

OTAY WATER DISTRICT

**ANNUAL
FINANCIAL REPORT**

JUNE 30, 2008 and 2007

Spring Valley, California
Prepared by the Finance Department

INDEPENDENT AUDITORS' REPORT

Board of Directors
Otay Water District
Spring Valley, California

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

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

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

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

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

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

Teaman Ramirez & Smith

October 24, 2008



MANAGEMENT'S DISCUSSION AND ANALYSIS

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

Financial Highlights

- The assets of the District exceeded its liabilities at the close of the most recent fiscal year by \$456.8 million (*net assets*). Of this amount, \$82.0 million (*unrestricted net assets*) may be used to meet the District's ongoing obligations to citizens and creditors.
- The District's total net assets increased by \$9.8 million. This is primarily attributable to capital contributions of \$14.9 million during the fiscal year.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the District's basic financial statements, which are comprised of the following: 1) Statement of Net Assets, 2) Statement of Revenues, Expenses and Changes in Net Assets, 3) Statement of Cash Flows, and 4) Notes to the financial Statements. This report also contains other supplementary information in addition to the basic financial statements.

The *Statement of Net Assets* presents information on all of the District's assets and liabilities, with the difference between the two reported as *net assets*. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the District is improving or weakening.

The *Statement of Revenues, Expenses and Changes in Net Assets* presents information showing how the District's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, *regardless of the timing of related cash flows*. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods (e.g., uncollected taxes and earned but unused vacation leave).

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

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

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

Financial Analysis

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

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



MANAGEMENT'S DISCUSSION AND ANALYSIS

Statement of Net Assets (In Millions of Dollars)

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

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

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



MANAGEMENT'S DISCUSSION AND ANALYSIS

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

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

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

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

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



MANAGEMENT'S DISCUSSION AND ANALYSIS

Capital Assets and Debt Administration

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

Capital Assets (In Millions of Dollars)

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

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

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

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

General Obligation Bonds	\$ 7.7
Certificates of Participation	63.3
Notes Payable	0.7
Total Long-term Debt	<u>\$ 71.7</u>

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