
FINANCIAL STATEMENTS
CAWCD Insurance Company, Inc.
Years Ended December 31, 2006 and 2005

CAWCD Insurance Company, Inc.

Financial Statements

Years Ended December 31, 2006 and 2005

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Report of Independent Auditors

Board of Directors
CAWCD Insurance Company, Inc.

We have audited the accompanying basic financial statements of CAWCD Insurance Company, Inc. (the Corporation), a component unit of the Central Arizona Water Conservation District, as of and for the years ended December 31, 2006 and 2005, as listed in the table of contents. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net assets of the Corporation as of December 31, 2006 and 2005, and the changes in its net assets and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

The management's discussion and analysis on pages 2 through 5 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

February 27, 2007

MANAGEMENT'S DISCUSSION AND ANALYSIS

For the Years Ended December 31, 2006 and 2005

The following is management's discussion and analysis for the financial performance of the CAWCD Insurance Company, Inc. (Corporation) for the years ended December 31, 2006 and 2005.

The Corporation is organized and operated exclusively to support, benefit or carry out some or all of the purposes of Central Arizona Water Conservation District ("the Parent") and its other affiliated organizations ("Affiliates"). In furtherance of such purposes, the Corporation provides or will enter into arrangements to insure various liability risks of the Parent and Affiliates.

The basic financial statements of the Corporation consist of the Statement of Net Assets, Statement of Revenues, Expenses and Changes in Net Assets and the Statement of Cash Flows. The Statement of Net Assets presents information on the Corporation's assets and liabilities, with the difference between the two reported as net assets. The Statement of Revenues, Expenses and Changes in Net Assets presents information showing how the Corporation's net assets changed during the year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the related cash flows, which is shown by the Statement of Cash Flows.

Statements of Net Assets

| | <u>2006</u> | <u>2005</u> | <u>2004</u> |
|---------------------------|---------------------|---------------------|-------------------|
| Current assets | | | |
| Cash and cash equivalents | \$ 2,178,222 | \$ 1,891,948 | \$ 794,587 |
| Escrow deposit | 10,000 | 10,000 | 10,000 |
| Total current assets | <u>\$ 2,188,222</u> | <u>\$ 1,901,948</u> | <u>\$ 804,587</u> |

The increase in current assets primarily results from cash received from the Parent for premiums and from an increase in investment income earned from the Money Market Mutual Fund and Time Certificate Deposit. These increases were offset by claim payments and general and administrative expense payments. The increase in 2005 current assets from 2004 primarily results from cash received from the Parent for insurance premiums and the receipt of \$669,200 for payment of certain hearing claims on behalf of the Parent.

MANAGEMENT'S DISCUSSION AND ANALYSIS
(continued)

Statements of Net Assets (continued)

| | 2006 | 2005 | 2004 |
|---|---------------------|---------------------|-------------------|
| Liabilities | | | |
| Hearing claims payable | \$ 275,000 | \$ 669,200 | \$ — |
| Due to Parent | 250,109 | — | — |
| Reserve for losses and loss adjustment expenses | 619,263 | 629,424 | 315,782 |
| Unearned premiums | 1,810 | 1,826 | 1,539 |
| Total insurance liabilities | 1,146,182 | 1,300,450 | 317,321 |
| Accrued expenses | 47,673 | 48,064 | 52,237 |
| Total liabilities | \$ 1,193,855 | \$ 1,348,514 | \$ 369,558 |

Management of the Corporation is committed to ensuring that reserves for reported and incurred but not reported losses are adequate. To accomplish this commitment, detailed loss reports are used to develop a conservative, actuarially sound level of reserves. Reserves for 2006 decreased primarily due to a change in the estimated severity of certain general liability claims. Reserves for 2005 increased from 2004 primarily due to an additional year of loss development and an increase in the provision for losses and loss adjustment expenses for 2004 claims because of higher than anticipated losses for the Corporation's workers' compensation risks.

During 2005, the Corporation received \$669,200 in cash from its Parent to pay certain hearing loss claims on behalf of the Parent. The hearing loss claims are payable to employees of the Parent that the Parent has determined have incurred hearing loss. Accordingly, the Parent has estimated its claim costs and is providing funds for payment of these claims. The cash is for the sole use of paying such claims. During 2006, the Corporation paid out \$144,091 in hearing loss claims. As a result of a change in estimate that the Parent has determined based on reported claims and history of claim payments, the remaining hearing loss payable was reduced to \$275,000 as of December 31, 2006. The Corporation has recorded a Due to Parent in the amount of \$250,109 at December 31, 2006 that represents cash advanced to Corporation that is in excess of the estimated remaining claims.

MANAGEMENT'S DISCUSSION AND ANALYSIS
(continued)

| | 2006 | 2005 | 2004 |
|--|-------------------|-------------------|-------------------|
| Revenue | | | |
| Premiums written | \$ 1,475,246 | \$ 1,408,378 | \$ 1,679,610 |
| Premiums to third party insurers on behalf of parent | 835,079 | 739,979 | 1,114,131 |
| Net premiums written | <u>640,167</u> | <u>668,399</u> | <u>565,479</u> |
| Change in unearned premium | 16 | (287) | (1,539) |
| Net premiums earned | 640,183 | 668,112 | 563,940 |
| Investment income | 104,397 | 31,078 | 5,511 |
| Total revenues | <u>\$ 744,580</u> | <u>\$ 699,190</u> | <u>\$ 569,451</u> |

The Corporation agrees to pay insurance premiums to third party insurers on behalf of the Parent to the extent the Corporation receives such premiums from its Parent. The Corporation's insurance premiums are estimated to provide for the projected ultimate losses for each policy year of the various liability risks of the Parent and its affiliates, premiums the Corporation pays to third party insurers on behalf of the Parent and general and administrative expenses. The Corporation's premiums written for 2006 were increased from 2005 because the Parent's premiums to third party insurers were higher for workers compensation and property. The Corporation's premiums written for 2005 were reduced from 2004 because the Parent's premiums to third party insurers were lower due to the Parent negotiating more favorable rates.

A higher investment balance and interest rate resulted in an increase in investment income during 2006 and 2005.

| | 2006 | 2005 | 2004 |
|-------------------------------------|-------------------|-------------------|-------------------|
| Expenses | | | |
| Losses and loss adjustment expenses | \$ 142,505 | \$ 443,671 | \$ 358,199 |
| General and administrative expenses | 161,142 | 137,114 | 126,233 |
| Total expenses | <u>\$ 303,647</u> | <u>\$ 580,785</u> | <u>\$ 484,432</u> |

The decrease in the 2006 losses and loss adjustment expenses compared to 2005 resulted from a change in the estimated severity of certain general liability claims. The increase in 2005 total losses and loss adjustment expenses compared to 2004 is due to higher than anticipated losses for prior year claims related to the Corporation's workers' compensation risks that are recorded in the current year.

MANAGEMENT'S DISCUSSION AND ANALYSIS
(continued)

| | <u>2006</u> | <u>2005</u> | <u>2004</u> |
|---------------------------------|-------------------|-------------------|-------------------|
| Net Assets | | | |
| Change in net assets | \$ 440,933 | \$ 118,405 | \$ 85,029 |
| Net assets at beginning of year | <u>553,434</u> | 435,029 | 350,000 |
| Net assets at end of year | <u>\$ 994,367</u> | <u>\$ 553,434</u> | <u>\$ 435,029</u> |

The combination of the decrease in premiums written and increase in investment income were greater than the decrease in total expenses for 2006 when compared to 2005, resulting in a greater increase in net assets for 2006 than the prior year. The increase in 2005 net premiums earned and investment income compared to 2004 were greater than the increase in total expenses for 2005 when compared to 2004, resulting in a greater increase in net assets for 2005 than the prior year.

CAWCD Insurance Company, Inc.

Statements of Net Assets

| | December 31 | |
|--|---------------------|---------------------|
| | 2006 | 2005 |
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents (including restricted cash of \$275,000 and \$669,200 at December 31, 2006 and 2005, respectively) | \$ 2,178,222 | \$ 1,891,948 |
| Escrow deposit | 10,000 | 10,000 |
| Total current assets | <u>\$ 2,188,222</u> | <u>\$ 1,901,948</u> |
| Liabilities | | |
| Current liabilities: | | |
| Accrued expenses | \$ 47,673 | \$ 48,064 |
| Hearing claims payable | 275,000 | 669,200 |
| Due to Parent | 250,109 | - |
| Reserve for losses and loss adjustment expenses | 619,263 | 629,424 |
| Unearned premiums | 1,810 | 1,826 |
| Total current liabilities | <u>1,193,855</u> | <u>1,348,514</u> |
| Net assets | | |
| Unrestricted | 994,367 | 553,434 |
| Total net assets and liabilities | <u>\$ 2,188,222</u> | <u>\$ 1,901,948</u> |

See accompanying notes.

CAWCD Insurance Company, Inc.

Statements of Revenues, Expenses and Changes in Net Assets

| | Years Ended December 31 | |
|---------------------------------|--------------------------------|-------------|
| | 2006 | 2005 |
| Operating revenue: | | |
| Premiums earned | \$ 640,183 | \$ 668,112 |
| Operating expenses: | | |
| Losses and loss adjustment | 142,505 | 443,671 |
| General and administrative | 161,142 | 137,114 |
| Total operating expenses | 303,647 | 580,785 |
| Operating income | 336,536 | 87,327 |
| Nonoperating revenue: | | |
| Interest income | 104,397 | 31,078 |
| Total nonoperating revenue | 104,397 | 31,078 |
| Change in net assets | 440,933 | 118,405 |
| Net assets at beginning of year | 553,434 | 435,029 |
| Net assets at end of year | \$ 994,367 | \$ 553,434 |

See accompanying notes.

CAWCD Insurance Company, Inc.

Statements of Cash Flows

| | Years Ended December 31 | |
|---|--------------------------------|---------------------|
| | 2006 | 2005 |
| Cash flows from operating activities | | |
| Premiums collected | \$ 640,167 | \$ 668,399 |
| Losses and loss adjustment expenses paid | (152,666) | (137,567) |
| Hearing Loss claim payments | (144,091) | - |
| Cash received from Parent to pay Hearing Loss claims | - | 669,200 |
| Other cash payments | (161,533) | (133,749) |
| Net cash provided by operating activities | <u>181,877</u> | <u>1,066,283</u> |
| Cash flows from investing activities | | |
| Interest income received | <u>104,397</u> | 31,078 |
| Net cash provided by investing activities | <u>104,397</u> | 31,078 |
| Net increase in cash and cash equivalents | 286,274 | 1,097,361 |
| Cash and cash equivalents, beginning of year | 1,891,948 | 794,587 |
| Cash and cash equivalents, end of year | <u>\$ 2,178,222</u> | <u>\$ 1,891,948</u> |
| Reconciliation of operating income to net cash provided by operating activities: | | |
| Operating income | \$ 336,536 | \$ 87,327 |
| Adjustment to reconcile operating income to net cash provided by operating activities: | | |
| Changes in assets and liabilities: | | |
| Accrued expenses | (391) | (4,173) |
| Hearing claims payable | (394,200) | 669,200 |
| Due to Parent | 250,109 | - |
| Reserve for losses and loss adjustment expenses | (10,161) | 313,642 |
| Unearned premiums | (16) | 287 |
| Net cash provided by operating activities | <u>\$ 181,877</u> | <u>\$ 1,066,283</u> |

See accompanying notes.

CAWCD Insurance Company, Inc.

Notes to Financial Statements

December 31, 2006

1. Organization and Reporting Entity

CAWCD Insurance Company, Inc. (“the Corporation”), a component unit of the Central Arizona Water Conservation District (“the Parent”), is organized and operated exclusively to support, benefit or carry out some or all of the purposes of the Parent and its other affiliated organizations (“Affiliates”). In furtherance of such purposes, the Corporation provides or will enter into arrangements to insure various liability risks of the Parent and Affiliates.

The Corporation was incorporated under the laws of the State of Hawaii and is formed to be a nonprofit captive insurance company pursuant to Article 19 of Chapter 431 of the Hawaii Revised Statutes. The Corporation received its Certificate of Authority from the Hawaii Insurance Division on December 18, 2003. The Certificate of Authority enables the Corporation to operate as a captive insurance company in the State of Hawaii. The Parent is the sole member of the Corporation. The Corporation was capitalized with \$350,000 on December 18, 2003, however operations commenced on January 1, 2004.

The Corporation insures the following risks for the January 1, 2005 to January 1, 2007 policy years:

| Type of Risk | Coverage Limits |
|--|--|
| Workers compensation | \$2,000,000 per occurrence, no annual aggregate except \$2,000,000 annual aggregate for disease only |
| Public officials liability, including employment practices liability | \$2,000,000 per claim, no annual aggregate on a claims-made basis |
| Property | \$2,000,000 per occurrence, no annual aggregate |

CAWCD Insurance Company, Inc.

Notes to Financial Statements (continued)

1. Organization and Reporting Entity (continued)

| Type of Risk | Coverage Limits |
|-------------------------------|--|
| Automobile liability | \$2,000,000 per occurrence, no annual aggregate |
| General liability | \$2,000,000 per occurrence, annual aggregate |
| Fiduciary | \$2,000,000 annual aggregate limit on a claims-made basis |
| Police professional liability | \$2,000,000 per claim, \$2,000,000 annual aggregate on a claims-made basis |
| Non-owned aircraft liability | \$2,000,000 per occurrence, no annual aggregate |

2. Basis of Presentation and Significant Accounting Policies

Basis of Accounting

The accounting policies of the Corporation conform to generally accepted accounting principles as applicable to an enterprise fund of a governmental unit. Accordingly, the accrual basis of accounting is utilized, whereby revenues are recorded when they are earned, and expenses are recorded when the liability is incurred.

The Corporation has elected not to apply Financial Accounting Standards Board Statements and Interpretations issued after November 30, 1989.

Notes to Financial Statements (continued)

2. Basis of Presentation and Significant Accounting Policies (continued)

Basis of Accounting (continued)

The operating revenues and expenses of the Corporation generally result from providing insurance coverages to the Parent and Affiliates in connection with the Corporation's ongoing operations.

Cash and Cash Equivalents

The Corporation considers all short-term investments (maturities of 90 days or less when originally acquired) to be cash equivalents. Escrow deposit relates to cash held in escrow to pay claims by the Corporation's claim administrator as of December 31, 2006 and 2005.

At December 31, 2006 and 2005, the Corporation's reported cash deposits were \$2,178,222 and \$1,891,948. The restricted cash to pay for certain hearing loss claims were \$275,000 and \$669,200 at December 31, 2006 and 2005, respectively. The bank balances related to these deposits totaled \$2,279,387 and \$1,231,956, at December 31, 2006 and 2005, respectively. Bank balances of \$2,179,387 and \$1,131,956 at December 31, 2006 and 2005, respectively, are uninsured and uncollateralized and are thus exposed to custodial credit risk. The Corporation does not have any formal policy with respect to custodial credit risk. Cash is a legally authorized investment pursuant to the Hawaii Insurance Code.

Reserve for Losses and Loss Adjustment Expenses

The reserve for losses and loss adjustment expenses includes the unpaid accumulation of case estimates for losses reported; estimates for losses incurred but not reported, and estimates of expenses for investigating and adjusting incurred losses. The reserve for losses and loss adjustment expenses is based upon the aggregated loss experience of the Parent and its Affiliates and is estimated using individual case-basis valuations and statistical analyses. These estimates are subject to the effects of trends in loss severity and frequency. Management believes the reserve for losses and loss adjustment expenses is adequate. The estimates are continually reviewed and adjusted, as necessary, as experience develops or new information becomes known; such adjustments are included in current operations.

Notes to Financial Statements (continued)

2. Basis of Presentation and Significant Accounting Policies (continued)

Reclassifications

Certain reclassifications have been made to the 2005 financial statements to conform to the 2006 presentation.

Hearing Claims Payable

During 2005, the Corporation received \$669,200 in cash from its Parent to pay certain hearing loss claims on behalf of the Parent. The hearing loss claims are payable to employees of the Parent that the Parent has determined have incurred hearing loss. Accordingly, the Parent has estimated its claim costs and is providing funds for payment of these claims. The cash is for the sole use of paying such claims. During 2006, the Corporation paid out \$144,091 in hearing losses. As a result of a change in estimate that the Parent has determined based on reported claims and history of claim payments, the remaining hearing loss payable was reduced to \$275,000 as of December 31, 2006. The Corporation has recorded a Due to Parent in the amount of \$250,109 at December 31, 2006 that represents cash advanced to Corporation that is in excess of the estimated remaining claims.

Premium Income

The Corporation derives all of its premium income from the Parent and Affiliates. Premiums are earned on a pro-rata basis over the term of the related policies. Premiums related to the unexpired terms of the policies are deferred.

The Corporation receives premiums for the Parent's insurance policies covering workers compensation, public officials and property risks in excess of \$2,000,000. The Corporation is obligated to remit these premiums to third party insurers on behalf of the Parent. For the policy periods January 1, 2005 to January 1, 2006 and January 1, 2006 to January 1, 2007, the Corporation's premium revenue consisted of the following:

CAWCD Insurance Company, Inc.

Notes to Financial Statements (continued)

2. Basis of Presentation and Significant Accounting Policies (continued)

Premium Income (continued)

| | 2006 | | 2005 | |
|--|-----------------|--------------|-----------------|--------------|
| | Received (Paid) | Earned | Received (Paid) | Earned |
| Direct premiums | \$ 1,475,246 | \$ 1,475,067 | \$ 1,408,378 | \$ 1,409,108 |
| Premiums to third party insurers of Parent | (835,079) | (834,884) | (739,979) | (740,996) |
| Net Premiums | \$ 640,167 | \$ 640,183 | \$ 668,399 | \$ 668,112 |

Use of Estimates

The accompanying financial statements have been prepared in conformity with U.S. generally accepted accounting principles. The preparation of those financial statements requires management to make estimates and assumptions that affect amounts reported in the financial statements and accompanying notes. Such estimates and assumptions could change in the future, as more information becomes known which could impact the amounts reported and disclosed herein. Actual results could differ from those estimates.

CAWCD Insurance Company, Inc.

Notes to Financial Statements (continued)

3. Reserve for Losses and Loss Adjustment Expenses

The following table provides a reconciliation of the beginning and ending balances of the reserve for losses and loss adjustment expenses at December 31:

| | <u>2006</u> | <u>2005</u> |
|--|-------------------|-------------------|
| Balance at beginning of year | \$ 629,424 | \$ 315,782 |
| Add provision for losses and loss adjustment expenses for claims occurring during: | | |
| Current year | 397,000 | 355,871 |
| Prior year | (254,495) | 87,800 |
| | <u>142,505</u> | <u>443,671</u> |
| Deduct loss and loss adjustment expense payments for claims occurring during: | | |
| Current year | 60,969 | 107,241 |
| Prior year | 91,697 | 22,788 |
| | <u>152,666</u> | <u>130,029</u> |
| Balance at end of year | <u>\$ 619,263</u> | <u>\$ 629,424</u> |

The decrease in the 2006 reserve for losses and loss adjustment expenses compared to 2005 resulted from a change in the estimated severity of certain general liability claims and the increase in 2005 is due to higher than anticipated losses for the Corporation's worker's compensation risks.

4. Income Taxes

Pursuant to the Corporation's status under Section 115 of the Internal Revenue Code, the increase in net assets are exempt from federal income taxes. Therefore, the accompanying financial statements do not include a provision for income taxes.

5. Minimum Capital and Surplus

The Hawaii Insurance Division has established certain minimum capital and surplus requirements for the Corporation. A minimum amount of \$250,000 in capital and surplus must be maintained at all times. As of December 31, 2006, the Corporation was in compliance with the minimum capital and surplus requirements of the State of Hawaii.