

**MONTECITO WATER DISTRICT
FINANCIAL STATEMENTS
JUNE 30, 2010 AND 2009**

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, 2010 and 2009, 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, 2010 and 2009, 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.

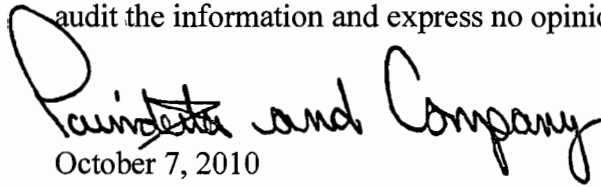
In accordance with *Government Auditing Standards*, I have also issued my report dated October 7, 2010, on my consideration of the Montecito Water District's internal control over financial reporting and my tests of its compliance with certain provisions of laws, regulations, contracts, and grants agreements 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.

A handwritten signature in cursive script that reads "Painters and Company". The signature is written in black ink and is positioned above the date.

October 7, 2010



MANAGEMENT DISCUSSION AND ANALYSIS For the Fiscal Year ending June 30, 2010

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, 2010. 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 17 to 21 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 46 of this report.



**MANAGEMENT DISCUSSION AND ANALYSIS
For the Fiscal Year ending June 30, 2010**

Financial Highlights

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

<u>Condensed Statement of Net Assets</u>				
	2010	2009	Variance	
			Dollars	Percent
			Favorable/(Unfavorable)	
Current Assets	\$ 16,660,081	\$ 15,467,778	\$ 1,192,303	7.71%
Capital assets	37,253,208	36,958,018	295,190	0.80%
Other assets	6,897,220	7,200,355	(303,135)	-4.21%
Total Assets	\$ 60,810,509	\$ 59,626,151	\$ 1,184,358	1.99%
Long-term liabilities outstanding	\$ 26,656,504	\$ 26,816,260	\$ 159,756	0.60%
Current liabilities	2,293,570	2,455,798	162,228	6.61%
Total Liabilities	28,950,074	29,272,058	321,984	1.10%
Invested in capital assets net of related debt	14,616,904	14,310,988	305,916	2.14%
Restricted	905,701	660,401	245,300	37.14%
Unrestricted assets	16,337,830	15,382,704	955,126	6.21%
Total Net Assets	31,860,435	30,354,093	1,506,342	4.96%
Total Liabilities and Net Assets	\$ 60,810,509	\$ 59,626,151	\$ 1,184,358	1.99%

Total assets of June 30, 2010 are \$60,810,509 or \$1,184,358 more than the June 30, 2009 amount.

Current assets are approximately \$1,192,303 more than the prior year, primarily due to a return of funds from the refinancing of the 1998A Revenue Project. The District had lower sales revenue during the year as a result of wet weather and the effects of the inclining block rate structure which was implemented during the previous year. The District sold 5,274 Acre Feet (AF) of water in 2009/10 compared to 5,963 AF of water in 2008/09. This resulted in \$585,988 less revenue from water sales.



**MANAGEMENT DISCUSSION AND ANALYSIS
For the Fiscal Year ending June 30, 2010**

Financial Highlights (Continued)

Capital assets are \$295,190 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.

Other assets are higher than the prior year primarily due to increases in the District's interest in the Cater Treatment Plant. This is offset by amortization of the interest in Cater Treatment Plant and bond issue costs.

Current liabilities are \$162,228 less than last year due to a lower accounts payable balance. The current portion of the DWR loan payments are included in current assets since the principal payments will begin in the fiscal year 2010/11.

Long-term liabilities are approximately \$159,756 lower than last year. This is primarily due to the reclassification of the \$360,535 current portion of the Ortega Loan to current liabilities and the refinancing of the 1998A Bonds. The 1998A bonds were refinanced with the 2010A Revenue Refunding Bonds on April 8, 2010. The District contributed \$1,000,000 towards the balance of the 1998A COPs prior to refinancing thus the 2010A COPs were financed at a lower balance.

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 \$31,860,435 at the close of the fiscal year ending June 30, 2010.

By far, the largest portion of the District's net assets (46 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 \$1,506,342 during the 2009/10 fiscal year. This increase reflects an increase in investments due to a return of \$1,300,000 from the 1998A Project Fund and a \$1,450,000 legal settlement for the Ortega Reservoir repairs.

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, 2010

Financial Highlights (Continued)

	2010		2009		Variance	
	\$		\$		Dollars	Percent
Condensed Statements of Activities and Changes in Net Assets						
Favorable/(Unfavorable)						
Operating Income						
Charges for services	\$ 12,437,342		\$ 12,988,753		\$ (551,411)	-4.25%
Operating expenses	(12,473,995)		(13,113,290)		639,295	4.88%
Operating income	(36,653)		(124,537)		87,884	70.57%
Nonoperating Revenues						
Capital contributions	6,235		102,430		(96,195)	-93.91%
Capital cost recovery fees	129,111		150,532		(21,421)	-14.23%
Interest income	80,436		210,025		(129,589)	-61.70%
Taxes and assessments	22		20		2	10.00%
Water availability charge	310,087		310,154		(67)	-0.02%
Late charges	69,257		50,584		18,673	36.91%
Disposal of assets	2,760		1,386		1,374	99.13%
Legal Settlement	1,450,000		0		1,450,000	100.00%
Other	76,949		162,418		(85,469)	-52.62%
Total Nonoperating revenues	2,124,857		987,549		1,137,308	115.16%
Nonoperating expenses:						
Interest expense	(507,337)		(361,223)		(146,114)	-40.45%
Change in Accounting Principal	(74,525)		0		(74,525)	100.00%
Total nonoperating expenses	(581,862)		(361,223)		(220,639)	-61.08%
Increase in Net Assets	\$ 1,506,342		\$ 501,789		\$ 1,004,553	200.19%

Charges for Services were lower than last year by \$551,411 due to a combination of wet weather and the effects of an inclining block rate structure.

Operating Expenses were lower than last year by \$639,295 due to lower water purchases related to the decrease in water sales. Lower administration costs also lowered the operating expenses. Water treatment costs remain high due to the increased costs to treat water at the Cater Treatment Plant due to watershed damage caused by the Zaca Fire in 2007.



MANAGEMENT DISCUSSION AND ANALYSIS
For the Fiscal Year ending June 30, 2010

Financial Highlights (Continued)

The Change in Net Assets of \$1,506,342 for the reporting period was higher than last year by \$1,004,553. This difference is largely due to a legal settlement award for the repairs of the Ortega Reservoir. The reservoir was damaged during construction of a roof to cover the reservoir. 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 19 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 lower than the 2008/09 fiscal year (last year) by \$585,988 and lower than budget by \$829,578 due to a combination of wet weather and the effects of the inclining block rate structure which was effective October 1, 2008. The district actually sold less water than the 2008/09 fiscal year. A total of 5,274 AF of water was sold during the reporting period, a decrease of 689 AF compared to last year's sales of 5,963 AF and was 526 AF less than the budgeted year's sales of 5,800 AF.

SERVICE CHARGE revenues were higher than last year by \$33,867. This is primarily due to an addition of 4 new meters, tea fire victims that reinstated their meter service charge and an increase in meter service charges which was effective on October 1, 2008. At the end of the current year, there was a net increase of 4 meters for a total of 4,647 meters as compared to 4,643 meters at the end of the same period last year.

TOTAL NONOPERATING REVENUES were \$941,275 higher than the prior year. This is primarily due to funds received from a legal settlement relating the Ortega Reservoir project. Presented below are summaries of the total nonoperating revenues:

CONNECTION FEES (i.e., service connection fees and capital cost recovery fees for new meter connections, relocations, or enlargements) was lower than last year by \$21,421. For the reporting period, \$21,743 in service connection fees and \$107,368 in capital cost recovery fees were collected as compared to \$24,766 and \$125,766, respectively last year.

INTEREST REVENUE was lower than last year by \$129,589 and lower than budget by \$81,464 for the reporting period primarily due to lower interest rates on investments in the Local Agency Investment Fund (LAIF). An average balance of \$7,664,346 at an average interest rate of .658% was invested in LAIF during the reporting period of



MANAGEMENT DISCUSSION AND ANALYSIS
For the Fiscal Year ending June 30, 2010

Revenue (Continued)

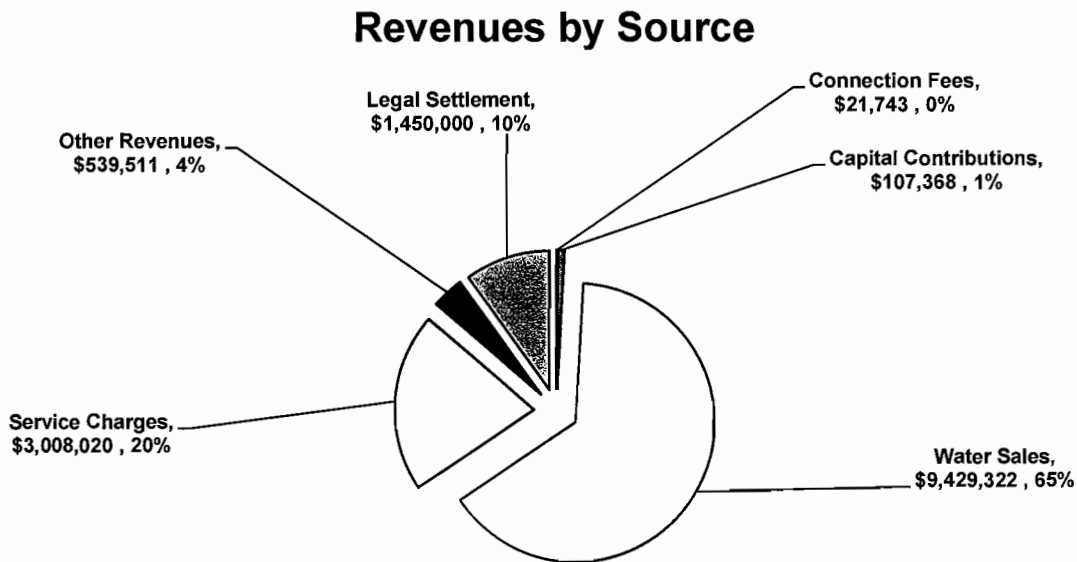
2009/10 as compared to an average balance of \$7,071,995 at an average interest rate of 2.185% that was invested in LAIF during the reporting period of 2008/09.

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.

DISPOSAL OF DISTRICT ASSETS was budgeted at \$4,000 this year. The gain of \$2,760 represents the sale of scrap metal related to the disposal of the office well.

LATE CHARGES were lower than last year by \$18,673.

The District's **TOTAL REVENUE** was \$14,555,964 and was higher than last year's total revenue by \$682,092, which includes contributions in aid of construction.





MANAGEMENT DISCUSSION AND ANALYSIS
For the Fiscal Year ending June 30, 2010

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 19 of this report.

TOTAL OPERATING EXPENSES were \$639,295 lower than the prior year primarily due to lower water purchase costs relating to lower water sales. Administration and general costs and treatment costs were less than the prior year, however water system operation and maintenance were higher than the prior year.

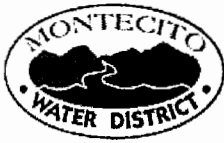
WATER PURCHASES were lower than last year by \$509,537. The decrease in water purchase costs is due to the lower water sales and less need to purchase supplemental water. In the prior two fiscal years, the District purchased additional water supply to meet customer demand.

WATER TREATMENT total costs were \$1,700,411 which was lower than last year by \$159,269. The costs for the reporting period were lower than last year due primarily to the treatment of less water at the Cater Treatment Plant. The treatment costs at the Cater Treatment Plant remain high due to the damage to the watershed for Lake Cachuma due to the Zaca Fire in 2007. Runoff in the fire area has caused more organic matter to be present in the water from the lake, which causes the treatment to be more difficult and more costly. This higher cost has been offset by the lower demand for water, which results in lower treatment costs. The District has a contract agreement with the City of Santa Barbara to treat water from Lake Cachuma at the City's Cater Treatment Plant.

WATER SYSTEM OPERATIONS AND MAINTENANCE was higher than last year by \$35,584 for a total expense of \$1,120,533.

METER READING AND CUSTOMER SERVICE expenses were \$330,882 which was higher than last year by \$41,130. The increase is due to increased payroll costs and higher meter reading costs. The District contracts for meter reading services and there is a periodic increase in the per meter fee to read the meters.

ADMINISTRATIVE AND GENERAL total expenses were lower than last year by \$183,391. These costs were lower primarily due to lower General Manager costs, lower public information, dues and subscriptions and lower property taxes. The General Manager received a bonus in the prior year which increased costs for that year. Property taxes are lower because the District successfully challenged the property tax charges on District owned property.

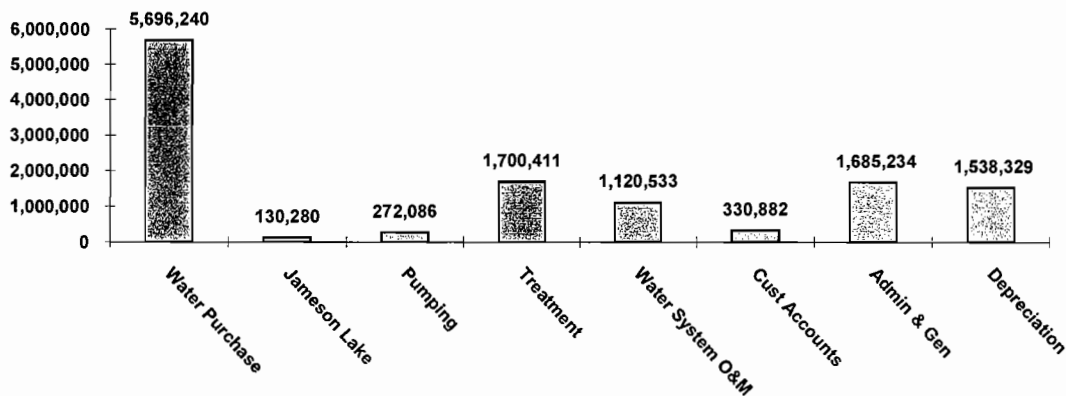


MANAGEMENT DISCUSSION AND ANALYSIS
For the Fiscal Year ending June 30, 2010

Expenses (Continued)

DEPRECIATION AND AMORTIZATION expense \$98,186 higher than last year. This represents a 7% increase and is primarily due to fixed assets which were transferred from Construction in Progress beginning to depreciate.

Operating Expenses



NONOPERATING EXPENSES which are comprised of interest expense was higher than last year by \$146,114. This is in due to the refinancing of the 1998A Project Bonds with the 2010A Refunding Revenue Bonds. Interest was paid on the new bonds as well as interest on the refinanced bonds.

Financial Analysis

The net assets of the District's water fund increased by \$1,506,342. Key elements of this change are as follows:

Water sales decreased by 6% and service charges increased by 1.2%. The decrease in water sales was due to a combination of wet weather and the effects of the inclining block rate structure implemented in 2008. The inclining block rate structure charges a higher price per unit of water for higher levels of consumption. The water sales volume was lower than the previous year. The District sold 5,963 AF (AF) of water in 2008/09 and sold only 5,252 AF in 2009/10. This represents approximately 11% reduction in consumption.

Expenses decreased during the year and the District had net operating loss of \$36,653. The District also realized net nonoperating revenues of \$2,118,662 and capital contributions for construction in the amount of \$6,235. Nonoperating revenues include interest income, the



MANAGEMENT DISCUSSION AND ANALYSIS
For the Fiscal Year ending June 30, 2010

Financial Analysis (Continued)

Water Availability Charge, late charges, Capital Cost recovery fees, connection fees and an award of legal settlement. Capital cost recovery and connection fees were \$129,111 which represents a decrease of \$21,421 from the prior year.

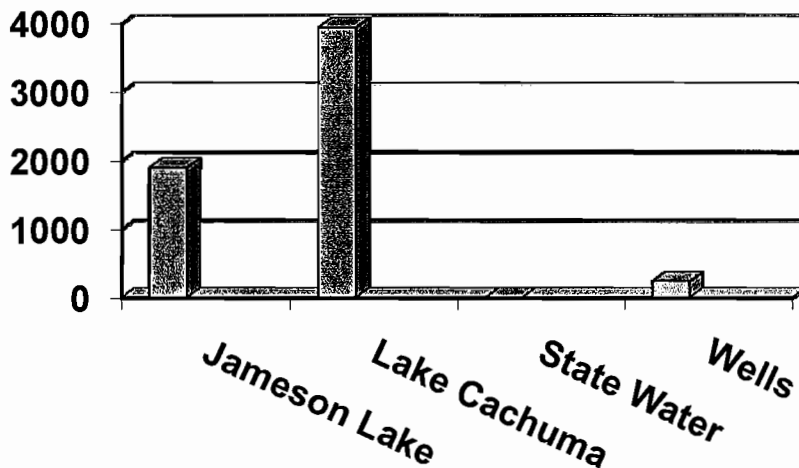
Capital contributions to the District were \$6,235 due to a main extension projects which were partially paid for with customer contributions.

Operating expenses were 4.88% lower than last year which is primarily due to lower water purchase costs, lower treatment costs and lower administration costs.

Water Production

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

Water Production By Source (AF)



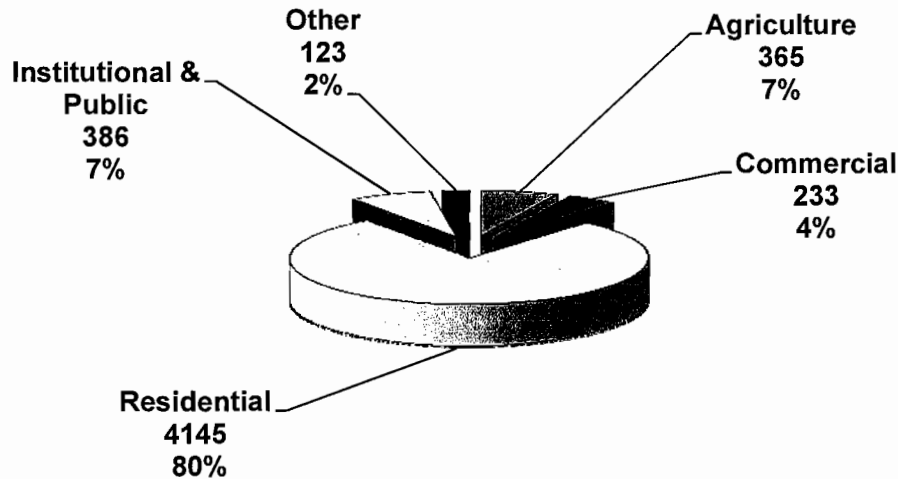


**MANAGEMENT DISCUSSION AND ANALYSIS
For the Fiscal Year ending June 30, 2010**

Water Sales

The following chart provides a comparison of the District's water sales in AF 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, 2010, amounts to \$37,253,208 (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 .80%.



MANAGEMENT DISCUSSION AND ANALYSIS
For the Fiscal Year ending June 30, 2010

Capital Asset and Debt Administration (Continued)

Montecito Water District's Capital Assets				
	Year Ended		Variance	
	June 30, 2010	June 30, 2009	Dollars Increase (decrease)	Percent
Land and water rights	\$ 243,586	\$ 243,586	\$ -	0.00%
Water supply sources	5,612,198	5,496,651	115,547	2.10%
Treatment plants	5,804,716	5,694,659	110,057	1.93%
Infrastructure	27,380,260	26,411,200	969,060	3.67%
Machinery, equipment and other	2,443,138	2,067,523	375,615	18.17%
Construction in progress	12,679,492	13,089,107	(409,615)	-3.13%
Total property, plant and equipment	54,163,390	53,002,726	1,160,664	2.19%
Accumulated Depreciation	(16,910,182)	(16,044,708)	(865,474)	5.39%
Net Property, Plant and Equipment	\$ 37,253,208	\$ 36,958,018	\$ 295,190	0.80%

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

Equipment was purchased for \$60,178 during for the year. The District disposed of a well through destruction and sale of metal parts. This disposal consisted of \$74,387 in original costs to develop and construct the well. Construction in Progress consists of system, improvements and main replacements. Construction in Progress had additions of \$1,142,920, which includes the Ortega Reservoir Improvement Project and pipeline replacements. A majority of the system improvements were funded with proceeds of the 1998A Revenue Bonds and Department of Water Resources (DWR) loans. \$1,552,535 of completed projects 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 6 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 \$27,483,630. Of this amount, \$14,150,067 comprises debt that represents bonds secured solely by specific revenue sources (i.e. revenue bonds). \$1,294,384 is a loan from the Department of Water Resources for the Bella Vista Treatment Plant, \$2,802,521 represents a loan from the Department of Water Resources for the Cater Treatment Plant improvements, and \$9,236,658 represents a construction loan from the DWR for the Ortega Reservoir Project.



Capital Asset and Debt Administration (Continued)

Montecito Water District's Outstanding Debt				
Revenue Bonds and Other Debt				
	June 30, 2010		June 30, 2009	
Revenue Bonds	\$	13,470,000	\$	14,150,066
Loans		13,333,564		13,333,564
Capital Lease		0		0
Total	\$	26,803,564	\$	27,483,630

The District's rating service, Standard & Poor's, a division of McGraw Hill, has assigned the Certificates the rating of "AA-". There is no assurance that any credit rating given to the Certificates will be maintained for any period of time or that the rating may not be lowered or withdrawn entirely by S&P if, in its judgment, circumstances so warrant. Any downward revision or withdrawal of such rating may have an adverse effect on the market price of the Certificates. Such rating reflects only the views of S&P and an explanation of the significance of such rating may be obtained from S&P.

The Trust Agreement establishes a Reserve Fund to be held by the Trustee solely for the benefit of the Owners of the Certificates. The District has deposited an amount equal to \$1,444,566.02 from the proceeds of the Certificates in the Reserve Fund (the "initial Reserve Requirement"), and thereafter as required to maintain in the reserve Fund an amount equal to the lesser of the Initial Reserve Requirement or the maximum annual Install Payments due in the current or any future Fiscal Year (the "Reserve Requirement").

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 \$95,774,598 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 8 through 9 in the notes to the financial statements.

Economic Factors and Next Year's Budget

In the 2009/10 fiscal year, the District sold less water than predicted and less water than it did in the previous three years. This resulted in \$585,988 less revenue than the prior year and \$868,548 less than budgeted for the year. This lower level of sales is due to a combination of cool wet weather and the conservation block rate structure. The reduction in District revenues from water sales and its effect on the 09/10 fiscal year budget was partially offset by a reduction



**MANAGEMENT DISCUSSION AND ANALYSIS
For the Fiscal Year ending June 30, 2010**

Economic Factors and Next Year's Budget (Continued)

in the purchase and treatment of expensive supplemental water supplies needed in the preceding three years.

- The multi-block conservation rate structure has exceeded the goals of the District to reduce the annual overall water production needs to meet customer demand. The expected drop in customer water demand was targeted at between 10-15%. Actual 09/10 water sales showed a 20% reduction from the peak water sales recorded during the 07/08 fiscal year. If this trend of low water sales continues, the District will need to consider an adjustment in its customer water rates to compensate for the decrease in revenues in order to meet operating costs and long-term debt obligations.
- One of the District's annual top ten water consumers has discovered a previously unknown ground water supply on its property that is expected to provide over 80% of its future water supply requirements. MWD is estimating over a \$100,000 drop in annual revenues from this one customer.
- A proposed reorganization of the water district service boundaries between the Montecito and the Carpinteria Valley Water District is being petitioned by nine landowners to the Local Agency Formation Commission (LAFCO). MWD does not support this petition however if the petitioners succeed, it is estimated that the MWD will see an annual drop in revenues of over \$225,000.
- Additional economic factors expected to affect general operating expenses are the increasing costs to fund employee benefit packages including health, dental and retirement. Increases in these plans over the last 5 years is expected to continue. It is unknown to what extent District operating expenses will be impacted by the benefit package cost increases.
- The District is a member of a Joint Powers Agency consisting of the City of Santa Barbara and the Carpinteria Valley Water District. The City of Santa Barbara treats the District's Cachuma and State Water supplies at the regional Cater Water Treatment facility located in the City of Santa Barbara. The capital program costs for the Cater Treatment Plant are projected to increase with the planned construction of an ozone treatment facility to meet the Federal Stage 2 disinfection by products rule that goes into effect in 2012. Funding for this estimated \$20M project will come from a low interest State loan. The District's share of the proposed debt service is approximately \$252,000 annually which is equivalent to 20% of all capital costs at the Cater facility.
- A lawsuit has been filed against the District by a district customer regarding the reclassification of water use on his property resulting in a change in the cost of water. This District will defend itself against this lawsuit with legal costs expected to be greater than \$100,000. All costs in the defense of this lawsuit will be taken from Operating Reserves.



**MANAGEMENT DISCUSSION AND ANALYSIS
For the Fiscal Year ending June 30, 2010**

Economic Factors and Next Year's Budget (Continued)

With the above factors considered, the District has decreased its operating expense budget for the 2010/11 fiscal year by \$708,019 and estimates \$311,400 less in total revenues. The capital expenditures budget has increased by \$121,298. The District's share of costs for COMB projects is estimated to be \$1,300,000 and has been included in the 2010/11 fiscal year budget. The Board of Directors will be requested to appropriate funds for the COMB projects from reserves if the projects exceed the estimated costs.

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, 2010 AND 2009

ASSETS

	<u>2010</u>	<u>2009</u>
Current Assets:		
Cash (Note 3)	\$ 355,059	\$ 819,442
Investments (Note 3)	5,551,867	4,438,817
Accounts receivable	1,280,819	1,458,373
Reimbursements receivable	105,355	44,590
Accounts receivable legal settlement	1,450,000	
Interest receivable	11,716	50,655
Inventory	176,863	173,719
Prepaid water (Note 5)	5,165,748	5,135,341
Prepaid expenses	31,080	30,508
Total Current Assets	<u>14,128,507</u>	<u>12,151,445</u>
Restricted Assets:		
Cash (Note 4)	905,701	660,401
Investments (Note 3)	1,625,873	2,655,932
Total Restricted Assets	<u>2,531,574</u>	<u>3,316,333</u>
Non Current Assets		
Capital Assets:		
Water supply sources	5,612,198	5,496,651
Treatment plants	5,804,716	5,694,659
Distribution system	27,380,260	26,411,200
Equipment	2,009,191	1,738,939
Buildings	340,216	328,584
Other capital assets	93,731	
Land and water rights	243,586	243,586
Construction in progress	12,679,492	13,089,107
Total Capital Assets	54,163,390	53,002,726
Less accumulated depreciation	<u>(16,910,182)</u>	<u>(16,044,708)</u>
Net Capital Assets (Note 6)	<u>37,253,208</u>	<u>36,958,018</u>
Other Assets:		
Bond issue costs, net of accumulated amortization of \$430,581 in 2010 and \$419,582 in 2009	285,034	423,081
Interest in Cater Treatment Plant, net of accumulated amortization of \$3,726,985 in 2010 and \$3,167,190 in 2009	4,847,326	5,008,966
Deposit CCWA rate coverage reserve fund	1,764,860	1,768,308
Total Other Assets	<u>6,897,220</u>	<u>7,200,355</u>
TOTAL ASSETS	<u>\$ 60,810,509</u>	<u>\$ 59,626,151</u>

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

MONTECITO WATER DISTRICT
STATEMENTS OF NET ASSETS
JUNE 30, 2010 AND 2009

LIABILITIES

	<u>2010</u>	<u>2009</u>
Current Liabilities:		
Accounts payable	\$ 571,595	\$ 680,000
Accrued interest payable	285,861	475,830
Accrued expenses	570,374	415,022
Customer deposits	34,641	41,237
Deferred liability	3,973	3,973
Current portion of bonds payable (Note 8)	35,000	30,000
Current portion of loans payable (Note 9)	792,126	781,735
Current portion of capital lease payable (Note 10)	-	28,001
	<u>2,293,570</u>	<u>2,455,798</u>
Total Current Liabilities		
Long Term Liabilities:		
Bonds payable (Note 8)	13,435,000	13,770,000
Loans payable (Note 9)	12,541,438	12,972,729
Capital lease payable (Note 10)	-	73,531
Premium on 2010A COPs	680,066	-
	<u>26,656,504</u>	<u>26,816,260</u>
Total Long Term Liabilities		
Total Liabilities	<u>28,950,074</u>	<u>29,272,058</u>

NET ASSETS

Invested in Capital Assets, Net of Related Debt	14,616,904	14,310,988
Restricted by covenant for:		
Debt service	905,701	660,401
Unrestricted net assets		
Designated (Note 18)	17,949,004	17,294,866
Undesignated	<u>(1,611,174)</u>	<u>(1,912,162)</u>
Total Net Assets	<u>31,860,435</u>	<u>30,354,093</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 60,810,509</u>	<u>\$ 59,626,151</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, 2010 AND 2009

	<u>2010</u>	<u>2009</u>
Operating Revenues:		
Sale of water	\$ 9,429,322	\$ 10,015,310
Water service charges	2,952,973	2,919,106
Fire hydrant rentals	55,047	54,337
Total Operating Revenues	<u>12,437,342</u>	<u>12,988,753</u>
Operating Expenses:		
Water purchase	5,696,240	6,205,777
Supply	130,280	115,022
Pumping	272,086	249,342
Water treatment	1,700,411	1,859,680
Water system operation and maintenance	1,120,533	1,084,949
Meter reading and customer service	330,882	289,752
Administration and general	1,685,234	1,868,625
Depreciation and amortization	1,538,329	1,440,143
Total Operating Expenses	<u>12,473,995</u>	<u>13,113,290</u>
Operating Income	<u>(36,653)</u>	<u>(124,537)</u>
Nonoperating Revenues/(Expenses)		
Late charges	69,257	50,584
Connection fees	21,743	24,766
Capital cost recovery fees	107,368	125,766
Interest income	80,436	210,025
Taxes and assessments	22	20
Water availability charge	310,087	310,154
Other income	76,949	162,418
Legal settlement	1,450,000	-
Gain/(loss) on sale/disposal of assets	2,760	1,386
Debt service interest expense	<u>(507,337)</u>	<u>(361,223)</u>
Total Nonoperating Revenues/(Expenses)	<u>1,611,285</u>	<u>523,896</u>
Income before contributions and change in accounting principle	1,574,632	399,359
Change in Accounting Principle	(74,525)	
Contributions in aid of construction	<u>6,235</u>	<u>102,430</u>
Change in Net Assets	1,506,342	501,789
Net Assets - Beginning of Year	<u>30,354,093</u>	<u>29,852,304</u>
Net Assets - End of Year	<u>\$ 31,860,435</u>	<u>\$ 30,354,093</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, 2010 AND 2009

	<u>2010</u>	<u>2009</u>
Cash Flows from Operating Activities:		
Receipts from customers and users	\$ 12,547,535	\$ 12,778,056
Payments to suppliers	(8,970,883)	(9,590,910)
Payments to employees	(1,951,959)	(1,998,647)
Net Cash Provided by Operating Activities	<u>1,624,693</u>	<u>1,188,499</u>
Cash Flows from Capital and Related Financing Activities		
Interest payments on debt	(697,306)	(357,860)
Capitalized interest on payments on debt	(574,349)	(699,800)
Principal payments on bonds, loans and capital leases	(14,212,432)	(467,090)
Premium on 2010A Bonds	1,085,660	-
Cost of Issuance 2010A Bonds	(121,460)	-
Loan proceeds	13,360,000	237,788
Funds used/(reserved) for CCWA rate coverage reserve	3,448	(166,013)
Reimbursements Received	319,181	(44,590)
Water availability charge	310,087	310,154
Net Cash Provided/(Used) by Capital and Related Financing Activities	<u>(527,171)</u>	<u>(1,187,411)</u>
Cash Flows from Noncapital Financing Activities:		
Taxes and assessments	22	20
Capital cost recovery fees	107,368	125,766
Connection fees	21,743	24,766
Late charges	69,257	50,584
Other	76,949	162,417
Net Cash and Cash Equivalents Provided by Noncapital Financing Activities	<u>275,339</u>	<u>363,553</u>
Cash Flows from Investing Activities:		
Purchase of property, plant and equipment (Excludes noncash contributed property additions of \$6,235 and \$102,430 in the years ended June 30, 2010 and 2009, respectively)	(1,267,614)	(1,272,583)
Gain from sale of assets	2,760	1,386
Increase in interest in Cater Treatment Plant	(398,155)	(278,214)
Interest received on 98 A Bond proceeds	34,681	65,817
Interest received	119,375	210,429
Net Cash Provided/(Used) by Investing Activities	<u>(1,508,953)</u>	<u>(1,273,165)</u>
Net Increase/(Decrease) in Cash and Cash Equivalents	(136,092)	(908,524)
Cash and Cash Equivalents at beginning of year	<u>8,574,592</u>	<u>9,483,116</u>
Cash and Cash Equivalents at End of Year	<u>\$ 8,438,500</u>	<u>\$ 8,574,592</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, 2010 AND 2009

	<u>2010</u>	<u>2009</u>
Reconciliation of Statement of Net Assets:		
Unrestricted cash	\$ 355,059	\$ 819,442
Unrestricted invested cash-		
Local Agency Investment Fund	5,551,867	4,438,817
Restricted invested cash -		
California Bank & Trust	905,701	660,401
Local Agency Investment Fund	<u>1,625,873</u>	<u>2,655,932</u>
	<u>\$ 8,438,500</u>	<u>\$ 8,574,592</u>
Reconciliation of operating income/(loss) to net		
Cash provided (used) by operating activities:		
Operating Income	<u>\$ (36,653)</u>	<u>\$ (124,537)</u>
Adjustments to reconcile operating income/(loss)		
to net cash provided/(used) by operating activities:		
Depreciation & amortization	1,538,329	1,440,143
(Increase)/decrease in receivables	116,789	(179,740)
(Increase)/decrease in inventory	(3,144)	(2,926)
(Increase)/decrease in prepaid expenses	(30,979)	(68,268)
Increase/(decrease) in accounts payable	(108,405)	87,630
Increase/(decrease) in accrued expenses	155,352	67,154
Increase/(decrease) in customers deposits	<u>(6,596)</u>	<u>(30,957)</u>
Total Adjustments	<u>1,661,346</u>	<u>1,313,036</u>
Net cash provided/(used) by operating activities	<u>\$ 1,624,693</u>	<u>\$ 1,188,499</u>

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

MONTECITO WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2010 AND 2009

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 nonoperating 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 nonoperating 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, 2010. 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, 2010 AND 2009

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, 2010 and 2009, 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 2010A 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 the assets or materially extend assets lives are not capitalized.

MONTECITO WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2010 AND 2009

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 \$115,298 of accrued vacation and \$223,649 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, 2010 AND 2009

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 Nonoperating 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 nonoperating 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, 2010 AND 2009

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

Operating and Nonoperating Revenues and Expenses (Continued)

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

Self Funded Dental Plan

Prior to the 2009/10 fiscal year the District maintained 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 ending December 31, 2009, the District paid out \$17,658 in benefits and for the plan year ending December 31, 2008, the District paid out \$23,375 in benefits.

In December 2009, the Board elected to discontinue the self funded dental plan and authorized district staff to establish dental benefits through Met Life Dental.

Changes in Classifications Made to Previously Issued Financial Statements

The Land and Water Rights balance and the Intangible Assets balance for the prior Statement of Net Assets have been reclassified to be consistent with the current year's presentation.

NOTE 2: DATE OF MANAGEMENT'S REVIEW

In preparing the financial statements, the District has evaluated events and transactions for potential recognition or disclosure through October 7, 2010, the date that the financial statements were available to be issued.

NOTE 3: 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 \$250,000 per institution. The District is also allowed to invest with the State Treasurer's Local Agency Investment Funds (LAIF).

MONTECITO WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2010 AND 2009

NOTE 3: CASH AND INVESTMENTS (Continued)

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.

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, 2010 and 2009 the carrying amounts of cash in banks and cash on hand and corresponding bank balances were as follows:

	<u>2010</u>		<u>2009</u>	
	<u>Carrying Amount</u>	<u>Bank Balance</u>	<u>Carrying Amount</u>	<u>Bank Balance</u>
Cash on Hand	\$ 350	\$ -	\$ 350	\$ -
Cash In Banks	<u>354,709</u>	<u>362,317</u>	<u>819,092</u>	<u>841,872</u>
Totals	<u>\$ 355,059</u>	<u>\$ 362,317</u>	<u>\$ 819,442</u>	<u>\$ 841,872</u>

\$250,000 was covered by federal depository insurance for the 2010 and 2009 fiscal years. \$104,709 and \$591,872 for 2010 and 2009 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

MONTECITO WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2010 AND 2009

NOTE 3: CASH AND INVESTMENTS (Continued)

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, 2010 and 2009, the average earnings rate was approximately .658% and 2.186%, respectively. The carrying value on deposit with LAIF as of June 30, 2010 and 2009 were \$5,551,867 and \$4,438,817, respectively. The fair value is \$5,560,993 and \$4,444,873 as of June 30, 2010 and 2009 respectively.

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>2010</u>	<u>2009</u>
Certificates of Participation:		
1998A bond proceeds restricted for capital projects	\$ -	\$ 2,655,932
Total restricted investments	<u>\$ -</u>	<u>\$ 2,655,932</u>

MONTECITO WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2010 AND 2009

NOTE 4: RESTRICTED CASH

In 2010 and 2009, 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 \$268,790. The balances at June 30, 2010 and 2009 were \$328,328 and \$327,029 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, 2010 and 2009 were \$577,373 and \$280,747, respectively.

	<u>2010</u>	<u>2009</u>
DWR Loans:		
Restricted for DWR Bella Vista Loan Reserve	\$ 328,328	\$ 327,029
Restricted for DWR Ortega Loan Reserve	<u>577,373</u>	<u>333,372</u>
Total restricted cash	<u>\$ 905,701</u>	<u>\$ 660,401</u>

NOTE 5: 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, 2010 to June 30, 2010.

MONTECITO WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2010 AND 2009

NOTE 6: CAPITAL ASSETS

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

	2010		
	Property, Plant and Equipment	Accumulated Depreciation	Net
Land & water rights	\$ 243,586	\$ -	\$ 243,586
Water supply sources	5,612,198	(3,727,614)	1,884,584
Treatment plants	5,804,716	(3,523,938)	2,280,778
Other improvements	27,380,260	(7,830,600)	19,549,660
Equipment	2,443,138	(1,828,030)	615,108
Construction	12,679,492	-	12,679,492
Total property, plant and equipment	\$ 54,163,390	\$ (16,910,182)	\$ 37,253,208

	2009		
	Property, Plant and Equipment	Accumulated Depreciation	Net
Land & water rights	\$ 243,586	\$ -	\$ 243,586
Water supply sources	5,496,651	(3,608,604)	1,888,047
Treatment plants	5,694,659	(3,359,443)	2,335,216
Other improvements	26,411,200	(7,364,046)	19,047,154
Equipment	2,067,523	(1,712,615)	354,908
Construction	13,089,107	-	13,089,107
Total property, plant and equipment	\$ 53,002,726	\$ (16,044,708)	\$ 36,958,018

MONTECITO WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2010 AND 2009

NOTE 6: CAPITAL ASSETS (Continued)

The following shows the capital asset activity for the fiscal years ended June 30, 2010 and 2009.

	<u>July 1,</u> <u>2009</u>	<u>Additions/</u> <u>reclassifications</u>	<u>Dispositions/</u> <u>Reclassifications</u>	<u>June 30,</u> <u>2010</u>
Land & water rights	\$ 243,586	\$ -	\$ -	\$ 243,586
Water supply sources	5,496,651	115,547	-	5,612,198
Treatment plants	5,710,552	168,551	(74,387)	5,804,716
Other improvements	26,395,307	984,953	-	27,380,260
Buildings	2,067,523	375,615	-	2,443,138
Construction	<u>13,089,107</u>	<u>1,142,920</u>	<u>(1,552,535)</u>	<u>12,679,492</u>
Total property	53,002,726	2,787,586	(1,626,922)	54,163,390
Less: Accumulated				
Depreciation	<u>(16,044,708)</u>	<u>(939,861)</u>	<u>74,387</u>	<u>(16,910,182)</u>
Net property	<u>\$ 36,958,018</u>	<u>\$ 1,847,725</u>	<u>\$ (1,552,535)</u>	<u>\$ 37,253,208</u>

	<u>July 1,</u> <u>2008</u>	<u>Additions/</u> <u>reclassifications</u>	<u>Dispositions/</u> <u>Reclassifications</u>	<u>June 30,</u> <u>2009</u>
Land & water rights	\$ 245,590	\$ -	\$ (2,004)	\$ 243,586
Water supply sources	5,496,651	-	-	5,496,651
Treatment plants	5,697,246	13,306	-	5,710,552
Other improvements	24,952,152	1,469,871	(26,716)	26,395,307
Equipment	2,040,405	88,835	(61,717)	2,067,523
Construction	<u>12,909,284</u>	<u>1,957,830</u>	<u>(1,778,007)</u>	<u>13,089,107</u>
Total property	51,341,328	3,529,842	(1,868,444)	53,002,726
Less: Accumulated				
Depreciation	<u>(15,218,331)</u>	<u>(910,974)</u>	<u>84,597</u>	<u>(16,044,708)</u>
Net property	<u>\$ 36,122,997</u>	<u>\$ 2,618,868</u>	<u>\$ (1,783,847)</u>	<u>\$ 36,958,018</u>

MONTECITO WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2010 AND 2009

NOTE 7: 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, 2010 is 4,847,326, which is net of accumulated amortization of \$3,726,985.

NOTE 8: BONDS PAYABLE

The following is a summary of bond transactions:

	Balance Payable <u>6/30/09</u>	New Bonds Issued	Bonds Retired	Balance Payable <u>6/30/10</u>	<u>Current</u>	<u>Long Term</u>
Certificates	\$ 13,690,000	\$13,360,000	\$13,690,000	\$ 13,360,000	\$ -	\$13,360,000
COMB 2004 Revenue Bonds	110,000			110,000	35,000	75,000
Total	\$ 13,800,000	\$13,360,000	\$13,690,000	\$13,470,000	\$ 35,000	\$13,435,000

Bonds payable at June 30, 2010 and 2009 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 \$4,400 and \$5,538 was reported for the year ending June 30, 2010 and June 30, 2009 respectively.

MONTECITO WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2010 AND 2009

NOTE 8: BONDS PAYABLE (Continued)

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, 2010 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 \$599,795 and \$699,800 for the years ended June 30, 2010 and 2009, respectively. On April 8, 2010, the District refinanced the 1998 Revenue COPs with the 2010A Refunding Revenue COPs

2010A Refunding Revenue Certificates of Participation:

\$13,360,000 2010A refunding revenue certificates of participation were issued in 2010 for the purpose of refinancing the 1998A Revenue Certificates of Participation. Payments of interest only are due through 2022. Scheduled annual interest payments are \$690,463 for the years ending June 30, 2011 through June 30, 2022. Annual principal payments of \$1,385,000 to \$1,990,000 plus interest are due beginning for the year ending June 30, 2023 and end June 30, 2027 with a true interest cost of 5.25% over the life of the bonds.

Resolutions #1978 and #2065 and #2010-1, authorizing the issuance of the COMB revenue bonds and the 1998A Certificates of Participation, respectively, require the District to comply with the following:

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, 2010 and 2009.

The annual requirements to amortize all bond debt outstanding as of June 30, 2010, including interest payments, are as follows:

MONTECITO WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2010 AND 2009

NOTE 8: BONDS PAYABLE (Continued)

Year Ended June 30	Principal	Interest	Total
2011	\$35,000	\$ 693,463	\$ 728,463
2012	40,000	691,863	731,863
2013	35,000	690,463	725,463
2014	-	690,463	690,463
2015	-	690,463	690,463
2016-2020	-	3,452,313	3,452,313
2021-2025	4,375,000	3,022,063	7,397,063
2026-2030	8,985,000	992,775	9,977,775
	<u>\$13,470,000</u>	<u>\$10,923,866</u>	<u>\$ 24,393,866</u>

NOTE 9 LOANS PAYABLE

The following is a summary of loan transactions:

	Balance Payable 6/30/09	Loan Proceeds	Loan Payments	Balance Payable 6/30/10	Current	Long Term
DWR Bella Vista Loan	\$ 1,563,174	\$ -	\$ 268,790	\$ 1,294,384	\$ 275,634	\$1,018,750
DWR Cater Loan	2,954,631	-	152,110	2,802,522	155,957	2,646,565
DWR Ortega Loan	9,236,659	-	-	9,236,658	360,535	8,876,123
Total	<u>\$ 13,754,464</u>	<u>\$ -</u>	<u>\$ 420,900</u>	<u>\$ 3,333,564</u>	<u>\$ 792,126</u>	<u>\$12,541,438</u>

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

MONTECITO WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2010 AND 2009

NOTE 9: LOANS PAYABLE (Continued)

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, 2010 and 2009 was \$1,294,384 and \$1,563,174, 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, 2010 is \$2,802,522 and at June 30, 2009 is \$2,954,631. 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 2.5132%. Payments of interest only will be made until July 1, 2010, when principal and interest payments will begin. The District will be required to fund its share of a reserve

MONTECITO WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2010 AND 2009

NOTE 9: LOANS PAYABLE (Continued)

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

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, 2010 and 2009 was \$9,236,658 and \$9,236,959 respectively.

The annual requirements to amortize all loans outstanding as of June 30, 2010, including interest payments, are as follows:

Year Ended June 30	Principal	Interest	Total
2011	\$ 792,126	\$ 328,976	\$ 1,121,102
2012	811,892	309,210	1,121,102
2013	832,151	288,951	1,121,102
2014	852,916	268,186	1,121,102
2015	721,566	246,903	968,469
2016-2020	3,077,893	1,001,444	4,079,337
2021-2025	3,487,101	592,077	4,079,178
2026-2030	2,757,919	194,178	2,952,097
	<u>\$ 13,333,564</u>	<u>\$ 3,229,925</u>	<u>\$ 16,563,489</u>

NOTE 10: 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. In November, 2010, the District paid the capital lease in full.

NOTE 11: 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

MONTECITO WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2010 AND 2009

NOTE 11: JOINT POWERS INSURANCE AUTHORITY (Continued)

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 12: 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.

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 13: 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

MONTECITO WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2010 AND 2009

contract with CalPERS and adopts those benefits through local ordinance. CalPERS issues a separate comprehensive annual financial report. Copies of the CalPERS' annual

NOTE 12: DEFERRED COMPENSATION PLAN (Continued)

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 2009/10 was 12.486%. The contribution rate is established and may be amended by CalPERS.

Annual Pension Cost

For fiscal year 2009/10, the District's annual pension cost was \$225,663 and the District actually contributed \$225,663. The required contribution for fiscal year 2009/10 was determined as part of the June 30, 2007 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

Fiscal Year <u>Ending</u>	Annual Pension <u>Cost (APC)</u>	Percentage of APC <u>Contributed</u>	Net Pension <u>Obligation</u>
6/30/08	\$ 207,734	100%	\$ -
6/30/09	\$ 234,781	100%	\$ -
6/30/10	\$ 225,663	100%	\$ -

MONTECITO WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2010 AND 2009

NOTE 14: OTHER POST-EMPLOYMENT BENEFITS

In addition to pension benefits described in Note 13, the District provides post-employment benefit options for health, dental and eye care to eligible retirees. 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 2010 expenses (net of participant contributions) of \$14,081 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.

During the fiscal year ended June 30, 2010, the District implemented GASB Statement No. 45, which changed the accounting and financial reporting used by local government employers for post employment benefits. Previously, the costs of such benefits were generally recognized as expenses of local government employers on a pay-as-you-go basis. The new reporting requirements for these benefit programs as they pertain to the District are set forth below.

Plan Description - Benefits

The District offers post employment medical benefits to retired employees who satisfy the eligibility rules. Retirees may enroll in any plan available through the District's CalPERS medical. The contribution requirements of Plan members and the District are established and may be amended by the Board of Directors.

Funding Policy

The District is required to contribute the *Annual Required Contribution (ARC) of the Employer*, an amount actuarially determined in accordance with the parameters of GASB Statement No. 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover the normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years. The current ARC rate is 35.0% of the annual covered payroll.

The District will pay 100% of the cost of the post-employment benefit plan. The District funds the plan on a pay-as-you-go basis and maintains reserves (and records a liability) for the difference between pay-as-you-go and the actuarially determined ARC cost.

MONTECITO WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2010 AND 2009

NOTE 14: OTHER POST-EMPLOYMENT BENEFITS (Continued)

Annual Costs

For the year ended June 30, 2010, the District's ARC cost is \$84,285. The District's net OPEB payable obligation amounted to \$144,729 for the year ended June 30, 2010. The District contributed \$14,081 in age adjusted contributions for current retiree OPEB premiums for the year ended June 30, 2010.

The balance at June 30 consists of the following:

Annual OPEB expense	<u>2010</u>	<u>2009</u>	<u>2008</u>
Annual required contribution (ARC)	\$84,285	\$84,285	*
Interest on net OPEB obligation	-	-	
Adjustment to annual required contribution	-	-	
Total Annual OPEB Expense	84,285	84,285	
Change in net OPEB payable obligation:			
Age adjusted contributions made			
Total change in net OPEB payable obligation	<u>(14,081)</u>	<u>(9,760)</u>	
OPEB payable - beginning of year	74,525	-	
OPEB payable - end of year	<u>\$144,729</u>	<u>\$74,525</u>	

Three-Year History of Net OPEB Obligation

Fiscal Year Ended	Annual OPEB Cost	Age Adjusted Contribution	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation Payable
2010	\$84,285	\$14,081	16.7%	\$144,729
2009	\$84,285	\$ 9,760	11.6%	\$ 74,525
2008	*	-	-	-

* The information for this year is unavailable
GASB 45 was implemented in the fiscal year 2010

MONTECITO WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2010 AND 2009

NOTE 14: OTHER POST-EMPLOYMENT BENEFITS (Continued)

Required Supplemental Information – Schedule of Funding Progress

Fiscal Year Ended	Actuarial Value of Plan Assets	Actuarial Accrued Liability	Unfunded Actuarial Accrued Liability	Funded Ratio	Covered Payroll	UAAL as a Percentage of Covered Payroll
	(a)	(b)	(b-a)	(a/b)	(c)	((b-a)/c)
2010	\$ -	\$14,081	\$144,729	0%	\$1,951,959	7.4%
2009	\$ -	\$ 9,760	\$ 74,525	0%	\$1,998,647	3.7%
2008	\$ -	\$ -	\$ -	0%	\$ -	N/A

The most recent valuation (dated February 28, 2009) includes an Actuarial Accrued Liability and Unfunded Actuarial Accrued Liability of \$144,729. There are no plan assets because the District funds on a pay-as-you-go basis. No trend information is reported because the year ended June 30, 2010, is the first year the District implemented GASB 45. The covered payroll (annual payroll of active employees covered by the plan) for the year ended June 30, 2010 was \$1,951,959. The ratio of the unfunded actuarial accrued liability to annual covered payroll is 7.4%.

Actuarial Methods and Assumptions

Actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of events far into the future. Actuarially determined amounts are subject to continual revision as actual results are compared to past expectations and new estimates are made about the future. Calculations are based on the types of benefits provided under the terms of the substantive plan at the time of each valuation and the pattern of sharing of costs between the employer and plan members to that point. Consistent with the long-term perspective of actuarial calculations, actuarial methods and assumptions used include techniques that are designed to reduce short-term volatility in actuarial accrued liabilities for benefits.

The following is a summary of the actuarial assumptions and methods:

Valuation date	February 28, 2009
Actuarial cost method	Entry age normal cost method
Amortization method	Level percent of payroll amortization
Remaining amortization period	30 Years as of the valuation date
Asset valuation method	30 Year smoothed market
Actuarial assumptions:	
Investment rate of return	5.00%
Projected salary increase	3.00%
Inflation - discount rate	3.50%
Individual salary growth	District annual COLA

MONTECITO WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2010 AND 2009

NOTE 15: 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 \$6,020 at June 30, 2010 and \$6,020 at June 30, 2009. 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 16: 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, 2010 AND 2009

NOTE 16: COMMITMENTS (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

Participation in State Water Project (Continued)

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 from amounts transferred from the Construction and Reserve Funds upon completion of

MONTECITO WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2010 AND 2009

NOTE 16: COMMITMENTS (Continued)

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.

Participation in State Water Project (Continued)

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>Fiscal Year</u>	<u>Fixed Costs</u>	<u>Variable Costs</u>	<u>Debt Service</u>	<u>Total</u>
2011	\$ 2,707,492	\$ 878,799	\$ 2,030,229	\$ 5,616,520
2012	2,836,027	881,735	2,036,339	5,754,101
2013	2,886,633	881,736	2,044,306	5,812,675
2013	2,988,713	848,904	2,034,336	5,871,953
2015	3,125,762		2,033,299	5,159,061
2016-20	15,474,418		10,143,660	25,618,078
2021-25	15,791,541		4,040,573	19,832,114
2026-30	15,459,010			15,459,010
2031-35	14,240,100			14,240,100
2035-36	1,646,452			1,646,452
	<u>\$ 77,156,148</u>	<u>\$ 3,491,174</u>	<u>\$ 24,362,742</u>	<u>\$105,010,064</u>

The above numbers are estimated based upon the following assumptions. The fixed costs after 2011 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, 2010 and 2009 was \$680,302 and \$688,672, respectively. The

MONTECITO WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2010 AND 2009

NOTE 16: COMMITMENTS (Continued)

Participation in State Water Project (Continued)

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 17: 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 18: 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, 2010 and 2009:

MONTECITO WATER DISTRICT
NOTES TO FINANCIAL STATEMENTS
JUNE 30, 2010 AND 2009

	<u>2010</u>	<u>2009</u>
Debt Repayment	\$ 8,527,548	\$ 7,655,357
Capital Repair and Replacement	4,045,009	4,045,009
Working Capital	2,326,447	3,044,500
Emergency	1,000,000	1,000,000
Water Purchase and Rate Stabilization Reserve	1,050,000	1,050,000
Debt Retirement and Capital Replacement Reserve	500,000	500,000
Total	<u>\$ 17,449,004</u>	<u>\$ 17,294,866</u>

NOTE 19: CONTINGENCIES

A proposed reorganization of the water district service boundaries between the Montecito and the Carpinteria Valley Water District is being petitioned by nine landowners to the Local Agency Formation Commission (LAFCO). MWD does not support this petition however if the petitioners succeed, it is estimated that the MWD will see an annual drop in revenues of over \$225,000.

A lawsuit has been filed against the District by a district customer regarding the reclassification of water use on his property resulting in a change in the cost of water. This District will defend itself against this lawsuit with legal costs expected to be greater than \$100,000. All costs in the defense of this lawsuit will be taken from Operating Reserves.

Required Supplementary Information

MONTECITO WATER DISTRICT
REQUIRED SUPPLEMENTARY INFORMATION
FOR THE YEARS ENDED JUNE 30, 2010 AND 2009

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, 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%
June 30, 2007	\$ 2,391,434	\$ 2,611,747	\$ 220,313	91.6%	\$ 665,523	33.1%
June 30, 2008	\$ 2,581,858	\$ 2,780,281	\$ 198,423	92.9%	\$ 688,607	28.9%

POINDEXTER & COMPANY

Certified Public Accountant

To the Board of Directors of
Montecito Water District

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, 2010 and 2009, and have issued my report thereon dated October 7, 2010. 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.

A deficiency in internal control 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 and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

My consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. I consider the following deficiencies to be material weaknesses 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.

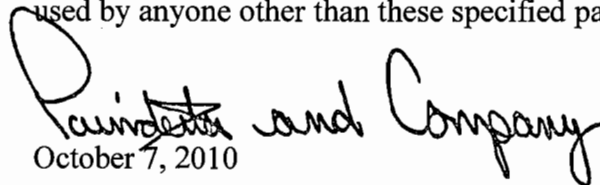
A material misstatement in the financial statements was noted for the period under audit that was not identified by the District's internal control, however that misstatement has been corrected in the audited financial statements.

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 7, 2010.

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.


October 7, 2010