Semitropic Water Storage District

Combined Financial Statements

December 31, 2008 and 2007

CONTENTS

BARBICH HOOPER KING
DILL HOFFMAN
ACCOUNTANCY CORPORATION

Independent Auditors' Report

Board of Directors
Semitropic Water Storage District
Wasco, California

We have audited the combined statements of net assets of Semitropic Water Storage District as of December 31, 2008 and 2007, and the related combined statements of revenue and expenses, changes in net assets, and cash flows for the years then ended. These combined financial statements are the responsibility of the District's management. Our responsibility is to express an opinion on these combined financial statements based on our audits.

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

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the financial position of Semitropic Water Storage District as of December 31, 2008 and 2007, and the results of its operations and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles as well as accounting systems prescribed by the State Controller's Office and state regulations governing special districts.

In accordance with Government Auditing Standards, we have also issued a report dated March 31, 2009 on our consideration of the District's internal control over financial reporting and our assessment of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be read in conjunction with this report in considering the results of our audit.

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The management's discussion and analysis on pages 2 - 9 and the supplementary information on pages 41 - 45 are not a required part of the basic combined financial statements but are supplementary information required by U.S. generally accepted accounting principles. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit this information and express no opinion on it.

BARBICH HOOPER KING
DILL HOFFMAN
Accountancy Corporation

Barbich Hooper King

Bakersfield, California
March 31, 2009

The following discussion and analyses of Semitropic Water Storage District financial performance provides an overview of the financial activities for the fiscal years ended December 31, 2008 and 2007. This information is presented in conjunction with the basic audited financial statements and accompanying notes, which follow this section.

Financial Highlights

The District's total net assets increased $8.7 million or 7% over the course of the year's operations.

The District's revenues experienced a net increase of $16 million or 40% during the fiscal year ended December 31, 2008. The primary reason for the increase is from a net increase of operating revenue of $5.6 million or 15% and $10.4 million or 359% increase in non-operating revenue. Operating revenue increased primarily due to an increase in groundwater banking revenues of $6.7 million or 24% due to a high level of return of water in the fiscal year 2008; a $1.1 million increase in land owner hookups within the District, over fiscal year 2007; and a decrease of $2.8 million in Contract and Non-contract water revenues caused by a reduction in State Entitlement Water from 65% in 2007 to 35% in 2008. Non-operating revenues increased primarily to an increase in earnings from investments of $8.5 million and other income of $1.9 million.

The District's total expenses increased $8.5 million or 22%. Operating expenses increased $8.4 million or 25% during the fiscal year ended December 31, 2008. The majority of this increase was related to increased energy costs due to the District's groundwater banking program and supplemental pumping for landowners in the amount of $6.1 million or 39%. Other increases in expenses were in Source and Supply in the amount of $1.3 million or 12% due to increase costs of State Entitlement Water; District's well drilling and pulling operation expenses in fiscal year ending December 31, 2007 increased $.5 million or 5% over 2007. The remaining balance was an increase in General and administration of $.4 million or 14% and an increase in Depreciation of $1.1 million or 27%. Non-operating expenses increased $0.1 million or 2% and was primarily caused by Interest expense.

The District's capital assets increased $44 million or 17.5% during the fiscal year ended December 31, 2008 primarily due to the purchase of $18.3 million of land acquisitions for future and construction and ground water preservation; increase of $23.6 million in the Construction in Progress, primarily due to the P565 distribution project and well construction. Construction in progress was decreased by $20 million for the District's investment in the Semitropic-Rosamond Water Bank Authority. See Note 10 of the financial statements for further description of these projects.

Overview of the Financial Statements

This annual report includes this management's discussion and analysis report, the independent auditor's report, the basic financial statements of the District and selected additional information. The financial statements also include notes that explain in more detail some of the information in the financial statements.

Required Financial Statements

The financial statements of the District report information of the District using accounting methods similar to those used by private sector companies. The financial statements conform to accounting principles which are generally accepted in the United States of America and utilize the accrual basis of accounting.

The Statement of Net Assets includes all of the District's assets and liabilities and provides information about the nature and amounts of investments in resources (assets) and the obligations to District creditors (liabilities), with the difference between the two reported as net assets. This statement will indicate which assets are restricted due to contractual, Board action, or other commitments. This statement also provides the basis for assessing the liquidity, capital structure and financial flexibility of the District.

Revenues and expenses for each of the last two fiscal years are accounted for in the Statement of Revenues and Expenses and Changes in Net Assets. These statements measure the success of the District's operations and can be used to determine profitability, credit worthiness and whether the District has successfully recovered all its costs through user fees and other charges.

The Statement of Cash Flows reports cash receipts, cash payments, and net changes in cash resulting from operations, investing, and financing activities. From this statement, information related to sources and uses of cash, and the change in cash balances can be compared for each of the last two fiscal years.

Financial Analysis of the District

The required financial statements, discussed above, assist the reader in making an assessment of whether its financial health is improving or deteriorating. However, one will need to consider other non-financial factors such as changes in economic conditions, population growth, and new or changed government legislation.

To begin our analysis, a summary of the District's Statements of Net Assets is presented in Table A.

Table A
Condensed Statements of Net Assets
December 31, 2008 and 2007
(millions)

	2008	*2007*	*Dollar Change*	*Percentage Change*
Current Assets	$ 34.5	$ 29.2	$ 5.3	18%
Noncurrent Capital Assets	218.2	199.5	18.7	9%
Noncurrent Other Assets	52.0	31.3	20.7	66%
Total Assets	304.7	260.0	44.7	17%
Current Liabilities	17.3	11.7	5.6	48%
Long-Term Debt	146.2	115.7	30.5	26%
Total Liabilities	163.5	127.4	36.1	28%
Invested in Capital Assets, Net of Related Debt	91.6	86.4	5.2	6%
Restricted	7.9	11.7	(3.8)	-32%
Unrestricted	41.7	34.4	7.3	21%
Total Net Assets	141.2	132.5	8.7	7%
Total Liabilities and Net Assets	$ 304.7	$ 259.9	$ 44.8	17%

As can be seen from the table above, total assets increased $44.7 million to $304.7 million at December 31, 2008, up from $260.0 million at December 31, 2007. The increase in total assets of the District was primarily due to three reasons; current assets increased by $5.3 million, which was derived from increased banking water revenues; Noncurrent Capital Assets increased $38.7 million due to an increase in the land assets of $18 million and an increase in the construction in progress due the P565 distribution projects of $20 million. Noncurrent Other Assets increased by $20.7 million as a direct result of recording the investment in the Semitropic-Rosamond Water Bank Authority of $20 million. This $20 million also reduced the amount of construction in progress as those assets will be used for the operations of the SRWBA.

Total liabilities increased $36.1 million to $163.5 million at December 31, 2008, from $127.4 million at December 31, 2007. The increase is primarily due to the issuance of long term bond debt of $30 million and deferred revenue of $5.6 million billed in 2008 but are 2009 revenues.

Semitropic Water Storage District

Management's Discussion and Analysis
Table B
Condensed Statements of Revenues and Expenses and Changes in Net Assets
Years Ended December 31, 2008 and 2007
(millions)

	2008	2007	Dollar Change	Percentage Change
Contract water	$ 3.4	$ 3.6	$ (0.2)	-6%
Noncontract water	0.0	2.8	(2.8)	-100%
Groundwater banking	34.2	27.5	6.7	24%
Electrical transfer & hookup	3.0	1.9	1.1	58%
Other revenue	2.6	1.8	0.8	44%
Operating Revenues	43.2	37.6	5.6	15%
Interest income	1.3	2.2	(0.9)	-41%
GA & GP service charges	1.0	0.0	1.0	0%
Prior year income, net	1.9	0.7	1.2	171%
Earnings from investments	8.5	-	8.5	100%
Other income	0.6	0.0	0.6	100%
Nonoperating Revenues	13.3	2.9	10.4	359%
Total Revenues	56.5	40.5	16.0	40%
Source of supply	11.9	10.6	1.3	12%
Well operations	-	0.5	(0.5)	0%
Transmission & distribution	21.8	15.7	6.1	39%
General and administration	3.3	2.9	0.4	14%
Depreciation expense	5.2	4.1	1.1	27%
Operating Expenses	42.2	33.8	8.4	25%
Interest expense	5.6	5.5	0.1	2%
Nonoperating Expenses	5.6	5.5	0.1	2%
Total Expenses	47.8	39.3	8.5	22%
Change in Net Assets	8.7	1.2	7.5	625%
Net Assets, beginning of year	132.5	131.3	1.2	1%
Net Assets, end of year	$ 141.2	$ 132.5	$ 8.7	7%

While the Statement of Net Assets shows the change in financial position of the District, the Statements of Revenues and Expenses and Changes in Net Assets provides answers as to the nature and source of these changes.

The District's total revenues increased $16 million to $56.5 million during the fiscal year ended December 31, 2008, from $40.5 million during the fiscal year ended December 31, 2007. The increase in revenue was primarily due to receiving banking revenue for the return of pervious banked water made by the District's groundwater banking customers during the fiscal year 2008; and earnings from investment in the Semitropic-Rosamond Water Banking Authority.

Total expenses increased $8.5 million to $47.8 million during the fiscal year ended December 31, 2008 from $39.3 million during the fiscal year ended December 31, 2007. The increase in expenses is primarily due to; increased energy charges associated with the return of water to Banking Partners and increased cost of water in fiscal year ended December 31, 2008.

As of December 31, 2008, the District had invested $274.2 million in capital assets as shown in Table C.

Table C
Capital Assets
December 31, 2008 and 2007
(millions)

	2008	2007	Dollar Change	Percentage Change
Land	$ 23.3	$ 5.0	$ 18.30	0%
Source of Supply	13.1	13.1	-	0%
Transmission and Distribution	209.7	208.5	1.2	1%
General Plant and Equipment	2.0	1.9	0.1	5%
Communication equip.	0.02	0.02	-	0%
Autos and trucks	1.4	1.3	0.1	8%
Office equip.	0.7	0.6	0.1	0%
Field and misc. equip.	0.4	0.4	-	0%
Well drilling equip.	3.0	2.3	0.7	30%
Wells	0.3	0.3	-	100%
Construction in Progress	20.3	16.8	3.5	21%
Total Gross Capital Assets	274.2	250.2	24.0	10%
Less: Accumulated Depreciation	56.0	46.7	9.3	20%
Total Net Capital Assets	$ 218.2	$ 203.5	$ 14.7	7%

As can be seen from the table above, Total Net Capital Assets increased $14.7 million to $218.2 million at December 31, 2008, from $203.5 million at December 31, 2007. The increase is due to an increase in land acquisitions of $18.3 million, which will be used for future District construction projects and water preservation programs, and an increase in the Constructions of progress of $23.6 million due to the construction of the P565 distribution systems and the construction of 20 District wells. $20 million was offset against construction in progress for the District's investment in the SRWBA. See Note 10 for more information.

Management's Discussion and Analysis
Table D
Debt
December 31, 2008 and 2007
(millions)

	2008	2007	Dollar Change	Percentage Change
Revenue bonds	$ 131.7	$ 102.1	$ 29.6	29%
Swap	3.3	3.3	-	0%
Other debt	14.0	15.2	(1.2)	-8%
Total debt	$ 149.0	$ 120.6	$ 28.4	24%

Revenue bonds are legally secured by the District's water banking revenue and District's general project and administrative charges. If the water banking revenue stream pledged to specific revenue bond is not sufficient to repay debt, the District is not legally obligated to appropriate other funds for debt service payments toward the debt. The District did obtain $50 million in revenue bonds in fiscal year 2008 that are secured by water banking revenues and the general administrative service charges. The District is obligated to appropriate other funds to service this debt.

Other debt represents District obligations paid out of its general fund. The District has no general obligations bonds at this time.

Total Debt increased $28.4 million to $149.0 million during the fiscal year ended December 31, 2008 from $120.6 million during the fiscal year ended December 31, 2007. The increase is due to issuing new debt of $30 million less the combined cost of issuance and annual debt payments. The debt issued in fiscal year ending December 31, 2008 also included the refunding of $20 million of prior bond debt; and a $5 million Department of Water Bond Debt.

The District received an AA- rating by Standard & Poors for the 2008 debt issued for capital projects to expand the District's existing water banking facilities.

Contacting the District Management

This financial report is designed to provide our customers and creditors with a general overview of the District's finances and to demonstrate the District's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the District at P.O. Box 8043, Wasco, CA 93280.

Semitropic Water Storage District

Combined Statements of Net Assets
December 31, 2008 and 2007

ASSETS	***2008***	***2007***
Current Assets		
Cash and cash equivalents	$ 9,538,590	$ 12,028,043
Receivables		
Accounts receivable, trade	14,908,985	13,165,897
Other receivables	6,113,443	62,993
General administrative and general project service charges receivable, less allowance for delinquency provision, 2008; $202,657 and 2007; $202,872	3,830,315	3,843,761
	24,852,743	17,072,651
Other prepaid expenses and deposits	148,482	87,845
Total current assets	34,539,815	29,188,539
Noncurrent Assets		
Restricted assets		
Cash	13,199,435	11,106,776
Investments	97,000	8,149,021
Total restricted assets	13,296,435	19,255,797
Capital assets		
Property, plant and equipment, at cost	274,180,361	250,301,865
Less accumulated depreciation	56,015,612	50,771,654
Total capital assets, net	218,164,749	199,530,211
Other noncurrent assets		
Banked water inventory	3,955,281	6,010,153
Investment in Semitropic-Rosamond Water Bank Authority	28,385,973	-
Investment in Kern Water Bank Authority	2,394,403	2,314,539
Investment in Pioneer Project	1,070,219	792,629
Investment in Cross Valley Canal Project	2,852,334	2,852,334
Total other noncurrent assets	38,658,210	11,969,655
Total noncurrent assets	270,119,394	230,755,663
Total Assets	$ 304,659,209	$ 259,944,202

See Notes to Combined Financial Statements.

LIABILITIES AND NET ASSETS	*2008*	*2007*
Current Liabilities		
Current maturities of long-term debt	$ 2,787,507	$ 4,924,199
Trade accounts payable	4,890,185	3,486,210
Customer deposits payable	2,154,055	2,085,411
Accrued liabilities	1,117,344	1,201,561
Unearned water banking revenue	6,256,803	-
Total current liabilities	17,205,894	11,697,381
Long-Term Debt, less discount and current maturities	146,223,319	115,723,560
Total Liabilities	163,429,213	127,420,941
Commitments and Contingencies (see Note 10)		
Net Assets		
Invested in capital assets, net of related debt	91,601,652	86,447,673
Restricted for:		
Debt service	7,806,061	11,616,831
Retirement trust fund	74,570	73,747
Unrestricted	41,747,713	34,385,010
Total Net Assets	141,229,996	132,523,261
Total Liabilities and Net Assets	$ 304,659,209	$ 259,944,202

Semitropic Water Storage District

Combined Statements of Revenue and Expenses
For the Years Ended December 31, 2008 and 2007

	2008	***2007***
Operating revenue:		
Contract water	$ 3,424,377	$ 3,623,293
Noncontract water	45,193	2,828,464
Groundwater banking	34,232,467	27,464,018
Electrical transfer and hookup charges	3,009,483	1,935,870
Other charges	2,555,663	1,785,104
	43,267,183	37,636,749
Operating expenses:		
Transmission and distribution	21,790,895	15,671,952
Well operations	-	531,683
Source of supply	11,922,427	10,593,342
General and administrative	3,242,495	2,955,980
Depreciation expense	5,243,958	4,064,948
	42,199,775	33,817,905
Operating income	1,067,408	3,818,844
Nonoperating revenue (expense):		
Interest income	1,273,210	2,189,748
General administrative and general project service income	987,360	9,446
Interest expense	(5,600,991)	(5,510,359)
Equity in income from water bank investments	8,465,837	29,900
Other income	409,728	33,887
Prior year income, net	1,908,751	672,051
Rental income	147,862	-
Gain on sale of investments	47,570	-
	7,639,327	(2,575,327)
Change in net assets	$ 8,706,735	$ 1,243,517

See Notes to Combined Financial Statements.

Semitropic Water Storage District

Combined Statement of Changes in Net Assets
For the Years Ended December 31, 2008 and 2007

	Net Assets
Balance, December 31, 2006	$ 131,279,744
Change in net assets	1,243,517
Balance, December 31, 2007	132,523,261
Change in net assets	8,706,735
Balance, December 31, 2008	$ 141,229,996

See Notes to Combined Financial Statements.

Semitropic Water Storage District

Combined Statements of Cash Flows
For the Years Ended December 31, 2008 and 2007

	2008	**2007**
Cash flows from operating activities:		
Receipts from customers	$ 41,743,894	$ 25,480,780
Payments to suppliers for goods and services	(27,229,911)	(23,717,139)
Payments to employees for services	(3,214,728)	(2,552,763)
Net cash provided by (used in) operating activities	11,299,255	(789,122)
Cash flows from capital and related financing activities:		
Payment for acquisition and construction of property, plant and equipment	(43,878,496)	(25,030,833)
Cash paid for interest on bonds and construction loans	(5,113,247)	(5,106,550)
Borrowings on long-term debt	49,559,182	10,001,312
Payments on long-term debt	(21,683,859)	(5,927,375)
Net cash used in capital and related financing activities	(21,116,420)	(26,063,446)
Cash flows from investing activities:		
Purchase of investments	(1,192,860)	-
Proceeds from sale of investments	9,340,021	18,564,458
Interest income	1,273,210	2,600,745
Net cash provided by investing activities	9,420,371	21,165,203
Net decrease in cash and cash equivalents	(396,794)	(5,687,365)
Cash and cash equivalents at beginning of the year	23,134,819	28,822,184
Cash and cash equivalents at the end of the year	$ 22,738,025	$ 23,134,819

See Notes to Combined Financial Statements.

	2008	2007
Reconciliation of operating income to net cash provided by (used in) operating activities:		
Operating income	$ 1,067,408	$ 3,818,844
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	5,243,958	4,064,948
Gain on sale of investments	(47,570)	-
Distributions from water bank investments	-	(29,900)
General administrative & general project service charges	987,360	9,446
Prior year income, net	1,908,751	672,051
Other income	557,590	-
Increase in receivables and general administrative and general project service charges receivable	(7,780,092)	(12,566,966)
(Increase) decrease in other prepaid expenses & deposits	(60,637)	317,763
Decrease in banked water inventory	2,054,872	2,234,103
Increase in investment in Pioneer Project	(277,590)	(162,825)
Increase in accounts payable and accrued liabilities	1,388,402	920,572
Increase in unearned water banking revenue	6,256,803	-
Decrease in year end payment due District landowners	-	(67,158)
Net cash used in operating activities	$ 11,299,255	$ (789,122)
Current unrestricted cash	$ 9,538,590	$ 12,028,043
Noncurrent restricted cash	13,199,435	11,106,776
	$ 22,738,025	$ 23,134,819
Noncash investing and investing activities:		
Equity ownership received in Semitropic-Rosamond Water Bank Authority	$ 20,000,000	$ -
Equity in income from water bank investments	$ 8,465,837	$ -

Note 1. Nature of Activities and Summary of Significant Accounting Policies

Principles of combination:

The combined financial statements include the accounts of Semitropic Water Storage District, Buttonwillow Improvement District of the Semitropic Water Storage District, Pond-Poso Improvement District of the Semitropic Water Storage District, Semitropic Wildlife Improvement District of the Semitropic Water Storage District and Semitropic Improvement District of the Semitropic Water Storage District. Inter-district accounts have been eliminated.

Nature of District's activities:

Semitropic Water Storage District (the District) was formed on August 27, 1958. It began as an irrigation district for the purpose of securing State Water Project supplies to reduce groundwater overdraft. The District, a special district of the State of California, is one of eight water storage districts in California and is the largest in Kern County. The District is governed by a Board of Directors consisting of seven members who are elected by rate payers to serve four-year terms. Semitropic Improvement District has been appointed as agent to administer contracts on behalf of Buttonwillow Improvement District, Pond-Poso Improvement District, Semitropic Wildlife Improvement District and Semitropic Water Storage District.

The District's service area is comprised of approximately 221,000 acres or 345 square miles in the northwestern portion of Kern County. Since its inception, Buttonwillow Improvement District, Pond-Poso Improvement District, Semitropic Improvement District and Semitropic Wildlife Improvement District were created to help administer and manage the course of action and policies of Semitropic Water Storage District.

Although Buttonwillow Improvement District, Pond-Poso Improvement District, Semitropic Improvement District and Semitropic Wildlife Improvement District are a part of the Semitropic Water Storage District, they are operated and reported on as Semitropic Improvement District. As such, Semitropic Water Storage District is generally not liable for any contracts entered into or commitments made by them.

Significant accounting policies are as follows:

Financial reporting:

The District has adopted the provisions of Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*. Statement No. 34 established standards for external financial reporting for all state and local governmental entities, which includes a statement of net assets, a statement of activities 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 and 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 net assets - This component of net assets consists of constraints placed on net asset 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 assets" or "invested in capital assets, net of related debt."

The District's Board of Directors has designated certain reserves as a component of Unrestricted Net Assets. These balances are detailed as of December 31, 2008 and 2007:

	2008	***2007***
Capital projects reserve fund	$ 7,000,000	$ 7,000,000

The capital projects reserve fund is earmarked by the Board of Directors for capital improvements to meet system reliability and future demand in the District.

Principles of presentation:

The District, utilizing GASB Statement No. 34 for enterprise funds, has the option to consistently follow pronouncements issued by the Financial Accounting Standards Board (FASB) subsequent to November 30, 1989. Unless FASB standards are specifically adopted by GASB, the District has not elected to follow FASB standards issued after that date.

When the District has both unrestricted and restricted resources available for District purposes, it is the District's practice to first expend restricted resources, subsequently utilizing unrestricted resources as needed.

The District has implemented Governmental Accounting Standards Board No. 40 (GASB Statement No. 40), *Deposits and Investments Risk Disclosures - an Amendment of GASB Statement No. 3.* This statement addresses common deposit and investment risks related to credit risks, concentration of credit risk, interest rate risk, and foreign currency risk. As an element of interest rate risk, this statement requires certain disclosures of investments that have fair values that are highly sensitive to changes in interest rates. Deposit and investment policies related to the risks identified in this statement also are required to be disclosed.

Fund accounting:

The District utilizes accounting for enterprise entities that account for operations (a) 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, (b) where the governing body has decided that periodic determination of revenue earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

Basis of accounting:

The accompanying financial statements have been prepared on the accrual basis of accounting, in conformity with the uniform system of accounts prescribed for water districts by the Controller of the State of California. Under the accrual basis, revenues are recognized when earned and expenses are recognized when incurred regardless of the timing of cash payments or receipts.

Revenue recognition:

The District has three primary sources of revenue. From its inception, the District has recognized revenue from the sale of surface irrigation water to water users located within the District for the purpose of halting the groundwater overdraft. The District's water rates are supported by an annual applied water cost analysis and are approved by the District's board on an annual basis. Water rates are not subject to regulation by the California Public Utilities Commission or by any other local, state or federal agency. Revenue from these sales is recognized on the accrual basis as water is delivered.

Beginning in 1995, the District entered into several groundwater banking relationships with its Banking Partners, customers who are mostly water districts located in California, using available space within the District's groundwater basin to store water during wet years (years when there is abundant rainfall and surplus water available), and pumping it back to the Banking Partners during dry years (years with little rainfall and no surplus water). The District primarily stores Banking Partners' water using in-lieu recharge, which stores water by utilizing surface water "in-lieu" of pumping groundwater, thereby storing an equal amount in the groundwater basin. The District is paid an annual fee for operating and maintaining the project and earns revenue on a per acre-foot basis at the time water is stored and when water is returned to the respective districts. The District also receives revenue toward energy reimbursement when water is returned. Revenue for groundwater banking is recognized in the period when annual fees are billed and when water is stored or returned for each respective Banking Partner.

Finally, the District receives revenue from general administrative and general project service charges for landowners receiving benefit from District services. These charges are established by the Board of Directors for the period January through December of each year and are levied to landowners within the District on their county property tax statements based on uniform rates per acre. For the years ended December 31, 2008 and 2007, $4,099,443 and $4,063,394, respectively, was earned by the District for general administrative and general project service charges. If available from District funds, the Board may authorize an end of the year discretionary payment in proportion to the general project service charge to the same district landowners. For the years ended December 31, 2008 and 2007, $3,112,083 and $4,053,948, respectively, was authorized as end of the year discretionary payments by the District. Amounts due for the end of the year payment at December 31, 2008 and 2007 were $325,441. The net of these items is reported as nonoperating revenue to the District for the same January through December period.

Other sources of revenue include interest income and miscellaneous revenue which is comprised of water wheeling income, materials sales and electrical services.

Allowance for delinquency provision:

The allowance for delinquency provision for general administrative and general project service charges is based on a percentage of assessments levied. The percentage is determined by collections from previous years.

Accounts receivable, trade:

Trade accounts receivable are stated at the amount management expects to collect from balances outstanding at year-end. Based on management's assessment of the credit history with customers having outstanding balances and current relationships with them, it has concluded that realization losses on balances outstanding at year-end will be immaterial; accordingly, no allowance for doubtful accounts is required.

Concentration of credit risk:

Credit is extended, in the form of accounts receivable, to landowners who are located in the District's service area.

Reclassifications:

Certain reclassifications have been made to the December 31, 2007 financial statements in order to conform to the December 31, 2008 presentation.

Property, plant and equipment:

The District's property, plant and equipment are recorded at cost. Assets are capitalized when the cost is greater than $5,000 and the asset has a useful life greater than two years. Depreciation is computed using the straight-line method over the following estimated useful lives:

	Years
Source of supply	15-60
Transmission and distribution	15-60
General plant and equipment	3-60
Communication equipment	5-60
Autos and trucks	5
Office equipment	3-10
Field and misc. equipment	5-10
Well drilling equipment	15-60
Wells	15-20

Maintenance and repairs of property, plant and equipment are charged to operations and major improvements are capitalized. Upon retirement, sale or other disposition of property, plant and equipment, the cost and accumulated depreciation are eliminated from the accounts and gain or loss is included in operations.

Deposits and investments

Cash and cash equivalents:

The District considers cash equivalents to be all highly liquid debt instruments purchased with a maturity of three months or less. At December 31, 2008 and 2007, cash and cash equivalents include cash on hand and amounts deposited with banks, the County of Kern Treasurer and the State Treasurer's office.

The District invests any excess funds not needed for immediate needs into State of California managed Local Agency Investment Fund (LAIF), which is a permitted investment by both State law and the District's investment policy. Created by state statute, the LAIF is a component of a pooled money program that is administered by the State Treasurer's Office. The fund has regulatory oversight from the Local Investment Advisory Board, which is comprised of the State Treasurer as chair, the State Controller, and the Director of Finance. As the LAIF does not make share-value adjustments due to immaterial differences between fair value and cost, the District's cost basis in the fund is reflected in cash and cash equivalents on the Combined Statements of Net Assets as of December 31, 2008 and 2007.

As of October 1, 2008 and throughout the year ending December 31, 2009, the federally insured limit on checking and saving accounts was increased from $100,000 to $250,000. In addition, some of the institutions in which the District maintains cash are participants in the FDIC's Temporary Liquidity Guarantee Program, whereby unlimited deposit insurance coverage is available through December 31, 2009 for non-interest bearing transaction accounts.

Deposits with financial institutions:

Cash funds deposited with the State Treasurer's office are in a pooled money fund. Funds are pooled with other agencies throughout California. Investments are made in accordance with Government Code Sections 16430 and 16480. Cash funds are also deposited with the County of Kern's Local Agency Investment Fund and are appropriately collateralized by cash, investments and securities.

Pooled funds may be invested in: (1) direct obligations of the United States government, the payment of which the full faith and credit of the United States government is pledged, (2) certificates of deposit at savings and loan associations and federally insured banks when secured by acceptable collateral and, (3) savings accounts at savings and loan associations and banks, to the extent fully insured.

As a government agency, the California Government Code dictates guidelines toward the District's investments in addition to the District's investment policy, which has been approved by the Board of Directors. This policy provides the District's treasurer with investment authority, summarizes authorized investments, and describes the District's procedures and other limitations. The objective of the District's investment policy is to maximize the yield of invested funds while assuring that investments are safe from loss, utilizing the "prudent person" policy of safety, legality and yield.

Below is a summary of the District's cash and investment policies, credit risk and description of the District's cash and investments. Separate internal accounts or funds have been created by the District to provide for specific events in accordance with bond covenants, trust agreements or certain regulations. These "restricted" accounts may have minimum balance requirements. The primary restrictions for these accounts are due to construction of capital assets, reserves for principal and interest on outstanding bonds and payments of the District's 401(k) and payroll obligations. All remaining cash and investments are unrestricted.

Cash and investments as of December 31, 2008 and 2007 are classified in the accompanying combined financial statements as follows:

	2008	***2007***
Current assets - cash	$ 9,538,590	$ 12,028,043
Noncurrent assets - restricted cash	13,199,435	11,106,776
Noncurrent assets - restricted investments	97,000	8,149,021
	$ 22,835,025	$ 31,283,840

Cash and investments as of December 31, 2008 and 2007 consisted of the following:

	2008	***2007***
Cash deposits	$ 12,464,311	$ 11,220,390
Deposits with Kern County	1,241,238	1,186,446
Deposits with LAIF	9,032,476	10,727,983
Investments	97,000	8,149,021
	$ 22,835,025	$ 31,283,840

Investments:

The District is permitted by both Board policy and State law to invest in various authorized investments, subject to a variety of limits and controls, including the LAIF, State of California bonds, U.S. Government Agency securities (Treasury and other federal agencies) and other securities (bankers' acceptances, negotiable certificates of deposit, etc.). The District investment portfolio is primarily comprised of holdings in Federal agency securities and U.S. Guarantees - GNMA's.

Disclosures relating to interest rate risk and credit 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 District 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.

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 the California Government Code, the District's investment policy, or debt agreement and the actual rating as of year-end for each investment type.

The minimum legal rating for the U.S. Government Agency Securities is A. The ratings for the District's U.S. Government Agency Securities at December 31, 2008 and 2007 are AAA.

As of December 31, 2008, the District had the following investments and maturities:

		Investment maturities		
	Fair Value	***Less Than 1 Year***	***1 Year to 5 Years***	***6 Years to 10 Years***
U.S. Govt. Agency Securities	$ 97,000	$ 97,000	$ -	$ -

As of December 31, 2007, the District had the following investments and maturities:

		Investment maturities		
	Fair Value	***Less Than 1 Year***	***1 Year to 5 Years***	***6 Years to 10 Years***
U.S. Govt. Agency Securities	$ 8,149,021	$ 3,217,946	$ 2,778,640	$ 2,152,435

Investment in Kern Water Bank Authority:

Upon adoption of the Monterey Agreement in 1997, the District obtained a 6.67% interest in Kern Water Bank Authority (KWBA) by reducing the District's annual entitlement water from 158,000 acre-feet to 155,000 acre-feet. This District is able to store water at the KWBA in wet years and draw water in dry years. The District's investment in Kern Water Bank Authority is accounted for using the equity method. Under this method, the District recognizes its share of the Authority's accrual basis income or loss. The District's equity in the earnings from this investment for the years ended December 31, 2008 and 2007 was $79,864 and $29,899, respectively. The earnings from this investment are included in nonoperating revenue on the combined statements of revenue and expenses.

Investment in Pioneer Project:

The Pioneer Project utilizes land that the Kern County Water Agency owns. The Pioneer Project Participation Agreement stipulates that certain member units have first priority utilizing the property for recharge and recovery. Recharge Participants are entitled to a first priority right of the stated recharge facilities, and Recovery Participants are entitled to a first priority right of the stated recovery facilities. The District is a Recovery Participant with a 14% allocation among this class of participants.

The District's investment in the Pioneer Project is accounted for using the equity method. Under this method, the District recognizes its share of the project's accrual basis income or loss.

The District paid for the construction of three wells for this project during the years ended December 31, 2008 and 2007, for a total cost of wells of $306,855 and $106,685, respectively.

Investment in Cross Valley Canal Project:

The Cross Valley Canal (CVC) serves as the Kern County Water Agency's primary conduit for water deliveries to and from the California Aqueduct. Construction has commenced on the CVC Expansion Project. The project is the largest component of the Phase II Grant Program and includes construction of the CVC/Friant-Kern Canal Intertie (Intertie). CVC conveyance capacity will be expanded from 922 cubic feet per second (cfs) to 1,422 cfs (an increase of about 54 percent), plus an additional 500 cfs of capacity in the Intertie. Construction completion is scheduled for 2009.

The District's investment in the Cross Valley Canal Project is accounted for using the equity method. Under this method, the District recognizes its share of the project's accrual basis income or loss.

Investment in Semitropic-Rosamond Water Bank Authority:

On July 28, 2008, the District entered into a Joint Powers Agreement with Valley Mutual Water Company, LLC, and Rosamond Community Service District to create the Semitropic-Rosamond Water Bank Authority (SRWBA).

Initially, the SRWBA is to consist of a "First Priority Right" to the following interests in the District's Stored Water Recovery Unit (SWRU) banking project that will provide: (1) 33,333 AF/year of SWRU Delivery Capacity, (2) 300,000 AF of SWRU Storage Capacity, and (3) 100,000 AF/year of SWRU Recovery and Return Capacity, together with rights to certain unused capacities in the SWRU and other elements of the Semitropic Water Bank, and the following rights in the Antelope Valley Water Bank (AVWB): (1) 100,000 AF/year of AVWB Delivery Capacity, (2) 500,000 AF of AVWB Storage Capacity, and (3) 100,000 AF/year of AVWB Recovery and Return Capacity.

As part of the agreement, the District recorded an investment in the amount of $20,000,000, which represents the District's equity ownership in the SWRBA. The District's investment in the SRWBA is accounted for using the equity method. Under this method, the District recognizes its share of the SRWBA's accrual basis income or loss. The District's equity in income from this investment for the years ended December 31, 2008 was $8,385,973. The earnings from this investment are included in the nonoperating revenue category on the combined statements of revenue and expenses.

Cash flows:

Governmental Accounting Standards Board No. 9 states for purposes of preparing the statement of cash flows, all transactions that are not classified as capital and related financing activities, noncapital financing activities or investing activities are classified as operating activities. The adjustments to reconcile operating income to net cash provided by operating activities includes other income which consists primarily of general administrative and general project service charges and water contract income from prior years.

Use of estimates:

The preparation of financial statements in conformity with U.S. 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.

Note 2. Water Received and Delivered

Detailed below is the Water Received and Delivered by the District. This information does not include water that is solely pumped and utilized by farmers. Rather, water information provided below represents water that is utilized by the District.

Water Received	***2008 (acre feet)***	***2007 (acre feet)***
Purchased from Kern County Water Agency		
Entitlement		
Current year allocation (35% & 60%)	54,250	93,000
Add borrowing (carryover) to next year	(24,184)	(2,780)
Add carryover from prior year	2,780	437
Subtotal	32,846	90,657
Article 21	-	29,887
Other	2,313	751
Total Water Received - Kern County Water Agency	35,159	121,295
Total Water Received from Banking Partners	8,130	18,305
Total Water received - Received from Other Water Agencies	11,114	6,362
In-District Ground Water Extraction		
District Wells Pumped	28,473	74,233
Pumping agreement with landowners	82,267	71,644
Total Water Received - Ground Water Extraction	110,740	145,877
Out of District Ground Water (Kern Fan)		
Kern Water Bank	50,048	18,607
Pioneer Project	13,592	14,000
	63,640	32,607
Total Water Received	228,783	324,446

	2008 (acre feet)	2007 (acre feet)
Water Delivered		
Delivered In-District		
Contract	65,602	78,334
Non-contract	759	64,269
In District spreading & overdraft correction	118	966
Supplemental Ag water	4,050	310
Other	801	3,205
Total Water Deliver - In-District	71,330	147,084
Recharge to Kern Fan Projects	-	2,475
Returned to Other Water Agencies	18,119	14,771
Returned to Banking Partners	112,181	74,631
Returned to Banking Partners exchange	22,217	71,000
	134,398	145,631
Losses	4,936	14,485
Total Water Delivered	228,783	324,446

Note 3. Restricted Assets

Reserve funds:

The District maintains several reserve funds under provisions of loan contracts and bond issuances and other restrictions. The amounts required for each fund are as follows:

	2008		2007	
	Amount Required	Amount on Deposit	Amount Required	Amount on Deposit
Bond and loan reserve fund	$ 13,221,865	$ 13,221,865	$ 19,182,050	$ 19,182,050
Retirement trust fund	74,570	74,570	73,747	73,747
	$ 13,296,435	$ 13,296,435	$ 19,255,797	$ 19,255,797

The provisions of the various loan contracts and reserve funds are as follows:

Bond and loan reserve fund:

The provisions of the District's various bond issuances and loans from the State of California, Department of Water Resources require the District to maintain reserves until the bonds have been redeemed, certain loan requirements are satisfied or until bond proceeds are exhausted.

Retirement trust fund:

The District funds a separate cash account for the 401(k) pension plan. Contributions for investments in mutual funds are paid from this account.

Note 4. Property, Plant and Equipment

The following is a summary of changes in the District's property, plant and equipment for the years ended December 31, 2008 and 2007:

	Assets-At Cost				
	Balance 12/31/07	***Acquisitions***	***Retirements***	***Reclass/ Transfers***	***Balance 12/31/08***
Capital Assets not being depreciated:					
Land	$ 5,010,519	$ 18,251,763	$ -	$ 77,150	$ 23,339,432
Construction in progress	16,847,729	24,805,987	-	(21,341,496)	20,312,220
Capital Assets being depreciated:					
Source of supply	13,121,062	-	-	-	13,121,062
Transmission and distribution	208,510,548	-	-	1,184,030	209,694,578
Communication equipment	19,976	-	-	-	19,976
Autos and trucks	1,317,028	43,153	-	-	1,360,181
Office equipment	611,059	40,351	-	-	651,410
Field and misc. equip.	388,565	17,096	-	-	405,661
Well drilling equip.	2,250,269	720,146	-	-	2,970,415
Wells	313,413	-	-	-	313,413
General plant and equipment	1,911,697	-	-	80,316	1,992,013
	$ 250,301,865	$ 43,878,496	$ -	$ (20,000,000)	$ 274,180,361

	Accumulated Depreciation				
	Balance 12/31/07	***Depreciation Expense***	***Retirements***	***Reclass/ Transfers***	***Balance 12/31/08***
Source of supply	$ 5,268,614	$ 333,096	$ -	$ -	$ 5,601,710
Transmission and distribution	42,873,820	4,585,329	-	-	47,459,149
Communication equipment	19,850	-	-	-	19,850
Autos and trucks	1,051,931	47,338	-	-	1,099,269
Office equipment	496,797	30,864	-	-	527,661
Field and misc. equip.	352,731	7,604	-	-	360,335
Well Drilling	56,034	167,869	-	-	223,903
Wells	-	15,671	-	-	15,671
General plant and equipment	651,877	56,187	-	-	708,064
	$ 50,771,654	$ 5,243,958	$ -	$ -	$ 56,015,612

`	Assets-At Cost				
	Balance 12/31/06	***Acquisitions***	***Retirements***	***Reclass/ Transfers***	***Balance 12/31/07***
Capital Assets not being depreciated:					
Land	$ 4,933,369	$ 77,150	$ -	$ -	$ 5,010,519
Construction in progress	63,785,186	24,339,679	-	(71,268,376)	16,847,729
Capital Assets being depreciated:					
Source of supply	13,121,062	-	-	-	13,121,062
Transmission and distribution	141,998,703	144,345	-	66,367,500	208,510,548
Communication equipment	19,976	-	-	-	19,976
Autos and trucks	1,110,631	206,397	-	-	1,317,028
Office equipment	596,429	14,630	-	-	611,059
Field and misc. equip.	354,311	-	-	34,254	388,565
Well drilling equip.	423,973	196,299	-	1,629,997	2,250,269
Wells	-	-	-	313,413	313,413
General plant and equipment	1,779,726	61,093	-	70,878	1,911,697
	$ 228,123,366	$ 25,039,593	$ -	$ (2,852,334)	$ 250,301,865

	Accumulated Depreciation				
	Balance 12/31/06	***Depreciation Expense***	***Retirements***	***Reclass/ Transfers***	***Balance 12/31/07***
Source of supply	$ 4,935,518	$ 333,096	$ -	$ -	$ 5,268,614
Transmission and distribution	39,322,594	3,551,226	-	-	42,873,820
Communication equipment	19,850	-	-	-	19,850
Autos and trucks	1,015,465	36,466	-	-	1,051,931
Office equipment	466,679	30,118	-	-	496,797
Field and misc. equip.	345,630	7,101	-	-	352,731
Well Drilling	-	56,034	-	-	56,034
General plant and equipment	600,970	50,907	-	-	651,877
	$ 46,706,706	$ 4,064,948	$ -	$ -	$ 50,771,654

Note 5. Long-Term Debt

Long-term debt at December 31, 2008 and 2007 was as follows:

	2008	2007
Contract payable, State of California, 3.4375%, unsecured, payable $33,735 semiannually including interest, due October 1, 2011 (proceeds were used for lining canals)	$ 190,924	$ 250,340
Contract payable, State of California, 3.0286%, unsecured, payable $167,545 semiannually including interest, due October 1, 2016 (proceeds were used for construction of the Water Conservation Element)	2,367,494	2,623,107
Contract payable, State of California, 2.8%, unsecured, payable $45,059 semiannually including interest, due October 1, 2015 (proceeds were used for construction of the Interconnection Pipeline)	571,858	644,658
Contract payable, State of California, 2.8%, unsecured, payable $124,725 semiannually including interest, due October 1, 2013 (proceeds were used to finance certain construction projects)	1,048,222	1,263,847
2006A Water Banking Revenue Bonds, 4.25-4.78%, collateralized by future groundwater banking revenue, principal payable annually, interest payable semiannually, due December 1, 2035 (proceeds were used to refund 2003 bonds and fund a portion of second phase of Stored Water Recovery Unit)	31,100,000	31,515,000

	2008	2007
2004A Revenue Bonds, 2% - 5.5%, collateralized by future groundwater banking revenue, principal payable annually, interest payable semiannually, due December 1, 2035 (proceeds used to finance certain improvements of water banking project and fund reserve for the bonds)	$ 46,155,000	$ 46,660,000
Contract payable, State of California, 2.4%, unsecured, payable $135,321 semiannually including interest, due May 2023 (proceeds used for construction of groundwater recharge project)	3,392,866	3,578,702
Contract payable, State of California, 2.6%, unsecured, payable $55,052 semiannually including interest, due August 15, 2023 (proceeds used for construction of groundwater recharge project)	1,360,582	1,433,866
Contract payable, State of California, 2.6%, unsecured, payable $161,076 quarterly including interest, due December 31, 2025 (proceeds used for construction of a water distribution system)	4,329,568	4,009,033
Contract payable, State of California, 2.4%, unsecured, payable $159,792 semiannually including interest, due April 1, 2025 (proceeds used for construction of a water distribution system)	4,723,596	4,926,080
2007 Revenue Bonds, 3.586%, collateralized by rights to deposits in investment accounts, principal payable semiannually, interest payable monthly, due May 15, 2017 (proceeds used for District's share of construction costs of CVC project)	4,490,673	5,000,000

		2008		**2007**
2008A Revenue Bonds, variable interest rate via Wells Fargo Bank weekly rate (0.7% at December 31, 2008), collateralized by future general project service charges, principal payable annually, interest payable monthly, due June 1, 2038 (proceeds were used to refund 2005 bonds and fund a portion of P-565 Conveyance and Distribution system and other projects)	$	50,000,000	$	-
Note payable, Margaret A. Cooper, 5%, secured by deed of trust, payable $10,079 quarterly including interest, paid in full (proceeds were used to purchase land)		-		10,009
2005A Revenue Auction Bonds, variable interest rate via weekly modified Dutch auction, collateralized by the District's general fund, principal payable annually, interest payable weekly, paid in full (proceeds were used to finance previous loans, finance District energy project and other projects, and fund reserve for the bonds)		-		19,000,000
		149,730,783		120,914,642
2005 Interest Rate Swap, at cost (See Note 7)		3,327,000		3,327,000
Less deferred amount on advance refunding of 2003 and 2005 bonds, net of accumulated amortization 2008, $46,051; 2007, $42,544		(1,440,243)		(1,233,762)
Less discount and costs of issuance on bonds, net of accumulated amortization 2008, $441,693; 2007, $257,619		(2,606,714)		(2,360,121)
Less current maturities		(2,787,507)		(4,924,199)
Long term debt, less discount and current maturities	$	146,223,319	$	115,723,560

The following is a summary of the long-term debt transactions for the years ended December 31, 2008 and 2007:

	Payable 12/31/07	***Debt Incurred***	***Debt Retired***	***Payable 12/31/08***
Bond principal	$ 102,175,000	$ 50,000,000	$ (20,429,327)	$ 131,745,673
Loans, State of California	18,729,633	500,000	(1,244,523)	17,985,110
Loan, Margaret A. Cooper	10,009	-	(10,009)	-
	$ 120,914,642	$ 50,500,000	$ (21,683,859)	$ 149,730,783

	Payable 12/31/06	***Debt Incurred***	***Debt Retired***	***Payable 12/31/07***
Bond principal	$ 101,970,000	$ 5,000,000	$ (4,795,000)	$ 102,175,000
Loans, State of California	14,822,104	5,001,312	(1,093,783)	18,729,633
Loan, Margaret A. Cooper	48,601	-	(38,592)	10,009
	$ 116,840,705	$ 10,001,312	$ (5,927,375)	$ 120,914,642

The annual requirements to amortize all debt outstanding as of December 31, 2008 are as follows:

Years Ending December 31,	*Principal*	*Interest*	*Total Debt Service*
2009	$ 2,787,507	$ 4,846,592	$ 7,634,099
2010	2,911,222	4,751,620	7,662,842
2011	3,041,198	4,648,632	7,689,830
2012	4,423,698	4,527,610	8,951,308
2013	4,502,930	4,400,631	8,903,561
2014-2018	22,747,477	19,990,256	42,737,733
2019-2023	25,063,025	16,430,032	41,493,057
2024-2028	27,853,726	12,217,520	40,071,246
2029-2033	33,310,000	7,052,763	40,362,763
2034-2038	23,090,000	1,078,019	24,168,019
	$ 149,730,783	$ 79,943,675	$ 229,674,458

Note 6. 2008A Revenue Bonds

The District issued the 2008A Revenue Bonds on July 1, 2008, in the aggregate principal amount of $50,000,000. From the proceeds of the bonds, the District paid $16,825,000 to Wells Fargo Bank, as escrow agent, for deposit in an escrow fund pertaining to the advance refunding of the 2005 Revenue Bonds of the District; all in accordance with the terms of an escrow agreement between the District and the aforementioned bank. As a result, the 2005 Revenue Bonds are considered to be defeased and the liability for those bonds has been removed from the combined statement of net assets of the District at December 31, 2008.

The 2008A Revenue Bond issue of $50,000,000, variable interest rate via Wells Fargo Bank weekly rate, was issued by the District to advance refund $16,775,000 of outstanding 2005 Revenue Bonds, with a variable interest rate via weekly modified Dutch auction. The advance refunding resulted in a difference between the reacquisition price and the net carrying amount of the old debt of $252,532. This difference, reported in the accompanying financial statements as a deduction from bonds payable, is being charged to operations as a component of interest expense through the year 2038 using the straight-line method.

Following is a summary of the advance refunding as recorded by the District as of December 31, 2008:

Reacquisition price (funds required to be deposited in escrow to refund 2005 bonds)		$ 16,825,000
Net carrying amount of 2005 bonds:		
2005 bonds outstanding	$ 16,775,000	
Unamortized bond discount and costs of issuance	(202,532)	16,572,468
Deferred amount on refunding		$ 252,532

Note 7. Interest Rate Swaps

2005 Forward Starting Swap:

On October 27, 2005, the District entered into an off-market forward starting swap (2005 swap) that was competitively bid in anticipation of a projected future issuance of variable rate bonds to synthetically advance refund the District's 2003 and 2004 Bonds. The swap will commence September 1, 2014, and is based on a notional amount of $53,895,000. The pay-fixed, receive-variable swap generated debt service savings in the form of an upfront payment in the amount of $3,927,850, from the counterparty, SunTrust Bank (SunTrust), who was the highest bidder. This amount is recorded in the Combined Statement of Net Assets as long-term debt and is not adjusted to the fair value at each reporting date. During the year ended December 31, 2006, $600,850 of the swap upfront payment was paid back as part of the advance refunding of the 2003 Revenue Bonds of the District, leaving $3,327,000 to be amortized when the swap agreement commences.

The fixed swap rate of 5.12% that the District will pay represents the average interest rate of the District's existing coupons for the District's refunded bonds after the swap commencement date. The variable swap rate that the District will receive is equal to 69% of the 1 month LIBOR rate, which was calculated to estimate the District's future interest rate for its projected bond issuance. The swap's scheduled notional amounts are reduced until the swap's termination date of December 1, 2035, to mirror the existing principal reductions in the District's refunded bonds which the District estimates will approximate the principal reductions of the new variable rate bonds issued in the future.

Fair value

As of December 31, 2008, the 2005 swap had a negative fair value of $12,299,969. This fair value takes into consideration the prevailing interest rate environment, the specific terms and conditions of the transaction and any upfront payments that may have been received. The fair value was estimated using the zero-coupon method. The method calculated the future net settlement payments required by the swap, assuming that the current forward rates implied by the yield curve are the market's best estimate of future spot interest rates. These payments were then discounted using the spot rates implied by the current yield curve for hypothetical zero-coupon bonds on the date of each future net settlement on the swap.

Credit risk

Credit risk is the risk that SunTrust cannot fulfill the terms and obligations specified in the swap agreement. Since the swap had a negative fair value as of December 31, 2008, the District did not have exposure related to credit risk on its swap with SunTrust. However, the District would have exposure related to credit risk in the amount of the swap's positive fair value if interest rates increased to cause the fair value of the swap to become positive. This would occur at any time prior to the swap's termination of December 1, 2035. The credit ratings of SunTrust are Aa3, A+ and A+ by Moody's, S&P and Fitch, respectively. The swap agreement contains no collateral requirements for either party.

Basis risk

Basis risk, which the District is exposed to on its swap, is the risk when the variable interest rate paid by the District on its projected future variable rate bond issuance and the variable swap interest rate received from SunTrust differ. Specifically, the District is exposed to basis risk should the interest rate equal to 69% of the 1 month LIBOR rate be lower than the actual variable bond rate the District pays on its projected future variable rate bond issuance. Based on the significance and extent of any basis risk exposure, the purpose of the swap to generate debt service savings may not be realized.

Termination risk

Under certain terms of the respective contracts, either the District or SunTrust may terminate the swap from nonperformance from the other party. If the swap is terminated, the projected future issuance of variable rate bonds would no longer be hedged to a fixed rate. If the swap is terminated and the swap has a negative fair value, the District would be liable to SunTrust for a payment equal to the fair value of the swap. The additional termination events in the agreement are limited to credit related events only and the ratings triggers are substantially below the current credit rating of SunTrust and the District.

Market-access risk

The District will likely need to issue variable rate debt to coincide with the commencement date of September 1, 2014. Market access risk addresses whether the District has the ability to efficiently issue variable rate debt at the time of commencement.

2007 Swap:

On April 24, 2007, the District entered into an off-market swap that was competitively bid in anticipation of a projected future issuance of variable rate bonds to synthetically advance refund the District's 2007 Bonds. The swap commenced November 15, 2007, and is based on a notional amount of $5,000,000. The pay-fixed, receive-variable swap will generate debt service savings over the life of the agreement from the counterparty, Wells Fargo Bank (Wells Fargo), who was the highest bidder.

The fixed swap rate of 3.586% that the District will pay represents the average interest rate of the District's existing coupons for the District's refunded bonds after the swap commencement date. The variable swap rate that the District will receive is equal to 67% of the 1 month LIBOR rate, which was calculated to estimate the District's future interest rate for its projected bond issuance. The swap's scheduled notional amounts are reduced until the swap's termination date of May 15, 2017, to mirror the existing principal reductions in the District's refunded bonds which the District estimates will approximate the principal reductions of the new variable rate bonds issued in the future.

Fair value

As of December 31, 2008, the swap had a negative fair value of $425,651. This fair value takes into consideration the prevailing interest rate environment, the specific terms and conditions of the transaction and any upfront payments that may have been received. The fair value was estimated using the zero-coupon method. The method calculated the future net settlement payments required by the swap, assuming that the current forward rates implied by the yield curve are the market's best estimate of future spot interest rates. These payments were then discounted using the spot rates implied by the current yield curve for hypothetical zero-coupon bonds on the date of each future net settlement on the swap.

Credit risk

Credit risk is the risk that Wells Fargo cannot fulfill the terms and obligations specified in the swap agreement. Since the swap had a negative fair value as of December 31, 2008, the District did not have exposure related to credit risk on its swap with Wells Fargo. However, the District would have exposure related to credit risk in the amount of the swap's positive fair value if interest rates increased to cause the fair value of the swap to become positive. This would occur at any time prior to the swap's termination of May 15, 2017. The credit ratings of Wells Fargo are Aa3, A+ and A+ by Moody's, S&P and Fitch, respectively. The swap agreement contains no collateral requirements for either party.

Basis risk

Basis risk, which the District is exposed to on its swap, is the risk when the variable interest rate paid by the District on its projected future variable rate bond issuance and the variable swap interest rate received from Wells Fargo differ. Specifically, the District is exposed to basis risk should the interest rate equal to 67% of the 1 month LIBOR rate be lower than the actual variable bond rate the District pays on its projected future variable rate bond issuance. Based on the significance and extent of any basis risk exposure, the purpose of the swap to generate debt service savings may not be realized.

Termination risk

Under certain terms of the respective contracts, either the District or Wells Fargo may terminate the swap from nonperformance from the other party. If the swap is terminated, the projected future issuance of variable rate bonds would no longer be hedged to a fixed rate. If the swap is terminated and the swap has a negative fair value, the District would be liable to Wells Fargo for a payment equal to the fair value of the swap. The additional termination events in the agreement are limited to credit related events only and the ratings triggers are substantially below the current credit rating of Wells Fargo and the District.

Market-access risk

The District has issued variable rate debt to coincide with the commencement date of November 15, 2007. Market access risk addresses whether the District has the ability to efficiently issue variable rate debt at the time of commencement.

Note 8. Self-Insurance

The District is a member of the Association of California Water Agencies, Joint Powers Insurance Authority (JPIA). JPIA is a group of California Water Districts who have pooled funds to provide self-insurance coverage as follows:

Type of Coverage	***Limits per Occurrence Self-Insurance***	***Limits per Occurrence Excess Insurance***
General liability/automobile liability	$10,000-$500,000	$500,000-$49,500,000
Property insurance	$1,000-$50,000	$10,000-$100,000,000

The District is in a group with a $10,000 retention level (deductible) per occurrence for auto and general liability, $1,000 per occurrence for property, and $500 per occurrence on licensed vehicles. Claims over the retention levels are insured by the group up to the self-insurance limits (see above) and by policies purchased by JPIA from the Insurance Company of Pennsylvania, Lexington Insurance Company, and Appalachian Insurance Company for the excess.

JPIA bills the District a deposit premium at the beginning of each policy year, which is placed in a reserve fund to cover the self-insurance portion of any claim. Settlements and/or expenses related to claims during the year are charged against the reserve. If the balance of the reserve at the end of the year is deemed too low in relation to the amount of outstanding claims, the District is billed for additional premiums. When the claims are fully settled, any amounts remaining in the reserve are refunded to the District.

Note 9. Commitments and Contingencies

Water Supply Contract with Kern County Water Agency:

The District obtained its surface water supply in accordance with certain contracts signed between 1969 and 1974 with the Kern County Water Agency (Agency), amended to its current annual amount of 155,000 acre feet of entitlement surface water, through the year 2039. The Agency, in turn, obtained its surface water supply in 1963 when it signed a contract with the State of California, Department of Water Resources (DWR), to purchase annual surface water, currently contracted at 998,731 acre feet, through the State Water Project (SWP) through the year 2035.

The District's contract with the Agency provides for various separate charges, all of which are included in "Source of Supply" in Operating Expenses of the District's Combined Statement of Revenue and Expenses. The "fixed charge" component of the contract is not necessarily reduced by annual water supply deficiencies as the District is obligated to pay 100% of the annual fixed costs billed by the Agency. Under certain circumstances, fixed charges could be reduced by the DWR when the District receives less than its full entitlement in years of low water supply. Source of supply costs attributable to this contract were $10,482,901 and $8,208,274 for the years ended December 31, 2008 and 2007, respectively.

The District expects a lower than average surface water supply in 2009 when compared to 2008. The District anticipates a 30% allocation of surface water entitlement from DWR in 2009. Accordingly, the Agency has provided the District with an estimate of both fixed and variable energy costs for 2008. A full entitlement, (155,000 acre feet) will be charged due to the depletion of the Ag Trust fund. The Agency estimates the District's 2009 water contract to be approximately $9,455,000.

On March 13, 2008, Judge Wanger of the Fresno Federal Court, ordered DWR to reduce the amount of SWP water exported by the Delta pumps. The State will be unable to fill the San Luis Reservoir, which precludes delivery of Article 21 water. DWR estimated water loss to the SWP as a result of the Wanger Remedy Order to be about 4% of allocation. This translated to a 6,200 AF loss of entitlement to the District and a loss of all Article 21 water, which in some years was between 20,000 and 50,000 acre-feet prior to the Wanger decision.

Because of continuing possibility of water deliveries being maintained at reduced levels each year for water users, the District has developed several programs among which are the utilization of wells, banking programs and transfers of water from sources outside the District. The District continues to work on financial aspect of the problems in an attempt to reduce charges and increase the reliability of the water supply to water users, wherever possible.

Uncalled assessments:

The Improvement Districts have levied assessments in prior years which have not been called. The uncalled assessments in the Improvement Districts serve as security on construction financing for Project Unit One in the Pond-Poso Improvement District and the Project Units One and Two in the Buttonwillow Improvement District. Uncalled assessments at December 31, 2008 and 2007 were $4,059,411.

As part of the Energy Development Element project approval vote on November 26, 1991, an assessment was authorized in the amount of $119 per acre on approximately 125,947 acres, for a total adjusted assessment of $14,987,729.

Although the assessments have been levied, they are uncalled and are not reflected as an asset and related liability in the combined financial statements. These assessments will not be recognized until such time as they are called by the District.

Construction projects:

In fiscal year 2008, the District's Board of Directors approved bids for the construction of the P565 conveyance and distribution system for $15,000,000. Each year in the winter months the District shuts down sections of canals for repairs and enhancements commonly known as "Winter Work." Winter work in 2008 is construction within various canal systems to enhance flow capacity.

The following table shows the approximate budget, year to date, remaining construction costs, and estimated completion date:

Construction Project	*Budget*	*Paid to Date*	*Balance Remaining*	*Estimated Completion Date*
P565 Distribution System	$ 15,412,781	$ 13,893,462	$ 1,519,319	March, 2009
Winter Work	$ 4,541,810	$ 1,992,593	$ 2,549,217	March, 2009

Note 10. Retirement Plan

In 2007, the District made certain modifications to its defined contribution pension plan, currently entitled "Semitropic Water Storage District 401(k) Plan," which is a 401(k) plan covering all eligible employees. The District administers this plan and can amend the Plan or its contributions at any time. The Plan consists of investments in mutual funds with Principal Funds and Van Kampen American Capital Trust Company. The District contributes an amount equal to 10% of the employees' base salary each month to the employees' pension plan. Employees are required to contribute 4% of base salary each month to receive District contributions. To determine the base salary for the plan year, the rates applicable on January 1 are used throughout the plan year and adjusted during the year if a pay increase is given. An employee is eligible for participation in the retirement plan after six months of service. The District's contributions for each employee are 20% vested after two years of employment with vesting increasing 20% for each additional year of employment up to six years. The District's contributions are 100% vested after six years of employment. Unvested contributions and interest forfeited by employees who leave before six years of service are used to reduce the District's current-period contribution requirement.

The District's payroll and contributions for the years ended December 31, 2008 and 2007 were as follows:

	2008	*2007*
Total payroll	$ 2,579,965	$ 2,331,843
Base salary for computing contributions	$ 2,477,380	$ 2,123,358
District contributions	$ 247,738	$ 212,336
Employee contributions	$ 132,925	$ 86,953

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ACCOUNTANCY CORPORATION

<u>Independent Auditors' Report on the Supplementary Information</u>

Board of Directors
Semitropic Water Storage District
Wasco, California

The accompanying information shown on pages 42 - 45 is presented only for purposes of additional analysis and is not a required part of the basic combined financial statements.

Our December 31, 2008 and 2007 audits of the basic combined financial statements were made for the purpose of forming an opinion on those statements taken as a whole. The accompanying information has been subjected to the procedures applied in the audits of the basic combined financial statements.

In our opinion, the accompanying information is fairly stated in all material respects in relation to the basic combined financial statements taken as a whole.

BARBICH HOOPER KING
DILL HOFFMAN
Accountancy Corporation

Barbich Hooper King

Bakersfield, California
March 31, 2009

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Semitropic Water Storage District

Combined Schedules of Operating Expenses
Years Ended December 31, 2008 and 2007

	2008	*2007*	*Increase (Decrease)*
Transmission and distribution:			
Power	$ 13,395,946	$ 9,731,321	$ 3,664,625
Kern Water Bank and Pioneer Expenses	4,519,715	2,286,290	2,233,425
Repairs and maintenance	1,313,226	1,139,414	173,812
Salaries and wages	1,242,798	1,248,610	(5,812)
Employee benefits	843,160	785,610	57,550
Fuel and oil	257,643	201,217	56,426
Payroll taxes	132,035	110,635	21,400
Operating supplies	30,850	122,758	(91,908)
Equipment rent	26,074	31,705	(5,631)
Utilities	17,122	5,393	11,729
Miscellaneous	4,274	1,960	2,314
Answering Service	4,140	4,140	-
Licenses and Fees	3,307	2,899	408
Equipment maintenance	605	-	605
	$ 21,790,895	$ 15,671,952	$ 6,118,943
Well operations:			
Salaries	$ 457,945	$ 153,104	$ 304,841
Repairs and maintenance	160,501	34,270	126,231
Employee benefits	157,407	62,122	95,285
Supplies	105,720	62,013	43,707
Payroll taxes	38,941	18,181	20,760
Drilling consulting	17,500	112,739	(95,239)
Well abandonment	15,451	76,908	(61,457)
Equipment rent	6,105	384	5,721
Security	1,166	8,510	(7,344)
Licenses and fees	375	726	(351)
Insurance	-	2,726	(2,726)
Allocation to construction in progress	(961,111)	-	(961,111)
	$ -	$ 531,683	$ (531,683)

	2008	2007	Increase (Decrease)
Source of supply:			
Water	$ 11,922,427	$ 10,593,342	$ 1,329,085
General and administrative:			
Salaries and wages	$ 975,747	$ 900,074	$ 75,673
Legal	394,778	174,397	220,381
Employee benefits	388,324	364,647	23,677
Public relations	234,499	79,223	155,276
Consulting and computer support	212,934	120,181	92,753
Financing and administration	154,412	89,132	65,280
Insurance	151,178	146,347	4,831
Grant related costs	94,646	452,497	(357,851)
Marketing	90,028	164,187	(74,159)
Dues	77,391	70,633	6,758
Office	76,395	23,667	52,728
Air Gap program	72,485	-	72,485
Repairs and maintenance	52,244	92,431	(40,187)
Payroll taxes	45,650	64,075	(18,425)
Travel	45,179	56,366	(11,187)
Utilities	34,481	36,594	(2,113)
Accounting and auditing	31,665	25,740	5,925
Equipment rent	30,929	22,671	8,258
Engineering	19,286	18,943	343
Directors' fees and expense	18,704	15,500	3,204
Property taxes	15,317	14,150	1,167
Bank fees	13,203	12,011	1,192
Building services	13,020	12,514	506
	$ 3,242,495	$ 2,955,980	$ 286,515
Depreciation expense	$ 5,243,958	$ 4,064,948	$ 1,179,010

Semitropic Water Storage District

Combined Schedule of Insurance Coverage
December 31, 2008

	Policy No.	*Effective Date*	*Expiration Date*
Joint Powers Insurance Authority - Association of California Water Agencies Property, Fidelity	Self-Insured	4/1/2008	4/1/2009
Joint Powers Insurance Authority - Association of California Water Agencies General, Auto, Public Officials Liability	Self-Insured	10/1/2008	10/1/2009
<u>Bonds</u>			
Western Surety	69311183	4/17/2007	4/17/2011
Western Surety	14558205	9/23/2007	9/23/2011
Western Surety	22171084	4/17/2007	4/17/2011
Western Surety	69485775	4/17/2007	4/17/2011
Western Surety	22185935	3/31/2005	4/12/2009
Western Surety	68970435	3/31/2005	3/31/2009
Great American	7909111	4/12/2005	4/12/2009
Great American	FS7909190	4/10/2005	4/10/2009

Annual Premium		Coverage
$	49,426	Property Insurance - all risk coverage $1,000 - $10,000 - combined single limit for each occurrence $50,000 - $100,000,000 - excess comprehensive liability - total insurance value $28,914,062 basic property and equipment ($5,000 deductible) - auto physical damage ($500 deductible) $100,000 - employee fidelity bond ($1,000 deductible)
$	97,274	Comprehensive Liability Insurance $ 10,000 - $500,000 - combined single limit for each occurrence $ 500,000 - $60,000,000 - excess comprehensive liability ($10,000 deductible) includes prior year retrospective premiums
$	340	$5,000 - public official bond - Jeff Fabbri
$	340	$5,000 - public official bond - Todd Tracy
$	340	$5,000 - public official bond - Theodore R. "Ted" Page
$	340	$5,000 - public official bond - Daniel Waterhouse
$	340	$5,000 - public official bond - Frederick Wegis
$	340	$5,000 - public official bond - James Crettol
$	313	$5,000 - public official bond - Philip W. Portwood
$	888	$50,000 - treasurer bond - Philip W. Portwood

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ACCOUNTANCY CORPORATION

Independent Auditors' Report on Compliance and on Internal Control over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards

Board of Directors
Semitropic Water Storage District
Wasco, California

We have audited the combined financial statements of Semitropic Water Storage District as of and for the year ended December 31, 2008 and 2007, and have issued our report thereon dated March 31, 2009. We conducted our audit in accordance with U. S. generally accepted auditing standards and the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States, and the State Controller's Minimum Audit Requirements for California Special Districts.

Compliance

Compliance with laws, regulations, contracts and grants applicable to Semitropic Water Storage District is the responsibility of Semitropic Water Storage District's management. As part of our audit, we assessed the risk that noncompliance with certain provisions of laws, regulations, contracts and grants could cause the combined financial statements to be materially misstated. We concluded that the risk of such material misstatement was sufficiently low and that it was not necessary to perform tests of the District's compliance with such provisions of laws, regulations, contracts and grants.

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Internal Control over Financial Reporting

In planning and performing our audit, we considered Semitropic Water Storage District's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

This report is intended for the information of the board of directors, management, and the California State Controller's office. However, this report is a matter of public record and its distribution is not limited.

BARBICH HOOPER KING
DILL HOFFMAN
Accountancy Corporation

Barbich Hooper King

Bakersfield, California
March 31, 2009