HESPERIA WATER DISTRICT

COMPONENT UNIT FINANCIAL STATEMENTS

WITH REPORT ON AUDIT BY
INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

June 30, 2010

June 30, 2010

DIEHL, EVANS & COMPANY, LLP
CERTIFIED PUBLIC ACCOUNTANTS & CONSULTANTS

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January 13, 2011

INDEPENDENT AUDITORS' REPORT

The Board of Directors
Hesperia Water District
Hesperia, California

We have audited the accompanying financial statements of Hesperia Water District (a component unit of the City of Hesperia) as of and for the year ended June 30, 2010, which collectively comprise the District's basic financial statements as listed in the table of contents. These component unit financial statements are the responsibility of the District's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control over financial reporting. Accordingly, we express no such opinion. An audit 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 audit provides a reasonable basis for our opinion.

In our opinion, the component unit financial statements referred to above present fairly, in all material respects, the respective financial position of the Hesperia Water District as of June 30, 2010, and the respective changes in financial position and its cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

As described in Note 9 to the basic financial statements, the District adopted the provisions of Governmental Accounting Standards Board Statement No. 53, "Accounting and Financial Reporting for Derivative Instruments", for the year ended June 30, 2010.

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The management's discussion and analysis and the schedule of funding progress for DPHP, as listed in the table of contents as required supplementary information, are not a required part of the basic financial statements but are supplementary information required by the accounting principles generally accepted in the United States of America. This information is an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic or historical context. We have applied certain limited procedures to the management's discussion and analysis and the schedule of funding progress in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during the audit of the basic financial statements. We do not express an opinion or provide any assurance on the management's discussion and analysis and the schedule of funding progress because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Diehl, Evans and Company, LLP

MANAGEMENT'S DISCUSSION AND ANALYSIS

Our discussion and analysis of the Hesperia Water District's financial performance provides an overview of the District's financial activities for the fiscal year ended June 30, 2010. Please read it in conjunction with the accompanying basic financial statements.

FINANCIAL HIGHLIGHTS

- The District's net assets decreased roughly $2.1 million from $82.2 million to $80.1 million or 2.5% as a result of this year's operations. This is primarily the result of growing costs to provide water service and a decline in the revenues primarily from the development portion of the non-operating revenues.

- During the year, the District's expenses exceeded revenues and contributions by $2.1 million, in spite of a decrease of operating expenses of $1.8 million, coupled with the decline in interest income revenue ($0.3 million). During FY 2009-10, 3 single family residential permits were issued as compared to the FY 2008-09 total of 12 permits, FY 2007-08 total of 106 permits, and FY 2006-07 total of 634 permits.

- The total cost of the District's operations and capital improvements was $21.3 million, which is a decrease of 8.0% from June 2009's total of $23.1 million. This reduction of expenses is due to decreased capital improvement activity.

USING THIS ANNUAL REPORT

This annual report consists of a series of financial statements. The Statement of Net Assets provides information about the activities of the District as a whole and with the water and sewer functions separately. Also, it presents a longer-term view of the District's finances. The Statement of Revenues, Expenses, and Changes in Net Assets describes how these services were financed in the short term as well as what remains for future spending. The remaining statement, The Statement of Cash Flows, provides financial information about cash flow activities of the District.

REPORTING THE DISTRICT AS A WHOLE

The financial statements presented herein include all the activities of the Hesperia Water District using the integrated approach as prescribed by GASB Statement No. 34.

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

The statement reports the District's *net assets*. You can think of the District's net assets—the difference between assets and liabilities—as one way to measure the District's financial health, or *financial position*. Over time, *increases or decreases* in the District's net assets are one indicator of whether its *financial health* is improving or deteriorating. You will need to consider other nonfinancial factors, however, such as the condition of the District's water lines, to assess the *overall health* of the District.

THE DISTRICT AS A WHOLE

Our analysis focuses on the net assets (Table 1) and changes in net assets (Table 2) of the District. In prior years, more than ten years ago, the District incurred debt to build some of the infrastructure. The Condensed Statement of Net Assets presents capital assets net of the debt incurred to pay for those assets.

The current year saw net assets decrease from $82.2 million to $80.1 million. This decrease of roughly $2.1 million comes from the change in net assets as recorded in the Condensed Statement of Revenues, Expenses, and Changes in Net Assets and flows through the Condensed Statement of Net Assets. The Water District continues to maintain the water and sewer infrastructure which includes water storage tanks, water pumping equipment, water transmission lines, and sewer lines, etc.

Table 1

Condensed Statement of Net Assets

			Changes from 2009 to 2010	
	2009	2010	Amount	Percentage
Current and other assets	$ 14,884,475	$ 20,257,530	$ 5,373,055	36.1%
Capital assets	92,617,855	92,751,289	133,434	0.1%
Total Assets	107,502,330	113,008,819	5,506,489	5.1%
Other liabilities	10,266,456	12,730,475	2,464,019	24.0%
Long-term debt outstanding	14,992,821	20,125,262	5,132,441	34.2%
Total Liabilities	25,259,277	32,855,737	7,596,460	30.1%
Net Assets:				
Invested in capital assets, net of debt	77,907,459	72,865,322	(5,042,137)	-6.5%
Restricted	395,487	1,890,305	1,494,818	378.0%
Unrestricted	3,940,107	5,397,455	1,457,348	37.0%
Total Net Assets	$ 82,243,053	$ 80,153,082	$ (2,089,971)	-2.5%

The following is a list of explanations for the $2.1 million decrease in net assets:

- Current and other assets – increased by $5.4 million or 36.1% from June 30, 2009. The increase is primarily due to a 5-year, $6.0 million loan from the Hesperia Community Redevelopment Agency (HCRA).

- Capital assets – increased by $0.1 million, net of depreciation, over June 30, 2009 principally from the replacement of aged steel water lines and other infrastructure projects of the District. The majority of this increase is shown in Construction in Progress in Table 3.

- Other liabilities – increased $2.5 million from June 30, 2009 which is primarily due to the implementation of GASB 53, Accounting and Financial Reporting of Derivative Instruments, wherein a liability of $2.6 million represents the June 30, 2010 fair value of the interest rate swap agreement in connection with the issuance of the $18.0 million Variable Rate Lease Revenue Refunding Bonds, Taxable Series 1998A.

- Long-term debt outstanding – debt service activity during the fiscal year resulted in a net increase of $5.1 million from June 30, 2009. The increase is primarily due to a $6.0 million loan from the Hesperia Community Redevelopment Agency (HCRA) and $0.9 million decrease from principal payments on outstanding debt, as shown in Table 4.

- Invested in capital assets, net of related debt – decreased by $5.0 million, or 6.5%, over the year ended June 30, 2009, which is due to changes in long-term debt and depreciation expense.

- Restricted net assets – increased $1.5 million or 378.0% from June 30, 2009. The increase is primarily due to the District meeting the bond trustee's requirement of providing additional collateral for the outstanding revenue bonds.

- Unrestricted net assets – increased by $1.5 million or 37.0% primarily due to a cash loan to the Water District from the Hesperia Community Redevelopment Agency.

DISTRICT ACTIVITIES

The District's net assets decreased $2.1 million or 2.5%. The cost of all Water District activities this year was $21.3 million which is about $1.8 million less than the $23.1 million from the prior year. Primarily the decrease is related to the decreased Water District contribution toward street paving, the result of the water line replacement projects. As shown in the Condensed Statement of Revenues, Expenses, and Changes in Net Assets (Table 2), the amount paid by users of the systems was $18.0 million, which is an increase of $0.6 million or 3.2% from the June 30, 2009 total of $17.4 million. The increase is attributed to the 4% water rate and a 7% sewer rate increase which became effective on November 2009. Non-operating revenues of $1.2 million make up the remainder of the $19.2 million total revenues.

Table 2

Condensed Statement of Revenues, Expenses, and Changes in Net Assets

			Changes from 2009 to 2010	
	2009	2010	Amount	Percentage
Revenues				
Operating revenues:				
Charges for services	$ 17,439,787	$ 17,993,175	$ 553,388	3.2%
Non-operating revenues:				
Property taxes	293,773	247,343	(46,430)	-15.8%
Interest income	326,570	36,712	(289,858)	-88.8%
System improvement and replacement	555,950	498,973	(56,977)	-10.2%
Rent income	389,357	402,320	12,963	3.3%
Sub-total non-operating revenues	1,565,650	1,185,348	(380,302)	-24.3%
Total revenues	19,005,437	19,178,523	173,086	0.9%
Expenses				
Water	21,404,975	19,121,036	(2,283,939)	-10.7%
Wastewater	1,711,325	2,147,458	436,133	25.5%
Total expenses	23,116,300	21,268,494	(1,847,806)	-8.0%
Change in net assets	(4,110,863)	(2,089,971)	2,020,892	49.2%
Net assets at July 1,	86,353,916	82,243,053	(4,110,863)	-4.8%
Net assets at June 30,	$ 82,243,053	$ 80,153,082	$ (2,089,971)	-2.5%

The major portions of the $1.2 million of non-operating revenues are the $0.5 million in capital facility and capital surcharge revenues and $0.4 million is rental income from District owned properties. The capital facility and capital surcharge revenues are primarily a reflection of the development activity occurring in Hesperia and are mostly attributable to offsetting the costs of adding the customers to the system. As seen in the above table, this revenue group reflects the continued decrease of the development activity within the City of Hesperia which saw a decrease in single family residential permits issued from 12 in FY 2008-09 to 3 for FY 2009-10. Additionally, investment earnings decreased to $36,712 from the 2008-09 amount of $326,570 because of less cash assets available for investment and decreased interest investment rates.

CAPITAL ASSETS

The capital assets of the District are those assets that are used in the performance of the District's functions including infrastructure assets. At June 30, 2010, capital assets, net of depreciation, totaled $92.8 million reflecting an increase of $0.1 million net of depreciation.

Table 3
Capital Assets at Year-End

	Balance at June 30, 2009 Net of Accumulated Depreciation	Increases	Decreases	Current Year Depreciation	Balance at June 30, 2010 Net of Accumulated Depreciation
Land	$ 3,073,419	$ 101,109	$ -	$ -	$ 3,174,528
Water rights	1,699,000	-	-	-	1,699,000
Land improvements	274,192	-	-	(32,654)	241,538
Vehicles	1,175,060	29,223	-	(206,176)	998,107
Building and structures	2,222,463	-	-	(239,588)	1,982,875
Machinery and equipment	953,175	22,535	-	(181,071)	794,639
Infrastructure:					
Water facilities	74,556,819	7,067,424	-	(2,811,876)	78,812,367
Sewer facilities	4,328,066	-	-	(178,951)	4,149,115
Construction in progress	4,335,661	3,630,883	(7,067,424)	-	899,120
	$ 92,617,855	$ 10,851,174	$ (7,067,424)	$ (3,650,316)	$ 92,751,289

The District has elected to use the "Basic Approach" as defined by GASB Statement No. 34 for infrastructure reporting for water lines. Using the "Basic Approach," the District will depreciate the value of the infrastructure over a forty (40) year period. As replacing of water line segments is done, the value of that work will be added and any remaining book value of the replaced segment will be reduced from the water facilities infrastructure class. The District's other capital assets are depreciated as outlined in Note 1 paragraph L.

DEBT ADMINISTRATION

Debt issued by the Hesperia Water District is not the responsibility of the City of Hesperia, in like manner; the debt issued by the City of Hesperia is not the responsibility of the Hesperia Water District. Debt of the Hesperia Water District increased by net amount of $5.1 million in FY 2009-10. The increase is due to a 5-year $6.0 million loan from the Hesperia Community Redevelopment Agency and $0.9 million decrease from the annual amortization of debt. Table 4, below, presents the outstanding debt.

Table 4
Outstanding Debt, at Year-End

	Principal Balance at June 30, 2009	Additions	Deductions	Principal Balance at June 30, 2010
Loans	$ 188,671	$ 6,000,000	$ (188,671)	$ 6,000,000
Certificates of participation	1,035,000	-	(45,000)	990,000
Revenue bonds	14,880,000	-	(675,000)	14,205,000
Less deferred amounts:				
Bond discounts	(120,742)	-	7,306	(113,436)
On refunding	(1,272,534)	-	76,937	(1,195,597)
Compensated absences	164,543	179,310	(171,330)	172,523
Claims payable	117,883	391,791	(442,902)	66,772
	$ 14,992,821	$ 6,571,101	$ (1,438,660)	$ 20,125,262

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

During the 2007-08 fiscal year the Board approved a series of water rate increases over a five year period starting with FY 2007-08. The overall rate increase for the first three years is 7% followed by two years of 4%. In addition, the Board approved sewer rate increases of 7% for all five years. The water rate increase for FY 2010-11 will be 4%, while the sewer rate increase will be 7%.

As detailed in the FY 2010-11 Budget, the District will not make any expenditures related to the capital improvement program.

CONTACTING THE DISTRICT'S FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, taxpayers, customers, investors, and creditors with a general overview of the District's finances and to show the District's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the District's Finance Division, at the Hesperia Water District, 9700 Seventh Avenue, Hesperia, California 92345.

STATEMENT OF NET ASSETS
June 30, 2010

	Water Operations & Capital	Sewer Operations & Capital	Total
ASSETS			
Current Assets:			
Cash and cash equivalents	$ -	$ 536,511	$ 536,511
Receivables:			
Accounts	2,681,501	487,458	3,168,959
Accrued interest	3,024	33,940	36,964
Deposits	22,284	-	22,284
Inventories	1,990,017	-	1,990,017
Due from other funds	-	6,715,499	6,715,499
Due from other governmental agencies	27,192	20,150	47,342
Deferred asset from derivative instrument	2,641,195	-	2,641,195
Restricted Assets:			
Cash and investments with fiscal agent	1,890,305	-	1,890,305
Cash held for bondholders	390,757	-	390,757
Total Current Assets	9,646,275	7,793,558	17,439,833
Noncurrent Assets:			
Other Noncurrent Assets:			
Prepaid expenses	497,600	-	497,600
Advance to VVWRA	-	1,577,098	1,577,098
Deferred charges	281,714	-	281,714
Deposits for self-insurance	419,295	41,990	461,285
Total Other Noncurrent Assets	1,198,609	1,619,088	2,817,697
Capital Assets:			
Land	1,371,741	1,802,787	3,174,528
Water rights	1,699,000	-	1,699,000
Construction in progress	899,120	-	899,120
Land improvements	790,727	-	790,727
Vehicles	2,271,302	75,819	2,347,121
Machinery and equipment	3,958,601	265,768	4,224,369
Buildings and improvements	7,889,838	-	7,889,838
Water and sewer facilities	117,408,505	7,137,408	124,545,913
Less: Accumulated depreciation	(49,672,972)	(3,146,355)	(52,819,327)
Total Capital Assets	86,615,862	6,135,427	92,751,289
Total Noncurrent Assets	87,814,471	7,754,515	95,568,986
Total Assets	$ 97,460,746	$ 15,548,073	$ 113,008,819

See accompanying independent auditors' report and notes to basic financial statements.

LIABILITIES	Water Operations & Capital	Sewer Operations & Capital	Total
Current Liabilities:			
Accounts payable	$ 1,432,470	$ 599,378	$ 2,031,848
Accrued personnel costs	139,714	8,395	148,109
Accrued interest payable	58,394	-	58,394
Deposits	560,107	226	560,333
Due to other funds	6,715,499	-	6,715,499
Current liabilities payable from restricted assets - due to bondholders	390,757	-	390,757
Liability from derivative instrument	2,641,195	-	2,641,195
Long term debt due within one year	2,093,928	26,694	2,120,622
Total Current Liabilities	14,032,064	634,693	14,666,757
Noncurrent Liabilities:			
Net OPEB obligation	156,500	-	156,500
Unearned revenue	-	27,840	27,840
Compensated absences	5,789	1,112	6,901
Claims payable	60,903	5,869	66,772
Loan payable	4,800,000	-	4,800,000
Revenue bonds (net of unamortized discounts and deferred amounts on refunding)	12,190,967	-	12,190,967
Certificates of participation	940,000	-	940,000
Total Noncurrent Liabilities	18,154,159	34,821	18,188,980
Total Liabilities	32,186,223	669,514	32,855,737
NET ASSETS			
Invested in capital assets, net of related debt	66,729,895	6,135,427	72,865,322
Restricted for debt service	1,890,305	-	1,890,305
Unrestricted	(3,345,677)	8,743,132	5,397,455
Total Net Assets	$ 65,274,523	$ 14,878,559	$ 80,153,082

See accompanying independent auditors' report and notes to basic financial statements.

STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
For the Year Ended June 30, 2010

	Water Operations & Capital	Sewer Operations & Capital	Total
OPERATING REVENUES			
Water sales	$ 14,194,844	$ -	$ 14,194,844
Water services	236,507	-	236,507
Sewer services	-	2,990,700	2,990,700
Other	571,124	-	571,124
Total Operating Revenues	15,002,475	2,990,700	17,993,175
OPERATING EXPENSES			
General and administrative	6,731,443	-	6,731,443
Engineering	980,133	-	980,133
Production	3,187,626	-	3,187,626
Distribution	1,565,582	2,048,377	3,613,959
Customer service	1,948,200	-	1,948,200
Depreciation and amortization	3,569,147	99,081	3,668,228
Total Operating Expenses	17,982,131	2,147,458	20,129,589
OPERATING INCOME (LOSS)	(2,979,656)	843,242	(2,136,414)
NON-OPERATING REVENUES (EXPENSES)			
Unrestricted system improvement and replacement	498,973	-	498,973
Property taxes	246,025	-	246,025
Property taxes - debt service	1,318	-	1,318
Rent income	402,320	-	402,320
Interest income	-	36,712	36,712
Contributed infrastructure expense	(292,569)	-	(292,569)
Contributed equipment expense	(29,922)	-	(29,922)
Interest expense	(816,414)	-	(816,414)
Total Non-Operating Revenues (Expenses)	9,731	36,712	46,443
Change In Net Assets	(2,969,925)	879,954	(2,089,971)
Net assets at beginning of year	68,244,448	13,998,605	82,243,053
Net assets at end of year	$ 65,274,523	$ 14,878,559	$ 80,153,082

See accompanying independent auditors' report and notes to basic financial statements.

STATEMENT OF CASH FLOWS
For the Year Ended June 30, 2010

	Water Operations & Capital	Sewer Operations & Capital	Total
Cash Flows from Operating Activities:			
Cash received from water and sewer customers	$ 14,652,455	$ 2,979,759	$ 17,632,214
Cash received from other operating receipts	571,124	-	571,124
Cash payments for water purchases	(3,223,957)	-	(3,223,957)
Cash payments for sewer collection and maintenance	-	(1,871,637)	(1,871,637)
Cash payments for services and supplies	(2,135,039)	-	(2,135,039)
Cash payments to employees for services	(9,604,696)	-	(9,604,696)
Net Cash Provided (Used) by Operating Activities	259,887	1,108,122	1,368,009
Cash Flows from Noncapital and Related Financing Activities:			
Property taxes received	247,343	-	247,343
Net Cash Provided by Noncapital and Related Financing Activities	247,343	-	247,343
Cash Flows from Capital and Related Financing Activities:			
Acquisition and construction of capital assets	(4,005,132)	(101,109)	(4,106,241)
Unrestricted system improvement and replacement receipts	498,973	-	498,973
Advances from/to other funds	(273,323)	273,323	-
Advance to VVWRA	-	(1,428,649)	(1,428,649)
Cash received from bondholders	6,983	-	6,983
Cash proceeds from loan payable to HCRA	6,000,000	-	6,000,000
Interest payments on long-term debt	(737,011)	-	(737,011)
Principal payments on long-term debt	(908,671)	-	(908,671)
Net Cash Provided (Used) by Capital and Related Financing Activities	581,819	(1,256,435)	(674,616)
Cash Flows from Investing Activities:			
Rents received	402,320	-	402,320
Interest received	10,432	21,451	31,883
Net Cash Provided by Investing Activities	412,752	21,451	434,203
Net Increase (Decrease) in Cash and Cash Equivalents	1,501,801	(126,862)	1,374,939
Cash and cash equivalents at beginning of year	779,261	663,373	1,442,634
Cash and cash equivalents at end of year	$ 2,281,062	$ 536,511	$ 2,817,573

(continued)

See accompanying independent auditors' report and notes to basic financial statements.

(continued)

STATEMENT OF CASH FLOWS
For the Year Ended June 30, 2010

	Water Operations & Capital	Sewer Operations & Capital	Total
Reconciliation of Operating Income to Net Cash Flows Provided by Operating Activities:			
Operating income (Loss)	$ (2,979,656)	$ 843,242	$ (2,136,414)
Adjustments to Reconcile Operating Income to Net Cash Provided by Operating Activities:			
Depreciation and amortization	3,569,147	99,081	3,668,228
Changes in operating assets and liabilities:			
(Increase) decrease in accounts receivable	221,104	311	221,415
(Increase) decrease in deposits	(94,676)	(5,172)	(99,848)
(Increase) decrease in inventory	(569,457)	-	(569,457)
(Increase) decrease in prepaid expenses	253,000	-	253,000
(Increase) decrease in due from other governments	(8,442)	(11,347)	(19,789)
Increase (decrease) in accounts payable	(289,331)	150,399	(138,932)
Increase (decrease) in accrued personnel costs	29,171	95	29,266
Increase (decrease) in customer deposits	43,354	226	43,580
Increase (decrease) in due to other governments	-	(310)	(310)
Increase (decrease) in net OPEB obligation	81,500	-	81,500
Increase (decrease) in deferred revenue	-	27,790	27,790
Increase (decrease) in compensated absences	4,173	3,807	7,980
Total Adjustments	3,239,543	264,880	3,504,423
Net Cash Provided (Used) by Operating Activities	$ 259,887	$ 1,108,122	$ 1,368,009

Supplemental Disclosures:

Noncash Capital and Financing Activities			
Contributed Capital for Assets	$ 322,491		
Amortization Related to Long-Term Debt	$ 84,242		

See accompanying independent auditors' report and notes to basic financial statements.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

The accounting policies of the Hesperia Water District (the District) conform to generally accepted accounting principles as applicable to governmental units. The following is a summary of the more significant policies:

a. Description of Reporting Entity:

The District was organized pursuant to Section 30000 et seq. of the California Water Code. The District has two main areas of responsibility that are as follows:

Water Operations & Capital - The Water Division's main objective is to deliver and ensure adequate supplies of water. The water is to meet all drinking water quality regulations and to maintain District Facilities to ensure unobstructed flows during water runoff.

Sewer Operations & Capital - The Sewer Division's main objective is to transmit and ensure continuous unobstructed flows of sewage to the regional plant.

The District is an integral part of the reporting entity of the City of Hesperia (the City). The accounts of the District have been included within the scope of the basic financial statements of the City because the City Council has financial accountability over the operations of the District. Only the accounts of the District are included herein, therefore, these financial statements do not purport to represent the financial position or results of operations of the City of Hesperia.

b. Basic Financial Statements:

The basic financial statements are comprised of the Statement of Net Assets, the Statement of Revenues, Expenses, and Changes in Net Assets, the Statement of Cash Flows and the Notes to Basic Financial Statements.

c. Basis of Presentation:

The District reports its activities as an enterprise fund, which is used to account for operations that are financed and operated in a manner similar to a private business enterprise, where the intent of the District is that the costs (including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges. Revenues and expenses are recognized on the accrual basis. Revenues are recognized in the accounting period in which they are earned and expenses are recognized in the period incurred.

The District has elected to apply all applicable Governmental Accounting Standards Board (GASB) pronouncements as well as any applicable pronouncements of the Financial Accounting Standards Board (FASB), the Accounting Principles Board (APB), or any Accounting Research Bulletins (ARB) issued on or before November 30, 1989, unless they contradict or conflict with GASB pronouncements. The District has opted not to apply Financial Accounting Standards Board (FASB) Statements and Interpretations issued after November 30, 1989.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued):

d. Measurement Focus and Basis of Accounting:

Measurement focus is a term used to describe “which” transactions are recorded within the various financial statements. Basis of accounting refers to “when” transactions are recorded regardless of the measurement focus applied. The accompanying financial statements are reported using the “economic resources measurement focus”, and the “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.

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.

The District distinguishes operating revenues and expenses from those revenues and expenses that are non-operating. Operating revenues are those revenues that are generated by water sales and sewer services while operating expenses pertain directly to the furnishing of those sales and services. Non-operating revenues and expenses are those revenues and expenses generated that are not directly associated with the normal business of supplying water and sewer services.

e. Net Assets:

In the Statement of Net Assets, net assets are classified in the following categories:

- Invested in capital assets, net of related debt - This amount consists of capital assets net of accumulated depreciation and reduced by outstanding debt that is attributed to the acquisition, construction, or improvement of the assets.
- Restricted net assets – This amount is restricted by external creditors, grantors, contributors, or laws or regulations of other governments or constraints imposed by law through constitutional provisions or enabling legislation.
- Unrestricted net assets – This amount is all net assets that do not meet the definition of “invested in capital assets, net of related debt” or “restricted net assets”.

f. Inventories:

Inventories consist of materials and supplies that are valued at cost and are recorded as expenses on a first-in, first-out basis when consumed.

g. Compensated Absences:

A liability is recorded for unused vacation and similar compensatory leave balances since the employees' entitlement to these balances are attributable to services already rendered and it is probable that virtually all of these balances will be liquidated by either paid time off or payments upon termination or retirement.

Vacation pay is payable to employees at the time vacation is taken or upon termination of employment. Normally, an employee can not accrue more than 160 hours during a one year accrual period.

Sick leave is payable when an employee is unable to work because of illness. Upon termination, any unused sick leave will not be paid.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued):

h. Unbilled Services:

Unbilled water revenue of the enterprise fund is recognized as earned when the water is consumed.

i. Use of Estimates:

The preparation of financial statements in conformity with generally accepted accounting principles in the United States of America 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.

j. Property Taxes:

Property tax in California is levied in accordance with Article 13A of the State Constitution at one percent of county-wide assessed valuations. This levy is allocated pursuant to state law to the appropriate units of local government.

Property tax revenue is recognized in the fiscal year in which they have been levied.

The property tax calendar is as follows:

Lien Date:	January 1
Levy Date:	July 1
Due Date:	First Installment - November 10
	Second Installment - February 10
Delinquent Date:	First Installment - December 11
	Second Installment - April 11

k. Cash and Investments:

Investments are stated at fair value (quoted market price or best available estimate thereof, see Note 2).

l. Capital Assets and Depreciation:

Capital Assets are stated at cost or estimated historical cost. Contributed fixed assets are recorded at estimated fair market value at the time received. Net interest costs are capitalized on projects during the construction period. The District's capitalization policy sets the threshold for reporting capital assets at $5,000.

Depreciation is charged using the straight-line method based on the estimated useful life of the related asset. The estimated useful life of the assets are as follows:

Buildings	30 years
Improvements	20 years
Machinery and equipment	5-30 years
Vehicles	8 Years
Water and sewer facilities	40 years

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued):

m. Statement of Cash Flows:

For purposes of the statement of cash flows, the District considers all highly liquid investments with an original maturity of three months or less when purchased and all amounts invested in a cash and investment pool to be cash equivalents.

n. Claims and Judgments and Self-Insurance Program:

When it is probable that a claim liability has been incurred at year end, and the amount of the loss can be reasonably estimated, the District records the estimated loss, net of any insurance coverage under its self-insurance program. At June 30, 2010, in the opinion of the District's Attorney, the District had no material unrecorded claims which would require loss provision in the financial statements, including losses for claims which are Incurred But Not Reported (IBNR). Small dollar claims and judgments are recorded as expenses when paid.

The District participates in the self-insurance program of the City of Hesperia. Information relating to the self-insurance program is available in the City of Hesperia Comprehensive Annual Financial Report.

o. Accounts Receivable and Allowances:

Accounts receivable are recorded at the invoiced amount. The District maintains an allowance for doubtful accounts. The allowance for doubtful accounts is based on the best estimate of the amount of probable future credit losses in existing accounts receivable. The District reviews the allowance for doubtful accounts on an annual basis. There was no allowance for doubtful accounts at June 30, 2010.

2. CASH, CASH EQUIVALENTS, AND INVESTMENTS:

Cash and investments at June 30, 2010 are classified in the accompanying financial statements as follows:

STATEMENT OF NET ASSETS:		
Current Assets:		
Cash and cash equvalents	$	536,511
Restricted assets:		
Cash and investments with fiscal agent		1,890,305
Cash held for bondholders		390,757
Total cash and investments	$	2,817,573

See accompanying independent auditors' report.

2. CASH, CASH EQUIVALENTS, AND INVESTMENTS (Continued):

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

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

Authorized Investment Type	Maximum Maturity	Maximum Percentage Of Portfolio	Maximum Investment In One Issuer
U.S. Treasury Obligations	5 years	100%	None
U.S. & State or Local Agency Securities	5 years	100%	None
Banker's Acceptances	180 days	25%	5%
Commercial Paper	270 days	15%	None
Negotiable Certificates of Deposit	5 years	25%	None
Repurchase Agreements	1 years	20%	None
Local Agency Investment Fund (LAIF)	N/A	100%	None
Medium-Term Notes	5 years	30%	None
Mutual & Money Market Funds	90 days	20%	None
Collateralized Bank Deposits	5 years	10%	None
Investment Pools	N/A	30%	None
Municipal Bonds	5 years	10%	None

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 City of Hesperia's investment policy. Investments authorized for funds held by bond trustee include, U.S. Treasury Obligations, Export-Import Bank, Federal Housing Administration Debentures, Government National Mortgage Association, U.S. Maritime Administration, U.S. Agency Securities, Money Market Funds, Certificates of Deposits, Commercial Paper, Interest Bearing Demand or Time Deposits, Banker's Acceptances, Repurchase Agreements, Repurchase Agreements Collateralized, Federal Home Loan Bank, Federal National Mortgage Association, Federal Home Loan Mortgage Corporation, Municipal Obligations, any other investment approved by the credit entity. There were no limitations on the maximum amount that can be invested in one issuer, maximum percentage allowed or the maximum maturity of an investment.

Disclosures Related to Interest Rate Risk, Credit Risk, and Custodial Credit Risk:

The District's cash and investments are pooled with the City of Hesperia's cash and investments. Additional disclosures regarding $2,817,573 in pooled investments related to interest rate risk, credit risk and custodial credit risk are available in the City of Hesperia's Comprehensive Annual Financial Report.

2. CASH, CASH EQUIVALENTS, AND INVESTMENTS (Continued):

Investment in State Investment Pool:

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

3. ADVANCE TO VVWRA:

The District made an advance to Victor Valley Wastewater Reclamation Authority (VVWRA) totaling $1,577,098 as of June 30, 2010. The advance bears a fixed interest rate of six percent (6%) per annum. This advance is not expected to be repaid within one year.

4. CAPITAL ASSETS AND DEPRECIATION:

Capital asset activity for the year ended June 30, 2010 was as follows:

	Balance at June 30, 2009	Increases	Decreases	Balance at June 30, 2010
Capital assets, not being depreciated				
Land	$ 3,073,419	$ 101,109	$ -	$ 3,174,528
Water rights	1,699,000	-	-	1,699,000
Construction in progress	4,335,661	3,630,883	(7,067,424)	899,120
Total capital assets, not being depreciated	9,108,080	3,731,992	(7,067,424)	5,772,648
Capital assets being depreciated:				
Land improvements	790,727	-	-	790,727
Vehicles	2,317,898	29,223	-	2,347,121
Machinery and equipment	4,201,834	22,535	-	4,224,369
Buildings and improvements	7,889,838	-	-	7,889,838
Water facilities	110,341,081	7,067,424	-	117,408,505
Sewer facilities	7,137,408	-	-	7,137,408
Total capital assets, being depreciated	132,678,786	7,119,182	-	139,797,968
Less accumulated depreciation for:				
Land improvements	(516,535)	(32,654)	-	(549,189)
Vehicles	(1,142,838)	(206,176)	-	(1,349,014)
Machinery and equipment	(3,248,659)	(181,071)	-	(3,429,730)
Buildings and improvements	(5,667,375)	(239,588)	-	(5,906,963)
Water facilities	(35,784,262)	(2,811,876)	-	(38,596,138)
Sewer facilities	(2,809,342)	(178,951)	-	(2,988,293)
Total accumulated depreciation	(49,169,011)	(3,650,316)	-	(52,819,327)
Total capital assets, being depreciated,net	83,509,775	3,468,866	-	86,978,641
Total capital assets, net	$ 92,617,855	$ 7,200,858	$ (7,067,424)	$ 92,751,289

See accompanying independent auditors' report.

5. LONG-TERM DEBT:

Following is a summary of the changes in principal balance of long-term debt for the year ended June 30, 2010:

	Principal Balance at June 30, 2009	Additions	Deductions	Principal Balance at June 30, 2010	Due Within One Year
Loans	$ 188,671	$ 6,000,000	$ (188,671)	$ 6,000,000	$ 1,200,000
Certificates of Participation	1,035,000	-	(45,000)	990,000	50,000
Revenue Bonds	14,880,000	-	(675,000)	14,205,000	705,000
Less deferred amounts:					
Bond discounts	(120,742)	-	7,306	(113,436)	-
On refunding	(1,272,534)	-	76,937	(1,195,597)	-
Total Revenue Bonds	13,486,724	-	(590,757)	12,895,967	705,000
Compensated absences	164,543	179,310	(171,330)	172,523	165,622
Claims Payable	117,883	391,791	(442,902)	66,772	-
Total Long-term Debt	$ 14,992,821	$ 6,571,101	$ (1,438,660)	$ 20,125,262	$ 2,120,622

Long-term debt at June 30, 2010 is comprised of the following issues:

	Balance at June 30, 2010
Proposition 28 Loan from State of California:	
The District had a contract with the State of California, as of May 20, 1987, for a $5,000,000 loan (additional $200,000 administrative fee) under the Safe Drinking Water Bond Law of 1984. These funds were to assist the District in meeting minimum safe drinking water standards for the domestic water supply. The interest rate was 4.144% per year and matured October, 2009 with semi-annual payments of $192,591. At June 30, 2010, this debt was fully retired.	$ -
2010 Loan from Hesperia Community Redevelopment Agency:	
The District was issued a 5-year loan by the Hesperia Community Redevelopment Agency on June 30, 2010, for $6,000,000 for various water capital projects. The issue bears quarterly variable interest based on the Local Agency Investment Fund Quarterly Apportionment Rate which at June 30, 2010 had a rate of 0.56%. The loan matures June 30, 2015 with annual principal payments of $1,200,000. The loan will be financed by revenues generated by the District through set rates and charges for water and sewer services.	6,000,000
1992B Certificates of Participation:	
The District issued 30-year Certificates of Participation on June 1, 1992, for $1,405,000 for the Administration Facilities Acquisition Project. The issue bears interest at a rate of 9% over its remaining life and matures through the year 2022 with principal payments ranging from $20,000 to $125,000. The Certificates will be financed by revenues generated by the District through set rates and charges for water and sewer services.	990,000

5. LONG-TERM DEBT (Continued):

1998A Variable Rate Lease Revenue Refunding Bonds:

The District issued 28-year variable rate lease revenue refunding bonds on July 2, 1998 for $18,040,000 to refund a 1991, $17,675,000 Certificate of Participation issue. The 1991 Certificate of participation is considered defeased; therefore, the issue is not included in the District's financial statements. The District is legally required to make principal and interest payments from the net revenues of the District. The 1998A issue has an initial interest rate of 5.95%, and weekly variable rates thereafter until the fixed rate conversion date, with maturities through the year 2026, ranging from $435,000 to $1,105,000. The 1998A bonds were issued at a discount of $180,400, which is being amortized over the life of the 1998A Bonds. The difference between the reacquisition price and the net carrying value of the 1991 Certificate of Participation, $1,906,482 has been deferred and is being amortized over the remaining life of the Bonds as a component of interest expense. In June, 2004, the District entered into a variable-to-fixed-interest rate swap with Bank of America, N.A. The swap requires Bank of America, N.A. to pay the variable rate while fixing the District rate at 5.96%. The agreement provides up to $10,000,000 can be fixed at 5.96%. The amount fixed with the counterparty decreases over time to $6,910,000 at June 20, 2020. At June 30, 2010 the amount fixed was $10,000,000.	12,935,000
1998B Variable Rate Lease Revenue Refunding Bonds:	
The District issued 24-year variable rate lease revenue refunding bonds on July 2, 1998 for $2,070,000 to refund a 1992, $1,855,000 Certificate of Participation issue. The 1992A Certificate of Participation is considered defeased; therefore, the issue is not included in the District's financial statements. The District is legally required to make principal and interest payments from the net revenues of the District. The 1998A issue has a initial interest rate of 3.95%, and weekly variable rates thereafter until the fixed rate conversion date, with maturities through the year 2022, ranging from $55,000 to $130,000. The difference between the reacquisition price and the net carrying value of the 1992A Certificate of Participation, $212,358 has been deferred and is being amortized over the remaining life of the Bonds as a component of interest expense.	1,270,000
Compensated Absences	172,523
Claims Payable	66,772
Subtotal	21,434,295
Less: Current Portion – Due Within One Year	(2,120,622)
Deferred amounts on bonds	(1,309,033)
Total Long-Term Portion of Long-Term Debt	$18,004,640

See accompanying independent auditors' report.

5. LONG-TERM DEBT (Continued):

The annual debt service requirements by year for Loans Payable are as follows:

Fiscal Year Ending	Principal	Interest	Total
2011	$ 1,200,000	$ 33,600	$ 1,233,600
2012	1,200,000	26,880	1,226,880
2013	1,200,000	20,160	1,220,160
2014	1,200,000	13,440	1,213,440
2015	1,200,000	6,720	1,206,720
	$ 6,000,000	$ 100,800	$ 6,100,800

Variable interest rate used for the 2010 Hesperia Community Redevelopment Agency Loan was 0.56%.

The annual debt service requirements by year for Revenue Bonds are as follows:

Fiscal Year Ending	Principal	Interest	Total
2011	$ 705,000	$ 611,353	$ 1,316,353
2012	730,000	608,843	1,338,843
2013	760,000	606,243	1,366,243
2014	790,000	603,538	1,393,538
2015	820,000	600,725	1,420,725
2016-2020	4,610,000	2,404,860	7,014,860
2021-2025	5,185,000	1,086,558	6,271,558
2026	605,000	36,058	641,058
	$ 14,205,000	$ 6,558,178	$ 20,763,178

Variable interest rate used for the 1998A Variable Rate Lease Revenue Refunding Bonds above the $10,000,000 fixed amounts was 0.35%. Variable interest rate used for the 1998B Variable rate Lease revenue Refunding Bonds was 0.40%.

The annual debt service requirements by year for the Certificates of Participation are as follows:

Fiscal Year Ending	Principal	Interest	Total
2011	$ 50,000	$ 89,100	$ 139,100
2012	55,000	84,600	139,600
2013	60,000	79,650	139,650
2014	65,000	74,250	139,250
2015	70,000	68,400	138,400
2016-2020	450,000	236,700	686,700
2021-2022	240,000	32,850	272,850
	$ 990,000	$ 665,550	$ 1,655,550

6. PENSION PLAN OBLIGATIONS:

Plan Description:

The District's employees participate in the Miscellaneous 2.7% at 55 Risk Pool (Plan) of the California Public Employees' Retirement System (PERS). This plan is cost-sharing, multiple-employer defined benefit pension plan administered by PERS. PERS provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. A menu of benefit provisions as well as other requirements is established by State statutes within the Public Employees' Retirement Law. The District selects optional benefit provisions from the benefit menu by contract with PERS and adopts those benefits through local ordinance. Copies of PERS' annual financial report may be obtained from the PERS Executive Office: 400 P Street, Sacramento, CA 95814.

Funding Policy:

Participants are required to contribute 8% of their annual covered salary. The employees of the District contribute 2% of the 8% contribution required of the District employees while the remaining 6% is contributed by the District on behalf of the employees. 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 for this year into the plan for the fiscal year ended June 30, 2010 was 8.971%, of their annual covered payroll. The contribution requirements of the plan members are established by State statute and the employer contribution rate is established and may be amended by PERS. The District's employer contribution for the last three fiscal years, which were equal to the required contribution each year were $504,838, $443,818 and $280,499 for the years ended June 30, 2010, 2009, and 2008 respectively. PERS does not provide individual plan trend information for risk pools.

7. OTHER POST EMPLOYMENT BENEFITS:

Plan Description:

The District's defined benefit postemployment healthcare plan (DPHP), provides medical benefits to eligible retired District employees and beneficiaries. DPHP is part of the Public Agency portion of the California Employers' Retiree Benefit Trust Fund (CERBT), an agent multiple-employer plan administered by California Public Employees' Retirement System (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 statute within the Public Employees' Retirement Law. DPHP selects optional benefit provisions from the benefit menu by contract with CalPERS and adopts those benefits through District resolution. CalPERS issues a separate Comprehensive Annual Financial Report. Copies of the CalPERS' annual financial report may be obtained from the CalPERS Executive Office, 400 P Street, Sacramento, California 95814.

Funding Policy:

The contribution requirements of plan members and the District are established and may be amended by the Board of Directors. DPHP members receiving benefits contribute based on their selected plan options. The District makes all contributions of the plan members.

7. OTHER POST EMPLOYMENT BENEFITS (Continued):

Annual OPEB Cost and Net OPEB Obligation/Asset:

The District's annual OPEB cost (expense) is calculated based on the annual required contribution of the employer (ARC), an amount actuarially determined in accordance with the parameters of GASB Statement 45. The ARC represents a level of funding that, if paid on an ongoing basis is projected to cover the normal annual cost. Any unfunded actuarial liability (or funding excess) is amortized over a period not to exceed thirty years. The current ARC rate is 2.9% of the annual covered payroll.

The following table shows the components of the District's annual OPEB cost for the year ending June 30, 2010, the amount actually contributed to the plan, and changes in the District's net OPEB obligation/asset:

Annual Required Contribution (ARC)	$ 87,400
Interest on net OPEB obligation	-
Adjustment to Annual Required Contribution (ARC)	-
Annual OPEB cost (expense)	87,400
Contributions made	(5,900)
Increase in net OPEB obligation	81,500
Net OPEB obligation - beginning of year	75,000
Net OPEB obligation - end of year	$ 156,500

The District's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for the fiscal years 2010, 2009 and 2008 were as follows:

THREE-YEAR TREND INFORMATION FOR CERBT

Fiscal Year	Annual OPEB Cost (AOC)	Percentage of OPEB Cost Contributed	Net OPEB Obligation
6/30/2010	$ 87,400	6.8%	$ 156,500
6/30/2009	$ 79,000	5.1%	$ 75,000
6/30/2008	*	*	*

*The information for the year ending June 30, 2008 is unavailable. GASB 45 was implemented prospectively in fiscal year 2009.

Funded Status and Funding Progress:

The funded status of the plan as of June 30, 2008, the most recent actuarial valuation date, was as follows:

Actuarial Accrued Liability (AAL)	$ 383,000
Actuarial Value of Plan Assets	-
Unfunded Actuarial Accrued Liability (UAAL)	383,000
Funded Ratio (Actuarial Value of Plan Assets/AAL)	0.0%
Covered Payroll (Active Members)	2,861,500
UAAL as a Percentage of Covered Payroll	13.4%

7. OTHER POST EMPLOYMENT BENEFITS (Continued)

Actuarial Methods and Assumptions:

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for the benefits.

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and the plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial assets, consistent with the long-term perspective of the calculations.

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

Valuation Date	June 30, 2008
Actuarial Cost Method	Entry Age Normal Cost Method
Amortization Method	Level Percent of Payroll
Remaining Amortization Period	30 Years as of the Valuation Date
Asset Valuation method	15 Year Smoothed Market
Actuarial Assumptions:	
Investment Rate of Return	4.25% (Net of Administrative Expenses)
Projected Salary Increase	3.25%
Inflation	3.00%
PEMHCA Minimum Growth	4.50%
Individual Salary Growth	CalPERS 1997-2002 Experience Study

8. SELF-INSURANCE RISK POOL:

The Water District, through the City of Hesperia, is a member of the Public Agencies Self-Insurance System, a joint powers authority of 8 California cities and districts, for the purpose of pooling the City's risk for worker's compensation insurance with those of other member cities and districts. The Water District, also through the City of Hesperia, is a member of the Public Agency Risk Sharing Authority of California (PARSAC), a joint powers authority for the purpose of achieving savings on insurance premiums. Disclosures regarding these policies are available in the City of Hesperia's Comprehensive Annual Financial Report. See Note 9 about the City of Hesperia's change in self-insurance.

9 DERIVATIVE INSTRUMENT - INTEREST RATE SWAP AGREEMENT:

Objective:

The Hesperia Water District executed an interest rate swap agreement on June 1, 2005 with swap provider Bank of America, N.A (counterparty) in connection with the issuance of the $18,040,000 Variable Rate Lease Revenue Refunding Bonds, Taxable Series 1998A (Federally Taxable). The Swap Agreement is a 15 year swap agreement scheduled to terminate on June 1, 2020. The swap establishes a fixed interest rate of 5.96%.

9 DERIVATIVE INSTRUMENT - INTEREST RATE SWAP AGREEMENT (CONTINUED):

Details on the swap agreement are as follows:

Notional Amount	Interest Rate	Issue	Termination Date	Intial Effective Date
$ 10,000,000	5.96%	Bank of America	6/1/2020	6/1/2005

Terms:

Under the swap agreement, the Water District will make a monthly interest payment at the fixed rate of 5.96%. The Water District will receive a variable rate interest payment for those variable interest rates in excess of the 5.96% cap and makes a payment if the variable rate is less than 5.96%. The rate is adjusted weekly every Wednesday at the 1-Month USD-LIBOR-BBA rate. The swap is for a total notional amount of $10,000,000 and will terminate on June 1, 2020.

Summary of Activities in Cash Flow Hedging Derivative Instrument:

Notional Amount	Fair Value At June 30, 2009	Change In Fair Value	Fair Value At June 30, 2010
$ 10,000,000	$ (2,031,090)	$ (610,105)	$ (2,641,195)

As of June 30, 2010, the negative fair value of $2,641,195 is reported as a deferred asset from derivative instruments and a liability from derivative instruments in the Statements of Net Assets. GASB 53, Accounting and Financial Reporting for Derivative Instruments, was implemented for the year ending June 30, 2010.

Credit Risk:

As of June 30, 2010, the Water District was exposed to credit risk because the swap had a negative fair value. However, should interest rates change and the fair value of the swap becomes positive, the Water District would not be exposed to credit risk in the amount of the derivative's fair value.

The swaps counterparty, Bank of America N.A., have the following credit ratings:

	Standards & Poor	Moody's
Bank of America N.A.	A+	Aa3

Basis Risk:

The swaps do expose the Water District to basis risk, which refers to a mismatch between the interest rate received from the swap contract and the interest paid on the variable rate payments to be made on the debt. The Water District pays the counterparty a fixed interest rate of 5.96% and receives a variable rate in excess of the 5.96% cap, based on the 1-month UDS-LIBOR-BBA. The Water District is at risk that the variable interest rate calculated on the debt is less than the 5.96%.

9 DERIVATIVE INSTRUMENT - INTEREST RATE SWAP AGREEMENT (CONTINUED):

Termination Risk:

The swaps may be terminated by the Water District or the counterparty if the other party fails to perform under the terms of the swap agreements. In addition, the Water District has the option to terminate the swaps upon proper notification to the counterparty. If the swaps are terminated, the Water District would prospectively pay the variable rates on the portion of the outstanding bonds related to the swap agreements. The termination of the swap agreements could therefore increase the Water District's total debt service. Also, if at the time of the termination, the swaps have a negative fair value, the Water District would be liable to the counterparty for a payment equal to such negative fair value. As of June 30, 2010 the swap had a negative fair value of $2,641,195.

Swap Payments and Associated Debt:

Using a fixed rate of 5.96% the $18,040,000 Variable Rate Lease Revenue Refunding Bonds, Taxable Series 1998A, as of June 30, 2010, debt service requirements of the Certificates and the swap payments through the termination date of June 1, 2020, assuming a current interest rate of 5.96% are as follows. As rates vary, the variable rate interest payments and net swap payments will vary.

Year Ending	Variable Rate Debt			Interest Rate	Fixed Debt
June 30,	Principal	Interest	Total	Swap, Net	Service
2011	$ -	$ 35,000	$ 35,000	$ 561,000	$ 561,000
2012	-	35,000	35,000	561,000	561,000
2013	-	35,000	35,000	561,000	561,000
2014	-	35,000	35,000	561,000	561,000
2015	-	35,000	35,000	561,000	561,000
2016-2020	-	148,960	148,960	2,387,616	2,387,616

10. SUBSEQUENT EVENTS:

Effective July 1, 2010 the District will participate with the Public Entity Risk Management Authority (PERMA) insurance pool for workers’ compensation coverage and administration. The District will be transferring all workers’ compensation liability prior to July 1, 2010 (tail program) to PERMA from its previous JPA, PASIS. The District will continue to be self-insured for the first $250,000 of each claim and PERMA will assume each claim’s liability between $250,000 and $10,000,000. On June 28, 2010 a partial funding transfer of $1,100,000 was made by PASIS to PERMA to fund the District’s current and tail programs.

REQUIRED SUPPLEMENTARY INFORMATION

Schedule of Funding Progress for DPHP

Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability (AAL) Entry Age	Unfunded (Over Funded) AAL (UAAL)	Funded Ratio	Covered Payroll	UAAL as a % of Covered Payroll
	(A)	(B)	(B - A)	(A / B)	(C)	(B - A / C)
6/30/2009:						
Water	n/a	n/a	n/a	n/a	n/a	n/a
Total	n/a	n/a	n/a	n/a	n/a	n/a
6/30/2008:						
Water	$ -	$ 383,000	$ 383,000	0.0%	$ 2,861,500	13.4%
Total	$ -	$ 383,000	$ 383,000	0.0%	$ 2,861,500	13.4%
6/30/2007:						
Water	*	*	*	*	*	*
Total	*	*	*	*	*	*

*GASB 45 was implemented prospectively in fiscal year 2009. The information for the year ending June 30, 2007 is unavailable.

N/A The Water District is only required to perform actuarial valuations biennially. An actuarial valuation was not performed for the year ending June 30, 2009.

See accompanying independent auditors' report.