ATTACHMENT B

OTAY WATER DISTRICT

ANNUAL
FINANCIAL REPORT

JUNE 30, 2008 and 2007

Spring Valley, California
Prepared by the Finance Department

TRS TEAMAN, RAMIREZ & SMITH, INC.
CERTIFIED PUBLIC ACCOUNTANTS

INDEPENDENT AUDITORS' REPORT

Board of Directors
Otay Water District
Spring Valley, California

We have audited the accompanying financial statements of the business-type activities of the Otay Water District, as of and for the years ended June 30, 2008 and 2007, which collectively comprise the District's basic financial statements, as listed in the Table of Contents. These basic financial statements are the responsibility of the District's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities of the Otay Water District, as of June 30, 2008 and 2007, and the cash flows where applicable, thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 24, 2008 on our consideration of the District's internal control over financial reporting and our test of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The information identified in the accompanying table of contents as *Management's Discussion and Analysis* and *Required Supplementary Information* is not a required part of the basic financial statements, but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquires of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and do not express an opinion on it.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements that collectively comprise the Otay Water District's basic financial statements. The introductory section and statistical section, as listed in the table of contents, are presented for purposes of additional analysis and are not a required part of the basic financial statements. The introductory section and statistical section have not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on them.

Teaman Ramirez & Smith

October 24, 2008

Richard A. Teaman, CPA • Greg W. Fankhanel, CPA • David M. Ramirez, CPA • Javier H. Carrillo, CPA
4201 Brockton Ave. Suite 100, Riverside CA 92501 • 951.274.9500 • 951.274.7828 FAX • www.trscpas.com

Management's Discussion and Analysis

As management of the Otay Water District (the "District"), we offer readers of the District's financial statements this narrative overview and analysis of the District's financial performance during the fiscal year ending June 30, 2008. Please read it in conjunction with the District's financial statements that follow Management's Discussion and Analysis. All amounts, unless otherwise indicated, are expressed in millions of dollars.

Financial Highlights

- The assets of the District exceeded its liabilities at the close of the most recent fiscal year by $456.8 million *(net assets).* Of this amount, $82.0 million *(unrestricted net assets)* may be used to meet the District's ongoing obligations to citizens and creditors.

- The District's total net assets increased by $9.8 million. This is primarily attributable to capital contributions of $14.9 million during the fiscal year.

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 following: 1) Statement of Net Assets, 2) Statement of Revenues, Expenses and Changes in Net Assets, 3) Statement of Cash Flows, and 4) Notes to the financial Statements. This report also contains other supplementary information in addition to the basic financial statements.

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 financial position of the District is improving or weakening.

The *Statement of Revenues, Expenses and Changes in Net Assets* presents information showing how the District's 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 (e.g., uncollected taxes and earned but unused vacation leave).

The *Statement of Cash Flows* presents information on cash receipts and payments for the fiscal year.

The *Notes to the Financial Statements* provide additional information that is essential to a full understanding of the data supplied in the each of the specific financial statements listed above.

In addition to the basic financial statements and accompanying notes, this report also presents certain *required supplementary information* concerning the District's progress in funding its obligation to provide pension benefits to its employees.

Financial Analysis

As noted earlier, net assets may serve over time as a useful indicator of an entity's financial position. In the case of the District, assets exceeded liabilities by $456.8 million at the close of the most recent fiscal year.

By far the largest portion of the District's net assets, $372.5 million (82%), reflects its investment in capital assets, less any related debt used to acquire those assets that is still outstanding. The District uses these capital assets to provide services to citizens; consequently, these assets are not available for future spending. Although the District's investment in its capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

Statement of Net Assets
(In Millions of Dollars)

	2008	2007	2006
Assets			
Current and Other Assets	$ 106.4	$ 122.1	$ 86.4
Capital Assets	446.7	424.3	397.0
Total Assets	553.1	546.4	483.4
Liabilities			
Long-term Debt Outstanding	71.7	74.2	33.9
Other Liabilities	24.6	25.2	27.4
Total Liabilities	96.3	99.4	61.3
Net Assets			
Invested in Capital Assets Net of Related Debt	372.5	374.6	361.6
Restricted	2.3	2.1	2.4
Unrestricted	82.0	70.3	58.1
Total Net Assets	$ 456.8	$ 447.0	$ 422.1

At the end of FY-2008 the District is able to report positive balances in all categories of net assets. This situation also held true for the prior two fiscal years. In FY-2008 total Net Assets increased approximately $9.8 million, to $456.8 million, as compared to FY-2007 when Net Assets increased by over $24.9 million. While the District's operations and population continue to grow, albeit at slower rates than in prior years, the pattern of reduced growth of the District's Net Assets is indicative of the reduction in new development projects within the District. This reduction is a result of the ongoing national housing slump and financial crisis.

The increase in Current and Other Assets of $35.7 million in FY-2007 corresponds with the increase in Long-term Debt of $40.3 million, due to the issuance of $42 million in new Certificates of Participation (COPS-2007). (See Note 5 in the Notes to Financial Statements). These funds are being used as a part of the District's substantial Capital Improvement Plan (CIP), as evidenced by an increase in Capital Assets of $27.3 million (net of accumulated depreciation) in FY-2007. In FY-2008 use of the COPS-2007 funds to finance the CIP program continued, contributing to the increase in Capital Assets of $22.4 million. The use of the COPS-2007 funds is also reflected in the decrease of Current and Other Assets of $15.7 million. (See Note 3 in the Notes to Financial Statements).

Statements of Revenues, Expenses, and Changes in Net Assets
(In Millions of Dollars)

	2008	2007	2006
Water Sales	$ 50.8	$ 48.6	$ 43.8
Wastewater Revenue	2.4	2.6	2.3
Connection and Other Fees	2.5	2.1	1.8
Non-operating Revenues	13.6	11.1	8.5
Total Revenues	69.3	64.4	56.4
Depreciation Expense	13.0	10.8	10.1
Other Operating Expense	58.5	53.9	49.5
Non-operating Expense	2.9	1.3	1.2
Total Expenses	74.4	66.0	60.8
Loss Before Capital Contributions	(5.1)	(1.6)	(4.4)
Capital Contributions	14.9	26.5	15.4
Change in Net Assets	9.8	24.9	11.0
Beginning Net Assets	447.0	422.1	411.1
Ending Net Assets	$ 456.8	$ 447.0	$ 422.1

Water Sales increased by $4.8 in FY-2007 and $2.2 million in FY-2008, mainly due to reduced rainfall during both years as well as rate increases in both years. Growth also had a partial impact, with new water meter sales of 548 and 220 meters respectively. Non-operating Revenues increased by $2.6 million in FY-2007 due primarily to rising rates of return on investment income. Despite a reversal of market rates of return in FY-2008, Non-operating Revenues increased an additional $2.5 million due to the increased level of investments from the COPS-2007, increased property tax revenues, and healthcare reimbursements from CalPERS for other post employment benefits (OPEB). (See Note 9 in the Notes to Financial Statements).

Depreciation Expense increased by a modest $0.7 million in FY-2007 and then $2.2 million in FY-2008, due to a comprehensive review and write-off of long-term fixed assets that were obsolete and/or no longer serviceable. Other Operating Expense increased by approximately $4.4 million in FY-2007 and $4.6 million in FY-2008 as a result of the cost of the additional water sold each year, as well as increases in outside services and higher pension costs. Non-operating Expense was consistent from FY-2006 to FY-2007, but increased $1.6 million in FY-2008 due to a full year of interest expense from the COPS-2007.

Capital Contributions increased $11.1 million in FY-2007 due to the completion of several developer construction projects. However, because of the nationwide housing mortgage crisis throughout FY-2008, developers either slowed-down or totally stopped work on as many projects as possible until economic conditions improve and the demand for growth returns, resulting in a decrease in Capital Contributions of $11.6 million from the prior year.

Capital Assets and Debt Administration

Capital Assets. The District's capital assets as of June 30, 2008, totaled $446.7 million (net of accumulated depreciation). Included in this amount is land. The total increase in the District's capital assets was 6.9% for FY-2007 and 4.6% in FY-2008.

Capital Assets
(In Millions of Dollars)

	2008	2007	2006
Land	$ 13.0	$ 13.0	$ 12.5
Construction in Progress	42.3	40.3	58.9
Water System	365.6	356.6	333.0
Reclaimed Water System	93.0	73.5	49.1
Sewer System	36.7	37.7	37.7
Buildings	17.6	17.6	17.5
Transportation Equipment	3.1	3.1	2.9
Engineering Equipment	5.7	5.6	5.7
Power Operated Equipment	1.6	1.6	1.6
Other Equipment	19.7	18.5	10.9
	598.3	567.5	529.8
Less Accumulated Depreciation	(151.6)	(143.2)	(132.8)
Net Capital Assets	$ 446.7	$ 424.3	$ 397.0

As indicated by figures in the table above, the majority of capital assets added during both fiscal years were related to the potable and reclaimed water systems. In addition, the majority of the cost of construction in progress is also related to these water systems.

Additional information on the District's capital assets can be found in Note 3 of the Notes to Financial Statements.

Long-term Debt. At June 30, 2008, the District had $71.7 million in outstanding debt which consisted of the following:

General Obligation Bonds	$ 7.7
Certificates of Participation	63.3
Notes Payable	0.7
Total Long-term Debt	$ 71.7

Additional information on the District's long-term debt can be found in Note 5 of the Notes to Financial Statements.

Fiscal Year 2008-2009 Budget

Economic Factors

Growth in the San Diego area has slowed over the last 2 years, and demand for housing is reflected in a similarly reduced pace. The District currently provides water service to about 69% of its total projected population, serving approximately 191,500 people. Long-term, this percentage should continue to increase as the District's service area continues to develop and grow. Ultimately, the District is projected to serve approximately 277,000 people, creating an average daily demand of 56 million gallons per day (MGD).

The District is projected to deliver approximately 38,800 acre-feet of water to 47,340 customers during Fiscal Year 2008-2009. Management feels that these projections are very realistic after accounting for low growth, supply changes, and a focus on conservation. Current economic conditions throughout America have created an unprecedented uncertainty for business and economic projections in the current fiscal year. The nationwide housing mortgage crisis has resulted in hundreds of foreclosures throughout the District. Additionally, the crisis in the banking and financial industry has begun to have a ripple effect of employee layoffs across a wide swath of the business community. One of the subsequent results of these two broad events is the relocation of many homeowners and renters into new housing arrangements throughout San Diego County. However, as housing patterns change throughout the District, people's need for water remains an underlying constant.

Financial

The District has implemented a six-year rate study projection that forecasts minimum essential rate increases in order to fund required growth and improvements in infrastructure, as well as to pass along cost increases from the City of San Diego, the County of San Diego, and the San Diego County Water Authority. The expanding demand for water service over the past few years continues to support the incremental costs associated with meeting this increase in demand. As a result, the District has been able to implement strategic changes that will provide long-term benefits to the District, while only increasing rates at modest levels.

Conversely, lower than average levels of rainfall over the last three years have caused historic dry conditions and depleted water reserves throughout the entire state. Following Governor Schwarzenagger's declaration of a statewide drought in California in June 2008, the District declared a Level 1 drought watch. By doing so, we have begun calling on all customers to achieve up to a 10 percent reduction in their water use through voluntary measures. By summer of next year, we estimate we could be in Level 2 drought alert where voluntary conservation gives way to mandatory measures and all customers are required to cut water use by up to 20 percent. Mitigating the impact of this revenue decrease would be corresponding reductions in expenses, to include the cost of water and the associated electricity required for pumping.

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

Contacting the District's Financial Management

This financial report is designed to provide a general overview of the Otay Water District's finances for the Board of Directors, taxpayers, creditors, and other interested parties. Questions concerning any of the information provided in the report or requests for additional information should be addressed to the District's Finance Department, 2554 Sweetwater Springs Blvd., Spring Valley, CA 91978-2004.

Statement of Net Assets
June 30, 2008 and 2007

	2008	2007
ASSETS		
Current Assets:		
Cash and Cash Equivalents (Note 2)	$ 23,351,911	$ 8,048,633
Restricted Cash and Cash Equivalents (Note 2)	3,753,983	11,191,213
Investments (Note 2)	60,682,507	68,912,864
Restricted Investments (Note 2)		19,975,538
Accounts Receivable	7,689,720	8,675,458
Accrued Interest Receivable	715,900	1,559,081
Restricted Taxes and Availability Charges Receivable	537,195	443,854
Inventory	711,240	633,697
Prepaid Expenses and Other Current Assets	1,908,028	1,164,300
Total Current Assets	99,350,484	120,604,638
Non-current Assets:		
Net OPEB Obligation	5,649,008	
Capital Assets, Net of Depreciation (Note 3)	446,714,397	424,260,968
Other Non-current Assets (Note 4)	1,408,971	1,490,515
Total Non-current Assets	453,772,376	425,751,483
Total Assets	553,122,860	546,356,121
LIABILITIES		
Current Liabilities:		
Current Maturities of Long-term Debt (Note 5)	2,445,214	1,519,048
Accounts Payable	11,075,807	10,930,658
Accrued Payroll Liabilities	2,491,182	2,270,958
Other Accrued Liabilities	1,615,402	1,597,012
Customer Deposits	2,719,331	2,622,646
Liabilities Payable From Restricted Assets:		
Accounts Payable	2,629,759	4,492,364
Accrued Interest	886,642	882,888
Total Current Liabilities	23,863,337	24,315,574
Non-current Liabilities:		
Liabilities Payable From Restricted Assets:		
Prepaid Capacity Fees	690,709	890,473
Long-term Debt (Note 5)		
General Obligation Bonds	7,678,302	8,045,029
Certificates of Participation	63,361,579	65,051,790
Notes Payable	701,516	1,031,730
Total Non-current Liabilities	72,432,106	75,019,022
Total Liabilities	96,295,443	99,334,596
NET ASSETS (NOTE 7)		
Invested in Capital Assets, Net of Related Debt	372,527,786	374,667,591
Restricted for Construction	2,314,400	2,071,307
Unrestricted	81,985,231	70,282,627
Total Net Assets	$ 456,827,417	$ 447,021,525

The accompanying notes are an integral part of this statement.

Statement of Revenues, Expenses and Changes in Net Assets
For The Years Ended June 30, 2008 and 2007

	2008	2007
OPERATING REVENUES		
Water Sales	$ 50,808,825	$ 48,605,606
Wastewater Revenue	2,386,285	2,604,431
Connection and Other Fees	2,519,735	2,040,444
Total Operating Revenues	55,714,845	53,250,481
OPERATING EXPENSES		
Cost of Water Sales	35,296,002	33,994,841
Wastewater	2,009,876	1,508,672
Administrative and General	21,127,922	18,418,441
Depreciation	13,040,572	10,729,096
Total Operating Expenses	71,474,372	64,651,050
Operating Income (Loss)	(15,759,527)	(11,400,569)
NON-OPERATING REVENUES (EXPENSES)		
Investment Income	4,538,791	4,416,342
Taxes and Assessments	4,591,023	4,151,956
Availability Charges	744,722	715,664
Gain on Sale of Capital Assets	15,243	1,817
Miscellaneous Revenues	3,676,963	1,809,802
Donations	(80,541)	(80,000)
Interest Expense	(2,601,252)	(950,479)
Miscellaneous Expenses	(261,492)	(271,410)
Total Non-operating Revenues (Expenses)	10,623,457	9,793,692
Income (Loss) Before Contributions	(5,136,070)	(1,606,877)
Capital Contributions	14,941,962	26,563,075
Change in Net Assets	9,805,892	24,956,198
Total Net Assets, Beginning	447,021,525	422,065,327
Total Net Assets, Ending	$ 456,827,417	$ 447,021,525

The accompanying notes are an integral part of this statement.

Statement of Cash Flows
For The Years Ended June 30, 2008 and 2007

	2008	2007
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash Received from Customers	$ 54,276,851	$ 49,477,123
Cash from Other Operating Activities	2,520,417	2,040,444
Other Receipts	1,797,869	894,234
Cash Payments to Suppliers	(41,996,845)	(41,462,779)
Cash Payments to Employees	(23,670,840)	(15,835,985)
Other Payments	(135,104)	(167,472)
Net Cash Provided (Used) By Operating Activities	(7,207,652)	(5,054,435)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Receipts from Taxes and Assessments	4,497,682	4,026,192
Receipts from Property Rents and Leases	977,313	951,020
Net Amounts Paid for Acquisition and Maintenance of Demonstration Garden	(80,541)	(80,000)
Net Cash Provided (Used) By Noncapital Financing Activities	5,394,454	4,897,212
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Proceeds from Capital Contributions	6,807,761	17,476,332
Proceeds from Sale of Capital Assets	15,243	1,817
Proceeds from Debt Related Taxes and Assessments	744,722	715,664
Proceeds from Long-Term Debt (Note 5)		40,989,797
Principal Payments on Long-Term Debt (Note 5)	(1,519,048)	(1,529,848)
Acquisition and Construction of Capital Assets	(27,359,800)	(28,915,737)
Interest Paid	(2,597,498)	(481,033)
Net Cash (Used) By Capital and Related Financing Activities	(23,908,620)	28,256,992
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest Received on Investments	5,381,971	3,676,059
Proceeds from Sale and Maturities of Investments	88,909,995	44,708,111
Purchase of Investments	(60,704,100)	(71,000,000)
Net Cash Provided (Used) by Investing Activities	33,587,866	(22,615,830)
Net Increase (Decrease) in Cash and Cash Equivalents	7,866,048	5,483,939
Cash and Cash Equivalents - Beginning of Year	19,239,846	13,755,907
Cash and Cash Equivalents - End of Year	$ 27,105,894	$ 19,239,846

The accompanying notes are an integral part of this statement.

STATEMENT OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2008 AND 2007

	2008	2007
Reconciliation of operating income (loss) to net cash provided (used) by operating activities:		
Net Operating Income (Loss)	$ (15,759,527)	$ (11,400,569)
Adjustments to Reconcile Operating Income to Net Cash Provided (Used) by Operating Activities:		
Depreciation	13,040,572	10,729,096
Miscellaneous Revenues	2,712,869	894,234
Miscellaneous Expenses	(135,104)	(167,472)
(Increase) Decrease in Accounts Receivable	985,738	(1,866,459)
(Increase) Decrease in Inventory	(77,543)	(41,271)
(Increase) Decrease in Net OPEB Obligation	(5,649,008)	
(Increase) Decrease in Prepaid Expenses and Other Current Assets	(743,728)	(500,167)
Increase (Decrease) in Accounts Payable	(1,717,456)	(3,827,697)
Increase (Decrease) in Accrued Payroll and Related Expenses	220,224	(77,895)
Increase (Decrease) in Other Accrued Liabilities	18,390	913,662
Increase (Decrease) in Customer Deposits	96,685	133,545
Increase (Decrease) in Prepaid Capacity Fees	(199,764)	156,558
Total Cash Provided (Used) By Operating Activities	$ (7,207,652)	$ (5,054,435)
SUPPLEMENTAL DISCLOSURES		
Non-cash Investing and Financing Activities Consisted of the Following:		
Contributed Capital for Water and Sewer System	$ 8,134,201	$ 8,812,611
Change in Fair Value of Investments and Recognized Gains/Losses	109,847	223,829
Capital Contribution Resulting from Prepaid Capacity Fees	33,356	156,558
Amortization Related to Long-term Debt	126,387	103,938
Cash Paid for Interest Expense	$ 2,970,780	$ 1,478,461

The accompanying notes are an integral part of this statement.

1) REPORTING ENTITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A) Reporting Entity

Otay Water District (the "District") is a public entity established in 1956 pursuant to the Municipal Water District Law of 1911 (Section 711 et. Seq. of the California Water Code) for the purpose of providing water and sewer services to the properties in the District. The District is governed by a Board of Directors consisting of five directors elected by geographical divisions based on District population for a four-year alternating term.

B) Measurement Focus, Basis of Accounting and Financial Statement Presentation

The basic financial statements of the Otay Water District have been prepared in conformity with accounting principles generally accepted in the United States of America. The Governmental Accounting Standards Board (GASB) is the accepted standard setting body for governmental accounting financial reporting purposes.

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. 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.

Fund equity is displayed as three components: (1) Invested in capital assets, net of related debt, which reflects the cost of capital assets less accumulated depreciation and less the outstanding principal of related debt not associated with unspent bond proceeds; (2) Restricted, which reflects the carrying value of assets less related liabilities that are restricted by outside covenants or by law; and (3) Unrestricted, which represents the remaining fund equity balance.

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 wastewater services while operating expenses pertain directly to the furnishing of those 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 wastewater treatment services.

The District recognizes revenues from water sales, wastewater revenues, and meter fees as they are earned. Taxes and assessments are recognized as revenues based upon amounts reported to the District by the County of San Diego, net of allowance for delinquencies of $59,688 and $49,317 at June 30, 2008 and 2007, respectively.

Additionally, capacity fee contributions received in an amount corresponding to expansion specific operating expenses are offset against these expenses and included in Cost of Water Sales in the Statement of Revenues and Expenses and Changes in Net Assets.

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 accounting policies of the District conform to generally accepted accounting principles (GAAP) as applicable to governmental enterprise funds. In accordance with GASB Statement 20, the District has elected to follow all GASB Pronouncements and apply all Financial Accounting Standards Board Statements and Interpretations issued on or before November 30, 1989, with the exception of those that conflict with or contradict GASB Pronouncements.

1) REPORTING ENTITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

C) Statement of Cash Flows

For purposes of the Statement of Cash Flows, the District considers all highly liquid investments (including restricted assets) with a maturity period, at purchase, of three months or less to be cash equivalents.

D) Investments

As a governmental entity other than an external investment pool in accordance with GASB 31, the District's investments are stated at fair value, which is determined using selected basis. Short-term investments are reported at cost, which approximates fair value. Investments in government obligations are valued on over-the-counter bid quotations available at year-end. Cash deposits are reported at carrying amount, which reasonably estimates fair value. Investments in governmental investment pools are reported on the fair value per share, of the pool's underlying portfolio.

E) Inventory and Prepaids

Inventory consists primarily of materials used in the construction and maintenance of the water and sewer system and is valued at weighted average cost. Both inventory and prepaids use the consumption method whereby they are reported as an asset and expensed as they are consumed.

F) Capital Assets

Capital assets are recorded at cost, where historical records are available, and at an estimated historical cost where no historical records exist. Infrastructure assets in excess of $20,000 and other Capital assets in excess of $10,000 are capitalized if they have an expected useful life of two years or more. The cost of purchased and self-constructed additions to utility plant and major replacements of property are capitalized. Costs include materials, direct labor, transportation, and such indirect items as engineering, supervision, employee fringe benefits, and interest incurred during the construction period. Repairs, maintenance, and minor replacements of property are charged to expense. Donated assets are capitalized at their approximate fair market value on the date contributed.

The District capitalizes interest on construction projects up to the point in time that the project is substantially completed. Capitalized interest is included in the cost of water system assets and is depreciated on the straight-line basis over the estimated useful lives of such assets.

Depreciation is calculated using the straight-line method over the following estimated useful lives:

Water System	15-70 Years
Engineering Equipment	2-50 Years
Buildings	30-50 Years
Power Operated Equipment	5-10 Years
Transportation Equipment	2-4 Years
Other Equipment	2-10 Years
Reclaimed Water System	50-75 Years
Sewer System	25-50 Years

1) REPORTING ENTITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

G) Compensated Absences

In accordance with GASB Statement No. 16, a liability is recorded for unused vacation and sick 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 payment upon termination or retirement.

H) Restricted Assets and Liabilities

Certain current liabilities have been classified as current liabilities payable from restricted assets as they will be funded from restricted assets.

I) Allowance for Doubtful Accounts

The District charges doubtful accounts arising from water sales receivable to bad debt expense when it is probable that the accounts will be uncollectible. Uncollectible accounts are determined by the allowance method based upon prior experience and management's assessment of the collectibility of existing specific accounts.

J) Use of Estimates

The financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and necessarily include amounts based on estimates and assumptions by management.

K) Property Taxes

Tax levies are limited to 1% of full market value (at time of purchase) which results in a tax rate of $1.00 per $100 assessed valuation, under the provisions of Proposition 13. Tax rates for voter-approved indebtedness are excluded from this limitation.

The County of San Diego (the "County") bills and collects property taxes on behalf of the District. The County's tax calendar year is July 1 to June 30. Property taxes attach as a lien on property on March 1. Taxes are levied on July 1 and are payable in two equal installments on November 1 and February 1, and become delinquent after December 10 and April 10, respectively.

L) Reclassifications

Certain reclassifications have been made to prior year amounts to conform to the current year presentation.

2) CASH AND INVESTMENTS

The primary goals of the District's Investment Policy are to assure compliance with all Federal, State, and Local laws governing the investment of funds under the control of the organization, protect the principal of investments entrusted, and generate income under the parameters of such policies.

The District's Investment Policy and State statues authorize the District to invest in obligations of the U.S. Treasury, agencies and instrumentalities, prime commercial paper, and negotiable certificates of deposit. Funds may also be invested in the State Treasurer's Local Agency Investment Fund (LAIF) and the San Diego County Treasurer's Pooled Money Fund.

2) CASH AND INVESTMENTS - Continued

Cash and Investments are classified in the accompanying financial statements as follows:

Statement of Net Assets:	
Cash and Cash Equivalents	$ 23,351,911
Investments	60,682,507
Restricted:	
Cash and Cash Equivalents	3,753,983
Total Cash and Investments	$ 87,788,401

Cash and investments consist of the following:

Cash on Hand	$ 2,800
Deposits with Financial Institutions	2,655,933
Investments	85,129,668
Total Cash and Investments	$ 87,788,401

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, 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[1]	Maximum Investment In One Issuer
U.S. Treasury Obligations	5 years	None	None
Federal Agency Securities	5 years	None	None
Certificates of Deposit	5 years	15%	None
Corporate Medium-Term Notes	5 years	15%	None
Commercial Paper	270 days	15%	10%
Money Market Mutual Funds	N/A	15%	None
County Pooled Investment Funds	N/A	None	None
Local Agency Investment Fund (LAIF)	N/A	None	None

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

2) 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.

Disclosures Relating to Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. One of the ways that the District manages its exposure to interest rates risk is by purchasing a combination of shorter term and longer term investments and by timing cash flows from maturities, so that a portion of the portfolio is maturing or coming close to maturity evenly over time, as necessary, to provide the cash flow and liquidity needed for operations.

Information about the sensitivity of the fair values of the District's investments (including investments held by the bond trustee) to market interest rate fluctuations is provided by the following table that shows the distribution of the District's investments by maturity.

		Remaining Maturity (in Months)			
Investment Type		12 Months Or Less	13 to 24 Months	25 to 60 Months	More Than 60 Months
Federal Agency Securities	$ 58,630,803	$	$ 22,018,478	$ 36,612,325	$
Local Agency Investment Fund (LAIF)	12,228,060	12,228,060			
Corporate Medium-Term Notes	2,051,704			2,051,704	
San Diego County Pool	12,219,101	12,219,101			
Total	$ 85,129,668	$ 24,447,161	$ 22,018,478	$ 38,664,029	$ 0

Disclosures Relating to 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 or the District's Investment Policy, or debt agreements, and the actual rating as of year end for each investment type.

		Minimum	Rating as of Year End		
Investment Type		Legal Rating	AAA	Aa	Not Rated
Federal Agency Securities	$ 58,630,803	N/A	$ 58,630,803	$	$
Local Agency Investment Fund (LAIF)	12,228,060	N/A			12,228,060
Corporate Medium-Term Notes	2,051,704		2,051,704		
San Diego County Pool	12,219,101	N/A			12,219,101
Total	$ 85,129,668		$ 60,682,507	$ 0	$ 24,447,161

2) CASH AND INVESTMENTS - Continued

Concentration of Credit Risk

The investment policy of the District contains no limitation on the amount that can be invested in any one issuer beyond that stipulated by the California Government Code, Sections 53600 through 53692. Investments in any one issuer (other than U.S. Treasury securities, mutual funds, and external investment pools) that represent 5% or more of total District investments are as follows:

Issuer	Investment Type	Reported Amount	
Federal Home Loan Bank	Federal Agency Securities	$	38,641,000
Federal Home Loan Mortgage Corp	Federal Agency Securities	$	13,987,228

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 Entity's investment policy do not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits or investments, other than the following provision for deposits: The California Government Code requires that a financial institution secure deposits made by state or local government 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 deposits by pledging first trust deed mortgage notes having a value of 150% of the secured public deposits.

As of June 30, 2008, $1,442,408 of the District's deposits with financial institutions in excess of federal depository insurance limits were held in collateralized accounts. As of June 30, 2008, District investments in the following investment types were held by the same broker-dealer (counter party) that was used by the District to buy the securities:

Investment Type	Reported Amount	
Federal Agency Securities	$	58,630,803

Local Agency Investment Fund (LAIF)

The District is a voluntary participant in the Local Agency Investment Fund (LAIF) that is regulated by California Government Code Section 16429 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 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.

The LAIF is a special fund of the California State Treasury through which local governments may pool investments. The District may invest up to $40,000,000 in the fund. Investments in LAIF are highly liquid, as deposits can be converted to cash within 24 hours without loss of interest. Investments with LAIF are secured by the full faith and credit of the State of California. The yield of LAIF during the quarter ended June 30, 2008 was 3.11%. The carrying value and estimated market value of the LAIF Pool at June 30, 2008 was $70,027,950,242 and $70,024,464,150, respectively. The District's share of the Pool at June 30, 2008 was approximately 0.018 percent. Included in LAIF's investment portfolio are structured notes and asset-backed securities totaling $6,113,006,000 and $4,188,272,000, respectively. LAIF's and the District's exposure to risk (credit, market or legal) is not currently available. The LAIF has oversight by the Local Investment Advisory Board. The LAIF Board consists of five members as designated by statute.

2) CASH AND INVESTMENTS - Continued

San Diego County Pooled Fund

As permitted by its Investment Policy, the District has placed funds with the San Diego County Pooled Fund. The pool may invest some of their portfolios in derivatives. Detailed information on derivative investments held by this pool is not readily available.

Collateral for Deposits

All cash and Certificates of Deposit are entirely insured or collateralized.

Under the provisions of the California Government Code, California banks and savings and loan associations are required to secure the District's deposits by pledging government securities as collateral. The market value of the pledged securities must equal at least 110% of the District's deposits. California law also allows financial institutions to secure city deposits by pledging first trust deed mortgage notes having a value of 150% of the District's total deposits.

The District may waive the 110% collateral requirement for deposits which are insured up to $100,000 by the FDIC.

3) CAPITAL ASSETS

The following is a summary of changes in Capital Assets for the year ended June 30, 2008:

	Beginning Balance	Additions	Deletions	Ending Balance
Capital Assets, Not Depreciated				
Land	$ 12,971,479	$ 53,885	$	$ 13,025,364
Construction in Progress	40,300,055	27,173,621	(25,135,456)	42,338,220
Total Capital Assets Not Depreciated	53,271,534	27,227,506	(25,135,456)	55,363,584
Capital Assets, Being Depreciated				
Infrastructure	467,803,021	31,880,962	(4,434,610)	495,249,373
Field Equipment	9,358,862	122,501	(51,087)	9,430,276
Buildings	17,607,655	28,469		17,636,124
Transportation Equipment	3,056,708	239,024	(193,071)	3,102,661
Communication Equipment	599,452	90,502		689,954
Office Equipment	15,787,313	1,060,821	(22,541)	16,825,593
Total Capital Assets Being Depreciated	514,213,011	33,422,279	(4,701,309)	542,933,981
Less Accumulated Depreciation:				
Infrastructure	119,327,467	10,219,528	(4,414,282)	125,132,713
Field Equipment	8,577,175	187,951	(51,087)	8,714,039
Buildings	5,064,435	573,250		5,637,685
Transportation Equipment	2,614,884	137,328	(193,071)	2,559,141
Communication Equipment	265,119	104,445		369,564
Office Equipment	7,374,497	1,818,070	(22,541)	9,170,026
Total Accumulated Depreciation	143,223,577	13,040,572	(4,680,981)	151,583,168
Total Capital Assets Being Depreciated, Net	370,989,434	20,381,707	(20,328)	391,350,813
Total Capital Assets, Net	$ 424,260,968	$ 47,609,213	$ (25,155,784)	$ 446,714,397

Depreciation expense for the year ended June 30, 2008 and 2007 was $13,040,572 and $10,729,096, respectively.

4) OTHER NON-CURRENT ASSETS

Contracts receivable totaled $41,375 and $55,759, net of no allowance as of June 30, 2008 and 2007, respectively.

Deferred bond issue costs totaled $1,198,791 and $1,254,821, net of accumulated amortization of $389,352 and $357,952 as of June 30, 2008 and 2007, respectively. The 2004 COPS had refunding transactions net of accumulated amortization of $168,805 for June 30, 2008 and $179,935 for June 30, 2007. The costs are amortized on the straight-line method based on the estimated term of the related bond debt. Amortization expense of $31,400 for the years ended June 30, 2008 and 2007 is included with miscellaneous expense.

5) LONG-TERM DEBT

Long-term liabilities for the year ended June 30, 2008 are as follows:

	Beginning Balance	Additions	Deletions	Ending Balance	Due Within One Year
General Obligation Bonds:					
Improvement District No. 27	$ 9,210,000	$	$ 400,000	$ 8,810,000	$ 415,000
Unamortized Bond Discount	(110,953)		(7,397)	(103,556)	
Deferred Amount of Funding	(654,018)		(40,876)	(613,142)	
Net General Obligation Bonds	8,445,029		351,727	8,093,302	415,000
Certificates of Participation:					
1996 Certificates of Participation	12,800,000		300,000	12,500,000	400,000
2004 Certificates of Participation	11,335,000		500,000	10,835,000	515,000
2007 Certificates of Participation	42,000,000			42,000,000	785,000
1996 COPS Unamortized Discount	(14,903)		(745)	(14,158)	
2007 COPS Unamortized Discount	(268,307)		(9,044)	(259,263)	
Net Certificates of Participation	65,851,790		790,211	65,061,579	1,700,000
Notes Payable					
State Water Resource Control Board	1,350,778		319,048	1,031,730	330,214
Total Long-Term Liabilities	$ 75,647,597	$	$ 1,460,986	$ 74,186,611	$ 2,445,214

General Obligation Bonds

In June 1998, the District issued $11,835,000 of General Obligation Refunding Bonds. The proceeds of this issue, together with other lawfully available monies, were to be used to establish an irrevocable escrow to advance refund and defease in their entirety the District's previous outstanding General Obligation Bond issue. These bonds are general obligations of Improvement District No. 27 (ID 27) of the District. The Board of Directors has the power and is obligated to levy annual ad valorem taxes without limitation, as to rate or amount for payment of the bonds and the interest upon all property which is within ID 27 and subject to taxation. The General Obligation Bonds are payable from District-wide tax revenues. The Board may utilize other sources for servicing the bond debt and interest.

5) LONG-TERM DEBT - Continued

The refunding resulted in a deferred amount of $1,021,903, which is being amortized over the remaining life of the refunded debt. Amortization for the years ended June 30, 2008 and 2007 was $40,876 for each year and is included in miscellaneous non-operating expenses. As of June 30, 2008 and 2007, the amortized deferred amount of refunding is $613,142, and $654,018, respectively.

The 1998 General Obligation Bonds have interest rates from 4.5% to 5% with maturities through Fiscal Year 2023.

Future debt service requirements for the bonds are as follows:

For the Year Ended June 30,	Principal	Interest
2009	$ 415,000	$ 422,047
2010	435,000	402,705
2011	455,000	382,235
2012	475,000	360,607
2013	495,000	337,565
2014-2018	2,870,000	1,287,673
2019-2023	3,665,000	475,875
	$ 8,810,000	$ 3,668,707

The following General Obligation Bonds have been authorized by the Board of Directors, but were unissued as of June 30, 2008:

Date Authorized	Improvement District (ID)	Construction Purpose	Bond Amount
December 30, 1960	5	Water System	$ 605,000
December 20, 1960	6	Sewer System	705,000
August 23, 1960	1 - 3	Sewer System	405,000
August 23, 1960	1 - 4	Water System	75,000
March 18, 1970	U - 18	Sewer System	2,700,000
April 19, 1971	U - 19	Water System	1,000,000
May 17. 1971	U - 20	Water System	13,000,000
June 5, 1972	U - 22	Water System	6,000,000
May 1, 1978	U - 25	Water System	5,050,000
November 1, 1989	U - 27	Water System	88,500,000

Certificates of Participation (COPS)

In June 1996, COPS with face value of $15,400,000 were sold by the Otay Service Corporation to finance the cost of design, acquisition, and construction of certain capital improvements. An installment purchase agreement between the District, as Buyer, and the Corporation, as Seller, was executed for the scheduled payment of principal and interest associated with the COPS. The installment payments are to be paid from taxes and "net revenues," as described in the installment agreement. The certificates bear interest at a variable weekly rate not to exceed 12%. The interest rate at June 30, 2008 was 1.33%. The installment payments are to be paid annually at $350,000 to $900,000 from September 1, 1996 through September 1, 2026.

5) LONG-TERM DEBT - Continued

Certificates of Participation (COPS) - Continued

In July 2004, Refunding Certificates of Participation (COPS) with a face value of $12,270,000 were sold by the Otay Service Corporation to advance refund $11,680,000 of outstanding 1993 COPS. An installment agreement between the District, as Buyer, and the Corporation, as Seller, was executed for the scheduled payment of principle and interest associated with the COPS. The installment payments are to be paid from taxes and "net revenues," as described in the installment agreement. The certificates are due in annual installments of $445,000 to $895,000 from September 1, 2005 through September 1, 2023; bearing interest at 3% to 4.625%.

In March 2007, Revenue Certificates of participation (COPS) with face value of $42,000,000 were sold by the Otay Service Corporation to improve the District's water storage system and distribution facilities. An installment purchase agreement between the District, as a Buyer, and the Corporation, as Seller, was executed for the scheduled payment of principle and interest associated with the COPS. The installment payments are to be paid from taxes and "net revenues," as described in the installment agreement. The certificates are due in annual installments of $785,000 to $2,445,000 from September 1, 2007 through September 1, 2036; bearing interest at 3.7% to 4.47%.

There is no aggregate reserve requirement for the COPS. Future debt service requirements for the certificates are as follows:

For the Year	1996 COPS		2004 COPS		2007 COPS	
Ended June 30,	Principal	Interest*	Principal	Interest	Principal	Interest
2009	$ 400,000	$ 160,930	$ 515,000	$ 418,309	$ 785,000	$ 1,730,532
2010	400,000	155,610	530,000	402,634	815,000	1,701,487
2011	400,000	150,290	545,000	386,236	850,000	1,671,333
2012	400,000	144,970	565,000	368,607	885,000	1,639,458
2013	500,000	138,320	580,000	349,566	920,000	1,606,270
2014-2018	2,800,000	583,870	3,250,000	1,401,425	5,175,000	7,485,187
2019-2023	3,700,000	361,760	3,955,000	660,819	6,260,000	6,411,638
2024-2028	3,900,000	82,460	895,000	20,697	7,670,000	5,028,046
2029-2033					9,460,000	3,261,119
2034-2037					9,180,000	1,025,500
	$ 12,500,000	$ 1,778,210	$ 10,835,000	$ 4,008,293	$ 42,000,000	$ 31,560,570

* Variable Rate - Interest reflected at June 30, 2008 at a rate of 1.33%.

Note Payable

In December 1990, the District entered into a 3.5% note payable to the State Water Resources Control Board. This note is unsecured and payable in annual installments of $366,325 including principal and interest from 1994 through 2010. The total amount outstanding at June 30, 2008 and aggregate maturities of the note for the fiscal years subsequent to June 30, 2008, are as follows:

For the Year Ended June 30,	Principal	Interest
2009	$ 330,214	$ 36,111
2010	341,772	24,553
2011	359,744	12,591
	$ 1,031,730	$ 73,255

6) SEGMENT INFORMATION

The District issued Certificates of Participation to finance certain capital improvements. Both the water and sewer departments are accounted for in a single fund. The sewer department operates the District's sewage treatment plant, sewage pumping stations, and collection systems, while the water department accounts for all other services. However, investors in the Certificates of Participation rely solely on the revenues generated by the individual activities for repayment.

Summary financial information for the water and sewer departments is presented below.

Condensed Statement of Net Assets

	Water	Sewer	Total
Assets:			
Current Assets	$ 94,971,245	$ 88,061	$ 95,059,306
Current Restricted Assets	4,291,178		4,291,178
Net OPEB Obligation	5,649,008		5,649,008
Capital Assets	430,098,108	16,616,289	446,714,397
Other Non-current Assets	1,408,971		1,408,971
Total Assets	536,418,510	16,704,350	553,122,860
Liabilities:			
Current Liabilities	20,025,537	321,399	20,346,936
Current Liabilities Payable from Restricted Assets	3,423,865	92,536	3,516,401
Non-current Liabilities Payable from Restricted Assets	683,209	7,500	690,709
Non-current Liabilities	71,741,397		71,741,397
Total Liabilities	95,874,008	421,435	96,295,443
Net Assets:			
Invested in Capital Assets, Net of Related Debt	355,911,497	16,616,289	372,527,786
Restricted	2,314,400		2,314,400
Unrestricted	82,318,605	(333,374)	81,985,231
Total Net Assets	$ 440,544,502	$ 16,282,915	$ 456,827,417

6) SEGMENT INFORMATION - Continued

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

	Water	Sewer	Total
Operating Revenues	$ 53,328,560	$ 2,386,285	$ 55,714,845
Depreciation	(12,160,845)	(879,727)	(13,040,572)
Other Operating Expenses	(56,423,924)	(2,009,876)	(58,433,800)
Operating Income	(15,256,209)	(503,318)	(15,759,527)
Non-operating Revenues (Expenses):			
Investment Income	3,947,418	591,373	4,538,791
Taxes and Assessments	4,197,092	393,931	4,591,023
Availability Charges	688,123	56,599	744,722
Gain on Sale of Capital Assets	15,243		15,243
Other Non-operating Revenues	3,676,963		3,676,963
Donations	(80,541)		(80,541)
Interest Expense	(2,560,489)	(40,763)	(2,601,252)
Other Non-operating Expenses	(261,492)		(261,492)
Transfers	1,198,468	(1,198,468)	0
Capital Contributions	14,941,962		14,941,962
Total Non-operating Revenues (Expenses)	25,762,747	(197,328)	25,565,419
Change in Net Assets	10,506,538	(700,646)	9,805,892
Total Net Assets, Beginning*	430,037,964	16,983,561	447,021,525
Total Net Assets, Ending	$ 440,544,502	$ 16,282,915	$ 456,827,417

*Beginning balances were restated from the prior year to reclassify infrastructure capital assets from water to sewer activities.

Condensed Statement of Cash Flows

	Water	Sewer	Total
Net Cash Provided (Used) by:			
Operating Activities	$ (6,462,401)	$ (745,251)	$ (7,207,652)
Non-capital Financing Activities	5,000,523	393,931	5,394,454
Capital and Related Financing Activities	(23,668,567)	(240,053)	(23,908,620)
Investing Activities	32,996,493	591,373	33,587,866
Net Increase (Decrease)	7,866,048	0	7,866,048
Beginning Cash and Cash Equivalents	19,239,846	0	19,239,846
Ending Cash and Cash Equivalents	$ 27,105,894	$ 0	$ 27,105,894

7) NET ASSETS

A summary of changes in net assets for the year ended June 30, 2008 is as follows:

Description	Investment in Capital Assets (Net of Related Debt)	Restricted Net Assets	Unrestricted Net Assets	Total
Beginning of Year	$ 374,667,591	$ 2,071,307	$ 70,282,627	$ 447,021,525
Income (Loss) Before Contributions	(13,040,572)*	2,734,492	5,170,010	(5,136,070)
Capital Contributions				
Construction of Water and Sewer Systems	8,134,201			8,134,201
Capacity Fees and Capital Contributions		6,281,326		6,281,326
Annexation Fees			526,435	526,435
Decrease in Related Capital Debt/(Transfers)	(24,593,234)	26,054,220	(1,460,986)	0
Acquisition and Construction/(Transfers)	27,359,800	(34,826,945)	7,467,145	0
End of Year	$ 372,527,786	$ 2,314,400	$ 81,985,231	$ 456,827,417

*Depreciation Expense

Designated Net Assets

In addition to the restricted net assets, unrestricted net assets have been designated by the Board of Directors for the following purposes as of June 30, 2008 and 2007:

	2008	2007
Replacement Reserve	$ 31,785,910	$ 31,779,960
Insurance Reserve	10,458,191	16,893,128
Expansion Reserve	34,877,733	17,809,405
Total	$ 77,121,834	$ 66,482,493

8) DEFINED BENEFIT PENSION PLAN

Plan Description

The District's defined plan, (the "Plan"), provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. The Plan is part of the Public Agency portion of the California Public Employees' Retirement System (CalPERS), an agent multiple-employer plan administered by CalPERS, which acts as a common investment and administrative agent for participating public employers within the State of California. A menu of benefit provisions as well as other requirements is established by State statute within the Public Employees' Retirement Law. The Plan 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.

8) DEFINED BENEFIT PENSION PLAN - Continued

Funding Policy

Active members in the Plan are required to contribute 8% of their annual covered salary. The District has elected to contribute 7% on behalf of its 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 rate for the fiscal year ended June 30, 2008 was 19.523%. The contribution requirements of the Plan members are established by State statute and the employer contribution rate is established and may be amended by the CalPERS.

Annual Pension Costs

For the fiscal year ended June 30, 2008, the District's annual pension cost and actual contribution was $2,252,601. The required contribution for the fiscal year ended June 30, 2008, was determined as part of the June 30, 2005 actuarial valuation.

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

Valuation Date	June 30, 2005
Actuarial Cost Method	Entry Age Actuarial Cost Method
Amortization Method	Level Percent of Payroll
Average Remaining Period	22 Years as of the Valuation Date
Asset Valuation Method	15 Year Smoothed Market
Actuarial Assumptions:	
Investment Rate of Return	7.75% (Net of Administrative Expenses)
Projected Salary Increase	3.25% to 14.45% Depending on Age, Service, and Type of Employment
Inflation	3.00%
Payroll Growth	3.25%
Individual Salary Growth	A merit scale varying by duration of employment coupled with an assumed annual inflation component of 3.00% and an annual production growth of 0.25%.

Initial unfunded liabilities are amortized over a closed period that depends on the Plan's date of entry into CalPERS. Subsequent Plan amendments are amortized as a level percentage of pay over a closed 20-year period. Gains and losses that occur in the operation of the plan are amortized over a rolling period, which results in an amortization of 6% of unamortized gains and losses each year. If the plan's accrued liability exceeds the actuarial value of the plan assets, then the amortization payment of the total unfunded liability may be lower than the payment calculated over a 30-year amortization period.

THREE-YEAR TREND INFORMATION FOR PERS

Fiscal Year	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation
6/30/08	2,252,601	100%	0
6/30/07	1,925,758	100%	0
6/30/06	2,120,529	100%	0

9) 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 of EPO, Silver or Gold and if they are located outside the State of California. Contributions by plan members range from $38 to $65 per month for coverage to age 65, and from $30 to $53 per month, respectively, thereafter.

The District is required to contribute 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 normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years. The current ARC rate is 7.7% of the annual covered payroll.

Annual OPEB Cost

For 2008, the District's annual OPEB cost (expense) of $846,000 for DPHP was equal to the ARC. In addition to the ARC, the District contributed an additional $5,000,000 and has cash and implied subsidy (healthcare reimbursements from CalPERS) amounts of $649,008 to the plan. The District's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for the 2008 and the two preceding years were as follows:

THREE-YEAR TREND INFORMATION FOR CERBT

Fiscal Year	Annual OPEB Cost (AOC)	Percentage of OPEB Cost Contributed	Net OPEB Obligation
6/30/08	$ 846,000	100%	$ (5,649,008)
6/30/07	*	*	*
6/30/06	*	*	*

*The information for the two preceding years is unavailable. GASB 45 was implemented in fiscal year 2008.

Funded Status and Funding Progress

The funded status of the plan as of June 30, 2007, was as follows:

Actuarial Accrued Liability (AAL)	$	11,408,000
Actuarial Value of Plan Assets	$	0
Unfunded Actuarial Accrued Liability (UAAL)	$	11,408,000
Funded Ratio (Actuarial Value of Plan Assets/AAL)		0%
Covered Payroll (Active Plan Members)	$	10,951,000
UAAL as a Percentage of Covered Payroll		104.2%

9) OTHER POST EMPLOYMENT BENEFITS - Continued

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 multiyear trend information that shows whether the actuarial value of the plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

Actuarial Methods and Assumptions

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and 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 the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce short-term volatility in actuarial accrued liabilities and the actuarial value of 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, 2007
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	7.75% (Net of Administrative Expenses)
Projected Salary Increase	3.25%
Inflation	3.00%
Individual Salary Growth	CalPERS 1997-2002 Experience Study

10) WATER CONSERVATION AUTHORITY

In 1999 the District formed the Water Conservation Authority (the "Authority"), a Joint Powers Authority, with other local entities to construct, maintain and operate a xeriscape demonstration garden in the furtherance of water conservation. The authority is a non-profit public charity organization and is exempt from income taxes. During the years ended June 30, 2008 and 2007, the District contributed $80,541 and $80,000, respectively, for the development, construction and operation costs of the xeriscape demonstration garden.

A summary of the Authority's June 30, 2007 audited financial statement is as follows (latest report available):

Assets	$ 2,556,885
Liabilities	97,538
Revenues, Gains and Other Support	685,299
Changes in Net Assets	12,540

11) COMMITMENTS AND CONTINGENCIES

Construction Commitments

The District had committed to capital projects under construction with an estimated cost to complete of $1,992,831 at June 30, 2008.

Litigation

Certain claims, suits and complaints arising in the ordinary course of operation have been filed or are pending against the District. In the opinion of the staff and counsel, all such matters are adequately covered by insurance, or if not so covered, are without merit or are of such kind, or involved such amounts, as would not have significant effect on the financial position or results of operations of the District if disposed of unfavorably.

Refundable Terminal Storage Fees

The District has entered into an agreement with several developers whereby the developers prepaid the terminal storage fee in order to provide the District with the funds necessary to build additional storage capacity. The agreement further allows the developers to relinquish all or a portion of such water storage capacity. If the District grants to another property owner the relinquished storage capacity, the District shall refund to the applicable developer $746 per equivalent dwelling unit (EDU). There were 17,867 EDUs that were subject to this agreement. At June 30, 2007, 1,750 EDUs had been relinquished and refunded, 13,424 EDUs had been connected, and 2,693 EDUs have neither been relinquished nor connected. At June 30, 2008, 1,750 EDUs had been relinquished and refunded, 14,622 EDUs had been connected, and 1,495 EDUs have neither been relinquished nor connected.

Developer Agreements

The District has entered into various Developer Agreements with developers towards the expansion of District facilities. The developers agree to make certain improvements and after the completion of the projects the District agrees to reimburse such improvements with a maximum reimbursement amount for each developer. Contractually, the District does not incur a liability for the work until the work is accepted by the District. As of June 30, 2008, none of the 6 outstanding developer agreements had been accepted, however it is anticipated that the District will be liable for an amount not to exceed $924,831 at the point of acceptance. Accordingly, the District did not accrue a liability as of year end.

12) RISK MANAGEMENT

General Liability

The District is exposed to various risks of loss related to torts, theft, damage and destruction of assets, errors and omissions, and natural disasters. The District pays an annual premium for commercial insurance covering general liability, excess liability, property, automobile, public employee dishonesty, and various other claims. Coverage limits range up to $100 million. Accordingly, the District retains no risk of loss.

Workers' Compensation

The District is a member of the Special District Risk Management Authority (SDRMA). SDRMA is a not-for-profit public agency formed under California Government Code Sections 6500 et. Seq. SDRMA is governed by a board composed of members from participating agencies. The mission of SDRMA is to provide renewable, efficiently priced risk financing and risk management services through a financially sound pool. The District is insured up to $300,000,000 for statutory workers' compensation and $5,000,000 for employers' liability coverage with no deductible. Separate financial statements of SDRMA may be obtained at Special District Risk Management Authority, 1112 "I" Street, Suite 300, Sacramento, CA 95814.

12) RISK MANAGEMENT - Continued

Health Insurance

The District maintains a self-insurance program covering all of its employees, retirees, and other dependents. Health claims are processed and administered through a health insurance administrator and paid by the District upon presentation. The District has obtained a stop-loss insurance policy to cover individuals with claims exceeding $45,000. The District has estimated accrued claims to be $137,029 and $474,413 at June 30, 2008 and 2007, respectively. Accrued health costs are included in other accrued liabilities. Changes in the balances of claims liabilities during the past two years are as follows:

	Year Ended June 30, 2008	Year Ended June 30, 2007
Unpaid Claims, Beginning of Fiscal Year	$ 474,413	$ 422,327
Incurred Claims (Including IBNRS)	1,712,810	1,399,661
Claim Payments	(2,050,194)	(1,347,575)
Unpaid Claims, End of Fiscal Year	$ 137,029	$ 474,413

Adequacy of Protection

During the past three fiscal (claims) years none of the above programs of protection have had settlements or judgments that exceeded pooled or insured coverage. There have been no significant reductions in pooled or insured liability coverage from coverage in the prior year.

13) INTEREST EXPENSE

Interest expense for the years ended June 30, 2008 and 2007, is as follows:

	2008	2007
Amount Expensed	$ 2,601,252	$ 950,479
Amount Capitalized as a Cost of Construction Projects	373,282	997,428
Interest Paid	$ 2,974,534	$ 1,947,907

Schedule of Funding Progress for PERS

Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability (AAL) Entry Age	Unfunded AAL (UAAL)	Funded Ratio	Covered Payroll	UAAL as a Percentage of Covered Payroll
	(A)	(B)	(B - A)	(A/B)	(C)	[(B-A)/C]
6/30/06 Miscellaneous	$ 40,321,483	$ 54,228,041	$ 13,906,558	74.4%	$ 10,470,766	132.8%
6/30/05 Miscellaneous	$ 36,029,595	$ 50,249,943	$ 14,220,348	71.7%	$ 10,005,158	142.1%
6/30/04 Miscellaneous	$ 31,591,156	$ 45,156,690	$ 13,565,534	70.0%	$ 9,764,596	138.9%

Schedule of Funding Progress for DPHP

Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability (AAL) Entry Age	Unfunded AAL (UAAL)	Funded Ratio	Covered Payroll	UAAL as a Percentage of Covered Payroll
	(A)	(B)	(B - A)	(A/B)	(C)	[(B-A)/C]
6/30/07 Miscellaneous	$ 0	$ 11,408,000	$ 11,408,000	0%	$ 10,951,000	104.2%
6/30/06 Miscellaneous	*	*	*	*	*	*
6/30/05 Miscellaneous	*	*	*	*	*	*

*GASB 45 was implemented in fiscal year 2008. The information for the two preceding years is unavailable.

TRS TEAMAN, RAMIREZ & SMITH, INC.
CERTIFIED PUBLIC ACCOUNTANTS

October 24, 2008

Joe Beachem, Chief Financial Officer
Otay Water District
2554 Sweetwater Springs Blvd.
Spring Valley, CA 91978-2096

Dear Mr. Beachem:

We have audited the financial statements of the Otay Water District (the "District") as of and for the year ended June 30, 2008, and have issued our report thereon dated October 24, 2008. In planning and performing our audit of the financial statements of the District, we considered its internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control. We noted no matters involving the internal control and its operation that we considered to be material weaknesses under standards established by the American Institute of Certified Public Accountants.

We would like to take this opportunity to express our appreciation for the assistance extended to us during the course of the audit. If we can be of further assistance, or if you have any questions regarding our recommendations, please call our office.

This report is intended solely for the information and use of the Board of Directors and management. This restriction is not intended to limit distribution of this report, which is a matter of public record.

Respectfully Submitted,
TEAMAN, RAMIREZ & SMITH, INC.

Richard A. Teaman

Richard A. Teaman
Certified Public Accountant

Richard A. Teaman, CPA • Greg W. Fankhanel, CPA • David M. Ramirez, CPA • Javier H. Carrillo, CPA
4201 Brockton Ave. Suite 100, Riverside CA 92501 • 951.274.9500 • 951.274.7828 FAX • www.trscpas.com

ATTACHMENT D

TEAMAN, RAMIREZ & SMITH, INC.
CERTIFIED PUBLIC ACCOUNTANTS

October 24, 2008

Finance Committee
Otay Water District
Spring Valley, CA

We have audited the financial statements of the Otay Water District (the "District") for the year ended June 30, 2008 and have issued our report thereon dated October 24, 2008. Professional standards require that we provide you with the following information related to our audit.

Our Responsibility under U.S. Generally Accepted Auditing Standards and OMB Circular A-133

As stated in our engagement letter dated November 15, 2007, our responsibility, as described by professional standards, is to express opinions about whether the financial statements prepared by management with your oversight are fairly presented, in all material respects, in conformity with U.S. generally accepted accounting principles. Our audit of the financial statements does not relieve you or management of your responsibilities.

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 opinions on the financial statements and not to provide assurance on the internal control over financial reporting. We also considered internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

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. Also in accordance with OMB Circular A-133, we examined, on a test basis, evidence about the District's compliance with the types of compliance requirements described in the "U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement" applicable to each of its major federal programs for the purpose of expressing an opinion on the District's compliance with those requirements. While our audit provides a reasonable basis for our opinion, it does not provide a legal determination on the District's compliance with those requirements.

We are responsible for communicating significant matters related to the audit that are, in our professional judgment, relevant to your responsibilities in overseeing the financial reporting process. However, we are not required to design procedures specifically to identify such matters.

Planned Scope and Timing of the Audit

We performed the audit according to the planned scope and timing previously communicated to you in our meeting about planning matters on May 2, 2008.

Richard A. Teaman, CPA • Greg W. Fankhanel, CPA • David M. Ramirez, CPA • Javier H. Carrillo, CPA
4201 Brockton Ave. Suite 100, Riverside CA 92501 • 951.274.9500 • 951.274.7828 FAX • www.trscpas.com

Significant Audit Findings

Qualitative Aspects of Accounting Practices

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by the District are described in Note 1 to the financial statements. As described in Note 9 to the financial statements, the District changed accounting policies related to post employment benefits by adopting Statement of Governmental Accounting Standards (GASB Statement) No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits other than Pensions,* in 2008. The accounting and disclosures required are done prospectively with no effect on the beginning of the year. We noted no transactions entered into by the District during the year for which there is a lack of authoritative guidance or consensus. There are no significant transactions that have been recognized in the financial statements in a different period than when the transaction occurred.

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimate(s) affecting the financial statements was (were):

> Management's estimate of the fair value of investments is based on information provided by financial institutions. We evaluated the key factors and assumptions used to develop the fair value of investments in determining that it is reasonable in relation to the financial statements taken as a whole.
>
> Management's estimate of capital assets depreciation is based on historical estimates of each capitalized item's useful life. We evaluated the key factors and assumptions used to develop the property and equipment depreciation in determining that it is reasonable in relation to the financial statements taken as a whole.

The disclosures in the financial statements are neutral, consistent, and clear. Certain financial statement disclosures are particularly sensitive because of their significance to financial statement users. The most sensitive disclosure(s) affecting the financial statements was (were):

> The disclosure of the fair value of investments in Note 2 to the financial statements represents amounts susceptible to market fluctuation.
>
> The disclosure of capital assets in Note 3 to the financial statements is based on historical information which could differ from actual useful lives of each capitalized item.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing and completing our audit.

Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. Management has corrected all such misstatements. In addition, none of the misstatements detected as a result of audit procedures and corrected by management were material, either individually or in the aggregate, to the financial statements taken as a whole.

Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

Management Representations

We have requested certain representations from management that are included in the management representation letter dated October 24, 2008.

Management Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a "second opinion" on certain situations. If a consultation involves application of an accounting principle to the District's financial statements or a determination of the type of auditor's opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Other Audit Findings or Issues

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the District's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

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

Very truly yours,

Teaman Ramirez & Smith

TRS TEAMAN, RAMIREZ & SMITH, INC.
CERTIFIED PUBLIC ACCOUNTANTS

Board of Directors
Otay Water District
Spring Valley, California

Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*

We have audited the financial statements of the business-type activities, of the Otay Water District as of and for the year ended June 30, 2008, which collectively comprise the District's basic financial statements and have issued our report thereon dated October 24, 2008. 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.

Internal Control Over Financial Reporting

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

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the District's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the District's financial statements that is more than inconsequential will not be prevented or detected by the District's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the District's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Otay Water District financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion.

Richard A. Teaman, CPA • Greg W. Fankhanel, CPA • David M. Ramirez, CPA • Javier H. Carrillo, CPA
4201 Brockton Ave. Suite 100, Riverside CA 92501 • 951.274.9500 • 951.274.7828 FAX • www.trscpas.com

The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

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

Seaman Ramirez & Smith

October 24, 2008

ATTACHMENT F

OTAY WATER DISTRICT
Spring Valley, California

SINGLE AUDIT REPORT ON
FEDERAL AWARD PROGRAMS

Year Ended June 30, 2008

OTAY WATER DISTRICT
SINGLE AUDIT REPORT ON FEDERAL AWARD PROGRAMS
Year Ended June 30, 2008

TABLE OF CONTENTS

TRS TEAMAN, RAMIREZ & SMITH, INC.
CERTIFIED PUBLIC ACCOUNTANTS

Board of Directors
Otay Water District
Spring Valley, California

Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*

We have audited the financial statements of the business-type activities, of the Otay Water District as of and for the year ended June 30, 2008, which collectively comprise the District's basic financial statements and have issued our report thereon dated October 24, 2008. 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.

Internal Control Over Financial Reporting

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

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the District's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the District's financial statements that is more than inconsequential will not be prevented or detected by the District's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the District's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Otay Water District financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion.

Richard A. Teaman, CPA • Greg W. Fankhanel, CPA • David M. Ramirez, CPA • Javier H. Carrillo, CPA
4201 Brockton Ave. Suite 100, Riverside CA 92501 • 951.274.9500 • 951.274.7828 FAX • www.trscpas.com

The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

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

Seaman Ramirez & Smith

October 24, 2008

TRS TEAMAN, RAMIREZ & SMITH, INC.
CERTIFIED PUBLIC ACCOUNTANTS

Board of Directors
Otay Water District
Spring Valley, California

Report on Compliance with Requirements Applicable to Each Major Program, Internal Control Over Compliance and on the Schedule of Expenditures of Federal Awards in Accordance with OMB Circular A-133

Compliance

We have audited the compliance of the Otay Water District with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2008. The Otay Water District's major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the Otay Water District's management. Our responsibility is to express an opinion on the Otay Water District's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Otay Water District's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the Otay Water District' compliance with those requirements.

In our opinion, the Otay Water District complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2008.

Internal Control Over Compliance

The management of the Otay Water District is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered the Otay Water District's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Otay Water District's internal control over compliance.

A control deficiency in a District's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the District's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the District's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the District's internal control.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, as defined above.

Schedule of Expenditures of Federal Awards

We have audited the financial statements of the business-type activities of the Otay Water District as of and for the year ended June 30, 2008, and have issued our report thereon dated October 24, 2008. Our audit was performed for the purpose of forming an opinion on the financial statements that collectively comprise the Otay Water District's basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by OMB Circular A-133 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.

This report is intended solely for the information and use of the Board of Directors, management, others within the entity, federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Teaman Ramirez & Smith

October 24, 2008

OTAY WATER DISTRICT
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
Year Ended June 30, 2008

Federal Grantor/Pass-Through Grantor Program Title	Federal CFDA Number	Grant/Contract Number		Expenditures
MAJOR PROGRAMS				
United States Department of the Interior:				
Passed-through the City of San Diego				
Water Reclamation and Refuse Program	15.504	06-FC-35-0182	$	2,210,000
OTHER FEDERAL AWARDS				
United States Department of the Interior:				
Cash for Plants	15.XXX			22,828
Artificial Turf Installation	15.XXX	05-FG-35-0167		50,000
Total Expenditures of Federal Awards			$	2,282,828

1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES APPLICABLE TO THE SCHEDULE OF FEDERAL AWARDS

a) Scope of Presentation

The accompanying schedule presents only the expenditures incurred (and related awards received) by the Otay Water District that are reimbursable under programs of federal agencies providing financial assistance. For the purpose of this schedule, financial assistance includes both federal financial assistance received directly from a federal agency, as well as federal funds received indirectly by the Otay Water District from a non-federal agency or other organization. Only the portion of the program expenditures reimbursable with such federal funds is reported in the accompanying schedule. Program expenditures in excess of the maximum federal reimbursement authorized or the portion of the program expenditures that were funded with state, local or other non-federal funds are excluded from the accompanying schedule.

b) Basis of Accounting

The expenditures included in the accompanying schedule were reported on the accrual basis of accounting. Under the accrual basis of accounting, expenditures are recognized in the period incurred. Expenditures reported include any property or equipment acquisitions incurred under the federal program.

c) Major Programs

The District had one major program for the year ended June 30, 2008, consisting of expenditures from a cooperative agreement with the City of San Diego and the United States Department of Interior. The major program had disbursements of $2,210,000. This amount calculates to 97% of the total disbursements from federal awards.

d) Relationship to Basic Financial Statements

Federal award expenditures agree or can be reconciled with the amounts reported in the District's financial statements.

OTAY WATER DISTRICT
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
Year Ended June 30, 2008

SECTION I - SUMMARY OF AUDITORS' RESULTS

Financial Statements

Type of Auditors' Report Issued:	Unqualified
Internal Control Over Financial Reporting:	
Material Weakness(es) Identified?	No
Significant Deficiency(ies) Identified not Considered to be Material Weaknesses?	None reported
Noncompliance Material to Financial Statements Noted?	No

Federal Awards

Internal Control Over Major Programs:	
Material Weakness(es) Identified?	No
Significant Deficiency(ies) Identified not Considered to be Material Weaknesses?	No
Type of Auditors' Report Issued on Compliance for Major Programs:	Unqualified
Any Audit Findings Disclosed that are Required to be Reported in Accordance With Circular A-133, Section .510(a)?	No

Identification of Major Programs:

CFDA Numbers	Name of Federal Program or Cluster
15.504	Water Reclamation and Refuse Program

Dollar Threshold used to Distinguish Between Type A and Type B Programs:	$ 300,000
Auditee Qualified as Low-Risk Auditee?	No

OTAY WATER DISTRICT
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
Year Ended June 30, 2008

SECTION II - FINANCIAL STATEMENT FINDINGS

There were no auditors' findings required to be reported in accordance with *Government Auditing Standards*.

SECTION III - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

There were no auditors' findings required to be reported in accordance with paragraph .510(a) of OMB Circular A-133.

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

Reportable Conditions:

None Reported

TRS TEAMAN, RAMIREZ & SMITH, INC.
CERTIFIED PUBLIC ACCOUNTANTS

INDEPENDENT ACCOUNTANTS' REPORT ON APPLYING AGREED-UPON PROCEDURES

Joe Beachem
Chief Financial Officer
Otay Water District
Spring Valley, CA

We have applied the procedures enumerated below, which were agreed to by the Otay Water District (the "District") to assist the District's senior management in evaluating the investments of the District for the fiscal year ending June 30, 2008.

This engagement to apply agreed-upon procedures was performed in accordance with attestation standards established by the American Institute of Certified Public Accountants. The sufficiency of the procedures is solely the responsibility of the specified users of the report, the District's senior management. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose.

The procedures performed and our findings were as follows:

1. Obtain a copy of the District's investment policy in effect for the time period under review.

   Findings: No exceptions were noted as a result of our procedures.

2. Select four (4) investments held at year end (Sample A) and determine if they are an allowable investment under the District's policy.

   Findings: No exceptions were noted as a result of our procedures.

3. Determine if the investments in Sample A are held in the District's name or as otherwise required by the District's policy.

   Findings: No exceptions were noted as a result of our procedures.

4. Confirm the par or original investment amount and market value for the investments in Sample A with the custodian or issuer of the investments.

   Findings: No exceptions were noted as a result of our procedures.

5. Select two (2) investment earnings transactions that took place during the year (Sample B) and recompute the earnings calculation to determine if the proper amount was received.

   Findings: No exceptions were noted as a result of our procedures.

6. Confirm the amounts received in Sample B with the custodian or issuer of the investments.

   Findings: No exceptions were noted as a result of our procedures.

Richard A. Teaman, CPA • Greg W. Fankhanel, CPA • David M. Ramirez, CPA • Javier H. Carrillo, CPA
4201 Brockton Ave. Suite 100, Riverside CA 92501 • 951.274.9500 • 951.274.7828 FAX • www.trscpas.com

7. Select five (5) investment transactions (buy, sell, trade or maturity) occurring during the year under review (Sample C) and determine that the transactions are permissible under the District's investment policy.

   Findings: No exceptions were noted as a result of our procedures.

8. Review the supporting documents for Sample C and determine if the transactions were appropriately recorded in the District's general ledger.

   Findings: No exceptions were noted as a result of our procedures.

We were not engaged to, and did not perform an audit, the objective of which would be the expression of an opinion on the investments of the District for the fiscal year ending June 30, 2008. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the use of the senior management of the Otay Water District and should not be used by those who have not agreed to the procedures and taken responsibility for the sufficiency of the procedures for their purposes.

Teaman Ramirez & Smith

October 24, 2008