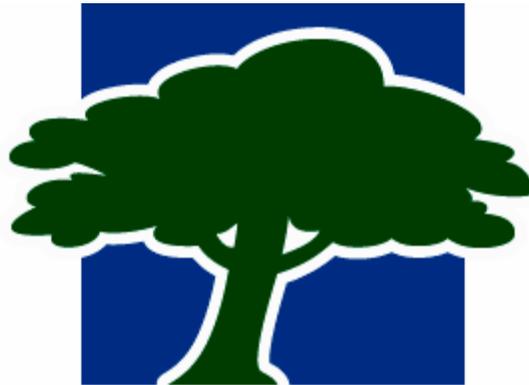


COMPREHENSIVE ANNUAL
FINANCIAL REPORT
FOR THE YEAR ENDED DECEMBER 31, 2005

FAIR OAKS WATER DISTRICT — Fair Oaks, California





**FAIR OAKS
WATER DISTRICT**

Fair Oaks, California

**COMPREHENSIVE ANNUAL
FINANCIAL REPORT**

**YEAR ENDED
DECEMBER 31, 2005**

*Prepared By
Finance Department*

FAIR OAKS WATER DISTRICT
COMPREHENSIVE ANNUAL FINANCIAL REPORT
December 31, 2005

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INTRODUCTORY SECTION



March 10, 2006

The Board of Directors
Fair Oaks Water District

The Fair Oaks Water District (“District”) hereby submits the Comprehensive Annual Financial Report (CAFR) for the year ending December 31, 2005. Responsibility for both the accuracy of the presented data and the completeness and fairness of the presentation, including all disclosures, rests with management. To the best of our knowledge and belief, the enclosed data is accurate in all material aspects and is reported in a manner designed to fairly present the financial positions and results of operations of the District. All disclosures necessary to enable the reader to gain an understanding of the District’s financial activities have been included.

The Comprehensive Annual Financial Report is presented in three sections: introductory, financial, and statistical. The introductory section includes the letter of transmittal, the District’s organization chart, and a list of principal officials. The financial section includes the management discussion and analysis which should be read in conjunction with the transmittal letter. The financial statements, schedules, and independent auditor’s report on these financial statements and schedules are included on the financial section of the report. The statistical section includes selected unaudited financial information of the District.

This report includes all funds, agencies, boards, commissions, and authorities that are financially accountable to the District’s Board of Directors. Financial accountability was determined on the basis of budget adoption, imposition of will, funding, and appointment of governing board. Based upon these criteria, the Fair Oaks Water District Financing Corporation (the Financing Corporation) is considered a component unit of the District. The Financing Corporation provides specific financial benefits or imposes specific financial burdens on the District in regards to proceeds from certificates of participation used for capital outlay.

District History and Service Description

Fair Oaks Water District was originally formed as the Fair Oaks Irrigation District in 1917. By 1979, residential development in the community had replaced all significant agricultural land; therefore, the board of directors passed a resolution declaring “irrigation district” no longer described the District’s actual functions and changed the name to Fair Oaks Water District. Even with the name change, the District is legally structured as an irrigation district operating under the California Water Code, Division 11.

The District is a retail water agency supplying water to a population of approximately 40,000 people on approximately 6,000 acres in Fair Oaks and a small portion of Orangevale. The District purchases most of its water from San Juan Water District (“San Juan”) as treated water, and delivers it to approximately 13,540 residential and commercial service connections. Additionally, the District maintains seven groundwater wells, 180 miles of pipeline, and a three million gallon water storage facility.

Mission Statement

The District’s mission statement is as follows: “Our mission is to provide our community with an adequate and reliable supply of water, exceeding all drinking water standards, at the lowest practicable cost. Our watchword is excellence. We operate in a responsive, professional, environmentally responsible manner, balancing immediate and long-term needs. The District strives to provide leadership in the community, and in regional water resource activities.”

Economic Condition and Outlook

Fair Oaks is primarily a residential bedroom community, with some commercial enterprises within its boundaries, located in Sacramento County in Northern California. The District area is almost built out; therefore, the District does not depend upon new growth to maintain revenue. Based on actual results from prior years, the District is forecasting a slow but steady revenue increase of 20 new system connections per year from the demand for semi-custom housing in the Fair Oaks area.

Revenues from residential accounts are based upon flat rate billing with a plan to convert the accounts to metered rates in 2011. During 2002 commercial customers were converted from a flat rate to a metered rate, which decreased the revenues for commercial accounts. To mitigate the forecasted future decline in revenues from account conversions to metered rates, the District has implemented a rate stabilization fund. Given this planning effort, the future financial stability of the District is positive relative to projected revenues.

The District continues the practice of establishing and maintaining reserves and designations to offset expected and unexpected significant expense fluctuations encountered year to year.

The Fair Oaks Water District and its wholesale water supplier continue to encounter changes in operations due to new regulations. The impact of current and future regulations and the resetting cost on water supply operations are an ongoing challenge for District management. The District used the best available data at the time of its budget preparation to forecast the impact of the regulatory environment on operational costs on the 2006 budget as adopted on December 19, 2005.

Significant Projects and Future Plans

Meters

On September 28, 1999 the Reed Consulting Group presented the Fair Oaks Water District's Meter Implementation Plan at a regularly scheduled Board meeting. The plan presented was the result of an advisory group process and included a section on Financial Planning. The financial recommendations of the report were to consider issuing Certificates of Participation (COP) within five years and the establishment of a financial reserve account for future rate stabilization. Since the report was completed, District leadership decided not to borrow money for meter installations at this time, with an intent to install all meters with District's funds at the rate of approximately \$1.5 million a year.

The District will invest approximately \$10.6 million in 1999 dollars to install meters and appurtenant hardware. During 2005, the District installed 816 meters as part of the meter implementation plan. As of December 31, 2005, the District has installed approximately 7,895 meters and has approximately 5,705 existing service connections that require meters to be installed. To expedite the metering installation, the District intends to use all of its crew to install meters in 2006 while contracting out non-emergency water main projects. Mandatory-metered rates for residential customers will go into effect after all residential meters are installed.

Infrastructure and Water Delivery

The District continues to repair and replace aging infrastructure throughout its system. As part of this process, the District completed design of the North Winding Way water main replacement project in 2005. In addition, the District began design and construction of the Heather Well and Town Well groundwater storage and recovery projects in 2005. The Town Well, Heather Well, and North Winding Way projects are all scheduled for completion in 2006. Additional projects scheduled for 2006 include:

- Replace 1,800 lineal feet of six-inch steel water main installed in 1954 with 12-inch C-900 water main at an estimated cost approximately \$200,700 (Timothy and Sunset).
- Watkins Drive water main replacement/extension estimated to cost \$231,000.

The District has deferred the following scheduled 2005 projects:

- Replace one mile of pipeline water main C-900 at Hazel Avenue, estimated cost of \$1,000,000.

Customer Service and Administration

The District completed the implementation of its new accounting system, Microsoft Great Plains and its billing system, Cogsdale in 2005.

To increase the quality of service to the public, as well as accommodate internal needs, the District is considering alternative options for its administrative and operations facilities. The existing facilities do not meet current building codes or accessibility requirements, are cramped, poorly ventilated, worn and poorly lit, making it increasingly difficult for the District's employees to adequately serve customers. Furthermore, preliminary structural investigations indicate the building does not meet current seismic or wind loading requirements. After reviewing several options, an architect's report recommended demolishing the existing structure, constructing a new building and reorganizing the existing site, as the most cost effective, long-term solution. The preliminary estimated cost of a new building ranged from \$2,000,000 to \$3,000,000 and was budgeted in 2004 and 2005. The District incurred \$5,480 in the building costs in 2005 and has budgeted \$550,000 for design and permitting in 2006. The District anticipates completing the construction of the building within the next two years.

Water Conservation

Conservation is an integral component of District's operations. Conservation is governed by local, state, and federal programs, such as those outlined by the: California Urban Water Conservation Council (CUWCC), Water Forum Agreement, and the U.S. Bureau Reclamation Central Valley Project Improvement Act. The District's objective is to implement water conservation best management practices (BMPs) in an efficient, cost effective and positive manner.

The District has developed the following proactive water efficiency outreach programs:

- Water-wise house calls; onsite water efficiency reviews that provide information on efficient water application at the specific property.
- The District toilet incentive rebate program; offered in partnership with the Sacramento Regional County Sanitation District and Regional Water Authority.
- Large landscape reviews; offered in conjunction with a grant from the U.S. Bureau of Reclamation and Proposition 13 through the Regional Water Authority Large Landscape Irrigation System Incentive Program.
- The Water Conservation School Poster Contest program. This program reaches out to grades 4 through 6 within the District, stressing an annual water conservation theme.
- Public outreach through community events such as: the Sacramento Convention Center Landscape Exposition, local Home and Garden Shows, Fair Oaks Fiesta Days, Get W.E.T. sponsored in part with the Bureau of Reclamation, Fair Oaks Harvest Day events and the Department of Fish and Games Salmon Festival.

These programs are designed to raise water conservation awareness among our customers and increase water supply available to the District.

Regional Planning

In early 1998, the District and other water utilities north of the American River initiated an effort to study and evaluate projects and programs for using surface water and groundwater resources better, particularly during supply shortages. This conjunctive use effort generally calls for the use of surface water from lakes and rivers in wet periods, while storing underground water supplies for later, when surface waters are needed for environmental purposes. As a follow up effort to the Sacramento region's *Water Forum Agreement*, participating members are motivated to plan for and meet the greater Sacramento areas' water needs to the year 2030, especially in drought years.

Two separate pilot studies have been undertaken to test conjunctive use concepts in the Sacramento groundwater basin; one with the Sacramento Area Flood Control Agency, and one program with the CALFED Environmental Water Account. Both programs are deemed a success in understanding hydrologic and hydraulic operations, while addressing regulatory, governmental and institutional constraints. In 2002, seven water utilities, including the District, sought and received grant funds from Proposition 13 in the amount of nearly \$23 million to construct and install groundwater storage and extraction facilities that advance conjunctive use strategies. The Proposition 13 grant requires a 50% local cost share proportionate to the partnering agency benefit. As previously discussed, the District will use these funds to construct groundwater storage and recovery facilities in 2006. The success of the Proposition 13 grant is a testament to the District's participation in recent regional cooperation efforts and joint planning, serving as a basis for future partnering efforts.

Financial Information

Internal Control

Management is responsible for establishing and maintaining an internal control structure designed to ensure its assets are protected from loss, theft, or misuse and to ensure adequate accounting data is compiled to allow for the preparation of financial statements in conformity with generally accepted accounting principles. The internal control structure is designed to:

- (1) provide reasonable, but not absolute, assurance these objectives are met;
- (2) transactions are executed in accordance with management's authorization; and
- (3) transactions are recorded properly.

The concept of reasonable assurance recognizes:

- (1) the cost of the control should not exceed the benefits likely to be derived; and
- (2) the evaluation of costs and benefits requires estimates and judgments by management.

Budgetary Control

While the District is not mandated to prepare budgets by State law, the District does prepare budgets as a matter of policy and financial control. The budget is a financial plan for detailing operating expenses, capital infrastructure investments, debt obligations, designations and reserves. For the year ending December 31, 2005, the budget was adopted November 19, 2003.

The financial plan establishes project priorities based upon District goals, policies and water distribution needs. The budget is developed following these steps:

- Assess current conditions and needs, including system quality and safety;
- Develop goals, objectives, policies, and plans based upon the assessment;
- Prioritize projects and develop work programs, based upon short-term and long-term cost effectiveness; and
- Prepare a plan to evaluate the effectiveness and shortcomings of the budget.

The budget is prepared on a cash basis, which differs from the basis used in preparing financial statements in conformity with generally accepted accounting principles (GAAP). The District staff works with a budget committee, which extensively reviews the proposed budget. The proposed budget is then presented to the board of directors for comments, suggestions, and feedback prior to notifying District customers.

The District notifies customers 45 days in advance of the public hearing and also holds public workshops designed to provide extensive budget information prior to the public hearing date. The District follows a very extensive and open budget process. The process is designed to educate and inform customers about the District's financial operations and requirements. The District adopts its budget at a Public Hearing. The adopted budget is then used as a management tool for projecting and measuring revenues and expenses for a ten to fifteen year planning horizon.

Cash Management

The District complies with published investment policies and the provisions of the State statutes pertaining to the types of investments held. The District's cash, except for small amounts on hand for paying current expenses and amounts held with fiscal agents, is deposited in the State of California's Local Agency Investment Fund. Cash surpluses in these accounts are invested and investment earnings are allocated to the District's funds on the basis of average daily cash balances. Amounts held with fiscal agents are invested according to permitted investments outlined in official statements.

Risk Management

The District participates in the Association of California Water Agency Joint Powers Insurance Authority (ACWA JPIA), a pooled self-insurance group. The District purchases its property, general liability, and automobile insurance from ACWA JPIA. Additionally, all contractors doing work for the District are required to furnish certificates of insurance for general liability, automobile liability, and workers' compensation and indemnification clauses.

The District also purchases worker's compensation insurance through Association of California Water Agency Joint Powers Insurance Authority (ACWA JPIA). The District's experience modification rate for the year beginning July 1, 2005 is 86%. The District has a

defined safety program, holding monthly safety and training sessions as well as on the spot training sessions to ensure employees conduct their work in a safe manner.

Other Information

Independent Audit

California Government Code Section 26909 requires independent annual audits to be conducted for special districts. Richardson & Company has been selected to conduct the annual audit. The auditor's report is included in the financial section of the Comprehensive Annual Financial Report.

Awards and Acknowledgements

The preparation of the comprehensive annual financial report on a timely basis requires the dedicated efforts of several staff members. We wish to express our appreciation to all District staff and managers who contributed to this report. Additionally, thank you to the Fair Oaks Water District Board of Directors for their interest and support in planning and conducting the financial operation of the District. The preparation of this report could not have been accomplished without the combined effort of the District leadership, Richardson & Company and staff.

The District received a certificate of achievement for excellence in financial reporting from the Government Finance Officers Association of the United States and Canada for year ended December 31, 2004.

Respectfully submitted,



Tom R. Gray
General Manager



Chi Ha-Ly
Senior Financial Analyst

Certificate of Achievement for Excellence in Financial Reporting

Presented to

Fair Oaks Water District,
California

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
December 31, 2004

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.



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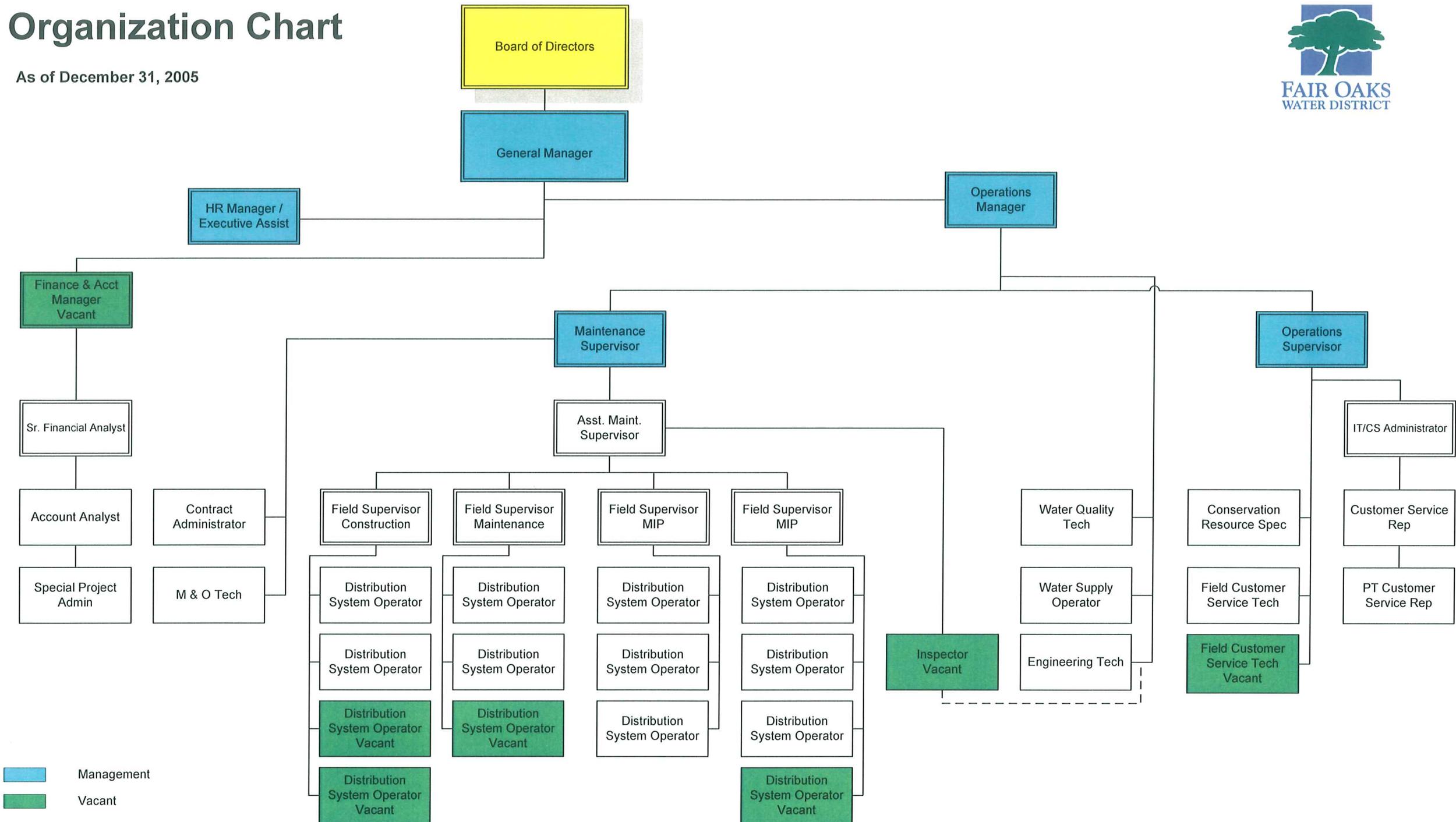
Tom R. Gray
General Manager

Michael Nisenboym
Operations Manager

Chi Ha-Ly
Senior Financial Analyst

Organization Chart

As of December 31, 2005



Management
 Vacant



FINANCIAL SECTION

Richardson & Company

550 Howe Avenue, Suite 210
Sacramento, California 95825

Telephone: (916) 564-8727
FAX: (916) 564-8728

INDEPENDENT AUDITOR'S REPORT

**To the Board of Directors
Fair Oaks Water District
Fair Oaks, California**

We have audited the accompanying balance sheets of the Fair Oaks Water District as of December 31, 2005 and 2004 and the related statements of revenues, expenses and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the District's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes 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 the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the District as of December 31, 2005 and 2004 and the results of its operations and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis, as listed in the accompanying table of contents, is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued a report thereon dated February 27, 2006 on our consideration of the District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, and contracts. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit

To the Board of Directors
Fair Oaks Water District

performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The Additional Information listed in the table of contents is presented for the purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

The Introductory and Statistical Sections listed in the table of contents are presented for purposes of additional analysis and is not a required part of the basic financial statements. Such additional information has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on it.

Richardson & Company

February 27, 2006

**MANAGEMENT'S DISCUSSION
AND ANALYSIS**

MANAGEMENT'S DISCUSSION AND ANALYSIS

As management of the Fair Oaks Water District (the District), we offer the readers of the District financial statements this narrative overview and analysis of the financial activities for the District for the year ended December 31, 2005. We encourage readers to consider the information presented here in conjunction with additional information that we have furnished in our letter of transmittal and the audited financial statements.

Financial Highlights

- The assets of the District exceeded its liabilities at the close of the most recent fiscal year by \$27,180,807 (net assets). Of this amount, \$11,189,727 of unrestricted net assets may be used to meet the District's ongoing obligations to citizens and creditors.
- The District has designated \$8.8 million dollars for future investment in capital assets.
- The District has invested \$1.4 million dollars of unrestricted net assets in water capacity entitlements.
- The District's total net assets increased by \$3,327,553.
- The District's total debt decreased by \$750,075 during the fiscal year due to scheduled principal payments.
- Water sales increased by \$628,498, while other operating revenues increased by \$122,985 during the fiscal year.
- Maintenance and Operation costs had a net decrease of \$131,723 and customer service, administration and general costs had a net decrease of \$163,133.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the District's basic financial statements which are comprised of the financial statements and the notes to the financial statements. This report also contains other supplementary information in addition to the basic financial statements themselves.

Financial Statements

The financial statements are designed to provide readers with a broad overview of the District's finances, in a manner similar to a private-sector business. The revenues and expenses for 2003 and 2004 have been reclassified to conform to the 2005 presentation.

The statement of net assets presents information on all of the District's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the District's financial position is improving or deteriorating.

The statement of revenues, expenses and changes in net assets presents information showing how net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of related cash flows. Thus, revenues and expenses are reported

in this statement for some items that will only result in cash flows in future fiscal periods (i.e. uncollected water sales and amounts due to vendors).

Since the District's primary function is to provide water delivery to its customers, with recovery of all the costs through user fees and charges, the financial statements only include business-type activities.

The accounts of the District are organized on the basis of fund accounting. A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. Because the District provides water delivery and recovers these costs through user fees and charges, the District's funds are accounted for as an enterprise fund type of the proprietary fund group.

The District has determined that the Fair Oaks Water District Financing Corporation (Financing Corporation) meets the requirements for inclusion within the financial reporting entity and has, therefore, included the Financing Corporation as a blended component unit in the District's financial statements.

The financial statements can be found on pages 12 to 15.

Notes to Financial Statements

The notes provide additional information that is essential to a full understanding of the financial data provided in the financial statements. The notes to the financial statements can be found on pages 16 to 31 of this report.

Other Information

In addition to the basic financial statements and accompanying notes, this report also presents certain supplementary information regarding the District's debt service rate covenant compliance. This information can be found on page 32. The report also includes a statistical section of selected financial information over a 10 year period. This information can be found on pages 35 to 37 of this report.

Financial Analysis

As noted earlier, net assets may serve as a useful indicator of a government's financial position over time. In the case of the District, assets exceeded liabilities by \$27,180,807 at the close of the most recent fiscal year.

The largest portion of the District's net assets (51 percent) reflects its investment in capital assets (e.g., land, buildings, machinery, and equipment), less any related debt and unused proceeds used to acquire those assets that are still outstanding. The District uses these capital assets to provide water service delivery to its users. Consequently, these assets are not available for future spending. Although the District's investment in its capital assets is reported net of related debt, resources are needed to repay this debt and must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

Fair Oaks Water District Net Assets

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Current assets	\$14,558,485	\$12,157,565	\$12,092,814
Other assets	3,276,531	3,392,030	3,507,529
Capital assets	<u>17,063,510</u>	<u>16,444,818</u>	<u>14,966,397</u>
Total assets	<u>34,898,526</u>	<u>31,994,413</u>	<u>30,566,740</u>
Long-term liabilities	\$ 4,004,554	\$ 4,763,211	\$ 5,483,979
Other liabilities	<u>3,713,165</u>	<u>3,377,948</u>	<u>3,129,316</u>
Total liabilities	7,717,719	8,141,159	8,613,295
Net assets:			
Invested in capital assets,			
Net of related debt	13,938,510	12,744,821	10,711,397
Restricted	2,052,570	1,389,828	1,230,338
Unrestricted	<u>11,189,727</u>	<u>9,718,605</u>	<u>10,011,710</u>
Total net assets	<u>\$27,180,807</u>	<u>\$23,853,254</u>	<u>\$21,953,445</u>

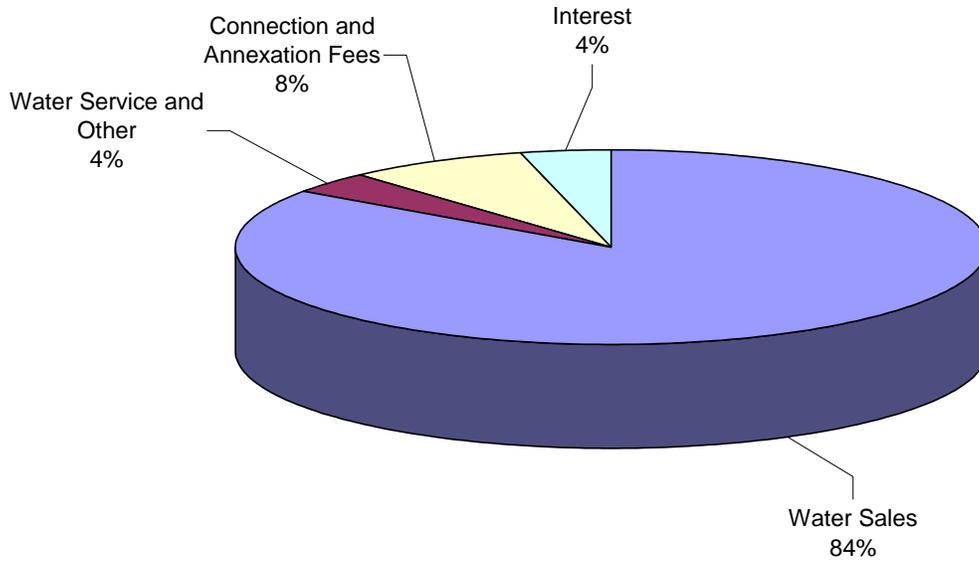
The remaining increase in net assets is largely due to increases in water sales to pay for ongoing and future anticipated capital asset replacement.

A portion of the District's net assets (approximately 8 percent) represents resources that are subject to external restrictions on how they may be used. Of the unrestricted portion, another 12 percent of the District's net assets have been invested in water pipeline capacity entitlements (see footnote D). The District has also designated \$8.8 million dollars for future investment in capital assets (see footnote F).

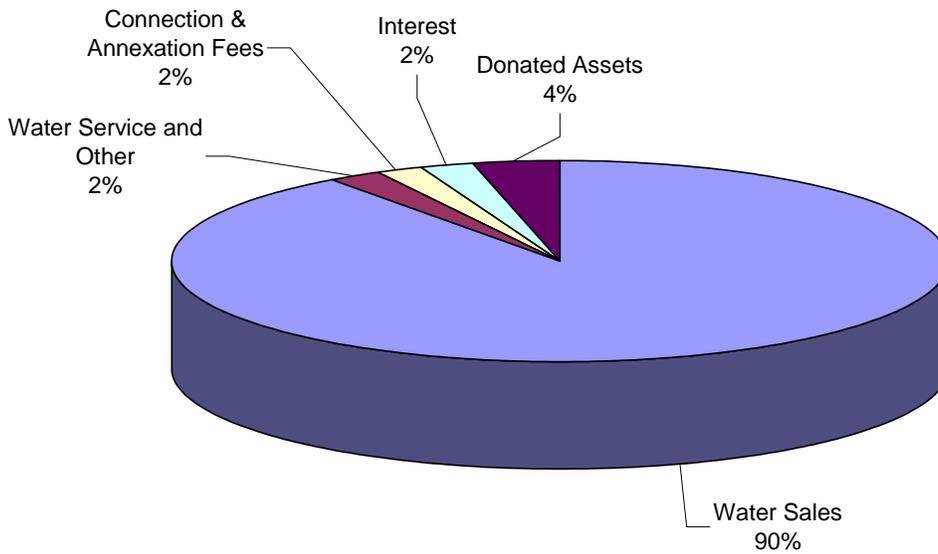
Fair Oaks Water District Changes in Net Assets

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Operating Revenues:			
Water Sales	\$7,681,395	\$7,052,897	\$6,569,055
Water Service	146,794	57,657	126,630
Other	<u>111,354</u>	<u>77,506</u>	<u>136,757</u>
Total Operating Revenues	7,939,543	7,188,060	6,832,442
Non-Operating Revenues:			
Interest Revenue	354,769	170,533	192,194
Grants	78,257	30,000	
(Loss) Gain on Disposal of Capital Assets	<u>12,190</u>	<u>(4,614)</u>	<u>10,709</u>
Total Non-Operating Revenues	445,216	195,919	202,903
Capital Revenues:			
Contributed Assets	8,000	289,839	504,800
Connections and Annexation Fees	<u>695,200</u>	<u>158,188</u>	<u>263,323</u>
Total Capital Revenues	703,200	448,027	768,123
Total Revenues	9,087,959	7,832,006	7,803,468
Operating Expenses:			
Water Supply and Pumping	1,285,208	1,333,038	1,066,372
Operations and Maintenance	1,653,915	1,785,638	1,496,583
Customer Service, Administrative and General	1,146,809	1,309,942	1,248,202
Depreciation and Amortization	<u>1,441,207</u>	<u>1,279,989</u>	<u>1,219,006</u>
Total Operating Expenses	5,527,139	5,708,607	5,030,163
Non-Operating Expenses:			
Interest Expense	<u>233,267</u>	<u>223,590</u>	<u>233,010</u>
Total Non-Operating Expenses	233,267	223,590	233,010
Total Expenses	5,760,406	5,932,197	5,263,173
Increase in net assets	3,327,553	1,899,809	2,540,295
Net assets January 1	<u>23,853,254</u>	<u>21,953,445</u>	<u>19,413,150</u>
Net assets December 31	<u>\$27,180,807</u>	<u>\$23,853,254</u>	<u>\$21,953,445</u>

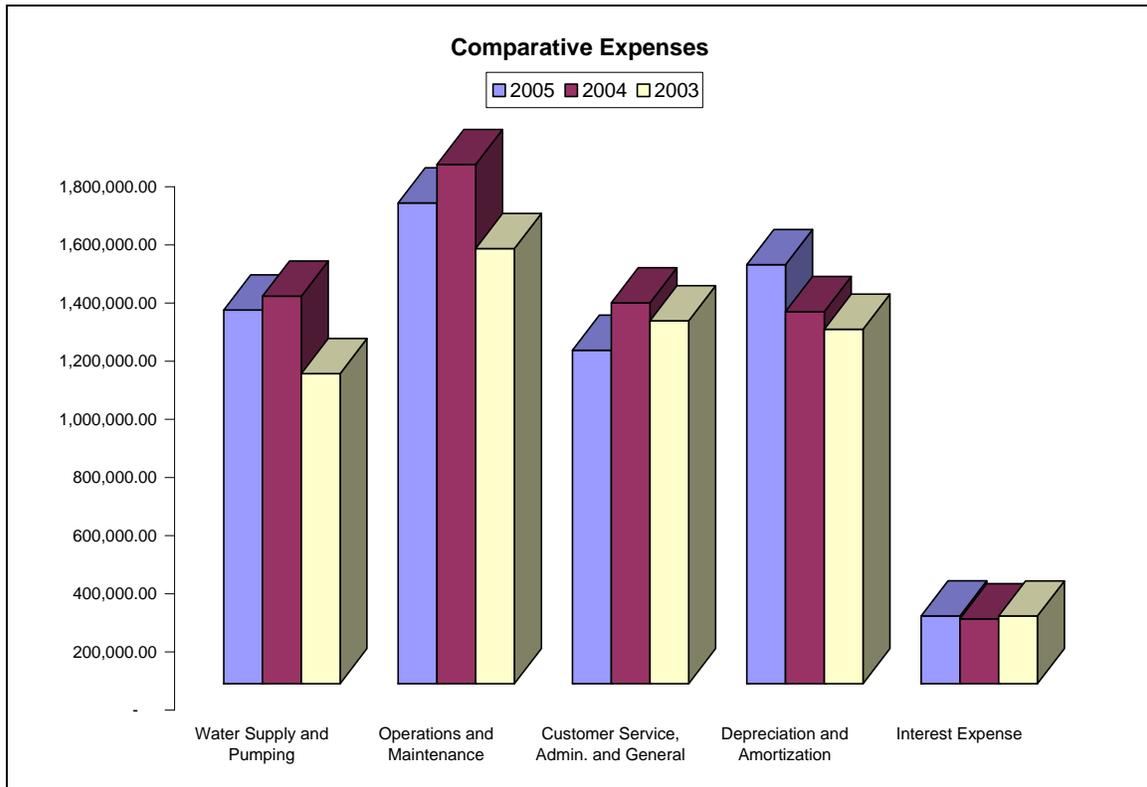
2005 Revenues by Source



2004 Revenues by Source



- Water sales increased by \$628,498 (9 percent) in 2005 and by \$483,842 (7 percent) in 2004. The District increased water rates in 2005 by 10 percent and in 2004 by 10 percent.
- Interest income increased by \$184,236 in 2005 and decreased by \$ 21,661 in 2004 due to a market interest rates fluctuation.



- The net decrease of \$131,723 in operations and maintenance expenses in 2005 includes a decrease in system maintenance and repairs of \$81,413; a decrease in vehicle repairs and maintenance of \$17,099; a decrease in training of \$12,385 and a decrease in utilities of \$12,636.
- Customer service, administration and general expenses had a net decrease of \$163,133 in 2005. There were decreases in legal fees and settlements of \$78,280; regional support of \$11,215; and remaining \$73,638 were mainly savings from salaries from unfilled positions, travel and training and from conservation program.
- Water supply costs decreased by \$30,399 due to lower water demand by the District.

Capital Asset and Debt Administration

The District's investment in capital assets as of December 31, 2005, amounts to \$17,063,510 (net of accumulated depreciation). This investment in capital assets includes land, buildings, system and distribution construction and improvements, machinery and equipment, wells, tanks, office equipment, and vehicles. The total net increase in investment in capital assets for the current fiscal year was four percent.

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

- The District began construction on Heather and Town Wells. The District incurred expenses totaling \$126,513 for both wells (\$65,921 for Heather and \$60,592 for Town Wells). The District expects to receive \$63,257 (50% reimbursement) from grant funding. The District anticipates completing the well projects in 2006 with the projected remaining costs of \$3.8 million.
- The District installed 816 meters and 2,979 AMR (Automated Radio Reads) units on customer service connections at a cost of approximately \$1.48 million as part of the metering implementation program (MIP).
- The District incurred \$29,475 of cost on North Winding Way project in 2005. The estimated cost to complete the project is \$370,000.
- Approximately \$145,000 was spent on various individual service line and hydrant upgrades in 2005.
- The District purchased one Dump Truck for \$67,270 in 2005.
- The administrative building was budgeted in 2005 for \$1,500,000 in building costs, but only \$5,480 was expended. The project was deferred to 2006.

Fair Oaks Water District Capital Assets, net of depreciation

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Capital Assets, not being depreciated:			
Land	\$323,961	\$323,961	\$ 323,961
Construction in Progress	<u>229,929</u>	<u>54,214</u>	<u>245,500</u>
Total Capital Assets, not being depreciated	<u>553,890</u>	<u>378,175</u>	<u>569,461</u>
 Capital Assets, being depreciated:			
Wells and Pumps	69,492	82,020	61,914
Transmission and Distribution System	11,395,551	10,486,664	9,173,869
Maintenance Equipment	41,168	52,410	57,950
Trucks, Trailers, and Mobile Equipment	386,857	460,708	330,388
Buildings	121,278	132,339	121,787
Office Equipment and Furnishings	258,474	357,879	179,431
Contributed Distribution Systems	4,034,269	4,254,733	4,188,529
Water Tank and Pumping	202,531	239,890	283,068
Total Capital Assets, being depreciated	<u>16,509,620</u>	<u>16,066,643</u>	<u>14,396,936</u>
 Total	 <u>\$17,063,510</u>	 <u>\$16,444,818</u>	 <u>\$14,966,397</u>

Additional information on the capital assets can be found in Note C on pages 24 to 25 of this report.

Long-Term Debt

At the end of the current fiscal year, the District had total debt outstanding of \$4,862,712. Of this amount, \$3,125,000 is comprised of certificates of participation debt secured solely by pledged water revenues. These certificates were issued to advance refund of outstanding 1989 and 1991 certificates of participation. The reacquisition price of the 1999 certificates compared to the net carrying value of the 1989 and 1991 certificates is netted against the liability and is systematically amortized over the remaining life of the refinanced certificates. The remaining debt represents a capacity entitlement agreement between the District and San Juan Water District for the District to pay a portion of principal and interest payments related to San Juan's certificates of participation debt for to the acquisition of capacity water rights in a transmission pipeline.

	<u>2005</u>	<u>2004</u>	<u>2003</u>
Certificates of Participation	\$3,125,000	\$3,700,000	\$4,255,000
Capacity Entitlement Agreement	<u>1,737,712</u>	<u>1,912,787</u>	<u>2,119,525</u>
Total Debt	4,862,712	5,612,787	6,374,525
Unamortized Difference	<u>(173,544)</u>	<u>(202,467)</u>	<u>(231,390)</u>
Total	<u>\$4,869,168</u>	<u>\$5,410,320</u>	<u>\$6,143,135</u>

Total debt decreased during the fiscal year by \$750,075 due to payments of scheduled principal made during the year. The District maintains an “AAA” rating by Moody’s and “AAA” rating by Fitch and Standard & Poor’s on the certificates of participation debt. Additional information on the District’s long-term debt can be found in Note E on pages 26 to 28 of this report.

Economic Factors and assumptions in preparing the 2006 Budget and Rates

- The unemployment rate for the greater Sacramento County in which the District resides averaged 4.1% in 2005, down from an average 6.2 % in 2004.
- The District is largely built out, serving approximately 13,540 customers, adding an average of 20 new customers a year.
- Inflationary trends in the region are comparable to national indices.
- The District continues to face increasing regulatory requirements that ultimately add new costs to delivering the water service (i.e. security measures, new water quality tests, etc.)
- There will be no rate increases in 2006.
- Health benefit costs are expected to increase another 10% in 2006.
- The District must continue to install water meters for its residential customers to meet the Federal and State mandates. In order to meet the time deadline, the District plans to install 1,141 meters in 2006. These costs are extensive and factored into the budget.
- The District intends to use the reserve to fund for the shortfall of expenses in 2006.

All of these factors were considered in preparing the District’s budget for the 2006 fiscal year.

Requests for Information

This financial report is designed to provide a general overview of the District’s finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to Senior Financial Analyst, Fair Oaks Water District, 10317 Fair Oaks Boulevard, Fair Oaks, CA 95628.

BASIC FINANCIAL STATEMENTS

FAIR OAKS WATER DISTRICT

BALANCE SHEETS

December 31, 2005 and 2004

	2005	2004
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 11,335,598	\$ 9,936,750
Restricted cash and cash equivalents	2,052,570	1,389,828
Accounts receivable	170,293	55,928
Water service receivable	162,212	149,544
Interest receivable	110,595	63,392
Inventory	577,963	234,067
Prepaid expenses	149,254	328,056
TOTAL CURRENT ASSETS	14,558,485	12,157,565
NON-CURRENT ASSETS		
Dues on deposit	77,928	80,678
Capital assets, net	17,063,510	16,444,818
Unamortized bond expenses, net	83,057	96,900
Capacity entitlements, net	3,115,546	3,214,452
TOTAL NON-CURRENT ASSETS	20,340,041	19,836,848
TOTAL ASSETS	\$ 34,898,526	\$ 31,994,413
LIABILITIES		
CURRENT LIABILITIES		
Accounts payable	\$ 315,835	\$ 223,716
Accrued expenses	10,204	5,683
Accrued payroll expense	103,569	85,582
Accrued interest expense	51,347	24,798
Deposits	15,500	11,975
Deferred revenue	2,442,910	2,276,119
Current portion of long-term debt	773,800	750,075
TOTAL CURRENT LIABILITIES	3,713,165	3,377,948
LONG-TERM LIABILITIES		
Long-term debt	3,915,368	4,660,245
Compensated absences	89,186	102,966
TOTAL LONG-TERM LIABILITIES	4,004,554	4,763,211
TOTAL LIABILITIES	7,717,719	8,141,159
NET ASSETS		
Invested in capital assets, net of related debt	13,938,510	12,744,821
Restricted:		
Connection and annexation fees	1,392,095	731,481
Certificates of participation	660,475	658,347
Unrestricted	11,189,727	9,718,605
TOTAL NET ASSETS	27,180,807	23,853,254
TOTAL LIABILITIES AND NET ASSETS	\$ 34,898,526	\$ 31,994,413

The accompanying notes are an integral part of these financial statements

FAIR OAKS WATER DISTRICT

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

For the years ended December 31, 2005 and 2004

	2005	2004
OPERATING REVENUES		
Water sales	\$ 7,681,395	\$ 7,052,897
Water service	146,794	57,657
Other	111,354	77,506
TOTAL OPERATING REVENUES	7,939,543	7,188,060
OPERATING EXPENSES		
Water supply and pumping	1,285,208	1,333,038
Operations and maintenance	1,653,915	1,785,638
Customer service, administrative and general	1,146,809	1,309,942
Depreciation and amortization	1,441,207	1,279,989
TOTAL OPERATING EXPENSES	5,527,139	5,708,607
NET INCOME FROM OPERATIONS	2,412,404	1,479,453
NON-OPERATING REVENUES (EXPENSES)		
Interest revenue	354,769	170,533
Grant revenue	78,257	30,000
Gain (loss) on disposal of capital assets	12,190	(4,614)
Interest expense	(233,267)	(223,590)
TOTAL NON-OPERATING REVENUES (EXPENSES)	211,949	(27,671)
NET INCOME BEFORE CAPITAL CONTRIBUTIONS	2,624,353	1,451,782
CAPITAL CONTRIBUTIONS		
Contributed assets	8,000	289,839
Connection and annexation fees	695,200	158,188
TOTAL CAPITAL CONTRIBUTIONS	703,200	448,027
CHANGE IN NET ASSETS	3,327,553	1,899,809
Net assets at beginning of year	23,853,254	21,953,445
NET ASSETS AT END OF YEAR	\$ 27,180,807	\$ 23,853,254

The accompanying notes are an integral part of these financial statements.

FAIR OAKS WATER DISTRICT

STATEMENTS OF CASH FLOWS

For the years ended December 31, 2005 and 2004

	<u>2005</u>	<u>2004</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash receipts from customers	\$ 8,046,083	\$ 7,423,989
Cash paid to suppliers	(2,266,608)	(2,588,344)
Cash paid to employees	(1,883,571)	(1,983,957)
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>3,895,904</u>	<u>2,851,688</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Proceeds from disposal of capital assets	12,190	4,093
Principal payments on long-term debt	(750,075)	(761,738)
Interest payments on long-term debt	(177,795)	(169,869)
Grants received	15,000	
Connection and annexation fees received	695,200	158,188
Purchases of capital assets	(1,939,150)	(2,364,529)
NET CASH USED BY RELATED FINANCING ACTIVITIES	<u>(2,144,630)</u>	<u>(3,133,855)</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest received	307,566	148,626
Dues on deposit received	2,750	2,750
NET CASH PROVIDED BY INVESTING ACTIVITIES	<u>310,316</u>	<u>151,376</u>
NET CHANGE IN CASH AND CASH EQUIVALENTS	2,061,590	(130,791)
Cash and cash equivalents at beginning of year	<u>11,326,578</u>	<u>11,457,369</u>
CASH AND CASH EQUIVLENTS AT END OF YEAR	<u>\$ 13,388,168</u>	<u>\$ 11,326,578</u>
COMPONENTS OF CASH AND CASH EQUIVALENTS		
Cash and equivalents	\$ 11,335,598	\$ 9,936,750
Restricted cash and cash equivalents	<u>2,052,570</u>	<u>1,389,828</u>
TOTAL CASH AND CASH EQUIVALENTS	<u>\$ 13,388,168</u>	<u>\$ 11,326,578</u>

(Continued)

FAIR OAKS WATER DISTRICT

STATEMENTS OF CASH FLOWS

For the years ended December 31, 2005 and 2004

	<u>2005</u>	<u>2004</u>
RECONCILIATION OF NET INCOME FROM OPERATIONS TO		
NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Net income from operations	\$ 2,412,404	\$ 1,479,453
Adjustments to reconcile net income from operations to net cash provided by operating activities:		
Depreciation and amortization	1,441,207	1,279,989
Changes in assets and liabilities:		
Accounts receivable	(51,108)	43,069
Water service receivable	(12,668)	(7,844)
Inventory	(343,896)	(77,908)
Prepaid expenses	178,802	(100,952)
Accounts payable	92,119	(16,808)
Accrued expenses	4,521	51,601
Accrued payroll expense	17,987	
Deposits	3,525	(125)
Deferred revenue	166,791	200,829
Compensated absences	(13,780)	384
NET CASH PROVIDED BY OPERATING ACTIVITIES	<u>\$ 3,895,904</u>	<u>\$ 2,851,688</u>
SUPPLEMENTAL DISCLOSURE OF NON-CASH ACTIVITIES		
Receipt of contributed assets	\$ 8,000	\$ 289,839

The accompanying notes are an integral part of these financial statements.

FAIR OAKS WATER DISTRICT

NOTES TO THE BASIC FINANCIAL STATEMENTS

December 31, 2005 and 2004

NOTE A--REPORTING ENTITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The basic financial statements of the Fair Oaks Water District (the District) have been prepared in conformity with generally accepted accounting principles as applied to government units. The Governmental Accounting Standards Board (GASB) is the accepted standard setting body for establishing governmental accounting and financial reporting principles. As allowed by the GASB, the District has elected not to apply to its proprietary activities Financial Accounting Standards Board Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins of the Committee of Accounting Procedures issued after November 30, 1989. The more significant of the District's accounting policies are described below.

Reporting Entity: The District was formed March 26, 1917 under the provisions of the California Water Code. The District is governed by a five member Board of Directors elected by the voters within the District for staggered, four-year terms, every two years. The District provides water to retail customers in the Fair Oaks area. The accompanying basic financial statements present the District and its component unit. The component unit discussed below is included in the District's reporting entity because of the significance of its operational and financial relationship with the District.

The District has created the Fair Oaks Water District Financing Corporation (the Financing Corporation) to provide assistance to the District in the issuance of debt. Although legally separate from the District, the Financing Corporation is reported as if it were part of the primary government because it shares a common Board of Directors with the District and its sole purpose is to provide financing to the District under the debt issuance documents of the District. Debt issued by the Financing Corporation is reflected as debt of the District in these financial statements. The Financing Corporation has no other transactions and does not issue separate financial statements.

Jointly Governed Organization: The District is a signatory to the Regional Water Authority's (the RWA) Joint Powers Agreement, formally known as Sacramento Metropolitan Water Authority. The mission of the RWA is to serve and represent the regional water supply interest, and to assist the members of the RWA in protecting and enhancing the reliability, availability, affordability and quality of water resources. The goals of the RWA are to assist in voluntary consolidation of services provided by existing industry associations; develop and provide subscription-based support services; and coordinate and implement regional water master planning, grant-funding acquisition, and related planning efforts.

The RWA carries out its missions and goals, yet does not exercise governing or regulatory authority over its members. The relationship between the District and the RWA is such that the RWA is not a component unit of the District for financial reporting purposes. Additionally, the District does not have an ongoing financial responsibility to the RWA and therefore is considered a jointly governed organization. Separate financial statements are available from RWA.

FAIR OAKS WATER DISTRICT

NOTES TO THE BASIC FINANCIAL STATEMENTS (Continued)

December 31, 2005 and 2004

NOTE A--REPORTING ENTITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Basis of Presentation--Fund Accounting: The District's resources are allocated to and accounted for in these basic financial statements as an enterprise fund type of the proprietary fund group. The enterprise fund is used to account for operations that are financed and operated in a manner similar to private business enterprises, where the intent of the governing body is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges, or where the governing body has decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other policies. Net assets for the enterprise fund represents the amount available for future operations.

Basis of Accounting: The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. The enterprise fund type is accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities associated with the operation of this fund are included on the balance sheet. Net assets is segregated into amounts invested in capital assets, net of related debt, amounts restricted and amounts unrestricted. Enterprise fund type operating statements present increases (i.e., revenues) and decreases (i.e., expenses) in net total assets.

The District uses the accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred. Earned but unbilled water services are accrued as revenue. Water lines are constructed by private developers and then dedicated to the District, which is then responsible for their future maintenance. These lines are recorded as capital contributions when they pass inspection by the District and the estimated costs are capitalized as part of the distribution system.

Operating revenues and expenses consists of those revenues and expenses that result from the ongoing principal operations of the District. Operating revenues consist primarily of charges for services. Non-operating revenues and expense consist of those revenues and expenses that are related to financing and investing types of activities and result from nonexchange transactions or ancillary activities.

When both restricted and unrestricted resources are available for use, it is the District's policy to use restricted resources first, then unrestricted resources as they are needed.

Budgetary Principles: The Board of Directors does not operate under any legal budgeting constraints. Budget integration is employed as a management control device. Budgets are formally adopted by the Board and take effect on each January 1.

FAIR OAKS WATER DISTRICT

NOTES TO THE BASIC FINANCIAL STATEMENTS (Continued)

December 31, 2005 and 2004

NOTE A--REPORTING ENTITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Use of Estimates: The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents: For purposes of the statement of cash flows, the District considers all highly liquid debt instruments purchased with an initial maturity of three months or less to be cash equivalents, including restricted assets. Cash in banks, deposits in the State of California Local Agency Investment Fund (LAIF) and deposits with fiscal agents are considered to be cash and cash equivalents.

Water Service Receivable and Deferred Revenue: Customers that are invoiced on a flat rate basis have the options of making payments annually, semi-annually, or bimonthly. Advanced collections on water services invoiced in the current year for service in the following year are recorded as deferred revenue since these collections have not been earned as of December 31. Customers who are invoiced on a metered basis receive their bills bimonthly in arrears of the service provided. Unpaid amounts as of December 31 are recorded as water service receivable. Water invoices that remain unpaid when the new water invoices are issued may have a lien placed on the property.

Capital Assets: Capital assets are recorded at historical cost. Contributed assets are valued at estimated fair value on the date received. Depreciation is calculated using the straight line method over the following estimated useful lives:

<u>Description</u>	<u>Estimated Life</u>
Wells and Pumps	5-30 years
Transmission and distribution system	30 years
Maintenance Equipment	5-30 years
Trucks, Trailers, and Mobile Equipment	5-10 years
Buildings	5-30 years
Office Equipment and Furnishings	3-5 years
Contributed distribution systems	30 years
Water Tank and Pumping	5-10 years

Maintenance and repairs are charged to operations when incurred. It is the District's policy to capitalize all capital assets with a cost of \$500 or more. Costs of assets sold or retired (and the related amounts of accumulated depreciation) are eliminated from the balance sheet in the year of sale or retirement, and the resulting gain or loss is recognized in operations.

FAIR OAKS WATER DISTRICT

NOTES TO THE BASIC FINANCIAL STATEMENTS (Continued)

December 31, 2005 and 2004

NOTE A--REPORTING ENTITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Inventory: Inventories are stated at the lower of cost, on a first-in, first-out method, or market. Inventories consist of materials and supplies.

Issuance Costs: Bond issuance costs are deferred and amortized over the life of the bonds. Bond issuance costs are reported as unamortized bond expenses, a component of Other Assets.

Compensated Absences: The District's policy allows employees to accumulate earned but unused vacation and administrative leave which will be paid to employees upon separation from the District's service, subject to a vesting policy. The cost of vacation and administrative leave is recorded in the period accrued.

Reclassifications: Certain reclassifications have been made to the 2004 financial statements to conform to the current presentation. These reclassifications had no effect on previously reported change in net assets.

NOTE B--CASH AND INVESTMENTS

Cash and investments as of December 31, 2005 and 2004 are classified in the accompanying financial statements as follows:

	<u>2005</u>	<u>2004</u>
Cash and cash equivalents	\$ 11,335,598	\$ 9,936,750
Restricted cash and cash equivalents	<u>2,052,570</u>	<u>1,389,828</u>
Total cash and investments	<u>\$ 13,388,168</u>	<u>\$ 11,326,578</u>

Cash and investments as of December 31, 2005 and 2004 consisted of the following:

	<u>2005</u>	<u>2004</u>
Cash on hand	\$ 950	\$ 602
Deposits with financial institutions	<u>1,691,788</u>	<u>483,835</u>
Total cash	<u>1,692,738</u>	<u>484,437</u>

FAIR OAKS WATER DISTRICT

NOTES TO THE BASIC FINANCIAL STATEMENTS (Continued)

December 31, 2005 and 2004

NOTE B--CASH AND INVESTMENTS (Continued)

	<u>2005</u>	<u>2004</u>
Mutual funds	\$ 594	\$ 663
Investments in Local Agency Investment Fund (LAIF)	<u>11,694,836</u>	<u>10,841,478</u>
Total investments	<u>11,695,430</u>	<u>10,842,141</u>
 Total cash and cash equivalents	 <u>\$ 13,388,168</u>	 <u>\$ 11,326,578</u>

Investment policy: California statutes authorize districts to invest idle or surplus funds in a variety of credit instruments as provided for in the California Government Code, Section 53600, Chapter 4 - Financial Affairs. The table below identifies the investment types that are authorized for the District by the California Government Code (or the District's investment policy, where more restrictive) that address interest rate risk, credit risk, and concentration of credit risk. This table does not address investments of debt proceeds held by the bond trustee that are governed by the provisions of debt agreements of the District, rather than the general provisions of the California Government Code or the District's investment policy. During the year ended December 31, 2005, the District's permissible investments included the following instruments:

<u>Authorized Investment Type</u>	<u>Maximum Maturity</u>	<u>Maximum Percentage Of Portfolio *</u>	<u>Maximum Investment In One Issuer</u>
Local Agency Bonds	5 years	None	None
U.S. Treasury Obligations	5 years	None	None
U.S. Agency Securities	5 years	None	None
Bankers Acceptances	180 days	40%	30%
Commercial Paper	270 days	25%	10%
Negotiable Certificates and Time Deposits	5 years	30%	None
Repurchase Agreements	92 days	20%	None
Medium Term Corporate Notes	5 years	30%	None
Mutual Funds	N/A	20%	10%
LAIF	N/A	None	None

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

The District complied with the provisions of the California Government Code pertaining to the types of investments held, the institutions in which deposits were made and the security requirements. The District will continue to monitor compliance with applicable statutes pertaining to public deposits and investments.

FAIR OAKS WATER DISTRICT

NOTES TO THE BASIC FINANCIAL STATEMENTS (Continued)

December 31, 2005 and 2004

NOTE B--CASH AND INVESTMENTS (Continued)

Investments Authorized by Debt Agreements: Investment of debt proceeds held by the bond trustee are governed by provisions of the debt agreements, rather than the general provisions of the California Government Code or the District's investment policy. The 1999 Revenue Certificates of Participation debt agreement contains certain provisions that address interest rate risk and credit risk, but not concentration of credit risk.

<u>Authorized Investment Type</u>	<u>Maximum Maturity</u>	<u>Maximum Percentage Of Portfolio</u>	<u>Maximum Investment In One Issuer</u>
Local Agency Bonds	None	None	None
U.S. Treasury Obligations	None	None	None
U.S. Agency Securities	None	None	None
Bankers Acceptances	360 days	None	None
Commercial Paper	270 days	None	None
Negotiable Certificates Deposits	None	None	None
Investment Agreements	None	None	None
Repurchase Agreements	None	None	None
Mutual Funds	N/A	None	None
LAIF	N/A	None	None

Interest rate risk: Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. Information about the sensitivity of the fair values of the District's investments (including investments held by bond trustee) to market interest rate fluctuations is provided by the following table that shows the distribution of the District's investments by maturity:

	<u>Total</u>	<u>Remaining Maturity 12 Months or less</u>
LAIF	\$ 11,034,955	\$ 11,034,955
Held by bond trustee:		
LAIF	659,881	659,881
Mutual funds	<u>594</u>	<u>594</u>
Total	<u>\$ 11,695,430</u>	<u>\$ 11,695,430</u>

FAIR OAKS WATER DISTRICT

NOTES TO THE BASIC FINANCIAL STATEMENTS (Continued)

December 31, 2005 and 2004

NOTE B--CASH AND INVESTMENTS (Continued)

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

	<u>Total</u>	<u>Minimum Legal Rating</u>	<u>Ratings as of Year End AAA</u>	<u>Not Rated</u>
LAIF	\$ 11,034,955	N/A		\$ 11,034,955
Held by bond trustee:				
LAIF	659,881	N/A		659,881
Mutual funds	<u>594</u>	AAA	<u>\$ 594</u>	<u> </u>
Total	<u>\$ 11,695,430</u>		<u>\$ 594</u>	<u>\$ 11,694,836</u>

Concentration of Credit Risk: The investment policy of the District limits the amount that can be invested in any one issuer to the California Government Code. There are no investments in any one issuer (other than external investment pools) that represent 5% or more of total District investments.

Custodial credit risk: Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty (e.g., broker-dealer) to a transaction, a government will not be able to recover the value of its investment or collateral securities that are in the possession of another party. The California Government Code and the District's investment policy do not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits, other than the following provision for deposits: The California Government Code requires that a financial institution secure deposits made by state or local governmental units by pledging securities in an undivided collateral pool held by a depository regulated under state law (unless so waived by the governmental unit). The market value of the pledged securities in the collateral pool must equal at least 110% of the total amount deposited by the public agencies. California law also allows financial institutions to secure public agency deposits by pledging first trust deed mortgage notes having a value of 150% of the secured public deposits.

FAIR OAKS WATER DISTRICT

NOTES TO THE BASIC FINANCIAL STATEMENTS (Continued)

December 31, 2005 and 2004

NOTE B--CASH AND INVESTMENTS (Continued)

At December 31, 2005, the carrying amount of the District's deposits were \$1,691,788 and the balances in financial institutions was \$1,769,269. Of the balance in financial institutions, \$100,000 was covered by federal depository insurance and \$1,669,269 was collateralized as required by State law (Government Code Section 53630), by the pledging financial institution with assets held in a common pool for the District and other governmental agencies, but not in the name of the District.

Investment in LAIF: LAIF is stated at amortized cost, which approximates fair value. The LAIF is a special fund of the California State Treasury through which local governments may pool investments. The total amount invested on December 31, 2005 by all public agencies in LAIF is \$57,674,819,766 managed by the State Treasurer. Of that amount, 97.1 percent is invested in non-derivative financial products and 2.9 percent in derivative financial products and structured financial instruments. The Local Investment Advisory Board (Board) has oversight responsibility for LAIF. The Board consists of five members as designated by State Statute. The fair value of the District's investment in this pool is reported in the accompanying financial statements at amounts based upon the District's pro-rata share of the fair value provided by LAIF for the entire LAIF portfolio (in relation to the amortized cost of that portfolio). The balance available for withdrawal is based on the accounting records maintained by LAIF, which are recorded on an amortized cost basis.

FAIR OAKS WATER DISTRICT

NOTES TO THE BASIC FINANCIAL STATEMENTS (Continued)

December 31, 2005 and 2004

NOTE C--CAPITAL ASSETS

Capital asset activity for the years ended December 31, 2005 and 2004 are as follows:

	Balance January 1 <u>2005</u>	<u>Additions</u>	<u>Disposals</u>	Transfers And <u>Adjustments</u>	Balance December 31 <u>2005</u>
Capital assets not being depreciated					
Land	\$ 323,961				\$ 323,961
Construction in progress	<u>54,214</u>	\$ 175,715	_____	_____	<u>229,929</u>
Total capital assets not being depreciated	378,175	175,715			553,890
Capital assets being depreciated:					
Wells and pumps	1,151,968	4,194			1,156,162
Transmission and distribution system	16,942,172	1,605,870			18,548,042
Maintenance equipment	201,257	7,378			208,635
Trucks, trailers and mobile equipment	1,131,635	68,321			1,199,956
Buildings	692,316	9,840			702,156
Office equipment and furnishings	892,513	63,357	\$ (38,269)		917,601
Contributed distribution system	6,853,935	8,000			6,861,935
Water tank and pumping	<u>411,771</u>	<u>4,521</u>	_____	_____	<u>416,292</u>
Total capital assets being depreciated	28,277,567	1,771,481	(38,269)		30,010,779
Less accumulated depreciation for:					
Wells and pumps	\$ (1,069,948)	\$ (16,722)			\$ (1,086,670)
Transmission and distribution system	(6,455,508)	(696,983)			(7,152,491)
Maintenance equipment	(148,847)	(18,620)			(167,467)
Trucks, trailers and mobile equipment	(670,927)	(142,172)			(813,099)
Buildings	(559,977)	(20,901)			(580,878)
Office equipment and furnishings	(534,634)	(162,762)	\$ 38,269		(659,127)
Contributed distribution system	(2,599,202)	(228,464)			(2,827,666)
Water tank and pumping	<u>(171,881)</u>	<u>(41,880)</u>	_____	_____	<u>(213,761)</u>
Total accumulated depreciation	<u>(12,210,924)</u>	<u>(1,328,504)</u>	<u>38,269</u>		<u>(13,501,159)</u>
Total capital assets being depreciated, net	<u>16,066,643</u>	<u>442,977</u>	_____	_____	<u>16,509,620</u>
Capital assets, net book value	<u>\$ 16,444,818</u>	<u>\$ 618,692</u>	<u>\$ _____</u>	<u>_____</u>	<u>\$ 17,063,510</u>

FAIR OAKS WATER DISTRICT

NOTES TO THE BASIC FINANCIAL STATEMENTS (Continued)

December 31, 2005 and 2004

NOTE C--CAPITAL ASSETS (Continued)

	<u>Balance</u> <u>January 1</u> <u>2004</u>	<u>Additions</u>	<u>Disposals</u>	<u>Transfers</u> <u>And</u> <u>Adjustments</u>	<u>Balance</u> <u>December 31,</u> <u>2004</u>
Capital assets not being depreciated					
Land	\$ 323,961				\$ 323,961
Construction in progress	<u>245,500</u>	<u>\$ 13,124</u>		<u>\$ (204,410)</u>	<u>54,214</u>
Total capital assets not being depreciated	569,461	13,124		(204,410)	378,175
Capital assets being depreciated:					
Wells and pumps	1,153,580		\$ (1,612)		1,151,968
Transmission and distribution system	15,001,825	1,735,937		204,410	16,942,172
Maintenance equipment	223,058	23,364	(35,468)	(9,697)	201,257
Trucks, trailers and mobile equipment	910,172	247,137	(35,371)	9,697	1,131,635
Buildings	663,157	34,020	(4,861)		692,316
Office equipment and furnishings	662,029	310,948	(80,464)		892,513
Contributed distribution system	6,564,096	289,839			6,853,935
Water tank and pumping	<u>411,771</u>				<u>411,771</u>
Total capital assets being depreciated, net	25,589,688	2,641,245	(157,776)	204,410	28,277,567
Less accumulated depreciation for:					
Wells and pumps	(1,091,666)	20,106	1,612		(1,069,948)
Transmission and distribution system	(5,827,956)	(627,552)			(6,455,508)
Maintenance equipment	(165,108)	(20,693)	36,954		(148,847)
Trucks, trailers and mobile equipment	(579,784)	(116,320)	25,177		(670,927)
Buildings	(541,370)	(18,607)			(559,977)
Office equipment and furnishings	(482,598)	(132,500)	80,464		(534,634)
Contributed distribution system	(2,375,567)	(223,635)			(2,599,202)
Water tank and pumping	<u>(128,703)</u>	<u>(48,039)</u>	<u>4,861</u>		<u>(171,881)</u>
Total accumulated depreciation	<u>(11,192,752)</u>	<u>(1,167,240)</u>	<u>149,068</u>		<u>(12,210,924)</u>
Total capital assets being depreciated, net	<u>14,396,936</u>	<u>1,474,005</u>	<u>(8,708)</u>	<u>204,410</u>	<u>16,066,643</u>
Capital assets, net book value	<u>\$14,966,397</u>	<u>\$ 1,487,129</u>	<u>\$ (8,708)</u>		<u>\$ 16,444,818</u>

FAIR OAKS WATER DISTRICT

NOTES TO THE BASIC FINANCIAL STATEMENTS (Continued)

December 31, 2005 and 2004

NOTE D--CAPACITY ENTITLEMENTS

In 1993, the District participated with four other water districts in a cooperative transmission pipeline project for the construction of additional transmission pipeline facilities. As a result of this project, the District participated with San Juan Water District (SJWD) to finance their share of the pipeline costs. The District's share of these pipeline costs totaled \$3,956,248. The Capacity Entitlements asset represents the capacity rights the District has purchased in the cooperative transmission pipeline project with SJWD. The asset will be amortized over the pipeline's estimated useful life of forty years. At December 31, 2005 and 2004, accumulated amortization was \$840,702 and \$741,796, respectively. In addition, the District has entered into an agreement with SJWD to pay for its share of these transmission pipeline facilities costs (see Note E).

NOTE E--LONG-TERM DEBT

The activity of the District's long-term debt during the years ended December 31, 2005 and 2004 are as follows:

	Balance January 1, <u>2005</u>	<u>Additions</u>	<u>Repayments</u>	Balance December 31, <u>2005</u>	Due Within <u>One Year</u>
1999 Revenue Certificates of Participation	\$ 3,700,000		\$ (575,000)	\$ 3,125,000	\$ 595,000
Capacity entitlement agreement	<u>1,912,787</u>		<u>(175,075)</u>	<u>1,737,712</u>	<u>178,800</u>
Total	5,612,787		<u>\$ (750,075)</u>	4,862,712	<u>\$ 773,800</u>
Deferred amount on refunding	(202,467)			(173,544)	
Less: Current portion of long-term debt	<u>(750,075)</u>			<u>(773,800)</u>	
	<u>\$ 4,660,245</u>			<u>\$ 3,915,368</u>	

FAIR OAKS WATER DISTRICT

NOTES TO THE BASIC FINANCIAL STATEMENTS (Continued)

December 31, 2005 and 2004

NOTE E--LONG-TERM DEBT (Continued)

	Balance January 1, <u>2004</u>	<u>Additions</u>	<u>Disposals</u>	Balance December 31, <u>2005</u>	Due Within <u>One Year</u>
1999 Revenue Certificates of Participation	\$ 4,255,000		\$ (555,000)	\$ 3,700,000	\$ 575,000
Capacity entitlement agreement	<u>2,119,525</u>		<u>(206,738)</u>	<u>1,912,787</u>	<u>175,075</u>
Total	6,374,525		<u>\$ (761,738)</u>	5,612,787	<u>\$ 750,075</u>
Deferred amount on refunding	(231,390)			(202,467)	
Less: Current portion of long-term debt	<u>(761,738)</u>			<u>(750,075)</u>	
	<u>\$ 5,381,397</u>			<u>\$ 4,660,245</u>	

Long-term debt consists of the following:

1999 Certificates of Participation: On January 13, 1999, the District issued \$6,580,000 of Revenue Certificates of Participation (Certificates) with interest ranging from 3.75% to 4.25%. These 1999 Certificates were issued to advance refund outstanding 1989 and 1991 Certificates. The repayment of the debt is secured by a pledge of and first lien on the revenue of the District's water system. Annual principal payments, ranging from \$270,000 to \$690,000 are due on December 1 through December 1, 2011 and semi-annual interest payments, ranging from \$5,737 to \$63,272 are due on June 1 and December 1 through December 1, 2011. On or after December 1, 2007, the Certificates are subject to prepayment at the option of the District.

The following is a schedule of maturities for the certificates of participation:

Year Ending December 31,	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2006	\$ 595,000	\$ 126,544	\$ 721,544
2007	620,000	103,488	723,488
2008	650,000	78,688	728,688
2009	690,000	52,688	742,688
2010	300,000	24,225	324,225
2011	<u>270,000</u>	<u>11,475</u>	<u>281,475</u>
	<u>\$ 3,125,000</u>	<u>\$ 397,108</u>	<u>\$ 3,522,108</u>

The District is required by its 1999 Revenue Certificates of Participation to collect rates and charges from its water system that will be sufficient to yield net revenues equal to 115% of debt service payments on any future debt issued.

FAIR OAKS WATER DISTRICT

NOTES TO THE BASIC FINANCIAL STATEMENTS (Continued)

December 31, 2005 and 2004

NOTE E--LONG-TERM DEBT (Continued)

The advance refunding of the 1989 and 1991 Certificates of Participation resulted in differences between the reacquisition price and the net carrying amount of the outstanding debt of \$376,005 at December 31, 2005 and 2004, net of accumulated amortization of \$202,461 and \$173,538, respectively. This deferred amount on refunding, reported in the accompanying financial statements as a deduction from long-term debt, is being charged to operations over 13 years.

Capacity entitlement agreement: On November 8, 1993, the District's Board of Directors passed Resolution No. 9313 requesting SJWD to acquire and construct additional pipeline facilities to supplement the existing transmission facilities which served the District. The water rate to be charged to the District, under its contract with SJWD which ends in 2013, will include installment payments relating to Certificates of Participation executed and delivered by SJWD to acquire the project. The District's share of the amount borrowed for the project is \$3,235,163 (37.25%), with interest rates ranging from 2.0% to 4.25%. On or after February 1, 2013, the Certificates with stated maturities on or after February 1, 2014 are subject to prepayment prior to their respective stated maturities.

Future estimated debt requirements for the agreement as of December 31, 2005 are as follows:

Year Ending December 31,	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2006	\$ 178,800	\$ 54,227	\$ 233,027
2007	184,387	49,673	234,061
2008	188,113	43,145	231,258
2009	195,562	36,938	232,500
2010	201,150	31,476	232,626
2011-2013	<u>789,700</u>	<u>51,312</u>	<u>841,012</u>
	<u>\$ 1,737,712</u>	<u>\$ 266,771</u>	<u>\$ 2,004,484</u>

NOTE F--NET ASSETS

Restrictions: Restricted net assets consist of constraints placed on net asset use through external requirements imposed by creditors (such as through debt covenants), grantors, contributors, or laws and regulations of other governments or constraints by law through constitutional provisions or enabling legislation. Restrictions include connection and annexation fees collected for future water system capacity and debt service reserves on the 1999 Certificates of Participation.

FAIR OAKS WATER DISTRICT

NOTES TO THE BASIC FINANCIAL STATEMENTS (Continued)

December 31, 2005 and 2004

NOTE F--NET ASSETS (Continued)

Designations: Designations of unrestricted net assets may be imposed by the Board of Directors to reflect future spending plans or concerns about the availability of future resources. Designations may be modified, amended or removed by Board action. The following is a summary of designated net asset balances at December 31:

	<u>2005</u>	<u>2004</u>
<u>Designated for Emergency</u> : For unanticipated expenditures	\$ 990,531	\$ 913,933
<u>Designated for Fixed Asset Replacement</u> : For future improvements, acquisition and replacement of the water distribution system, well sites, tank sites, vehicles, and equipment as identified in the annual budget and rate process	4,537,290	3,147,594
<u>Designated for Rate Stabilization</u> : To offset the estimated impact of revenue fluctuations and lag effects in converting to meter based billing	1,324,630	1,018,239
<u>Designated for Residential Metering</u> : For budgeted but unexpended amounts for the meter installation program		364,937
<u>Designated Administrative Facility Reserve</u> : For future administrative facility improvements and acquisitions	<u>1,994,520</u>	<u>1,171,960</u>
Total Designated Net Assets	<u>\$ 8,846,971</u>	<u>\$ 6,616,663</u>

NOTE G--EMPLOYEES' RETIREMENT PLAN

Plan Description: The District contributes to the California Public Employees Retirement System (PERS), an agent multiple-employer public employee defined benefit pension plan. PERS provides retirement and disability benefits, annual cost-of-living adjustments and death benefits to plan members and beneficiaries. PERS acts as a common investment and administrative agent for participating public employers within the State of California. All full and part time District employees working at least 1,000 hours per year are eligible to participate in PERS. Under PERS, benefits vest after five years of service. Upon retirement, participants are entitled to an annual retirement benefit, payable for life, in an amount equal to a benefit factor times the monthly average salary of their highest twelve consecutive months full-time equivalent monthly pay. Copies of the PERS annual financial report may be obtained from their Executive Office, 400 P Street, Sacramento, CA 95814.

Funding Policy: Active plan members are required to contribute 7% of their annual covered salary. The District makes the contributions required of District employees on their behalf and for their account. Contributions made on behalf of District employees total \$124,128 and \$112,012 for the years ended December 31, 2005 and 2004, respectively. The District is required to contribute to an actuarially determined rate; the rate for January 1 to June 30, 2005 was zero and for July 1 to December 31, 2005 was 4.44%. The rate for 2004 was zero. The contribution requirements of plan members and the District are established and may be amended by PERS.

FAIR OAKS WATER DISTRICT

NOTES TO THE BASIC FINANCIAL STATEMENTS (Continued)

December 31, 2005 and 2004

NOTE G--EMPLOYEES' RETIREMENT PLAN (Continued)

Annual Pension Cost: For the years ending December 31, 2005, the District incurred an annual pension cost of \$40,861. No annual pension cost was incurred for the year ending December 31, 2004. The required contribution was determined as part of the June 30, 2003 actuarial valuation using entry age actuarial cost method. The actuarial assumptions included (a) 7.75% investment rate of return (net of administrative expenses); (b) projected salary increases that vary in duration of service ranging from 3.25% to 14.45% and (c) 3.25% cost of living adjustment. Both (a) and (b) include an inflation component of 3.0%. The actuarial value of the plan's assets was determined using techniques that smooth the effects of short term volatility in the market value of investments over a three year period (smoothed market value). The plan's excess assets are being amortized as a level percentage of projected payroll on a closed basis. The remaining amortization period at June 30, 2004 was 15 years.

<u>Three-Year Trend Information for the District</u>		
<u>Fiscal</u> <u>Year</u> <u>Ending</u>	<u>Annual</u> <u>Pension</u> <u>Cost (APC)</u>	<u>Percentage</u> <u>Of APC</u> <u>Contributed</u>
December 31, 2003	\$ 0	100%
December 31, 2004	\$ 0	100%
December 31, 2005	\$ 40,861	100%

<u>Required Supplementary Information - Funded Status of Plan</u>						
<u>Actuarial</u> <u>Valuation</u> <u>Date</u>	<u>Actuarial</u> <u>Assets Value</u>	<u>Entry Age</u> <u>Actuarial</u> <u>Accrued</u> <u>Liability</u>	<u>Excess</u> <u>Assets</u> <u>(Unfunded</u> <u>Liability)</u>	<u>Funded</u> <u>Ratio</u>	<u>Covered</u> <u>Payroll</u>	<u>Excess Assets</u> <u>(Unfunded Liability)</u> <u>As a % of</u> <u>Covered Payroll</u>
June 30, 2001	\$4,409,165	\$ 2,936,460	\$ 1,472,705	150.2%	\$ 1,159,141	127.1%
June 30, 2002	4,165,810	3,197,801	968,009	130.3%	1,216,878	79.5%
June 30, 2003	4,289,283	3,953,480	335,803	108.5%	1,580,680	21.2%

Funded status information as of June 30, 2004 was not available for the District, only the risk pool in which the District belongs.

NOTE H--INSURANCE

The District participates in the Association of California Water Agencies Joint Powers Insurance Authority (ACWA/JPIA) a public entity risk pool of California water agencies, for general and auto liability, public officials liability property damage and fidelity insurance. ACWA/JPIA provides insurance through the pool up to a certain level, beyond which group-purchased commercial excess insurance is obtained.

FAIR OAKS WATER DISTRICT

NOTES TO THE BASIC FINANCIAL STATEMENTS (Continued)

December 31, 2005 and 2004

NOTE H--INSURANCE (Continued)

The District pays an annual premium to ACWA/JPIA that includes its pro-rata share of excess insurance premiums, charges for the pooled risk, claims adjusting and legal costs, and administrative and other costs to operate the ACWA/JPIA. The District's deductibles and maximum coverage are as follows:

<u>Coverage</u>	<u>ACWA/JPIA</u>	<u>Commercial Insurance</u>	<u>Deductible</u>
General and Auto Liability (includes public officials liability)	\$ 1,000,000	\$ 39,000,000	None
Property Damage	50,000	50,000,000	\$500 to 25,000
Fidelity	100,000		1,000
Workers Compensation	2,000,000	Statutory	None
Employers liability	2,000,000	Statutory	None

The District continues to carry commercial insurance for all other risks of loss to cover all claims for risk of loss to which the District is exposed. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years.

NOTE I--COMMITMENTS AND CONTINGENCIES

The District has developed a meter implementation plan that will entail installing meters at a cost of over \$10,000,000 for all District customers by approximately 2011. As of December 31, 2005, the estimated remaining cost to install meters is approximately \$7,350,000.

The District has the following capital project commitments as of December 31, 2005:

Town Well Project	\$ 474,239
North Winding Way Project	369,450
Heather Well Project	<u>464,545</u>
Total	<u>\$ 1,308,234</u>

NOTE J--ECONOMIC DEPENDENCY

The District purchases approximately 97% of its water supplies from SJWD. During the years ended December 31, 2005 and 2004, the District's total water purchases from SJWD were \$1,071,645 and \$1,102,044, respectively.

ADDITIONAL INFORMATION

FAIR OAKS WATER DISTRICT
DEBT SERVICE RATE COVENANT

December 31, 2005 and 2004

In conjunction with the 1999 Certificate of Participation, the District has covenanted to fix, prescribe and collect rates and charges for the water service which will be sufficient to yield during the year net revenues equal to 115% of the debt service paid during the year. For purposes of this calculation, net revenues equals net income plus depreciation and amortization expenses. The debt service requirement for 2005 and 2004 is as follows:

	2005	2004
Operating Income	\$ 2,412,404	\$ 1,479,453
Add:		
Depreciation and Amortization	1,441,207	1,279,989
Interest Revenue	354,769	170,533
Unrealized loss on investments	26,968	20,915
(Loss) gain on disposal of capital assets	12,190	(4,614)
Less:		
Capitalized Interest	(35,700)	(35,700)
Net Revenue	4,247,538	2,910,576
 Debt Service		
Principal	750,075	761,738
Interest	233,267	259,290
Total Debt Service	\$ 983,342	\$ 1,021,028
 Calculated Coverage	432%	285%

COMPLIANCE REPORT

**REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER
FINANCIAL REPORTING BASED ON AN AUDIT OF
FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH
*GOVERNMENT AUDITING STANDARDS***

**Board of Directors
Fair Oaks Water District
Fair Oaks, California**

We have audited the basic financial statements of the Fair Oaks Water District (the District) of and for the year ended December 31, 2005 and have issued our report thereon dated February 27, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

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

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the District's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the basic financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the basic financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We

Board of Directors
Fair Oaks Water District

noted no matters involving internal control over financial reporting and its operation that we consider to be material weaknesses. However, we noted other matters involving the internal control over financial reporting, which we have reported to management of the District in a separate letter dated February 27, 2006.

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

Richardson & Company

February 27, 2006



STATISTICAL SECTION

**FAIR OAKS WATER DISTRICT
SCHEDULE OF REVENUES (a)
(UNAUDITED)
FOR TEN YEARS**

	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>
Operating Revenues:										
Water Sales	\$ 3,378,917	\$ 3,552,718	\$ 3,639,761	\$ 4,248,439	\$ 5,068,311	\$ 5,780,430	\$ 6,025,807	\$6,569,055	\$ 7,052,897	\$ 7,681,395
Water Service and Other	<u>97,735</u>	<u>171,883</u>	<u>92,271</u>	<u>193,919</u>	<u>145,872</u>	<u>234,725</u>	<u>284,925</u>	<u>263,387</u>	<u>135,163</u>	<u>258,148</u>
Total Operating Revenues	3,476,652	3,724,601	3,732,032	4,442,358	5,214,183	6,015,155	6,310,732	6,832,442	7,188,060	7,939,543
Non-Operating Revenues:										
Interest Revenue	461,916	400,634	430,522	391,062	510,144	464,309	265,141	192,194	170,533	354,769
Grants									30,000	78,257
Gain (Loss) on Disposal	<u>325,829</u>	<u>1,887</u>	<u>582</u>	<u>3,631</u>	<u>2,219</u>	<u>2,200</u>	<u>4,555</u>	<u>10,709</u>	<u>(4,614)</u>	<u>12,190</u>
Total Non-Operating Revenues	787,745	402,521	431,104	394,693	512,363	466,509	269,696	202,903	195,919	445,216
Capital Revenues:										
Connection Fees and Annexation Fees								263,323	158,188	695,200
Capital Contributions	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>235,800</u>	<u>295,000</u>	<u>504,800</u>	<u>289,839</u>	<u>8,000</u>
Total Capital Revenues	-	-	-	-	-	235,800	295,000	768,123	448,027	703,200
Total Revenues	<u>\$ 4,264,397</u>	<u>\$ 4,127,122</u>	<u>\$ 4,163,136</u>	<u>\$ 4,837,051</u>	<u>\$ 5,726,546</u>	<u>\$ 6,717,464</u>	<u>\$ 6,875,428</u>	<u>\$7,803,468</u>	<u>\$ 7,832,006</u>	<u>\$ 9,087,959</u>

(a) The 2003 through 2004 revenues have been reclassified to reflect the current 2005 classification for comparative purposes. The 2002 and prior were not adjusted for these reclassifications.

Source:
District Finance Department

**FAIR OAKS WATER DISTRICT
SCHEDULE OF EXPENSES (a)
(UNAUDITED)
FOR TEN YEARS**

	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>
Operating Expenses:										
Water Supply and Pumping	\$ 743,143	\$ 784,952	\$ 817,910	\$ 855,186	\$ 893,682	\$ 987,537	\$ 987,140	\$ 1,066,372	\$ 1,333,038	\$ 1,285,208
Operations and Maintenance	647,204	899,735	860,315	917,542	1,042,020	1,275,303	1,698,240	1,496,583	1,785,638	1,653,915
Administrative and General	678,862	963,978	969,087	1,075,638	1,082,505	1,069,037	996,913	1,248,202	1,309,942	1,146,809
Depreciation and Amortization	<u>637,805</u>	<u>734,646</u>	<u>1,111,811</u>	<u>1,037,935</u>	<u>1,014,439</u>	<u>1,102,859</u>	<u>1,247,291</u>	<u>1,219,006</u>	<u>1,279,989</u>	<u>1,441,207</u>
Total Operating Expenses	2,707,014	3,383,311	3,759,123	3,886,301	4,032,646	4,434,736	4,929,584	5,030,163	5,708,607	5,527,139
Non-Operating Expenses:										
Interest Expense	<u>614,318</u>	<u>587,890</u>	<u>555,056</u>	<u>406,023</u>	<u>435,066</u>	<u>379,327</u>	<u>344,021</u>	<u>233,010</u>	<u>223,590</u>	<u>233,267</u>
Total Non-Operating Expenses	<u>614,318</u>	<u>587,890</u>	<u>555,056</u>	<u>406,023</u>	<u>435,066</u>	<u>379,327</u>	<u>344,021</u>	<u>233,010</u>	<u>223,590</u>	<u>233,267</u>
Total Expenses	<u>\$ 3,321,332</u>	<u>\$ 3,971,201</u>	<u>\$ 4,314,179</u>	<u>\$ 4,292,324</u>	<u>\$ 4,467,712</u>	<u>\$ 4,814,063</u>	<u>\$ 5,273,605</u>	<u>\$ 5,263,173</u>	<u>\$ 5,932,197</u>	<u>\$ 5,760,406</u>

(a) The 2003 through 2004 expenses have been reclassified to reflect the current 2005 classification for comparative purposes. The 2002 and prior were not adjusted for these reclassifications.

Source:
District Finance Department

**FAIR OAKS WATER DISTRICT
SCHEDULE OF DEBT SERVICE (a)
(UNAUDITED)
FOR TEN YEARS**

	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>
Net Revenue	\$ 1,407,443	\$ 1,075,936	\$ 1,515,825	\$ 1,979,985	\$ 2,703,739	\$ 3,139,387	\$ 2,894,134	\$ 3,195,488	\$ 2,910,576	\$ 4,247,538
Debt Service	651,828	657,402	1,017,393	1,183,246	976,591	972,643	971,923	942,298	1,021,028	983,342
Coverage	216%	164%	149%	167%	276%	323%	298%	339%	285%	432%

(a) The 2003 through 2004 information have been adjusted to reflect the current reclassifications of revenues and expenses. 2002 and prior were not adjusted for these reclassifications.

Source:
District Finance Department



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