SAN GORGONIO PASS WATER AGENCY

Beaumont, California

Annual Financial Report

For the fiscal year ended June 30, 2010

San Gorgonio Pass Water Agency

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For the fiscal year ended June 30, 2010

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Rogers, Anderson, Malody & Scott, LLP
CERTIFIED PUBLIC ACCOUNTANTS

ROBERT B. MEMORY, C.P.A. (1945-2009)

OF COUNSEL
JAY H. ZERCHER, C.P.A.

Board of Directors
San Gorgonio Pass Water Agency
Beaumont, California 92223

Independent Auditors' Report

We have audited the accompanying statements of net assets of the San Gorgonio Pass Water Agency as of June 30, 2010, and the related statements of revenues, expenses and changes in net assets, and cash flows for the year then ended. These financial statements are the responsibility of the Agency's management. Our responsibility is to express an opinion on these financial statements based on our audit. The prior year summarized comparative information has been derived from the Agency's 2009 financial statements and, in our report dated October 14, 2009, we expressed an unqualified opinion on the statement of net assets and the related statements of revenues, expenses and changes in net assets and cash flows for the year then ended.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the San Gorgonio Pass Water Agency as of June 30, 2010, and the respective changes in financial position and cash flows of the Agency for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 to the financial statements, the Agency adopted the provision of GASB Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, in 2010.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis, as listed in the table of contents, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Government Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Rogers, Anderson, Malody & Scott, LLP

October 18, 2010

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The Agency

The San Gorgonio Pass Water Agency is one of 29 state water contractors and was created by the Legislature of the State of California under Senate Bill Number 8, Chapter 40, which was signed into law by the Governor of California on April 19, 1962. The purpose of creating this public agency by special law was for the "planning, conservation, development, distribution, control and use of an adequate water supply for the public good and for the protection of life and property therein." As part of the act, the Agency was given taxing authority similar to the taxing power of other local governments.

The Agency has completed the East Branch Extension, Phase 1, of the State Water Project and the East Branch Extension, Phase 2 project is in process. The Agency is the last of the State Water Project contractors to receive water. The Agency has entered into a contract with the State Department of Water Resources to receive an annual allotment of 17,300 acre-feet from the State Water Project. The "Extension" delivers water to the Agency's service area, which extends from Calimesa to Cabazon through the San Gorgonio Pass area.

The Basic Financial Statements

San Gorgonio Pass Water Agency is a special purpose government (Special District) engaged only in activities that support themselves through user and capacity fees and tax levies. Accordingly, the accompanying financial statements are presented in the format prescribed for proprietary funds by the Governmental Accounting Standards Board.

These financial statements consist of three interrelated statements designed to provide the reader with relevant, understandable data about the Agency's financial condition and operating results. They are the Statement of Net Assets, the Statement of Revenues, Expenses and Changes in Net Assets, and the Statement of Cash Flows.

The Statement of Net Assets presents the Agency's assets and liabilities and the difference, or net, between what is owned and what is owed as of the last day of the Agency's fiscal year. The Statement of Revenues, Expenses and Changes in Net Assets describes the financial results of the Agency's operations for the years reported. These results, or changes in net assets, are the increases or decreases in the bottom line of the Statement of Net Assets.

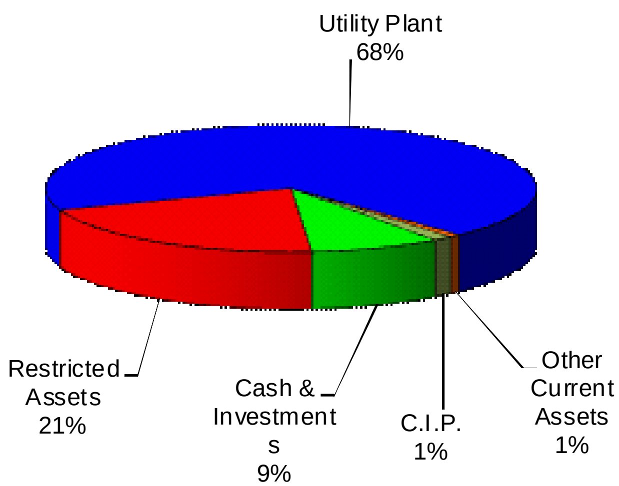
The Statement of Cash Flows conveys to financial statement users how the Agency managed cash resources during the year. This statement converts the Change in Net Assets presented on the Statement of Revenues, Expenses and Changes in Net Assets into actual cash provided by or used for operations. The Statement of Cash Flows also details how the Agency obtains cash through financing and investing activities and, conversely, how cash is spent for these purposes.

Summary Financial Information and Analysis

During the year ended June 30, 2010, the Agency's Total Assets increased by $4.68 million and net assets increased by $4.47 million. A majority of the increase in Total Assets resulted from an increase in cash and investments ($1.67 million) and payments to the Department of Water Resources ($5.96 million) for Investment in State Water Rights in the State Water Project Transportation System.

Assets Owned

June 30, 2010



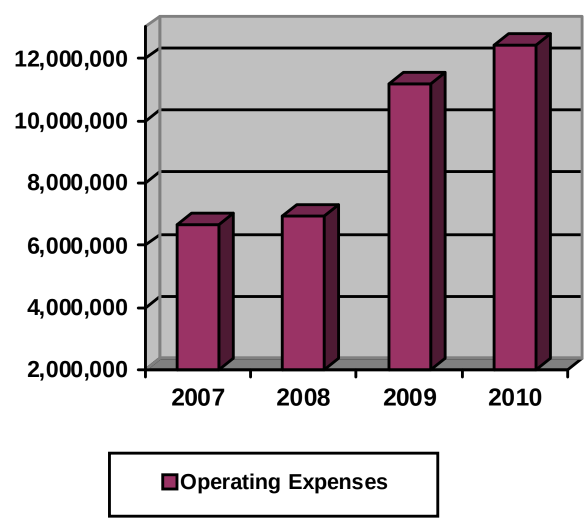
Total Cash in bank, Cash in Local Agency Investment Fund and Investments increased by $1.67 million. The increase can be further divided into general unrestricted and restricted cash and investments. Unrestricted cash and investments increased $1.73 million and restricted cash and investments decreased $66 thousand. The $1.77 million increase in Current Assets was due primarily to an increase in cash and investments from water sales, property taxes and interest. The $470 thousand decrease in Restricted Assets is a result of a decrease in the amount of property taxes collected for debt service pertaining to the State Water Project.

The $4.47 million increase in Net Assets included non-operating revenue net of non-operating expenses of $14.51 million and Capital Contributions of $387 thousand. This amount was reduced by a loss from operations of $10.43 million.

Financial Statement Summary

(In millions)

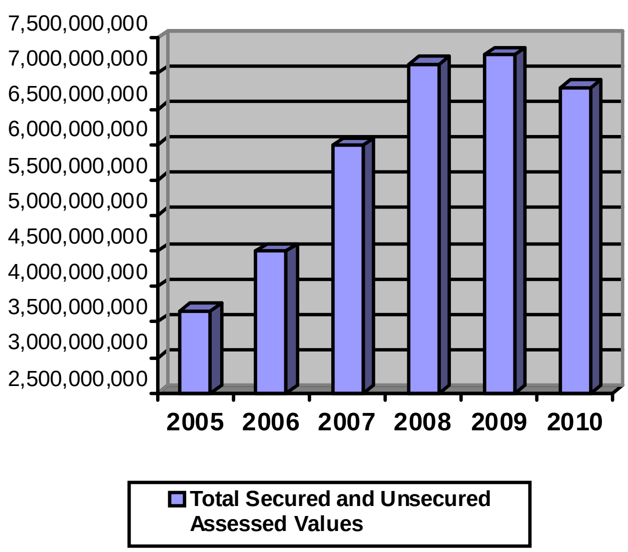
	6/30/10	6/30/09
Current Assets	$ 11.61	$ 9.88
Restricted Assets	25.86	26.33
Capital Assets	87.02	83.59
Total Assets	124.49	119.80
Total Liabilities	.77	.55
Net Assets	123.72	119.25
Oper. Revenues	2.00	.78
Oper. Expenses	(12.43)	(11.18)
Non Oper. Rev.:		
Interest	.26	.68
Property Taxes	14.27	16.01
Miscellaneous	.03	-
Non Oper. Exp.	(.05)	(.06)
Contributions	.39	-
Change in Net Assets	$ 4.47	$ 6.23



Operating expenses increased $1.25 million or 11% from the prior year. The increase in operating expenses is primarily attributable to costs associated with the increased purchase and delivery of water. Source of supply maintenance expenditures increased $814 thousand; amortization of State Water Rights increased $882 thousand; legal and engineering costs decreased $526 thousand over the prior year.

Non-operating revenues decreased over the prior year. Total property taxes received decreased $1.74 million. This decrease was derived from a $221 thousand decrease from general-purpose property tax distribution and $1.51 million decrease from Debt Service property taxes. Interest earned on reserves decreased by $421 thousand that was attributable to a reduction of interest rates and a decrease in reserves available by $2.50 million.

The following reflects the Agency's assessed property tax valuations. Assessed valuations have increased significantly from the years ending June 30, 2005 to 2008; however, as a result of the economic slow down, assessed values leveled off for the year ending 2009 and declined by 6.4% for 2010.



Categories of Net Assets

The Agency is required to present its net assets in three categories: Invested in Capital Assets, Restricted and Unrestricted.

Invested in Capital Assets

At June 30, 2010, Invested in Capital Assets totaled $86.98 million and consisted of Utility Plant in Service and Construction in Progress, net of Accumulated Depreciation and Amortization.

Restricted

The Agency had restricted Net Assets of $25.86 million, which consisted of tax proceeds that were levied for State Water Project payments less actual State Water Project related expenditures.

Unrestricted

The Agency had unrestricted Net Assets of $10.88 million at June 30, 2010.

Capital asset activity for the year was as follows:

	Balance July 1, 2009	Additions	Deletions	Balance June 30, 2010
Capital assets not being depreciated:				
Land and rights of way	$ 468,444	$ 200,575	$ -0-	$ 669,019
Construction in progress	747,458	877,086	-0-	1,624,544
Total capital assets, not being depreciated	1,215,902	1,077,661	-0-	2,293,563
Capital assets being depreciated:				
Investment in State Water Rights	75,635,186	5,956,876	-0-	81,592,062
Source of supply	14,672,383	146,269	-0-	14,818,652
Transmission and distribution	1,351,614	-0-	-0-	1,351,614
Buildings	1,439,396	-0-	-0-	1,439,396
Furniture and fixtures	170,442	4,187	-0-	174,629
Technical equipment	53,700	40,739	-0-	94,439
Transportation equipment	52,060	-0-	-0-	52,060
Total capital assets, being depreciated	93,374,781	6,148,071	-0-	99,522,852
Total capital assets	$ 94,590,683	$ 7,225,732	$ -0-	$ 101,816,415

Capital Assets

The Agency made payments to the Department of Water Resources during the year totaling $11.65 million net of credits and refunds for participation rights in the State Water Project. The unit rate has been determined by dividing the total estimated capital costs to be charged to the Agency by total estimated water deliveries over the project repayment period. The resulting rate, which will be adjusted periodically to reflect changes in estimates, would then be applied to actual water deliveries in the current year.

State Water Project deliveries through the East Branch Extension and the Cherry Valley Pump Station to the Agency service area started in July, 2003. Deliveries to the Little San Gorgonio Creek Recharge Facility in the 2009-10 year totaled 855 acre feet for overdraft mitigation. Deliveries to retailers in the 2009-10 year totaled 6,254 acre feet.

The Agency's future commitment for State Water Project costs over the years 2010 to 2035, according to a payment schedule dated June 30, 2010, is estimated to total $272 million.

Construction in Progress (CIP)

Construction in Progress increased $884 thousand to $1.62 million between July 1, 2009 and June 30, 2010.

The projects in Construction in Progress include an in-stream recharge project at Noble Creek, a permanent turnout for the Beaumont Cherry Valley Water District and the East Branch Extension, Phase 2 project.

Contacting the Agency's Financial Management

This financial report is designed to provide our customers, taxpayers, and creditors with an overview of the Agency's financial operations and condition. If you have questions about this report or need additional information, you may contact the Agency's Finance Manager at 1210 Beaumont Ave., Beaumont, California 92223.

Statements of Net Assets
June 30, 2010 and 2009

	2010	For comparative purposes only 2009
ASSETS		
Current assets:		
Cash in bank and on hand	$ 4,488,397	$ 318,012
Cash in Local Agency Investment Fund	3,216,139	4,289,960
Investments	3,003,451	4,368,838
Accounts receivable	386,260	170,497
Taxes receivable, net	471,947	627,925
Interest receivable	33,554	99,045
Prepaid expenses and other assets	6,020	4,050
Total current assets	11,605,768	9,878,327
Restricted assets:		
Cash in Local Agency Investment Fund	23,431,245	23,496,952
Taxes receivable, net	2,431,622	2,835,815
Total restricted assets	25,862,867	26,332,767
Non-current assets:		
Capital assets:		
Investment in State Water Rights	81,592,062	75,635,186
Utility plant in service	17,930,790	17,739,595
Less: accumulated depreciation	3,542,016	2,923,798
accumulated amortization	11,255,600	8,074,311
	84,725,236	82,376,672
Land and rights of way	669,019	468,444
Construction in progress	1,624,544	747,458
Total non-current assets	87,018,799	83,592,574
Total assets	124,487,434	119,803,668
LIABILITIES		
Accounts payable	697,150	483,468
Accrued vacation and sick leave	68,527	64,546
Total liabilities	765,677	548,014
NET ASSETS		
Invested in capital assets	86,978,251	83,592,575
Restricted for State Water Project	25,862,867	26,332,767
Unrestricted	10,880,639	9,330,312
Total net assets	$ 123,721,757	$ 119,255,654

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

Statements of Revenues, Expenses and Changes in Net Assets
For the years ended June 30, 2010 and 2009

	2010	For comparative purposes only 2009
OPERATING REVENUES		
Water sales - purveyors	$ 2,001,419	$ 783,169
OPERATING EXPENSES		
Source of supply:		
Maintenance	5,935,324	5,121,562
Purchased water	1,090,722	1,029,319
Total source of supply	7,026,046	6,150,881
Transmission and distribution:		
Utilities	5,205	4,805
Maintenance	102,026	91,628
Total transmission and distribution	107,231	96,433
General and administrative expenses:		
Salaries	415,171	398,540
Director fees	90,574	85,891
Payroll taxes	28,578	26,751
Employee health benefits	147,886	147,673
Employee retirement benefits	141,698	138,520
Office supplies and expense	12,099	14,251
Travel expenses	28,793	32,778
Automotive expense	9,185	11,650
Utilities and telephone	23,461	23,510
Repairs and maintenance	10,333	15,948
Computer and telephone support service	4,303	4,539
Insurance	21,211	22,335
Administration expense	2,914	2,494
Membership dues and assessments	65,359	51,989
Public relations	52,383	20,858
Legal services	121,309	314,117
Engineering services	249,882	583,528
Consulting services	39,385	37,810
Accounting and auditing	23,661	22,718
Outside professional services	14,385	18,263
Election expense	-	73,958
Depreciation	618,218	588,811
Amortization	3,181,289	2,299,232
Total general and administrative	5,302,077	4,936,164
Total operating expenses	12,435,354	11,183,478
Loss from operations	$ (10,433,935)	$ (10,400,309)

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

Statements of Revenues, Expenses and Changes in Net Assets (Continued)
For the years ended June 30, 2010 and 2009

	2010	For comparative purposes only 2009
NON-OPERATING REVENUES (EXPENSES)		
Interest	$ 261,537	$ 682,367
Property taxes:		
General-purpose distribution	2,215,613	2,436,998
Debt service	12,055,739	13,568,172
Miscellaneous income	32,577	372
County collection charges	(52,877)	(56,202)
Total non-operating revenues	14,512,589	16,631,707
Income before contributions	4,078,654	6,231,398
CONTRIBUTIONS		
Local government	387,449	-
CHANGE IN NET ASSETS	4,466,103	6,231,398
NET ASSETS, BEGINNING OF YEAR	119,255,654	113,024,256
NET ASSETS, END OF YEAR	$ 123,721,757	$ 119,255,654

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

Statements of Cash Flows
For the years ended June 30, 2010 and 2009

	2010	For comparative purposes only 2009
CASH FLOWS FROM OPERATING ACTIVITIES		
Cash received from customers	$ 1,785,656	$ 863,972
Cash payments to suppliers for goods and services	(7,600,228)	(7,457,513)
Cash payments to employees for services	(819,926)	(785,038)
Other income received	32,577	372
Net cash used for operating activities	(6,601,921)	(7,378,207)
CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES		
Property taxes received	2,362,996	2,524,513
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Property taxes received	12,415,650	13,058,557
Contribution received	387,449	-
Capital payments	(7,225,732)	(4,236,815)
Net cash provided by capital and related financing activities	5,577,367	8,821,742
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of investments	(6,000,000)	(4,243,943)
Sale of investments	7,381,278	9,228,970
Interest received	311,137	456,637
Net cash provided by investing activities	1,692,415	5,441,664
NET INCREASE IN CASH	3,030,857	9,409,712
CASH AT BEGINNING OF YEAR	28,104,924	18,695,212
CASH AT END OF YEAR	$ 31,135,781	$ 28,104,924
CASH AT END OF YEAR		
Current assets:		
Cash in bank and on hand	$ 4,488,397	$ 318,012
Cash in Local Agency Investment Fund	3,216,139	4,289,960
Restricted cash in Local Agency Investment Fund	23,431,245	23,496,952
	$ 31,135,781	$ 28,104,924

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

Statements of Cash Flows (Continued)
For the years ended June 30, 2010 and 2009

	2010	For comparative purposes only 2009
RECONCILIATION OF OPERATING LOSS TO NET CASH USED FOR OPERATING ACTIVITIES:		
Operating loss	$ (10,433,935)	$ (10,400,309)
Adjustments:		
Depreciation and amortization	3,799,507	2,888,043
Miscellaneous income	32,577	372
Change in assets and liabilities:		
(Increase) decrease in accounts receivable	(215,763)	(40,768)
(Increase) decrease in prepaid expenses	(1,970)	720
(Increase) decrease in other receivable	-	121,571
Increase (decrease) in accounts payable	213,682	39,827
Increase (decrease) in accrued vacation and sick leave	3,981	12,337
Net cash used for operating activities	$ (6,601,921)	$ (7,378,207)

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

Note 1: Nature of Activities and Significant Accounting Policies

The San Gorgonio Pass Water Agency (the Agency) is one of 29 state water contractors created by the state legislature. The Agency will ultimately manage water resources and supply water to local water districts. The Agency's service area extends from Calimesa to Cabazon through the Pass area in Riverside County (the County).

(a) Basis of accounting and measurement focus

The Agency accounts for its operation in an enterprise fund using the economic resources measurement focus and the accrual basis of accounting in conformity with the Uniform System of Accounts for Water Utility Districts as prescribed by the Controller of the State of California. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

An enterprise fund distinguishes operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the Agency's principal ongoing operations. The principal operating revenues of the Agency will be charges for wholesale water sales to purveyors within the Agency's service area. Operating expenses of the Agency include cost of sales, administrative expenses, depreciation and amortization on capital assets. All revenues and expenses not meeting this definition are reported as non-operating revenues and expenses.

The Agency has elected to follow Financial Accounting Standards Board pronouncements issued before November 30, 1989, and all pronouncements of the Governmental Accounting Standards Board.

On July 1, 2000, the Agency adopted the provisions of Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments.* Statement 34 established standards for external financial reporting for all state and local governmental entities, which includes a statement of net assets, a statement of revenues, expenses and changes in net assets, and a statement of cash flows. It requires the classification of net assets into three components – invested in capital assets, net of related debt; restricted; and unrestricted. These classifications are defined as follows:

- *Invested in capital assets, net of related debt* – This component of net assets consists of capital assets, including restricted capital assets, net of accumulated depreciation, reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets. If there are significant unspent related debt proceeds at year end, the portion of the debt attributable to the unspent proceeds are not included in the calculation of invested in capital assets, net of related debt. Rather, that portion of the debt is included in the same net assets component as the unspent proceeds.

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

- *Unrestricted net assets* – This component of net assets consists of net assets that do not meet the definition of "restricted" or "invested in capital assets, net of related debt."

On July 1, 2000, the Agency also adopted the provisions of Governmental Accounting Standards Board Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*. This statement requires that capital contributions to the Agency be presented as a change in net assets.

Note 1: Nature of Activities and Significant Accounting Policies (continued)

(b) Cash and investments

Changes in fair value that occur during a fiscal year are recognized as *interest* reported for that fiscal year. *Interest* also includes interest earnings and any gains or losses realized upon the liquidation, maturity, or sale of investments. Investments are reported in the accompanying balance sheet at fair value except for certain investment contracts that are reported at cost because they are not transferable and they have terms that are not affected by changes in market interest rates.

(c) Use of estimates

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

(*d) Comparative data*

Prior year data has been included where practical for comparison purposes only. The prior year data does not represent a complete presentation in accordance with generally accepted accounting principles.

(e) Capital assets

Capital assets are stated at original cost. The capital cost component of the transportation charges and the Delta water charges the Agency pays for participation rights in the State Water Project are being capitalized as paid, in accordance with instructions from the Controller of the State of California. Amortization of these participation rights has been calculated based on the actual water delivery in the current fiscal year over the estimated total water delivery over the life of the State Water Project contract.

Capital assets include property, plant, equipment and infrastructure assets, and are defined by the Agency as assets with an initial cost of more than $750 and an estimated useful life in excess of two years. The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend the asset’s life are not capitalized.

Property, plant and equipment of the Agency is depreciated using the straight-line method over the following estimated useful lives:

Assets	Years
Pipelines	20 - 40
Spreading ground facilities	20
Buildings	25
Furniture and fixtures	5 - 10
Technical equipment	5
Transportation	5

Participation rights are being amortized on a unit-rate basis. The unit rate has been determined by dividing the total estimated capital costs to be charged to the Agency by total estimated water deliveries over the project repayment period. The resulting rate, which will be adjusted periodically to reflect changes in estimates, would then be applied to actual water deliveries in the current year.

Note 1: Nature of Activities and Significant Accounting Policies (continued)

(f) Property taxes

Property tax in California is levied in accordance with Article XIIIA of the State Constitution at 1% of countywide assessed valuations. The property taxes are placed in a pool and are then allocated to the local governmental units based upon complex formulas. Property tax revenue is recognized in the fiscal year in which taxes have been levied.

The property tax calendar is as follows:

Lien date:	January 1
Levy date:	July 1
Due date:	First installment – November 1
	Second installment – February 1
Delinquent date:	First installment – December 11
	Second installment – April 11

The County will designate property taxes relating to debt service (restricted) or general purposes. Funds have been established by the Agency to account for the use of these designated assets. As of June 30, 2010 and 2009, certain taxes levied by the County and allocated to the Agency remain uncollected. The Agency has established allowances to estimate the extent of uncollectible property taxes as follows:

	2010		2009	
	Debt service (restricted)	General purposes	Debt service (restricted)	General purposes
Property taxes receivable	$ 2,502,806	$ 485,763	$ 2,905,406	$ 643,334
Less: allowance for uncollectible taxes	(71,184)	(13,816)	(69,591)	(15,409)
Total	$ 2,431,622	$ 471,947	$ 2,835,815	$ 627,925

(g) Accrued vacation and sick leave

The Agency has a policy whereby an employee can accumulate unused sick leave and vacation. Sick leave is to be used for extended periods of sickness; however, upon termination or retirement, a portion will be paid as additional benefits to the employee. At retirement or termination, employees will be paid for 50% of the then unused sick leave up to the maximum of 480 hours at their regular payroll rates in effect at the date of termination. The Agency has provided for these future costs by accruing 50% of the earned and unused sick leave up to the maximum number of hours and 100% of the earned and unused vacation.

(h) Cash and cash equivalents

For purposes of reporting cash flows, cash and cash equivalents include cash on hand, deposits with financial institutions and deposits in the State of California Local Agency Investment Fund. Investments are carried at fair value and deposits in the Local Agency Investment Fund can be withdrawn at any time.

(i) Management review

Management has evaluated subsequent events through October 18, 2010, the date which the financial statements were available to be issued.

Note 1: Nature of Activities and Significant Accounting Policies (continued)

(j) Postemployment healthcare benefits

On July 1, 2008, the Agency adopted the provisions of Governmental Accounting Standards Board Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions* (GASB 45). This statement requires the annual cost of other postemployment benefits other than pensions (OBEP) and the unfunded actuarial liabilities for past service to be reported in the government financial statements. Previously, the costs of such benefits were generally recognized as expenses when incurred by retirees. Under GASB 45, the cost of these benefits will be estimated over the years employees are providing service. GASB 45 also requires comprehensive disclosure regarding OPEB activities, see Note 7, Postemployment Benefits Other Than Pension.

(k) Implementation of new pronouncements

Effective July 1, 2009, the Agency adopted a new accounting standard issued by the Governmental Accounting Standards Board (GASB):

Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*

The objective of this statement is to establish accounting and financial reporting requirements for intangible assets to reduce inconsistencies, particularly in the areas of recognition, initial measurement and amortization, which have occurred in practice due to the absence of sufficiently specified authoritative guidance. By reducing inconsistencies, this statement enhances the comparability of the accounting and financial reporting of such assets among state and local governments. It also results in a more faithful representation of the service capacity of intangible assets, and therefore the financial position of governments, and of the periodic cost associated with the usage of such service capacity in governmental financial statements.

Note 2: Cash and Investments

Cash and investments as of June 30, 2010, consists of the following:

Cash on hand	$ 100
Deposits with financial institutions	4,488,297
Investments	29,650,835
Total cash and investments	$ 34,139,232

Cash and investments as of June 30, 2010 are classified in the accompanying financial statements as follows:

Statement of net assets:	
Current assets:	
Cash in bank and on hand	$ 4,488,397
Cash in Local Agency Investment Fund	3,216,139
Investments	3,003,451
Restricted assets:	
Cash in Local Agency Investment Fund	23,431,245
Total cash and investments	$ 34,139,232

Note 2: Cash and Investments (continued)

Investments Authorized by the California Government Code and the Agency's Investment Policy

The following table identifies the investment types that are authorized for the Agency by the California Government Code and the Agency's investment policy. The table also identifies certain provisions of the California Government Code (or the Agency's investment policy, if more restrictive) that address interest rate risk and concentration of credit risk. This table does not address investments of debt proceeds held by bond trustee that are governed by the provisions of debt agreements of the Agency, rather than the general provisions of the California Government Code or the Agency's investment policy.

Investment type authorized by state law	Authorized by investment policy	Maximum maturity	Maximum percentage of portfolio	Maximum investment in one issuer
U.S. Treasury Obligations	Yes	2 years	None	None
U.S. Agency Securities	No	5 years	None	None
Banker's Acceptances	No	180 days	40%	30%
Commercial Paper	No	270 days	40%	10%
Certificates of Deposit	Yes	2 years	30%	None
Repurchase Agreements	Yes	1 year	None	None
Reverse Repurchase Agreements	No	92 days	20%	None
Medium-Term Notes	No	5 years	30%	None
Mutual Funds	No	N/A	20%	10%
Mortgage Pass-Through Securities	No	5 years	20%	None
County Pooled Investment Funds	No	N/A	None	None
Local Agency Investment Funds (LAIF)	Yes	N/A	None	$50,000,000
JPA Pools (other investment pools)	No	N/A	None	None

Maximum maturity is based on state law requirements or investment policy requirements, whichever is more restrictive.

Disclosures Relating to Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates. One of the ways that the Agency manages its exposure to interest rate risk is by purchasing a combination of shorter term and longer term investments and by timing cash flows from maturities so that a portion of the portfolio is maturing or coming close to maturity evenly over time as necessary to provide the cash flow and liquidity needed for operations.

Information about the sensitivity of the fair values of the Agency's investments to market interest rate fluctuations is provided by the following table that shows the distribution of the Agency's investments by maturity:

		Remaining maturity (in months)			
Investment type	Amount	12 or less	13 to 24	25 to 60	More than 60
Federal Home Loan Bank Bonds	$ 3,003,451	$ -0-	$ -0-	$ 3,003,451	$ -0-
Local Agency Investment Fund	26,647,384	26,647,384	-0-	-0-	-0-
Total	$ 29,650,835	$ 26,647,384	$ -0-	$ 3,003,451	$ -0-

Note 2: Cash and Investments (continued)

Disclosures Relating to Credit Risk

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

			Rating as of Year End		
Investment type	Amount	Minimum legal rating	Exempt from disclosure	AAA	Not rated
Federal Home Loan Bank Bonds	$ 3,003,451	N/A	$ -0-	$ 3,003,451	$ -0-
Local Agency Investment Fund	26,647,384	N/A	-0-	-0-	26,647,384
Total	$ 29,650,835	N/A	$ -0-	$ 3,003,451	$ 26,647,384

Concentration of Credit Risk

The investment policy of the Agency contains no limitations on the amount that can be invested in any one issuer beyond that stipulated by the California Government Code. The Agency did not hold any investments in any one issuer (other than external investment pools) that represent 5% or more of total Agency investments.

Custodial Credit Risk

Custodial credit risk for *deposits* is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for *investments* is the risk that, in the event of the failure of the counterparty (e.g., broker-dealer) to a transaction, a government will not be able to recover the value of its investment or collateral securities that are in the possession of another party. The California Government Code and the Agency's investment policy do not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits or investments, other than the following provision for deposits: The California Government Code requires that a financial institution secure deposits made by state or local governmental units by pledging securities in an undivided collateral pool held by a depository regulated under state law (unless so waived by the governmental unit). The market value of the pledged securities in the collateral pool must equal at least 110% of the total amount deposited by the public agencies. As of June 30, 2010, none of the Agency's deposits with financial institutions in excess of federal depository insurance limits were held in uncollateralized accounts.

Investment in State Investment Pool

The Agency is a voluntary participant in the Local Agency Investment Fund (LAIF) that is regulated by the California Government Code under the oversight of the Treasurer of the State of California. The fair value of the Agency's investment in this pool is reported in the accompanying financial statements at amounts based upon the Agency's pro-rata share of the fair value provided by LAIF for the entire LAIF portfolio (in relation to the amortized cost of that portfolio), which was $26,647,384 as of June 30, 2010. The balance available for withdrawal of $26,603,654 as of June 30, 2010 is based on the accounting records maintained by LAIF, which are recorded on an amortized cost basis. Effective November 16, 2009, the Agency may invest up to $50,000,000 in the LAIF fund. Investments in LAIF are highly liquid, as deposits can be converted to cash within 24 hours without loss of interest. All investments with LAIF are secured by the full faith and credit of the State of California. Separate LAIF financial statements are available from the California State Treasurer's Office on the internet at http://www.treasurer.ca.gov.

Note 2: Cash and Investments (continued)

Investments with Fair Values Highly Sensitive to Interest Rate Fluctuations

The Agency does not hold investments that are highly sensitive to interest rate fluctuation beyond that already indicated in the information provided above.

Note 3: Capital Assets

A summary of changes in capital assets follows:

	Beginning Balance	Increase	Decrease	Ending Balance
Capital assets, not being depreciated:				
Land and rights of way	$ 468,444	$ 200,575	$ -0-	$ 669,019
Construction in progress	747,458	877,086	-0-	1,624,544
Total capital assets, not being depreciated	1,215,902	1,077,661	-0-	2,293,563
Capital assets, being depreciated/amortized:				
Investment in State Water Rights	75,635,186	5,956,876	-0-	81,592,062
Source of supply	14,672,383	146,269	-0-	14,818,652
Transmission and distribution	1,351,614	-0-	-0-	1,351,614
Buildings	1,439,396	-0-	-0-	1,439,396
Furniture and fixtures	170,442	4,187	-0-	174,629
Technical equipment	53,700	40,739	-0-	94,439
Transportation equipment	52,060	-0-	-0-	52,060
Total capital assets, being depreciated or amortized	93,374,781	6,148,071	-0-	99,522,852
Total capital assets	$ 94,590,683	$ 7,225,732	$ -0-	$ 101,816,415
Accumulated depreciation and amortization for:				
Investment in State Water Rights	$ 8,074,311	$ 3,181,289	$ -0-	$ 11,255,600
Source of supply	2,070,416	458,848	-0-	2,529,264
Transmission and distribution	371,694	67,581	-0-	439,275
Buildings	310,665	57,571	-0-	368,236
Furniture and fixtures	116,800	12,960	-0-	129,760
Technical equipment	44,624	10,846	-0-	55,470
Transportation equipment	9,599	10,412	-0-	20,011
Total depreciation and amortization	10,998,109	3,799,507	-0-	14,797,616
Total capital assets, net	$ 83,592,574	$ 3,426,225	$ -0-	$ 87,018,799

Note 4: Commitments

State Water Project

The Agency has entered into a contract with the State Department of Water Resources to receive an annual entitlement for water from the State Water Project. The Agency assumed a proportionate share of capital costs and minimum operations, maintenance, power and replacement costs of the state facilities, in addition to paying variable operations, maintenance, power and replacement costs on a per-acre-foot charge for water deliveries when they are received. The Agency received delivery of 6,987 acre feet of State Project Water during the fiscal year ended June 30, 2010.

The Agency's future commitment for State Water Project costs over the years 2010 to 2035, according to a payment schedule dated June 30, 2010, is estimated as follows:

Transportation charge:	
Capital cost components:	
State Water Project	$ 13,620,476
East branch extension	109,972,256
Minimum operations, maintenance, power and replacement component	75,503,359
Variable operations, maintenance, power and replacement component	51,584,377
	250,680,468
Delta water charges	18,616,987
Water system revenue bond surcharge	2,695,288
Total	$ 271,992,743

Note 5: Employees' Retirement Plan

Plan Description

San Gorgonio Pass Water Agency contributes to the California Public Employees' Retirement System (PERS), a cost-sharing 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 entities within the State of California. Benefit provisions and all other requirements are established by state statute and Agency policy. Copies of PERS' annual financial report may be obtained from their executive office: 400 P Street, Sacramento, CA 95814.

All full-time Agency employees are eligible to participate in PERS with benefits vesting after five years of service. Agency employees who retire at age 60 with five years of credited service are entitled to an annual retirement benefit, payable monthly for life, in increasing percentage increments up to 3% of their average full-time monthly par rate for the highest 12 consecutive months for each year of credited service.

Funding Policy

Agency employees are required to contribute 8% of their annual salary to PERS. The Agency makes the contributions required of Agency employees on their behalf and for their account. The Agency is required to contribute an amount necessary to fund the benefits of its members, using the actuarial basis recommended by the PERS actuaries and actuarial consultants and adopted by the Board of Administration. For the year ended June 30, 2010 and 2009, the amount contributed by the Agency on behalf of the employees was $32,783 and $29,642, respectively.

Note 5: Employees' Retirement Plan (continued)

Annual Pension Cost

Under GASB 27, an employer reports an annual pension cost (APC) equal to the annual required contribution (ARC) plus an adjustment for cumulative difference between the APC and the employer's actual plan contributions for the year. The cumulative difference is called the net pension obligation (NPO). The ARC for the period July 1, 2009 to June 30, 2010 has been determined by an actuarial valuation of the plan as of June 30, 2007. The contribution rate for the indicated period is 26.578% of covered payroll. In order to calculate the dollar value of the ARC for inclusion in financial statements prepared as of June 30, 2010, this contribution rate would be multiplied by the payroll of covered employees that was actually paid during the period July 1, 2009 to June 30, 2010. A summary of the APC for the current year and each of the preceding two years is as follows:

Fiscal Year	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation
June 30, 2008	$ 91,372	100%	$ -0-
June 30, 2009	103,741	100%	-0-
June 30, 2010	108,914	100%	-0-

Note 6: Risk Management

The Agency participates in a joint venture under a joint powers agreement (JPA) with the Association of California Water Agencies Joint Powers Insurance Authority (Authority). The Authority is a risk-pooling self-insurance authority created under the provisions of California Government Code Section 6500 et. sec.

The Authority is governed by a board consisting of a representative from each member agency. The board controls the operations of the Authority including selection of management and approval of operating budgets. The relationship between the Agency and the Authority is such that the Authority is not a component unit of the Agency for financial reporting purposes. The purpose of the Authority is to arrange and administer programs of insurance for the pooling of self-insured losses and to purchase excess insurance coverage.

At June 30, 2010, the Agency participation in the self-insurance programs of the Authority was as follows:

Property Loss: Insured up to replacement value with $1,000 deductible for building and personal property, $500 for vehicles and $0 for mobile equipment per occurrence; the Authority is self-insured up to $10,000 per occurrence and has purchased excess insurance coverage.

General Liability: Insured up to $40,000,000 per occurrence with $2,500 shared expense; the Authority is self-insured up to $1,000,000 and excess insurance coverage has been purchased.

Crime Coverage - Public Employee Dishonesty, Forgery and Alteration, and Computer Fraud: Insured up to $100,000 per occurrence with a $1,000 deductible.

Terrorism Coverage: Provides up to $2,500,000 per occurrence for property damage caused by malicious or violent act declared by the U.S. government to involve terrorism.

Crisis Management Coverage by Public Response: Insured up to $250,000 above the coverage limits.

Note 6: Risk Management (continued)

Condensed financial information of the Authority for the year ended September 30, 2009 is as follows:

Total assets	$ 124,067,027
Total liabilities	$ 83,993,363
Designated equity	40,073,664
Total liabilities and designated equity	$ 124,067,027
Total revenues	$ 27,377,336
Total expenses	25,663,970
Increase in designated equity	$ 1,713,366

Note 7: Postemployment Benefits Other Than Pension

On July 1, 2008, the Agency implemented GASB Statement No. 45 which changed the accounting and financial reporting used by local government employers for postemployment benefits other than pensions. The reporting requirements for these benefit programs as they pertain to the Agency are as set forth in the following.

Plan Description

Through CalPERS, the Agency offers health care benefits to active and retired employees, as well as their qualified dependents. The CalPERS plan is an agent multiple-employer plan governed by the Public Employees' Medical & Hospital Care Act (PEMHCA). Under PEMHCA, health coverage for the employee continues into retirement for employees who have reached at least age 50 with a minimum of 5 years service. Eligible retirees may enroll in any of the plans available through the CalPERS Program. The Agency pays the entire cost of coverage for the retiree and his or her dependents. The Agency provided health care benefits continue for the life of the retiree and spouse.

Funding Policy and Annual Other Postemployment Benefit Costs

Contribution requirements of the Agency are established and may be amended through Board action to update the original Ordinance. The Agency's annual OPEB expense for the plan is calculated based on the annual required contribution of the employer (ARC), an amount actuarially determined in accordance with the parameters of GASB 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and to amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed 30 years. The Agency's annual OPEB cost for the current year and the related information for the plan are shown below.

Annual required contribution	$ 72,120
Contribution made	(72,120)
Net OPEB obligation - end of year	$ -

Note 7: Postemployment Benefits Other Than Pension (continued)

The Agency's annual OPEB cost which is equal to its annual required contribution has been recognized as a part of the operating expenses of the Agency in the accompanying financial statements.

The Agency's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation for 2010 are shown in the following table. The Agency implemented GASB Statement No. 45 for the June 30, 2009 fiscal year end. As a result, information is only available for the current and prior year.

Plan	Year End	Annual OPEB Cost	Actual Contribution	Percentage of OPEB Cost Contributed	Net OPEB Obligation
Retired Employee	June 30, 2009	$ 68,847	$ 68,847	100%	$ -0-
Healthcare Plan	June 30, 2010	72,120	72,120	100%	-0-

Funded Status

The funded status of the plan as of June 30, 2010, based on the July 1, 2008 actuarial valuation is as follows:

Actuarial accrued liability (AAL)	$ 459,402
Actuarial value of trust assets	52,369
Unfunded actuarial accrued liability (UAAL)	$ 407,033
Funded ratio (actuarial value of trust asset / AAL)	11.4%
Covered payroll (active members)	$ 415,171
UAAL as a percentage of covered payroll	98.0%

Actuarial valuations of the ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future.

Actuarial Methods and Assumptions

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and the plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial assets, consistent with the long-term perspective of the calculations.

Note 7: Postemployment Benefits Other Than Pension (continued)

Significant methods and assumptions were as follows:

Valuation date	July 1, 2008
Actuarial cost method	Entry age normal
Amortization method	Level percent of payroll
Remaining amortization period	30-year closed period
Asset valuation method	N/A - no assets
Actuarial assumption:	
Investment rate of return	7.75%
Payroll growth	3.25%
Healthcare trend rate:	
2010	8.20%
2011-2015	7.30%
2016-2018	6.10%
2019 and thereafter	5.50%

Note 8: Deferred Compensation Plan

The Agency offers its employees a deferred compensation plan through the California Public Employees' Deferred Compensation Plan and was created in accordance with Internal Revenue Code Section 457. The plan, available to all full-time Agency employees, permits them to defer a portion of their salary to be deposited in individual investment accounts. Funds may be withdrawn by participants upon termination, retirement, death or certified emergency. All assets and income of the deferred compensation plan are held in trust for the exclusive benefit of plan participants and their beneficiaries.

Note 9: Proposition 1A Borrowing by the State of California

Under the provisions of Proposition 1A and as part of the 2009-2010 budget package passed by the California state legislature on July 28, 2009, the State of California (State) borrowed 8% of the amount of property tax revenue. The State is required to repay this borrowing plus interest by June 30, 2013. After repayment of this initial borrowing, the California legislature may consider only one additional borrowing within a ten-year period. The amount of this borrowing pertaining to the Agency was $165,666.

Authorized with the 2009-10 State budget package, the Proposition 1A Securitization Program was instituted by the California Statewide Communities Development Authority (California Communities), a joint powers authority sponsored by the California State Association of Counties and the League of California Cities, to enable local governments to sell their Proposition 1A receivable to California Communities. Under the Securitization Program, California Communities simultaneously purchased the Proposition 1A receivables and issued bonds (“Prop 1A Bonds”) to provide local agencies with cash proceeds in two equal installments, on January 15, 2010 and May 3, 2010. The purchase price paid to the local agencies equaled 100% of the amount of the property tax reduction. All transaction costs of issuance and interest were paid by the State. Participating local agencies have no obligation on the bonds and no credit exposure to the State. The Agency participated in the Securitization Program and, accordingly, property taxes have been recorded in the same manner as if the State had not exercised its rights under Proposition 1A.