the numerous issues the City raised which the Court of Appeal did not address. However, if the matter does not settle, the District would likely be faced with payment of the City's attorneys' fees under Code of Civil Procedure Section 1021.5, which are likely to be significant. In addition, if there were an unfavorable outcome at trial or after appeal, the amount of the judgment could be significant and pose a risk of a material adverse financial effect on the District. However, California law allows public agencies certain means of satisfying judgments that would enable the District to mitigate that impact. Also, payment of such a judgment would be a proper factor to consider as an operating expense in future water rate setting actions.

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.

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Report on Internal Controls and Compliance

LSL
CERTIFIED PUBLIC ACCOUNTANTS

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- David E. Hale, CPA, CFP
  A Professional Corporation
- Donald G. Slater, CPA
- Richard K. Kikuchi, CPA
- Susan F. Matz, CPA
- Shelly K. Jackley, CPA
- Bryan S. Gruber, CPA
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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 financial statements of the basic financial statements of the Palmdale Water District, (the District) as of and for the year ended December 31, 2011, and have issued our report thereon dated May 8, 2012. 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 audit, 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.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control that we consider to be material weaknesses.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the District's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the following deficiencies in the District's internal control to be material weaknesses:

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CERTIFIED PUBLIC ACCOUNTANTS

Board of Directors
Palmdale Water District
Palmdale, California

Net Asset Restatement

As a result of our audit procedures, we noted certain items that required a net asset restatement. There were capital assets that had been disposed of in prior years that had not been fully depreciated and the transaction was not recorded when the assets were disposed of. Therefore a journal entry was recorded to remove the capital assets from the District's records along with the related accumulated depreciation. The capital assets, net of accumulated depreciation, was the amount of the net asset restatement.

Bank Reconciliations

During the audit, we noted that bank statements for the District's various accounts were not being reconciled to the general ledger timely, on a monthly basis, and also as of the balance sheet date. Most of the problems encountered within the area of cash can be avoided if a proper system of checks and balances is incorporated into the company's procedures. A proper system would include the bank reconciliations being completed monthly for all bank accounts and the proper review and approval of the bank reconciliations in a timely manner. As a result of the bank reconciliations not being completed in a timely manner, journal entries were recorded to address these reconciling differences.

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 grant agreements, 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.

In addition, we noted other matters that we reported to management of the District in a separate letter dated May 8, 2012.

We did not audit the District's responses to the findings described above and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of management, management, the audit committee, the Board of Directors, federal awarding agencies and pass-through entities, and is not intended to be and should not be used by anyone other than these specified parties.

Lance, Soll & Lunghard, LLP

Brea, California
May 8, 2012

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