

TUOLUMNE UTILITIES DISTRICT

**INDEPENDENT AUDITOR'S REPORT
AND
FINANCIAL STATEMENTS**

JUNE 30, 2010

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Tuolumne Utilities District
Sonora, California

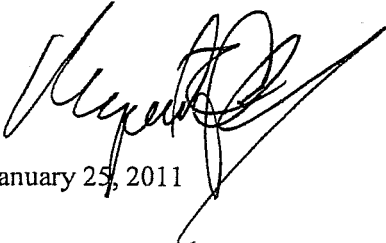
We have audited the accompanying financial statements of the Tuolumne Utilities District as of and for the year ended June 30, 2010, which collectively comprise the District's basic financial statements as listed in the table of contents. These basic financial statements are the responsibility of the District's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Tuolumne Utilities District as of June 30, 2010 and the respective changes in the financial position and cash flows, thereof for the year 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 January 25, 2011 on our consideration of the Tuolumne Utilities 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 the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The District has not presented the Management Discussion and Analysis that accounting principles generally accepted in the United States have determined is necessary to supplement, although not required to be part of, the financial statements.



January 25, 2011

TUOLUMNE UTILITIES DISTRICT

STATEMENT OF NET ASSETS – PROPRIETARY FUNDS JUNE 30, 2010

ASSETS	Water	Sewer	Total
Current assets			
Cash and investments	\$ (6,162,856)	\$ 13,016,533	\$ 6,853,677
Accounts receivable, net of allowance	680,687	342,707	1,023,394
Intergovernmental receivable	550,853	65,930	616,783
Miscellaneous receivable	281,425	25,049	306,474
Interest receivable	7,252	3,413	10,665
Prepaid expense	15,239	7,172	22,411
Inventory	156,990	73,878	230,868
Total current assets	<u>(4,470,408)</u>	<u>13,534,680</u>	<u>9,064,272</u>
Non-current assets			
Capital assets, net of allowance for depreciation	43,864,385	21,063,834	64,928,219
Assessments receivable	-	693,685	693,685
Total non-current assets	<u>43,864,385</u>	<u>21,757,519</u>	<u>65,621,904</u>
Restricted assets			
Cash and investments	1,035,199	291,674	1,326,873
Total restricted assets	<u>1,035,199</u>	<u>291,674</u>	<u>1,326,873</u>
Total assets	<u>40,429,176</u>	<u>35,583,873</u>	<u>76,013,049</u>
LIABILITIES			
Current liabilities			
Accounts payable and accrued expenses	341,076	141,670	482,746
Deposits	149,460	39,125	188,585
Accrued interest payable	38,317	460	38,777
Current portion of long-term debt	558,921	109,034	667,955
Total current liabilities	<u>1,087,774</u>	<u>290,289</u>	<u>1,378,063</u>
Non-current liabilities			
Long-term debt	4,593,099	1,846,943	6,440,042
Compensated absences	662,722	311,869	974,591
Total noncurrent liabilities	<u>5,255,821</u>	<u>2,158,812</u>	<u>7,414,633</u>
Total liabilities	<u>6,343,594</u>	<u>2,449,102</u>	<u>8,792,696</u>
NET ASSETS			
Invested in capital assets, net of related debt	38,712,366	19,107,856	57,820,222
Unrestricted	(4,626,784)	14,026,915	9,400,131
Total net assets	<u>\$ 34,085,582</u>	<u>\$ 33,134,771</u>	<u>\$ 67,220,353</u>

TUOLUMNE UTILITIES DISTRICT

STATEMENT OF REVENUE, EXPENSE, AND CHANGES IN FUND NET ASSETS – PROPRIETARY FUNDS YEAR ENDED JUNE 30, 2010

	Water	Sewer	Total
Operating Revenues			
Service charges	\$ 6,770,114	\$ 2,842,322	\$ 9,612,436
Other revenue	2,775	170,745	173,520
Total operating revenues	<u>6,772,889</u>	<u>3,013,067</u>	<u>9,785,956</u>
Operating Expenses			
Supply and pumping	855,618	-	855,618
Collection	-	552,915	552,915
Treatment	1,749,019	667,588	2,416,607
Transmission and distribution	948,273	-	948,273
Disposal	-	137,151	137,151
Customer services	260,656	44,380	305,036
Administration and general	4,795,724	1,576,652	6,372,376
Depreciation	1,655,142	918,267	2,573,409
Total operating expenses	<u>10,264,432</u>	<u>3,896,953</u>	<u>14,161,385</u>
Operating income/(loss)	<u>(3,491,543)</u>	<u>(883,886)</u>	<u>(4,375,429)</u>
Nonoperating Revenues/(Expenses)			
Property taxes	613,471	288,692	902,163
Connection fees	71,276	275,896	347,172
Capital recovery service charges	1,659,597	1,373,794	3,033,391
Debt service recovery charge	485,619	-	485,619
Intergovernmental revenue	221,385	-	221,385
Investment income	32,151	61,635	93,786
Contributed capital revenue	1,826,711	559,770	2,386,481
Other income	32,381	300	32,681
Gain (loss) on sale of assets	(10,014)	15,117	5,103
Interest expense	(276,309)	(95,460)	(371,769)
Total nonoperating revenues/(expenses)	<u>4,656,269</u>	<u>2,479,743</u>	<u>7,136,012</u>
Net income before transfers	1,164,726	1,595,857	2,760,583
Transfers			
Transfers in/(out)	-	-	-
Change in Net Assets	<u>1,164,726</u>	<u>1,595,857</u>	<u>2,760,583</u>
Net Assets			
Beginning of year	32,920,856	31,538,914	64,459,770
End of year	<u>\$ 34,085,582</u>	<u>\$ 33,134,771</u>	<u>\$ 67,220,353</u>

TUOLUMNE UTILITIES DISTRICT

STATEMENT OF CASH FLOWS - PROPRIETARY FUNDS YEAR ENDED JUNE 30, 2010

	Water	Sewer	Total
Operating Activities			
Receipts from customers and users	\$ 6,678,158	\$ 3,022,383	\$ 9,700,541
Payments to employees	(3,721,394)	(1,388,056)	(5,109,450)
Payments to suppliers for goods and services	(5,140,592)	(2,007,760)	(7,148,352)
Net cash provided by (used in) operating activities	<u>(2,183,828)</u>	<u>(373,433)</u>	<u>(2,557,261)</u>
Non-capital Financing Activities			
Property taxes and assessments received	613,471	322,675	936,146
Receipts from customers for connection fees	71,276	275,896	347,172
Receipts from customers for capital recovery	1,659,597	1,373,794	3,033,391
Receipts from customers for debt recovery	485,619	-	485,619
Other income	32,381	300	32,681
Receipts from other governments	1,404,896	28,257	1,433,153
Net cash provided (used) by noncapital financing activities	<u>4,267,240</u>	<u>2,000,922</u>	<u>6,268,162</u>
Capital and Related Financing Activities			
Purchase and disposal of capital assets, net	(1,931,860)	(660,252)	(2,592,112)
Principal paid on long-term debt	(628,620)	(169,935)	(798,555)
Interest paid on long-term debt	(279,137)	(119,966)	(399,103)
Net cash used in capital and related financing activities	<u>(2,839,617)</u>	<u>(950,153)</u>	<u>(3,789,770)</u>
Investing Activities			
Investment earnings	43,989	67,206	111,195
Net cash provided by investing activities	<u>43,989</u>	<u>67,206</u>	<u>111,195</u>
Net Increase (Decrease) in Cash	(712,216)	744,542	32,326
Cash and Investments			
Beginning of year	(4,415,441)	12,563,665	8,148,224
End of year	<u>\$ (5,127,657)</u>	<u>\$ 13,308,207</u>	<u>\$ 8,180,550</u>
Cash and investments as presented on Statement of Net Assets:			
Cash and investments	(6,162,856)	13,016,533	6,853,677
Cash and investments, restricted	1,035,199	291,674	1,326,873
Total cash and investments	<u>\$ (5,127,657)</u>	<u>\$ 13,308,207</u>	<u>\$ 8,180,550</u>

TUOLUMNE UTILITIES DISTRICT

STATEMENT OF CASH FLOW - PROPRIETARY FUNDS (CONTINUED) YEAR ENDED JUNE 30, 2010

	Water	Sewer	Total
Cash Flows from Operating Activities			
Operating income (loss)	\$ (3,491,543)	\$ (883,886)	\$ (4,375,429)
Adjustments to reconcile operating income (loss) to net cash provided (used) by operating activities:			
Depreciation	1,655,142	918,267	2,573,409
(Increase) Decrease in accounts receivable	1,746	28,818	30,564
(Increase) Decrease in miscellaneous receivables	(107,001)	(24,791)	(131,792)
(Increase) Decrease in prepaid expenses	98,683	46,439	145,122
(Increase) Decrease in inventories	20,474	9,635	30,109
(Increase) Decrease in preliminary surveys	18,610	-	18,610
Increase (Decrease) in accounts payable and accrued expenses	(83,340)	(328,676)	(412,016)
Increase (Decrease) in deposits payable	10,524	5,289	15,813
Increase (Decrease) in post retirement benefits	(338,951)	(159,506)	(498,457)
Increase (Decrease) in compensated absences	31,828	14,978	46,806
Net Cash Provided (Used) by Operating Activities	<u>\$ (2,183,828)</u>	<u>\$ (373,433)</u>	<u>\$ (2,557,261)</u>

TUOLUMNE UTILITIES DISTRICT

NOTES TO FINANCIAL STATEMENTS YEAR ENDED JUNE 30, 2010

Note 1 – Summary of Significant Accounting Policies

Reporting Entity

The Tuolumne Utilities District (District) is a Special District governed by an elected five member Board of Directors. The District was organized on July 1, 1992 as the result of combining the Tuolumne Regional Water District and the County Water Department under Division 12 of the California Water Code. The District's Board is elected at large and has the authority to develop and operate water facilities for consumption and hydroelectric power generation, and sewer facilities for collection, treatment and disposal of sewage. The District has no component units.

Basis of Accounting and Measurement Focus

The District accounts for its operations in an enterprise fund using the economic resources measurement focus and the accrual basis of accounting. A fund is an accounting entity with a self-balancing set of accounts established to record the financial position and results of operations of a specific government activity. The activities of enterprise funds closely resemble those of ongoing businesses in which the purpose is to conserve and add to basic resources while meeting operating expenses from current revenues. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

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

The District reports the following major proprietary funds:

Water Fund – This fund accounts for the activities of providing water to residents of the District.

Sewer Fund – This fund accounts for the activities of providing sewer management to residents of the District.

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 expenditures/expenses during the reporting period. In addition, the District allocates general and administrative activities 68% to the Water Fund and 32% to the Sewer Fund. Actual results could differ from those estimates.

TUOLUMNE UTILITIES DISTRICT

NOTES TO FINANCIAL STATEMENTS YEAR ENDED JUNE 30, 2010

Note 1 – Summary of Significant Accounting Policies (Continued)

Budgetary Policy and Control

The District's Board approves each year's budget submitted by the Controller prior to the beginning of the new fiscal year. All amendments to the budget, or transfers of budget amounts between Funds, require Board approval.

Financial Statement Amounts

Cash and Cash Equivalents – For purposes of the statement of cash flows, the District considers all highly liquid investments including cash and cash equivalents in restricted assets to be cash equivalents. Deposits of cash and cash equivalents must comply with the District's Investment Policy which complies with the California Government Code.

Accounts Receivable – Billed, but unpaid, services provided to individuals or non-governmental entities are recorded as accounts receivable. The Proprietary Funds include a year end accrual for services through the end of the fiscal year which have not yet been billed.

Property Taxes - Secured and unsecured property taxes are levied on January 1 by the County of Tuolumne. Secured property taxes are due in two installments, the first installment is due on November 1 and delinquent with penalties after December 10; and the second installment is due February 1 and delinquent with penalties after April 10th, on the property taxes assessed on January 1. Unsecured property taxes are payable in one installment on or before August 31. Property tax revenues are recognized in the fiscal year in which they are levied.

Inventory – Inventories are stated at cost on a first-in, first-out basis.

Interfund Receivables/Payables - Items classified as interfund receivable/payable represent short-term lending/borrowing transactions between funds. This classification also includes the current portion of an advance to or from another fund.

Capital Assets – Capital assets, including infrastructure, are recorded at cost. Capital assets are defined by the government as assets with an initial individual cost of more than \$1,000 (amount not rounded) and an estimated useful life in excess of three years. Donated capital assets are recorded at estimated fair market value at the date of donation.

The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend assets lives are not capitalized. Betterments and major improvements which significantly increase values, change capacities or extend useful lives are capitalized. Upon sale or retirement of fixed assets, the cost and related accumulated depreciation are removed from the respective accounts and any resulting gain or loss is included in the results of operations.

Major outlays for capital assets and improvements are capitalized as projects are constructed. Interest incurred during the construction phase of capital assets of business-type activities are included as part of the capitalized value of the assets constructed.

TUOLUMNE UTILITIES DISTRICT

NOTES TO FINANCIAL STATEMENTS YEAR ENDED JUNE 30, 2010

Note 1 – Summary of Significant Accounting Policies (Continued)

Property, plant, and equipment of the primary government are depreciated using the straight line method over the following estimated useful lives:

	<u>Years</u>
Utility plant	10-50
Transportation and other equipment	3-10
Office furniture and equipment	3-10

Preliminary Survey and Investigations – Preliminary survey and investigations are accumulated costs of effort to determine the need for and feasibility of acquiring additional water and sewer system facilities. Upon completion of the effort, the accumulated cost is transferred to construction in progress or charged to operations if a project is not feasible.

Compensated Absences – It is the District’s policy to permit employees to accumulate earned but unused vacation and sick leave, which will be paid to employees upon separation from the District’s service. The cost of vacation and sick leave is recorded in the period accrued.

Long-Term Obligations - Long-term debt and other long-term obligations are reported as liabilities in the Proprietary Fund Type Statement of Net Assets. Debt principal payments are reported as decreases in the balance of the liability on the Statement of Net Assets. Bond premiums and discounts, as well as issuance costs, are deferred and amortized over the life of the bonds using the effective interest method. Bonds payable are reported net of the applicable bond premium or discount. Bond issuance costs are reported as deferred charges and amortized over the term of the related debt.

Net Assets/Fund Equity - The financial statements utilize a net assets presentation. Net assets are categorized as invested capital assets (net of related debt), restricted and unrestricted.

- **Invested In Capital Assets, Net of Related Debt** - This category groups all capital assets, including infrastructure, into one component of net assets. Accumulated depreciation and the outstanding balances of debt that are attributable to the acquisition, construction or improvement of these assets reduce the balance in this category.
- **Restricted Net Assets** - This category presents external restrictions on net assets imposed by creditors, grantors, contributors, laws or regulations of other governments and restrictions imposed by law through constitutional provisions or enabling legislation.
- **Unrestricted Net Assets** - This category represents net assets of the District not restricted for any project or other purpose.

TUOLUMNE UTILITIES DISTRICT

NOTES TO FINANCIAL STATEMENTS YEAR ENDED JUNE 30, 2010

Note 2 – Cash and Investments

The District pools all of its cash and investments except those funds required to be held by outside fiscal agents under the provisions of bond indentures. Interest income earned on pooled cash is allocated to the various funds on average cash balances. Interest income from cash investments held with fiscal agents is credited directly to the related funds.

Cash and investments are reported in the financial statements as follows:

Statement of Net Assets	
Cash and investments	\$ 6,853,677
Restricted cash and investments	1,326,873
Total Cash and Investments	<u>\$ 8,180,550</u>

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

Cash on Hand	\$ 275
Deposits with Financial Institutions	616,231
Local Agency Investment Fund	7,490,739
Held by Bond Trustee:	
Money Market Mutual Funds	<u>73,305</u>
Total Cash and Investments	<u>\$ 8,180,550</u>

Authorized Investments by the District

The District's investment policy only authorizes selection of investments based on safety, liquidity and yield, authorizing investment in the Local Agency Investment Fund administered by the State of California (LAIF). Except for Government Code 53601, as amended in 1995, prohibiting investment in "inverse floaters", "range notes", and "interest only strips", the District's investment policy does not contain any specific provisions intended to limit the District's exposure to interest rate risk, credit risk, and concentration of credit risk.

Investments Authorized by Debt Agreements

Investment of debt proceeds held by escrow agent is governed by provisions of the Escrow Agreement, rather than the general provisions of the California Government Code or the District's investment policy. The table below identifies the investment types authorized for investments held by escrow agent. The table also identifies certain provisions of the agreement that address interest rate risk, credit risk, and concentration of credit risk. Although certain investments have no maximum maturity, the terms of the agreement call for the maturity to be not later than the date such moneys are estimated by the District to be required for the projects financed.

TUOLUMNE UTILITIES DISTRICT

NOTES TO FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2010

Note 2 – Cash and Investments (Continued)

<u>Authorized Investment Type</u>	<u>Maximum Maturity</u>	<u>Maximum Percentage of Portfolio</u>	<u>Maximum in One Issue</u>
U.S. Treasury Obligations	None	None	None
Federal Agency Obligations	None	None	None
Senior Debt Obligations	3 Years	None	None
Commercial Paper	270 Days	None	None
Bankers' Acceptances	1 Year	None	None
Money Market Mutual Funds	N/A	None	None
State and Municipal Bonds	None	None	None
Local Agency Investment Fund (LAIF)	N/A	None	None

Interest Rate Risk

Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. Generally, the longer the maturity of an investment, the greater the sensitivity of its fair value to changes in market interest rates.

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

<u>Investment Type</u>	<u>12 Months or less</u>	<u>13 to 24 Months</u>	<u>25 to 60 Months</u>	<u>Total</u>
Money Market Funds	\$ 73,305	\$ -	\$ -	\$ 73,305
Local Agency Investment Fund	7,490,739	-	-	7,490,739
Total Investments	<u>\$ 7,564,044</u>	<u>\$ -</u>	<u>\$ -</u>	<u>7,564,044</u>
Cash in bank and on hand				616,506
Total Cash and Investments				<u>\$ 8,180,550</u>

Credit Risk

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 by Standard & Poor's required by the California Government Code or the District's investment policy, and the actual rating as of June 30, 2010 for each investment type:

TUOLUMNE UTILITIES DISTRICT

NOTES TO FINANCIAL STATEMENTS YEAR ENDED JUNE 30, 2010

Note 2 – Cash and Investments (Continued)

<u>Investment Type</u>	<u>Minimum Rating</u>	<u>Not Rated</u>
Cash in bank and on hand	N/A	\$ 616,506
Local Agency Investment Fund	N/A	7,490,739
Cash held by bond trustee	N/A	73,305
Total Investments		<u>\$ 8,180,550</u>

Concentration of Credit Risk

The District's investment policy contains no limitations on the amount that can be invested in any one issuer beyond that stipulated in California Government Code. The District did not have any investments that represent 5% or more of total District-wide investments as of June 30, 2010.

Custodial Credit Risk

Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The California Government Code and the City's investment policy do not contain legal or policy requirements that would limit the exposure to custodial credit risk for deposits, 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 City deposits by pledging first trust deed mortgage notes having a value of 150% of the secured public deposits.

California Local Agency Investment Fund

The District is a voluntary participant in the Local Agency Investment Fund (LAIF) which is regulated by California Government Code Section 16429 under the oversight of the Treasurer of the State of California. The District reports its investment in LAIF at the fair value amount provided by LAIF, which is the same as the value of the pool share. The balance is available for withdrawal on demand, and is based on the accounting records maintained by LAIF, which are recorded on an amortized cost basis. Included in LAIF's investment portfolio are collateralized mortgage obligations, mortgage-backed securities, other asset-backed securities, loans to certain state funds, and floating rate securities issued by federal agencies, government-sponsored enterprises, United States Treasury Notes and Bills and corporations. The carrying value of LAIF approximates fair value.

TUOLUMNE UTILITIES DISTRICT

NOTES TO FINANCIAL STATEMENTS YEAR ENDED JUNE 30, 2010

Note 3 – Capital Assets

Capital asset activity for the year ended June 30, 2010, was as follows:

	<u>Balance</u> <u>July 1, 2009</u>	<u>Additions</u>	<u>Retirements</u>	<u>Balance</u> <u>June 30, 2010</u>
Capital assets, not being depreciated				
Land	\$ 5,074,847	\$ -	\$ (11,356)	\$ 5,063,491
Construction in progress	844,371	1,191,189	(2,959)	2,032,601
Total capital assets, not being depreciated	<u>5,919,218</u>	<u>1,191,189</u>	<u>(14,315)</u>	<u>7,096,092</u>
Capital assets, being depreciated				
Water utility system - infrastructure	52,768,227	2,505,912	(133,439)	55,140,700
Sewer utility system - infrastructure	32,047,147	938,669	-	32,985,816
Buildings - administration	3,768,969	-	-	3,768,969
Equipment and machinery	6,900,661	352,811	(64,044)	7,189,428
Total capital assets, being depreciated	<u>95,485,004</u>	<u>3,797,392</u>	<u>(197,483)</u>	<u>99,084,913</u>
Less: accumulated depreciation	<u>(38,886,407)</u>	<u>(2,573,408)</u>	<u>207,029</u>	<u>(41,252,786)</u>
Total capital assets, being depreciated, net	<u>56,598,597</u>	<u>1,223,984</u>	<u>9,546</u>	<u>57,832,127</u>
Total capital assets, net	<u>\$ 62,517,815</u>	<u>\$ 2,415,173</u>	<u>\$ (4,769)</u>	<u>\$ 64,928,219</u>

Note 4 – Proposition 1A Borrowing by the State of California

Under the provisions of Proposition 1A and as part of the 2009-10 budget package passed by the California state legislature on July 28, 2009, the State of California borrowed 8% of the amount of property tax revenue, including those property taxes associated with the in-lieu motor vehicle license fee, the triple flip in lieu sales tax, and supplemental property tax, apportioned to cities, counties, and special districts. The state is required to repay this borrowing plus interest by June 30, 2013. After repayment of this initial borrowing, the California legislature may consider only one additional borrowing within a ten-year period. The amount of this borrowing pertaining to the District was \$72,457. This borrowing by the State of California was recognized as a receivable in the accompanying financial statements.

TUOLUMNE UTILITIES DISTRICT

NOTES TO FINANCIAL STATEMENTS YEAR ENDED JUNE 30, 2010

Note 5 – Long-Term Debt

The District generally incurs long-term debt to finance projects or purchase assets which will have useful lives equal to or greater than the related debt. The District's debt issues and transactions are summarized below and discussed in detail thereafter.

	Balance July 1, 2009	Additions	Retirements	Balance June 30, 2010	Current Portion
Special Assessment Bonds					
1976 Pinecrest Assessment District *	\$ 21,875	\$ -	\$ -	\$ 21,875	\$ 21,875
1983 Greenly Basin Assessment District *	5,000	-	-	5,000	5,000
1984 Clean Water Assessment District	584,097	-	(59,000)	525,097	-
Certificates of Participation					
1991 COP	886,000	-	(20,000)	866,000	22,000
Loans Payable					
2007 LaSalle	1,095,058	-	(65,609)	1,029,449	33,998
2005 LaSalle	1,037,287	-	(73,755)	963,532	77,300
2005 SDWSRF	37,986	-	(2,451)	35,535	1,225
1996 SDWR	57,955	-	(4,212)	53,743	4,335
1996 LaSalle	2,101,701	-	(226,333)	1,875,368	241,047
1994 LaSalle	713,554	-	(161,654)	551,900	84,788
1994 SDWR	681,158	-	(143,142)	538,016	147,724
1994 SDWR	32,680	-	(12,368)	20,312	6,522
1991 SDWR	80,850	-	(5,570)	75,280	5,759
1987 SDWR	23,652	-	(2,165)	21,487	2,165
1978 USDA	46,130	-	(5,581)	40,549	5,859
2008 SDWSRF	501,452	-	(16,715)	484,737	8,358
Total Long-Term Debt	<u>\$ 7,906,435</u>	<u>\$ -</u>	<u>\$ (798,555)</u>	<u>\$ 7,107,880</u>	<u>\$ 667,955</u>

* These bond amounts represent fully matured but unsurrendered certificates.

1984 Clean Water Assessment Bonds

A Special Assessment District was formed August 28, 1983 to provide funding for the design and construction of four wastewater collection facilities in the communities of Willow Springs, Mono Vista, Crystal Falls Unit #1 and Ranchos Poquitos that experienced chronic failures of on-site septic systems. The Tuolumne County Treasury forwards capital contributions from special assessment districts to the District as the proceeds are received. A loan agreement with the United States Department of Agriculture, Rural Development was also obtained in August 1983, payable in installments semi-annually through August 28, 2023, including interest at 5.0%. The original amount of the debt was \$1,230,000.

TUOLUMNE UTILITIES DISTRICT

NOTES TO FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2010

Note 5 – Long-Term Debt (Continued)

1991 Certificates of Participation (COP)

On March 1, 1991 the District issued \$1,100,000 of 1991 net revenue Certificates of Participation. The issue was used to provide funds to design and construct a new water treatment plant (Columbia Water Project) with a capacity of 1 million gallons per day and one storage tank with a capacity of 150,000 gallons. These Certificates are held by the United States Department of Agriculture, Rural Development, and mature through March 1, 2031. The Certificates are not subject to prepayment and are paid semi-annually on February 15 and August 15 and have a stated interest rate of 6.0%. The Certificates require that a reserve be maintained in an amount equal to 100% of the maximum annual debt service. An invested deposit in the amount of \$73,653 is held on behalf of the District by the Trustee.

2007 LaSalle Loan

On January 18, 2007, the District entered into an Installment Sale Agreement with LaSalle Bank National Association for the purchase of land. The loan is paid semi-annually in installments of \$58,859 which includes interest at 4.83% for a period of 15 years, maturing on January 18, 2022.

2005 LaSalle Loan

On March 23, 2005, the District entered into an Installment Sale Agreement with LaSalle Bank National Association for the design and construction of two water storage tanks in the Crystal Falls (1.5 MG) and Sonora (1.0 MG) water systems. The Agreement is secured by a first lien against all water revenues, "at Parity" with the 1991 COP's and the 1994 and 1996 Installment Sale Agreements. The loan is paid semi-annually in installments of \$61,080 which includes interest at 4.75% for a period of 15 years, maturing on March 23, 2020.

2005 SDWSRF Loan

In 2005, the District entered into a Revolving Fund Agreement with the California State Department of Water Resources, State Revolving Fund for the design and construction of a treated water distribution system including remote read meters to approximately 50 rural residences along an untreated raw water conveyance. The Agreement pledged water fund revenues. The loan is paid semi-annually in principal installments of \$1,225 which includes interest at 0% for a period of 20 years, maturing on January 1, 2025.

1996 SDWR Loan

In 1996, the District entered into a Loan Agreement with the California State Department of Water Resources for the design and construction of a treated water distribution system. The Agreement is secured by real and personal property. The loan is paid semi-annually in installments of \$3,076 which includes interest at 3.46%, maturing on October 1, 2020.

TUOLUMNE UTILITIES DISTRICT

NOTES TO FINANCIAL STATEMENTS YEAR ENDED JUNE 30, 2010

Note 5 – Long-Term Debt (Continued)

1996 LaSalle Loan

In 1996, the District entered into an Installment Sale Agreement with LaSalle Bank National Association for water infrastructure improvements. The Agreement is secured by a first lien against all water revenues, “at Parity” with the 1991 COP’s and the 1994 Installment Sale Agreement. The loan is paid semi-annually in installments of \$178,546 which includes interest at 6.39%, maturing on December 23, 2016.

1994 LaSalle Loan

In 1994, the District entered into an Installment Sale Agreement with LaSalle Bank National Association for water infrastructure improvements. The Agreement is secured by a first lien against all water revenues, “at Parity” with the 1991 COP’s. The loan is paid semi-annually in installments of \$102,725 which includes interest at 6.5%, maturing on July 1, 2013.

1994 SDWR Loan

In 1994, the District entered into a Loan Agreement with the California State Department of Water Resources for the design and construction of the Shaws Flat raw water pipeline. The Agreement is secured by real and personal property. The loan is paid semi-annually in installments of \$80,815 which includes interest at 3.18%, maturing on October 1, 2013.

1994 SDWR Loan

In 1994, the District entered into a Loan Agreement with the California State Department of Water Resources for the design and construction of water infrastructure improvements to the Sugar Pine water system. The Agreement is secured by real and personal property. The loan is paid semi-annually in installments of \$7,350 which includes interest at 7.4%, maturing on January 14, 2012.

1991 SDWR Loan

In 1991, the District entered into a Loan Agreement with the California State Department of Water Resources for the design and construction of water distribution improvements to the Columbia water system. The Agreement is secured by real and personal property. The loan is paid semi-annually in installments of \$4,153 which includes interest at 3.37%, maturing on April 21, 2021.

1987 SDWR Loan

In 1991, the District entered into a Loan Agreement with the California State Department of Water Resources for the design and construction of an interconnecting pipeline. The Agreement is secured by real and personal property. The loan is paid semi-annually in installments of \$1,522 which includes interest at 4.14%, maturing on October 1, 2018.

TUOLUMNE UTILITIES DISTRICT

NOTES TO FINANCIAL STATEMENTS YEAR ENDED JUNE 30, 2010

Note 5 – Long-Term Debt (Continued)

1978 USDA Loan

In 1978, the District entered into a Loan Agreement with the United States Department of Agriculture, Rural Development for the design and construction of improvements to the Sugar Pine water system. The Agreement is secured by real and personal property. The loan is paid semi-annually in installments of \$7,887 which includes interest at 5.0%, maturing on December 2, 2016.

2008 SDWSRF Loan

In 2008, the District entered into a Revolving Fund Agreement with the California State Department of Water Resources, State Revolving Fund for the design and construction of a water treatment plant. The Agreement pledged water fund revenues. The loan is paid semi-annually in principal installments of \$8,358 which includes interest at 0% for a period of 30 years, maturing on January 1, 2039.

The annual requirement to amortize the principal and interest on the above long-term debt at June 30, 2010 were as follows:

Years ending June 30,	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2011	\$ 667,955	\$ 293,456	\$ 961,411
2012	845,383	311,645	1,157,028
2013	876,991	266,490	1,143,481
2014	743,203	219,496	962,699
2015	591,998	183,635	775,633
2016-2020	2,097,233	508,452	2,605,685
2021-2025	681,748	174,995	856,743
2026-2030	375,575	75,240	450,815
2031-2035	152,575	4,140	156,715
2036-2040	75,219	-	75,219
	<u>\$ 7,107,880</u>	<u>\$ 2,037,549</u>	<u>\$ 9,145,429</u>

Debt covenants for the installment sale agreements to LaSalle Bank National Association, the loan agreements to the California State Department of Water Resources, the United States Department of Agriculture, and the Certificates of Participation include reserve requirements be maintained by the District equal to the annual debt service payments. The District is in compliance with those covenants as of June 30, 2010.

TUOLUMNE UTILITIES DISTRICT

NOTES TO FINANCIAL STATEMENTS YEAR ENDED JUNE 30, 2010

Note 6 – Defined Benefit Pension Plan

Plan Description

The District contributes to the California Public Employees Retirement System (PERS), an agent multiple-employer public employee defined benefit pension. PERS provides retirement and disability benefits, annual cost of living adjustments and death benefits to plan members and beneficiaries. PERS acts as a common investment and administrative agent for participating public entities within the State of California. Benefit provisions and all other requirements are established by State statute and District resolution. PERS' annual financial report may be obtained from their Executive Office located at 400 P Street, Sacramento, CA 95814.

Funding Policy

Active plan members are required by State statute to contribute 8% of their annual covered salary. The District makes the contributions required of the District employees on their behalf and for their account, which amounted to \$391,510 for the year ended June 30, 2010. The District employer is required to contribute for fiscal year 2010/2011 at an actuarially determined rate of 17.943% of annual covered payroll.

Annual Pension Cost

For fiscal year 2010, the District's annual pension cost of \$1,190,408 for PERS was equal to the District's required and actual contributions. The required contribution was determined as part of the June 30, 2009 actuarial valuation using the entry age normal actuarial cost method. The actuarial assumptions included (a) 7.75% investment rate of return (net administrative expenses), (b) projected annual salary increases ranging from 3.55% to 14.45% for miscellaneous employees, and (c) 3.00% per year cost-of-living adjustments. Both (a) and (b) included an inflation component of 3.25%. The actuarial value of PERS assets was determined using techniques that smooth the effects of short-term volatility in the market value of investments over a fifteen-year period (smoothed market value). PERS unfunded actuarial accrued liability is being amortized as a level percentage of projected payroll on a closed nineteen year period.

THREE-YEAR TREND INFORMATION FOR PERS

Fiscal Year	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation
06/30/08	\$ 955,456	100%	-
06/30/09	1,018,776	100%	-
06/30/10	1,190,408	100%	-

A new State law authorized the creation of risk pools by PERS and required mandatory participation of employers to help reduce large fluctuations in their contribution rates. The District is now required to participate in the risk pool. Under this pooling method, assets and liabilities of the participant employers are aggregated. As such, individual employer's retirement data is no longer available.

TUOLUMNE UTILITIES DISTRICT

NOTES TO FINANCIAL STATEMENTS YEAR ENDED JUNE 30, 2010

Note 7 – Deferred Compensation Plan

The District has adopted a deferred compensation plan on July 28, 1992 in accordance with Internal Revenue Code Section 457 for its eligible employees. Under this plan, employees may choose to defer income until retirement or termination. All deferred wages are credited to the participating employee accounts. The District makes no contributions under this plan. Section 457 of the Internal Revenue Code currently requires that plan assets be held in trust for the exclusive benefit of the participants and their beneficiaries. Investments in the Deferred Compensation Plan are held by a fiscal agent in investment options chosen by the participants.

In certain prior years all of the plan assets, until paid or made available to the employees or their beneficiaries, were the sole property of the District. On September 9, 1997, the District formally established a trust in accordance with Internal Revenue Code 457(b) for its deferred compensation plan for the exclusive benefit of plan participants and their beneficiaries. Since the District neither has custody of the plan assets, nor directs or accounts for the plan investments, GASB Statement 32 requires the plan assets and liabilities be excluded from the financial statements.

Note 8 – Compensated Absences

It is the District's policy to permit employees to accumulate earned but unused vacation, sick leave pay and compensatory time off (CTO) benefits. All vacation, sick pay and CTO is recorded as an expense and a liability at the time the benefit is earned.

	<u>Balance</u> <u>July 1, 2009</u>	<u>Additions</u>	<u>Retirements</u>	<u>Balance</u> <u>June 30, 2010</u>
Vacation	\$ 349,147	\$ -	\$ (10,368)	\$ 338,779
Sick Leave	568,468	57,848	-	626,316
Comp Time	10,170	-	(674)	9,496
	<u>\$ 927,785</u>	<u>\$ 57,848</u>	<u>\$ (11,042)</u>	<u>\$ 974,591</u>

Vacation Pay

Vacation pay is accrued and credited to regular full time employees after three months of service, and are entitled to take up to one week accrued vacation with pay after 1,040 hours of actual continuous service. Employees are limited to a maximum vacation credit accrual of 360 hours. Once an employee has accrued 360 hours of vacation pay, no further accrual is allowed. Vacation credit is accumulated as follows:

<u>Years of Service</u>	<u>Equivalent Days per Annum</u>
0 - 2 years	10
3 - 9 years	15
10 - 20 years	20
over 20 years	25

TUOLUMNE UTILITIES DISTRICT

NOTES TO FINANCIAL STATEMENTS YEAR ENDED JUNE 30, 2010

Note 8 – Compensated Absences (Continued)

Sick Leave Pay

Regular full time employees receive 3.692 hours of sick leave credit for each pay period worked. There is no limit on the maximum amount of sick leave hours accrued. Employees terminating District service in good standing shall be compensated for all accrued sick leave. The rate of compensation paid at termination is the employee's current base rate of pay for the first two hundred and forty (240) hours and 50% for all additional hours accrued. An employee retiring from the District with five or more years of service may elect to convert accumulated sick leave hours to additional PERS retirement service at the rate of .004 year of service credit for each day of unused sick leave per Government Code Section 20862.8.

Compensatory Time Off (CTO)

An hourly employee may elect to accrue CTO in lieu of receiving overtime pay. Employees with accrued CTO credit may take up to a maximum of five (5) days at any one time. Any unused CTO credits will be paid out by January 31 of each year.

Note 9 – Risk Management

The District is exposed to various risks of loss related to torts, theft of, damage to and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The District participates in the Special District Risk Management Authority Property and Liability Insurance Program for risk of loss. The program provides general liability, property, commercial auto, boiler and machinery, employment practices, employee dishonesty coverage, employment benefits liability, public official errors and omissions and public official personal liability insurance coverage.

The Authority is composed of California public entities and is organized under a joint powers agreement pursuant to California Government Code Section 6500, et seq. The purpose of the Authority is to arrange and administer programs for the pooling of self-insurance losses, to purchase excess insurance or reinsurance, and to arrange for group-purchased insurance and administrative services.

Settled claims have not exceeded any of the coverage amounts in any of the last three fiscal years. Liabilities are recorded when it is probable that a loss has been incurred and the amount of the loss can be reasonably estimated net of the respective insurance coverage.

The District's maximum coverage as of June 30, 2010 consisted of \$10 million for general liability, public officials and employees errors, employment practices liability, employee benefits liability and auto liability. In addition, the District has property coverage of \$1 billion and boiler and machinery coverage of \$100 million.

TUOLUMNE UTILITIES DISTRICT

NOTES TO FINANCIAL STATEMENTS YEAR ENDED JUNE 30, 2010

Note 10 – Other (than pensions) Post Employment Benefits (OPEB) Plan

Post Retirement Benefits

From an accrual accounting perspective, the cost of postemployment healthcare benefits, like the cost of pension benefits, generally should be associated with the periods in which the cost occurs, rather than in the future year when it will be paid. Prior to adopting the requirements of GASB Statement No. 45, the District recognized the cost of postemployment healthcare in the year when the employee services were received. With the implementation of GASB Statement No. 45 the District will report the accumulated liability from prior years in order to provide information useful in assessing potential demands on the District's future cash flows. Recognition and funding of the liability accumulated from prior years will be phased in over 30 years, commencing with the 2008-2010 liability.

Plan Description

The District provides 100% of the monthly medical insurance premiums for retired employees and qualified family members until they reach age 65 and are eligible for Medicare. At age 65, these benefits are then reduced to include the coverage provided by Medicare. To be eligible for these benefits, the employee must be 50 years of age upon retirement with five (5) years of service. Currently 26 retirees meet this eligibility requirement.

Effective February 1, 2006 all newly hired employees will vest on a sliding scale as follows:

<u>Credited Year of Service</u>	<u>Vesting %</u>
10 years	50%
11 years	55%
12 years	60%
13 years	65%
14 years	70%
15 years	75%
16 years	80%
17 years	85%
18 years	90%
19 years	95%
20 years	100%

Funding Policy

Prior to fiscal year 2001, the District expensed as it incurred the amounts for retiree medical premiums. Beginning February 1, 2001, the District established an actuarial determined accrual method for funding retiree medical benefits. This method accrues the expected cost of providing health benefits, to an employee and the employee's beneficiaries and covered dependents, during the years of service rendered by the employee. The latest actuarial valuation was made for the fiscal year ended June 30, 2008. The post-retirement plan does not issue stand-alone financial reports. The District made its initial funding contribution of \$1,006,000 in September 2010.

TUOLUMNE UTILITIES DISTRICT

NOTES TO FINANCIAL STATEMENTS YEAR ENDED JUNE 30, 2010

Note 10 – Other (than pensions) Post Employment Benefits (OPEB) Plan (Continued)

The District is currently funding the OPEB plan on a pay-as-you-go basis, with an additional amount to prefund future benefits as actuarially determined.

Annual OPEB Cost and Net OPEB Obligation

The District's annual OPEB cost (expense) is calculated based on the annual required contribution of the employer (ARC), an amount actuarially determined in accordance with the parameters of GASB Statement 45. The ARC represents a level funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) over a period of thirty (30) years. The following table shows the amount contributed to the plan, and changes in the District's net OPEB obligation:

Net OPEB obligation, beginning of year	\$ 498,457
Annual required contribution (OPEB cost)	744,664
Contributions made	<u>(1,243,121)</u>
Net OPEB obligation, end of year	<u>\$ -</u>

The District's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan and the net OPEB obligation for 2010 was as follows:

Fiscal Year Ending	Annual OPEB Cost	Employer Contributions	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation
June 30, 2009	\$ 744,664	\$ 246,207	33.1%	\$ 498,457
June 30, 2010	\$ 744,664	\$ 1,243,121	166.9%	\$ -

Funding Status and Progress

The funded status of the liability as of June 30, 2010 was as follows:

Actuarial Valuation Date	Project Unit Credit Cost Accrued Liability	Actuarial Value of Assets	Unfunded Liability (Excess Assets)	Funded Ratio	Annual Covered Payroll	UAAL As a % of Payroll
June 30, 2009	\$ 8,377,000	\$ -	8,377,000	0.0%	\$ 4,271,478	196.1%
June 30, 2010	\$ 8,377,000	\$ 1,967,251	6,409,749	23.5%	\$ 4,776,245	134.2%

TUOLUMNE UTILITIES DISTRICT

NOTES TO FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2010

Note 10 – Other (than pensions) Post Employment Benefits (OPEB) Plan (Continued)

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding status and progress, as shown above, presents multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

Actuarial Methods and Assumptions

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

The annual OPEB cost was determined as part of the June 30, 2008 actuarial valuation. Additional information as of the last actuarial valuations follows:

Valuation Date	June 30, 2008	
Actuarial Cost Method	Entry Age Normal	
Asset Valuation Method	Market Value	
Amortization Method	Level Percent of Pay	
Remaining Amortization Period	30 years	
Actuarial Assumptions:		
Investment Rate of Return	7.75%	
Inflation Rate	3.0%	
Payroll Increase	3.25%	
Health Cost Trend Rates:	Annual increases in premium for retired medical and prescription drug benefits are assumed to be as follows:	
	Year After Valuation Date	Medical Premiums
	2009	Actual Premiums
	2010	10.1%
	2011 - 2016	9.3%
	Thereafter	4.5%

TUOLUMNE UTILITIES DISTRICT

NOTES TO FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2010

Note 11 – Groveland/Tuolumne Financing Authority

The Groveland/Tuolumne Financing Authority was created on June 1, 1994, by a Joint Exercise of Powers Agreement by and between the Groveland Community Services District and the Tuolumne Utilities District. The purpose of the Authority is to assist in financing the acquisition, construction and improvement of property for either or both of the Districts. The Authority serves as a legal mechanism by which conduit debt issuances are accomplished by both Districts. Debt transactions of the Authority that represent liabilities of Tuolumne Utilities District are reflected in the accompanying financial statements.

The Authority placed \$4,500,000 of revenue bonds in April 1996 for the purpose of financing facilities to be utilized exclusively by the Groveland Community Services District. These bonds are conduit debt issued in the name of the Authority on behalf of Groveland Community Services District. These bonds are not a liability of Tuolumne Utilities District and are secured by and payable exclusively from the revenues of Groveland Community Services District. The Authority, as of June 30, 2010, has placed no debt for Tuolumne Utilities District. Copies of the Authority's annual financial report may be obtained from the Groveland Community Services District office: 18966 Ferretti Road, Groveland, California 95321.

Note 12 – Contingent Liabilities

Amounts received or receivable from grant agencies are subject to audit and adjustment by grantor agencies, principally the federal and state government. Any disallowed claims, including amounts already collected, may constitute a liability of the applicable funds. The amount, if any, of expenditures that may be disallowed by the grantor cannot be determined at this time, although the government expects such amounts, if any, to be immaterial.

Note 13 – Subsequent Events

The District has received Federal approval for a \$3.9 million grant for West Big Hill water system improvements. In addition, the District has been approved for a State loan of approximately \$1.3 million for Crystal Falls water improvements.

**INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER
FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS
BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED
IN ACCORDANCE WITH GOVERNMENTAL AUDITING STANDARDS**

To the Board of Directors
Tuolumne Utilities District
Sonora, California

We have audited the financial statements of the Tuolumne Utilities District, as of, and for the year ended June 30, 2010, and have issued our report thereon dated January 25, 2011. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Tuolumne Utilities District's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing our 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 a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

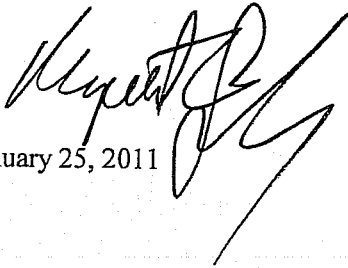
Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. 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 Tuolumne Utilities District's 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*.

We noted certain matters that we reported to management of the District, in a separate letter dated January 25, 2011.

This report is intended solely for the information and use of the Board of Directors, management, federal and state awarding agencies, and pass-through entities, and is not intended to be, and should not be, used by anyone other than these specified parties.

A handwritten signature in black ink, appearing to be "K. J. [unclear]", written in a cursive style.

January 25, 2011