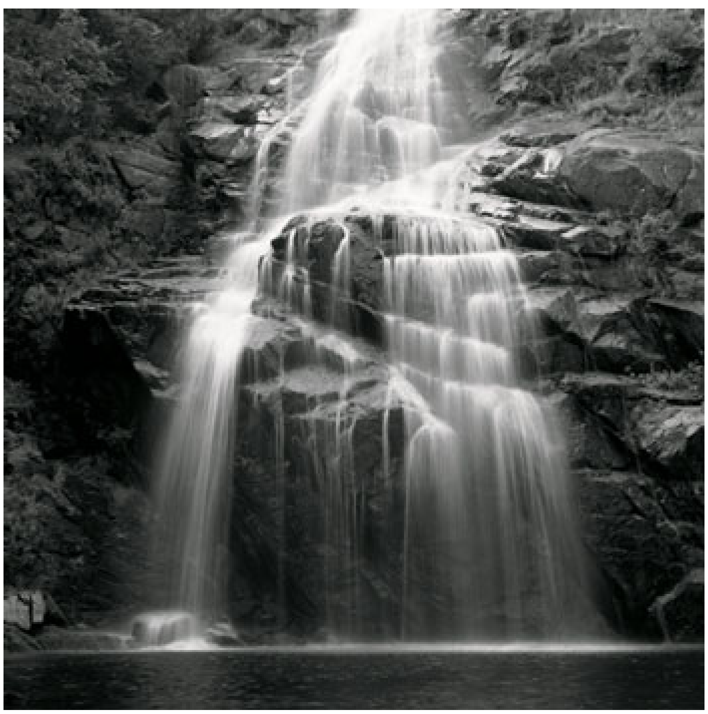
East Orange County Water District

Annual Financial Report

June 30, 2005 and 2004



Our Mission Statement

"To provide the most cost effective, reliable, and highest quality water services for the present as well as the future by operating in the most cost efficient manner possible, keeping the cost of water to our customers affordable and provide a safe working environment for its employees. Serve the community in an open manner and, at all times, communicate and deliberate in public meetings where open discussions are promoted."

East Orange County Water District

Board of Directors as of June 30, 2005

Name	Title	Elected/ Appointed	Current Term
William VanderWerff	President	Elected	12/04 - 12/08
Douglas M. Chapman	Vice President	Elected	12/04 - 12/08
Richard E. Barrett	Director	Elected	12/02 - 12/06
Richard B. Bell	Director	Elected	12/02 - 12/06
Gary R. Veeh	Director	Elected	12/02 - 12/06

William H. Redcay, General Manager
East Orange County Water District
185 North McPherson Road
Orange, California 92869
(714) 538-5815
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East Orange County Water District

Annual Financial Report

For the Years Ended June 30, 2005 and 2004

East Orange County Water District
Annual Financial Report
For the Years Ended June 30, 2005 and 2004

Table of Contents

Introductory Section

October 14, 2005

Board of Directors
East Orange County Water District
Orange, California

Introduction

It is our pleasure to submit the Annual Financial Report for the East Orange County Water District (District) for the fiscal year ended June 30, 2005. District staff, following guidelines set forth by the Governmental Accounting Standards Board, prepared this financial report. The District is ultimately responsible for both the accuracy of the data and the completeness and the fairness of presentation, including all disclosures in this financial report. We believe that the data presented is accurate in all material respects. This report is designed in a manner that we believe is necessary in order to enhance your understanding of the District's financial position and activities.

This report is organized into two sections: (1) Introductory and (2) Financial. The Introductory section provides general information about the District's organization and activities, and provides information useful in assessing the District's financial condition. The Financial section includes the Independent Auditors' Report, Management's Discussion and Analysis of the District's basic financial statements, and the District's audited basic financial statements with accompanying notes.

Generally Accepted Accounting Principles (GAAP) requires that management provide a narrative introduction, overview, and analysis to accompany the financial statements in the form of a Management's Discussion and Analysis (MD&A) section. This letter of transmittal is designed to complement the MD&A and should be read in conjunction with it. The District's MD&A can be found immediately following the Independent Auditors' Report.

District Background

The East Orange County Water District was formed in December of 1961 and is operating under the County Water District Law, which is contained in Division 12 of the California Water Code, Sections 30000 - 33901. The District is an independent special district governed by its Board of Directors elected by the voters within the District's service area. Initially the District was formed to provide an agency, which would furnish imported water to the area within its boundaries. In July of 1985, the District assumed the operations of the County of Orange WWD # 8 Retail Zone and became a retail operation as well as a wholesale operation. The District's pipeline distribution system delivers water to five sub-agencies within its boundaries consisting of the Southern California Water Company, the City of Tustin, Orange Park Acres Mutual, the City of Orange and its own Retail Zone. All of the sub-agencies use groundwater with supplemental water supplied by the District from the Allen McCulloch Pipeline or the East Orange County Feeder No.2.

The District encompasses an area of approximately 100,000 acres and is a member of the Municipal Water District of Orange County, which is a member of the Metropolitan Water District of Southern California (Metropolitan) and therefore is entitled to receive Colorado River and Northern California imported water through the distribution facilities of the Metropolitan system.

185 North McPherson Road ♦ Orange ♦ California ♦ 92869 ♦ (714) 538-5815

Industry Outlook

California's water supply continues to pose many new and complex challenges for water suppliers in the state. In recent years, the District has been an active participant and leader in addressing these concerns. Through coordination and planning with other local and regional water suppliers, the District continues to engage in developing long-term solutions to the various water supply challenges.

Internal Control Structure

District management is responsible for the establishment and maintenance of the internal control structure that ensures that the assets of the District are protected from loss, theft, or misuse. The internal control structure also ensures that adequate accounting data are compiled to allow for the preparation of financial statements in conformity with generally accepted accounting principles. The District's internal control structure is designed to provide reasonable assurance that these objectives are met. The concept of reasonable assurance recognizes that (1) the cost of a control should not exceed the benefits likely to be derived, and (2) the valuation of costs and benefits requires estimates and judgments by management.

Budgetary Control

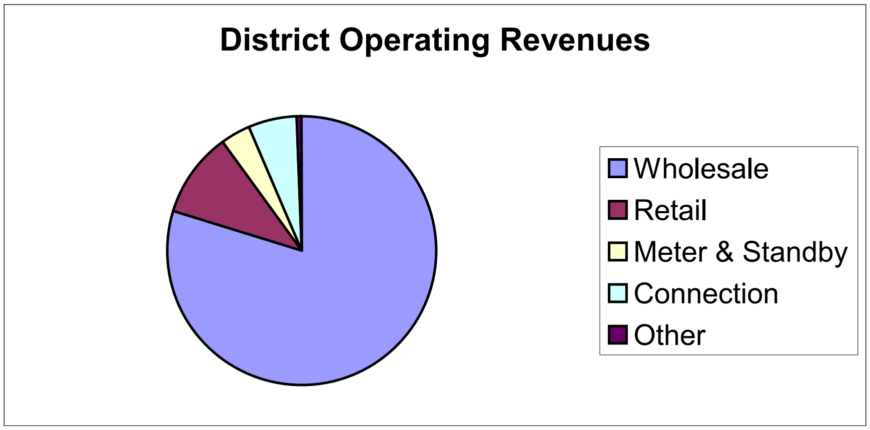
The District's Board of Directors annually adopts a balanced operating and capital budget prior to each new fiscal year. The budget authorizes and provides the basis for reporting and control of financial operations and accountability for the District's enterprise operations and capital projects. The budget is prepared on the cash basis of accounting, the District's interim financial statements are on a modified accrual basis and the final financial statements are prepared using the full accrual basis.

Financial Plan

This District is committed to provide its customers with a safe, reliable and efficient water system. The foundation for this commitment is based in the District's Capital Improvement Plan and the Financial Masterplan. These plans are reviewed annually as part of the District's budgeting process. The District's financial plan includes the establishment of reserve funds in accordance with the District's reserve practices. Reserve funds are set to ensure the continued orderly operation of the District's water systems, the providing of services to residents at established levels, and the continued stability of the District's rate structure. The purpose and structure of these funds are further discussed in the Management's Discussion and Analysis.

Water Rates and District Revenues

The District's policy objective is that all revenues from user charges generated from District customers must support all District operations including capital project funding. Water rates are user charges imposed on customers for services and are the primary component of the District's revenue. Water rates are composed of a commodity (usage) charge, and a fixed meter and standby service charge, and are reviewed on an annual basis as part of the budgeting process. The following chart reflects the District's operating revenue mix for the year ending June 30, 2005:



Debt Administration

While the District has no bonded indebtedness, the District does have an obligation under a separate note payable agreement. Additional information regarding this obligation can be found in the District's audited financial statements and accompanying notes.

Investment Policy

The Board of Directors annually adopts an investment policy that conforms to California State law, District ordinance and resolutions, prudent money management, and the "prudent person" standards. The objectives of the Investment Policy are safety, liquidity, and yield. District funds are normally invested in the State Treasurer's Local Agency Investment Fund, Certificates of Deposits, Government Agency Obligations or other specifically authorized investments.

Audit and Financial Reporting

State Law and Bond covenants require the District to obtain an annual audit of its financial statements by an independent certified public accountant. The accounting firm of Charles Z. Fedak & Co., CPAs has conducted the audit of the District's financial statements. Their unqualified Independent Auditor's Report appears in the Financial Section.

Risk Management

The District is a member of the Association of California Water Agencies – Joint Powers Insurance Authority (Authority). The purpose of the Authority is to arrange and administer risk management programs for the pooling of self-insured losses, and the purchase of excess insurance coverage.

Water Conservation Programs

The District has been implementing conservation management practices for many years. The District distributes materials that encourages water conservation. Additionally, the District has offered the following conservation programs through its affiliation with the Municipal Water District of Orange County:

- Residential and Multi-family low flush toilet distribution
- Residential Appliance Rebate Program
- Residential Drought-tolerant Landscape Classes

Other References

More information is contained in the Management's Discussion and Analysis and the Notes to the Basic Financial Statements found in the Financial Section of the report.

Acknowledgements

Preparation of this report was accomplished by the combined efforts of District staff. We appreciate the dedicated efforts and professionalism that our staff members bring to the District. We would also like to thank the members of the Board of Directors for their continued support in the planning and implementation of the East Orange County Water District's fiscal policies.

Respectfully submitted,

William H. Redcay General Manager	Carl R. Schoonover District Accountant/Treasurer

Financial Section

Charles Z. Fedak & Company
Certified Public Accountants
An Accountancy Corporation

6081 Orange Avenue
Cypress, California 90630
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Charles Z. Fedak, CPA, MBA
Paul J. Kaymark, CPA

Independent Auditor's Report

Board of Directors
East Orange County Water District
Orange, California

We have audited the accompanying financial statements of the East Orange County Water District (District) as of and for the years ended June 30, 2005 and 2004, 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 basic 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 basic 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 East Orange County Water District as of June 30, 2005 and 2004, and the respective changes in net assets and cash flows 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 a report dated October 14, 2005, on our consideration of the District's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, 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 read in conjunction with this report in considering the results of our audit. This report can be found on page 30.

Management's Discussion and Analysis and the Schedule of Funding Progress on pages 6 through 9 and 29, respectively, are not required parts of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information or express an opinion on it.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements that collectively comprise the District's basic financial statements. The accompanying introductory section on pages 1 through 4 is presented for purposes of additional analysis and is not a required part of the basic financial statements. The introductory section has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on it.

October 14, 2005
Cypress, California

Charles Z. Fedak & Co CPAs
An Accountancy Corporation

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The following Management's Discussion and Analysis (MD&A) of activities and financial performance of the East Orange County Water District (District) provides an introduction to the financial statements of the District for the fiscal years ended June 30, 2005 and 2004. We encourage readers to consider the information presented here in conjunction with the transmittal letter in the Introductory Section and with the basic financial statements and related notes, which follow this section.

Financial Highlights

- The District's net assets decreased 4.3% or ($675,667) to $15,000,730 in 2005 and decreased 0.3% or ($43,011) to $15,676,397 in 2004 as a result of each year's operations.
- The District's operating revenues increased by 22.6% or $1,093,918 in 2005 from the prior year due primarily to an increase in wholesale water sales of $971,373, retail water sales of $12,297 and connection fees of $99,240 and 15.3% or $658,554 in 2004 from the prior year due primarily to an increase in wholesale water sales of $400,270, retail water sales of $19,707 and other service charges of $146,313.
- The District's operating expenses increased by 17.3% or $936,062 in 2005 from the prior year due primarily to an increase in water purchases (source of supply) of $846,268 and 10.6% or $516,298 in 2004 from the prior year due primarily to an increase in water purchases of $414,800.

Required Financial Statements

This annual report consists of a series of financial statements. The Statement of Net Assets, Statement of Revenues, Expenses and Changes in Net Assets, and Statement of Cash Flows provide information about the activities and performance of the District using accounting methods similar to those used by private sector companies.

The Statement of Net Assets includes all of the District's investments in resources (assets) and the obligations to creditors (liabilities). It also provides the basis for computing a rate of return, evaluating the capital structure of the District and assessing the liquidity and financial flexibility of the District. All of the current year's revenue and expenses are accounted for in the Statement of Revenues, Expenses and Changes in Net Assets. This statement measures the success of the District's operations over the past year and can be used to determine if the District has successfully recovered all of its costs through its rates and other charges. This statement can also be used to evaluate fiscal stability and credit worthiness. The final required financial statement is the Statement of Cash Flows, which provides information about the District's cash receipts and cash payments during the reporting period. The Statement of Cash Flows reports cash receipts, cash payments and net changes in cash resulting from operations, investing, non-capital financing, and capital and related financing activities.

Notes to the Basic Financial Statements

The notes provide additional information that is essential to a full understanding of the data provided in the basic financial statements. The notes to the basic financial statements can be found on pages 14 through 28.

Financial Analysis of the District

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

These two statements report the District's *net assets* and changes in them. One can think of the District's net assets – the difference between assets and liabilities – as a way to measure the District's financial health, or *financial position*. Over time, *increases or decreases* in the District's net assets are one indicator of whether its *financial health* is improving or deteriorating. However, one will need to consider other non-financial factors such as changes in economic conditions, population growth, zoning and new or changed government legislation, such as changes in Federal and State water quality standards.

Condensed Statement of Net Assets

		2005	2004	Change
Assets:				
Current assets	$	1,589,813	2,177,243	(587,430)
Restricted assets		72,978	83,181	(10,203)
Non-current assets		5,164,008	4,670,895	493,113
Capital assets, net		9,229,631	9,625,214	(395,583)
Total assets		16,056,430	16,556,533	(500,103)
Liabilities:				
Current liabilities – payable from unrestricted assets		740,232	519,843	220,389
Current liabilities – payable from restricted assets		55,518	65,218	(9,700)
Non-current liabilities		259,950	295,075	(35,125)
Total liabilities		1,055,700	880,136	175,564
Net assets:				
Net investment in capital assets		8,934,556	9,296,168	(361,612)
Restricted		17,460	17,963	(503)
Unrestricted		6,048,714	6,362,266	(313,552)
Total net assets	$	15,000,730	15,676,397	(675,667)

As noted earlier, net assets may serve over time as a useful indicator of a government's financial position. In the case of the District, assets of the District exceeded liabilities by $15,000,730 as of June 30, 2005 and $15,676,397 as of June 30, 2004.

By far the largest portion of the District's net assets (60% in 2005 and 59% in 2004) reflects its investment in capital assets (net of accumulated depreciation), less any related debt used to acquire those assets that is still outstanding. The District uses these capital assets to provide services to customers within the District's service area; consequently, these assets are *not* available for future spending.

At the end of fiscal year 2005 and 2004, the District shows a positive balance in its unrestricted net assets of $6,048,714 and $6,362,266, respectively that may be utilized in future years. The Board of Directors has taken action to reserve aspects of the unrestricted net assets for specified purposes such as asset replacement, rate stabilization, growth accommodation and emergency reserves. The District has committed to the following funds and objectives:

1. Operating Fund – Funds are maintained to capture all operating and maintenance revenues and expenditures separately for the Wholesale and Retail Zone operations. Excess revenues over expenditures are routinely transferred to the Replacement and Capital Improvements funds.
2. Replacement and Capital Improvement Funds – Separate replacement and capital improvement funds are maintained for the Wholesale District and Retail Zone.
3. Emergency Reserve Fund – This fund is earmarked by the Board of Directors for unforeseen emergencies or contingency expenditures.

Condensed Statement of Revenues, Expenses and Changes in Net Assets

		2005	2004	Change
Revenues:				
Operating revenues	$	5,930,684	4,836,766	1,093,918
Non-operating revenues		409,802	939,317	(529,515)
Total revenues		6,340,486	5,776,083	564,403
Expenses:				
Operating expenses		6,333,498	5,397,436	936,062
Depreciation and amortization		392,027	386,599	5,428
Non-operating expenses		290,628	35,059	255,569
Total expenses		7,016,153	5,819,094	1,197,059
Net income before capital contributions		(675,667)	(43,011)	(632,656)
Capital contributions		-	-	-
Change in net assets		(675,667)	(43,011)	(632,656)
Net assets, beginning of year (restated)		15,676,397	15,719,408	(43,011)
Net assets, end of year	$	15,000,730	15,676,397	(675,667)

The Statement of Revenues, Expenses and Changes in Net Assets shows how the District's net assets change during the fiscal year. In the case of the District, net assets decreased by ($675,667) in 2005 and decreased by ($43,011) in 2004.

In 2005, a closer examination of the sources of changes in net assets reveals that the District's total revenues increased by $564,403 due primarily to an increase in wholesale water sales of $971,373, retail water of $12,297 and connection fees of $99,240 and a decrease in property tax revenue of $398,260. In addition, total expenses increased by $1,197,056 due primarily to an increase in water purchases (source of supply) of $846,268 and a one-time loss on disposal of capital assets (water treatment plant) of $139,313.

In 2004, a closer examination of the sources of changes in net assets reveals that the District's total revenues increased by $514,419 due primarily to an increase in wholesale water sales of $400,270, retail water of $19,707 and other service charges of $146,313. In addition, total expenses increased by $458,104 due primarily to an increase in water purchases (source of supply) of $414,800.

Capital Asset Administration

Changes in capital assets for 2005 were as follows:

		Balance 2004	Additions	Deletions/ Transfers	Balance 2005
Non-depreciable assets		277,198	128,926	(162,569)	243,555
Depreciable assets		16,420,224	169,400	(490,476)	16,099,148
Accumulated depreciation and amortization		(7,072,208)	(392,027)	351,163	(7,113,072)
Total capital assets, net	$	9,625,214	(93,701)	(301,882)	9,229,631

Changes in capital assets for 2004 were as follows:

		Balance 2004	Additions	Deletions/ Transfers	Balance 2005
Non-depreciable assets		187,203	142,832	(52,837)	277,198
Depreciable assets		16,379,031	56,455	(15,262)	16,420,224
Accumulated depreciation and amortization		(6,700,871)	(386,599)	15,262	(7,072,208)
Total capital assets, net	$	9,865,363	(187,312)	(52,837)	9,625,214

Capital Asset Administration, continued

At the end of fiscal year 2005 and 2004, the District's capital assets totaled $9,229,631 and $9,625,214 (net of accumulated depreciation) respectively, including land and easements, transmission and distribution systems, equipment, capacity rights and construction-in-process. There were various capital asset additions during the years. In 2005, the District, in accordance with GASB Statement No. 42, wrote off its water treatment plant due to impairment. The capital assets of the District are summarized on the following page and in Note 5 to the basic financial statements.

Debt Administration

Long-term debt decreased by $33,971 due to principal payments made on the Note Payable to the Department of Water Resources. The long-term debt position of the District is summarized below and more fully analyzed in Note 6 to the basic financial statements.

Changes in long-term debt amounts for the year were as follows:

	Balance 2004	Additions	Principal Payments	Balance 2005
Long-term debt:				
Note payable – DWR	$ 329,046	-	(33,971)	295,075
Total long-term debt	$ 329,046	-	(33,971)	295,075

Conditions Affecting Current Financial Position

In 1992, the State of California found itself in a serious deficit position. To meet its obligations to fund education at specified levels the State enacted legislation that shifted partial financial responsibility for funding education to local government (cities, counties, and special districts). The State did this by instructing county auditors to shift the allocation of local property tax revenues from local government to 'educational revenue augmentation funds' (ERAFs), directing that specified amounts of city, county, and other local agency property taxes be deposited into these funds to support schools.

In fiscal year 2004, the annual impact of the ERAF shift is $5.2 billion from cities, counties, and special districts. The Governor's 2005 budget however, proposes to shift an additional $1.34 trillion in property tax revenues from cities, counties, special districts and redevelopment agencies to the ERAF accounts in each county to help defer the state's obligation for K-12 education funding. This additional shift is expected to impact the District by reducing expected property tax revenue by approximately $543,584 in fiscal years 2005 and 2006.

Requests for Information

This financial report is designed to provide the District's funding sources, customers, stakeholders and other interested parties with an overview of the District's financial operations and financial condition. Should the reader have questions regarding the information included in this report or wish to request additional financial information, please contact the District's Accountant/Treasurer, Carl R. Schoonover, at (949) 248-9929.

Basic Financial Statements

East Orange County Water District

Statements of Net Assets

June 30, 2005 and 2004

Assets		**2005**	**2004**
Current assets:			
Cash and cash equivalents (note 3)	$	469,254	1,139,482
Accrued interest receivable		1,760	1,561
Accounts receivable – water sales and services:			
Wholesale		487,139	466,923
Retail		173,092	131,163
Other		513	540
Property taxes receivable		30,041	19,536
Accrued interest receivable – AMP		25,064	29,408
Note receivable – current portion – AMP (note 4)		160,221	150,583
Prepaid expenses and other assets		141,826	140,764
Water-in-storage inventory		15,668	14,350
Materials and supplies inventory		85,235	82,933
Total current assets – unrestricted		1,589,813	2,177,243
Restricted assets – cash and cash equivalents (note 3)		72,978	83,181
Total current assets		1,662,791	2,260,424
Non-current assets:			
Capital assets, net (note 5)		9,229,631	9,625,214
Investments (note 3)		4,455,154	3,801,820
Note receivable – AMP (note 4)		708,854	869,075
Total non-current assets		14,393,639	14,296,109
Total assets	$	16,056,430	16,556,533
Liabilities and Net Assets			
Current liabilities:			
Payable from current assets – unrestricted:			
Accounts payable and accrued expenses	$	703,620	492,814
Accrued wages and compensated absences		36,612	27,029
Payable from current assets – unrestricted		740,232	519,843
Payable from restricted assets:			
Accounts payable		3,600	-
Advances for construction		-	16,685
Deposits and deferred revenue		14,250	11,750
Accrued interest on note payable – DWR		2,543	2,812
Note payable – current portion – DWR (note 6)		35,125	33,971
Payable from restricted assets		55,518	65,218
Total current liabilities		795,750	585,061
Non-current liabilities – note payable – DWR (note 6)		259,950	295,075
Total liabilities		1,055,700	880,136
Net assets:			
Net investment in capital assets (note 7)		8,934,556	9,296,168
Restricted for debt service		17,460	17,963
Unrestricted		6,048,714	6,362,266
Total net assets		15,000,730	15,676,397
Total liabilities and net assets	$	16,056,430	16,556,533

East Orange County Water District

Statements of Revenues, Expenses and Changes in Net Assets

For the Years Ended June 30, 2005 and 2004

	2005	2004
Operating revenues:		
Water sales:		
Wholesale	$ 4,729,235	3,757,862
Retail	600,817	588,520
Meter and standby service charges	226,560	203,843
Connection fees	342,956	243,716
Other service charges	31,116	42,825
Total operating revenues	5,930,684	4,836,766
Operating expenses:		
Source of supply	5,311,819	4,465,551
Pipeline capacity lease	87,796	87,617
Pumping	55,850	39,945
Treatment, transmission and distribution	623,485	570,907
General and administrative	254,548	233,416
Total operating expenses	6,333,498	5,397,436
Operating loss before depreciation and amortization	(402,814)	(560,670)
Depreciation and amortization	(392,027)	(386,599)
Operating loss	(794,841)	(947,269)
Non-operating revenues(expenses):		
Property taxes	273,464	671,724
Rental income – cellular antennas	33,217	35,661
Interest and investment earnings	155,111	197,347
Change in fair-value of cash equivalents and investments	(115,244)	(180,408)
Interest income – note receivable – AMP	50,227	59,267
Interest expense – note payable – DWR	(10,730)	(11,895)
Gain(Loss) on sale of investments	(12,133)	-
Federal EPA grant – vulnerability study	-	23,164
Grant related expenditures	-	(23,164)
Gain(Loss) on sale/disposal of capital assets	(139,313)	2,500
MWDOC excess reserves refund – pass through	(128,452)	128,452
Other, net	13,027	1,610
Total non-operating revenues, net	119,174	904,258
Net income before capital contributions	(675,667)	(43,011)
Capital contributions:	-	-
Change in net assets	(675,667)	(43,011)
Net assets, beginning of year	15,676,397	15,622,125
Adjustment to reflect change in accounting method for: (note 2)		
Water-in-storage inventory	-	14,350
Materials and supplies inventory	-	82,933
Total change in accounting method	-	97,283
Net assets, end of year	$ 15,000,730	15,676,397

See accompanying notes to the basic financial statements

East Orange County Water District

Statements of Cash Flows

For the Years Ended June 30, 2005 and 2004

		2005	2004
Cash flows from operating activities:			
Receipts from customers for water sales and services	$	5,867,408	4,540,769
Payments to employees for salaries		(298,786)	(282,249)
Payments to vendors for materials and services		(5,815,405)	(4,968,013)
Net cash used by operating activities		(246,783)	(709,493)
Cash flows from non-capital financing activities:			
Proceeds from property taxes		262,959	676,151
Proceeds from rental income – cellular antennas		33,217	35,661
Net cash provided by non-capital financing activities		296,176	711,812
Cash flows from capital and related financing activities:			
Acquisition and construction of capital assets		(154,447)	(146,450)
Proceeds from the sale/disposition of capital assets		-	2,500
Principal and interest paid on note payable – DWR		(44,970)	(44,971)
Net cash used by capital and related financing activities		(199,417)	(188,921)
Cash flows from investing activities:			
Purchase of investments		(4,890,402)	-
Sale of investments		4,000,000	-
Proceeds from interest and investment earnings		154,912	197,677
Change in fair-value of cash equivalents		(71)	(2,450)
Proceeds from note receivable – AMP		150,583	141,495
Proceeds from interest income – note receivable – AMP		54,571	62,941
Net cash provided by investing activities		(530,407)	399,663
Net increase(decrease) in cash and cash equivalents		(680,431)	213,061
Cash and cash equivalents (unrestricted and restricted), beginning of year		1,222,663	1,009,602
Cash and cash equivalents (unrestricted and restricted), end of year	$	542,232	1,222,663

Reconciliation of cash and cash equivalents to statement of financial position:			
Cash and cash equivalents	$	469,254	1,139,482
Restricted assets – cash and cash equivalents		72,978	83,181
Total cash and cash equivalents	$	542,232	1,222,663

Continued on next page

See accompanying notes to the basic financial statements

East Orange County Water District
Statements of Cash Flows, continued
For the Years Ended June 30, 2005 and 2004

		2005	2004
Reconciliation of operating loss to net cash used by operating activities:			
Operating loss	$	(794,841)	(818,817)
Adjustments to reconcile operating loss to net cash used by operating activities:			
Deprecation and amortization		392,027	386,599
Adjustment to reflect change in accounting method		-	97,283
Other non-operating revenues, net		13,027	1,610
Changes in assets – (increase)decrease:			
Accounts receivable – water and other:			
Wholesale		(20,216)	(369,737)
Retail		(41,929)	(31,715)
Other		27	564
Prepaid and other		(1,062)	(2,713)
Water-in-storage inventory		(1,318)	(14,350)
Materials and supplies inventory		(2,302)	(82,933)
Changes in liabilities – increase(decrease):			
Accounts payable and accrued expenses		214,406	145,107
Accrued wages and compensated absences		9,583	4,780
Retentions payable		-	-
Advances for construction		(16,685)	(7)
Deposits and deferred revenue		2,500	(25,164)
Total adjustments		548,058	109,324
Net cash used by operating activities	$	(246,783)	(709,493)

See accompanying notes to the basic financial statements

(1) Reporting Entity and Summary of Significant Accounting Policies

A. Organization and Operations of the Reporting Entity

The East Orange County Water District (the District) was formed in 1961 in order to furnish imported potable water to an area encompassing the eastern half of the City of Orange. The District provides wholesale potable water to five sub-agencies in the region through its pipeline transmission and distribution system. The five sub-agencies consist of the East Orange County Waterworks District Retail Zone, Southern California Water Company, City of Tustin, Orange Park Acres Mutual Water Company, and the City of Orange. Also, the District provides potable water service through the East Orange County Waterworks District Retail Zone to approximately 1,179 customers within its service area. The District is governed by a Board of Directors, which consists of five directors, each of whom is elected at-large for a four-year term by the citizens living within the District's service area.

B. Basis of Accounting and Measurement Focus

The District reports its activities as an enterprise fund, which is used to account for operations that are financed and operated in a manner similar to a private business enterprise, where the intent of the District is that the costs of providing water to its customers on a continuing basis be financed or recovered primarily through user charges (water sales and services), capital grants and similar funding. Revenues and expenses are recognized on the full accrual basis of accounting. Revenues are recognized in the accounting period in which they are earned and expenses are recognized in the period incurred, regardless of when the related cash flows take place.

Operating revenues, such as water sales, result from exchange transactions associated with the principal activity of the District. Exchange transactions are those in which each party receives and gives up essentially equal values. Non-operating revenues, such as grant funding and investment income, result from non-exchange transactions, in which, the District gives (receives) value without directly receiving (giving) value in exchange.

C. Financial Reporting

The District's basic financial statements are presented in conformance with the provisions of Governmental Accounting Standards Board (GASB) Statement No. 34, *"Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments"* (GASB No. 34). This statement established revised financial reporting requirements for state and local governments throughout the United States for the purpose of enhancing the understandability and usefulness of financial reports.

GASB No. 34 and subsequent GASB pronouncements provide for a revised view of financial information and restructure the format of financial information provided prior to its adoption. A statement of net assets replaces the balance sheet and reports assets, liabilities, and the difference between them as net assets, not equity. A statement of revenues, expenses and changes in net assets replaces both the income statement and the statement of changes in retained earnings and contributed capital. GASB No. 34 also requires that the statement of cash flows be prepared using the direct method. Under the direct method, cash flows from operating activities are presented by major categories.

Under GASB No. 34, enterprise funds, such as the District, have the option of consistently following or not following pronouncements issued by the Financial Accounting Standards Board (FASB) subsequent to November 30, 1989. The District has elected not to follow FASB standards issued after that date, unless such standards are specifically adopted by GASB.

(1) Reporting Entity and Summary of Significant Accounting Policies, continued

D. Implementation of New Governmental Accounting Standards Board Statements

Governmental Accounting Standards Board Statement No. 40

As of July 1, 2003, the District adopted the provisions of Governmental Accounting Standards Board (GASB) Statement No. 40, *Deposit and Investment Risk Disclosures*, *an amendment of GASB No 3*. This statement modifies the Deposit and Investment Risk Categorization Disclosures and requires additional information on an entity's cash and investment portfolio. Accordingly, certain footnote disclosures have been revised to conform to the provisions of GASB Statement No. 40.

Governmental Accounting Standards Board Statement No. 41

In May 2003, the GASB issued Statement No. 41, *Budgetary Comparison Schedules- Perspective Differences, an amendment of GASB No. 34.* This statement established guidance for governments with significant budgetary perspective differences to report budgetary comparison schedules within the GASB Statement No. 34 reporting model. Accordingly, the District considers the effects of this statement when presenting its financial statements in accordance with the GASB No. 34 financial reporting model.

Governmental Accounting Standards Board Statement No. 42

In November 2003, the GASB issued Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries.* This statement requires governmental agencies to measure, recognize, and disclose the effects of capital asset impairments in their financial statements when it occurs. Also, this statement clarifies and establishes accounting requirements for insurance recoveries, including those associated with capital asset impairment. Accordingly, the District has analyzed its capital assets that may be impaired or in need of an insurance recovery provision as of June 30, 2005 and determined that the District's water treatment plant is no longer in use and is impaired by the definition set forth in GASB Statement No. 42. Therefore, the District has written-off the un-depreciated portion of the water treatment plant.

E. Assets, Liabilities and Net Assets

1. Use of Estimates

The preparation of the basic financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported changes in net assets during the reporting period. Actual results could differ from those estimates.

2. Cash and Cash Equivalents

Substantially all of the District's cash is invested in interest bearing accounts. The District considers all highly liquid investments with a maturity of three months or less to be cash equivalents.

3. Investments and Investment Policy

The District has adopted an investment policy directing the Treasurer to deposit funds in financial institutions. Investments are to be made in the following areas:

- Securities of the U.S. government or its agencies
- Federal agency obligations
- Certificates of deposit (negotiable and placed)
- Commercial paper (prime)
- Money market and mutual fund accounts
- State of California – Local Agency Investment Fund (LAIF)

(1) Reporting Entity and Summary of Significant Accounting Policies, continued

E. Assets, Liabilities and Net Assets, continued

3. Investments and Investment Policy, continued

Changes in fair value that occur during a fiscal year are recognized as investment income reported for that fiscal year. Investment income includes interest earnings, changes in fair value, and any gains or losses realized upon the liquidation or sale of investments.

4. Restricted Assets

Amounts shown as restricted assets have been restricted for the subsequent year's debt service payments to the Department of Water Resources (DWR) loan as required by the contract and certain contractual obligations payable for construction related projects.

5. Accounts Receivable

The District extends credit to customers in the normal course of operations. Management deems all accounts receivable as collectible at year-end. Accordingly, an allowance for doubtful accounts has not been recorded.

6. Property Taxes

Property taxes receivable at year-end are related to property taxes collected by the County of Orange, which have not been credited to the District's cash balance as of June 30. The property tax calendar is as follows:

Lien date	March 1
Levy date	July 1
Due dates	November 1 and March 1
Collection dates	December 10 and April 10

The County of Orange Assessor's Office assesses all real and personal property within the County each year. The County of Orange Tax Collector's Office bills and collects the District's share of property taxes and assessments. The County of Orange Treasurer's Office remits current and delinquent property tax collections to the District throughout the year. Property tax in California is levied in accordance with Article 13A of the State Constitution at one percent (1%) of countywide assessed valuations.

7. Prepaid Expenses

Certain payments to vendors reflect costs or deposits applicable to future accounting periods and are recorded as prepaid items in the basic financial statements.

8. Water-In-Storage Inventory

Annually, a controlled quantity of water is purchased by the District and, if not used in the current year, is stored for use the following year. Purchased stored water is subject to loss through evaporation, natural disasters, dam ruptures, excess rainfall and spillage at the various facilities. The losses are not covered by insurance nor has a loss reserve been recorded.

9. Materials and Supplies Inventory

Materials and supplies inventory consists primarily of water meters, pipe and pipefittings for construction and repair to the District's water transmission and distribution system. Inventory is valued at cost using a weighted average cost method. Inventory items are charged to expense at the time that individual items are withdrawn from inventory or consumed.

(1) Reporting Entity and Summary of Significant Accounting Policies, continued

E. Assets, Liabilities and Net Assets, continued

10. Capital Assets

Capital assets acquired and/or constructed are capitalized at historical cost. District policy has set the capitalization threshold for reporting capital assets at $5,000. Donated assets are recorded at estimated fair market value at the date of donation. Upon retirement or other disposition of capital assets, the cost and related accumulated depreciation are removed from the respective balances and any gains or losses are recognized. Depreciation is recorded on a straight-line basis over the estimated useful lives of the assets as follows:

- Transmission and distribution systems – 5 to 100 years
- Structures and improvements – 3 to 50 years
- Capacity rights – 75 years
- Water treatment plant – 10 to 100 years
- Equipment – 5 to 50 years

11. Construction-in-Process

The costs associated with developmental stage projects are accumulated in an in-progress account until the project is fully developed. Once the project is complete, the entire cost of the project is transferred to a capital asset account and depreciated over the estimated useful life.

12. Compensated Absences

The District's policy allows full-time employees to accumulate a maximum of 160 hours of vacation time. No compensation in lieu of time off is allowed except for termination or disability. Employees may accumulate up to 80 hours of sick time. As of November 30 each year, one-half of the excess over 80 hours may be credited to additional vacation or may be paid to the employee. The remaining one-half is forfeited. The District has recorded the liability for accrued vacation and sick pay in the accompanying financial statements.

13. Restricted Liabilities – Payable From Restricted Assets

Certain liabilities, which are currently payable, have been classified as current liabilities payable from restricted assets since assets have been restricted for their payment.

14. Net Assets

The financial statements utilize a net assets presentation. Net assets are categorized as follows:

- **Net Investment in Capital Assets** – This component of net assets consists of capital assets, net of accumulated depreciation and reduced by any outstanding debt outstanding against the acquisition, construction or improvement of those assets.

- **Restricted Net Assets** – This component of net assets consists of constraints placed on net assets use through external constraints imposed by creditors, grantors, contributors, or laws or regulations of other governments or constraints imposed by law through constitutional provisions or enabling legislation.

- **Unrestricted Net Assets** – This component of net assets consists of net assets that do not meet the definition of *restricted* or *net investment in capital assets*.

(1) Reporting Entity and Summary of Significant Accounting Policies, continued

E. Assets, Liabilities and Net Assets, continued

15. Water Sales – Wholesale and Retail

Wholesale water sales are billed on a monthly basis and retail water sales are billed on a bi-monthly cyclical basis. Estimated unbilled retail water sales revenue through June 30 has been accrued at year-end.

16. Overhead Allocation

Certain general and administrative expenses are allocated to treatment, transmission and distribution using management's allocation of manpower and services estimates that are directly related to the treatment, transmission and distribution function of the District.

17. Capital Contributions

Capital contributions represent cash and capital asset additions contributed to the District by property owners, granting agencies or real estate developers desiring services that require capital expenditures or capacity commitment.

18. Budgetary Policies

The District adopts an annual non-appropriated budget for planning, control, and evaluation purposes. Budgetary control and evaluation are affected by comparisons of actual revenues and expenses with planned revenues and expenses for the period. Encumbrance accounting is not used to account for commitments related to unperformed contracts for construction and services.

(2) Change in Accounting Method

During 2004, the District changed its method of accounting for its water-in-storage inventory and materials and supplies inventory. In prior years, the remaining balances of these unused items, at years end, were not capitalized as assets, but were expensed as costs were incurred. Therefore, the District has recorded a one-time non-cash increase of $97,283 to account for the beginning balances as of July 1, 2003, in the accompanying financial statements.

(3) Cash and Investments

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

		2005	2004
Cash and cash equivalents	$	469,254	1,139,482
Restricted cash and cash equivalents		72,978	83,181
Investments		4,455,154	3,801,820
Total Cash and Investments	$	4,997,386	5,024,483

Cash and investments as of June 30, consist of the following:

		2005	2004
Cash on hand	$	250	250
Deposits with financial institutions		20,000	19,880
Investments		4,977,136	5,004,353
Total cash and investments	$	4,997,386	5,024,483

(3) Cash and Investments, continued

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. With respect to investments, custodial credit risk generally applies only to direct investments in marketable securities. Custodial credit risk does not apply to a local government's indirect investment in securities through the use of mutual funds or government investment pools (such as LAIF).

The California Government Code and the District's investment policy do not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits 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 governmental units by pledging securities in an undivided collateral pool held by a depository regulated under state law (unless so waived by the governmental unit). The market value of the pledged securities in the collateral pool must equal at least 110% of the total amount deposited by the public agencies. California law also allows financial institutions to secure District deposits by pledging first trust deed mortgage notes having a value of 150% of the secured public deposits. The District had deposits with bank balances of $227,585 and $23,442 as of June 30, 2005 and 2004, respectively. Of the bank balances, up to $100,000 is federally insured and the remaining balance is collateralized in accordance with the Code; however, the collateralized securities are not held in the District's name.

Investment in State Investment Pool

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

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 rate 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 matures or comes close to maturity evenly over time as necessary to provide requirements for cash flow and liquidity needed for operations. Information about the sensitivity of the fair values of the District's investments to market interest rate fluctuations is provided by the following table that shows the distribution of the District's investments by maturity date:

Maturities of investments at June 30, 2005, are as follows:

		Remaning Maturity (in Months)	
Investment Type	**Total**	**12 Months Or Less**	**25-60 Months**
U.S. Treasury obligations	$ 4,455,154	-	4,455,154
Local Agency Investment Fund (LAIF)	343,695	343,695	-
Money market funds	178,287	178,287	-
Total	$ 4,977,136	521,982	4,455,154

(3) Cash and Investments, continued

Maturities of investments at June 30, 2004, are as follows:

Investment Type		Total	Remaining Maturity (in months) 12 Months Or Less
U.S. Treasury mutual funds	$	3,801,820	3,801,820
Local Agency Investment Fund (LAIF)		435,639	435,639
Money market funds		766,894	766,894
Total	$	5,004,353	5,004,353

Credit Risk

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

Credit ratings of investments as of June 30, 2005, were as follows:

Investment Types		Total	Minimum Legal Rating		Exempt From Disclosure	Not Rated
U.S. Treasury obligations	$	4,455,154	N/A	$	4,455,154	-
Local Agency Investment Fund (LAIF)		343,695	N/A		-	343,695
Money market funds		178,287	N/A		178,287	-
Total	$	4,977,136		$	4,633,441	343,695

Credit ratings of investments as of June 30, 2004, were as follows:

Investment Types		Total	Minimum Legal Rating		Exempt From Disclosure	Not Rated
U.S. Treasury mutual funds	$	3,801,820	N/A	$	3,801,820	-
Local Agency Investment Fund (LAIF)		435,639	N/A		-	435,639
Money market funds		766,894	N/A		766,894	-
Total	$	5,004,353		$	4,568,714	435,639

(4) Note Receivable – Allen-McColloch Pipeline

On July 1, 1994, the District signed an agreement along with the Municipal Water District of Orange County (MWDOC) and several other participants for the sale of capacity rights in the Allen-McColloch Pipeline (AMP) to the Metropolitan Water District of Southern California (Metropolitan). Under the terms of the sale, the District became a 3.039029% recipient of principal and interest in the following MWDOC Certificates of Participation (COPs):

		1989 COPs Series A & B		1989 COPs Series D	1992 COPs	Total COPs
Total MWDOC COPs	$	60,453,013	*	715,000	59,800,000	120,968,013
District's COPs share	$	1,837,185		715,000	1,817,339	4,369,524
Annual receipts due		Jan 1 & July 1		Jan 1 & July 1	Jan 1 & July 1	
Interest rate		5.80%		7.0% - 7.1%	Floating rate	
Initial payment received		April 10, 1995		July 1, 1995	April 10, 1995	
Final payment due		July 1, 2016		July 1, 2016	July 1, 2006	

* Amount has been adjusted for debt service reserve and negotiated capacity changes in the AMP for the City of Juan Capistrano, Coastal Municipal Water District and the El Toro Water District.

Metropolitan acknowledged in its purchase that the purchase price was substantially less than the value of the AMP based on replacement costs less depreciation, but MWDOC and the seller participants accepted the price because Metropolitan will expand the capacity of the AMP at their expense and will provide new delivery points along with AMP which will benefit the sellers.

Note receivable from the AMP consists of the following:		2005	2004
Note receivable – current – AMP	$	160,221	150,583
Note receivable – non-current – AMP		708,854	869,075
Total	$	869,075	1,019,658

(5) Capital Assets

Changes in capital assets for 2005 were as follows:

		Balance 2004	Additions	Deletions/ Transfers	Balance 2005
Non-depreciable assets:					
Land and easements	$	56,289	-	-	56,289
Construction-in-process		220,909	128,926	(162,569)	187,266
Total non-depreciable assets		277,198	128,926	(162,569)	243,555
Depreciable assets:					
Transmission and distribution system		10,205,967	124,757	(106,201)	10,224,523
Structures and improvements		4,769,732	31,882	(81,019)	4,720,595
Capacity rights		943,320	-	-	943,320
Water treatment plant		260,093	-	(260,093)	-
Equipment		241,112	12,761	(43,163)	210,710
Total depreciable assets		16,420,224	169,400	(490,476)	16,099,148
Accumulated depreciation and amortization		(7,072,208)	(392,027)	351,163	(7,113,072)
Total depreciable assets, net		9,348,016	(222,627)	(139,313)	8,986,076
Total capital assets, net	$	9,625,214	(93,701)	(301,882)	9,229,631

(5) Capital Assets, continued

Changes in capital assets for 2004 were as follows:

	Balance 2003	Additions	Deletions/ Transfers	Balance 2004
Non-depreciable assets:				
Land and easements	$ 56,289	-	-	56,289
Construction-in-process	130,914	142,832	(52,837)	220,909
Total non-depreciable assets	187,203	142,832	(52,837)	277,198
Depreciable assets:				
Transmission and distribution system	10,209,805	1,809	(5,647)	10,205,967
Structures and improvements	4,716,895	52,837	-	4,769,732
Capacity rights	943,320	-	-	943,320
Water treatment plant	260,093	-	-	260,093
Equipment	248,918	1,809	(9,615)	241,112
Total depreciable assets	16,379,031	56,455	(15,262)	16,420,224
Accumulated depreciation and amortization	(6,700,871)	(386,599)	15,262	(7,072,208)
Total depreciable assets, net	9,678,160	(330,144)	-	9,348,016
Total capital assets, net	$ 9,865,363	(187,312)	(52,837)	9,625,214

Major capital assets additions during the years include the rehabilitation of many of the District's wells and the District's transmission and distribution systems. A significant portion of these additions were constructed by the District and/or sub-contractors and transferred out of construction-in-process upon competition of these various projects.

Construction-In-Process

The District has been involved in various construction projects throughout the year. The balances of the various construction projects that comprise the construction-in-process balances at year-end are as follows:

The balance at June 30, consist of the following projects:	2005	2004	2003
Transmission and distribution system upgrades	$ 187,266	220,909	130,914
Total	$ 187,266	220,909	130,914

(6) Note Payable – Department of Water Resources

In 1991, the California Department of Water Resources contracted with the District to loan the District up to $718,500 to fund a Water Conservation Project to replace 6,600 lf. of 12" and 14" diameter steel distribution mainline with 14" C900 PVC or ductile iron piping. The construction amount financed was $646,561. The note is scheduled to mature in 2013. Principal and interest are payable semi-annually on October 1st and April 1st each year at a rate of 3.4375%. Remaining annual debt service requirements on the 1991 Department of Water Resources Note are as follows:

Fiscal Year		Principal	Interest	Total
2006	$	35,125	9,846	44,971
2007		36,344	8,627	44,971
2008		37,589	7,382	44,971
2009		38,920	6,051	44,971
2010		40,256	4,715	44,971
2011-2013		106,841	5,576	112,417
Total	$	295,075	42,197	337,272
Less current portion		(35,125)		
Total non-current	$	259,950		

(7) Net Investment in Capital Assets

The balance consists of the following:		2005	2004
Capital assets, net	$	9,229,631	9,625,214
Note payable – current portion – DWR		(35,125)	(33,971)
Note payable – DWR		(259,950)	(295,075)
	$	8,934,556	9,296,168

(8) Allen-McColloch Pipeline Lease

On July 1, 1994, the District, along with Municipal Water District of Orange County (MWDOC), as well as other participants, sold its capacity rights in the Allen-McColloch Pipeline AMP). In addition, it was agreed with the buyer, Metropolitan Water District of Southern California (Metropolitan), that East Orange County Water District and other participants would continue to receive water from the AMP as requested, subject to availability, through the term of the agreement and thereafter. In consideration for the availability of water through the AMP and other matters, the District and other participants agree to make payments related to debt service previously incurred and assumed by Metropolitan. The semiannual lease payments for rent have been accounted for and are being reported as an operating lease. The minimum lease payments for rent are scheduled below:

	Lease Payable For		
Fiscal Year	1989 COPs Series D	1996 Refunding	Total
2006	$ 58,795	73,370	132,165
2007	61,870	-	61,870
2008	59,770	-	59,770
2009	58,975	-	58,975
2010	57,575	-	57,575
2011-2016	428,095	-	428,095
Total	$ 725,080	73,370	798,450

(9) Deferred Compensation Savings Plan

For the benefit of its employees, the District participates in the California Public Employees Retirement System (CalPERS) Section 457 Deferred Compensation Program (Program). The purpose of this Program is to provide deferred compensation for California public employees that elect to participate in the Program. This Program is established pursuant to sections 21670 through 21685 of the Government Code of the State of California and is intended to constitute an "eligible deferred compensation plan" within the meaning of Section 457 of the Federal Internal Revenue Code. Generally, eligible employees may defer receipt of a portion of their salary until termination, retirement, death or unforeseeable emergency. Until the funds are paid or otherwise made available to the employee, the employee is not obligated to report the deferred salary for income tax purposes.

The Program was created under the administrative and investment control of the CalPERS Board, which requires the Board to act in the interest of Program participants. Also, Federal law requires deferred compensation assets to be held in trust for the exclusive benefit of participants. Accordingly, the District is in compliance with legislation, which requires Section 457 plan assets to be held in trust for employees. This means that employee assets held in Section 457 plans are no longer viewed as the legal property of the District and are no longer subject to claims of the District's general creditors.

The District has implemented GASB Statement No. 32, Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans. Since the District has little administrative involvement and does not perform the investing function for this plan, the assets and related liabilities are not shown on the statement of net assets.

(10) Defined Benefit Pension Plan

Plan Description

The District contributes to the California Public Employees Retirement System (CalPERS), an agent multiple-employer public employee defined benefit pension plan. CalPERS provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. CalPERS acts as a common investment and administrative agent for participating public agencies within the State of California. Benefit provisions and all other requirements are established by state statute and the District. Copies of CalPERS annual financial report may be obtained from their Executive Office: 400 P Street, Sacramento, CA, 95814.

Funding Policy

The contribution rate for participants is 7% of their annual covered salary. The District makes these contributions required of District employees on their behalf and for their account. Additionally, the District is required to contribute the actuarially determined remaining amounts necessary to fund the benefits for its members. The required employer contribution rate for fiscal year 2005 and 2004 was 4.924% and 0.000%, respectively. The contribution requirements of the plan members are established by State statute, and the employer contribution rate is established and may be amended by CalPERS.

Annual Pension Cost

For fiscal year 2005 and 2004, the District's annual pension cost was $33,668 and $0, respectively, for CalPERS and was equal to the District's required and actual contributions. The required contributions were determined as part of the June 30, 2003 and 2002, respectively, actuarial valuations using the entry age normal actuarial cost method. The actuarial assumptions included (a) 7.75% investment rate of return (net of administrative expense), (b) projected annual salary increases that vary by duration of service, and (c) 3.25% per year cost of living adjustments to 14.45% depending on age. Both (a) and (b) included an inflation component of 3.50% and a payroll growth rate of 3.25%. The actuarial value of CalPERS assets was determined using techniques that smooth the effects of short-term volatility in the market value of investment over a three-year period (smoothed market value). 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 10% of unamortized gains and losses each year. If the plan's accrued liability exceeds the actuarial value of plan assets, then the amortization payment on the total unfunded liability may not be lower than the payment calculated over a 30 year amortization period.

Trend information gives an indication of the progress made in accumulating sufficient assets to pay benefits when due. The District presents the most recent available three-year Annual Pension Cost (APC) information for the plan, along with required supplementary information as follows:

Three-Year Trend Information for CalPERS

Fiscal Year	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation
2002-2003	$ -	100%	-
2003-2004	-	100%	-
2004-2005	33,668	100%	-

(11) Risk Management

The District is exposed to various risks of loss related to torts, theft of, damage to and destruction of assets, errors and omissions, injuries to employees and natural disasters. The District is a member of the Association of California Water Agencies/Joint Powers Insurance Authority (ACWA/JPIA), an intergovernmental risk sharing joint powers authority created to provide self-insurance programs for California water agencies. The purpose of the ACWA/JPIA is to arrange and administer programs of self-insured losses and to purchase excess insurance coverage. At June 30, 2005, the District participated in the liability and property programs of the ACWA/JPIA as follows:

- General and auto liability, public officials and employees' errors and omissions: Total risk financing self-insurance limits of $500,000, combined single limit at $500,000 per occurrence. The District purchased additional excess coverage layers: $45 million for general, auto and public officials liability, which increases the limits on the insurance coverage noted above.

In addition to the above, the District also has the following insurance coverage:

- Fidelity coverage up to $250,000 per loss includes public employee dishonesty, forgery or alteration, computer fraud and ERISA coverage's, subject to a $100,000 pooled self –insurance limit with a deductible of $1,000 per claim.
- Property loss is paid at the replacement cost for property on file, if replaced within two years after the loss, otherwise paid on an actual cash value basis, to a combined total of $50 million per occurrence, subject to a $50,000 pooled self –insurance limit.
- Boiler and machinery coverage for the replacement cost up to $50 million per occurrence, subject to various deductibles depending on the type of equipment.
- Workers' compensation insurance up to California statutory limits for all work related injuries/illnesses covered by California law.

Settled claims have not exceeded any of the coverage amounts in any of the last three fiscal years and there were no reductions in the District's insurance coverage during the years ending June 30, 2005 and 2004. Liabilities are recorded when it is probable that a loss has been incurred and the amount of the loss can be reasonably estimated net of the respective insurance coverage. Liabilities include an amount for claims that have been incurred but not reported (IBNR). There were no IBNR claims payable as of June 30, 2005 and 2004.

(12) Governmental Accounting Standards Board Statements Issued, Not Yet Effective

The Governmental Accounting Standards Board (GASB) has issued several pronouncements prior to June 30, 2005, that have effective dates that may impact future financial presentations. Management has not currently determined what, if any, impact implementation of the following statements may have on the District's future financial statements.

Governmental Accounting Standards Board Statement No. 43

In April 2004, the GASB issued Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*. This statement establishes accounting and financial reporting standards for plans that provide postemployment benefits other than pension benefits (known as other postemployment benefits or OPEB). This statement is not effective until June 30, 2007. This statement is not expected to have a significant impact on the presentation of the District's financial statements.

(12) Governmental Accounting Standards Board Statements Issued, Not Yet Effective

Governmental Accounting Standards Board Statement No. 44

In May 2004, the GASB issued Statement No. 44, *Economic Condition Reporting: The Statistical Section, an amendment of NCGA Statement No.1.* This statement amends the portions of NCGA Statement 1, *Governmental Accounting and Financial Reporting Principles,* that guide the preparation of the statistical section. The statistical section presents detailed information, typically in ten-year trends, that assists users in utilizing the basic financial statements, notes to basic financial statements, and required supplementary information to assess the economic condition of a government. This statement is not effective until June 30, 2006. The District has not determined the effect this statement will have on its financial statement presentation.

Governmental Accounting Standards Board Statement No. 45

In June 2004, the GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. This Statement establishes standards for the measurement, recognition, and display of OPEB expense/expenditures and related liabilities (assets), note disclosures, and, if applicable, required supplementary information (RSI) in the financial reports of state and local government employers. This statement is not effective until June 30, 2008. The District has not determined the effect this statement will have on its financial statement presentation.

Governmental Accounting Standards Board Statement No. 46

In December 2004, GASB issued Statement No. 46, *Net Assets Restricted by Enabling Legislation, an amendment of GASB Statement No. 34*. GASB Statement No. 34 requires that limitations on the use of net assets imposed by enabling legislation be reported as restricted net assets. In the process of applying this provision, some governments have had difficulty interpreting the requirement that those restrictions be "legally enforceable." The confusion over this phrase has resulted in a diversity of practice that has diminished comparability. This statement clarifies that a legally enforceable enabling legislation restriction is one that a party external to a government – such as citizens, public interest groups, or the judiciary – can compel the government to honor. This statement also specifies the accounting and financial reporting requirements if new enabling legislation replaces existing enabling legislation or if legal enforceability is reevaluated. Finally, this statement requires governments to disclose the portion of net assets that are restricted by enabling legislation. This statement is not effective until June 30, 2006. The District has not determined the effect this statement will have on its financial statement presentation.

Governmental Accounting Standards Board Statement No. 47

In June 2005, GASB issued Statement No. 47, *Accounting for Termination Benefits*. This statement establishes accounting standards for *voluntary* and *involuntary* termination benefits. This statement is not effective until June 30, 2006. The District has not determined the effect this statement will have on its financial statement presentation.

(13) Commitments and Contingencies

Joint Facilities Agreement

The District is a party to a 50-year joint facilities agreement, dated February 13, 1964, with the Irvine Ranch Water District (IRWD) for the original purpose of constructing, operating and maintaining a water treatment plant, reservoir and pipelines. The construction was completed in 1964 and the District has capitalized the water treatment plant, reservoir and pipelines as part of its utility plant assets. IRWD entered into this agreement with the District to gain capacity rights in the water treatment plant, reservoir and pipelines. The water treatment plant has since been shut down but not demolished. The District and IRWD continue to proportionally share in the costs of maintenance and operations of the reservoir and pipelines.

(13) Commitments and Contingencies, continued

Construction Contracts

The District has a variety of agreements with private parties relating to the installation, improvement or modification of water facilities and distribution systems within its service area. The financing of such construction contracts is being provided primarily from the District's replacement reserves and advances for construction.

Grant Awards

Grant funds received by the District are subject to audit by the grantor agencies. Such audit could lead to requests for reimbursements to the grantor agencies for expenditures disallowed under terms of the grant. Management of the District believes that such disallowances, if any, would not be significant.

Litigation

In the ordinary course of operations, the District is subject to claims and litigation from outside parties. After consultation with legal counsel, the District believes that there are no legal matters that will materially affect its financial condition.

Required Supplementary Information

East Orange County Water District
Schedule of Funding Progress – CalPERS Pension Plan
For the Years Ended June 30, 2005 and 2004

Required Supplementary Information – *Funded Status of the CalPERS Pension Plan*

Actuarial Valuation Date	Entry Age Normal Accrued Liability [A]	Actuarial Value of Assets [B]	Unfunded Liability (Excess Assets) [A-B]	Funded Status [B/A]	Annual Covered Payroll [C]	(Excess Assets) as a % of Payroll [(A-B)/C]
June 30, 2001	$ 460,660	658,882	(198,222)	143.0%	219,066	(90.5%)
June 30, 2002	553,094	645,937	(92,843)	116.8%	244,144	(38.0%)
June 30, 2003	739,544	687,594	51,950	93.0%	255,700	20.3%

The Schedule of Funding Progress above shows the District's recent history of its CalPERS Plan actuarial value of assets, actuarial accrued liability, their relationship, and the relationship of the unfunded actuarial accrued liability to payroll.

Report on Compliance and Internal Controls

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Independent Auditor's Report on Compliance and on Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

Board of Directors
East Orange County Water District
Orange, California

We have audited the financial statements of the East Orange County Water District (District) as of and for the years ended June 30, 2005, and have issued our report thereon dated October 14, 2005. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

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

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the District's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

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

Charles Z. Fedak & Co. CPAs
An Accountancy Corporation

October 14, 2005
Cypress, California