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**San Lorenzo Valley Water District
Annual Financial Report
June 30, 2006 and 2005**



Mission Statement

Our mission is to provide our customers and all future generations with reliable, safe and high quality water at an equitable price; to create and maintain outstanding customer service; to manage and protect the environmental health of the aquifers and watersheds; and, to ensure the fiscal vitality of the San Lorenzo Valley Water District.

Board of Directors as of June 30, 2006

<u>Name</u>	<u>Title</u>	<u>Elected/ Appointed</u>	<u>Current Term</u>
James Nelson	President	Elected	12/04-12/08
Larry Prather	Vice-President	Elected	12/04-12/08
Terry Vierra	Director	Elected	12/04-12/08
James Rapoza	Director	Elected	12/04-12/08
Fred McPherson	Director	Appointed	12/04-12/08

**James Mueller, District Manager
San Lorenzo Valley Water District
13060 Highway 9
Boulder Creek, California 95006
(831) 338-2153 – www.slvwd.com**

San Lorenzo Valley Water District
Annual Financial Report
For the Years Ended June 30, 2006 and 2005

**San Lorenzo Valley Water District
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Introductory Section



October 31, 2006

Board of Directors
San Lorenzo Valley Water District

Introduction

It is our pleasure to submit the Annual Financial Report for the San Lorenzo Valley Water District for the fiscal year ended June 30, 2006, following guidelines set forth by the Governmental Accounting Standards Board. District staff prepared this financial report. The District is ultimately responsible for both the accuracy of the data and the completeness and the fairness of presentation, including all disclosures in this financial report. We believe that the data presented is accurate in all material respects. The report is designed in a manner that we believe necessary to enhance your understanding of the District's financial position and activities.

This report is organized into two sections: (1) Introductory and (2) Financial. The Introductory section offers general information about the District's organization and current District activities and reports on a summary of significant financial results. The Financial section includes the Independent Auditors' Report, Management's Discussion and Analysis of the District's basic financial statements, and the District's audited basic financial statements with accompanying Notes.

Generally Accepted Accounting Principles (GAAP) requires that management provide a narrative introduction, overview and analysis to accompany the financial statements in the form of the Management's Discussion and Analysis (MD&A) section. This letter of transmittal is designed to complement the MD&A and should be read in conjunction with it. The District's MD&A can be found immediately after the Independent Auditors' Report.

District Structure and Leadership

The San Lorenzo Valley Water District is an independent special district, which operates under the authority of Division 12 of the California Water Code. The San Lorenzo Valley Water District has been providing services to the residents with the district's boundaries since 1941. The District is governed by a five-member Board of Directors, elected at-large from within the District's service area. The District Manager administers the day-to-day operations of the District in accordance with policies and procedures established by the Board of Directors. The San Lorenzo Valley Water District employs a full-time staff of 21 employees with 3 long-term temporary employees. The District's Board of Directors meets on the first and third Thursday of each month. Meetings are publicly noticed and citizens are encouraged to attend.

The District provides water, sewer or a combination of both services to residents and businesses within its service area. The service area lies within most of the town of Boulder Creek, and portions of the cities or townships of Ben Lomond, Felton, Scotts Valley, and some areas of Brookdale. The District includes approximately 2030 acres of land comprising 3.17 square miles. The District currently provides service to 5827 residential, commercial, and agricultural connections.

Economic Condition and Outlook

The District's administrative offices are located in the City of Boulder Creek in Santa Cruz County. The economic outlook for the area is one of moderate growth, which is projected to continue through 2007.

California's water supply continues to be a concern due to projected population increases. This concern has increased interest in conservation and in irrigation methods and systems.

Major Initiatives

The activities of the Board and staff of the District are driven by its Mission Statement: "Our mission is to provide our customers and all future generations with reliable, safe and high quality water at an equitable price; to create and maintain outstanding customer service; to manage and protect the environmental health of the aquifers and watersheds; and, to ensure the fiscal vitality of the San Lorenzo Valley Water District."

1. To supply clean, wholesome water to the community and provide water for the future.
2. To plan, construct, operate, maintain and upgrade the water system facilities to adequately serve customer needs.
3. To utilize the District's financial resources in an effective, responsible, and prudent manner.
4. To provide quality customer service for District customers.
5. To inform, educate, and communicate with the community on District and water issues.
6. To review and maintain a plan to be proactive in preventative maintenance of the District's water and sewer systems.

All programs and operations of the District are developed and performed to provide the highest level of services to its customers.

Internal Control Structure

District management is responsible for the establishment and maintenance of the internal control structure that ensures the assets of the District are protected from loss, theft or misuse. The internal control structure also ensures adequate accounting data is compiled to allow for the preparation of financial statements in conformity with generally accepted accounting principles. The District's internal control structure is designed to provide reasonable assurance that these objectives are met. The concept of reasonable assurance recognizes that (1) the cost of a control should not exceed the benefits likely to be derived, and (2) the valuation of costs and benefits requires estimates and judgments by management.

Budgetary Control

The District Board of Directors adopts an operating and capital budget every year. The budget authorizes and provides the basis for reporting and control of financial operations and accountability for the District's enterprise operations and capital projects. The budget and reporting treatment applied to the District is consistent with the accrual basis of accounting and the financial statement basis.

Investment Policy

The Board of Directors has adopted an investment policy that conforms to state law, District ordinance and resolutions, prudent money management, and the “prudent person” standards. The objective of the Investment Policy is safety, liquidity and yield.

Water and Sewer Rates and District Revenues

District policy direction ensures that all revenues from user charges and surcharges generated from District customers must support all District operations including capital project funding. Accordingly, water and sewer rates are reviewed periodically. Water rates are user charges imposed on customers for services and are the primary component of the District’s revenue. Water rates are composed of a commodity (usage) charge and a fixed (readiness-to-serve) charge. Sewer rates are composed of a fixed charge of \$140.

Water Conservation Programs

The District has implemented conservation management practices. District staff participates in community events and distributes materials to encourage water conservation. The District offers the following conservation programs:

- Voluntary Water Conservation Program
- Low-Flow Retrofit Program

Audit and Financial Reporting

State Law and Bond covenants require the District to obtain an annual audit of its financial statements by an independent certified public accountant. The accounting firm of Charles Z. Fedak & Co., CPAs has conducted the audit of the District’s financial statements. Their unqualified Independent Auditor’s Report appears in the Financial Section.

Risk Management

The District is a member of the Special District Risk Management Authority (Authority). The purpose of the Authority is to arrange and administer programs of insurance for the pooling of self-insured losses and to purchase excess insurance coverage.

Other References

More information is contained in the Management’s Discussion and Analysis and the Notes to the Basic Financial Statements found in the Financial Section of the report.

Acknowledgements

Preparation of this report was accomplished by the combined efforts of District staff. We appreciate the dedicated efforts and professionalism that these staff members contribute to the District. We would also like to thank the members of the Board of Directors and especially the Finance-Accounting Committee members for their continued support in planning and implementation of the San Lorenzo Valley Water District's fiscal policies.

Respectfully submitted,

James Mueller
District Manager

Karen Alvarez
Finance Manager

Financial Section

Independent Auditor's Report

Board of Directors
San Lorenzo Valley Water District
Boulder Creek, California

We have audited the accompanying financial statements of the San Lorenzo Valley Water District (District) as of and for the year ended June 30, 2006, which collectively comprise the District's basic financial statements as listed in the table of contents. These basic financial statements are the responsibility of the District's management. Our responsibility is to express an opinion on these basic financial statements based on our audit. The comparative financial information as of June 30, 2005, was audited by other auditors whose report dated October 3, 2005, expressed an unqualified opinion on those basic financial statements.

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

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the respective financial position of the San Lorenzo Valley Water District as of June 30, 2006, and the respective changes in net assets 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 a report dated October 31, 2006, on our consideration of the District's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit. This report can be found on page 34.

Management's Discussion and Analysis on pages 7 through 10, the Schedule of Funding Progress on page 31 and the Schedules on pages 32 through 33 are not required parts of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted primarily of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit this information and express no opinion on it.

Independent Auditor's Report (Continued)

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the District's basic financial statements. The accompanying introductory section on pages 1 through 4 is presented for purposes of additional analysis and is not a required part of the basic financial statements. The introductory section has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on it.

October 31, 2006
Cypress, California

San Lorenzo Valley Water District
Management's Discussion and Analysis
For the Years Ended June 30, 2006 and 2005

The following Management's Discussion and Analysis (MD&A) of activities and financial performance of the San Lorenzo Valley Water District (District) provides an introduction to the financial statements of the District for the fiscal years ended June 30, 2006 and 2005. We encourage readers to consider the information presented here in conjunction with the transmittal letter in the Introductory Section and with the basic financial statements and related notes, which follow this section.

Financial Highlights

- The District's net assets decreased 3.4% or (\$886,415) to \$25,466,105 in fiscal year 2006. In 2005, the District's net assets increased 0.8% or \$200,340 to \$26,352,520.
- The District's operating revenues decreased 2.3% or (\$74,674) in fiscal year 2006. In 2005, the District's operating revenues increased 13.0% or \$496,808.
- The District's operating expenses increased 17.5% or \$480,047 in 2006. In 2005, the District's operating expenses increased 2.6% or \$99,573.

Required Financial Statements

This annual report consists of a series of financial statements. The Statement of Net Assets, Statement of Revenues, Expenses and Changes in Net Assets and Statement of Cash Flows provide information about the activities and performance of the District using accounting methods similar to those used by private sector companies.

The District's statements consist of two funds, the Water Fund and the Sewer Fund. The District's records are maintained on an enterprise basis, as it is the intent of the Board of Directors that the costs of providing water and sewer to the customer of the District are financed primarily through user charges.

The Statement of Net Assets includes all of the District's investments in resources (assets) and the obligations to creditors (liabilities). It also provides the basis for computing a rate of return, evaluating the capital structure of the District and assessing the liquidity and financial flexibility of the District. All of the current year's revenue and expenses are accounted for in the Statement of Revenues, Expenses and Changes in Net Assets. This statement measures the success of the District's operations over the past year and can be used to determine if the District has successfully recovered all of its costs through its rates and other charges. This statement can also be used to evaluate profitability and credit worthiness. The final required financial statement is the Statement of Cash Flows, which provides information about the District's cash receipts and cash payments during the reporting period. The Statement of Cash Flows reports cash receipts, cash payments and net changes in cash resulting from operations, investing, non-capital financing, and capital and related financing activities and provides answers to such questions as where did cash come from, what was cash used for, and what was the change in cash balance during the reporting period.

Financial Analysis of the District

One of the most important questions asked about the District's finances is, "Is the District better off or worse off as a result of this year's activities?" The Statement of Net Assets and the Statement of Revenues, Expenses and Changes in Net Assets report information about the District in a way that helps answer this question. These statements include all assets and liabilities using the *accrual basis of accounting*, which is similar to the accounting used by most private sector companies. All of the current year's revenues and expenses are taken into account regardless of when the cash is received or paid.

San Lorenzo Valley Water District
Management's Discussion and Analysis
For the Years Ended June 30, 2006 and 2005

Financial Analysis of the District (Continued)

These two statements report the District's *net assets* and changes in them. You can think of the District's net assets (the difference between assets and liabilities), as one way to measure the District's financial health, or *financial position*. Over time, *increases or decreases* in the District's net assets are one indicator of whether its *financial health* is improving or deteriorating. However, one will need to consider other non-financial factors such as changes in economic conditions, population growth, zoning and new or changed government legislation, such as changes in Federal and State water quality standards.

Notes to the Basic Financial Statements

The notes provide additional information that is essential to a full understanding of the data provided in the basic financial statements. The notes to the basic financial statements can be found on pages 15 through 30.

Statement of Net Assets

Condensed Statements of Net Assets			
	2006	2005	Change
Assets:			
Current assets	\$ 13,011,333	13,682,772	(671,439)
Restricted assets	1,373,473	1,468,326	(94,853)
Non-current assets	324,603	349,855	(25,252)
Capital assets, net	21,289,629	18,494,618	2,795,011
Total assets	35,999,038	33,995,571	2,003,467
Liabilities:			
Liabilities payable from unrestricted current assets	949,443	913,631	35,812
Liabilities payable from restricted assets	587,886	436,103	151,783
Non-current liabilities	8,995,604	6,293,317	2,702,287
Total liabilities	10,532,933	7,643,051	2,889,882
Net assets:			
Net investment in capital assets	11,781,321	11,819,002	(37,681)
Restricted for debt service	1,373,473	1,468,326	(94,853)
Unrestricted	12,311,311	13,065,192	(753,881)
Total net assets	25,466,105	26,352,520	(886,415)
Total liabilities and net assets	\$ 35,999,038	33,995,571	2,003,467

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. In the case of the District, assets of the District exceeded liabilities by \$25,466,105 and \$26,352,520 as of June 30, 2006 and 2005, respectively.

By far the largest portion of the District's net assets (48% and 49% as of June 30, 2006 and 2005, respectively) reflects the District's investment in capital assets (net of accumulated depreciation) less any related debt used to acquire those assets that is still outstanding. The District uses these capital assets to provide services to customers within the District's service area; consequently, these assets are *not* available for future spending.

At the end of fiscal year 2006 and 2005, the District showed a positive balance in its unrestricted net assets of \$12,311,311 and \$13,065,192, respectively, which may be utilized in future years.

San Lorenzo Valley Water District
Management's Discussion and Analysis
For the Years Ended June 30, 2006 and 2005

Statement of Revenues, Expenses and Changes in Net Assets

Condensed Statements of Revenues, Expenses and Changes in Net Assets

	<u>2006</u>	<u>2005</u>	<u>Change</u>
Revenues:			
Operating revenues	\$ 3,142,207	3,216,881	(74,674)
Non-operating revenues	523,865	578,507	(54,642)
Total revenues	<u>3,666,072</u>	<u>3,795,388</u>	<u>(129,316)</u>
Expenses:			
Operating expenses	3,217,570	2,737,523	480,047
Depreciation and amortization	916,807	916,626	181
Non-operating expenses	486,859	341,579	145,280
Total expenses	<u>4,621,236</u>	<u>3,995,728</u>	<u>625,508</u>
Net income before capital contributions	(955,164)	(200,340)	(754,824)
Capital contributions	68,749	-	68,749
Change in net assets	(886,415)	(200,340)	(686,075)
Net assets, beginning of year	26,352,520	26,552,860	(200,340)
Net assets, end of year	<u>\$ 25,466,105</u>	<u>26,352,520</u>	<u>(886,415)</u>

The statement of revenues, expenses and changes of net assets shows how the District's net assets changed during the fiscal years. In the case of the District, net assets decreased by \$886,415 and \$200,340 for the fiscal years ended June 30, 2006 and 2005, respectively.

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

In 2006, the District's total revenues decreased by (\$129,316), primarily due to a decrease in operating revenues of (\$74,674) due to a reduction in water consumption sales of (\$28,072) and meter sales of (\$34,595). Additionally, non-operating revenues decreased by (\$54,642) primarily due to a decrease in interest and investment earning earnings of (\$130,502) which was partially offset by increases in property tax revenues of \$45,563. In addition, total expenses increased by \$625,508, due to increases in departmental and operational expenses.

In 2005, the District's total revenues decreased by (\$969,235), primarily from a decrease in property tax revenues from the 2005 ERAF shift of over approximately \$277,000 and a (\$407,057) decrease in grant funding. In addition, total expenses decreased by (\$616,540), due to a decrease in unrealized investment losses related to rising interest rates.

Capital Asset Administration

At the end of fiscal year 2006 and 2005, the District's investment in capital assets amounted to \$11,781,321 and \$11,819,002, respectively, (net of accumulated depreciation). This investment in capital assets includes land, transmission and distribution systems, reservoirs, tanks, pumps, buildings and structures, equipment, vehicles and construction-in-process, etc. Major capital assets additions during the year included upgrades to the District's pumping plant and the transmission and distribution system.

San Lorenzo Valley Water District
Management's Discussion and Analysis
For the Years Ended June 30, 2006 and 2005

Capital Asset Administration (Continued)

Changes in capital asset amounts for the year were as follows:

	<u>Balance 2005</u>	<u>Additions</u>	<u>Transfers/ Deletions</u>	<u>Balance 2006</u>
Capital assets:				
Non-depreciable assets	\$ 2,536,332	2,940,016	(1,759,349)	3,716,999
Depreciable assets	26,861,114	2,503,240	(11,995)	29,352,359
Accumulated depreciation and amortization	(10,902,828)	(888,896)	11,995	(11,779,729)
Total capital assets, net	<u>\$ 18,494,618</u>	<u>4,554,360</u>	<u>(1,759,349)</u>	<u>21,289,629</u>
	<u>Balance 2004</u>	<u>Additions</u>	<u>Transfers/ Deletions</u>	<u>Balance 2005</u>
Capital assets:				
Non-depreciable assets	\$ 1,955,730	580,602	-	2,536,332
Depreciable assets	25,895,409	996,580	(30,875)	26,861,114
Accumulated depreciation and amortization	(10,109,252)	(824,009)	27,433	(10,905,828)
Total capital assets, net	<u>\$ 17,741,887</u>	<u>753,173</u>	<u>(3,442)</u>	<u>18,491,618</u>

Debt Administration

Changes in long-term debt amounts for the year ended June 30, 2006 were as follows:

	<u>Balance 2005</u>	<u>Additions</u>	<u>Principal Payments</u>	<u>Balance 2006</u>
Long-term debt:				
Lease payable	\$ 165,000	-	(15,000)	150,000
Notes payable	3,380,616	3,250,000	(219,512)	6,411,104
Bonds payable	930,000	-	(65,000)	865,000
Certificates of participation	2,200,000	-	(117,796)	2,082,204
Total long-term debt	<u>\$ 6,675,616</u>	<u>3,250,000</u>	<u>(417,308)</u>	<u>9,508,308</u>

Changes in long-term debt amounts for the year ended June 30, 2005 were as follows:

	<u>Balance 2004</u>	<u>Additions</u>	<u>Principal Payments</u>	<u>Balance 2005</u>
Long-term debt:				
Lease payable	180,000	-	(15,000)	165,000
Notes payable	\$ 3,558,493	-	(177,877)	3,380,616
Bonds payable	995,000	-	(65,000)	930,000
Certificates of participation	2,375,000	-	(175,000)	2,200,000
Total long-term debt	<u>\$ 7,108,493</u>	<u>-</u>	<u>(432,877)</u>	<u>6,675,616</u>

Conditions Affecting Current Financial Position

Management is unaware of any conditions that would have a significant impact on the District's financial position, net assets, or operating results in terms of past, present and future.

Requests for Information

This financial report is designed to provide the District's funding sources, customers, stakeholders and other interested parties with an overview of the District's financial operations and financial condition. Should the reader have questions regarding the information included in this report or wish to request additional financial information, please contact the District at 13060 Highway 9 Boulder Creek, California 95006 or the Finance Department at (831) 430-4636.

Basic Financial Statements

San Lorenzo Valley Water District
Statements of Net Assets
June 30, 2006 and 2005

<i>Assets</i>	<u>2006</u>	<u>2005</u>
Current assets:		
Cash and cash equivalents (note 2)	\$ 1,156,301	2,256,958
Investments (note 2)	9,549,750	10,903,382
Accrued interest receivable	83,042	95,402
Accounts receivable – water sales and services, net	252,082	259,513
Accounts receivable – property taxes	29,471	-
Accounts receivable – other	1,754,945	3,844
Materials and supplies inventory	164,315	140,583
Prepaid expenses and other deposits	21,427	23,090
Total current assets	<u>13,011,333</u>	<u>13,682,772</u>
Restricted assets:		
Investments (note 2)	<u>1,373,473</u>	<u>1,468,326</u>
Total restricted assets	<u>1,373,473</u>	<u>1,468,326</u>
Non-current assets:		
Capital assets, net (note 4)	21,289,629	18,494,618
Deferred charges, net (note 3)	324,603	349,855
Total non-current assets	<u>21,614,232</u>	<u>18,844,473</u>
Total assets	<u>\$ 35,999,038</u>	<u>33,995,571</u>
<i>Liabilities and Net Assets</i>		
Current liabilities – payable from unrestricted current assets:		
Accounts payable and accrued expenses	\$ 148,216	145,049
Accrued salaries and wages	41,379	31,403
Accrued compensated absences (note 5)	287,338	274,812
Customer deposits	318,919	309,127
Connection and construction deposits	153,591	153,240
Liabilities payable from unrestricted current assets	<u>949,443</u>	<u>913,631</u>
Liabilities – payable from restricted assets:		
Accrued interest payable	75,182	53,804
Long-term debt - current portion (note 6)	512,704	382,299
Liabilities payable from restricted assets	<u>587,886</u>	<u>436,103</u>
Total current liabilities	<u>1,537,329</u>	<u>1,349,734</u>
Non-current liabilities:		
Long-term debt (note 6)	8,995,604	6,293,317
Total non-current liabilities	<u>8,995,604</u>	<u>6,293,317</u>
Total liabilities	<u>10,532,933</u>	<u>7,643,051</u>
Net assets:		
Net investment in capital assets (note 7)	11,781,321	11,819,002
Restricted for debt service	1,373,473	1,468,326
Unrestricted	12,311,311	13,065,192
Total net assets	<u>25,466,105</u>	<u>26,352,520</u>
Total liabilities and net assets	<u>\$ 35,999,038</u>	<u>33,995,571</u>

See accompanying notes to the basic financial statements

San Lorenzo Valley Water District
Statements of Revenues, Expenses and Changes in Net Assets
For the Years Ended June 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
Operating revenues:		
Water consumption sales	\$ 2,849,697	2,877,769
Wastewater service	45,906	45,360
Assessments	136,916	146,788
Meter sales	52,359	86,954
Charges and penalties	34,695	37,135
Other charges and services	22,634	22,875
Total operating revenues	<u>3,142,207</u>	<u>3,216,881</u>
Operating expenses:		
Salaries and benefits	2,076,452	1,821,314
Professional services	252,750	179,646
Materials and supplies	155,972	105,627
Utilities and telephone	258,978	289,231
Insurance	50,075	46,188
Election fees	-	24,989
LAFCO fees	5,193	22,876
Vehicle and equipment maintenance	76,362	62,114
Building maintenance	24,771	15,605
Repairs	184,694	54,979
Collections fees and charges	1,492	2,540
Travel, meals and conferences	9,404	8,428
Auto allowance	4,200	4,200
Office expenses	43,886	36,755
Rental and permits	16,272	16,087
Miscellaneous	57,069	46,944
Total operating expenses	<u>3,217,570</u>	<u>2,737,523</u>
Operating income before depreciation and amortization	(75,363)	479,358
Depreciation and amortization	(916,807)	(916,626)
Operating loss	\$ (992,170)	(437,268)
Non-operating revenue(expense)		
Property taxes	\$ 132,169	86,606
Interest and investment earnings	361,399	491,901
Rental revenue	30,297	-
Interest expense – long-term debt	(305,088)	(302,367)
Gain (loss) on disposition of capital assets	-	(3,442)
Gain (loss) on investments	(181,771)	(35,770)
Total non-operating revenues, net	<u>37,006</u>	<u>236,928</u>
Net loss before capital contributions	<u>(955,164)</u>	<u>(200,340)</u>
Capital contributions:		
Developers and others	68,749	-
Capital contributions	<u>68,749</u>	<u>-</u>
Change in net assets	(886,415)	(200,340)
Net assets, beginning of year	<u>26,352,520</u>	<u>26,552,860</u>
Net assets, end of year	\$ <u>25,466,105</u>	<u>26,352,520</u>

See accompanying notes to the basic financial statements

San Lorenzo Valley Water District
Statements of Cash Flows
For the Years Ended June 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
Cash flows from operating activities:		
Cash receipts from customers for water and wastewater sales and services	\$ 3,119,066	3,217,039
Cash paid to vendors and suppliers for materials and services	(1,609,402)	(1,816,136)
Cash paid to employees for salaries and wages	(1,532,035)	(892,598)
Net cash (used) provided by operating activities	<u>(22,371)</u>	<u>508,305</u>
Cash flows from non-capital financing activities:		
Proceeds from property taxes	<u>102,698</u>	<u>86,606</u>
Net cash provided by non-capital financing activities	<u>102,698</u>	<u>86,606</u>
Cash flows from capital and related financing activities:		
Acquisition and construction of capital assets	(3,895,251)	(1,577,183)
Proceeds from capital contributions	68,749	-
Principal paid on long-term debt	(417,308)	(432,877)
Interest paid on long-term debt	(283,629)	(422,385)
Net cash used in capital and related financing activities	<u>(4,527,439)</u>	<u>(2,432,445)</u>
Cash flows from investing activities:		
Proceeds from sale of investments	4,750,845	-
Purchases of investments	(3,015,798)	(290,333)
Interest and investment earnings	<u>373,759</u>	<u>480,409</u>
Net cash provided by investing activities	<u>2,108,806</u>	<u>190,076</u>
Net decrease in cash and cash equivalents	<u>(2,338,306)</u>	<u>(1,647,458)</u>
Cash and cash equivalents (unrestricted and restricted), beginning of year	<u>3,494,607</u>	<u>5,142,065</u>
Cash and cash equivalents (unrestricted and restricted), end of year	<u>\$ 1,156,301</u>	<u>3,494,607</u>
Reconciliation of cash and cash equivalents to statement of financial position:		
Cash and cash equivalents	\$ 1,156,301	2,256,958
Restricted assets – cash and cash equivalents	<u>-</u>	<u>1,237,649</u>
Total cash and cash equivalents	<u>\$ 1,156,301</u>	<u>3,494,607</u>

Continued on next page

See accompanying notes to the basic financial statements

San Lorenzo Valley Water District
Statements of Cash Flows (Continued)
For the Year Ended June 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
Reconciliation of operating loss to net cash provided (used) by operating activities:		
Operating loss	\$ <u>(992,170)</u>	<u>(437,268)</u>
Adjustments to reconcile operating loss to net cash provided (used) by operating activities:		
Deprecation and amortization	916,807	916,626
Other non-operating expenses, net	27,820	-
Changes in assets and liabilities:		
(Increase)Decrease in assets:		
Accounts receivable	(23,141)	7,467
Materials and supplies inventory	(23,732)	45,797
Prepaid expenses and other deposits	1,663	-
Increase(Decrease) in liabilities:		
Accounts payable and accrued expenses	3,167	(17,025)
Accrued salaries and wages	41,379	-
Accrued compensated absences	12,526	-
Other liabilities	<u>13,310</u>	<u>(7,292)</u>
Total adjustments	<u>969,799</u>	<u>945,573</u>
Net cash provided (used) by operating activities	\$ <u><u>(22,371)</u></u>	<u><u>508,305</u></u>

See accompanying notes to the basic financial statements

San Lorenzo Valley Water District
Notes to the Basic Financial Statements (Continued)
For the Years Ended June 30, 2006 and 2005

(1) Reporting Entity and Summary of Significant Accounting Policies

A. Organization and Operations of the Reporting Entity

The San Lorenzo Valley Water District is an independent special district established in 1941, pursuant to Chapter 592, Status of 1913, since codified into Section 30,000 et seq. of the California Water Code for the purpose of developing and providing water for domestic use, fire protection, and recreation in the San Lorenzo Valley. Additionally, the District provides sewer service to the Bear Creek Estates area within the District. The District utilizes separate Water and a Sewer funds to account for District operations. The District is governed by a five member Board of Directors elected by the voters in the area to four-year terms. The District provides water and sewer service to approximately 5,827 customers within its service area.

B. Basis of Accounting and Measurement Focus

The District reports its activities as an enterprise fund, which is used to account for operations that are financed and operated in a manner similar to a private business enterprise, where the intent of the District is that the costs of providing water and sewer services to its customers on a continuing basis be financed or recovered primarily through user charges (water and sewer service fees). Revenues and expenses are recognized on the full accrual basis of accounting. Revenues are recognized in the accounting period in which they are earned and expenses are recognized in the period incurred, regardless of when the related cash flows take place.

Operating revenues, such as water and sewer fees, result from exchange transactions associated with the principal activity of the District. Exchange transactions are those in which each party receives and gives up essentially equal values. Non-operating revenues, such as property taxes and investment income, result from non-exchange transactions, in which, the District gives (receives) value without directly receiving (giving) value in exchange.

The District recognizes revenue from water and sewer service charges based on cycle billings preformed every month. The District accrues revenues with respect to water and sewer service sold but not billed at the end of a fiscal period.

C. Financial Reporting

The District's basic financial statements are presented in conformance with the provisions of Governmental Accounting Standards Board (GASB) Statement No. 34, *"Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments"* (GASB No. 34). This statement established revised financial reporting requirements for state and local governments throughout the United States for the purpose of enhancing the understandability and usefulness of financial reports.

GASB No. 34 and its related GASB pronouncements provide for a revised view of financial information and restructure the format of financial information provided prior to its adoption. A statement of net assets replaces the balance sheet and reports assets, liabilities, and the difference between them as net assets, not equity. A statement of revenues, expenses and changes in net assets replaces both the income statement and the statement of changes in retained earnings and contributed capital. GASB No. 34 also requires that the statement of cash flows be prepared using the direct method. Under the direct method, cash flows from operating activities are presented by major categories.

San Lorenzo Valley Water District
Notes to the Basic Financial Statements (Continued)
For the Years Ended June 30, 2006 and 2005

(1) Reporting Entity and Summary of Significant Accounting Policies (Continued)

C. Financial Reporting (Continued)

Under GASB No. 34, enterprise funds, such as the District, have the option of consistently following or not following pronouncements issued by the Financial Accounting Standards Board (FASB) subsequent to November 30, 1989. The District has elected not to follow FASB standards issued after that date, unless such standards are specifically adopted by GASB.

D. Implementation of New Governmental Accounting Standards Board Statements

Governmental Accounting Standards Board Statement No. 46

In December 2004, GASB issued Statement No. 46, *Net Assets Restricted by Enabling Legislation, an amendment of GASB Statement No. 34*. GASB Statement No. 34 requires that limitations on the use of net assets imposed by enabling legislation be reported as restricted net assets. In the process of applying this provision, some governments have had difficulty interpreting the requirement that those restrictions be "legally enforceable." The confusion over this phrase has resulted in a diversity of practice that has diminished comparability. This statement clarifies that a legally enforceable enabling legislation restriction is one that a party external to a government – such as citizens, public interest groups, or the judiciary – can compel the government to honor. This statement also specifies the accounting and financial reporting requirements if new enabling legislation replaces existing enabling legislation or if legal enforceability is reevaluated. Finally, this statement requires governments to disclose the portion of net assets that are restricted by enabling legislation. The District has noted no restrictions in enabling legislation applicable in fiscal year 2006.

Governmental Accounting Standards Board Statement No. 47

In June 2005, GASB issued Statement No. 47, *Accounting for Termination Benefits*. This statement establishes accounting standards for *voluntary* and *involuntary* termination benefits. There were no voluntary or involuntary termination benefits accounted for in fiscal year 2006.

E. Assets, Liabilities and Net Assets

1. Use of Estimates

The preparation of the basic financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported changes in net assets during the reporting period.

2. Reclassification

Certain prior year information has been reclassified to conform with the current year financial statement presentation.

3. Cash and Cash Equivalents

Substantially all of the District's cash is invested in interest bearing accounts. The District considers all highly liquid investments with a maturity of three months or less at the time of purchase to be cash equivalents.

4. Investments and Investment Policy

The District has adopted an investment policy directing the District Manager to deposit funds in financial institutions. Changes in fair value that occur during a fiscal year are recognized as investment income reported for that fiscal year. Investment income includes interest earnings, changes in fair value, and any gains or losses realized upon the liquidation or sale of investments.

San Lorenzo Valley Water District
Notes to the Basic Financial Statements (Continued)
For the Years Ended June 30, 2006 and 2005

(1) Reporting Entity and Summary of Significant Accounting Policies (Continued)

E. Assets, Liabilities and Net Assets (Continued)

5. Accounts Receivable

The District extends credit to customers in the normal course of operations. Management has evaluated the accounts and believes they are all collectible. Management evaluates all accounts receivable and if it is determined that they are uncollectible they are written off as a bad debt expense. A charge of \$1,214 and \$722 was made to bad debt expense for the fiscal years ended June 30, 2006 and 2005, respectively.

6. Property Taxes and Assessments

The Santa Cruz County Assessor's Office assesses all real and personal property within the County each year. The Santa Cruz Tax Collector's Office bills and collects the District's share of property taxes and assessments. The Santa Cruz County Treasurer's Office remits current and delinquent property tax collections to the District throughout the year. Property tax in California is levied in accordance with Article 13A of the State Constitution at one percent (1%) of countywide assessed valuations.

Property taxes receivable at year-end are related to property taxes collected by the Santa Cruz County Tax Collector which have not been credited to the District's cash balance as of June 30. The property tax calendar is as follows:

Lien date	January 1
Levy date	March 1
Due dates	November 1 and February 1
Collection dates	December 10 and April 10

7. Prepaid Expenses

Certain payments to vendors reflect costs or deposits applicable to future accounting periods and are recorded as prepaid items in the basic financial statements.

8. Inventory

Inventory consists primarily of materials used in construction and maintenance of the water and sewer system and is stated at cost using the average-cost method.

9. Capital Assets

Capital assets acquired and/or constructed are capitalized at historical cost. District policy has set the capitalization threshold for reporting capital assets at \$500. Contributed assets are recorded at estimated fair market value at the date of contribution. Upon retirement or other disposition of capital assets, the cost and related accumulated depreciation are removed from the respective balances and any gains or losses are recognized. Depreciation is recorded on a straight-line basis over the estimated useful lives of the assets as follows:

Buildings	30 to 40 years
Improvements	20 to 30 years
Reservoirs and Tanks	50 years
Mains	40 years
Wells	30 years
Equipment	5 to 20 years

San Lorenzo Valley Water District
Notes to the Basic Financial Statements (Continued)
For the Years Ended June 30, 2006 and 2005

(1) Reporting Entity and Summary of Significant Accounting Policies (Continued)

E. Assets, Liabilities and Net Assets (Continued)

10. Deferred Charges

Bond issuance costs are amortized on a straight-line methodology based on the estimated term of the related bond debt. Bond issuance cost were \$324,603 and \$363,493, net of accumulated amortization of \$131,493 and \$111,730 at June 30, 2006 and 2005, respectively.

11. Compensated Absences

The District's policy is to permit employees to accumulate earned vacation and sick leave. The liability for vested vacation and sick leave is recorded as an expense when earned.

Upon termination or retirement, permanent employees are entitled to receive compensation at their current base salary for all unused vacation leave except for those employees that have not completed the probationary period.

12. Construction Advances and Deposits

Construction deposits are collected by the District to cover the cost of construction projects within the District. Funds in excess of project costs are refunded to the customer.

13. Prepaid Connection Fees

Connection fees are collected by the District to cover the cost of service connections within the District. Funds in excess of connection costs are refunded to the customer.

14. Water and sewer sales

The District recognizes water and sewer services charges based on cycle billings rendered to the customers each month.

15. Capital Contributions

Capital contributions represent cash and capital asset additions contributed to the District by property owners or real estate developers desiring services that require capital expenditures or capacity commitment.

16. Budgetary Policies

The District adopts a one year non-appropriated budget for planning, control, and evaluation purposes. Budgetary control and evaluation are affected by comparisons of actual revenues and expenses with planned revenues and expenses for the period. Encumbrance accounting is not used to account for commitments related to unperformed contracts for construction and services.

17. Net Assets

The financial statements utilize a net assets presentation. Net assets are categorized as follows:

- **Net Investment in Capital Assets** – This component of net assets consists of capital assets, net of accumulated depreciation and reduced by any outstanding debt against the acquisition, construction or improvement of those assets.
- **Restricted Net Assets** – This component of net assets consists of constraints placed on net assets use through external constraints imposed by creditors, contributors, or laws or regulations of other governments or constraints imposed by law through constitutional provisions or enabling legislation.
- **Unrestricted Net Assets** – This component of net assets consists of net assets that do not meet the definition of *restricted* or *net investment in capital assets*.

San Lorenzo Valley Water District
Notes to the Basic Financial Statements (Continued)
For the Years Ended June 30, 2006 and 2005

(2) Cash and Investments

Cash and investments as of June 30, are classified in the accompanying financial statements as follows:

	<u>2006</u>	<u>2005</u>
Cash and cash equivalents	\$ 1,156,301	2,256,958
Investments	9,549,750	10,903,382
Restricted investments	<u>1,373,473</u>	<u>1,468,326</u>
Total Cash and Investments	<u>\$ 12,079,524</u>	<u>14,628,666</u>

Cash and investments as of June 30, consist of the following:

	<u>2006</u>	<u>2005</u>
Cash on hand	\$ 200	200
Deposits with financial institutions	65,703	87,562
Investments	<u>12,013,621</u>	<u>14,540,904</u>
Total cash and investments	<u>\$ 12,079,524</u>	<u>14,628,666</u>

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

The table below identifies the investment types that are authorized by the District in accordance with the California Government Code (or the District's investment policy, where more restrictive). The table also identifies certain provisions of the California Government Code (or the District's investment policy, where more restrictive) that address interest rate risk, credit risk, and concentration of credit risk. This table does not address investments of debt proceeds held by bond trustees that are governed by the provisions of debt agreements of the District, rather than the general provisions of the California Government Code or the District's investment policy.

<u>Authorized Investment Type</u>	<u>Maximum Maturity</u>	<u>Maximum Percentage Of Portfolio *</u>	<u>Maximum Investment In One Issuer</u>
U.S. Treasury Obligations	7 years	None	None
U.S. Agency Securities	7 years	50%	None
Certificates of Deposit	7 years	50%	\$100,000
Local Agency Investment Fund (LAIF)	N/A	None	\$100,000
Savings Accounts	N/A	50%	\$100,000

* Excluding amounts held by bond trustee that are not subject to California Government Code restrictions.

San Lorenzo Valley Water District
Notes to the Basic Financial Statements (Continued)
For the Years Ended June 30, 2006 and 2005

(2) Cash and Investments (Continued)

Custodial Credit Risk

Custodial credit risk for *deposits* is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for *investments* is the risk that, in the event of the failure of the counterparty (e.g., broker-dealer) to a transaction, a government will not be able to recover the value of its investment or collateral securities that are in the possession of another party. With respect to investments, custodial credit risk generally applies only to direct investments in marketable securities. Custodial credit risk does not apply to a local government's indirect investment in securities through the use of mutual funds or government investment pools (such as LAIF).

The California Government Code and the District's investment policy do not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits or investments, other than the following provision for deposits: The California Government Code requires that a financial institution secure deposits made by state or local governmental units by pledging securities in an undivided collateral pool held by a depository regulated under state law (unless so waived by the governmental unit). The market value of the pledged securities in the collateral pool must equal at least 110% of the total amount deposited by the public agencies. California law also allows financial institutions to secure District deposits by pledging first trust deed mortgage notes having a value of 150% of the secured public deposits. The District had deposits with bank balances of \$121,555 and \$75,982 as of June 30, 2006 and 2005, respectively. Of the bank balances, up to \$100,000 is federally insured and the remaining balance is collateralized in accordance with the Code; however, the collateralized securities are not held in the District's name.

Investment in State Investment Pool

The District is a voluntary participant in the Local Agency Investment Fund (LAIF) that is regulated by the California Government Code under the oversight of the Treasurer of the State of California. The fair value of the District's investment in this pool is reported in the accompanying financial statements at amounts based upon the District's pro-rata share of the fair value provided by LAIF for the entire LAIF portfolio (in relation to the amortized cost of that portfolio). The balance available for withdrawal is based on the accounting records maintained by LAIF, which are recorded on an amortized cost basis.

San Lorenzo Valley Water District
Notes to the Basic Financial Statements (Continued)
For the Years Ended June 30, 2006 and 2005

(2) Cash and Investments (Continued)

Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. One of the ways that the District manages its exposure to interest rate risk is by purchasing a combination of shorter term and longer term investments and by timing cash flows from maturities so that a portion of the portfolio matures or comes close to maturity evenly over time as necessary to provide requirements for cash flow and liquidity needed for operations. Information about the sensitivity of the fair values of the District's investments to market interest rate fluctuations is provided by the following table that shows the distribution of the District's investments by maturity date:

Maturities of investments at June 30, 2006 are as follows:

Investment Type	Total	Remaining Maturity (in Months)		
		12 Months Or Less	13 to 24 Months	25-60 Months
U.S. Treasury bills	\$ 3,386,810	736,088	679,630	1,971,092
Federal Home Loan Bank	1,193,256	-	-	1,193,256
Federal Farm Credit Bank	97,844	-	-	97,844
Federal Home Loan Mortgage Corporation	1,247,428	-	1,247,428	-
Federal National Mortgage Association	3,375,874	-	928,469	2,447,405
Certificates of Deposit	2,037,628	74,731	270,317	1,692,580
Local Agency Investment Fund (LAIF)	610,271	610,271	-	-
County of Santa Cruz Pool	31,903	31,903	-	-
Money market funds	7,107	7,107	-	-
Held by bond trustee:	-	-	-	-
Money market funds	25,500	25,500	-	-
Total	\$ 12,013,621	1,485,600	3,125,844	7,402,177

Maturities of investments at June 30, 2005 are as follows:

Investment Type	Total	Remaning Maturity (in Months)		
		12 Months Or Less	13 to 24 Months	25-60 Months
U.S. Treasury bills	\$ 5,154,909	-	3,115,906	2,039,003
Federal Home Loan Bank	250,390	250,390	-	-
Federal Home Loan Mortgage Corporation	1,270,802	-	1,270,802	-
Federal National Mortgage Association	4,432,864	-	2,178,120	2,254,744
Certificates of Deposit	1,770,640	283,337	377,724	1,109,579
Local Agency Investment Fund (LAIF)	1,578,800	1,578,800	-	-
County of Santa Cruz Pool	31,903	31,903	-	-
Money market funds	25,096	25,096	-	-
Held by bond trustee:	-	-	-	-
Money market funds	25,500	25,500	-	-
Total	\$ 14,540,904	2,195,026	6,942,552	5,403,326

San Lorenzo Valley Water District
Notes to the Basic Financial Statements (Continued)
For the Years Ended June 30, 2006 and 2005

(2) Cash and Investments (Continued)

Credit Risk

Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of the investment. This is measured by the assignment of a rating by a nationally recognized statistical rating organization. Presented below is the minimum rating required by (where applicable) the California Government Code, the District's investment policy, or debt agreements, and the actual rating as of year end for each investment type.

Credit ratings of investments as of June 30, 2006, were as follows:

Investment Types	Total	Minimum Legal Rating	Exempt From Disclosure	Rating as of Year End	
				AAA	Not Rated
U.S. Treasury bills	\$ 3,386,810	N/A	\$ 3,386,810	-	-
Federal Home Loan Bank	1,193,256	AAA	-	1,193,256	-
Federal Farm Credit Bank	97,844	AAA	-	97,844	-
Federal Home Loan Mortgage Corporation	1,247,428	AAA	-	1,247,428	-
Federal National Mortgage Association	3,375,874	AAA	-	3,375,874	-
Certificates of Deposit	2,037,628	AAA	-	2,037,628	-
Local Agency Investment Fund (LAIF)	610,271	N/A	-	-	610,271
County of Santa Cruz Pool	31,903	AAA	-	31,903	-
Money market funds	7,107	N/A	7,107	-	-
Held by bond trustee:					
Money market funds	25,500	N/A	25,500	-	-
Total	\$ 12,013,621		\$ 3,419,417	7,983,933	610,271

Credit ratings of investments as of June 30, 2005, were as follows:

Investment Types	Total	Minimum Legal Rating	Exempt From Disclosure	Rating as of Year End	
				AAA	Not Rated
U.S. Treasury bills	\$ 5,154,909	N/A	\$ 5,154,909	-	-
Federal Home Loan Bank	250,390	AAA	-	250,390	-
Federal Home Loan Mortgage Corporation	1,270,802	AAA	-	1,270,802	-
Federal National Mortgage Association	4,432,864	AAA	-	4,432,864	-
Certificates of Deposit	1,770,640	AAA	-	1,770,640	-
Local Agency Investment Fund (LAIF)	1,578,800	N/A	-	-	1,578,800
County of Santa Cruz Pool	31,903	AAA	-	31,903	-
Money market funds	25,096	N/A	25,096	-	-
Held by bond trustee:					
Money market funds	25,500	N/A	25,500	-	-
Total	\$ 14,540,904		\$ 5,205,505	7,756,599	1,578,800

Concentration of Credit Risk

The investment policy of the District contains no limitations on the amount that can be invested in any one issuer beyond that stipulated by the California Government Code.

(3) Deferred Charges

Changes in Deferred Charges were as follows:

	Balance 2005	Additions	Amortization	Balance 2006
1999 Limited Obligation Improvement Refunding Bonds	\$ 85,154	-	(7,740)	77,414
California Safe Drinking Water Loan	117,072	-	(7,000)	110,072
California Safe Drinking Water Loan	27,629	-	(2,512)	25,117
1998 Certificates of Participation	120,000	-	(8,000)	112,000
Total	\$ 349,855	-	(25,252)	324,603

San Lorenzo Valley Water District
Notes to the Basic Financial Statements (Continued)
For the Years Ended June 30, 2006 and 2005

(4) Capital Assets

Changes in capital assets for the year were as follows:

	<u>Balance 2005</u>	<u>Additions/ Transfers</u>	<u>Deletions/ Transfers</u>	<u>Balance 2006</u>
Non-depreciable assets:				
Land	\$ 1,086,984	2,406,851	-	3,493,835
Construction-in-process	1,449,348	533,165	(1,759,349)	223,164
Total non-depreciable assets	<u>2,536,332</u>	<u>2,940,016</u>	<u>(1,759,349)</u>	<u>3,716,999</u>
Depreciable assets:				
Water transmission and distribution system	22,215,022	1,333,794	-	23,548,816
Wastewater system	1,252,032	225,576	-	1,477,608
Buildings	1,732,997	887,816	-	2,620,813
Transportation equipment	533,446	39,496	(11,995)	560,947
Field and shop equipment	496,412	8,927	-	505,339
Office equipment	631,205	7,631	-	638,836
Total depreciable assets	<u>26,861,114</u>	<u>2,503,240</u>	<u>(11,995)</u>	<u>29,352,359</u>
Accumulated depreciation and amortization:				
Water transmission and distribution system	(8,839,947)	(684,545)	-	(9,524,492)
Wastewater system	(540,651)	(34,253)	-	(574,904)
Buildings	(438,073)	(52,257)	-	(490,330)
Transportation equipment	(407,779)	(44,335)	11,995	(440,119)
Field and shop equipment	(313,748)	(28,867)	-	(342,615)
Office equipment	(362,630)	(44,639)	-	(407,269)
Total accum depr. and amort.	<u>(10,902,828)</u>	<u>(888,896)</u>	<u>11,995</u>	<u>(11,779,729)</u>
Total depreciable assets, net	<u>15,958,286</u>	<u>1,614,344</u>	<u>-</u>	<u>17,572,630</u>
Total capital assets, net	<u>\$ 18,494,618</u>	<u>4,554,360</u>	<u>(1,759,349)</u>	<u>21,289,629</u>

Changes to capital assets in 2006 consisted primarily of the purchase of land for \$1,750,000, building and land to be utilized for District offices for \$1,500,000, and upgrades to the water transmission and distribution system of \$1,333,794.

San Lorenzo Valley Water District
Notes to the Basic Financial Statements (Continued)
For the Years Ended June 30, 2006 and 2005

(4) Capital Assets (Continued)

Changes in capital assets for the year were as follows:

	Balance 2004	Additions/ Transfers	Deletions/ Transfers	Balance 2005
Non-depreciable assets:				
Land	\$ 1,086,984	-	-	1,086,984
Construction-in-process	868,746	580,602	-	1,449,348
Total non-depreciable assets	1,955,730	580,602	-	2,536,332
Depreciable assets:				
Water transmission and distribution system	22,067,433	147,589	-	22,215,022
Wastewater system	1,252,032	-	-	1,252,032
Buildings	979,301	753,696	-	1,732,997
Transportation equipment	525,458	31,394	(23,406)	533,446
Field and shop equipment	456,843	39,569	-	496,412
Office equipment	614,342	24,332	(7,469)	631,205
Total depreciable assets	25,895,409	996,580	(30,875)	26,861,114
Accumulated depreciation and amortization:				
Water transmission and distribution system	(8,204,025)	(635,922)	-	(8,839,947)
Wastewater system	(510,157)	(30,494)	-	(540,651)
Buildings	(399,613)	(41,460)	-	(441,073)
Transportation equipment	(386,846)	(44,339)	23,406	(407,779)
Field and shop equipment	(287,112)	(26,636)	-	(313,748)
Office equipment	(321,499)	(45,158)	4,027	(362,630)
Total accum depr. and amort.	(10,109,252)	(824,009)	27,433	(10,905,828)
Total depreciable assets, net	15,786,157	172,571	(3,442)	15,955,286
Total capital assets, net	\$ 17,741,887	753,173	(3,442)	18,491,618

Changes to capital assets in 2005 consisted primarily of the purchase of land and buildings for \$722,000 and upgrades to the water transmission and distribution system for \$147,589.

Construction-In-Process

The District has been involved in various construction projects throughout the year. The balance of construction-in-process at June 30, 2006 and 2005 are \$223,164 and \$1,449,348, respectively.

(5) Compensated Absences

Compensated absences comprise unpaid vacation leave, sick leave and compensating time off which is accrued as earned. The District's liability for compensated absences is determined annually.

The changes to compensated absences balances at June 30, were as follows:

Balance 2005	Earned	Taken	Balance 2006	Due Within One Year
\$ 274,812	187,474	(174,948)	287,338	287,338
Balance 2004	Earned	Taken	Balance 2005	Due Within One Year
\$ 275,146	172,008	(172,342)	274,812	274,812

San Lorenzo Valley Water District
Notes to the Basic Financial Statements (Continued)
For the Years Ended June 30, 2006 and 2005

(6) Long-Term Debt

Changes in long-term debt amounts for the year ended June 30, 2006 were as follows:

Long-term debt:	Balance 2005	Additions	Principal Payments	Balance 2006	Current Portion	Long-term Portion
1999 Refunding bonds	\$ 930,000	-	(65,000)	865,000	70,000	795,000
1997 Certificates of participation, series EE	165,000	-	(15,000)	150,000	15,000	135,000
California safe drinking water loan	2,650,994	-	(131,137)	2,519,857	135,832	2,384,025
California safe drinking water refunding loan	729,622	-	(53,245)	676,377	55,563	620,814
1998 Certificates of participation	2,200,000	-	(117,796)	2,082,204	122,919	1,959,285
Malosky creek loan	-	1,750,000	-	1,750,000	40,661	1,709,339
Johnson building loan	-	1,500,000	(35,130)	1,464,870	72,729	1,392,141
Total long-term debt	\$ 6,675,616	3,250,000	(417,308)	9,508,308	512,704	8,995,604

1999 Limited Obligation Improvement Refunding Bonds

Original issuance of North Boulder Creek Assessment District Bonds within the District's water system. Bonds were originally issued under the State of California's 1915 Bond Act/Refunding Act of 1984, which are payable through special assessments on property tax bills that cover the assessment area. In 1999, the District issued Limited Obligation Improvement Refunding Bonds for the purpose of refunding and redeeming the North Boulder Creek Assessment District Bonds. The bonds bear interest ranging from 3.75% to 5.20%, with principal and interest payments payable semi-annually on September 2nd and March 2nd, with final maturity on September 2, 2015.

Fiscal Year	Principal	Interest	Total
2007	\$ 70,000	41,855	111,855
2008	75,000	38,410	113,410
2009	75,000	34,773	109,773
2010	80,000	30,936	110,936
2011	85,000	26,811	111,811
2012-2016	480,000	63,633	543,633
Total	\$ 865,000	236,418	1,101,418
Less current portion	(70,000)		
Total non-current	\$ 795,000		

California Special District Lease Finance Program, COP 1997, Series EE

In 1997, the District issued Certificates of Participation for the purpose of purchasing and renovating the District's operations building. The Certificates of Participation bear interest ranging from 4.10% to 6.00%, per annum, with interest only payments due June 1st and principal and interest payments due December 1st, and a final maturity date of March 1, 2012 with a final principal payment of \$25,000 on that date.

Fiscal Year	Principal	Interest	Total
2007	\$ 15,000	8,308	23,308
2008	20,000	7,336	27,336
2009	20,000	6,206	26,206
2010	20,000	5,056	25,056
2011	25,000	3,738	28,738
2012	50,000	3,000	53,000
Total	\$ 150,000	33,644	183,644
Less current portion	(15,000)		
Total non-current	\$ 135,000		

San Lorenzo Valley Water District
Notes to the Basic Financial Statements (Continued)
For the Years Ended June 30, 2006 and 2005

(6) Long-Term Debt (Continued)

California Safe Drinking Water Loan

California Safe Drinking Water Loan bearing interest at 3.524% per annum with a maturity at October 1, 2020. The District makes semi-annual payments of \$111,725 including principal and interest on April 1st and October 1st each year.

<u>Fiscal Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2007	\$ 135,832	87,618	223,450
2008	140,493	82,957	223,450
2009	145,818	77,632	223,450
2010	150,839	72,611	223,450
2011	156,201	67,249	223,450
2012-2016	868,270	248,440	1,116,710
2017-2021	922,404	83,126	1,005,530
Total	\$ 2,519,857	719,633	3,239,490
Less current portion	(135,832)		
Total non-current	\$ 2,384,025		

California Safe Drinking Water Refunding Loan

In 2003, the District refinanced this loan through a refunding payment agreement bearing interest at 4.25% per annum with a maturity on June 1, 2016. The District makes semi-annual payments of \$41,860 including principal and interest on June 1st and December 1st each year.

<u>Fiscal Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2007	\$ 55,563	28,157	83,720
2008	57,949	25,771	83,720
2009	60,439	23,281	83,720
2010	63,035	20,685	83,720
2011	65,741	17,979	83,720
2012-2016	373,650	45,040	418,690
Total	\$ 676,377	160,913	837,290
Less current portion	(55,563)		
Total non-current	\$ 620,814		

San Lorenzo Valley Water District
Notes to the Basic Financial Statements (Continued)
For the Years Ended June 30, 2006 and 2005

(6) Long-Term Debt (Continued)

1998 Certificates of Participation

In 1998, the District issued Certificates of Participation Bonds for the Water System Improvement Project. The obligation of the District is payable from tax revenues and if and to the extent necessary net revenues. In 2005, the District refinanced the Certificates of Participation through a refunding agreement bearing interest at 4.25% per annum with maturity date of June 1, 2019. The District makes semi-annual payments of \$105,059 including principal and interest on June 1st and December 1st each year.

<u>Fiscal Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2007	\$ 122,919	87,199	210,118
2008	128,198	81,920	210,118
2009	133,705	76,413	210,118
2010	139,448	70,670	210,118
2011	145,437	64,681	210,118
2012-2016	826,430	224,160	1,050,590
2017-2019	586,067	44,287	630,354
Total	\$ 2,082,204	649,330	2,731,534
Less current portion	(122,919)		
Total non-current	\$ 1,959,285		

Malosky Creek Loan

In 2006, the District entered into an agreement to purchase land at a fixed rate of 4.75%, maturing on July 18, 2021. The District will make semi-annual payments of \$82,224 including principal and interest on January 18th and July 18th each year.

<u>Fiscal Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2007	\$ 40,661	41,563	82,224
2008	84,242	80,205	164,447
2009	88,291	76,156	164,447
2010	92,535	71,912	164,447
2011	96,982	67,465	164,447
2012-2016	559,479	262,757	822,236
2017-2021	707,494	114,742	822,236
2022	80,316	1,908	82,224
Total	\$ 1,750,000	716,708	2,466,708
Less current portion	(40,661)		
Total non-current	\$ 1,709,339		

San Lorenzo Valley Water District
Notes to the Basic Financial Statements (Continued)
For the Years Ended June 30, 2006 and 2005

(6) Long-Term Debt (Continued)

Johnson Building Loan

In 2006, the District entered into an agreement to purchase a building and land to be utilized as the future main office of the District with a fixed rate of 4.65%, maturing on December 15, 2020. The District will make semi-annual payments of \$70,005 including principal and interest on June 15th and December 15th each year.

<u>Fiscal Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2007	\$ 72,729	67,281	140,010
2008	76,150	63,860	140,010
2009	79,732	60,278	140,010
2010	83,483	56,527	140,010
2011	87,410	52,600	140,010
2012-2016	502,736	197,314	700,050
2017-2021	562,630	67,410	630,040
Total	\$ 1,464,870	565,270	2,030,140
Less current portion	(72,729)		
Total non-current	\$ 1,392,141		

(7) Net Investment in Capital Assets

Net investment in capital assets:

	<u>2006</u>	<u>2005</u>
The balance at June 30, consists of the following:		
Capital assets, net	\$ 21,289,629	18,494,618
Long-term debt - current portion	(512,704)	(382,299)
Long-term debt	(8,995,604)	(6,293,317)
Net investment in capital assets	\$ 11,781,321	11,819,002

(8) Defined Benefit Pension Plan

Plan Description

The District contributes to the California Public Employees Retirement System (CalPERS), an agent multiple-employer public employee defined benefit pension plan. CalPERS provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. CalPERS acts as a common investment and administrative agent for participating public agencies within the State of California. Benefit provisions and all other requirements are established by state statute and the District. Copies of CalPERS annual financial report may be obtained from the PERS Executive Office: 400 P Street, Sacramento, CA, 95814.

Funding Policy

The contribution rate for participants is 3.5% of their annual covered salary. The District makes these contributions required of District employees on their behalf and for their account. Also, the District is required to contribute the actuarially determined remaining amounts necessary to fund the benefits for its members. The required employer contribution rate for fiscal year 2006 and 2005 was 6.154% and 0.00%, respectively. The contribution requirements of the plan members are established by State statute, and the employer contribution rate is established and may be amended by CalPERS.

San Lorenzo Valley Water District
Notes to the Basic Financial Statements (Continued)
For the Years Ended June 30, 2006 and 2005

(8) Defined Benefit Pension Plan (Continued)

Annual Pension Cost

For fiscal year 2006 and 2005, the District's annual pension cost was \$86,671 and \$0, respectively, for CalPERS and was equal to the District's required and actual contributions. The required contribution was determined as part of the June 30, 2004, actuarial valuation using the entry age normal actuarial cost method. The actuarial assumptions included (a) 7.75% investment rate of return (net of administrative expense), (b) projected annual salary increases that vary by duration of service, and (c) 3.25% per year cost of living adjustments to 14.45% depending on age. Both (a) and (b) included and inflation component of 3.00% and a payroll growth rate of 3.25%. The actuarial value of CalPERS assets was determined using techniques that smooth the effects of short-term volatility in the market value of investment over a three-year period (smoothed market value). Initial unfunded liabilities are amortized over a closed period that depends on the plan's date of entry into CalPERS. Subsequent plan amendments are amortized as a level percentage of pay over a closed 20-year period.

Gains and losses that occur in the operation of the plan are amortized over a rolling period, which results in an amortization of 10% of unamortized gains and losses each year. If the plan's accrued liability exceeds the actuarial value of plan assets, then the amortization payment on the total unfunded liability may not be lower than the payment calculated over a 30 year amortization period.

Trend information gives an indication of the progress made in accumulating sufficient assets to pay benefits when due. The District presents the most recent available three-year Annual Pension Cost (APC) information for the plan, along with required supplementary information as follows:

Three-Year Trend Information for CalPERS

<u>Fiscal Year</u>	<u>Cost (APC)</u>	<u>APC Contributed</u>	<u>Obligation</u>
2004	\$ -	100%	-
2005	-	100%	-
2006	86,671	100%	-

(9) Risk Management

The District is exposed to various risks of loss related to torts, theft of, damage to and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The District, as a member of the Special District Risk Management Authority (SDRMA), has purchased various insurance policies to manage the potential liabilities that may occur from the previously named sources. SDRMA's purpose is to arrange and administer programs of self-insured losses and to purchase excess insurance coverage. At June 30, 2006, the District participated in the liability and property programs of the SDRMA as follows:

- General and auto liability, public officials and employees' errors and omissions and employment practices liability: Total risk financing limits of \$5 million, combined single limit at \$5 million per occurrence, subject to the following deductibles – \$500/\$1,000 per occurrence for third party general liability property damage – 50% co-insurance of cost expended by SDRMA, in excess of \$10,000 up to \$50,000, per occurrence, for employment related claims. However, 100% of the obligation will be waived if certain criteria are met.
- Employee dishonesty coverage up to \$400,000 per loss includes public employee dishonesty, forgery or alteration and theft, disappearance and destruction coverages.
- Property loss is paid at the replacement cost for property on file, if replaced within two years after the loss, otherwise paid on an actual cash value basis, to a combined total of \$1 billion per occurrence, subject to a \$2,000 deductible per occurrence.

San Lorenzo Valley Water District
Notes to the Basic Financial Statements (Continued)
For the Years Ended June 30, 2006 and 2005

(9) Risk Management, continued

- Boiler and machinery coverage for the replacement cost up to \$100 million per occurrence, subject to a \$1,000 deductible.
- Public officials personal liability up to \$500,000 each occurrence, with an annual aggregate of \$500,000 per each elected/appointed official to which this coverage applies, subject to the terms, conditions and exclusions as provided in the Memorandum of Coverage, deductible of \$500 per claim.

The District maintains workers' compensation coverage and employer's liability coverage in accordance with the statutory requirements of the State of California.

Settled claims have not exceeded any of the coverage amounts in any of the last three fiscal years and there were no reductions in the District's insurance coverage during the years ending June 30, 2006, 2005 and 2004. Liabilities are recorded when it is probable that a loss has been incurred and the amount of the loss can be reasonably estimated net of the respective insurance coverage. Liabilities include an amount for claims that have been incurred but not reported (IBNR). There were no IBNR claims payable as of June 30, 2006, 2005 and 2004.

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

The Governmental Accounting Standards Board (GASB) has issued several pronouncements prior to June 30, 2006, that have effective dates that may impact future financial presentations. Management has not currently determined what, if any, impact implementation of the following statements may have on the District's future financial statements.

Governmental Accounting Standards Board Statement No. 45

In June 2004, the GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. This Statement establishes standards for the measurement, recognition, and display of Other Post-Employment Benefit expense/expenditures and related liabilities (assets), note disclosures, and, if applicable, required supplementary information (RSI) in the financial reports of state and local government employers. This statement is not effective until June 30, 2009. The District has not determined the effect this statement will have on its financial statement presentation.

(11) Commitments and Contingencies

Litigation

In the ordinary course of operations, the District is subject to claims and litigation from outside parties. After consultation with legal counsel, the District believes the ultimate outcome of such matters, if any, will not materially affect its financial condition.

Required Supplementary Information

San Lorenzo Valley Water District
Schedule of Funding Progress
For the Year Ended June 30, 2006

Required Supplementary Information – *Funded Status of the District's Plan*

Following the creation of risk pools pursuant to Section 20840 of the Government Code, any existing contracting agency with a rate plan of less than 100 active members on any annual actuarial valuation date shall be required to participate in a risk pool. Participation shall be effective as of the valuation date for all members of that rate plan, but no earlier than June 30, 2003. Risk pool valuations will be used to set employer contribution rates for future fiscal years.

Rate Plan belonging to the Miscellaneous Employee 2.0% at 55 Risk Pool Retirement Plan

The Schedule of Funding Progress below shows the recent history of the CalPERS Miscellaneous Employee 2.0% at 55 Risk Pool Retirement Plan actuarial value of assets, actuarial accrued liability, their relationship, and the relationship of the unfunded actuarial accrued liability (UL) to payroll.

<u>Valuation Date</u>	<u>Accrued Liabilities</u>	<u>Actuarial Assets</u>	<u>Unfunded Liabilities (UL)</u>	<u>Funded Ratio</u>	<u>Annual Covered Payroll</u>	<u>UL As a % of Payroll</u>
June 30, 2003	\$ 2,596,966,545	2,372,879,034	224,087,511	91.4%	725,020,458	30.9%
June 30, 2004	2,746,095,668	2,460,944,656	285,151,012	89.6%	743,691,970	38.3%
June 30, 2005	2,891,460,651	2,588,713,000	302,747,651	89.5%	755,046,679	40.1%

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Supplemental Information

San Lorenzo Valley Water District
Combining Schedule of Net Assets
For the Year Ended June 30, 2006

<i>Assets</i>	Enterprise Funds		Total
	Water Fund	Sewer Fund	
Current assets:			
Cash and cash equivalents	\$ 1,152,339	3,962	1,156,301
Investments	9,549,750	-	9,549,750
Accrued interest receivable	83,042	-	83,042
Accounts receivable – water sales and services, net	252,082	-	252,082
Accounts receivable – property taxes	29,471	-	29,471
Accounts receivable – other	1,754,945	-	1,754,945
Due from/to other fund	203,206	(203,206)	-
Materials and supplies inventory	164,315	-	164,315
Total current assets	13,189,150	(199,244)	12,989,906
Restricted assets:			
Investments	1,373,473	-	1,373,473
Total restricted assets	1,373,473	-	1,373,473
Non-current assets:			
Capital assets, net	20,386,925	902,704	21,289,629
Deferred charges, net	346,030	-	346,030
Total non-current assets	20,732,955	902,704	21,635,659
Total assets	\$ 35,295,578	703,460	35,999,038
<i>Liabilities and Net Assets</i>			
Current liabilities – payable from unrestricted current assets:			
Accounts payable and accrued expenses	\$ 148,216	-	148,216
Accrued salaries and wages	41,379	-	41,379
Compensated absences	284,549	2,789	287,338
Customer deposits	318,919	-	318,919
Connection and construction deposits	153,591	-	153,591
Liabilities payable from unrestricted current assets	946,654	2,789	949,443
Liabilities – payable from restricted assets:			
Accrued interest payable	75,182	-	75,182
Long-term debt - current portion	512,704	-	512,704
Liabilities payable from restricted assets	587,886	-	587,886
Total current liabilities	1,534,540	2,789	1,537,329
Non-current liabilities:			
Long-term debt	8,995,604	-	8,995,604
Total non-current liabilities	8,995,604	-	8,995,604
Total liabilities	10,530,144	2,789	10,532,933
Net assets:			
Net investment in capital assets	10,878,617	902,704	11,781,321
Restricted for debt service	1,373,473	-	1,373,473
Unrestricted	12,513,344	(202,033)	12,311,311
Total net assets	24,765,434	700,671	25,466,105
Total liabilities and net assets	\$ 35,295,578	703,460	35,999,038

San Lorenzo Valley Water District
Combining Schedule of Revenues, Expenses and Changes in Fund Net Assets
For the Year Ended June 30, 2006

	Enterprise Funds		
	Water Fund	Sewer Fund	Total
Operating revenues:			
Water consumption sales	\$ 2,849,697	-	2,849,697
Wastewater service	-	45,906	45,906
Assessments	136,916	-	136,916
Meter sales	52,359	-	52,359
Charges and penalties	34,695	-	34,695
Other charges and services	19,880	2,754	22,634
Total operating revenues	3,093,547	48,660	3,142,207
Operating expenses:			
Salaries and benefits	2,061,624	14,828	2,076,452
Professional services	241,938	10,812	252,750
Materials and supplies	153,421	2,551	155,972
Utilities and telephone	253,113	5,865	258,978
Insurance	49,611	464	50,075
LAFCO fees	5,193	-	5,193
Vehicle and equipment maintenance	75,670	692	76,362
Building maintenance	24,591	180	24,771
Repairs	184,694	-	184,694
Collections fees and charges	1,492	-	1,492
Travel, meals and conferences	9,404	-	9,404
Auto allowance	4,200	-	4,200
Office expenses	40,465	3,421	43,886
Rental and permits	13,801	2,471	16,272
Miscellaneous	52,569	4,500	57,069
Total operating expenses	3,171,786	45,784	3,217,570
Operating income before depreciation and amortization	(78,239)	2,876	(75,363)
Depreciation and amortization	(882,554)	(34,253)	(916,807)
Operating loss	\$ (960,793)	(31,377)	(992,170)
Non-operating revenue(expense)			
Property taxes	\$ 132,169	-	132,169
Interest and investment earnings	361,399	-	361,399
Rental revenue	30,297	-	30,297
Interest expense – long-term debt	(305,088)	-	(305,088)
Gain (loss) on disposition of capital assets	-	-	-
Gain (loss) on investments	(181,771)	-	(181,771)
Total non-operating revenues, net	37,006	-	37,006
Net loss before capital contributions	(923,787)	(31,377)	(955,164)
Capital contributions:			
Developers and others	68,749	-	68,749
Capital contributions	68,749	-	68,749
Change in net assets	(855,038)	(31,377)	(886,415)
Net assets, beginning of year	25,620,472	732,048	26,352,520
Net assets, end of year	<u>\$ 24,765,434</u>	<u>700,671</u>	<u>25,466,105</u>

Report on Compliance and Internal Controls

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

Board of Directors
San Lorenzo Valley Water District
Boulder Creek, California

We have audited the financial statements of the San Lorenzo Valley Water District (District) as of and for the year ended June 30, 2006, and have issued our report thereon dated October 31, 2006. 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.

Compliance

As part of obtaining reasonable assurance about whether the District's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control over Financial Reporting

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 opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the Board of Directors and management and is not intended to be and should not be used by anyone other than these specified parties. This restriction is not intended to limit the distribution of this letter, which is a matter of public record.

October 31, 2006
Cypress, California