

SACRAMENTO SUBURBAN WATER DISTRICT

SACRAMENTO, CALIFORNIA

AUDITED FINANCIAL STATEMENTS

For the Fiscal Years Ended

January 31, 2004 and 2003

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TABLE OF CONTENTS

Independent Auditor's Report 1
Management's Discussion and Analysis..... 2

Basic Financial Statements

Balance Sheets 10
Statement of Revenues, Expenses and Changes in Net Assets 11
Statement of Cash Flows 12
Notes to the Basic Financial Statements 13

Requests for Information

If you have questions about this report or need additional financial information please contact the District's Director of Finance at:

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Sacramento Suburban Water District
Sacramento, California

We have audited the accompanying basic financial statements of the Sacramento Suburban Water District (the District) as of January 31, 2004 and 2003 and for the years then ended. These basic financial statements are the responsibility of the District's management. Our responsibility is to express an opinion on these basic financial statements based on our audits.

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

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the financial position of the District as of January 31, 2004 and 2003 and the results of its operations and cash flows for the years then ended in conformity with auditing standards generally accepted in the United States of America.

As discussed in Note J to the financial statements, the District restated its beginning retained earnings to reflect the implementation of Governmental Accounting Standards Board (GASB) Statement No. 34. Also, as discussed in Note K, the District adopted a new fixed asset policy that changed the estimated useful lives used to compute depreciation on various capital assets and changed the criteria for capitalizing costs.

The Management's Discussion and Analysis on pages 2 through 9 is not a required part of the basic financial statements but is supplementary information required by the GASB. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However we did not audit the information and express no opinion of it.

April 7, 2004

Management's Discussion and Analysis

As management of the Sacramento Suburban 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 January 31, 2004. We encourage readers to consider the information presented here in conjunction with the basic financial statements and related footnotes, which can be found on pages 10 to 25 of this report.

2004 OPERATIONAL HIGHLIGHTS

During fiscal-year 2004 the District was able to accomplish many critical goals. Among them, were the following:

- The District delivered over 14.5 billion gallons of water to its approximately 43,000 customers. Of this amount, approximately 2/3 was pumped from the ground, while the remainder was obtained by purchasing treated surface water from the Folsom reservoir.
- The District is also pleased to report that water provided to its customers continues to meet all state and federal drinking water safety standards. The District has a practice of rigorously testing the water it delivers to its customers on a regular basis. During fiscal-year 2004, over 2,700 bacteria samples were taken from the District's delivery system and over 200 water quality constituents were collected from 30 different wells and distribution facilities. Testing on all these samples came in positive as no adverse concerns were detected.
- In addition to delivering a safe, reliable water supply to its customers, the District also prides itself on its customer service accomplishments. During fiscal-year 2004, District staff serviced over 500 main or service lines for its customers, tested and repaired hundreds of other District assets, installed nearly 2,000 meters, responded to over 7,000 calls to identify its underground facilities, and answered over 70,000 customer telephone calls.
- In the midst of all these efforts, the District hired an entirely new senior management team. During the year a new general manager, assistant general manager, and director of finance were hired.
- As a result of the efforts of the new management team, significant improvements have been made to the operational efficiency of the District as well as to restoring financial responsibility and accountability. Thus far, many oversight and operational policies have been established, a new budget program has been enacted that incorporates all District expenditures and allows for functional reporting and administrative accountability, and a new water-rate billing basis has been approved that connects the components of District costs to customer billing charges.

As we look forward to fiscal year 2005 and beyond, the District will continue to face, and meet, the significant challenges that lie ahead. The District will continue in its efforts to develop "conjunctive" use of both surface treated water and groundwater to alleviate the historic "over drafting" of the groundwater aquifer underlying North Sacramento County. This will secure and protect a safe and reliable water supply for the future of the District's customers. To that end, we are finalizing an arrangement to provide many of our customers with surface water from the American River. Once

complete, all District customers will be able to receive water from either groundwater wells or treated surface water. Though ambitious, nevertheless, a significantly important achievement.

2004 FINANCIAL HIGHLIGHTS

- The assets of the District exceeded its liabilities at the close of the most recent fiscal year by \$93.8 million (net assets). Of this amount, \$17.1 million (unrestricted net assets) may be used to meet the District's ongoing obligations to its ratepayers and creditors.
- The District's total debt decreased by \$1.9 million (2.3 percent) during the current fiscal year. The key factor in this decrease was \$2.4 million in principal payments on long-term debt and capital leases.
- The District incurred a net loss of \$8.3 million in fiscal 2004 compared to a net loss of \$12.8 million in fiscal 2003.
- Operating expenses included a \$12.6 million charge for depreciation expense, of which \$7.2 million was for one-time charges due to the implementation of a new fixed asset policy that changed the estimated useful lives of certain assets and capitalization eligibility requirements.
- In early 2004, the District discovered that there were questionable business expenses and compensation payments made to certain directors and employees. As a result, the Board sought repayment from these individuals totaling \$409,967. As of January 31, 2004, repayment had been received from all but two of the individuals. Repayment consisted of \$126,877 in cash, while \$70,551 was determined to be appropriate business expenses. Subsequent to January 31, 2004, the remaining balance was satisfied: \$193,767 was received in cash, while \$18,772 was determined to be appropriate business expenses. The cash portion of the recovered amounts received after year end will be recorded as a reduction to non-operating expense in fiscal year 2005.

OVERVIEW OF THE BASIC FINANCIAL STATEMENTS

This discussion and analysis are intended to serve as an introduction to the District's basic financial statements. The District's basic financial statements comprise two components: 1) the balance sheet, the statement of revenues, expenses, and changes in net assets, and the statement of cash flows, and 2) the notes to the basic financial statements.

Basic financial statements. The basic financial statements are designed to provide readers with a broad overview of the District's finances, in a manner similar to a private-sector business.

The balance sheet 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. Additionally, readers will need to consider other nonfinancial factors, such as the condition of the District's capital assets, to assess the overall financial health of the District.

The statement of revenues, expenses and changes in net assets presents information showing how the District's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the related cash flows. Thus, revenue and expenses are reported in this statement for some items that will result in cash flows in future periods (e.g., compensated absences).

Both of these basic financial statements detail functions of the District that recovers all of its costs through user fees and charges.

The statement of cash flows presents information about the District's cash receipts and cash payments during the fiscal year. Such information is divided into four different areas: cash flows from operating activities, cash flows from noncapital financing activities, cash flows from capital and related financing activities, and cash flows from investing activities. For purposes of reporting, the District defines cash as: cash and cash-equivalents, which includes such items as restricted and unrestricted cash, and short-term investments.

These basic financial statements can be found on pages 10 to 12 of this report.

Notes to the basic financial statements. The notes provide additional information that is essential to a full understanding of the data provided in the basic financial statements. The notes to the financial statements can be found on pages 13 to 25 of this report.

FINANCIAL ANALYSIS OF THE DISTRICT

Net Assets

As noted earlier, net assets may serve over time as a useful indicator of the District's financial position. In the case of the District, assets exceed liabilities by \$93.8 million and \$102.1 million at the close of January 31, 2004 and 2003, respectively.

By far the largest portion of the District's net assets (79 percent) reflects its investment in capital assets (e.g., land, buildings, pipelines, wells, reservoirs, and equipment), less any related debt used to acquire those assets that is still outstanding. The District uses these capital assets to provide services to its customers; consequently, these assets are not available for future spending. Although the District's investment in capital assets is reported net of related debt, it should be noted that the resources needed to repay this debt must be provided from other sources, since the capital assets themselves cannot be used to liquidate these liabilities.

Condensed Balance Sheets As of January 31,

	<u>2004</u>	<u>2003</u>
Current and Other Assets	\$ 33,201,952	\$ 36,533,403
Net Capital Assets	<u>147,907,866</u>	<u>154,887,888</u>
Total Assets	<u>\$181,109,818</u>	<u>\$191,421,291</u>
Current Liabilities	\$ 5,972,845	\$ 6,146,396
Long Term Liabilities	<u>81,315,186</u>	<u>83,148,357</u>
Total Liabilities	<u>\$ 87,288,031</u>	<u>\$ 89,294,753</u>
Invested in Capital Assets*	\$ 74,142,179	\$ 82,145,520
Restricted	2,512,672	2,280,443
Unrestricted	<u>17,166,936</u>	<u>17,700,575</u>
Total Net Assets	<u>\$ 93,821,787</u>	<u>\$102,126,538</u>

* (net of related debt)

An additional portion of the District's net assets (2.7 percent) represents resources that are subject to external restrictions on how they may be used. The remaining balance of unrestricted net assets (\$17.2 million) may be used to meet the District's ongoing obligations to its customers.

At the end of the current fiscal year, the District is able to report positive balances in all three categories of net assets. The same situation held true for the prior fiscal year.

The District's net assets decreased by \$8.3 million during the current fiscal year. A primary reason for the decrease is \$7.2 million of one-time charges to depreciation expense due to implementing a new fixed asset policy as explained earlier. In the prior fiscal year net assets decreased by \$12.8 million primarily the result of two events. One event was an \$11.3 million one-time charge to depreciation expense as changes were made to the estimated useful lives of certain District assets, while the other event was the implementation of a new accounting standard that called for the immediate recognition of future retiree health, dental and other benefit costs that resulted in a \$3.8 million charge representing the cost of such benefits prior to the date of implementing the new standard.

District Activities

As indicated, the District's recorded a net loss of \$8.3 million in fiscal year 2004 and \$12.8 million in fiscal year 2003. In the current fiscal year, total revenues for the District decreased by 9 percent (\$1.8 million), while total expenses decreased 17 percent (\$6.2 million). District revenues and expenses comprise the following for the fiscal year ended January 31:

Condensed Statement of Revenues, Expenses and Changes in Net Assets
For the Period Ended January 31,

	<u>2004</u>	<u>2003</u>
Operating Revenue	\$ 17,610,728	\$ 17,826,079
Non-Operating Revenue	2,210,079	2,159,879
Capital Contributions	<u>1,769,979</u>	<u>3,380,403</u>
Total Revenues	21,590,786	23,366,361
Depreciation Expense	12,596,754	15,387,474
Other Operating Expenses	12,636,066	12,356,521
Non-Operating Expenses	4,662,717	4,585,792
Prior Period Expense	<u> </u>	<u>3,803,144</u>
Total Expenses	29,895,537	36,132,931
Net Loss	(8,304,751)	(12,766,570)
Beginning Net Assets	<u>102,126,538</u>	<u>114,893,108</u>
Ending Net Assets	<u>\$ 93,821,787</u>	<u>\$102,126,538</u>

The \$4.5 million reduction in the net loss in fiscal 2004 compared to fiscal 2003 was due to the following:

Significant Changes in Revenues and Expenses
For the Period Ended January 31,

	<u>2004</u>	<u>2003</u>	<u>Change</u>
Investment Income	\$ 534,440	\$ 911,233	\$ (376,793)
Surcharges	1,360,130	743,153	616,977
Capital Contributions	1,769,979	3,380,403	(1,610,424)
Depreciation	(12,596,754)	(15,387,474)	2,790,720
Administrative and General	(4,643,359)	(3,213,441)	(1,429,918)
Water Purchase	(1,271,510)	(1,760,547)	489,037
Non-Pension Post-Employment Benefits		(3,803,144)	3,803,144
All Other Changes	<u>6,542,323</u>	<u>6,363,247</u>	<u>179,076</u>
Total Net Loss	<u>\$ (8,304,751)</u>	<u>\$ (12,766,570)</u>	<u>\$ 4,461,819</u>

Investment income – Investment income has decreased due to a reduction in market rates from an average of 3.45% in fiscal 2003, to 2.15% in fiscal 2004. Additionally, the average amount of invested funds has decreased by \$4.0 million between fiscal 2004 and 2003, primarily due to expenditures for capital projects.

Surcharges – Surcharge revenue increased as pipeline surcharge rates were increased by \$2.00 per month, per customer (67%) in line with previously adopted rate increases in July 2004 on Northridge Service Area ratepayers.

Capital contributions– Contributed capital revenue decreased by \$1.6 million from the prior year, despite an increase of \$0.2 million from grant revenue received from the State Department of Water Resources. The reduction was primarily due to a reduction in the number and size of developer projects occurring in the District.

Depreciation – Depreciation expense decreased relative to fiscal 2003, but remains high due to one-time adjustments pursuant to the District adopting a new fixed asset policy in fiscal 2004. In fiscal 2003, the District reduced the estimated useful life on certain assets from 150 to 100 years and for other assets down to a useful life as low as 30 years. The result of this change was an \$11.3 million one-time charge to depreciation expense. In fiscal 2004, as stated, the District adopted a new fixed asset policy. This policy further reduced the estimated useful lives of assets to 80 years or less resulting in a one-time charge of \$5.8 million. Additionally, the new policy also established capitalization eligibility criteria that resulted in \$2.7 million of assets being removed from capital assets (\$1.4 million net of accumulated depreciation).

Administrative and General – Administrative expenses increased by \$1.4 million relative to fiscal 2003 primarily due to increased legal and audit expenses (\$0.7 million) relative to internal financial improprieties discovered in early 2003, as well as to litigation that resulted from a contractual dispute with a contractor that was filed in August 2002 and ultimately settled in February 2004. Other administrative cost increases included workers compensation insurance, building upgrades as the District made certain changes to its facilities to meet safety standards, and administrative salaries as a new senior management team was hired during the year.

Water Purchase – Water purchase costs decreased by \$0.5 million primarily due to excessive accruals recorded in fiscal 2003 that were reversed in fiscal 2004.

Non-Pension Post-employment Benefits – This expense, recorded in fiscal 2003, was a nonrecurring charge for prior period accumulated post-employment health, dental, and vision

benefit costs that came about as the result of implementing a new accounting standard.

To avoid a repeat of a deficit in fiscal year 2005, District management has taken two major actions that should avoid the level of deficit reported in the last two years. One of these actions increases future District revenues, while the other is a nonrecurring action that increased expenses in prior years:

- In March 2004, the District changed the basis upon which customers are charged for its services. The change was necessary due to District customers being charged differently depending upon the location within the District where they live. Included with this change, was an increase in water rates by an average of 18 percent. This increase, a portion of which had been deferred from prior Board approved increases, is expected to raise District revenues by \$3.2 million in fiscal 2005. Additionally, the Board of Directors approved further rate increases of 16 percent and 13 percent at the beginning of fiscal years 2006 and 2007, respectively.
- A new fixed asset policy was adopted in fiscal 2004. Therefore, future changes in the estimated useful lives or capitalization eligibility requirements of capital assets that have occurred in the past two years are not anticipated to recur in the future.

The cost of overall District activities for the year was \$29.9 million compared to \$36.1million last year. However, as shown in the Statement of Revenues, Expenses, and Changes in Net Assets on page 11, the amount that our customers ultimately financed for these activities through rate charges was only \$29.1 million in fiscal 2004 and \$34.8 million in fiscal 2003, because some of the cost was paid by non-operational activities of the District such as investment and sublease income (\$0.8 million in 2004 and \$1.3 million in 2003).

CAPITAL ASSET AND DEBT ADMINISTRATION

At the end of 2004, the District had \$200.3 million invested in a broad range of capital assets, including reservoirs, pipelines, wells, pumps, meters and buildings. This amount represents an increase of \$2.9 million, or 1.5 percent, over last year. The increase in capital assets primarily resulted from various new transmission and pipeline projects, many of which are still in process.

Capital Assets As of January 31,

	<u>2004</u>	<u>2003</u>
Land	\$ 1,480,522	\$ 1,480,522
Construction in Progress	1,172,571	1,322,806
Pipelines, Reservoirs, Pumps	186,763,670	181,476,275
Buildings	5,682,035	5,439,142
Vehicles and Equipment	2,513,224	2,607,184
Furniture and Fixtures	2,261,869	2,130,973
Intangible Assets	<u>409,735</u>	<u>2,937,841</u>
Total Capital Assets	200,283,626	197,394,743
Less Accumulated Depreciation	<u>(52,375,760)</u>	<u>(42,506,855)</u>
Net Capital Assets	<u>\$ 147,907,866</u>	<u>\$154,887,888</u>

The District's fiscal year 2005 capital budget calls for spending another \$13.6 million for capital projects, principally for the completion of two pipelines in the Northridge Service Area as well as many other needed and necessary capital improvement and replacement projects. In anticipation of funding the cost to purchase facilities to procure treated surface water from the City of Sacramento in fiscal 2006, the District plans to issue an additional \$25 to \$30 million in debt in fiscal year 2005.

At year-end the District had \$78.9 million in bonds and notes outstanding versus \$81.2 million last year – a decrease of 2.8 percent - as shown in the table below.

Long – Term Debt As of January 31,		
	2004	2003
1996 COP	\$ 20,645,000	\$ 21,565,000
1997 COP	41,585,000	42,490,000
2001 COP	15,890,000	16,075,000
Improvement Bonds	80,000	155,000
Arvin Water Company	661,840	879,842
Loans to Developers	63,374	15,929
Total Long - Term Debt	\$ 78,925,214	\$ 81,180,771

As part of issuing debt for new capital projects, as described above, the District will evaluate refinancing opportunities on existing debt. As of January 31, 2004, the District had a strong credit rating, which should enable it to obtain financing at competitive rates as it vies for debt funds in the capital markets.

FUTURE PLANS AND NEXT YEARS BUDGETS AND RATES

The District's Board of Directors considered many factors when setting goals for fiscal year 2005 and beyond. While the District has accomplished much in the past year, significant opportunities for improvement remain.

Future Plans

One of the biggest challenges the District faces is aging facilities and problems with the location of many of those facilities. Over 40 percent of the District's pipelines are more than 50 years old, and 18 percent are located in backyards. Significant plans are underway to replace these aging facilities and to relocate backyard main lines to front streets. Additionally, the District is rapidly implementing the ability to provide all of its customers with water from either surface or ground water sources. Additionally, the District has completed negotiations with the City of Sacramento to receive treated surface water from the City's Fairbairn Treatment Plant. Once connected and brought on-line, this project will double the District's ability to provide surface treated water "conjunctively" with its groundwater supply. This will protect and ensure water availability for the future of the District's customers.

These and many other projects are all part of a strategic plan the District is in the process of formulating during fiscal year 2005. Once complete, the District's strategic plan will cover all facets

of the District and incorporate current and multi-year goals as well. Key to this plan will be goals to help improve operational efficiencies so that District costs can continue to be reduced and/or mitigated, such as implementing new software programs for preventive maintenance, service orders, and accounting.

Fiscal 2005 Budgets

The District utilizes two budgets to manage its activities. One is an annual Capital Budget and the other is an Operations and Maintenance Budget. The Capital Budget is intended to cover all District infrastructure projects that incorporate significant costs or long lead times and planning to complete. The Operations and Maintenance Budget covers all recurring operational activities as well as operational capital costs. Operational capital costs include such items as new computers, software programs, vehicles, equipment, building improvements, furniture, and communication equipment.

For fiscal year 2005, the District has approved a \$13.6 million Capital Budget and a \$14.5 million Operations and Maintenance Budget. Key components of the Capital Budget include expenditures of \$2.7 million related to facilities for delivery of surface water from the American River to the District; \$4.0 million for two large transmission pipelines in the northern service area; \$3.8 million for replacing aging pipelines and wells; \$1.4 million for installing new meters; and \$1.7 million for other projects.

The fiscal year 2005 Operations and Maintenance Budget represents an increase of \$0.9 million over fiscal year 2004. Key components of the 2005 Operations and Maintenance Budget include personnel costs of \$4.6 million; \$4.3 million to purchase and pump water; \$1.3 million to repair existing facilities; \$2.0 million for administrative costs; \$1.0 million for other costs; and \$1.3 million for new projects and additional staff. The new projects and additional staff comprise - one additional field staff position and two new office staff positions; the purchase of new hardware and software programs to upgrade accounting and work order systems; upgrades to various vehicles and heavy equipment; and improved security systems.

Fiscal 2005 to 2007 Rate Plan

On March 15, 2004, the Board adopted the first ever comprehensive rate plan for the District. Prior to the adoption of this plan, District customers were billed based on prior rate plans established by predecessor districts to the District. This new rate plan incorporates many new and important features. First, all customers within the District are now billed on the same basis, regardless of where they live. Second, there are economic incentives for metered customers to conserve water usage. Third, all District charges are grouped into one of three categories that now align directly with District expenses: operations and maintenance, debt service, and capital projects. Fourth, the District is moving from funding capital projects through a combination of debt and current revenues to current revenues only. Fifth, the bases upon which rates are charged have been simplified so that they are more easily understood and more readily verifiable. And sixth, the new rate plan incorporates water rate increases of 18 percent beginning May 1, 2004, and another 16 percent and 13 percent effective February 1, 2005 and 2006, respectively.

SACRAMENTO SUBURBAN WATER DISTRICT

BALANCE SHEETS

January 31, 2004 and 2003

	<u>2004</u>	<u>2003</u>
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents (See Note B)	\$ 23,669,992	\$ 24,410,184
Accounts receivable, net of allowance for uncollectible accounts of \$77,234 and \$65,302	822,623	844,724
Interest receivable	37,634	51,520
Other receivables	304,974	8,098
Inventory	432,037	540,827
Prepaid expenses and other assets	480,479	268,615
Restricted cash and cash equivalents (See Note B)	<u>6,637,584</u>	<u>9,290,787</u>
TOTAL CURRENT ASSETS	32,385,323	35,414,755
CAPITAL ASSETS (See Note C)		
Property, plant and equipment	200,283,626	197,394,743
Accumulated depreciation	<u>(52,375,760)</u>	<u>(42,506,855)</u>
TOTAL CAPITAL ASSETS	147,907,866	154,887,888
OTHER ASSETS		
Unamortized bond expenses	811,369	989,688
Notes receivable, net of allowance for uncollectible notes of \$15,835 and \$13,841	<u>5,260</u>	<u>128,960</u>
TOTAL ASSETS	<u>\$181,109,818</u>	<u>\$ 191,421,291</u>
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES		
Current portion of long-term debt and capital leases	\$ 2,567,710	\$ 2,304,419
Accounts payable	1,286,989	1,379,950
Accrued interest	1,429,253	1,470,041
Deferred revenue and other liabilities	350,447	805,363
Accrued expenses	<u>338,446</u>	<u>186,623</u>
TOTAL CURRENT LIABILITIES	5,972,845	6,146,396
LONG-TERM LIABILITIES		
Long-term debt (See Note D)	75,297,699	77,399,964
Accrued postemployment benefits (See Note G)	5,672,930	5,262,000
Obligation under capital leases (See Note D)		32,597
Compensated absences	319,367	389,537
Pension benefits payable	<u>25,190</u>	<u>64,259</u>
TOTAL LIABILITIES	<u>87,288,031</u>	<u>89,294,753</u>
NET ASSETS (See Note E)		
Invested in capital assets, net of related debt	74,142,179	82,145,520
Restricted	2,512,672	2,280,443
Unrestricted	<u>17,166,936</u>	<u>17,700,575</u>
TOTAL NET ASSETS	<u>93,821,787</u>	<u>102,126,538</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$181,109,818</u>	<u>\$ 191,421,291</u>

The accompanying notes are an integral part of these financial statements.

SACRAMENTO SUBURBAN WATER DISTRICT

STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

For the Years Ended January 31, 2004 and 2003

	2004	2003
OPERATING REVENUES		
Water sales	\$ 16,568,429	\$ 17,038,758
Water services	<u>1,042,299</u>	<u>787,321</u>
TOTAL OPERATING REVENUES	17,610,728	17,826,079
OPERATING EXPENSES		
Depreciation (See Note K)	12,596,754	15,387,474
Transmission and distribution	3,048,146	3,392,470
Administrative and general	4,643,359	3,213,441
Pumping	2,404,771	2,344,907
Water purchase	1,271,510	1,760,547
Customer accounts	893,695	1,009,495
Water treatment	<u>374,585</u>	<u>635,661</u>
TOTAL OPERATING EXPENSES	<u>25,232,820</u>	<u>27,743,995</u>
NET LOSS FROM OPERATIONS	(7,622,092)	(9,917,916)
NONOPERATING REVENUES		
Investment income	534,440	911,233
Surcharges	1,360,130	743,153
Miscellaneous income	212,133	249,871
Intergovernmental revenues		168,186
Property taxes	<u>103,376</u>	<u>87,436</u>
TOTAL NONOPERATING REVENUES	2,210,079	2,159,879
NONOPERATING EXPENSES		
Long-term debt and capital lease interest	4,635,442	4,302,583
Other	<u>27,275</u>	<u>283,209</u>
TOTAL NONOPERATING EXPENSES	<u>4,662,717</u>	<u>4,585,792</u>
NET LOSS BEFORE CAPITAL CONTRIBUTIONS	(10,074,730)	(12,343,829)
CAPITAL CONTRIBUTIONS		
Facility development charges	613,082	940,739
Grant revenues	236,400	
Developer contributions	<u>920,497</u>	<u>2,439,664</u>
TOTAL CAPITAL CONTRIBUTIONS	1,769,979	3,380,403
NET LOSS BEFORE CUMULATIVE EFFECT OF A CHANGE IN ACCOUNTING PRINCIPLE	(8,304,751)	(8,963,426)
Cumulative effect on prior years of accruing a liability for postemployment benefits other than pensions (See Note G)		<u>(3,803,144)</u>
CHANGE IN NET ASSETS	<u>(8,304,751)</u>	<u>(12,766,570)</u>
Retained earnings at beginning of year, as previously reported	102,126,538	60,284,040
Prior period adjustments (See Note J)		<u>54,609,068</u>
Net assets at beginning of year, as restated	<u>102,126,538</u>	<u>114,893,108</u>
NET ASSETS AT END OF YEAR	<u>\$ 93,821,787</u>	<u>\$102,126,538</u>

The accompanying notes are an integral part of these financial statements.

SACRAMENTO SUBURBAN WATER DISTRICT

STATEMENT OF CASH FLOWS

For the Years Ended January 31, 2004 and 2003

	2004	2003
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash receipts from customers	\$ 17,117,437	\$ 17,834,901
Cash paid to suppliers for goods and services	(9,651,966)	(9,472,691)
Cash paid to employees for services	<u>(2,521,538)</u>	<u>(2,481,067)</u>
NET CASH PROVIDED BY OPERATING ACTIVITIES	4,943,933	5,881,143
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Surcharges received	1,360,130	743,153
Pension benefit payments	(130,139)	(17,155)
Other income/expenses	<u>288,234</u>	<u>286,141</u>
NET CASH PROVIDED BY NONCAPITAL FINANCING ACTIVITIES	1,518,225	1,012,139
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Acquisitions of capital assets	(4,767,730)	(7,359,047)
Principal payments on notes receivable	121,706	5,567
Proceeds from sale of capital assets	78,883	
Principal payments on long-term debt	(2,303,931)	(2,026,883)
Interest payments on long-term debt	(4,086,446)	(4,052,335)
Principal payments on capital lease obligations	(59,443)	(106,550)
Capital contributions received	<u>613,082</u>	<u>738,269</u>
NET CASH USED FOR CAPITAL AND RELATED FINANCING ACTIVITIES	(10,403,879)	(12,800,979)
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest received on investments	<u>548,326</u>	<u>960,469</u>
NET CASH PROVIDED BY INVESTING ACTIVITIES	<u>548,326</u>	<u>960,469</u>
NET DECREASE IN CASH AND CASH EQUIVALENTS	(3,393,395)	(4,947,228)
Cash and cash equivalents at beginning of year	<u>33,700,971</u>	<u>38,648,199</u>
CASH AND CASH EQUIVALENTS AT END OF YEAR	<u>\$ 30,307,576</u>	<u>\$ 33,700,971</u>
RECONCILIATION OF NET LOSS FROM OPERATIONS TO CASH USED FOR OPERATING ACTIVITIES		
Net loss from operations	\$ (7,622,092)	\$ (9,917,916)
Adjustments to reconcile net loss from operations to net cash provided by operating activities		
Depreciation	12,596,754	15,387,474
Loss on disposal of property, plant and equipment	(7,388)	444
Loans to developers and arbitrage liability	80,338	
Provision for uncollectible notes receivable	1,994	13,840
Changes in assets and liabilities:		
Accounts receivable	22,101	108,492
Other receivables	(60,476)	(8,752)
Inventory	108,790	200,601
Prepaid expenses and other assets	(211,864)	1,021,940
Accounts payable	(92,961)	(1,141,224)
Deferred revenue and other liabilities	(454,916)	(90,918)
Compensated absences	(70,170)	(118,708)
Accrued expenses	151,823	(92,986)
Accrued postemployment benefits	<u>502,000</u>	<u>518,856</u>
	<u>\$ 4,943,933</u>	<u>\$ 5,881,143</u>
NON-CASH INVESTING, CAPITAL AND FINANCING ACTIVITIES:		
Receipt of contributed assets	\$ 920,497	\$ 2,642,134
Accrued capital - grant revenue	\$ 236,400	
Notes receivable taken in lieu of customer payments		\$ 11,858
Write-off of uncollectible notes receivable		\$ (63,857)

The accompanying notes are an integral part of these financial statements.

SACRAMENTO SUBURBAN WATER DISTRICT

NOTES TO THE BASIC FINANCIAL STATEMENTS

January 31, 2004 and 2003

NOTE A--REPORTING ENTITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The basic financial statements of the Sacramento Suburban Water District (the District) have been prepared in conformity with generally accepted accounting principles (GAAP) as applied to government units. The Governmental Accounting Standards Board (GASB) is the accepted standard setting body for establishing governmental accounting and financial reporting principles. As allowed by the GASB, the District has elected not to apply to its proprietary activities Financial Accounting Standards Board Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins of the Committee of Accounting Procedures issued after November 30, 1989. The more significant of the District's accounting policies are described below.

Reporting Entity: The District provides water to residential, commercial and industrial customers in Sacramento County within its boundaries and was formed under the County Water District Law of the State of California (Sections 30000 et. seq., Title 5, Division 3 of the California Government Code) upon the consolidation of the former Arcade Water District and Northridge Water District pursuant to the Sacramento Local Agency Formation Commission, Resolution No. 1237. On February 1, 2002, the District accepted the transfer of the assets of water systems from the Arcade Water District and Northridge Water District. The assets of the Arcade Water District and Northridge Water District were transferred to the District's books at their historical cost, less accumulated depreciation, in a manner similar to a pooling of interests. The District is currently governed by a seven member Board of Directors elected by the voters within the District for staggered, four year terms, every two years. Pursuant to the passage of Measure H on the March 2, 2004 ballot, the District Board will be reduced from seven to five members effective subsequent to the November 2004 general election.

Arcade Water District had created the Arcade Water District Financing Corporation (the Corporation) to provide assistance in the issuance of debt. Although legally separate from the Arcade Water District, the Corporation was reported as if it were part of the primary government, because it shared a common Board of Directors with the Arcade Water District, and its sole purpose was to provide financing to the Arcade Water District. When Sacramento Suburban Water District accepted the transfer of the assets of water systems of Arcade Water District, the Corporation's activity was included in the transfer. Debt issued by the Corporation is reflected as debt of Sacramento Suburban Water District in these financial statements. The Corporation has no other transactions and does not issue separate financial statements.

Basis of Presentation: The District's resources are allocated to and accounted for in these basic financial statements as an enterprise fund type of the proprietary fund group. The enterprise fund is used to account for operations that are financed and operated in a manner similar to private business enterprises, where the intent of the governing body is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges, or where the governing body has decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other policies. Net assets represent the amounts available for future operations.

Basis of Accounting: The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. The enterprise fund type is accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities associated with the operation of the District are included on the balance sheet. Net assets are segregated into amounts invested in capital assets, net of related debt, amounts restricted and amounts unrestricted. Enterprise fund type operating statements present increases (i.e., revenues) and decreases (i.e., expenses) in total net assets.

The District uses the accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred. Grant revenue is recognized when program expenditures are incurred in accordance with program guidelines. Earned but unbilled water services are accrued as revenue. Water lines are constructed by private developers and then dedicated to the District, which is then responsible for their future maintenance. These water lines are recorded as capital contributions when they pass inspection by the District, and the estimated costs are capitalized as Pipeline, Reservoir, and Pumping Station assets.

Operating revenues and expenses consist of those revenues and expenses that result from the ongoing principal operations

SACRAMENTO SUBURBAN WATER DISTRICT

NOTES TO THE BASIC FINANCIAL STATEMENTS (continued)

January 31, 2004 and 2003

NOTE A--REPORTING ENTITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

of the District. Operating revenues consist primarily of charges for services. Non-operating revenues and expenses consist of those revenues and expenses that are related to financing and investing types of activities and result from nonexchange transactions or ancillary activities.

When both restricted and unrestricted resources are available for use, it is the District's policy to use restricted resources first, then unrestricted resources as they are needed.

Budgetary Principles: The District does not operate under any legal budgetary constraints. However, the District chooses to adopt an annual operating and maintenance budget and a capital project budget as part of a prudent managerial and oversight practice. These budgets are formally adopted by the Board and take effect at the beginning of each fiscal year.

Use of Estimates: The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents: For purposes of the statement of cash flows, the District considers all highly liquid debt instruments purchased with an initial maturity of three months or less to be cash equivalents, including restricted assets, and all pooled deposits in the Local Agency Investment Fund, which are available upon demand.

Accounts Receivable: Accounts receivable arise from billings to customers for water usage, certain improvements to customers' property, and surcharges for debt service payments and various designated purposes.

Capital Assets: Capital assets are recorded at historical cost. Donated assets are valued at estimated fair value on the date received. Depreciation is calculated using the straight-line method over the following estimated useful lives:

<u>Description</u>	<u>Estimated Life</u>
Pipelines, Reservoirs, and Pumping Stations	10 to 80 Years
Buildings and Building Improvements	10 to 40 Years
Vehicles and Equipment	5 Years
Furniture and Fixtures	4 to 7 Years

Maintenance and repairs are charged to operations when incurred. It is the District's policy to capitalize all capital assets with a cost of more than \$3,000 for water system infrastructure assets, \$500 for office furniture and computer and communication equipment, and \$1,000 for all other assets. Costs of assets sold or retired (and the related amounts of accumulated depreciation) are eliminated from the balance sheet in the year of sale or retirement, and the resulting gain or loss is recognized in operations. In cases where an improvement or replacement is made to an existing capital asset and the existing capital asset's book value is not separately identifiable, the cost of the new capital asset is capitalized as it is assumed the existing capital asset's book value is negligible.

Inventory: Inventories are stated at the lower of average cost or market. Inventories consist of parts, supplies, and fuel.

Bond Discounts and Issuance Costs: Bond discounts, as well as issuance costs, are deferred and amortized over the lives of the bonds. Bonds payable are reported net of the applicable bond discounts. Bond issuance costs are reported as unamortized bond expenses, a component of Other Assets.

Property Taxes: The District receives property taxes from Sacramento County. Property taxes receivable are recorded in the fiscal year for which the tax is levied based on the assessed value as of March 1 of the preceding fiscal year. They become a lien on the first day of the year they are levied. Secured property tax is levied on January 1 and is due in two installments, on November 1 and February 1. They become delinquent on December 10 and April 10, respectively.

SACRAMENTO SUBURBAN WATER DISTRICT

NOTES TO THE BASIC FINANCIAL STATEMENTS (continued)

January 31, 2004 and 2003

NOTE A--REPORTING ENTITY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

At that time, delinquent accounts are assessed a penalty of 10 percent. Accounts that remain unpaid on June 30 are charged an additional 1.5 percent per month. Unsecured property tax is levied on July 1 and due on July 31, and becomes delinquent on August 31. The penalty percentage rates are the same as for secured property tax. The District elected to receive the property taxes from the County under the Teeter Bill. Under this program, the District receives 100% of the levied property taxes in periodic payments with the County assuming responsibility for delinquencies.

Compensated Absences: The District's policy allows employees to accumulate earned but unused vacation, administrative leave, and compensated time-off, which will be paid to employees upon separation from the District's service, subject to a vesting policy. Unused sick leave is paid to employees who are age 55 and older upon retirement. The District accrues the liability for all such time-off benefits when the employee earns the right to the benefit.

Deferred Revenues: Deferred revenues represents revenues received for future connections and maintenance that have not been earned as of the end of the fiscal year.

Reclassifications: Certain reclassifications have been made to the prior year financial statements to conform to the current presentation.

NOTE B--CASH AND CASH EQUIVALENTS

California statutes authorize districts to invest idle or surplus funds in a variety of credit instruments as provided for in the California Government Code, Section 53600, Chapter 4 - Financial Affairs. During the years ended January 31, 2004 and 2003, the District's permissible investments included the following instruments:

- U.S. Government and Agency obligations
- Bankers acceptances
- Negotiable Certificates of Deposit
- High grade commercial paper
- Repurchase agreements
- Time Deposits
- Medium-term corporate notes
- Mortgage obligations and asset-backed securities
- Local Agency Investment Fund
- Money market funds

The District complied with the provisions of State statutes pertaining to the types of investments held, institutions in which deposits were made and security requirements. The District will continue to monitor compliance with applicable statutes pertaining to public deposits and investments.

The District's cash and cash equivalents consisted of the following as of January 31, 2004 and 2003:

	<u>2004</u>	<u>2003</u>
Unrestricted cash and equivalents		
Investment in Local Agency Investment Fund (LAIF)	\$ 23,032,590	\$ 22,919,986
Deposits in financial institutions	635,202	1,488,298
Cash on hand	<u>2,200</u>	<u>1,900</u>
	23,669,992	24,410,184
Restricted cash and equivalents		
Investment in LAIF	4,448,207	7,155,508
Deposits in financial institutions	(535)	2,688
Money market mutual funds	<u>2,189,912</u>	<u>2,132,591</u>
	<u>6,637,584</u>	<u>9,290,787</u>
Total cash and cash equivalents	<u>\$ 30,307,576</u>	<u>\$ 33,700,971</u>

SACRAMENTO SUBURBAN WATER DISTRICT

NOTES TO THE BASIC FINANCIAL STATEMENTS (continued)

January 31, 2004 and 2003

NOTE B--CASH AND CASH EQUIVALENTS (Continued)

At January 31, 2004, the carrying amount of the District's deposits was \$634,667 and the balance in financial institutions was \$1,103,070. Of the balance in financial institutions, \$398,014 was covered by federal depository insurance and \$705,056 was collateralized as required by State law (Government Code Section 53630), by the pledging financial institution with assets held in a common pool for the District and other governmental agencies. At January 31, 2003, the carrying amount of the District's deposits was \$1,490,986 and the balance in financial institutions was \$2,058,271. Of the balance in financial institutions, \$398,014 was covered by federal depository insurance and \$1,660,257 was collateralized as required by State law. State law requires that the market value of the common pool of collateral be equal to or greater than 110% of all public deposits with the pledging financial institution if governmental securities are used, or 150% if mortgages are used, as collateral. The collateral is not held by, or in the name of, the District.

The District's investments in money market mutual funds and LAIF are stated at fair value and are not subject to categorization under GASB Statement No. 3. The LAIF is a special fund of the California State Treasury through which local governments may pool investments. The total amount invested by all public agencies in LAIF is \$53,984,385,400 all of which is managed by the State Treasurer. Of that amount, 98.0 percent is invested in non-derivative financial products and 2.0 percent in derivative financial products. The Local Investment Advisory Board (Board) has oversight responsibility for LAIF. The Board consists of five members as designated by State Statute. The value of pool shares in LAIF which may be withdrawn is determined on an amortized cost basis, which is different than the fair value of the District's position in the pool.

Included in restricted cash and cash equivalents are balances the District is required to maintain for debt service payments, and for certain construction projects funded by the 1996 and 2001 certificates of participation, and funds held for retirement benefits of one employee.

NOTE C--CAPITAL ASSETS

Capital asset activity for the years ended January 31, 2004 and 2003 are as follows:

	Balance February 1, 2003	Additions	Disposals	Transfers And Adjustments	Balance January 31, 2004
Capital assets not being depreciated					
Land	\$ 1,480,522				\$ 1,480,522
Construction in progress	<u>1,322,806</u>	<u>\$ 3,229,855</u>		<u>\$ (3,380,090)</u>	<u>1,172,571</u>
Total capital assets not being depreciated	2,803,328	3,229,855		(3,380,090)	2,653,093
Capital assets being depreciated:					
Pipelines, reservoirs, pumping stations	181,476,275	2,182,629		3,104,766	186,763,670
Buildings	5,439,142	101,173		141,720	5,682,035
Vehicles and equipment	2,607,184	45,782	\$ (119,045)	(20,697)	2,513,224
Furniture and fixtures	2,130,973	128,788	(2,987)	5,095	2,261,869
Intangible assets	<u>2,937,841</u>			<u>(2,528,106)</u>	<u>409,735</u>
Total capital assets being depreciated	194,591,415	2,458,372	(122,032)	702,778	197,630,533

SACRAMENTO SUBURBAN WATER DISTRICT

NOTES TO THE BASIC FINANCIAL STATEMENTS (continued)

January 31, 2004 and 2003

NOTE C--CAPITAL ASSETS (Continued)

	Balance February 1, 2003	Additions	Disposals	Transfers And Adjustments	Balance January 31, 2004
Less accumulated depreciation for:					
Pipelines, reservoirs, pumping stations	(36,876,696)	(4,542,475)	(885)	(4,603,887)	(46,023,943)
Buildings	(1,702,381)	(376,237)		(595,832)	(2,674,450)
Vehicles and equipment	(1,354,851)	(324,441)	61,988	(382,607)	(1,999,911)
Furniture and fixtures	(1,198,153)	(151,820)	253	(327,736)	(1,677,456)
Intangible assets	(1,374,774)			1,374,774	
Total accumulated depreciation	(42,506,855)	(5,394,973)	61,356	(4,535,288)	(52,375,760)
Total capital assets being depreciated, net	<u>152,084,560</u>	<u>(2,936,601)</u>	<u>(60,676)</u>	<u>(3,832,510)</u>	<u>145,254,773</u>
Capital assets, net	<u>\$ 154,887,888</u>	<u>\$ 293,254</u>	<u>\$ (60,676)</u>	<u>\$ (7,212,600)</u>	<u>\$ 147,907,866</u>
	Balance February 1, 2002	Additions	Disposals	Transfers And Adjustments	Balance January 31, 2003
Capital assets not being depreciated					
Land	\$ 1,384,913			\$ 95,609	\$ 1,480,522
Construction in progress	4,320,417	\$ 4,315,090		(7,250,953)	1,384,554
Total capital assets not being depreciated	5,705,330	4,315,090		(7,155,344)	2,865,076
Capital assets being depreciated:					
Pipelines, reservoirs, pumping stations	171,456,019	4,830,634	\$ (14,599)	6,036,742	182,308,796
Buildings	4,887,563	80,230		283,722	5,251,515
Vehicles and equipment	2,182,559	185,302			2,367,861
Furniture and fixtures	1,530,514	239,079	(3,000)		1,766,593
Intangible assets	2,491,368	350,846		(7,312)	2,834,902
Total capital assets being depreciated	182,548,023	5,686,091	(17,599)	6,313,152	194,529,667
Less accumulated depreciation for:					
Pipelines, reservoirs, pumping stations	(22,608,965)	(3,437,121)	14,599	(10,845,209)	(36,876,696)
Buildings	(1,884,276)	16,365		(28,681)	(1,896,592)
Vehicles and equipment	(979,915)	(416,759)		41,822	(1,354,852)
Furniture and fixtures	(1,124,137)	(103,381)	2,556	26,810	(1,198,152)
Intangible assets	(539,243)	(143,692)		(497,628)	(1,180,563)
Total accumulated depreciation	(27,136,536)	(4,084,588)	17,155	(11,302,886)	(42,506,855)
Total capital assets being depreciated, net	<u>155,411,487</u>	<u>1,601,503</u>	<u>(444)</u>	<u>(4,989,734)</u>	<u>152,022,812</u>
Capital assets, net	<u>\$ 161,116,817</u>	<u>\$ 5,916,593</u>	<u>\$ (444)</u>	<u>\$ (12,145,078)</u>	<u>\$ 154,887,888</u>

SACRAMENTO SUBURBAN WATER DISTRICT

NOTES TO THE BASIC FINANCIAL STATEMENTS (continued)

January 31, 2004 and 2003

NOTE C--CAPITAL ASSETS (Continued)

During 2004 the District implemented a new fixed asset policy. Among other items, the policy defined various new asset classes. These classifications differed from asset classifications used previously. Therefore, comparison of capital asset activity between 2004 and 2003, in the table above reflect the classification changes pursuant to the new policy.

As described in Note K, depreciation expense for 2004 was \$12,596,754, which includes \$7,212,717 resulting from the adoption of a new fixed asset policy that incorporated a change in estimates of useful lives and eligibility requirements for capitalization. Depreciation expense for 2003 was \$15,387,474, which includes \$11,302,885 resulting from the change in estimates of useful lives.

NOTE D--LONG-TERM LIABILITIES

Long-term debt consists of the following at January 31:

	<u>2004</u>	<u>2003</u>
<u>1996 Certificates of Participation:</u> In 1996, the Northridge Water District issued Certificates of Participation in the amount of \$24,880,000. The Certificates were used to finance the cost of the acquisition of capacity in a water transmission pipeline outside the District, construction of a water transmission pipeline in the District and certain other capital improvements to the District's water system. The District purchased a Municipal Bond Insurance Policy in lieu of establishing a reserve fund when these Certificates were issued. These Certificates are to be repaid from net revenues derived from water sales in the Northridge District service area. Interest rates range from 4.6% to 5.25%. Principal payments, ranging from \$960,000 to \$1,915,000, are due annually on February 1 and interest payments, ranging from \$50,269 to \$505,314, are due semi-annually on February 1 and August 1, through February 1, 2018.	\$20,645,000	\$21,565,000
<u>1997 Certificates of Participation:</u> In 1997, Certificates of Participation in the amount of \$45,000,000 were sold by the Arcade Water District Financing Corporation to finance the cost of design, acquisition and construction of various facilities and improvements relating to the Arcade Water District's water system. The District purchased a Municipal Bond Insurance Policy in lieu of establishing a reserve fund when these Certificates were issued. The Certificates are secured by a lien on the net revenues from water sales in the Arcade District service area. Interest rates range from 4.4% to 5.25%. Principal payments, ranging from \$945,000 to \$2,870,000, and interest payments, ranging from \$107,625 to \$2,055,690, are due annually on November 1 through November 1, 2027.	41,585,000	42,490,000
<u>2001 Certificates of Participation:</u> In 2001, the Northridge Water District issued Certificates of Participation in the amount of \$16,075,000. A portion of the Certificates were used to advance refund \$8,600,000 of outstanding 1993 Certificates of Participation. Those proceeds were deposited in an irrevocable trust with an escrow agent to provide for all future debt service payments on the 1993 Certificates. Accordingly, the trust account assets and liabilities for the defeased 1993 Certificates are not included in the District's financial statements. At January 31, 2004 and 2003, \$7,831,654 and \$8,513,795 of the 1993 Certificates outstanding are considered defeased. The remaining Certificate of Participation proceeds were used to finance certain capital improvements in the Northridge District service area. A surety bond was purchased in lieu of establishing a reserve fund when these Certificates were issued. These Certificates are to be repaid from net revenues derived by the District		

SACRAMENTO SUBURBAN WATER DISTRICT

NOTES TO THE BASIC FINANCIAL STATEMENTS (continued)

January 31, 2004 and 2003

NOTE D--LONG-TERM LIABILITIES (Continued)

	<u>2004</u>	<u>2003</u>
from water sales in the Northridge District service area. Interest rates range from 3.0% to 5.25%. Principal payments, ranging from \$265,000 to \$2,890,000, are due annually on February 1 and interest payments, ranging from \$75,863 to \$378,354, are due semi-annually on February 1 and August 1, through February 1, 2022.	15,890,000	16,075,000
<u>Northridge Water District Improvement District No. 2 Bonds, Sixth Division:</u> In 1961, the Northridge Water District authorized the issuance of bonds in the principal amount of \$1,050,000. Proceeds from the bonds were used to finance certain capital improvements. The interest rate on the remaining payments is 10.70%. Principal payments of \$75,000 are due annually on September 15 and interest payments of \$4,013 are due semi-annually on September 15 and March 15 through September 15, 2004.	80,000	155,000
<u>Loan to Purchase Arvin Water Company:</u> In 1986, the Northridge Water District entered into an agreement for the purchase of Arvin Water Company for \$3,500,000, of which \$500,000 was paid at the closing date and the remaining \$3,000,000 was payable to the Arvin Water District shareholders. Quarterly principal and interest payments of \$65,027, including interest at 5.27%, are due through November 2006.	661,840	879,842
<u>Loans to Developers:</u> In 1986, the Northridge Water District entered into an agreement for the purchase of Arvin Water Company. As part of that agreement the District assumed loans to developers of \$112,649 of which \$39,082 remains outstanding. In addition, in 2000 the Arcade Water District acquired the Sierra Oaks System from Citizens Utilities of California. As part of that agreement, the District assumed loans to developers of \$27,720 of which \$24,292 remains outstanding. All of these loans to developers are non-interest bearing. Payments on these loans are based upon either a straight-line amortization over a period of 40 years or as a percentage of annual revenues from the services connected to the extended main line.	63,374	15,929
	78,925,214	81,180,771
Add: Arbitrage liability	31,964	
Less: Unamortized bond discount	(1,116,384)	(1,163,144)
Less: Defeasance Cost	77,840,794	(364,705)
	<u>77,840,794</u>	<u>79,652,922</u>
Less: Current portion	<u>(2,543,095)</u>	<u>(2,252,958)</u>
Long-term portion	<u>\$75,297,699</u>	<u>\$77,399,964</u>

SACRAMENTO SUBURBAN WATER DISTRICT

NOTES TO THE BASIC FINANCIAL STATEMENTS (continued)

January 31, 2004 and 2003

NOTE D--LONG-TERM LIABILITIES (Continued)

The activity of the District's long-term liabilities during the years ended January 31, 2004 and 2003 are as follows:

	Balance February 1, 2003	<u>Additions</u>	<u>Reductions</u>	Balance January 31, 2004	Due Within One Year
1996 Certificates of Participation	\$ 21,565,000		\$ (920,000)	\$ 20,645,000	\$960,000
1997 Certificates of Participation	42,490,000		(905,000)	41,585,000	945,000
2001 Certificates of Participation	16,075,000		(185,000)	15,890,000	265,000
Improvement Bonds	155,000		(75,000)	80,000	80,000
Arvin Water Company	879,842		(218,002)	661,840	229,720
Loans to Developers	<u>15,929</u>	<u>\$ 48,374</u>	<u>(929)</u>	<u>63,374</u>	<u>63,375</u>
	81,180,771	48,374	(2,303,931)	78,925,214	2,543,095
Capital Leases	<u>84,058</u>		<u>(59,443)</u>	<u>24,615</u>	<u>24,615</u>
Total	<u>81,264,829</u>	<u>\$ 48,374</u>	<u>\$ (2,363,374)</u>	<u>78,949,829</u>	<u>\$ 2,567,710</u>
Add: Revenue bond arbitrage liability				31,964	
Less: Unamortized bond discount	(1,163,144)			(1,116,384)	
Less: Defeasance costs	(364,705)				
Less: Current portion of long-term liabilities	<u>(2,304,419)</u>			<u>(2,567,710)</u>	
	<u>\$ 77,432,561</u>			<u>\$ 75,297,699</u>	
Compensated absences	<u>\$ 389,537</u>		<u>\$ (70,170)</u>	<u>\$ 319,367</u>	

	Balance February 1, 2002	<u>Additions</u>	<u>Reductions</u>	Balance January 31, 2003	Due Within One Year
1996 Certificates of Participation	\$ 22,445,000		\$ (880,000)	\$ 21,565,000	\$920,000
1997 Certificates of Participation	43,360,000		(870,000)	42,490,000	905,000
2001 Certificates of Participation	16,075,000			16,075,000	185,000
Improvement bonds	225,000		(70,000)	155,000	80,000
Arvin Water Company	1,086,724		(206,882)	879,842	162,427
Loans to Developers	<u>15,929</u>			<u>15,929</u>	<u>531</u>
	83,207,653		(2,026,882)	81,180,771	2,252,958
Capital Leases	<u>171,836</u>		<u>(87,778)</u>	<u>84,058</u>	<u>51,461</u>
Total	<u>83,379,489</u>		<u>\$(2,114,660)</u>	<u>81,264,829</u>	<u>\$ 2,304,419</u>
Add: Revenue bond arbitrage liability	235,958				
Less: Unamortized bond discount	(1,209,903)			(1,163,144)	
Less: Defeasance costs	(490,985)			(364,705)	
Less: Current portion of long-term liabilities	<u>(1,917,681)</u>			<u>(2,304,419)</u>	
	<u>\$ 79,996,878</u>			<u>\$ 77,432,561</u>	
Compensated absences	<u>\$ 508,245</u>		<u>\$ (118,708)</u>	<u>\$ 389,537</u>	

SACRAMENTO SUBURBAN WATER DISTRICT

NOTES TO THE BASIC FINANCIAL STATEMENTS (continued)

January 31, 2004 and 2003

NOTE D--LONG-TERM LIABILITIES (Continued)

The following is a schedule of maturities for long-term debt:

Year Ended January 31,	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2005	\$ 2,543,094	\$ 3,858,429	\$ 6,401,523
2006	2,507,068	3,744,159	6,251,227
2007	2,550,052	3,626,767	6,176,819
2008	2,475,000	3,506,340	5,981,340
2009	2,590,000	3,383,792	5,973,792
2010-2014	14,980,000	14,790,665	29,770,665
2015-2019	19,135,000	10,470,594	29,605,594
2020-2024	21,465,000	5,071,088	26,536,088
2025-2028	<u>10,680,000</u>	<u>1,233,940</u>	<u>11,913,940</u>
Total	<u>\$ 78,925,214</u>	<u>\$ 49,685,774</u>	<u>\$ 128,610,988</u>

The District leases vehicles under lease agreements which have been classified as capital leases. Leased vehicles are included in capital assets in the balance sheet. Capitalized lease obligations are payable in monthly installments through fiscal year 2005 with interest rates ranging from 8.92% to 12.70%.

The following is a schedule of the future minimum lease payments required under capital leases and the present value of the net minimum lease payments as of January 31, 2004:

Total minimum lease payments	\$ 27,622
Less: Amount representing interest	<u>(3,007)</u>
Present value of minimum lease payments (capital lease obligation)	<u>\$ 24,615</u>

Assets under capital leases are recorded as Vehicles and Equipment and totaled \$377,574 and \$291,787 at January 31, 2004 and 2003. Accumulated amortization on these assets totaled \$294,388 and \$178,937 at January 31, 2004 and 2003, respectively. Amortization is included with depreciation expense.

NOTE E--NET ASSETS

Restrictions: Restricted net assets consists of constraints placed on net asset use through external requirements imposed by creditors (such as through debt covenants), grantors, contributors, or laws and regulations of other governments or constraints by law through constitutional provisions or enabling legislation. Restrictions include the following at January 31:

	<u>2004</u>	<u>2003</u>
Debt service payments	<u>2,512,672</u>	<u>2,280,443</u>
Total restricted net assets	<u>\$ 2,512,672</u>	<u>\$ 2,280,443</u>

Designations: Designations of unrestricted net assets may be imposed by the Board of Directors to reflect future spending plans or concerns about the availability of future resources. Designations may be modified, amended or removed by Board action. Effective January 31, 2004, the Board of Directors adopted a new reserve policy. The new policy removed all prior designations of unrestricted net assets, including those established in 2001 by the Northridge Board of Directors. The new reserve policy calls for the designation of unrestricted net assets for two purposes. One purpose is for replacing capital assets. Designated net assets for this purpose will come from facility development charges and capital

SACRAMENTO SUBURBAN WATER DISTRICT

NOTES TO THE BASIC FINANCIAL STATEMENTS (continued)

January 31, 2004 and 2003

NOTE E--NET ASSETS (Continued)

replacement charges under the newly adopted rate program. Expenditures will be for all non-debt financed, non-operational capital projects. The other designated fund will be for repaying long-term debt. Revenues for this fund will come from debt service charges from the newly adopted rate program, while expenditures will be incurred on bond principal and interest payments. At January 31, 2004, there were no amounts set aside for designated net assets. As of January 31, 2003, designations included:

	<u>2003</u>
Capital improvements	\$ 43,710
Surface water	2,910,445
Pipeline debt service	1,633,724
Unemployment insurance	187,665
Bond repayment reserve	<u>363,968</u>
Total designated net assets	<u>\$ 5,139,512</u>

NOTE F--EMPLOYEES' RETIREMENT PLAN

Plan Description: The District contributes to the California Public Employees Retirement System (PERS), an agent multiple-employer public employee defined benefit pension plan. PERS provides retirement and disability benefits, annual cost-of-living adjustments, and death benefits to plan members and beneficiaries. PERS acts as a common investment and administrative agent for participating public employers within the State of California. All permanent full and part time District employees working at least 1,000 hours per year are eligible to participate in PERS. Under PERS, benefits vest after five years of service. Upon retirement, participants are entitled to an annual retirement benefit, payable for life, in an amount equal to a benefit factor times their highest average monthly salary over twelve consecutive months of full-time equivalent monthly pay. Copies of the PERS annual financial report may be obtained from their Executive Office, 400 P Street, Sacramento, CA 95814.

On September 30, 2002, the District entered into a new contract with PERS due to the conversion of the plan from Northridge Water District to Sacramento Suburban Water District and the addition of the former Arcade Water District employees to the plan. This new contract is a continuation of the contract of the Northridge Water District. The accumulated contributions, assets and liabilities for prior and current service credits under the service contract were continued in the new contract.

In September 2003, the District amended the PERS contract to include Federal Social Security benefit coverage for members employed on or after September 30, 2002. The impact of this change for the year ended January 31, 2004, was \$222,335, which consisted of employer matching contributions to the Federal Social Security Administration.

Funding Policy: Active plan members are required to contribute 8% of their annual covered salary. The District makes the contributions required of District employees on their behalf and for their account. The District is required to contribute at an actuarially determined rate; the rate for February 1, 2002 to September 29, 2002 was 7.014% and for September 30, 2002 to January 31, 2004 was 12.387% of annual covered payroll. The contribution requirements of plan members and the District are established and may be amended by PERS.

Annual Pension Cost: The District incurred an annual pension cost of \$510,804 and \$297,699 in fiscal years 2004 and 2003, respectively. The required contribution was determined as part of the June 30, 2002 actuarial valuation using entry age actuarial cost method. The actuarial assumptions included (a) 8.25% investment rate of return (net of administrative expenses); (b) projected salary increases that vary in duration of service ranging from 3.75% to 14.20% and (c) 3.75% cost of living adjustment. Both (a) and (b) include an inflation component of 3.5%. The actuarial value of the plan's assets was determined using techniques that smooth the effects of short term volatility in the market value of investments

SACRAMENTO SUBURBAN WATER DISTRICT

NOTES TO THE BASIC FINANCIAL STATEMENTS (continued)

January 31, 2004 and 2003

NOTE F--EMPLOYEES' RETIREMENT PLAN (Continued)

over a three year period (smoothed market value). The plan's excess assets are being amortized as a level percentage of projected payroll on a closed basis. The average remaining amortization period at June 30, 2002 was 20 years.

The table below, which is from the latest available actuarial valuation, shows an analysis of the actuarial value of assets as a percentage of the actuarial accrued liability and the funded status of the accrued liability as a percentage of the annual covered payroll for the District's contribution of PERS as of June 30:

Required Supplementary Information – Funded Status of the Plan

<u>Actuarial Valuation Date</u>	<u>Actuarial Asset Value</u>	<u>Entry Age Actuarial Accrued Liability</u>	<u>(Unfunded Liability) Excess Assets</u>	<u>Funded Ratio</u>	<u>Covered Payroll</u>	<u>Excess Assets as Percentage of Covered Payroll</u>
June 30, 2002	\$9,312,438	\$9,193,423	\$119,015	101.29%	\$2,410,713	4.94%

As the contract with PERS is new, three year trend information is not yet available.

Pension Funds: Prior to the merger, the Arcade Water District had established a money purchase pension plan which was administrated by the Arcade Water District that covered all employees with one year of service that had attained the age of twenty. Contributions to the plan were based upon 20% of the wages of the eligible employees. In September 2002, all active participants in the Plan elected to be covered by the new Sacramento Suburban Water District's PERS contract. All participants in the Arcade plan received credit from PERS for prior service equal to one year for every ten months of prior service. Effective September 23, 2002, all active participant assets and liabilities in the Plan were transferred to the Sacramento Suburban Water District's PERS account. On August 18, 2003, the Board of Directors terminated the Plan. Remaining Plan retiree's and former employees agreed to a lump sum distribution of their assets. As of January 31, 2004, \$1,894 of assets remain undistributed. Sacramento Suburban Water District made no contributions to the Plan since September 23, 2002.

In addition, pension funds are being held by the District which were contributed by the Arcade Water District on behalf of one of its former employees. At January 31, 2004 and 2003, the liability for these pension funds was \$25,190 and \$64,259, respectively.

NOTE G--POSTEMPLOYMENT BENEFITS

In addition to the pension benefits, the District provides certain healthcare benefits through PERS, and dental and vision benefits through private insurance carriers for retired employees, directors and their survivor dependents, subject to certain conditions. Substantially all of the District's full-time employees may become eligible for those benefits, if they reach normal retirement age after working for the District for twenty years. In addition, former Northridge Water District directors with 12 years of service are also eligible. At January 31, 2004, 18 retired employees/survivor dependents met those eligibility requirements. Covered employees are not required to make contributions to receive the benefits. The actuarially accrued liability was \$5,672,930 at January 31, 2004, and \$5,262,000 at January 31, 2003. Since assets are not being set aside to fund these benefits, the unfunded actuarial accrued liability is also \$5,672,930 and \$5,262,000 for January 31, 2004 and 2003, respectively. The District's actuarially required contributions were \$502,000 for the years ended January 31, 2004 and 2003. This contribution includes normal cost of \$275,000, \$201,000 to amortize the unfunded actuarial accrued liability, and \$26,000 of interest. No actual contributions were made. The contribution and liability were determined using the Projected Unit Credit actuarial cost method. The actuarial assumptions included an interest rate of 5.5% per annum, and medical premium increases of 12% in 2005, 10% in 2006, 8% in 2007, 7% in 2008, 6% in 2009, and 5% annually thereafter. Dental and vision premiums were assumed to rise 4% and 3% per annum,

SACRAMENTO SUBURBAN WATER DISTRICT

NOTES TO THE BASIC FINANCIAL STATEMENTS (continued)

January 31, 2004 and 2003

NOTE G--POSTEMPLOYMENT BENEFITS (Continued)

respectively. A long-term general inflation rate of 3.5% was also used.

Prior to the consolidation, the Northridge Water District had accrued a liability for postemployment healthcare benefits; however, Arcade Water District financed these benefits on a pay-as-you-go basis. Sacramento Suburban Water District opted to accrue a liability on an actuarially determined basis consistent with the proposed GASB Statement entitled "Accounting and Financial Reporting by Employers for Postemployment Benefits other than Pensions" effective February 1, 2003. The cumulative effect of this change in accounting principle is to increase the District's net loss by \$3,803,144 for the year ended January 31, 2003.

NOTE H--INSURANCE

The District participates in the Association of California Water Agencies Joint Powers Insurance Authority (AWA/JPIA), a public entity risk pool of California water agencies, for general and auto liability, public official's liability, property damage, and fidelity insurance. ACWA/JPIA provides insurance through the pool up to a certain level, beyond which group purchased commercial excess insurance is obtained.

The District pays an annual premium to ACWA/JPIA that includes a pro-rata share of excess insurance premiums, charges for the pooled risk, claims adjusting and legal costs, and administrative or other costs to operate the ACWA/JPIA. The District's deductibles and maximum coverage are as follows:

<u>Coverage</u>	<u>ACWA/JPIA</u>	<u>Commercial Insurance</u>	<u>Deductible</u>
General and Auto Liability (includes public officials liability)	\$500,000	\$39,500,000	None
Property Damage	50,000	50,000,000	\$1,000 to 15,000
Fidelity	100,000		1,000

The District continues to carry commercial insurance for all other risks of loss to which the District is exposed. Settled claims have not exceeded commercial insurance in any of the past three fiscal years.

NOTE I--COMMITMENTS AND CONTINGENCIES

The District is a party to claims and lawsuits arising in the ordinary course of business. The District is vigorously defending its position and the District's management and legal counsel are of the opinion that the ultimate liability, if any, arising from these claims will not have a material adverse impact on the financial position of the District.

In early 2004, the District had an evaluation performed of its compliance with internal policies and Internal Revenue Service (IRS) rules and regulations related to business expense reimbursements and compensation payments to employees and directors. As a result of this evaluation, the Board has sought repayment from certain directors and employees totaling approximately \$409,967, representing compensation overpayments, undocumented business expenses, excess transportation advances and payroll taxes on amounts that had not previously been reported to the IRS. As of January 31, 2004, repayment had been received from all but two individuals. Repayment consisted of \$126,877 in cash, while \$70,551 was determined to be appropriate business expenses. Subsequent to January 31, 2004, the remaining balance was satisfied: \$193,767 was received in cash, while \$18,772 was determined to be appropriate business expenses. Recovered amounts received after January 31, 2004, will be recorded as a reduction to non-operating expense in fiscal year 2005..

The District has signed various capital project contracts for a total of \$4,862,422 with different consulting firms for project design and construction work. As of January 31, 2004, \$3,869,086 was committed but unpaid related to these contracts.

SACRAMENTO SUBURBAN WATER DISTRICT

NOTES TO THE BASIC FINANCIAL STATEMENTS (continued)

January 31, 2004 and 2003

NOTE I--COMMITMENTS AND CONTINGENCIES (Continued)

On February 23, 2004, the Board of Directors approved a "Water Meter Retrofit Plan" that calls for the installation of meters on all District service connections over the next 20 years at an estimated total cost of \$26.9 million.

NOTE J--RESTATEMENT

In June 1999, the GASB unanimously approved Statement No. 34, "Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments." Retained earnings at February 1, 2002, have been restated to reflect the cumulative effect of the implementation of GASB Statement No. 34. Implementation of this Statement resulted in a prior period adjustment of \$54,609,068 at January 31, 2002, to remove revenues recorded as contributed capital and record this amount as unrestricted net assets, certain amounts were also reclassified as net assets invested in capital assets, net of related debt.

NOTE K--CHANGE IN ESTIMATE

During the year ended January 31, 2004, the District adopted a new fixed asset policy. The new policy changed the estimated useful lives used to compute depreciation on various capital assets from a range of three to 100 years to a range of four to 80 years. Additionally, eligibility for capitalization of assets also changed. These changes resulted in an increase in depreciation expense for the year ended January 31, 2004, and an increase in accumulated depreciation and a decrease in the net book value of capital assets at January 31, 2004 of \$7,212,717. Depreciation expense consists of the following for the year ended January 31, 2004:

Current year depreciation expense	\$ 5,384,037
Additional depreciation expense due to:	
change in estimated useful lives	5,805,320
change in capitalization eligibility requirement	<u>1,407,397</u>
	<u>\$ 12,596,754</u>

During the year ended January 31, 2003, the District changed the estimated useful lives used to compute depreciation on various capital assets from 150 years to a range of 30 to 100 years. This change resulted in an increase in depreciation expense for the year ended January 31, 2003, and an increase in accumulated depreciation and a decrease in the net book value of capital assets at January 31, 2003 of \$11,302,885. Depreciation expense consists of the following for the year ended January 31, 2003:

Current year depreciation expense	\$ 4,084,589
Additional depreciation expense due to:	
change in estimated useful lives	<u>11,302,885</u>
	<u>\$ 15,387,474</u>

NOTE L--SUBSEQUENT EVENT

On February 23, 2004, the District settled a contractual dispute with a contractor that was originally filed in August of 2002. The terms of the settlement were \$1,100,000 in cash for a full, unconditional release of all claims against the District.