Semitropic Water Storage District

Combined Financial Statements

December 31, 2011 and 2010

C O N T E N T S

BHK
BARBICH HOOPER KING
DILL HOFFMAN
ACCOUNTANCY CORPORATION

Independent Auditors' Report

Board of Directors
Semitropic Water Storage District
Wasco, California

We have audited the accompanying statements of net assets of Semitropic Water Storage District (District) as of December 31, 2011 and 2010, and the related 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 auditing standards generally accepted in the United States of America and the standards applicable to the financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the 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 the District as of December 31, 2011 and 2010, and the respective changes in net assets and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards,* we have also issued our report dated April 9, 2012, on our consideration of the District's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

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Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 11 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental 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.

Our audits were conducted for the purpose of forming an opinion on the combined financial statements that collectively comprise the District's combined financial statements as a whole. The supplementary information is presented for purposes of additional analysis and is not a required part of the combined financial statements. These schedules are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the combined financial statements. The information has been subjected to the auditing procedures applied in the audit of the combined financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the combined financial statements or to the combined financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the combined financial statements as a whole.

BARBICH HOOPER KING
DILL HOFFMAN
Accountancy Corporation

Barbich Hooper King

Bakersfield, California
April 9, 2012

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, 2011 and 2010. 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 $25.2 million or 8% over the course of the year's operations.

The District's total revenues experienced a net increase of $2.3 million or 5% during the year ended December 31, 2011. The primary reason for the net increase in total revenues was the combined increase of $7.3 million in contract and noncontract water revenue, a decrease in groundwater banking revenue of $1.7 million and a decrease in grant revenue of $3 million. Both 2011 and 2010 were considered water delivery years, which means that there was more water available for purchase by the District's landowners and also more water available for groundwater banking partners to potentially bank within the District.

The District's total expenses decreased $4.3 million, or 12%. The primary reason for the decrease was due to a reduction of operating expenses in the amount of $3.6 million, or 13%, during the year ended December 31, 2011. This decrease was primarily due to a combination of the decrease in source of supply, or water costs, by $6.4 million and an increase in transmission and distribution expense of $3.0 million. Due to the high amount of water available, the District was able to bank most of its annual water allocation from the State for future use, thereby decreasing the amount expensed. Transmission and distribution costs increased due to the increase in electricity costs for delivering water and also from the fees incurred for banking excess water.

The District's gross capital assets increased $8.2 million, or 3%, during the year ended December 31, 2011 primarily due to the purchase of land during the year.

Overview of the Financial Statements

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

Required Financial Statements

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

The combined 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 combined 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 combined 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-1
Condensed Statements of Net Assets
December 31, 2011 and 2010
(in millions)

	2011	*2010 (Restated)*	*Dollar Change*	*Percentage Change*
Current assets	$ 21.4	$ 17.3	$ 4.1	24%
Noncurrent capital assets	237.8	235.4	2.4	1%
Noncurrent other assets	91.1	72.4	18.7	26%
Total assets	350.3	325.1	25.2	8%
Current liabilities	7.4	8.4	(1.0)	-12%
Long-term liabilities	161.5	150.4	11.1	7%
Total liabilities	168.9	158.8	10.1	6%
Invested in capital assets,				
Net of related debt	87.1	88.6	(1.5)	-2%
Restricted	12.2	10.9	1.3	12%
Unrestricted	82.1	66.8	15.3	23%
Total net assets	181.4	166.3	15.1	9%
Total liabilities and net assets	$ 350.3	$ 325.1	$ 25.2	8%

As the net asset table above indicates, total assets increased by $25.2 million to $350.3 million at December 31, 2011, up from $325.1 million at December 31, 2010. The increase in the total assets of the District was primarily due to a net increase in cash and investments of $7.6 million, an increase in banked water inventory of $9.6 million and an increase of $8 million in deferred outflow of interest rate swaps.

Total liabilities increased by $10.1 million to $168.9 million at December 31, 2011, from $158.8 million at December 31, 2010. The increase is due to a combination of the issuance of the 2011 Warrants of $8.4 million and an increase of $8 million in obligations of interest rate swaps, as well as decreases due to annual debt principal payments and decrease in accounts payable and GPSC refunds payable.

Table B
Condensed Statements of Revenues and Expenses and Changes in Net Assets
For the Years Ended December 31, 2011 and 2010
(in millions)

	2011	2010	Dollar Change	Percentage Change
Operating Revenues		*(Restated)*		
Contract water	$ 8.2	$ 5.9	$ 2.3	39%
Noncontract water	12.4	7.4	5.0	100%
Groundwater banking	14.9	16.6	(1.7)	-10%
Electrical transfer & hookup	0.6	1.3	(0.7)	-54%
Other charges	0.7	1.0	(0.3)	-30%
	36.8	32.2	4.6	14%
Nonoperating Income				
Grant revenue	0.2	3.2	(3.0)	-94%
Interest income	1.0	1.2	(0.2)	-17%
GA & GP service charges	4.1	3.8	0.3	8%
Prior year income, net	3.6	2.2	1.4	64%
Earnings from investments	0.3	(0.1)	0.4	-400%
Other income	(0.7)	0.5	(1.2)	-240%
	8.5	10.8	(2.3)	-21%
Total Revenues	45.3	43.0	2.3	5%
Operating Expenses				
Transmission & distribution	12.0	9.0	3.0	33%
Well operations	0.2	0.6	(0.4)	0%
Source of supply	2.2	8.6	(6.4)	-74%
General and administration	2.9	2.8	0.1	4%
Depreciation expense	6.2	6.1	0.1	2%
	23.5	27.1	(3.6)	-13%
Nonoperating Expenses				
Interest expense	6.7	7.4	(0.7)	-9%
Total Expenses	30.2	34.5	(4.3)	-12%
Change in Net Assets	15.1	8.5	6.6	78%
Net Assets, beginning of year	166.3	157.8	8.5	5%
Net Assets, end of year	$ 181.4	$ 166.3	$ 15.1	9%

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 by $2.3 million to $45.3 million during the year ended December 31, 2011, from $43.0 million during the year ended December 31, 2010. As mentioned before, 2011 was a water delivery, or wet, year. A wet year means there is water available other than the District's allocation from the State Water Project (SWP). It also means that our groundwater banking partners may also have additional water that may need to be stored, or banked, within the District. In 2011, contract water revenue increased by $2.3 million, or 39%, due to the larger allocation of the District's share of the SWP and noncontract water increased by $5.0 million, or 100%, due to the increased amount of water available due to the wet year. Groundwater banking revenues decreased by $1.7 million from 2010, mainly due to there being no energy charges from prior year District pumping of wells for water deliveries. Grant revenues decreased by $3.0 million, or 94%, as the grants were completed during the year.

Total expenses decreased $4.3 million to $30.2 million during the year ended December 31, 2011 from $34.5 million during the year ended December 31, 2010. This decrease was primarily due to the decrease in source of supply, or water costs, by $6.4 million. Due to the high amount of water available, the District was able to bank most of its annual water allocation from the SWP for future use. The offset against the decrease in source of supply expense was the increase in transmission and distribution expenses (increase of $2.5 million from 2010) due to the increase in electricity costs of delivering water to landowners and the costs incurred to bank the District's excess water with the Kern Water Bank Authority and the Pioneer Project.

As of December 31, 2011, the District had invested $311.2 million in capital assets as shown in Table C.

Table C
Capital Assets
December 31, 2011 and 2010
(in millions)

	2011	*2010 (Restated)*	*Dollar Change*	*Percentage Change*
Land	$ 32.5	$ 24.0	$ 8.5	35%
Source of Supply	13.1	13.1	-	0%
Transmission and Distribution	243.2	238.3	4.9	2%
General Plant and Equipment	3.1	2.8	0.3	11%
Communication equip.	0.02	0.02	-	0%
Autos and trucks	1.5	1.5	-	0%
Office equip.	0.5	0.7	(0.2)	0%
Field and misc. equip.	0.4	0.4	-	0%
Well drilling equip.	3.0	3.0	-	0%
Wells	1.7	0.3	1.4	467%
Construction in progress	12.2	18.8	(6.6)	-35%
Total capital assets	311.2	302.9	8.3	3%
Less: accumulated depreciation	73.4	67.5	5.9	9%
Total net capital assets	$ 237.8	$ 235.4	$ 2.4	1%

As can be seen from the table above, total capital assets increased $8.3 million to $311.2 million at December 31, 2011, from $302.9 million at December 31, 2010. The increase is due to the purchase of land during the year.

Table D
Debt
December 31, 2011 and 2010
(in millions)

	2011	2010 (Restated)	Dollar Change	Percentage Change
Revenue bonds	$ 126.5	$ 131.4	$ (4.9)	-4%
Swap	15.7	7.6	8.1	107%
Other debt	24.2	15.3	8.9	58%
Total debt	$ 166.4	$ 154.3	$ 12.1	8%

Revenue bonds are legally secured by a portion of the District's water banking revenues and/or the District's general administrative and general project service charges. If the water banking revenue streams pledged to specific revenue bonds are not sufficient to repay the debt, the District is not legally obligated to appropriate other funds for debt service payments.

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

Total debt increased $12.1 million to $166.4 million during the year ended December 31, 2011 from $154.3 million during the year ended December 31, 2010. The increase is due to 2011 Warrants issued for the purchase of land and the increase in the obligations under interest rate swap.

The District received a AA- rating by Standard & Poors for the 2009 fixed rate debt issued to replace variable debt.

Budgetary Comparison

The following table is a comparison of the Board approved budget for 2011 against actual.

Table E
Budget vs. Actual Comparison
For the Year Ended December 31, 2011
(in millions)

	Actual	Budget	Change	Percentage Change
Operating Revenues				
Contract water	$ 8.2	$ 7.3	$ 0.9	12%
Noncontract water	12.4	13.7	(1.3)	-9%
Groundwater banking	14.9	16.4	(1.5)	-9%
Electrical transfer & hookup	0.6	3.7	(3.1)	-84%
Other revenue	0.7	1.0	(0.3)	-30%
	36.8	42.1	(5.3)	-13%
Nonoperating Income				
Grant revenue	0.2	-	0.2	0%
Interest income	1.0	0.5	0.5	100%
GA & GP service charges	4.1	4.0	0.1	3%
Prior year income, net	3.6	1.3	2.3	177%
Earnings from investments	0.3	-	0.3	100%
Other income	(0.7)	0.6	(1.3)	-217%
	8.5	6.4	2.1	33%
Total Revenue	45.3	48.5	(3.2)	(2.3)
Operating Expenses				
Source of supply	2.2	11.7	(9.5)	-81%
Well operations	0.2	-	0.2	100%
Transmission & distribution	12.0	6.2	5.8	94%
General and administration	2.9	7.7	(4.8)	-62%
Depreciation expense	6.2	6.2	-	0%
	23.5	31.8	(8.3)	-26%
Nonoperating Expenses				
Interest expense	6.7	6.6	0.1	2%
Change in Net Assets	$ 15.1	$ 10.1	$ 5.0	50%

Total revenue was below budgeted revenues for 2011 mainly due to the lower amount of revenues from electrical transfers and hookups and groundwater banking. Electrical transfers and hookups revenue is derived from District power (electricity) costs incurred by landowners from use of their wells. This also includes any work done during the year for new connection of landowner wells to the District's power source. Groundwater banking revenues were lower than budget due to the District not receiving one annual O&M payment (approximately $2 million) from a groundwater banking customer, due to that customer's prior year's level of activity.

The actual versus budgeted difference in operating expenses was due to the lower amount of source of supply expense and the increased amount in transmission and distribution expense. Source of supply was lower due to the District's banking of available excess water, thereby lowering the amount of expense for the year. Transmission and distribution expense increased due to the increased use of electricity to deliver water to landowners during the year and also the amount of fees associated with banking excess water.

The annual budget is presented and approved by the District's Board of Directors each October. An updated budget is presented and approved in June, if necessary.

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, 2011 and 2010

ASSETS	***2011***	***2010***
		(Restated)
Current Assets		
Cash and cash equivalents	$ 11,295,114	$ 4,928,796
Receivables		
Current portion of note receivable	684,441	650,260
Accounts receivable, trade	6,274,343	5,562,019
Grant reimbursements receivable	-	1,017,069
Other receivables	-	1,254,289
Other receivables, related party	1,161,497	880,566
General administrative and general project service charges receivable	1,850,135	2,914,858
	9,970,416	12,279,061
Other prepaid expenses and deposits	100,765	82,294
Total current assets	21,366,295	17,290,151
Noncurrent Assets		
Restricted assets		
Cash	4,705,814	9,246,853
Investments	7,494,715	1,622,094
Total restricted assets	12,200,529	10,868,947
Capital assets, net of accumulated depreciation	237,776,081	235,387,457
Other noncurrent assets		
Note receivable, less current portion	14,373,184	15,057,624
Banked water inventory	13,925,343	4,321,472
Investment in Semitropic-Rosamond Water Bank Authority	27,666,660	27,309,692
Investment in Kern Water Bank Authority	3,009,618	3,044,120
Investment in Pioneer Project	1,204,270	1,204,270
Investment in Cross Valley Canal Project	3,050,831	3,050,831
Deferred outflow of interest rate swaps	15,722,361	7,590,651
Total other noncurrent assets	78,952,267	61,578,660
Total noncurrent assets	328,928,877	307,835,064
	$ 350,295,172	$ 325,125,215

See Notes to Combined Financial Statements.

LIABILITIES AND NET ASSETS	*2011*	*2010*
		(Restated)
Current Liabilities		
Current portion of long-term debt	$ 4,956,448	$ 3,996,066
Trade accounts payable	53,430	744,216
Customer deposits	1,453,237	1,383,256
Accrued liabilities	956,792	2,316,676
Total current liabilities	7,419,907	8,440,214
Long-Term Liabilities		
Long-term debt, less current portion	145,694,791	142,748,476
Obligations under interest rate swap	15,722,362	7,590,651
Total long-term liabilities	161,417,153	150,339,127
Total Liabilities	168,837,060	158,779,341
Commitments and Contingencies		
Net Assets		
Invested in capital assets, net of related debt	87,124,842	88,642,915
Restricted for:		
Debt service	12,120,616	10,789,513
Retirement trust fund	79,912	79,434
Unrestricted	82,132,742	66,834,012
	181,458,112	166,345,874
	$ 350,295,172	$ 325,125,215

Semitropic Water Storage District

Combined Statements of Revenue and Expenses
For the Years Ended December 31, 2011 and 2010

	2011	2010 (Restated)
Operating revenue:		
Contract water	$ 8,242,779	$ 5,908,146
Noncontract water	12,354,414	7,441,195
Groundwater banking	14,893,056	16,578,088
Electrical transfer and hookup charges	633,362	1,318,346
Other charges	673,976	967,993
	36,797,587	32,213,768
Operating expenses:		
Transmission and distribution	12,023,692	8,991,633
Well operations	228,723	573,604
Source of supply	2,161,130	8,565,622
General and administrative	2,923,921	2,783,560
Depreciation expense	6,190,554	6,103,609
	23,528,020	27,018,028
Operating income	13,269,567	5,195,740
Nonoperating income (expense):		
Grant revenue	226,363	3,230,535
Interest income	1,025,913	1,158,627
General administrative and general project service income	4,059,095	3,834,914
Interest expense	(6,674,112)	(7,399,923)
Equity in income (loss) from investments	322,466	(169,921)
Other income	258,498	283,897
Prior year income, net	3,598,249	2,209,153
Rental income	114,080	180,322
Loss on disposal of assets	(1,067,232)	-
Loss on sale of investments	(20,648)	(12,479)
	1,842,672	3,315,125
Change in net assets	$ 15,112,239	$ 8,510,865

See Notes to Combined Financial Statements.

Semitropic Water Storage District

Combined Statements of Changes in Net Assets
For the Years Ended December 31, 2011 and 2010

Balance, December 31, 2009, as previously stated	$ 141,509,338
Prior period adjustment (see Note 12)	16,325,670
Balance, December 31, 2009, as restated	157,835,008
Change in net assets	8,510,865
Balance, December 31, 2010, as restated	166,345,873
Change in net assets	15,112,239
Balance, December 31, 2011	$ 181,458,112

See Notes to Combined Financial Statements.

Semitropic Water Storage District

Combined Statements of Cash Flows
For the Years Ended December 31, 2011 and 2010

	2011	2010 (Restated)
Cash flows from operating activities:		
Receipts from customers	$ 46,223,247	$ 37,429,521
Payments to suppliers for goods and services	(25,326,083)	(23,210,213)
Payments to employees for services	(3,684,395)	(3,155,766)
Net cash provided by operating activities	17,212,769	11,063,542
Cash flows from capital and related financing activities:		
Payment for acquisition and construction of property, plant and equipment	(1,249,447)	(4,946,407)
Cash paid for interest on bonds and construction loans	(6,715,020)	(7,356,942)
Receipts from grants	1,243,432	2,443,223
Proceeds from sale of property, plant and equipment	3,037	-
Payments on long-term debt	(4,452,395)	(3,527,820)
Net cash used in capital and related financing activities	(11,170,393)	(13,387,946)
Cash flows from investing activities:		
Purchase of investments	(6,111,990)	(946,081)
Proceeds from sale of investments	218,721	-
Proceeds from payments on note receivable	650,259	617,786
Contribution to investment in Kern Water Bank Authority	-	(204,668)
Contribution to investment in Pioneer Project	-	(51,559)
Contribution to Cross Valley Canal Project	-	(198,497)
Interest income	1,025,913	1,158,627
Net cash provided by (used in) investing activities	(4,217,097)	375,608
Net increase (decrease) in cash and cash equivalents	1,825,279	(1,948,796)
Cash and cash equivalents at beginning of the year	14,175,649	16,124,445
Cash and cash equivalents at the end of the year	$ 16,000,928	$ 14,175,649

See Notes to Combined Financial Statements.

	2011	2010 (Restated)
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	$ 13,269,567	$ 5,195,740
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	6,190,554	6,103,609
General administrative & general project service charges	4,059,095	3,834,914
Prior year income, net	3,598,249	2,209,153
Other income	372,578	451,741
Changes in operating assets and liabilities:		
Receivables and general administrative and general project service charges receivable	1,325,757	(1,292,533)
Other prepaid expenses & deposits	(18,471)	14,016
Banked water inventory	(9,603,871)	(745,840)
Accounts payable and accrued liabilities	(1,980,689)	(4,707,258)
Net cash provided by operating activities	$ 17,212,769	$ 11,063,542
Reconciliation of cash and cash equivalents		
Cash and cash equivalents	$ 11,295,114	$ 4,928,796
Restricted cash	4,705,814	9,246,853
	$ 16,000,928	$ 14,175,649
Noncash investing and investing activities:		
Issuance of long-term debt for purchase of land	$ 8,400,000	$ -
Change in fair value of interest rate swaps	$ 7,872,618	$ 1,571,098

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.”

Principles of presentation:

The District, utilizing GASB Statement No. 20 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. At December 31, 2011, the District held 924,091 acre-feet (AF) of water in storage for future delivery to banking partners.

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, 2011 and 2010, $4,059,095 and $3,834,914, 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, 2011 and 2010, there was no end of the year discretionary payment authorized by the District. 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:

In prior years, the allowance for delinquency provision for general administrative and general project service charges has been based on a percentage of assessments levied. The percentage is determined by collections from previous years. As of December 31, 2011, the District's management decided an allowance for delinquency provision for general administrative and general project service charges was not necessary.

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 of 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.

Capital assets:

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.

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, 2011 and 2010, 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, 2011 and 2010.

Custodial credit risk

Custodial credit risk of deposits is the risk that in the event of a bank failure, the District's deposits may not be returned to it. The California Government Code and the District's investment policy do not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits and 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. California law also allows financial institutions to secure District deposits by pledging first trust deed mortgage notes having a value of 150% of the secured public deposits. At December 31, 2011, the District had no risk associated with custodial assets.

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 (LAIF) 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, 2011 and 2010 are classified in the accompanying combined financial statements as follows:

	2011	2010
Current assets - cash	$ 11,295,114	$ 4,928,796
Noncurrent assets - restricted cash	4,705,814	9,246,853
Noncurrent assets - restricted investments	7,494,715	1,622,094
	$ 23,495,643	$ 15,797,743

Cash and investments as of December 31, 2011 and 2010 consisted of the following:

	2011	2010
Cash deposits	$ 10,697,953	$ 8,058,682
Deposits with Kern County	1,457,096	1,446,119
Deposits with LAIF	3,845,879	4,670,848
Investments	7,494,715	1,622,094
	$ 23,495,643	$ 15,797,743

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 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 certificates of deposits, 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.

There is no minimum legal rating for U.S. Government Agency Securities and certificates of deposit.

As of December 31, 2011, 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
Certificates of deposit	$ 5,715,000	$ 3,808,000	$ 1,907,000	$ -
U.S. Govt. Agency Securities	1,779,715	-	-	1,779,715
	$ 7,494,715	$ 3,808,000	$ 1,907,000	$ 1,779,715

As of December 31, 2010, 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	$ 1,622,094	$ 1,622,094	$ -	$ -

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. The 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, 2011 and 2010 was ($34,502) and $63,237, 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 cost method. Under this method, the District does not recognize any share of the project's income or loss.

The District paid for the construction of three wells for this project during the year ended December 31, 2010, for a total cost of wells of $51,559.

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). During 2009, the CVC conveyance capacity was 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.

The District's investment in the Cross Valley Canal Project is accounted for using the cost method. Under this method, the District does not recognize any share of the project's income or loss.

The District made an additional capital contribution during the year ended December 31, 2010, for construction and engineering costs of $198,497.

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 (loss) from this investment for the years ended December 31, 2011 and 2010 was $356,968 and $(233,159), respectively. The earnings from this investment are included in the nonoperating revenue 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 accounting principles generally accepted in the United States of America 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.

Reclassifications:

Certain reclassifications have been made to the December 31, 2010 financial statements in order to conform to the December 31, 2011 presentation.

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	***2011 (acre feet)***	***2010 (acre feet)***
Purchased from Kern County Water Agency		
Entitlement		
Current year allocation (80% and 40%)	124,000	77,500
Add borrowing (carryover) to next year	(7,396)	(35,799)
Add carryover from prior year	23,390	21,333
Agency adjustment to carryover	12,409	-
Subtotal	152,403	63,034
Article 21	42,935	-
Other	2,731	515
Total Water Received - Kern County Water Agency	198,069	63,549
Total Water Received from Banking Partners	261,694	139,997
Total Water Received from Other Water Agencies	26,717	8,000
In-District Ground Water Extraction		
District Wells Pumped	-	10,614
Total Water Received	486,480	222,160

	2011 (acre feet)	2010 (acre feet)
Water Delivered		
Delivered In-District		
Contract	109,269	80,850
Non-contract	205,452	103,376
In District spreading and overdraft correction	18,953	12,853
Supplemental Ag water	1,394	400
Other	-	954
Total Water Delivered - In-District	335,068	198,433
Recharge to Kern Fan Projects	148,761	15,623
Returned to Other Water Agencies	40	-
Losses	2,611	8,104
Total Water Delivered	486,480	222,160

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:

	2011		2010	
	Amount Required	Amount on Deposit	Amount Required	Amount on Deposit
Bond and loan reserve fund	$ 12,120,617	$ 12,120,617	$ 10,789,513	$ 10,789,513
Cafeteria plan	59,912	59,912	59,340	59,340
Retirement trust fund	20,000	20,000	20,094	20,094
	$ 12,200,529	$ 12,200,529	$ 10,868,947	$ 10,868,947

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.

Cafeteria plan:

The District has a cafeteria plan whereby employees may elect to defer a portion of their current salary to be reimbursed for future medical expenses.

Retirement trust fund:

The District has a separate cash account for the 401(k) pension plan.

Note 4. Capital Assets

The following is a summary of changes in the District's property, plant and equipment for the years ended December 31, 2011 and 2010:

	Assets-At Cost				
	Balance 12/31/10	**Acquisitions**	**Retirements**	**Reclass/ Transfers**	**Balance 12/31/11**
Capital Assets not being depreciated:					
Land	$ 23,954,036	$ 8,578,798	$ -	$ -	$ 32,532,834
Construction in progress	18,764,979	1,070,650	(1,069,751)	(6,573,972)	12,191,906
Capital Assets being depreciated:					
Source of supply	13,121,062	-	-	20,681	13,141,743
Transmission and distribution	238,343,809	-	-	4,859,810	243,203,619
Communication equipment	19,976	-	-	-	19,976
Autos and trucks	1,461,683	-	(21,580)	-	1,440,103
Office equipment	671,109	-	(159,040)	-	512,069
Field and misc. equip.	405,661	-	(1,582)	-	404,079
Well drilling equip.	2,992,979	-	-	-	2,992,979
Wells	313,413	-	-	1,357,281	1,670,694
General plant and equipment	2,796,799	-	-	336,200	3,132,999
	$ 302,845,506	$ 9,649,448	$ (1,251,953)	$ -	$ 311,243,001

	Accumulated Depreciation				
	Balance 12/31/10	**Depreciation Expense**	**Retirements**	**Reclass/ Transfers**	**Balance 12/31/11**
Source of supply	$ 6,267,774	$ 332,594	$ -	$ -	$ 6,600,368
Transmission and distribution	57,445,148	5,449,911	-	-	62,895,059
Communication equipment	19,850	-	-	-	19,850
Autos and trucks	1,204,467	66,468	(21,580)	-	1,249,355
Office equipment	596,795	21,954	(158,521)	-	460,228
Field and misc. equip.	377,080	7,254	(1,582)	-	382,752
Well Drilling	673,424	226,264	-	-	899,688
Wells	47,012	15,671	-	-	62,683
General plant and equipment	826,499	70,438	-	-	896,937
	$ 67,458,049	$ 6,190,554	$ (181,683)	$ -	$ 73,466,920

Notes to Combined Financial Statements

	Assets-At Cost				
	Balance 12/31/09	***Acquisitions***	***Retirements***	***Reclass/ Transfers***	***Balance 12/31/10***
Capital Assets not being depreciated:					
Land	$ 23,838,239	$ 115,797	$ -	$ -	$ 23,954,036
Construction in progress	19,379,543	4,721,267	-	(5,335,829)	18,764,981
Capital Assets being depreciated:					
Source of supply	13,121,062	-	-	-	13,121,062
Transmission and distribution	233,772,712	-	-	4,571,097	238,343,809
Communication equipment	19,976	-	-	-	19,976
Autos and trucks	1,374,902	86,780	-	-	1,461,682
Office equipment	671,109	-	-	-	671,109
Field and misc. equip.	405,661	-	-	-	405,661
Well drilling equip.	2,970,415	22,563	-	-	2,992,978
Wells	313,413	-	-	-	313,413
General plant and equipment	2,032,067	-	-	764,732	2,796,799
	$ 297,899,099	$ 4,946,407	$ -	$ -	$ 302,845,506

	Accumulated Depreciation				
	Balance 12/31/09	***Depreciation Expense***	***Retirements***	***Reclass/ Transfers***	***Balance 12/31/10***
Source of supply	$ 5,934,806	$ 332,968	$ -	$ -	$ 6,267,774
Transmission and distribution	52,072,795	5,372,353	-	-	57,445,148
Communication equipment	19,850	-	-	-	19,850
Autos and trucks	1,150,396	54,071	-	-	1,204,467
Office equipment	561,303	35,492	-	-	596,795
Field and misc. equip.	369,028	8,052	-	-	377,080
Well Drilling	448,663	224,761	-	-	673,424
Wells	31,341	15,671	-	-	47,012
General plant and equipment	766,258	60,241	-	-	826,499
	$ 61,354,440	$ 6,103,609	$ -	$ -	$ 67,458,049

Note 5. Note Receivable

The note receivable consists of the following at December 31, 2011 and 2010:

	2011	2010
Note receivable, Poso Creek Water Company, LLC., 5.19%, secured by letter of credit in favor of the District for 18% of outstanding balance and 20,000 AF of water in storage, semiannual principal and interest payments of $728,523, due December 2026	$ 15,057,625	$ 15,707,884
Current portion	684,441	650,260
	$ 14,373,184	$ 15,057,624

Note 6. Long-Term Debt

Long-term debt at December 31, 2011 and 2010 was as follows:

	2011	2010
Contract payable, State of California, 3.4375%, unsecured, payable $33,735 semiannually including interest, due October 1, 2011 (proceeds were used for lining canals), paid in full	$ -	$ 65,821
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)	1,544,317	1,826,297
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)	341,004	420,003
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)	364,066	598,481

	2011	***2010***
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)	29,640,000	30,165,000
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)	44,355,000	45,005,000
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)	2,807,744	3,007,437
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)	1,128,907	1,208,127
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)	3,673,077	3,897,558
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)	4,085,986	4,303,587

	2011	2010
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)	2,940,040	3,460,225
2009A Refunding Revenue Bonds, interest rates vary over life of bonds between 2.5%-5.25%, collateralized by the District's general project service charges, principal payable annually, interest payable semi-annually, due December 1, 2038 (proceeds were used to refund 2008 bonds, fund reserve for the bonds, and pay for cost of issuance of bonds)	49,545,000	50,500,000
2011 Warrants, LIBOR multiplied by .87672 plus 2.47%, semiannual principal payment of $420,000 plus interest, final balloon payment due June 1, 2016 (proceeds were used to purchase land)	7,980,000	-
	148,405,141	144,457,536
2005 Interest Rate Swap, at cost (See Note 8)	3,327,000	3,327,000
Less deferred amount on advance refunding of 2003 and 2005 bonds, net of accumulated amortization 2011, $74,919; 2010, $146,227	$ (1,907,384)	$ (1,982,303)
Plus premium, discount, and costs of issuance on bonds, net of accumulated amortization 2011, $115,827; 2010, $179,716	826,482	942,309
Less current maturities	(4,956,448)	(3,996,066)
Long term debt, less discount and current maturities	$ 145,694,791	$ 142,748,476

The following is a summary of the long-term debt transactions for the years ended December 31, 2011 and 2010:

	Payable 12/31/10	***Additions***	***Deletions***	***Payable 12/31/11***	***Due within One Year***
Bonds principal	$ 129,130,228	$ -	$ (2,650,188)	$ 126,480,040	$ 2,765,193
Warrants	-	8,400,000	(420,000)	7,980,000	840,000
Loans, State of California	15,327,309	-	(1,382,208)	13,945,101	1,351,255
	144,457,537	8,400,000	(4,452,396)	148,405,141	$ 4,956,448
Fair Value of interest rate swap	7,590,651	8,131,711	-	15,722,362	
	$ 152,048,188	$ 16,531,711	$ (4,452,396)	$ 164,127,503	

	Payable 12/31/09	***Additions***	***Deletions***	***Payable 12/31/10***	***Due within One Year***
Bond principal	$ 131,312,425	$ -	$ (2,182,197)	$ 129,130,228	$ 2,651,181
Loans, State of California	16,672,932	-	(1,345,623)	15,327,309	1,344,885
	147,985,357	-	(3,527,820)	144,457,537	$ 3,996,066
Fair Value of interest rate swap	6,019,553	1,571,098	-	7,590,651	
	$ 154,004,910	$ 1,571,098	$ (3,527,820)	$ 152,048,188	

The annual requirements to amortize all debt outstanding as of December 31, 2011 are as follows:

Years Ending December 31,	***Principal***	***Interest***	***Interest Rate Swaps, net***	***Total Debt Service***
2012	$ 4,956,448	$ 6,664,025	$ 95,167	$ 11,715,640
2013	4,997,504	6,502,580	77,333	11,577,417
2014	5,038,812	6,340,854	942,602	12,322,268
2015	5,222,904	6,167,401	2,606,165	13,996,470
2016	9,114,638	5,966,520	2,529,656	17,610,814
2017-2021	21,641,440	26,486,777	11,485,454	59,613,671
2022-2026	26,343,395	21,234,052	9,168,197	56,745,644
2027-2031	30,525,000	14,770,430	5,940,299	51,235,729
2032-2036	34,305,000	6,288,775	1,754,926	42,348,701
2037-2038	6,260,000	313,000	-	6,573,000
	$ 148,405,141	$ 100,734,414	$ 34,599,799	$ 283,739,354

Note 7. 2011 Tax and Revenue Anticipation Notes

During the year ended December 31, 2011, in anticipation of the receipt of taxes, revenues and other monies to be received by the District allocable to fiscal year 2011, the District issued through Wells Fargo Bank the 2011 Tax and Revenue Anticipation Notes (TRAN), for an amount not to exceed $4,700,000. Interest is at daily one-month LIBOR plus 3%, due monthly. The TRAN is collateralized by amounts on deposit in investment accounts. The outstanding balance on these notes at December 31, 2011 was $-0-. Any outstanding principal is due by December 31, 2011.

On December 23, 2011, the District issued the 2012 TRAN (maximum borrowings of $4,300,000). All terms and conditions were the same as the 2011 TRAN. The outstanding balance on these notes at December 31, 2011 was $-0-.

Note 8. Derivatives

The District accounts for derivatives under GASB No. 53, "Accounting and Financial Reporting for Derivative Instruments." The objectives and terms of the District's hedging derivative instruments outstanding at December 31, 2011 are listed below:

Type	*Objective*	*Notional Amount*	*Effective Date*	*Maturity Date*	*Terms*	*Fair Value*
Pay-fixed interest rate swap	Hedge of changes in interest rates of future bond issuances	$45,093,885	9/1/2014	12/1/2035	Pay 5.12%, receive 69% of LIBOR	$ (15,463,270)
Pay-fixed interest rate swap	Hedge of changes in interest rates of the 2007 Revenue Bonds	$ 2,939,044	11/15/2007	5/15/2017	Pay 3.586%, receive LIBOR	$ (259,092)
						$ (15,722,362)

On October 27, 2005, the District entered into an off-market forward starting swap (2005 swap). The swap will commence September 1, 2014, and is based on an initial 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). 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.

On April 24, 2007, the District entered into an off-market swap with Wells Fargo Bank (Wells Fargo) 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 an initial notional amount of $5,000,000.

The fair values of the interest rate swaps were estimated using the zero-coupon method. This method calculates the future net settlement payments required by the swap, assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These payments are then discounted using the spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the date of each future net settlement on the swaps. The above swaps were classified as deferred outflows on the balance sheet. The total change in fair value for the year ended December 31, 2011 was $8,131,710. The balance reported on the December 31, 2010 and 2011 combined statement of net assets was $15,722,362 and $7,590,651.

Risks

Credit Risk - Credit risk is the risk that Wells Fargo Bank or Sun Trust Bank cannot fulfill the terms and obligations specified in the swaps agreements. Because the swap had a negative fair value as of December 31, 2011, the District did not have exposure related to credit risk on its swaps with either bank. However, the District would have exposure related to credit risk in the amount of the swaps' positive fair value if interest rates increased to cause the fair value of the swaps to become positive. The credit ratings of Wells Fargo and SunTrust are A+ and BBB by Standard & Poors, respectively.

Basis Risk - The District is exposed to basis risk on its 2007 pay-fixed interest rate swap because the variable rate payments received are based on an index other than the interest rates the District pays on its 2007 Revenue bonds. As of December 31, 2011, the interest rate on the District's hedged bond was 3.586%, while the rate being received was LIBOR, which was .28%.

The District is exposed to basis risk on its 2005 pay-fixed interest rate swap because the variable rate payments received are equal to 69% of LIBOR, which could 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/ 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 Wells Fargo/ 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.

Rollover Risk - The District is exposed to rollover risk on swaps that mature or may be terminated prior to the maturity of the associated financings. When these swaps terminate, or in the case of termination option, if the counterparty exercises its option, the District will not realize the synthetic rate offered by the swaps on the underlying issues. The District is exposed to rollover risk on the 2007 swap should it be terminated prior to the maturity of the associated findings.

Foreign Currency Risk - All derivatives are denominated in U.S. dollars and therefore, the District is not exposed to foreign currency risk.

Note 9. 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/ public officials liability	$2,000,000	$2,000,000-$60,000,000
Fidelity insurance	$ 100,000	$100,000-$500,000
Property insurance	$ 50,000	$50,000-$100,000,000

The District is in a group with a $0 retention level (deductible) per occurrence for auto and general liability, $5,000 per occurrence for buildings, personal property, fixed equipment and mobile equipment, $500 per occurrence on licensed vehicles, $1,000 per occurrence for fidelity claims and $10,000 - $25,000 for machinery. 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 Starr Indemnity and Liability Company, Ironshore Specialty Insurance Co, Allied World National Assurance Co., Great American Assurance Company, Federal Insurance Co. and Travelers Casualty and Surety Co. 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 10. 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 $10,135,669 and $11,016,807 for the years ended December 31, 2011 and 2010, respectively.

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.

On May 25, 2010, Judge Wanger of the Fresno Federal Court eased pumping restrictions that were set in place on March 13, 2008. The federal court granted a preliminary injunction on the biological opinion for salmon, stating that the federal agencies responsible for drafting the biological opinion must take in account human impacts and also demonstrate why certain water exports restriction were called for in the opinion.

Because of the continuing possibility of state water allocations being maintained at reduced levels for water users due to the 2008 and 2010 decisions, the District has developed several programs to augment the Districts available water supply among which are, the utilization of wells, banking programs and the transfer of water from sources outside the District. Additionally, the District continues to work on the financial aspect of the problems in an attempt to reduce charges and increase the reliability of the water supply to water users, wherever possible.

During the year ending December 31, 2011, the DWR allocated 80% of entitlement to state water contractors, due to the high snow pack and rain in the winter of 2010-2011. However, due to the pumping restrictions and extremely dry winter of 2011-2012, the District is projecting a 50% allocation for the 2012 water year.

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, 2011 and 2010 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. These assessments will collateralize the bonds until paid. It is anticipated these assessments, which were levied in February 1992, will remain uncalled and that bond obligations will be paid from operations.

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.

Note 11. 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 John Hancock, Principal Financial and Invesco. 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, 2011 and 2010 were as follows:

	2011	***2010***
Total payroll	$ 2,949,299	$ 3,194,435
Base salary for computing contributions	$ 2,751,788	$ 2,652,741
District contributions	$ 268,470	$ 265,274
Employee contributions	$ 133,707	$ 142,765

Note 12. Prior Period Adjustment

During 2007, the District entered into an agreement to sell water banking capacity rights to another entity. This agreement and monies received were inadvertently treated as annual water banking revenue as opposed to a sale of capacity rights, which the District financed on behalf of the purchasing entity. Therefore, the financial statements have been restated to reflect the prior year sale and resulting note receivable (Note 5), which resulted in an increase in net assets of $16,325,670 at December 31, 2009.

The 2010 combined statements of net assets, revenue and expenses, change in net assets and cash flows have been restated for the aforementioned prior period and the impact of that restatement is as follows on the 2010 financial statements:

	Previously Stated	***Restated Amount***	***Change***
Total Assets	$ 309,417,331	$ 325,125,215	$ 15,707,884
Net Assets	$ 150,637,990	$ 166,345,874	$ 15,707,884
Change in Net Assets	$ 9,128,652	$ 8,510,865	$ (617,787)

BARBICH HOOPER KING
DILL HOFFMAN
ACCOUNTANCY CORPORATION

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

Board of Directors
Semitropic Water Storage District
Wasco, California

We have audited the accompanying combined statements of net assets of Semitropic Water Storage District (District) as of and for the years ended December 31, 2011 and 2010, and the combined related statements of revenue, expenses and changes in net assets, and cash flows for the years then ended, and have issued our report thereon dated April 9, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in the *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audit, we considered the District's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the District's internal control over financial reporting.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that material misstatement of the District's financial statements will not be prevented, or detected and corrected on a timely basis.

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

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the District's combined financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of management, the board of directors, the California State Controller's office, and federal awarding agencies and is not intended to be and should not be used by anyone other than these specified parties.

BARBICH HOOPER KING
DILL HOFFMAN
Accountancy Corporation

Barbich Hooper King
Bakersfield, California
April 9, 2012

Semitropic Water Storage District

Combined Schedules of Operating Expenses
For the Years Ended December 31, 2011 and 2010

	2011	2010	Increase (Decrease)
Transmission and distribution:			
Power	$ 5,696,183	$ 5,165,071	$ 531,112
Kern Water Bank and Pioneer Expenses	2,556,857	232,897	2,323,960
Salaries and wages	1,452,227	1,623,552	(171,325)
Repairs and maintenance	1,038,715	591,110	447,605
Employee benefits	751,278	976,810	(225,532)
Fuel and oil	251,260	177,394	73,866
Payroll taxes	146,247	140,090	6,157
Operating supplies	43,408	45,932	(2,524)
Equipment maintenance	32,157	1,368	30,789
Equipment rent	27,772	15,529	12,243
Utilities	24,072	15,348	8,724
Miscellaneous	2,701	2,555	146
Licenses and fees	815	3,977	(3,162)
	$ 12,023,692	$ 8,991,633	$ 3,032,059
Well operations:			
Employee benefits	$ 102,932	$ 175,478	$ (72,546)
Salaries	76,624	210,625	(134,001)
Payroll taxes	25,609	47,594	(21,985)
Equipment rent	9,953	5,558	4,395
Insurance	4,258	4,334	(76)
Supplies	298	5,827	(5,529)
Repairs and maintenance	9,049	123,524	(114,475)
Licenses and fees	-	664	(664)
	$ 228,723	$ 573,604	$ (344,881)

	2011	2010	Increase (Decrease)
Source of supply:			
Water	$ 2,161,130	$ 8,565,622	$ (6,404,492)
General and administrative:			
Salaries and wages	$ 1,109,793	$ 1,086,455	$ 23,338
Employee benefits	401,717	456,949	(55,232)
Consulting and computer support	287,061	156,736	130,325
Legal	166,916	129,852	37,064
Public relations	155,000	155,854	(854)
Insurance	138,720	140,259	(1,539)
Engineering	87,806	35,144	52,662
Financing and administration	77,910	148,546	(70,636)
Dues	74,988	95,715	(20,727)
Damage claim cost	71,598	-	71,598
Office	50,354	76,758	(26,404)
Payroll taxes	48,227	51,714	(3,487)
Utilities	45,751	54,007	(8,256)
Accounting and auditing	43,375	42,980	395
Equipment rent	28,910	30,101	(1,191)
Travel	28,775	29,879	(1,104)
Repairs and maintenance	62,768	42,704	20,064
Building services	14,649	13,787	862
Bank fees	12,760	11,500	1,260
Directors' fees and expense	11,275	12,012	(737)
Marketing	5,331	2,049	3,282
Property taxes	237	236	1
Grant related costs	-	10,323	(10,323)
	$ 2,923,921	$ 2,783,560	$ 140,361
Depreciation expense	$ 6,190,554	$ 6,103,609	$ 86,945

Semitropic Water Storage District

Combined Schedule of Insurance Coverage
December 31, 2011

	Policy No.	Effective Date	Expiration Date
Joint Powers Insurance Authority - Association of California Water Agencies Property, Fidelity	Self-Insured	4/1/2011	4/1/2012
Joint Powers Insurance Authority - Association of California Water Agencies General, Auto, Public Officials Liability	Self-Insured	10/1/2011	10/1/2012
Bonds			
Western Surety	22185935	3/31/2006	4/1/2013
Great American	7909111	4/12/2006	4/12/2013
Western Surety	69311183	4/17/2011	4/17/2015
Western Surety	14558205	9/23/2011	9/23/2015
Great American	150683301	4/11/2011	4/11/2013
Western Surety	69485775	4/17/2011	4/17/2015
Western Surety	24916412	2/14/2011	2/14/2014
Western Surety	24916405	2/14/2011	2/14/2014

Annual Premium	***Coverage***
$ 55,019	Property Insurance - all risk coverage $1,000 - $10,000 - combined single limit for each occurrence $50,000 - $100,000,000 - excess comprehensive liability - total insurable value $35,841,941 basic property and equipment ($5,000 deductible) - auto physical damage ($500 deductible) $100,000 - $500,000 - employee fidelity bond ($1,000 deductible)
$ 92,411	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 - Frederick Wegis
$ 313	$5,000 - public official bond - Philip W. Portwood
$ 340	$5,000 - public official bond - Jeff Fabbri
$ 340	$5,000 - public official bond - Todd Tracy
$ 1,094	$5,000 - public official bond - Daniel Waterhouse
$ 340	$50,000 - treasurer bond - Daniel Waterhouse
$ 255	$5,000 - public official bond - Robert McCarthy
$ 255	$5,000 - public official bond - Courtney Howard