

**CITRUS HEIGHTS WATER DISTRICT  
BASIC FINANCIAL STATEMENTS  
DECEMBER 31, 2006**

**CITRUS HEIGHTS WATER DISTRICT  
TABLE OF CONTENTS**

	<u>Page</u>
Independent Auditor’s Report .....	1-2
Management’s Discussion and Analysis .....	3-10
Basic Financial Statements:	
Statement of Net Assets .....	11
Statement of Revenues, Expenses, and Changes in Net Assets .....	12
Statement of Cash Flows .....	13-14
Notes to the Basic Financial Statements .....	15-30
Other Report	
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 <i>Government Auditing Standards</i> .....	31-32
Schedule of Findings and Responses:	
2006-1: Controls Over Financial Reporting .....	33-34



## INDEPENDENT AUDITOR'S REPORT

To the Board of Directors  
Citrus Heights Water District  
Citrus Heights, California

We have audited the accompanying basic financial statements of Citrus Heights Water District (District) as of and for the year ended December 31, 2006, as listed in the table of contents. These financial statements are the responsibility of the District's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control over financial reporting. Accordingly, we express no such opinion. 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 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 opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Citrus Heights Water District as of December 31, 2006, and the respective changes in financial position and cash flows, for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated April 4, 2007, 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, 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 considered in assessing the results of our audit.

To the Board of Directors  
Citrus Heights Water District  
Citrus Heights, California

The Management's Discussion and Analysis (MD & A) on pages 3 through 10 is not a required part of the basic financial statements but is supplementary information required by the accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

BARTIG, BASLER & RAY, LLP  
A Gallina LLP Company

A handwritten signature in black ink that reads "Bartig Basler & Ray, LLP". The signature is written in a cursive, flowing style.

April 4, 2007  
Roseville, California

## **MANAGEMENT'S DISCUSSION AND ANALYSIS**

# CITRUS HEIGHTS WATER DISTRICT

## Management's Discussion and Analysis December 31, 2006

The management of the Citrus Heights Water District (District) presents this Management Discussion and Analysis to achieve two goals:

1. To comply with the requirements of Governmental Accounting Standards Board Statement 34 (GASB 34) that are designed to provide more and easier-to-understand information about the finances of local government agencies such as the District; and
2. To provide readers with narrative information that may help in understanding and interpreting the information presented in the District's financial statements for the fiscal year ended December 31, 2006 (FY2006).

Questions or comments regarding this Management Discussion and Analysis may be directed to the District Treasurer via the following methods:

Mailing address: Citrus Heights Water District, P.O. Box 286, Citrus Heights, California 95611

Telephone: (916) 725-6873  
Facsimile: (916) 725-0345  
E-mail: dkane@chwd.org

### **Financial Highlights**

The following items are, in the opinion of District management, among the most significant in assessing the District's overall financial activities during 2006 and its financial position at the close of FY2006:

- ❖ The District's assets exceeded its liabilities at the end of FY2006 by \$33,281,261. Over 82 percent of the District's net assets, \$27,347,444, are composed of the capital assets of the District – the water transmission and distribution system, land, buildings and equipment belonging to the District. Unrestricted net assets totaled \$4,602,986, up from \$3,748,298 at the end of FY2005. This increase is due primarily to revenues that were budgeted for capital improvements projects during 2006 but not spent. Of this unrestricted amount, the District has designated \$900,000 for rate stabilization and/or catastrophic losses, leaving \$3,702,986 for current and future operations and projects.
- ❖ The District's operating revenues for FY2006 were \$8,452,027. The great majority of revenues, \$7,953,173, came from water sales to customers. The District adopted a 13.5 percent increase in water rates for the majority of its customers that went into effect at the beginning of 2006. The second-largest source of revenue for 2006 was \$272,616 in capacity fees. Capacity fees are collected on each new connection to the District's water distribution system to reflect the cost already paid by existing users to provide capacity in

# CITRUS HEIGHTS WATER DISTRICT

## Management's Discussion and Analysis December 31, 2006

the water system to serve additional users, a method of calculating fees known as the "system buy-in" method.

- ❖ The District's total net long-term liabilities at the end of FY2006, including the 2003 Certificates of Participation, the 2000 Certificates of Participation, the information technology systems lease and compensated absences, is \$9,266,837. This is a decrease of \$580,784 from net long-term liabilities at the end of FY2005, reflecting the payment of principal on debt during 2006.

### **OVERVIEW OF THE FINANCIAL STATEMENTS**

This annual report consists of two parts: (1) management's discussion and analysis; and (2) the financial statements, including the notes to financial statements.

The financial statements provide both long-term and short-term information about the District's overall financial status. The financial statements also include notes that explain some of the information in the financial statements and provide more detailed data.

The District's financial statements are prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) as applied to government units on an accrual basis. Under this basis, revenues are recognized in the period in which they are earned, expenses are recognized in the period in which they are incurred, and depreciation of assets is recognized in the Statement of Revenues, Expenses and Changes in Net Assets. All assets and liabilities associated with the operation of the District are included in the Statement of Net Assets.

The Statement of Net Assets presents the financial position of the District on a full accrual historical cost basis and provides information about the nature and amount of resources and obligations at year-end.

## CITRUS HEIGHTS WATER DISTRICT

### Management's Discussion and Analysis December 31, 2006

#### *Statement of Net Assets*

As of December 31, 2006, the total net assets of the District were \$33,281,261. The following table summarizes assets, liabilities and net assets at December 31, 2006 and 2005:

	<u>2006</u>	<u>2005</u>
Current assets, unrestricted	\$ 4,396,224	\$ 5,075,653
Restricted cash and cash equivalents	1,330,831	1,310,808
Capital assets, net	38,008,635	36,539,802
Other assets	222,198	236,117
Total assets	<u>43,957,888</u>	<u>43,162,380</u>
Current liabilities	1,409,790	1,855,895
Long-term liabilities	9,266,837	9,847,621
Total liabilities	<u>10,676,627</u>	<u>11,703,516</u>
<b>Net Assets</b>		
Invested in capital assets, net of related debt	27,347,444	26,581,634
Restricted	1,330,831	1,128,932
Unrestricted	4,602,986	3,748,298
Total net assets	<u>\$ 33,281,261</u>	<u>\$ 31,458,864</u>

The District's net assets reflect restrictions imposed as a condition of its Certificates of Participation debt. Funds that the District has collected through Capacity Fees are restricted to use for evaluating and constructing capital facilities to benefit District customers. The remaining net assets are unrestricted.

## CITRUS HEIGHTS WATER DISTRICT

### Management's Discussion and Analysis December 31, 2006

#### *Changes in Net Assets*

The following table summarizes the changes in net assets for the fiscal year ended December 31, 2006 and 2005:

	2006	2005
Operating revenues	\$ 8,452,027	\$ 7,648,363
Operating expenses:		
Water Purchases	1,681,402	1,617,386
Pumping and Well Maintenance	65,585	56,480
Transmission and Distribution	1,451,237	1,182,795
Customer Service, Administrative and General	2,340,930	2,013,045
Depreciation and Amortization	1,636,745	1,603,059
Total operating expenses	7,175,899	6,472,765
Operating income	1,276,128	1,175,598
Net nonoperating revenues (expenses)	36,172	(425,917)
Net Income Before Capital Contributions	\$ 1,312,300	\$ 749,681
Capital Contributions:		
Donated Assets	836,979	240,267
Special Item*	(358,943)	-
Change in Net Assets	\$ 1,790,336	\$ 989,948

\*Refer to Note 7 of the Notes to the Basic Financial Statements.

Total net assets increased \$1,790,336, or 5.4 percent from the prior year. The receipt of \$836,979 in donated assets from private developer additions to the District's water distribution system accounted for about 46.7 percent of the increase in net assets.

Total operating revenues increased \$100,530 or 8.6 percent from the prior year, primarily as a result of an increase in water charges. Operating expenses increased \$703,134 or 10.9 percent from the prior year, with increases in the cost of water purchases and in employee salary and benefit expenditures.

# CITRUS HEIGHTS WATER DISTRICT

Management's Discussion and Analysis  
December 31, 2006

## **CAPITAL ASSETS AND DEBT ADMINISTRATION**

### *Capital Assets*

As of December 31, 2006, the District's investment in capital assets was \$38,008,635, including: the water transmission and distribution system (underground pipelines, water services, water meters, fire hydrants, and other components); water production facilities (groundwater wells); land; buildings and both mobile and fixed equipment.

Significant additions to the District's capital assets include the installation of over 2,100 new water meters throughout the District's system as part of the ongoing Water Meter Retrofit Program. A number of smaller private development projects resulted in the addition of about \$836,979 in donated capital assets.

The District reimbursed a private developer in the amount of \$358,943 for a portion of donated water mains that were received by the District in FY2004. At the time, the water mains were installed in conjunction with a commercial development in the Stock Ranch area of Citrus Heights. The District requested that the developer install certain improvements that were not the responsibility of the developer. The District agreed that it would pay the cost for these improvements. The District benefited from the efficiencies and economies of scale of having the developer install these improvements at the time that other improvements required for the commercial development were being installed. The value of the District's portion of the improvements was determined and payment for this portion was made to the private developer during FY2006. Note 7, Special Item, of the notes to the basic financial statements, addresses this matter.

Additional information on the District's capital assets can be found in Note 4, Capital Assets, of the notes to the basic financial statements.

### *Debt Administration*

The District issued no new debt in 2006. The District's total Certificates of Participation (COP) debt from its issuances in 2000 and 2003 now stands at approximately \$9.37 million.

The District also had lease obligations totaling \$215,803 as of December 31, 2006. Most of this amount is for the final year of a five-year lease for technology improvements (computer hardware and software and related equipment) that was initiated in 2002.

Compensated absences, composed of leave hours earned by employees that are payable upon termination or retirement, are valued at \$320,082.

Additional information on debt activity can be found in Note 5, Long-Term Debt, of the notes to the basic financial statements.

# CITRUS HEIGHTS WATER DISTRICT

Management's Discussion and Analysis  
December 31, 2006

## **ECONOMIC FACTORS AND FUTURE BUDGET CONSIDERATIONS**

Nearly all aspects of District operating costs will experience some increase in 2007, compared with 2006 costs. Major increases include:

- ❖ An eight percent increase in the cost of water purchased from the District's treated water wholesaler, the San Juan Water District, with a budget increase of \$105,336;
- ❖ A 14.2 percent increase in budgeted salary costs, including one new authorized full-time employee, an annual cost-of-living adjustment and possible merit adjustments to employee salaries with a budget increase of \$230,617;
- ❖ A 9.6 percent increase in budgeted benefit costs (+\$65,233), primarily resulting from anticipated increases in the costs of employee health insurance and CalPERS retirement contributions;
- ❖ A 24.2 percent increase in water meter reading costs (\$+16,700) and a 160.2 percent increase in bill printing and mailing costs (+\$19,700) due to the growing number of water meters being read and billed bi-monthly.

As the District continues to move in the direction of becoming a fully-metered water system, its costs for reading water meters, billing customers based on metered consumption, and servicing and repairing water meters will also continue to rise. As of the end of FY2006, about 16,000 of the District's 19,253 customer accounts were still paying on a flat-rate basis. The District plans on converting all customer accounts to a metered billing basis as of January 1, 2008. A 2007 Operating Budget Summary is included at the conclusion of this Management's Discussion and Analysis to provide an overview of the District's operating budget.

Along with rising operating costs, the District will continue to incur significant costs for capital improvements. Most significant among these is the cost of constructing new groundwater wells, budgeted at about \$1.4 million in 2007 and the cost of replacing aging underground water distribution and transmission pipelines, budgeted at \$1.23 million in 2007. The District has nearly completed the installation of water meters on all customer services, with only 459 services remaining to be metered as of the end of FY2006. A 2007 Capital Improvement Budget Summary is included at the conclusion of this Management's Discussion and Analysis to provide an overview of the District's capital improvement budget.

A significant portion of the District's budget continues to be the repayment of long-term debt financing in the form of Certificates of Participation issued in 2000 and 2003. The annual debt service for these two issuances is budgeted at \$828,332 for 2007, representing about 10.7 percent of the District's 2007 Operating Budget.

In order to keep pace with these rising costs, the District's Board of Directors adopted a water rate increase of 7.4 percent for 2007, following a rate increase of 13.5 percent for 2006. Even with these water rate increases, the District's water rates are still about 12.5 percent below the average water rate in the Sacramento region.

# CITRUS HEIGHTS WATER DISTRICT

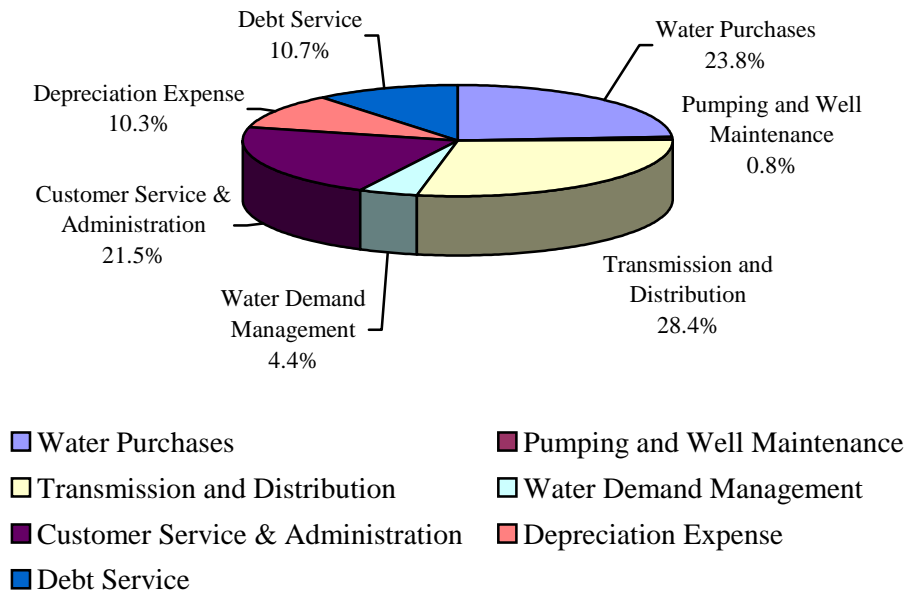
## Management's Discussion and Analysis December 31, 2006

The District's Long-Range Financial Planning Model, which was updated in 2006, forecasts a need for annual water rate increases in the range of 3 to 10 percent annually through the Year 2015. These increases will be needed to meet the anticipated operating and capital improvement costs of the District while maintaining financial reserves to comply with debt covenants and to provide funds for emergencies or catastrophic losses.

### Citrus Heights Water District 2007 Operating Budget Summary

<u>Expense Category</u>	2005 Actual	2006 Adopted	2007 Adopted	% Change 2007 vs. 2006
Water Purchases	\$ 1,617,388	\$ 1,728,661	\$ 1,833,997	6.1%
Pumping and Well Maintenance	33,901	77,500	65,000	- 16.1%
Transmission and Distribution	2,381,202	2,069,213	2,191,354	5.9%
Water Demand Management	249,036	321,526	339,266	5.5%
Customer Service & Administration	1,345,359	1,495,981	1,661,660	11.1%
Depreciation Expense	641,726	819,149	794,288	-3.0%
Debt Service	828,707	827,807	828,332	0.1%
<b>Total</b>	<b>\$ 7,097,319</b>	<b>\$ 7,339,837</b>	<b>\$ 7,713,897</b>	<b>5.1%</b>

### CHWD 2007 Operating Budget By Category



# CITRUS HEIGHTS WATER DISTRICT

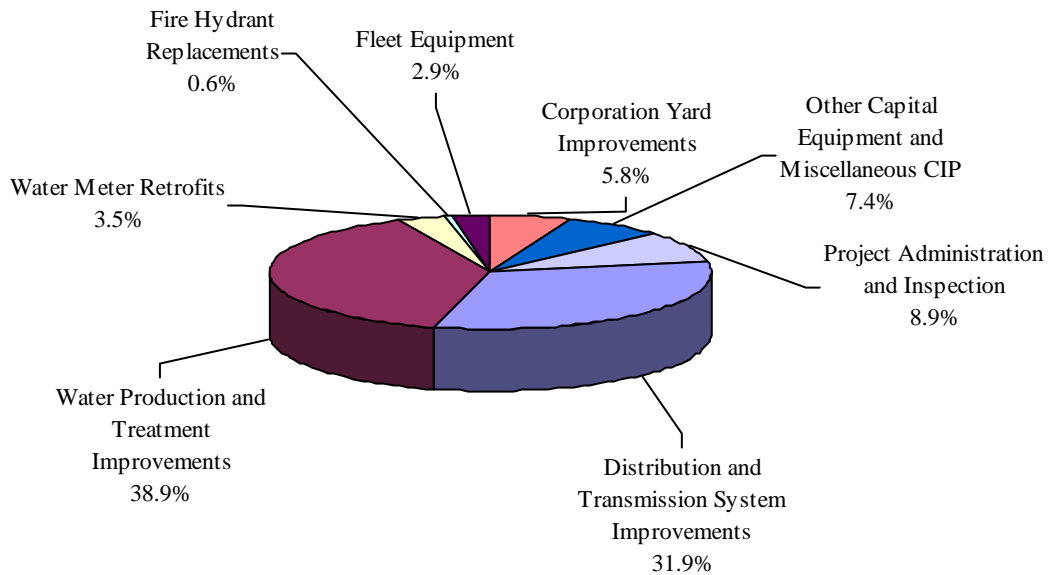
Management's Discussion and Analysis  
December 31, 2006

## Citrus Heights Water District 2007 Capital Improvement Budget Summary

<u>Capital Improvement Expense Categories*</u>	2007 Adopted
Distribution and Transmission System Improvements	\$ 1,211,128
Water Production and Treatment Improvements	1,477,200
Water Meter Retrofits	132,195
Fire Hydrant Replacements	23,850
Fleet Equipment	108,000
Corporation Yard Improvements	219,680
Other Capital Equipment and Miscellaneous CIP	282,500
Project Administration and Inspection	336,507
<b>Total</b>	<b>\$ 3,791,060</b>

\* Expenses shown do not include District force account labor included in Operating Budget

CHWD 2007 Capital Improvement Budget  
By Category



## **BASIC FINANCIAL STATEMENTS**

# CITRUS HEIGHTS WATER DISTRICT

## Statement of Net Assets

December 31, 2006

### ASSETS

#### Current Assets:

Cash and investments, unrestricted	\$ 3,053,903
Receivables:	
Accounts, net	308,119
Interest	73,724
Inventory	317,456
Prepaid expenses	643,022
Total Current Assets	<u>4,396,224</u>

#### Non-Current Assets:

Capital assets:	
Nondepreciable	555,221
Depreciable, net	37,453,414
Cash and investment, restricted	1,330,831
Issuance costs, net of accumulated amortization	222,198
Total Non-Current Assets	<u>39,561,664</u>

Total Assets \$ 43,957,888

### LIABILITIES

#### Current Liabilities:

Accounts payable	\$ 18,229
Accrued interest payable	195,820
Accrued salaries and benefits	353
Deferred revenue	552,740
Deposits payable	36,845
Capital leases, current	215,803
Certificates of participation, current	390,000
Total Current Liabilities	<u>1,409,790</u>

#### Long-term liabilities:

Certificates of participation	8,946,755
Compensated absences	320,082
Total Long-term Liabilities	<u>9,266,837</u>

Total Liabilities 10,676,627

### NET ASSETS

Invested in capital assets, net of related debt	27,347,444
Restricted for:	
Connection fees	39,830
Debt service	866,397
Capital improvements	424,604
Unrestricted	4,602,986
Total Net Assets	<u>33,281,261</u>

Total Liabilities and Net Assets \$ 43,957,888

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

**CITRUS HEIGHTS WATER DISTRICT**  
Statement of Revenues, Expenses and Changes in Net Assets  
For the Fiscal Year Ended December 31, 2006

Operating revenues:	
Water sales - annual	\$ 6,188,180
Water sales - apartments and meters	1,764,993
Penalties and back charges	90,443
Service charges and repairs	66,347
Tap fees (water service and meter installation)	57,844
Water wheeling	11,604
Capacity fees	<u>272,616</u>
Total operating revenues	<u>8,452,027</u>
Operating expenses:	
Water purchases	1,681,402
Pumping and well maintenance	65,585
Transmission and distribution	1,451,237
Customer service, administrative, and general	2,340,932
Amortization expense	13,713
Depreciation expense	<u>1,623,030</u>
Total operating expense	<u>7,175,899</u>
Operating income (loss)	<u>1,276,128</u>
Non-operating revenues (expenses):	
Grant revenue	184,884
Investment earnings	263,087
Gain (loss) on disposition of capital assets	(16,339)
Other income	31,690
Interest expense	<u>(427,150)</u>
Total Non-operating revenues (expenses)	<u>36,172</u>
Income (loss) before capital contributions and special item	1,312,300
Capital contributions	836,979
Special item	<u>(358,943)</u>
Change in net assets	<u>1,790,336</u>
Net Assets, Beginning of year	31,458,864
Prior period adjustment	<u>32,061</u>
Net Assets, Beginning of year, restated	<u>31,490,925</u>
Net assets, End of year	<u>\$ 33,281,261</u>

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

**CITRUS HEIGHTS WATER DISTRICT**  
Statement of Cash Flows  
For the Fiscal Year Ended December 31, 2006

<b>Cash Flows from Operating Activities:</b>	
Receipts from customers	\$ 8,174,279
Payments to suppliers	(3,126,208)
Payments to employees	<u>(2,377,388)</u>
Net Cash Flows Provided (Used) by Operating Activities	<u>2,670,683</u>
<b>Cash Flows from Non-Capital and Related Financing Activities:</b>	
Other income	<u>31,690</u>
Net Cash Flows Provided (Used) by Non-Capital and Related Financing Activities	<u>31,690</u>
<b>Cash Flows from Capital and Related Financing Activities:</b>	
Grant proceeds	184,884
Interest paid	(459,261)
Payments for capital acquisitions	(2,271,223)
Payments on long-term debt	(641,727)
Reimbursements paid to developer	<u>(358,943)</u>
Net Cash Flows Provided (Used) by Capital and Related Financing Activities	<u>(3,546,270)</u>
<b>Cash Flows from Investing Activities:</b>	
Investment earnings received	<u>227,503</u>
Net Cash Flows Provided (Used) by Investing Activities	<u>227,503</u>
Net increase (decrease) in cash and cash equivalents	(616,394)
Cash and cash equivalents, January 1, 2006	<u>5,001,128</u>
Cash and cash equivalents, December 31, 2006	<u>\$ 4,384,734</u>
<b>Reconciliation of Cash and Cash Equivalents to the Statement of Net Assets:</b>	
Cash and investments	\$ 3,053,903
Cash and investments, restricted	<u>1,330,831</u>
Total Cash and Cash Equivalents	<u><u>\$ 4,384,734</u></u>

continued

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

**CITRUS HEIGHTS WATER DISTRICT**  
Statement of Cash Flows (continued)  
For the Fiscal Year Ended December 31, 2006

**Reconciliation of Operating Income (Loss) to Net Cash**

**Provided (Used) By Operating Activities:**

Operating income (loss)	\$ 1,276,128
Adjustments to reconcile operating loss to net cash provided by operating activities:	
Depreciation	1,623,030
Amortization	13,713
(Increase) Decrease in Assets:	
Accounts receivable	(43,115)
Inventory	204,926
Prepaid expenses	(106,458)
Increase (Decrease) in Liabilities:	
Accounts payable	(97,228)
Deferred revenue	(236,733)
Deposits payable	2,100
Accrued salaries and benefits	(823)
Compensated absences	35,143
Net Cash Provided (Used) for Operating Activities	\$ 2,670,683

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

## **NOTES TO THE BASIC FINANCIAL STATEMENTS**

The notes provided in the Financial Section of this report are considered an integral and essential part of adequate disclosure and fair presentation of this report. The notes include a Summary of Significant Accounting Policies for the District, and other necessary disclosure of pertinent matters relating to the financial position of the District. The notes express significant insight to the financial statements and are conjunctive to understanding the rationale for presentation of the financial statements and information contained in this document.

# CITRUS HEIGHTS WATER DISTRICT

Notes to the Basic Financial Statements  
December 31, 2006

## Note 1: **Summary of Significant Accounting Policies**

### A. **Reporting Entity**

The Citrus Heights Water District (District) is an irrigation district formed on October 25, 1920, under Division 11 of the Act of Legislature of the State of California titled, "Act to Provide for Organization and Government of Irrigation Districts." The District constructs and maintains waterworks and supplies domestic and irrigation water in an area of approximately 7,900 acres to 19,500 connections in Sacramento and Placer counties with an estimated population of 66,000.

The District's basic financial statements include the operations of all organizations for which the District Board of Directors exercises oversight responsibility. Oversight responsibility is demonstrated by financial interdependency, selection of governing authority, designation of management, ability to significantly influence operations, and accountability for fiscal matters.

The Board of Directors serves in a separate session as the governing body of the Citrus Heights Water District Financing Corporation (Corporation), although the Corporation is a legal entity apart from the District.

The Corporation is included as a blended component unit in the accompanying financial statements. The financial activities of the foregoing entities have been aggregated and merged (termed "blending") with those of the District in the accompanying financial statements, as they meet the criteria for inclusion as set forth in the Governmental Accounting Standards Board (GASB) Statement No. 14 as amended by GASB Statement No. 39.

The Corporation was established by the Board of Directors for the purpose of providing assistance to the District in financing public improvements.

### B. **Basis of Presentation and Method of Accounting**

The District accounts for its activities as a single enterprise fund, and the financial statements are accounted for on a flow of economic resources measurement focus, using the accrual basis of accounting. Revenues are recognized when earned and expenses are recognized when the related liability is incurred, regardless of the timing of the cash flows.

The District distinguishes *operating* revenues and expenses from *nonoperating* items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with principal ongoing operations. The principal operating revenues of the District are charges to customers for water sales and services. The District also recognizes as operating revenue the portion of tap fees

# CITRUS HEIGHTS WATER DISTRICT

Notes to the Basic Financial Statements  
December 31, 2006

Note 1: **Summary of Significant Accounting Policies** (continued)

**B. Basis of Presentation and Method of Accounting** (continued)

intended to recover the cost of connecting new customers to the system. Operating expenses include the cost of water delivery and services, administrative expenses, and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

Non-exchange transactions, in which the District gives (or receives) value without directly receiving (or giving) equal value in exchange, include grants, entitlements, and donations. In accordance with GASB No. 33, *Accounting and Reporting for Non-exchange Transactions*, revenues from grants, entitlements, and donations are recognized in the fiscal year in which all eligible requirements have been satisfied.

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed in the financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. The government has elected not to follow subsequent private-sector guidance.

**C. Budget and Budgeting**

Budget integration is employed as a management control device. Budgets are formally adopted by the Board of Directors and take effect the following January 1. The budgets are used as a management tool and are not a legal requirement.

**D. Restricted Assets**

Restricted assets are financial resources generated for a specific purpose such as construction of improvements and financing of debt obligations. These assets are for the benefit of a distinct group and as such are legally or contractually restricted.

**E. Inventory and Prepaid Expenses**

Inventories of supplies and expendable equipment are stated at the lower of cost or market. Cost is determined on a first-in, first-out basis.

Certain payments to vendors reflect costs applicable to future accounting periods and are recorded as prepaid expenses.

# CITRUS HEIGHTS WATER DISTRICT

Notes to the Basic Financial Statements  
December 31, 2006

Note 1: **Summary of Significant Accounting Policies** (continued)

## F. Capital Assets

Purchased capital assets are stated at historical cost or estimated historical cost when original cost is not available. Donated capital assets are recorded at their estimated fair value at the date of donation. The District's policy is to capitalize all capital assets with costs exceeding a minimum threshold of \$1,000. Depreciation is recorded using the straight-line method over the estimated useful lives of the capital assets which range from three to forty years for the plant and pipelines, and three to five years for other equipment.

## G. Cash Equivalents

For purposes of the statement of cash flows, the District considers all highly liquid investment instruments purchased with a maturity of three months or less to be cash equivalents.

## H. Compensated Absences

All earned annual leave and administrative leave hours and compensatory time-off (CTO) hours are payable upon termination or retirement and are accrued as compensated absences. Upon death while employed by the District or retirement from the District, employees are paid one-third of their accumulated sick leave time. Since no means exists to reasonably estimate the amount that might be liquidated with expendable currently available financial resources, if any, they are reported as long-term debt on the Statement of Net Assets. The compensated absences liability is calculated in accordance with GASB Statement No. 16. As of December 31, 2006, the total estimated liability for all compensated absences is \$320,082.

## I. Use of Estimates

The preparation of basic financial statements in conformity with accounting principles generally accepted in the United States of America, as prescribed by the GASB and the American Institute of Certified Public Accountants (AICPA), requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

# CITRUS HEIGHTS WATER DISTRICT

Notes to the Basic Financial Statements  
December 31, 2006

Note 1: **Summary of Significant Accounting Policies** (continued)

## J. Net Assets

GASB Statement No. 34 requires that the difference between assets and liabilities be reported as net assets. Net assets are classified as either invested in capital assets, net of related debt, restricted, or unrestricted.

Net assets that are invested in capital assets, net of related debt, consist of capital assets, net of accumulated depreciation, and reduced by the outstanding principal of related debt. Restricted net assets are those net assets that have external constraints placed on them by creditors, grantors, contributors, laws, or regulations of other governments, or through constitutional provisions or enabling legislation. Unrestricted net assets consist of net assets that do not meet the definition of invested in capital assets, net of related debt, or restricted net assets. Net assets restricted because of enabling legislation was \$0 at December 31, 2006.

Note 2: **Cash and Investments**

At December 31, 2006, the District's total cash and investments at fair value were as follows:

<i>Cash:</i>	
Cash on hand	\$ 375
Deposits	<u>11,996</u>
Total cash	<u>12,371</u>
 <i>Investments:</i>	
Unrestricted	3,041,532
Restricted with fiscal agent	<u>1,330,831</u>
Total investments	<u>4,372,363</u>
Total cash and investments	<u>\$ 4,384,734</u>

### Custodial Credit Risk of Cash Deposits

Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The California Government Code requires that a financial institution secure the District's cash deposits by pledging securities in an undivided collateral pool held by a depository regulated under state law. The market value of pledged securities in the collateral pool must equal at least 110% of the District's cash deposits. California law also allows institutions to secure District deposits by pledging first trust deed mortgage notes having a value of 150% of the District's total cash deposits.

# CITRUS HEIGHTS WATER DISTRICT

Notes to the Basic Financial Statements  
December 31, 2006

Note 2: **Cash and Investments** (continued)

**Custodial Credit Risk of Cash Deposits** (continued)

At December 31, 2006, the recorded amount of the District's deposits was \$11,996 and the bank balance was \$502,599. The entire bank balance was covered by Federal Depository Insurance Corporation (FDIC) or the multiple financial institution collateral pool that insures public deposits.

**Investments**

At December 31, 2006, the District had the following investments:

	Fair Value	WAM* (Years)
<b>Investments, Unrestricted</b>		
California Local Agency Investment Fund (LAIF)	\$ 3,041,532	-
<b>Total investments, unrestricted</b>	<b>\$ 3,041,532</b>	-
 <b>Investments, Restricted</b>		
Federal Agencies	\$ 344,359	1.28
Money Market	986,472	-
<b>Total investments, restricted</b>	<b>\$ 1,330,831</b>	0.33
<b>Total fair value</b>	<b>\$ 4,372,363</b>	

\*Weighted Average Maturity

The following table identifies the investment types that are authorized for the District by the California Government Code, sections 53600 and 53603. The table also identifies certain provisions of the District's investment policy that address interest rate risk, credit risk, and concentration risk.

## CITRUS HEIGHTS WATER DISTRICT

Notes to the Basic Financial Statements  
December 31, 2006

Note 2: **Cash and Investments** (continued)

Investments (continued)

Authorized Investment Type	Maximum Maturity	Maximum Percentage of Portfolio	Maximum Investment in One Issuer
Local Agency Bonds	5 Years	None	None
U.S. Treasury Obligations	5 Years	None	None
U.S. Agency Obligations	5 Years	None	None
State of California Obligations	5 Years	None	None
Banker's Acceptances	180	40%	30%
Prime Commercial Paper	270	40%	10%
Negotiable Certificates of Deposit	5 Years	30%	None
Medium Term Corporate Notes	5 years	30%	None
Mutual Funds/Money Market Mutual Funds	N/A	20%	10%
Mortgage Pass-Through Securities	5 years	20%	None
Time Deposits	5 years	None	None
Joint Powers Authority	N/A	None	None
Local Agency Investment Fund (LAIF)	N/A	None	None

Interest Rate Risk

The District manages its exposure to declines in fair values by limiting the weighted average maturity (WAM) of its investment portfolio to five years or less in accordance with its investment policy.

Credit Risk

The District's investments in money market funds meet the requirements of State Code Sections 16429.1, 53601, 53635, and 53638. Investments in obligations of the U.S. government, U.S. government agencies, or government-sponsored enterprises are exempt from these limitations.

Concentration of Credit Risk

At December 31, 2006, in accordance with State law and the District's Investment Policy, the District did not have 5% or more of its net investment in commercial paper, corporate bonds or medium term notes of a single organization. Investments in obligations of the U.S. government, U.S. government agencies, or government-sponsored enterprises are exempt from these limitations.

# CITRUS HEIGHTS WATER DISTRICT

Notes to the Basic Financial Statements  
December 31, 2006

Note 2: **Cash and Investments** (continued)

Concentration of Credit Risk (continued)

The following is a summary of the credit quality distribution and concentration of credit risk by investment type as a percentage of the District's total investment portfolio at December 31, 2006:

	<u>S&amp;P</u>	<u>Moody's</u>	<u>% of Portfolio</u>
Federal Agencies (FNMA)	AA-	AA2	2.29%
Federal Agencies (FHLB)	AAA	AAA	2.25%
Federal Agencies (FFCB)	None	AAA	1.13%
Federal Agencies (Freddie Mac)	AAA	AAA	2.21%
Money Market	N/A	N/A	22.56%
California Local Agency Investment Fund	Unrated	Unrated	69.56%
Total			<u>100.00%</u>

Custodial Credit Risk

For investments and deposits held with fiscal agents, custodial credit risk is the risk that, in the event of the failure of the counterparty, the District will not be able to recover the value of its investments or deposits that are in the possession of an outside party. At year end, the District's cash and investments with fiscal agents had no securities exposed to custodial credit risk.

Local Agency Investment Fund

The District maintains an investment in the State of California Local Agency Investment Fund (LAIF), managed by the State Treasurer. This fund is not registered with the Securities and Exchange Commission as an investment company, but is required to invest according to California State Code. Participants in the pool include voluntary and involuntary participants, such as special districts and school districts for which there are legal provisions regarding their investments. The Local Investment Advisor Board (Board) has oversight responsibility for LAIF. The Board consists of five members as designated by State Statute.

At December 31 2006, the District's investment position in the State of California Local Agency Investment Fund (LAIF) was approximately \$3.0 million which approximates fair value and is the same value as the pooled shares. The total amount invested by all public agencies in LAIF on that day was \$37.1 billion. Of that amount, 96.8% was invested in

# CITRUS HEIGHTS WATER DISTRICT

Notes to the Basic Financial Statements  
December 31, 2006

Note 2: **Cash and Investments** (continued)

Local Agency Investment Fund (continued)

non-derivative financial products and 3.2% in structured notes and asset-backed securities. Fair value is based on information provided by the State for the Local Agency Investment Fund.

Note 3: **Restricted Cash and Investments**

Funds Held by Fiscal Agents

The District had \$1,330,831 in cash and investments as of December 31, 2006, held by fiscal agents pledged for the payment or security of certain certificates of participation. The California Government Code provides that these monies, in the absence of specific statutory provisions governing the issuance of bonds, certificates, or leases, may be invested in accordance with the ordinance, resolutions, policies or indentures specifying the types of investments its fiscal agents may make.

# CITRUS HEIGHTS WATER DISTRICT

## Notes to the Basic Financial Statements December 31, 2006

### Note 4: Capital Assets

Capital assets at December 31, 2006 consisted of the following:

	Balance 1/1/2006	Additions	Retirements	Balance 12/31/2006
Capital assets, not being depreciated				
Land	\$ 171,684	\$ --	\$ --	\$ 171,684
Right of ways	26,080	--	--	26,080
Construction in progress	258,234	99,223	--	357,457
Total capital assets, not being depreciated	<u>455,998</u>	<u>99,223</u>	<u>--</u>	<u>555,221</u>
Capital assets, being depreciated				
Capacity entitlements	5,615,262	--	--	5,615,262
Improvements	55,847	--	--	55,847
Pipelines and infrastructure	30,813,319	2,012,783	(91,851)	32,734,251
Equipment and machinery	2,392,194	159,217	(1,076)	2,550,335
Buildings	1,083,462	--	--	1,083,462
Well improvements	1,104,171	--	--	1,104,171
Donated pipelines	12,616,736	836,979	--	13,453,715
Total capital assets, being depreciated	<u>53,680,991</u>	<u>3,008,979</u>	<u>(92,927)</u>	<u>56,597,043</u>
Less accumulated depreciation for:				
Improvements	(29,268)	(782)	--	(30,050)
Pipelines and infrastructure	(9,892,083)	(914,968)	75,512	(10,731,539)
Equipment and machinery	(1,442,847)	(335,103)	1,076	(1,776,874)
Buildings	(408,545)	(27,087)	--	(435,632)
Well improvements	(395,587)	(27,928)	--	(423,515)
Donated pipelines	(5,428,857)	(317,162)	--	(5,746,019)
Total accumulated depreciation	<u>(17,597,187)</u>	<u>(1,623,030)</u>	<u>76,588</u>	<u>(19,143,629)</u>
Total capital assets, being depreciated, net	<u>36,083,804</u>	<u>1,385,949</u>	<u>(16,339)</u>	<u>37,453,414</u>
Capital assets, net	<u>\$ 36,539,802</u>	<u>\$ 1,485,172</u>	<u>\$ (16,339)</u>	<u>\$ 38,008,635</u>

From 1993 through 1998, the District participated with four other water agencies in a cooperative transmission pipeline project for the construction of additional transmission pipeline facilities. The District's share of these pipeline costs totaled \$5,615,262. The Capacity Entitlements asset represents the capacity rights the District has purchased in the cooperative transmission pipeline project owned by San Juan Water District. The asset will be amortized over the pipeline estimated useful life of forty years.

**CITRUS HEIGHTS WATER DISTRICT**

Notes to the Basic Financial Statements  
December 31, 2006

Note 5: **Long-Term Debt**

**A. Compensated Absences**

The following is a summary of compensated absences activity of the District for the year ended December 31, 2006:

	<u>January 1,</u> <u>2006</u>	<u>Additions</u>	<u>Retirements</u>	<u>December 31,</u> <u>2006</u>	<u>Amount</u> <u>Due Within</u> <u>One Year</u>
Compensated absences	\$ 284,939	\$ 143,581	\$ (108,438)	\$ 320,082	\$ --

**B. Capital Lease Obligation**

In 2002, the District entered into a lease/purchase agreement with LaSalle Bank totaling \$1,150,000 to acquire certain equipment. At December 31, 2006, the value of that equipment net of accumulated depreciation of \$934,197 is \$215,803. The total capital lease balance at December 31, 2006 is \$215,803. The lease arrangement bears interest at a yield of 3.45% and is payable in monthly installments and matures November 15, 2007. Future minimum lease payment at December 31, 2006 is \$219,395, including \$3,592 of interest.

**C. Certificates of Participation Payable**

The District entered into an agreement in October 2000, concerning the sale and delivery of Certificates of Participation in the aggregate principal amount of \$7,900,000 with interest ranging from 4.00% to 5.25%. These 2000 Certificates of Participation were issued to finance the cost of certain capital improvements to the District's water system. The obligation of the District to make the debt service payments is a special obligation of the District payable solely from net revenues and certain debt reserve accounts. The 2000 Certificates of Participation mature through 2020 as follows:

<u>Year Ending</u> <u>December 31</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2007	\$ 325,000	\$ 308,976	\$ 633,976
2008	340,000	294,839	634,839
2009	355,000	279,879	634,879
2010	370,000	264,081	634,081
2011	385,000	247,246	632,246
2012 - 2016	2,220,000	938,978	3,158,978
2017 - 2021	2,225,000	299,513	2,524,513
	<u>\$ 6,220,000</u>	<u>\$ 2,633,512</u>	<u>\$ 8,853,512</u>

## CITRUS HEIGHTS WATER DISTRICT

Notes to the Basic Financial Statements  
December 31, 2006

Note 5: **Long-Term Debt** (continued)

### C. **Certificates of Participation Payable** (continued)

The District entered into an agreement with San Juan Water District in December 2003, concerning the sale and delivery of Certificates of Participation in the aggregate principal amount of \$27,215,000 with interest ranging from 2.00% to 4.25%. The District's portion of the principal amount is \$3,050,000. These 2003 Certificates of Participation were issued to finance the cost of certain capital improvements to the District's water system. The obligation of the District to make the debt service payments is a special obligation of the District payable solely from net revenues and certain debt reserve accounts. The 2003 Certificates of Participation mature through 2033 as follows:

Year Ending December 31	Principal	Interest	Total
2007	\$ 65,000	\$ 129,356	\$ 194,356
2008	70,000	127,406	197,406
2009	70,000	124,606	194,606
2010	75,000	122,856	197,856
2011	75,000	120,606	195,606
2012 - 2016	420,000	561,206	981,206
2017 - 2021	505,000	473,106	978,106
2022 - 2026	625,000	359,461	984,461
2027 - 2031	780,000	201,400	981,400
2032 - 2033	365,000	26,125	391,125
	3,050,000	2,246,128	5,296,128
Plus: Unamortized Premium	66,755	--	66,755
	\$ 3,116,755	\$ 2,246,128	\$ 5,362,883

## CITRUS HEIGHTS WATER DISTRICT

Notes to the Basic Financial Statements  
December 31, 2006

Note 5: **Long-Term Debt** (continued)

### D. Changes in Long-Term Liabilities

Long-term liability activity for the year ended December 31, 2006, was as follows:

	Balance December 31, 2005	Additions	Retirements	Balance December 31, 2006	Due Within One Year
Capital leases payable	\$ 482,530	\$ --	\$ (266,727)	\$ 215,803	\$ 215,803
Certificates of Participation	9,711,755	--	(375,000)	9,336,755	390,000
Compensated Absences	284,939	143,581	(108,438)	320,082	--
Long-term liabilities	<u>\$ 10,479,224</u>	<u>\$ 143,581</u>	<u>\$ (750,165)</u>	<u>\$ 9,872,640</u>	<u>\$ 605,803</u>

Note 6: **Deferred Charges**

The long-term debt issuance costs and discounts are capitalized and amortized over the terms of the respective debt using the life of the underlying debt.

Note 7: **Special Item**

In 2004, the District received capital contributions from donated waterlines through a developer. During the year ended December 31, 2006, the District and the developer agreed that a portion of the donated waterlines totaling \$358,943 were not the responsibility of the developer. This portion of the capital contribution was reimbursed to the developer during March 2006.

Note 8: **Employees' Retirement Plan Description**

The District's defined benefit pension plan, Public Employees' Retirement System (PERS), provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. PERS is part of the Public Agency portion of the California Public Employees' Retirement System, (CalPERS), an agent multiple-employer plan administered by CalPERS, which acts as a common investment and administrative agent for participating public employers within the State of California. A menu of benefit provisions as well as other requirements is established by State statutes with the Public Employees' Retirement Law. The District selects optional benefit provisions from the benefit menu by contract with CalPERS and adopts those benefits through local ordinance (other local methods). CalPERS issues a separate comprehensive annual financial report. Copies of the CalPERS' annual financial report may be obtained from the CalPERS Executive Office – 400 Q Street – Sacramento, California 95814.

# CITRUS HEIGHTS WATER DISTRICT

Notes to the Basic Financial Statements  
December 31, 2006

Note 8: **Employees' Retirement Plan Description** (continued)

**Funding Policy**

The District contributes the employee and employer shares for the Miscellaneous Plan. The District is required to contribute the actuarially determined remaining amounts necessary to fund the benefits for its members. The actuarial methods and assumptions used are those adopted by the CalPERS Board of Administration. The District's employer contribution rate for 2005/06 was 15.006% and for 2006/07 was 15.922% for miscellaneous employees. The contribution requirements of the plan members are established by the State statute and the employer contribution rate is established and may be amended by CalPERS.

**Annual Pension Cost**

For year 2006, the District's annual pension cost was \$258,357 and was equal to the District's required and actual contributions. The required contribution for year 2006 was determined as part of the June 30, 2003 actuarial valuation using the entry age normal actuarial cost method with the contributions determined as a percent of pay. The actuarial assumptions included (a) 7.75% investment rate of return (net of administrative expenses); (b) projected salary increases that vary by duration of service, and (c) no cost-of-living adjustment. Both (a) and (b) include an inflation component of 3.00%. The actuarial value of the District's assets was determined using a technique that smoothes the effect of short-term volatility in the fair value of investments over a two to five year period depending on the size of investment gains and/or losses. The District's unfunded actuarial accrued liability (UAAL) (or excess assets) is being amortized as a level percentage of projected payroll on a closed basis. The remaining amortization period at June 30, 2003, was 17 years.

**Three Year Trend Information for the District Public Employees' Retirement Plan**

<u>Year</u> <u>Ending</u>	<u>Annual</u> <u>Pension Cost</u> <u>(APC)</u>	<u>Percentages</u> <u>APC</u> <u>Contribution</u>	<u>Net Pension</u> <u>Obligation</u>
12/31/04	\$ 108,198	100%	\$ --
(1) 12/31/05	191,372	100%	--
12/31/06	258,357	100%	--

(1) The Annual Pension Cost was updated for the fiscal year ended December 31, 2005 to reflect current information.

# CITRUS HEIGHTS WATER DISTRICT

Notes to the Basic Financial Statements  
December 31, 2006

Note 8: **Employees' Retirement Plan Description** (continued)

## **Schedule of Funding Progress**

### **Funded Status of Miscellaneous Plan**

This information is no longer available for the Miscellaneous Plan. Information is available on a pooled-basis only and can be obtained from CalPERS, P.O. Box 942709, Sacramento, California 94229-2709.

Note 9: **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. During October 1979, the District determined it was unable to obtain general liability and property insurance at a cost it considered to be economically justifiable. The District participates in the Association of California Water Agencies Joint Powers Insurance Authority (ACWA/JPIA), a public entity risk pool currently operating as a common risk carrier management and insurance program for member agencies. The purpose of ACWA/JPIA is to spread the adverse effect of losses among the members and to purchase excess insurance as a group, thereby reducing its expenses. The District pays an annual premium to the ACWA/JPIA for its general liability, automobile, and property coverage. The formation agreement of the ACWA/JPIA provides that the ACWA/JPIA will be self-sustaining through member premiums and will reinsure through commercial companies for claims in excess of \$1,000,000 for liability and \$10,000 for property for each insured event.

The District has a self-insured retention (similar to a deductible) of \$10,000 for automobile and general liability and \$1,000 for property.

The District's workers' compensation program is carried through ACWA/JPIA and the District pays annual premiums to the fund.

Below is the most recent condensed financial information for the ACWA/JPIA for the fiscal year ended September 30, 2006:

Total Assets	<u>\$ 102,216,230</u>
Total Liabilities	\$ 73,348,877
Retained Earnings	<u>28,867,353</u>
Total Liabilities and Retained Earnings	<u>\$ 102,216,230</u>

# CITRUS HEIGHTS WATER DISTRICT

Notes to the Basic Financial Statements  
December 31, 2006

Note 9: **Risk Management** (continued)

Total Revenues	\$ 20,068,101
Total Expenses	<u>16,228,461</u>
Net Income	<u>\$ 3,839,640</u>

Complete separate audited financial statements for the ACWA/JPIA may be obtained at 5620 Birdcage Street, Suite 200, Citrus Heights, California 95610-7632.

Note 10: **Post-Employment Health Care Benefits**

In addition to providing pension benefits through PERS, the District provides certain health care benefits for retired employees through written policy approved by the Board of Directors. Benefits cover the participant and his/her dependents, depending on years of services, with a qualifying minimum of twenty (20) years of service. As of December 31, 2006, three retirees and their dependents meet eligibility requirements and participate in the plan.

The District's contributions are financed on a pay-as-you-go basis and are recognized as expenses when paid. Total expenses recognized for post-employment health care benefits were \$4,026 for the year ended December 31, 2006.

Note 11: **Commitments and Contingencies**

Various claims have been filed against the District. In the opinion of the District's management and legal counsel, the claims will not have a material impact on the basic financial statements.

The District has received state and federal grants for specific purposes that are subject to review and audit by the federal government. Although such audits could result in expenditure disallowances under grant terms, any required reimbursements are not expected to be material.

Note 12: **Economic Dependency**

During 2006, the District purchased 99.5% of its water supply from San Juan Water District (SJWD). Total purchases for the year ended December 31, 2006 was \$1,681,402. In addition, the District owns water transmission capacity entitlements through the cooperative transmission pipeline project owned and operated by SJWD.

## **OTHER REPORT**



**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***

To the Board of Directors  
Citrus Heights Water District  
Citrus Heights, California

We have audited the financial statements of the Citrus Heights Water District as of and for the year ended December 31, 2006, and have issued our report thereon dated April 4, 2007. 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 Citrus Heights Water District's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing our 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 would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

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 entity'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 entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control. The significant deficiency is described in the accompanying schedule of findings and responses as item 2006-1.

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 entity's internal control.

To the Board of Directors  
Citrus Heights Water District  
Citrus Heights, California

Our consideration of the 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 the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we do not believe that the significant deficiency described above is a material weakness.

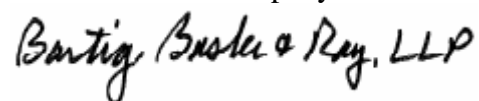
Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Citrus Heights Water 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. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to management of the District, in a separate letter dated April 4, 2007.

This report is intended solely for the information and use of the Citrus Heights Water District, management, and federal and state awarding agencies and is not intended to be and should not be used by anyone other than these specified parties.

BARTIG, BASLER & RAY, LLP  
A Gallina LLP Company



April 4, 2007  
Roseville, California

# CITRUS HEIGHTS WATER DISTRICT

## Schedule of Findings and Responses As of December 31, 2006

### **2006-1: CONTROLS OVER FINANCIAL REPORTING**

#### Condition

This past year, a new auditing standard, Statement on Auditing Standard No. 112, *Communicating Internal Control Related Matters Identified in a Audit* (SAS 112), was issued and applies to the District's current year fiscal audit. The standard provides guidance in that if an entity is unable to draft its own financial statements, there may be a material weakness or significant deficiency. External auditors cannot be part of the District's internal control, including controls over the preparation of the financial statements and are prohibited from auditing their own work as doing so impairs their independence. The District should have the capacity to prepare full disclosure financial statements in accordance with generally accepted accounting principles.

#### Effect of Condition

As a result of recently issued standards, the District is required to take full responsibility for the adequacy of its financial statements in accordance with generally accepted accounting principles. To carry out this responsibility, the District is required to have in place proper internal controls over financial reporting. Proper internal controls over financial reporting include retaining individuals competent in financial reporting and related oversight roles.

#### Recommendation

We recommend the District provide training opportunities for its accounting staff that would enable them to become more familiar with the general disclosure requirements. This training should include, but is not limited to, the usage of the disclosure checklist, which provides guidance to the financial statement's content and whether a necessary disclosure has been overlooked. There is a disclosure checklist on the *Government Finance Officers Association (GFOA)* website which is specific to enterprise type organizations such as the Citrus Heights Water District. This checklist can be obtained for free.

#### Management Response

The District first became aware of Statement on Auditing Standard No. 112 (SAS 112) in February 2007 in discussions with the auditor at the beginning of the financial audit engagement. It is Management's understanding that the independent auditors themselves only very recently learned of this new auditing standard. Therefore, there was no way that Management could reasonably comply with SAS 112 for its FY2006 audited financial statements.

SAS 112 fundamentally changes the approach that Citrus Heights Water District (and likely thousands of other small public entities across the United States) has used for decades, which entails having the independent auditor also prepare its financial statements. Although the new auditing standard suggests that an entity's inability to draft its own financial statements may be a material weakness or significant deficiency, Management is confident that its internal controls are sound and that the approach used to prepare its FY2006 financial statements is as fundamentally sound as it has been for many years before SAS 112 was issued.

## CITRUS HEIGHTS WATER DISTRICT

### Schedule of Findings and Responses As of December 31, 2006

Management has not yet determined what approach it will use to comply with SAS 112. The independent auditor's recommendation, providing training opportunities for the District's accounting staff to enable preparation of the financial statements, is one possible approach. However, by design, District financial and accounting staff members are generalists in nature. Each staff member has a broad array of functional responsibilities and, as such, they have never been expected to have the expertise to prepare full disclosure financial statements in accordance with generally accepted accounting principles. It is unclear what level of training may be needed in order to attain this level of expertise.

Another possible approach may be to contract for preparation of the financial statements by a Certified Public Accountant or other qualified persons separate from the independent auditor. It is not entirely clear to Management whether this approach would satisfy SAS 112, but on the surface it appears that it would meet the standard. Each approach carries with it both costs and challenges, and the District will carefully weigh these before determining the approach that will best serve the District, its Board of Directors and its customers.