

CITRUS HEIGHTS WATER DISTRICT

AUDIT REPORT

**FOR THE YEAR ENDED
DECEMBER 31, 2008**

**CITRUS HEIGHTS WATER DISTRICT
TABLE OF CONTENTS**

	<u>Page</u>
Independent Auditor’s Report.....	1-2
Management’s Discussion and Analysis	3-11
Basic Financial Statements:	
Statement of Net Assets	12
Statement of Revenues, Expenses, and Changes in Net Assets	13
Statement of Cash Flows.....	14-15
Notes to the Basic Financial Statements.....	16-31
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>	32-33
Schedule of Findings and Responses.....	34-36
Schedule of Prior Year Findings and Responses	37



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, 2008, 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 also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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 opinion.

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, 2008, 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 March 31, 2009, 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 11 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.

Gallina LLP

Roseville, California
March 31, 2009

MANAGEMENT'S DISCUSSION AND ANALYSIS

CITRUS HEIGHTS WATER DISTRICT

Management's Discussion and Analysis December 31, 2008

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, 2008 (FY2008).

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 2008 and its financial position at the close of FY2008:

- ❖ The District's assets exceeded its liabilities at the end of FY2008 by \$39,576,386. Over 88.8 percent of the District's net assets, \$35,153,932, 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 \$3,556,762, down from \$4,011,914 at the end of FY2007. This decrease is due primarily to an increase in the District's investment in capital assets. Of this unrestricted amount, the District has designated \$200,000 for rate stabilization and/or catastrophic losses, leaving \$3,356,762 for current and future operations and projects.
- ❖ The District's operating revenues for FY2008 were \$8,686,514. The great majority of revenues, \$8,315,513 came from water sales to customers. The District adopted a 12.4 percent increase in water rates for the majority of its customers that went into effect at the beginning of 2008. The second-largest source of revenue for 2008 was \$140,744 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 the water system to serve additional users, a method of calculating fees known as the "system buy-in" method.

CITRUS HEIGHTS WATER DISTRICT

Management's Discussion and Analysis December 31, 2008

- ❖ The District's total net long-term liabilities at the end of FY2008, including the 2003 Certificates of Participation, the 2000 Certificates of Participation, and compensated absences, is \$8,380,519. This is a decrease of \$369,705 from net long-term liabilities at the end of FY2007, reflecting the payment of principal on debt during 2008.

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, 2008

Statement of Net Assets

As of December 31, 2008, the total net assets of the District were \$39,576,386. The following table summarizes assets, liabilities and net assets at December 31, 2008 and 2007:

	<u>2008</u>	<u>2007</u>
Current assets, unrestricted	\$ 4,977,447	\$ 5,672,411
Restricted cash and cash equivalents	840,903	854,022
Capital assets, net	42,770,416	40,092,556
Other assets	194,771	208,484
Total assets	<u>48,783,537</u>	<u>46,827,473</u>
Current liabilities	826,632	933,006
Long-term liabilities	8,380,519	8,750,224
Total liabilities	<u>9,207,151</u>	<u>9,683,230</u>
Net Assets		
Invested in capital assets, net of related debt	35,153,932	32,278,307
Restricted	865,692	854,022
Unrestricted	3,556,762	4,011,914
Total net assets	<u>\$ 39,576,386</u>	<u>\$ 37,144,243</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 designated 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, 2008

Changes in Net Assets

The following table summarizes the changes in net assets for the fiscal year ended December 31, 2008 and 2007:

	2008	2007
Operating revenues	\$ 8,686,514	\$ 9,864,606
Operating expenses:		
Water Purchases	1,931,082	1,809,591
Pumping and Well Maintenance	90,349	62,454
Transmission and Distribution	1,047,545	1,089,189
Customer Service, Administrative and General	2,702,249	2,323,874
Depreciation and Amortization	1,648,002	1,677,899
Total operating expenses	7,419,227	6,963,007
Operating income	1,267,287	2,901,599
Net nonoperating revenues (expenses)	(180,059)	(1,493)
Net Income Before Capital Contributions	1,087,228	2,900,106
Capital Contributions:		
Grant Revenue	376,476	527,408
Donated Capital Assets	968,439	435,468
Change in Net Assets	2,432,143	3,862,982
Net Assets, Beginning of year	37,144,243	33,281,261
Net Assets, End of year	\$ 39,576,386	\$ 37,144,243

Total net assets increased \$2,432,143, or 6.5 percent from the prior year. Operating revenue that exceeded operating expenses by \$1,267,287 accounts for slightly more than one-half of the increase in net assets, and these funds were expended for the construction of capital improvements or set aside for that purpose. The receipt of \$968,439 in donated assets from private developer additions to the District's water distribution system accounted for about 40 percent of the increase in net assets.

CITRUS HEIGHTS WATER DISTRICT

Management's Discussion and Analysis December 31, 2008

Total operating revenues decreased \$1,178,092 or 11.9 percent from the prior year, primarily as a result of converting all remaining flat-rate water accounts, over 16,000 residential accounts, to metered water billing. Flat-rate water accounts that had previously been billed in advance for the next six months of water service were now being billed in arrears starting on January 1, 2008, resulting in several months at the beginning of 2008 with very little income from water sales.

Operating expenses increased \$456,220 or 6.6 percent from the prior year. The most significant increases in operating expenses were a result of greatly increased billing, collections, and other customer service costs associated with the bi-monthly metered water billing for all District customers. Increased water purchases costs were due to a 19.3 percent increase in the cost per acre-foot of water from San Juan Water District, the District's supplier of treated surface water.

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

As of December 31, 2008, the District's investment in capital assets was \$35,153,932, 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 Mitchell Farms Groundwater Well which was completed in early 2008 and the Bonita Way Groundwater Well which was still under construction at the end of 2008. A number of private development projects resulted in the addition of \$968,439 in donated capital assets.

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 2008. The District's total Certificates of Participation (COP) debt from its issuances in 2000 and 2003 now stands at approximately \$8.46 million.

The District had no lease obligations as of December 31, 2008.

Compensated absences, composed of leave hours earned by employees that are payable upon termination or retirement, are valued at \$415,833.

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, 2008

ECONOMIC FACTORS AND FUTURE BUDGET CONSIDERATIONS

Nearly all aspects of District operating costs will experience some increase in 2009, compared with 2008 costs. Major increases include:

- ❖ A 19.0 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 \$397,217;
- ❖ A 1.1 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 \$22,386;
- ❖ A 6.0 percent increase in budgeted benefit costs (+\$40,527), primarily due to increases in the costs of employee health insurance and CalPERS retirement contributions;
- ❖ An 11.2 percent increase (+\$251,100) in water transmission and distribution costs, due to rapidly rising costs for waterworks materials and fuel for vehicles and equipment.

The District will see costs related to customer billing and bill processing continue to rise as the trend toward greater use of credit cards to pay water bills continues. New customer water statements will be implemented in 2009, and these will increase the cost of printing and mailing bills. The web-based bill payment option, which was introduced near the end of 2008, will increase costs associated with credit card and other transaction fees. However, some of these costs will be offset by savings of District staff time due to the self-service nature of the web pay option. A 2009 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.

The District has greatly curtailed its planned spending for capital improvements in 2009. The total capital improvement budget for 2009 is about \$1.05 million, compared with a \$4.33 million capital budget in 2008. This reduction in capital spending will help to begin to rebuild the District's financial reserves, which have been depleted by heavy investment in water meter retrofits since the late 1990's. Of the \$1.05 million budgeted, \$400,000 is earmarked for completion of the Bonita Way Groundwater Well and a storage building at the well site. A 2009 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 \$829,486 for 2009, representing about 8.5 percent of the District's 2009 Operating Budget.

In order to keep pace with these rising costs, the District's Board of Directors adopted a water rate increase of 12.6 percent in the bi-monthly service charge and 19 percent in the commodity rate for water for 2009, following a rate increase of 8.0 percent in the bi-monthly service charge and 19 percent in the commodity rate for water for 2008. Even with these water rate increases,

CITRUS HEIGHTS WATER DISTRICT

Management's Discussion and Analysis December 31, 2008

the District's water rates are still about 9.2 percent below the average water rate in the Sacramento region.

The District anticipates the need for ongoing annual water rate increases to fund replacement of portions of the District's 265 miles of underground water mains and to pay the continually-rising operating costs of the District while maintaining financial reserves to comply with debt covenants and to provide funds for emergencies or catastrophic losses.

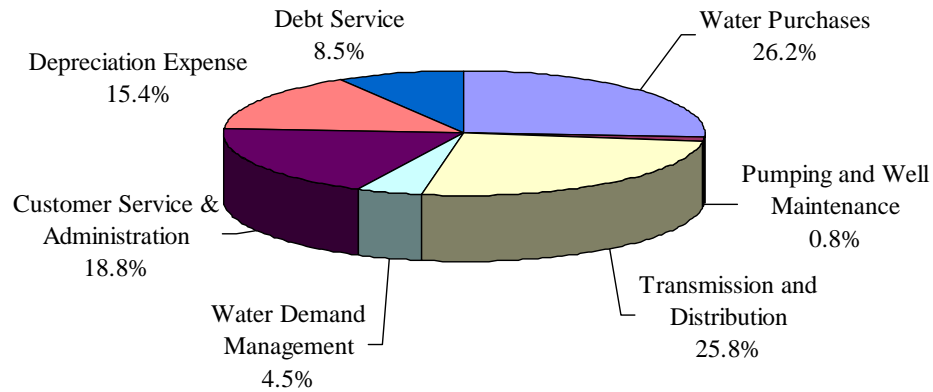
Citrus Heights Water District **2009 Operating Budget Summary**

<u>Expense Category</u>	2007 Actual	2008 Adopted	2009 Adopted	% Change 2009 vs. 2008
Water Purchases	\$ 1,833,997	\$ 2,146,006	\$ 2,543,223	18.5%
Pumping and Well Maintenance	65,000	60,404	75,444	24.9%
Transmission and Distribution	2,192,306	2,258,257	2,502,329	10.8%
Water Demand Management	339,362	398,709	437,249	9.7%
Customer Service & Administration	1,662,103	1,917,342	1,826,610	-4.7%
Depreciation, Capital Improvement and Rate Stabilization Expense	794,288	811,515	1,500,000	84.8%
Debt Service	828,332	830,845	829,486	-0.2%
Totals	\$ 7,715,388	\$8,423,078	\$ 9,714,341	15.3%

CITRUS HEIGHTS WATER DISTRICT

Management's Discussion and Analysis
December 31, 2008

CHWD 2009 Operating Budget By Category



- Water Purchases
- Pumping and Well Maintenance
- Transmission and Distribution
- Water Demand Management
- Customer Service & Administration
- Depreciation Expense
- Debt Service

Citrus Heights Water District 2009 Capital Improvement Budget Summary

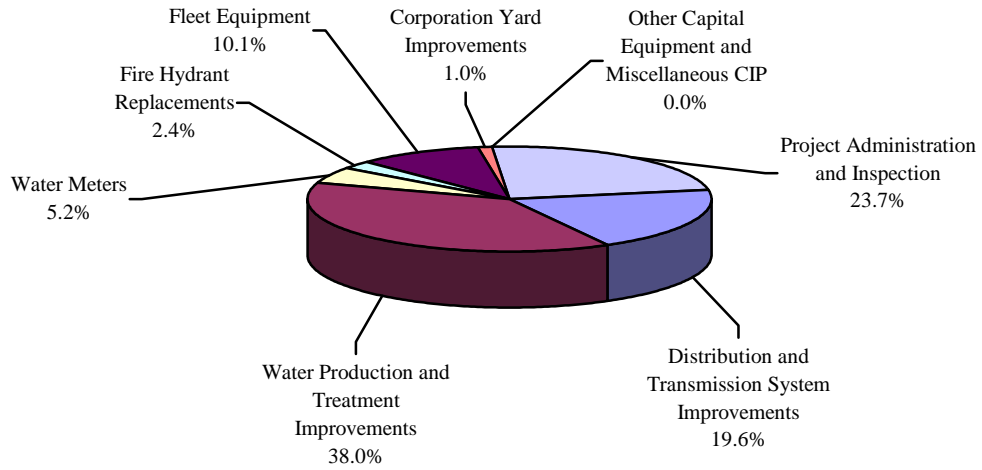
<u>Capital Improvement Expense Categories*</u>	2009 Adopted
Distribution and Transmission System Improvements	\$206,000
Water Production and Treatment Improvements	400,000
Water Meter Retrofits	55,000
Fire Hydrant Replacements	25,000
Fleet Equipment	106,500
Corporation Yard Improvements	10,000
Other Capital Equipment and Miscellaneous CIP	0
Project Administration and Inspection	248,759
Total	\$ 1,051,259

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

CITRUS HEIGHTS WATER DISTRICT

Management's Discussion and Analysis
December 31, 2008

CHWD 2009 Capital Improvement Budget By Category



BASIC FINANCIAL STATEMENTS

CITRUS HEIGHTS WATER DISTRICT

Statement of Net Assets

December 31, 2008

ASSETS

Current Assets:

Cash and investments, unrestricted	\$ 2,187,221
Receivables:	
Accounts, net	1,359,498
Grants	276,618
Interest	13,211
Inventory	363,409
Prepaid expenses	777,490
Total Current Assets	<u>4,977,447</u>

Non-Current Assets:

Capital assets:	
Nondepreciable	2,318,509
Depreciable, net	40,451,907
Cash and investment, restricted	840,903
Issuance costs, net of accumulated amortization	194,771
Total Non-Current Assets	<u>43,806,090</u>

Total Assets \$ 48,783,537

LIABILITIES

Current Liabilities:

Accounts payable	\$ 75,412
Accrued interest payable	37,094
Accrued salaries and benefits	61,122
Deposits payable	160,303
Certificates of participation, current	355,000
Compensated absences, current	137,701
Total Current Liabilities	<u>826,632</u>

Long-term Liabilities:

Certificates of participation	8,102,387
Compensated absences	278,132
Total Long-term Liabilities	<u>8,380,519</u>

Total Liabilities 9,207,151

NET ASSETS

Invested in capital assets, net of related debt	35,153,932
Restricted for:	
Debt service	865,692
Unrestricted	3,556,762
Total Net Assets	<u>39,576,386</u>

Total Liabilities and Net Assets \$ 48,783,537

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, 2008

Operating revenues:	
Water sales - annual	\$ 2,283
Water sales - apartments and meters	8,315,513
Penalties and back charges	104,854
Service charges and repairs	96,420
Tap fees (water service and meter installation)	26,700
Capacity fees	<u>140,744</u>
Total operating revenues	<u>8,686,514</u>
Operating expenses:	
Water purchases	1,931,082
Pumping and well maintenance	90,349
Transmission and distribution	1,047,545
Customer service, administrative, and general	2,702,249
Amortization expense	4,345
Depreciation expense	<u>1,643,657</u>
Total operating expense	<u>7,419,227</u>
Operating income (loss)	<u>1,267,287</u>
Non-operating revenues (expenses):	
Investment earnings	113,579
Gain (loss) on disposition of capital assets	(30,579)
Other income	151,238
Interest expense	<u>(414,297)</u>
Total Non-operating revenues (expenses)	<u>(180,059)</u>
Income (loss) before capital contributions	1,087,228
Capital contributions:	
Grant revenue	376,476
Donated capital assets	<u>968,439</u>
Change in net assets	2,432,143
Net Assets, Beginning of year	<u>37,144,243</u>
Net Assets, End of year	<u><u>\$ 39,576,386</u></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, 2008

Cash Flows from Operating Activities:	
Receipts from customers	\$ 7,741,732
Payments to suppliers	(3,780,452)
Payments to employees	<u>(2,113,266)</u>
Net Cash Flows Provided (Used) by Operating Activities	<u>1,848,014</u>
Cash Flows from Non-Capital and Related Financing Activities:	
Other income	<u>151,238</u>
Net Cash Flows Provided (Used) by Non-Capital and Related Financing Activities	<u>151,238</u>
Cash Flows from Capital and Related Financing Activities:	
Grant proceeds	307,260
Interest paid	(414,058)
Payments for capital acquisitions	(3,383,657)
Payments on long-term debt	<u>(410,000)</u>
Net Cash Flows Provided (Used) by Capital and Related Financing Activities	<u>(3,900,455)</u>
Cash Flows from Investing Activities:	
Investment earnings received	<u>174,057</u>
Net Cash Flows Provided (Used) by Investing Activities	<u>174,057</u>
Net increase (decrease) in cash and cash equivalents	(1,727,146)
Cash and cash equivalents, January 1, 2008	<u>4,755,270</u>
Cash and cash equivalents, December 31, 2008	<u><u>\$ 3,028,124</u></u>
Reconciliation of Cash and Cash Equivalents to the Statement of Net Assets:	
Cash and investments	\$ 2,187,221
Cash and investments, restricted	<u>840,903</u>
Total Cash and Cash Equivalents	<u><u>\$ 3,028,124</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, 2008

Reconciliation of Operating Income (Loss) to Net Cash

Provided (Used) By Operating Activities:

Operating income (loss)	\$ 1,267,287
Adjustments to reconcile operating income to net cash provided by operating activities:	
Depreciation	1,643,657
Amortization	4,345
(Increase) Decrease in Assets:	
Accounts receivable	(944,782)
Inventory	6,744
Prepaid expenses	(72,287)
Increase (Decrease) in Liabilities:	
Accounts payable	(258,501)
Deposits payable	87,864
Accrued salaries and benefits	59,033
Compensated absences	54,654
	54,654
Net Cash Provided (Used) for Operating Activities	\$ 1,848,014

Non-Cash Capital and Related Financing Activities:

Donated capital assets	\$ 968,439
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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, 2008

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, 2008

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, 2008

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. The range of estimated useful lives by type of asset is as follows:

Improvements	10-50 years
Pipelines and infrastructure	20-40 years
Equipment and machinery	3-10 years
Buildings	20-39 years
Well improvements	40 years
Donated pipelines	40 years

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.

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, 2008

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. The District did not have any Net Assets restricted by legislation at December 31, 2008.

Note 2: **Cash and Investments**

At December 31, 2008, the District's total cash and investments at fair value were as follows:

<i>Cash:</i>	
Cash on hand	\$ 550
Deposits	<u>17,894</u>
Total cash	<u>18,444</u>
 <i>Investments:</i>	
Unrestricted	2,168,777
Restricted with fiscal agent	<u>840,903</u>
Total investments	<u>3,009,680</u>
Total cash and investments	<u>\$ 3,028,124</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, 2008

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

Custodial Credit Risk of Cash Deposits (continued)

At December 31, 2008, the recorded amount of the District's deposits was \$17,894 and the bank balance was \$620,582. Of the bank balance, \$250,000 was covered by Federal Depository Insurance Corporation (FDIC) and the remainder was covered by the multiple financial institution collateral pool that insures public deposits.

Investments

At December 31, 2008, the District had the following investments:

	Fair Value	WAM* (Years)
Investments, Unrestricted		
California Local Agency Investment Fund (LAIF)	\$ 1,666,596	-
Certificate of Deposit	190,408	2.38
Federal Agencies	294,520	3.01
Money Market	17,253	-
Total investments, unrestricted	\$ 2,168,777	0.45
Investments, Restricted		
Money Market	\$ 840,903	-
Total investments, restricted	\$ 840,903	-
Total fair value	\$ 3,009,680	

*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, 2008

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

Investments (continued)

Authorized Investment Type	Maximum Maturity	Maximum Percentage of Portfolio	Maximum Investment in One Issuer
Local Agency Obligations	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	N/A	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, 2008, 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, 2008

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, 2008:

	<u>S&P</u>	<u>Moody's</u>	<u>% of Portfolio</u>
Federal Agencies (FHLB)	AAA	AAA	6.40%
Federal Agencies (FHLMC)	AAA	AAA	3.38%
Money Market	N/A	N/A	28.52%
Certificate of Deposit	Unrated	Unrated	6.33%
California Local Agency Investment Fund	Unrated	Unrated	55.37%
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 Government 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 Advisory Board (Board) has oversight responsibility for LAIF. The Board consists of five members as designated by State Statute.

CITRUS HEIGHTS WATER DISTRICT

Notes to the Basic Financial Statements
December 31, 2008

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

Local Agency Investment Fund (continued)

At December 31, 2008, the District's investment position in the State of California Local Agency Investment Fund (LAIF) was approximately \$1.7 million determined on an amortized cost basis 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 \$63.3 billion. Of that amount, 87.07% was invested in non-derivative financial products and 12.93% 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 \$840,903 in cash and investments as of December 31, 2008, 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, 2008

Note 4: Capital Assets

Capital assets at December 31, 2008 consisted of the following:

	Balance 1/1/2008	Additions	Retirements	Adjustments	Balance 12/31/2008
Capital assets, not being depreciated					
Land	\$ 382,684	\$ 441,526	\$ --	\$ --	\$ 824,210
Right of ways	26,080	--	--	--	26,080
Construction in progress	1,933,696	1,415,592	--	(1,881,069)	1,468,219
Total capital assets, not being depreciated	<u>2,342,460</u>	<u>1,857,118</u>	<u>--</u>	<u>(1,881,069)</u>	<u>2,318,509</u>
Capital assets, being depreciated					
Capacity entitlements	5,615,262	--	--	--	5,615,262
Improvements	55,847	--	--	--	55,847
Pipelines and infrastructure	34,036,037	1,397,189	(146,495)	--	35,286,731
Equipment and machinery	2,512,025	127,706	(42,666)	58,807	2,655,872
Buildings	1,115,235	1,644	--	--	1,116,879
Well improvements	1,104,171	--	--	1,822,262	2,926,433
Donated pipelines	13,889,183	968,439	--	--	14,857,622
Total capital assets, being depreciated	<u>58,327,760</u>	<u>2,494,978</u>	<u>(189,161)</u>	<u>1,881,069</u>	<u>62,514,646</u>
Less accumulated depreciation for:					
Improvements	(30,833)	(782)	--	--	(31,615)
Pipelines and infrastructure	(11,616,029)	(993,948)	115,916	--	(12,494,061)
Equipment and machinery	(1,932,470)	(232,269)	42,666	--	(2,122,073)
Buildings	(463,834)	(28,464)	--	--	(492,298)
Well improvements	(451,228)	(38,947)	--	--	(490,175)
Donated pipelines	(6,083,270)	(349,247)	--	--	(6,432,517)
Total accumulated depreciation	<u>(20,577,664)</u>	<u>(1,643,657)</u>	<u>158,582</u>	<u>--</u>	<u>(22,062,739)</u>
Total capital assets, being depreciated, net	<u>37,750,096</u>	<u>851,321</u>	<u>(30,579)</u>	<u>1,881,069</u>	<u>40,451,907</u>
Capital assets, net	<u>\$ 40,092,556</u>	<u>\$ 2,708,439</u>	<u>\$ (30,579)</u>	<u>\$ --</u>	<u>\$ 42,770,416</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, 2008

Note 5: **Long-Term Liabilities**

The following is a summary of long-term liabilities of the District for the year ended December 31, 2008:

	Balance January 1, 2008	Additions	Retirements	Balance December 31, 2008	Due Within One Year
Certificates of participation	\$ 8,876,755	\$ --	\$ (419,368)	\$ 8,457,387	\$ 355,000
Compensated absences	361,179	273,855	(219,201)	415,833	137,701
Long-term liabilities	\$ 9,237,934	\$ 273,855	\$ (638,569)	\$ 8,873,220	\$ 492,701

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:

Year Ending December 31	Principal	Interest	Total
2009	\$ 355,000	\$ 279,879	\$ 634,879
2010	370,000	264,081	634,081
2011	385,000	247,246	632,246
2012	405,000	229,440	634,440
2013	420,000	210,000	630,000
2014-2018	2,450,000	706,125	3,156,125
2019-2020	1,170,000	92,925	1,262,925
	\$ 5,555,000	\$ 2,029,696	\$ 7,584,696

CITRUS HEIGHTS WATER DISTRICT

Notes to the Basic Financial Statements
December 31, 2008

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

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 \$2,915,000. 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
2009	\$ --	\$ 62,303	\$ 62,303
2010	75,000	122,856	197,856
2011	75,000	120,606	195,606
2012	80,000	118,356	198,356
2013	80,000	115,556	195,556
2014-2018	450,000	528,256	978,256
2019-2023	550,000	431,543	981,543
2024-2028	680,000	302,188	982,188
2029-2033	855,000	125,400	980,400
	2,845,000	1,927,064	4,772,064
Plus: Unamortized Premium	57,387	--	57,387
	\$ 2,902,387	\$ 1,927,064	\$ 4,829,451

CITRUS HEIGHTS WATER DISTRICT

Notes to the Basic Financial Statements
December 31, 2008

Note 6: **Deferred Charges**

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

Note 7: **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), a cost-sharing 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.

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 2007/08 was 16.335% and for 2008/09 was 16.173% 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 2008, the District's annual pension cost was \$278,806 and was equal to the District's required and actual contributions. The required contribution for year 2008 was determined as part of the pool's June 30, 2005 actuarial valuation.

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>
12/31/06	\$ 258,357	100%	\$ --
12/31/07	278,599	100%	--
12/31/08	278,806	100%	--

CITRUS HEIGHTS WATER DISTRICT

Notes to the Basic Financial Statements
December 31, 2008

Note 7: **Employees' Retirement Plan Description** (continued)

Schedule of Funding Progress

The schedule of funding progress for the District's Miscellaneous Plan is no longer available. Information is available on a pooled-basis only and can be obtained from CalPERS, P.O. Box 942709, Sacramento, California 94229-2709.

Note 8: **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, 2008:

Total Assets	<u>\$ 117,864,564</u>
Total Liabilities	\$ 79,504,265
Net Assets	<u>38,360,299</u>
Total Liabilities and Net Assets	<u>\$ 117,864,564</u>
Total Revenues	\$ 30,818,975
Total Expenses	<u>23,984,544</u>
Net Income	<u>\$ 6,834,431</u>

CITRUS HEIGHTS WATER DISTRICT

Notes to the Basic Financial Statements
December 31, 2008

Note 8: **Risk Management** (continued)

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

Note 9: **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, 2008, 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 \$7,076 for the year ended December 31, 2008.

Note 10: **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 11: **Economic Dependency**

During 2008, the District purchased 98% of its water supply from San Juan Water District (SJWD). Total purchases for the year ended December 31, 2008 was \$1,931,082. In addition, the District owns water transmission capacity entitlements through the cooperative transmission pipeline project owned and operated by SJWD.

Note 12: **New Accounting Pronouncements**

The Governmental Accounting Standards Board (GASB) released GASB Statement No. 45, *Accounting and Financial Reporting by Employers of Postemployment Benefits Other than Pensions (OPEB)*, which may have a significant impact on the District's financial reporting process. GASB Statement No. 45 establishes standards for the measurement, recognition and display of OPEB expenses/expenditures, related assets and liabilities, note disclosures and, if applicable, required supplementary information in the

CITRUS HEIGHTS WATER DISTRICT

Notes to the Basic Financial Statements
December 31, 2008

Note 12: **New Accounting Pronouncements** (continued)

financial reports of state and local government employers. GASB No. 45 will be effective for the fiscal year ending December 31, 2009.

The GASB has issued Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, which may have a significant impact on the District's financial reporting process. GASB Statement No. 51 establishes accounting and financial reporting requirements for intangible assets including easements, water rights, timber rights, patents, trademarks and computer software. GASB No. 51 will be effective for the fiscal year ending December 31, 2010.

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 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, 2008, and have issued our report thereon dated March 31, 2009. 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. 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 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 statement is more than inconsequential will not be prevented or detected by the entity's internal control. We consider the deficiency described in the accompanying schedule of findings and responses (2007-1) to be a significant deficiency in internal control over financial reporting.

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

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.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

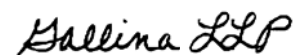
Compliance and Other Matters

As part of obtaining reasonable assurance about whether the 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 March 31, 2009.

The District's response to the findings identified in our audit is described in the accompanying schedule of findings and responses. We did not audit the District's response, and, accordingly, we express no opinion on it.

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.



Roseville, California
March 31, 2009

CITRUS HEIGHTS WATER DISTRICT

Schedule of Findings and Responses As of December 31, 2008

Finding 2007-1

Controls Over Financial Reporting *Reporting Requirement: Significant Deficiency*

Criteria

Statement on Auditing Standard No. 112, *Communicating Internal Control Related Matters Identified in an Audit* (SAS 112) applies to the District's internal control over preparation of the financial statements. The standard provides guidance to the auditor in evaluating an entity's internal controls over financial reporting.

External auditors cannot be part of an entity's internal controls, including controls over the preparation of the financial statements, and are prohibited from auditing their own work as doing so impairs their independence. Under SAS 112, an entity's inability to draft its own financial statements is an indication of a potential significant deficiency or material weakness.

The District should have the capacity to prepare full disclosure financial statements in accordance with generally accepted accounting principles (GAAP). To carry out this responsibility, an entity must have proper internal controls over financial reporting in place. Proper internal controls over financial reporting include, but are not limited to, internal controls that identify misstatements in the financial records, ensuring staff in financial reporting and related oversight roles (or outside consultants who fill reporting roles) are equipped with the necessary knowledge and abilities, and adequate design of internal control over the preparation of the financial statements.

Condition

Currently, the District relies on the external auditors to ensure its financial statements are in accordance with GAAP. In addition, the District relies on the external auditor to ensure that all necessary disclosures are included in the notes to the financial statements.

Cause

Prior to the issuance of SAS 112, the District was able to rely on the external auditors to assist with preparation of the financial statements and related notes without being subject to control deficiencies.

Effect or Potential Effect

The risk of misstatement in the financial statements increases when management is not able to apply GAAP in recording the entity's financial transactions or preparing its financial statements, including the

CITRUS HEIGHTS WATER DISTRICT

Schedule of Findings and Responses As of December 31, 2008

Finding 2007-1
(continued)

related notes. Also, by relying on the external auditors to ensure its financial statements are in accordance with GAAP, the District is considering the external auditors a part of its internal controls over the preparation of the financial statements.

Recommendation

The District may consider the following possible actions:

- Provide training opportunities for its staff that would enable them to become more familiar with the requirements for financial statements prepared using GAAP.
- Hire an external professional experienced in preparing governmental type financial statements to confirm that the accounting records, financial statements and related disclosures are in accordance with GAAP.
- Take no action. The District may find that the costs outweigh the benefits to adhere to this standard. No action will result in a significant deficiency (or material weakness, depending on magnitude) in the District's internal controls over the preparation of the financial statements.

Management Response

The District first became aware of Statement on Auditing Standard No. 112 (SAS 112) in February 2007 during the audit for FY2006. SAS 112 imposes a new standard that fundamentally changes the approach that Citrus Heights Water District (and thousands of other small public entities across the United States) has used for decades – having its independent auditor also prepare its financial statements. Although this 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 FY2008 financial statements is as fundamentally sound as it has been for many years before SAS 112 was issued.

Management has evaluated approaches that it can employ to comply with SAS 112. The Independent Auditor's Recommendation cites providing training opportunities for its accounting staff to enable preparation of the financial statements by District staff as one possible approach. However, by design, District financial and accounting staff members are generalists in nature. Each staff member has a broad array

CITRUS HEIGHTS WATER DISTRICT

Schedule of Findings and Responses As of December 31, 2008

Finding 2007-1 (continued)

Management Response (continued)

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 the position of Management that the level of training needed in order to attain this level of expertise is beyond what the District wishes to have its staff members undergo.

Contracting for preparation of the financial statements by a Certified Public Accountant or other qualified persons separate from the Independent Auditor has also been considered as a possible approach to comply with SAS 112. It appears that this approach would satisfy SAS 112. However, this approach also involves significant additional expense for the District to employ another individual or firm separate from the Independent Auditor to prepare its financial statements. It has been the recommendation of Management, supported by the District's Board of Directors, that the District not incur this significant additional expense simply to satisfy SAS 112.

As stated in the Recommendation for this Finding, taking no action is a possible alternative to compliance with SAS 112. The District has elected to continue to employ this alternative in the preparation of its financial statements for FY2008, and believes that this course of action best serves the District, its Board of Directors and its customers.

CITRUS HEIGHTS WATER DISTRICT

Schedule of Prior Year Findings and Responses
As of December 31, 2008

Finding 2007-1

Controls Over Financial Reporting

Reporting Requirement: Significant Deficiency

Recommendation

The District may consider the following possible actions:

- Provide training opportunities for its staff that would enable them to become more familiar with the requirements for financial statements prepared using GAAP.
- Hire an external Certified Public Accountant to prepare or confirm that the accounting records, financial statements and related disclosures are in accordance with GAAP.
- Take no action. The District may find that the costs outweigh the benefits to adhere to this standard. No action will result in a significant deficiency (or material weakness, depending on magnitude) in the District's internal controls over the preparation of the financial statements.

Status

Not Implemented

Finding 2007-2

Controls Over Grant Revenue

Reporting Requirement: Significant Deficiency

Recommendation

We recommend the District record grant revenues when qualifying expenditures have been incurred instead of when the reimbursements are received.

Status

Corrective measures taken

CITRUS HEIGHTS WATER DISTRICT

**Management Report
For the Year Ended December 31, 2008**

CITRUS HEIGHTS WATER DISTRICT
Management Report
For The Year Ended December 31, 2008

Table of Contents

	<u>Page</u>
Introduction.....	1-2
Required Communication	3-5
Current Year Findings and Recommendations	6
Status of Prior Year Recommendations	7



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 (District) for the fiscal year ended December 31, 2008, 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.

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 a 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.

A material weakness is a significant deficiency, or a 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.

Our consideration of internal control was for the limited purpose described in the first paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. In addition, because of inherent limitations in internal control, including the possibility of management override of controls, misstatements due to error or fraud may occur and not be detected by such controls. We consider the following deficiency to be a significant deficiency in internal controls as reported within the report on the District's internal control in the audit report dated March 31, 2009:

2007-1: Controls Over Financial Reporting

The memorandum that accompanies this letter summarizes our comments and suggestions concerning certain recommendations made in the District's prior year audit and current year recommendations. We previously reported on the District's internal control in our report dated March 31, 2009. This letter does not affect our report dated March 31, 2009 on the financial statements of the Citrus Heights Water District.

Board of Directors
Citrus Heights Water District
Citrus Heights, California

Citrus Heights Water District's management has provided responses to the comments described in the memorandum that accompanies this letter. We did not audit the District's responses and accordingly, we express no opinion on it.

This report is intended for the use of management, the Board of Directors, and others within the organization, and is not intended to be and should not be used by anyone other than these specified parties. We thank the District's staff for its cooperation during our audit.

Gallina LLP

Roseville, California
March 31, 2009

CITRUS HEIGHTS WATER DISTRICT

Management Report
Required Communication
as of December 31, 2008

Our Responsibility under U.S. Generally Accepted Auditing Standards and Government Auditing Standards

As stated in our engagement letter dated October 24, 2008, our responsibility, as described by professional standards, is to express an opinion about whether the financial statements prepared by management with your oversight are fairly presented, in all material respects, in conformity with U.S. generally accepted accounting principles. Our audit does not relieve you or management of your responsibilities.

As part of our audit, we considered the internal control of the District. Such considerations were solely for the purpose of determining our audit procedures and not to provide any assurance concerning such internal control.

As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of Citrus Heights Water District's compliance with certain provisions of laws, regulations, contracts, and grants. However, the objective of our tests was not to provide an opinion on compliance with such provisions.

Planned Scope and Timing of the Audit

We performed the audit according to the planned scope and timing previously communicated to you in our engagement letter dated October 24, 2008.

Qualitative Aspects of Accounting Practices

Significant Accounting Policies

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the District are described in Note 1 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during the year ended December 31, 2008. We noted no transactions entered into by the District during the year for which there is a lack of authoritative guidance or consensus. There are no significant transactions that have been recognized in the financial statements in a different period than when the transaction occurred.

Significant 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

CITRUS HEIGHTS WATER DISTRICT

Management Report Required Communication as of December 31, 2008

affecting them may differ significantly from those expected. The most sensitive estimates affecting the financial statements were:

- Accrual and disclosure of compensated absences: Management's estimate is based on information collected by the District using current pay rates and District's policy on employee use of compensating time-off. Our audit agreed balances reported in the financial statements to those in the District calculated spreadsheets.
- Capital asset lives and the related depreciation expense: Management's estimate is based on the District's policy of depreciating assets. We scanned asset listings for reasonable compliance to this approach.

Difficulties Encountered in Performing the Audit

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

Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. None of the misstatements detected as a result of audit procedures and corrected by management were material, either individually or in the aggregate, to the financial statements taken as a whole.

Immaterial Misstatements Corrected by Management

The following misstatement was brought to the attention of, and corrected by, management:

- Grants receivable was understated by \$276,618 for anticipated grant reimbursements related to Mitchell Farms and Bonita Groundwater Well construction performed during the year ended.

Immaterial Misstatements Not Corrected by Management

Management passed on the following adjustments:

- Adjust restricted for debt service net assets by \$24,789 to agree to the restricted cash amount at December 31, 2008.

Management has determined that the effect is immaterial to the financial statements taken as a whole.

CITRUS HEIGHTS WATER DISTRICT

Management Report
Required Communication
as of December 31, 2008

Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, 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.

Management Representations

We have requested certain representations from management that are included in the management representation letter dated March 31, 2009.

Management Consultations with Other Independent Accountants

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.

Other Audit Findings or Issues

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.

CITRUS HEIGHTS WATER DISTRICT

Management Report Current Year Findings and Recommendations For the Year Ended December 31, 2008

GRANTS RECEIVABLE

Criteria

During its year-end closing process, the District should enforce policies and procedures to ensure that year-end accruals are properly identified, reviewed and recorded for all account balances, including grant revenues and grant receivables.

Condition

During the Audit, we noted that grants receivable was not recorded at the end of the year despite the revenue recognition criteria being met. The amount of the audit adjustment was \$276,618.

Cause

During the year-end closing process, the District did not gather the grant revenue accrual data and record the adjustment on its general ledger. A schedule of grants receivable is maintained independent of the general ledger.

Effect of Condition

By not recording the grant revenue accrual at year-end even though eligibility requirements are met, the District could materially understate its receivables and revenue. Internal controls over financial reporting are strengthened when general ledger balances directly translate to the District's financial reports.

Recommendation

We recommend that the District implement its year-end closing process by obtaining the grant receivable adjustment and accordingly record the accrual on its general ledger.

Management's Response

District Management agrees with the Auditor's recommendation. The District has a procedure in place for recording grant revenue accrual at the time when requests are submitted for grant reimbursement, but the procedure was not followed on one occasion in 2008. This resulted in a grants receivable not being recorded at the time it was accrued. District staff has been re-instructed as to the procedure, which involves providing a copy of all grant reimbursement requests to District accounting staff at the time that such requests are prepared and submitted by any District staff member.

CITRUS HEIGHTS WATER DISTRICT

Status of Prior Year Recommendations As of December 31, 2008

<u>Recommendation</u>	<u>Status</u>
<p>We recommended 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.</p>	<p>The District considered the recommendation and determined that costs to implement exceed benefits. No further action required.</p>
<p>We recommended 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.</p>	<p>The District considered the recommendation and determined that costs to implement exceed benefits. No further action required.</p>