

**MOJAVE BASIN AREA
WATERMASTER**

Report on Audit

June 30, 2006 and 2005

MOJAVE BASIN AREA WATERMASTER

June 30, 2006 and 2005

TABLE OF CONTENTS

	Page
INDEPENDENT AUDITORS' REPORT.....	1
MANAGEMENT'S DISCUSSION AND ANALYSIS.....	2
FINANCIAL STATEMENTS	
Statements of Net Assets.....	7
Statements of Revenues, Expenses and Changes in Net Assets.....	9
Statements of Cash Flows.....	10
NOTES TO FINANCIAL STATEMENTS.....	12
ADDITIONAL INFORMATION	
Schedule of Operating Expenses.....	18

INDEPENDENT AUDITORS' REPORT

The Board of Directors of
Mojave Basin Area Watermaster

We have audited the accompanying statement of net assets of Mojave Basin Area Watermaster, as of June 30, 2006 and 2005, and the related statements of revenues, expenses and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Mojave Basin Area Watermaster'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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining on a test basis evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statements 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 Mojave Basin Area Watermaster, as of June 30, 2006 and 2005, and the results of its operations, changes in net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The information identified in the accompanying *Management's Discussion and Analysis* is not a required part of the financial statements but is supplementary information required by the Government Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.



Messner & Hadley, LLP
Certified Public Accountants

December 15, 2006

MOJAVE BASIN AREA WATERMASTER

MANAGEMENT'S DISCUSSION AND ANALYSIS

June 30, 2006 and 2005

THE ORGANIZATION

Mojave Basin Area Watermaster (the "Watermaster") was organized September 23, 1993, to administer a judgment by the Superior Court of the State of California for the County of Riverside. The Judgment divided the Mojave Basin into five distinct but hydrologically interrelated sub-areas named for the Spanish words describing their respective locations in the basin: *Este, Oeste, Alto, Centro, and Baja*. Because the Court found each of these sub-areas to be in overdraft – a condition in which more water is pumped than is naturally replenished – it developed a plan, known as "the Judgment", to manage the water resources of the entire basin.

To maintain proper water balances between the sub-areas, the Judgment established a decreasing *free production allowance* (FPA) in each sub-area during the first five years of the plan, with a provision for the Court to review and adjust the FPA annually thereafter. Each water producer's share of the FPA in a sub-area was determined by verifying the maximum annual production, or *base annual production* (BAP), for each producer during a five-year base period, 1986-1990. This data was compiled for each sub-area and each producer's share of the sub-area's total was calculated. The Judgment requires that producers who pump more than their FPA's replace the excess water. Replacement of excess water can be accomplished by paying the Watermaster for future replacement of the water, or by purchasing the unused FPA of another producer by mutual agreement.

In addition to establishing a policy for the over-pumping of underground water, the Judgment also established a policy for the over-usage of water determined by a measurement of the flow of surface water in the Mojave River. Upstream users deemed to be responsible for a decrease in the surface flow reaching downstream users are assessed a make-up charge. Make-up charges are assessed to producers in a sub-area based upon their percentage shares in the sub-area's overall FPA.

The Watermaster is responsible for monitoring, verifying production, reporting to the Court, collecting assessments and conducting studies. All producers stipulating to the Judgment are assessed a quarterly administrative fee to offset some of the expense incurred by the Watermaster in executing its responsibilities. Besides the replacement, make-up, and administrative fees, producers are charged a fee for environmental protection.

THE BASIC FINANCIAL STATEMENTS

The Judgment described above appointed Mojave Water Agency (the "Agency") as the initial Watermaster. This means that while the management of the Watermaster issues the separate financial statements included here, the Watermaster's financial statements are also included in the financial statements of Mojave Water Agency as a component unit.

The accompanying financial statements are presented in the format prescribed for proprietary funds by the Governmental Accounting Standards Board (GASB). They consist of three interrelated statements designed to provide the reader with relevant, understandable data about the Organization's financial condition and operating results. These are the statement of net assets, statement of revenues, expenses and changes in net assets, and the statement of cash flows.

MOJAVE BASIN AREA WATERMASTER

MANAGEMENT'S DISCUSSION AND ANALYSIS

June 30, 2006 and 2005

THE BASIC FINANCIAL STATEMENTS, Continued

The statement of net assets presents the Organization's assets and liabilities and the difference, or net, between what is owned and what is owed as of the last day of the Organization's fiscal year. The statement of revenues, expenses and changes in net assets describes the financial results of the Organization's operations for the year reported. These results, or changes in net assets, are the increases or decreases in the bottom line of the statement of net assets.

The statement of cash flows conveys to financial statement users how the Organization managed cash resources during the year. This statement converts the change in net assets presented on the statement of revenues, expenses and changes in net assets into actual cash provided by and used for operations. The statement of cash flows also details how the Organization obtains cash through financing and investing activities, and how cash is spent for these purposes.

SUMMARY FINANCIAL INFORMATION ANALYSIS

ASSETS

The organization's assets consist of cash, assessments receivable, and equipment. The change of approximately \$0.6 million in total assets is comprised of an increase in cash of about \$0.5 million.

LIABILITIES

The \$0.8 million increase in liabilities is a combination of an increase of \$2 million in current liabilities due to the purchase of water in the year 2006 and a \$1.3 million decrease in net assets.

	<u>2006</u>	<u>2005</u>
Total assets	\$ 3,937,801	\$ 3,315,517
Total liabilities	<u>3,176,677</u>	<u>1,172,236</u>
Total net assets	<u>\$ 761,124</u>	<u>\$ 2,143,281</u>

OPERATING REVENUES AND EXPENSES

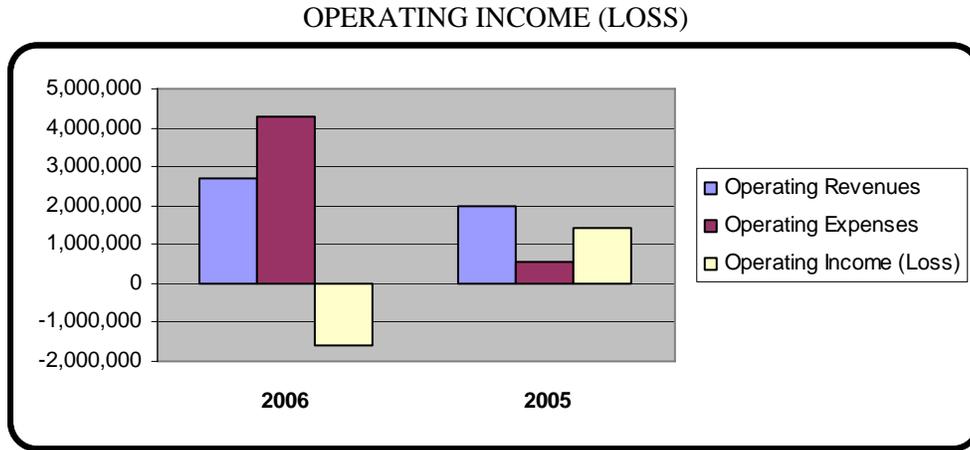
For the year ending June 30, 2006, the Organization's operating income (assessments less operating expenses) decreased significantly from operating income for the year ending June 30, 2005. The Organization collected over \$2.3 million due to the "ramp-down" of water use in the area, but they also purchased over \$3.9 million in water during the year.

MOJAVE BASIN AREA WATERMASTER

MANAGEMENT'S DISCUSSION AND ANALYSIS June 30, 2006 and 2005

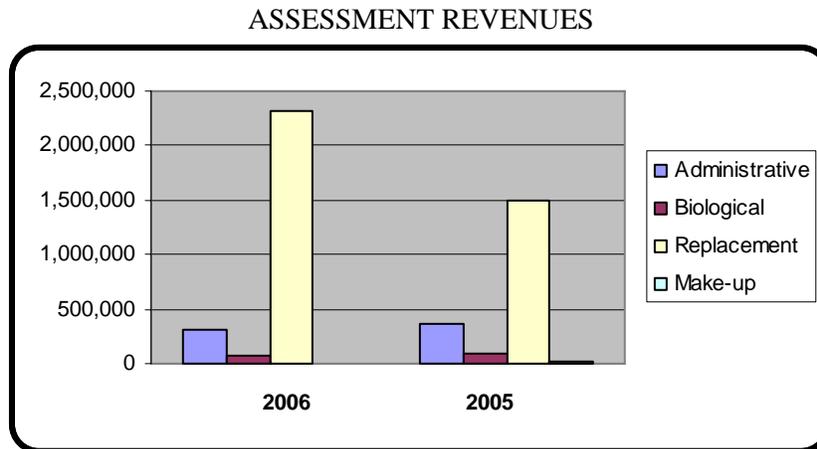
SUMMARY FINANCIAL INFORMATION ANALYSIS, Continued

OPERATING REVENUES AND EXPENSES, Continued



As the graph immediately above illustrates, both operating revenues and operating expenses increased at June 30, 2006. However, operating costs increased significantly more than operating revenues.

Assessment revenues had increases and decreases in all assessment types, as shown below.



For the year ending June 30, 2006, administrative and biological assessments both decreased slightly. The slight decrease in revenue is explained by a decrease in the quantity of water produced.

Revenues from replacement assessments increased from \$1,502,052 for the fiscal year ended June 30, 2005 to \$2,309,069 for the year ended June 30, 2006. The large increase is due to the continued “ramp-down” process.

MOJAVE BASIN AREA WATERMASTER

MANAGEMENT'S DISCUSSION AND ANALYSIS

June 30, 2006 and 2005

SUMMARY FINANCIAL INFORMATION ANALYSIS, Continued

OPERATING REVENUES AND EXPENSES, Continued

Revenues from make-up assessments decreased from \$16,042 in the year ended June 30, 2005 to \$0 in the year ended June 30, 2006. Some producers paid the other producers for make-up water instead of paying the Watermaster for their unused FPA's which were used to satisfy the make-up obligation.

During the year ended June 30, 2006, the Organization purchased \$3,922,769 in replacement and make-up water from Mojave Water Agency. For the year ended June 30, 2005, \$75,896 in water purchases was made.

NON-OPERATING REVENUES

Non-operating revenues for the fiscal year ended June 30, 2006 included \$59,150 in interest income and \$596 in finance charges. For the year ended June 30, 2005, interest income amounted to \$33,607 and finance charges remained relatively the same. Higher rates paid by the Local Agency Investment Fund (LAIF) are responsible for the increase in interest revenue.

	<u>2006</u>	<u>2005</u>
Operating revenues	\$ 2,688,383	\$ 1,978,820
Operating expenses before depreciation	<u>4,265,405</u>	<u>530,642</u>
Operating income (loss) before depreciation	(1,577,022)	1,448,178
Depreciation	<u>4,059</u>	<u>4,442</u>
Operating income (loss)	(1,581,081)	1,443,736
Non-operating income	59,746	35,114
Extra-ordinary item – litigation settlement	-	(736,000)
Extra-ordinary item – litigation recovery	<u>139,178</u>	<u>-</u>
Change in net assets	(1,382,157)	742,850
Net assets, beginning	<u>2,143,281</u>	<u>1,400,431</u>
Net assets, ending	<u>\$ 761,124</u>	<u>\$ 2,143,281</u>

CATEGORIES OF NET ASSETS

The Organization is required to present its net assets in three categories: (1) invested in capital assets, (2) restricted, and (3) unrestricted.

Invested in Capital Assets

During the year ended June 30, 2006, the Watermaster purchased furniture and fixtures and computer equipment totaling \$9,856. Current year depreciation amounted to \$4,059. Capital assets with an original cost basis of \$7,107 and \$5,323 in accumulated depreciation were retired. Total capital assets, net of accumulated depreciation, equal \$12,932.

MOJAVE BASIN AREA WATERMASTER

MANAGEMENT'S DISCUSSION AND ANALYSIS June 30, 2006 and 2005

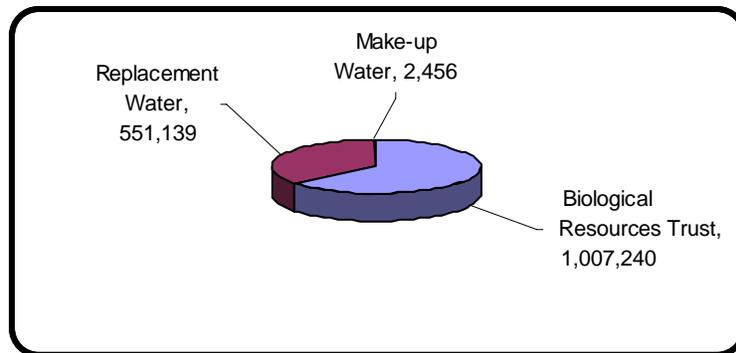
CATEGORIES OF NET ASSETS, Continued

Restricted Net Assets

The Organization's restricted net assets consist of net assets restricted for a Biological Resources Trust Fund (\$1,007,240), net assets restricted for replacement water (\$551,139) and net assets restricted for make-up water (\$2,456). Net assets restricted for biological resources trust are derived from assessments collected from producers less amounts spent on environmental mitigation. Net assets restricted for replacement and make-up water are comprised of assessments collected from producers less purchases of water from the Agency.

At June 30, 2006, the composition of restricted net assets is as follows:

RESTRICTED NET ASSETS



Unrestricted Net Assets

The Watermaster calculates its unrestricted net assets by deducting its administrative costs from the administrative assessments it collects. This category of net assets decreased from a deficit balance of \$(972,454) at June 30, 2005 to a deficit balance of \$(816,656) at June 30, 2006.

MOJAVE BASIN AREA WATERMASTER

STATEMENTS OF NET ASSETS June 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
ASSETS		
Current assets		
Cash and cash investments	\$ -	\$ (39,875)
Accounts receivable and other current assets	<u>244,611</u>	<u>240,017</u>
Total current assets	244,611	200,142
Restricted assets		
Cash and cash investments	3,641,034	3,067,232
Accounts receivable	<u>35,211</u>	<u>35,211</u>
Total restricted assets	3,676,245	3,102,443
Non-current assets		
Utility plant, net	<u>16,945</u>	<u>12,932</u>
Total non-current assets	<u>16,945</u>	<u>12,932</u>
TOTAL ASSETS	<u>\$ 3,937,801</u>	<u>\$ 3,315,517</u>

See accompanying notes and auditors' report

MOJAVE BASIN AREA WATERMASTER

STATEMENTS OF NET ASSETS

June 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
LIABILITIES AND NET ASSETS		
Current liabilities		
Accounts payable	\$ 2,338,670	\$ 779,319
Due to Mojave Water Agency	<u>838,007</u>	<u>392,917</u>
Total current liabilities / total liabilities	3,176,677	1,172,236
Net assets		
Invested in capital assets	16,945	12,932
Restricted for:		
Biological assessments	1,007,240	935,508
Replacement water	551,139	2,145,339
Make-up water	2,456	21,956
Unrestricted	<u>(816,656)</u>	<u>(972,454)</u>
Total net assets	<u>761,124</u>	<u>2,143,281</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 3,937,801</u>	<u>\$ 3,315,517</u>

See accompanying notes and auditors' report

MOJAVE BASIN AREA WATERMASTER

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

For the Years Ended June 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
Operating revenues		
Administrative assessments	\$ 307,582	\$ 373,919
Biological assessments	71,732	86,807
Replacement assessments	2,309,069	1,502,052
Make-up assessments	<u>-</u>	<u>16,042</u>
Total operating revenues	<u>2,688,383</u>	<u>1,978,820</u>
Operating expenses		
Sources of supply: water acquired	3,913,635	75,896
General and administrative	<u>351,770</u>	<u>454,746</u>
Total expenses	4,265,405	530,642
Depreciation	<u>4,059</u>	<u>4,442</u>
Total operating expenses	<u>4,269,464</u>	<u>535,084</u>
OPERATING INCOME (LOSS)	(1,581,081)	1,443,736
Non-operating revenues		
Interest income	59,150	33,607
Miscellaneous income	<u>596</u>	<u>1,507</u>
Total non-operating revenues	<u>59,746</u>	<u>35,114</u>
CHANGE IN NET ASSETS	(1,521,335)	1,478,850
NET ASSETS		
Beginning of year	2,143,281	1,400,431
Extraordinary item – litigation settlement	-	(736,000)
Extraordinary item – litigation recovery	<u>139,178</u>	<u>-</u>
End of year	<u>\$ 761,124</u>	<u>\$ 2,143,281</u>

See accompanying notes and auditors' report

MOJAVE BASIN AREA WATERMASTER

STATEMENTS OF CASH FLOWS

For the Years Ended June 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
Cash flows from operating activities		
Cash received from producers	\$ 2,690,662	\$ 1,900,340
Cash payments to suppliers for goods and services	(2,260,964)	(612,515)
Other revenue	<u>139,774</u>	<u>1,507</u>
Net cash provided by operating activities	569,472	1,289,332
Cash flows from non-capital financing activities	-	-
Cash flows from investing activities		
Purchase of equipment	(8,082)	(7,005)
Interest received	<u>52,287</u>	<u>28,256</u>
Net cash provided by investing activities	<u>44,205</u>	<u>21,251</u>
NET INCREASE IN CASH	613,677	1,310,583
CASH		
Beginning of year	<u>3,027,357</u>	<u>1,716,774</u>
End of year	<u>\$ 3,641,034</u>	<u>\$ 3,027,357</u>
Reconciliation of cash and cash equivalents to the statements of net assets		
Cash and cash investments, unrestricted	\$ -	\$ (39,875)
Cash and cash investments, restricted	<u>3,641,034</u>	<u>3,067,232</u>
TOTAL CASH AND CASH EQUIVALENTS	<u>\$ 3,641,034</u>	<u>\$ 3,027,357</u>

See accompanying notes and auditors' report

MOJAVE BASIN AREA WATERMASTER

STATEMENTS OF CASH FLOWS

For the Years Ended June 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
Reconciliation of operating loss to cash provided by operating activities		
Operating income (loss)	\$ (1,581,081)	\$ 1,443,736
Adjustments		
Depreciation	4,059	4,442
Miscellaneous non-operating revenue	139,774	1,507
Changes in assets and liabilities		
(Increase) decrease in accounts receivable and other current assets	2,279	(78,480)
(Increase) decrease in prepaid expenses	-	679
Increase in accounts payable	1,559,351	28,689
Increase (decrease) due to Mojave Water Agency	<u>445,090</u>	<u>(111,241)</u>
 Net cash provided by operating activities	 <u>\$ 569,472</u>	 <u>\$ 1,289,332</u>

See accompanying notes and auditors' report

MOJAVE BASIN AREA WATERMASTER

NOTES TO FINANCIAL STATEMENTS

June 30, 2006 and 2005

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization

Mojave Basin Area Watermaster (the “Watermaster”) was organized September 22, 1993, pursuant to a Stipulated Judgment by the Superior Court of the State of California for the County of Riverside. In the Judgment, Mojave Water Agency (the “Agency”) was appointed as the initial Watermaster, which is responsible for administering the Judgment of the Court. Since the Watermaster meets the reporting entity criteria established by the Governmental Accounting Standards Board (GASB), the Watermaster’s financial statements have also been included in the financial statements of Mojave Water Agency as a “component unit” for the fiscal years ended June 30, 2006 and 2005. The Watermaster is responsible for monitoring, verifying production, reporting to the Court, collecting assessments and conducting studies.

Uniform Accounting System

The accounts of the Watermaster have been maintained in accordance with generally accepted accounting principles and in conformity with the California State Controller’s uniform system of accounts. Basis of accounting refers to when revenues and expenses are recognized in the accounts and reported in the financial statements. Revenues and expenses are recognized on the accrual basis. Revenues are recognized in the accounting period in which they are earned and expenses are recognized in the period incurred.

Basis of Accounting

On July 1, 2000, the Watermaster adopted the provisions of Governmental Accounting Standards Board Statement No. 34, “*Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments*”. Statement No. 34 established standards for external financial reporting for all state and local governmental entities, which includes a statement of net assets, a statement of revenues, expenses, and changes in net assets, and a statement of cash flows. It requires the classification of net assets into three components: (1) invested in capital assets, net of related debt; (2) restricted; and (3) unrestricted. These classifications are defined as follows:

(1) *Invested in Capital Assets, Net of Related Debt*

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

(2) *Restricted*

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

(3) *Unrestricted Net Assets*

This component of net assets consists of net assets that do not meet the definition of “restricted” or “invested in capital assets, net of related debt”.

MOJAVE BASIN AREA WATERMASTER

NOTES TO FINANCIAL STATEMENTS, Continued June 30, 2006 and 2005

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Continued

Basis of Accounting, Continued

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

The Watermaster follows all applicable GASB pronouncements and all FASB Statements and Interpretations, Accounting Principles Board (APB) Opinions and Accounting Research Bulletins (ARB) issued on or before November 30, 1989 unless they conflict with or contradict GASB pronouncements. The Watermaster applies all GASB pronouncements issued after November 30, 1989.

Cash and Cash Equivalents

For purposes of the statement of cash flows, cash and cash equivalents have been defined as demand deposits and highly liquid investments purchased with an original maturity of three months or less.

Use of Restricted Resources

The Watermaster uses restricted resources, prior to using unrestricted resources, to pay expenditures meeting the criteria imposed on the use of restricted resources by a third party.

Use of Estimates

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

Accounts Receivable and Allowance for Bad Debts

The Watermaster considers accounts receivable to be fully collectible; accordingly, no allowance for doubtful accounts has been made.

Utility Plant

Utility plant is stated at original cost. Depreciation of utility plant use by the Watermaster is charged as an expense against its operations. Depreciation has been provided using the straight-line method over the estimated useful lives of five to seventy-five years.

NOTE 2 – PERSONNEL

The Watermaster is governed by a Board of Directors consisting of the seven members of Mojave Water Agency’s Board of Directors. Watermaster operations are supervised by an appointed Executive Officer. Mojave Water Agency’s employees perform administrative services for the Watermaster.

As of June 30, 2006, the Executive Officers were as follows:

OFFICERS

Kirby Brill	Executive Officer
Kenneth Weel	Treasurer

MOJAVE BASIN AREA WATERMASTER

NOTES TO FINANCIAL STATEMENTS, Continued June 30, 2006 and 2005

NOTE 2 – PERSONNEL, Continued

As of June 30, 2006, the Board of Directors was as follows:

BOARD OF DIRECTORS

Michael Page	Chairman
Kimberly Cox	Vice-Chairman
James Ventura, Jr.	Member
Beverly J. Lowry	Member
Richard Hall	Member
Richard Fortyune	Member
Art Bishop	Member

NOTE 3 – CASH AND INVESTMENTS

The Watermaster maintains a cash and investment pool that is available for all funds. Each fund type balance in the pool is reflected on the combined balance sheet as cash and investments. The Watermaster apportions interest earnings to all funds based on their monthly cash balances.

Cash Deposits

The carrying amounts of the Watermaster's cash deposits were \$3,641,034 at June 30, 2006. Bank balances before reconciling items were \$3,641,034 at that date, the total amount of which was collateralized or insured with securities held by pledging financial institutions in the Watermaster's name as discussed below.

The California Government Code requires California banks and savings and loan associations to secure the Watermaster's cash deposits by pledging securities as collateral. This Code states that collateral pledged in this manner shall have the effect of perfecting a security interest in such collateral superior to those of a general creditor. Thus, collateral for cash deposits is considered to be held in the Watermaster's name.

The market value of the pledged securities must equal at least 110% of the Watermaster's deposits. California law also allows financial institutions to secure the Watermaster's deposits by pledging first trust deed mortgage notes having a value of 150% of the Watermaster's deposits. The Watermaster may waive collateral requirements for cash deposits, which are fully insured up to \$100,000 by the Federal Deposit Insurance Corporation (FDIC).

The Watermaster follows the practice of pooling cash and investments of all funds, except for funds required to be held by fiscal agents under provisions of bond indentures. Interest income earned on pooled cash and investments is allocated on an accounting period basis to the various funds based on the period-end cash and investment balances. Interest income from cash and investments with fiscal agents is credited directly to the related fund.

MOJAVE BASIN AREA WATERMASTER

NOTES TO FINANCIAL STATEMENTS, Continued June 30, 2006 and 2005

NOTE 3 – CASH AND INVESTMENTS, Continued

Investments

Under the provisions of the Watermaster's investment policy, and in accordance with California Government Code, the following investments were authorized:

- Securities issued by the U.S. Treasury
- Securities issued and fully guaranteed as to payment by an agency of the U.S. Government
- Banker's Acceptances
- Non-negotiable certificates of deposit
- Repurchase Agreements
- California Local Agency Investment Fund (State Pool)
- Corporate medium-term notes
- Mortgage-backed securities
- Diversified Management Companies, as defined by Section 23701m of the Revenue Taxation Code

In accordance with GASB Statement No. 31, "Accounting and Financial Reporting for Certain Investments and for External Investment Pools", investments were stated at fair value using the aggregate method in all funds, resulting in the following investment income in all funds:

	<u>June 30, 2006</u>
Interest income	\$ <u>59,150</u>

The Watermaster portfolio value fluctuates in an inverse relationship to any change in interest rate. Accordingly, if interest rates have risen, the portfolio value will have declined. If interest rates have fallen, the portfolio value will have risen.

In accordance with GASB Statement No. 31, the portfolio for year-end reporting purposes is treated as if it were all sold. Therefore, fund balance must reflect the portfolio's change in value. These portfolio value changes are unrealized unless sold. The Watermaster's policy is to buy and hold investments until their maturity dates.

Summary of Cash and Investments

The following is a summary of pooled cash and investments at June 30, 2006:

	<u>Business-Type Activities</u>
Cash and investments	\$ <u>3,641,034</u>

MOJAVE BASIN AREA WATERMASTER

NOTES TO FINANCIAL STATEMENTS, Continued

June 30, 2006 and 2005

NOTE 3 – CASH AND INVESTMENTS, Continued

Summary of Cash and Investments, Continued

At June 30, 2006, the Watermaster had the following deposits and investments:

	<u>Credit Quality Ratings</u>	<u>Fair Value</u>
Deposits	Not Rated	\$ 2,084,390
Local Agency Investment Funds (LAIF)	Not Rated	<u>1,556,644</u>
Total deposits and investments		<u>\$ 3,641,034</u>

Risk Disclosures

Interest Rate Risk. As a means of limiting its exposure to fair value losses arising from rising interest rates, the Watermaster's investment policy limits the Watermaster's investment portfolio to maturities not to exceed five years at time of purchase.

Credit Risk. State law limits investments in commercial paper and corporate bonds to the top two ratings issued by nationally recognized statistical rating organizations (NRSROs). It is the Watermaster's policy to limit its investments in these investment types to the top rating issued by NRSROs, including raters Standard & Poor's, Fitch Ratings, and Moody's Investors Service.

Investments in Local Agency Investment Funds

The Watermaster's investments with the Local Agency Investment Fund (LAIF), a State of California investment pool, at June 30, 2006, included a portion of the pool funds invested in Structured Notes and Asset-Backed Securities. These investments included the following:

Structured Notes are debt securities (other than asset-backed securities) whose cash flow characteristics (coupon rate, redemption amount, or stated maturity) depend upon one or more indices and/or that have embedded forwards or options.

Asset-Backed Securities, the bulk of which are mortgaged-backed securities, entitle their purchasers to receive a share of the cash flows from a pool of assets such as principal and interest repayments from a pool of mortgages (such as Collateralized Mortgage Obligations) or credit card receivables.

As of June 30, 2006, the Watermaster had invested in LAIF which had invested 2.4% of the pool investment funds in Structured Notes and Asset-Backed Securities. The Watermaster valued its investments in LAIF as of June 30, 2006 by multiplying its account balance with LAIF by a fair value factor determined by LAIF. The fair value factor was determined by dividing all LAIF participants' total aggregate fair value by total aggregate amortized cost.

Summary of Investments to Maturity

The fair value of investments held by maturity at June 30, 2006 are shown below:

Maturity:	Current to one year	\$ 3,641,034
	Two to three years	-
	Four to five years	<u>-</u>
	Total	<u>\$ 3,641,034</u>

MOJAVE BASIN AREA WATERMASTER

NOTES TO FINANCIAL STATEMENTS, Continued

June 30, 2006 and 2005

NOTE 4 – RECEIVABLES AND OTHER CURRENT ASSETS

The following summarizes the significant categories of receivables and other current assets at June 30, 2006 and 2005:

	<u>2006</u>	<u>2005</u>
Accounts receivable	\$ 262,276	\$ 264,555
Accrued interest	<u>17,546</u>	<u>10,673</u>
Total accounts receivable and other current assets	279,822	275,228
Accounts receivable – restricted	(35,211)	(35,211)
Accounts receivable – liened	<u>-</u>	<u>-</u>
Receivables and other current assets	<u>\$ 244,611</u>	<u>\$ 240,017</u>

The Watermaster, in response to a Judgment of the Court, assesses producers for their share of excess production, administration and environmental protection. The assessments receivable are considered by Management, in response to the Court Order, to be fully collectible, as all delinquent assessments are appropriately liened. Accordingly, no allowance for doubtful accounts has been recorded.

NOTE 5 – UTILITY PLANT

A summary of changes in utility plant for the year ended June 30, 2006 is as follows:

	<u>Balance</u> <u>June 30, 2005</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance</u> <u>June 30, 2006</u>
Office furniture and equipment	\$ 22,485	\$ 9,856	\$ (7,107)	\$ 25,234
Less: accumulated depreciation	<u>(9,553)</u>	<u>(4,059)</u>	<u>5,323</u>	<u>(8,289)</u>
TOTAL UTILITY PLANT, NET	<u>\$ 12,932</u>	<u>\$ 5,797</u>	<u>\$ (1,784)</u>	<u>\$ 16,945</u>

A summary of changes in utility plant for the year ended June 30, 2005 is as follows:

	<u>Balance</u> <u>June 30, 2004</u>	<u>Additions</u>	<u>Deletions</u>	<u>Balance</u> <u>June 30, 2005</u>
Office furniture and equipment	\$ 15,480	\$ 7,005	\$ -	\$ 22,485
Less: accumulated depreciation	<u>(5,111)</u>	<u>(4,442)</u>	<u>-</u>	<u>(9,553)</u>
TOTAL UTILITY PLANT, NET	<u>\$ 10,369</u>	<u>\$ 2,563</u>	<u>\$ -</u>	<u>\$ 12,932</u>

ADDITIONAL INFORMATION

MOJAVE BASIN AREA WATERMASTER

SCHEDULE OF OPERATING EXPENSES For the Years Ended June 30, 2006 and 2005

GENERAL AND ADMINISTRATIVE

	<u>2006</u>	<u>2005</u>
Salaries and benefits	\$ 291,916	\$ 278,671
Aerial photos	9,748	8,997
Audit and accounting	4,000	-
Auto	1,408	1,409
Education	1,883	3,284
Engineering	117,300	189,299
Equipment and building maintenance	3,257	1,438
Office expenses and supplies	18,318	22,604
Professional fees	5,990	15,431
Recruiting expense	10,668	6,909
Safety supplies	278	-
Travel and meals	<u>3,857</u>	<u>697</u>
Total expenses	468,623	528,739
Overhead allocated	<u>(116,853)</u>	<u>(73,993)</u>
TOTAL GENERAL AND ADMINISTRATIVE	<u>\$ 351,770</u>	<u>\$ 454,746</u>