



ROY T. HOSAKA, C.P.A.
JAMES C. NAGEL, C.P.A.

MEMBER
CALIFORNIA SOCIETY OF
CERTIFIED PUBLIC ACCOUNTANTS
AMERICAN INSTITUTE OF
CERTIFIED PUBLIC ACCOUNTANTS

RAINBOW MUNICIPAL WATER DISTRICT

**REPORT ON EXAMINATION OF
FINANCIAL STATEMENTS**

FOR THE YEAR ENDED

JUNE 30, 2009

RAINBOW MUNICIPAL WATER DISTRICT

INTRODUCTORY SECTION

JUNE 30, 2009

**RAINBOW MUNICIPAL WATER DISTRICT
TABLE OF CONTENTS
JUNE 30, 2009**

	<u>Page Number</u>
INTRODUCTORY SECTION	
Table of Contents	i - ii
FINANCIAL SECTION	1
Independent Auditors' Report	2 - 3
Management's Discussion and Analysis	4 - 9
Statement of Net Assets	10 - 11
Statement of Revenues, Expenses, and Changes in Net Assets	12 - 13
Statement of Cash Flows	14 - 15
Notes to the Basic Financial Statements	16 - 31
SUPPLEMENTARY INFORMATION SECTION	32
Organization	33
Assessed Valuation	34
OTHER INDEPENDENT AUDITORS' REPORTS SECTION	35
Report on Internal Control Over Financial Reporting And On Compliance And Other Matters Based On An Audit Of Financial Statements Performed In Accordance With <i>Government Auditing Standards</i>	36 - 37

**RAINBOW MUNICIPAL WATER DISTRICT
TABLE OF CONTENTS (CONTINUED)
JUNE 30, 2009**

	<u>Page Number</u>
FINDINGS AND RECOMMENDATIONS SECTION	38
Schedule of Audit Findings and Questioned Costs	39 - 40
Status of Prior Year Findings and Recommendations	41

RAINBOW MUNICIPAL WATER DISTRICT

FINANCIAL SECTION

JUNE 30, 2009

INDEPENDENT AUDITORS' REPORT

Board of Directors
Rainbow Municipal Water District
Fallbrook, California

We have audited the accompanying financial statements of the Rainbow Municipal Water District as of, and for the year ended June 30, 2009, as listed in the Table of Contents. These financial statements are the responsibility of the Rainbow Municipal Water 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, standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States, and the State Controller's *Minimum Audit Requirements for California Special Districts*. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Rainbow Municipal Water District, as of June 30, 2009, and the results of its operations for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis on pages 4 through 9 is not a required part of the basic financial statements, but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, consisting principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

INDEPENDENT AUDITORS' REPORT

Page 2

In accordance with *Government Auditing Standards*, we have also issued our report, dated August 31, 2009, on our consideration of the Rainbow Municipal Water District's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants agreements and other matters. The purpose of that report is to describe the scope of 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.

Our audit was made for the purpose of forming an opinion on the financial statements taken as a whole. The supplementary financial and statistical information listed in the Table of Contents, is presented for purposes of additional analysis and is not a required part of the financial statements of the Rainbow Municipal Water District. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated in all material respects in relation to the financial statements taken as a whole.

Kirscha, Nagel & Company

San Diego, California
August 31, 2009

**RAINBOW MUNICIPAL WATER DISTRICT
MANAGEMENT DISCUSSION AND ANALYSIS
JUNE 30, 2009**

As management of the Rainbow Municipal Water District, we offer readers of the District's financial statements this narrative overview and analysis of the financial activities of the District for the fiscal year ended June 30, 2009. We encourage readers to consider the information presented here in conjunction with the District's basic financial statements, which begin immediately following this analysis. This annual financial report consists of two main parts (1) Management's Discussion and Analysis and, (2) Basic Financial Statements.

In June 1999, the Governmental Accounting Standards Board (GASB) issued Statement No. 34, Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments. GASB No. 34 established financial reporting standards for state and local governments, including cities, villages and special purpose governments.

FINANCIAL HIGHLIGHTS

- The District's ending Total Net Asset balance was \$90,041,038.
- The Decrease in Net Assets for the year was \$608,122.
- The District had Operating Expenses in excess of Operating Revenue in the amount of \$3,629,944 in the current year compared to \$2,156,555 in the previous year.
- This year the District had \$1,863,143 worth of additions to Capital Assets compared to \$1,525,982 last year.
- The District's Budget for this year showed Excess Revenue over Expenditures (before Transfers) of \$1,193,723 compared to the actual amount of Excess Expenditures over Revenue of \$3,629,944.

OVERVIEW OF FINANCIAL STATEMENTS

This discussion and analysis is intended to serve as an introduction to the District's basic financial statements. The District's audit report is comprised of four components: 1) financial statements and notes, 2) supplementary information, 3) reports on compliance and internal control, and 4) findings and recommendations.

**RAINBOW MUNICIPAL WATER DISTRICT
MANAGEMENT DISCUSSION AND ANALYSIS (CONTINUED)
JUNE 30, 2009**

Basic financial statements. The basic financial statements include District financial statements and fund statements.

The District, as a whole, is reported in the District statements and uses accounting methods similar to those used by companies in the private sector.

The *Statement of Net Assets*, a District statement, 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 deteriorating.

The *Statement of Revenues, Expenses and Changes in Net Assets*, a District statement, 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.

The *Statement of Cash Flows* provides information regarding the District's cash receipts and cash disbursements during the year.

The *Notes to the Basic Financial Statements* are included to provide more detailed data and explain some of the information in the statements.

The *Supplementary Information* gives an overview of the operations of the District and the governing body and outlines assessed property valuation.

Reports on Compliance and Internal Control encompass the independent auditor's reports showing compliance with *Government Auditing Standards* and provides additional information that is essential to a full understanding of the data provided in the government-wide and fund financial statements.

The *Findings and Recommendations* section notes material weaknesses in the system and recommendations.

**RAINBOW MUNICIPAL WATER DISTRICT
MANAGEMENT DISCUSSION AND ANALYSIS (CONTINUED)
JUNE 30, 2009**

The District's net assets decreased from the prior fiscal year by 0.7%. Revenue for this fiscal year increased 3.8% over the prior year. The Metropolitan Water District mandated a 30% reduction in agricultural program water supplies starting January 1, 2008 for those customers participating in the Interim Agricultural Water Program (IAWP). Approximately 70% of Rainbow's water sales are for agricultural irrigation, however less than 10% remain in the IAWP. The IAWP is scheduled to be phased out 12/31/2012.

Additional water allocations are to be initiated July 1, 2009 for all other water customers of the District. Special Agricultural Water Rate customers were mandated to reduce their usage 13% based on the 2006-07 fiscal year. Domestic water allocations were reduced by 8%.

The District sold approximately 25,000 acre feet of water during 2008-09. The District has sold in excess of 30,000 acre feet in four of the prior six years.

Operating expenses increased from the year prior due to increased wholesale water prices. The District also incurred significant expenses in the repair of mainline breaks and leaks. The District had nearly twice as many breaks in 2008-09 over the prior year.

New development paid \$618,822 for sewer capacity fees and \$817,283 for water capacity fees which will be used to fund current and future capital projects.

Statement of Net Assets

To begin our analysis, a summary of the District's Statement of Net Assets is presented in Table 1 below for the current year and the prior year.

Net assets may serve over time, as a useful indicator of a District's financial position. In the case of the District, assets exceeded liabilities by \$90,041,038 as of June 30, 2009.

Total assets decreased 1.1% from the prior fiscal year mostly due to the decrease in depreciated value of fixed assets and the payout of cash to retire the long-term debt.

Noncurrent assets increased due to a shift from short-term investments to higher yielding long-term investments. Long-term investments consist of AAA rated government-backed bonds.

Total liabilities decreased as a result of the connection of prepaid water and sewer accounts for developers as well as the surrender of reserved sewer capacity.

The District's financial position is the product of several financial transactions including the net results of revenue and expense, the acquisition and disposal of capital assets, and the depreciation of capital assets.

**RAINBOW MUNICIPAL WATER DISTRICT
MANAGEMENT DISCUSSION AND ANALYSIS (CONTINUED)
JUNE 30, 2009**

Table 1
Condensed Statement of Net Assets

	June 30, 2009	June 30, 2008	\$ Change	% of Change
Current and Other Assets	\$ 27,290,756	\$ 36,549,548	\$ (9,258,792)	-25.2%
Non-current Assets	13,989,303	5,871,334	8,117,969	135.8%
Capital Assets (Net)	64,371,974	64,446,551	(74,577)	-0.1%
TOTAL ASSETS	\$ 105,652,033	\$ 106,867,433	\$ (1,215,400)	-1.1%
Current Liabilities	\$ 5,783,412	\$ 5,542,128	\$ 241,284	4.4%
Non-current Liabilities	9,827,583	10,676,145	(848,562)	-7.9%
TOTAL LIABILITIES	\$ 15,610,995	\$ 16,218,273	\$ (607,278)	-3.7%
Invested in Capital Assets, Net of Related Debt	\$ 64,371,974	\$ 63,931,551	\$ 440,423	0.7%
Restricted	-	862,089	(862,089)	0.0%
Unrestricted	25,669,064	25,855,520	(186,456)	-0.7%
TOTAL NET ASSET	90,041,038	90,649,160	(608,122)	-0.7%
TOTAL LIABILITIES AND NET ASSETS	\$ 105,652,033	\$ 106,867,433	\$ (1,215,400)	-1.1%

Statement of Revenues, Expenses and Changes in Net Assets

- The District's total operating revenues for the fiscal year ended June 30, 2009, excluding inter-fund transfers, increased by \$1,017,925 to \$27,927,180.
- The District's total operating expenses increased by \$2,491,314 to \$31,557,124 due primarily to the increased price of water.
- The excess of operating expenses over operating revenue was \$3,629,944.

**RAINBOW MUNICIPAL WATER DISTRICT
MANAGEMENT DISCUSSION AND ANALYSIS (CONTINUED)
JUNE 30, 2009**

The following table presents a summary of the Statement of Activities for the fiscal year ended June 30, 2009.

Table 2
Condensed Statement of Activities

	<u>June 30, 2009</u>	<u>June 30, 2008</u>	<u>\$ Change</u>	<u>% of Change</u>
Operating Revenue	\$ 27,927,180	\$ 26,909,255	\$ 1,017,925	3.8%
Operating Expense	31,557,124	29,065,810	2,491,314	8.6%
TOTAL OPERATING INCOME (LOSS)	<u>(3,629,944)</u>	<u>(2,156,555)</u>	<u>(1,473,389)</u>	<u>-68.3%</u>
Non-operating Revenue	3,053,680	5,380,538	(2,326,858)	-43.2%
Non-operating Expense	31,858	109,916	(78,058)	-71.0%
TOTAL NON-OPERATING INCOME (LOSS)	<u>3,021,822</u>	<u>5,270,622</u>	<u>(2,248,800)</u>	<u>-42.7%</u>
TOTAL NET INCOME (LOSS)	<u>\$ (608,122)</u>	<u>\$ 3,114,067</u>	<u>\$ (3,722,189)</u>	<u>-119.5%</u>

General Fund Budgetary Highlights

The General Fund had the following Excess of Expenditures over Appropriations (instances where actual amounts exceeded budgeted amounts) in individual categories:

TABLE 3
Excess Expenditures over Appropriations

Water Distribution Expense	<u>\$ 190,238</u>
----------------------------	-------------------

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

TABLE 4
Changes in Capital Assets

Capital Assets	<u>Balance June 30, 2009</u>	<u>Balance June 30, 2008</u>
Land	\$ 1,627,756	\$ 1,627,756
Construction in Progress	5,642,790	5,329,115
Property, Plant, Equipment, Net of Accumulated Depreciation	<u>57,101,428</u>	<u>57,489,680</u>
TOTAL	<u>\$ 64,371,974</u>	<u>\$ 64,446,551</u>

**RAINBOW MUNICIPAL WATER DISTRICT
MANAGEMENT DISCUSSION AND ANALYSIS (CONTINUED)
JUNE 30, 2009**

Capital Assets (Continued)

The increase in Construction in Progress is due to the start-up of the reservoir covering projects. The decrease in Property, Plant, and Equipment results from the capital assets depreciating faster than they are being replaced.

Long-Term Debt

The 1993 Certificates of Participation were retired in August 2008. No new long-term debt was acquired during the fiscal year.

FACTORS BEARING ON THE DISTRICT'S FUTURE

The District recorded a loss from operations of \$3,629,944 which includes \$2,251,396 of depreciation expense. Net income from all sources resulted in a loss of \$608,122. A significant variance in delivery and consumption of water can greatly affect the District's financial position. The District purchases 100% of its water from the San Diego County Water Authority. Extended periods of drought plus court-ordered pumping restrictions in the Sacramento Delta have sharply reduced the amount of available water supply. It is anticipated that the current conditions will continue if broader water restrictions are imposed in the subsequent years.

In July 2007 the District signed an agreement to purchase 7,500 acre feet of desalinated water from the Carlsbad desalination plant. The construction of the plant is scheduled to be completed in 2011.

The District's income is also affected by the significant downturn in the building industry as well as the general economy.

CONTACTING THE DISTRICT

Questions regarding this report should be directed to Dave Seymour, General Manager or Gene Buckley, Finance Manager at (760) 728-1178, or by mail at 3707 Old Highway 395, Fallbrook, CA 92028.

RAINBOW MUNICIPAL WATER DISTRICT

**RAINBOW MUNICIPAL WATER DISTRICT
STATEMENT OF NET ASSETS
JUNE 30, 2009**

ASSETS

CURRENT ASSETS

Cash and Cash Equivalents	\$	21,416,227
Accounts Receivable, Net of Allowance		
Water and Sewer		4,069,233
Interest Receivables		216,710
Other Receivables		147,231
Inventory		749,671
Letters of Credit		488,983
Prepaid Expenses		202,701

Total Current Assets		27,290,756
----------------------	--	------------

NON-CURRENT ASSETS

Investments		13,989,303
Capital Assets:		
Land		1,627,756
Buildings and Improvements		900,443
Reservoir, Pipelines, and Tanks		103,865,816
Meters		302,678
Equipment		3,420,559
Investment in Sewer Rights		5,645,196
Less: Accumulated Depreciation		(57,033,264)
Construction in Progress		5,642,790

Total Non-Current Assets		78,361,277
--------------------------	--	------------

TOTAL ASSETS		\$ 105,652,033
---------------------	--	-----------------------

The notes to the financial statement are an integral part of this statement.

**RAINBOW MUNICIPAL WATER DISTRICT
STATEMENT OF NET ASSETS (CONTINUED)
JUNE 30, 2009**

LIABILITIES AND NET ASSETS

CURRENT LIABILITIES

Accounts Payable	\$ 4,445,273
Accrued Payroll Liabilities	849,156
Letter of Credit - Sewer	488,983
Accrued Interest Payable	-
Current Portion of Bonds Payable	-

Total Current Liabilities 5,783,412

NON-CURRENT LIABILITIES

Deferred Revenue	9,827,583
Bond Payable After One Year	-

Total Non-Current Liabilities 9,827,583

TOTAL LIABILITIES 15,610,995

NET ASSETS

Invested in Capital Assets, Net of Related Debt	64,371,974
Unrestricted	25,669,064

TOTAL NET ASSETS 90,041,038

**TOTAL LIABILITIES AND
NET ASSETS** \$ 105,652,033

The notes to the financial statement are an integral part of this statement.

**RAINBOW MUNICIPAL WATER DISTRICT
STATEMENT OF REVENUES, EXPENSES, AND
CHANGES IN NET ASSETS
FOR THE YEAR ENDED JUNE 30, 2009**

OPERATING REVENUES

Water Sales	\$ 24,552,036
Waste Water Revenue	<u>3,375,144</u>

Total Operating Revenues	<u>27,927,180</u>
--------------------------	-------------------

OPERATING EXPENSES

Water Purchases	16,818,224
Water Pumping	750,083
Transmission and Distribution	4,918,363
Meter Services	1,076,967
Sewer Services	2,011,150
Administrative and General	2,089,336
Engineering	959,852
Finance	433,023
Customer Service	248,730
Depreciation	<u>2,251,396</u>

Total Operating Expenses	<u>31,557,124</u>
--------------------------	-------------------

Loss from Operations	<u>(3,629,944)</u>
----------------------	--------------------

NON-OPERATING REVENUES

Interest	898,317
Property Tax Revenue	411,374
Other	<u>1,743,989</u>

Total Non-Operating Revenues	<u>3,053,680</u>
------------------------------	------------------

NON-OPERATING EXPENSES

Bond Administration	<u>31,858</u>
---------------------	---------------

Total Non-Operating Expenses	<u>31,858</u>
------------------------------	---------------

The notes to the financial statement are an integral part of this statement.

**RAINBOW MUNICIPAL WATER DISTRICT
STATEMENT OF REVENUES, EXPENSES, AND
CHANGES IN NET ASSETS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2009**

Loss Before Contributions	<u>(608,122)</u>
Decrease in Net Assets	(608,122)
NET ASSETS - Beginning	<u>90,649,160</u>
NET ASSETS - Ending	<u><u>\$ 90,041,038</u></u>

The notes to the financial statement are an integral part of this statement.

**RAINBOW MUNICIPAL WATER DISTRICT
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2009**

CASH FLOWS FROM OPERATING ACTIVITIES	
Receipts from Customers	\$ 27,028,700
Payments to Suppliers and Vendors	(24,965,956)
Payments to Employees	<u>(3,641,416)</u>
Net Cash Used by Operating Activities	<u>(1,578,672)</u>
 CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES	
Property Taxes Received	411,374
Other Revenue	<u>1,743,989</u>
Net Cash Provided by Non-Capital Financing Activities	<u>2,155,363</u>
 CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES	
Acquisition and Construction of Capital Assets	(2,183,319)
Principal Payments on Bonds	(515,000)
Bond Administration	<u>(31,858)</u>
Net Cash Used by Capital and Related Financing Activities	<u>(2,730,177)</u>
 CASH FLOWS FROM INVESTING ACTIVITIES	
Net (Increase) Decrease in Investments	
Purchase of Investments	(8,980,058)
Interest on Investments	<u>898,317</u>
Net Cash Used by Investing Activities	<u>(8,081,741)</u>

The notes to the financial statement are an integral part of this statement.

**RAINBOW MUNICIPAL WATER DISTRICT
STATEMENT OF CASH FLOWS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2009**

Net Increase (Decrease) in Cash and Cash Equivalents	(10,235,227)
CASH AND CASH EQUIVALENTS - Beginning	<u>31,651,454</u>
CASH AND CASH EQUIVALENTS - Ending	<u><u>\$ 21,416,227</u></u>
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES:	
Operating Loss	\$ (3,629,944)
Adjustments to Reconcile Net Income from Operations to Net Cash Provided by Operating Activities	
Depreciation	2,251,396
(Increase) Decrease in Operating Assets:	
Water and Other Receivables	(49,918)
Inventory	65,190
Prepaid Expenses	(202,701)
Increase (Decrease) in Operating Liabilities:	
Accounts Payable	654,609
Deferred Revenue	(848,562)
Accrued Payroll	199,283
Accrued Interest Payable	<u>(18,025)</u>
Net Cash Used by Operating Activities	<u><u>\$ (1,578,672)</u></u>
RECONCILIATION TO BALANCE SHEET	
Cash	\$ 21,416,227
Restricted: Cash and Cash Equivalents	-
	<u><u>\$ 21,416,227</u></u>
SUPPLEMENTAL DISCLOSURES	
Cash Payments for Interest	<u><u>\$ (18,025)</u></u>

The notes to the financial statement are an integral part of this statement.

**RAINBOW MUNICIPAL WATER DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 2009**

The notes provided in the Financial Section of this report are considered an integral and essential part of adequate disclosure and fair presentation. The notes include a summary of accounting policies and other necessary disclosure of pertinent matters relating to financial position and results of operations of the Rainbow Municipal Water District (the District). The notes express significant insight to the financial statements and are conjunctive to understanding the rationale for presentation of the financial statements and information contained in this report.

NOTE 1 - ORGANIZATION

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

- A. Accounting Policies
- B. Basis of Accounting
- C. Financial Reporting
- D. Water Systems
- E. Depreciation
- F. Investments
- G. Inventories
- H. Accrued Vacation and Sick Leave
- I. Unbilled Water Receivable
- J. Tax Status
- K. Net Assets Restricted

NOTE 3 - USE OF ESTIMATES IN PREPARING FINANCIAL STATEMENTS

NOTE 4 - CLASSIFICATION OF ITEMS

NOTE 5 - CASH, CASH EQUIVALENTS, AND INVESTMENTS

- A. Deposits
- B. Investments

NOTE 6 - FIXED ASSETS

NOTE 7 - BONDS PAYABLE

NOTE 8 - RISK MANAGEMENT

NOTE 9 - RETIREMENT PLAN

**RAINBOW MUNICIPAL WATER DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
JUNE 30, 2009**

NOTE 10 - DEFERRED COMPENSATION PLAN

NOTE 11 - OTHER POST EMPLOYMENT BENEFITS

NOTE 12 - EARLY RETIREMENT INCENTIVE

NOTE 13 - LEASES

NOTE 14 - COMMITMENTS AND CONTINGENCIES

NOTE 15 - DEFERRED REVENUE

NOTE 16 - PENDING LITIGATION

**RAINBOW MUNICIPAL WATER DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
JUNE 30, 2009**

NOTE 1 - ORGANIZATION

Rainbow Municipal Water District (the District) was organized in 1953 and operates under the provisions of the Irrigation District Law, now Division 11 of the California State Water Code. The District supplies water and wastewater collection services to unincorporated areas of Bonsall, Rainbow, and parts of Fallbrook. It is governed by a Board consisting of five Directors, each of whom is elected by divisions of the District for a four-year term.

The District's Administration and Operations are located at 3707 Old Highway 395 in Fallbrook, California.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Accounting Policies

The accounting policies of the District conform to generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (GASB) and the American Institute of Certified Public Accountants (AICPA).

B. Basis of Accounting

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) or 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 flow took place.

Operating revenues and expenses are generated and incurred through the water sales activities to the District's customers. Administration and depreciation expenses are also considered operating expenses. Other revenues and expenses not included in the above categories are reported as non-operating revenues and expenses.

**RAINBOW MUNICIPAL WATER DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
JUNE 30, 2009**

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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 reporting.

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.

D. Water Systems

Water Systems contributed to the District are recorded at cost if constructed by the District and reimbursed by the property owner; otherwise, engineers' estimates are used. The Board of Directors approves major contributions prior to recording them.

E. Depreciation

Depreciation is charged to expense for all fixed assets (including assets contributed to the District) and is computed using the straight-line method over the estimated useful asset lives as follows:

Water System	10 - 50 years
Building and Building Improvements	10 - 50 years
Automotive Equipment	5 years
Other Equipment	5 - 10 years

**RAINBOW MUNICIPAL WATER DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
JUNE 30, 2009**

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

F. Investments

Investments are carried at fair market value in accordance with GASB 31.

G. Inventories

The value of water inventory is determined based upon the quantity of water in storage at recent purchase rates.

H. Accrued Vacation and Sick Leave

At June 30, 2009, the District's policy is to record a liability equal to 100 percent of accrued vacation and sick leave available to all employees. Included in accrued payroll liabilities in the Statement of Net Assets is \$622,935 of accrued vacation and sick leave.

I. Unbilled Water Receivable

The District accrues revenue for water and service supplied to customers but not billed as of year-end. The accrual is an estimate of the water usage for each meter based upon the period from the last meter billing to year-end.

J. Tax Status

The Rainbow Municipal Water District is exempt from income taxes of the Internal Revenue Code and California tax law.

K. Net Assets Restricted

Restrictions of the ending net assets indicate the portion of net assets not available for expenditures. This amount is legally segregated for a specific future use.

NOTE 3 - USE OF ESTIMATES IN PREPARING FINANCIAL STATEMENTS

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

**RAINBOW MUNICIPAL WATER DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
JUNE 30, 2009**

NOTE 4 - CLASSIFICATION OF ITEMS

Certain items may have been classified differently from one year to another.

NOTE 5 - CASH, CASH EQUIVALENTS, AND INVESTMENTS

For purposes of the statement of cash flows, cash and cash equivalents consist of short-term highly liquid investments with maturities of ninety days or less from the date of purchase. These include cash on hand, cash held in the restricted assets accounts, and the Local Agency Investment Fund.

The District's investment policy and state statutes authorize the District to invest in obligations of the U.S. Treasury, its agencies and instrumentalities, certificates of deposit with national and state-licensed or chartered banks or federal or state savings and loan associations, money market and mutual funds whose portfolios consist of one or more of the foregoing investments, and the Local Agency Investment Fund.

State statutes require all deposits be insured or collateralized. Depositories holding public funds on deposit are required to maintain collateral in the form of a pool of securities with the agent of the depository having a market value of at least 10 to 50 percent in excess of the total amount of all public funds on deposit.

A. Deposits

The summary of cash and cash equivalents is as follows at June 30, 2009:

Deposits	
Cash and Cash Equivalents	\$ 21,416,227
Non-Current Assets	
Investments	<u>13,989,303</u>
TOTAL CASH AND INVESTMENTS	<u>\$ 35,405,530</u>
Cash on Hand	\$ 1,250
Deposits with Financial Institutions	757,558
Pooled Funds	20,657,419
Investments	<u>13,989,303</u>
TOTAL CASH AND INVESTMENTS	<u>\$ 35,405,530</u>

**RAINBOW MUNICIPAL WATER DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
JUNE 30, 2009**

NOTE 5 - CASH, CASH EQUIVALENTS, AND INVESTMENTS (CONTINUED)

The summary which presents the amount of the District's deposits which are fully insured or collateralized with securities held by the District or its agent in the District's name (Category One), those deposits which are collateralized with securities held by the pledging financial institution's trust department, or agent in the District's name (Category Two), and those deposits which are not collateralized or are collateralized with securities held by the pledging financial institution, or its trust department, or agent, but not in the District's name (Category Three), is as follows at June 30, 2009:

	Category One	Category Two	Category Three	Total Bank Balance	Carrying Amount
Cash	\$ 500,000	\$ 2,113,201	\$ -	\$ 2,613,201	\$ 757,578

B. Investments

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 the District's pro-rata share of the fair value provided by LAIF for the entire LAIF portfolio (in relation to the amortized costs 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 District categorizes investments according to the level of risk assumed by the District. Category One includes investments that are insured or registered, with securities held by the District or its agent in the District's name. Category Two includes uninsured and unregistered investments held by the counter-party's trust department, or agent in the District's name. Category Three includes uninsured and unregistered deposits held by the counter-party, its trust department, or its agent, but not in the District's name. Certain investments have not been categorized because securities are not used as evidence of the investment. These uncategorized investments include ownership interest in pooled investment funds. A summary, which identifies the level of risk assumed by the District and the total carrying amount and market value of the District's investments are as follows at June 30, 2009:

**RAINBOW MUNICIPAL WATER DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
JUNE 30, 2009**

NOTE 5 - CASH, CASH EQUIVALENTS, AND INVESTMENTS (CONTINUED)

	Category			Uncategorized	Total Investments	Market Value
	One	Two	Three			
Local Agency Investment Fund	\$ -	\$ -	\$ -	\$ 20,608,335	\$ 20,608,335	\$ 20,657,419
U.S. Government Agency Obligation	14,128,837	-	-	-	14,128,837	13,989,303
TOTAL	\$ 14,128,837	\$ -	\$ -	\$ 20,608,335	\$ 34,737,172	\$ 34,646,722

NOTE 6 - FIXED ASSETS

A schedule of changes in fixed assets and accumulated depreciation for the year ended June 30, 2009, is shown as follows:

	Balance June, 30 2008	Additions	Deletions	Balance June 30, 2009
Capital Assets, Not Being Depreciated:				
Land	\$ 1,627,756	\$ -	\$ -	\$ 1,627,756
Construction in Progress	5,329,115	2,248,457	1,934,782	5,642,790
Total Capital Assets, Not Being Depreciated	6,956,871	2,248,457	1,934,782	7,270,546
Capital Assets, Being Depreciated:				
Buildings and Improvements	3,575,148	196,075	2,870,780	900,443
Reservoir, Pipelines, and Tanks	99,707,330	4,158,486	-	103,865,816
Meter	149,756	152,922	-	302,678
Equipment	3,194,118	226,441	-	3,420,559
Investment in Sewer Rights	5,645,196	-	-	5,645,196
Total Capital Assets, Being Depreciated	112,271,548	4,733,924	2,870,780	114,134,692
Less Accumulated Depreciation for:				
Buildings and Improvements	2,710,091	38,106	2,116,094	632,103
Reservoir, Pipelines, and Tanks	49,278,848	3,798,285	-	53,077,133
Meter	82,367	45,560	-	127,927
Equipment	2,710,562	316,183	-	3,026,745
Investment in Sewer Rights	-	169,356	-	169,356
Total Accumulated Depreciation	54,781,868	4,367,490	2,116,094	57,033,264
Total Capital Assets, Being Depreciated, Net	57,489,680	366,434	754,686	57,101,428
Government Activities Capital Assets, Net	\$ 64,446,551	\$ 2,614,891	\$ 2,689,468	\$ 64,371,974

**RAINBOW MUNICIPAL WATER DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
JUNE 30, 2009**

NOTE 7 - BONDS PAYABLE

The following is a summary of changes in the principal balance of long-term debt for the year ended June 30, 2009:

	<u>Balance at June 30, 2008</u>	<u>Additions</u>	<u>Retirements</u>	<u>Balance at June 30, 2009</u>
Certificates of Participation	\$ 515,000	\$ -	\$ 515,000	\$ -
Less Revenue Bonds:				
Unamortized Discount	-	-	-	-
Unamortized Deferred Amount on Refunding	-	-	-	-
TOTAL LONG-TERM DEBT	<u><u>\$ 515,000</u></u>	<u><u>\$ -</u></u>	<u><u>\$ 515,000</u></u>	<u><u>\$ -</u></u>

Long-term debt is comprised of the following issue:

1993 Crossover Refunding Certificates of Participation Bonds:

On July 15, 1993, the District issued 15-year Crossover Refunding Certificates of Participation Bonds in the amount of \$4,170,000. The purpose of the issue was to provide monies for the crossover refunding of the 1988 Certificates of Participation (COP) on August 1, 1988, (the crossover date) and pay certain costs of issuance. The liability for the 1988 COP's has been completely removed from the District's financial statements. The refunding resulted in a deferred amount of \$212,320 which is being amortized over the remaining life of the debt. Amortization in the amount of \$35,387 is reported as non-operating expenses.

The District is obligated to levy ad valorem taxes (without limits to rate or amount) sufficient to pay principal and interest in the event the revenues of the District are insufficient. The Bonds bear interest at rates of 4.6% to 5.25% with principal payments ranging from \$345,000 to \$515,000.

During the year ended June 30, 2009 the Certificates of Participation were paid off.

NOTE 8 - RISK MANAGEMENT

The District is a member of the Special District Risk Management Authority (SDRMA), an intergovernmental risk sharing joint powers authority created pursuant to California Government Code Section 6500 et. Seq. At June 30, 2009, the District participated in the self-insurance programs of the Authority as follows:

**RAINBOW MUNICIPAL WATER DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
JUNE 30, 2009**

NOTE 8 - RISK MANAGEMENT (CONTINUED)

Property Loss:

The District is insured up to \$1,000,000,000 per occurrence with a \$500 deductible.

General Liability

The District is insured up to \$10,000,000 per occurrence with a \$100,000 deductible.

Auto Liability

The District is insured up to \$10,000,000 per occurrence with a \$1,000 deductible for property damage.

The District has insurance for uninsured/underinsured motorist up to \$750,000 per accident.

Boiler and Machinery Coverage

The District is insured up to \$100,000,000 per occurrence with a \$1,000 deductible.

Public Officials and Employee Errors

The District is insured up to \$10,000,000 per occurrence, with an aggregate of \$10,000,000 per each elected/appointed official to which this coverage applies. Personal liability coverage for Board Members is \$500,000 per occurrence with a \$500 deductible.

Workers' Compensation & Employer's Liability

Employer's liability is insured up to \$5,000,000 per occurrence and workers' compensation up to statutory limits.

Fidelity Bond

The District is insured up to \$400,000 per loss.

Employment Practices and Employee Benefits Liability

The District is insured up to \$10,000,000 per occurrence with a general aggregate of \$10,000,000.

**RAINBOW MUNICIPAL WATER DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
JUNE 30, 2009**

NOTE 8 - RISK MANAGEMENT (CONTINUED)

The purpose of becoming a member of SDRMA, was to achieve a joint powers authority for savings on insurance premiums for general liability, employment practices, and property insurance. Each member pays for its proportionate share of its individually contracted insurance coverage.

NOTE 9 - RETIREMENT 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 entities within the State of California. Benefit provisions and state statute and District policies establish all other requirements. Copies of CalPERS' annual financial report may be obtained from their Executive Office, 400 P Street, Sacramento, CA 95814.

Funding Policy

Participants are required to contribute 8.0% of their annual covered salary; the District contributes 7.0% of the 8.0% employees' portion and additionally is required to contribute the actuarially determined remaining amounts necessary to fund the benefits for its members. The District makes the contributions required of the District's employees on their behalf and for their account. 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, 2009, was 24.101%. 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 the year ended June 30, 2009, the District's annual pension cost of \$606,157 was equal to the District's required and actual contributions. The required contribution was determined as part of the June 30, 2006 actuarial valuation, using the entry age normal actuarial cost method. The actuarial assumptions included (a) 7.75% investment rate of return (net of administrative expenses), (b) projected annual salary increases that vary by duration of service, and (c) 3.25% per year payroll growth adjustments. Both (a) and (b) included an inflation component of 3.0%. The actuarial value of CalPERS assets was determined using techniques that smooth the effects of short-term volatility in the market value of investments over a three-year period (smoothed market value).

**RAINBOW MUNICIPAL WATER DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
JUNE 30, 2009**

NOTE 9 - RETIREMENT PLAN (CONTINUED)

Three-year trend information for CalPERS showing the net pension obligation is as follows:

Fiscal Year	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation
6/30/2007	\$ 474,746	100%	\$ -
6/30/2008	\$ 579,150	100%	\$ -
6/30/2009	\$ 606,157	100%	\$ -

The following table shows a brief history of the funding status of the plan. Actuarial information was not yet available for the years ended June 30, 2009 and 2008.

Valuation Date	Entry Age Normal Accrued Liability (a)	Actuarial Value of Assets (b)	Unfunded Liability (a)-(b)	Funded Status (b)/(a)	Annual Covered Payroll (c)	UAAL as a % of Payroll [(a)-(b)]/(c)
6/30/2005	\$ 579,276,103	\$ 500,388,523	\$ 78,887,580	86.38%	\$ 129,379,492	60.97%
6/30/2006	\$ 912,988,585	\$ 787,758,909	\$ 125,229,676	86.28%	\$ 200,320,145	62.51%
6/30/2007	\$ 1,315,454,361	\$ 1,149,247,298	\$ 166,207,063	87.37%	\$ 289,090,187	57.49%

NOTE 10 - DEFERRED COMPENSATION PLAN

The District offers its employees a deferred compensation plan in accordance with Internal Revenue Code Section 457. The plan, administered by Lincoln Financial Group, is available to all regular employees, permits deferment of a portion of current salary to future years. Benefits from the plans are not available to employees until termination, retirement, disability, death, or unforeseeable emergencies.

All assets and income of the plans are held in trust for the exclusive benefit of the participants and their beneficiaries. The District does not meet the criteria for fiduciary fund reporting since it does not have either significant administrative involvement (e.g. custody) or perform the investment function. Therefore, the fair market value of the plans assets at June 30, 2009, in the amount of \$1,126,750, is not included in the District's financial statements.

**RAINBOW MUNICIPAL WATER DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
JUNE 30, 2009**

NOTE 11 - OTHER POST EMPLOYMENT BENEFITS

The District provides Other Post Employment Benefits (OPEB) including medical, prescription drugs, and dental benefits, in accordance with a resolution approved by the board of Directors. Medical insurance is provided through a choice of a Blue Cross HMO or a Blue Cross Classic PPO, both offered through the Association of California Water Agencies Joint Powers Insurance Authority. Dental insurance is provided through Assurant Employee Benefits.

Plan Description

Exempt employees of the District retiring after the later of age 50 and 5 consecutive years of District service are eligible to receive a monthly District contribution towards the purchase of health insurance. Non-exempt employees of the District are eligible after the later of age 50 and 20 consecutive years of District service. The District makes the following contributions:

<u>Monthly Payments</u>	<u>Exempt Employees</u>	<u>Non-Exempt Employees</u>
Retiree and spouse both under age 65	\$600	\$400
Retiree under age 65	\$300	\$200
Under age 65 spouse of a retiree over age 65	\$300	\$200

The District contribution ends after ten(10) years of benefit payments have been made, even if retiree or spouse are still under age 65 at the time.

Funding Policy

The District does not establish a trust account for this plan. The District funds the plan on a pay-as-you-go basis.

Annual OPEB Cost

The District's OPEB cost is presented as follows:

**RAINBOW MUNICIPAL WATER DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
JUNE 30, 2009**

NOTE 11 - OTHER POST EMPLOYMENT BENEFITS (CONTINUED)

Annual OPEB Cost (Continued)

	<u>As of June 30, 2008</u>
Present Value of Future Benefits	
Active Employees	\$ 110,521
Retired Employees	<u>29,723</u>
Total Present Value of Future Benefits	<u><u>\$ 140,244</u></u>
Accrued Liability	
Active Employees	\$ 57,127
Retired Employees	<u>29,723</u>
Total Accrued Liability	86,850
Assets - Funded Amounts	<u>-</u>
Total Unfunded Accrued Liability	<u><u>\$ 86,850</u></u>
Annual Required Contributions	
Service Cost at Year Ended	\$ 7,298
Thirty (30) Year Amortization of Unfunded Accrued liability	<u>6,310</u>
Total Annual Required Contributions	<u><u>\$ 13,608</u></u>

The District provided 2007-2008 annual OPEB Cost analysis which is the most recent available information.

Funded Status of the Plan

Actuarial Accrued Liability and Unfunded Actuarial Accrued Liability are \$155,249. There are no plan assets because the District funds on a pay-as-you-go basis.

Actuarial Assumptions

Actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of events far into the future. Actuarially determined amounts are subject to continual revision as actual results are compared to past expectations and new estimates are made about the future. In order to perform the valuation, the actuary must make certain assumptions regarding such items as rate of employee turnover, retirement, and mortality, as well as economic assumptions regarding healthcare inflation and interest rates.

**RAINBOW MUNICIPAL WATER DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
JUNE 30, 2009**

NOTE 12 - EARLY RETIREMENT INCENTIVE

For the year ended June 30, 2009, the District did not provide for early retirement incentives.

NOTE 13 - LEASES

Operating Lease

The District has entered into operating leases for office equipment.

Future minimum lease payments are as follows:

Year Ending June 30,	Lease Payments
2010	\$ 25,460
2011	21,492
2012	21,492
2013	19,701
Thereafter	-
TOTAL	\$ 88,145

The District does not sublease the office equipment.

The District paid \$33,406 in equipment rental as of June 30, 2009.

NOTE 14 - COMMITMENTS AND CONTINGENCIES

Tank Maintenance Commitments

On December 10, 2003, the District entered into a ten (10) year contract with Utility Service Co., Inc. to maintain twelve water tanks at an annual cost of \$715,000. The contract can be cancelled annually if intent to cancel is received within ninety (90) days prior to the anniversary date. Any outstanding balance for completed work would be due and payable within thirty (30) days of cancellation.

**RAINBOW MUNICIPAL WATER DISTRICT
NOTES TO BASIC FINANCIAL STATEMENTS (CONTINUED)
JUNE 30, 2009**

NOTE 14 - COMMITMENTS AND CONTINGENCIES (CONTINUED)

Capacity Rights for Sewage Treatment

On February 13, 2002, Rainbow Municipal Water District (the District) entered into a contract with the City of Oceanside, California (the City) to provide for the construction, operation, maintenance, and replacement of a wastewater system to service the needs of both the City and the District. The City owns the wastewater conveyance, treatment, and disposal facilities and the District has the contractual right to discharge wastewater into the City's System. The City and the District have previously entered into agreements on January 2, 1973, and September 10, 1989. This agreement reflects the planned expansion and rehabilitation of facilities built from those previous agreements. Under the agreement, the District's share any cost for planned expansion and rehabilitation of the facilities would be 10%.

NOTE 15 - DEFERRED REVENUE

Deferred Revenue represents fees collected for expansion, replacement, and capacity fees that have not yet been expended. At June 30, 2009, Deferred Revenue consisted of the following:

Sewer Replacement	\$ 1,749,612
Sewer Expansion	7,432,397
Capacity Fees	621,349
Construction Meter Deposits	<u>24,225</u>
TOTAL	<u><u>\$ 9,827,583</u></u>

NOTE 16 - PENDING LITIGATION

The District has been named in a personal injuries claim associated with an automobile collision due to a leaking water line. Although the financial impact to the District cannot be determined at the present time, the District's liability would be limited to its insurance deductible, which would not have a material impact on the financial statements.

**RAINBOW MUNICIPAL WATER DISTRICT
SUPPLEMENTARY INFORMATION SECTION
JUNE 30, 2009**

**RAINBOW MUNICIPAL WATER DISTRICT
ORGANIZATION
JUNE 30, 2009**

<u>Name</u>	<u>Office</u>	<u>Term Expires</u>
Rua Petty	President	December 31, 2010
Gerald Walson	Vice President	December 31, 2012
George McManigle	Secretary	December 31, 2010
Jack Griffiths	Director	December 31, 2012
Robert Lucy	Director	December 31, 2010

General Manager

David Seymour

Finance Manager

Gene Buckley

**RAINBOW MUNICIPAL WATER DISTRICT
ASSESSED VALUATION
JUNE 30, 2009**

The assessed valuation of the Rainbow Municipal Water District at June 30, 2009, is as follows:

Assessed Valuation

Secured Property	\$ 3,868,287,914
Unsecured Property	<u>21,252,537</u>
Total Assessed Valuation	<u><u>\$ 3,889,540,451</u></u>

RAINBOW MUNICIPAL WATER DISTRICT
OTHER INDEPENDENT AUDITORS' REPORTS SECTION
JUNE 30, 2009

**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**

Board of Directors
Rainbow Municipal Water District
Fallbrook, California

We have audited the financial statements of the Rainbow Municipal Water District (the District) as of and for the year ended June 30, 2009, and have issued our report thereon dated August 31, 2009. 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 the District's 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 misstatement 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.

**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**

Page 2

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 District's 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 statements 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 or other matters that are required to be reported under *Government Auditing Standards*.

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

Kosaka, Nagel & Company

San Diego, California
August 31, 2009

**RAINBOW MUNICIPAL WATER DISTRICT
FINDINGS AND RECOMMENDATIONS SECTION**

JUNE 30, 2009

**RAINBOW MUNICIPAL WATER DISTRICT
SCHEDULE OF AUDIT FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2009**

Section I – Summary of Auditors' Results

Financial Statements

Type of auditors' report issued: Unqualified

Internal control over financial reporting:
 Material weakness(es) identified? Yes X No
 Reporting condition(s) identified not considered
 to be material weaknesses? Yes X None

Noncompliance material to financial statements noted? Yes X No

Federal Awards

Internal control over major programs:
 Material weakness(es) identified? Yes X No
 Reporting condition(s) identified not considered
 to be material weaknesses? Yes X None

Type of auditors' report issued on compliance for
 major programs: N/A

Any audit findings disclosed that are required to be
 reported in accordance with Circular A-133,
 Section 510(a) Yes X No

Identification of major programs

CFDA Number

Name of Federal Program

None

None

Dollar threshold used to distinguish between
 Type A and Type B programs:

\$300,000

Auditee qualified as low-risk auditee?

N/A

**RAINBOW MUNICIPAL WATER DISTRICT
SCHEDULE OF AUDIT FINDINGS AND QUESTIONED COSTS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2009**

Section II -- Financial Statement Findings

No matters were reported.

Section III -- Federal Award Findings and Questioned Costs

No matters were reported.

**RAINBOW MUNICIPAL WATER DISTRICT
STATUS OF PRIOR YEAR FINDINGS AND RECOMMENDATIONS
JUNE 30, 2009**

<u>Findings/Recommendations</u>	<u>Current Status</u>	<u>District Explanation If Not Implemented</u>
Finding	N/A	N/A