VAVRINEK, TRINE, DAY
& COMPANY, LLP
Certified Public Accountants

VALUE THE DIFFERENCE

March 27, 2011

Clemens Heldmaier
General Manager
Montara Water and Sanitary District
Montara, CA

Dear Mr. Heldmaier:

Enclosed are one unbound and five bound copies of the Montara Water and Sanitary District financial statement for the period ended June 30, 2010. We have also enclosed one copy of our audit communication letter to those charged with governance, and our internal control comments letter.

If you have any questions, please feel free to call me.

Sincerely,

A.J. Major, III, Partner
of VAVRINEK, TRINE, DAY & CO., LLP

AJM/klh

Enclosures

5000 Hopyard Road, Suite 335 Pleasanton, CA 94588 Tel: 925.734.6600 Fax: 925.734.6611 www.vtdcpa.com

MONTARA WATER AND SANITARY DISTRICT

FINANCIAL STATEMENTS

JUNE 30, 2010

WITH

INDEPENDENT AUDITORS' REPORT

MONTARA WATER AND SANITARY DISTRICT

TABLE OF CONTENTS
JUNE 30, 2010

MONTARA WATER AND SANITARY DISTRICT

ELECTED OFFICIALS AND ADMINISTRATIVE PERSONNEL

JUNE 30, 2010

BOARD OF DIRECTORS

Paul Perkovic
Jim Harvey
Scott Boyd
Bob Ptacek
Kathryn Slater-Carter

GENERAL MANAGER

Clemens Heldmaier

VAVRINEK, TRINE, DAY
& COMPANY, LLP
Certified Public Accountants

VALUE THE DIFFERENCE

INDEPENDENT AUDITORS' REPORT

To the Board of Directors
Montara Water and Sanitary District
Montara, California

We have audited the accompanying basic financial statements of Montara Water and Sanitary District as of and for the year ended June 30, 2010, 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 State Controller's Minimum Audit Requirements for California Special Districts. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall basic financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Montara Water and Sanitary District as of June 30, 2010, and the results of its operations and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America, as well as accounting systems prescribed by the State Controller's office for special districts.

As discussed in Note 1 to the basic financial statements, the accompanying financial statements reflect certain changes required as a result of the implementation of Governmental Accounting Standards Board Statement No. 51 for the year ended June 30, 2010.

Our audit was performed for the purpose of forming an opinion on the financial statements taken as a whole. The Management's Discussion and Analysis is not a required part of the basic financial statements but is supplemental information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Vavrinek, Trine, Day & Co., LLP

Pleasanton, California
March 27, 2011

5000 Hopyard Road, Suite 335 Pleasanton, CA 94588 Tel: 925.734.6600 Fax: 925.734.6611 www.vtdcpa.com

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MONTARA WATER AND SANITARY DISTRICT

MANAGEMENT'S DISCUSSION AND ANALYSIS
JUNE 30, 2010

Our discussion and analysis of the Montara Water and Sanitary District's (District) financial performance provides an overview of the District's financial activities for the fiscal year ended June 30, 2010. Please read it in conjunction with the District financial statements and accompanying notes, which follow this section.

HIGHLIGHTS

District Financial Highlights

- The net assets of the District for its water and sewer operations increased during the year ending June 30, 2010. While economic conditions were slow, the District maintained its operations on budget and its operating expenses were comparable to the prior year.

USING THIS ANNUAL REPORT

This annual report consists of two parts: Management's Discussion and Analysis, and Financial Statements. The Financial Statements also include notes that explain in more detail the information contained in those statements.

Required Financial Statements

District financial statements report information about the District using accounting methods similar to those used by private sector companies. The Statement of Net Assets includes all District assets and liabilities and provides information about the nature and amounts of investments in resources (assets) and obligations to creditors (liabilities). It also provides the basis for computing rate of return; evaluating the capital structure of the District; and assessing the liquidity and financial flexibility of the District. All of the current year's revenues and expenses are accounted for in the Statement of Revenues, Expenses, and Changes in Net Assets. This statement measures the success of the District operations over the past year and can be used to determine whether the District has successfully recovered all its costs through its user fees and other charges, profitability, and credit worthiness. The final required financial statement is the Statement of Cash Flows. The primary purpose of this statement is to provide information about District cash receipts, cash disbursements and changes in cash resulting from operations, investing, and capital and non capital financing activities. It provides answers to such questions as, "Where did the cash come from?", "For what was the cash used?", and "What was the change in cash balance during the reporting period?"

FINANCIAL ANALYSIS OF THE DISTRICT

One of the most important questions asked about District finances is whether or not the District's overall financial position has improved or deteriorated. The Statement of Net Assets and the Statement of Revenues and Expenses and Changes in Net Assets report information about District activities in a way that will help answer this question. These two statements report the net assets of the District and changes in them. You can think of District net assets -- the difference between assets and liabilities -- as one way to measure financial health or financial position. Over time, increases or decreases in District net assets are one indicator of whether its financial health is improving or deteriorating. Other factors to consider include changes in economic conditions, population growth, and new or changed legislation.

Net Assets Statement & Analysis

The District's total net assets remained relatively constant increasing by $394,874.

The following is the District's condensed statement of net assets:

		Sewer		Water		Total	
		2010	2009	2010	2009	2010	2009
Current assets		$ 3,733,342	$ 3,198,786	$ 1,979,301	$ 1,459,507	$ 5,712,643	$ 4,658,293
Capital assets net of accumulated depreciation		4,467,036	4,868,649	16,846,973	17,496,257	21,314,009	22,364,906
Other long term assets		3,905,605	3,931,978	1,447,006	1,318,872	5,352,611	5,250,850
	Total assets	12,105,983	11,999,413	20,273,280	20,274,636	32,379,263	32,274,049
Current liabilities		251,489	78,142	1,080,185	892,560	1,331,674	970,702
Long-term liabilities		977,223	995,181	17,354,109	17,986,783	18,331,332	18,981,964
	Total liabilities	1,228,712	1,073,323	18,434,294	18,879,343	19,663,006	19,952,666
Net assets							
Invested in capital assets, net of related debt		3,479,199	3,858,649	198,744	257,197	3,677,943	4,115,846
Restricted for debt service		-	-	1,087,029	1,093,856	1,087,029	1,093,856
Unrestricted		7,398,072	7,067,441	553,213	44,240	7,951,285	7,111,681
	Total net assets (1)	$ 10,877,271	$ 10,926,090	$ 1,838,986	$ 1,395,293	$ 12,716,257	$ 12,321,383

(1) 2009 reflects pro forma change in accounting method for MD&A comparative purposes only. See footnote #1

Revenues, Expenses and Changes in Net Assets

The sewer system generated operating revenue of $1,909,255 and operating expenses of $2,214,481, while the water system generated operating revenue of $1,608,184 and operating expenses of $2,070,944. The cash & cash equivalents increased from $5,282,556 to $6,314,747 by year-end due primarily to less operating expenses.

The following is the District's condensed statement of revenues, expenses, and changes in net assets:

	Sewer		Water		Total	
	2010	2009	2010	2009	2010	2009
Operating revenues	$ 1,909,255	$ 1,794,299	$ 1,608,184	$ 1,569,601	$ 3,517,439	$ 3,363,900
Tax revenues	139,720	196,764	1,357,622	1,547,019	1,497,342	1,743,783
Interest and investment income	14,436	14,848	12,342	7,573	26,778	22,421
Connection fees and other non operating revenues	158,229	162,735	230,277	141,368	388,506	304,103
Total revenues	2,221,640	2,168,646	3,208,425	3,265,561	5,430,065	5,434,207
Operating expenses	2,214,481	2,010,278	2,070,944	1,977,482	4,285,425	3,987,760
Non-operating expenses	55,978	12,605	693,788	781,348	749,766	793,953
Equity transfers						
Total expenses	2,270,459	2,022,883	2,764,732	2,758,830	5,035,191	4,781,713
Change in fund net assets	(48,819)	145,763	443,693	506,731	394,874	652,494
Fund net assets - beginning of year (1)	10,926,090	10,780,327	1,395,293	888,562	12,321,383	11,668,889
Fund net assets - end of year	$ 10,877,271	$ 10,926,090	$ 1,838,986	$ 1,395,293	$ 12,716,257	$ 12,321,383

(1) - 2010 restated see footnote 1; 2009 restated for MD&A comparative purposes only

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

At the end of fiscal year 2010, the District had $ 21,314,009 (net of accumulated depreciation) invested in a variety of capital assets.

The assets include: land; sanitary sewer collection system subsurface lines and pump stations; water supply wells; surface water diversion and storage tank; water treatment plant; treated water storage tanks; water distribution system subsurface lines, valves, hydrants, and pumps; administration building; and vehicles. The District's net investment in capital assets as of June 30, 2010, decreased by $1,050,897 or 4.7% over the prior year. This is due primarily to depreciation expense.

Major capital assets events during the fiscal year included the following:

- Capital improvements to the water system
- Sewer pipeline replacement

The following summarizes District capital assets for fiscal year ended June 30, 2010:

Category	Audited Balance June 30, 2009	Additions	Deletions	Transfers	Audited Balance June 30, 2010
Land & easement	$ 739,500	$ -	$ -	$ -	$ 739,500
Sewage collection facilities	5,326,472	15,064	-	-	5,341,536
Sewage treatment facilities	244,540	-	-	-	244,540
General plant & administration facilities	855,852	-	-	-	855,852
Seal Cove collection system	995,505	-	-	-	995,505
Other capital improvements	2,794,280	-	-	-	2,794,280
Water facilities plant	18,660,688	127,177	-		18,787,865
Water general plant	174,309	-	-	-	174,309
Surface water rights	300,000	-	-	-	300,000
Construction in progress	-	156	-	-	156
Total	30,091,146	142,397	-	-	30,233,543
Accumulated Depreciation	7,726,240	1,193,294	-	-	8,919,534
Property, Plant & Equipment, net	$ 22,364,906	$ (1,050,897)	$ -	$ -	$ 21,314,009

Additional information on capital assets can be found in Note #3 of the notes to the financial statements of this report.

Long Term Obligations

On July 17, 2003 the District issued $17,500,000 in Water General Obligation Bonds Series 2003 with an average interest rate of 4.625% to purchase the water system and pay off the series 2002 General Obligation Notes.

The District entered into a capital lease for approximately $1.8 million in October of 2006 at a rate of 5.45%, to finance the acquisition of capital assets for the water operations.

The following is a summary of long term debt activity for the year:

	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion	Long Term Portion
General Obligation Bonds, 2003 Series	$ 15,480,000	$ -	$ 535,000	$ 14,945,000	$ 545,000	$ 14,400,000
General Obligation Bonds Premium	17,053	-	898	16,155	-	16,155
Citimortgage/Chevron Capital Lease	1,788,653	-	57,389	1,731,264	36,802	1,694,462
CIEDB loan	1,010,000		22,162	987,838	22,838	965,000
Totals	$ 18,295,706	$ -	$ 615,449	$ 17,680,257	$ 604,640	$ 17,075,617

Additional information on the long term debt can be found in Note #5 of the notes to the financial statements of this report.

ECONOMIC FACTORS, RATES, AND BUDGETARY CONTROL

The District is a California Special District maintained as an enterprise fund. As a special district, charges to customers are made only to those who receive services. The District is not typically subject to general economic conditions such as increases or declines in property tax values or other types of revenues that vary with economic conditions such as sales taxes. However, it does receive a small amount of property tax which is dependent on property tax valuations. Accordingly, the District sets its rates to its users to cover the costs of operation, maintenance and recurring capital replacement and debt financed capital improvements, plus any increments for known or anticipated changes in program costs.

The District and its Board adopts an annual budget to serve as its approved financial plan. The Board sets all fees and charges required to fund the District's operations and capital programs. The budget is used as a key control device (1) to ensure Board approval for amounts set for operations and capital projects, (2) to monitor expenses and project progress and (3) as compliance that approved spending levels have not been exceeded. All operating activities and capital activities of the District are included within the approved budget. The budget and capital expenditures are within the Gann limits established by State law.

REQUEST FOR INFORMATION

This financial report is designed to provide our customers and creditors with a general over view of District finances, and demonstrate District accountability for the money it receives. If you have any questions about this report, or need additional financial information, contact the General Manager at 8888 Cabrillo Highway, Montara, CA 94037 or 650-728-3545.

MONTARA WATER AND SANITARY DISTRICT

STATEMENT OF NET ASSETS
AS OF JUNE 30, 2010

	Sewer	Water	Total
ASSETS			
Current assets:			
Cash and cash equivalents	$ 3,492,876	$ 1,734,842	$ 5,227,718
Accounts receivable	93,766	203,534	297,300
Inventory	-	40,925	40,925
Employee note receivable	146,700	-	146,700
Total current assets	3,733,342	1,979,301	5,712,643
Non-current assets:			
Capital assets:			
Property, plant and equipment	9,177,642	21,055,901	30,233,543
Less accumulated depreciation	4,710,606	4,208,928	8,919,534
Net property, plant and equipment	4,467,036	16,846,973	21,314,009
Other assets:			
Unamortized bond issuance costs	-	44,190	44,190
Restricted cash and cash equivalents	-	1,087,029	1,087,029
Interfund advances - Due from water fund	1,218,058	-	1,218,058
Other assets	-	315,787	315,787
Investment in joint powers authorities	2,687,547	-	2,687,547
Total other assets	3,905,605	1,447,006	5,352,611
Total non-current assets	8,372,641	18,293,979	26,666,620
Total assets	12,105,983	20,273,280	32,379,263

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

MONTARA WATER AND SANITARY DISTRICT

STATEMENT OF NET ASSETS (CONTINUED)
AS OF JUNE 30, 2010

	Sewer	Water	Total
LIABILITIES			
Current liabilities:			
Accounts payable	216,097	219,563	435,660
Interest payable	12,554	278,820	291,374
Current portion of long-term obligations	22,838	581,802	604,640
Total current liabilities	251,489	1,080,185	1,331,674
Long term liabilities:			
Accrued compensated absences	12,224	19,434	31,658
General obligation bonds, less current portion	-	14,416,155	14,416,155
Other long term obligations, less current portion	964,999	1,694,462	2,659,461
Interfund advances - Due to sewer fund	-	1,218,058	1,218,058
Deposits	-	6,000	6,000
Total long term liabilities	977,223	17,354,109	18,331,332
Total liabilities	1,228,712	18,434,294	19,663,006
NET ASSETS			
Invested in capital assets, net of related debt	3,479,199	198,744	3,677,943
Restricted for debt service	-	1,087,029	1,087,029
Unrestricted	7,398,072	553,213	7,951,285
Total net assets	$ 10,877,271	$ 1,838,986	$ 12,716,257

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

MONTARA WATER AND SANITARY DISTRICT

STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS FOR THE YEAR ENDED JUNE 30, 2010

	Sewer	Water	Total
OPERATING REVENUES			
Sales and service charges	$ 1,779,913	$ 1,519,276	$ 3,299,189
Other revenues	129,342	88,908	218,250
Total operating revenues	1,909,255	1,608,184	3,517,439
OPERATING EXPENSES			
General and administrative	311,972	628,563	940,535
Contractual services	1,458,969	431,375	1,890,344
Depreciation	416,833	776,461	1,193,294
Maintenance and repairs	23,857	233,032	256,889
Other	2,850	1,513	4,363
Total operating expenses	2,214,481	2,070,944	4,285,425
OPERATING INCOME (LOSS)	(305,226)	(462,760)	(767,986)
NONOPERATING REVENUES (EXPENSE)			
Taxes - District share of one percent	139,720	139,720	279,440
Taxes - Ad valorem for general obligation bonds	-	1,217,902	1,217,902
Investment income	14,436	12,342	26,778
Interest expense	(55,978)	(693,788)	(749,766)
Other revenues	130,770	185,840	316,610
Total non-operating revenues (expenses)	228,948	862,016	1,090,964
INCOME BEFORE CONTRIBUTIONS AND TRANSFERS	(76,278)	399,256	322,978
Capital contributions - connection fees	27,459	44,437	71,896
Changes in net assets	(48,819)	443,693	394,874
NET ASSETS, BEGINNING OF YEAR - RESTATED (See footnote 1)	10,926,090	1,395,293	12,321,383
TOTAL NET ASSETS, END OF YEAR	$ 10,877,271	$ 1,838,986	$ 12,716,257

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

MONTARA WATER AND SANITARY DISTRICT

STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2010

	Sewer	Water	Total
CASH FLOWS FROM OPERATING ACTIVITIES:			
Receipts from customers and users	$ 1,907,915	$ 1,592,510	$ 3,500,425
Payments to suppliers - other	(1,325,559)	(470,046)	(1,795,605)
Payments to employees	(307,091)	(622,059)	(929,150)
Net cash provided (used) by operating activities	275,265	500,405	775,670
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:			
Property taxes collected	139,720	139,720	279,440
Principal paid on long term debt	(22,163)	(593,286)	(615,449)
Interest paid on long term debt	(43,424)	(719,874)	(763,298)
Acquisition and construction of capital assets	(15,220)	(127,177)	(142,397)
Funds advanced from sewer to water (water paid to sewer)	26,373	(26,373)	-
Connection fees and other non operating revenue collected	158,229	1,450,634	1,608,863
Net cash provided (used) by capital and related financing activities	243,515	123,644	367,159
CASH FLOWS FROM INVESTING ACTIVITIES:			
Paid for other assets	-	(137,416)	(137,416)
Investment income	14,436	12,342	26,778
Net cash provided (used) by investing activities	14,436	(125,074)	(110,638)
NET INCREASE IN CASH AND EQUIVALENTS	533,216	498,975	1,032,191
Cash and cash equivalents, July 1	2,959,660	2,322,896	5,282,556
Cash and cash equivalents, June 30	$ 3,492,876	$ 2,821,871	$ 6,314,747
AMOUNTS AS THEY APPEAR ON THE STATEMENT OF NET ASSETS:			
Cash and cash equivalents	$ 3,492,876	$ 1,734,842	$ 5,227,718
Restricted cash and cash equivalents	-	1,087,029	1,087,029
	$ 3,492,876	$ 2,821,871	$ 6,314,747

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

STATEMENT OF CASH FLOWS (CONTINUED)
FOR THE YEAR ENDED JUNE 30, 2010

	Sewer	Water	Total
RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES:			
Operating income (loss)	$ (305,226)	$ (462,760)	$ (767,986)
Adjustments to reconcile operating income to net cash provided (used) by operating activities:			
Depreciation expense	416,833	776,461	1,193,294
Accounts and notes receivable	(1,340)	(6,974)	(8,314)
Inventory	-	(7,018)	(7,018)
Accounts payable	160,117	202,892	363,009
Deposits	-	(8,700)	(8,700)
Compensated absences	4,881	6,504	11,385
Total adjustments	580,491	963,165	1,543,656
Net cash provided (used) by operating activities	$ 275,265	$ 500,405	$ 775,670

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

NOTE #1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. General

Montara Water and Sanitary District (the District), a governmental entity legally constituted as a special district under California law, is located on the coast in northwestern San Mateo County. The District was formed in 1958 to provide sanitary sewer services and franchise solid waste collection for the unincorporated areas known as Montara and Moss Beach. On May 2003 an agreement to acquire Cal-Am Montara Water District was reached with operations beginning as of August 1, 2003.

B. Basis of Accounting

The District is a proprietary entity; it uses an enterprise fund format to report its activities for financial statement purposes. Enterprise funds are used to account for operations that are financed and operated in a manner similar to private business enterprise, where the intent of the governing body is that the costs and expenses, including depreciation, and providing goods or services to the general public on a continuing basis, be financed or recovered primarily through user charges.

An enterprise fund is used to account for activities similar to those in the private sector, where the proper matching of revenues and costs is important and the full accrual basis of accounting is required. With this measurement focus, all assets and all liabilities of the enterprise are recorded on its statement of net assets, and under the full accrual basis of accounting, all revenues are recognized when earned and all expenses, including depreciation, are recognized when incurred.

A major fund is a fund whose revenues, expenditures/expenses, assets or liabilities (excluding extraordinary items) are at least 10 percent of corresponding totals for all funds.

The District reports the following major Proprietary Funds:

Water Enterprise – This enterprise accounts for the operation, maintenance and capital improvement projects of the water system which is funded by user charges and other fees.

Sewer Enterprise – This enterprise accounts for the operation, maintenance and capital improvement projects of the sewer system. These activities are funded by user charges and other fees.

The District applies all applicable pronouncements of the Governmental Accounting Standards Board (GASB) as well as any applicable pronouncements of the Financial Accounting Standards Board, the Accounting Principles Board, or any Accounting Research Bulletins issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements.

Net assets are reported as restricted when there are limitations imposed on their use either through the enabling legislation adopted by the District or through external restrictions imposed by creditors, grantors, or laws and regulations of other governments. The District first applies restricted resources when an expense is incurred for purposes for which both restricted and unrestricted net assets are available.

NOTE #1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

C. Measurement Focus

Enterprise funds are accounted for on a cost of services or *economic resources* measurement focus, which means that all assets and all liabilities associated with their activity are included on their balance sheets. Enterprise fund type operating statements present increases (revenues) and decreases (expenses) in total net assets.

The District 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 services. Operating expenses for the District include the cost of goods 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.

D. Inventory

Inventory is held for consumption and is recorded at cost using the first-in-first-out (FIFO) basis.

E. Capital Assets

Capital assets, which include property, plant, and equipment are recorded at historical costs or estimated historical cost, if actual cost is not available. Contributed assets are recorded at estimated fair value on the date of contribution.

The District defines capital assets as assets with an initial, individual cost of $2,500 and an estimated useful life in excess of one year.

Depreciation is computed by the straight-line method based on the estimated useful lives of related asset classifications of 3 to 50 years of assets.

F. Cash Flows Defined

For purpose of the statements of cash flows the District defines cash and cash equivalents to include all cash in deposit accounts, highly liquid investments, and cash on hand but does not include cash held in escrow for restricted purposes.

G. Accounts Receivable

The District bills its water consumption and sewer usage on a cycle billing method. Cycle billing results in an amount of services rendered but not yet billed at year-end. The District has recorded this revenue by estimating the unbilled amount. The estimate was calculated by using the billing subsequent to the balance sheet date (June 30) and calculating the amount of service provided prior to June 30. This calculated amount is included in accounts receivable.

NOTE #1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The delinquent water and sewer charges for services and facilities furnished by the District's water and sewage system, and all the penalties or delinquent charges accrued thereon shall constitute a lien upon the real property served. The District is allowed to place such charges and fees on the property tax rolls annually as of July 1.

H. Accrued Compensated Absences

The liability for vested vacation pay is calculated and accrued on an annual basis. The amount is computed using current employee accumulated vacation hours at current pay rates.

I. Budgets and Budgetary Accounting

Budgets are prepared on a basis consistent with generally accepted accounting principles. A general budget is adopted annually by the Board of Directors which includes operations, maintenance, and administration.

J. Property Taxes

Secured property taxes attach as an enforceable lien on property as of March 1. Taxes are payable in two installments due November 15 and March 15. Unsecured property taxes are payable in one installment on or before August 15. The County of San Mateo bills and collects the taxes for the District. Tax revenues are recognized by the District when received. The sewer service charges are included in secured property tax bills.

K. Contract Services

The District contracted out the operation and maintenance of its sewer facilities to the Sewer Authority Mid-Coastside (SAM).

L. Estimates

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

M. Changes in Accounting Principles

In July 2004, GASB issued GASBS No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. This Statement will require local governmental employers who provide other postemployment benefits (OPEB) as part of the total compensation offered to employees to recognize the expense and related liabilities (assets) in the government-wide financial statements of net assets and activities. This Statement establishes standards for the measurement, recognition, and display of OPEB expense/expenditures and related liabilities (assets), note disclosures, and, if applicable, required supplementary information (RSI) in the financial reports of State and local governmental employers.

Current financial reporting practices for OPEB generally are based on pay-as-you-go financing approaches. They fail to measure or recognize the cost of OPEB during the periods when employees render the services or to provide relevant information about OPEB obligations and the extent to which progress is being made in

NOTE #1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

funding those obligations.

This Statement generally provides for prospective implementation - that is, that employers set the beginning net OPEB obligation at zero as of the beginning of the initial year. The District does not provide other postemployment benefits to its employees, and therefore the implementation of this statement had no impact the statement of net assets and statement of revenues, expenses and changes in net assets.

In June 2007, GASB issued Statement No. 51, *Accounting and Financial Reporting for Intangible Assets.* This Statement requires that certain intangible assets be classified as capital assets. Accordingly, existing authoritative guidance related to the account and financial reporting for capital assets should be applied to these intangible assets as applicable. The requirements of this Statement are effective for financial statements for period beginning after June 15, 2009. The District implemented the provisions of this Statement in the fiscal year ended June 30, 2010. As a result, $225,500 of accumulated amortization related to rights of way, easements, and surface water rights was eliminated, and these assets will no longer be amortized as they are not deemed to have a finite life. The beginning net assets were restated to reflect this change in accounting principal.

In June 2008, GASB issued GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments.* This Statement addresses the recognition, measurements, and disclosure of information regarding derivative instruments entered into by state and local governments. The District does not have any derivative instruments and therefore this statement had no impact on the financial statements.

In December 2009, the GASB issued GASB Statement No. 58, *Accounting and Financial Reporting for Chapter 9 Bankruptcies.* The objective of this Statement is to provide accounting and financial reporting guidance for governments that have petitioned for protection from creditors by filing for bankruptcy under Chapter 9 of the United States Bankruptcy Code. It requires governments to remeasure liabilities that are adjusted in bankruptcy when the bankruptcy court confirms (that is, approves) a new payment plan. This Statement is effective for periods beginning after June 15, 2009. The District implemented provisions of this Statement in the fiscal year ended June 30, 2010.

N. New Accounting Pronouncements

In February 2009, GASB issued GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions.* The objective of this statement is to enhance the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied and by clarifying the existing governmental fund type definitions. This Statement establishes fund balance classifications that comprise a hierarchy based primarily on the extent to which a government is bound to observe constraints imposed upon the use of the resources reported in governmental funds. The requirements of this Statement are effective for the financial statements for periods beginning after June 15, 2010. The District is accounted for as an enterprise fund and therefore this statement does not apply.

In December 2009, GASB issued GASB Statement No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans.* The objective of this Statement is to address issues related to the use of the alternative measurement method and the frequency and timing of measurements by employers that participate

NOTE #1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

in agent multiple-employer other postemployment benefit (OPEB) plans (that is, agent employers). In addition, this Statement clarifies that when actuarially determined OPEB measures are reported by an agent multiple-employer OPEB plan and its participating employers, those measures should be determined as of a common date and at a minimum frequency to satisfy the agent multiple-employer OPEB plan's financial reporting requirements. The provisions related to the use and reporting of the alternative measurement method are effective on the date of issuance. The provisions related to the frequency and timing of measurements are effective for valuations first used to report funded status information in OPEB plan financial statements for periods beginning after June 15, 2011. The District does not provide other postemployment benefits to its employees, therefore when the District will be required to implement the provision of this Statement in fiscal year ending June 30, 2012, it will have no impact on the financial statements.

In June 2010, GASB issued GASB Statement No. 59, *Financial Instruments Omnibus.* The objective of this Statement is to update and improve existing standards regarding financial reporting and disclosure requirements of certain financial instruments and external investment pools for which significant issues have been identified in practice. The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2010. The District will be required to implement the provisions of this Statement in fiscal year ending June 30, 2011, and does not believe it will have a significant impact on the financial statements.

NOTE #2 - CASH AND INVESTMENTS

A. Cash and Investment Summary

The following is a summary of the cash and investments as of June 30, 2010:

Cash Deposits	$	3,001,230
Investments (Local Agency Investment Fund)		3,313,517
	$	6,314,747
Restricted cash and cash equivalents		1,087,029
Unrestricted cash and cash equivalents		5,227,718
	$	6,314,747

NOTE #2 - CASH AND INVESTMENTS (Continued)

B. General Authorizations

Limitations as they relate to interest rate risk, credit risk, and concentration of credit risk are indicated in the schedules below:

Authorized Investment Type	Maximum Remaining Maturity	Maximum Percentage of Portfolio	Maximum Investment In One Issuer
Local Agency Bonds, Notes, Warrants	5 years	None	None
Registered State Bonds, Notes, Warrants	5 years	None	None
U.S. Treasury Obligations	5 years	None	None
U.S. Agency Securities	5 years	None	None
Banker's Acceptance	180 days	40%	30%
Commercial Paper	270 days	25%	10%
Negotiable Certificates of Deposit	5 years	30%	None
Repurchase Agreements	1 year	None	None
Reverse Repurchase Agreements	92 days	20% of base	None
Medium-Term Notes	5 years	30%	None
Mutual Funds	N/A	20%	10%
Money Market Mutual Funds	N/A	20%	10%
Mortgage Pass-Through Securities	5 years	20%	None
County Pooled Investment Funds	N/A	None	None
Local Agency Investment Fund (LAIF)	N/A	None	None
Joint Powers Authority Pools	N/A	None	None

C. 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. The District manages its exposure to interest rate risk by depositing the majority of its funds with the State Local Agency Investment Fund (LAIF), which is short term investment.

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

Investment Type	Fair Value	Average Maturity
LAIF	$ 3,318,964	203 days

NOTE #2 - CASH AND INVESTMENTS (Continued)

D. 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 measure by the assignment of a rating by a nationally recognized statistical rating organization. LAIF doesn't have a credit rating.

E. Custodial Credit Risk - Investments

This is the risk that, in the event of the failure of the counterparty (e.g., broker-dealer) to a transaction, the District will not be able to recover the value of its investments or collateral securities that are in possession of an outside party. It is the District's policy that all securities are evidenced by specific identifiable pieces of paper called *securities instruments*, or by electronic entry registering the owner in the records of the institution issuing the security, called the *book entry* system. In order to maximize security, the District employs the Trust Department of a bank as the custodian of its investments with the U.S. Government or its agencies, regardless of their form.

Investment in the State Investment Pool – the District is a voluntary participant in the Local Agency Investment Fund (LAIF) that is regulated by California government code Section 16429 under the oversight of the Treasurer of the State of California. The fair value of the District's investment in the pool is reported in the accompanying financial statement at amounts based upon the District's pro-rata share of the fair value provided by LAIF for the entire LAIF portfolio (in relation to the amortized cost of that portfolio). The balance available for withdrawal is based on the accounting records maintained by LAIF, which is recorded on the amortized cost basis.

NOTE #3 – CAPITAL ASSETS

Changes in capital assets accounts are summarized below:

Category	Audited Balance June 30, 2009	Additions	Deletions	Transfers	Audited Balance June 30, 2010
Land & easement	$ 739,500	$ -	$ -	$ -	$ 739,500
Sewage collection facilities	5,326,472	15,064	-	-	5,341,536
Sewage treatment facilities	244,540	-	-	-	244,540
General plant & administration facilities	855,852	-	-	-	855,852
Seal Cove collection system	995,505	-	-	-	995,505
Other capital improvements	2,794,280	-	-	-	2,794,280
Water facilities plant	18,660,688	127,177	-		18,787,865
Water general plant	174,309	-	-	-	174,309
Surface water rights	300,000	-	-	-	300,000
Construction in progress	-	156	-	-	156
Total	30,091,146	142,397	-	-	30,233,543
Accumulated Depreciation	7,726,240	1,193,294	-	-	8,919,534
Property, Plant & Equipment, net	$ 22,364,906	$ (1,050,897)	$ -	$ -	$ 21,314,009

NOTE #4 – INVESTMENT IN JOINT POWER AUTHORITY

Investment in Sewer Authority Mid-Coastside

The District has an ownership percentage (20%) of the Sewer Authority Mid-Coastside (SAM), a public entity created February 3, 1976 by a Joint Exercise of Powers Agreement pursuant to the provisions of Title 1, Division 7, Chapter 5 of the Government code of the State of California. Other joint power members include the City of Half Moon Bay (50%) and the Granada Sanitary District (30%). The District reports its financial interest in SAM on the cost basis.

Under this agreement, SAM is granted the power of the member agencies to construct, maintain, and operate facilities for the collection, transmission, treatment and disposal of wastewater for the benefit of the lands and inhabitants within their respective boundaries.

Each member agency has the power to appoint two representatives of their own governing body to SAM's Board of Directors. Budgets prepared by SAM are subject to approval by the member agencies, expenditures in excess of the budgeted amounts require unanimous consent and approval of SAM's Board of Directors.

NOTE #4 - INVESTMENT IN JOINT POWER AUTHORITY (Continued)

SAM provides sewage collection and treatment services, for which the District pays a monthly fee. The District paid $1,155,613 for these collection and treatment services for the year.

Summary details of SAM's financial position and results of operation from the most recent audited financial statement at June 30, 2010 are as follows:

Total assets	$	20,959,866
Total liabilities		406,154
Net assets	$	20,553,712
Total revenues	$	5,141,313
Total expenses		5,598,572
Decrease in net assets	$	(457,259)

The District specific SAM plant expansion costs, not shared by the other equity participation are burdened on Montara Water and Sanitary District alone and have been included in the District's total Investment in Joint Power Authorities.

NOTE #5 - LONG TERM OBLIGATIONS

Following is a summary of the changes in long term obligations for the year:

	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion	Long Term Portion
General Obligation Bonds, 2003 Series	$ 15,480,000	$ -	$ 535,000	$ 14,945,000	$ 545,000	$ 14,400,000
General Obligation Bonds Premium	17,053	-	898	16,155	-	16,155
Citimortgage/Chevron Capital Lease	1,788,653	-	57,389	1,731,264	36,802	1,694,462
CIEDB loan	1,010,000		22,162	987,838	22,838	965,000
Totals	$ 18,295,706	$ -	$ 615,449	$ 17,680,257	$ 604,640	$ 17,075,617

NOTE #5 - LONG TERM OBLIGATIONS (Continued)

A. General Obligation Bonds, Series 2003

On July 17, 2003, the District issued General Obligation Bonds, Series 2003 for $17,500,000. These bonds are payable from the levy of ad valorem taxes on all property within the District. Proceeds of the issuance are for the acquisition and improvements of a domestic water supply, treatment, and fire protection system serving the entire District service area. Interest rates range from 4% to 4.625%. These bonds mature through 2028 with principal amounts due August 1, and interest payments due on February 1 and August 1 of each year.

The Bonds are registered in the name of Cede & Co., as nominee of the Depository Trust Company ("DTC"), New York, as the initial securities depository for the bond. Principal and interest payments with respect to the Bonds are payable directly to DTC by the paying agent.

B. Repayment Schedule

Fiscal Year Ending June 30,	Principal	Interest	Total
2011	$ 545,000	$ 658,268	$ 1,203,268
2012	565,000	636,068	1,201,068
2013	580,000	613,168	1,193,168
2014	600,000	589,568	1,189,568
2015	620,000	565,168	1,185,168
2016-2020	3,505,000	2,422,231	5,927,231
2021-2025	4,315,000	1,580,658	5,895,658
2026-2028	4,215,000	433,875	4,648,875
Total	$ 14,945,000	$ 7,499,004	$ 22,444,004

C. Capital Lease

On November 7, 2006, the District entered into a lease/purchase agreement with a financial institution in the amount of $1,854,443 at a fixed interest rate of 4.56% annually. The agreement matures on October 7, 2026. The agreement was to finance the acquisition, construction and installation of energy conservation capital facilities for the District's water system with the expectation that the cost thereof will be offset through reductions in future energy costs created by the facilities. As security for its obligation under this lease the District has pledged to the Lessor a security interest in the net revenue of both the water and sewer enterprises.

NOTE #5 - LONG TERM OBLIGATIONS (Continued)

D. Repayment Schedule

Fiscal Year Ending June 30,		Principal		Interest		Total
2011	$	36,802	$	76,635	$	113,437
2012		38,516		74,921		113,437
2013		45,130		73,037		118,167
2014		52,725		70,822		123,547
2015		60,975		68,247		129,222
2016-2020		451,330		287,999		739,329
2021-2025		761,820		151,568		913,389
2026-2027		283,967		8,150		292,117
Total	$	1,731,264	$	811,379	$	2,542,643

E. CIEDB Loan

On October 1, 2008, the District entered into an enterprise fund installment sale agreement with California Infrastructure and Economic Development Bank (CIEDB) in the amount of $1,010,000. The agreement was to purchase a facility in order to renovate and upgrade two sewer pump stations. The agreement matures on December 3, 2037 with principal amounts due August 1, and interest payments due on February 1 and August 1 of each year. The interest rate is 3.05% per annum.

F. Repayment Schedule:

June 30,		Principal		Interest		Total
2011	$	22,838	$	32,744	$	55,583
2012		23,535		31,969		55,503
2013		24,253		31,169		55,422
2014		24,992		30,345		55,338
2015		25,755		29,497		55,659
2016-2020		141,047		133,815		274,862
2021-2025		163,909		108,356		272,265
2026-2030		190,477		78,769		269,246
2031-2035		221,352		44,387		265,739
3036-3038		149,680		7,846		157,527
	$	987,838	$	528,898	$	1,517,144

NOTE #6 - DEFERRED COMPENSATION PLAN

The District's defined contribution, IRS code section 457 pension plan, provides deferred compensation retirement benefits to plan members and beneficiaries. Under this plan participants may defer a portion of their compensation and are not taxed on the deferred portion until it is distributed to them. Distribution may be made only at termination, retirement, death, or in an emergency as defined by the plan. The District has contracted with a third party to provide administration and management of the plan's assets which are to be held for the exclusive benefit of plan participants and their beneficiaries. Since the assets held under this plan are not the District's property and are not subject to claims by general creditors of the District, they have been excluded from these financial statements.

NOTE #7 - RISK MANAGEMENT

The District is exposed to various risks of loss related to torts: theft, damage, and destruction of assets; errors and omissions; injuries to employees and natural disaster. The District joined together with other entities to form the California Sanitation Risk Management Authority (CSRMA), a public entity risk pool currently operating as a common risk management and insurance program for 54 member entities. The purpose of CSRMA is to spread the adverse effects of losses among the member entities and to purchase excess insurance as a group, thereby reducing its cost. The District pays annual premiums to CSRMA for its general, liability, property damage and monthly premiums to State Fund for its workers compensation insurance.

CSRMA is governed by a Board composed of one representative from each member agency. The Board controls the operations of CSRMA including selection of management and approval of operating budgets, independent of any influence by member entities.

Settled claims for CSRMA or commercial fidelity bonds have not exceeded coverage in any of the past three fiscal years.

The following is a summary of the insurance policies carried by the District as of June 30, 2010:

Type of Coverage	Coverage Limits
Excess General Liability	$ 1,000,000
Workers' Compensation	1,000,000
Boiler & Machinery	100,000,000
Property	1,000,000

NOTE #7 - RISK MANAGEMENT (Continued)

Audited condensed financial information for CSRMA is presented below for the year ended June 30, 2010:

Total assets	$	30,183,457
Total liabilities		16,996,072
Net assets	$	13,187,385
Total revenues	$	10,635,989
Total expenses		11,926,934
Increase (decrease) in net assets	$	(1,290,945)

Claims and judgments, including provision for claims incurred but not reported, are recorded when a loss is deemed probable of assertion and the amount of the loss is reasonably determinable. As discussed above, the District has coverage for such claims, but it had retained the risk for the deductible or uninsured portion of these claims.

The District has not exceeded its insurance coverage limits in any of the last three years. Any District liability is included in accrued expenses on the financial statements.

NOTE #8 – COMMITMENTS AND CONTINGENT LIABILITIES

The District has an agreement with Sewer Authority Mid-Coastside (SAM), Granada Sanitary District, and City of Half Moon Bay for the purchase of additional plant sewer capacity on an as needed basis. Montara Water and Sanitary District may purchase additional capacity in the SAM plant, if such additional capacity is available, at a cost per Equivalent Residential Unit (ERU) in effect. The future price would be an average current cost per ERU charged a property in the City of Half Moon Bay and Granada Sanitary Districts. At this time the District needs no additional capacity.

The District is a plaintiff or defendant in a number of lawsuits, which have arisen in the normal course of business. In the opinion of the District, these actions when finally adjudicated will not have a material adverse effect on the financial position of the District.