

CITRUS HEIGHTS WATER DISTRICT

**MANAGEMENT REPORT
FOR THE YEAR ENDED
DECEMBER 31, 2007**

CITRUS HEIGHTS WATER DISTRICT

Management Report
For the Year Ended December 31, 2007

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Board of Directors
Citrus Heights Water District
Citrus Heights, California

In planning and performing our audit of the basic financial statements of the Citrus Heights Water District for the fiscal year ended December 31, 2007, we considered its internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the basic financial statements and not to provide assurance on internal control.

Our consideration of the internal control over financial reporting would not necessarily identify all deficiencies in the internal control that might be significant deficiencies or material weaknesses under standards established by the American Institute of Certified Public Accountants. 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. However, we noted the matters identified below involving the internal control over financial reporting that we considered to be significant deficiencies as defined above and is described in our report on the District's internal control in our report dated March 28, 2008:

2007-1: Controls Over Financial Reporting
2007-2: Controls Over Grant Revenue

The memorandum that accompanies this letter summarizes our comments and suggestions concerning other matters. We previously reported on the District's internal control in our report dated March 28, 2008. This letter does not affect our report dated March 28, 2008 on the financial statements of the Citrus Heights Water District.

This report is intended for the use of management, the Board of Directors, and the officials of federal and state grantor agencies. We thank the District's staff for its cooperation during our audit.

BARTIG, BASLER & RAY, LLP
A Gallina LLP Company

Bartig Basler & Ray, LLP

Roseville, California
March 28, 2008

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The Auditor's Responsibility under U.S. Generally Accepted Auditing Standards

As stated in our engagement letter dated July 8, 2005, our responsibility, as described by professional standards, is to plan and perform our audit to obtain reasonable, but not absolute assurance that the financial statements are free of material misstatement and are fairly presented in accordance with U.S. generally accepted accounting principles. Because an audit is designed to provide reasonable, but not absolute assurance and because we did not perform a detailed examination of all transactions, there is a risk that material misstatements may exist and not be detected by us.

In planning and performing our audit, we considered the District's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide assurance on the internal control over financial reporting.

As part of obtaining reasonable assurance about whether the District's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit. While our audit provides a reasonable basis for our opinion, it does not provide a legal determination on the District's compliance with those requirements.

Significant Accounting Policies

Management is responsible for the selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by the District are described in Note 1 to the financial statements. We noted no transactions entered into by the District during the year that were both significant and unusual, and of which, under professional standards, we are required to inform you, or transactions for which there is a lack of authoritative guidance or consensus.

Accounting Estimates

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

- Accrual and collectibility of receivables subject to grant requirements

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- Accrual and disclosure of compensated absences
- Capital asset lives and depreciation expense

Audit Adjustments

For purposes of this letter, professional standards define an audit adjustment as a proposed correction of the financial statements that, in our judgment, may not have been detected except through our auditing procedures. An audit adjustment may or may not indicate matters that could have a significant effect on the District's financial reporting process (that is, cause future financial statements to be materially misstated).

The following audit adjustment, in our judgment, indicates a matter that could have a significant effect on the County's financial reporting process:

During the audit, we proposed that the District accrue grant revenue of \$207,402. Not recording the adjustment would result in an understatement of both revenues and receivables.

Disagreements with Management

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

Consultations with Other Independent Auditors

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

Issues Discussed Prior to Retention of Independent Auditors

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

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Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing our audit.

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Management Report Current Year Recommendations For the Year Ended December 31, 2007

Physical Safeguards Over Inventory

Condition

Currently, the District does not maintain sufficient safeguards over physical inventory. A majority of District personnel have unrestricted access to the inventory items. This condition is amplified by the absence of a perpetual inventory system.

Effect of Condition

Inventories should be properly safeguarded to protect them from loss. Physical access should be limited. The current control environment does not provide such assurance. Without proper safeguards over inventory, the risk of inventory being accounted for incorrectly or misappropriated is increased.

Recommendation

We recommend that the District reduce the possibility of misappropriation by restricting access or by using other compensating controls such as use of a perpetual inventory system. The District may find it costly to restrict access because of the nature of the inventory items. The implementation of a perpetual inventory system will provide compensating controls.

Management's Response

District Management agrees that by storing most inventory items in the Shop Building that houses the workshops, crew trucks and equipment/tool storage for Operations, a majority of District personnel have unrestricted access to inventory items. This is a situation that cannot be easily changed, since the District has no other buildings where it can reasonably store inventory items to prevent access by a majority of employees. Securing inventory items within the Shop Building with locking cabinets or containers, while theoretically possible, would be an extremely costly and impractical remedy.

As part of its review of current inventory procedures and practices to be performed in the coming year, District Management will examine methods to improve physical safeguards over inventory and inventory control. Again, Management's goal will be to determine those safeguards or procedures that can be reasonably established without incurring significant additional costs or creating inefficiencies for Operations crews in acquiring the parts and materials needed to perform their work.

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Use a Perpetual Inventory System

Condition

Currently, the District does not maintain a perpetual inventory system. An inventory physical is taken at or close to the District's year end. The inventory account balance on the general ledger is adjusted to agree to the result of the physical count. The current system does not provide the means to compare the results of the physical count to what the inventory balance should have been considering purchases (additions to inventory) and transfers (items consumed). As such, there is no way to measure inventory shrinkage due to loss, theft or other misappropriation.

Effect of Condition

A good perpetual inventory system should provide timely and accurate information on inventory costing, activity/turnover, quantity levels, and obsolescence. Without a perpetual inventory system, the risk of misappropriation without detection is increased.

Recommendation

We recommend that the District consider implementing a perpetual inventory system. This system will allow management to monitor inventory levels on hand, provide a comparison for the physical inventory count, and allow for better inventory management.

Management's Response

District Management agrees that the absence of a perpetual inventory system may increase the risk of misappropriation without detection, and that there may be other benefits of more timely and accurate information on inventory levels and turnover. However, Management also believes that the costs of implementing and maintaining a full-fledged perpetual inventory system could outweigh the benefits. Unlike some larger agencies, the District does not have a department or even one employee whose sole job is to perform the procurement and inventory function. Accounting for materials being removed from inventory for use by Operations crews on a continual basis and maintaining a perpetual inventory of these items would likely require a significantly greater investment of employee time than is currently devoted to this effort.

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Use a Perpetual Inventory System (continued)

Management's Response (continued)

The relatively small size of the District's operation lends itself to a reasonable level of inventory control without a perpetual inventory system in place. Through experience, the persons charged with the procurement and inventory responsibilities develop knowledge of the types and quantities of items generally used by Operations crews on a daily basis. With this knowledge, it is possible to detect abnormal patterns of usage. Although Management acknowledges that the absence of a perpetual inventory system increases the risk of misappropriation, there is no reason to believe that such misappropriation is taking place.

District Management feels that it will be worthwhile to examine its current inventory procedures and practices. Management's goal will be to determine those systems or procedures that can be reasonably put into place to improve inventory control without incurring significant additional costs or creating inefficiencies for Operations crews in acquiring the parts and materials needed to perform their work.