Appendix I

Financial Statements

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Kern Water Bank Authority

Financial Statements

December 31, 2011 and 2010

CONTENTS

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BROWN ARMSTRONG
Certified Public Accountants

INDEPENDENT AUDITOR'S REPORT

Board of Directors
Kern Water Bank Authority
Bakersfield, California

We have audited the accompanying basic financial statements of the Kern Water Bank Authority (the Authority) as of December 31, 2011 and 2010, as listed in the table of contents. These basic financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these basic financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States; and the State Controller's minimum audit requirements for California Special Districts. Those standards require that we plan and perform the audits 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 basic financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the financial position of the Kern Water Bank Authority as of December 31, 2011 and 2010, and the respective changes in financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in United States of America as well as accounting systems prescribed by the State Controller's Office and state regulations governing special districts.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 2 through 8 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 this required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

In accordance with *Government Auditing Standards*, we have also issued our report dated April 4, 2012, on our consideration of the Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

BROWN ARMSTRONG
ACCOUNTANCY CORPORATION

Bakersfield, California
April 4, 2012

Management's Discussion and Analysis

As management of the Kern Water Bank Authority (the Authority), we offer readers of the Authority's financial statements this narrative overview and analysis of the Authority's financial performance during the fiscal years ended December 31, 2011 and 2010. Please read it in conjunction with the Authority's financial statements, which follow this section.

The Authority is a Joint Powers Authority, established October 16, 1995, under the Joint Exercise of Powers Act. The Authority operates the Kern Water Bank, which is an area of land (approximately 20,000 acres) located in the southwest portion of the San Joaquin Valley uniquely suited for water recharge, water recovery and habitat preservation.

The Authority is a public agency, whose participants are the Kern County Water Agency, water storage districts, water districts and a mutual water company. The Authority oversees the day-to-day operations of the Kern Water Bank on behalf of the Participants.

The Authority recharges, extracts and stores this water on behalf of the Participants. The Authority's governing body is a seven-member Board of Directors, comprised of Participant representatives, which annually elects a Chairman and Vice-Chairman.

Participants receive water from a number of sources including the State Water Project (SWP), the Central Valley Project via the Friant-Kern Canal, and the Kern River. Participants recognized the benefit of developing the Kern Water Bank lands and constructed recharge basins, recovery wells, canals and other banking facilities on a portion of the Kern Water Bank lands while preserving the land for habitat conservation. Participants, under the Authority, utilize these banking facilities to create a more reliable water supply.

Hydrological patterns tend to be cyclical, often creating multiple years of excess water supply followed by multiple years of water supply shortage. Participants have, or acquire, water surplus to accommodate their needs in years of high rainfall and place it in storage in the Kern Water Bank for future recovery in dry years. This provides Participants with a unique water supply regulation tool.

The cyclical hydrology patterns are evident in recent Authority operations. The Authority both recovered and recharged water in 2010. Onerous regulatory restrictions in the Delta and dry conditions in prior years threatened SWP deliveries in 2010, which necessitated the recovery of water in early 2010. Improving hydrology as the year progressed, particularly in the fall of 2010, allowed Participant recharge operations to start in late 2010 – the first time Participant recharge had occurred since early 2007. Improved hydrology in 2011 allowed for recharge throughout the year. In fact, the Authority recharged more water in 2011 (over 460,000 acre feet) than in any other year. This large volume of recharge resulted in higher operating revenue in 2011 as compared to 2010. Unfortunately, the 2011-2012 water year to date is very dry, and recovery operations are expected for 2012.

Financial Highlights

The Authority's total assets increased by $3.7 million, or 5.4%, over the course of the 2011 operations, largely due to increases in cash and accounts receivable. Current liabilities increased from $5.6 million to $10.3 million reflecting the anticipated distributions to Participants of capital fees and overpayments for operational expenses.

The Authority's total gross operating revenues increased from $7.8 million to $10 million as a result of the large volume of water recharged in 2011, whereas total operating expenses decreased from $6.5 million to $5.9 due to a cessation of expensive recovery activities. Net operating revenues decreased from $6.8 million to $5.3 million due to a large Participant refund in 2011.

The Authority's long-term debt decreased by $.4M from $23.1 million to $22.7 million. This was due to principal payments paid to the variable rate bond investors and to the State of California Department of Water Resources (DWR) of $1,080,000 and $233,990, respectively, and an increase in the fair value of the interest rate swap of $844,914.

Overview of the Financial Statements

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

Required Financial Statements

The financial statements of the Authority report information of the Authority using accounting methods similar to those used by private sector companies. These statements offer short and long-term financial information about its activities. The Statements of Net Assets include all of the Authority's assets and liabilities and provides information about the nature and amounts of investments in resources (assets) and the obligations to Authority creditors (liabilities). It also provides the basis for evaluating the capital structure of the Authority and assessing the liquidity and financial flexibility of the Authority.

All of the current year's revenues and expenses are accounted for in the Statements of Revenues, Expenses and Changes in Net Assets. This statement can be used to determine whether the Authority has successfully recovered all of its costs through its user fees and other charges, its profitability, and its credit worthiness.

The final required financial statement is the Statement of Cash Flows. This statement reports cash receipts, cash payments, and net changes in cash resulting from operations, financing, and investing activities and provides answers to such questions as where did cash come from, what was cash used for, and what was the change in the cash balance during the reporting period.

Financial Analysis of the Authority

One of the most important questions asked about the Authority's finances is, "Is the Authority, as a whole, better off or worse off as a result of this year's activities?" The Statements of Net Assets and the Statements of Revenues, Expenses and Changes in Net Assets report information about the Authority's activities in a way that will help answer this question. These two statements report the net assets of the Authority and the changes in them. One can think of the Authority's net assets - the difference between assets and liabilities - as one way to measure financial health or financial position. Increases or decreases in the Authority's net assets is also an indicator of whether its financial health is improving or deteriorating. However, one will need to consider other non-financial factors such as changes in economic conditions, population growth, and new or changed government legislation.

Net Assets

To begin our analysis, a summary of the Authority's Statements of Net Assets is presented in the following table.

Condensed Statements of Net Assets
December 31, 2011 and 2010
(000's)

	2011	*2010*	*Dollar Change*	*Percentage Change*
Current Assets	$ 11,238	$ 7,445	$ 3,793	50.95 %
Capital Assets - Net	55,679	56,382	(703)	(1.25) %
Other Assets - Net	3,261	2,452	809	32.99 %
Restricted Assets	1,863	2,060	(197)	(9.56) %
Total Assets	72,041	68,339	3,702	5.42 %
Current Liabilities	10,329	5,628	4,701	83.53 %
Long-Term Debt	22,658	23,140	(482)	(2.08) %
Total Liabilities	32,987	28,768	4,219	14.67 %
Invested in Capital Assets, Net of Related Debt	31,695	31,922	(227)	(0.71) %
Restricted	1,863	2,060	(197)	(9.56) %
Unrestricted	5,496	5,589	(93)	(1.66) %
Total Net Assets	$ 39,054	$ 39,571	$ (517)	(1.31) %

The increase in current assets from the year ended 2010 to 2011 of 51% is due, primarily, to an increase in cash and accounts receivable from recharge operations. The increase in current liabilities of 84% is due, primarily, to the accrual of a large reimbursement to Participants for capital fees and overpayments for operational expenses.

The following chart summarizes the Comparative Statements of Revenues, Expenses and Changes in Net Assets.

Condensed Statements of Revenues, Expenses and Changes in Net Assets
Years Ended December 31, 2011 and 2010
(000's)

	2011	*2010*	*Dollar Change*	*Percentage Change*
Operating Revenues, Net	$ 5,288	$ 6,780	$ (1,492)	(22.01) %
Non-operating Revenues	1,303	1,915	(612)	(31.96) %
Total Revenues	6,591	8,695	(2,104)	(24.20) %
Operating Expenses	5,908	6,523	(615)	(9.43) %
Non-operating Expenses	1,200	1,223	(23)	(1.88) %
Total Expenses	7,108	7,746	(638)	(8.24) %
Change in Net Assets	(517)	949	(1,466)	
Net Assets, beginning of year	39,571	38,622	949	
Net assets, end of year	$ 39,054	$ 39,571	$ (517)	

Net operating revenues at December 31, 2011 were $5.3 million compared to $6.8 million at December 31, 2010. As discussed above, this decrease is largely due to a large Participant refund in 2011. Operating expenses in 2011 of $5.9 million represent a decrease of 9.4% from the 2010 expenses reported at $6.5 million. This decrease is also due, primarily, to lower total operating expenses resulting from a cessation of recovery operations in 2011. The Authority distributes capital use fees and returns unused deposits and fees to Participants each fiscal year.

Budgetary Highlights

The Authority adopts an annual budget each year to project the expected coming year's administrative, land management, and general maintenance operations. The budget includes these proposed expenses and the means of financing them. The Authority's budget remains in effect the entire year. Budget-to-actual comparison was analyzed by management throughout the year; however, it is not reported on nor shown in the financial statements section of this report.

A December 31, 2011 budget-to-actual comparison is presented in the following table:

General and Administrative
Budget vs. Actual Comparison
Year Ended December 31, 2011
(000's)

	Actual	Budget	Variance
G&A Revenues	$ 2,073	$ 1,717	$ 356
Other G&A Revenues	161	85	76
Total G&A Revenues	2,234	1,802	432
G&A Expenses	2,590	1,802	788
Net loss	$ (356)	$ -	$ (356)

The Authority collected both semi-annual general and administrative (G&A) assessments for the year ended December 31, 2011. The G&A revenues exceeded the budget by $432,000 due to higher than anticipated income from conservation credit sales and right-of-way negotiations with mineral producers. The G&A expenses are administrative expenses, such as payroll and benefits, equipment and supplies, general maintenance and legal fees. The 2011 G&A actual expenses were higher than anticipated expenses because of on-going legal matters and maintenance of water banking facilities.

The Authority collects estimated fees from Participants for their recharge and recovery activity based on usage. These fees and the expenses, in addition to offsetting debt service assessments and payments, are not included in the annual G&A budget.

Capital Assets

As of December 31, 2011, the Authority had invested $69.9 million in gross capital assets as shown in the following table:

Capital Assets
December 31, 2011 and 2010
(000's)

	2011	*2010*	*Dollar Change*	*Percentage Change*
Land	$ 23,614	$ 23,614	$ -	- %
Wells - Recovery	30,026	29,559	467	1.58 %
Canals and Related Facilities	12,087	12,075	12	0.10 %
Earthwork - Recharge	3,145	3,125	20	- %
Pumps - Recharge	326	326	-	- %
Roads and Fences	511	411	100	24.33 %
Equipment	6	6	-	- %
Office Equipment and Furniture	81	81	-	- %
Trucks and Autos	89	60	29	48.33 %
Property and Equipment	69,885	69,257	628	0.91 %
Less: Accumulated Depreciation	14,206	12,875	1,331	10.34 %
Total Capital Assets	$ 55,679	$ 56,382	$ (703)	(1.25) %

Total capital assets net of depreciation decreased slightly, from $56.4 million at December 31, 2010 to $55.7 million at December 31, 2011, due to the 2011 depreciation expense.

Debt Service Requirements

Between 1999 and 2002, the Authority received a $5 million loan from the DWR. The proceeds of this loan were used to complete the Master Plan Construction Project, and the Authority makes monthly deposits into a fiscal service agent account for semi-annual principal, interest, and reserve payments. As of December 31, 2011, the outstanding principal on this loan was approximately $2.95 million.

On November 25, 2003, the Authority received $27 million in proceeds from the issuance of two series of variable rate demand bonds, 2003A (tax exempt) and 2003B (taxable). The proceeds from this bond issuance were designated to pay off a 1999 Bank of America loan, fund the Authority's 50% match for the DWR Proposition 13 grant to construct the River Area well and pipeline project, enhance recharge pond capacities, expand security fencing and roads, and possibly build an office facility on the Kern Water Bank property.

As part of the bond issuance, Zions First National Bank, Trustee, established restricted cash accounts, including a $1 million Reserve Fund. The remainder of the bond proceeds was placed, primarily, in the Project Fund to be used for the construction projects. The final requisition was drawn in 2007.

The principal amount owed on this bond issuance as of December 31, 2011 was $18.4 million. Principal is payable in annual installments, or mandatory redemptions, of $1.08 million due on July 1, beginning in 2004 and ending in 2028 (maturity). Variable interest on the two series of bonds is accrued weekly and paid monthly.

On July 27, 2005, the Authority entered into an Interest Rate Master Agreement with Wells Fargo Bank, N.A. which established a fixed interest rate swap on the outstanding balance of the Series A and Series B bonds through July 1, 2023, in which the Authority pays interest at 3.86% and 4.75%, respectively, in exchange for receiving a Bond Market Association (BMA) rate and LIBOR, respectively. Payments are made monthly.

Contacting the Authority's Management

This annual financial report is designed to provide our customers and creditors with a general overview of the Authority's finances and to demonstrate the Authority's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the Kern Water Bank Authority, 1620 Mill Rock Way, Suite 500, Bakersfield, CA 93311.

Kern Water Bank Authority

Statements of Net Assets
December 31, 2011 and 2010

ASSETS	*2011*	*2010*
Current Assets		
Cash and cash equivalents	$ 9,652,354	$ 6,888,582
Accounts receivable	1,568,146	543,881
Interest receivable	17,489	11,902
	11,237,989	7,444,365
Property, Plant and Equipment, net of accumulated depreciation	55,679,477	56,382,368
Intangibles, net of accumulated amortization, 2011, $292,866; 2010, $256,934	590,448	626,380
Deferred Outflow of Interest Rate Swap	2,670,567	1,825,653
Restricted Assets	1,862,515	2,060,178
	$ 72,040,996	$ 68,338,944

See Notes to Basic Financial Statements.

LIABILITIES AND NET ASSETS	*2011*	*2010*
Current Liabilities		
Current maturities of long-term debt	$ 1,326,823	$ 1,320,234
Accounts payable	928,820	327,865
Accounts payable, water transfers	825,467	1,770,098
Participant reimbursements payable	4,762,614	1,035,929
Advanced 2011 and 2010 assessments	647,477	314,061
Advanced 2011 and 2010 loan/bond payments	1,694,370	712,529
Deferred banking facility maintenance	105,291	105,291
Accounts payable - Department of Fish and Game	19,125	21,000
Accrued interest payable	19,528	21,161
	10,329,515	5,628,168
Long-Term Liabilities		
Long-term debt, less current maturities	19,987,258	21,314,197
Fair value of interest rate swap	2,670,567	1,825,653
	22,657,825	23,139,850
Net Assets		
Invested in capital assets, net of related debt	31,694,829	31,922,284
Restricted for debt service	1,862,515	2,060,178
Unrestricted	5,496,312	5,588,464
	39,053,656	39,570,926
	$ 72,040,996	$ 68,338,944

Kern Water Bank Authority

Statements of Revenues, Expenses and Changes in Net Assets
Years Ended December 31, 2011 and 2010

	2011	*2010*
Operating revenues (net of participant refunds)	$ 5,287,823	$ 6,779,613
Operating expenses	(5,908,688)	(6,523,061)
Operating income (loss)	(620,865)	256,552
Non-operating revenues	1,303,439	1,915,077
Non-operating expenses	(1,199,844)	(1,223,115)
Non-operating income	103,595	691,962
Change in net assets	(517,270)	948,514
Net assets, beginning of year	39,570,926	38,622,412
Net assets, end of year	$ 39,053,656	$ 39,570,926

See Notes to Basic Financial Statements.

Kern Water Bank Authority

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

	2011	*2010*
Cash flows from operating activities:		
Receipts from customers and participants	$ 9,305,499	$ 5,970,884
Payments to other suppliers for goods and services	(4,709,984)	(5,632,912)
Payments to employees for services	(382,719)	(341,232)
Net cash provided by (used in) operating activities	4,212,796	(3,260)
Cash flows from capital and related financing activities:		
Payments for construction loan principal	(1,320,350)	(1,313,990)
Payments for construction of water banking facilities and fixed assets	(532,426)	(561,915)
Interest paid on construction loans	(801,531)	(927,198)
Reimbursement from Participants for interest on construction loan	117,360	123,720
Reimbursement from Participants for annual bond fees	834,598	1,119,760
Net cash used in capital and related financing activities	(1,702,349)	(1,559,623)
Cash flows from investing activities:		
Receipt of interest	55,662	118,933
Net increase (decrease) in cash and cash equivalents	2,566,109	(1,443,950)
Cash and cash equivalents at beginning of the year	8,948,760	10,392,710
Cash and cash equivalents at end of the year	$ 11,514,869	$ 8,948,760

See Notes to Basic Financial Statements.

	2011	2010
Reconciliation of operating income (loss) to net cash provided by (used in) operating activities:		
Operating income (loss)	$ (620,865)	$ 256,552
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	1,367,477	1,344,879
Change in operating assets, liabilities, and other income (expense):		
Accounts receivable	(1,024,265)	1,720,744
Accounts payable	4,229,537	(3,491,432)
Accounts payable, water transfers	(944,631)	32,810
Advanced 2011 and 2010 assessments and loan/bond payments	1,315,257	322,748
Deferred banking facility maintenance	-	(468,505)
Other income (expense)	(109,714)	278,944
Net cash provided by (used in) operating activities	$ 4,212,796	$ (3,260)
Reconciliation of cash and cash equivalents:		
Unrestricted cash	$ 9,652,354	$ 6,888,582
Restricted cash	1,862,515	2,060,178
	$ 11,514,869	$ 8,948,760
Supplemental disclosures of cash flow information:		
Noncash activities:		
Property and equipment purchased through issuance of accounts payable	$ 99,922	$ -
Participant refund through issuance of accounts payable	$ 4,762,614	$ 1,035,929
Change in fair value of interest rate swap	$ 844,914	$ 435,465

Note 1. Summary of Significant Accounting Policies

The reporting entity:

In 1995, the Monterey Agreement was signed which, among other things, modified how State Water Project water supplies are allocated and how users are charged. One of the components of the Monterey Agreement was the transfer of Kern Water Bank from the California Department of Water Resources (DWR) to local ownership.

Kern Water Bank Authority (the Authority) was established October 16, 1995 under the Joint Exercise of Powers Act, as amended by the First Amended and Restated Joint Powers Agreement signed July 19, 1999. The Authority is a public agency comprised of the Kern County Water Agency, water storage districts, water districts and a mutual water company. Water is stored in aquifers during times of surplus and recovered during times of shortage. The Authority oversees all day-to-day operations of these facilities. As organized, the Authority does not own the stored water, but rather, acts on behalf of the Participants.

Kern Water Bank Authority Participants:

The Participants and their percentage of ownership are:

Tejon-Castac Water District	2.00%
Semitropic Water Storage District	6.67%
Dudley Ridge Water District	9.62%
Kern County Water Agency	9.62%
Wheeler Ridge-Maricopa Water Storage District	24.03%
Westside Mutual Water Company	48.06%

Management and Board of Directors:

The Authority has a full time staff to administer the day-to-day operations. The Authority's governing body is its seven-member Board of Directors (Board), which annually elects a Chairman and Vice-Chairman. The joint powers agreement directs that voting is based on each member's ownership in the Authority.

Financial reporting:

The Authority has adopted the provisions of Governmental Accounting Standards Board (GASB) Statement No. 34, "Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments." Statement No. 34 established standards for external financial reporting for all state and local governmental entities, which includes a statement of net assets; a statement of revenues, expenses and changes in net assets; and a statement of cash flows. It requires the classification of net assets into three components - invested in capital assets, net of related debt; restricted; and unrestricted. These classifications are defined as follows:

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

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

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

The Authority has adopted the provisions of GASB Statement No. 53, "Accounting and Financial Reporting for Derivative Instruments." Statement No. 53 addresses the recognition, measurement, and disclosure of information regarding derivative instruments entered into by state and local governments. It requires governments to measure derivative instruments, which include interest rate swaps, at fair value.

Fund accounting:

The Authority utilizes a proprietary enterprise fund category to account for its activities. Enterprise funds are used to account for operations (a) that are financed and operated in a manner similar to private business enterprises - where the intent of the governing body is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges or (b) where the governing body has decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability or other purposes. Other items not properly included among operating revenues are reported as non-operating revenues. All assets and liabilities associated with an enterprise fund's activities are included on its statement of net assets.

Basis of accounting:

The accompanying financial statements are reported using the economic resource measurement focus and the accrual basis of accounting. Revenues are recognized when earned and expenses are recognized when a liability is incurred regardless of the timing of related cash flows.

The Authority applies all GASB pronouncements as well as the Financial Accounting Standard Board pronouncements issued on or before November 30, 1989, unless these pronouncements conflict or contradict GASB pronouncements.

Use of estimates:

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reporting of assets and liabilities and revenue and expenses in the financial statements and accompanying notes. Actual results could differ from those estimates.

Pension plan:

Employees of the Authority may participate in the 457 deferred compensation plan, and employees with at least one year of service are eligible for the 401(a) employer match program. Maximum annual contributions to the 457 plan, as established by the IRS, were $16,500 for the years ended 2011 and 2010. The employer match by the Authority is 100% of the employee's annual deferred compensation, up to 6% of the employee's annual salary, in 2011 and 2010. Subject to eligibility requirements, employees are vested in the 401(a) employer match contribution at 25% per year of employment, whereby they are fully vested at the end of the fourth year of employment. For the years ended 2011 and 2010, the plan expense was $28,443 and $23,340, respectively.

Property, plant and equipment, and depreciation:

The straight-line method has been used to determine depreciation based on the following estimated useful lives:

	Years
Wells - recovery	39
Canals and related facilities	20-50
Earthwork - recharge	20-50
Pumps - recharge	20-25
Roads and fences	10-50
Equipment	7
Office equipment and furniture	5
Trucks/autos	5

Property, plant and equipment is capitalized at cost and updated for additions and retirements during the year. The Authority maintains a capitalization threshold of $10,000. Maintenance and repairs of property and equipment that do not add to the value of the asset or materially extend the asset's life are charged to operations; major improvements are capitalized. Upon retirement, sale or other disposition of property and equipment, the cost and accumulated depreciation are eliminated from the accounts, and the gain or loss is included in operations.

Deposits and investments:

Cash and cash equivalents

For purposes of reporting cash flows, the Authority considers highly liquid investments (including restricted assets) with an original maturity of three months or less when purchased to be cash equivalents. The Authority utilizes a financial institution to service bonded debt as principal and interest payments come due. The balances in these accounts are presented on the financial statements as "Restricted Assets." Cash and cash equivalents also include cash on hand and amounts deposited with banks and Kern County's investment pool money fund. Investments are reported at fair value, which is based on quoted market prices.

Cash deposits

The Authority has adopted GASB Statement No. 40, "Deposit and Investment Risk Disclosures - an amendment of GASB Statement No. 3." This statement addresses common deposit and investment risks related to credit risk, concentration of credit risk, interest rate risk and foreign currency risk. As an element of interest rate risk, this statement requires certain disclosures of investments that have fair values that are highly sensitive to changes in interest rates. Deposit policies related to the risks identified in this statement also are required to be disclosed.

The Authority's cash deposits at December 31, 2011 and 2010 were either entirely insured by appropriate federal depository insurance, partially insured up to the federal limit and the remainder collateralized, or fully collateralized with collateral held by the pledging financial institution's trust department or agent in the Authority's name in accordance with provisions of the California Government Code. The carrying amount and bank balance of the Authority's deposits at December 31, 2011 and 2010 are as follows:

	2011		2010	
	Carrying Amount	Bank Balance	Carrying Amount	Bank Balance
Insured	$ 536,767	$ 536,767	$ 529,863	$ 529,863
Uninsured and collateralized with securities held by the pledging financial institution	1,006,524	1,006,524	1,006,232	1,006,232
Uncollateralized	375,074	449,306	565,905	565,905
Kern County's investment pool	9,596,504	9,576,135	6,846,760	6,519,881
	$ 11,514,869	$ 11,568,732	$ 8,948,760	$ 8,621,881

Cash funds deposited with Kern County are in a pooled money fund. Funds are pooled with other agencies in the county. Investments are made in accordance with California Government Code Section 53635.

Pooled funds may be invested in: (1) direct obligations of the United States government, the payment of which the full faith and credit of the United States government is pledged, (2) certificates of deposit at savings and loan associations and federally insured banks when secured by acceptable collateral and (3) savings accounts at savings and loan associations and banks, to the extent fully insured.

Cash flows:

GASB Statement No. 9, "Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting" states, for all purposes of preparing the statement of cash flows, all transactions not classified as capital and related financing activities or investing activities are classified as operating activities. The adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities include other income (expense) which consists of unrestricted non-operating revenues and expenses.

Water banking revenue and assessments:

Water banking revenue

Water banking revenue to cover the costs of recharging and recovering water is received from the Participants. The amount charged per acre foot recharged or recovered is set after considering actual cost incurred in the most recent year for recharge and recovery operations. Any revenue collected in excess of actual expenses is refunded to the Participants in the following year. If the amount collected is less than the recharge and recovery expenses incurred by the Authority, the Participants will be billed for their proportionate share of the shortage.

In 1999, the Authority began billing the Participants capital fees for their recharge and recovery use of the facilities. These fees are distributed annually to the Participants based on their ownership shares in the Authority.

General administrative assessment revenue

Assessments for general and administrative, general maintenance, and land management expenses are collected from the Participants. The amount of the assessment is determined by the Board based on the operating budget and the amount of cash that is available. Each Participant pays its proportionate share of the operating assessments based on ownership shares. For each of the years ended 2011 and 2010, the Authority recorded general administrative assessment revenue of $1,387,500.

Reclassifications:

Certain amounts in 2010 have been reclassified to conform with the 2011 presentation.

Note 2. Property, Plant and Equipment

Property, plant and equipment consist of land and the accumulated costs to build the ponds, basins, and roads used for collection and storage of the water; wells used for recovery of the water; canals, pump station, pipelines, pumps, and equipment used for transportation of the water; and office equipment and furniture.

Title transfer of assets from the DWR to the Authority was completed on August 9, 1996. Upon the exchange of water entitlements by the Participants to the DWR, reflected as a contribution of capital in the amount of $27,858,500 by the respective Participants, the Participants received Kern Water Bank land and facilities and 42,830 acre feet of banked water. The 42,830 acre feet of water was subsequently transferred to each of the Participants in proportion to their ownership shares in the Authority.

Notes to Basic Financial Statements

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

	Assets			
	Balance 12/31/10	***Additions***	***Transfers/ Retirements***	***Balance 12/31/11***
Land	$ 23,613,500	$ -	$ -	$ 23,613,500
Wells-recovery	29,558,658	467,520	-	30,026,178
Canals and related facilities	12,074,390	12,203	-	12,086,593
Earthwork – recharge	3,124,992	19,888	-	3,144,880
Pumps – recharge	325,904	-	-	325,904
Roads and fences	411,121	99,922	-	511,043
Equipment	6,235	-	-	6,235
Office equipment and furniture	81,283	-	-	81,283
Trucks/autos	60,834	29,121	-	89,955
Construction in progress	-	-	-	-
	$ 69,256,917	$ 628,654	$ -	$ 69,885,571

	Accumulated Depreciation			
	Balance 12/31/10	***Expense***	***Transfers/ Retirements***	***Balance 12/31/11***
Wells-recovery	$ 7,466,627	$ 764,324	$ -	$ 8,230,951
Canals and related facilities	4,208,313	443,711	-	4,652,024
Earthwork – recharge	834,881	64,712	-	899,593
Pumps – recharge	127,869	15,128	-	142,997
Roads and fences	146,461	22,919	-	169,380
Equipment	6,235	-	-	6,235
Office equipment and furniture	74,608	4,216	-	78,824
Trucks/autos	9,555	16,535	-	26,090
	$ 12,874,549	$ 1,331,545	$ -	$ 14,206,094

	Assets			
	Balance 12/31/09	***Additions***	***Transfers/ Retirements***	***Balance 12/31/10***
Land	$ 23,613,500	$ -	$ -	$ 23,613,500
Wells-recovery	29,235,325	318,068	5,265	29,558,658
Canals and related facilities	12,074,390	-	-	12,074,390
Earthwork – recharge	3,124,992	-	-	3,124,992
Pumps – recharge	209,202	-	116,702	325,904
Roads and fences	411,121	-	-	411,121
Equipment	6,235	-	-	6,235
Office equipment and furniture	81,283	-	-	81,283
Trucks/autos	22,287	60,834	(22,287)	60,834
Construction in progress	-	121,967	(121,967)	-
	$ 68,778,335	$ 500,869	$ (22,287)	$ 69,256,917

	Accumulated Depreciation			
	Balance 12/31/09	***Expense***	***Transfers/ Retirements***	***Balance 12/31/10***
Wells-recovery	$ 6,714,195	$ 752,432	$ -	$ 7,466,627
Canals and related facilities	3,765,720	442,593	-	4,208,313
Earthwork – recharge	770,501	64,380	-	834,881
Pumps – recharge	116,631	11,238	-	127,869
Roads and fences	123,542	22,919	-	146,461
Equipment	6,235	-	-	6,235
Office equipment and furniture	68,779	5,829	-	74,608
Trucks/autos	22,287	9,555	(22,287)	9,555
	$ 11,587,890	$ 1,308,946	$ (22,287)	$ 12,874,549

Note 3. Intangible Assets

At December 31, 2011 and 2010, intangible assets consisted of bond issuance costs. These costs are amortized over the life of the bonds using the straight-line method. Amortization expense related to these costs for each of the years ended December 31, 2011 and 2010 was $35,932.

Note 4. Restricted Assets

Restricted assets are cash and cash equivalents whose use is limited by legal requirements.

Restricted cash:

As part of the Authority's 2000 loan agreement with the DWR, the Authority executed a Fiscal Services Agent Agreement with Bank of America to collect monthly deposits for the semiannual principal and interest payments to DWR. The Authority also agreed to accumulate a Reserve Fund equal to at least two semiannual payments within the first ten years of the repayment period. Beginning April 1, 2002, the Authority deposited $2,710 per month into the Fiscal Services Agent Account and will accumulate a $325,200 reserve over the 10-year period.

As part of the Authority's 2003 Bond Indenture for two series of variable rate demand bonds, the Authority agreed to maintain a debt service reserve of $1,000,000 with the bond trustee, Zions First National Bank. This reserve was funded as part of the bond closing in November 2003.

The following schedule summarizes the restricted assets at December 31, 2011 and 2010:

	2011	2010
Cash, Wells Fargo Bank - debt retirement	$ 434,100	$ 665,327
Cash, Zions First National Bank - debt retirement	6,524	6,232
Cash, Zions First National Bank - reserve fund	1,000,000	1,000,000
Cash, Bank of America - debt retirement	421,891	388,619
	$ 1,862,515	$ 2,060,178

Note 5. Loans for Master Plan

DWR Proposition 204 Construction Loan:

In March 2000, the Authority and the DWR executed a contract for a $5,000,000 "Groundwater Recharge Construction Loan under the Safe, Clean, Reliable Water Supply Act."

After all conditions were met, the DWR began disbursing the loan commitment to the Authority in 2001. At December 31, 2002, the DWR had advanced the full loan commitment to the Authority. In 2011 and 2010, interest expense on the loan principal balance was $82,999 and $89,403, respectively.

The interest rate is 2.7% per annum on the unpaid balance, and the DWR bills the Authority's Fiscal Services Agent, Bank of America, for semiannual principal and interest payments until the principal is repaid. Principal repayment commenced upon completion of the initial project and will continue at semiannual intervals for a period not to exceed 20 years.

Variable Rate Demand Revenue Bonds - Series "A" and "B":

On November 25, 2003, the Authority issued Series 2003A (tax exempt) and Series 2003B (taxable) variable rate demand revenue bonds, pursuant to an Indenture of Trust dated November 1, 2003 between the Authority and Zions First National Bank, as Trustee. The 2003 Bonds were identified in the Official Statement as:

A. Series 2003A	$10,800,000 – CUSIP: 492291 AA7
B. Series 2003B	$16,200,000 – CUSIP: 492291 AB5

The 2003 Bonds were issued to provide funds to (a) prepay in full the principal amount owed by the Authority to Bank of America under the 1999 Loan Agreement; (b) finance certain capital expenditures of the Authority; (c) fund a $1,000,000 Reserve Fund; (d) fund a deposit to the Interest Fund to pay capitalized interest on the bonds; and (e) pay costs of issuance. The bonds will mature in 2028.

The Indenture of Trust, executed by the Authority and Zions First National Bank, as Trustee, documented that the Trustee received $27,870,412 on the date of closing as the aggregate purchase price of the bonds, including $1,000,000 relating to repayment of the Bank of America loan. The Trustee transferred $19,000,000 as repayment of the principal for the Bank of America loan, and the remaining proceeds were deposited by the Trustee as follows:

Project Fund	-	$ 6,166,332
Reserve Fund	-	$ 1,000,000
Costs of Issuance Fund	-	$ 704,080
Interest Fund	-	$ 1,000,000

The bonds bear interest at variable rates determined weekly which is paid semi-annually to the Trustee for the benefit of the bond holders. The Participants are assessed semi-annually for their proportionate share of the interest due to bond holders. Interest expense for the years ended December 31, 2011 and 2010 was $746,708 and $806,396, respectively. The interest rates in effect as of December 31, 2011 and 2010 were 0.04% and 0.22% and 0.28% and 0.29%, for Series 2003A and Series 2003B (taxable) bonds, respectively.

On July 27, 2005, the Authority entered into an Interest Rate Master Agreement with Wells Fargo Bank, N.A. which established a fixed interest rate swap on the outstanding balance of the Series A and Series B bonds through July 1, 2023 at 3.86% and 4.75%, respectively. These rates were used to calculate the interest rate swap, net in the "Summary of long-term debt" schedule of this note. Also, see Note 6 regarding derivatives.

Equal portions of the bonds are subject to mandatory redemption annually, on July 1, until they reach maturity in 2028. The bonds are selected by lot and are redeemed by Authority revenues at a redemption price equal to the principal amount to be redeemed. The annual redemption amount for Series 2003A and Series 2003B (taxable) bonds is $432,000 and $648,000, respectively.

While the bonds are outstanding, the Authority is required, with certain exceptions, to maintain a Letter of Credit, currently provided by Wells Fargo Bank, or alternate credit facility to provide security and/or liquidity. The Wells Fargo Letter of Credit (LOC) was issued for $27,434,959 and expired on November 1, 2011; however, the LOC is automatically extended every year on November 1 unless notice is given by Wells Fargo Bank to the contrary. The Authority is required to meet certain loan covenants. At December 31, 2011, the Authority was out of compliance with one of the loan covenants, and has received a waiver from Wells Fargo Bank.

Summary of long-term debt:

The following summarizes long-term debt transactions for the years ended December 31, 2011 and 2010:

	Payable 12/31/10	***Additions***	***Deductions***	***Payable 12/31/11***	***Amount Due Within One Year***
Bond principal	$ 19,440,000	$ -	$ (1,080,000)	$ 18,360,000	$ 1,080,000
Loan, DWR	3,194,431	-	(240,350)	2,954,081	246,823
Fair value of interest rate swap	1,825,653	844,914	-	2,670,567	-
	$ 24,460,084	$ 844,914	$ (1,320,350)	$ 23,984,648	$ 1,326,823

	Payable 12/31/09	*Additions*	*Deductions*	*Payable 12/31/10*	*Amount Due Within One Year*
Bond principal	$ 20,520,000	$ -	$ (1,080,000)	$ 19,440,000	$ 1,080,000
Loan, DWR	3,428,421	-	(233,990)	3,194,431	240,234
Fair value of interest rate swap	1,390,188	435,465	-	1,825,653	-
	$ 25,338,609	$ 435,465	$ (1,313,990)	$ 24,460,084	$ 1,320,234

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

Years Ending December 31,	*Principal*	*Interest*	*Interest Rate Swap, net*	*Total Debt Service*
2012	$ 1,326,823	$ 104,487	$ 648,742	$ 2,080,052
2013	1,333,532	96,179	592,330	2,022,041
2014	1,340,424	87,689	535,918	1,964,031
2015	1,347,503	79,011	479,505	1,906,019
2016	1,354,774	70,142	423,093	1,848,009
2017-2021	6,890,049	210,554	1,269,278	8,369,881
2022-2026	5,560,976	38,141	112,825	5,711,942
2027-2028	2,160,000	3,197	-	2,163,197
	$ 21,314,081	$ 689,400	$ 4,061,691	$ 26,065,172

Note 6. Derivatives

The Authority accounts for derivatives under GASB Statement No. 53. The objectives and terms of the Authority's hedging derivative instruments outstanding at December 31, 2011 are listed below:

Type	*Objective*	*Notional Amount*	*Effective Date*	*Maturity Date*	*Terms*	*Fair Value*
Pay-fixed interest rate swap	Hedge of changes in interest rates of the Series 2003A Bonds	$ 6,480,000	8/1/2005	7/1/2023	Pay 3.86%, receive BMA	$ (899,017)
Pay-fixed interest rate swap	Hedge of changes in interest rates of the Series 2003B Bonds	$ 9,720,000	8/1/2005	7/1/2023	Pay 4.75%, receive LIBOR	$ (1,771,550)
						$ (2,670,567)

The objectives and terms of the Authority's hedging derivative instruments outstanding at December 31, 2010 are listed below:

Type	*Objective*	*Notional Amount*	*Effective Date*	*Maturity Date*	*Terms*	*Fair Value*
Pay-fixed interest rate swap	Hedge of changes in interest rates of the Series 2003A Bonds	$ 7,020,000	8/1/2005	7/1/2023	Pay 3.86%, receive BMA	$ (606,552)
Pay-fixed interest rate swap	Hedge of changes in interest rates of the Series 2003B Bonds	$10,530,000	8/1/2005	7/1/2023	Pay 4.75%, receive LIBOR	$ (1,219,101)
						$ (1,825,653)

The fair values of the interest rate swaps were estimated using the zero-coupon method. This method calculates the future net settlement payments required by the swap, assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These payments are then discounted using the spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the date of each future net settlement on the swaps. The above swaps were classified as deferred outflows on the statements of net assets. The total change in fair value for the years ended December 31, 2011 and 2010 was $844,914 and $435,465, respectively. The balance at December 31, 2011 and 2010 was $2,670,567 and $1,825,653, respectively.

Risks

Credit Risk - Credit risk is the risk that Wells Fargo Bank cannot fulfill the terms and obligations specified in the swaps agreements. Because the swap had a negative fair value as of December 31, 2011 and 2010, the Authority did not have exposure related to credit risk on its swaps with Wells Fargo Bank. However, the Authority would have exposure related to credit risk in the amount of the swaps' positive fair value if interest rates increased to cause the fair value of the swaps to become positive. The credit ratings of Wells Fargo Bank are AA- and Aa3 by S&P and Moody's, respectively.

Basis Risk - The Authority is exposed to basis risk on its pay-fixed interest rate swaps because the variable rate payments received are based on an index other than the interest rates the Authority pays on its Series 2003A and 2003B revenue bonds. As of December 31, 2011, the weighted average interest rate on the Authority's hedged variable rate bonds was 0.04% and 0.22%, respectively, while the BMA rate was 0.11% and LIBOR was 0.28%. As of December 31, 2010, the weighted average interest rate on the Authority's hedged variable rate bonds was 0.28% and 0.29%, respectively, while the BMA rate was 0.30% and LIBOR was 0.26%.

Termination Risk - Neither party may terminate the transaction prior to its maturity date, unless the Authority or Wells Fargo Bank fails to make any payment when due or otherwise fails to perform any of its obligations with respect to the swap agreement. The non-defaulting party may terminate the swap agreement. If at the time of termination, a derivative instrument is in a liability position, the Authority would be liable to Wells Fargo Bank for a payment equal to the liability, plus interest.

Note 7. Self-Insurance

The Authority is a member of the Association of California Water Agencies, Joint Powers Insurance Authority (JPIA). JPIA is a group of California Water Districts who have pooled funds to provide self-insurance coverage as follows:

Type of Coverage	*Limits per Occurrence* Self-Insurance		Excess Insurance	
General, automobile and public officials liability	$	2,000,000	$	58,000,000
Buildings, fixed equipment, personal property and licensed vehicles	$	50,000	$	100,000,000
Fidelity coverage	$	100,000	$	-
Workers' Compensation	$	2,000,000	$	2,000,000

The Authority is in a group that has a $2,500 retention level (deductible) per occurrence for property damage due to theft and natural causes. Property includes buildings, personal property, fixed equipment, mobile equipment, licensed vehicles, and turbine generators and transformers. For mechanical damages to turbines, generators and transformers, the deductible ranges from $10,000 to $25,000. For fidelity coverage, the deductible is $1,000. Claims over the retention levels are insured by the group up to the self-insurance limits (see above) and by policies purchased by JPIA from the Federal Insurance Co., Great American Assurance Company, Starr Indemnity and Liability Company, Ironshore Specialty Insurance Co., Safety National Casualty Corp., and Allied World National Assurance Co. for the excess.

JPIA bills the Authority a deposit premium at the beginning of each policy year, which is placed in a reserve fund to cover the self-insurance portion of any claim. Settlements and/or expenses related to claims during the year are charged against the reserve. If the balance of the reserve at the end of the year is deemed too low in relation to the amount of outstanding claims, the Authority is retrospectively billed for additional premiums. When the claims are fully settled, any amounts remaining in the reserve are refunded to the Authority.

Note 8. Commitments

Leases:

The Authority entered into a lease agreement for office space commencing on November 1, 2008. The base rent for the first year of the agreement required monthly payments of $4,882 and are adjusted at the end of each year of the lease. Total rent expense related to this lease for the years ended December 31, 2011 and 2010 was $62,105 and $59,392, respectively. The agreement expires on October 31, 2013.

Future minimum lease payments are as follows:

Years Ending December 31,		
2012	$	63,732
2013		54,240
	$	117,972

Note 9. Contingent Liabilities

Covered Species Viability Fund:

On October 2, 1997, the Authority received a 75-year Federal Fish and Wildlife Permit, the purpose of which is to authorize incidental "take" of endangered species subject to the terms and conditions of the Kern Water Bank Authority Habitat Conservation Plan/Natural Community Conservation Plan (KWBA HCP/NCCP) and the California Endangered Species Act Management Authorization, also executed on October 2, 1997. In accordance with the Implementation Agreement (IA) of the KWBA HCP/NCCP, in 1997 the Authority established the KWBA Covered Species Viability Fund (Viability Fund) with the Treasurer of Kern County for $50,000. The Wildlife Agencies may draw up to $10,000 per year, not to exceed $75,000, from this account to fund preservation of covered species not undertaken by the Authority. If necessary, on January 1 of each year during the term of the KWBA HCP/NCCP, the Authority will deposit up to $10,000 to restore this fund to $50,000, however, the Authority is not obligated to make additional deposits above a cumulative contribution of $75,000. As of December 31, 2011, the Wildlife Agencies had made no withdrawals from this fund and no additional principal had been deposited by the Authority. Interest earned on the required $50,000 principal may be withdrawn by the Authority annually. Withdrawals of $-0- were made during the years ended December 31, 2011 and 2010. In 2011 and 2010, interest earned was $413 and $721, respectively.

Financial guarantees:

The KWBA HCP/NCCP is designed to achieve both water conservation and environmental objectives, including protection of the sensitive habitat. In addition to the agreement with the United States Fish and Wildlife Service and the California Department of Fish and Game (Wildlife Agencies), and in accordance with the KWBA HCP/NCCP and IA, the Authority executed financial guarantees with the Wildlife Agencies in 1997. The purpose of the guarantees is to ensure the Authority's performance of mutually agreed upon covenants, conditions, and obligations. The guarantees include two promissory notes with principal amounts of $200,000 and $300,000 which are secured by Deeds of Trust and Subordination Agreements.

The $200,000 Ongoing Management Note requires the Authority to pay principal and interest on demand if the Authority violates any provision of the KWBA HCP/NCCP or IA while the 75-year permit is in effect.

The $300,000 Permanent Management Note requires the Authority to pay principal and interest if the Wildlife Agencies choose to call the note after the 75-year permit terminates, or following revocation of the permit, or following the Authority's relinquishment of the permit, whichever occurs first.

Litigation:

The Authority was involved in the mediation phase of pending litigation involving the propriety of a series of amendments to the contracts between the State Water Project contractors and the DWR. In 2003, the Court approved a settlement agreement which, among other things, confirms that the Authority will continue to own and control the Kern Water Bank. Pursuant to the settlement, the Plaintiffs agreed to dismiss the validation cause of action without prejudice and to not re-file it if conditions of the settlement agreement were fulfilled. A new Environmental Impact Report (EIR) was finalized in May 2010 by the DWR. As expected, during the summer, litigation challenging the new EIR was filed. The preliminary phases of these cases are in progress. In September 2010, four Kern County water agencies filed a lawsuit which claimed the Authority has not complied with the recorded CC&R's and provided second priority use of the Authority's land and facilities. No ruling has been made in this case. Since the ultimate outcome of the litigation and its impact on the Authority are unknown at this time, no specific reserve for any potential liability has been recorded.

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BROWN ARMSTRONG
Certified Public Accountants

INDEPENDENT AUDITOR'S REPORT
ON THE ADDITIONAL INFORMATION

Board of Directors
Kern Water Bank Authority
Bakersfield, California

Our report on our audits of the basic financial statements of Kern Water Bank Authority for December 31, 2011 and 2010, appears on page 1. The audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The additional information as listed in the table of contents is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic financial statements, and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements for December 31, 2011 and 2010, taken as a whole.

BROWN ARMSTRONG
ACCOUNTANCY CORPORATION

Bakersfield, California
April 4, 2012

Kern Water Bank Authority

Schedules of Revenues
Years Ended December 31, 2011 and 2010

	2011	2010
Operating revenues:		
Recharge/recovery revenues:		
Water banking O & M	$ 2,587,957	$ 632,609
Water banking capital use fees	2,193,711	1,218,774
Energy fees	1,261,488	2,031,399
Third party conveyance	616,293	131,496
	6,659,449	4,014,278
Other operating revenues:		
Assessments	1,387,500	1,387,500
Cattle and sheep grazing	29,284	39,549
Easements	108,854	485,225
Conservation credits	545,000	575,000
Loan principal charges received from Participants	1,320,350	1,313,990
	3,390,988	3,801,264
Total operating revenues	10,050,437	7,815,542
Participant refunds:		
Participant refund	(4,762,614)	(1,035,929)
Net operating revenues	5,287,823	6,779,613
Non-operating revenues:		
Loan interest charges received from Participants	117,360	123,720
Line of credit bond fees from Participants	834,598	1,119,760
Interest income	61,249	95,145
Other non-operating income	290,232	576,452
Total non-operating revenues	1,303,439	1,915,077
Total revenues	$ 6,591,262	$ 8,694,690

Kern Water Bank Authority

Schedules of Expenses
Years Ended December 31, 2011 and 2010

	2011	2010
Operating expenses:		
General and administrative	$ 1,580,852	$ 1,304,440
Depreciation and amortization	1,367,477	1,344,879
Operating and maintenance - Participants	1,953,699	2,978,349
Operating and maintenance - general	1,006,660	895,393
Total operating expenses	5,908,688	6,523,061
Non-operating expenses:		
Other expense	125,000	-
Interest expense	799,898	925,608
Finance charges	274,946	297,507
Total non-operating expenses	1,199,844	1,223,115
Total expenses	$ 7,108,532	$ 7,746,176

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BROWN ARMSTRONG
Certified Public Accountants

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

Board of Directors
Kern Water Bank Authority
Bakersfield, California

We have audited the basic financial statements of the Kern Water Bank Authority (the Authority), as of and for the years ended December 31, 2011 and 2010, which collectively comprise the Authority's basic financial statements and have issued our report thereon dated April 4, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

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

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

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Authority'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*.

This report is intended solely for the information and use of the Board of Directors, management, others within the Authority, the California State Controller's Office, federal awarding agencies, and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

BROWN ARMSTRONG
ACCOUNTANCY CORPORATION

Bakersfield, California
April 4, 2012