MATSON
& ISOM

ANDERSON-COTTONWOOD IRRIGATION DISTRICT

Redding, California

FINANCIAL STATEMENTS WITH
INDEPENDENT AUDITORS' REPORTS

December 31, 2012

Exhibit 10.c.

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December 31, 2012

Anderson-Cottonwood Irrigation District

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MATSON
& ISOM

INDEPENDENT AUDITORS' REPORT

To the Board of Directors
Anderson-Cottonwood Irrigation District
Anderson, California

Report on the Financial Statements

We have audited the accompanying financial statements of the business-type activities of Anderson-Cottonwood Irrigation District (the District) as of December 31, 2012, and for the year then ended, and the related notes to the financial statements, which collectively comprise the District's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

The District's management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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 about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the District's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the District's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the business-type activities of the District as of December 31, 2012, and the respective changes in financial position and, where applicable, cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America (GAAP).

Other Matters

In accordance with *Government Auditing Standards*, we have issued our report dated April 18, 2013, on our consideration of the District's internal control over financial reporting and 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.

Accounting principles generally accepted in the United States of America require that management's discussion and analysis be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with evidence sufficient to express an opinion or provide any assurance.

Matson and Isom

April 18, 2013
Redding, California

MANAGEMENT'S DISCUSSION AND ANALYSIS
(Required Supplementary Information)

The following discussion and analysis of the Anderson-Cottonwood Irrigation District's financial performance provides an overview of the District's financial activities for the fiscal year ended December 31, 2012. Please read it in conjunction with the financial statements, which begin on page 10 of this report.

FINANCIAL HIGHLIGHTS

- The District's net position increased by $1,407,103 as a result of grant contributions received and used primarily for capital assets.

- During the year the operating revenues of $972,848 were $688,911 less than operating expenses of $1,661,759. Total operating revenues decreased $2,667 compared to the prior year, while operating expenses decreased by $54,478 from the prior year. Revenue from water sales decreased by $3,693, while revenues for water transfer sales decreased by $741.

- Budgeted non-operating revenues (principally taxes and interest income) were $404,500.

USING THIS ANNUAL REPORT

This annual report consists of a series of financial statements. The Statement of Net Position; the Statement of Revenues, Expenses, and Changes in Net Position; and the Statement of Cash Flows provide information about the activities of the District and a long-term view of the District's finances.

These statements include all assets and liabilities using the accrual basis of accounting, which is similar to the accounting used by most private-sector companies. All of the current year's revenue and expenses are taken into account regardless of when cash is received or paid.

CONDENSED FINANCIAL INFORMATION

The difference between assets and liabilities is one way to measure the District's financial health. Over time, increases or decreases in net position are an indication of whether its financial health is improving or deteriorating.

The District's total net position increased from $12,703,526 a year ago to $14,110,629 this year, an increase of $1,407,103. In contrast, last year's total net position decreased by $93,512 from the prior year.

The analysis below focuses on the net position (Table 1) and changes in net position (Table 2).

Table 1
Net Position (in dollars)

December 31	2012	2011
ASSETS		
Current and other assets	$ 2,774,447	$ 2,470,955
Capital assets	11,669,390	10,465,642
Total Assets	$ 14,443,837	$ 12,936,597
LIABILITIES		
Current liabilities	$ 320,253	$ 213,187
Other liabilities	12,955	19,884
Total Liabilities	$ 333,208	$ 233,071
NET POSITION		
Invested in capital assets - net of debt	$ 11,669,390	$ 10,465,642
Unrestricted	2,441,239	2,237,884
Total Net Position	$ 14,110,629	$ 12,703,526

Unrestricted net position, the part of net position that can be used to finance day-to-day operations without constraints established by legal requirements or District restrictions increased from $2,237,884 on December 31, 2011, to $2,441,239 at the end of the current year.

Table 2
Changes in Net Position (in dollars)

Years Ended December 31	2012	2011
Total operating revenues	$ 972,848	$ 975,515
Total operating expenses	1,661,759	1,716,237
Net Operating Income	(688,911)	(740,722)
Total Nonoperating Revenues (Expenses)	457,776	424,434
Net Income (Loss) Before Capital Contributions	(231,135)	(316,288)
Capital contributions - principally grants	1,638,238	222,776
Increase (Decrease) in Net Position	$ 1,407,103	$ (93,512)

Operating revenues stayed consistent when compared to prior year, decreasing by less than 1 percent from $975,515 to $972,848, as there was no significant change in operations.

Operating expenses decreased by $54,478, or approximately 3 percent. This was primarily due to decreases in general maintenance expenses.

Non-operating revenues for future years, principally taxes and interest income, should be relatively stable with minor year-to-year variations. State allocation of property tax income and reduced interest income resulting from federal rate adjustments are the most likely sources of reduced non-operating revenues in future years. Interest income may see an increase in future years as current rates are at historical lows.

BUDGETARY HIGHLIGHTS

The District's 2012 operating budget was discussed and approved at the Board of Directors regular meeting in December 2011.

Comparing actual revenue and expenses with budgeted revenues and expenses shows a favorable variance of $1,408,840 as shown in Table 3.

Table 3
Changes in Net Position (in dollars)

	Budget	Actual	Variance + or (-)
Total Operating Revenues	$ 877,000	$ 972,848	$ 95,848
Total Operating Expenses	(1,283,237)	(1,661,759)	(378,522)
Net Operating Income (Loss)	(406,237)	(688,911)	(282,674)
Net Budgeted Income (Loss)	$ (1,737)	$ 1,407,103	$ 1,408,840

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

As of December 31, 2012, the District had $11,669,390 invested in capital assets. This amount represents a net increase of $1,203,748 from the prior year; acquisition of capital assets, including equipment and infrastructure improvements, offset depreciation expenses to result in this increase.

Implementation of two projects funded by State and Federal grants is underway. The current projects include the Main Canal Modernization Program and the Conjunctive Use Program – Groundwater Production Element, both of which will provide additions to the District's capital assets.

Debt

The District has no outstanding bonds, loans, or certificates of participation.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET

Factors considered in preparation of the 2013 operating budget included:

- Salaries and benefits, including anticipated increases pursuant to the 2011-2014 Collective Bargaining Agreement with the Teamsters.
- Water rights protection costs, specifically the defense of litigation filed in Federal court by the National Resources Defense Council challenging the District's Settlement Contract and right to divert.
- Increased liability insurance costs.
- System improvements, including improvements to the Clear Creek siphon; and replacement of rolling stock.
- Confirmed and expected revenue from water transfer sales.

Financial uncertainties in 2013 that may affect the District's position include: fuel and chemical costs; repairs/improvements to the Clear Creek siphon; continuing defense of the Natural Resource Defense Council (NRDC) litigation; and the potential for State reallocation of property tax revenues.

CONTACTING THE DISTRICT

This financial report is designed to provide the public with a general overview of the District's finances and to show the District's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the District's office at 2810 Silver Street, Anderson, California, 96007; or call (530) 365-7329.

FINANCIAL SECTION

STATEMENT OF NET POSITION

Anderson-Cottonwood Irrigation District

December 31, 2012

ASSETS	
CURRENT ASSETS	
Cash and cash equivalents	$ 1,013,756
Certificate of deposit	263,149
Grants receivable	1,158,159
Assessments receivable	263,030
Supplies inventory	39,451
Prepaid expenses	36,902
Total Current Assets	2,774,447
CAPITAL ASSETS	
Nondepreciable assets	2,483,712
Depreciable capital assets - net	9,185,678
Total Capital Assets	11,669,390
Total Assets	$ 14,443,837
LIABILITIES	
CURRENT LIABILITIES	
Accounts payable	$ 12,936
Accrued grant expenses	264,058
Accrued wages	19,864
Accrued compensation absences - current portion	21,940
Amount held for others	1,455
Total Current Liabilities	320,253
OTHER LIABILITIES	
Accrued compensation absences - noncurrent portion	12,955
Total Liabilities	$ 333,208
NET POSITION	
Invested in capital assets	$ 11,669,390
Unrestricted	2,441,239
Total Net Position	$ 14,110,629

The accompanying notes are an integral part of these financial statements

STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION

Anderson-Cottonwood Irrigation District

Year Ended December 31, 2012

OPERATING REVENUES	
Water sales	$ 646,818
Water transfer sales	311,607
Penalty revenue	5,041
Other revenues	9,382
Total Operating Revenues	972,848
OPERATING EXPENSES	
Salaries and benefits	694,272
Depreciation expense	468,574
Source of supply	171,174
Operations and maintenance	76,049
Pumping	124,257
General and administrative expenses	127,433
Total Operating Expenses	1,661,759
Income (Loss) From Operations	(688,911)
NONOPERATING REVENUES (EXPENSES)	
County tax allocation	449,572
Interest income	8,204
Total Nonoperating Revenues (Expenses) - Net	457,776
CAPITAL CONTRIBUTIONS	1,638,238
Change in Net Position	1,407,103
Net Position - Beginning of Year	12,703,526
Net Position - End of Year	$ 14,110,629

The accompanying notes are an integral part of these financial statements

STATEMENT OF CASH FLOWS

Anderson-Cottonwood Irrigation District

Year Ended December 31, 2012

CASH FLOWS FROM OPERATING ACTIVITIES	
Cash received from customers	$ 961,325
Cash paid to suppliers	(720,313)
Cash paid to employees	(685,835)
Net Cash (Used) by Operating Activities	(444,823)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES	
Cash received from county tax allocation	396,002
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES	
Acquisition of capital assets	(1,408,264)
Cash received from capital grants	626,585
Net Cash (Used) by Capital and Related Financing Activities	(781,679)
CASH FLOWS FROM INVESTING ACTIVITIES	
Purchase of certificate of deposit	(263,149)
Interest received	8,204
Net Cash (Used) by Investing Activities	(254,945)
Net Change in Cash and Cash Equivalents	(1,085,445)
Cash and Cash Equivalents - Beginning of Year	2,099,201
Cash and Cash Equivalents - End of Year	$ 1,013,756
RECONCILIATION OF INCOME (LOSS) FROM OPERATIONS TO NET CASH USED BY OPERATING ACTIVITIES	
Income (loss) from operations	$ (688,911)
Adjustments to reconcile income (loss) from operations to net cash used by operating activities:	
Depreciation	468,574
Changes in current assets and current liabilities:	
Supplies inventory	(27,894)
Prepaid expenses	(32,671)
Accounts payable	(160,835)
Accrued wages	4,046
Accrued compensated absences	4,392
Amounts held for others	(11,524)
Total Adjustments	244,088
Net Cash Used By Operating Activities	$ (444,823)

The accompanying notes are an integral part of these financial statements

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity The Anderson-Cottonwood Irrigation District (the District) was formed in 1914 and provides irrigation water to residents of the District. The District encompasses approximately 32,000 acres in Shasta and Tehama Counties. District irrigation facilities include the main canal diversion dam on the Sacramento River in Redding, a pump station to serve the Churn Creek Bottom area, and approximately 120 miles of canals and pipelines.

The District operates under an elected Board of Directors. The accounting methods and procedures adopted by the District conform to generally accepted accounting principles (GAAP) as applied to government entities. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. Consistent with GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the District has elected to apply all Financial Accounting Standards Board (FASB) Statements and Interpretations issued after November 30, 1989, except those that conflict with or contradict GASB pronouncements. As required by accounting principles generally accepted in the United States of America, these financial statements present the Anderson-Cottonwood Irrigation District alone, as the District has no component units, related organizations, or jointly governed organizations.

Basis of Accounting The District's activities are accounted for as an enterprise fund (a business-type activity) and the accounting records are maintained on the accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred. When both restricted and unrestricted resources are available for use, it is the District's policy to use restricted resources first, then unrestricted resources as they are needed.

Cash and Cash Equivalents For the purposes of the statement of cash flows, the District considers all highly liquid investments with an original maturity of three months or less to be cash equivalents. Funds invested in the County Treasurer's investment pool are considered cash equivalents.

Grants and Assessments Receivable Grants and assessments receivable include amounts due from the federal government, state, and local governments, or private sources, in connection with reimbursement of allowable expenditures made pursuant to the District's grants and contracts. Losses on uncollectible accounts receivable are recognized when such losses become known or indicated. No allowance is recorded at December 31, 2012, as management believes all amounts are collectible.

Prepaid Expenses Payments made to vendors for services that will benefit periods beyond the fiscal year-end are recorded as prepaid assets.

Capital Assets The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend asset lives are not capitalized. Improvements are capitalized and depreciated over the remaining useful lives of the related assets, as applicable.

All purchased capital assets are valued at cost based upon purchasing records when available and at an estimated historical cost where no historical records exist. Donated capital assets are valued at estimated fair market value on the date received.

Accumulated depreciation is reported on the accompanying statements of net position. Depreciation has been provided over the estimated useful lives of the assets using the straight-line method.

The estimated useful lives are as follows:

Transmission and distribution	50-60 years
Machinery	3-5 years
Pumps	20-25 years
Autos and trucks	5 years
Buildings	10-30 years
Yard improvements	15 years
Furniture and fixtures	3-10 years
Fish screens	25 years
Fish ladders	50 years
SCADA equipment	5 years
Groundwater program	50 years

Compensated Absences Vested or accumulated sick leave and vacation pay is recorded as an expense and liability as the benefits accrue to employees. In accordance with the provisions of Governmental Accounting Standards Board (GASB) Statement No. 16, *Accounting for Compensated Absences*, no liability is recorded for nonvesting accumulating rights to receive sick pay benefits.

Net Position Net position represents the difference between assets and liabilities. The District's net position is classified as follows:

Invested in Capital Assets: This represents the District's total investment in capital assets.

Restricted - Expendable: Restricted expendable net position represents resources which are legally or contractually obligated to be spent in accordance with restrictions imposed by external third parties.

Unrestricted: Unrestricted net position represents resources available for transactions relating to the general operations of the District, and may be used at the discretion of the governing board to meet current expenses for any purpose.

Operating Revenue and Expense The District distinguishes operating revenues and expenses from nonoperating 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 sales and 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 nonoperating revenues and expenses.

Tax Revenues The County of Shasta assesses, bills, and collects property taxes for the District. The County property tax is levied each November 1st on the assessed valuation of land located in the County as of the preceding lien date (March 1). Taxes are receivable in two equal installments, which become delinquent the first working day after December 10th and April 10th. The County adopted the alternative method of tax apportionment ("Teeter Plan"). The District determined they would participate in this plan. Under the plan, the County remits all property taxes and special assessments due to the District without regard to their current or delinquent status.

Use of Estimates The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Budget The District's budget is adopted on a modified accrual basis, which is a comprehensive basis of accounting other than generally accepted accounting principles. Under the modified accrual basis of accounting, revenues are recognized when susceptible to accrual (i.e., when they become both measurable and available). "Measurable" means the amount of the transaction can be determined and "available" means collectible within the current period or soon enough thereafter to be used to pay liabilities of the current period. The annual appropriations lapse at fiscal year-end.

Subsequent Event Management has evaluated subsequent events through April 18, 2013, the date which the financial statements were available to be issued.

2. CASH AND CASH EQUIVALENTS AND INVESTMENTS

Cash and cash equivalents at December 31, 2012, consisted of the following:

Cash in banks	$ 962,517
State of California - Local Agency Investment Fund	51,239
Total	$ 1,013,756

Custodial Credit Risk – Deposits

The *California Government Code* requires California banks and savings and loan associations to secure local agency deposits by pledging government securities as collateral (unless so waived by the governmental unit). The market value of pledged securities must equal at least 110% of a local agency's deposits.

At June 30, 2012, the Agency had cash and certificate of deposit balances in excess of insurance of $780,513. None of the Agency's deposits with institutions in excess of federal deposit insurance limits were held in uncollateralized accounts.

Collateral was not held in the District's name (there is no government code requirement that collateral be held in the District's name).

Equity In Pooled Cash and Investments

The District invests funds in the State Treasurer's Pooled Money Investment Account (PMIA) through the Local Agency Investment Fund (LAIF), a voluntary program created by statute in 1977. The PMIA has regulatory oversight from the Pooled Money Investment Board and an in-house Investment Committee. The Local Agency Investment Advisory Board has oversight of LAIF. The fair value of the District's position in the pool is materially equivalent to the value of pool shares. The pool is unrated. In accordance with authorized investment laws, the State Treasurer's Investment Pool (LAIF) invests in various structured notes and mortgage-backed securities, such as collateralized mortgage obligations. As of December 31, 2012, 1.87% of LAIF's investment portfolio was invested in structured notes and other asset-backed securities. (Copies can be obtained from the Local District Investment Fund, P.O. Box 942809, Sacramento, CA 94209.) PMIA's weighted average maturities was 292 days at December 31, 2012.

3. CAPITAL ASSESTS

A summary of changes in capital assets for the year ended December 31, 2012, is as follows:

	Beginning Balance	Additions	Transfers/ Deletions	Ending Balance
NONDEPRECIABLE CAPITAL ASSETS				
Land	$ 18,885	$ 7,343	$ -	$ 26,228
Construction in progress	847,858	1,609,626	-	2,457,484
Total Nondepreciable Capital Assets	866,743	1,616,969	-	2,483,712
DEPRECIABLE CAPITAL ASSETS				
Transmission and distribution	2,878,721	29,219	126,344	3,034,284
Machinery	298,162	3,766	(126,344)	175,584
Pumps	236,595	3,866	-	240,461
Autos and trucks	207,834	17,400	-	225,234
Buildings	54,241	-	-	54,241
Yard improvements	14,697	-	-	14,697
Furniture and fixtures	29,704	1,102	-	30,806
Fish screens	5,575,575	-	-	5,575,575
Fish ladders	5,575,575	-	-	5,575,575
SCADA equipment	159,616	-	-	159,616
Groundwater program	300,000	-	-	300,000
Total Depreciable Capital Assets	15,330,720	55,353	-	15,386,073
Less: Accumulated depreciation	5,731,821	468,574	-	6,200,395
Depreciable Capital Assets - Net	9,598,899	(413,221)	-	9,185,678
Capital Assets - Net	$ 10,465,642	$ 1,203,748	$ -	$ 11,669,390

4. EMPLOYEE BENEFIT PLANS

Deferred Compensation Plan

The District offers its employees a deferred compensation plan created in accordance with IRC Section 457. The plan, available to all District employees, permits them to defer a portion of their current salary until future years. Deferred compensation benefits are not available to the employees until termination, retirement, death, or unforeseeable emergency. The account balances in this plan are unfunded and represent money that the participants have previously earned and voluntarily elect to defer.

Pension Plan

District employees (except for the general manager) are covered by a pension plan through their collective bargaining agreement with the General Teamsters Local #137. Total District contributions for the year ended December 31, 2012, totaled $31,747.

5. 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. During the year ended December 31, 2012, the District carried insurance through various commercial carriers to cover all types of risks of losses. The District has had no settled claims resulting from these risks that exceeded its commercial coverage in any of the past three fiscal years.

During the year ended December 31, 2012, the District did not reduce insurance coverages from coverage levels in place as of December 31, 2011.

6. NET POSITION

The District's net position at December 31, 2012, consisted of the following:

INVESTMENT IN CAPITAL ASSETS	$ 11,669,390
UNRESTRICTED	
Board designated:	
Drainage fund	25,000
Water right protection	250,000
Capital improvement fund	60,000
Equipment reserve	146,539
M/S annexation	1,455
Subtotal	482,994
Undesignated	1,958,245
Total Net Position	$ 14,110,629

OTHER REPORT SECTION

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

To the Board of Directors
Anderson-Cottonwood Irrigation District
Anderson, California

We have audited the basic financial statements of Anderson-Cottonwood Irrigation District (the District) as of and for the year ended December 31, 2012, and have issued our report thereon dated April 18, 2013. 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

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

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the District'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. However, we identified a deficiency in internal control over financial reporting, described in the accompanying schedule of findings as item 12-1 that we consider to be a significant deficiency in internal control over financial reporting. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the 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*.

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

The purpose of this report is solely to describe the scope of our testing of internal control over financial reporting and compliance, and the result of that testing, and not to provide an opinion on the effectiveness of the District's internal control over financial reporting or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the District's internal control over financial reporting and compliance. Accordingly, this report is not suitable for any other purpose.

Matson and Isom

April 18, 2013
Redding, California

FINDINGS SECTION

AUDIT ADJUSTMENTS

Condition

12-1

During our audit of the current year, we noted adjustments that were material to the financial statements that were required in order for the financial statements to be prepared in accordance and/or conformity with generally accepted accounting principles. These adjustments were not identified through the District's internal control.

Criteria

All adjustments necessary for financial statements to be prepared in accordance and/or conformity with generally accepted accounting principles should be identified and posted by the District.

Effect

Financial statements which are not in conformity with generally accepted accounting principles could have been prepared and distributed.

Recommendation

We recommend that management take steps to ensure that all adjustments necessary to prepare financial statements in conformity with generally accepted accounting principles be identified and posted prior to the start of the audit.

AUDIT ADJUSTMENTS

11-1

Condition

During our audit of the prior year, we noted an adjustment that was material to the financial statements that was required in order for the financial statements to be prepared in accordance and/or conformity with generally accepted accounting principles. This adjustment was not identified through the District's internal control. The adjustment related to one specific grant that is complicated due to the fact that there are numerous parties involved. While the District overall has a good process in place for capturing and accounting for the revenue and expenses of this grant, they did not account for costs that had accrued under the grant but not been billed to the District yet.

Criteria

All adjustments necessary for financial statements to be prepared in accordance and/or conformity with generally accepted accounting principles should be identified and posted by the District.

Effect

Financial statements which are not in conformity with generally accepted accounting principles could have been prepared and distributed.

Current Status

See current year finding.