



**Hosaka, Nagel & Company**

CERTIFIED PUBLIC ACCOUNTANTS  
A PROFESSIONAL CORPORATION

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CERTIFIED PUBLIC ACCOUNTANTS

**RAINBOW MUNICIPAL WATER DISTRICT**

**REPORT ON EXAMINATION OF  
FINANCIAL STATEMENTS**

**FOR THE YEAR ENDED**

**JUNE 30, 2011**

**RAINBOW MUNICIPAL WATER DISTRICT**

**INTRODUCTORY SECTION**

**JUNE 30, 2011**

**RAINBOW MUNICIPAL WATER DISTRICT  
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JUNE 30, 2011**

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**RAINBOW MUNICIPAL WATER DISTRICT**

**FINANCIAL SECTION**

**JUNE 30, 2011**

## 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, 2011, 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, 2011, 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

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In accordance with *Government Auditing Standards*, we have also issued our report, dated August 10, 2011, 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 conducted for the purpose of forming opinions on the financial statements which collectively comprise the Rainbow Municipal Water District's basic financial statement. The accompanying Schedule of Expenditures of Federal Awards required by the U.S. Office of management and Budget Circular A-133, *Audits of States, Local Governments and Non-Profit Organizations* and the supporting schedules listed in the table of contents are 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.

*Hosaka, Nagel & Company*

San Diego, California  
August 10, 2011

**RAINBOW MUNICIPAL WATER DISTRICT  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
JUNE 30, 2011**

As management of the Rainbow Municipal Water District (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, 2011. 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 \$94,215,306.
- The Change in Net Assets for the year was an increase of \$155,103.
- The District had Operating Expenses in excess of Operating Revenue in the amount of \$346,807 in the current year compared to \$2,338,296 in the previous year.
- This year the District had \$8,829,113 worth of additions to Capital Assets compared to \$6,182,204 last year.
- The District's Budget for this year showed Excess Revenue over Expenditures (before Transfers) of \$2,172,408 compared to the actual amount of Excess Expenditures over Revenue of \$346,807.

**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.

**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.

**RAINBOW MUNICIPAL WATER DISTRICT  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
JUNE 30, 2011**

**OVERVIEW OF FINANCIAL STATEMENTS (CONTINUED)**

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 Questioned Costs* section notes material weaknesses in the system and recommendations.

**DISTRICT'S FINANCIAL ANALYSIS**

The District's net assets increased from the prior fiscal year by 0.2%. Revenue for this fiscal year decreased 11.3% 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). The mandated reduction was established as 20% effective January 1, 2011. Approximately 65% of Rainbow's water sales are for agricultural irrigation. The IAWP is scheduled to be phased out December 31, 2012. Metropolitan Water District suspended the mandated reductions as of April 2011.

Additional water allocations were 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%. Metropolitan Water District, also, suspended the domestic water reductions as of April 2011.

The District sold approximately 17,700 acre feet of water during 2010-2011. The District has sold in excess of 30,000 acre feet in previous years.

Operating expenses decreased from the year prior due to increased wholesale water prices. The District also incurred significant expenses in the repair of mainline breaks and leaks.

**RAINBOW MUNICIPAL WATER DISTRICT  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
JUNE 30, 2011**

**DISTRICT'S FINANCIAL ANALYSIS (CONTINUED)**

New development paid \$404,534 for sewer capacity fees and \$227,469 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 \$94,215,306 as of June 30, 2011.

Total assets decreased 0.2% from the prior fiscal year mostly due to the decrease depreciated value of fixed assets.

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.

**Table 1**  
Condensed Statement of Net Assets

	<u>2011</u>	<u>2010</u>	<u>\$ Change</u>	<u>% of Change</u>
<b>Assets:</b>				
Current assets	\$ 19,574,004	\$ 27,233,093	\$ (7,659,089)	-28.1%
Noncurrent assets	18,125,000	16,128,572	1,996,428	12.4%
Capital assets, net	73,752,096	68,291,322	5,460,774	8.0%
Total assets	<u>\$ 111,451,100</u>	<u>\$ 111,652,987</u>	<u>\$ (201,887)</u>	-0.2%
<b>Liabilities:</b>				
Current liabilities	\$ 6,245,757	\$ 6,406,051	\$ (160,294)	-2.5%
Noncurrent liabilities	10,990,037	11,186,733	(196,696)	-1.8%
Total liabilities	<u>\$ 17,235,794</u>	<u>\$ 17,592,784</u>	<u>\$ (356,990)</u>	-2.0%
<b>Net assets:</b>				
Invested in capital asset, net	\$ 71,079,002	\$ 68,291,322	\$ 2,787,680	4.1%
Unrestricted	23,136,304	25,768,881	(2,632,577)	-10.2%
Total net assets	<u>\$ 94,215,306</u>	<u>\$ 94,060,203</u>	<u>\$ 155,103</u>	0.2%

**RAINBOW MUNICIPAL WATER DISTRICT  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
JUNE 30, 2011**

**DISTRICT'S FINANCIAL ANALYSIS (CONTINUED)**

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

- The District's total operating revenues for the fiscal year ended June 30, 2011, excluding inter-fund transfers, decreased by \$4,013,993 to \$31,368,549. This was due primarily to the increase in the pass-through price of water purchased for the year.
- The District's total expenses decreased by \$407,970 to \$31,715,356 due to the District's efforts to reduce staff through attrition.
- The excess of operating expenses over operating revenue was \$346,807.

The following table presents a summary of the Statement of Activities for the fiscal year ended June 30, 2011:

**Table 2**  
Condensed Statement of Revenues, Expenses, and Changes in Net Assets

	<u>2011</u>	<u>2010</u>	<u>\$ Change</u>	<u>% of Change</u>
<b>Operating revenues:</b>				
Direct	\$ 28,068,091	\$ 29,784,930	\$ (1,716,839)	-5.8%
Indirect	3,300,458	5,597,612	(2,297,154)	-41.0%
Total operating revenues	<u>31,368,549</u>	<u>35,382,542</u>	<u>(4,013,993)</u>	-11.3%
<b>Operating expenses:</b>	31,715,356	32,123,326	(407,970)	-1.3%
<b>Nonoperating revenues:</b>	<u>501,910</u>	<u>759,849</u>	<u>(257,939)</u>	-33.9%
<b>Change in net assets</b>	<u>\$ 155,103</u>	<u>\$ 4,019,065</u>	<u>\$ (3,863,962)</u>	-96.1%

**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:

Water Distribution Expense	<u>\$ 293,598</u>
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The District's Total Operating Expenses other than purchased water was 2% less than the budget. The Water Distribution department exceeded the budget due to an increase in large mainline water breaks.

The District has reduced its annual operating budget each of the last two years. Several expense categories including wages and benefits have been reduced in efforts to meet the challenge of decreasing water sales.

**RAINBOW MUNICIPAL WATER DISTRICT  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
JUNE 30, 2011**

**CAPITAL ASSETS AND DEBT ADMINISTRATION**

**Capital Assets**

**Table 3**  
Changes in Capital Assets

	<u>2011</u>	<u>2010</u>	<u>\$ Change</u>	<u>% of Change</u>
Land	\$ 1,627,756	\$ 1,627,756	\$ -	0.0%
Construction in progress	15,998,648	11,138,434	4,860,214	43.6%
Buildings and improvements	969,773	969,773	-	0.0%
Reservoir, pipelines, and tanks	103,957,997	104,067,954	(109,957)	-0.1%
Meters	302,678	302,678	-	0.0%
Equipment	2,570,331	3,170,836	(600,505)	-18.9%
Investment in sewer rights	7,246,540	5,645,196	1,601,344	28.4%
Less: accumulated depreciation	(58,921,627)	(58,631,305)	(290,322)	0.5%
Total capital assets, net	<u>\$ 73,752,096</u>	<u>\$ 68,291,322</u>	<u>\$ 5,460,774</u>	8.0%

The increase in Construction in Progress is due to the continual construction of the reservoir covering rehabilitation projects. The increase in Property, Plant, and Equipment results from construction in progress being placed into service.

**Long-Term Debt**

The District applied for and received funding from the Safe Drinking Water State Revolving Fund/American Recovery and Reinvestment Act. The District became eligible for a \$6,702,680 loan with subsidization in the form of 50% in forgiveness of principal. The award was used to pay for the covering and rehabilitation of the North and Northside reservoirs as mandated by the Department of Public Health Services. Payment on the debt is projected to begin September 2013.

**FACTORS BEARING ON THE DISTRICT'S FUTURE**

The District recorded a loss from operations of \$346,807 which includes \$2,448,105 of depreciation expense. Net income from all sources resulted in a gain of \$155,103. The downturn in the local and national economy has created significant reductions in water sales for the District. The District has historically been dependent on agriculture for the majority of its water sales; however, many growers have abandoned or greatly reduced their operation which leaves the District with the challenge of providing a reliable supply of drinking water at a reasonable cost. 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 and Metropolitan Water District. Extended periods of drought can also significantly affect the amount of available water supply.

**RAINBOW MUNICIPAL WATER DISTRICT  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
JUNE 30, 2011**

**FACTORS BEARING ON THE DISTRICT'S FUTURE (CONTINUED)**

The District remains involved in the prospect of purchasing reclaimed seawater from the Carlsbad desalination plant. The District is also studying possibilities of locating and tapping new ground water supplies. Access to desalinated water does not promise to be a cost savings but it does become a virtually inexhaustible supply of quality drinking water.

**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, 2011**

**Assets:**

Current assets:

Cash and cash equivalents	\$ 12,071,024
Grant receivable	69,882
Accounts receivable:	
Water and sewer, net of allowance	4,454,593
Interest receivables	33,204
Other receivables	115,473
Inventory	812,743
Letters of credit	365,756
Prepaid expenses	1,651,329
Total current assets	19,574,004

Noncurrent assets:

Investments	18,125,000
Capital assets:	
Land	1,627,756
Construction in progress	15,998,648
Buildings and improvements	969,773
Reservoir, pipelines, and tanks	103,957,997
Meters	302,678
Equipment	2,570,331
Investment in sewer rights	7,246,540
Less: accumulated depreciation	(58,921,627)
Total noncurrent assets	91,877,096
Total assets	\$ 111,451,100

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

**RAINBOW MUNICIPAL WATER DISTRICT  
STATEMENT OF NET ASSETS  
JUNE 30, 2011**

**Liabilities and net assets:**

Current liabilities:

Accounts payable	\$ 5,116,631
Accrued expenses	763,370
Letters of credit	365,756
Total current liabilities	<u>6,245,757</u>

Noncurrent liabilities:

Deferred revenue	8,316,943
Note payable	2,673,094
Total noncurrent liabilities	<u>10,990,037</u>
Total liabilities	<u>17,235,794</u>

Net assets:

Invested in capital assets, net of related debt	71,079,002
Unrestricted	23,136,304
Total net assets	<u>94,215,306</u>

Total liabilities and net assets	<u><u>\$ 111,451,100</u></u>
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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, 2011**

Operating revenues:	
Direct operating revenues:	
Water sales	\$ 24,602,344
Waste water revenue	3,465,747
Total direct operating revenues	<u>28,068,091</u>
Indirect operating revenues:	
Property tax revenue	859,741
Grant revenue	684,942
Other	1,755,775
Total indirect operating revenues	<u>3,300,458</u>
Total operating revenues	<u>31,368,549</u>
Operating expenses:	
Water purchases	17,328,605
Water pumping	473,421
Transmission and distribution	5,203,680
Meter services	962,265
Sewer services	1,782,654
Administrative and general	1,943,841
Engineering	734,752
Finance	537,603
Customer service	300,430
Depreciation	2,448,105
Total operating expenses	<u>31,715,356</u>
Loss from operations	<u>(346,807)</u>
Non-operating revenues:	
Interest income	501,910
Total non-operating revenues	<u>501,910</u>
Change in net assets	155,103
Net assets, beginning	<u>94,060,203</u>
Net assets, ending	<u>\$ 94,215,306</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, 2011**

<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>	
Receipts from customers	\$ 27,644,857
Receipts from the state	4,591,364
Receipts from county	859,741
Receipts from others	1,767,376
Payments to suppliers and vendors	(28,675,200)
Payments to employees	(2,045,398)
Net cash provided from operating activities	<u>4,142,740</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>	
Acquisition and construction of capital assets	(11,832,446)
Retirement of capital assets	3,923,567
Net cash (used) by investing activities	<u>(7,908,879)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>	
Purchase of investments	(1,996,428)
Proceeds from loans	684,942
Interest received	539,691
Net cash (used) by financing activities	<u>(771,795)</u>
Net decrease in cash and cash equivalents	(4,537,934)
CASH AND CASH EQUIVALENTS - Beginning	<u>16,608,958</u>
CASH AND CASH EQUIVALENTS - Ending	<u>\$ 12,071,024</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, 2011**

RECONCILIATION OF OPERATING INCOME TO NET CASH  
PROVIDED (USED) BY OPERATING ACTIVITIES:

Operating loss	\$ (346,807)
Adjustments to reconcile net income from operations to net cash provided by operating activities	
Depreciation	2,448,105
(Increase) decrease in operating assets:	
Grant receivable	3,906,422
Water and sewer	458,404
Other receivables	11,601
Inventory	75,812
Prepaid expenses	(1,421,875)
Increase (decrease) in operating liabilities:	
Accounts payable	(5,727)
Accrued expenses	(101,557)
Deferred revenue	(881,638)
Net cash provided from operating activities	\$ 4,142,740

RECONCILIATION TO BALANCE SHEET

Cash	\$ 12,071,024
Net reconciliation to balance sheet	\$ 12,071,024

SUPPLEMENTAL DISCLOSURES

Schedule of non-cash investing and financing activities	
Contributions of water system assets by customers and developers	\$ -
Cash payments for interest	\$ -

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

**RAINBOW MUNICIPAL WATER DISTRICT  
NOTES TO BASIC FINANCIAL STATEMENTS  
JUNE 30, 2011**

A. Summary of Significant Accounting Policies

Rainbow Municipal Water District (District) accounts for its financial transactions in accordance with the policies and procedures of the Irrigation District Law, now Division 11 of the California State Water Code. The accounting policies of the District conform to accounting principles generally accepted in the United State of American (GAAP) as prescribed by the Governmental Accounting Standards Board (GASB) and the American Institute of Certified Public Accountants (AICPA).

1. Reporting Entity

The District's combined financial statements include the accounts of all its operations. The District evaluated whether any other entity should be included in these financial statements. The criteria for including organizations as component units within the District's reporting entity, as set forth in GASB Statement No 14, "The Financial Reporting Entity," as amended by GASB Statement NO. 39 "Determining Whether Certain Organizations are Component Units", include whether:

- the organization is legally separate (can sue and be sued in its name)
- the District holds the corporate powers of the organization
- the District appoints a voting majority of the organization's board
- the District is able to impose its will on the organization
- the organization has the potential to impose a financial benefit/burden on the District
- there is fiscal dependency by the organization on the District
- it would be misleading or cause the financial statements to be incomplete to exclude another organization

Based on these criteria, the District has no component units. Additionally, the District is not a component unit of any other reporting entity as defined by the GASB statement.

2. 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  
JUNE 30, 2011**

A. Summary of Significant Accounting Policies (Continued)

3. 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.

4. Assets, Liabilities, and Equity

a. Deposits 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.

**RAINBOW MUNICIPAL WATER DISTRICT  
NOTES TO BASIC FINANCIAL STATEMENTS  
JUNE 30, 2011**

A. Summary of Significant Accounting Policies (Continued)

b. Stores Inventories and Prepaid Expenditures

Inventories are recorded using the purchase method in that the cost is recorded as an expenditure at the time individual inventory items are purchased. Inventories are valued at average cost and consist of expendable supplies held for consumption. Reported inventories are equally offset by a fund balance reserve, which indicates that these amounts are not "available for appropriation and expenditure" even though they are a component of net current assets.

The District has the option of reporting an expenditure in governmental funds for prepaid items either when purchased or during the benefiting period. The District has chosen to report the expenditure during the benefiting period.

c. Capital Assets

Purchased or constructed capital assets are reported at cost or estimated historical cost. Donated fixed assets are recorded at their estimated fair value at the date of the donation. The cost of normal maintenance and repairs that do not add to the value of the asset or materially extend the assets' lives are not capitalized. A capitalization threshold of \$5,000 is used.

Capital Assets are being depreciated using the straight-line method over the following estimated useful lives:

<u>Asset Class</u>	<u>Estimated Useful Lives</u>
Buildings	10-50
Water systems	10-50
Improvements of Sites	7-25
Equipment	5-10

d. Compensated Absences

Accumulated unpaid employee vacation benefits and sick leave are recognized as accrued payroll liabilities in the Statement of Net Assets. As of June 30, 2011, the District had \$605,597 of accrued vacation and sick leave.

e. Deferred Revenue

Cash received for federal and state special projects and programs is recognized as revenue to the extent that qualified expenditures have been incurred. Deferred Revenue is recorded to the extent cash received on specific projects and programs exceeds qualified expenditures.

**RAINBOW MUNICIPAL WATER DISTRICT  
NOTES TO BASIC FINANCIAL STATEMENTS  
JUNE 30, 2011**

A. Summary of Significant Accounting Policies (Continued)

f. Interfund Activity

Interfund Activity results from loans, services provided, reimbursements or transfers between funds. Loans are reported as interfund receivables and payables as appropriate and are subject to elimination upon consolidation. Reimbursements occur when one fund incurs a cost, charges the appropriate benefiting fund and reduces its related cost as a reimbursement. All other interfund transactions are treated as transfers. Transfers In and Transfers Out are netted and presented as a single "Transfers" line on the government-wide statement of activities. Similarly, interfund receivables and payables are netted and presented as a single "Internal Balances" line of the government-wide statement of net assets.

g. Property Taxes

Secured property taxes attach as an enforceable lien on property as of January 1. Taxes are payable in two installments on November 1 and February 1. Unsecured property taxes are payable in one installment on or before August 31. The County of San Diego bills and collects the taxes for the District.

h. Use of Estimates

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.

B. Compliance and Accountability

1. Finance-Related Legal and Contractual Provisions

In accordance with GASB Statement No 38, "Certain Financial Statement Note Disclosures," violations of finance-related legal and contractual provisions, if any, are reported below, along with actions taken to address such violations:

<u>Violation</u>	<u>Action Taken</u>
None reported	Not applicable

**RAINBOW MUNICIPAL WATER DISTRICT  
NOTES TO BASIC FINANCIAL STATEMENTS  
JUNE 30, 2011**

B. Compliance and Accountability (Continued)

2. Deficit Fund Balance or Fund Net Assets of Individual Funds

Following are funds having deficit fund balances or fund net assets at year end, if any, along with remarks which address such deficits:

<u>Fund Name</u>	<u>Deficit Amount</u>	<u>Remarks</u>
None reported	Not applicable	Not applicable

C. Cash Equivalents

The summary of cash equivalents is as follows at June 30, 2011:

	<u>Credit Quality Rating</u>	<u>Fair Value</u>
Cash on hand	Not Applicable	\$ 1,300
Deposits with financial institutions	Not Applicable	5,947,451
Pooled funds	Not Applicable	<u>6,122,273</u>
Total cash and cash equivalents		<u>\$ 12,071,024</u>

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 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, 2011:

	<u>Category One</u>	<u>Category Two</u>	<u>Category Three</u>	<u>Total Bank Balance</u>	<u>Carrying Amount</u>
Deposits with Financial Institutions	<u>\$ 3,872,825</u>	<u>\$ 2,317,346</u>	<u>\$ -</u>	<u>\$ 6,190,171</u>	<u>\$ 5,947,451</u>

**RAINBOW MUNICIPAL WATER DISTRICT  
NOTES TO BASIC FINANCIAL STATEMENTS  
JUNE 30, 2011**

**D. Investments**

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, 2011:

	<u>Category</u>			<u>Uncategorized</u>	<u>Total Investments</u>	<u>Market Value</u>
	<u>One</u>	<u>Two</u>	<u>Three</u>			
U.S. Government Agency Obligation	\$18,125,000	\$ -	\$ -	\$ -	\$18,125,000	\$17,951,145
TOTAL	<u>\$18,125,000</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$18,125,000</u>	<u>\$17,951,145</u>

**E. Accounts receivable**

Accounts receivable as of June 30, 2011, consist of the following:

Water and sewer, net of allowance	\$ 4,454,593
Interest receivables	33,204
Other receivables	115,473
Total accounts receivables	<u>\$ 4,603,270</u>

**F. Fixed assets**

A schedule of changes in fixed assets and accumulated depreciation for the year ended June 30, 2011, is shown as follows:

	<u>Balance June 30, 2010</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance June 30, 2011</u>
Capital assets, not being depreciated:				
Land	\$ 1,627,756	\$ -	\$ -	\$ 1,627,756
Construction in progress	11,138,434	8,783,781	(3,923,567)	15,998,648
Total capital assets, not being depreciated	<u>12,766,190</u>	<u>8,783,781</u>	<u>(3,923,567)</u>	<u>17,626,404</u>

**RAINBOW MUNICIPAL WATER DISTRICT  
NOTES TO BASIC FINANCIAL STATEMENTS  
JUNE 30, 2011**

**F. Fixed assets (continued)**

	Balance June 30, 2010	Additions	Deletions	Balance June 30, 2011
Capital assets, being depreciated:				
Buildings and improvements	969,773	-	-	969,773
Reservoir, pipelines, and tanks	104,067,954	1,404,964	(1,514,921)	103,957,997
Meters	302,678	-	-	302,678
Equipment	3,170,836	42,357	(642,862)	2,570,331
Investment in sewer rights	5,645,196	1,601,344	-	7,246,540
Total capital assets, being depreciated	<u>114,156,437</u>	<u>3,048,665</u>	<u>(2,157,783)</u>	<u>115,047,319</u>
Less accumulated depreciation for:				
Buildings and improvements	(672,520)	(40,416)	-	(712,936)
Reservoir, pipelines, and tanks	(54,533,031)	(2,219,157)	1,514,921	(55,237,267)
Meters	(173,487)	(45,560)	-	(219,047)
Equipment	(2,970,007)	(30,068)	642,862	(2,357,213)
Investment in sewer rights	(282,260)	(112,904)	-	(395,164)
Total accumulated depreciation	<u>(58,631,305)</u>	<u>(2,448,105)</u>	<u>2,157,783</u>	<u>(58,921,627)</u>
Total capital assets, being depreciated, net	<u>55,525,132</u>	<u>600,560</u>	<u>-</u>	<u>56,125,692</u>
Government activities capital assets, net	<u>\$ 68,291,322</u>	<u>\$ 9,384,341</u>	<u>\$ (3,923,567)</u>	<u>\$ 73,752,096</u>

**G. Deferred revenue**

Deferred revenue represents fees collected for expansion, replacement, and capacity fees that have not yet been expended. At June 30, 2011, Deferred Revenue consisted of the following:

Sewer replacement	\$ 1,685,159
Sewer expansion	6,325,751
Capacity fees	227,469
Construction meter deposits	27,625
Developer deposits	50,939
Total deferred revenue	<u>\$ 8,316,943</u>

**H. Long-term obligations**

**1. Long-term obligation activity**

Long-term obligations include debt and other long-term liabilities. Changes in long-term obligations for the year ended June 30, 2011, are as follows:

**RAINBOW MUNICIPAL WATER DISTRICT  
NOTES TO BASIC FINANCIAL STATEMENTS  
JUNE 30, 2011**

H. Long-term obligations (continued)

	Balance at June 30, 2010	Additions	Retirements	Balance at June 30, 2011	Amount Due Within One Year
Capitalization grant for drinking water fund loan	\$ 1,988,152	\$ 684,942	\$ -	\$ 2,673,094	\$ -
Total long-term debt	<u>\$ 1,988,152</u>	<u>\$ 684,942</u>	<u>\$ -</u>	<u>\$ 2,673,094</u>	<u>\$ -</u>

2. Capitalization Grant for Drinking Water Fund Loan

On September 30, 2009, an agreement was entered into between the State of California, Department of Public Health (the State) and District which constituted funding in the form of a loan with a forgiveness of principal made by the State to the District under the provision of the California Safe Drinking Water State Revolving Fund Law of 1997, Part 12, Chapter 4.5, of Division 104 of Health and Safety Code (Section 116760 and following) and the American Recovery and Reinvestment Act of 2009 (ARRA) Public Law 111-5. The purpose of the funding is to assist in financing construction of a project which will enable the District to meet safe drinking water standards established pursuant to Part 12, Chapter 4 (commencing with Section 116270), of Division 104 of the Health and Safety Code and California Code of Regulations Title 22, or to address other health concerns, herein referred to as the "Project" whose costs are approved by the State.

The District is solely responsible for the design, construction, operation, and maintenance of the Project; and for all persons or entities engaged in such work, including but not limited to subcontractors, supplies, and providers of services. Total cost of the Project is estimated at \$7,475,000 and the State has agreed that \$6,702,680 is eligible for Safe Drinking Water State Revolving Fund ARRA financing.

Pursuant to the Safe Drinking Water State Revolving Fund Law of 1997, its applicable rules and regulations, and ARRA and its implementing guidelines and criteria, and subject to the availability of funds, the State will lend to the District in accordance with the terms of this agreement an amount not to exceed \$6,702,680 for a term of twenty (20) years with interest at 2.5017% per annum and that this agreement also constitutes a promissory note.

In addition, pursuant to the Safe Drinking Water State Revolving Fund Law of 1997, its applicable rules and regulations, and ARRA and its implementing guidelines and criteria, the State agrees to provide additional subsidization in the form of forgiveness of the principal portion of the promissory note equal to fifty percent (50%) of each disbursement to the District under the terms of this agreement and shall not be added to the principal amount of the loan.

As of June 30, 2011, the District has incurred \$5,346,188 in costs related to the Project, of which \$2,673,094 will be paid back to the State once all funding has been received.

**RAINBOW MUNICIPAL WATER DISTRICT  
NOTES TO BASIC FINANCIAL STATEMENTS  
JUNE 30, 2011**

I. Operating leases

The District has entered into operating leases for office equipment with lease terms in excess of one year. These agreements contain no purchase options. The agreements are non-cancelable leases. Future minimum lease payments are as follows:

Year Ending June 30,	Lease Payments
2012	\$ 23,710
2013	22,796
2014	22,796
2015	22,796
2016	18,448
2017	2,218
TOTAL	\$ 112,764

The District will receive no sublease rental revenues nor pay any contingent rentals associated with these leases. Rent expense for the year ended June 30, 2011, was 23,710.

J. Joint ventures (joint powers agreements)

The District participates in a jointly governed organization under a joint power agreement (JPA): the Special District Risk Management Authority (SDRMA). The relationship between the District and the JPA is such that the JPA is not a component unit of the District for financial reporting purposes.

The JPA was established as an agency under the provisions of the California Government Code, Title I, Division 7, Chapter 5, Article 1, Section 6500, et seq. The purpose of the JPA is to provide self-insurance programs such as insurance premiums for general liability, employment practices, and property insurance.

K. Employee Retirement Systems

Qualified employees are covered under multiple-employer defined benefit pension plans maintained by agencies of the State of California. Classified employees are members of the California Public Employees Retirement System (CalPERS).

PERS:

Plan Description

The District contributes to the California Public Employees Retirement System (CalPERS); a cost-sharing multiple-employer public employee retirement system defined benefit pension plan. The plan provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries.

**RAINBOW MUNICIPAL WATER DISTRICT  
NOTES TO BASIC FINANCIAL STATEMENTS  
JUNE 30, 2011**

**K. Employee Retirement Systems**

Benefit provisions and state statute and District policies establish all other requirements. CalPERS issues a separate comprehensive annual financial report that includes financial statements and required supplementary information.

Funding Policy

Active plan members are required to contribute 8.0% of their annual covered salary and the District contributes 16.339% of the annual covered salary. In addition, the District contributes 3.5% of the participants 8.0% required contribution. 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 contribution rate for the fiscal year ended June 30, 2011 was 19.839%. The contribution requirements of the plan members are established by state statute. The District contributions to CalPERS for the fiscal years ending June 30, 2011, 2010 and 2009, were \$605,538, \$638,466 and \$606,157, respectively, and equal 100% of the required contributions for each year.

**L. 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, 2011, in the amount of \$1,396,799, is not included in the District's financial statements.

**M. 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:

**RAINBOW MUNICIPAL WATER DISTRICT  
NOTES TO BASIC FINANCIAL STATEMENTS  
JUNE 30, 2011**

M. Other post employment benefits (continued)

<u>Monthly Payments</u>	<u>Exempt Employees</u>	<u>Non-Exempt Employees</u>
Retiree and spouse both under age 65	\$660	\$600
Retiree under age 65	\$330	\$300
Under age 65 spouse of a retiree over age 65	\$330	\$300

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:

	<u>As of June 30, 2009</u>
Present value of future benefits	
Active employees	\$ 274,151
Retired employees	24,247
Total present value of future benefits	<u>\$ 298,398</u>
Accrued liability	
Active employees	\$ 131,002
Retired employees	24,247
Total accrued liability	155,249
Assets - funded amounts	-
Total unfunded accrued liability	<u>\$ 155,249</u>
Annual required contributions	
Service cost at year ended	\$ 16,751
Thirty (30) year amortization of unfunded accrued liability	10,099
Total annual required contributions	<u>\$ 26,850</u>

The District provided 2008-2009 annual OPEB Cost analysis which is the most recent available information.

**RAINBOW MUNICIPAL WATER DISTRICT  
NOTES TO BASIC FINANCIAL STATEMENTS  
JUNE 30, 2011**

M. Other post employment benefits (continued)

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.

N. 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.

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%.

O. 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, 2011**

**RAINBOW MUNICIPAL WATER DISTRICT  
ORGANIZATION  
JUNE 30, 2011**

Name	Office	Term	Term Expires
Gerald Walson	President	4 Years	December 31, 2012
Dennis Sanford	Vice President	4 Years	December 31, 2012
George McManigle	Secretary	4 Years	December 31, 2014
Jack Griffiths	Director	4 Years	December 31, 2012
Robert Lucy	Director	4 Years	December 31, 2014

Administration

Name	Position
David Seymour	General Manager
Gene Buckley	Finance Manager

**RAINBOW MUNICIPAL WATER DISTRICT  
ASSESSED VALUATION  
JUNE 30, 2011**

The assessed valuation of the Rainbow Municipal Water District at June 30, 2011, is as follows:

Assessed valuation	
Secured property	\$ 3,626,439,126
Unsecured property	<u>21,287,419</u>
Total assessed valuation	<u><u>\$ 3,647,726,545</u></u>

**RAINBOW MUNICIPAL WATER DISTRICT  
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS  
FOR THE YEAR ENDED JUNE 30, 2011**

<b>Federal Grantor/ Pass-Through Entity Program Title</b>	<b>Federal CFDA Number</b>	<b>Pass-Through Entity Identifying Number</b>	<b>Federal Expenditures</b>
<b>U.S. Environmental Protection Agency</b>			
Direct:			
Capitalization grants for drinking water state revolving funds	66.468	N/A	\$ 684,942
<b>Total U.S. Environmental Protection Agency</b>			<u>684,942</u>
<b>Total Expenditures of Federal Awards</b>			<u>\$ 684,942</u>

A. Basis of presentation

The accompanying Schedule of Expenditures of Federal Awards includes the federal grant activity of the Rainbow Municipal Water District and is presented on the modified accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133: *Audits of States, Local Governments, and Non-Profit Organizations*.

**RAINBOW MUNICIPAL WATER DISTRICT**  
**OTHER INDEPENDENT AUDITORS' REPORTS SECTION**  
**JUNE 30, 2011**

**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 (District) as of and for the year ended June 30, 2011, and have issued our report thereon dated August 10, 2011. 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 opinions 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 deficiency in internal control* 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, to detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, 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.

**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**

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 Audit/Finance Committee, management, the Board of Directors, 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.

*Hosaka, Nagel & Company*

San Diego, California  
August 10, 2011

**REPORT ON COMPLIANCE WITH REQUIREMENTS THAT COULD HAVE A DIRECT  
AND MATERIAL EFFECT ON EACH MAJOR PROGRAM AND ON INTERNAL CONTROL  
OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133**

Independent Auditor's Report

Board of Directors  
Rainbow Municipal Water District  
Fallbrook, California

**Compliance**

We have audited Rainbow Municipal Water District's (District) compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of the District's major federal programs for the year ended June 30, 2011. The District's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the District's management. Our responsibility is to express an opinion on the District's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred.

An audit includes examining, on a test basis, evidence about the District's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination on the District's compliance with those requirements.

In our opinion, the District complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2011.

**REPORT ON COMPLIANCE WITH REQUIREMENTS THAT COULD HAVE A DIRECT AND MATERIAL EFFECT ON EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133**

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**Internal Control Over Compliance**

Management of the District is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the District's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the District's internal control over compliance.

*A deficiency in internal control over compliance* exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A material weakness in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis.

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

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

*Hosaka, Nagel & Company*

San Diego, California  
August 10, 2011

**RAINBOW MUNICIPAL WATER DISTRICT  
FINDINGS AND QUESTIONED COSTS SECTION  
JUNE 30, 2011**

**RAINBOW MUNICIPAL WATER DISTRICT  
SCHEDULE OF AUDIT FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2011**

**A. Summary of auditors' results**

1. Financial statements

Type of auditors' report issued: Unqualified

Internal control over financial reporting:

One or more material weaknesses identified?  Yes  No

One or more significant deficiencies identified that are not considered to be material weaknesses?  Yes  None Reported

Noncompliance material to financial statements noted?  Yes  No

2. Federal awards

Internal control over major programs:

One or more material weaknesses identified?  Yes  No

One or more significant deficiencies identified that are not considered to be material weaknesses?  Yes  None Reported

Type of auditors' report issued on compliance for major programs: Unqualified

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

Identification of major programs:

<u>CFDA Number(s)</u>	<u>Name of Federal Program or Cluster</u>
66.468	Capitalization Grants for Drinking Water State Revolving Funds

Dollar threshold used to distinguish between type A and type B programs: \$300,000

Auditee qualified as low-risk auditee?  Yes  No

**RAINBOW MUNICIPAL WATER DISTRICT  
SCHEDULE OF AUDIT FINDINGS AND QUESTIONED COSTS  
FOR THE YEAR ENDED JUNE 30, 2011**

**B. Financial statement findings**

NONE

**C. Federal award findings and questioned costs**

NONE

**RAINBOW MUNICIPAL WATER DISTRICT  
STATUS OF PRIOR YEAR FINDINGS AND RECOMMENDATIONS  
JUNE 30, 2011**

<u>Finding/Recommendation</u>	<u>Current Status</u>	<u>Management's Explanation If Not Implemented</u>
None	N/A	N/A