

MONTECITO WATER DISTRICT

FINANCIAL STATEMENTS

JUNE 30, 2008 AND 2007

MONTECITO WATER DISTRICT
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POINDEXTER & COMPANY

Certified Public Accountant

To the Board of Directors of
Montecito Water District

INDEPENDENT AUDITOR'S REPORT

I have audited the accompanying financial statements of Montecito Water District, as of and for the years ended June 30, 2008 and 2007, as listed in the table of contents. These financial statements are the responsibility of the District's management. My responsibility is to express opinions on these financial statements based on my audit.

I conducted my audits in accordance with auditing standards generally accepted in the United States of America, the standards applicable to financial audits contained in *Governmental Auditing Standards*, issued by the Comptroller General of the United States and the State Controller's Minimum Audit Requirements for California Special Districts. Those standards require that I plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. I believe that my audits provide a reasonable basis for my opinions.

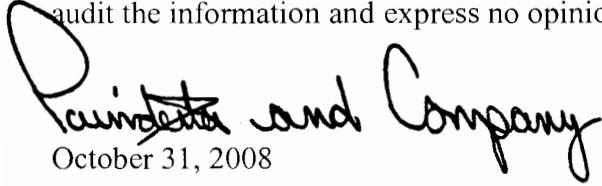
In my opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Montecito Water District, as of June 30, 2008 and 2007, and the respective changes in financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America, as well as accounting systems prescribed by the State Controller's Office and state regulations governing special districts.

In accordance with *Government Auditing Standards*, I have also issued my report dated October 31, 2008, on my consideration of the Montecito Water District's internal control over financial reporting and my tests of its compliance with certain provisions of laws, regulations, contracts, and grants agreements and other matters. The purpose of that report is to describe the scope of my 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 my audit.

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The management discussion and analysis on pages three through sixteen and the required supplementary information on page forty-five are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. I 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, I did not audit the information and express no opinion on it.

Pwinteta and Company
October 31, 2008



MANAGEMENT DISCUSSION AND ANALYSIS For the Fiscal Year ending June 30, 2008

As management of the Montecito Water District (the District), we offer readers of the District's financial statements this narrative overview and analysis of the financial activities of the District for the fiscal year ended June 30, 2008. Readers are encouraged to read this section in conjunction with the accompanying financial statements.

Summary of Organization – an Overview

The District was incorporated on November 10, 1921 under the statutes of the State of California for the purposes of furnishing potable water within the District. The District is located in the southern coastal portion of Santa Barbara County and includes the unincorporated communities of Montecito and Summerland, parts of the Carpinteria Valley and part of the City of Santa Barbara. It has a population of approximately 13,500 and currently provides water service to approximately 4,583 customers. The District currently employs 25 persons.

The major activities include acquisition of water from Jameson Lake, the Cachuma Water Project, the State Water Project and the production of groundwater. The District operates water treatment facilities and has entered into a Joint Powers Agreement with the City of Santa Barbara to have water from Lake Cachuma treated at the City's Cater Treatment Plant. The major activities also include the sale and delivery of water to domestic, agricultural and commercial accounts. The District owns and maintains 110 miles of pipeline to deliver water to its customers.

Overview of the Financial Statements

The District operates as a proprietary fund-type. All proprietary fund-types are accounted for on a flow of economic resources measurement focus. Under this measurement focus, all assets and liabilities associated with the operation of these funds are included on the balance sheet. Proprietary fund-type operating statements present increases (revenues) and decreases (expenses) in total net assets.

All proprietary fund types utilize the accrual basis of accounting. Under this method, revenues are recognized when earned, regardless of when received, and expenses are recognized at the time the related liabilities are incurred, regardless of when paid.

This discussion and analysis is intended to serve as an introduction to the District's basic financial statements. The basic proprietary fund financial statements can be found on pages 16 to 20 of this report. The **Notes to the Financial Statements** provide additional information that is essential to a full understanding of the data provided in the basic fund financial statements. The notes to the financial statements can be found on pages 22 to 43 of this report.



**MANAGEMENT DISCUSSION AND ANALYSIS
For the Fiscal Year ending June 30, 2008**

Financial Highlights

The following table shows a condensed version of the District's Statement of Net Assets with corresponding analysis.

Condensed Statement of Net Assets				
	2008	2007	Variance	
			Dollars	Percent
			Favorable/(Unfavorable)	
Current Assets	\$ 16,125,771	\$ 15,174,547	\$ 951,224	6.27%
Capital assets	36,122,997	34,609,510	1,513,487	4.37%
Other assets	6,977,566	7,808,602	(831,036)	-10.64%
Total Assets	\$ 59,226,334	\$ 57,592,659	\$ 1,633,675	2.84%
Long-term liabilities outstanding	\$ 27,420,434	\$ 27,131,775	\$ (288,659)	-1.06%
Current liabilities	1,953,596	2,190,526	236,930	10.82%
Total Liabilities	29,374,030	29,322,301	(51,729)	-0.18%
Invested in capital assets net of related debt	13,136,437	12,350,820	785,617	6.36%
Restricted	588,099	499,186	88,913	17.81%
Unrestricted assets	16,127,768	15,420,352	707,416	4.59%
Total Net Assets	29,852,304	28,270,358	1,581,946	5.60%
Total Liabilities and Net Assets	\$ 59,226,334	\$ 57,592,659	\$ 1,633,675	2.84%

Total assets of June 30, 2008 are \$59,226,334 or \$1,633,675 more than the June 30, 2007 amount.

Current assets are approximately \$951,224 more than the prior year, primarily due to an increase in investments. Investments increased due to higher water sales during the year. The District sold 6,519 Acre Feet of water in 2007/08 compared to 6,333 Acre Feet of water in 2006/07. This resulted in \$724,949 more revenue for water sales.

Restricted assets are lower than the prior year due to the progress of District-wide system improvements and main replacements. The restricted fund assets invested in the Local Agency Investment Fund (LAIF) are comprised of loan proceeds from the 1998A Revenue Certificates of Participation and are to be used for system improvements. Due to the progress of the projects, funds were withdrawn from the investment accounts to fund the projects.



**MANAGEMENT DISCUSSION AND ANALYSIS
For the Fiscal Year ending June 30, 2008**

Financial Highlights (Continued)

Capital and other assets are higher than last year primarily due to the progress of the Ortega Reservoir Improvement Project and the progress of District-wide system improvements. As the projects progress, the expenditures of the projects are included in the Construction in Progress section of Capital Assets. Completed projects are transferred to the appropriate Capital Asset categories.

Current liabilities are comparable to last year or approximately \$236,930 lower than last year.

Long-term liabilities are approximately \$288,659 higher than last year due to increases in DWR Ortega Loan.

Net assets may serve over time as a useful indicator of a government's financial position. In the case of the District, assets exceeded liabilities by \$29,852,304 at the close of the fiscal year ending June 30, 2008.

By far, the largest portion of the District's net assets (44 percent) reflects its investment in capital assets (e.g., land, buildings and improvements, machinery, work in progress, and infrastructure), less any related debt used to acquire those assets that is still outstanding. The District uses these capital assets to provide services to customers; consequently, these assets are not available for future spending.

The District's investment in its capital assets is reported net of related debt. It should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

At the end of the current fiscal year, the District is able to report positive balances in all three categories of net assets. The same held true for the prior fiscal year.

The District's net assets increased by \$1,581,946 during the 2007/08 fiscal year. This increase reflects an increase in water sales due to dry weather. An 8% rate increase was effective on March 1, 2007, which also attributed to the increase in water sales revenue. The District benefitted from the effects of the rate increase in the prior year for the entire fiscal year ending June 30, 2008. The District was also able to earn more interest on its investments in the State of California Local Agency Investment Fund (LAIF).

The following table shows a condensed version of the District's Statement of Activities and Change in Net Assets with corresponding analysis regarding significant variances.



**MANAGEMENT DISCUSSION AND ANALYSIS
For the Fiscal Year ending June 30, 2008**

Financial Highlights (Continued)

Condensed Statements of Activities and Changes in Net Assets				
	2008	2007	Variance	
			Dollars	Percent
			Favorable/(Unfavorable)	
Operating Income				
Charges for services	\$ 12,759,990	\$ 11,885,917	\$ 874,073	7.35%
Operating expenses	(12,062,814)	(11,344,157)	(718,657)	-6.34%
Operating income	697,176	541,760	155,416	-28.69%
Non operating Revenues				
Capital contributions	41,298	84,929	(43,631)	-51.37%
Capital cost recovery fees	332,611	275,825	56,786	20.59%
Interest income	366,967	337,658	29,309	8.68%
Taxes and assessments	1	1	-	0.00%
Water availability charge	311,926	310,554	1,372	0.44%
Reimbursements	-	28,140	(28,140)	-100.00%
Late charges	59,198	72,585	(13,387)	-18.44%
Disposal of assets	6,080	3,148	2,932	93.14%
Other	131,174	100,709	30,465	30.25%
Total Non operating revenues	1,249,255	1,213,549	35,706	2.94%
Non operating expenses:				
Interest expense	(364,485)	(309,102)	(55,383)	-17.92%
Total non-operating expenses	(364,485)	(309,102)	(55,383)	-17.92%
Increase in Net Assets	\$ 1,581,946	\$ 1,446,207	\$ 135,739	9.39%

Charges for Services were higher than last year by \$874,073 due primarily to increased water sales.

Operating Expenses were higher than last year by \$718,657 due to increased water purchase costs and treatment costs associated with the cost of purchasing and delivering more water. In addition, administration and general costs, and depreciation and amortization costs were higher than the prior year.



**MANAGEMENT DISCUSSION AND ANALYSIS
For the Fiscal Year ending June 30, 2008**

Financial Highlights (Continued)

The Change in Net Assets of \$1,581,946 for the reporting period was higher than last year by \$135,739. This difference is largely due to higher water sales revenue in the current reporting period than in the prior reporting period. A more detailed explanation of revenue, expenses, debt service and capital improvements follows:

REVENUE

The following is a summary of total revenue for the reporting period. When reviewing the following revenue line items, please refer to the *Statement of Activities and Changes in Net Assets* on page 18 of this report.

TOTAL OPERATING REVENUES were higher than last year primarily due to higher water sales. Presented below are summaries of the components of total operating revenue:

WATER SALES revenue was higher than the 2006/07 fiscal year (last year) by \$724,949 and higher than budget by \$710,521 due to higher water sales during the 2007/08 fiscal year (current year) as compared to last year. A total of 6,519 acre feet of water was sold during the reporting period, an increase of 186 acre feet compared to last year's sales of 6,333 acre feet and was 333 acre feet higher than the budgeted year's sales of 6,000 acre feet.

SERVICE CHARGE revenues were higher than last year by \$149,124. At the end of the current year, there was a net increase of 19 meters for a total of 4,628 meters as compared to 4,609 meters at the end of the same period last year.

TOTAL NON OPERATING REVENUES were \$35,706 higher than the prior year. Presented below are summaries of the total non-operating revenue:

CONNECTION FEES (i.e., service connection fees and capital cost recovery fees for new meter connections, relocations, or enlargements) revenue was higher than last year by \$56,786. For the reporting period, \$54,373 in service connection fees and \$278,238 in capital cost recovery fees were collected as compared to \$26,544 and \$249,281, respectively last year.

INTEREST REVENUE was higher than last year by \$29,309 and higher than budget by \$77,521 for the reporting period primarily due to larger amounts invested than the prior year. An average balance of \$5,762,269 at an average interest rate of 4.367% was invested in LAIF during the reporting period of 2007/08 as compared to an average balance of \$4,165,901 at an average interest rate of 5.121% that was invested in LAIF during the reporting period of 2006/07.



**MANAGEMENT DISCUSSION AND ANALYSIS
For the Fiscal Year ending June 30, 2008**

REVENUE (Continued)

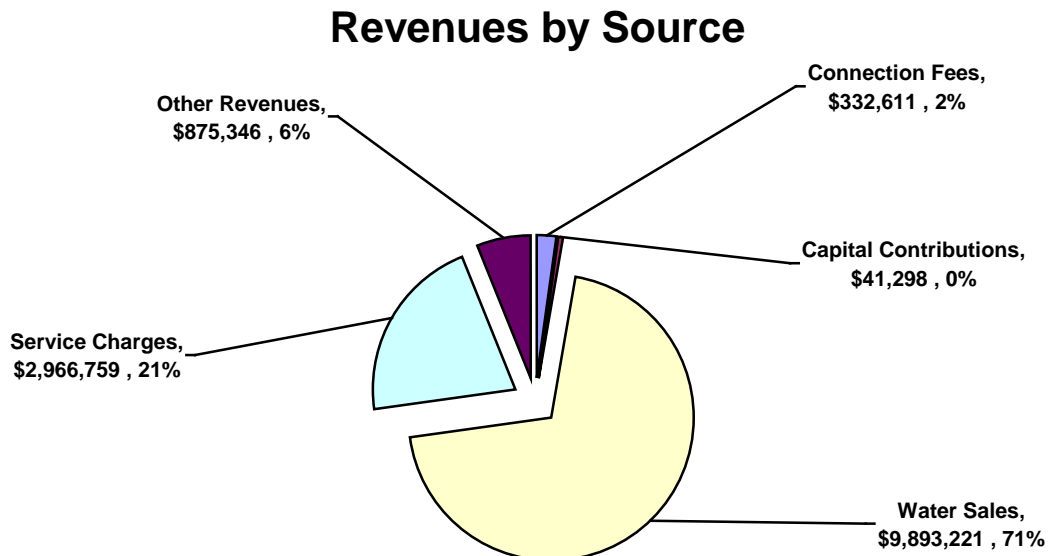
WATER AVAILABILITY CHARGE is collected by the County of Santa Barbara when property taxes are paid in December and April. This charge is placed on all properties within the District's service area and is utilized to pay for the current water main replacement program.

REIMBURSEMENTS In the prior year, the District received \$28,140 from the State of California for mandated costs associated with the Brown Act. The District did not receive any mandated costs reimbursements during 2007/08.

DISPOSAL OF DISTRICT ASSETS was budgeted at \$4,000 this year. The gain of \$6,080 represents the disposal of two vehicles.

LATE CHARGES were lower than last year by \$13,387.

The District's **TOTAL REVENUE** was higher than last year's total revenue by \$909,779, which includes contributions in aid of construction.





MANAGEMENT DISCUSSION AND ANALYSIS For the Fiscal Year ending June 30, 2008

EXPENSES

The following is a summary review of operating expenses for the reporting period. When reviewing the following discussion, please refer to the *Statements of Activities and Changes in Nets Assets* page 18 of this report.

TOTAL OPERATING EXPENSES were \$718,657 higher than the prior year primarily due to higher water purchase costs, higher pumping costs and higher treatment costs.

WATER PURCHASES were higher than last year by \$431,689. The increase in Cachuma water purchase costs this year as compared to last year was primarily due to higher water sales due to dry weather. The Acre Foot water costs charged to the District from the Cachuma Operations and Maintenance Board (COMB) increased.

WATER TREATMENT was higher than last year by \$114,677. The costs for the reporting period were higher than last year due primarily to the treatment of more water due to higher water sales. The District also replaced filter media at the Bella Vista Treatment Plant, which also contributed to the higher treatment costs.

WATER SYSTEM OPERATIONS AND MAINTENANCE was lower than last year by \$32,185.

METER READING AND CUSTOMER SERVICE was higher than last year by \$8,250. The costs for the reporting period were higher than last year due to higher costs associated with meter reading, rush reads, and customer service requests. The District began outsourcing the printing of customer water bills during the previous year and these costs are reflected in the prior year's costs. The cost of printing bills in-house for prior years was reported in the administrative and general costs for office supplies and personnel costs.

ADMINISTRATIVE AND GENERAL total expenses were higher than last year by \$249,436. This represents a 14% increase and is lower than budget by \$91,475. The increase is due to a 3.6% Cost of Living adjustment and increased cost for water rights on Lake Cachuma paid to the Cachuma Conservation Release Board. There were also increased public relations expenses due to the development of a new conservation block rate structure.

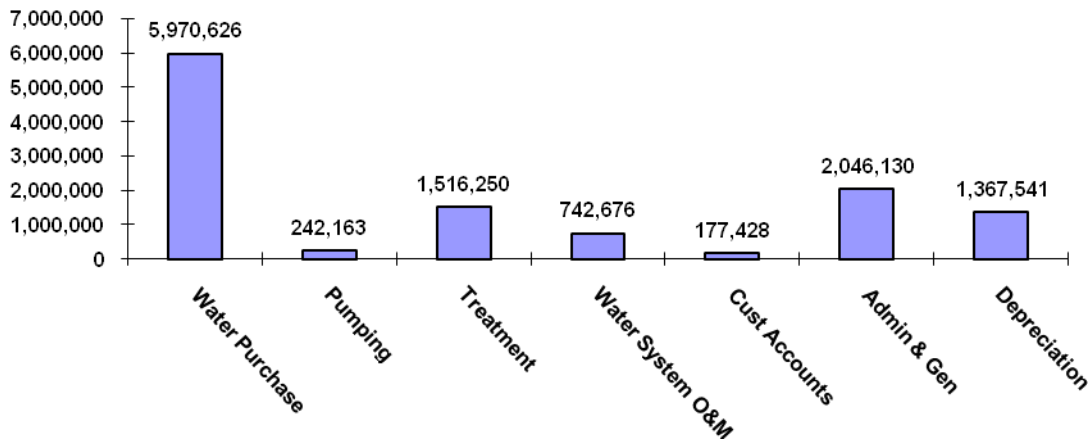
DEPRECIATION AND AMORTIZATION expense \$13,784 lower than last year. This represents a 1% decrease and is primarily due to fixed assets which have become fully depreciated no longer being depreciated.



**MANAGEMENT DISCUSSION AND ANALYSIS
For the Fiscal Year ending June 30, 2008**

EXPENSES (Continued)

Operating Expenses



NON-OPERATING EXPENSES which are comprised of interest expense was higher than last year by 55,383. This is due to increased interest associated with the DWR Ortega Cover Loan. This loan was increased during the year as the project progressed, therefore the interest due on each loan also increased.

Financial Analysis

The net assets of the District's water fund increased by \$1,581,946. Key elements of this change are as follows:

Water sales increased by 8% and service charges increased by 5%. The increase in water sales was due primarily due to extremely dry weather conditions which caused an increase in the demand for water. This resulted in \$724,949 more in water sales revenue than in the previous year and \$710,521 more than was budgeted. The service charges increased due to a rate increase midway through the 2006/07 fiscal which the District benefitted from for the entire 2007/08 fiscal year.

Expenses also increased during the year and the District had net operating income of \$697,176. The District also realized net non operating revenues of \$843,472. Non operating revenues include interest income, the Water Availability Charge, late charges and the Capital Cost recovery fees and connection fees. Capital cost recovery and connection fees were \$332,611 which represents an increase of \$56,786 over the prior year.



**MANAGEMENT DISCUSSION AND ANALYSIS
For the Fiscal Year ending June 30, 2008**

Financial Analysis (Continued)

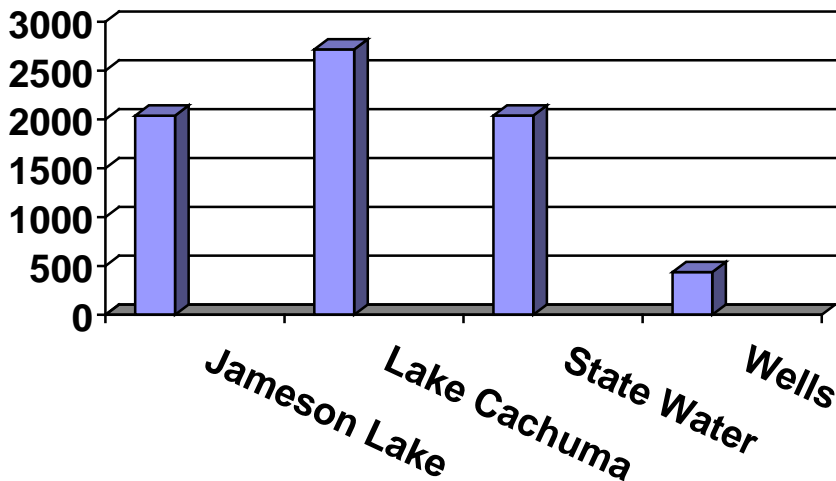
Capital contributions to the District were \$41,298 due to a main extension project which was partially paid for with customer contributions.

Operating expenses were 6.3% higher than last year which reflects the increase in water sales and the increase in depreciation expense for the current year.

Water Production

The following chart provides a comparison of the District's water production by source of supply.

Water Production By Source (AF)



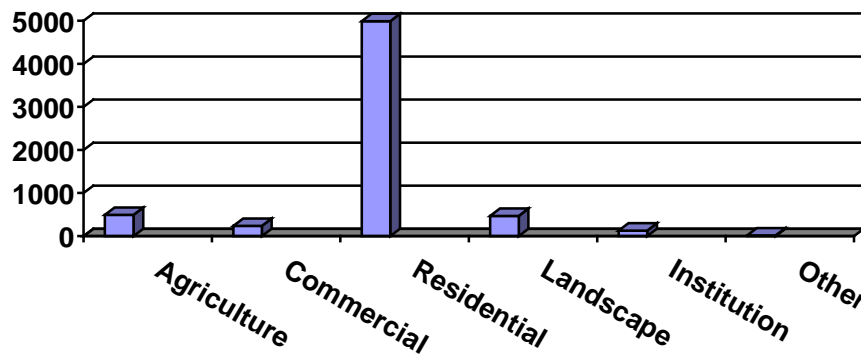


**MANAGEMENT DISCUSSION AND ANALYSIS
For the Fiscal Year ending June 30, 2008**

Water Sales

The following chart provides a comparison of the District's water sales in Acre Feet by category of user.

Water Sales by User Category (AF)



Capital Asset and Debt Administration

Capital assets. The District's investment in capital assets as of June 30, 2008, amounts to \$36,122,997 (net of depreciation). This investment in capital assets included land, buildings and improvement, equipment, infrastructure, and work in progress. The District's investments in capital assets increased by 4.37%.

Montecito Water District's Capital Assets					
	Year Ended		Variance		
	June 30, 2008	June 30, 2007	Dollars	Percent	
			Increase (decrease)		
Land	\$ 245,590	\$ 245,590	\$ -		0.00%
Water supply sources	5,496,651	5,267,556	229,095		4.35%
Treatment plants	5,681,353	5,649,876	31,477		0.56%
Infrastructure	24,968,045	23,172,819	1,795,226		7.75%
Machinery & equipment	2,040,405	1,885,059	155,346		8.24%
Construction in progress	12,909,284	12,801,153	108,131		0.84%
Total property, plant and equipment	51,341,328	49,022,053	2,319,275		4.73%
Accumulated Depreciation	(15,218,331)	(14,412,543)	(805,788)		5.59%
Net Property, Plant and Equipment	\$ 36,122,997	\$ 34,609,510	\$ 1,513,487		4.37%



**MANAGEMENT DISCUSSION AND ANALYSIS
For the Fiscal Year ending June 30, 2008**

Capital Asset and Debt Administration (Continued)

Major capital asset events during the current fiscal year included the following:

Equipment was purchased for \$235,169 during for the year. Equipment with a cost of \$79,823 was disposed of during the year. Construction in Progress consists of system, improvements and main replacements. Construction in Progress had additions of \$2,104,534, which includes the Ortega Reservoir Improvement Project. A majority of the system improvements were funded with proceeds of the 1998A Revenue Bonds and Department of Water Resources (DWR) loans. \$1,996,403 was transferred from Construction in Progress to Fixed assets during the year.

Additional information on the District's capital assets can be found in Note 5 in the notes to the financial statements.

Long-Term Debt. At the end of the current fiscal year, the District had total debt outstanding of \$27,885,158. Of this amount, \$13,830,000 comprises debt that represents bonds secured solely by specific revenue sources (i.e. revenue bonds). \$1,825,963 is a loan from the Department of Water Resources for the Bella Vista Treatment Plant, \$3,102,989 represents a loan from the Department of Water Resources for the Cater Treatment Plant improvements, and \$8,998,870 represents a construction loan from the DWR for the Ortega Reservoir Project.

Montecito Water District's Outstanding Debt Revenue Bonds and Other Debt				
	June 30, 2008		June 30, 2007	
Revenue Bonds	\$	13,830,000	\$	13,860,000
Loans		13,927,822		13,671,045
Capital Lease		127,336		-
Total	\$	27,885,158	\$	27,531,045

The 1998A bonds are insured by Ambac Assurance Corporation (insurer). Ambac Assurance Corporation is a Wisconsin-domiciled stock insurance corporation regulated by the Office of the Commissioner of Insurance of the State of Wisconsin and licensed to do business in 50 states, the District of Columbia, the Territory of Guam and the Commonwealth of Puerto Rico.

Statutory capital consists of the Certificate Insurer's policyholders' surplus and statutory contingency reserve. Standard & Poor's Ratings Service, a division of the McGraw-Hill



MANAGEMENT DISCUSSION AND ANALYSIS For the Fiscal Year ending June 30, 2008

Capital Asset and Debt Administration (Continued)

Companies, Inc, has assigned a Baa1 financial strength rating to the certificate insurer. Moody's Investors Service has assigned an A rating and Fitch IBCA, Inc., has withdrawn its rating of the Certificate Insurer.

State statutes limit the amount of general obligation debt a governmental entity may issue to 1% of its total assessed valuation. The current debt limit for the District is \$83,642,198 which is significantly in excess of the District's outstanding debt subject to this limit.

Additional information on the District's long-term debt can be found in Notes 7 through 8 in the notes to the financial statements.

Economic Factors and Next Year's Budget

- The District has developed and implemented a tiered rate structure during the 2008/09 fiscal year. This type of structure is different from the flat rate structure the District previously had. While the goal of the tiered rate structure is to encourage customers to decrease usage and conserve water, it is unknown at this time how this will affect the water sales revenues. If customers decrease their usage due to higher billing rates at higher usage rates, the District may experience a significant decrease in water sales revenue. If customers do not reduce usage, the District may have an increase in its water sales revenue.
- Extremely dry weather has caused the District to sell more water than projected for the 2007/08 fiscal year and the 2006/07 fiscal year. If the District faces a third consecutive dry year, the District will be forced to pay more for water it purchases or may not be able to find additional water to purchase. The District may be forced to implement strict conservation measures.
- With a majority of water used by customers on residential vegetation, the District could be expected to use existing water supplies and seek to purchase more expensive additional supplies, if available, in the future.
- The current state of the economy and the performance of the investment markets may cause the District to see an increase in its contributions to the PERS pension plan. The District will not know how its employer contribution rates will be affected until after CalPERS has an actuarial study completed.
- Costs for state water purchases continue to increase. The Central Coast Water Authority charges the District for its share of the State Water Project. The variable costs of the project have been increasing due to higher energy costs and fewer credits applied from the State of California.



**MANAGEMENT DISCUSSION AND ANALYSIS
For the Fiscal Year ending June 30, 2008**

Economic Factors and Next Year's Budget (Continued)

- The capital program costs for the Cater Treatment Plant are projected to increase. The District is a member of a Joint Powers agreement in which District water from Lake Cachuma is treated at the City of Santa Barbara's Cater Treatment Plant. Costs of capital projects for the Cater Treatment Plant are expected to increase and the District's share of those costs (19.7%) are passed on to the District.
- The Ortega Project is near completion and the loan through the Department of Human Resources will increase as the project is completed. The District will pay higher interest costs due to the higher loan balance.

With all the above factors considered, the District increased its operating expenses budget for next fiscal year by \$567,249 and estimates \$652,625 more in total revenues. The capital expenditures budget has decreased by \$2,398,355. The decrease in capital expenditures is due to the fact that the Ortega Improvement Project is near completion and expenditures were not budgeted for 2008/09.

Other factors for future consideration include the following:

The District is in the process of addressing the issue of rising demand for water and limited water supplies. A water conservation rate structure was implemented in October 2008 which includes increasing block rates to encourage water conservation. The District is continuing this search for additional water supply in order to continue to meet the demand. If the District is not able to obtain reliable supplies for the future and the weather remains dry may find it necessary to implement more stringent conservation measures.

The District is facing an increase in its required debt service in the fiscal year ending 2014. The District will be establishing a reserve in order to collect funds for early pay off its debt service before the required payments increase.

The District currently has approximately \$3 million in its 1998A bond project funds. Those funds are expected to be depleted in the next two years. Once those funds are depleted, the District will continue to have a need for capital replacements and improvements at a cost of over \$1 million annually. The District will establish and contribute to a reserve for future capital replacements and improvements.

On July 24, 2006, the California Supreme Court decided on the issue of whether Article XIII D Section 6 (i.e. Proposition 218) of the California constitution applies to an increase in consumption based water rates. The court decided that domestic water delivery through a pipeline is a property-related service within the meaning of Article XIII D Section 6. This section requires that the District must comply with the notice and



**MANAGEMENT DISCUSSION AND ANALYSIS
For the Fiscal Year ending June 30, 2008**

Economic Factors and Next Year's Budget (Continued)

majority protest proceedings set out in Article XIII D Section 6. In addition, revenues from water services are governed by the substantive requirements set out in Section 6 (b), which provided that water rates may not exceed the costs of providing the service and that rate proceeds be used only to provide the service.

In the fiscal year 2005/06, the District established a rate stabilization and water purchase reserve. Funding for this reserve was included in the 2008/09 Budget. The District plans to continue funding this reserve with the increase in net assets during the current year.

Request for Information

This financial report is designed to provide a general overview of the District's finances for all those with an interest in the District's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Business Manager at the Montecito Water District, 583 San Ysidro Rd., Montecito, CA 93108.

MONTECITO WATER DISTRICT

STATEMENTS OF NET ASSETS

JUNE 30, 2008 AND 2007

ASSETS

	<u>2008</u>	<u>2007</u>
Current Assets:		
Cash (Note 2)	\$ 389,762	\$ 201,782
Investments (Note 2)	5,119,227	3,255,275
Accounts receivable	1,323,223	1,348,147
Interest receivable	51,058	72,411
Reimbursement receivable from Carpinteria Valley Water District		11,036
Inventory	170,793	168,522
Prepaid water (Note 4)	5,065,567	4,827,170
Prepaid expenses	32,014	36,728
	<u>12,151,644</u>	<u>9,921,071</u>
Total Current Assets		
Restricted Assets:		
Cash (Note 3)	588,099	499,186
Investments (Note 2)	3,386,028	4,754,290
	<u>3,974,127</u>	<u>5,253,476</u>
Total Restricted Assets		
Non Current Assets		
Capital Assets:		
Land and water rights	245,590	245,590
Water supply sources	5,496,651	5,267,556
Treatment plants	5,681,353	5,649,876
Improvements - other	24,968,045	23,172,819
Equipment	2,040,405	1,885,059
Construction in progress	12,909,284	12,801,153
	<u>51,341,328</u>	<u>49,022,053</u>
Total Capital Assets		
Less accumulated depreciation	<u>(15,218,331)</u>	<u>(14,412,543)</u>
Net Capital Assets (Note 5)	<u>36,122,997</u>	<u>34,609,510</u>
Other Assets:		
Bond issue costs, net of accumulated amortization of \$383,238 in 2008 and \$346,894 in 2007	459,425	495,769
Interest in Cater Treatment Plant, net of accumulated amortization of \$2,676,366 in 2008 and \$2,230,780 in 2007	4,898,598	5,272,355
Deposit CCWA rate coverage reserve fund	1,619,543	2,040,478
	<u>6,977,566</u>	<u>7,808,602</u>
Total Other Assets		
TOTAL ASSETS	<u>\$ 59,226,334</u>	<u>\$ 57,592,659</u>

See Independent Auditor's Report
See accompanying notes to the financial statements

MONTECITO WATER DISTRICT
STATEMENTS OF NET ASSETS
JUNE 30, 2008 AND 2007

LIABILITIES

	<u>2008</u>	<u>2007</u>
Current Liabilities:		
Accounts payable	\$ 592,370	\$ 945,190
Accrued interest payable	472,467	458,817
Accrued expenses	347,868	315,940
Customer deposits	72,194	67,336
Deferred liability	3,973	3,973
Current portion of bonds payable (Note 7)	30,000	-
Current portion of loans payable (Note 8)	411,146	399,270
Current portion of capital lease payable (Note 9)	23,578	-
	<u>1,953,596</u>	<u>2,190,526</u>
Total Current Liabilities		
Long Term Liabilities:		
Bonds payable (Note 7)	13,800,000	13,860,000
Loans payable (Note 8)	13,516,676	13,271,775
Capital lease payable (Note 9)	103,758	-
	<u>27,420,434</u>	<u>27,131,775</u>
Total Long Term Liabilities		
Total Liabilities	<u>29,374,030</u>	<u>29,322,301</u>

NET ASSETS

Invested in Capital Assets, Net of Related Debt	13,136,437	12,350,820
Restricted by covenant for:		
Debt service	588,099	499,186
Unrestricted net assets		
Designated (Note 16)	16,877,941	15,358,231
Undesignated	(750,173)	62,121
	<u>29,852,304</u>	<u>28,270,358</u>
Total Net Assets		
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 59,226,334</u>	<u>\$ 57,592,659</u>

See Independent Auditor's Report
See accompanying notes to the financial statements

MONTECITO WATER DISTRICT
STATEMENTS OF ACTIVITIES AND CHANGES IN NET ASSETS
FOR THE YEARS ENDED JUNE 30, 2008 AND 2007

	<u>2008</u>	<u>2007</u>
Operating Revenues:		
Sale of water	\$ 9,893,221	\$ 9,168,272
Water service charges	2,817,275	2,678,161
Fire hydrant rentals	49,494	39,484
Total Operating Revenues	<u>12,759,990</u>	<u>11,885,917</u>
Operating Expenses:		
Water purchase	5,970,626	5,538,937
Pumping	242,163	281,589
Water treatment	1,516,250	1,401,573
Water system operation and maintenance	742,676	774,861
Meter reading and customer service	177,428	169,178
Administration and general	2,046,130	1,796,694
Depreciation and amortization	1,367,541	1,381,325
Total Operating Expenses	<u>12,062,814</u>	<u>11,344,157</u>
Operating Income	<u>697,176</u>	<u>541,760</u>
Nonoperating Revenues/(Expenses)		
Connection fees	54,373	26,544
Capital cost recovery fees	278,238	249,281
Interest income	366,967	337,658
Taxes and assessments	1	1
Water availability charge	311,926	310,554
Reimbursements	-	28,140
Debt service interest expense	(364,485)	(309,102)
Gain/(loss) on sale/disposal of assets	6,080	3,148
Late charges	59,198	72,585
Other income	131,174	100,709
Total Nonoperating Revenues/(Expenses)	<u>843,472</u>	<u>819,518</u>
Income before contributions	1,540,648	1,361,278
Contributions in aid of construction	<u>41,298</u>	<u>84,929</u>
Change in Net Assets	1,581,946	1,446,207
Net Assets - Beginning of Year	<u>28,270,358</u>	<u>26,824,151</u>
Net Assets - End of Year	<u>\$ 29,852,304</u>	<u>\$ 28,270,358</u>

See Independent Auditor's Report
See accompanying notes to the financial statements

MONTECITO WATER DISTRICT
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2008 AND 2007

	<u>2008</u>	<u>2007</u>
Cash Flows from Operating Activities:		
Receipts from customers and users	\$ 12,789,772	\$ 11,651,416
Payments to suppliers	(9,416,898)	(8,066,110)
Payments to employees	(1,835,221)	(1,749,991)
Net Cash Provided by Operating activities	<u>1,537,653</u>	<u>1,835,315</u>
Cash Flows from Capital and Related Financing Activities		
Interest payments on debt	(350,835)	(233,999)
Capitalized interest on payments on debt	(699,800)	(699,800)
Principal payments on bonds, loans and capital leases	(447,217)	(461,504)
Loan proceeds	657,844	2,878,922
Funds used/(reserved) for CCWA rate coverage reserve	420,935	(193,912)
Reimbursements	11,036	167,210
Water availability charge	311,926	310,554
Net Cash Provided/(Used) by Capital and Related Financing Activities	<u>(96,111)</u>	<u>1,767,471</u>
Cash Flows from Noncapital Financing Activities:		
Taxes and assessments	1	1
Capital cost recovery fees	278,238	249,281
Connection fees	54,373	26,544
Late charges	59,198	72,585
Other	131,174	100,709
Net Cash and Cash Equivalents Provided by Noncapital Financing Activities	<u>522,984</u>	<u>449,120</u>
Cash Flows from Investing Activities:		
Purchase of property, plant and equipment (Excludes noncash contributed property additions of \$41,298 and \$84,929 in the years ended June 30, 2008 and 2007, respectively)	(1,709,326)	(3,130,031)
Gain from sale of assets	6,080	5,325
Increase in interest in Cater Treatment Plant	(71,829)	(133,217)
Interest received on 98 A Bond proceeds	194,812	250,153
Interest received	388,320	310,891
Net Cash Provided/(Used) by Investing Activities	<u>(1,191,943)</u>	<u>(2,696,879)</u>
Net increase/(decrease) in cash and cash equivalents	772,583	1,355,027
Cash and Cash Equivalents at beginning of year	<u>8,710,533</u>	<u>7,355,506</u>
Cash and Cash Equivalents at End of Year	<u>\$ 9,483,116</u>	<u>\$ 8,710,533</u>

See Independent Auditor's Report
See accompanying notes to the financial statements

MONTECITO WATER DISTRICT
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2008 AND 2007

	<u>2008</u>	<u>2007</u>
Reconciliation of Statement of Net Assets:		
Unrestricted Cash	\$ 389,762	\$ 201,782
Unrestricted invested cash-		
Local Agency Investment Fund	5,119,227	3,255,275
Restricted invested cash -		
California Bank & Trust	588,099	499,186
Local Agency Investment Fund	<u>3,386,028</u>	<u>4,754,290</u>
	<u>\$ 9,483,116</u>	<u>\$ 8,710,533</u>
Reconciliation of operating income/(loss) to net		
Cash provided (used) by operating activities:		
Operating Income	<u>\$ 697,176</u>	<u>\$ 541,760</u>
Adjustments to reconcile operating income/(loss)		
to net cash provided/(used) by operating activities:		
Depreciation & amortization	1,367,541	1,381,325
(Increase)/decrease in receivables	24,924	(236,994)
(Increase)/decrease in inventory	(2,271)	(9,531)
(Increase)/decrease in prepaid expenses	(233,683)	55,919
Increase/(decrease) in accounts payable	(352,820)	92,125
Increase/(decrease) in accrued expenses	31,928	8,218
Increase/(decrease) in customers deposits	<u>4,858</u>	<u>2,493</u>
Total Adjustments	<u>840,477</u>	<u>1,293,555</u>
Net cash provided/(used) by operating activities	<u>\$ 1,537,653</u>	<u>\$ 1,835,315</u>
Non-cash Transactions:		
Acquisition of financial and utility billing software		
through issuance of a capital lease	<u>\$ 143,487</u>	

See Independent Auditor's Report
See accompanying notes to the financial statements

MONTECITO WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2008 AND 2007

NOTE 1: REPORTING ENTITY AND SUMMARY OF SIGNIFICANT ACCOUNTING PRINCIPLES

Reporting Entity

The Montecito Water District (the District) was incorporated in 1921 and is responsible for the construction, operation and maintenance of a water system in the Santa Barbara County communities of Montecito, Summerland, portions of Carpinteria Valley and parts of the City of Santa Barbara. The District's Board of Directors is comprised of five members who are elected at large.

Basis of Accounting

The District accounts for its operation in an enterprise fund using the economic resources measurement focus and an accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

An enterprise fund distinguishes operating revenues and expenses from non operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the District's principal ongoing operations. The principal operating expenses for the District include cost of sales and services, administrative expenses and depreciation on capital assets. All revenues and expenses not meeting this definition are reported as non operating revenues and expenses.

This report has been prepared in conformance with Accounting Principles Generally Accepted in the United States of America as promulgated by the Governmental Accounting Standards Board (GASB). Additionally, the District applies all Financial Accounting Standards Board (FASB) statements and interpretations, Accounting Principles Board (APB) opinions, and Accounting Research Bulletins (ARB's) issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements.

The District has adopted GASB Statements 33 through 50, and related interpretations issued through June 30, 2008. Statement 34 and subsequent statements and interpretations required certain other changes in terminology, format and content, as well as inclusion of the management's discussion and analysis as required supplementary information.

Cash and Cash Equivalents

For the purposes of the statement of cash flows, the District considers cash and funds invested in a Local Agency Investment Fund, as well as highly liquid investments with a maturity of three months or less (including restricted assets) to be cash equivalents.

MONTECITO WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2008 AND 2007

NOTE 1: REPORTING ENTITY AND SUMMARY OF SIGNIFICANT ACCOUNTING PRINCIPLES
(Continued)

Investments

The district has developed an investment policy that exceeds the minimum requirements established by the State of California. The District believes that it has adhered to established policies for all investment activities. As of June 30, 2008 and 2007, the District's investments were invested in the Local Agency Investment Fund.

Investments are generally carried at cost, which approximates fair market value. Interest and investment income are recognized when earned.

Accounts Receivable

No allowance for doubtful accounts has been established since management believes that substantially all amounts are collectible.

Inventory

Inventory is valued at the lower of cost (first-in, first-out) or market.

Debt Issuance Costs

The 1998 A Certificates of Participation issue costs, the DWR Bella Vista Treatment Plant loan issue costs and the 2004 Cachuma Operations and Maintenance Board (COMB) bond costs, are being amortized using the straight-line method over the life of the related bonds.

Capital Assets

Capital Assets, which include property, plant, equipment, and infrastructure (water pipelines) are carried at cost. Depreciation of these assets is computed by use of the straight-line method over the estimated useful lives of the assets, ranging from 3 to 100 years. Contributed assets (water line extensions, water wells and modifications constructed by the District and reimbursed by the customer) are recorded at their fair value at the time of contribution and depreciated over their useful lives. The District does not have a formal capitalization policy.

The costs of normal maintenance and repairs that do not add value to of the assets or materially extend assets lives are not capitalized.

MONTECITO WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2008 AND 2007

NOTE 1: REPORTING ENTITY AND SUMMARY OF SIGNIFICANT ACCOUNTING PRINCIPLES
(Continued)

Capital Assets (Continued)

Capital assets of the District are depreciated using the straight-line method over the following estimated useful lives:

Water supply & sources	5 – 50 years
Treatment plants	25 – 50 years
Distribution system	25 – 70 years
Reservoirs	25 – 100 years
Buildings & Improvements	5 – 50 years
Office	5 – 25 years
Equipment	5 – 20 years

Restricted Assets

Amounts shown as restricted assets have been restricted by either bond indenture, by law, or contractual obligations to be used for specified purposes, such as servicing bonded debt and construction of capital assets.

Generally, restricted resources are not commingled with unrestricted resources in financing projects and activities. The funding source for each project and activity is determined by board action depending upon the type of project or activity. Restricted resources are used for specific types of projects for which such funding is designated.

Compensated Absences

The District's personnel policies provide for the accumulation of vacation and sick leave which are recognized as liabilities of the District. Employees may accrue up to 960 hours of sick time and up to 160 hours of vacation. The amounts are included in accrued expenses on the balance sheet and consist of \$120,068 of accrued vacation and \$185,399 of accrued sick leave.

Estimates

Management uses estimates and assumptions in preparing financial statements. Those estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the reported revenues and expenses.

MONTECITO WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2008 AND 2007

NOTE 1: REPORTING ENTITY AND SUMMARY OF SIGNIFICANT ACCOUNTING PRINCIPLES
(Continued)

Estimates (Continued)

Significant estimates used in preparing these financial statements include:

- Collectibility of accounts and notes receivable
- Useful lives of capitalized assets
- Depreciation methods of capitalized assets

It is at least reasonably possible that the significant estimates used will change within the next year.

Concentration of Risks

The District grants credit to its customers, substantially all of whom are homeowners in Santa Barbara County.

Property Taxes

The County of Santa Barbara bills and collects property taxes and the water availability surcharge for the District. Tax and water availability revenues are recognized by the District when earned.

Capitalized Interest

Interest expense on debt related to projects under construction, net of any interest revenue earned from bond proceeds held for construction, is capitalized during the construction period.

Operating and Non Operating Revenues and Expenses

Operating revenues and expenses generally result from operating activities. Operating activities are the costs of providing services, producing and delivering goods to customers and the revenues thus generated.

Water sales and service charges are considered operating revenues. Connection fees, capital cost recovery fees, interest income, taxes and assessments, water availability charge, gain on disposal of assets, late charges and other income are considered to be non-operating revenues.

Water purchases, pumping, water treatment, water system operation and maintenance, meter reading, customer service, administration and general, and depreciation and

MONTECITO WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2008 AND 2007

NOTE 1: REPORTING ENTITY AND SUMMARY OF SIGNIFICANT ACCOUNTING PRINCIPLES
(Continued)

Operating and Non Operating Revenues and Expenses (Continued)

amortization are considered operating expenses. Bond and loan interest expense and other extraordinary expenses are considered non-operating expenses.

Self Funded Dental Plan

The District maintains a self insured plan for dental coverage offered to employees. Under the provisions of the plan each full time employee and each qualified dependent is provided \$2,000 per calendar year to pay dental expenses. The District provides one party coverage. The District pays the premium for the employee. The premium for qualified dependents is paid by the employee through a payroll deduction. Retirees and directors pay their premium to the District monthly. The Plan year is from January 1 to December 31. For the plan year 2007, the District paid out \$23,485 in benefits and for the plan year 2006, the District paid out \$22,901 in benefits.

NOTE 2: CASH AND INVESTMENTS

The District is authorized by its investment policy, in accordance with Section 53601 of the California Government code, to invest in the following instruments: T-Bills and T-Bonds, banks and savings and loan companies that are insured through the FDIC, Credit unions that are insured through the National Credit Union Association up to \$100,000 per institution. The District is also allowed to invest with the State Treasurer's Local Agency Investment Funds (LAIF).

Credit Risk and Concentration of Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. Concentration of credit risk is the risk of loss attributed to the magnitude of an investment in a single issuer. The District invests its fund in LAIF which mitigates these risks by holding a diversified portfolio of high quality investments.

Custodial Credit Risk

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, the District will not be able to recover the value of investment or collateral securities that are in the possession of an outside party. The District has invested the proceeds of the 1998A Bond Funds in a collateralized Guaranteed Investment Contract with an investment bank. The GIC is invested with the LAIF.

MONTECITO WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2008 AND 2007

NOTE 2: CASH AND INVESTMENTS (Continued)

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The District invests its funds in LAIF, which is a short term investment that is not subject to significant adjustments due to interest rate fluctuations.

Cash:

At June 30, 2008 and 2007 the carrying amounts of cash in banks and cash on hand and corresponding bank balances were as follows:

	<u>2008</u>		<u>2007</u>	
	<u>Carrying</u> <u>Amount</u>	<u>Bank</u> <u>Balance</u>	<u>Carrying</u> <u>Amount</u>	<u>Bank</u> <u>Balance</u>
Cash on Hand	\$ 350	\$ -	\$ 350	\$ -
Cash In Banks	<u>389,412</u>	<u>394,782</u>	<u>201,432</u>	<u>216,521</u>
Totals	<u>\$ 389,762</u>	<u>\$ 394,782</u>	<u>\$ 201,782</u>	<u>\$216,521</u>

\$100,000 was covered by federal depository insurance for each year and \$294,782 and \$116,521, respectively, were secured with collateral. The California Government Code requires all California financial institutions to secure a local government agency's deposits by pledging government securities as collateral. The market value of pledged securities must equal 110% of an agency's deposits. California law also allows financial institutions to secure agency deposits by pledging first trust deed mortgage notes having a value of 150% of the agency's total deposits. All cash held by a financial institution is, therefore, entirely insured or collateralized.

Unrestricted Investments:

Short-term investments consist of deposits with the Local Agency Investment Fund, a fund established by the State of California to assist local agencies in the achievement of maximum earnings. The interest rate on the Local Agency Investment Fund deposit varies. For the years ended June 30, 2008 and 2007, the average earnings rate was approximately 4.461% and 5.121%, respectively. The carrying value on deposit with LAIF as of June 30, 2008 and 2007 were \$5,119,482 and \$3,253,794, respectively. The fair value is \$5,119,227 and \$3,255,275 as of June 30, 2008 and 2007 respectively.

MONTECITO WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2008 AND 2007

NOTE 2: CASH AND INVESTMENTS (Continued)

Unrestricted Investments (Continued):

The fair value of pooled investments is determined annually and is based on current market prices received from the securities custodian. The fair value of participants' position in the pool is the same as the value of the pool shares. The method used to determine the value of participants' equity withdrawn is based on the book value of the participants' percentage participation at the date of such withdrawal. LAIF is required to invest with State statutes.

Restricted Investments:

The proceeds from 1998 A Certificates of Participation are restricted for capital projects. The proceeds from the general and water revenue bond issuances are to be used for payment of water acquisition, treatment, storage and distribution facilities. There is an amount restricted for principal and interest payments on the water revenue bond. The restricted investments are invested in money market accounts and United States Treasury Bills. The interest rates fluctuate depending on the interest rate environment.

	<u>2008</u>	<u>2007</u>
Certificates of Participation:		
1998A bond proceeds restricted for capital projects	<u>\$ 3,386,028</u>	<u>\$ 4,754,290</u>
Total restricted investments	<u>\$ 3,386,028</u>	<u>\$ 4,754,290</u>

NOTE 3: RESTRICTED CASH

In 2008 and 2007, restricted cash represents a reserve fund for the Department of Water Resources Loans. The Department of Water Resources requires a reserve of two semi-annual bond payments to be accumulated during the first 10 years.

The semi-annual payment amount for the DWR Bella Vista Loan is \$152,634. The balances at June 30, 2008 and 2007 were \$323,094 and \$314,612 respectively.

A reserve fund is being held for the interest payments on the DWR Ortega Loan during the construction period. The balances at June 30, 2008 and 2007 were \$265,005 and \$184,574, respectively.

MONTECITO WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2008 AND 2007

NOTE 3: RESTRICTED CASH (Continued)

	2008	2007
DWR Loans:		
Restricted for DWR Bella Vista Loan Reserve	\$ 323,094	\$ 314,612
Restricted for DWR Ortega Loan Reserve	265,005	184,574
Total restricted investments	\$ 588,099	\$ 499,186

NOTE 4: PREPAID WATER

A controlled quantity of water is purchased annually by the District and, if not used in the current year, is stored in the Lake Cachuma facility for use the following year. In addition, an amount of unused water carried over from prior years, if available, is also stored in the facility. The District has its own facilities for storing water (Juncal Dam and various reservoirs) in which stored water carries no cost. This stored water is subject to loss through evaporation, natural disasters, dam ruptures, excess rainfall and dam spillage at the various facilities. The losses are not covered by insurance. However, stored water is also subject to replenishment by natural rainfall and runoff.

Prepaid water also includes the required payment to the Central Coast Water Authority for the costs of State Water for the period July 1, 2008 to June 30, 2009.

NOTE 5: CAPITAL ASSETS

Property, plant and equipment consisted of the following at June 30:

	2008		
	Property, Plant and Equipment	Accumulated Depreciation	Net
Land & water rights	\$ 245,590	\$ -	\$ 245,590
Water supply sources	5,496,651	(3,487,040)	2,009,611
Treatment plants	5,681,353	(3,129,161)	2,552,192
Other improvements	24,968,045	(6,949,606)	18,018,439
Equipment	2,040,405	(1,652,524)	387,881
Construction	12,909,284	-	12,909,284
Total property, plant and equipment	\$ 51,341,328	\$ (15,218,331)	\$ 36,122,997

MONTECITO WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2008 AND 2007

NOTE 5: CAPITAL ASSETS (Continued)

	2007		
	Property, Plant and Equipment	Accumulated Depreciation	Net
Land & water rights	\$ 245,590	\$ -	\$ 245,590
Water supply sources	5,267,556	(3,367,027)	1,900,529
Treatment plants	5,649,876	(2,905,279)	2,744,597
Other improvements	23,172,819	(6,537,448)	16,635,371
Equipment	1,885,059	(1,602,789)	282,270
Construction	12,801,153	-	12,801,153
Total property, plant and equipment	\$ 49,022,053	\$ (14,412,543)	\$ 34,609,510

The following shows the capital asset activity for the fiscal years ended June 30, 2008 and 2007.

	July 1, 2007	Additions/ reclassifications	Dispositions/ Reclassifications	June 30, 2008
Land & water rights	\$ 245,590	\$ -	\$ -	\$ 245,590
Water supply sources	5,267,556	229,095	-	5,496,651
Treatment plants	5,649,876	31,477	-	5,681,353
Other improvements	23,172,819	1,795,226	-	24,968,045
Equipment	1,885,059	235,169	(79,823)	2,040,405
Construction	12,801,153	2,104,534	(1,996,403)	12,909,284
Total property	49,022,053	4,395,501	(2,076,226)	51,341,328
Less: Accumulated				
Depreciation	(14,412,543)	(885,611)	79,823	(15,218,331)
Net property	\$ 34,609,510	\$ 3,509,890	\$ (1,996,403)	\$ 36,122,997

MONTECITO WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2008 AND 2007

NOTE 5: CAPITAL ASSETS (Continued)

	<u>July 1,</u> <u>2006</u>	<u>Additions/</u> <u>Reclassifications</u>	<u>Dispositions/</u> <u>Reclassifications</u>	<u>June 30,</u> <u>2007</u>
Land & water rights	\$ 245,590	\$ -	\$ -	\$ 245,590
Water supply sources	5,267,556	-	-	5,267,556
Treatment plants	5,649,876	-	-	5,649,876
Other improvements	23,146,185	26,634	-	23,172,819
Equipment	1,820,939	99,265	(35,145)	1,885,059
Construction	<u>9,258,754</u>	<u>3,542,399</u>	<u>-</u>	<u>12,801,153</u>
Total property	45,388,900	3,668,298	(35,145)	49,022,053
Less: Accumulated				
Depreciation	<u>(13,516,550)</u>	<u>(929,567)</u>	<u>33,574</u>	<u>(14,412,543)</u>
Net property	<u>\$ 31,872,350</u>	<u>\$ 2,738,731</u>	<u>\$ (1,571)</u>	<u>\$ 34,609,510</u>

NOTE 6: INTEREST IN CATER TREATMENT PLANT

The District has entered into a joint powers agreement with the City of Santa Barbara for water treatment. The District currently obtains approximately 50% of its water supplies from the Cachuma Project. These surface water supplies are treated at the City of Santa Barbara's Cater Water Filtration Plant. The District entered into a joint powers agreement with the City of Santa Barbara effective November 1, 2003 in which the District agreed to participate in a California Drinking Water State Revolving Fund contract financing totaling \$19.2 million to fund improvements required at the Cater Treatment plant. The District's share is estimated to be 19.7%. The District has recorded an intangible asset for its 19.7% interest in the Cater Treatment Plant improvements. This asset will be amortized over 20 years which is equal to the remaining life of the joint powers agreement. The balance of this asset at June 30, 2008 is 4,898,598, which is net of accumulated amortization of \$2,676,366.

MONTECITO WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2008 AND 2007

NOTE 7: BONDS PAYABLE

The following is a summary of bond transactions:

	Balance Payable <u>6/30/07</u>	New Bonds Issued	Bonds Retired	Balance Payable <u>6/30/08</u>	<u>Current</u>	<u>Long Term</u>
Certificates	\$ 13,690,000	\$ -	\$ -	\$ 13,690,000	\$ -	\$13,690,000
COMB 2004 Revenue Bonds	170,000		30,000	140,000	30,000	110,000
Total	<u>\$ 13,860,000</u>	<u>\$ -</u>	<u>\$ 30,000</u>	<u>\$13,830,000</u>	<u>\$ 30,000</u>	<u>\$13,800,000</u>

Bonds payable at June 30, 2008 and 2007 are comprised of the following individual issues:

2004 Cachuma Operations and Maintenance Board Revenue Refunding Bonds:

\$260,000 Cachuma Operations and Maintenance Board (COMB) Revenue Refunding Bonds were issued August 18, 2004. These bonds are due in annual installments beginning on January 1, 2006 and ending on July 1, 2013 with a rate of interest of 4%. Interest expense of \$7,400 and \$7,894 was reported for the year ending June 30, 2008 and June 30, 2007 respectively.

1998A Revenue Certificates of Participation:

\$13,690,000 1998A revenue certificates of participation were issued in 1998. Payments of interest only are due through 2012. Scheduled annual interest payments are \$699,800 for the years ending June 30, 2009 through June 30, 2012. Annual principal payments of \$340,000 to \$1,290,000 plus interest are due beginning for the year ending June 30, 2013 and end June 30, 2027 with a true interest cost of 5.347% over the life of the bonds. Interest expense, net of interest revenue earned from bond proceeds, is being capitalized during the construction period. Interest payments were \$699,800 for the years ended June 30, 2008 and 2007.

Resolutions #1978 and #1855, authorizing the issuance of the COMB revenue bonds and the 1998A Certificates of Participation, respectively, require the District to comply with the following:

MONTECITO WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2008 AND 2007

NOTE 7: BONDS PAYABLE (Continued)

Water rates should be fixed so that the net revenues are at least 1.25 times the interest and principal payments of the bonds as they become due and payable plus 1.00 times the current operating obligations of the District. The District was in compliance with this resolution at June 30, 2008 and 2007.

The annual requirements to amortize all bond debt outstanding as of June 30, 2008, including interest payments, are as follows:

Year Ended June 30	Principal	Interest	Total
2009	\$ 30,000	\$ 705,400	\$ 735,400
2010	35,000	704,200	739,200
2011	40,000	702,800	742,800
2012	35,000	701,200	736,200
2013	0	699,800	699,800
2014-2018	3,245,000	3,125,264	6,370,264
2019-2023	4,580,000	2,063,813	6,643,813
2024-2028	5,865,000	761,875	6,626,875
2029	0	0	0
	<u>\$13,830,000</u>	<u>\$ 9,464,352</u>	<u>\$23,294,352</u>

NOTE 8: LOANS PAYABLE

The following is a summary of loan transactions:

	Balance Payable 6/30/07	Loan Proceeds	Loan Payments	Balance Payable 6/30/08	Current	Long Term
DWR Bella Vista Loan	\$ 2,082,330	\$ -	\$ 256,368	\$ 1,825,962	\$262,788	\$1,563,174
DWR Cater Loan	3,247,688	-	144,699	3,102,989	148,358	2,954,631
DWR Ortega Loan	8,341,027	657,844	-	8,998,871	-	8,998,871
Total	<u>\$ 13,671,045</u>	<u>\$657,844</u>	<u>\$ 401,067</u>	<u>\$13,927,822</u>	<u>\$411,146</u>	<u>\$13,516,676</u>

MONTECITO WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2008 AND 2007

NOTE 8: LOANS PAYABLE (Continued)

Department of Water Resources – Bella Vista Treatment Plant Contract

In December 1993, the District entered into a loan agreement with the Department of Water Resources (DWR) for a loan of \$3,990,000, which was increased to \$4,818,450 in August 1994, including a 5% administrative fee. The proceeds from this loan were used to refinance the District's construction loan and pay other costs related to the Bella Vista Treatment Plant construction. California Bank & Trust is the fiscal agent responsible for acting as trustee for the loan repayment with semi-annual payments of \$152,634 including principal and interest at the rate of 2.4175% per annum. Loan payments commenced when the loan became fully funded, and the first payment was made April 1, 1995.

The loan is due October 2014, and is secured by real property and water sales. The contract between the DWR and the District requires a reserve fund of two semi-annual payments to be accumulated within ten years. The outstanding balance on the loan at year-end June 30, 2008 and 2007 was \$1,825,962 and \$2,082,330, respectively, including the administrative fee.

Department of Water Resources – Cater Treatment Plant Contract

The District currently obtains approximately 50% of its water supplies from the Cachuma Project. These surface water supplies are treated at the City of Santa Barbara's Cater Water Filtration Plant. The District entered into a joint powers agreement with the City of Santa Barbara, effective November 1, 2003, in which the District agreed to participate in a California Drinking Water State Revolving Fund contract financing totaling \$19.2 million to fund improvements required at the Cater Treatment plant. The District's share is estimated to be 19.7% or \$3.8 million to be financed over 20 years. Interest is payable semiannually at a rate of 2.5132% per annum. The District's share of the outstanding balance at June 30, 2008 is \$3,102,989 and at June 30, 2007 is \$3,247,688. The District's annual payments for its share of the debt service are \$225,416 per year. In December 2004, the Cater Treatment Plant project was complete and principal payments on the loan began on January 1, 2006.

Department of Water Resources – Ortega Reservoir Improvement Project Contract

In December of 2003, the District entered into a funding agreement, along with Carpinteria Valley Water District, with the Department of Water Resources (DWR) for a loan of \$10,800,000, which was increased to \$19,900,000 in July of 2006. The District's share of this loan is 50% of the total amount, which is a total of \$9,950,000. The proceeds from this loan were are being used to finance the construction of a roof on the Ortega Reservoir which will enable the District to meet safe drinking water standards established pursuant to Chapter 4, commencing with Section 116270, of Part 12, of Division 104 of the Health and Safety Code and California Code of Regulations. California Bank & Trust is the fiscal agent responsible for acting as trustee for the loan repayment with semi-annual payments of \$318,009 including principal and interest at an annual rate of

MONTECITO WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2008 AND 2007

NOTE 8: LOANS PAYABLE (Continued)

Department of Water Resources – Ortega Reservoir Improvement Project Contract (Continued)

2.5132%. Payments of interest only will be made until July 1, 2008, when principal and interest payments will begin. The District will be required to fund its share of a reserve fund equal to two semiannual payments. The funds are to be accumulated within a ten year period and be held by a trustee. The outstanding balance of the loan at year end June 30, 2008 and 2007 was \$8,998,871 and \$8,341,027 respectively.

The annual requirements to amortize all loans outstanding as of June 30, 2008, including interest payments, are as follows:

Year Ended June 30	Principal	Interest	Total
2009	\$ 411,146	119,538	530,684
2010	595,731	222,564	818,295
2011	787,259	318,645	1,105,904
2012	806,858	299,046	1,105,904
2013	827,068	278,836	1,105,904
2014-2018	3,347,098	1,113,853	4,460,951
2019-2023	3,285,933	717,247	4,003,180
2024-2028	3,025,139	301,792	3,326,931
2029-2033	841,590	21,239	862,829
	<u>\$ 13,927,822</u>	<u>\$ 3,392,760</u>	<u>\$ 17,320,582</u>

NOTE 9: CAPITAL LEASE

On December 13, 2007, the District entered into a capital lease with Diversified Lenders Inc. for the lease of Financial and Utility Billing software. The lease is a lease purchase agreement with 60 monthly payments of \$2,880 each with an imputed annual interest rate of 7.571%. At the end of the lease in October 2012, the District will have the option to purchase the software for \$1.00. The cost of the assets capitalized under this capital lease is \$143,487 with no accumulated depreciation as of June 30, 2008.

MONTECITO WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2008 AND 2007

NOTE 9: CAPITAL LEASE (Continued)

The annual requirements to amortize the capital lease are as follows:

Year Ended June 30	Principal	Interest	Total
2009	\$ 23,578	\$ 8,102	\$31,680
2010	27,651	6,909	34,560
2011	29,819	4,741	34,560
2012	32,156	2,404	34,560
2013	14,132	268	14,400
	<u>\$ 127,336</u>	<u>\$ 22,424</u>	<u>\$ 149,760</u>

NOTE 10 JOINT POWERS INSURANCE AUTHORITY

The District participates in the property and liability program organized by the Association of California Water Agencies/Joint Powers Insurance Authority (ACWA/JPIA). ACWA/JPIA is a Joint Powers Authority created to provide a self-insurance program to water agencies in the state of California. The ACWA/JPIA is not a component unit of the District for financial reporting purposes, as explained below.

ACWA/JPIA provides liability, property and workers' compensation insurance for approximately 289 water agencies for losses in excess of the member districts' specified self-insurance retention levels. Individual claims (and aggregate public liability and property claims) in excess of specified levels are covered by excess insurance policies purchased from commercial carriers. ACWA/JPIA is governed by a board comprised of members from participating districts. The board controls the operations of ACWA/JPIA, including selection of management and approval of operating budgets, independent of any influence by the members beyond the representation on the board. Each member shares surpluses and deficiencies proportionately to its participation in ACWA/JPIA.

Additional information and complete financial statements for the ACWA/JPIA are available for public inspection at 5620 Birdcage Street, Suite 200, Citrus Heights, CA, between the hours of 8 a.m. and 5 p.m., Monday through Friday.

NOTE 11: DEFERRED COMPENSATION PLAN

The District offers its employees a deferred compensation plan (the "Plan") created in accordance with Internal Revenue Code Section 457. The Plan, available to all District employees, permits them to defer a portion of their salary until future years.

MONTECITO WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2008 AND 2007

NOTE 11: DEFERRED COMPENSATION PLAN (Continued)

As a result of legislative changes, all amounts of compensation deferred, all property and the rights purchased, and all income, property, or rights are (until paid or made available to the employee or other beneficiary) held in trust for the exclusive benefit of the participants and their beneficiaries, whereas, prior to these legislative changes, these amounts were solely the property of the District subject only to the claims of the District's general creditors.

In prior years the total deferred compensation was shown as an asset and a corresponding liability on the balance sheet. As a result of the new legislation, no amounts have been included in these financial statements for the deferred compensation plan.

NOTE 12: DEFINED BENEFIT PENSION PLAN

Plan Description

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

Funding Policy

Active plan members in The Plan are required to contribute 7% of their annual covered salary. The Montecito Water District pays this amount to CalPERS on behalf of the employees. Also, 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 required employer contribution rate for fiscal 2007/08 was 12.049%. The contribution rate is established and may be amended by CalPERS.

MONTECITO WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2008 AND 2007

NOTE 12: DEFINED BENEFIT PENSION PLAN (Continued)

Annual Pension Cost

For fiscal year 2007/08, the District's annual pension cost was \$207,807 and the District actually contributed \$207,807. The required contribution for fiscal year 2007/08 was determined as part of the June 30, 2005 actuarial valuation using the entry age normal actuarial cost method with the contributions determined as a percentage of pay. The actuarial assumptions included (a) 7.75% investment rate of return (net of administrative expenses); (b) projected salary increases that vary by duration of service ranging from 3.25% to 14.45% for miscellaneous members, and (c) 3.25% overall payroll growth. Both (a) and (b) include an inflation component of 3.00%.

The actuarial value of The Plan's assets was determined using a technique that smoothes the effect of short-term volatility in the market value of investments over a two to five year period depending on the size of investment gains and/or losses. The Plan's unfunded actuarial accrued liability (or excess assets) is being amortized as a level percentage of projected payroll on a closed basis.

Three-Year Trend Information

<u>Fiscal Year</u> <u>Ending</u>	<u>Annual</u> <u>Pension</u> <u>Cost (APC)</u>	<u>Percentage</u> <u>of APC</u> <u>Contributed</u>	<u>Net</u> <u>Pension</u> <u>Obligation</u>
6/30/06	\$ 169,106	100%	\$ -
6/30/07	\$ 200,694	100%	\$ -
6/30/08	\$ 207,734	100%	\$ -

NOTE 13: OTHER POST-EMPLOYMENT BENEFITS

In addition to pension benefits described in Note 12, the District provides post-employment benefit options for health, dental and eye care to eligible retirees, resigned and terminated employees and their dependents. The benefits are provided in accordance with District resolution and the Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA). The criteria to determine eligibility include: years of service, employee age and whether the employee has vested in the respective retirement plan.

The District funds the benefits on a pay-as-you-go basis. Eligible employees are required to pay set premiums for the cost to the District. During fiscal year 2008 expenses (net of participant contributions) of \$9,742 were recognized for post-employment benefits. There are 33 participants eligible. Expenses for post-retirement health care benefits are recognized as eligible employee claims are paid.

MONTECITO WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2008 AND 2007

NOTE 14: CONTINGENT LIABILITIES

State of California Unemployment Insurance Requirements:

As of January 1, 1978, the District elected to be self-insured for unemployment coverage. The District's liability was estimated to be \$8,689 at June 30, 2008 and 2007. The liability is recorded on the books of the District and reported in these financial statements under accrued expenses.

Underground Storage Tank Cleanup

The District had underground petroleum storage tanks located on the District office grounds. These tanks were removed in 1990 by a State mandated order. Upon removal of these tanks, it was apparent that they had been leaking for some time. The District subsequently entered the LUFT (Leaking Underground Fuel Tank) program as Site number 50504. Currently, this site is being monitored and cleanup efforts are ongoing. The cost of the cleanup is fully funded by the State of California's Underground Storage Tank Cleanup (USTC) fund.

NOTE 15: COMMITMENTS

Participation in State Water Project

On June 4, 1991, the voters of the District approved participation in the California State Water Project (SWP). As a result the District joined in the formation of the Central Coast Water Authority (CCWA) in September 1991. The purpose of the CCWA is to provide for the financing, construction, operation and maintenance of certain local (non-state owned) facilities required to deliver water from the SWP to certain water purveyors and users in Santa Barbara County.

Each Santa Barbara County State Water Project participant, including the District, has entered into a Water Supply Agreement in order to provide for the development, financing, construction, operation and maintenance of the CCWA Project. The purpose of the Water Supply Agreements is to assist in carrying out the purposes of CCWA with respect to the)

CCWA Project by: (1) requiring CCWA to sell, and the Santa Barbara County State Water Project participants to buy, a specified amount of water from CCWA ("take or pay"); and (2) assigning the Santa Barbara County State Water Project participant's entitlement rights in the SWP to CCWA. Although the District does have an ongoing financial responsibility pursuant to the Water Supply Agreement between the District and CCWA, the District does not have an equity interest as defined by GASB Code Sec. J50.105.

MONTECITO WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS

JUNE 30, 2008 AND 2007

NOTE 15: COMMITMENTS (Continued)

Participation in State Water Project (Continued)

Each Santa Barbara County State Water Project participant is required to pay to CCWA an amount equal to its share of the total cost of “fixed project costs” and certain other costs in the proportion established in the Water Supply Agreement. This includes the Santa Barbara County State Water Project participant’s share of payments to the State Department of Water Resources (DWR) under the State Water Supply Contract (including capital, operation, maintenance, power and replacement costs of the DWR facilities), debt service on CCWA bonds and all CCWA operating and administrative costs.

Each Santa Barbara County Project participant is required to make payments under its Water Supply Agreement solely from the revenues of its water system. Each participant has agreed in its Water Supply Agreement to fix, prescribe and collect rates and charges for its water system which will be at least sufficient to yield each fiscal year net revenues equal to 125% of the sum of (1) the payments required pursuant to the Water Supply Agreement, and (2) debt service on any existing participant obligation for which revenues are also pledged.

CCWA is composed of eight members, all of which are public agencies. CCWA was organized and exists under a joint exercise of powers agreement among the various participating public agencies. The Board of Directors is made up of one representative from each participating entity. Votes on the Board are apportioned between the entities based upon each entity’s pro-rata share of the water provided by the project. The

District’s share of the project based upon number of acre-feet of water is 7.78% and entitles the District to 3,000 acre-feet of water per year from the SWP plus 300 acre-feet of drought capacity. Operating and capital expenses are allocated among the members based upon various formulas recognizing the benefits of the various project components to each member.

On October 1, 1992, CCWA sold \$177.1 million in revenue bonds at a true interest cost of 6.64% to enable CCWA to finance a portion of the costs of constructing a water treatment plant to treat State water for use by various participating water purveyors and users within Santa Barbara and San Luis Obispo Counties, a transmission system to deliver such water to the participating water purveyors and users within Santa Barbara County, and certain local improvements to the water systems of some of the participating purveyors. The District’s share of bonds issued for this project is \$27.1 million.

In November 1996, CCWA sold \$198.0 million of revenue bonds at a true interest cost of 5.55% to defease CCWA’s \$177.1 million 1992 revenue bonds and to pay certain costs of issuing the bonds. The 1996 bonds were issued in two series: Series A of \$173.0 million and Series B of \$25.0 million. The Series B bonds are subject to mandatory redemption

MONTECITO WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2008 AND 2007

NOTE 15: COMMITMENTS (Continued)

Participation in State Water Project (Continued)

from amounts transferred from the Construction and Reserve Funds upon completion of the construction of CCWA facilities. On June 25, 1998, the project was deemed complete and the Series B bonds were redeemed in October 1998. The District's share of the Series A bonds issued is \$28.7 million.

On September 28, 2006 the Central Coast Water Authority (CCWA) issued Series 2006A refunding revenue bonds in the amount of \$123,190,000. This refunded the outstanding \$142,985,000 Series 1996A revenue bonds. The 2006A revenue bonds were issued at a true interest cost of 4.24% and were issued to reduce the Authority's total debt service payments over the next 15 years by \$4.4 million, and to obtain an economic gain (difference between the present values of the old and new debt service payments) of \$3.4 million. The District's share of the Series 2006A refunding revenue bonds issued is \$20.3 million.

District's Share of State Water Project:

	<u>Fixed Costs</u>	<u>Variable Costs</u>	<u>Debt Service</u>	<u>Total</u>
2009	\$ 2,411,061	\$ 868,733	\$ 1,960,512	\$ 5,240,306
2010	2,797,751	879,690	2,067,200	5,744,641
2011	3,102,092	884,155	2,067,174	6,053,421
2012	2,707,226	904,819	2,070,624	5,682,669
2013	2,727,502		2,044,306	4,771,808
2014-2018	14,008,220		10,161,610	24,169,830
2019-2023	13,828,717		8,090,257	21,918,974
2024-2028	13,819,075			13,819,075
2029-2033	12,650,159			12,650,159
2034-2036	<u>6,476,258</u>			<u>6,476,258</u>
Total	<u>\$ 74,528,061</u>	<u>\$ 3,537,397</u>	<u>\$ 28,461,683</u>	<u>\$ 106,527,141</u>

MONTECITO WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2008 AND 2007

NOTE 15: COMMITMENTS (Continued)

Participation in State Water Project (Continued)

The above numbers are estimated based upon the following assumptions. The fixed costs after 2008 are estimated to increase 3% annually and are projected to the year 2036. No variable costs are assumed after 2012 because delivery requests are not made beyond that year. The debt service payments are based upon estimated final debt service schedules and are subject to change.

The projected required costs of State Water Project for the District do not reflect the effects of prepayments and credits held at CCWA. The balance of these prepayments and credits at June 30, 2008 and 2007 was \$551,343 and \$1,019,347, respectively. The District's prepayments and credits lower the future cost of payments to CCWA for the State Water Project.

Additional information and complete financial statements for the CCWA are available for public inspection at 255 Industrial Way, Buellton, CA, between the hours of 8 a.m. and 5 p.m., Monday through Friday.

Cachuma Project

The United States Department of the Interior, Bureau of Reclamation ("USBR") entered into an agreement on September 12, 1949 with the Santa Barbara County Water Agency (the "County") and constructed the Cachuma Project on the Santa Ynez River. The District entered into an agreement with the County to purchase water from those facilities. The agreement fixes charges for water furnished to repay the capital costs, and to pay the costs to operate and maintain works and facilities at Lake Cachuma and Bradbury Dam. Both these contracts were renewed in 1995.

NOTE 16: RELATED ENTITY

The Montecito Water District Financing Corporation, a nonprofit public benefit corporation, was incorporated April 30, 1998. The Montecito Water District Financing Corporation was established by the Board of Directors of the Montecito Water District to assist in the financing, refinancing, acquiring, constructing and rehabilitating of facilities, land and equipment, and the sale and leasing of facilities, land and equipment for the use, benefit and enjoyment of the public. All net earnings, funds or assets of the Financing Corporation shall inure to the benefit of the Montecito Water District.

NOTE 17: DESIGNATED NET ASSETS

In 2001, the District transferred a portion of its net assets which were formerly unreserved to designated classifications for debt repayment, working capital, emergency, and capital repair and replacement costs. The following is a schedule of the designated net assets as of June 30, 2008 and 2007:

MONTECITO WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2008 AND 2007

NOTE 17: DESIGNATED NET ASSETS (Continued)

	<u>2008</u>	<u>2007</u>
Debt Repayment	\$ 7,738,432	\$ 6,918,722
Capital Repair and Replacement	4,045,009	4,045,009
Working Capital	3,044,500	3,044,500
Emergency	1,000,000	1,000,000
Water Purchase and Rate Stabilization Reserve	<u>1,050,000</u>	<u>350,000</u>
	<u>\$ 16,877,941</u>	<u>\$ 15,358,231</u>

NOTE 18: CONTINGENCIES

Ortega Reservoir Cover

The District, together with Carpinteria Valley Water District (CVWD) utilizes a 21.2 million gallon potable water reservoir to store Cachuma and State water. The District and CVWD are currently under order by the state of California Department of Health to construct a cover for the Ortega reservoir. The District has signed an agreement with CVWD to pay for 50% of the cost to cover Ortega Reservoir, which currently is estimated at \$19.9 million total.

After the Reservoir Cover project was completed in December of 2007, a defect in construction was discovered. The District contacted the DWR to keep the project open while the District, together with Carpinteria Valley Water District, determines a course of action regarding the construction defect.

Required Supplementary Information

MONTECITO WATER DISTRICT
REQUIRED SUPPLEMENTARY INFORMATION
FOR THE YEARS ENDED JUNE 30, 2008 AND 2007

The schedule of funding progress for PERS included information for the entire risk pool, is as follows:

Actuarial Valuation Date	Actuarial Asset Value (in '000)	Entry Age Actuarial Accrued Liability (AAL) (in '000)	Unfunded AAL [(B)-(A)] (in '000)	Funded Ratio [(A)/(B)]	Covered Payroll (in '000)	Unfunded AAL as Percentage of Covered Payroll [(B)-(A)/(E)]
June 30, 2003	\$ 2,372,879	\$ 2,596,966	\$ 224,087	91.4%	\$ 725,020	30.9%
June 30, 2004	\$ 2,460,945	\$ 2,746,096	\$ 285,151	89.6%	\$ 743,692	38.3%
June 30, 2005	\$ 2,588,713	\$ 2,891,461	\$ 302,748	89.5%	\$ 755,047	40.1%
June 30, 2006	\$ 2,492,226	\$ 2,754,397	\$ 262,171	90.5%	\$ 699,897	37.5%

POINDEXTER & COMPANY

Certified Public Accountant

To the Board of Directors of
Montecito Water District

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

I have audited the financial statements of the Montecito Water District, as of and for the years ended June 30, 2008 and 2007 and have issued my report thereon dated October 31, 2008. I conducted my audits 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 Controller General of the United States; and the State Controller's Minimum Audit Requirements for California Special Districts.

Internal Control Over Financial Reporting

In planning and performing my audits, I considered the Montecito Water District's, internal control over financial reporting as a basis for designing my auditing procedures for the purpose of expressing my opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control over financial reporting. Accordingly, I do not express an opinion on the effectiveness of the District's internal control over financial reporting.

My 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, I identified a certain deficiency in internal control over financial reporting that I consider to be a material weakness.

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 District'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 District's internal control. I consider the following deficiency to be a significant deficiency in internal control over financial reporting.

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The internal control design relating to segregation of duties is insufficient. In general, internal controls are designed to safeguard assets and help prevent losses from employee dishonesty or error.

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 District's internal control.

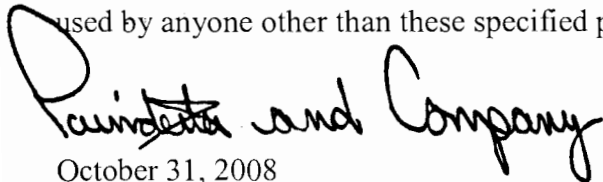
My consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies of material weaknesses. However, I consider the significant deficiency described above to be a material weakness.

Compliance

As part of obtaining reasonable assurance about whether the Montecito Water District's financial statements are free of material misstatement, I 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 my audits, and accordingly, I do not express such an opinion. The results of my tests disclosed no instances of noncompliance or other matters that are required to be reported under Government Auditing Standards.

I noted certain matters that I reported to management of Montecito Water District in a separate letter dated October 31, 2008.

This report is intended solely for the information and use of the management, others within the District and the Board of Directors and is not intended to be and should not be used by anyone other than these specified parties.

Rainetta and Company

October 31, 2008