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Board of Directors of the
Esparto Community Services District
Esparto, California

In planning and performing our audit of the financial statements of the Esparto Community Services District for the year ended June 30, 2006, we considered the District's internal control structure to determine our auditing procedures for the purpose of expressing an opinion on the financial statements and not to provide assurance on the internal control structure.

Our consideration of the internal control would not necessarily disclose all matters in the internal control that might be material weaknesses under standards established by the American Institute of Certified Public Accountants. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the basic financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

However, during our audit, we became aware of a few matters that are opportunities for strengthening internal controls and operating efficiency. The memorandum that accompanies this letter summarizes our comments and suggestions regarding those matters. The comments are not intended to reflect on the honesty or integrity of any employee of the Esparto Community Services District, nor does this letter affect our report dated May 16, 2007 on the financial statements of the District.

We will review the status of these comments during our next audit engagement. We will be pleased to discuss them in further detail at your convenience, to perform any additional study of these matters, or to assist you in implementing the recommendations. We thank the District's staff for its cooperation on this audit.

BARTIG, BASLER & RAY, LLP
a Gallina LLP Company

May 16, 2007
Roseville, California
The Auditor's Responsibility under U.S. Generally Accepted Auditing Standards

As stated in our engagement letter dated March 15, 2007, our responsibility, as described by professional standards, is to plan and perform our audit to obtain reasonable, but not absolute assurance that the financial statements are free of material misstatement and are fairly presented in accordance with U.S. generally accepted accounting principles. Because an audit is designed to provide reasonable, but not absolute assurance and because we did not perform a detailed examination of all transactions, there is a risk that material misstatements may exist and not be detected by us.

In planning and performing our audit, we considered the District's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting.

As part of obtaining reasonable assurance about whether the District financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, 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.

Significant Accounting Policies

Management is responsible for the selection and use of appropriate accounting policies. In accordance with the terms of our engagement letter, we will advise management about the appropriateness of accounting policies and their application. The significant accounting policies used by the District are described in Note I to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during the year. We noted no transactions entered into by the District during the year that were both significant and unusual, and of which, under professional standards, we are required to inform you, or transactions for which there is a lack of authoritative guidance or consensus.
ESPARTO COMMUNITY SERVICES DISTRICT
Required Communication
For the Year Ended June 30, 2006

Accounting Estimates

Accounting estimates are an integral part of the financial statements prepared by management and are based on management’s knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected. The most sensitive estimate(s) affecting the financial statements were:

- Accrual and disclosure of compensated absences
- Capital asset lives and depreciation expense

Audit Adjustments

For purposes of this letter, professional standards define an audit adjustment as a proposed correction of the financial statements that, in our judgment, may not have been detected except through our auditing procedures. An audit adjustment may or may not indicate matters that could have a significant effect on the District’s financial reporting process (that is, cause future financial statements to be materially misstated). The following audit adjustments, in our judgment, indicate matters that could have a significant effect on the District’s financial reporting process:

- Adjustments to deferred revenue arising from developer fees.
- Posting of changes in accounts receivable balances.

Disagreements with Management

For purposes of this letter, professional standards define a disagreement with management as a matter, whether or not resolved to our satisfaction, concerning a financial accounting, reporting, or auditing matter that could be significant to the financial statements or the auditor’s report. We are pleased to report that no such disagreements arose during the course of our audit.

Consultations with Other Independent Auditors

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a “second opinion” on certain situations. If a consultation involves application of an accounting principle to the governmental unit’s financial statements or a determination of the type of auditor’s opinion that may be expressed on those statements, our professional standards require the consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.
Issues Discussed Prior to Retention of Independent Auditors

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the District's auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing our audit.
Effect of New Auditing Standards – Information Only

Statement on Auditing Standard No. 112, Communicating Internal Control Related Matters Identified in a Audit

There have been recent developments in the auditing profession that may affect the District’s audit in 2007. This past year, a new auditing standard, Statement on Auditing Standard No. 112, Communicating Internal Control Related Matters Identified in a Audit (SAS 112), was issued and will apply to the District’s next fiscal audit. The new standard provides guidance on communicating internal control matters. This new guidance replaces a similar standard but it also includes some new guidance and revises certain terminology. Of particular importance, the new standard and its interpretive guidance emphasize that management is responsible for establishing, maintaining, and monitoring internal controls, and for the fair presentation of the financial statements, including the notes to the financial statements, in conformity with U.S. generally accepted accounting principles. The District’s external auditor cannot be a part of the internal controls.

The new standard requires us to:

- Evaluate identified control deficiencies to determine if they are significant deficiencies or material weaknesses.
- Communicate significant deficiencies and material weaknesses in writing.

Guidance in SAS 112 also provides:

- The auditor cannot be a part of the District’s internal control, including controls over the preparation of the financial statements. Becoming part of the District’s internal control system impairs the auditor’s independence.
- The District’s inability to draft their own financial statements is a strong indication of a material weakness in internal control especially if the District’s controls over this process are weak or absent.
- The procedures and processes performed by the external auditors are independent of the District’s system of internal control over financial reporting. The external auditors cannot be a compensating control for the District.
- External auditors are prohibited from auditing their own work. Doing so impairs independence.

Not implementing adequate controls over preparation of financial statements and the reporting process for the period ended June 30, 2007, may result in communication of a significant deficiency or material weakness.
Condition

During the course of audit testing, we selected several credit memos that had been posted to customer accounts in order to determine whether the accounts had been credited appropriately. The Administrative Assistant was readily able to explain the reasons for each memo. One common explanation for the adjustments was that customers often move away without notifying the District that they are no longer using District services. When this situation is discovered, the Administrative Assistant posts a credit to the old account for the charges billed in the months after the customer departed in addition to stopping future billings.

Although the credits we inquired about were readily explained, no audit trail of the transactions had been kept other than print-outs the Administrative Assistant had made of each memo from the billing system. We also observed that the District did not have a policy of requiring approval of credit memos by anyone other than the Administrative Assistant.

Effect of Condition

Without third party documentation of the reasons for issuance of a credit memo, it is difficult to positively verify that the memo was issued for the reasons described to us. If no requirement exists for management approval of credit memos, the risk of errors or fraud from inappropriate credit memos is heightened.

Recommendation

We recommend that the District implement a policy requiring independent documentation of the reasons for issuance of any credit memos. Such documentation might include a credit request signed by the customer or a memo to the file signed by the general manager.

Management Response

We have come up with a set of policies or rules, that incorporate the third person policy on account credits, for the Board of Directors to act on as soon as the District's Counsel is through checking everything to make sure we are legal. Hopefully they will be adopted at the regular meeting of the Board of Directors on September 12, 2007 at 7:00pm.
ACCOUNTS RECEIVABLE PENALTIES

Condition

In March 2007, the District determined that it had been charging penalties on past-due customer account balances that were in excess of the legal limit. The District estimated that approximately $46,000 of the penalties charged over a three year period were not legally recoverable and credited customer accounts accordingly.

Effect of Condition

When penalties are applied to customer accounts that are not legally recoverable, an overstatement results in the District’s revenues and accounts receivable. Even if the excess penalties are collected, the District has an obligation to return the funds to its customers, so revenue recognition is inappropriate.

Recommendation

We recommend that the District consult legal counsel when making any major changes to accounts receivable policies. We further recommend that District management periodically review accounts receivable balances to facilitate the early detection of any unusual trends.

Management Response

It was discovered by our Administrative Assistant that the Computer was charging 10% per month instead of the legal 10% the first month of delinquency and 1% thereafter, and brought it to the General Manager’s attention. It was then taken to the Board of Directors and the District’s Counsel as to how they wished the General Manager to handle this inaccurate programming of the computer and how far to go back on refunds to our customers. So with guidance from the District Counsel, staff went over each and every account to calculate what was owed to them and whom still had large overdue bills. The District’s Counsel recommended we go back three (3) years on all adjustments to accounts and refunds. The refunds have been completed and the Billing computer reprogrammed so everything is legal and above board now.
UNCOLLECTIBLE ACCOUNTS

Criteria

Generally Accepted Accounting Principles require that accounts receivable be reduced by an estimated allowance for uncollectible accounts, and that specific accounts in the overall balance of accounts receivable be written off when management determines that the accounts are not collectible.

Condition

The District does not currently reduce its accounts receivable by an allowance for uncollectible accounts and does not currently have a policy in place to write off specific customer accounts that are not collectible.

Effect of Condition

Without procedures to estimate and write off uncollectible accounts, the District's balance of accounts receivable may be overstated due to the inclusion of accounts that it will be unable to collect.

Recommendation

We recommend that the District analyze its customers' payment history and current balance of accounts receivable and develop a policy for estimating and writing off uncollectible accounts.

Management Response

We agree with the policy of writing off uncollectible accounts and have proposed a policy to that effect along with the other policies we are having the District's Counsel review for the September 12, 2007 Board of Directors meeting.
STATUS OF PRIOR YEAR RECOMMENDATIONS
ESPARTO COMMUNITY SERVICES DISTRICT
Status of Prior Year Recommendations
For the Year Ended June 30, 2006

There were no prior year recommendations.